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Item 105 and the Third Circuit's Crystal Ball Standard: I See Regulatory Risk in Your Future

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ITEM 105 AND THE THIRD CIRCUIT'S CRYSTAL BALL STANDARD: I SEE REGULATORY RISK IN YOUR FUTURE

COOPER D'ANTON*

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I. INTRODUCTION

A few weeks before Hudson City Bancorp ("Hudson") merged with M&T Bank Corporation ("M&T"), former Hudson shareholders sued, alleging that the banks omitted facts concerning M&T's compliance with federal regulations from their joint proxy statement.[1] The United States District Court for the District of Delaware dismissed the suit, so the shareholders appealed to the Third Circuit and prevailed.[2] M&T appealed, but the Supreme Court denied its Petition for Writ of Certiorari.[3]

The shareholders succeeded when the Third Circuit found the bank's Item 105 risk factor disclosures deficient.[4] Relying on Securities and Exchange Commission ("SEC") guidance, the court ruled that M&T should have specifically linked its proxy statements to the regulatory risks that its BSA/AML program posed using particular details.[5] To the Third Circuit, M&T failed to disclose just how treacherous "jumping through" its already disclosed "regulatory hoops" would be.[6] The Third Circuit effectively held that issuers of publicly traded securities are liable for failing to disclose unknown and unadjudicated risks, lowering the bar for issuer liability.[7] The

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1. Emilie Ruscoe, *High Court Won't Take Up M&T Bank Merger Case*, LAW360 (Jan. 25, 2021, 11:31 AM), https://www.law360.com/articles/1348070/high-court-won-t-take-up-m-t-bank-merger-case; James P. McLoughlin Jr. & Neil T. Bloomfield, *3rd Circuit Panel Raises the Bar on Risk Disclosures as the Trend Toward Greater Disclosure Continues*, 26 WESTLAW J. BANK & LENDER LIAB., Apr. 12, 2021, at 2 (including facts like M&T's alleged Bank Secrecy Act and Anti-Money Laundering (BSA/AML) compliance weaknesses and a checking account issue).

2. Jaroslawicz v. M&T Bank Corp., 296 F. Supp. 3d 670, 678 (D. Del. 2017), *vacated*, 962 F.3d 701 (3d Cir. 2020), *cert. denied* 141 S. Ct. 1284 (2021).

3. Jaroslawicz v. M&T Bank Corp., 141 S. Ct. 1284, 1284 (2021); *see also* Ruscoe, *supra* note 1.

4. *See* Jaroslawicz v. M&T Bank Corp., 962 F.3d 701, 715 (3d Cir. 2020) (stating that "the Shareholders have plausibly alleged that had M&T disclosed" its money laundering program practices, shareholders would have considered those practices when voting and that M&T's discussions of its checking account practices were deficient).

5. *Id.* (asserting that M&T's disclosure was too general and applicable to any industry).

6. *Id.* (describing regulatory compliance requirements as "jumping through . . . regulatory hoops").

7. *Compare* Brief for SIFMA et al. as Amicus Curiae Supporting Petitioners at 6,

holding's Item 105 standard significantly expands class action securities liability, the legal risk of which disincentivizes securities issuance, negatively impacting the process by which public companies access capital.[8]

The Second and First Circuits' interpretation of Item 105 disclosure requirements do not require the same exhaustive disclosure the Third Circuit required in *Jaroslawicz v. M&T Bank.*[9] Unlike the Third Circuit, the First and Second Circuits only require disclosure of known risk and do not require the issuer to disclose uncharged and unadjudicated risk.[10] These varying circuit court interpretations of Item 105 create confusion among securities market participants in an industry that funds over 70 percent of all economic activity in the U.S.[11] In addition, the Third Circuit's standard is unworkable and threatens to become the default nationwide standard for Item 105 due to the Third Circuit's jurisdiction over Delaware, the source of most United States corporate law.[12]

Part II of this Comment outlines the current Regulation S-K: Item 105 requirements and the cases establishing the different Item 105 disclosure standards of the Third, Second, and First Circuits, including the Third Circuit's hindsight 2020 standard requiring the disclosure of unknown risk,

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M&T Bank v. Jaroslawicz, 962 F.3d 701 (3d Cir. 2020) (No. 20-678) [hereinafter SIFMA Brief] (providing the industry's interpretation of the holding's effect), *with Jaroslawicz*, 962 F.3d at 716 ("Later . . . regulatory enforcement does not create a retroactive duty to disclose.").

8. SIFMA Brief, *supra* note 7, at 6; *see* Mark Klock, *Do Class Action Filings Affect Stock Prices? The Stock Market Reaction to Securities Class Actions Post PSLRA*, 15 J. BUS. & SEC. L. 109, 110 (2015) (finding "a significant negative return at the time of filing" and in "the weeks preceding the filing" of securities class action lawsuits).

9. *See* 962 F.3d 701, 713 (3d Cir. 2020).

10. Silverstrand Invs. v. AMAG Pharms., Inc., 707 F.3d 95, 103 (1st Cir. 2013) ([T]o withstand dismissal at the pleading stage, a complaint alleging omissions of . . . risks needs to allege sufficient facts to infer that a registrant knew, as of the time of an offering, that . . . a risk factor existed."); City of Pontiac Policemen's & Firemen's Ret. Sys. v. UBS AG, 752 F.3d 173, 184 (2d Cir. 2014) (establishing the Second Circuit's Item 105 interpretation); *see also* SIFMA Brief, *supra* note 7, at 16.

11. *See* SIFMA Brief, *supra* note 7, at 4 (stating that the varying Item 105 interpretations are irreconcilable and create confusion in securities markets); *see also Our Markets*, SIFMA, https://www.sifma.org/about/our-markets/ (last visited June 11, 2021) [hereinafter Our Markets].

12. *See* SIFMA Brief, *supra* note 7, at 16 (noting the burden of the Third Circuit's standard on underwriters and issuers); 15 U.S.C.A. § 78aa (listing the Securities Act's process and revenue provisions); WILLIAM F. GRIFFIN, A PRACTICAL GUIDE TO MASSACHUSETTS CLOSELY HELD BUSINESS ORGANIZATIONS (MCLE) § 10.1 (2015) (describing the historical context for Delaware's rise to prominence as the domicile for most U.S. companies); *Why Businesses Choose Delaware*, DEL. DIV. OF CORPS., https://corplaw.delaware.gov/why-businesses-choose-delaware/ (last visited Mar. 1, 2022) (describing why companies choose to incorporate in Delaware).

the Second Circuit's uncharged and unadjudicated standard and the First Circuit's actual knowledge standard.[13] Part III will analyze the appropriate Item 105 standard in light of SEC guidance and Item 105.[14] Specifically, this Comment will argue that M&T complied with SEC guidance and the text of Item 105, which the Third Circuit failed to properly apply in its holding. Finally, Part IV will recommend that the SEC end the confusion around Item 105 by clarifying the appropriate standard through rulemaking or guidance adopting the Second and First Circuits' interpretations.[15] Additionally, the Supreme Court should grant certiorari to future appeals from circuit court decisions with similar circumstances to M&T's and affirm the standards of the Second and First Circuits' interpretations of Item 105 disclosure requirements.[16]

This analysis should be taken in the context of the larger discussion around risk disclosure and not interpreted as an endorsement of anything less than a robust, meaningful disclosure regime.[17] The national trend and most appropriate path forward in this conversation is and should be requiring disclosure of known, material risk factors widely acknowledged as necessary for the integrity of our capital markets.[18] Risk factor disclosure compliance requirements must be strong but achievable and supportive of access to capital.

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13. *See* 962 F.3d at 705–06 (establishing the Third Circuit's Item 105 interpretation); *City of Pontiac Policemen's & Firemen's Ret. Sys.*, 752 F.3d at 184 (establishing the Second Circuit's Item 105 interpretation); *Silverstrand Invs.*, 707 F.3d at 103 (stating the First Circuit's Item 105 interpretation).

14. *See, e.g.*, SEC Updated Staff Legal Bulletin No. 7, 1999 WL 34984247, at *1 (June 7, 1999) [hereinafter Bulletin No. 7] (concerning SEC guidance on Item 105).

