KIRKLAND **ALERT**

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Courts Increasingly Skeptical of Need to Routinely Disclose Government Investigations under Rule 10b-5

The U.S. District Court for the Southern District of New York, among the most important courts in the country for securities suits, has recently held that there exists no per se duty to disclose regulatory investigations, or even Wells Notices, to shareholders under Section 10(b) of the Exchange Act or Rule 10b-5.[1] As the court previously decided in *Richman v. Goldman Sachs Group, Inc.*, "[a] Wells Notice may be considered an indication that the staff of a government agency is considering making a recommendation, but that is well short of litigation."[2] In the context of an issuer of securities' duty to disclose, "[w]hen the regulatory investigation matures to the point where litigation is apparent and substantially certain to occur, then 10(b) disclosure is mandated . . . Until then, disclosure is not required."

Taken together, the decisions in *Richman* and *Lions Gate* demonstrate an increasing flexibility in judicial decisions concerning the application of disclosure obligations to regulatory investigations and related developments. Under these cases, issuers of securities have some leeway to engage in their own analysis of materiality rather than make a reflexive disclosure.

This reasoning was adopted and expanded upon in the January 22, 2016, decision in *Lions Gate Entertainment Corp. Securities Litigation*, which dismissed a putative class action for securities fraud.[3] The *Lions Gate* plaintiffs alleged multiple theories of securities fraud based on the company's failure to disclose both the existence of an investigation by the U.S. Securities and Exchange Commission and the receipt of several Wells Notices. Reaching a similar holding that investigations do not per se require disclosure, the court analyzed the facts set forth in the complaint in view of Section 10(b) of the Exchange Act and Rule 10b-5, as well as SEC Regulation S-K Item 103, Item 303, and Item 503. Further, the court determined that the company's actual disclosure that it was "involved in certain claims and legal proceedings" was not misleading, but rather was an accurate statement of the company's affairs. In short, "[t]he securities laws do not require a company to hypothesize the worst results of an investigation . . . when the company chooses not to speak about the investigation."

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Issuers should note, however, that while there is now growing resistance to a per se duty to disclose government investigations, there is nonetheless no general right to forego disclosure. Instead, *Richman* and *Lions Gate* call for a substantive analysis of materiality based on the facts of the case. More specifically, disclosure may well remain the most conservative or risk-adverse approach when the facts underlying the investigation are, themselves, material. Further, once an issuer *has* elected to

disclose an investigation, disclosure of developments (such as Wells Notices) may be necessary in order to ensure that existing disclosure does not become misleading by omission.[4]

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1 "Wells Notice" is the common term for formal notice by the SEC staff that it intends to recommend to the full Commission that an enforcement action be filed against the investigation target.

2 868 F. Supp. 261, 272 (S.D.N.Y. 2012).

3 No. 14-CV-5197 (JGK), 2016 WL 297722 (S.D.N.Y. Jan. 22, 2016).

4 Id. at *6 ("Even though Rule 10b–5 imposes no duty to disclose all material, nonpublic information, once a party chooses to speak, it has a duty to be both accurate and complete.").

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