NOTE

LORENZO V. SEC AND THE EXPANSION OF SCHEME LIABILITY: WHY COURTS SHOULD IMPLEMENT A "MODIFIED CREATOR STANDARD"

Jordan Lieberman*

In March 2019, the Supreme Court ruled in Lorenzo v. SEC *that the disseminator of a false statement over email could be held primarily liable for engaging in a scheme to defraud investors under Rules 10b-5(a) and (c). The decision has the potential to upend the Court's prior precedents limiting the scope of primary liability under 10b-5, as the Court had previously ruled that primary liability under 10b-5(b) should be limited to the attributed author of a misstatement. This Note argues for an expansive reading of* Lorenzo*, adopting a "modified creator standard" that would expand primary liability under 10b-5(a) and (c) to include a subset of participants in the creation and dissemination of a misstatement beyond its attributed author. The goal of this approach is to ensure that culpable actors cannot escape liability while also preserving the Supreme Court's emphasis on the distinction between primary and secondary liability under Rule 10b-5.*

I. Introduction 354
II. Background on Rule 10b-5 and the Private Right of Action 356

* J.D. Columbia Law School '21. I would like to thank my Note advisor Joshua Mitts for his guidance and to my family for their support. I also would like to thank the staff attorneys at SEC's New York Regional Office (NYRO), where I interned in 2019, as my experience working with them provided the inspiration for this Note topic. I lastly would like to thank my editors at the *Columbia Business Law Review* for their helpful feedback.

A. The Origins of Rule 10b-5 357
B. Limiting the Scope of the Private Right of Action 359
C. The *Janus* Decision 362
D. The Fallout from *Janus* and the Lead-up to *Lorenzo* 366
III. The *Lorenzo* Decision 368
A. Facts of *Lorenzo v. SEC* and Lower Court Decisions...368
B. Justice Breyer's Majority Opinion 371
C. Justice Thomas's Dissent 374
D. The Legal Community's Reaction to *Lorenzo* 377
IV. Defining the "Modified Creator Standard" 381
A. Why Choose the "Creator Standard" as the Framework?..382
B. The Textual Justification from *Lorenzo* for Adopting the Test 386
C. The Contours of the "Modified Creator Standard"…. 389
1. Who Is a "Creator"? 390
2. Why These "Creators"?...................................392
3. Scienter Under the "Modified Creator Standard"...395
V. The "Modified Creator Standard" and the Private Right of Action 398
A. Criticisms of the Private Right of Action...........398
B. The "Modified Creator Standard" as an Effective Fraud Deterrent 402
C. Guardrails Against Vexatious Litigation and the Issue of Reliance...406
VI. The "Modified Creator Standard" and SEC Enforcement..410
VII. Conclusion 415

I. INTRODUCTION

Securities and Exchange Commission (SEC) Rule 10b-5[1] is arguably the most important regulation in all of securities law, as it is the primary tool used to hold perpetrators of securities fraud liable for their misconduct.[2] Subsection (b) of the Rule makes it unlawful to provide false or misleading information (whether by lying or by omission) to investors, the government, or the public when it relates to the purchase or sale of securities.[3] It is commonly invoked in suits brought by both private actors and the SEC.[4] However, despite the straightforward language of the regulation, federal courts have provided a gloss on both its meaning and its scope that is sometimes counterintuitive or, at least, not apparent from the text itself.

In the 2011 case *Janus Capital Group v. First Derivative Traders*, the Supreme Court defined the "maker" of a fraudulent statement under 10b-5(b) as "the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it."[5] This means that a party that helps to draft a fraudulent statement cannot be held liable under 10b-5(b) if they do not have final control

[1] 17 C.F.R. § 240.10b-5 (2020).

[2] WILLIAM A. KLEIN, J. MARK RAMSEYER, & STEPHEN M. BAINBRIDGE, BUSINESS ASSOCIATIONS: CASES AND MATERIALS ON AGENCY, PARTNERSHIPS, LLCS, AND CORPORATIONS 447 (10th ed. 2018).

[3] The text of 10b-5(b) states that it is unlawful "[t]o 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 . . . in connection with the purchase or sale of any security." 17 CFR § 240.10b-5. Claims brought under this provision are referred to as "misstatement liability" claims. Matthew C. Turk & Karen E. Woody, *Justice Kavanaugh,* Lorenzo v. SEC*, and the Post-Kennedy Supreme Court*, 71 ADMIN. L. REV. 193, 204 (2019).

[4] In the year before *Janus Capital Group v. First Derivative Traders*, multiple circuits issued reported opinions on 10b-5(b) claims. *See, e.g.*, Badger v. S. Farm Bureau Life Ins. Co., 612 F.3d 1334 (11th Cir. 2010); Pac. Inv. Mgmt. Co. v. Mayer Brown LLP, 603 F.3d 144 (2d Cir. 2010); United States v. Schiff, 602 F.3d 152 (3d Cir. 2010); SEC v. Tambone, 597 F.3d 436 (1st Cir. 2010).

