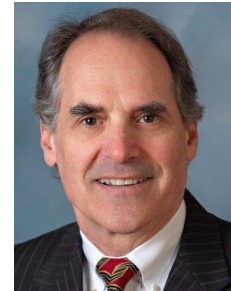


Half-Truths Vs. Omissions: Slicing Justices' Macquarie Cake

By **Daniel Levy and Pavithra Kumar** (July 23, 2024)

The U.S. Supreme Court recently ruled in *Macquarie Infrastructure Corp. v. Moab Partners LP* that claims based on "pure omissions are not actionable under Rule 10b-5(b)" even where a U.S. Securities and Exchange Commission rule or regulation requires disclosure. Instead, to be actionable, an omission must make other separate "affirmative assertions (i.e., 'statements made')" misleading — a "half-truth."^[1]



Daniel Levy

Although the Supreme Court does not explicitly address other fundamental questions about the standards for establishing liability in Rule 10b-5 shareholder suits, its statements about why omitted information alone is not actionable under Rule 10b-5 provide a road map for what additional conditions would make the omitted information misleading.



Pavithra Kumar

And, according to the Supreme Court, they all relate to cake.

The Supreme Court provides the following pastry-based heuristic to elucidate what omitted information would be misleading and therefore actionable in a Rule 10b-5 litigation: "[T]he difference between a pure omission and a half-truth is the difference between a child not telling his parents he ate a whole cake and telling them he had dessert."^[2]

In this example, the Supreme Court says if the child never mentioned dessert, omitting that he ate the entire cake would have been a pure omission, which the Supreme Court rules is not actionable.

However, by mentioning eating dessert, while keeping mum about gorging on the entire cake, the child has told the parent a half-truth in his cake-related statements. Due to the half-truth, the parent might think the child ate some cake, but not all the sugar the cake had to offer, and therefore the parent might not know that the child's current peak performance would likely deteriorate precipitately in the near-term.

The above highlights that in the Supreme Court's plain vanilla cake example, while the child is the consumer of the cake, the parent is the consumer of the statement. Therefore, to understand whether the child's omitted information is misleading to the parent, the finder of fact would need to view the statement and concomitant omission through the eyes, knowledge and understanding of the parent.

When the child says "dessert," the Supreme Court believes the parent understands "a slice of cake," making the child's silence on the demise of the entire cake misleading.

However, it is a cake statement of an entirely different flavor if the parent knows that when the child says dessert the child always means the entire cake, and therefore understands that the child's performance will deteriorate, even though the child did not explicitly mention it in his dessert statement.

If the court found that the typical definitions and language used by the child and the parent effectively communicated all the relevant information to the parent, there would be no misleading half-truth — and therefore, according to the Supreme Court, no actionable Rule 10b-5 avenue for the parent, closing out the case. Let them eat cake.

In the case of a Rule 10b-5 shareholder suit, the same fundamental issue exists. Who is the consumer of the information in the statement and the omitted information? The answer to that question allows the finder of fact to answer three other questions that follow directly from it.

In total, there are four fundamental answers needed to determine whether some omitted information is misleading to the consumer of the information:

1. From whose perspective must the omitted information be misleading?
2. What is the definition of a corporate statement?
3. How do the consumers of corporate statements use them?
4. What omissions make a corporate statement misleading?

Who is the consumer of corporate statements?

The Supreme Court did not explicitly address who the half-truth misleads in a viable Rule 10b-5 shareholder suit. Perhaps the "who" is so clear that this omission by the Supreme Court creates no confusion.

We rule they were not misleading on this point. Obviously, economists, financial experts and generally shareholders of the company's stock are the intended audience of the corporate statements.

Economists, experts and professional or institutional investors manage trillions of dollars in assets — approximately 80% of the equity market — making them the primary users of that information.[3]

While in some situations, a judge may determine whether the omitted information created a misleading half-truth, that determination cannot appropriately be made from the perspective of the legal profession. Rather, it has to be made based on the practices and definitions of the economists, financial analysts and investment professionals who would rely on it and therefore potentially be misled by it.

What is a corporate statement?

What is a "statement" that could become misleading if the company omits fuller information? For that answer, the Supreme Court turns to the Oxford English Dictionary — the 1933 edition, to be exact — which the court says "define[s] a 'statement' as a 'written or oral communication setting forth facts, arguments, demands or the like.'"[4]

In making this statement, the Supreme Court omits more of the definition of the word "statement" than it includes — which could be misleading, because directly after the selection chosen by the Supreme Court, the OED 1933 defines a "statement" as "a document setting out the items of debit and credit between two parties" — i.e., a financial statement.[5]

While an accounting error in the financial statement itself would not be a violation of Rule 10b-5, an omitted statement that makes a statement unclear would be.

Even the Supreme Court's limited citation identifies a broad range of facts delivered to economists, financial experts and investors in everything from advertisements and investor calls to financial statements, Form 10-Ks and Form 10-Qs, among others, as a "statement" that is potentially corruptible by a material omission of some other statement.