15. *See* SIFMA Brief, *supra* note 7, at 20 (suggesting that a federal agency clarify Item 105, implying a need for federal regulatory rulemaking); *see also City of Pontiac Policemen's & Firemen's Ret. Sys.*, 752 F.3d at 184 (establishing the Second Circuit's Item 105 interpretation); *Silverstrand Invs.*, 707 F.3d at 103 (stating the First Circuit's Item 105 interpretation).

16. *See* SIFMA Brief, *supra* note 7, at 3 (requesting that the Supreme Court grant M&T's petition for certiorari to reverse the Third Circuit's decision).

17. *See* John D. Frey, *Striving for Simplicity: Updates to Regulation S-K Items 101 and 105*, 81 LA. L. REV. 999, 1032–33 (2021) (discussing Item 105 and its genericism); *see also* Virginia Harper Ho, *Disclosure Overload? Lessons for Risk Disclosure & ESG Reporting Reform from the Regulation S-K Concept Release*, 65 VILL. L. REV. 67 (2020) (discussing Item 105 and downplaying concerns of disclosure overload).

18. *Cf.* SIFMA, Comment Letter on Climate Change Disclosures (June 10, 2021), https://www.sec.gov/news/public-statement/lee-climate-change-disclosures (recommending "principles-based" disclosure of climate-related information as part of Regulation S-K Item 101). *See generally* Lael Brainard, Governor, Fed. Reserve Bd., Financial Stability Implications of Climate Change, Address at "Transform Tomorrow Today" Ceres 2021 Conference (Mar. 23, 2021).

II. IDENTIFYING THE CIRCUIT SPLIT ON ITEM 105 DISCLOSURE

A. Regulation S-K: Item 105 Risk Disclosure

Regulation S-K: Item 105, formerly 503(c), requires issuers, including companies soliciting approval from shareholders for mergers, to discuss in their proxy statements material details about their company or line of business that make an investment speculative or risky, as opposed to factors absent from the Item 105 statute, such as unknown, uncharged, or unadjudicated risks.[19] Adopted in 1977, Regulation S-K details the SEC's disclosure provisions for nonfinancial statement sections of forms filed for the Securities Act of 1933 ("Securities Act") and the Securities Exchange Act of 1934 ("Exchange Act").[20] Per the SEC's intent, Regulation S-K harmonizes disclosure requirements for both laws.[21] The Securities Act provides for nationwide service of process and a wide choice of venue under claims regarding Item 105.[22] Item 105 provides a number of stylistic, organizational, and substantive instructions for risk factor disclosure.[23] This disclosure intends to provide investors with a clear and concise summary of the material risk — as opposed to what economist Frank Knight classically described as uncertainty — to an investment in the issuer's securities.[24] Materiality, in the context of risk in proxy statements, requires "a substantial

19. 17 C.F.R. § 229.105 (2022) (omitting of any requirement to disclose uncharged, unadjudicated wrongdoing); Modernization of Regulation S-K Items 101, 103, and 105, 85 Fed. Reg. 63,726 (Oct. 8, 2020) (codified at 17 C.F.R. pts. 229, 239, 240) [hereinafter Modernization of Regulation S-K]; *accord* Petition for Writ of Certiorari at 5, M&T Bank Corp. v. Jaroslawicz, 141 S. Ct. 1284 (2021) (No. 20-678) [hereinafter Petition for Certiorari];; United States v. Matthews, 787 F.2d 38, 49 (2d Cir. 1986) (holding that "at least so long as uncharged criminal conduct is not required to be disclosed by any rule lawfully promulgated by the SEC, nondisclosure of such conduct cannot be the basis of a criminal prosecution"); Ciresi v. Citicorp, 782 F. Supp. 819, 823 (S.D.N.Y. 1991) (stating that "the law does not impose a duty to disclose uncharged, unadjudicated wrongdoing"); *see also* Jaroslawicz v. M&T Bank Corp., 962 F.3d 701, 716 (3d Cir. 2020) (clarifying that the court does not hold that the regulatory enforcement actions alone required M&T to disclose its issues and stating that "later litigation or regulatory enforcement does not create a retroactive duty to disclose").

20. Petition for Writ of Certiorari, *supra* note 19, at 5..

21. *Id.* (recommending harmonizing both regulations by creating a single repository for disclosure regulation).

22. *See* 15 U.S.C. § 78aa (listing the Act's process and revenue provisions).

23. *See* 17 C.F.R. § 229.105 (stating that the discussion must be "concise," "organized logically," and non-generic, explain how the risk affects the issuer or securities offered, and place risk factors "under a subcaption that adequately describes the risk").

24. Securities Offering Reform, SEC Release No. 8501, 2004 WL 2610458, at *86 (Nov. 3, 2004); *see* FRANK H. KNIGHT, RISK, UNCERTAINTY, AND PROFIT 19–20 (1921) (explaining the difference between risk and uncertainty).

likelihood that a reasonable shareholder would consider [the information] important in deciding how to vote."[25]

i. Item 105 SEC Guidance

The SEC provided guidance over two decades ago to clarify then-Item 503(c).[26] The Commission's guidance describes Item 105, then Item 503(c), as being "the least understood of the plain English requirements."[27] The bulletin guidance obligates issuers to "specifically link each risk to [the] industry, company, or investment, as applicable" and provides two examples contrasting a generic discussion with a satisfactory disclosure.[28]

The first example involves a hypothetical lawn care company with substantially fewer financial and other resources than its competitors in what is described as a highly competitive industry.[29] The guidance requires the company to not only disclose the financial disadvantage, but also what that disadvantage means for the company's ability to capture its markets, and then what the inability to capture those markets means for the company's growth.[30] The second example in the SEC's guidance is of a public offering for a company with outstanding privately held common stock in which the satisfactory guidance highlights the potential for restricted shares to be sold into the market, thereby driving down the price of the common stock.[31]

The two guidance examples suggest a preference by the SEC for disclosure language that does not rely on inferences to deduce the connection

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25. 17 C.F.R. § 240.12b-2 (2022); *see also* 3 THOMAS LEE HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION § 10:77 (2022) (explaining common law establishing the definition of materiality).

26. *Contra* Bulletin No. 7, *supra* note 14, at *1 (stating that the bulletin is merely guidance, neither approved nor disapproved by the SEC); Jaroslawicz v. M&T Bank Corp., 962 F.3d 701, 711 (3d Cir. 2020) (citing the SEC staff bulletin).

27. *See* Bulletin No. 7, *supra* note 14, at *1.

28. *Id.* at *6–7 (showing before and after examples of a lawn care company and an unidentified stock issuer).

29. *Id.* at *6 (providing an example disclosure where the company states that its competitors' "financial strength could prevent [the lawn care company] from capturing those [geographical] markets" and provides examples of how a competitor used its resources to expand and how the company's lack of resources may result in failure to realize forecasted growth).

30. *See id.* (implying the requirement to draw a connection between a material risk factor and an effect on the purpose for which shareholders would invest in the company).

31. *Id.* at *7–8 (providing two sub-examples: (1) a generic example stating how the sale of common stock in the market after an offering could lower the stock price, that there is a resale ban for some time, and that underwriters can release the restricted shareholders from the resale ban; and (2) a satisfactory example linking the end of the resale restrictions to a significant drop in market price if the restricted shareholders sell, even if the company is doing well).

between the company's activities and shareholder risk.[32] The guidance also states in the risk factor comments section that the document should: (1) eliminate legalese and industry jargon; (2) state the risk as quickly as possible; (3) present the risk in concrete terms; (4) provide information necessary to assess the magnitude of risk; (5) avoid stating general risk factors; and (6) replace language stating "that" a risk factor would have an effect with language stating "how" a risk factor would have an effect.[33]

B. The Third Circuit's Item 105 Standard: Hindsight 2020

In August 2012, M&T and Hudson executed a merger agreement requiring approval by both banks' shareholders and filed a preliminary proxy statement in October 2012 that became effective in February 2013.[34] On April 12, 2013, the banks announced delays in the merger.[35] Three days later, the banks held a conference call with shareholders to discuss the delay, and shareholders voted to approve the merger a few days after the call.[36] In October 2014, the Consumer Financial Protection Bureau ("CFPB") took action against M&T, and in September 2015, the Federal Reserve approved the merger.[37] To provide the requisite notice for the merger, Hudson and M&T opted to issue a joint proxy statement, which requires Item 105 risk factor disclosure information.[38]

The joint proxy laid out a litany of references to potential regulatory hurdles.[39] The proxy further discussed the merger's subjection to the Federal

32. *See id.* at *7–8, 10 (implying the requirement to draw a connection between a risk factor and the object of the shareholder's investment—not just state that a risk factor exist—to guide the shareholder through the disclosure document since there may be investors who do not work in that industry).