[5] Janus Cap. Grp. v. First Derivative Traders, 564 U.S. 135, 142 (2011).

over its contents.[6] The ramifications of this case were enormous, as it cabined the ability of private actors to bring suits for misstatement liability and limited the tools available to the SEC in bringing 10b-5(b) enforcement actions.[7] Yet, while *Janus* defined the scope of misstatement liability, it remained unclear whether an individual who is not the "maker" of a misstatement could be held liable for participating in crafting or disseminating it under Rule 10b-5's more general provisions, subsections (a) and (c).[8] The Supreme Court partially answered that question in March 2019 in *Lorenzo v. SEC*, which held that

> [d]issemination of false or misleading statements with intent to defraud can fall within the scope of subsections (a) and (c) of Rule 10b-5, as well as [section 17(a)(1) of the Securities Act] . . . even if the disseminator did not 'make' the statements and consequently falls outside subsection (b) of the Rule.[9]

---

[6] Rather they would have to be held liable for aiding and abetting the fraud under section 20(e) of the Securities and Exchange Act. *See* 15 U.S.C. § 78t(e) (2018).

[7] *See* Stephen M. Juris, *Janus Capital Group Inc. v. First Derivative Traders and the Law of Unintended Consequences*, FORBES (Sept. 21, 2011, 11:51AM), https://www.forbes.com/sites/insider/2011/09/21/janus-capital-group-inc-v-first-derivative-traders-and-the-law-of-unintended-consequences/ #347e80665ae7 [https://perma.cc/RC26-A7QG].

[8] Rule 10b-5(a) and (c) together state:

> It shall be 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 [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.

17 CFR § 240.10b-5. These are collectively known as the "scheme liability" provisions of 10b-5. Turk & Woody, *supra* note 3, at 205.

[9] Lorenzo v. SEC, 139 S. Ct. 1094, 1100–01 (2019).

However, the issue of how broadly the opinion should be read remains unresolved: should it be limited to the dissemination of false information, or should its holding be extended to other misconduct, such as authoring a false statement?

This Note argues that *Lorenzo v. SEC* should be broadly applied in order to enhance the private right of action under Rule 10b-5 and provide the SEC with more tools to go after people who participate in the creation and dissemination of false statements to the investing public. Specifically, it advocates for a "modified creator standard" for assessing "scheme" liability. The test would ask whether the person or entity being sued is effectively the author of the misstatement or else responsible for the statement reaching defrauded investors.

Part II of this Note will discuss the passage of Rule 10b-5 and the case law that led to *Lorenzo*. Part III will discuss the *Lorenzo* opinion in detail and the legal community's initial reaction to it. Part IV will make the case for a more expansive reading of *Lorenzo* through the adoption of the "modified creator standard" and outline the specifics of the test. Parts V and VI will discuss the policy rationales behind implementing the "modified creator standard" in both private litigation and SEC enforcement. The scope of this analysis will be limited to the judiciary's application of *Lorenzo*; solutions that would require the passage of a new statute or a new regulation are not contemplated here. Finally, Part VII concludes.

II. BACKGROUND ON RULE 10B-5 AND THE PRIVATE RIGHT OF ACTION

This Part discusses the historical background leading up to the court's decision in *Lorenzo*. It begins by discussing the origins of Rule 10b-5 and the development by the courts of the private right of action under that regulation. The next section discusses the court's jurisprudence, from the 1970s through the 2000s, limiting the scope of the private right of action under section (b) of the Rule. Finally, Section II.C discusses the court's decision in *Janus* to restrict liability under Rule 10b-5(b) to the "maker" of a false statement, and Section II.D

discusses the aftermath of *Janus* and the cases that set up the legal issue in *Lorenzo*.

A. The Origins of Rule 10b-5

Rule 10b-5 was adopted pursuant to section 10(b) of the Securities Exchange Act of 1934 (Exchange Act).[10] That statutory provision is broad in scope and applies to the sale of all securities (registered or not), but it is not self-executing, meaning that it does not prohibit anything until the SEC passes pertinent regulations.[11] The SEC passed Rule 10b-5 in 1942, nearly a decade after the enactment of the Exchange Act, under fairly unusual circumstances: the provision was written in a single day and was intentionally patterned after section 17(a) of the Securities Act of 1933 (Securities Act),[12] the main anti-fraud provision that statute.[13] The Rule

[10] Securities Exchange Act of 1934 (Exchange Act), Pub. L. No. 73-291, § 10(b), 48 Stat. 881, 891 (codified as amended at 15 U.S.C. 78j(b)) (making it unlawful "[t]o use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe as necessary or appropriate in the public interest or for the protection of investors"). The modern version differs only in its coverage of certain swap agreements. 15 U.S.C. § 78j(b).

[11] 15 U.S.C. § 78j(b).

[12] Securities Act of 1933 (Securities Act), Pub. L. No. 73-22, § 17(a), 48 Stat. 74, 84–85 (codified as amended at 15 U.S.C. 77q(a)).

[13] Theresa A. Gabaldon, *Crossing the River: Lorenzo v. SEC*, GEO. WASH. L. REV. ON THE DOCKET (Apr. 2, 2019), https://www.gwlr.org/crossing-the-river-lorenzo-v-sec [https://perma.cc/SPC9-QDMB]. Section 17(a) states:

> It shall be unlawful for any person in the offer or sale of any securities . . .
> (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.

responded to a gap within section 17(a), which only applied "to fraud or deceit upon the purchaser" but not upon the seller in a transaction.[14] Rule 10b-5 specifically made it unlawful "[t]o employ any device, scheme, or artifice to defraud,"[15] to make a misstatement or misleading omission of material fact,[16] or "[t]o engage in any act, practice, or course of business which operates . . . as a fraud or deceit upon any person"[17] in connection with the sale *or* purchase of a security. Despite these humble origins, Rule 10b-5 is now "easily the most famous, and arguably the most important, of all the SEC's many rules."[18]

