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## Lorenzo v. SEC: Blurring the Line Between Primary and Secondary Securities Fraud Liability

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## LORENZO V. SEC: BLURRING THE LINE BETWEEN PRIMARY AND SECONDARY SECURITIES FRAUD LIABILITY

*Brian Elzweig\**

### I. INTRODUCTION

In 2019, the Supreme Court decided *Lorenzo Securities v. Securities Exchange Commission*.<sup>1</sup> *Lorenzo* held that a person can be held primarily liable for securities fraud if they disseminate a material misstatement in connection with the sale or purchase of securities, even if they did not originally make the statement<sup>2</sup> In doing so, the Court expanded its previous holding in *Janus Capital Group v. First Derivative Traders*, which held that a maker of a statement is the one who has ultimate authority over that statement.<sup>3</sup> If all other elements of securities fraud are met, *Lorenzo* now allows for primary liability for making or disseminating a misrepresentation.<sup>4</sup> This allows for primary liability for a secondary violation of the scheme liability provisions of the Securities Act of 1933 (Securities Act)<sup>5</sup> and the Securities Exchange Act of 1934 (Exchange Act).<sup>6</sup> *Lorenzo*'s impact on aiding and abetting claims under the securities laws will likely be decided in future cases. Aiding and abetting liability is limited to Securities and Exchange Commission ("SEC") enforcement actions and not allowed in private lawsuits.<sup>7</sup> Allowing for assignment of primary liability to secondary actors will aid private rights of action for fraud, because private rights of action are allowed for primary violations of securities fraud. *Lorenzo*'s expansion of primary liability blurs the line between primary liability and secondary liability in securities fraud cases. However, many questions as to the breadth of this expansion are left unanswered. The SEC will have expanded power in enforcement actions because it can charge more people as primary violators. Private rights of action for securities fraud will also be impacted. Private rights of action require more elements to make a prima facie case for fraud than does an SEC enforcement action. Two of these required elements—scienter and reliance—may be difficult to prove for private plaintiffs. This Article first examines the enactment

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1. 139 S. Ct. 1094 (2019).
2. *Id.* at 1099.
3. 564 U.S. 135, 137 (2011).
4. *Lorenzo*, 139 S. Ct. at 1104.
5. 15 U.S.C. § 77 (2012).
6. 15 U.S.C. § 78 (2012).
7. *Lorenzo*, 139 S. Ct. at 1103.

of securities fraud statutes. Next, this Article discusses the *Lorenzo* case's effect on *Janus*. The Article then discusses how *Lorenzo* distinguishes and expands other cases. Finally, the Article discusses how future litigation in the areas of scienter and reliance will likely shape securities fraud jurisprudence in light of *Lorenzo*.

## II. THE ANTI-FRAUD PROVISIONS OF THE SECURITIES ACT AND THE EXCHANGE ACT

In response to the stock market crash of 1929, Congress enacted major securities reforms to promote honesty and fairness in the United States securities markets. One such reform was the Securities Act of 1933, which covers the initial issuance of securities to investors by requiring “full and fair disclosure of information to the public in the sales of [those] securities.”<sup>8</sup> The following year, Congress promulgated the Exchange Act to regulate “post-distribution trading on the [n]ation’s stock exchanges and securities trading markets.”<sup>9</sup> This regulation was designed to prevent fraudulent ongoing securities transactions after the initial offering of the securities to the public.<sup>10</sup> Together the Securities Act and the Exchange Act were implemented to restore faith in the securities markets after the crash.

To aid enforcement of the provisions of the Securities Act and the Exchange Act, each act added broad antifraud provisions. Specifically, Section 10(b) of the Exchange Act and SEC Rule 10b-5 are the major antifraud enforcement mechanisms.

Rule 10b-5 states that it is:

unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

- (a) To employ any device, scheme, or artifice to defraud,
- (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
- (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.<sup>11</sup>

The main antifraud provision in the Securities Act is Section 17(a), which states:

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8. *Pinter v. Dahl*, 486 U.S. 622, 646 (1988).

9. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 752 (1975).

10. *Cyan, Inc. v. Beaver Cty. Emps. Ret. Fund*, 138 S. Ct. 1061, 1066 (2018).

11. 17 C.F.R. § 240.10b-5 (2007).

It shall be unlawful for any person in the offer or sale of any securities ... or any security-based swap agreement...by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.<sup>12</sup>

The SEC created rule 10b-5 by adapting the language of Section 17(a).<sup>13</sup> Courts have held that the two provisions require essentially the same elements because of their shared foundation in common law.<sup>14</sup> While these provisions are similar, however, there are some key differences between the two. *Aaron v. SEC* held that scienter is required to prove a violation of Section 10(b) and Rule 10b-5 “regardless of the identity of the plaintiff or the nature of the relief sought.”<sup>15</sup> Actions under Section 17(a)(1) also require a finding of scienter; however, actions under section 17(a)(2) and (3) only require proof of negligence.<sup>16</sup> Section 17(a) is more limited than Section 10b and Rule 10b-5 in that it only creates liability in SEC enforcement actions and does not allow for private rights of action.<sup>17</sup> Section 10(b) and all of the subsections of Rule 10b-5 allow for SEC actions.<sup>18</sup> Rule 10b-5(b) also allows for a private right of action. *Lorenzo* implies this private right of action is extended to cases brought under Rule 10b-5 subsections (a) and (c). The relationship between the subsections of Rule 10b-5 is important due to the implications that *Lorenzo* has on allowing for private rights of action under those subsections. Because of the similarity between the text of Rule 10b-5 and Section 17(a) they are often discussed together under the auspices of Section 10(b) and Rule 10b-5. This Article discusses the two fraud provisions in a similar fashion, except in areas where the differences between the two are relevant.

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12. 15 U.S.C. § 77q(a) (2012).

13. Andrew P. Arnold, *Two Faces of Janus in the District Courts: Is Liability for Securities Fraud under Section 17(a) Limited to Actors with "Ultimate Authority" over Untrue Statements?*, 91 N.C. L. REV. 1054, 1064 (2013).

14. *Id.*

15. 446 U.S. 680, 691 (1980).

16. *Id.* at 696.

17. *Touche Ross & Co. v. Redington*, 442 U.S. 560, 568-71 (1979).

18. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 731 (1975).

III. THE FACTS OF *LORENZO*

The Court examined the relationship between Rule 10b-5's subsections in *Lorenzo*.<sup>19</sup> At issue in *Lorenzo* was whether a person could be liable for disseminating a false or misleading statement when that person was not the maker of the statement.<sup>20</sup> Francis Lorenzo was the director of investment banking at Charles Vista, LLC ("Charles Vista"), a registered broker-dealer firm.<sup>21</sup> Lorenzo's only investment banking client at the time was Waste2Energy Holdings, Inc. (Waste2Energy),<sup>22</sup> which was developed to turn solid waste into clean energy.<sup>23</sup> Waste2Energy claimed to have developed gasification technology that generated electricity by converting solid waste to gas.<sup>24</sup> In June of 2009, Waste2Energy filed a Form 8-K ("8-K") with the SEC containing unaudited financial statements that claimed its total assets were worth around \$14 million.<sup>25</sup> \$10 million of this was attributed to intangible assets consisting mainly of intellectual property relating to the gasification process.<sup>26</sup> Waste2Energy's business was modeled around its gasification technology, and the company faced financial ruin when its technology failed to live up to its potential.<sup>27</sup> In September 2009, to combat its financial issues, Waste2Energy made an offering of up to \$15 million of convertible debentures.<sup>28</sup> In conjunction with the debentures, Waste2Energy issued a Private Placement Memorandum claiming that its intangibles were still worth \$10 million.<sup>29</sup> Charles Vista was hired as the sole placement agent for the debentures.<sup>30</sup> Lorenzo later testified that he doubted Waste2Energy's stated valuation, claiming that the intangibles were a "dead asset" because the gasification technology "didn't really work."<sup>31</sup>

After an audit, Waste2Energy issued an amended 8-K on October 1, 2009, stating that its intangible assets were worthless. With the gasification technology not performing as planned, management

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19. *Lorenzo v. Sec. & Exch. Comm'n*, 139 S. Ct. 1094, 1100 (2019).

20. *Id.* at 1099.

21. *Id.*

22. *Id.*

23. *Id.*

24. *Lorenzo v. Sec & Exch. Comm'n*, 872 F.3d 578 (D.C. Cir. 2017), *aff'd*, 139 S. Ct. 1094 (2019).

25. Gregg C. Lorenzo, Francis V. Lorenzo, and Charles Vista, LLC, Release No. 544, 107 SEC Docket 5934, 2013 WL 6858820, at \*3 (Dec. 31, 2013).

