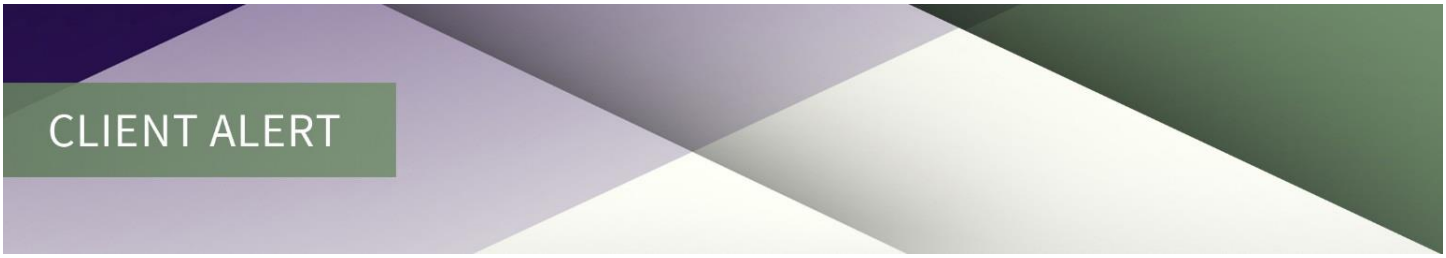


# Supreme Court Expands "Scheme Liability" In *Lorenzo v. SEC*

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Today, the United States Supreme Court issued a long-awaited decision in *Lorenzo v. Securities and Exchange Commission*, No. 17-1077. In its 6-2 decision,[1] the U.S. Supreme Court held that the dissemination of false or misleading statements with an intent to defraud an investor can give rise to liability under Rules 10b-5(a) and (c) even if the disseminator of the false information did not "make" the statements. This decision marks an expansion in so-called "scheme liability" under Section 10(b) of the Securities Exchange Act of 1934 — in contrast to the Supreme Court's landmark decisions in *Janus Capital Group Inc. v. First Derivative Traders*[2] and *Stonebridge Investment Partners, LLC v. Scientific-Atlanta, Inc*.[3]

**Background**

The appellant, Francis Lorenzo, was the director of investment banking for a registered brokerage firm. Lorenzo was advising a client, Waste2Energy, that was struggling financially and decided to sell convertible debentures. In connection with the offering, Lorenzo sent two emails "on behalf of" his boss to potential investors that failed to disclose that Waste2Energy was undergoing serious financial difficulties. Lorenzo's boss (not Lorenzo himself) supplied the content of the emails and approved the messages. After the Company's financial struggles were revealed, the SEC commenced

1 Justice Brett Kavanaugh recused himself from this matter after dissenting from the D.C. Circuit's decision below.

2 564 U.S. 135 (2011).

3 552 U.S. 148 (2008).

enforcement proceedings against Lorenzo and others charging that he had violated Rule 10b-5, §10(b) of the Exchange Act, and §17(a)(1) of the Securities Act of 1933.

An Administrative Law Judge determined that Lorenzo sent false and misleading statements to investors with an intent to defraud, and thus, his conduct violated Section 17(a)(1) of the Securities Act and all three subdivisions of Rule 10b-5, Rules 10b-5(a), (b) and (c). Lorenzo appealed and the D.C. Circuit reversed as to liability under Rule 10b-5(b). Under *Janus*, the D.C Circuit reasoned, Lorenzo was not the "maker" of the statements in the challenged emails because his boss had the final authority over the email's contents. The D.C. Circuit affirmed Lorenzo's liability, however, under Rules 10b-5(a) and (c), the so-called "scheme liability" provisions, which respectively prohibit "any device, scheme, or artifice to defraud," and "any act, practice, or course of business" that "operates…as a fraud or deceit upon any person in connection with the purchase or sale of securities."

In November 2018, the Supreme Court granted certiorari to resolve a circuit split over whether scheme liability under the federal securities laws extends to persons who would not be considered "makers" of the misstatements for purposes of the Supreme Court's test in *Janus*.

**Expanding "Scheme Liability"**

In today's majority decision (authored by Justice Breyer), the Court held that the dissemination of false or misleading statements with an intent to defraud an investor can give rise to liability under Rules 10b-5(a) and (c). The Court noted that by sending the emails with false information, Lorenzo "employ[ed]" a "device," "scheme," and "artifice to defraud" within the meaning of Rule 10b-5(a). The Court also expressly rejected Lorenzo's argument that Rule 10b-5(b) exclusively regulates conduct involving false statements. The Court stated that "using false representations to induce the purchase of securities would seem a paradigmatic example of securities fraud. We do not know why Congress or the Commission would have wanted to disarm enforcement in this way." The Court did stress that *Janus* still governs situations where the individual "neither *makes* nor *disseminates* false information—provided, of course, that the individual is not involved in some other form of fraud." Justice Thomas (with Justice Gorsuch joining) penned a forceful dissent. That dissent maintained that applying Rules 10b-5(a) and (c) to the conduct at issue would render *Janus* "a dead letter" because Lorenzo was *not* the maker of the fraudulent misstatements.[4]

**Conclusion**

Given the relatively unusual facts of *Lorenzo*—the speaker copying and pasting a statement drafted by somebody else and disseminating it with the intent of defrauding investors—*Janus* will continue to be a strong defense in private securities class actions and SEC enforcement actions predicated on the making of false statements to investors.

[4] "Today, the Court eviscerates this [primary and secondary liability] distinction by holding that a person who has not 'made' a fraudulent misstatement can nevertheless be primarily liable for it." (Thomas, J., dissenting).

However, the use of "scheme liability" in *Lorenzo* to persons who would not be considered "makers" of misstatements expands the potential scope of liability under the federal securities laws to secondary actors. As Justice Thomas stated in the dissent, *Lorenzo* may blur the line between primary and secondary liability in fraudulent misstatement cases where now "virtually any person who assists with the making of a fraudulent misstatement will be primarily liable and thereby subject not only to SEC enforcement, but private lawsuits."

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

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