While the SEC's enforcement powers are self-evident from the text of 10b-5, why there is also a private right of action may be less obvious. It is a "judicial gloss" on the text and was once referred to by then-Justice William Rehnquist as "a species of federal common law only loosely tied to the statutory text."[19] While implying a private right of action would seem strange today given the federal judiciary's adoption of textualism,[20] Justice John Paul Stevens pointed out that "[a]s was true during most of our history, the federal courts [in the 1940s] presumed that a statute enacted to

15 U.S.C. § 77q(a).

[14] *See* 15 U.S.C. § 77q(a). According to the author of the regulation, SEC Assistant Solicitor Milton V. Freeman, he simply "looked at Section 10(b) and . . . Section 17, and [he] put them together, and the only discussion [he and a fellow SEC official had] was where 'in connection with the purchase or sale' should be, and [they] decided it should be at the end." Milton V. Freeman, *Administrative Procedures*, 22 BUS. LAW. 891, 922 (1967). The SEC Commissioners unanimously approved it the same day.

[15] 17 C.F.R. § 240.10b-5(a) (2020).

[16] *Id.* § 240.10b-5(b).

[17] *Id.* § 240.10b-5(c).

[18] KLEIN ET AL., *supra* note 2, at 447.

[19] *Id.* Justice Rehnquist similarly characterized the rule's jurisprudence as "a judicial oak which has grown from little more than a legislative acorn." Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 737 (1975).

[20] That is because textualism holds "that the words of a governing text are of paramount concern and that what they fairly convey in their context is what the text means." *Textualism*, BLACK'S LAW Dictionary (11th ed. 2019). Thus, under this approach, a private right of action would not be read into a statute or regulation unless explicitly stated.

benefit a special class provided a remedy for those members injured by violations of the statute."[21] The Supreme Court has continually upheld the private right of action ever since.[22]

It is important to note that in the course of defining the scope of the private right of action, the courts also developed six elements that must be shown in order to bring a successful securities fraud action under 10b-5 as a private litigant. According to the Supreme Court, these 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."[23] These elements, in particular the scienter requirement[24] and the reliance requirement,[25] play an important role in this Note, both in understanding the cases discussed and the application of the "modified creator standard."

B. Limiting the Scope of the Private Right of Action

While the private right of action remains in place, its scope has been reduced by the courts, and, to a lesser extent,

[21] Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 501 U.S. 350, 366 (1991) (Stevens, J., dissenting) (citing Tex. & Pac. Ry. Co. v. A. R. Rigsby, 241 U.S. 33, 39–40 (1916)). The private right of action originated in *Kardon v. National Gypsum Co.*, 69 F. Supp. 512, 514 (E.D. Pa. 1946).

[22] *See* Superintendent of Ins. of N.Y. v. Bankers Life & Cas. Co., 404 U.S. 6, 13 n.9 (1971) ("It is now established that a private right of action is implied under § 10(b).").

[23] Amgen Inc. v. Conn. Ret. Plans & Tr. Funds, 568 U.S. 455, 460–61 (2013) (quoting Matrixx Initiatives, Inc. v. Siracusano, 563 U.S. 27, 37–38 (2011)).

[24] Scienter refers to "[i]ntent or knowledge of wrongdoing"—false statements or material omissions for purposes of this Note. *See Scienter*, LEGAL INFO. INST., https://www.law.cornell.edu/wex/scienter [https://perma.cc/RR8P-HGYY] (last visited Nov. 19, 2020).

[25] Reliance specifically refers to "reliance upon the misrepresentation or omission." *Amgen*, 568 U.S. at 461. It is necessary for a plaintiff to show reliance "because proof of reliance ensures that there is a proper 'connection between a defendant's misrepresentation and a plaintiff's injury.'" Erica P. John Fund v. Halliburton Co., 563 U.S. 804, 810 (2011) (quoting Basic Inc. v. Levinson, 485 U.S. 224, 243 (1988)).

Congress since the 1970s.[26] The primary reason for this is that federal courts feared the "danger of vexatious litigation which could result from a widely expanded class of plaintiffs under Rule 10b-5"[27] and thus believed that narrowing the scope for lawsuits brought by private parties would increase the proportion of meritorious suits that are litigated.

One of the most significant developments on this front was the Supreme Court's holding that a "private plaintiff may not maintain an aiding and abetting suit under [section] 10(b)" in the 1994 case *Central Bank of Denver v. First Interstate Bank of Denver*.[28] Thus, under section 10(b)—and therefore Rule 10b-5—private plaintiffs can only bring suits against those who are primarily liable for securities fraud, not those responsible for assisting with fraud. The court justified the decision on the basis that imposing aiding and abetting liability would mean that "the defendant could be liable without any showing that the plaintiff relied upon the aider and abettor's statements or actions."[29] However, there were fears that the limitations on aider and abettor liability would be extended to SEC enforcement actions as well.[30]

One year later, Congress responded by amending the Exchange Act to include section 20(e), which allowed "the SEC, but not a private plaintiff, to bring an action against 'any person that knowingly or recklessly provides substantial assistance to another person' that violated the Exchange Act

[26] This trend began with the 1975 case *Blue Chip Stamps v. Manor Drug Stores*, where the court restricted the private right of action to "actual purchasers and sellers of securities" and thus excluded decisions not to make a sale or purchase because of a false statement. 421 U.S. 723, 731, 749 (1975).