33. *Id.* at *10, 13–14.

34. Jaroslawicz v. M&T Bank Corp., 296 F. Supp. 3d 670, 673–74 (D. Del. 2017); *see, e.g.*, SEC Form PREM14A Preliminary proxy statement relating to a merger or acquisition, https://sec.report/Form/PREM14A ("A preliminary proxy statement, which remains subject to review by the SEC staff, filed in connection with a merger or acquisition.").

35. *Jaroslawicz*, 296 F. Supp. 3d at 674 (announcing through a press release the merger delay as a result of the need for regulatory approval); *see also* Amended Class Action Complaint for Violations of Securities and State Law at 3, Jaroslawicz v. M&T Bank Corp., 296 F. Supp. 3d 670 (D. Del. 2017) (No. 1:15-cv-00897-RGA) (stating the existence of the announcement of the merger delay followed by a Rule 425 prospectus supplement).

36. *Jaroslawicz*, 296 F. Supp. 3d at 674.

37. *Id.*

38. Jaroslawicz v. M&T Bank Corp., 962 F.3d 701,705 (3d Cir. 2020) (providing disclosure through a single Form S-4 requiring Item 503 disclosure).

39. *See* M&T Bank Corp., Prospectus Supplement (Form 424B3), at 15, 26, 29 (Feb. 22, 2013) [hereinafter M&T Joint Proxy] (referencing several mentions of the need for

Reserve's approval and the potential impact that lack of approval could have on the timeline of the merger.[40]

In the "Risks Relating to the Regulatory Environment" subsection, the proxy disclosed the effects that regulation would have on M&T's practices and how failure to comply would result in regulatory action affecting M&T's business and business opportunities.[41] The subsection also addressed potential CFPB actions and their effects on compliance costs.[42] Under the subsection titled, "M&T is subject to operational risk," the proxy disclosed the risk that M&T faced as a result of failed internal processes.[43] Under a following legal and regulatory risk subsection, the proxy disclosed the possibility of government investigations impacting M&T's business.[44] Under the section titled, "Regulatory Approvals Required for the Merger," the proxy disclosed that completion of the merger was subject to the Federal Reserve's approval based on the effectiveness of M&T's anti-money laundering programs.[45] The proxy supplement fully disclosed that the Federal Reserve identified issues with M&T's anti-money laundering programs and that in order to address the regulator's concerns the closing of the merger would have to be delayed.[46]

A few weeks before the merger closed, former Hudson shareholders sued, alleging that the banks violated the Securities and Exchange Act by omitting from their joint proxy statement—issued before their supplemental proxy—several facts concerning M&T's compliance with federal regulations.[47] These facts included (1) M&T's alleged BSA/AML compliance weaknesses, the broad risk of which M&T disclosed in its proxy statement, (2) a checking account practice the bank had remedied before issuing the proxy, and (3) M&T's publishing of a misleading opinion that federal regulators would

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regulatory approval by federal regulators including the proxy's statement that the merger was subject to approval from the Federal Reserve).

40. *See id.*

41. *See id.* at 34.

42. *See id.* at 35 (referencing potential rules promulgated by the CFPB and how those actions could affect compliance costs, including a merger delay).

43. *See id.* at 40.

44. *See id.* at 43 (stating that an investigation could lead to monetary damages or reputational harm).

45. *See id.* at 100 (citing the Federal Reserve's authority under the Bank Holding Company Act of 1956 to approve or disapprove the merger based on M&T anti-money laundering effectiveness).

46. M&T Bank Corp., Exhibit 99, Joint Press Release (Form 8-K) (Apr. 12, 2013) [hereinafter Form 8-K].

47. Jaroslawicz v. M&T Bank Corp., 296 F. Supp. 3d 670, 674–75 (D. Del. 2017); *see also* Ruscoe, *supra* note 1.

approve the merger in the second quarter of 2013.[48] M&T disclosed its belief that its BSA/AML programs were compliant with federal law, demonstrating that the bank did not know its BSA/AML program was wrongful at the time of disclosure.[49] The checking account practice "had ceased prior to the publication of the joint proxy" but "cast doubt on M&Ts controls and compliance systems," and that doubt "created a regulatory risk to the merger that had to be disclosed."[50] Considering M&T thought its BSA/AML program was compliant with federal law and remedied its checking account practices, the bank did not know its BSA/AML program was wrongful and was unaware it was doing anything that would prompt regulatory action when it issued the joint proxy.[51] Still, the shareholders alleged that the regulatory compliance failures led to the delay in the merger that financially harmed them.[52]

The shareholders alleged that the banks violated Section 14(a) of the Exchange Act and SEC Rule 14a-9.[53] They argued that the non-compliant BSA/AML and checking account practices posed significant risks to regulatory approval of the merger and that Item 503(c) of Regulation SK therefore mandated that those risks be disclosed. However, the district court dismissed the suit. [54]

The Third Circuit on appeal found the bank's Item 105 risk factor disclosures around its BSA/AML programs deficient and that M&T knew it was under a federal regulatory review that could harm the merger if deficiencies were discovered.[55] The Third Circuit also found that M&T's consumer checking practice disclosures were deficient, inferring that the consumer checking practices cast doubt on M&T's controls and compliance systems and posed an independent regulatory risk to the merger material

48. McLoughlin, *supra* note 1; Memorandum of Law in Support of Defendants' Motion to Dismiss, Jaroslawicz v. M&T Bank Corp., 296 F. Supp. 3d 670 (D. Del. 2017) (No. 15-897) (naming the Federal Reserve and applicable BSA/AML law in the proxy statement); Jaroslawicz v. M&T Bank Corp., 962 F.3d 701, 718 (3d Cir. 2020) (affirming the lower court's dismissal of the misleading disclosure allegation).

49. *See* M&T Joint Proxy, *supra* note 39, at 99.

50. McLoughlin, *supra* note 1; *accord Jaroslawicz*, 296 F. Supp. 3d at 674–75.

51. *See* M&T Joint Proxy, *supra* note 39, at 99; *see also* McLoughlin, *supra* note 1.

52. *See Jaroslawicz*, 962 F.3d at 705 (stating the shareholders' argument that the merger delay caused them financial harm, despite their healthy return on investment).

53. *Jaroslawicz*, 296 F. Supp. 3d at 673; *see also* 15 U.S.C. § 78n(a); 17 C.F.R. § 240.14a-9 (2020).

54. 296 F. Supp. 3d at 677–79 (concluding that the Plaintiffs failed to state a claim based on Item 503(c) since, at the time the proxy statement was issued, although the violations posed a risk to regulatory approval of the merger, M&T adequately disclosed risk that compliance failure posed to the merger).