26. *Lorenzo*, 139 S. Ct. at 1099.

27. *Lorenzo*, 872 F.3d at 581.

28. *Id.*

29. *Id.*

30. *Id.*

31. *Lorenzo v. Sec. & Exch. Comm'n*, 139 S. Ct. 1094, 1099 (2019).

determined that the intangible assets “should have been valued at zero.”<sup>32</sup> This left the total asset value of Waste2Energy at \$370,552.<sup>33</sup> On the same day, Waste2Energy also filed a Form 10-Q (“10-Q”) which listed the total asset value of the company as \$660,408 as of June 30, 2009.<sup>34</sup> Lorenzo’s secretary alerted him when Waste2Energy filed the amended 8-K.<sup>35</sup> The next day, Lorenzo emailed all of Charles Vista’s brokers with links to the both the 10-Q and 8-K.<sup>36</sup>

On October 14, 2009, about two weeks after his secretary alerted him to the amended 8-K, Lorenzo was directed by his boss to send two emails to prospective investors in the debenture offering.<sup>37</sup> Lorenzo’s boss supplied the content of the emails, which stated that investing in Waste2Energy’s debenture offering had “3 layers of protection: (I) [Waste2Energy] has over \$10 mm in confirmed assets; (II) [Waste2Energy] has purchase orders and LOI’s for over \$43 mm in orders; (III) Charles Vista has agreed to raise additional monies to repay these Debenture holders (if necessary).”<sup>38</sup> The emails were signed by Lorenzo as “Vice President — Investment Banking,” and directed the recipients to call him with any questions.<sup>39</sup> The emails did not contain any information about Waste2Energy’s asset devaluation.<sup>40</sup> The information that Lorenzo sent in the emails was “cut and pasted” from information that was sent to him by his boss.<sup>41</sup> The emails also stated that they were sent at the request of the owner of Charles Vista.<sup>42</sup>

The SEC brought an administrative action against Lorenzo, his boss, and Charles Vista.<sup>43</sup> Lorenzo was charged with willfully violating Section 10(b) of the Exchange Act and SEC Rule 10b-5, and Section 17(a)(1) of the Securities Act.<sup>44</sup> The administrative law judge (“ALJ”) who heard the case found that Lorenzo violated the antifraud provisions because the emails contained material misstatements and omissions.<sup>45</sup> The ALJ noted:

[T]he evidence shows that [Lorenzo] was reckless—although he knew that [Waste2Energy] was in terrible financial shape, he sent the emails without

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32. *Lorenzo*, 872 F.3d at 581.

33. *Id.*

34. *Id.*

35. *Id.*

36. *Id.*

37. *Lorenzo v. Sec. & Exch. Comm’n*, 139 S. Ct. 1094, 1099 (2019).

38. *Lorenzo*, 872 F.3d at 581.

39. *Lorenzo*, 139 S. Ct. at 1099.

40. *Id.*

41. *Id.* at 1107 (Thomas, J., dissenting).

42. *Id.*

43. *Id.* at 1099.

44. *Lorenzo*, 2013 WL 6858820, at \*6.

45. *Id.* at \*7.

thinking. Had he taken a minute to read the text, he would have realized that it was false and misleading and that [Waste2Energy] was not worth anything near what was being represented to potential investors. Also, he cannot escape liability by claiming that [his boss] ordered him to send the emails. The fact that [his boss] contributed to the misrepresentation does not relieve Frank Lorenzo from responsibility.<sup>46</sup>

Based on its findings, the ALJ ordered that Lorenzo cease and desist from committing or causing future violations of the antifraud provisions.<sup>47</sup> Additionally, the ALJ ordered Lorenzo to pay a civil money penalty of \$15,000 and barred him from any further participation in the securities industry.<sup>48</sup> On review of the ALJ's order, the SEC affirmed the penalties.<sup>49</sup>

Having exhausted his administrative remedies, Lorenzo appealed the SEC's decision.<sup>50</sup> Because Rule 10b-5(b) makes it illegal to "make any untrue statement of a material fact or to omit to state a material fact,"<sup>51</sup> Lorenzo argued that his boss was the maker of the statements contained in the emails, rather than Lorenzo himself.<sup>52</sup> Because the emails were sent upon order from his boss, and any false information contained therein was supplied by his boss, Lorenzo argued that his boss was the maker of the statements.<sup>53</sup> The definition of maker had previously been interpreted in *Janus*, as will be discussed below in Part IV.<sup>54</sup>

#### IV. RECONCILING *LORENZO* WITH *JANUS*

##### A. *The Court's Decision on Janus*

*Janus* involved Janus Capital management ("JCM"), an investment advisor for mutual funds.<sup>55</sup> JCM was a wholly owned subsidiary of Janus Capital Group ("JCG").<sup>56</sup> JCG created the Janus family of mutual funds.<sup>57</sup> The mutual funds were organized in a trust called the Janus Investment

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46. *Id.*

47. *Id.* at \*10.

48. *Id.*

49. Francis V. Lorenzo, SEC Release No. 9762, 111 SEC Docket 1761, 2015 WL 1927763, at \*17 (Apr. 29, 2015).

50. Lorenzo v. Sec. & Exch. Comm'n, 872 F.3d 578, 580 (D.C. Cir. 2017), *aff'd*, 139 S. Ct. 1094 (2019).

51. 17 C.F.R. § 240.10b-5(b) (2007).

52. *Lorenzo*, 872 F.3d at 587.

53. *Id.* at 587.

54. Janus Capital Grp., Inc. v. First Derivative Traders, 564 U.S. 135, 142-48 (2011).

55. *Id.* at 137.

56. *Id.* at 138.

57. *Id.*

Fund.<sup>58</sup> The Janus Investment Fund was a separate legal entity from JCG, and was owned by mutual fund investors.<sup>59</sup> Janus Investment Fund used JCM as its investment adviser and fund administrator.<sup>60</sup> First Derivative Traders (“First Derivative”) was an owner of JCG stock.<sup>61</sup> Janus Investment Fund stated in its prospectuses that the funds were not suitable for market timing.<sup>62</sup> The prospectuses alluded to Janus Investment Funds creating policies to curb its market timing practices.<sup>63</sup> After the prospectuses were made public, the New York Attorney General filed a lawsuit against JCG and JCM alleging that JCG made secret arrangements to allow market timing of JCM funds.<sup>64</sup> JCM received a significant part of its value from fees paid by Janus Investment Fund that were based on the value of the company’s holdings.<sup>65</sup> After the allegations became known, fund investors withdrew large amounts of money from the funds.<sup>66</sup> Because the withdrawal caused JCM to lose management fees, JCG’s stock value fell by nearly twenty-five percent.<sup>67</sup>

First Derivative, as the representative of a class, initiated a private action against JCM and JCG, alleging that the two entities “caused mutual fund prospectuses to be issued for Janus mutual funds and made them available to the investing public, which created the misleading impression that [JCG and JCM] would implement measures to curb market timing in the Janus [mutual funds].”<sup>68</sup> The stockholders alleged that this caused inflation of JCG’s prices.<sup>69</sup> First Derivative further claimed that “JCG and JCM ‘materially misled the investing public’” because investors relied on the market price as an accurate value of the stock;<sup>70</sup> and finally, that JCM violated Rule 10b-5 and that JCG was liable for JCM’s actions because it was a “controlling person” under Section 20 of the Securities Act.<sup>71</sup>

*Janus* focused on whether JCM itself was the maker of the statements contained in the misleading prospectuses.<sup>72</sup> The Court first examined First Derivative’s claim that the “well-recognized and uniquely close

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58. *Id.*

59. *Id.*

60. *Id.*

61. *Id.* at 140.

62. *Id.* 138-39.

63. *Id.* at 139.

64. *Id.*

65. *Id.* at 139-40.

66. *Id.* at 139.

67. *Id.* at 140 (citation omitted).

68. *Id.*

69. *Id.*

70. *Id.* (citation omitted).

