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Supreme Court Holds that Persons Who Do Not "Make" Misstatements Can Nevertheless Be Liable for Other Securities-Fraud Violations

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The Supreme Court held today that persons who do not "make" material misstatements or omissions, but who disseminate them to potential investors with fraudulent intent, can be held to have violated other provisions of the securities laws that do not depend on actually "making" the misstatements or omissions. The Court's decision in *Lorenzo v. SEC* (No. 17-1077) reads the anti-fraud provisions broadly and bolsters the ability of investors and governmental authorities to pursue persons who employ fraudulent schemes or practices even if those persons themselves do not "make" any material misrepresentations or omissions.

Background

The *Lorenzo* case involves the interplay between the three subsections of SEC Rule 10b-5 and the Supreme Court's 2011 decision in *Janus Capital Group, Inc. v. First Derivative Traders*.

Rule 10b-5, promulgated under § 10(b) of the Securities Exchange Act of 1934, forbids any person, directly or indirectly, (a) "[t]o employ any device, scheme, or artifice to defraud," (b) "[t]o *make* any untrue statement of a material fact," or any material omission, in connection with the purchase or sale of a security, or (c) "[t]o engage in any act, practice, or course of business which operates or would operate as a fraud or deceit" (emphasis added). These three subsections – so-called "scheme liability" in subsections (a) and (c), and "misstatement liability" in subsection (b) – roughly track subsections (1) through (3) of § 17(a) of the Securities Act of 1933.

The Supreme Court's *Janus* decision construed subsection (b) of Rule 10b-5, which prohibits "mak[ing]" any untrue or misleading statement. The Court held that, for purposes of Rule 10b-5(b), "the maker of a statement is the person or entity with ultimate authority over the statement, including its content and whether or how to communicate it." Someone who merely "prepares or publishes a statement on behalf of another is not its maker," because that person "can merely suggest what to say, not 'make' a statement in [that person's] own right." The Court observed that, "in the ordinary case," "attribution within a statement or implicit from surrounding circumstances is strong evidence that a statement was made by – and only by – the party to whom it is attributed."

The *Lorenzo* Case

The SEC brought a cease-and-desist proceeding against Francis Lorenzo – the director and vice president of investment banking at a broker-dealer – under §§ 17(a) and 10(b) and Rule 10b-5 for his role in an alleged fraud. The firm's biggest client, and Lorenzo's only investment-banking client, was a start-up company that was experiencing financial difficulties and was planning a debenture offering. As the company's financial problems mounted, Lorenzo sent allegedly false and misleading emails to two potential investors about the pending offering and the start-up's "'3 layers of protection.'"

One of the emails stated that it had been sent "'[a]t the direction of'" Lorenzo's boss; the other stated that it had been sent "'[a]t the request of'" the boss and another broker. But Lorenzo signed both emails with his own name and title, and both emails urged the recipients to "'call [him] with any questions.'"

An SEC administrative law judge concluded that Lorenzo had willfully violated the Exchange Act's anti-fraud provisions by his material misrepresentations and omissions concerning the start-up's financial condition. The Commission sustained the ALJ's ruling that Lorenzo had violated § 17(a) and all three subsections of Rule 10b-5. Lorenzo appealed, and, in a 2-1 decision – with then-Judge Brett Kavanaugh dissenting – the Court of Appeals for the District of Columbia Circuit vacated the SEC's sanctions and remanded the case.

The majority first agreed with Lorenzo's objection that the finding of "misstatement liability" under Rule 10b-5(b) could not stand because Lorenzo had not actually "made" the alleged misstatements. Lorenzo had sent the emails at the request of his boss, who had "supplied the content of the false statements, which Lorenzo copied and pasted into the messages before distributing them." The boss, not Lorenzo, thus had retained "ultimate authority" over the false statements, so Lorenzo could not be held liable as their "maker" under Rule 10b-5(b) and *Janus*.

The court was not troubled that Lorenzo had put his own name and phone number on the emails and had sent them from his own email account. "That sort of signature line . . . can often exist when one person sends an email that publishes a statement on behalf of another, with the latter person retaining ultimate authority over the statement."

But even though Lorenzo could not be held liable under Rule 10b-5(b) or § 17(a)(2) for having "made" the alleged misstatements, the D.C. Circuit nevertheless upheld the SEC's findings of "scheme liability." The court ruled that, "[a]t least in the circumstances of this case, in which Lorenzo produced email messages containing false statements and sent them directly to potential investors expressly in his capacity as head of the Investment Banking Division – and did so with scienter – he can be found to have infringed Section 10(b), Rules 10b-5(a) and (c), and Section 17(a)(1), regardless of whether he was the 'maker' of the false statements for purposes of Rule 10b-5(b)."

