

HARVARD BUSINESS LAW REVIEW

STUCK WITH *STECKMAN*: WHY ITEM 303 CANNOT BE A SURROGATE FOR SECTION 11

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*Item 303 of SEC Regulation S-K requires companies to disclose “known trends and uncertainties” in certain public filings. In securities class action litigation, plaintiffs increasingly allege the omission of such “known trends and uncertainties” as a basis for liability. But Item 303 provides no private right of action. A private plaintiff can bring an Item 303 action only if there is a separate violation of a securities law for which there is a private right of action. To state a claim under section 11 of the 33 Act, plaintiffs (and courts) rely on a decades-old Ninth Circuit decision, *Steckman v. Hart Brewing Co.* *Steckman* held that an Item 303 violation automatically states a claim under section 11, short-circuiting any separate consideration under the statute. This Article examines the *Steckman* decision and contends that it was wrongly decided. Analysis in recent decisions by the U.S. Courts of Appeal for the Second, Third, and Ninth Circuits contradict *Steckman*’s holding. These courts held that an Item 303 violation does not sufficiently state a claim for liability under section 10(b) of the 34 Act, for the simple reason that Item 303 sets a lower threshold for materiality than 10(b): Item 303 materiality is defined by a “reasonably likely” standard set by the SEC, but 10(b) materiality is subject to a heightened “substantial likelihood” standard set by the U.S. Supreme Court in *Basic v. Levinson*. This Article argues that this materiality distinction applies equally to section 11. Courts agree that an omission under section 11—like section 10(b)—must be material under the heightened *Basic* standard. Given that (i) an Item 303 violation cannot sufficiently establish *Basic* materiality, and (ii) *Basic* materiality is required under section 11, it follows that an Item 303 violation cannot be sufficient to state a claim for liability under Section 11. *Steckman* should be reconsidered.*

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I. Introduction

Nearly fifty years after Congress enacted the Securities Act of 1933 (33 Act) and the Securities Exchange Act of 1934 (34 Act) (collectively, the securities laws), the Securities and Exchange Commission (SEC) adopted Regulation S-K (Reg. S-K).¹ Reg. S-K provides instructions for companies filing disclosure forms under the securities laws.² However, Reg. S-K does not provide a private remedy.³ A company that omits a Reg. S-K disclosure is subject to liability in a private action only if that omission is actionable under the securities laws.⁴ Yet in initial public offering (IPO) litigation across the country, class action plaintiffs—and increasingly courts—view certain Reg. S-K omissions as sufficient to state a claim, without separately analyzing whether the omissions are actionable under the securities laws.⁵

Plaintiffs typically focus on Reg. S-K Item 303's requirement to disclose known trends and uncertainties.⁶ An Item 303 violation is easy to plead, for three reasons. First, a plaintiff need not allege that any disclosed fact was untrue, but simply that a trend or uncertainty was omitted.⁷

¹ 17 C.F.R. § 229 (1982); *see also* 2 THOMAS LEE HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION § 9.4(1) (6th ed. 2009).

² 17 C.F.R. § 229.10 (2017).

³ *See, e.g.,* *Oran v. Stafford*, 226 F.3d 275, 287 (3rd Cir. 2000) (“Neither the language of the regulation nor the SEC’s interpretative releases construing it suggest that it was intended to establish a private cause of action, and courts construing the provision have unanimously held that it does not do so.”) (citations omitted).

⁴ *Id.*; *see also, e.g., id.* at 288 (“[T]he demonstration of a violation of the disclosure requirements of Item 303 does not lead inevitably to the conclusion that such disclosure would be required under Rule 10b-5. Such a duty to disclose must be separately shown.”) (citation omitted); *In re Sofamor Danek Group*, 123 F.3d 394, 403 (6th Cir. 1997) (holding that there is no private action under Item 303 but acknowledging that “disclosure dut[ies] under [a statutory] claim may stem from Item 303”); *Silverstein v. Globus Med., Inc.*, No. 15-5386, 2016 U.S. Dist. LEXIS 113740, at *32 (E.D. Pa. Aug. 24, 2016) (quoting *Oran*, 226 F.3d); *In re Quintel Entertainment Inc. Secs. Litig.*, 72 F. Supp. 2d 283, 293 (S.D.N.Y. 1999) (“Violations of Item 303 may be relevant to determining when a false or misleading omission has been made [under the securities laws.]”).

⁵ *E.g.,* *Steckman v. Hart Brewing, Inc.*, 143 F.3d 1293, 1296 (9th Cir. 1998) (“[A]ny omission of facts ‘required to be stated’ under Item 303 will produce liability under Section 11.”); *Welgus v. Trinet Grp., Inc.*, No. 15-cv-03625-BLF, 2017 U.S. Dist. LEXIS 6347, at *51 (N.D. Cal. Jan. 17, 2017) (order granting in part and denying in part motions to dismiss with leave to amend in part and without leave to amend in part) (“Allegations which state a claim under Item 303(a) of Regulation S-K also sufficiently state a claim under Sections 11 and 12(a)(2).”) (quoting *Steckman*, 143 F.3d); *In re Initial Pub. Offering Secs. Litig.*, 358 F. Supp. 2d 189, 211 (S.D.N.Y. 2004) (“An omission of fact ‘required to be stated’ under Item 303 will generally produce liability under section 11.”) (citing *Steckman*, 143 F.3d); *Simon v. American Power Conversion Corp.*, 945 F. Supp. 416, 431 (D.R.I. 1996) (“[B]ecause [the company] was under an affirmative duty to disclose [under Item 303] and did not, the Court finds this omission to be actionable [under section 10(b).]”); Lead Plaintiff’s Opposition to Defendant Trinet’s, The Individual and Director Defendants’ and General Atlantic’s Motions to Dismiss First Amended Complaint, *Welgus v. Trinet Grp., Inc.*, No. 5:15-cv-03625-BLF, 2016 WL 4501063 (N.D. Cal. Aug. 19, 2016); *cf. In re SAIC, Inc.*, No. 12 Civ. 1353 (DAB), 2013 U.S. Dist. LEXIS 142606, at *33 (S.D.N.Y. Sept. 30, 2013) (citing *Steckman*, 143 F.3d) (analyzing only Item 303, not the Exchange Act); *Mallen v. Alphatec Holdings, Inc.*, No. 10-cv-1673 – BEN (MDD), 2013 U.S. Dist. LEXIS 46159, at *40 (S.D. Cal. Mar. 28, 2013) (citing *Steckman*, 143 F.3d) (focusing analysis on whether the complaint “allege[d] that defendants violated a disclosure duty under Regulation S-K”, without considering the statutory standards for materiality); *O’Donnell v. Coupons*, No. 1-15-cv-278399, 2016 Cal. Super. LEXIS 1097 (Cal. Super. Ct., Santa Clara Cty. May 24, 2016) (dismissing plaintiffs’ section 11 claim because the omitted information was “not required by item 303”).

⁶ *See* 17 C.F.R. § 229.303(a) (2017).

⁷ Item 303 requires issuers to “[d]escribe any known trends or uncertainties.” 17 C.F.R. § 229.303(a)(3)(ii) (2017). Item 303 is therefore violated if such known trends or uncertainties are omitted. *E.g.,* *Steckman*, 143 F.3d at 1296 (“[A]ny omission of facts required to be stated under Item 303 will produce liability under Section 11.”)

Second, an Item 303 allegation is inherently speculative—making it harder to dismiss at the pleadings stage before fact discovery—because it calls for hindsight analysis of forward-looking information.⁸ In light of negative results that have now come to pass, plaintiffs look back to the time of the offering and assert that the company had enough information then to identify a trend or uncertainty that would have predicted the current results. Finally, Item 303 has a lower materiality threshold than section 10b of the 34 Act.⁹

In recent years, courts have begun paying close attention to attempts by plaintiffs to leverage Item 303 allegations to state a claim for liability under section 10(b) of the 34 Act.¹⁰

Less attention has been paid to attempts to leverage Item 303 allegations to state a claim under section 11 of the 33 Act. Many courts assume, with little or no analysis, that an Item 303 violation is automatically sufficient to state a claim.¹¹ This assumption can be traced to the Ninth Circuit’s “short and cryptic opinion”¹² in *Steckman v. Hart Brewing*.¹³ The *Steckman* court concluded that “allegations which sufficiently state a claim under Item 303 also state a claim under section 11.”¹⁴

This view of Item 303 as a surrogate¹⁵ for section 11 has dire consequences for companies and their officers and directors. Item 303’s lower materiality threshold and murky cause of action¹⁶ make it easier to survive dismissal. By viewing an Item 303 violation as

(quotations omitted).

⁸ Unlike the securities laws, Item 303 expressly requires the disclosure of certain forward-looking information. See Management’s Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures, Securities Act Release No. 6835, Exchange Act Release No. 26831, Investment Company Act Release No. 16961, 54 Fed. Reg. 22427 (May 18, 1989) [hereinafter SEC May 18, 1989 Release], <https://www.sec.gov/rules/interp/33-6835.htm> (“Several specific provisions in Item 303 require disclosure of forward-looking information.”).

