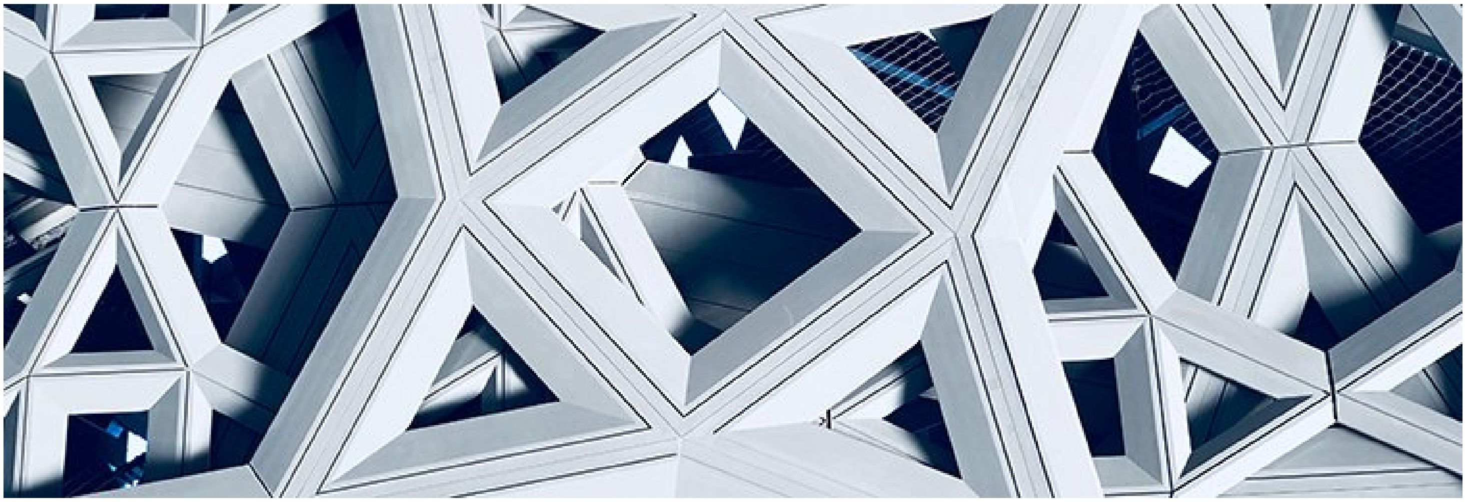

Supreme Court *Lorenzo* decision extends securities fraud liability to those who disseminate false statements made by others

Litigation Alert

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A divided Supreme Court yesterday ruled that a person may be held liable for securities fraud for passing along false statements in connection with the purchase or sale of securities, even if that person did not "make" the original statement, provided the disseminator knows that the statement is false or misleading.

The Court's ruling in *Lorenzo v. SEC* has potentially wide-reaching implications for ancillary participants in securities transactions, including investment banks, brokers, and law firms. Participants in securities markets must now be more careful than ever when communicating with investors and prospective investors.

Most securities fraud actions are based on SEC Rule 10b-5(b), which prohibits any person from "mak[ing] any untrue statement of material fact" in connection with the purchase or sale of a security. In its 2011 opinion in *Janus Capital Group, Inc. v. First Derivative Traders*, the Court held that "[w]ithout control" of the contents of and decision to issue a statement, "a person or entity can merely suggest what to say, not 'make' a statement in its own right."

In *Lorenzo*, a target of an Securities and Exchange Commission ("SEC") administrative proceeding (Lorenzo) did not "make" a statement. Rather, at his boss's direction, Lorenzo disseminated to prospective investors emails written by his boss that materially misrepresented the value of the assets of a company whose securities he was helping to sell. Thus, under *Janus*, Lorenzo could not be liable for securities fraud under Rule 10b-5(b), even though he did not challenge the SEC's finding that he acted with scienter because he knew the statements about the assets were false.

In a 6-2 opinion authored by Justice Breyer, the Court sided with the SEC and held that Lorenzo could instead be liable under Rule 10b-5(a) and (c), which prohibit "employ[ing] any device, scheme, or artifice to defraud," and "engag[ing] in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person," in connection with the purchase or sale of securities.

Relying on dictionary definitions of "device," "scheme," "artifice," "act," and "practice," the Court held that Rule 10b-5(a) and (c) "capture a wide range of conduct" that, in the Court's opinion, plainly encompasses Lorenzo's actions. The Court acknowledged that its interpretation could present "difficult problems of scope in borderline cases" but that no such problems existed in the case before it, as Lorenzo had signed the emails with his name and title (Vice-President, Investment Banking of his firm) and invited recipients to contact him with any questions. The Court held that Lorenzo was also liable under similar language in Section 10(b) of the Securities Exchange Act of 1934 and Section 17(a)(1) of the Securities Act of 1933.

Justice Thomas, in a dissent joined by Justice Gorsuch, argued that the majority's interpretation of subsections (a) and (c) to cover false or misleading statements that a person did not "make" would render Rule 10b-5(b) superfluous. The majority dismissed this concern, noting that the Court and the SEC "have long recognized considerable overlap among the subsections of the Rule and related provisions of the securities laws." Justice Kavanaugh recused himself from the Court's rulings because he had participated in the case while sitting on the D.C. Circuit.

What does the Court's ruling mean, in practical terms?

The Court's ruling somewhat surprisingly expands the scope of federal securities fraud law and broadens the group of those who may be held responsible for material misrepresentations. The Court justified its opinion in part by noting that, if it ruled otherwise, "plainly fraudulent" behavior would fall outside the scope of the Rule. It further noted that a narrower interpretation would be contrary to a purpose behind the securities laws "to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry."

As a practical matter, the Court's opinion should be seen as a warning to all participants in securities markets to be especially cautious and careful when working with or disseminating statements made by others. If a broker, banker, lawyer, or other individual knows or recklessly disregards that a statement is untrue before sending it to prospective investors, and the SEC is able to establish sufficiently an intent to defraud based on that knowledge, that person could be subject to liability for securities fraud. Because *Lorenzo* rests on its peculiar facts, only time will tell how widely the new ruling will be applied, but one possibility certainly is an expansion of targets of SEC securities fraud investigations to include any market participant who may have passed along false information created by others.

This ruling may also result in the expansion of private securities fraud litigation (class action or otherwise) against ancillary players to securities transactions beyond the issuer and its officers and directors, bringing into play more serious sanctions and exposure. Although the Supreme Court ruled out a private right of action against secondary violators of securities laws twenty-five years ago, *Lorenzo* expressly holds that those who disseminate false statements with an intent to defraud are *primarily* liable under Rules 10b-5(a) and (c), suggesting that the Court would be more amenable to allow private lawsuits against persons who did not themselves author the statements about an issuer or security but were otherwise involved in a transaction.

See the Court's decision here. To learn more, contact any of the authors.

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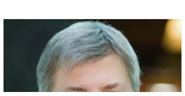

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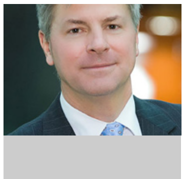

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