

## Supreme Court: Considers Applicability of Rules 10b-5(a) and (c) to an Individual Who Was Not the “Maker” of a Fraudulent Statement

12.21.18



(Article from *Securities Law Alert*, December 2018)

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On December 3, 2018, the Supreme Court heard oral arguments in *Lorenzo v. SEC* (No. 17-1077), a case in which the Court will decide whether an individual who merely distributed a material misstatement or omission, and was not the “maker” of the statement under the test set forth in *Janus Capital Group v. First Derivative Traders*, 564 U.S. 135 (2011), can nonetheless be held liable under the “fraudulent scheme” provisions of Rule 10b-5(a) and (c).<sup>[1]</sup> The circuit courts are split on this issue: The Second, Eighth, and Ninth Circuits have held that a misstatement cannot be the sole basis for a fraudulent scheme claim, while the D.C. Circuit and the Eleventh Circuit have held that a misstatement, standing alone, can be the basis for such a claim.<sup>[2]</sup>

### Background

SEC Rule 10b-5 enables the SEC—or private plaintiffs—to bring civil actions to enforce three types of securities fraud violations: those committed by (a) employing any “device, scheme or artifice to defraud;” (b) making a false statement or omitting information that would be misleading to an investor; or (c) engaging in fraudulent or deceitful conduct.

Francis Lorenzo, a registered representative of a broker-dealer, sent two emails to potential investors containing material misstatements. The emails indicated they were sent “at the request” of Lorenzo’s boss, and Lorenzo testified that he copied and pasted content that was supplied by his boss. The SEC initiated an administrative enforcement action against Lorenzo, charging violations of, *inter alia*, all three Rule 10b-5 provisions. An SEC Administrative Law Judge found that Lorenzo’s conduct amounted to offenses under all three provisions of Rule 10b-5. The Commission affirmed this ruling, issuing a lifetime bar on Lorenzo working in the securities industry, as well as imposing a \$15,000 monetary penalty.

A divided panel of the D.C. Circuit reversed the Commission in part, finding that Lorenzo’s tenuous connection to the statements was insufficient to find that Lorenzo was the “maker” of the statements under *Janus*, as required to impose fraudulent misstatement liability under Rule 10b-5(b). *Lorenzo v. SEC*, 872 F.3d 578 (D.C. Cir. 2017). In reaching this conclusion, the D.C. Circuit emphasized that under *Janus*, Lorenzo’s boss was the one with control and the “ultimate authority” over when and how to communicate the information.

However, the D.C. Circuit affirmed the SEC’s decision to impose fraudulent scheme liability on Lorenzo under Rules 10b-5(a) and (c) due to his role in disseminating the misstatements to potential investors. The Court reasoned that although Lorenzo was not the “maker” of the misstatement, he “conveyed materially false information to prospective investors about a pending securities offering backed by the weight of his office as director of investment banking,” thereby using the statements to defraud investors. The Court took an expansive view of the securities laws and found that Rules 10b-5(a) and (c) could be employed to find liability in connection with false statements even where the defendant’s conduct was outside the scope of Rule 10b-5(b). In a dissenting opinion, then-Judge Kavanaugh—who is not participating in the decision at the Supreme Court—argued that “scheme liability must be based on conduct that goes beyond a defendant’s role in preparing mere misstatements or omissions made by others.”

Lorenzo petitioned the Supreme Court for a writ of certiorari, which was granted on June 18, 2018.

## Oral Argument Highlights

The oral argument focused heavily on whether permitting liability under Rule 10b-5(a) and (c) would allow for an end run around the Court’s ruling in *Janus*. In addressing this issue,

the Justices also explored whether the provisions of Rule 10b-5 were intended to be mutually exclusive, or whether the provisions were in fact intended to operate together to broadly prohibit fraudulent conduct in the securities industry.

Lorenzo’s counsel argued that imposing fraudulent scheme liability in this case, where an individual only distributed someone else’s false statement, would essentially reduce *Janus* to a case of incorrect pleading. After receiving some pushback from Justice Kagan on the idea that Rules 10b-5(a) and (c) are meant to operate separately from Rule 10b-5(b), Lorenzo’s counsel did admit that there could be a situation where additional deceptive conduct could take a misstatement into fraudulent scheme territory; however, Lorenzo’s counsel reiterated that the act of sending an email, as was the case here, would be insufficient to do so because such an act is not “inherently deceptive.”

Justice Alito asked: “Why doesn’t his conduct fall squarely within the language of (c)?” He questioned how an individual could violate Rule 10b-5(c) without a misstatement of some type: “I don’t quite know how you’re going to engage in a fraud . . . without saying some words.” Lorenzo’s counsel argued that liability under Rule 10b-5(c) is “a type of fraud that’s categorically different than merely misstatements or omissions.”

Justice Gorsuch seemed to be convinced by Lorenzo’s arguments, as he challenged the government’s insistence that sending the email itself was an act of fraud. Instead, Justice Gorsuch appeared to be of the opinion that the misstatement was the sole act of fraud, and Lorenzo could not be held liable as he did not “make” the statement. The government continued to rely on the fact that *Janus* was decided exclusively within the context of fraudulent misstatement allegations under Rule 10b-5(b) and argued that the “maker” standard was not relevant to an interpretation of Rule 10b-5(a) or (c).

Argument also focused on the Supreme Court’s decision in *Central Bank of Denver, v. First Interstate Bank of Denver*, 511 U.S. 165 (1994), which drew a distinction between primary and secondary liability. Lorenzo’s counsel argued that if the Court were to affirm the D.C. Circuit’s decision, essentially holding Lorenzo liable for conduct amounting to aiding and abetting his boss’s misstatement, such a holding would blur the lines between primary and secondary liability, opening a new avenue of lawsuits to private plaintiffs. Lorenzo’s counsel acknowledged that Section 17(a)(2), which makes it unlawful to obtain money or property by means of any untrue statement of material fact, would have been a better mechanism through which the SEC could have sought liability for Lorenzo’s conduct that would not jeopardize the distinction made in *Central Bank*, as enforcement under Section 17(a)(2) is only available to the government.

A decision in *Lorenzo* is expected before next summer.

[1] Please [click here](#) to read our discussion of the Supreme Court’s decision in *Janus*.

[2] Compare *Lentell v. Merrill Lynch*, 396 F.3d 161 (2d Cir. 2005) (holding that plaintiffs cannot successfully assert “a market manipulation claim under Rule 10b-5(a) and (c)” if “the sole basis for such claims is alleged misrepresentations or omissions”), *Public Pension Fund Grp. v. KV Pharm.*, 679 F.3d 972 (8th Cir. 2012) (“[A] scheme liability claim must be based on conduct beyond misrepresentations or omissions actionable under Rule 10b-5(b).”), and *WPP Luxembourg Gamma Three Sarl v. Spot Runner*, 655 F.3d 1039 (9th Cir. 2011) (“A defendant may only be liable as part of a fraudulent scheme based upon misrepresentations and omissions under Rules 10b-5(a) or (c) when the scheme also encompasses conduct beyond those misrepresentations or omissions.”) with *Lorenzo v. SEC*, 872 F.3d 578 (D.C. Cir. 2017) (holding defendant liable under Rules 10b-5(a) and (c) for disseminating a statement he did not make), and *SEC v. Big Apple Consulting USA*, 783 F.3d 786 (11th Cir. 2015) (“[E]ven a person . . . who is not the ‘maker’ of an untrue statement of a material fact, nonetheless could be liable as a primary violator of Rule 10b-5(a) and (c).”).

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