

Inside the Courts

An Update From Skadden Securities Litigators

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In *Malouf*, Tenth Circuit Applies Supreme Court's *Lorenzo* Decision

On August 13, 2019, in the first case by a U.S. Court of Appeals to apply the U.S. Supreme Court's recent decision in *Lorenzo v. SEC*, 139 S. Ct. 1094 (2019), the U.S. Court of Appeals for the Tenth Circuit held that the defendant could be liable under Rules 10b-5(a) and (c) for knowingly failing to correct another party's material misstatements in connection with a securities transaction. See *Malouf v. SEC*, No. 16-9546, 2019 WL 3788225 (10th Cir. Aug. 13, 2019).

Dennis Malouf was an executive at two firms: a securities brokerage and an investment adviser (UASNM). Malouf sold his interest in the brokerage in a transaction that compensated him in installments based on the commissions the brokerage earned on securities sales. Afterward, Malouf steered UASNM clients to the brokerage without disclosing to the clients or UASNM his financial interest in the brokerage and despite knowing that UASNM had represented that Malouf did not have any financial conflicts. After learning of Malouf's conflicts of interest, the Securities and Exchange Commission (SEC) brought enforcement proceedings, and an administrative law judge found that Malouf had violated, among other provisions, Rules 10b-5(a) and (c), which prohibit fraudulent schemes and artifices.

The Tenth Circuit affirmed. Applying *Lorenzo*, which held that a defendant can be liable under Rules 10b-5(a) and (c) for knowingly disseminating material misstatements made by others, the Tenth Circuit reasoned that Malouf's knowledge "that a conflict existed" and "that UASNM was telling its clients that he was independent," combined with his failure "to correct UASNM's statements," constituted an unlawful fraudulent scheme. The court rejected Malouf's argument that the SEC had improperly collapsed the distinction between provisions prohibiting false or misleading statements in connection with securities transactions, which apply only to the persons or entities who themselves "make" the unlawful statements, and provisions prohibiting fraudulent schemes, which purportedly have no such limitations.

Malouf is significant as the first post-*Lorenzo* circuit court case to address whether a knowing failure to correct another's material misstatements can trigger liability under Rule 10b-5. Like *Lorenzo*, *Malouf* was decided in the context of an SEC enforcement action, and therefore, it does not necessarily reflect how *Lorenzo* may apply in a private action context. Nevertheless, plaintiffs may point to *Malouf* to suggest that *Lorenzo* broadened the universe of parties with potential Rule 10b-5 exposure.

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