The Advocate
FOR INSTITUTIONAL INVESTORS

Supreme Court Roundup

Revisiting *Lorenzo*

The Supreme Court Forces Investment Managers to Take Responsibility For Their Conduct

By Kyle Panton

As we reported in the fall 2018 issue of The Advocate, the case *Lorenzo v. SEC* concerned an investment manager who sent emails to prospective investors containing false representations about a company's financials. Because the investment manager's boss authored the false representations — and the investment manager distributed the emails at his boss's instruction — a legal ambiguity emerged: is a person who merely repeats a false and misleading statement authored by another liable under SEC Rule 10b-5(a), which prohibits any individual from using any instrument of interstate commerce to defraud in connection with the purchase of a security, and SEC Rule 10b-5(c), which prohibits any business practice that operates as a fraud in connection with the purchase or sale of a security?

With its decision in Lorenzo, the Court may be hinting at its openness to expand liability for dissemination of false statements beyond its earlier ruling in Janus.

The Supreme Court's 2018 *Lorenzo* decision followed the Court's 2011 case *Janus Capital Group, Inc. v. First Derivative Traders* in which it held that only the "maker" of a statement — that is, "the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it"— can violate SEC Rule 10b-5(b). With this precedent in place, the courts considering the *Lorenzo* case had to determine if the "maker" requirement applied to SEC Rules 10-b5 (a) and (c) as well. Both the SEC and the D.C. Circuit Court of Appeals found that, in *Lorenzo*, the investment manager's behavior did not violate Rules 10-5(b), (a), or (c). Justice Kavanaugh (then-Judge Kavanaugh) dissented in connection with the D.C. Court of Appeals opinion and thus recused himself once the Supreme Court agreed to hear the appeal.

In March 2019, the Court determined that although Lorenzo did not qualify as a "maker" of a statement under Rule 10b-5(b), he was indeed liable for violating SEC Rules 10b-5 (a) and (c). Although the investment manager did not "make" the false statements himself, he understood that he was distributing material that contained "untruths," in violation of section (a), and he understood that he engaged in a course of business that operated as a fraud, in violation of section (c). With this decision, the Court may be hinting at its openness to expand liability for dissemination of false statements beyond its initial ruling in *Janus*. We will keep our readers updated on any further developments in the *Lorenzo* and *Janus* lines of cases.

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A Chink In The Armor

The Supreme Court Leaves Section 14(e) Claims Intact — For Now

By Jesse Jensen

On April 23, 2019, the Supreme Court unexpectedly dismissed the appeal in *Emulex Corp. v. Varjabedian* as having been improvidently granted. The Supreme Court had granted certiorari in *Emulex* to address whether Section 14(e) of the Securities Exchange Act of 1934, which protects investors from fraudulent acts committed in connection with a tender offer, required a showing of mere negligence (the position of the Ninth Circuit Court of Appeals) or a showing of knowledge or recklessness (the position of the Second, Third, Fifth, Sixth, and Eleventh Circuits). Once the case was on its way to the Supreme Court, however, the defendants broached a more fundamental question: can investors sue under Section 14(e) at all? For decades, courts have recognized an *implied* private right of action under Section 14(e) — even though none exists in the text of the law. Before the Supreme Court, the defendants seized on Section 14(e)'s silence to argue that the absence of express language meant investors could not bring claims under the statute. Corporate lobbying groups, including the Chamber of Commerce, joined this attack on Section 14(e), and the Solicitor General of the United States argued that the right to enforce Section 14(e) belonged solely to the government — not to private investors.

On April 15, 2019, the debate over the private right of action dominated the *Emulex* oral argument before the Supreme Court. While Chief Justice Roberts, Justice Kavanaugh, and Justice Gorsuch appeared sympathetic to the defendants' position, several Justices — from across the political spectrum — expressed skepticism about the defendants' bait-and-switch. These Justices were concerned that, while defendants first asked the Court to address the circuit split over Section 14(e)'s pleading standards, they were now staking out a more consequential position—that private plaintiffs cannot sue under the law. For example, Justice Ginsburg chastised that the Supreme Court "is a court of review, not of first view," and Justice Alito asked the defendants' counsel why it was "appropriate" for the Court to reach an issue that had not previously been in dispute, inquiring whether doing so would be "the precedent you want us to set."

One week later, the Supreme Court dismissed the appeal as improvidently granted. The Court's procedural concerns were the likely cause, though the Court did not specify. However, that several Justices expressed their willingness to consider the existence of Section 14(e)'s private right of action all but guarantees that the issue will be back before the Supreme Court before long. When that happens, the onus will be on investors to persuade the Court not to disrupt a long-settled and important feature of the securities laws: Section 14(e)'s private right of action.

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The fact that several Justices had expressed willingness to consider the existence of Section 14(e)'s private right of action all but guarantees that the issue will be back before the Supreme Court. Then, the onus will be on investors to persuade the Court not to disrupt a long-settled and important feature of the securities laws: Section 14(e)'s private right of action.