71. *Id.*

72. *Id.* at 141.



relationship between a mutual fund and its investment adviser” suggested a relationship of influence between Janus Investment Fund and JCM.<sup>73</sup> The Court dismissed First Derivative’s argument that this made JCM a “maker” because it would broaden Rule 10b-5’s scope, and create “a theory of liability similar to—but broader in application than . . . what Congress has already created expressly elsewhere.”<sup>74</sup> The Court opined that would make an influential relationship equivalent to a controlling party.<sup>75</sup> Congress had already decided who would be liable as a controlling party in Section 20 of the Exchange Act, and declined to include a relation of influence.<sup>76</sup>

First Derivative further claimed that JCM was the maker of the misleading statement because it had been significantly involved in the preparation of the prospectuses. The Court held that “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.”<sup>77</sup> “Without such authority, it is not ‘necessary or inevitable’ that any falsehood will be contained in the statement.”<sup>78</sup> The Court noted that publishing another person’s statement does not render that person a maker of the statement.<sup>79</sup> To illustrate, the Court noted that “[t]his rule might best be exemplified by the relationship between a speechwriter and a speaker. Even when a speechwriter drafts a speech, the content is entirely within the control of the person who delivers it. And it is the speaker who takes credit—or blame—for what is ultimately said.”<sup>80</sup> Because only Janus Investment Fund had a statutory obligation to create the prospectuses, it controlled the content.<sup>81</sup> As the controller of the content, in alignment with its legal duties, Janus Investment Fund, not JCM, was the maker of the statements in the prospectuses.<sup>82</sup> The Court also noted that its conclusion was consistent with *Central Bank of Denver, N. A. v. First Interstate Bank of Denver, N.A.*,<sup>83</sup> which held that Rule 10b-5’s private right of action does not include suits against aiders and abettors.<sup>84</sup> “Such suits—against entities that contribute ‘substantial assistance’ to the

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73. *Id.* at 145.

74. *Id.* at 146.

75. *Id.*

76. *Id.*

77. *Id.* at 142.

78. *Id.* at 144.

79. *Id.* at 142.

80. *Id.* at 143.

81. *Id.* at 146-47.

82. *Id.*

83. 511 U.S. 164 (1994). *Central Bank’s* holding that there is not private right of action for aiders and abettors of securities violations is discussed *infra*.

84. *Janus*, 564 U.S. at 143.

making of a statement but do not actually make it—may be brought by the SEC, but not by private parties.”<sup>85</sup> “A broader reading of ‘make,’ including persons or entities without ultimate control over the content of a statement, would substantially undermine *Central Bank*.”<sup>86</sup>

*B. Finding Liability for Non-Makers Disseminating False or Misleading Statements*

The Court in *Lorenzo* illustrated that Lorenzo was not a maker, as defined by *Janus*, of the false statements in Waste2Energy’s 8-K.<sup>87</sup> Using the speechwriter analogy, the Court noted that *Janus* “meant that an investment adviser who had merely ‘participat[ed] in the drafting of a false statement’ ‘made’ by another could not be held liable in a private action under subsection (b) of Rule 10b-5.”<sup>88</sup> When examining the case, the D.C. Circuit held that *Janus* foreclosed Lorenzo’s liability under Rule 10b-5(b).<sup>89</sup> To be liable under this subsection, a person must have made an untrue statement of material fact in connection with the sale or purchase of securities.<sup>90</sup> The Court did not question this finding.<sup>91</sup> The Court agreed that Lorenzo was not the maker of any false statements regarding the sale of Waste2Energy debentures.<sup>92</sup> Instead, the Court had to determine whether Lorenzo could be liable under other parts of Rule 10b-5 and Section 17(a)(1) for disseminating false statements that were made by another person.<sup>93</sup>

The Court first focused on Rule 10b-5 Subsections (a) and (c).<sup>94</sup> Rule 10b-5(a) makes it illegal to “employ any device, scheme, or artifice to defraud” in connection with the sale or purchase of securities.<sup>95</sup> Violations of this provision are referred to as scheme liability.<sup>96</sup> Rule 10b-5(c) prohibits engaging in fraudulent courses of business in connection with the sale or purchase of securities.<sup>97</sup> Section 17(a)(1) and (3) contain similar prohibitions against scheme liability and fraudulent

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85. *Id.*

86. *Id.*

87. *Lorenzo v. Sec. & Exch. Comm’n*, 193 S. Ct. 1094, 1099 (2019).

88. *Id.* at 1098-99, quoting *Janus*, 564 U.S. 145.

89. *Lorenzo v. Sec. & Exch. Comm’n*, 872 F.3d 578, 586 (D.C. Cir. 2017), *aff’d*, 139 S. Ct. 1094 (2019).

90. 17 C.F.R. § 240.10b-5(b) (2007).

91. *Lorenzo*, 139 S. Ct. at 1099.

92. *Id.* at 1100.

93. *Id.* at 1099.

94. *Id.* at 1100.

95. 17 C.F.R. § 240.10b-5(a) (2007).

96. Robert A. Prentice, *Scheme Liability: Does It Have A Future After Stoneridge?*, 2009 WIS. L. REV. 351, 353 (2009).

97. 17 C.F.R. § 240.10b-5(c) (2007).

courses of business as those found in Rule 10b-5 sections (a) and (c).<sup>98</sup> The Court did not consider Lorenzo's liability under Section 17(a)(3) because the SEC did not charge him with a violation of that section.<sup>99</sup>

Lorenzo contended that the charge against him related to a false statement made in connection with the sale of a security.<sup>100</sup> Lorenzo noted that Rule 10b-5(b) and Section 17(a)(2) specifically prohibit false claims, and that they are the exclusive section under which he could be charged.<sup>101</sup> Because the other sections of Rule 10b-5 dealt with fraud provisions other than making false statements, allegations under those sections are limited to accusations of scheme liability.<sup>102</sup> Lorenzo claimed that because Subsection (b) is that only part of Rule 10b-5 containing a prohibition against making false statements, it is the only section that can be used to charge for such actions.<sup>103</sup> In other words, Lorenzo argued that because he was not the maker of the statements, he had not violated Rule 10b-5(b), and because the case arose from false statements, he had not violated the scheme liability sections of Rule 10b-5(a) and (c).<sup>104</sup>

The Court looked to the language of Rule 10b-5(a) and (c) and Section 17(a)(1).<sup>105</sup> Lorenzo had previously admitted that he was skeptical of the valuation of Waste2Energy's intangible valuation prior to sending the email directed by his boss,<sup>106</sup> and admitted that he knew the gasification process did not work.<sup>107</sup> Further, Waste2Energy publicly disclosed, and Lorenzo was told, that Waste2Energy's intellectual property was worthless and had been written off.<sup>108</sup> When the email containing the misstatement was sent, Lorenzo knew that Waste2Energy's assets were worth around \$370,000, not \$10 million in "confirmed assets" as was referenced in the emails.<sup>109</sup> In applying the rule and statute referencing these facts, the Court found that Lorenzo could be primarily liable under the scheme liability provisions of Rule 10b-5 and Section 17(a).<sup>110</sup> In its analysis, the Court relied on the plain meaning of the words in those provisions.

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98. 15 U.S.C. §77q (a)(1)-(3).

99. *Lorenzo*, 139 S. Ct. at 1100.

100. *Id.* at 1101.

101. *Id.*

102. *Id.*

103. *Id.* at 1102.

104. *Id.* at 1101. The SEC did not charge Lorenzo with violations of the scheme liability subsections of Section 17(a)(2) and (3).

105. *Id.*

106. *Id.* at 1099.

107. *Id.*

108. *Id.*

109. *Id.*

110. *Id.* at 1102.

Using expansive dictionary definitions, the Court stated “[a] ‘device,’ . . . is simply ‘[t]hat which is devised, or formed by design’; a ‘scheme’ is a ‘project,’ ‘plan[,] or program of something to be done’; and an ‘artifice’ ” is “ ‘an artful stratagem or trick.’”<sup>111</sup> In the Court’s opinion, the plain language of Rule 10b-5(c) and Section 17(a)(1) showed that Lorenzo’s conduct had violated those provisions.<sup>112</sup> Additionally, the Court noted that Lorenzo did not challenge the circuit court’s finding that he acted with scienter, so it was assumed that his actions were done with “intent to deceive, manipulate and defraud.”<sup>113</sup> Disseminating false statements with such intent was considered by the Court an “artful strategy or a plan, devised to defraud an investor.”<sup>114</sup> The Court used a similar approach when analyzing whether any of Lorenzo’s statements violated Rule 10b-5(c). The Court noted that the words “act” and “practice” have similarly expansive definitions, and that Lorenzo had engaged in an act, practice or course of business that operates as a fraud or deceit.<sup>115</sup> By doing so, Lorenzo had violated Rule 10b-5(c).<sup>116</sup> Using these expansive definitions to allow for primary liability under those fraud provisions, the Court cautioned that determining whether there is a violation may be problematic in borderline cases.<sup>117</sup> However, the Court stated it saw “nothing borderline about this case, where the relevant conduct (as found by the [SEC]) consist[ed] of disseminating false or misleading information to prospective investors with the intent to defraud.”<sup>118</sup>

In its discussion, the Court noted that the individual sections of Rule 10b-5 and Section 17(a) were not mutually exclusive as Lorenzo had argued.<sup>119</sup> Instead, the Court ruled that the same defendant can be both primarily liable under 10b-5(b) as well as secondarily liable under Subsections (a) and (c). Lorenzo argued that this would make<sup>120</sup> a “dead letter.”<sup>120</sup> In *Janus*, the Court stated that a person without control of a statement “can merely suggest what to say, not ‘make’ a statement in its own right. One who prepares or publishes a statement on behalf of another is not its maker.”<sup>121</sup> In his dissenting opinion, Justice Thomas agreed with

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111. *Id.* at 1101, quoting WEBSTER’S INTERNATIONAL DICTIONARY 713, 2234, 157 (2d ed. 1934)) (internal quotations omitted).

