Capital Markets, Professional Perspective - Silence Is Golden: No Liability for Failure to Disclose Future Trends Under Rule 10b-5(b)

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In rejecting an investor's bid to hold Macquarie Infrastructure liable for failure to disclose information required by Item 303 of SEC Regulation S-K, 17 C.F.R. § 229.303(b)(2)(ii) (2022), the Supreme Court in *Macquarie Infrastructure Corp. v. Moab Partners, L.P.*, LP, 144 S. Ct. 885, 218 L. Ed.2d 214 (Apr. 12, 2024) resolved a circuit split and confirmed "pure omissions" are not actionable.

The Court in its succinct April 12, 2024, opinion declined to address wider-ranging arguments explored during oral arguments, yet provided another arrow in the quiver of defense counsel—one that may be increasingly important to companies navigating evolving ESG and climate disclosure regimes across multiple international jurisdictions. Conversely, the Court's decision foretells litigation to come as half-truths—"representations that state the truth only so far as it goes, while omitting critical qualifying information"— remain actionable.

No Liability For Pure Omissions

The US Supreme Court's ruling in *Macquarie Infrastructure v. Moab Partners* is a watershed moment that indicates, in plain and simple terms, that silence is golden. Justice Sotomayor, writing in a rare unanimous decision for the Court, held that pure omissions are not actionable under 10b-5(b) and explained it this way: "[l]ogically and by its plain text, Rule 10b-5(b) therefore covers half-truths, not pure omissions, because it requires identifying affirmative assertions (*i.e.*, 'statements made') before determining if other facts are needed to make those statements 'not misleading.'"

This ruling suggests that even where there are world events—such as proposed legislation, new regulations, climate changes, war or even court rulings—that could lead to a change in industry trends, impact the future outlook of the company or cause a material decline in profit for the business, as was the case in *Macquarie*, the failure to disclose these cannot, by itself, support a claim for securities fraud under Rule 10b-5(b). There must be more, although not that much more, than the alleged omissions.

A Disclosure Case Born Out of an Environmental Regulation

Macquarie's infrastructure-related business includes a subsidiary that operates large "bulk liquid storage terminals" within the US. These terminals handle and store liquid commodities, such as petroleum, biofuels, chemicals, and oil products. The Macquarie subsidiary's largest single product was fuel oil No. 6.

In October 2016, the UN International Maritime Organization announced that it would be reducing the sulfur content limit for fuels used by ships in international waters to a maximum of 0.5%, effective starting Jan. 1, 2020. No. 6 fuel oil generally has a sulfur content of 3%, exceeding the UN limit. As a result of the UN regulations, the market for No. 6 fuel, and storage for the same, decreased. Given that storage of No. 6 fuel oil comprised around 40% of the subsidiary's storage business, this regulation stood to impact their business substantially.

Even though the regulation potentially affected Macquarie's future revenues from contracts for fuel oil No. 6 storage, Macquarie did not immediately disclose the new regulation to investors. It revised its 2017 guidance for free cash flow growth, but otherwise left its guidance unchanged. Only when Macquarie announced in its fourth-quarter earnings on Feb. 21, 2018, did it "reveal[] that it would be cutting its quarterly 2018 dividend guidance by 31%" and "blamed all this bad news on . . . the structural decline in the [oil market]", resulting in "tumbling utilization" of Macquarie's profitable fuel storage business. See Consolidated Amended Class Action Complaint, Case 1:18-cv-03608-VSB (Doc. 56) (SDNY).

Jeffrey Frost, the company's then COO and future CEO, explained that this dramatic shift in market demand resulted from "uncertainty surrounding the implementation of new regulations related to low sulfur fuel oil in 2020"—i.e., the implementation of the U.N. regulation announced and adopted in October 2016. Per the plaintiffs, this belated disclosure "shocked the market" and resulted in a single-day 41% decline of Macquarie's share price.