[27] *Id.* at 740.

[28] 511 U.S. 164, 191 (1994).

[29] *Id.* at 180.

[30] The SEC read the *Central Bank* decision in this way, "announc[ing] it would generally refrain from asserting aiding and abetting theories of liability unless a statute expressly provided for it." Andrew N. Vollmer, *SEC Revanchism and the Expansion of Primary Liability Under Section 17(a) and Rule 10b-5*, 10 VA. L. & BUS. REV. 273, 284 (2016) (citing John W. Avery, *Securities Litigation Reform: The Long and Winding Road to the Private Securities Litigation Reform Act of 1995*, 51 BUS. LAW. 335, 342 n.33 (1996)).

or its regulations."[31] Congress passed section 20(e) as part of the 1995 Private Securities Litigation Reform Act (PSLRA),[32] which sought to impede frivolous claims by private litigants while preserving the private right of action, recognizing that "private lawsuits promote public confidence in our capital markets and help to deter wrongdoing."[33] The statute set limitations on securities class actions and imposed heightened pleading requirements, limitations on damage awards, and sanctions for frivolous suits—all intended to discourage suits seeking to extract a settlement from defendants.[34]

The private right of action was further curtailed by the Supreme Court in the 2008 case *Stoneridge Investment Partners v. Scientific-Atlanta, Inc.*.[35] The Court held that plaintiffs "may only sue those who issued statements or otherwise took direct action that the [plaintiffs] had relied upon in buying or selling stock" and therefore could not sue third parties "that did not directly mislead [the plaintiffs] but were business partners with those who did."[36] This limited

---

[31] *Id.* (quoting 15 U.S.C. 78t(e) (2012)).

[32] Private Securities Litigation Reform Act of 1995 (PSLRA), Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 U.S.C.).

[33] H.R. REP. NO. 104-369, at 31 (1995).

[34] *See* 15 U.S.C. § 78u-4(a)–(c), (e) (2018). The heightened pleading requirements mean that a plaintiff "must specify [e]ach misleading statement and the reasons why the statement was misleading[;] [i]f an allegation is based on 'information and belief,' all facts on which that belief was formed[;] [and] [t]he facts giving rise to a strong inference that the defendant acted with the required state of mind." David M.J. Rein, Matthew A. Schwartz, & John P. Collins, Jr., *Securities Litigation Involving the Private Securities Litigation Reform Act*, PRAC. L.J.—LITIG., Oct.-Nov. 2017, at 39, 40 (bullet points omitted) (first citing 15 U.S.C. § 78u-4(b)(1)–(2); and then citing Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 345 (2005)).

[35] 552 U.S. 148 (2008).

[36] Lyle Denniston, *Court Limits Securities Fraud Lawsuits*, SCOTUSBLOG, https://www.scotusblog.com/2008/01/court-limits-securities-fraud-law [https://perma.cc/4VB8-LGF2] (last updated Jan. 15, 2008, 11:20 AM); *see also Stoneridge*, 552 U.S. at 161. The facts of the case involved claims by the plaintiff that Motorola and Scientific Atlanta helped a "giant cable TV firm, Charter Communications, inflate artificially its financial statements in order to bolster its stock's price. The investors contended that the two companies should be treated as 'primary violators,' even though

view of reliance[37] greatly reduced the class of potential defendants since private plaintiffs had to show they relied directly upon defendants' actions or misstatements: "there is no reliance, and hence no liability, when the link between [a] third party's actions and the resulting misrepresentation by the issuer is too remote or attenuated."[38]

C. The *Janus* Decision

Two years after *Stoneridge*, the Court decided *Janus Capital Group v. First Derivative Traders*, which limited primary liability under Rule 10b-5(b) to "the person or entity with ultimate authority over the [challenged] statement, including its content and whether and how to communicate it."[39] Respondent First Derivative Traders, on behalf of a class of investors in Janus Capital Group (JCG), alleged that JCG and its wholly-owned subsidiary, Janus Capital Management

---

they had not themselves issued any public statements to advance the alleged manipulation plot." Denniston, *supra*.

[37] Note that only private litigants need to show reliance. *See* Lorenzo v. SEC, 139 S. Ct. 1094, 1104 (2019) ("[T]he [SEC], unlike private parties, need not show reliance in its enforcement actions.").

[38] *See* Donald C. Langevoort, *Reading* Stoneridge *Carefully: A Duty-Based Approach to Reliance and Third-Party Liability Under Rule 10b-5*, 158 U. PA. L. REV. 2125, 2126–27 (2010). The court also noted that the fraud-on-the-market (FOTM) theory of reliance did not apply because "[r]espondents had no duty to disclose; and their deceptive acts were not communicated to the public. . . . Petitioner, as a result, cannot show reliance upon any of respondents' actions except in an indirect chain that we find too remote for liability." *Stoneridge*, 552 U.S. at 159. The FOTM presumption comes from the 1988 Supreme Court case *Basic Inc. v. Levinson*, 485 U.S. 224, 245–47 (1988), and holds that "investors could satisfy the reliance requirement by invoking a presumption that the price of stock traded in an efficient market reflects all public material information." Yaron Nili, *Supreme Court Upholds Fraud-on-the-Market Presumption in Halliburton*, HARV. L. SCH. F. ON CORP. GOVERNANCE (June 24, 2014), https://corpgov.law.harvard.edu/2014/06/24/supreme-court-upholds-fraud-on-the-market-presumption-in-halliburton [https://perma.cc/RN3K-DEW8]. This is an especially important presumption in securities class actions, as it ensures that class certification is possible without requiring each individual member of a class to show reliance. *See id.*

[39] Janus Cap. Grp. v. First Derivative Traders, 564 U.S. 135, 142 (2011).

