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The Broad Impact of the Supreme Court's 'Lorenzo' Decision

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In March 2019, the Supreme Court delivered a major, and surprising, decision in *Lorenzo v. Securities & Exchange Comm.*, 139 S. Ct. 1094 (2019). Since that decision, the lower federal courts have broadly expanded liability under Rule 10b5(a,c), first by expanding it for persons who "disseminate" false or misleading information and by breathing new life into claims based on "artifices or schemes" to defraud under Rule 10b5(a,c)

Prior Caselaw

In the decades prior to *Lorenzo*, the major decisions by the Supreme Court had largely served to limit the scope of claims under Rule 10b5. In *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U. S. 164 (1994), the court found that the private right of action under 10b5(b) extended only to "primary violators" and not "aiders and abettors." Similarly, in *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U. S. 148 (2008), the court ruled that investors could not bring securities fraud actions whose allegedly deceptive acts were not known to investors at the time of the purchase or sale.

In the decision most immediately impacted by *Lorenzo*, in *Janus Capital Group, Inc. v. First Derivative Traders*, 564 U. S. 135 (2011), the court limited liability for misleading statements or omissions under Rule 10b5(b) to the "maker" of the statement, narrowly defined as the person or entity with "ultimate authority" over the statement in question.

These decisions may have set expectations that the court would continue to advance relatively defense-friendly interpretations of Rule 10b5. *Lorenzo* certainly upset that.

'Lorenzo'

The defendant, Francis Lorenzo, had sent emails to prospective investors including statements made by (and attributed to) his superior. While Lorenzo knew that the statements were false or misleading, he had relied on

previous Supreme Court precedent in *Janus* that limited liability to "makers" of statements. As a mere "disseminator," Lorenzo argued that he fell outside the reach of the statute.

In a 6-2 decision (Justice Brett Kavanaugh recused himself) the Supreme Court disagreed. While finding that prior Supreme Court precedent did protect Lorenzo from liability under Rule 10(b)(5)(b), the court held that precedent did not absolve Lorenzo from liability under two other subsections of Rule 10(b)(5), subsections (a) and (c) which respectively prohibit "artifices" and "schemes" to defraud.

The court found it "obvious" that Lorenzo's conduct fit into the plain language of the scheme or artifice liability provisions of Rule 10b-5. It rejected as "difficult to reconcile with the Rule's language" the notion offered by Lorenzo that subsection (b)—the only part of the Rule that expressly mentions speech—was supposed to be the exclusive vehicle by which speech-based claims could be pursued. The court explained that "Congress intended to root out all manner of fraud in the securities industry" and Lorenzo's conduct was "plainly fraudulent."

By so holding, the court in *Lorenzo* did two important things, both of which substantially expanded the reach of Rule 10b5.

First, and more obviously, the decision in *Lorenzo* effectively did away with the limitations in *Janus* of liability solely to "makers" of false or misleading statements. While preserving the holding in *Janus* that only such "makers" were liable under Rule 10b5(b), *id.*at 1103, the court held that persons who were not "makers" of statements, because they lacked the necessary authority, could nonetheless be liable under Rule 10b5(a) and 10b5(c).

The dissemination of such statements, the court reasoned, could render a person primarily liable for participating in a "scheme" or "artifice" to defraud: "using false representations to induce the purchase of securities would seem a paradigmatic example of securities fraud." Id. That also, the court noted, applies to mere disseminators like Lorenzo.

Second, and perhaps more importantly, throughout *Lorenzo*, the court used language that emphasized the expansiveness of the anti-fraud protections of Rule 10b5. For example, it found that even "bit participants" could be held liable for securities fraud violation under the rule, *id.* at 1104, and that the subsections of the rule deliberately overlap to cover a wide variety of fraud, *id.* at 1102. Finally, the court also said frauds may be shown without any statement being made at all, noting that "we can assume 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." *Id.* at 1103 (emphasis added).

Lower Courts Embrace 'Lorenzo'

In the year since *Lorenzo*, the lower courts have not only widely embraced *Lorenzo*'s principal holding regarding the liability of "disseminators" under Rule 10b5, but have also relied upon and expanded its other prescriptions. That includes Lorenzo's emphasis on the breadth and flexibility of Rule 10b5(a,c) in addressing fraud claims.