55. *Jaroslawicz*, 962 F.3d at 716.

enough that a reasonable shareholder would consider it important in deciding how to vote.[56] Relying on SEC guidance, the court said that M&T should have used details to specifically link its statements of risk to the financial consequences of that risk to shareholders.[57] The court also said that concise and plain discussions of regulatory review similar to the SEC's guidance examples and "framed in the context of M&T's particular business and industry were absent from the [proxy statement]."[58] The court added that disclosing the weaknesses present in M&T's BSA/AML and consumer compliance programs would have altered shareholders' decision-making.[59] "[W]hether M&T had actual knowledge of the shortcomings in its BSA/AML compliance or its consumer checking practices" was not important to the court.[60] To the Third Circuit, "the risk to the merger posed by the regulatory inspection itself" gave rise to the disclosure requirement, and M&T failed to disclose how treacherous regulatory compliance would be despite disclosing in the proxy that regulatory compliance stood between the proposed merger and a final deal.[61] The court believed it could reasonably infer from the evidence in the shareholders' allegations that within the context of regulatory scrutiny and completion of the merger, the details of M&T's programs and those programs' wrongfulness were material and therefore required disclosure. According to the court, M&T did not adequately provide this disclosure.[62]

The Third Circuit affirmed in part and vacated in part the district court's decision.[63] M&T appealed to the Supreme Court asking two questions:

> (1) Whether Item 105 . . . requires a company with knowledge of a general risk factor to ascertain and disclose facts that may bear on that general risk factor that are not otherwise within the company's actual knowledge[;]
> (2) Whether Item 105 . . . requires companies to identify and discuss potentially unlawful business practices or inadequate compliance procedures in circumstances where neither the company nor any regulator

56. *Id.* at 717 (stating that the shareholders' allegations met the plaintiff's pleading burden and that it was also plausible that disclosing the weaknesses in M&T's programs "would have been viewed by the reasonable investor as having significantly altered the total mix of information made available" (quoting EP Medsystems, Inc. v. EchoCath, Inc., 235 F.3d 865, 872 (3d Cir. 2000)).

57. *Id.* at 715.

58. *Id.*

59. *Id.* at 717.

60. *Id.* at 716. ("[A]ctual knowledge . . . is of no moment . . . .").

61. *Id.* at 715–16.

62. *Id.* at 716–17.

63. *Id.* at 718 (affirming the "dismissal of the Shareholders' claims that M&T made misleading opinion statements, and vacat[ing] the dismissal of the claims about M&T's risk disclosure obligations").

> has identified an issue or concern and the company believes that such practices or procedures are compliant with applicable law.[64]

The Supreme Court denied M&T's Petition for Writ of Certiorari.[65]

Importantly, M&T's Petition for Writ of Certiorari to the Supreme Court gave the SEC an opportunity to weigh in on the questions presented.[66] The Third Circuit invited the SEC to file an amicus brief addressing whether Item 105 is satisfied where a proxy filer "neglects to disclose that one of the parties to the proposed merger has serious regulatory violations that could derail or significantly delay a merger[,]" but the SEC declined to comment.[67]

C. The Second Circuit's Item 105 Standard: No Need to Disclose Uncharged or Unadjudicated Wrongdoing

In *City of Pontiac Policemen's and Firemen's Retirement System v. UBS AG* ,[68] a group of institutional investors sued a Swiss bank ("UBS"), arguing in part that UBS's offering materials distributed as part of its 2008 offering were materially false because the bank was engaged in an undisclosed cross-border tax scheme at the time of the offering.[69] The investors argued that UBS's failure to disclose the tax scheme violated Item 503(c) and rendered the disclosures UBS made concerning a Department of Justice ("DOJ") investigation into the tax scheme materially incomplete.[70] The investors also argued that in addition to disclosing the existence of the DOJ investigation, the bank should have disclosed its engagement in the tax scheme.[71] The United States District Court for the Southern District of New York dismissed the case for failure to state a claim, and the investors appealed.[72]

On the issue of then-Item 503(c) disclosure, the Second Circuit asserted the long-standing doctrine that "[d]isclosure is not a right of confession" and that companies do not have a duty "to disclose uncharged, unadjudicated

64. Petition for Certiorari, *supra* note 19, at i.

65. M&T Bank Corp. v. Jaroslawicz, 141 S. Ct. 1284, 1284 (2021); *see also* Ruscoe, *supra* note 1.

66. Petition for Certiorari, *supra* note 19, at 9 (inviting the SEC to answer two legal questions regarding Item 105).

67. *Id.* at 9, 12 (noting the SEC's excuse that the agency could not meet Third Circuit's deadline to answer the legal questions raised, expressing no views on those legal questions, and, instead, offering background information on Item 105).

68. 752 F.3d 173 (2d Cir. 2014).

69. *Id.* at 182.

70. *Id.* at 183–84 (stating that 503(c) requires disclosure of facts that could make UBS's offer risky).

71. *Id.* at 184.

72. *Id.* at 178–79 (stating the District Court dismissed the claims for failure to state a claim for fraud, allege material misstatement, and lack of standing).

wrongdoing."[73] The Second Circuit held that UBS met its obligations by disclosing its "involvement in legal . . . proceedings and government investigations and indicating that its involvement" carried financial risks.[74] The Second Circuit affirmed the district court's ruling and dismissed all claims with prejudice.[75]

D. The First Circuit's Item 105 Standard: Actual Knowledge of Risk

In *Silverstrand Investments v. AMAG Pharmaceuticals Inc.*,[76] investors sued AMAG Pharmaceuticals ("AMAG") alleging that AMAG wrongly failed to disclose to investors twenty-three serious adverse reactions to the iron deficiency treatment drug Feraheme that occurred prior to a 2010 stock offering.[77] After reports came out about adverse reactions to the drug, "AMAG's stock price plummet[ed] by more than 70 percent from the offering price."[78]

The First Circuit explained that actionable omissions of Item 503 risks require "that a registrant knew, as of the time of an offering, that (1) a risk factor existed; (2) the risk factor could adversely affect the registrant's present or future business expectations; and (3) the offering documents failed to disclose the risk factor".[79] This interpretation meant that the investors made a reasonable claim that AMAG failed its disclosure obligations.[80] AMAG knew that a risk factor — the serious adverse reactions — existed and that their possible discovery could harm its business, yet they still neglected to disclose those risk factors in its offering documents.[81]

The First Circuit's holding revived the investors' claim, and the Supreme

73. *Id.* at 184 (quoting *In re* Morgan Stanley Info. Fund Sec. Litig., 592 F.3d 347, 365 (2d Cir. 2010); Ciresi v. Citicorp, 782 F. Supp. 819, 823 (S.D.N.Y. 1991)).

74. *Id.*

75. *Id.* at 176.

76. 707 F.3d 95 (1st Cir. 2013).

77. *Id.* at 100–01; *see also* Zachary Zagger, *AMAG Pharma Fails To Shirk Drug-Risks Investor Suit*, LAW360 (Apr. 9, 2014, 6:46 PM), https://www.law360.com/articles/526240 ("The First Circuit revived the case, ruling that omissions by AMAG and other defendants were actionable.").

78. Zagger, *supra* note 77.

79. *Silverstrand Invs.*, 707 F.3d at 103 (stating the First Circuit's interpretation of Item 105).

80. *See* Stewart Bishop, *High Court Won't Review Feraheme Investor Class Action*, LAW360 (Oct. 7, 2013, 3:26 PM), https://www.law360.com/articles/478632/high-court-won-t-review-feraheme-investor-class-action.

81. *See Silverstrand Invs.*, 707 F.3d at 106 (stating that since AMAG knew about the adverse reactions before the offering and omitted those risk factors from its offering document, the investors stated a plausible claim for omission of the risks).

Court denied AMAG's petition for writ of certiorari.[82] Following the First Circuit's ruling, the U.S. District Court for the District of Massachusetts denied a motion by AMAG to dismiss the investors' punitive class action against AMAG and its bank underwriters.[83] The case was eventually settled out of court.[84]

E. Summarizing the Three Standards

In short, the three circuit court opinions offer three different interpretations of Item 105.[85] The Third Circuit requires disclosure of risk unknown to the issuer at the time of disclosure.[86] The Second Circuit absolves the issuer of the duty to disclose uncharged, unadjudicated wrongdoing.[87] The First Circuit demands disclosure only of risks known to the issuer at the time of disclosure.[88]

III. ANALYZING THE APPROPRIATE ITEM 105 STANDARD IN LIGHT OF SEC GUIDANCE

A. The Third Circuit's Unlawful, Unworkable Standard

The Third Circuit's standard that requires disclosure of unknown risk and uncertainty does not comply with the law because unknown risk and uncertainty are absent from the text of Item 105.[89] Item 105 requires

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82. Silverstrand Invs. v. AMAG Pharm., 571 U.S. 941, 941 (2013) (denying the petition without comment); Bishop, *supra* note 80.