(JCM), had participated in the preparation of a prospectus[40] "describing the investment strategy and operations of its mutual funds to investors" which fraudulently stated that the "the funds were not suitable for market timing and . . . suggest[ed] that JCM would implement policies to curb the practice."[41]

Although JCM and JCG had participated in the preparation of the prospectus, it was actually issued by the Janus Investment Fund (Janus Fund), which, despite being created by JCG, was "a separate legal entity owned entirely by mutual fund investors. . . . [that] ha[d] no assets apart from those owned by the investors."[42] Although JCM and the Janus Fund were legally independent, "[b]ecause [the Janus Fund] compensated JCM based on the total value of the fund[] and JCM's management fees comprised a significant percentage of JCG's income, [the Janus Fund's] loss of value affected JCG's value as well."[43] Thus, as investors in JCG, the respondents

---

[40] A prospectus usually is

> [a] formal written document that accompanies a new offering of a corporate security, meant to provide information to potential buyers of that security. It contains detailed information on the business' history, financial state, current business plans, the names of its directors and officers as well as any pending litigation it is involved in. The prospectus is usually an abridged version of the business' registration statement filed with the Securities and Exchange Commission.

Prospectus, LEGAL INFO. INST., https://www.law.cornell.edu/wex/prospectus [https://perma.cc/PZ6M-93WT] (last visited Jan. 19, 2021). The Securities Act, however, gives a broader definition. *See* 15 U.S.C. § 77b(10) (2018).

[41] *Janus*, 564 U.S. at 138–39. Explaining the complexities of market timing is not relevant for the purposes of this Note. It suffices to say that the practice is legal but also unpopular since "it harms other investors in [a] mutual fund." *Id.* at 139. For an explanation of market timing, see *id.* at 139 n.1.

[42] *Id.* at 138. In *Janus*, the Court explained the full relationship in more detail. For example, the Court noted that "JCM provides Janus Investment Fund with investment advisory services, which include 'the management and administrative services necessary for the operation of'" the Janus Fund. *Id.*

[43] *Id.* at 139–40.

claimed that they were harmed by an "untrue statement of a material fact" related to the fund.[44] The question became whether or not JCM could be sued under Rule 10b-5(b) based on their participation in drafting the prospectuses issued by the Janus Fund.[45]

The Court ruled that the suit could not be brought under 10b-5(b) because "[t]he statements in the Janus . . . Fund prospectuses were made by [the] Janus . . . Fund."[46] In his majority opinion, Justice Clarence Thomas noted that "[w]ithout control, a person or entity 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."[47] He also spoke to the issue of attribution, stating that "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."[48] He went on to use an analogy to speechwriting, asserting that "[e]ven 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."[49]

Justice Thomas also invoked *Central Bank*, writing,

> [a] broader reading of 'make,' including persons or entities without ultimate control over the content of a statement, would substantially undermine *Central Bank*. If persons or entities without control over the content of a statement could be considered primary violators who 'made' the statement, then aiders and abettors would be almost nonexistent.[50]

Overall, the decision meant that if someone without "ultimate authority" participated in the creation of a false

[44] *Id.* at 137–38 (quoting 17 C.F.R. § 240.10b-5(b) (2010)).

[45] *Id.*

[46] *Id.* at 148.

[47] *Id.* at 142.

[48] *Id.* at 142–43.

[49] *Id.* at 143.

[50] *Id.* For a discussion of *Central Bank*, see *supra* text accompanying notes 28–30.

statement, then they would be outside the scope of primary liability under 10b-5(b) and off-limits as defendants in private suits.

Justice Stephen Breyer's dissent took a different approach, arguing that "[n]either common English nor this Court's earlier cases limit the scope of [the word 'make'] to those with 'ultimate authority' over a statement's content."[51] Beyond repudiating Justice Thomas's textual analysis, Justice Breyer criticized Justice Thomas's invocation of *Central Bank*, claiming that "the present case is about *primary* liability—about individuals who allegedly themselves 'make' materially false statements, not about those who help *others* to do so."[52] Justice Breyer also noted the impact the Court's decision could have on SEC enforcement actions under Rule 10b-5: because aiding and abetting liability requires there to be a primary actor who can be held liable, and because in this case "the managers, not having 'ma[d]e' the statement, would not be liable as principals . . .[,] there would be no other primary violator they might have tried to 'aid' or 'abet.'"[53] Overall, Justice Breyer felt that the Court had gone too far adrift by setting such a limited definition of what constitutes being the "maker" of a statement and thereby placing participants in the crafting of false statements outside the ambit of primary liability.[54]

---

[51] *Janus*, 564 U.S. at 149–50 (Breyer, J., dissenting). Rather, Justice Breyer claimed that "both language and case law indicate that, depending upon the circumstances, a management company, a board of trustees, individual company officers, or others, separately or together, might 'make' statements contained in a firm's prospectus—even if a board of directors has ultimate content-related responsibility." *Id.* at 150.

[52] *Id.* at 153. He specifically noted that

> [t]he *Central Bank* defendant concededly did *not* make the false statements in question (others did), while here the defendants allegedly *did* make those statements. And a rule (the majority's rule) absolving those who allegedly *did* make false statements does not "follow from" a rule (*Central Bank's* rule) absolving those who concededly did *not* do so.

