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U.S. Supreme Court Skirts *Janus* Securities Liability for Distributing False or Misleading Information

By Jonathan A. Forman

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The Supreme Court of the United States recently upheld a broad interpretation of the antifraud rule[1] of the federal securities laws that likely will have far-reaching implications for enforcement and civil actions. The 6-2 decision in *Lorenzo v. Securities and Exchange Commission*[2] now imposes primary liability on a person who disseminates false or misleading information to investors with intent to defraud, even if that person did not "make" the false or misleading statement.[3] As discussed herein, by sidestepping its *Janus* precedent, the Supreme Court empowered not only the Securities and Exchange Commission (SEC) but also the securities plaintiffs' bar to go after a broader class of potential defendants who may have had only a minor role in distributing allegedly misleading information.

Background

The case stemmed from two emails, sent by defendant Francis V. Lorenzo to prospective investors, describing the offering of debentures in his investment banking client Waste2Energy Holdings Inc.[4] The emails, which were written and approved by Lorenzo's boss, contained statements that Lorenzo knew were false.[5] In particular, the emails stated that the investment in Waste2Energy had "3 layers of protection," including $10 million in "confirmed assets" even though Lorenzo was skeptical of both that valuation and the company's intellectual property on which the valuation was based.[6] The company also had previously announced that its total assets amounted to only $370,552.[7]

The SEC thereafter charged Lorenzo and found that he had violated Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, as well as Section 17(a)(1) of the Securities Act of 1933.[8] On appeal, Lorenzo argued that he lacked the intent required to find those violations and that he could not be held liable for the false statements because he did not "make" them according to *Janus Capital Group, Inc. v. First Derivative Traders*.[9] Previously, in Janus, the Supreme Court held that to be a "maker" of a statement under Rule 10b-5(b), one must have "ultimate authority over the statement, including its content and whether and how to communicate it."[10] In that case, the Supreme Court found that an investment adviser who had merely "participat[ed] in the drafting of a false statement" that was "made" by another person could not be held liable in a private action under that subsection.[11]

Although the U.S. Court of Appeals for the District of Columbia Circuit rejected Lorenzo's lack of intent argument (with one judge dissenting) and agreed that he did not violate Rule 10b-5(b), the D.C. Circuit sustained the SEC's finding that Lorenzo violated other parts of Rule 10b-5, namely subsections (a) and (c), as well as Sections 10(b) and 17(a)(1).[12]

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1. SEC Rule 10b-5 makes it unlawful: "(a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of a material fact . . . , or (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit . . . in connection with the purchase or sale of any security." 17 C.F.R. § 240.10b-5 (2018).
2. Justice Breyer wrote the majority opinion as joined by Chief Justice Roberts and Justices Ginsburg, Alito, Sotomayor, and Kagan, whereas Justice Thomas penned the dissent as joined by Justice Gorsuch. Justice Kavanaugh took no part in the consideration or decision of the case because he was involved in its consideration below.
3. 587 U.S. __, *1-2 (2019).
4. 587 U.S. at *2-3.
5. *Id.* at *3.
6. *Id.*
7. *Id.*
8. *Id.*
9. *Id.* at *4.
10. 564 U.S. 135, 142 (2011).
11. *Id.* at 145.
12. *Id.*

Lorenzo then filed a petition for certiorari on the issue of "whether someone who is not a 'maker' of a misstatement under Janus can nevertheless be found to have violated the other subsections of Rule 10b-5 and related provisions of the securities laws, when the only conduct involved concerns a misstatement."[13] Notably, Lorenzo did not challenge the D.C. Circuit's scienter finding.[14]

The Majority Opinion

The majority opinion affirmed the D.C. Circuit decision, noting that "Congress intended to root out all manner of fraud in the securities industry" and provided the "Commission the tools to accomplish that job."[15] Specifically, the opinion reasoned that it was "obvious" that Rule 10b-5 and Sections 10(b) and 17(a)(1) were worded "sufficiently broad to include within their scope the dissemination of false or misleading information with the intent to defraud."[16]

The opinion noted that there was "nothing borderline" about finding that Lorenzo's conduct violated these provisions.[17] The opinion distinguished Lorenzo's misconduct from other situations, like a "mailroom clerk" where liability would typically be inappropriate, noting that Lorenzo "sent false statements directly to investors, invited them to follow up with questions, and did so in his capacity as vice president of an investment banking company."[18] In this sense, it appears that Justice Breyer used basic agency principles to guide whether it is reasonable to impose primary liability for a person's involvement in the dissemination of false or misleading information.