83. Silverstrand Invs. v. AMAG Pharm., 12 F. Supp. 3d 241, 254 (D. Mass. 2014); Zagger, *supra* note 77 (summarizing the First Circuit's ruling that the putative class of plaintiff investors "met the minimum pleading standards, after . . . consider[ing] the dismissal motion on remand following [the] First Circuit's decision to partially overturn the previously dismissed case").

84. Angeion Group, *Claims Administrator Angeion Group Announces Settlement in* Silverstrand Investments v. AMAG Pharmaceuticals, Inc. *Litigation*, PR NEWSWIRE (Oct. 31, 2014, 8:00 PM), https://www.prnewswire.com/news-releases/claims-administrator-angeion-group-announces-settlement-in-silverstrand-investments-v-amag-pharmaceuticals-inc-litigation-281051452.html.

85. *Compare* Jaroslawicz v. M&T Bank Corp., 962 F.3d 701, 705 (3d Cir. 2020) (establishing the Third Circuit's Item 105 interpretation), *with* City of Pontiac Policemen's & Firemen's Ret. Sys. v. UBS AG, 752 F.3d 173, 184 (2d Cir. 2014) (establishing the Second Circuit's Item 105 interpretation), *and Silverstrand Invs.*, 707 F.3d at 103 (establishing the First Circuit's Item 105 interpretation).

86. *Jaroslawicz*, 962 F.3d 701, 705 (establishing the Third Circuit's Item 105 interpretation).

87. *See City of Pontiac Policemen's & Firemen's Ret. Sys.*, 752 F.3d at 184 (establishing the Second Circuit's Item 105 interpretation).

88. *See Silverstrand Invs.*, 707 F.3d at 103 (establishing the First Circuit's Item 105 interpretation).

89. *See* 17 C.F.R. § 229.105 (2022) (omitting the Third Circuit's risk disclosure

disclosure of material risk, but according to the SEC's guidance, that disclosure must be clearly explained and include specific details, a goal inconsistent with disclosing risks that an issuer does not believe to exist, despite whether that issuer is right.[90] The detailed and predictive disclosure of hypothetical risk promotes the kind of boilerplate, generic disclosure that the SEC sought to avoid in its most recent modification of Item 105.[91] The use of lengthy, boilerplate risk disclosure is a predictable consequence of requiring disclosure of unknown, unperceived, uncharged, and unadjudicated risk, because such a disclosure obligation increases legal costs that issuers and underwriters can lower by using this kind of disclosure language.[92] If underwriters can lower their legal costs through boilerplate disclosure, they will likely do so at the expense of market participants, issuers, and their shareholders who may suffer from inadequate and overly complex disclosure information when making investment decisions.[93]

The Third Circuit found that the proxy disclosures were deficient and that M&T should have disclosed the state of its BSA/AML program in the context of regulatory scrutiny by specifically linking its statements to its risks using details. Through that finding, the court effectively held that issuers of publicly traded securities are liable for failing to disclose not only known risks, but also risks that were not known or believed to exist by the issuer and not yet charged by regulators.[94] Under the Third Circuit's

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requirement); *see also* Shaw v. Digital Equip. Corp., 82 F.3d 1194, 1202 (1st Cir. 1996) ("The proposition that silence, absent a duty to disclose, cannot be actionably misleading, a fixture of securities law."); Roeder v. Alpha Indus., 814 F.2d 22, 27 (1st Cir. 1987) (stating that "there is no affirmative duty" to disclose material information without regulation requiring disclosure or under two other circumstances).

90. SIFMA Brief, *supra* note 7, at 15–16 (describing the SEC's guidance requirements for clarity and specificity and asserting that the Third Circuit's required disclosure cannot meet the SEC's clarity and specificity standard).

91. *Id.*; *see* Modernization of Regulation S-K, *supra* note 19, at 29 (noting that inclusion of disclosure of generic, boilerplate risks contributes to the increased length of risk factor disclosure and that the modernization of Item 105 is meant to address the lengthy and generic nature of many registrants' disclosures).

92. SIFMA Brief, *supra* note 7, at 16 (noting that the Third Circuit's standard would require underwriters to undertake costly investigation to uncover risks to the business that the issuer itself may not have perceived); *see also* Jeremy McClane, *Boilerplate and the Impact of Disclosure in Securities Dealmaking*, 72 VAND. L. REV. 191, 197 (2019) (stating that boilerplate disclosure language is associated with lower legal costs on average). *But cf.* McClane, *supra* note 92, at 191 (stating that issuers lose "$5 to $6 million in the market on average for each additional 10% of their disclosure" containing "rote recitations").

93. McClane, *supra* note 92, at 197 (stating that boilerplate disclosure language is associated with "higher average losses to issuers from mispricing" and does little to inform the investing public of the risk).

94. Jaroslawicz v. M&T Bank Corp., 962 F.3d 701, 715 (3d Cir. 2020); *see also*

reasoning, in order to avoid liability, M&T needed to (1) preemptively confess in its proxy to what the Federal Reserve and any of M&T's other regulators would later determine to be M&T's wrongful BSA/AML program and checking account misconduct that had not yet resulted in any regulatory action and (2) disclose the risk of unborn regulatory action regarding that conduct.[95] The Third Circuit imposed these requirements despite admitting in its opinion that it did not intend to require after-the-fact regulatory enforcement action to create a retroactive duty to disclose.[96]

The Third Circuit's standard is unworkable in practice as it demands that issuers disclose purely hypothetical or imagined risk or risk that the issuer does not know or cannot identify at the time of disclosure.[97] This requirement is ineffective since issuers cannot disclose what they do not already know is there to disclose.[98] In order to comply with the Third Circuit's standard, M&T would have had to disclose any regulatory compliance deficiencies that could be targeted by regulators, despite M&T being blind to (1) the existence of those deficiencies, as was the case for its BSA/AML program, or (2) the potential that, in hindsight and as was the case for its checking account practices, doubt in the programs would trigger regulatory action at the time of disclosure.[99]

B. Analyzing M&T's Actions Under the Second and First Circuit's Item 105 Standards

The Second Circuit's Item 105 interpretation complies with the text of Item 105 and the SEC's Item 105 guidance, which require only a discussion of material risk factors, not of uncharged conduct.[100] The Second Circuit's

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SIFMA Brief, *supra* note 7, at 3–4.

95. *See* SIFMA Brief, *supra* note 7, at 3–4 (referencing regulatory action taken by the Federal Reserve and CFPB); Petition for Certiorari, *supra* note 19, at *3 (implying that the Third Circuit's standard would require an issuer to preemptively confess to misconduct that has not resulted in any regulatory or other sanction); *Jaroslawicz*, 962 F.3d at 715–16 (asserting M&T should have mentioned its non-compliant account practices before the CFPB took action, even though those practices had been curtailed prior to issuing the joint proxy).

96. *See Jaroslawicz*, 962 F.3d at 705, 716 ("Later litigation or regulatory enforcement does not create a retroactive duty to disclose.").

97. *See* SIFMA Brief, *supra* note 7, at 5–6. (stating that the standard is unworkable and would subject issuers and underwriters to liability for failing to disclose hypothetical, imagined, or unperceived risks).

98. *See id.*

99. *See id.* (arguing the impracticability of requiring foresight of regulatory risk).

