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SECURITIES GROUP

Supreme Court Addresses "Cut and Paste" Securities Fraud Case

By Edward B. Whittemore | March 29, 2019

Earlier this week, in Lorenzo v. SEC, the US Supreme Court held – by a 6-2 vote – that a person who disseminates false statements with the requisite intent (state of mind) can be found liable for a violation of Rule 10b–5(b), even if the person sending the false statements did not "make" the statements in question. Previously, in the Supreme Court's Janus ruling in 2011, the Court had found that to be a "maker" of a statement under subsection (b) (the "making false statements provision" of the Rule), one must have "ultimate authority over the statement, including its content and whether and how to communicate it."

Lorenzo, a former investment banker at a broker-dealer firm, was found by the SEC in 2015 to have sent to prospective investors false statements about a new waste-to-energy company attempting to raise up to $10 million in debentures. The statements about the company's assets and technology were prepared by Lorenzo's boss, and were objectively false (which Lorenzo knew to be the case). Lorenzo had put his own name and phone number on the emails and had sent them from his own email account. After he was fined and sanctioned by the SEC, Lorenzo filed suit, arguing that under Janus, that he could not be held liable as a "maker" of the statements, because his boss had asked him to send the emails, provided the substantive content, and approved the messages for distribution.

The Supreme Court rejected this claim, finding that Lorenzo's conduct ran afoul of subsections (a) and (c) of Rule 10b-5. Justice Breyer, writing for the Court, explained that "[b]y sending emails he understood to contain material untruths, Lorenzo 'employ[ed]' a 'device,' 'scheme,' and 'artifice to defraud' within the meaning of subsection (a) of the Rule, §10(b),and §17(a)(1). By the same conduct, he 'engage[d] in a[n]act, practice, or course of business" that "operate[d] . . . as a fraud or deceit' under subsection (c) of the Rule."

The Court thus made clear that the three subsections of Rule 10b-5 do not occupy mutually exclusive territory. The Court, however, vacated Lorenzo's sanctions and remanded for further consideration because the SEC had chosen the level of sanctions based in part on its incorrect conclusion that Lorenzo had "made" the allegedly false statements.

The Lorenzo decision may increase the ability of the SEC and private investors to assert claims (relying on provisions other than Rule 10b-5(b)) against persons who did not actually "make" a misstatement or omission about a security under Janus, but who nevertheless participated in its dissemination with the requisite scienter under broader anti-fraud provisions.

If you have questions about the Lorenzo decision or the scope of the liability provisions of the federal securities laws generally, please contact:
Edward B. Whittemore at ewhittemore@murthalaw.com or 860.240.6075 or
Anthony R. Leone at aleone@murthalaw.com or 617.457.4117