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Second Circuit Rules on MD&A Trend Disclosure Requirements

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The U.S. Court of Appeals for the Second Circuit recently decided *Litwin v. Blackstone Group, L.P. (2d Cir. 2011)*, addressing "trend disclosure" requirements under Item 303 of Regulation S-K, 17 C.F.R. § 229.303(a)(3)(ii). This decision highlights the importance of giving appropriate consideration to trend disclosures in public filings, including registration statements as well as annual and quarterly reports.

The Second Circuit vacated the dismissal of claims under Sections 11 and 12(a)(2) of the Securities Act of 1933 based upon alleged misstatements and omissions in the registration statement and prospectus issued in connection with an initial public offering. The alleged misstatements and omissions, which primarily concerned the impact of adverse developments and market trends with respect to particular investments in the firm's corporate private equity and real estate business segments, were found sufficient to state a claim at the pleading stage, even though the performance of those investments was not specifically broken out in the firm's reporting. In particular, the Second Circuit declined to find immaterial as a matter of law (i) alleged omissions concerning known adverse trends, events or uncertainties related to two portfolio investments, each of which individually accounted for less than 5% of the firm's total assets under management but were significant to the firm's corporate private equity segment, which accounted for approximately 37% of the firm's total, and (ii) alleged omissions concerning known downward trends affecting the firm's residential real estate holdings, which amounted to at most 15% of its real estate segment assets under management, which, in turn, comprised approximately 23% of the firm's total assets under management.

In so holding, the Second Circuit stated that "[e]ven where a misstatement or omission may be quantitatively small compared to a registrant's firm-wide financial results, its significance to a particularly important segment of a registrant's business tends to show its materiality." Despite this language, the Second Circuit reiterated that the concept of materiality is still capable of "some defined boundaries," that not all aspects of a company's business will be deemed material, and that it is "only when there is both materiality and a duty to disclose that a company may be held liable for omitting information from a registration statement or prospectus." Further, the Second Circuit specifically noted that "in the area of pure omissions, disclosure of the information must be required" (Item 303 provided that requirement here), but "without that regulatory requirement" there would be "no obligation to disclose even material information."

The Second Circuit's approach suggests that companies with multiple business units should focus on known trends that are reasonably likely to materially impact revenues or income and consider the impact of such trends on all material aspects of a firm's business.