Unsurprisingly, the courts have adopted the central holding of *Lorenzo* that Rule 10b5(a,c) can impose liability on persons who spread false or misleading information even if they are not the "makers" of such statements, as required for liability under Rule 10b5(b): "The Court expressly held that a person could incur liability under these provisions [Rule 10b5(a,c)] when the conduct involves another person's false or misleading statement. *Id.* at 1102" *Malouf v. Sec. & Exch. Comm'n,* 933 F.3d 1248, 1260 (10th Cir. 2019), *cert. denied*, 140 S. Ct. 1551, 206 L. Ed. 2d 386 (2020); *see also U.S. Sec. & Exch. Comm'n v. Weaver*, 773 F. App'x 354, 356 (9th Cir. 2019); *Sec. & Exch. Comm'n v. Fiore*, 416 F. Supp. 3d 306, 320 (S.D.N.Y. 2019); *United States Sec. & Exch. Comm'n v. Ustian*, No. 16 C 3885, 2019 WL 7486835, at *40 (N.D. Ill. Dec. 13, 2019); *S.E.C. v. SeeThruEquity, LLC*, No. 18-CV-10374, 2019 WL 1998027, at *5 (S.D.N.Y. Apr. 26, 2019); *Merkamerica Inc. v. Glover*, No. CV196111PSGGJSX, 2019 WL 8989833, at *13 (C.D. Cal. Dec. 3, 2019); *Sec. & Exch. Comm'n v. Blackburn*, No. CV 15-2451, 2020 WL 1166995, at *2 (E.D. La. Mar. 11, 2020).

In addition, courts have firmly embraced *Lorenzo*'s vision of a series of broad, and overlapping, anti-fraud provisions embodied in subsections a, b, and c of Rule 10b5:

"Lorenzo effectively abrogated the line of cases on which defendants rely and permits liability under Rule 10b-5(a) and (c) for both making and disseminating misleading statements—despite some resulting redundancy with Rule 10b-5(b)." *United States Sec. & Exch. Comm'n v. Kameli*, No. 17 C 4686, 2020 WL 2542154, at *14 (N.D. Ill. May 19, 2020); *see also Sec. & Exch. Comm'n v. SeeThruEquity, LLC*, No. 18 CIV. 10374 (LLS), 2019 WL 1998027, at *5 (S.D.N.Y. Apr. 26, 2019).

Further, courts have relied on *Lorenzo'*s broad view of the anti-fraud provisions of Rule 10b5. In *Malouf*, the Ninth Circuit applied the logic of *Lorenzo* to extend liability to a participant in a "scheme" or "artifice" to defraud who did not disseminate a statement but instead failed to correct one made by his employer. *Id.; see also Set Capital LLC v. Credit Suisse Grp. AG*, No. 18-CV-2268 (AT)(SN), 2019 WL 3940641, at *14 (S.D.N.Y. Aug. 16, 2019),

report and recommendation adopted sub nom. Set Capital LLC v. Credit Suisse Grp. AG, No. 18CIV2268ATSN, 2019 WL 4673433 (S.D.N.Y. Sept. 25, 2019) (noting that both *Janus* and *Lorenzo* could impose liability on an otherwise responsible party for failing to correct a false or misleading statement in the appropriate circumstances).

Finally, courts have revived Rule 10b5(a,c) theories of liability, referencing "scheme" or "artifice" case law that may have seemed outdated or even disfavored prior to *Lorenzo*. In *Takata v. Riot Blockchain, Inc.*, No. CV 18-02293 (FLW), 2020 WL 2079375, at *15 (D.N.J. Apr. 30, 2020), for example, the district court held that the "artifice" and "scheme" subsections covered a wide variety of frauds, not just "market manipulation," citing a number of "scheme" or "artifice" cases from the early 2000s, in addition to *Lorenzo*.

Synthesizing *Lorenzo* with prior caselaw regarding "schemes" or "artifices" the court found that in analyzing an individual defendant's potential liability, the allegations should be viewed cumulatively, rejecting as false distinctions in this context between statements (previously thought only to be considered for Rule 10b5(b) frauds) and deceptive acts (previously thought only to be considered for Rule 10b5(a,c) frauds).

As another example, in *In re Cognizant Tech. Sols. Corp. Sec. Litig.*, No. CV166509ESCLW, 2020 WL 3026564, (D.N.J. June 5, 2020), the court found that *Lorenzo* abrogated the distinction between "statement" and "scheme or artifice" fraud, allowing plaintiffs to plead statements along with other conduct in order to show fraud. *Id.* at *18.

Conclusion

In sum, the lower courts have so far picked up not only on *Lorenzo*'s core holding, as groundbreaking as it was in expanding Rule 10b5 liability beyond the relative confines of "makers" of statements with "ultimate authority" over them, but in endorsing a broader and more expansive view of the types of fraud covered by Rule 10b5.

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