The opinion rejected Lorenzo's argument that Rule 10b-5(b) is the only part of the rule that regulates false statements, reasoning that both "this Court and the Commission have long recognized considerable overlap among the subsections of the Rule and related provisions of the securities laws."[19] Holding otherwise, the opinion reasoned, could allow "plainly fraudulent" behavior to "fall outside the scope of the Rule."[20]

The opinion also rejected the contention by Lorenzo and the dissent that it renders Janus meaningless, explaining that the Court's previous decision did not speak to Rule 10b-5's application to the dissemination of false or misleading information.[21] Instead, the opinion noted that Janus "would remain relevant (and preclude liability) where an individual neither makes nor disseminates false information – provided, of course, that the individual is not involved in some other form of fraud."[22]

The opinion similarly rejected Lorenzo's argument that the D.C. Circuit's decision blurred the line between primary and secondary liability, reasoning that holding otherwise could allow fraudulent conduct to fall through the regulatory cracks.[23] As a hypothetical, the opinion posed the situation where "a 'maker' of a false statement does not violate subsection (b) of the Rule (perhaps because he lacked the necessary intent), a disseminator of those statements, even one knowingly engaged in an egregious fraud," would avoid secondary liability because the aiding and abetting statute requires a primary violation.[24]

The Dissent

The dissent criticized the majority opinion for "eviscerat[ing]" the distinction between primary and secondary liability in fraudulent misstatement cases and "render[ing] Janus a dead letter."[25] In particular, the dissent emphasized that "[t]he conduct-based provisions of Rules 10b-5(a) and (c) and §17(a)(1) must be interpreted in view of the specificity of these false-statement provisions, and therefore cannot be construed to encompass primary liability solely for false statements."[26] The dissent also characterized Lorenzo's misconduct as "essentially administrative [in] nature" and noted that, while it may have "*assisted* in a scheme," it was not indicative of scheming in and of itself to subject Lorenzo to liability under Rule 10b-5(a).[27] The dissent ultimately worried that the opinion would now subject persons "tangentially involved in disseminating fraudulent misstatements" (e.g., a "secretary") to primary liability for those misstatements and private lawsuits.[28]

13. *Id.*
14. *Id.*
15. *Id.* at *13
16. *Id.* at *5-6.
17. *Id.* at *7.
18. *Id.*
19. *Id.* at *7-8.
20. *Id.* at *9.
21. *Id.* at *9-10.
22. *Id.* at *10 (emphasis in original).
23. *Id.* at *10-11.
24. *Id.* at *12 (emphasis in original).
25. 587 U.S. __, *1, 9 (2019) (Thomas, J., dissenting).
26. *Id.* at *5.
27. *Id.*
28. *Id.* at *9-10.

Key Takeaways

As outlined above, this decision is notable because it broadens the scope of primary liability for misconduct that would have previously been charged as a false or misleading statement under Rule 10b-5(b). Now the SEC may pursue peripheral actors who had some role in distributing such statements under a scheme theory pursuant to Rule 10b-5(a) or (c), even if those actors only had an administrative role (as feared by the dissent) or even if they were not involved with the drafting or creating of the statement. Notably, the decision now opens the door for the securities plaintiffs' bar to bring primary liability cases against ostensibly secondary players because there is no private right of action against aiders and abettors.

Given all this, it will be interesting to see how courts apply *Lorenzo* and whether they impose an obligation on persons distributing information to verify its accuracy before, for example, copying and pasting it into an email to an investor. No doubt this issue (and others) will come to the fore as the SEC and securities plaintiffs' bar continue to push the boundaries of *Janus* after this victory.