The majority saw no reason to treat the three subsections of Rule 10b-5 and § 17(a) "as occupying mutually exclusive territory, such that false-statement cases must reside exclusively within the province of Rule 10b-5(b)." Nor was the majority concerned that allowing some overlap between "misstatement liability" and "scheme liability" would undermine the *Janus* decision or erode the distinction between primary liability and aiding-and-abetting liability, which is not permitted in private actions (although the Government can bring aiding-and-abetting claims). However, the court vacated the sanctions against Lorenzo and remanded for further consideration because the SEC had chosen the level of sanctions based in part on its erroneous conclusion that Lorenzo had "made" the allegedly false statements.

Judge Kavanaugh agreed with the majority's ruling that Lorenzo could not be held liable for having "made" the statements, but he dissented from its ruling on "scheme liability." In Judge Kavanaugh's view, "scheme liability must be based on conduct that goes beyond a defendant's role in preparing mere misstatements or omissions made by others."

Lorenzo sought review in the Supreme Court, contending that a misstatement claim that does not satisfy *Janus* cannot be "repackaged and pursued as a fraudulent scheme claim." He did not challenge the ruling on scienter. In a 6-2 decision, with Justice Kavanaugh not participating, the Supreme Court affirmed the D.C. Circuit.

Supreme Court's Decision

The Supreme Court held that "dissemination of false or misleading statements with intent to defraud can fall within the scope of subsections (a) and (c) of Rule 10b-5, as well as the relevant statutory provisions, . . . even if the disseminator did not 'make' the statements and consequently falls outside section (b) of the Rule." "By sending emails he understood to contain material untruths, Lorenzo 'employ[ed]' a 'device,' 'scheme,' and 'artifice to defraud' within the meaning of subsection (a) of the Rule, § 10(b), and § 17(a)(1). By the same conduct, he 'engage[d] in a[n] act, practice, or course of business' that 'operate[d] . . . as a fraud or deceit' under subsection (c) of the Rule."

The Court rejected the argument that each of the three subsections of Rule 10b-5 "should be read as governing different, mutually exclusive, spheres of conduct." Rather, the Court stressed that it and the SEC "have long recognized considerable overlap among the subsections of the Rule and related provisions of the securities laws." Thus, the fact that the only conduct at issue involved alleged misstatements did not preclude liability under the other two subsections of Rule 10b-5. The Court noted that "Lorenzo's view that subsection (b), the making-false-statements provision, *exclusively* regulates conduct involving false or misleading statements would mean those who disseminate false statements with intent to cheat investors might escape liability under the Rule altogether."

The Court also rejected the contention – advanced by the two dissenters (Justices Thomas and Gorsuch) and by then-Judge Kavanaugh in the D.C. Circuit – that imposing primary "scheme liability" on someone who cannot be liable for "misstatement liability" would erode the line between primary liability and aiding/abetting liability, which is available only to the Government. "It is hardly unusual for the same conduct to be a primary violation with respect to one offense [here, "scheme liability"] and aiding and abetting with respect to another [here, the liability of the statement's "maker" under *Janus*]." Accordingly, "[t]hose who disseminate false statements with intent to defraud are primarily liable under Rules 10b-5(a) and (c), § 10(b), and § 17(a)(1), even if they are secondarily liable under Rule 10b-5(b)."

Implications

The *Lorenzo* decision appears to expand the arsenal available to investors and governmental authorities seeking to assert claims against persons who did not actually "make" a misstatement or omission under *Janus*, but who nevertheless participated in its dissemination with the requisite scienter. The decision might be less consequential to the Government, which perhaps could bring aiding/abetting claims against persons in Lorenzo's position even if the Supreme Court had come out the other way. But private investors would not have had that option.

The Court saw "nothing borderline about this case, where the relevant conduct (as found by the Commission) consists of disseminating false or misleading information to prospective investors with the intent to defraud" – and where the dissemination was done by the vice president of an investment-banking company who "invited [the investors] to follow up with questions." But the Court noted that "one can readily imagine other actors tangentially involved in dissemination – say, a mailroom clerk – for whom liability would typically be inappropriate." Future cases will likely explore where the line should be drawn.

The decision should put to rest any lingering question about whether *Janus* applies to Rule 10b-5(b) claims asserted by the SEC and the Department of Justice, not just by private plaintiffs. If a person did not "make" a statement as defined by *Janus*, he or she cannot be sued or prosecuted for misstatement liability under Rule 10b-5(b).