Investors predictably sued Macquarie for securities fraud under Rule 10b-5(b), claiming that the failure to disclose the regulation and anticipated market decline sooner than the 2018 end-of-year financial results was an actionable omission. More specifically, Moab Partners, the lead plaintiff in the underlying securities class action, alleged that Macquarie was required to disclose business risks posed by this environmental regulation in its Management's Discussion and Analysis of Financial Conditions and Results of Operation (MD&A), which requires companies in annual and quarterly securities filings to "[d]escribe any known trends or uncertainties that have had or that are reasonably likely to have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations" pursuant to Item 303 of Regulation S–K. 17 C.F.R.§229.303(b)(2)(ii) (2022).

Despite this express requirement, Macquarie failed to disclose that its top asset and largest profit-driver was materially exposed to upcoming regulations—i.e., the UN environmental initiative aimed at reducing the sulfur content in ship fuel. See Consolidated Amended Complaint Therefore, at issue was whether an issuer's failure to disclose information required by Item 303 can support a private action under Rule 10b-5(b), even if the failure does not render any statements that the issuer actually made misleading.

The district court dismissed Moab Partners' complaint. The Second Circuit Court of Appeals reversed, and held that Macquarie's failure to disclose the UN regulation as required by Item 303 was an omission that could, without more, amount to securities fraud under Rule 10b-5(b). The

Second Circuit's decision conflicted with the holding of the Third and Ninth Circuit Courts of Appeal, which had previously held that Item 303 does not create obligations to disclose that are actionable under Rule 10b-5. Macquarie sought certiorari from the US Supreme Court.

Pure Omissions Not Actionable Under Rule 10b-5

The Supreme Court vacated the Second Circuit's decision, remanding the case for further proceedings. The Supreme Court held that Rule 10b-5(b) does not apply to "pure omissions." In reaching that conclusion, the Court principally relied on the plain text of Rule 10b-5(b), which proscribes any untrue statement of a material fact as well as any omission of a material fact "necessary *in order to make the statements made*, in the light of the circumstances under which they were made, not misleading." (Emphasis added.) The central issue before the Court was whether the latter category covers "pure omissions" in addition to "half-truths."

Pure omissions are when a disclosing company "says nothing, in circumstances that do not give any particular meaning to that silence." The Court provided as an example of a pure omission when a company totally fails to file an MD&A, a situation in which the omission of particular information that was required to be disclosed in the MD&A "has no special significance because no information was disclosed."

By contrast to pure omissions are "half-truths." Half-truths are "'representations that state the truth only so far as it goes, while omitting critical qualifying information.'" As the Court painstakingly noted, the appeal in *Macquarie* addressed the Second Circuit Court of Appeal's analysis of pure omissions, and not —despite the arguments of Moab Partners and [amicus] US—half-truths.

The Court held that Rule 10b-5(b) does not reach pure omissions, focusing first on the text of the rule's omissions prong and its reference to "statements made." The Court reasoned that the language of Rule 10b-5(b) "requires disclosure of information necessary to ensure that statements *already made* are clear and complete." (Emphasis added). Omissions thus are actionable under Rule 10b-5(b) only when first identifying affirmative statements for which additional facts are necessary to make them not misleading.

This reading of Rule 10b-5(b) is supported by the express imposition of liability for pure omissions in another federal securities statutory section. The Court noted that, in contrast to Rule 10b-5's tethering to "statements made," Section 11(a) of the 1933 Securities Act prohibits registration statements from "omit[ting] to state a material fact required to be stated therein or necessary to make the statements therein not misleading."

In addition, Section 10b-5 does not establish an affirmative duty to disclose generally all material information. The Court rejected Moab Partners' argument that reasonable investors expect the affirmative disclosures required by Item 303 because it both disregards Rule 10b-5(b)’s “statements made” language and impermissibly changes the thrust of the rule from prohibiting fraud to requiring disclosure.

