Securities Regulation Daily Wrap Up, TOP STORY—U.S.: High Court finds liability for spreading false statements, even if not 'maker', (Mar. 27, 2019)

Securities Regulation Daily Wrap Up

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By Rodney F. Tonkovic, J.D.

Disseminating false statements can lead to liability under Rule 10b-5(a) and (c), even if the person spreading the statements did not "make" them under *Janus*.

The U.S. Supreme Court has affirmed a D.C. Circuit judgment that an investment banker who disseminated, but did not "make," a statement was liable under Rule 10b-5 (a) and (c). Six justices joined in concluding that the dissemination of false or misleading statements with intent to defraud can fall within the scope of Rule 10b–5 subsections (a) and (c) even if subsection (b) does not apply because the disseminator did not "make" the statements under *Janus* (*Lorenzo v. SEC*, March 27, 2019, Breyer, S.).

"Staggeringly" false emails. While working as an investment banker at a registered broker-dealer, Petitioner Francis Lorenzo sent two emails to prospective investors. While the emails were sent under Lorenzo's account and signature, his supervisor supplied the content of the emails, which, the SEC later concluded, contained "staggering" false information. The Commission ultimately found that Lorenzo intentionally sent false and misleading statements to investors in violation of Securities Act 17(a) and Exchange Act Section 10(b) and Rule 10b-5(a), (b), and (c).

On review, the D.C. Circuit overturned the Commission's finding that Lorenzo violated Rule 10b-5(b) on the grounds that he did not "make" the statements at issue. In a 2-1 decision, however, the court upheld the remainder of the violations, noting that Rules 10b-5(a) and (c) and Securities Act Section 17(a)(1) do not speak in terms of an individual's "making" a false statement, which was the critical language construed in *Janus*. While not a "maker," Lorenzo played an active role in producing and sending the emails, which constituted employing a deceptive "device," "act," or "artifice to defraud" for purposes of liability under those provisions. The dissenting judge (now Justice Kavanaugh, who took no part in this case) scolded the minority for finding that Lorenzo acted with scienter and for creating a circuit split by holding that mere misstatements may constitute the basis for scheme liability.

In his petition for certiorari, Lorenzo argued that the D.C. Circuit's decision allows plaintiffs to sidestep *Janus* by repackaging a fraudulent statement claim as a fraudulent scheme claim. Only the D.C. Circuit and the Eleventh Circuit had held that a misstatement standing alone can be the basis of a fraudulent scheme claim, the petition said, while three other circuits held that scheme liability requires something more than just deceptive statements. The petition argued further that The D.C. Circuit ignored the distinction between claims for fraudulent statements and claims for fraudulent schemes and also erased the distinction between primary and secondary liability.

Disseminating, but not "making." Justice Breyer, joined by five other justices, affirmed the D.C. Circuit's judgment. The relevant language, precedent, and purpose led the Court to the conclusion that dissemination of false or misleading statements with intent to defraud can fall within the scope of Rule 10b–5 subsections (a) and (c) even if subsection (b) does not apply because the disseminator did not "make" the statements. Echoing the D.C. Circuit, the Court first said that the language of subsections (a) and (c) is broad enough to encompass the dissemination of false or misleading information with the intent to defraud (i.e., Lorenzo's conduct). While there may be problems of scope in borderline cases, Justice Breyer remarked, this was not a borderline case.

Subsections overlap. Lorenzo argued that only those who "make" untrue statements under Rule 10b-5(b) can be liable in connection with statements. The other provisions, Lorenzo said, apply to scheme liability and conduct other than misstatements. To hold otherwise, he contended, would render subsection (b) "superfluous."

The Court said, however, that it and the SEC recognizes that there is "considerable overlap" among the subsections of Rule 10b-5 and related provisions. To adopt Lorenzo's view would mean that those who disseminate false statements with the intent to cheat investors could escape liability. "Using false representations to induce the purchase of securities would seem a paradigmatic example of securities fraud," the Court stated, and to find otherwise would conflict with the basic purpose of the securities laws.

***Janus* not a "dead letter," and other points.** Justice Breyer then took issue with the dissent's position that this holding would render *Janus* a "dead letter." That case, however, did not discuss Rule 10b-5's application to the dissemination of false or misleading information. And, the Court assumes, Janus would still preclude liability when an individual "neither *makes* nor *disseminates* false information—provided, of course, that the individual is not involved in some other form of fraud.

Lorenzo also asserted that imposing primary liability upon his conduct would weaken or even erase the distinction between primary and secondary liability. That is, one could have primary liability under subsections (a) and (c) and also aid and abet the maker of a false statement under subsection (b). The Court noted that it is "hardly unusual" for the same conduct to simultaneously be both a primary and secondary violation of different offenses. Moreover, if the "maker" of a false statement, for example, lacked the requisite intent, someone disseminating the statement would not be substantially assisting a primary violation and, thus, would not be secondarily liable. That is not what Congress intended, Justice Breyer wrote.

Thomas dissents. Justice Thomas, joined by Justice Gorsuch dissented. The dissent asserts that the majority "eviscerates" *Janus's* clear distinction between primary and secondary liability by holding that a person who has not "made" a fraudulent misstatement can nevertheless be primarily liable for it. Lorenzo may have assisted in a scheme, Justice Thomas said, but he did not "plan, scheme, design, or strategize": his role was essentially administrative. There are specific prohibitions against false statements in Rule 10b-5, and if a person's only role is to transmit someone else's false statements, that conduct is a matter of secondary liability. He concluded by arguing that the majority opinion is not reconcilable with *Janus*, rendering it a "dead letter," and that there is now no clear line between primary and secondary liability in fraudulent-misstatement cases.

The case is No. 17-1077.

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