

Client Alert

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Supreme Court Will Not Consider *Leidos* Case After Apparent Settlement

As a result of a last-minute settlement, the Supreme Court of the United States announced on October 17, 2017, that it would not resolve a closely watched conflict among the lower courts as to whether shareholders can bring private actions for securities fraud premised on a corporation's failure to disclose information required by Item 303 of Regulation S-K.

The Second Circuit's Decision in *Leidos*

In *Leidos, Inc., v. Indiana Public Retirement System*, the Supreme Court was to review a Second Circuit decision reviving a putative class action asserting claims for securities fraud under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder.¹ The defendant had contracted with the City of New York to develop and implement an automated timekeeping program. Several of the defendant's employees on the project became embroiled in a kickback scheme with a subcontractor, prompting federal and state authorities to conduct a criminal investigation. The investor plaintiffs alleged that the investigation was a "known trend or uncertainty" that should have been disclosed in the Management Discussion and Analysis (MD&A) section of the defendant's quarterly and annual reports months before it was actually disclosed.

The district court dismissed the plaintiffs' claim, but the Second Circuit reversed. Following an earlier decision,² the Second Circuit held that an omission of material information that must be disclosed in the MD&A section of a quarterly or annual report can provide the basis for a claim for securities fraud even if the omission does not make an affirmative statement misleading. In finding that Item 303 of Regulation S-K imposed a "duty to disclose" the omitted information, the Second Circuit departed from an earlier Ninth Circuit opinion holding that such "pure omissions" are not actionable under Section 10(b) and Rule 10b-5.³ The Supreme Court granted certiorari in March to review the Second Circuit's decision. Hunton & Williams LLP, on behalf of the National Association of Manufacturers, submitted amicus briefs at both the certiorari and merits stages in support of the defendant's position.

In light of the settlement in principle between the parties, the Supreme Court removed the scheduled oral arguments from its calendar and will hold in abeyance any further proceedings in the case. The parties will now seek approval of the settlement in the district court. If the district court does not approve the settlement, the parties have asked the Supreme Court to hear arguments next fall.

Implications of the Settlement

With the Supreme Court no longer hearing *Leidos*, plaintiffs may continue to bring claims for securities fraud premised on a violation of SEC disclosure requirements in the Second Circuit. The Second Circuit

¹ *Indiana Pub. Ret. Sys. v. SAIC, Inc.*, 818 F.3d 85 (2d Cir. 2016).

² See *Stratte-McClure v. Morgan Stanley*, 776 F.3d 94 (2d Cir. 2015).

³ See *In re NVIDIA Corp. Sec. Litig.*, 768 F.3d 1046 (9th Cir. 2014), cert. denied, 135 S. Ct. 2349 (2015).

hears more federal securities cases than any other circuit. Given most public companies' regular interaction with customers and sources of financing in New York City, as well as their listings on the major stock exchanges headquartered there, plaintiffs seeking to advance such a "pure omission" claim can be expected to sue in the Second Circuit instead of other circuits where those companies may be incorporated or headquartered. Even before the Supreme Court granted certiorari, plaintiffs were filing an increasing number of claims for securities fraud in the Second Circuit based on alleged violations of Regulation S-K. The forward-looking nature of MD&A disclosures, and the difficult judgments that they require management to make regarding materiality, make such claims particularly attractive to plaintiffs.

The existing circuit split between the Second Circuit and the Ninth Circuit will also deepen. Because the Ninth Circuit hears more federal securities cases than any circuit aside from the Second Circuit, the circuit split will lead to a divergent development of case law. Already district courts outside the Second and Ninth Circuits have had to choose which approach to follow, with predictably inconsistent results. As new cases continue to be heard, other circuits will likely weigh in on the question eventually. Undecided circuits may well take notice of the SEC's amicus brief in the case, which supported the position advanced by the investor plaintiffs. Given the Supreme Court's apparent interest, and the SEC's apparent position, the Court may welcome the opportunity to consider a future case in which the question presented in *Leidos* is at issue again.

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