112. *Id.*

113. *Id.* (citation omitted).

114. *Id.* (citation omitted).

115. *Id.*

116. *Id.*

117. *Id.*

118. *Id.*

119. *Id.* at 1102.

120. *Id.* at 1103.

121. *Janus Capital Grp., Inc. v. First Derivative Traders*, 564 U.S. 135, 142 (2011).

Lorenzo that the Court's interpretation of 10b-5 liability could not be reconciled with *Janus*.<sup>122</sup> The majority, however, distinguished *Janus* by noting that *Janus* dealt with draft misstatements that were then issued by an altogether different entity.<sup>123</sup> In that case there was no liability under Rule 10b-5(b).<sup>124</sup> The Court noted that *Janus* was silent about Rule 10b-5(b)'s application to the dissemination of false or misleading information. The Court stated 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."<sup>125</sup> The dissent opined the majority's attempt to preserve *Janus* was illusory because its opinion would make administrative actions brought because of a misstatement qualify as "other forms of fraud"<sup>126</sup>

### *C. Blurring the Line between Primary and Secondary Liability*

Lorenzo also argued that permitting liability for disseminating false information by a person other than the maker would blur the line between primary liability and secondary liability for securities fraud.<sup>127</sup> Lorenzo argued that Section 20(e) of the Exchange Act, which regulates aiding and abetting a securities fraud, addresses secondary liability.<sup>128</sup> Section 20(e) gives liability to secondary violators as if they were primary violators in SEC enforcement actions, stating:

[A]ny person that knowingly or recklessly provides substantial assistance to another person in violation of a provision of [the Exchange Act], or of any rule or regulation issued under [the Exchange Act], shall be deemed to be in violation of such provision to the same extent as the person to whom such assistance is provided.<sup>129</sup>

Lorenzo averred that allowing his conduct to be considered a primary violation Rule 10b-5 would "erase or weaken" the clear distinction between primary and secondary liability in Exchange Act violations.<sup>130</sup> Lorenzo argued, and the dissent agreed, that *Janus* "drew a clear line between primary and secondary liability in fraudulent-misstatement

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122. *Lorenzo*, 139 S. Ct. at 1107 (Thomas, J., dissenting). Justice Gorsuch joined Justice Thomas in his dissenting opinion.

123. *Id.* at 1103.

124. *Id.*

125. *Id.*

126. *Id.* at 1110 (Thomas, J., dissenting).

127. *Id.* at 1103.

128. *Id.*

129. 15 U.S.C. § 78t(e) (2011).

130. *Lorenzo*, 139 S. Ct. at 1103.

cases.”<sup>131</sup> The dissent opined that a person who lacks ultimate authority over a statement does not make the statement and therefore cannot be primarily liable.<sup>132</sup> The person, however, could be found liable as an aider and abettor under principles of secondary liability.<sup>133</sup> The dissent opined that allowing for a person who is not a maker to be primarily liable for a fraudulent misstatement “eviscerates” the distinction created by *Janus*.<sup>134</sup> In doing so, the dissent also accused the majority of misconstruing securities law and subverting precedent in a way that has “far-reaching consequences.”<sup>135</sup> The dissent alleged that the majority did what the Court declined to do in *Janus*, which is to impose broad liability for fraudulent misstatements, leaving aiding and abetting “almost nonexistent.”<sup>136</sup>

The majority distinguished *Janus* noting that the Court did not believe its decision had the effect of weakening the distinction between primary and secondary liability.<sup>137</sup> The Court noted that it is not unusual for the same action to lead to liability for the actor to be an aider and abettor regarding one offense, and being primarily liable for another.<sup>138</sup> It used the example that “John...might sell Bill an unregistered firearm in order to help Bill rob a bank, under circumstances that make him primarily liable for the gun sale and secondarily liable for the bank robbery.”<sup>139</sup> The dissent responded by claiming that the majority’s example dealt with two separate and distinct offenses. *Lorenzo* is different, the dissent claimed, because the majority’s example uses two distinct crimes with different punishments.<sup>140</sup> The Court’s interpretation would use subsections of a statute, Rule 10b-5(a) and (c), to eliminate limitations in a neighboring provision of the same law, Rule 10b-5(b).<sup>141</sup> Further, the dissent noted that this interpretation could not only be used in SEC enforcement actions, but could also lead to a non-maker who assisted in making a misstatement being open to private lawsuits.<sup>142</sup> In *Central Bank of Denver, NA v. First Interstate Bank of Denver*, the Court specifically disallowed private rights of actions against secondary violators under Rule 10b-5.<sup>143</sup> *Lorenzo* and

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131. *Id.* at 1105-06 (Thomas, J., dissenting).

132. *Id.* at 1106.

133. *Id.*

134. *Id.*

135. *Id.*

136. *Id.* at 1110 (quoting *Janus Capital Grp., Inc. v. First Derivative Traders*, 564 U.S. 135, 143 (2011)).

137. *Id.* at 1103.

138. *Id.*

139. *Id.* at 1103-04.

140. *Id.* at 1110 (Thomas, J., dissenting).

141. *Id.*

142. *Id.*

143. 511 U.S. 164, 177 (1994).

the dissent argued that this would drastically change the landscape of private securities litigation.<sup>144</sup>

## V. THE IMPACT OF *LORENZO* ON PRECEDENT

Over the last several decades, there has been a trend towards limiting actions against securities issuers.<sup>145</sup> Commenters were varied in their opinions on how the *Lorenzo* decision would affect this trend. Most seem to agree that the decision will make SEC enforcement actions more common.<sup>146</sup> However, *Lorenzo*'s impact on private litigation invites more disputes.<sup>147</sup> *Lorenzo* and the dissent make two fundamental claims. First, a question arises as to whether *Lorenzo* blurs or eliminates the distinction between primary and secondary liability under the Exchange Act. Second, allowing liability for people who are not makers of false or misleading statements under the scheme liability provisions of Rule 10b-5 would greatly increase the scope of coverage of the rule. *Lorenzo* cited two Supreme Court cases to bolster his position that allowing for him to have primary liability would end, or at least substantially diminish, the distinction between primary and secondary liability: *Central Bank of Denver* and *Stoneridge*.<sup>148</sup>

### A. *Lorenzo*'s effect on *Central Bank of Denver*

Although the SEC brought action against *Lorenzo*'s boss as well,, *Lorenzo* was not charged with aiding and abetting his boss's violations.<sup>149</sup> Instead, he was charged with primary liability under Rule 10b-5. Charging *Lorenzo* with primary liability is significant because *Central Bank of Denver* held that the private right of action under Rule 10b-5 did not extend to aiders and abettors.<sup>150</sup> Prior to *Central Bank*, many courts

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144. *Lorenzo*, 139 S. Ct. at 1104.

145. Joel C. Haims et al., *Does 'Lorenzo' Expand the Scope of Private Securities Litigation?*, N.Y. L.J. (May 31, 2019).

146. See, e.g., JAY B. SYKES, CONG. RESEARCH SERV., LSB10293, LIES AND SCHEMES: SUPREME COURT EXPANDS SECURITIES FRAUD LIABILITY (Apr. 29, 2019), available at <https://crsreports.congress.gov/product/pdf/LSB/LSB10293>; Joshua G. Hamilton, et al., *Supreme Court Ruling Extends Reach of Primary Liability for Securities Fraud*, 2480 LATHAM & WATKINS CLIENT ALERT (Apr. 2, 2019), <https://www.lw.com/thoughtLeadership/Supreme-Court-Ruling-Extends-Reach-of-Primary-Liability-for-Securities-Fraud>; and Martin J. Crisp, David Hennes & R. Daniel O'Connor, *Lorenzo v. SEC: Expanded Scope of Securities Fraud Liability*, HARV. L. SCH. F. ON CORP. GOV. (APR. 14, 2019), <https://corpgov.law.harvard.edu/2019/04/14/lorenzo-v-sec-expanded-scope-of-securities-fraud-liability/>.