Id.

[53] *Id.* at 157 (first alteration in original).

[54] *See id.* at 160–61.

D. The Fallout from *Janus* and the Lead-up to *Lorenzo*

After *Janus* was decided, the question became whether private litigants and the SEC could find a way that avoids the roadblocks put up by *Janus* to bring primary liability claims against those who participate in the making of false statements or omissions. One avenue was to make use of Rule 10b-5(a) and (c)—the "scheme" liability provisions[55] not addressed in *Janus*—to hold participants liable for their participation in a scheme to defraud investors. This resulted in a circuit split, based primarily on whether misconduct related to misstatements could be litigated under the scheme liability provisions or whether such claims were restricted to 10b-5(b).

Many courts rejected fraudulent statement claims brought using the scheme liability provisions. For example, in *SEC v. Kelly*, Judge McMahon of the United States District Court for the Southern District of New York ruled against a broader interpretation of scheme liability and accused the SEC of attempting "to bypass the elements necessary to impose 'misstatement' liability under [10b-5(b)] by labeling the alleged misconduct a 'scheme' rather than a 'misstatement.'"[56] The Second Circuit agreed, stating that "where the sole basis

[55] The reason why they are referred to as the "scheme liability" provisions is that securities fraud under those provisions "rests not on the making of any false or misleading statement or omission [as required by Rule 10b-5(b)] but on participation in a scheme to defraud." James C. Dugan, *Scheme Liability Under Rule 10b-5: An Emerging Cause of Action - Part I*, CORP. COUNS. BUS. J. (Dec. 1, 2006), https://ccbjournal.com/articles/scheme-liability-under-rule-10b-5-emerging-cause-action-part-i [https://perma.cc/CJQ9-S4MM].

[56] SEC v. Kelly, 817 F. Supp. 2d 340, 343 (S.D.N.Y. 2011), *abrogated by* Lorenzo v. SEC, 139 S. Ct. 1094 (2019). This case, as well as many that follow, also discusses section 17(a) of the Securities Act. *Id.* at 345–46. As noted earlier, section 17(a) provided the basis for Rule 10b-5 but only applies to the sellers of securities rather than both sellers and buyers. *See supra* text accompanying notes 12–18. Another notable difference between Rule 10b-5 and section 17(a) is that the latter does not create an implied right of action and thus can only be used by the SEC in its enforcement actions. Touche Ross & Co. v. Redington, 442 U.S. 560, 575–76 (1979). For further discussion of section 17(a), see *infra* text accompanying notes 255–65.

for such claims is alleged misrepresentations or omissions, plaintiffs have not made out a market manipulation claim under Rule 10b–5(a) and (c)."[57] The Ninth Circuit similarly held that "[a] defendant may only be liable as part of a fraudulent scheme based upon misrepresentations and omissions under Rules 10b–5(a) or (c) when the scheme also encompasses conduct beyond those misrepresentations or omissions."[58]

On the other side of the coin, the Eleventh Circuit held that *Janus* does not extend to scheme liability, writing that "*Janus* only discussed what it means to 'make' a statement for purposes of Rule 10b-5(b), and did not concern . . . Rule 10b-5(a) or (c)."[59] Instead, the court stated that "subsections (a) and (c) of Rule 10b-5 'are not so restricted' as subsection (b), because they are not limited to 'the making of an untrue statement of a material fact.'"[60]

The D.C. Circuit embraced the Eleventh Circuit's view when it weighed in on *Lorenzo* prior to its appeal to the Supreme Court, noting that "Rules 10b-5(a) and (c), along with Section[] 10(b) . . .—all unlike Rule 10b-5(b)—do not speak in terms of an individual's 'making' a false statement. Indeed, '[t]o make any . . . statement' was the critical language construed in *Janus*."[61] The court therefore held that, despite *Lorenzo*'s assertion that "actions involving false statements must fit within Rule 10b-5(b) and cannot be brought separately under Rules 10b-5(a) or (c)," it knew "of no blanket

[57] Lentell v. Merrill Lynch & Co., 396 F.3d 161, 177 (2d Cir. 2005), *abrogated by Lorenzo*, 139 S. Ct. 1094.

[58] WPP Lux. Gamma Three Sarl *v.* Spot Runner, Inc., 655 F.3d 1039, 1057 (9th Cir. 2011) (first citing SEC v. Lucent Techs., Inc., 610 F. Supp. 2d 342, 359 (D.N.J. 2009); then citing SEC v. Patel, No. 07-cv-39, 2009 WL 3151143, at *6–7 (D.N.H. Sept. 30, 2009); then citing *In re* Nat'l Century Fin. Enters., Inc., Inv. Litig., No. 03-MD-1565, 2006 WL 469468, at *21 (S.D. Ohio Feb. 27, 2006); and then citing *In re* Alstom SA, 406 F. Supp. 2d 433, 475 (S.D.N.Y. 2005)), *abrogated by Lorenzo*, 139 S. Ct. 1094.

[59] SEC v. Monterosso, 756 F.3d 1326, 1334 (11th Cir. 2014) (per curiam).

[60] *Id.* (quoting Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128, 152–52 (1972)).