100. *See* 17 C.F.R. § 229.105 (2020) (omitting requirement for the disclosure of uncharged, unadjudicated wrongdoing); *see also* United States v. Matthews, 787 F.2d 38, 49 (2d Cir. 1986) (holding that, as long as the SEC does not require uncharged criminal conduct to be disclosed, omitting such conduct disclosure cannot be criminally

interpretation in *City of Pontiac Policemen's & Firemen's Retirement System* would not have obligated M&T to disclose its BSA/AML compliance weaknesses and checking account issues because those issues had yet to be charged or adjudicated by regulators at the time the proxy statement was made.[101] Unlike the Third Circuit holding in which disclosing the Federal Reserve's potential and eventual regulatory action was insufficient, the court in *City of Pontiac Policemen's & Firemen's Retirement System* decided that disclosing UBS's involvement in government investigations and that those investigations could lead to regulatory restrictions were all that were needed for the issuer, UBS, to comply with its Item 503(c) obligations.[102] Just like UBS, M&T disclosed the Federal Reserve's inquiries into M&T's programs and that those inquiries could stall the merger; M&T complied with Regulation S-K disclosure requirements under the Second Circuit's interpretation of Item 105.[103] Likewise, the First Circuit's Item 105 interpretation is in line with Regulation S-K disclosure requirements, which require firms to discuss only risk known by the issuer at the time of disclosure.[104] The First Circuit's interpretation in *Silverstrand* would not have demanded M&T to disclose regulatory risks with any more detail than the bank had already disclosed because it had no knowledge at the time of disclosure that its programs were wrongful and would certainly be challenged by regulators who would stall the merger.[105]

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prosecuted); Ciresi v. Citicorp, 782 F.Supp. 819, 823 (S.D.N.Y. 1991) (stating that "the law does not impose a duty to disclose uncharged, unadjudicated wrongdoing or mismanagement."); *Jaroslawicz*, 962 F.3d 701 at 716 (clarifying that the court is not holding that later regulatory enforcement creates a retroactive duty to disclose).

101. *See* Jaroslawicz v. M&T Bank Corp., 296 F. Supp. 3d 670, 674 (D. Del. 2017) (describing the timeline of the merger when the proxy was effective before regulators halted the merger); 752 F.3d 173, 184 (2d Cir. 2014); *see also Jaroslawicz*, 962 F.3d at 713 (summarizing the Second Circuit's Item 503(c) standard).

102. *See City of Pontiac Policemen's & Firemen's Ret. Sys.*, 752 F.3d at 184 (stating that "[b]y disclosing its involvement in . . . government investigations and indicating that its involvement could expose UBS to [regulatory restrictions], UBS complied with its disclosure obligations").

103. *See id.* at 184 (noting that UBS disclosed its involvement in government investigations and indicated that its involvement could expose UBS to regulatory restrictions); Form 8-K, supra note 46 (disclosing that the Federal Reserve identified issues with M&T's BSA/AML programs and that to address the regulator's concerns, the closing of the merger would have to be delayed).

104. *See* § 229.105 (omitting the disclosure of risk that is unknown to the issuer at the time of disclosure); Silverstrand v. AMAG Pharms., Inc., 707 F.3d 95, 103 (1st Cir. 2013).

105. *See Silverstrand*, 707 F.3d at 103; *Jaroslawicz*, 296 F. Supp. 3d at 674 (describing the timeline of the merger process in which the proxy was filed and made effective before regulators halted the merger); *see also Jaroslawicz*, 962 F.3d at 713 (explaining the First Circuit's Item 503(c) standard).

The First and Second Circuit's interpretations of Item 105 comply with the text of Item 105 and the SEC's guidance, but the Third Circuit's interpretation adds an ineffective requirement for predictive disclosure of how regulators may or may not treat specific wrongdoing unknown to issuers at the time of disclosure.[106]

C. M&T Complied with the Text of Item 105

M&T satisfied its disclosure obligation under the Second and First Circuits' Item 105 standards in compliance with the text of Item 105 and the SEC's guidance to provide a non-generic, adequate discussion of material risk.[107] M&T specifically discussed in its proxy statement the specific federal agencies taking action—the Federal Reserve and CFPB—the applicable laws for compliance, and the regulatory hurdles regarding its BSA/AML program that could but had not yet stalled the merger.[108] These were all specific details of the material risk that regulatory action posed to M&T's shareholders in the context of the merger that the shareholders were voting on.[109] Although M&T's disclosures certainly contained some generic language apparently included to couch its risk statements within the context of broader industry-wide risk, the proxy still contained the specificity, similar to that of the SEC's guidance, linking risk to M&T's activities.[110]

M&T disclosed that "regulatory hoops stood between the proposed merger and a final deal."[111] The proxy statement was littered with references to the threat that regulatory approval from the Federal Reserve posed to the merger

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106. *See* SIFMA Brief, *supra* note 7, at 5–6 (stating that the Third Circuit's standard is "unworkable in practice"); § 229.105 (listing the existing requirements for Item 105 disclosure, omitting the Third Circuit's required disclosures); *cf. Jaroslawicz*, 962 F.3d at 716 (claiming it did not matter whether M&T knew about the shortcomings in its programs).

107. Memorandum of Law in Support of Defendants' Motion to Dismiss at 10, Jaroslawicz v. M&T Bank Corp. (D. Del. 2016) (No. 15-897) [hereinafter Defendants' Memo] (naming the Federal Reserve and applicable BSA/AML law in the proxy statement); *see also* M&T Joint Proxy, *supra* note 39, at 24, 27 (listing several warnings in the Risk Factor section and elsewhere about the threat posed to the merger by regulatory action).

108. Defendants' Memo, *supra* note 107, at 10; *see also* M&T Joint Proxy *supra* note 39, at 24, 27.

109. *See* M&T Joint Proxy, *supra* note 39, at 24, 27 (listing details of the material risk of regulatory action including the agencies involved, applicable laws, and their impact on the merger and M&T's business activities).

110. *Compare* Modernization of Regulation S-K, *supra* note 19 (noting that the modernization of Item 105 is meant to address the lengthy and generic nature of many registrants' disclosures), *with* M&T Joint Proxy, *supra* note 39, at 40 ("Like all businesses, M&T is subject to operational risk . . . .").

111. *Jaroslawicz*, 962 F.3d at 715.

and emphasized that completion of the merger was subject to the Federal Reserve's approval of M&T's BSA/AML program.[112] The proxy statement also clearly warned shareholders that M&T's internal programs might be wrongful and threaten the merger that the shareholders were voting on.[113] M&T specifically disclosed which federal agencies were applying which federal laws to scrutinize which of M&T's compliance programs and how the agency's application of those laws to M&T's compliance programs could halt completion of the merger.[114] Importantly, M&T's supplemental proxy following its press release about the Federal Reserve's action disclosed the action that the Federal Reserve took against M&T in the context of a specific law and specific M&T program and that action's effect of extending the merger.[115]

The Third Circuit even admitted that M&T identified that the merger hinged on obtaining the Federal Reserve's approval and singled out that determining the effectiveness of its BSA/AML program would be crucial to obtaining that approval.[116] M&T's disclosure stated that "in every case under the Bank Merger Act, the Federal Reserve must take into consideration . . . records of compliance with anti-money-laundering laws."[117] The Third Circuit also conceded that M&T disclosed that the Federal Reserve had the authority to evaluate the bank's BSA/AML compliance under two laws — the Bank Holding Company Act of 1956 and

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112. Defendants' Memo, *supra* note 107, at 10; *see, e.g.*, M&T Joint Proxy, *supra* note 39, at 15, 26, 29, 43 (referencing several mentions of the need for regulatory approval for closing the merger and disclosing that the Federal Reserve identified certain regulatory concerns regarding M&T's Bank Secrecy Act and anti-money-laundering compliance program).

113. M&T Joint Proxy, *supra* note 39, at 40 (stating that, under the subsection titled, "M&T is subject to operational risk," that M&T is subject to risk resulting from inadequate processes).

114. *See id.* at 99–100 (showing where, under the section titled "Regulatory Approvals Required for the Merger," the proxy states that "[c]ompletion of the merger is subject . . . to . . . the Federal Reserve's [approval] pursuant to . . . the Bank Holding Company Act" and that approval was also subject to the Federal Reserve's review of the effectiveness of M&T's anti-money laundering programs).

115. Form 8-K, *supra* note 46 (stating that M&T learned that the Federal Reserve identified certain regulatory concerns with M&T's procedures, systems, and processes relating to M&T's anti-money laundering program, M&T's effort to address the Federal Reserve's concerns, and that to do so would require an extension of the merger's closing beyond the date previously expected).

116. *Jaroslawicz*, 962 F.3d at 714–15 (conceding that M&T seemingly disclosed what it should have in its supplemental proxy regarding the merger's reliance on approval from the Federal Reserve regarding its BSA/AML programs).