147. See, e.g., *Id.* But see, e.g., Haims et al., *supra* note 145.

148. *Lorenzo*, 139 S. Ct. at 1104.

149. *Id.* at 1106 (Thomas J., dissenting).

150. *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 191 (1994).

allowed for private rights of action for aiding and abetting securities violations.<sup>151</sup> *Central Bank* revolved around investments in the Colorado Springs–Stetson Hills Public Building Authority (the “Authority”).<sup>152</sup> In 1986 and 1988 the Authority issued a total of \$26 million worth of bonds to finance improvements to a planned residential and commercial development in Colorado Springs.<sup>153</sup> Central Bank of Denver served as indenture trustee for the bonds.<sup>154</sup> The bonds were secured by liens on land and contained a covenant requiring that the value of the land must be at least 160% of the bonds.<sup>155</sup> Due to declining property values in the area, there were allegations the property values did not meet the required amount.<sup>156</sup> To evaluate these concerns, Central Bank of Denver first conducted an in-house appraisal of the land.<sup>157</sup> The in-house appraiser recommended that the bank get an outside appraisal.<sup>158</sup> Central Bank of Denver delayed reviewing the outside appraisal until six months after the bond closing dates.<sup>159</sup> The Authority defaulted on the bonds prior to Central Bank conducting its independent review of the appraisal.<sup>160</sup> The respondents had purchased \$2.1 million dollars of the bonds.<sup>161</sup> The respondents sued the underwriters of the bonds and claimed that Central Bank of Denver, by delaying the review of a suspicious appraisal, was an aider and abettor to the underwriters’ violation and were therefore also liable under §10(b).<sup>162</sup>

Using the wording of the statute, the Court found that Central Bank of Denver could not be held liable for aiding and abetting because Section 10(b) did not allow such private rights of action.<sup>163</sup> The Court noted that Congress could have specifically allowed for those type of lawsuits when drafting the statute.<sup>164</sup> In its discussion the Court held that Section 10(b) “prohibits only the making of a material misstatement (or omission) or the commission of a manipulative act.”<sup>165</sup> If the Court allowed for a private right of action for aiding and abetting, it would be tantamount to

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151. Haims et al., *supra* note 145.

152. *Cent. Bank of Denver*, 511 U.S. at 167.

153. *Id.*

154. *Id.*

155. *Id.*

156. *Id.*

157. *Id.*

158. *Id.* at 168.

159. *Id.*

160. *Id.*

161. *Id.*

162. *Id.*

163. *Id.* at 176.

164. *Id.* at 176-77.

165. *Id.* at 177.



judicially created law.<sup>166</sup> In its opinion, the Court “could not amend the statute to create liability for acts that are not themselves deceptive within the meaning of the statute.”<sup>167</sup> The Court did note that aiding and abetting “ought to be actionable” at times, but it was not the purview of the judiciary to create policy.<sup>168</sup> The Court, however, gave a strong warning that there are times secondary actors may still be liable under the securities laws.<sup>169</sup> The Court stated that:

Any person or entity, including a lawyer, accountant, or bank, who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser or seller of securities relies may be liable as a primary violator under 10b-5, assuming *all* of the requirements for primary liability under Rule 10b-5 are met.<sup>170</sup>

The Court articulated the necessary requirements for a private party to state a claim under Rule 10b-5 in *Dura Pharmaceuticals, Inc. v. Boudo*.<sup>171</sup> *Dura Pharmaceuticals* laid out a six-part test to determine whether a private party would have a claim under section 10(b).<sup>172</sup> It was determined, by summarizing previous cases, that the required elements are:

(1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation.<sup>173</sup>

After *Central Bank*, a split arose in the federal circuits as to whether a private party can recover under a theory of scheme liability. The Ninth Circuit took the position in *Simpson v. AOL Time Warner* that “conduct by a defendant that had the principal purpose and effect of creating a false appearance in deceptive transactions as part of a scheme to defraud is conduct that uses or employs a deceptive device within the meaning of § 10(b).”<sup>174</sup> The *Simpson* decision noted that *Central Bank* did not allow for private recovery for aiding and abetting liability, but it did caution that secondary actors may still be liable as a primary violator under Section 10(b).<sup>175</sup>

The Eighth Circuit, in *In re Charter Communications Inc. Securities*

166. *Id.* at 177-78.

167. *Id.*

168. *Id.* at 177.

169. *Id.* at 191.

170. *Id.* (emphasis supplied).

171. 544 U.S. 336 (2005).

172. *Id.* at 341-42.

173. *Id.* (citations omitted).

174. 452 F.3d 1040, 1052 (9th Cir. 2007).

175. *Id.* at 1042-43.

*Litigation*<sup>176</sup>, took a more limiting approach to *Central Bank*. The Eighth Circuit stated that *Central Bank* stood for three principles.<sup>177</sup> First, there is a categorical declaration that private plaintiffs may not bring a case for acts that Section 10(b) does not specifically prohibit.<sup>178</sup> Second, absent some misstatement or a failure to disclose by a person who has a duty to disclose, a device or contrivance is not deceptive.<sup>179</sup> Third, the term “manipulative” in Section 10(b) is limited to illegal trading practices such as wash sales, matched orders or rigged pricing intended to mislead investors.<sup>180</sup> Applying these principles, the Eighth Circuit stated that “any defendant who does not make or affirmatively cause to be made a fraudulent misstatement or omission, or who does not directly engage in manipulative securities trading practices, is at most guilty of aiding and abetting and cannot be held liable under § 10(b) or any subpart of Rule 10b-5.”<sup>181</sup> The Fifth Circuit took a similar approach to the Eighth Circuit’s interpretation of *Central Bank* in *Regents of the University of California v. Credit Suisse First Boston*.<sup>182</sup>

#### *B. Lorenzo’s effect on Stoneridge*

In *Stoneridge*, the Court addressed the split in the circuits by granting certiorari to review *In re Charter Communications*.<sup>183</sup> Although not necessary for its holding, in *Central Bank*, the Court noted that element of reliance was missing.<sup>184</sup> The Court noted the plaintiffs could not show that they relied on Central Bank of Denver’s misstatement or omission.<sup>185</sup> The Court did not offer much analysis why the *Central Bank* plaintiffs lacked reliance, but it is presumably because the case was premised on Central Bank of Denver’s inaction in timely performing an appraisal. It was not based on a misstatement or omission in connection with the sale or purchase of securities so there was no statement to rely on. The Court noted that there were no allegations that Central Bank of Denver committed a “deceptive or manipulative act within the meaning of Section 10(b).”<sup>186</sup> Instead, it was only claimed that Central Bank was secondarily

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176. 443 F.3d 987 (8th Cir. 2006).

177. *Id.* at 992.

178. *Id.*

179. *Id.*

180. *Id.* (citing *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 475 (1977)).

181. *Id.*

182. 482 F.3d 372 (5th Cir. 2007).

183. *Stoneridge Inv. Partners, L.L.C. v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 156 (2008).

184. *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 180 (1994).

185. *Id.*

186. *Id.* at 191.

liable for aiding abetting the fraud.<sup>187</sup> As such, the Court stated that “because of [its] conclusion that there is no private aiding and abetting liability under § 10(b), Central Bank may not be held liable as an aider and abettor.”<sup>188</sup>

The Court delved further into the reliance requirement in *Stoneridge* than it did in *Central Bank*. *Stoneridge* involved a class action lawsuit filed by investors in Charter Communications, Inc. (“Charter”), a cable television supplier.<sup>189</sup> The lead plaintiff was Stoneridge Investment Partners (“Stoneridge Partners”), a group of investors in Charter.<sup>190</sup> Charter was involved in a scheme with two of its suppliers, Scientific Atlanta and Motorola.<sup>191</sup> To meet Charter’s quarterly financial estimates, “it misclassif[ied] . . . its customer base; delayed reporting of terminated customers; improper[ly] capitaliz[ed] costs that should have been shown as expenses; and manipulate[ed] . . . the company’s billing cutoff dates to inflate reported revenues.”<sup>192</sup> Scientific Atlanta and Motorola supplied cable boxes for Charter.<sup>193</sup> Scientific Atlanta and Motorola entered into an arrangement with Charter where Charter would overpay for cable boxes, and the overpayment would then be used for Scientific Atlanta and Motorola to purchase advertising at an inflated rate back from Charter.<sup>194</sup> In violation of Generally Accepted Accounting Principles, Charter recorded the advertising as revenue and capitalized the purchase of the cable boxes.<sup>195</sup> These agreements allowed Charter to inflate its revenue and cash flow by approximately \$17 million.<sup>196</sup> The transactions allowed Charter to fool its auditors into approving financial statements that met revenue expectations.<sup>197</sup> Stoneridge Partners lost money on stock purchases in Charter, and brought the private action alleging violations of Section 10(b) and Rule 10b-5.<sup>198</sup>

The Court noted that a deceptive act in a private right of action under Rule 10b-5 does not necessarily have to be from a statement or omission.<sup>199</sup> Conduct itself could be deceptive.<sup>200</sup> The Court, as it did in

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187. *Id.*

188. *Id.*

189. *Stoneridge Inv. Partners, L.L.C. v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 153 (2008).