So, while the Supreme Court's Macquarie opinion discusses statements and omissions in the Management Disclosure and Analysis found in a Form 10-K, the set of statements that could become misleading due to an omission of some other statement could include financial statements in numerical form or written sentences — both of which are written presentations of facts.

How do economists, financial experts and investors use corporate statements?

To understand what omissions of information would make a given corporate statement misleading, we must understand how economists, financial experts and investors use corporate statements.

Economists, financial experts and investors as a group value a publicly traded company in a way that produces stock prices consistent with what economists call the efficient market theory, at least for many stocks.

In contrast to their common English meaning, the words "efficient market" have a technical meaning to economists that all available information in the market is already embedded in the stock price to an extent that prevents participants from gaining additional profit by using that already-public information.

That point, made famous by Nobel Prize winner Eugene Fama, is taught to most, if not all, Ph.D. and MBA students in the fields of finance and investing.[6] This current information encompasses all statements by the company, including its financial performance, market conditions in which the company achieved its financial performance, and any known changes or risks for the company or the market in the future.

Economists, financial experts and professional investors use the current and historical information presented by a company, among other sources, to assess how it is likely to perform in the future.[7] This does not imply that every investor uses all of this information, but rather that the market as a whole impounds this information into stock prices, which reflect its collective expectations of future financial performance.

What omissions make corporate statements misleading?

Having defined who could be misled and what they could be misled about, we turn to how they could be misled in a way that results in a Rule 10b-5 violation, bringing us back to the Supreme Court's cake example.

Following the Supreme Court, if the finder of fact in the cake dispute, understanding what the child's statement communicates to the parent, determines that the parent was misled by an omission causing a half-truth, the Supreme Court would find there could be a viable claim by the parent.

If, on the other hand, understanding the child-parent communication definitions and practices, the child's cake statement fully communicated to the parent the child's likely performance due to cake consumption without any further statements, the parent's case

against the child would not pass the Supreme Court's test for a viable Rule 10b-5 violation for omissions due to half-truths in reporting, because the parent was not misled — leaving the parent's claim half-baked.

In the same way, a corporate financial statement listing current financial performance, but omitting a change material to the market or corporate condition known by the company, is misleading about the potential future performance of the company, if misleading to the consumers of that information.

Following the Supreme Court's ruling, financial statements of a mining company, for example, listing revenues and profits from current mining operations, but omitting the fact that the company knew that its mineral resources had been completely consumed, would be very misleading, just like the child who omitted from his cake statement that the cake was gone.

Even if the company never mentions ore deposits, the omission of the material change in the ore deposits that drives the results in the statement of financials is misleading to economists, financial experts and investors about the mining company's current statement of financials and what those financial statements mean about the companies' future performance.

In essence, in this case, the company had eaten all its cake, but omitted that important, known fact in its standard communications to the consumers of corporate information.

Any known omission of information material to the current performance of the company, or known material change in the corporate or market conditions supporting the current performance, is misleading to economists, financial experts and investors, because they are using that information to understand the current corporate performance and form expectations about the companies' future performance to assess what the company is worth today.

It all turns on how the users of the statement — economists, financial experts and investors — understand the statement with and without the omitted information, based on the definitions used by them.

Viewed from this perspective of how economists, financial experts and investors use corporate statements and financials, the Supreme Court decision in *Macquarie* may be more prescriptive in how to form a Rule 10b-5 claim than limiting in what omitted factors would make a corporate statement misleading.

The ruling makes clear that shareholders who can identify with sufficient specificity how they were misled, due to omitted information materially altering their understanding of statements — including those of financial condition — should have a viable Rule 10b-5 litigation based on the definitions and interpretations used by economists, financial experts and investors, even if those definitions and interpretations differ from those used in the legal profession.

The mining company, like the child, cannot eat all of its cake and let investors think it still has it too.

Daniel S. Levy, Ph.D., is national managing director at Advanced Analytical Consulting

Group Inc. and the CEO of EquiCalc Inc.

Pavithra Kumar, Ph.D., is a principal at Advanced Analytical Consulting Group.

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[1] *Macquarie Infrastructure Corp. v. Moab Partners LP*, No. 22-1165, 2024 U.S. LEXIS 1575, 601 U.S. ____ (April 12, 2024), ("SCOTUS Opinion") at p. 2.

[2] SCOTUS Opinion at p. 5.

[3] See, for e.g., *Pensions & Investments*, 80% of equity market cap held by institutions (April 25, 2017).

[4] SCOTUS Opinion at p. 6. SCOTUS also refers to Webster's New International Dictionary 2461 (2d ed. 1942), defining a "statement" as the "[a]ct of stating, reciting, or presenting, orally on paper."

[5] Oxford English Dictionary (1933) (def. 3.b).

[6] "Efficient Capital Markets: II," Eugene F. Fama, *The Journal of Finance*, Dec. 1991, Vol. XLVI, No. 5, pp. 1575-1617 at p. 1575.

[7] See, for e.g., Brief of Institutional Investors as Amici Curae in Support of Respondents in *Macquarie Infrastructure Corp. v. Moab Partners LP*, Dec. 20, 2023, at pp. 12-14.