117. *Id.* at 714.

the Federal Deposit Insurance Act.[118]

M&T fulfilled its Item 105 obligations through the combination of its amended proxy and subsequent supplemental statements.[119] Per the text of Item 105, M&T discussed material risk factors, namely, the threat that federal regulatory action posed to completion of the merger.[120] The bank organized the discussion with relevant subheadings and subcaptions describing the risk that regulatory action posed to the merger.[121] The proxy also explained how the risk factor, regulatory action, would affect the registrant, M&T, by disclosing that regulators could stall the merger.[122] The proxy addressed the main points of Item 105, demonstrating that M&T complied with the law in this regard.

D. Analyzing M&T's Disclosure Under the SEC's Example

Furthermore, M&T's disclosure mirrors that of the SEC's guidance examples, which the court relied on for its opinion in *Jaroslawicz v. M&T Bank*.[123] Just as the SEC guidance's lawn care example specifically named the hypothetical lawn care company's asset size relative to its competitors as a risk that might render it unable to compete against larger competitors, M&T named a specific federal agency – the Federal Reserve – and that agency's scrutiny of specific M&T programs – its BSA/AML programs – as a potential roadblock for the merger that the shareholders were voting on.[124]

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118. *Id.*

119. *See* M&T Joint Proxy, *supra* note 39; Form 8-K, *supra*, note 46.

120. *See* 17 C.F.R. § 229.105 (2020) (stating the requirement to provide "a discussion of the material factors that make an investment in the registrant or offering speculative or risky"); M&T Joint Proxy, *supra* note 39, at 15, 26, 29, 34, 40, 43 (listing several points throughout the proxy statement where M&T disclosed that regulatory hurdles from the Federal Reserve might hinder the merger); Form 8-K, *supra* note 46 (disclosing the material risk factor that M&T had to delay the merger in order to address the concerns of the Federal Reserve).

121. *See* § 229.105 (stating the requirement that the disclosure discussion "be organized logically with relevant headings and that each risk factor should be placed under a subcaption that adequately describes the risk); M&T Joint Proxy, *supra* note 39, at 34, 40, 100 (organizing the disclosures under the subcaptions "Risks Relating to the Regulatory Environment," "M&T is subject to operational risk," and "Regulatory Approvals Required for the Merger").

122. *See* § 229.105 (stating the requirement for the disclosure to "[c]oncisely explain how each risk affects the registrant"); M&T Joint Proxy, *supra* note 39, at 15, 26, 29, 34, 40, 43 (describing instances where regulation could stall the merger).

123. *See* Petition for Certiorari, *supra* note 19, at 5; Bulletin No. 7, *supra* note 14, at 6–7; *Jaroslawicz*, 962 F.3d at 711–13, 715 (citing the SEC's Bulletin No. 7).

124. M&T Joint Proxy, *supra* note 39, at 15, 26, 29, 34, 40, 43 (disclosing that regulatory hurdles from the Federal Reserve might hinder M&T's business activities, including the merger); *see* Form 8-K, *supra* note 46 (disclosing that the merger was being held up by the Federal Reserve's regulatory action against M&T for its BSA/AML

The proxy also stated that the Federal Reserve was taking longer to render a decision on applications than the typical time period for approval set forth in the Federal Reserve's regulations.[125] This is the kind of detailed, non-generic statement describing a smaller facet of a larger generic risk that the SEC is looking for and provided an example of.[126]

E. Uncertainty is Not an Item 105 Disclosure Requirement

Item 105 does not require disclosure of uncertainty, which is different than risk and reflects the category of information the Third Circuit stipulated in its ruling.[127] Widely cited in academia, economist Frank Knight's classic differentiation between risk and uncertainty sheds light on the divergence of the uncertainty that the Third Circuit identified as risk from the risk that Item 105 requires for disclosure.[128] Given that uncertainty is unmeasurable and lacks the quantifiability inherent in risk, risk that is unknown or unperceived by the issuer at the time of disclosure is best classified as unmeasurable uncertainty because its nature makes it not quantifiable.[129] Aside from the policy argument over whether registrants ought to disclose uncertainty and whether some uncertainty is material, uncertainty and risk are different, and Item 105 does not require disclosure of uncertainty.[130] Item 105 demands that registrants disclose only material risk, which must be quantifiable under the classic definition of risk, and such measurability is absent from the Third

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practices and that a delay in the merger's closing was necessary for M&T to address the Federal Reserve's concerns). *But see* Bulletin No. 7, *supra* note 14, at *1 (exemplifying a preference by the SEC for disclosure language that does not rely on the inferences of the reader to deduce the connection between the company's activities and the risk borne by the shareholder).

125. Petition for Certiorari, *supra* note 19, at 6.

126. *See* Bulletin No. 7, *supra* note 14, at 6 (giving an example of how the hypothetical lawn care company's larger financial disadvantage keeps it from capturing market share due to its inability to open more offices, which is a detail within the overarching risk of the company's limited resources relative to its competitors).

127. *See* § 229.105 (omitting a requirement to disclose uncertainty); *see also* KNIGHT, *supra* note 24 (differentiating risk and uncertainty).

128. *See* § 229.105 (noting the absence of a requirement to disclose uncertainty); KNIGHT, *supra* note 24 (differentiating risk and uncertainty); Daniel Cahoy, *Patently Uncertain*, 17 NW. J. TECH. & INTELL. PROP. 1, 12 (2019) (noting there is no one more cited for conceptualizing uncertainty than Frank Knight).

129. *See* KNIGHT, *supra* note 24, at 233 (explaining that for risk, the distribution of outcome in a group of instances is known through calculation or statistics of past experience—in other words, risk is measurable—whereas uncertainty is judgment of future events using opinion, not scientific knowledge).

130. *See id.* (explaining the difference between risk and uncertainty); § 229.105 (omitting a requirement to disclose uncertainty).

Circuit's compulsion for disclosure of unknown risk.[131] Therefore, the Third Circuit's holding fails to conform to the Item 105 text's requirement for disclosure of material risk and instead demands disclosure of uncertainty.[132]

F. The Broad Reach of the Third Circuit's Ruling

The Third Circuit's ruling likely will not be confined to its own jurisdiction.[133] As M&T's noted in its Petition for Writ of Certiorari, the Third Circuit's interpretation could become the nationwide standard for Item 105 due to federal securities laws' broad venue provisions and Delaware's status as the dominant jurisdiction for U.S. public companies.[134] The Securities Act of 1933 and the Securities Exchange Act of 1934 contain expansive process and forum provisions for plaintiffs under the law.[135] The nationwide service of process provision specifies that process under the Act "may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found."[136] Plaintiffs can serve defendants anywhere they are.[137] The law provides for proper venue in any district where a violation of the Act occurred or where a defendant is found, lives, or conducts business.[138] Most large public companies and many private corporations choose Delaware for their domicile.[139] According to the Delaware Division of Corporations website, "more than one million business entities have made Delaware their legal home," and "more than 60 percent

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131. Jaroslawicz v. M&T Bank Corp., 962 F.3d 701, 705 (3d Cir. 2020) (failing to provide a measurability requirement for the disclosed risk); KNIGHT, *supra* note 24, at 233 (explaining the definition of risk).

132. *Compare* KNIGHT, *supra* note 24, at 19–20 (defining risk), *and* § 229.105 (2020) (noting the absence of a requirement to disclose uncertainty), *with Jaroslawicz*, 962 F.3d at 705 (establishing the Third Circuit's Item 105 standard).

133. *See* Petition for Certiorari, *supra* note 19, at 5 (Nov. 15, 2020) (stating that the Third Circuit's expansive interpretation of Item 105 "threatens to become the de facto national standard").

134. *Id.*

135. 6 THOMAS LEE HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION § 17:1 (2021) ("Section 22 of the Securities Act of 1933 and Section 27 of the Securities Exchange Act of 1934 provide for nationwide service of process" and "a wide choice of federal forums.").

136. 15 U.S.C. § 78aa.

137. *See id.* (summarizing the relevant gist of the expansive service of process provision under the Securities Exchange Act).

