

Northern District of Illinois: Items 105 and 303 Impose a Duty to Disclose an Alleged Years-Long Bribery Scheme as Regulatory Noncompliance

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On April 21, 2021, the Northern District of Illinois denied dismissal of a putative securities fraud class action that alleged that an electric company, its subsidiary and certain executives made false and misleading statements and omissions that concealed an eight-year scheme to bribe state lawmakers to pass favorable legislation. [Flynn v. Exelon](#), 2021 WL 1561712 (N.D. Ill. 2021) (Kendall, J.). While recognizing that the Seventh Circuit has not held that Items 105 and 303 of Regulation S-K impose a duty to disclose any regulatory noncompliance, the court held that plaintiff sufficiently alleged that defendants had a duty to disclose their alleged bribery scheme under Items 105 and 303 and failed to do so.

Disclosure Requirements Under Items 105 and 303

Defendants argued that they were not under a general duty to disclose, whereas plaintiff argued that Items 105 and 303 of SEC Regulation S-K impose a duty to disclose any regulatory noncompliance. The court stated that “Item 303, which sets forth disclosure requirements for Forms 8-K and 10-Q, requires disclosure of ‘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.’” Citing the regulation, the court also explained that “Item 105 requires disclosure of the most significant factors that make an investment in the registrant or offering speculative or risky.”

Defendants Had a Duty to Disclose Their Alleged Bribery Scheme Under Items 105 and 303

The court observed that although the Seventh Circuit has yet to rule on the issue, a line of recent Northern District of Illinois cases have held that Items 105 and 303 of SEC Regulation S-K impose a duty to disclose any regulatory noncompliance in its SEC forms. The court then held that plaintiff “sufficiently alleged that [d]efendants had a duty to disclose their alleged bribery scheme under Items 105 and 303 and that they failed to do so.”

The court pointed out that plaintiff specifically alleged how defendants plausibly had a duty to disclose under Items 105 and 305. With respect to Item 105, plaintiff alleged that the company’s 2018 Form 10-K and Forms 10-Q for the first two quarters of 2019 “failed to discuss the

following significant factors that made investment in [the company] risky: that [the company] and [the subsidiary] faced substantial risk of criminal penalties, and substantial risk that proposed and future favorable legislation would be compromised, due to the [c]ompany’s changed strategy from legal lobbying to an eight-year illegal and undisclosed bribery scheme[.]”

With respect to Item 303, plaintiff alleged that the same SEC forms “failed to disclose material trends, events, and uncertainties known to management that were reasonably expected to have a material adverse effect on the [c]ompany’s resources and results of operations, namely that: the [c]ompany faced substantial risk of criminal penalties due to the [c]ompany’s changed strategy from legal lobbying to an eight-year illegal and undisclosed bribery scheme[.]” As to this topic, the court concluded that plaintiff “sufficiently alleged that [d]efendants had a duty to disclose their alleged bribery scheme under Items 105 and 303 and that they failed to do so.”

Authors and
Contacts

Meaghan Kelly
Partner
mkelly@stblaw.com
[+1-202-636-5542](tel:+12026365542)

George Wang
Partner
gwang@stblaw.com
[+1-212-455-2228](tel:+12124552228)

Cheryl Scarboro
Of Counsel
cscarboro@stblaw.com
[+1-202-636-5529](tel:+12026365529)