⁹ See *infra* Part II.C.

¹⁰ Compare *In re NVIDIA Corp. Secs. Litig.*, 768 F.3d 1046, 1056 (9th Cir. 2014) (“Item 303 does not create a duty to disclose for purposes of Section 10(b) and Rule 10b-5. Such a duty to disclose must be separately shown . . .”), *cert. denied*, 135 S. Ct. 2349 (2015), with *Stratte-McClure v. Stanley*, 776 F.3d 94, 102 (2d Cir. 2015) (“Item 303 imposes the type of duty to speak that can, in appropriate cases, give rise to liability under Section 10(b).”), and *Ind. Pub. Ret. Sys. v. SAIC, Inc.*, 818 F.3d 85, 94 (2d Cir. 2016) (quoting *Stratte-McClure*, 776 F.3d at 101 n. 7), *cert. granted*, *Leidos, Inc. v. Ind. Pub. Sys.*, 2017 WL 1114966 (U.S. Mar. 27, 2017) (No. 16-581). See also *Petition for Writ of Certiorari, SAIC*, 818 F.3d 85 (No. 16-581), 2016 WL 6472615 (asking the Supreme Court to resolve the circuit split). This Article’s core argument against *Steckman*’s conclusion that an Item 303 violation is sufficient to state a claim under section 11 is not likely to be resolved by *Leidos*.

¹¹ See sources cited *supra* note 5.

¹² Jared L. Kopel, Ignacio E. Salceda & Scott L. Adkins, *United States: The Duty to Disclose Intra-Quarter Financial Results*, MONDAQ (May 6, 1999), www.mondaq.com/unitedstates/x/7306/The+Duty+to+disclose+IntraQuarter+Financial+Results+disclose+intraquarter+financial+results.

¹³ See 143 F.3d 1293 (9th Cir. 1998).

¹⁴ *Id.* at 1296. To this day, *Steckman* remains the only Ninth Circuit Court of Appeals decision in a section 11 case holding that an Item 303 violation is a surrogate for section 11 liability. Arguably, it is the only such federal appellate decision in any circuit. See *infra* note 112 (discussing recent Second Circuit decisions).

¹⁵ Leveraging a rule violation to state a claim construes the rule as a “surrogate” for the statute. See *In re VeriFone Secs. Litig.*, 11 F.3d 865, 870 (9th Cir. 1993); *In re NVIDIA Corp. Secs. Litig.*, No. 08-CV-04260-RS, 2010 U.S. Dist. LEXIS 114230, at *33–34 (N.D. Cal. Oct. 19, 2010) (applying *VeriFone* to Item 303).

¹⁶ *E.g.*, *In re Canandaigua Secs. Litig.*, 944 F. Supp. 1202, 1210 (S.D.N.Y. 1996) (“The difficulty in interpreting S-K 303 is compounded by the broad and ambiguous language of the item and the S.E.C.’s decision to leave the standard of disclosure ‘intentionally general’”) (quoting SEC May 18, 1989 Release, *supra* note 8); Brief for the Securities Industry and Financial Markets Association and the Chamber of Commerce of the United States of

actionable under section 11, *Steckman* opens companies up to costly discovery and “virtually absolute” liability even when the alleged materiality falls below the statutory threshold.¹⁷

This Article contends that *Steckman*’s conclusion was wrong. To reach it, *Steckman* ignored statutory language and U.S. Supreme Court precedent.¹⁸ The conclusion was not necessary for its holding.¹⁹ *Steckman* ignored the parties’ reasoning and distorted their arguments. Its view of materiality is incoherent and unsupported.

Most important, *Steckman* is contradicted by recent analyses in the U.S. Courts of Appeals for the Ninth, Third, and Second Circuits. These courts hold that an Item 303 violation does not sufficiently state a claim under section 10(b). Their reasoning is straightforward: Item 303 sets a lower threshold for materiality than section 10(b).²⁰ Under section 10(b), the alleged omission must be material under a heightened “substantial likelihood” standard followed by the Supreme Court in *Basic v. Levinson*.²¹ In contrast, Item 303 materiality is defined by a lower (and different) “reasonably likely” standard set by the SEC.²² An omission sufficiently material under the lower standard of Item 303 is not necessarily material under the higher standard of section 10(b). Thus, these courts conclude that an Item 303 violation cannot be a surrogate for section 10(b) liability.²³

By this logic, Item 303 cannot be a surrogate for section 11, either. Courts agree that an omission under section 11—like section 10(b)—must be material under the heightened *Basic* standard.²⁴ Given that (i) an Item 303 violation cannot sufficiently establish *Basic* materiality and (ii) *Basic* materiality is required under section 11, it follows that an Item 303 violation cannot be sufficient to state a claim for liability under section 11.

The Article proceeds as follows: Part II outlines the statutory and regulatory framework. Part III analyzes the arguments and decision in *Steckman*. Part IV examines three Circuit Court of Appeals decisions rejecting *Steckman*’s analysis. Part V shows how their reasoning applies with equal force to 33 Act claims. Part VI shows how these courts have struggled to preserve *Steckman*’s distinction between 34 Act and 33 Act claims and contends that these attempts fail. The Article concludes by urging practitioners and courts to reconsider *Steckman*, following the lead of a 2011 federal district court decision.

II. Statutory and Regulatory Framework

A. Statutory Provisions

America as Amici Curiae Supporting Petitioner, *Leidos, Inc. v. Ind. Pub. Ret. Sys.*, No. 16-581, 2016 WL 7011426 at *3 (March 27, 2017) (“[T]he breadth and amorphousness of Item 303’s reporting standards make it almost impossible in many instances to determine when management is obligated to make a disclosure.”).

¹⁷ *Herman & MacLean v. Huddleston*, 459 U.S. 375, 382 (1983) (“Liability [under section 11] against the issuer of a security is virtually absolute, even for innocent misstatements.”) (footnote omitted).

¹⁸ See Brian Neach, *Item 303’s Role in Private Causes of Action Under the Federal Securities Laws*, 76 NOTRE DAME L. REV. 741, 770–72 (2001).

¹⁹ See *id.*

²⁰ See *Stratte-McClure v. Stanley*, 776 F.3d 94, 103–34 (2d Cir. 2015); *In re NVIDIA Corp. Secs. Litig.*, 768 F.3d 1046, 1054 (9th Cir. 2014); *Oran v. Stafford*, 226 F.3d 275, 288 (3rd Cir. 2000); see also *infra* Part III.

²¹ See *Basic Inc. v. Levinson*, 485 U.S. 224, 231–32 (1988) (quoting *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)).

²² See SEC May 18, 1989 Release, *supra* note 8.

²³ See cases cited *supra* note 5.

²⁴ See *infra* note 112.

Sections 11 and 12 of the 33 Act provide a private remedy to the purchaser of a security in connection with a misleading offering. Section 11 provides a remedy if the security was issued pursuant to a registration statement that “omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading”²⁵ Section 12(a)(2) provides a remedy if the security was offered or sold by means of a prospectus or communication that omitted “to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading”²⁶

Section 10(b) of the 34 Act makes it unlawful to sell securities using “any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.”²⁷ The SEC implemented section 10(b) by promulgating Rule 10b-5. The rule makes it unlawful “to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading”²⁸ Although neither section 10(b) nor Rule 10b-5 contains an express private remedy, courts have “implied a private cause of action from the text and purpose of [section] 10(b).”²⁹

B. Reg. S-K Item 303

Item 303 requires companies to include in certain public filings management’s discussion and analysis of their financial condition and results of operations (MD&A).³⁰ Among numerous MD&A line item disclosures, one frequently asserted by plaintiffs is the requirement to “[d]escribe any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations.”³¹

C. Contrasting Statutory Materiality with Item 303 Materiality

Both the securities laws and Item 303 contain a materiality requirement.³² However, the standard for materiality under these two varies.

1. Securities Laws

Materiality of an omission for purposes of liability under the securities laws is subject to a “substantial likelihood” standard set by the U.S. Supreme Court. In *Basic v. Levinson*,³³ the Court “expressly adopt[ed]” the materiality standard defined in the Court’s 1976 decision *TSC v. Northway*³⁴:

²⁵ 15 U.S.C. § 77k(a) (2012). The securities laws impose liability for false or misleading *statements* as well as *omissions*. This Article focuses on omissions, as that is where Item 303 allegations typically arise.

²⁶ 15 U.S.C. § 77q(a)(2) (2012).

²⁷ 15 U.S.C. § 78j(b) (2012).

²⁸ 17 C.F.R. § 240.10b-5(b) (2017).

²⁹ See *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 37 (2011).

³⁰ 17 C.F.R. § 229.303 (2017).

³¹ 17 C.F.R. § 229.303(a)(3)(ii).

³² The securities laws refer to “material fact.” *Supra* Part II.A. Item 303 refers to “material favorable or unfavorable impact.” *Supra* Part II.B.

