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Lorenzo v. SEC: Disseminating false information can create Rule 10b-5 liability even for those who did not "make" the false statement

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On March 27, 2019, the Supreme Court issued its opinion in *Lorenzo v. SEC*, affirming the decision of the United States Court of Appeals for the District of Columbia. The Court held that "dissemination of false or misleading statements with intent to defraud can fall within the scope" of SEC Rule 10b-5(a) and (c) even if the disseminator did not "make" the statements. Justice Breyer delivered the 6-2 opinion of the Court (Justices Thomas and Gorsuch dissented). The decision limits the reach of *Janus Capital Group, Inc. v. First Derivative Traders* (2011), in which the Supreme Court held that only those who "make" a false statement are primarily liable under 10b-5(b).

The key question presented was what constitutes "dissemination" and why that amounts to a "device, scheme, and artifice to defraud" under Rule 10b-5(a) and an "act, practice, or course of business which operates or would operate as fraud or deceit" under 10b-5(c). Here, the "dissemination" consisted of someone (Lorenzo) sending two emails to investors containing false information, but which were composed by someone else. The Court emphasized that Lorenzo disseminated the emails knowing the information was false and with an intent to defraud. In holding Lorenzo primarily liable, the Court highlighted that (1) he communicated directly with investors; (2) he invited investors to ask him follow-up questions; and (3) he sent the emails "in his capacity as vice-president of an investment banking company". In so holding, the Court stressed that the fundamental policy of the securities law is to protect the market from the spread of misinformation: "Congress intended to root out all manner of fraud in the securities industry. And it gave to the Commission the tools to accomplish that job." The Court also made clear, however, that not everyone – they used the example of a mailroom clerk – would be liable for dissemination.

The decision is notable because in *Janus*, a divided Court held that an individual who helped to draft a misleading statement that was then issued by a different entity was not primarily liable as the "maker" of that statement for purposes of SEC Rule 10b-5(b). Under *Janus,* the "maker" of a statement is "the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it." *Lorenzo* makes clear that *Janus* only addressed the "making" of a statement and "said nothing about Rule 10b-5's application to persons disseminating false or misleading information." Thus, the Court in *Lorenzo* noted that *Janus* would still apply (and preclude primary liability) "where an individual neither makes nor disseminates false information."

Lorenzo is a case brought by the SEC, not a private action. But by opening the defendant up to primary liability under Rule 10b-5(a) and (c), the Court paved the way for private rights of actions against persons

communicating statements to investors, even where that person is not the "maker" of a false or misleading statement.

Background

Lorenzo was director of investment banking at a registered broker-dealer. His main client was a start-up preparing an offering in convertible debentures based on a forthcoming technology. When the start-up ultimately failed to deliver that technology, the company became worthless. Lorenzo knew this, but—at the request of his boss—emailed two potential investors information prepared by his boss which contained false assurances about the start-up's financial standing.

The Securities and Exchange Commission found that Lorenzo had violated the Securities Act of 1933 § 17(a), the Securities Exchange Act of 1934 § 10(b), and SEC Rule 10b-5, which render it unlawful to wilfully defraud (or engage in a scheme to defraud) purchasers through the intentional or negligent misstatement or omission of a material fact relevant to the sale of securities. (Both Lorenzo's boss and the registered broker-dealer were charged, but they settled with the SEC.)

Lorenzo appealed to the United States Court of Appeals for the District of Columbia, which upheld the SEC's findings. The D.C. Circuit, relying on *Janus*, reversed the holding that Lorenzo violated Rule 10b-5(b), which specifically renders "mak[ing] any untrue statement of a material fact" unlawful, because it was Lorenzo's boss who "made" the statement. But the DC Circuit nonetheless held that Lorenzo could be primarily liable under two other sub-sections of Rule 10b-5 for engaging in a "fraudulent scheme." Then Circuit Judge (now Justice) Kavanaugh dissented from the "fraudulent scheme" holding. Specifically, he disagreed with the premise that one could "willfully engage[] in a scheme to defraud" without "making" fraudulent statements, where the "scheme" was based entirely on a statement or omission. (Justice Kavanaugh recused himself from the Supreme Court's consideration of the case.)

Implications

The Court's opinion clarifies *Janus* by holding that, under certain circumstances, a person "can" be primarily liable under Rule 10b-5(a) and (c) even if not the "maker" of a statement under 10b-5(b). The Circuit courts had been divided on this issue, so it will be important to watch how the lower federal courts now implement *Lorenzo* and the concept of "dissemination." The decision also will focus attention on the knowledge of the person disseminating information, because in *Lorenzo* it was accepted that the defendant knew that the emails he was sending contained false and misleading information.

Lorenzo is significant because the Supreme Court confirmed the idea that anyone responsible for communicating to investors, even if not individually responsible for the content of those communications, may incur primary liability for disseminating information they know to be false or misleading.

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