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Supreme Court Extends Primary Liability Under Rule 10b-5 to Disseminators of False Statements who Did Not "Make" the False Statement

The Supreme Court recently held in a 6–2 decision in *Lorenzo v. Securities and Exchange Commission,*[1] that a person who disseminates false or misleading statements with intent to defraud, falls within the scope of Rule 10b-5(a) and (c) of the Securities Exchange Act of 1934, as amended (the "Exchange Act") and can be held primarily liable even if that person did not "make" the statement and consequently would fall outside the scope of Rule 10b-5(b).

The *Lorenzo* decision is significant because it expands potential primary liability under Rule 10b-5. In a previous Supreme Court ruling, *Janus Capital Group, Inc. v. First Derivative Traders,*[2] the Court examined Rule 10b-5(b), which prohibits "mak[ing] any untrue statement of a material fact." The *Janus* Court held that to be a "*maker*" of a statement under subsection (b) of Rule 10b-5, one must have " 'ultimate authority over the statement, including its content and whether and how to communicate it.' " Based on *Janus*, this meant that a person who had "merely 'participat[ed] in the drafting of a false statement' 'made' by another could not be held liable in a private action under subsection (b)."

Background

Petitioner Francis Lorenzo was the director of investment banking at an SEC-registered brokerage firm, and at the direction of his boss, sent two emails to prospective investors. The content of those emails, which Lorenzo's boss supplied, described a potential investment in a company with "confirmed assets" of $10 million. In fact, Lorenzo knew that the company recently had disclosed that its total assets were worth less than $400,000. Lorenzo signed the emails with his own name, identified himself as vice president and invited follow up questions.

An SEC administrative law judge, and ultimately the full Commission, found that Lorenzo had violated Section 10(b) and Rule 10b-5 of the Exchange Act. Lorenzo appealed to the U.S. Court of Appeals for the District of Columbia Circuit. The Court of Appeals agreed with Lorenzo that in light of *Janus*, he could not be held liable under Rule 10b-5(b) because he was not the "maker," of the fraudulent statement, that is, he did not have "ultimate authority" over the content of the statement. The Court of Appeals, however, sustained the SEC'S finding that by

[1] No. 17-1077, slip opinion (Mar. 27, 2019), here.
[2] 564 U.S. 135 (2011)

knowingly disseminating false information to prospective investors, Lorenzo had violated Rule 10b-5(a) and (c), as well as Section 10(b) of the Exchange Act. Lorenzo then filed a petition to the Supreme Court for certiorari.

The Supreme Court's Opinion in Lorenzo

The Supreme Court granted certiorari to resolve the issue as to whether someone who is not the "maker" of a misstatement under *Janus* and Rule 10b-5(b), but who merely disseminates false or misleading information to potential investors with the intent to defraud*,* nevertheless, can be found to have violated the other subsections of Rule 10b-5, namely subsections (a) and (c), and related provisions of the securities laws.

The Court reviewed Rule 10b-5 that makes it unlawful:

- under subsection (a) "to employ any device, scheme, or artifice to defraud,"
- under subsection (b) "to make any untrue statement of a material fact…," or
- under subsection (c) "to "engage in any act, practice or course of business which operates or could operate as a fraud or deceit…."

"in connection with the purchase or sale of any security."

After examining the "relevant language, precedent, and purpose" of the Rule, the Supreme Court held that dissemination of false or misleading statements with intent to defraud can fall within the scope of Rule 10b-5(a) and (c), even if the disseminator did not "make" the statements and otherwise would fall outside the scope of Rule 10b-5(b). The Court reasoned that Lorenzo "employ[ed] a device, scheme, or artifice to defraud" within the meaning of subsection (a) of Rule 10b-5 … and "engage[d] in an act, practice, or course of business which operate[d]….as a fraud or deceit" under subsection (c) of Rule 10b-5.

The Court noted that Lorenzo did not challenge the Appellate Court's findings, and it took "for granted" that he sent the emails with the " 'intent to deceive, manipulate, or defraud the recipients.' " In holding Lorenzo liable, the Court stated that under the circumstances, "it is difficult to see how his actions could escape the reach" of the provisions of Rule 10b-5(a) and (c). Interestingly, the Court recognized that Rule 10b-5 captures a "wide range of conduct," which could present difficult problems of scope in "borderline cases." However, the Court found "nothing borderline" about the conduct in this case, where Lorenzo disseminated false or misleading information to investors with the intent to defraud. The Court distinguished Lorenzo's conduct from that of a person "tangentially involved in dissemination," such as a "mailroom clerk," for whom liability typically would be inappropriate.

The Court rejected Lorenzo's argument that his liability under Rule 10b-5(a) and (c) would render the Court's decision in *Janus* a "dead letter." The Court stated that in *Janus,* the Court considered *only* the language of Rule 10b-5(b), which prohibits "the 'mak[ing]' " of 'any untrue statement of a material fact,' " and held that the "maker" of a "statement" is the " 'person or entity with ultimate authority over the statement,' " but said "nothing" about the Rule's application to dissemination of false or misleading information. The Court stated that it

"assume[d] that *Janus* would remain relevant (and preclude liability) where an individual neither *makes* nor *disseminates* false information…."

The Court also rejected Lorenzo's argument regarding the "aiding and abetting" provision of the statute, which is enforceable only by the SEC (and not by a private person) and makes it unlawful to "knowingly or recklessly… provide substantial assistance to another person" who violates the Rule. Lorenzo claims that imposing primary liability on him would "erase or at least weaken" the clear distinction between primary and secondary (aiding and abetting) liability. In rejecting the argument, the Court recognized that it is "hardly unusual for the same conduct to be a primary violation with respect to one offense and aiding and abetting [secondary liability] with respect to another." The Court stated, "those who disseminate false statements with intent to defraud are primarily liable under Rules 10b-5(a) and (c) … even if they are secondarily liable under Rule 10b-5(b)."

Conclusion

The *Lorenzo* decision clarifies that a person who knowingly disseminates false or misleading information will be held primarily liable under the antifraud provisions of the securities laws, even if he was not the "maker" of the statement. The *Lorenzo* decision also clarifies that *Janus* still would preclude liability where a person neither "makes" nor "disseminates" false or misleading information with intent to defraud. Another effect of the *Lorenzo* decision is that it will allow private plaintiffs to pursue claims against persons who disseminate false or misleading information, something private plaintiffs had been unable to do previously. This is because prior to *Lorenzo*, a person who simply disseminated false or misleading information but was not the "maker" of the alleged misstatements would have been deemed only secondarily liable for aiding and abetting the "maker," and therefore, not subject to a private action, as only the SEC, *not* a private person can assert claims for secondary liability (aiding and abetting).

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