³³ See *Basic v. Levinson*, 485 U.S. 224, 232 (1988). The *Basic* test was reaffirmed in 2011. See *Matrixx*, 563 U.S. at 38–45.

³⁴ See *Basic*, 485 U.S. at 232, 249 (“We specifically adopt, for the § 10(b) and Rule 10b-5 context, the standard of materiality set forth in [*TSC Indus., v. Northway, Inc.*, 426 U.S. 438 (1976)].”).

An omitted fact is material if there is a *substantial likelihood* that a reasonable shareholder would consider it important [To establish materiality,] there must be a *substantial likelihood* that the disclosure of the omitted fact would have been viewed by a reasonable investor as having *significantly altered the ‘total mix’ of information* made available.³⁵

Basic noted that “with respect to contingent or speculative information or events, . . . materiality ‘will depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity.’”³⁶

Though *Basic* involved 34 Act claims, courts have made clear that the *Basic* standard applies to 33 Act claims as well.³⁷

2. Item 303

By contrast, materiality under Item 303 is subject to a “reasonably likely” standard set by the SEC³⁸:

Where a trend, demand, commitment, event or uncertainty is known, management must make two assessments:

(1) Is the known trend, demand, commitment, event or uncertainty likely to come to fruition? If management determines that it is not *reasonably likely* to occur, no disclosure is required.

(2) If management cannot make that determination, it must evaluate objectively the consequences of the known trend, demand, commitment, event or uncertainty, on the assumption that it will come to fruition. Disclosure is then required unless management determines that a material effect on the registrant’s financial condition or results of operations is not *reasonably likely* to occur.³⁹

The SEC has expressly distinguished the Item 303 standard from the *Basic* standard:

[Item 303] mandates disclosure of specified forward-looking information, and specifies its own standard for disclosure, i.e., reasonably likely to have a material effect. This specific standard governs the circumstances in which Item 303 requires disclosure. The probability/magnitude test for materiality approved by the Supreme Court in *Basic Inc. v. Levinson*, 108 S. Ct. 978 (1986), is inapposite to Item 303 disclosure.⁴⁰

³⁵ *Id.* at 231 (emphasis added) (quoting *TSC Indus.*, 426 U.S. at 449); see also *Matrixx*, 563 U.S. at 38 (emphasis added) (quoting *Basic*, 485 U.S. at 231–32).

³⁶ *Basic*, 485 U.S. at 238 (quoting SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968)).

³⁷ See *infra* note 112.

³⁸ See SEC May 18, 1989 Release, *supra* note 8.

³⁹ *Id.* (emphasis added).

⁴⁰ *Id.* at n. 27. Commentators offer various ways to measure the difference between these two tests. See Neach, *supra* note 18, at 752–55 (“[A] simple comparison of the literal language of the SEC’s two-step analysis in the 1989 Release to the Supreme Court’s language in *Basic* reveals a marked difference between the two standards [T]he Supreme Court uses the term ‘substantial likelihood;’ this language connotes a higher standard for materiality than does the ‘reasonably likely’ language of the 1989 Release Item 303’s threshold for disclosure is lower than the *Basic* standard because management can no longer discount the magnitude of the uncertainty with a probability factor.”); Suzanne J. Romajas, *The Duty to Disclose Forward-Looking Information: A Look at the Future of MD&A*,

III. *Steckman v. Hart Brewing*

In *Steckman*, shareholder Jeffrey Steckman brought a class action on behalf of shareholders against Hart Brewing, a craft brewery, six months after it went public.⁴¹ The complaint alleged that Hart Brewing's IPO registration statement contained omissions under sections 11 and 12(a)(2) of the 33 Act.⁴² According to the complaint, the company "knew that a plateau in sales and earnings had been reached" prior to the IPO, "and that subsequent quarters would experience declining sales."⁴³ Steckman contended that this was a known "adverse trend" required to be disclosed under Item 303.⁴⁴ The district court found no Item 303 violation and dismissed the action.⁴⁵

On appeal, the defendants maintained that Item 303 had not been violated.⁴⁶ In addition, the underwriter defendants raised a new argument in the alternative: even if, *arguendo*, Item 303 had been violated, that "would not be sufficient to state a cause of action under the [33] Act."⁴⁷

A. *The Underwriters' New Argument*

The underwriters noted that the *Basic* test governs materiality under section 11.⁴⁸ They then distinguished the *Basic* test from the materiality test under Item 303.⁴⁹ The underwriters concluded that, in light of Item 303's different (and lower) threshold for materiality, it could not serve as a surrogate for liability under section 11: "[b]ecause the SEC and Section 11 employ different standards for determining when required information is 'material[,] . . . it is inevitable that their disclosure obligations cannot be used interchangeably."⁵⁰

61 FORDHAM L. REV. S245, S256 n.83 (1993) ("It is helpful to visualize the difference between the tests in mathematical terms. With respect to the first step of Item 303's test, Former SEC Commissioner Fleischman has suggested that 'reasonably likely' may be in the 40% probability range. With respect to the second step, one commentator has noted that 'the MD&A [test] requires the probability [of occurrence] to be assumed at 100% unless it can be determined to be close to zero, whereas *Basic* allows the probability of occurrence to be estimated at any point from zero to 100%.'") (citations omitted).

⁴¹ *Steckman v. Hart Brewing, Inc.*, 143 F.3d 1293, 1294–95 (9th Cir. 1998).

⁴² Class Action Complaint Violations of the Securities Laws at 12–13, *Steckman*, 143 F.3d 1293 (No. 396CV01077), 1996 WL 34446326.

⁴³ *Steckman*, 143 F.3d at 1296.

⁴⁴ *Id.*

⁴⁵ *Steckman v. Hart Brewing, Inc.*, No. 96-1077-K (RBB), 1996 U.S. Dist. LEXIS 22424, at *14–16 (S.D. Cal. Dec. 24, 1996).

⁴⁶ Brief of Defendants/Appellees, *Steckman*, 143 F.3d 1293 (9th Cir. 1998) (No. 97-55199), 1997 WL 33555008 [hereinafter Appellees' Brief].

⁴⁷ *Steckman*, 143 F.3d at 1296; see also Brief of the Underwriter Defendants/Appellees, *Steckman*, 143 F.3d 1293 (No. 97-55199), 1997 WL 33555009 [hereinafter Underwriters' Brief]; Appellees' Brief, *supra* note 46.

⁴⁸ The Underwriters' Brief notes that "[b]y its terms, Section 11 addresses only 'material' misstatements or omissions. As this Court has held, . . . the definition of materiality that governs any such [33] Act claim is set forth in *Basic, Inc. v. Levinson*['.]'" Underwriters' Brief, *supra* note 47, at 17 (citing *In re Worlds of Wonder Secs. Litig.*, 35 F.3d 1407, 1413 n.2 (9th Cir. 1994)) (noting that *Worlds of Wonder* "confirm[s] that the *Basic* standard governs [33] Act claims"); see also *In re Worlds of Wonder*, 814 F. Supp. 850, 859 (N.D. Cal. 1993) (applying the *Basic* test to section 11 claims).

⁴⁹ Underwriters' Brief, *supra* note 47, at 17 ("By contrast, the SEC has expressly *rejected* the *Basic* test for the purposes of determining whether there has been an omission under Item 303.")

⁵⁰ *Id.* at 18 ("Contrary to *Alfus, Caere* and the SEC's own interpretation, plaintiff assumes that the requirements of Item 303 are interchangeable with those of section 11. Because, in fact, there are fundamental differences between the standards governing a private claim under the Securities Act and an SEC enforcement action—and because plaintiff has not attempted to 'separately show' any section 11 violation—this action was properly dismissed

The underwriters also quoted *Alfus v. Pyramid*, a federal district court decision.⁵¹ *Alfus* held that the “demonstration of a violation of the disclosure requirements of Item 303 does not lead inevitably to the conclusion that such disclosure would be required under Rule 10b-5[, which, like section 11, applies the *Basic* materiality standard]. Such a duty to disclose must be separately shown.”⁵²

B. Steckman’s Reply

In his reply, Steckman did not dispute the underwriters’ central argument. He did not contend that even if Item 303 materiality is subject to a lower threshold than section 11, it could nonetheless be a surrogate for section 11 liability. Instead, he objected to the premise; he argued that Item 303 materiality and statutory materiality are in fact interchangeable: “the general standards of materiality set forth in *TSC*, *Basic* [(section 10(b))], and *Worlds of Wonder* [section 11] do apply to Item 303.”⁵³

C. The Ninth Circuit’s Ruling

The Ninth Circuit affirmed the district court’s finding that Steckman “ha[d] failed to state a claim under Item 303.”⁵⁴ It did not need to pass on the underwriters’ new argument in the alternative, had an Item 303 violation been established.⁵⁵ Yet the court chose to address the

with prejudice.”). The underwriters erred, however, in citing *In re VeriFone Securities Litigation*. 784 F. Supp. 1471 (N.D. Cal. 1992), *aff’d* 11 F.3d 865 (9th Cir. 1993). That case did not consider whether Item 303 was sufficient for a section 11 violation, but whether 303 was violated in the first instance. *See* Neach, *supra* note 18, at 769 n.169.