190. *Id.*

191. *Id.*

192. *Id.*

193. *Id.* at 154.

194. *Id.*

195. *Id.*

196. *Id.*

197. *Id.*

198. *Id.* at 152.

199. *Id.* at 158.

200. *Id.*

*Central Bank* noted that private rights of actions under Section 10b are not permitted in cases against aiders and abettors.<sup>201</sup> However, the Court did note that conduct of a secondary actor may be deceptive, and therefore actionable, if all of the elements of Rule 10b-5 are present.<sup>202</sup> The Court focused on whether the reliance element of Rule 10b-5 was met.<sup>203</sup> Reliance is met when the “requisite causal connection between a defendant’s misrepresentation and a plaintiff’s injury” exists.<sup>204</sup> The Court noted that there were two circumstances in which a rebuttable presumption of liability can occur under Section 10(b).<sup>205</sup> First, when there is an omission of a material fact by a person with a duty to disclose, the investor to whom the duty is owed does not need to prove specific proof of reliance.<sup>206</sup> Second, if a deception becomes public, reliance can be met using the fraud-on-the-market theory.<sup>207</sup> The fraud-on-the market theory was created in *Basic v. Levinson*, which stated:

[I]n an open and developed securities market, the price of a company’s stock is determined by the available material information regarding the company and its business . . . . Misleading statements will therefore defraud purchasers of stock even if the purchasers do not directly rely on the misstatements . . . . The causal connection between the defendants’ fraud and the plaintiffs’ purchase of stock in such a case is no less significant than in a case of direct reliance on misrepresentations.<sup>208</sup>

The fraud-on-the market theory assumes that markets are efficient and, therefore, all public information is built into the price of a security.<sup>209</sup> This creates a rebuttable presumption that a purchaser of securities can rely on the market price of a security as a proxy of all public information about the security.<sup>210</sup> The Court in *Stoneridge* noted that Scientific Atlanta and Motorola had no duty to disclose its deceptive acts, nor were the deceptive acts communicated to the public.<sup>211</sup> The Court opined that without direct reliance between Stoneridge Partners and the deceptive act, the requisite causal connection, and therefore the reliance element of Rule 10b-5, could not be met.<sup>212</sup> The Court also examined whether scheme liability would

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201. *Id.*

202. *Id.*

203. *Id.* at 159.

204. *Id.* (quoting *Basic v. Levinson*, 485 U.S. 224, 243 (1988)).

205. *Id.*

206. *Id.*

207. *Id.*

208. *Basic v. Levinson*, 485 U.S. 224, 241-42 (1988) (quoting *Peil v. Speiser*, 806 F.2d 1154, 1160-61 (3d Cir. 1986)).

209. *Erica P. John Fund, Inc. v. Halliburton*, 563 U.S. 804, 810 (2011).

210. *Id.* at 811.

211. *Stoneridge*, 552 U.S. at 159.

212. *Id.* at 166-67.

make Scientific Atlanta and Motorola, although secondary actors, primarily liable using the fraud-on-the-market theory.<sup>213</sup> Stoneridge Partners argued that because of the efficiency of the markets, the market price of the stock that it purchased reflected the Scientific Atlanta and Motorola's deception.<sup>214</sup> The Court noted that if reliance were met under the fraud-on-the-market theory, "the implied cause of action would reach the whole marketplace in which the issuing company does business."<sup>215</sup> The Court specified that there was no authority to expand the reach of Section 10(b) in this way. Further, the Court noted that even if causation could be found in that way, the deception was not "in connection with the purchase or sale of any security" as required by Section 10(b).<sup>216</sup>

#### VI. SEC ENFORCEMENT ACTIONS AFTER *LORENZO*

Certainly, the *Lorenzo* opinion will be an aid to the SEC in enforcement actions. Allowing for a person to be primarily liable under the scheme liability provisions of Rule 10b-5 will give the SEC another weapon in these actions. One comment noted that "it [is not] surprising that the Supreme Court believes that the SEC is able to bring a case against an individual that knowingly disseminates a fraudulent statement in connection with a securities transaction."<sup>217</sup> This is especially important when a person, like Lorenzo, was a vice president of an investment banking firm. Lorenzo, although not the maker of a misstatement, knowingly distributed those misstatements to potential clients.<sup>218</sup> Further, Lorenzo knew that people receiving the statements would use them in their decisions on whether to purchase securities.<sup>219</sup> Interestingly, the primary basis of Lorenzo's appeal to the D.C. Circuit was that he lacked scienter, and therefore that required element of Section 10(b) and Rule 10b-5 would be missing.<sup>220</sup> The D.C. Circuit rejected the lack of intent argument.<sup>221</sup> In the Supreme Court, Lorenzo's defense focused primarily on the fact that he was not the maker of the misstatements, and he did not challenge the D.C. Circuit's finding that he acted with scienter.<sup>222</sup> By doing so, the SEC could assume that, in Lorenzo's case,

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213. *Id.* at 159-60.

214. *Id.* at 160.

215. *Id.*

216. *Id.* (quoting 15 U.S.C. § 78j(b)).

217. Crisp et al., *supra* note 146.

218. *Id.*

219. *Id.*

220. *Id.*

221. *Id.*

222. *Id.*

he sent the emails with the intent to deceive the potential investors.<sup>223</sup> With the emails being sent in connection with the sale or purchase of securities, and assuming the intent to deceive, it is easy to see that the SEC would like to quell that type of behavior. SEC enforcement actions will be aided by the fact that the Court held the different subsections of Rule 10b-5 were not mutually exclusive.<sup>224</sup> This ruling provides a path for the SEC to act on claims of scheme liability to be made for the dissemination of a false statement by one who is not the maker of the statement. However, in order to do so, all the requisite requirements of primary liability under Rule 10b-5 must be met.<sup>225</sup> The Court in *Lorenzo* also noted that the SEC does not have to meet the element of reliance in its enforcement actions in order to prove liability under Rule 10b-5.<sup>226</sup> Private plaintiffs, however, do need to prove that they relied on the defendant's action to be successful in a lawsuit.<sup>227</sup>

The Court, by requiring that all of the elements of Rule 10b-5 must be met in order for a secondary party to be liable as a primary violator, is likely signaling that these cases may only be brought against the most egregious violators.<sup>228</sup> However, the Court gave few parameters as to how much involvement and what level of control a non-maker must have over a statement that is disseminated to be considered primarily liable for fraud.<sup>229</sup> The Court admits that applying primary liability for secondary actors may “present difficult in problems of scope in borderline cases.”<sup>230</sup> The Court however did not think that *Lorenzo*'s actions were borderline. The Court stated that *Lorenzo*, with the intent to defraud, “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.”<sup>231</sup> The Court noted that there would be people who are tangentially involved in the dissemination of a fraudulent statement where liability would be inappropriate.<sup>232</sup> An example given is a mailroom clerk.<sup>233</sup> Justice Thomas, in his dissent in *Lorenzo*, took umbrage with this characterization, stating that “[t]he fact that *Lorenzo* ‘sent false

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223. *Id.*

224. *Id.*

225. *Id.*

226. *Id.*

227. *Id.*

228. See, e.g., Howard Fischer, ‘*Lorenzo*’: *What Happens Next and What to Do About It?*, N.Y.L.J. (Apr. 30, 2019), available at <https://www.law.com/newyorklawjournal/2019/04/30/lorenzo-what-happens-next-and-what-to-do-about-it/>.

229. Crisp et al., *supra* note 146.

230. *Lorenzo v. Sec. & Exch. Comm'n*, 139 S. Ct. 1094, 1101 (2019).

231. *Id.*

232. *Id.*

233. *Id.*

statements directly to investors’ in e-mails that ‘invited [investors] to follow up with questions,’ puts him in precisely the same position as a secretary asked to send an identical message from her e-mail account.”<sup>234</sup> But the Court gives no further example of the difference between tangential involvement and primary liability. The difference will likely be decided in future enforcement actions.