138. *Id.*

139. Griffin, *supra* note 12; *see also* Why Businesses Choose Delaware, *supra* note 12 (noting that "Delaware has been the premier state of formation for business entities since the early 1900s"); Petition for Certiorari, *supra* note 19, at 23 (noting "Delaware's status as the domicile of choice for U.S. public companies.").

of the Fortune 500 companies are incorporated in Delaware."[140]

G. Negative Impact of the Third Circuit's Hindsight 2020 Standard on Capital Markets

Varying circuit court interpretations of Item 105 create confusion among securities market participants.[141] The Third Circuit's interpretation "significantly reduce[s] the pleading and evidentiary standards plaintiffs must meet in bringing claims under the federal securities laws," thereby "submit[ting] issuers to liability for failing to disclose otherwise unknown and unperceived risks."[142] This would "significantly expand potential class action securities liability," "negative[ly] impact[ing] . . . the process by which public companies access investment capital."[143] Concerns over securities liability could disincentivize lenders from working with early stage and start-up small businesses perceived to be higher risk than their counterparts who have the financial resources and internal infrastructure to manage and litigate compliance with the Third Circuit's standard, limiting the growth and health of the small business sector, a huge driver of the U.S. economy.[144]

IV. RECOMMENDING THE SECOND AND FIRST CIRCUIT'S ITEM 105 STANDARD TO RESOLVE INDUSTRY CONFUSION

A. The Supreme Court Should Grant Cert

The Third Circuit incorrectly applied Item 105 in *Jaroslawicz*.[145] The Supreme Court should grant certiorari in future cases where the federal Circuit has required an issuer to disclose uncharged, unadjudicated,

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140. *Why Businesses Choose Delaware*, *supra* note 12.

141. *See* SIFMA Brief, *supra* note 7, at 4 (noting the confusion caused by the different Item 105 standards).

142. SIFMA Brief, *supra* note 7, at 6; Petition for Certiorari, *supra* note 19, at *3.

143. SIFMA Brief, *supra* note 7, at 5–6.

144. *Id.* at 5 (explaining that the standard could discourage underwriters and investment banks from raising capital for entrepreneurial and start-up businesses perceived as posing greater litigation risks). *See generally* Abigail Thorpe, *Infographic: The Cost of Compliance*, NFIP (Oct. 24, 2016), https://www.nfib.com/content/resources/infographic/infographic-the-cost-of-compliance-75773/ (stating that "[s]mall businesses are the engine of the economy . . . make up 99 percent of all U.S. employer firms" and shoulder disproportionate compliance costs relative to other businesses).

145. SIFMA Brief, *supra* note 7, at 3 (describing the Third Circuit's Item 105 interpretation as wrong as a matter of law and policy and requesting that the Supreme Court grant M&T's petition for certiorari to reverse the decision).

unknown, and unperceived risk in proxy statements at the time of issuance.[146] In doing so, the Court should clarify the disclosure standard fractured by *Jaroslawicz* to hold that knowledge of specific, charged, or adjudicated wrongdoing presenting risk at the time of issuance is the only applicable standard for Item 105.[147] This would be in contrast to the Third Circuit's standard compelling disclosure of company-specific unknown future risk of harm not yet developed, identified by the issuer, or charged by regulators.[148]

This standard captures the knowledge element of the First Circuit interpretation and the adjudicated or charged element of the Second Circuit interpretation while satisfying the specificity element that the Third Circuit opinion emphasized.[149] The Third Circuit and the SEC demand specificity as part of Item 105.[150] As a desired policy outcome and to the extent the letter of the law demands, the Supreme Court should include specificity in its Item 105 risk disclosure standard so long as the material risk that issuers disclose is recognizable and identifiable enough to be specified in the issuers' proxy statement.[151]

B. New SEC Rulemaking or Amending Existing Guidance

The SEC should promulgate a rule to clarify the standard applied to Item 105 disclosure.[152] The SEC could similarly put forth guidance supplementing its 1999 guidance or most recent rulemaking governing Item 105 to establish a combination of the Second and First Circuits' Item 105 interpretations as the appropriate standard.[153]

This may entail the SEC adding a section onto its 1999 guidance or amending the "Risk factor comments" section of its guidance to dispel the

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146. *See id.* at 3 (stating a request by industry participants, as represented by SIFMA, BPI, and ABA, for the Supreme Court to grant M&T's petition for certiorari).

147. *See* Petition for Certiorari, *supra* note 19, at 12 (highlighting that "[t]he Third Circuit's decision in this case establishes a clear split of authority in the federal circuit courts regarding the scope of Item 105").

148. *See* Jaroslawicz v. M&T Bank Corp., 962 F.3d 701, 705, 715 (3d Cir. 2020) (establishing the Third Circuit's Item 105 standard).

149. *See id.* at 713 (explaining the Second Circuit's and First Circuit's Item 105 standards); SIFMA Brief, *supra* note 7, at 6 (explaining that the Third Circuit's standard would make issuers liable for not disclosing unknown and unperceived risks).

150. *See* SIFMA Brief, *supra* note 7, at 15 (describing the SEC's guidance requirements for clarity and specificity in Item 105).

151. *But see id.* at 16 (contrasting the Third Circuit's standard with a recognizable and identifiable material risk disclosure requirement).

152. *See id.* at 20 (suggesting that the U.S. Solicitor General under the U.S. Department of Justice clarify Item 105, implying a need for federal regulatory rulemaking).

153. *See id.* (suggesting agency clarification on Item 105).

need to predict specific regulatory action.[154] The SEC could either add new language or simply amend an existing comment. Regardless of the path the SEC chooses, the language should specify that the risk factors needed for disclosure should be identifiable and known at the time of disclosure and answer the question of whether Item 105 requires disclosure of unknown facts or facts pertaining to business practices or procedures that are unknown to be wrongful or noncompliant at the time of disclosure.[155]

The SEC missed an invited opportunity to weigh in on this issue when M&T petitioned for writ of certiorari and failed to do so in part because of deadline restraints.[156] There is no court deadline now, but there exists ample time to address the Circuit split through the various regulatory tools at the SEC's disposal.[157]

V. CONCLUSION

Despite the Third Circuit's opinion, M&T complied with the SEC's Regulation S-K Item 105 disclosure requirements and 1999 guidance when it disclosed regulatory risks posed by a specific program and a specific federal regulator. Per the Second and First Circuits' interpretations, the Third Circuit should not have applied a disclosure standard compelling M&T to predictively disclose the wrongfulness of its programs and the unknown risks those programs posed to the timeline of the merger.[158]

The Supreme Court should grant future petitions for writ of certiorari in similar cases to clarify the standard, or the SEC should promulgate a rule or issue guidance to clarify the standard in order to provide certainty to securities market participants in an industry that fuels 70 percent of the U.S. economy.[159] Item 105 risk factor disclosure obligations must be clear and

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154. Bulletin No. 7, *supra* note 14, at 13–14.

155. *See* Petition for Certiorari, *supra* note 19, at 9 (raising two questions for the Supreme Court).

156. *See id.* (inviting the SEC to weigh in on the questions for the Supreme Court and noting deadline restraints for why the SEC did not weigh in).

157. *See* Ruscoe, *supra* note 1 (stating that the Supreme Court denied M&T Bank's petition for certiorari, negating the deadline issue for the SEC to weigh in on the appropriate Item 105 standard); *SEC Interpretive Releases*, U.S. SECURITIES & EXCHANGE COMMISSION, https://www.sec.gov/rules/interp.shtml (Feb. 25, 2020) (explaining one of the SEC's regulatory instructive tools that could clarify Item 105).

158. City of Pontiac Policemen's & Firemen's Ret. Sys. v. UBS AG, 752 F.3d 173, 184 (2d Cir. 2014) (explaining the doctrine that disclosure is not a right of confession and that companies do not have to disclose uncharged, unadjudicated wrongdoing).

159. Our Markets, *supra* note 11; *see* SIFMA Brief, *supra* note 7 at 3, 20 (requesting for the Supreme Court to grant M&T's petition for certiorari and suggesting that the U.S. Solicitor General clarify Item 105).

achievable, so the standard set should not be predictive and should require disclosure only of material risk factors identifiable and known at the time of disclosure. This will strengthen the disclosure regime by setting an achievable, meaningful standard for the issuers to whom it applies.