⁵¹ *Alfus v. Pyramid Tech. Corp.*, 764 F. Supp. 598 (N.D. Cal. 1991); *see also* *Feldman v. Motorola*, Civ. A. No. 90-C-5887, 1993 U.S. Dist. LEXIS 14631 (N.D. Ill. Oct. 14, 1993) (quoting *Alfus*, 764 F. Supp.).

⁵² Underwriters’ Brief, *supra* note 47, at 18 (quoting *Alfus*, 764 F. Supp.).

⁵³ Plaintiff’s/Appellant’s Joint Reply Brief, *Steckman v. Hart Brewing, Inc.*, 143 F.3d 1293 (9th Cir. 1998) (No. 97-55199), 1997 WL 33555006 [hereinafter Plaintiff’s Reply] (emphasis added). Steckman submitted that *Basic* contains two tests: the “probability/magnitude” test and the “substantial likelihood/total mix” test. He contended that the “probability/magnitude” test is limited to the preliminary merger context of the *Basic* case. Before *Basic*, a company was not required to disclose merger negotiations until an “agreement-in-principle” had been reached: “*Basic* rejected this bright line test, and held that materiality in the merger context should [be] viewed by assessing the probability the merger would occur.” *Id.* (citing *Basic v. Levinson*, 485 U.S. 224, 239 (1988)). Outside the merger context, however, materiality is governed by *Basic*’s “substantial likelihood/total mix” test, which is a “general materiality standard[.]” that governs materiality for omissions under the 33 Act, 34 Act, and Item 303. *Id.*; *see also* *Romajas*, *supra* note 40, at 257 (“In *Basic*, the Court was concerned with the disclosure of one very specific type of forward-looking information—preliminary merger negotiations. In determining whether there was a duty to disclose such information, the Court applied the probability/magnitude test. It limited its decision to the merger context, however, expressly stating that it was not addressing the applicability of its test to the disclosure of projections or other forward-looking information. In practice, most courts have dispensed with the probability/magnitude test when determining whether disclosure of projections is required. Therefore, it is not surprising that Item 303 also dispenses with that test.”). This view however has not been widely followed. Courts apply the “probability/magnitude” test beyond the merger context. *See, e.g.*, *Stratte-McClure v. Stanley*, 776 F.3d 94, 103 (2d Cir. 2015) (noting that plaintiffs must “allege that the omitted information was material under *Basic*’s probability/magnitude test”); *In re Alliance Pharm. Secs. Litig.*, 1995 U.S. Dist. LEXIS 11351, *10, *19 (S.D. Cal. May 23, 1995) (applying the “probability/magnitude” test to “securities violations involving nondisclosure relat[ing] to information suggesting that something might happen in the future”); *see also* SEC May 18, 1989 Release, *supra* note 8 (applying “probability/magnitude” test to securities violations in general, not limited to the merger context).

⁵⁴ *Steckman v. Hart Brewing*, 143 F.3d 1293, 1298 (9th Cir. 1998).

⁵⁵ *See* Neach, *supra* note 18, at 771. The court “declined to pass” on other issues it did not need to address in light of Steckman’s failure to state an Item 303 violation. *Steckman*, 143 F.3d at 1298.

“threshold issues” raised by the underwriters’ new argument.⁵⁶

In a “short and cryptic opinion,” the *Steckman* court held that Item 303 can be a surrogate for liability under the 33 Act, but not the 34 Act.⁵⁷ This result was advocated by neither party. The court did not weigh in on the central question in dispute: whether Item 303 materiality is interchangeable with *Basic* materiality. Instead, it adopted a position presented by neither party, contrary to precedent and statute: *neither Item 303 nor section 11 require Basic materiality*. *Steckman*’s holding has three components: an Item 303 violation is (1) a surrogate for section 11 liability, (2) a surrogate for section 12(a)(2) liability, and (3) not a surrogate for section 10(b) liability. Each will be analyzed in turn.

1. Surrogate for Section 11 Liability

First, the court asserted that “allegations which sufficiently state a claim under Item 303[(a) of Regulation S-K] also state a claim under section 11”⁵⁸:

Form S-1, which [the company] used in its registration, requires the registrant to follow Item 303. There is liability under section 11 if a registrant ‘omit[s] to state a material fact required to be stated’ in the registration statement. *See* section 11(a). Therefore, any omission of facts ‘required to be stated’ under Item 303 will produce liability under Section 11.⁵⁹

The court here took the position—not taken by either party—that the mere omission of a fact that the company had a legal duty to disclose states a claim for liability under section 11.⁶⁰ The court quotes the “material fact” language from section 11 and then reads it out of the statute, translating the statute as imposing liability for “*any* omission of facts required to be stated.”⁶¹ But the statute expressly requires the omission of a “*material* fact.” It is well-settled that section

⁵⁶ *Steckman*, 143 F.3d at 1296.

⁵⁷ Kopel, et al., *supra* note 8 (noting that “*Steckman* is also very hard to harmonize with *Worlds of Wonder*, which was also issued by the Ninth Circuit Court of Appeals” and that “in light of this, it is not surprising that other courts have largely ignored *Steckman*’s holding,” and focusing on whether *Steckman* imposed a duty to report intra-quarter results).

⁵⁸ *Steckman*, 143 F.3d at 1296. *Steckman* is not consistent with the Ninth Circuit’s *VeriFone* decision (cited by *Steckman*) as *VeriFone* has been understood by other courts. *See In re VeriFone Secs. Litig.*, 11 F.3d 865, 870 (9th Cir. 1993) (“We decline to hold that a violation of exchange rules governing disclosure may be imported as a surrogate for straight materiality analysis under § 10(b) and Rule 10b–5.”); *In re NVIDIA Corp. Secs. Litig.*, No. 08-CV-04260-RS, 2010 U.S. Dist. LEXIS 114230, at *33–34 (N.D. Ca. Oct. 19, 2010) (applying *VeriFone* to an Item 303 violation); *Kriendler v. Chemical Waste Management*, 877 F. Supp. 1140, 1157 (N.D. Ill. 1995) (similar).

⁵⁹ *Steckman*, 143 F.3d at 1296.

⁶⁰ *Cf.* *Shaw v. Digital Equip. Corp.*, 82 F.3d 1194, 1204 (1st Cir. 1996) (“The information ‘required to be stated’ in a registration statement is spelled out . . . in various regulations promulgated by the SEC”) (quoting section 11).

⁶¹ *Id.* (emphasis added). The court may have been drawing from the following language in *Steckman*’s brief: “Item 303 establishes a ‘duty’ to disclose. Item 303 is relevant to cases arising under section 11 of [the 33] Act where plaintiff alleges [that] an issuer[] ‘omitted to state a material fact required to be stated [in the registration statement].’ The question ‘what is required to be stated’, is answered by reference to Item 303.” Plaintiff’s Reply, *supra* note 53, at 19. But *Steckman*’s focus was never that such an omission would automatically impose liability. He stated merely that Item 303 creates a “duty to disclose,” rendering a violation an omission. However, such omission may still need to be separately established as material. *See infra* Part VI.E (discussing the Second Circuit’s “two-step” approach); *see also* Plaintiff’s Reply, *supra* note 53, at 3 (stating that “[t]he omission of material facts, which [defendants] had a duty to disclose, establishes a violation of Section 11 and Section 12(2) of the [33 Act],” thereby implying that the duty to disclose and materiality are separate elements).

11 liability is predicated on a *material* omission.⁶² Further, the lack of a materiality requirement leads to a strange result. Reg. S-K requires many line item disclosures of little or no significance to investors.⁶³ Under this reading of *Steckman*, an omission of any of these trivialities would subject a company to strict liability under section 11 because the information was “required to be stated” by Reg. S-K.⁶⁴ This runs counter to the U.S. Supreme Court’s repeated warnings against excessive disclosure.⁶⁵

2. Surrogate for Section 12(a)(2) Liability

The *Steckman* court then extended its conclusion to section 12(a)(2): “[a]llegations which would support a claim under Item 303[] are sufficient to support a claim under [s]ection 12(a)(2).”⁶⁶

This position—suggested by neither party—is even more problematic. The “required to be stated” language central to the court’s analysis of section 11 is absent from section 12(a)(2).⁶⁷ With respect to section 12(a)(2), the court cannot claim that “any omission of facts” triggers liability. Instead, it apparently concedes that an omission must be material, but suggests a new standard for materiality. Quoting a Third Circuit case not involving Item 303 and cited by neither party, the court asserts that “disclosures mandated by law are presumably material.”⁶⁸

Steckman’s ultimate conclusion, then, is that materiality under the securities laws is

⁶² See *infra* note 112, at 102.