## VII. PRIVATE RIGHTS OF ACTION AFTER *LORENZO*

The impact of *Lorenzo* on private securities actions is more ambiguous than it is on enforcement actions. The dissent in *Lorenzo* opined that the majority blurs the line between primary liability and secondary liability in fraudulent misstatement cases.<sup>235</sup> The distinction is important because there is no private right of action against aiders and abettors.<sup>236</sup> Thus, the SEC can bring a larger variety of actions than private plaintiffs. Shortly after *Central Bank*, Congress passed the Private Securities Litigation Reform Act of 1995 (“PSLRA”).<sup>237</sup> The PSLRA specifically empowered the SEC to bring actions for aiding and abetting.<sup>238</sup> By not giving private plaintiffs the same ability, it appears Congress ratified the holding in *Central Bank* that there is no private right of action for aiding and abetting.<sup>239</sup> Because *Lorenzo* was based on an SEC enforcement action, the Court did not address the effect of blurring or eliminating the distinction between primary liability and secondary liability on private plaintiffs. It does appear that private plaintiffs are now able to bring cases that would previously be considered aiding and abetting cases. As one comment noted, “[b]y effectively converting [a secondary] claim to a direct claim, *Lorenzo* added a powerful arrow to the quiver of the plaintiffs’ bar.”<sup>240</sup> Certainly, *Lorenzo* allows for primary liability under Subsections (a) and (c) of Rule 10b-5. However, the effectiveness of this new arrow in the quiver has yet to be determined. While the holding in *Lorenzo* seems expansive on its face, the impact on private rights of action will be limited by previous Supreme Court precedent. It will also be limited by the requirement that all of the elements of primary liability must be met. The Court in *Lorenzo* relied on language from *Central Bank* in holding that “even a bit participant in the securities markets ‘may be liable as a primary violator under [Rule] 10b-5’ so long as ‘all of the

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234. *Id.* at 1111 (Thomas, J., dissenting).

235. *Id.* at 1110.

236. *Id.* at 1103.

237. Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 U.S.C.).

238. 15 U.S.C. § 78t(e) (2011).

239. Crisp et al., *supra* note 146.

240. Fischer, *supra* note 228.

requirements for primary liability . . . are met.”<sup>241</sup> This point was reiterated in *Stoneridge* as well, which stated that “the implied [private] right of action in § 10(b) continues to cover secondary actors who commit primary violations.”<sup>242</sup> Future case law will need to define the framework for determining those who are only providing substantial assistance to another allowing only aiding and abetting liability, and those who have primary liability.<sup>243</sup> The line may be blurred between the two and people may be found liable for a primary violation where, prior to *Lorenzo*, they would only be aiders and abettors of a securities fraud.<sup>244</sup> However, the impact of *Lorenzo* is limited by precedent, making two of the required elements for a private right of action under Rule 10b-5 difficult to prove: scienter and reliance.

#### A. Proving Scienter

In the Supreme Court, Lorenzo did not dispute that he acted with scienter. If Lorenzo did challenge the finding of scienter, the Court would have had to show specifically how the scienter requirement was met, as the PLSRA requires that scienter be pleaded with particularity.<sup>245</sup> Rule 10b-5’s scienter requirement was recognized by the Court in *Ernst & Ernst v. Hochfelder*.<sup>246</sup> *Ernst & Ernst* held that scienter in the context of Rule 10b-5 was the “intent to deceive, manipulate, or defraud.”<sup>247</sup> Courts have adopted a recklessness standard of proof to meet the scienter requirement.<sup>248</sup> It is likely that the SEC did not doubt its ability to prove that Lorenzo acted with scienter, or it would have likely added violations of Sections 17(a)(2) and (3), which only have a negligence standard for enforcement.<sup>249</sup> The D.C. Circuit did analyze Lorenzo’s scienter in disseminating the false statements.<sup>250</sup> The court addressed many facts to show that Lorenzo acted with either an “intent to deceive or defraud, or extreme recklessness to that effect.”<sup>251</sup> It was noted that one of Lorenzo’s

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241. *Lorenzo*, 139 S. Ct. at 1104 (quoting *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 191 (1994)).

242. *Stoneridge Inv. Partners, L.L.C. v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 773-74 (2008).

243. *Crisp et al.*, *supra* note 146.

244. *Id.*

245. 15 U.S.C. § 78u-4(b)(2)(A) (2010).

246. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 188 (1976).

247. *Id.*

248. Samuel W. Buell, *What is Securities Fraud?*, 61 DUKE L.J. 511, 548-49 (2011).

249. *Aaron v. Sec. & Exch. Comm’n*, 446 U.S. 680, 701-02 (1980).

250. *Lorenzo v. Sec. & Exch. Comm’n*, 872 F.3d 578, 583-86 (D.C. Cir. 2017), *aff’d*, 139 S. Ct. 1094 (2019).

251. *Id.* at 589.



chief duties involved conducting due diligence inquiries on his clients. Lorenzo stated that he knew that Waste2Energy's gasification technology did not work before he disseminated the false statement with valuations that he knew were incorrect.<sup>252</sup> It was also shown that Lorenzo enticed people to purchase Waste2Energy's debenture based on an assertion that there was already a large purchase of the securities.<sup>253</sup> However, this was not based on a purchase agreement, but on a letter of intent that did not create an obligation to purchase the securities.<sup>254</sup>

The Court in *Lorenzo* clearly stated that "those who disseminate false statements *with intent to defraud* are primarily liable under Rules 10b-5(a) and (c), § 10(b), and § 17(a)(1), even if they are secondarily liable under Rule 10b-5(b)."<sup>255</sup> In *Geoffrey A. Orley Revocable Trust U/A/D 1/26/2000 v. Genovese*, the Southern District of New York distinguished the facts in that case from those in *Lorenzo*.<sup>256</sup> However, in doing so, the court stated "even though [Lorenzo] had not 'made' the underlying language, he could nevertheless be held liable *through a private suit* brought under paragraphs (a) and (c) of Rule 10b-5 because he disseminated the language with the intent to defraud."<sup>257</sup> This presages that many cases will likely turn on a factual examination of whether the defendant acted with scienter. The scienter requirement will likely keep future litigants from reaching potential defendants who are not closely related to the false statements in question. Justice Thomas asserted that a secretary who knowingly disseminated false information would be in the same position as Lorenzo. However, because of the normal duties and responsibilities of a secretary or mailroom clerk, it is unlikely that the actions of these individuals were done in a manner that meets the scienter requirement. Considering the Court's pronouncement that liability would be inappropriate for those only tangentially involved in disseminating as false statement,<sup>258</sup> the duties of those involved would likely be considered in future litigation. It seems hard to conflate intent equally with a person in Lorenzo's position, a vice president of an investment banking company, who had due diligence duties and expertise in the analysis of financial records of a company, with a secretary or a mailroom clerk that had no similar duties, credentials or responsibilities. While it was shown that Lorenzo acted with scienter, a secretary or mailroom clerk disseminating information does not necessarily intend to deceive the

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252. *Id.* at 583.

253. *Id.* at 585.

254. *Id.*

255. *Lorenzo v. Sec. & Exch. Comm'n*, 139 S. Ct. 1094, 1104 (2019) (emphasis added).

256. No. 18-Civ-8460-ER, 2020 WL 611506, at \*8 (S.D. N.Y., Feb. 5, 2020).

257. *Id.* (emphasis added).

258. *Lorenzo*, 139 S. Ct. at 1101.

recipient of the information. Rather, that person is likely acting as a conduit in disseminating the statement of an employer and likely does not examine the veracity of the statement.

One could imagine a scenario where a secretary had responsibilities similar to those of an executive like Lorenzo, but that would likely be rare. Further, a person in Lorenzo's position would stand to financially gain from the fraudulent misconduct, giving reason to have the intent to deceive; whereas a secretary or mailroom clerk would probably not. It would be hard to imagine a court finding that a secretary or a mailroom clerk who sent a message acted with a level of recklessness sufficient to meet the scienter requirement merely by relaying a message over which they have no control or responsibility, nor any financial incentive to deceive the recipient.

*Central Bank* specifically warned that there can be primary liability attributed to lawyers, accountants, and bankers that are secondary actors if all the requirements of Rule 10b-5 are met.<sup>259</sup> These types of professionals have more control over statements that are often disseminated in their name. They are often compiling information including statements made by other people. However, because of their expertise, it is expected that they operate with more care and responsibility than a secretary or mailroom clerk for the information that they send to people who will use the statements in a decision to purchase or sell securities. The amount of control a person has over a statement will likely determine whether scienter can be found for secondary actors to determine if primary liability can be found.