Significant Disclosure Risks Remain for Half-Truths & Through SEC Enforcement

The ruling in *Macquarie* limits civil liability for securities fraud, making it more challenging for plaintiffs to state a claim under Rule 10b-5(b) due to a company's failure to disclose future business risks, even if Item 303 requires that an issuer disclose certain information. But the Court also highlighted additional theories of liability that plaintiffs and the US Securities and Exchange Commission (SEC) may continue to assert going forward.

The Court stated that private litigants will still be able to bring claims under Rule 10b-5(b) for omissions that create misleading “half-truths.” The holding in *Macquarie* reached only whether pure omissions are actionable under Rule 10b-5(b), and the Court declined to address broader arguments on half-truths asserted by Moab Partners and the SEC. By requiring private plaintiffs to point to a misleading affirmative statement without clarifying—indeed, disclaiming any decision on—fundamental questions such as what constitutes a statement made or when a statement made pursuant to Item 303 is misleading as a half-truth, the Court has set the stage for future litigation.

The Court also noted that the SEC could still pursue enforcement actions for both pure omissions and half-truths. The SEC still maintains that where an MD&A (management's discussion and analysis) makes certain statements but omits information required by Item 303, this is considered a misleading half-truth because reasonable investors will infer from an issuer's silence that the types of events for which disclosure is required have not occurred. See Brief for the US as amicus curiae supporting respondent Moab Partners, L.P., *Macquarie Infrastructure Corp, et al., v. Moab Partners et al.* No. 22-1165, at 7 (Dec. 20, 2023).

For these reasons, the Court dismissed the concerns voiced by Moab Partners that the Court's decision creates a gap in the US securities laws for fraudulent statements.

Additional Practical Implications & Takeaways

Application of the broad disclosure required by the facts of a certain situation under Item 303 is complex and can be second-guessed in hindsight. Thus, it will be imperative moving forward to check disclosures for, and consult outside counsel on, the duty to make related disclosures. This case underscores that where disclosures are made, including under Item 303, all related facts must be disclosed where they are necessary to prevent the statement from being misleading.

The Court's opinion also has implications for a broad range of private securities claims including those relating to ESG standards, artificial intelligence, and data breaches. For example, undisclosed risks relating to the use of artificial intelligence in a business may not be actionable absent some affirmative statement that would render that nondisclosure misleading. But where a company makes statements about their cybersecurity framework, failure to disclose all of the company's risks and vulnerabilities related to data breaches may be an actionable omission. Thus, this decision calls for company boards to design disclosure strategies knowing that silence is golden—at least under 10b-5(b)—which may impact disclosures even outside of the context of a 10-K or 10-Q.

Plaintiffs may argue, and did so in *Macquarie,* that this ruling creates a perverse incentive for public companies to withhold information that could materially impact the company when concerned with “known trends or uncertainties . . . that are reasonably likely to have a material favorable or unfavorable impact . . . [on the company's] continuing operations.” 17 C.F.R.§229.303(b)(2)(ii).

On the other hand, if a company makes an affirmative statement about an industry trend, potential legislation, and the like, a failure to disclose a related business risk could be considered a “misleading half-truth” such that investors would have a private right of action. *Macquarie* suggests that a company can limit its disclosure obligations by engaging in silence on the subject. However, this does not foreclose the possibility for plaintiffs to litigate omissions, as pure omissions in registration statements may still be the subject of private litigation. In contrast to 10b-5 and its underlying statute Section 10(b) of the 1933 Securities Act, registration statements are governed by Section 11 of the Act, which prohibits pure omissions.

Although plaintiffs lawyers in *Macquarie* sought to import the liability for pure omissions from Section 11 onto Rule 10b-5, the Court resisted this attempt. The holding in *Macquarie* contains Rule 10b-5's scope within the bounds of its plain language: materially false or misleading *statements*. At bottom, the Court's decision in *Macquarie* may interrupt the recent slate of cases premised upon allegations of a failure to properly disclose industry “risk factors” under Regulation S-K Item 105 and omissions from MD&A disclosure under Item 303, and shift the focus to “half-truths.”