⁶³ E.g., 17 C.F.R. § 229.102 (2017) (“[S]tate briefly the location and general character of the . . . physical properties of the registrant and its subsidiaries.”); 17 C.F.R. § 229.502 (2017) (explaining that the registrant must “include the table of contents immediately following the cover page in any prospectus you deliver electronically”); 17 C.F.R. §§ 229.510, 229.702 (2017) (indemnification of officers and directors); see also Neach, *supra* note 18, at 773 (“[M]andatory Item 303 disclosures encompass a broad spectrum of both material and immaterial information. The unfairness of the *Steckman* court’s holding becomes evident when applied to a reporting company that complies fully with all Item 303 disclosures that are material (in the *Basic* sense), yet could still be liable for seemingly minor omissions.”).

⁶⁴ *Reductio ad absurdum* is further grounds for rejecting *Steckman*’s reading. See, e.g., *Corley v. United States*, 556 U.S. 303, 316 (2009) (rejecting a statutory reading where taking it to its logical extreme would lead to “absurdities”). Moreover, legislative history supports a narrower reading of the “required to be stated” language. See H.R. REP. NO. 73-152, at 26 (1933) (“[U]nless the [A]ct expressly requires such a fact to be stated”) (emphasis added) (implying that the “required to be stated” language refers only to a disclosure required by the Act itself, and not one required merely by regulation such as Reg. S-K).

⁶⁵ See *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 38 (2011) (“We were ‘careful not to set too low a standard of materiality,’ for fear that management would ‘bury the shareholders in an avalanche of trivial information.’”) (quoting *Basic v. Levinson*, 485 U.S. 224, 231 (1988)); see also *infra* Part VI.

⁶⁶ *Steckman v. Hart Brewing*, 143 F.3d 1293, 1296 (9th Cir. 1998).

⁶⁷ *Shaw v. Digital Equip. Corp.*, 82 F.3d 1194, 1204 (1st Cir. 1996) (“That predicate is unique to Section 11; neither Section 12(2) of the Securities Act nor Section 10(b) or Rule 10b-5 under the Exchange Act contains comparable language.”); see also *Stratte-McClure v. Stanley*, 776 F.3d 94, 104 (2d Cir. 2015) (noting that “Section 12(a)(2)’s prohibition on omissions is textually identical to that of Rule 10b-5”).

⁶⁸ *Steckman*, 143 F.3d at 1296 (quoting *Craftmatic Secs. Litig. v. Kraftsow*, 890 F.2d 628, 641 n.17 (3d Cir. 1990)). *Craftmatic* does not discuss Item 303 or specify what it meant by “mandated by law.” In a subsequent decision, the Third Circuit noted that it is “far from certain that the requirement that there be a duty to disclose under Rule 10b-5 may be satisfied by importing the disclosure duties from S-K 303.” *In re Burlington Coat Factory Secs. Litig.*, 114 F.3d 1410, 1419 (3d Cir. 1997) (internal quotation marks omitted) (quoting *In re Canandaigua Secs. Litig.*, 944 F. Supp. 1202, 1209 n.4 (S.D.N.Y. 1996)); see also Neach, *supra* note 18, at 771 (arguing that the “presumably material” language is sourced in an unsupported phrase in a law review article that “does not provide any source for this proposition; thus indicating that the *Steckman* court’s decision rested on a rather fragile foundation”).

presumed simply by the fact that the company omitted a disclosure “mandated by law,” including by SEC regulation. This is essentially the same result the court articulated under section 11, but now the court labels this as material. As discussed, such a result was advocated by neither party and leads to absurd results. *Steckman*’s presumption of materiality ignores Supreme Court jurisprudence defining heightened materiality under the securities laws.⁶⁹

3. Not a Surrogate for Section 10(b) Liability

The *Steckman* court limited its conclusion to 33 Act claims. With respect to 34 Act claims, however, the court conceded that Item 303 is *not* a surrogate for liability.⁷⁰ The court offered one sentence of explanation: “Section 10(b) of the Exchange Act, which has only an implied right of action, differs significantly from Sections 11 and 12(a)(2) of the Securities Act, which have express rights of action.”⁷¹

Why should that matter? As one commentator has pointed out, “none of the courts rejecting Item 303 as a basis for Rule 10b-5 liability mentioned the implied nature of the cause of action as being a factor.”⁷² The court’s distinction has no basis in case law or legislative history. Though the remedy for section 10(b) is implied, its standard for liability is defined in identical terms to section 12(a)(2), for which the court just held Item 303 *is* a surrogate.⁷³ Further, the Ninth, Third, and Second Circuits all hold that the same materiality standard applies to *both* 33 Act and 34 Act claims.⁷⁴ If materiality can be presumed, liability should follow, whether the cause of action is express or implied.⁷⁵

For all of these reasons, *Steckman* was wrongly decided.

IV. The Underwriters’ Argument is Adopted by the Third, Ninth, and Second Circuits

Since *Steckman*, at least three federal Courts of Appeal have come to endorse the underlying argument made by Hart Brewing’s underwriters distinguishing Item 303 materiality from *Basic* materiality.

⁶⁹ See Neach, *supra* note 18, at 771 (“[I]ntertwining a presumption of materiality with SEC-required disclosures completely undercuts the Supreme Court’s decisions regarding materiality.”) (citing *Basic*, 485 U.S. 231–32; *TSC Indus., Inc. v. Northway, Inc.* 426 U.S. 438, 449 (1976)); see also *infra* note 112 (discussing *Worlds of Wonder*, an earlier Ninth Circuit decision that applied *Basic/TSC* materiality to section 11).

⁷⁰ This distinction was advocated by neither party. *Steckman* may have been trying to distinguish *VeriFone*, a case cited by the underwriters that declined to find section 11 liability where Item 303 violations were alleged. See *In re VeriFone Securities Litigation*, 784 F. Supp. 1471, 1483 (N.D. Cal. 1992), *aff’d* 11 F.3d 865 (9th Cir. 1993). But *VeriFone* was misconstrued by the underwriters. It concerned whether Item 303 had been violated *in the first instance*, not whether an Item 303 violation is sufficient to state a securities claim. See Neach, *supra* note 18, at 769 n.169.

⁷¹ *Steckman*, 143 F.3d at 1296.

⁷² Neach, *supra* note 18, at 770.

⁷³ See *Stratte-McClure v. Stanley*, 776 F.3d 94, 104 (2d Cir. 2015) (explaining, “[b]ut Section 12(a)(2)’s prohibition on omissions is textually identical to that of Rule 10b-5: both make unlawful omission of ‘material fact[s] . . . necessary to make . . . statements, in light of the circumstances under which they were made, not misleading’” and holding that Item 303 requirements establish a duty to disclose under both 33 Act and 34 Act claims) (citations omitted) (quoting 15 U.S.C.A. §771 (West 2000)).

⁷⁴ See *infra* note 112. One such case is *Craftmatic Secs. Litig. v. Kraftsow*, 890 F.2d 628, 640–41 (3d Cir. 1990), which *Steckman* itself cites, 143 F.3d at 1296.

⁷⁵ After the 2011 *Matrixx* decision, there may be grounds to distinguish 34 Act materiality as requiring something more than *Basic*. See *infra* Part VI. However, such grounds did not exist in 1993 when *Steckman* was decided.

A. Third Circuit

In *Oran v. Stafford*,⁷⁶ shareholders brought a class action against a drug manufacturer, alleging 34 Act violations for not “disclos[ing] several studies linking the drugs to heart-valve damage.”⁷⁷ The district court dismissed for failure to state a claim.⁷⁸ On appeal, the plaintiffs argued that by not disclosing the alleged “link between its drugs and valvular heart disorder,”⁷⁹ the company violated Item 303’s requirement to disclose “known trends and uncertainties,”⁸⁰ and that “such a violation can support a claim under [the 34 Act].”⁸¹

Then-Judge Alito explained that to prevail, plaintiffs had to show “either that [Item] 303 creates an independent private right of action, or that the regulation imposes an affirmative duty of disclosure on [the company] that, if violated, would constitute a material omission under Rule 10b-5.”⁸²

After holding that Item 303 does not create a private right of action,⁸³ the court proceeded to analyze plaintiffs’ contention that a violation of Item 303 constitutes a material omission under the securities laws. In the court’s view, the critical question was the same question identified three years earlier by the *Steckman* underwriters (but ignored by the *Steckman* court): “whether the disclosure mandated by [Item] 303 is governed by standards consistent with those that the Supreme Court has imposed for private fraud actions under the federal securities laws.”⁸⁴

Oran began by quoting the SEC’s two-part “reasonably likely” materiality standard that “characterized a company’s disclosure obligations under [Item] 303.”⁸⁵ It then contrasted that with the materiality standard under the securities laws:

[T]he general test for securities fraud materiality [was] set out by the Supreme Court in *Basic, Inc. v. Levinson*, which premised forward-looking disclosure ‘upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity.’⁸⁶

The Third Circuit concluded, like the *Steckman* underwriters, that the standards “var[y] considerably.”⁸⁷ Specifically, “[Item] 303’s disclosure obligations extend considerably beyond those required by Rule 10b-5.”⁸⁸ “Because the materiality standards for Rule 10b-5 and [Item] 303 differ significantly,” Item 303 cannot be a surrogate for section 10(b) or Rule 10b-5.⁸⁹ Thus, “a violation of [Item] 303’s reporting requirements does not automatically give rise to a material

⁷⁶ 226 F.3d 275 (3d Cir. 2000).