### *B. Proving Reliance*

Further cases will probably also be decided based on the element of reliance. In *Lorenzo*, the court did not address reliance as it is not a necessary element of an SEC enforcement action.<sup>260</sup> The Court in *Stoneridge* specifically rejected a fraud-on-the-market theory of reliance in scheme liability cases, as it would be an improper expansion of the scope of Section 10(b).<sup>261</sup> Without the fraud-on-the-market theory of reliance, a plaintiff would have to show a direct causal connection between a defendant's misrepresentation and the plaintiff's injury.<sup>262</sup> Allowing for a fraud-on-the market theory would make "any aider and abettor liable under § 10(b) if he or she committed a deceptive act in the

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259. *Cent. Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164, 191 (1994).

260. *Lorenzo*, 139 S. Ct. at 1104.

261. *Stoneridge Inv. Partners, L.L.C. v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 159-60 (2008).

262. *Id.* at 159.

process of providing assistance.”<sup>263</sup> This would go beyond limits that the Court found in *Central Bank* and Congress affirmed in the PSLRA.<sup>264</sup> The fraud-on-the-market theory has aided plaintiffs in meeting the reliance requirement for many securities class actions because it can be used to show reliance across the entire class.<sup>265</sup> Prior to the fraud-on-the-market theory, each plaintiff would have to show a direct causal connection between a defendant's misrepresentation and the plaintiff's injury.<sup>266</sup> Similar to an examination of the scienter requirement, reliance would distinguish those that were tangentially involved in a fraud versus those who had primary liability. The defendants in *Stoneridge* had no primary liability because although they aided in the fraud, the investing public did not directly rely on the fraudulent conduct. The defendants had no duty to disclose any information about the fraud and the fraudulent acts were not distributed to the public.<sup>267</sup> It would be easier for a plaintiff to show reliance on a person in someone like Lorenzo's position than a person who was a secretary or a mailroom clerk. *Stoneridge* makes it likely that plaintiffs would have to show reliance on the conduct of a particular defendant for that defendant to have primary liability. This would limit many class action lawsuits because, without being able to presume reliance using the fraud-on-the-market theory, all the members of the class would have had to rely on the same false statement or omission.

The Court in *Lorenzo* stated that those who are only tangentially involved in a fraud should not have primary liability for the fraud.<sup>268</sup> However, the Court also quoted *Central Bank* stating that “even a bit participant in the securities markets ‘may be liable as a primary violator under [Rule] 10b–5’ so long as ‘all of the requirements for primary liability . . . are met.’”<sup>269</sup> No reference was made to the difference between tangential involvement and a bit participant, other than stating that mailroom clerks should not have liability and Lorenzo should. However, it appears that the Court is allowing for scheme liability to be the basis of primary liability, not only for the information that was sent in the emails, but also for the overall actions causing misinformation to be disseminated. Reliance is defined as “dependence or trust by a person, esp[ecially] when combined with action based on that dependence or

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263. *Id.* at 162.

264. *Id.*

265. Note, *Congress, The Supreme Court, and the Rise of Securities-Fraud Class Actions*, 132 HARV. L. REV. 1067, 1070 (2019).

266. *Stoneridge*, 552 U.S. at 159.

267. *Id.*

268. *Lorenzo v. Sec. & Exch. Comm'n*, 139 S. Ct. 1094, 1101 (2019).

269. *Id.* at 1104.

trust.”<sup>270</sup> By emphasizing that Lorenzo disseminated “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,” it appears as if the Court is allowing that the disseminated information be relied upon as if Lorenzo had himself made the statement.

*Lorenzo* was interpreted in *In Re Longfin Corp. Securities Class Action Litigation*.<sup>271</sup> The court in *Longfin* denied dismissal of a Rule 10b-5 class action where it was alleged that an underwriter facilitated a securities issuance and exchange listing knowing that the issuance was outside of regulatory compliance. While *Longfin* did not address reliance, it noted that “[c]onduct itself can be deceptive, and so liability under § 10(b) or Rule 10b-5 does not require a specific oral or written statement.”<sup>272</sup> This seems to indicate that there could be reliance on the dissemination of misinformation if the person who received the information would perceive, from the facts surrounding the sending of the statement, that the disseminator had control over the statement. In *Lorenzo*, the receivers of the messages would have had reason to trust that Lorenzo had vetted the information contained in the messages. This would allow an inference that Lorenzo had the level of control over the statement that the Court required in *Janus*. *Janus* focused on who controlled the content of the information. It appears that *Lorenzo* would allow a non-maker who knowingly disseminated false information to create primary liability if the disseminator should be relied upon. If a message containing a misrepresentation was disseminated by a mailroom clerk, the receiver might rely on the information, but not necessarily think that it was scrutinized for accuracy. Nor would a receiver likely rely on the mailroom clerk’s analysis of the information contained in the message, even if the mailroom clerk had reason to believe that the message contained a misrepresentation. Instead, the reliance would be on the person who had control of the message and allowed it to be disseminated.

In *Janus*, the Court used the analogy that a speechwriter who drafts a speech does not control the content of that speech.<sup>273</sup> Instead, the speaker has control over the statement and therefore takes the credit or blame for the content of the speech.<sup>274</sup> The Court noted in *Janus* that “in the ordinary case, attribution within a statement or implicit from surrounding circumstances is strong evidence that a statement was made by—and only by—the party to whom it is attributed.”<sup>275</sup> This is because people do not

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270. BLACK’S LAW DICTIONARY, (11th ed. 2011), available at Westlaw.

271. No. 18cv2933(DLC), 2019 WL 1569792, (S.D. N.Y. Apr. 11, 2019)

272. *Id.* at \*7 (quoting *United States v. Finnerty*, 533 F.3d 143, 148 (2d Cir. 2008)).

273. *Janus Capital Grp., Inc. v. First Derivative Traders*, 564 U.S. 135, 143 (2011).

274. *Id.*

275. *Id.* at 142-43.

rely on the action of the speechwriter when interpreting the content of the speech. People rely on the speaker because the credentials and knowledge of the speaker give the speaker control over the information in the speech. Lorenzo was acting in a similar fashion to a person delivering a speech. Although he did not make the statements in the message, because of the wording of the information sent, along with other factors such as his position as vice president and his credentials as a director of a registered broker-dealer, the statements should be attributed to him. As such, the receivers should be able to rely on the information contained in the message.

### VIII. CONCLUSION

The *Lorenzo* decision expands the reach of SEC enforcement actions by adding a new weapon: it allows for primary liability for a disseminator who is not a maker of a statement. *Lorenzo* allows a person to be charged as a primary violator using scheme liability provisions found in 10b-5 sections (a) and (c), and under Section 17(a). This would eliminate the fear, laid out by the Court in *Lorenzo*, that finding secondary liability can prove illusory in cases where the maker of a false or misleading statement has not violated Rule 10b-5(b).<sup>276</sup> Not allowing a person to be primarily liable in a scheme liability case would allow a person, even one who is knowingly engaged in an egregious fraud, to escape liability for aiding and abetting. This is because an aider and abettor can only be charged where there is a primary violator.<sup>277</sup> Further, the aider and abettor can only be found liable for the violation to the same extent as the person with primary liability.<sup>278</sup> However, SEC enforcement actions do not require all of the same elements as a private right of action. Section 17(a)(1) does not require proof of scienter in enforcement actions. Neither Rule 10b-5 nor Section 17(a) require that the SEC show reliance in enforcement actions.

The impact of *Lorenzo* on private rights of action has yet to be determined. The Court in *Lorenzo* expanded, but did not overturn, *Janus*.<sup>279</sup> Even though the *Janus* defendant helped draft the statement at issue, the defendant did not participate in its dissemination. The Court found no liability under Rule 10b-5 because the defendant who drafted the statement did not control the content of the statement and, therefore, was not the maker of the statement. *Lorenzo* expands *Janus* in that it allows liability for those who either make or disseminate a misstatement.

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276. *Lorenzo v. Sec. & Exch. Comm'n*, 139 S. Ct. 1094, 1104 (2019).

277. *Id.* at 1103-04.

278. 15 U.S.C. § 78t(e) (2011).

279. *Lorenzo*, 139 S. Ct. at 1099.

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The question of how much control over a statement and how much involvement in the dissemination is needed for liability to be triggered will need to be determined in future cases. The Court offered little analysis on the distinction between someone who has primary liability in the dissemination of misleading information and a person who is peripherally involved in the fraud. To determine the difference, future cases will likely be decided using a factual analysis of the elements of scienter and reliance, both of which are required in private actions under Rule 10b-5.