[61] Lorenzo v. SEC, 872 F.3d 578, 589 (D.C. Cir. 2017) (second alteration in original), *aff'd*, 139 S. Ct. 1094.

reason . . . to treat the various provisions as occupying mutually exclusive territory, such that false-statement cases must reside exclusively within the province of Rule 10b-5(b)."[62]

This question of whether or not to include misstatements and omissions within the scope of 10b-5(a) and (c) became the crux of the Supreme Court's inquiry in *Lorenzo*.

III. THE *LORENZO* DECISION

A. Facts of *Lorenzo v. SEC* and Lower Court Decisions

Francis Lorenzo was the investment banking director at Charles Vista LLC, a registered broker-dealer in Staten Island whose only client during the relevant timeframe was Waste2Energy Holdings, a company attempting to develop technology that would "convert 'solid waste' into 'clean renewable energy.'"[63] Nearly the entire valuation of Waste2Energy was dependent on this technology: in June 2009, the company valued its assets at $14 million, including $10 million attributed to intangible assets (its intellectual property).[64] "Lorenzo was skeptical of this valuation" because the technology "didn't really work," and the intellectual property therefore was a "dead asset."[65]

During the summer of 2009, Waste2Energy hired Charles Vista to sell $15 million worth of debt to investors,[66] which became a difficult proposition when Waste2Energy announced in a Form 8-K on October 1 that its technology had failed, meaning its intangible assets were essentially worthless.[67] Nevertheless, Francis Lorenzo's (unrelated) boss

[62] *Id.* at 591.

[63] *Lorenzo*, 139 S. Ct. at 1099.

[64] *Id.*

[65] *Id.* (internal quotation marks omitted). One pair of commentators likened the technology to "modern day alchemy." Turk & Woody, *supra* note 3, at 200.

[66] *Lorenzo*, 139 S. Ct. at 1099

[67] Turk & Woody, *supra* note 3, at 200 & n.31. A Form 8-K is a "'current report' companies must file with the SEC to announce major events that shareholders should know about." *Fast Answers: Form 8-K*, U.S. SEC. &

Gregg Lorenzo drafted an email on October 14 to be sent to two potential investors stating that an investment in Waste2Energy would have three layers of protection, including $10 million in "confirmed assets."[68] The email was drafted in Francis Lorenzo's name, included his title, and "also included text indicating that the recipients should contact [Francis] Lorenzo with any questions."[69] Francis Lorenzo sent the emails later that day.[70]

The SEC brought civil enforcement actions against Francis Lorenzo, Gregg Lorenzo, and Charles Vista LLC for violations of section 10(b) and Rule 10b-5 based on these misstatements.[71] While Gregg Lorenzo and Charles Vista both settled with the SEC, Francis Lorenzo did not, and his case was brought before an SEC Administrative Law Judge (ALJ) and thereafter the SEC Board of Commissioners prior to its appeal to the D.C. Circuit.[72]

EXCH. COMM'N, https://www.sec.gov/fast-answers/answersform8khtm.html [https://perma.cc/YDW9-VYBD] (last updated Aug. 10, 2012); *see also* 17 C.F.R. § 249.308 (2020) (describing the purpose of the form). In its Form 8-K, Waste2Energy announced that its assets as a whole were worth only $370,552. *Lorenzo*, 139 S. Ct. at 1099.

[68] Turk & Woody, *supra* note 2, at 200–01 (emphasis deleted) (quoting Gregg C. Lorenzo, SEC Release No. 544, 2013 WL 6858820, at *4 (ALJ Dec. 13, 2013), *aff'd sub nom.* Francis V. Lorenzo, Exchange Act Release No. 74,836, 2015 WL 1927763 (Apr. 29, 2015), *aff'd in part and vacated in part sub nom.* Lorenzo v. SEC, 872 F.3d 578 (D.C. Cir. 2017), *aff'd*, 139 S. Ct. 1039).

[69] *Id.* at 201 (citing *Gregg C. Lorenzo*, 2013 WL 6858820, at *4).

[70] *Id.* (citing *Gregg C. Lorenzo*, 2013 WL 6858820, at *4). Despite the case's long path to the Supreme Court, Lorenzo ended up only making $150 off of the misstatements made in the emails; one of the email recipients ended up not investing and "may have never opened the email," while the other invested $15,000 in acquiring the corporate debt, upon which Lorenzo received a standard one percent commission. *Id.* (first citing *Gregg C. Lorenzo*, 2013 WL 6858820, at *4; and then citing *Francis V. Lorenzo*, 2015 WL 1927763, at *5).

[71] *Id.* at 201–02.

[72] *Id.* at 202 (first citing Gregg C. Lorenzo (*Lorenzo Settlement*), Exchange Act Release No. 70,904, 2013 WL 6087352, at *1 (Nov. 20, 2013); then citing *Francis V. Lorenzo*, 2015 WL 1927763, at *1; and then citing *Gregg C. Lorenzo*, 2013 WL 6858820, at *1).

The ALJ held Lorenzo liable for all of the violations claimed by the SEC, calling the extent of the falsehoods contained in the email "staggering."[73] Most pertinent for the subsequent procedural posture of the case, the ALJ found that Lorenzo "sent the emails without thinking about their contents"[74] and that such neglect amounted to "willful violation of the securities laws" because Lorenzo would have immediately realized the emails contained materially false statements had he even glanced at their contents.[75]

On appeal, the SEC Commissioners affirmed the ALJ's ruling and came to an even stronger conclusion on scienter, stating that "Lorenzo was well aware that the emails falsely represented crucial facts about [Waste2Energy] and its debenture offering."[76] The Commission's findings on scheme liability and scienter were affirmed by the D.C. Circuit.[77] Lorenzo only appealed the scheme liability ruling—that Rules 10b-5(a) and (c) applied—and did not challenge the D.C Circuit's decision on scienter.[78] This meant that the Supreme Court would "take for granted that he sent the emails with 'intent to deceive, manipulate, or defraud' the recipients,"[79] restricting the its inquiry to the question of whether or not Lorenzo's conduct fell within the scope of Rule 10b-5.[80]

---

[73] *Id.* (quoting *Gregg C. Lorenzo*, 2013 WL 6858820, at *7).