⁷⁷ *Id.* at 279.

⁷⁸ *See id.*

⁷⁹ *Id.* at 287.

⁸⁰ *Id.* at 281.

⁸¹ *Id.*

⁸² *Id.* at 287.

⁸³ *See id.* at 288.

⁸⁴ *Id.* at 287.

⁸⁵ *Id.* (citing SEC May 18, 1989 Release, *supra* note 8).

⁸⁶ *Id.* at 288 (citation omitted); *see also* Underwriters’ Brief, *supra* note 47, at 17.

⁸⁷ 226 F.3d at 288 (“[T]he materiality standards for Rule 10b-5 and [Item] 303 differ significantly.”) (quoting SEC May 18, 1989 Release, *supra* note 8); *see also* Underwriters’ Brief, *supra* note 47, at 17.

⁸⁸ *Oran*, 226 F.3d at 288 (emphasis added); *see also* Underwriters’ Brief, *supra* note 47, at 18.

⁸⁹ *Oran*, 226 F.3d at 228 (quoting *Alfus v. Pyramid Tech. Corp.*, 764 F. Supp. 598 (N.D. Cal. 1991)).

omission under Rule 10b-5.”⁹⁰

B. Ninth Circuit

The question of Item 303 as a surrogate for federal securities claims did not again come before the Ninth Circuit until 2014, sixteen years after *Steckman*. Shareholders brought a securities class action under the 34 Act against semiconductor manufacturer NVIDIA for not disclosing alleged product defects.⁹¹ The district court dismissed the claims for failure to plead scienter.⁹² On appeal, plaintiffs contended that “the district court’s analysis should have focused on whether NVIDIA acted with scienter in failing to make the Item 303 disclosure.”⁹³

In its opinion, the Ninth Circuit noted that it had “never directly decided whether Item 303’s disclosure duty is actionable under Section 10(b) and Rule 10b-5. We now hold that it is not.”⁹⁴ In reaching this holding, the court followed *Oran*: “In *Oran v. Stafford*, the Third Circuit decided this issue more directly. We are persuaded by its reasoning.”⁹⁵

After analyzing the materiality tests under Item 303 and *Basic*, NVIDIA determined, as did *Oran* and the *Steckman* underwriters, that “these two standards differ considerably”⁹⁶:

Management’s duty to disclose under Item 303 is much broader than what is required under the standards pronounced in *Basic*. . . . The SEC’s effort to distinguish *Basic*’s materiality test from Item 303’s disclosure requirement provides further support for the position that Item 303 requires more than *Basic*—what must be disclosed under Item 303 is not necessarily required under the standard in *Basic*. Therefore, . . . the ‘demonstration of a violation of the disclosure requirements of Item 303 does not lead inevitably to the conclusion that such disclosure would be required under Rule 10b-5.’⁹⁷

C. Second Circuit

In *Stratte-McClure*,⁹⁸ shareholders brought a putative class action under the 34 Act against Morgan Stanley for alleged misstatements and omissions regarding its exposure to subprime mortgages.⁹⁹ The plaintiffs alleged that Morgan Stanley should have disclosed its exposure earlier as a “known trend[] or uncertaint[y]” under Item 303 that had or was “reasonably expected to have an unfavorable material effect on revenue.”¹⁰⁰ The district court “ruled that Morgan Stanley *did* have a duty [to disclose] under Item 303.”¹⁰¹ It found further that the “alleged disregard of Item 303 of Regulation S-K, constituted an actionable omission under Section 10(b) and Rule 10b-5.”¹⁰² But the district court dismissed the claim for failure “to plead

⁹⁰ *Id.*

⁹¹ *In re* NVIDIA Corp. Secs. Litig., 768 F.3d 1046, 1048 (9th Cir. 2014).

⁹² *Id.*

⁹³ *Id.* at 1054.

⁹⁴ *Id.*

⁹⁵ *Id.* (citation omitted).

⁹⁶ *Id.* at 1055.

⁹⁷ *Id.* at 1054 (quoting *Oran v. Stafford*, 226 F.3d 275 (3rd Cir. 2000)) (quoting the *Alfus* language cited by the *Steckman* underwriters).

⁹⁸ *Stratte-McClure v. Morgan Stanley*, 776 F.3d 94, 94 (2d Cir. 2015).

⁹⁹ *Id.* at 96.

¹⁰⁰ *Id.* at 98.

¹⁰¹ *Id.* at 99.

¹⁰² *Id.* at 100.

‘a strong inference of scienter.’”¹⁰³ The Second Circuit affirmed:

We conclude, as a matter of first impression in this Court, that a failure to make a required Item 303 disclosure in a 10-Q filing is indeed an omission that can serve as the basis for a Section 10(b) securities fraud claim. *However, such an omission is actionable only if it satisfies the materiality requirements outlined in Basic Inc. v. Levinson*, and if all of the other requirements to sustain an action under Section 10(b) are fulfilled. Here, the district court properly dismissed Plaintiffs’ exposure claim predicated on Morgan Stanley’s failure to disclose under Item 303 because the second amended complaint did not sufficiently plead scienter.¹⁰⁴

The Second Circuit further broke down its analysis. It first acknowledged that “Item 303 imposes the type of duty to speak that can, in appropriate cases, give rise to liability under Section 10(b).”¹⁰⁵ But then it clarified: “The failure to make a required disclosure under Item 303, however, is not by itself sufficient to state a claim for securities fraud under Section 10(b). Significantly, Rule 10b-5 makes only ‘material’ omissions actionable.”¹⁰⁶

The Second Circuit went on to draw the same contrast shown by the *Steckman* underwriters, the Third Circuit in *Oran*, and the Ninth Circuit in *NVIDIA*.¹⁰⁷ It contrasted the *Basic* test with the SEC’s “two-part (and different) inquiry” that determines a “duty to report under Item 303.”¹⁰⁸ It noted—as did the *Steckman* underwriters, *Oran*, and *NVIDIA*—that the SEC has itself stated that “this disclosure standard is unique to Item 303,” and “is inapposite” to *Basic* materiality.¹⁰⁹ The court then adopted *Oran*’s conclusion that “Item 303’s disclosure obligations ‘extend considerably beyond those required by Rule 10b-5’”¹¹⁰:

Since the Supreme Court’s interpretation of ‘material’ in Rule 10b-5 dictates whether a private plaintiff has properly stated a claim, we conclude that a violation of Item 303’s disclosure requirements can only sustain a claim under Section 10(b) and Rule 10b-5 if the allegedly omitted information satisfies *Basic*’s test for materiality.¹¹¹

Thus, the Second Circuit joined the Third and Ninth in embracing the *Steckman* underwriters’ distinction of Item 303 materiality from *Basic* materiality. For this reason, these courts hold that Item 303 cannot be a surrogate for section 10(b) liability.

V. Because 33 Act Claims are Governed by *Basic* They Cannot Be Distinguished From 34 Act Claims

The position of the *Steckman* underwriters, *Oran*, *NVIDIA*, and *Stratte-McClure* cannot logically be contained to claims under the 34 Act. The reason is simple: these courts agree that

¹⁰³ *Id.* at 99 (quoting *Stratte-McClure v. Morgan Stanley*, No. 09 Civ.2017(DAB), 2013 WL 297954, at *9 (S.D.N.Y. Jan. 18, 2013)).

¹⁰⁴ *Id.* at 100 (emphasis added) (citation omitted).

¹⁰⁵ *See id.* at 102.

¹⁰⁶ *See id.*; *see also infra* part VI.E (discussing the Second Circuit’s “two-step” approach).

¹⁰⁷ *See Stratte-McClure*, 776 F.3d at 103–04.

¹⁰⁸ *Id.* at 103.

¹⁰⁹ *See id.* (quoting SEC May 18, 1989 Release, *supra* note 8).

¹¹⁰ *See id.*

¹¹¹ *Id.*

Basic materiality—and not the SEC’s broader Item 303 test—governs 33 Act claims.¹¹² Just as Item 303 is not sufficient to state a section 10(b) claim because it is subject to the heightened *Basic* standard, for the same reason Item 303 cannot be sufficient to state a claim under section 11.

