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Inside the Courts
An Update From Skadden Securities Litigators

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Supreme Court Rules That Misstatement From Someone Who Is Not Its 'Maker' Can Still Be Basis of Fraudulent Scheme Claim

The U.S. Supreme Court held today in *Lorenzo v. SEC*, No. 17-1077 (2019), that dissemination of false or misleading statements with an intent to defraud can fall within the scope of Rules 10b-5(a) and (c) of the Securities Exchange Act, as well as the relevant statutory provisions, even if the disseminator did not "make" the statements and consequently falls outside Rule 10b-5(b).

As the director of investment banking in a brokerage firm, petitioner Francis Lorenzo sent two emails about an investment to prospective investors, misrepresenting the value and financial condition of the company. The content of the emails was supplied by the CEO, and the emails were sent "on behalf of" the CEO of the brokerage firm, but they were signed by Lorenzo and encouraged investors to contact him with any questions.

The U.S. Court of Appeals for the District of Columbia Circuit held 2-1 (Justice Brett M. Kavanaugh dissenting) that although Lorenzo was not the "maker" of the statements and could not be held liable under Rule 10b-5(b), the Court's 2011 decision in *Janus Capital Group, Inc. v. First Derivative Traders*, 564 U.S. 135, did not bar liability under Rules 10b-5(a) and (c) of the Exchange Act and Section 17(a)(1) of the Securities Act that do not speak in terms of an individual "making" a false statement. The Court held that these provisions encompassed Lorenzo's alleged misconduct, which involved directly sending to investors materially false information with scienter.

Justice Stephen G. Breyer delivered the opinion of the Court, in which Chief Justice John G. Roberts, Jr. as well as Justices Ruth Bader Ginsburg, Samuel A. Alito, Jr., Sonia Sotomayor and Elena Kagan joined. Justice Clarence Thomas filed a dissenting opinion joined by Justice Neil M. Gorsuch. (Justice Kavanaugh recused himself from this case.)

The Court rejected the petitioner's narrow interpretation of Rule 10b-5, holding that Rule 10b-5 (a), (b) and (c) necessarily overlap, and conduct similar to Lorenzo's in this case could certainly fall within the ambit of Rule 10b-5 (a) and (c). The Court stated that it is "obvious" that the ordinary meaning of the words in these provisions is sufficiently broad to include within their scope the dissemination of false or misleading information with the intent to defraud. The Court noted that because the defendant sent the emails and understood that they contained material untruths, Lorenzo "employ[ed]" a "device,"

"scheme" and "artifice to defraud" within the meaning of subsection (a) of the Rule, Section 10(b) and Section 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 Lorenzo's argument that its holding renders Rule 10b-5(b) "superfluous," stating that there is "considerable overlap" among the subsections of the Rule and related provisions of the securities laws because at least some conduct that amounts to "employ[ing]" a "device, scheme, or artifice to defraud" under subsection (a) also amounts to "engag[ing] in a[n] act ... which operates ... as a fraud" under subsection (c). The Court also observed that a contrary conclusion would leave Lorenzo's "plainly fraudulent behavior" outside the Rule's scope even though "using false representations to induce the purchase of securities would seem a paradigmatic example of securities fraud. The Court noted that *Janus* remains relevant where an individual neither makes nor disseminates false information, provided "that the individual is not involved in some other form of fraud."

Justice Thomas, writing for the dissent, stated that the Court's holding effectively rendered *Janus* "a dead letter," because Lorenzo "undisputedly did not 'make' the false statements under Rule 10b-5(b)."

We anticipate that private plaintiffs will attempt to seize upon this decision to expand potential liability under Section 10(b). While the decision certainly has that potential, there are other rigorous requirements — such as the necessity to plead a strong inference of scienter (intent) — in order to sustain a Section 10(b) claim that should continue to temper such a movement.

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