This result is not only logical, but also supported by the Court’s reasoning in *Basic*. The *Basic* Court explained that it deliberately raised the materiality standard:

Acknowledging that certain information concerning corporate developments could well be of ‘dubious significance,’ the Court was careful not to set too low a standard of materiality; it was concerned that a minimal standard might bring an overabundance of information within its reach, and lead management ‘simply to bury the shareholders in an avalanche of trivial information—a result that is hardly conducive to informed decisionmaking.’¹¹³

¹¹² *Ninth Circuit*. In *Worlds of Wonder*, a case involving section 11 claims, the Ninth Circuit confirmed that the *Basic* test for materiality applies to omissions challenged under section 11. *In re Worlds of Wonder Secs. Litig.*, 35 F.3d 1407, 1413 n.2 (9th Cir. 1994) (“[F]or nondisclosure to be actionable ‘there must be a *substantial* likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having *significantly* altered the ‘total mix’ of information made available.’”) (citation omitted). The court rejected the *Worlds of Wonder* plaintiffs’ argument that bespeaks caution applied only to section 10(b) claims, reasoning that the “[bespeaks caution] doctrine is primarily an application of the *materiality concept, which applies equally to both statutory provisions.*” *Id.* at 1415 n.3 (emphasis added).

That section 11 materiality is governed by the heightened *Basic* standard is oft-repeated in the Ninth Circuit. *See, e.g.*, *Hemmer Grp. v. Southwest Water Co.*, 527 Fed. Appx. 623, 626 (9th Cir. 2013) (“A fact is material [under section 11] if there is ‘a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available.’”) (quoting *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 38 (2011)); *Sherman v. Network Commerce, Inc.*, 346 Fed. Appx. 211, 213 (9th Cir. 2009) (“To establish materiality, plaintiffs must demonstrate a ‘substantial likelihood that a reasonable investor would have acted differently if the misrepresentation had not been made or the truth had been disclosed.’”) (quoting *Livid Holdings Ltd. v. Salomon Smith Barney, Inc.*, 416 F.3d 940, 946 (9th Cir. 2005)); *Aaron v. Empresas La Moderna*, 46 F. App’x 452, 454 (9th Cir. 2002) (discussing that under section 11, an “omission is material if there is ‘a substantial likelihood that the disclosure of the omitted [or misrepresented] fact would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available’”) (quoting *TSC Indus., Inc. v. Northway, Inc.* 426 U.S. 438, 449 (1976)).

Second Circuit. *See In re Morgan Stanley Info. Fund Secs. Litig.*, 592 F.3d 347, 360 (2d Cir. 2010) (“The definition of materiality is the same for these provisions [sections 11 and 12(a)(2)] as it is under section 10(b) of the Exchange Act.”); *Kronfeld v. Trans World Airlines, Inc.*, 832 F.2d 726, 731 (2d Cir. 1987) (“The materiality standard of *Northway* has been applied in this circuit under Section 11 of the 1933 Act.”) (citing, *inter alia*, *Akerman v. Oryx Commc’ns, Inc.*, 609 F.Supp. 363, 367 (S.D.N.Y. 1984), *aff’d*, 810 F.2d 336 (2d Cir. 1987) (applying *Basic*’s “substantial likelihood” and “probability/magnitude” test to section 11 claims)).

Third Circuit. In *Craftmatic*, the Third Circuit reviewed allegations under sections 11, 12(a)(2), and 10(b) for a company’s alleged failure to predict certain results. *Craftmatic Secs. Litig. v. Kraftsow*, 890 F. 2d 628, 640–41 (3rd Cir. 1989). Judge Scirica equated all three claims, and analyzed them uniformly under the *Basic/TSC* “substantial likelihood/total mix” materiality standard: “In *Basic*, the Supreme Court expressly adopted the *TSC* standard of materiality for § 10(b) and Rule 10b-5. Other courts have held that the definition of materiality from *TSC* applies to actions under both § 11 and § 12(2).” *Id.* at 641 n.18 (citations omitted); *see also id.* at 638 n.14 (“[U]nder all three sections [11, 12(a)(2), and 10(b)], liability flows from material misrepresentations or omissions.”); *see also In re Ressler Hardwoods & Flooring, Inc.*, 427 B.R. 312, 325 (Bankr. M.D. Pa. 2010) (“The *TSC Industries* definition has been extended to apply to ‘materiality’ in the context of a sale of securities under § 12(2) of the Securities Act of 1933.”).

¹¹³ *Basic Inc. v. Levinson*, 485 U.S. 224, 231 (1988) (quoting *TSC*, 426 U.S. at 448–49); *see also Matrixx*, 563 U.S. at 38 (first quoting *Basic*, 485 U.S. at 238; then quoting *TSC*, 426 U.S. at 449).

This rationale applies with equal (if not stronger) force to section 11.¹¹⁴ Disclosures pose the same risk of “burying the shareholders in an avalanche of trivial information” whether they are subject to challenge under section 11 or section 10(b).¹¹⁵ Moreover, the “*interrorem* nature”¹¹⁶ of section 11’s “virtually absolute” strict liability¹¹⁷ (which, unlike section 10(b), has no scienter requirement) makes it even more likely to spur excessive disclosure. Were *Basic* applied only to section 10(b) claims and not section 11, its purpose would be defeated: the specter of section 11’s strict liability would still induce issuers to bury investors in trivial information.

VI. Attempts to Distinguish 33 Act Claims Fail

Not wishing to overrule *Steckman*, the *Oran* and *NVIDIA* courts attempt to confine their holding to 34 Act claims. These attempts—which are mere dicta¹¹⁸—fail.

A. Reliance on *Steckman* is Misplaced

Oran assumes in a footnote that section 11 claims are different simply because *Steckman* says so.¹¹⁹ It neither engages with *Steckman*’s rationale nor offers any basis for such distinction. Likewise, *NVIDIA* begins by noting that, “as we acknowledged in [*Steckman*], ‘section 10(b) of the Exchange Act . . . differs significantly from sections 11 and 12(a)(2) of the Securities Act.’”¹²⁰

These courts’ reliance on *Steckman* is misplaced (putting aside that *Steckman* was wrongly decided). Unlike these courts, *Steckman* never adopted the argument that Item 303 is not sufficient to state a claim requiring *Basic* materiality. Thus *Steckman* was able to hold that Item 303 could be interchangeable with, and a surrogate for, section 11. In contrast, these courts have all embraced the argument—ignored by *Steckman*—that Item 303 and *Basic* (which applies to section 11) are *not* interchangeable. Arguably, the *Steckman* court itself would never have distinguished 33 Act claims had it adopted the underwriters’ insufficiency argument as do these courts. These courts’ adoption of the underwriters’ argument effectively overrules *Steckman*’s conclusion.

B. Distinction Based on Statutory Language Fails

The *NVIDIA* court attempts to distinguish 33 Act claims based on purported differences in statutory language: “[l]iability under sections 11 and 12(a)(2) of the Securities Act may arise from ‘omit[ting] to state a material fact required to be stated.’ . . . There is no such requirement

¹¹⁴ See *Kaplan v. Rose*, 49 F.3d 1363, 1374 (9th Cir. 1994) (acknowledging that for purposes of a section 11 claim, a “prospectus should not ‘bury the shareholders in an avalanche of trivial information’”) (quoting *Basic*, 485 U.S. at 231).

¹¹⁵ Item 303, in contrast, does not impose a private right of action. The mere prospect of regulatory enforcement would not have the same “*interrorem*” effect as strict private liability under section 11. *Panther Partners Inc. v. Ikanos Communs., Inc.*, 681 F.3d 114, 119–20 (2d Cir. 2012) (quoting *In re Morgan Stanley*, 592 F.3d at 359).

¹¹⁶ *Id.*

¹¹⁷ *Herman & MacLean v. Huddleston*, 459 U.S. 375, 382 (1983).

¹¹⁸ These cases did not involve section 11 claims—that they uphold Item 303 as a surrogate for section 11 liability is dicta.

¹¹⁹ *Oran v. Stafford*, 226 F.3d 275, 288 n.9 (3rd Cir. 2000) (“[The *Steckman*] court carefully limited its holding, however, making clear that it did not extend to claims under Section 10(b) or Rule 10b-5.”).

¹²⁰ *In re NVIDIA Corp. Secs. Litig.*, 768 F.3d 1046, 1055 (9th Cir. 2014) (quoting *Steckman v. Hart Brewing, Inc.*, 143 F.3d 1293, 1296 (9th Cir. 1998)).

under section 10(b) or Rule 10b-5.”¹²¹ As the Second Circuit pointed out, however, this misreads the statute: “section 12(a)(2)’s prohibition on omissions is textually identical to that of Rule 10b-5”¹²²

C. 33 Act Materiality is Set by Basic even after *Matrixx*

NVIDIA cites the Second Circuit’s decision in *Panther Partners* that “[33 Act] liability arises from ‘an omission in contravention of an affirmative legal disclosure obligation,’”¹²³ and contrasts that with 34 Act liability as defined in *Matrixx*.¹²⁴ If the court means, like *Steckman*, that there is *no* materiality requirement for 33 Act claims, this reads materiality out of the statute and suffers the same ills as *Steckman*.¹²⁵ The more plausible reading is that 33 Act claims have a *lower* materiality standard than 34 Act claims. But this is contradicted by the Second Circuit’s statement in *Blackstone* that “the test for materiality is the same [under section 10(b) as] when claims are brought pursuant to sections 11 and 12(a)(2)”¹²⁶ Further, neither *Blackstone* nor *Panther Partners* state that section 12(a)(2) has a lower materiality standard than section 10(b).

Moreover, even were it true that after *Matrixx*, materiality under the 34 Act is higher than under the 33 Act, that still does not reduce 33 Act claims from the *Basic* materiality threshold, which is itself a higher standard than under Item 303. *Matrixx* stated that under section 10(b), even “material information need not be disclosed unless omission of that information would cause other information that is disclosed to be misleading.”¹²⁷ But *Matrixx* did not address section 11. Nothing in *Matrixx* overrules the well-settled appellate jurisprudence that *Basic* materiality applies equally to section 11 and section 10(b) claims. Indeed, *Matrixx* reaffirms *Basic* as the baseline standard for materiality. At most, *Matrixx* sets the bar for 34 Act omissions *higher than* the *Basic* standard. It does nothing to *lower* the standard for section 11.¹²⁸ Section 11 remains subject to *Basic* materiality, which is not interchangeable with Item 303 materiality.

D. Differences Regarding *Scienter* and Pleading Requirements are Irrelevant

NVIDIA proffers a seemingly meaningless distinction: 33 Act claims are different because

¹²¹ *Id.* at 1055–56 (citation omitted). The Ninth Circuit here may have mistakenly quoted from section 12(b) regarding loss causation, which contains the “required to be stated” language. 15 U.S.C. § 771(b) (2012).

¹²² *Stratte-McClure v. Stanley*, 776 F.3d 94, 104 (2d Cir. 2015) (quoting 15 U.S.C. § 771 (2012)).

¹²³ *NVIDIA*, 768 F.3d at 1055–56 (quoting *Panther Partners v. Ikanos Communications, Inc.*, 681 F.3d 114, 120 (2d Cir. 2012)).

¹²⁴ *Id.* at 1056 (citing *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 43–44 (2011)).

¹²⁵ See *supra* Part III.C.

¹²⁶ See *Litwin v. Blackstone Group, L.P.*, 634 F.3d 706, 716 n.10 (2d Cir. 2011). There is one line in *Blackstone* that suggests that Item 303’s “reasonably likely” materiality would apply to sections 11 and 12(a)(2). *Id.* at 716. However, the decision thereafter makes clear that the heightened *Basic* “substantial likelihood” materiality governs these claims. *Id.*

¹²⁷ *NVIDIA*, 768 F.3d at 1056 (citing *Matrixx*, 563 U.S. at 45–46) (emphasis added).

¹²⁸ At one point *Stratte-McClure* suggests that the reason a 34 Act plaintiff must “allege that the omitted information was material under *Basic*’s probability/magnitude test” is “because 10b-5 only makes unlawful an omission of ‘material information’ that is ‘necessary to make . . . statements made’ . . . ‘not misleading.’” *Stratte-McClure v. Stanley*, 776 F.3d 94, 103 (2d Cir. 2015) (quoting *Matrixx*, 563 U.S. at 36). That is not the reason. The reason is that the 34 Act—like the 33 Act—requires an omission of “material” information which courts have repeatedly recognized is governed by *Basic*. See *supra* note 112. The “necessary to make statements made not misleading” language quoted from and discussed by *Matrixx* relates to why *even information that is material* may not need to be disclosed. *Stratte-McClure* itself describes “the Supreme Court’s interpretation of ‘material’” as the *Basic* test. *Stratte-McClure*, 776 F.3d at 103.

“scienter is not an element.”¹²⁹ Scienter is not an element, but materiality is. And materiality is governed by *Basic* which is higher than Item 303 materiality, which makes it impossible for an Item 303 violation to automatically trigger section 11 liability. This same logic applies to *NVIDIA*’s purported distinction on the grounds that 33 Act claims are “not subject to the PSLRA’s heightened pleading standards.”¹³⁰

E. The Second Circuit’s “Two-Step” Approach

Recent Second Circuit decisions may reject surrogate liability with respect to both 33 Act and 34 Act claims.¹³¹

The Second Circuit recognizes two discrete elements in establishing an omission under the securities laws: (1) a duty to disclose and (2) a material omission.¹³² An Item 303 violation “establishes that the defendant had a duty to disclose. A plaintiff must then allege that the omitted information was material under *Basic*’s probability/magnitude test.”¹³³ An omission required under Item 303 may still not be actionable under the securities laws if not material under *Basic*.¹³⁴ Although *Stratte-McClure* focuses on 34 Act claims, this two-step approach may apply to 33 Act claims as well.¹³⁵ If so, Item 303 would not be sufficient to state a claim under section 11.¹³⁶

VII. Conclusion

Steckman’s conclusion that Item 303 is a surrogate for section 11 liability is worth reconsidering. Its conclusion was not necessary for its holding.¹³⁷ Further, *Steckman* has been effectively overruled. The widespread rejection of Item 303 as a surrogate for *Basic* materiality makes clinging to *Steckman* indefensible.¹³⁸ Misplaced reliance on *Steckman* end runs the Supreme Court’s carefully calibrated materiality standards. It promotes excessive disclosure and frivolous litigation.

¹²⁹ *NVIDIA*, 768 F.3d at 1056.

¹³⁰ *Id.*

¹³¹ Neither *Panther*, *Panther Partners v. Ikanos Communications, Inc.*, 681 F.3d 114 (2nd Cir. 2012), nor *Blackstone*, 634 F.3d, state that section 10(b) claims are different from 33 Act claims with respect to an Item 303 violation.

¹³² *Stratte-McClure*, 776 F.3d at 103; *see also supra* note 61 (discussing that the duty to disclose and materiality are separate elements).

¹³³ *Stratte-McClure*, 776 F.3d at 103.

¹³⁴ *Id.* at 107–08.

¹³⁵ *See Blackstone*, 634 F.3d at 716 (reasoning that after finding Item 303 required certain trends to be stated, the “remaining issue” to find section 11 liability was whether the effect of the omitted information was material).

¹³⁶ *Stratte-McClure* states that the Ninth Circuit in *Steckman* “also adopted th[e] position” established in *Panther* and *Blackstone* “that Item 303 creates a duty to disclose for the purposes of liability under section 12(a)(2).” 776 F.3d at 104; *see also id.* at 101 (“We have already held [in *Panther* and *Blackstone*] that failing to comply with Item 303 by omitting known trends or uncertainties from a registration statement or prospectus is actionable under sections 11 and 12(a)(2).”). However, this may mean simply that Item 303’s “affirmative duty to disclose in Form 10-Qs can serve as the basis for a securities fraud claim” by providing step one—a duty to disclose. *See id.* at 99 (“[*Panther* and *Blackstone*] held that Item 303 may provide a *basis for disclosure obligations* under sections 11 and 12(a)(2) of the Securities Act of 1933.”) (emphasis added). Neither *Panther* nor *Blackstone* mention *Steckman*, let alone state that they follow it. Those cases can be read as stating merely that the omissions *in those cases* both (1) violated Item 303 and (2) were material under *Basic*, but not that *every* Item 303 violation necessarily is material under *Basic* to trigger section 11 liability, as *Steckman* held.

¹³⁷ *See Neach, supra* note 18, at 770–72.

¹³⁸ *See supra* Part V.

Instead, courts should side with the *Steckman* underwriters and the reasoning in *NVIDIA*, *Oran*, and *Stratte-McClure*—and follow that reasoning to its inexorable conclusion: 33 Act claims, like 34 Act claims, cannot sufficiently be established by an Item 303 violation. Such an approach will restore the careful balance struck by the Supreme Court in *Basic*, benefiting both issuers and investors with more substantive disclosures and less meritless litigation.

The break with *Steckman* has already begun.¹³⁹ In *In re Thornburg Mortgage Securities Litigation*, the federal district court left open the possibility that Item 303 is *not* a surrogate for section 11.¹⁴⁰ Where plaintiffs did not “establish[] a violation of Item 303,” the court expressly declined to “decide whether every violation [of Item 303] is necessarily also a violation of section 11.”¹⁴¹

Securities litigators and judges—that’s your cue.¹⁴²

¹³⁹ See *supra* Part VI (discussing that the Second Circuit may reject *Steckman*).

¹⁴⁰ *In re Thornburg Mortg., Inc. Secs. Litig.*, 824 F. Supp. 2d 1214, 1256 (D.N.M. 2011).

¹⁴¹ *Id.* (emphasis added); see also *id.* at 1267 (“[If] the omission was not material, it is of no moment whether Item 303 required disclosure.”).

¹⁴² This Article’s argument may be readily deployed in litigation of section 11 class actions in state courts not bound by the federal *Steckman* decision. *E.g.*, *Marshall v. County of San Diego*, 238 Cal. App. 4th 1095, 1115 (2015) (“Decisions of the lower federal courts interpreting federal law, though persuasive, are not binding on state courts.”) (internal quotation marks omitted) (quoting *Raven v. Deukmejian*, 52 Cal.3d 336 (1990)).