[74] *Gregg C. Lorenzo*, 2013 WL 6858820, at *5.

[75] Turk & Woody, *supra* note 3, at 203. This satisfied the scienter requirement necessary for a successful Rule 10b-5 claim. *See Gregg C. Lorenzo*, 2013 WL 6858820, at *5 (giving the scienter requirement).

[76] Turk & Woody, *supra* note 3, at 203 (alteration in original) (quoting *Francis V. Lorenzo*, 2015 WL 1927763, at *9).

[77] Lorenzo v. SEC, 872 F.3d 578, 583–86, 588–90 (D.C. Cir. 2017), *aff'g in part and vacating in part Francis V. Lorenzo*, 2015 WL 1927763, *aff'd*, 139 S. Ct. 1094 (2019).

[78] *See* Turk & Woody, *supra* note 3, at 214–15.

[79] Lorenzo v. SEC, 139 S. Ct. 1094, 1101 (2019) (quoting Aaron v. SEC, 446 U.S. 680, 686 n.5 (1980)).

[80] Then-Judge Kavanaugh wrote a scathing dissent while he was still on the D.C. Circuit, which is why he did not participate in the Supreme Court's decision. Turk & Woody, *supra* note 3, at 213. His dissent was critical of the factual determinations made by both the ALJ and the Commission and was critical of the majority's determinations regarding scienter. *See* Turk & Woody, *supra* note 3, at 209–12. He also vehemently

B. Justice Breyer's Majority Opinion

Justice Breyer wrote the majority opinion in *Lorenzo* while Justice Thomas wrote the dissent, reversing their roles in *Janus*. The decision was a six-two split, with only Justice Thomas and Justice Neil Gorsuch dissenting.[81] Justice Breyer began with the "conclu[sion] that (assuming other here-irrelevant legal requirements are met) dissemination of false or misleading statements with intent to defraud can fall within the scope of subsections (a) and (c) of Rule 10b-5."[82] This is the case "even if the disseminator did not 'make' the statements and consequently falls outside subsection (b) of the Rule."[83] Justice Breyer applied a textual analysis of the scheme liability provisions to justify his claims, noting that "[i]t would seem obvious that the words in these provisions are, as ordinarily used, sufficiently broad to include within their scope the dissemination of false or misleading information with the intent to defraud."[84] He then engaged in a close reading of each word's dictionary definition, finding that "[r]esort[ing] to dictionary definitions only strengthens" the Court's conclusion.[85]

---

attacked the decision for upholding the Commission's determination regarding scheme liability and accused the SEC of attempting to "end-run the Supreme Court" by figuring out clever ways to abolish the distinction between primary and secondary liability and "unilaterally rewrite the law." *Lorenzo*, 872 F.3d at 601 (Kavanaugh, J., dissenting).

[81] This means both Chief Justice John Roberts and Justice Samuel Alito, who signed onto Justice Thomas's *Janus* majority opinion, sided with Justice Breyer and the rest of the liberal justices. Thus, even with Justice Kavanaugh's participation, the outcome of the case would likely have remained the same.

[82] *Lorenzo*, 139 S. Ct. at 1100.

[83] *Id.* at 1100–01.

[84] *Id.* at 1101. He elaborated in terms of *Lorenzo*'s facts, stating 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." *Id.* (second, third, and fourth alterations in original).

[85] *Id.* In reference to 10b-5(a), Justice Breyer defined a device as "simply [t]hat which is devised, or formed by design; a scheme is a project,

The majority also rejected the argument put forward by Lorenzo that even if their "natural reading" is correct, the subsections of 10b-5 should be read to govern mutually exclusive spheres of conduct, so that false statements can only be governed by 10b-5(b) and not the scheme liability provisions.[86] Engaged in the "first experiment in federal regulation of the securities industry,"[87] the drafters of the Rule "thought [it] prudent 'to include both a general proscription against fraudulent and deceptive practices and, out of an abundance of caution, a specific proscription against nondisclosure' even though 'a specific proscription against nondisclosure' might in other circumstances be deemed 'surplusage.'"[88] Justice Breyer thus claimed that a broader reading of subsections (a) and (c) is proper, meaning that they could govern misstatements as well as other misconduct.[89]

---

plan[,] or program of something to be done; and an artifice is an artful stratagem or trick." *Id.* (alterations in original) (internal quotation marks omitted) (quoting Aaron v. SEC, 446 U.S. 680, 696 n.13 (1980). Thus, "dissemination of false or misleading material is easily an 'artful stratagem' or a 'plan,' 'devised' to defraud an investor under subsection (a)." *Id.* Similarly, a subsection (c) "act" or refers to "'a doing' or a 'thing done,'" and a subsection (c) "practice" refers to "an 'action' or 'deed.'" *Id.* (quoting WEBSTER'S NEW INTERNATIONAL DICTIONARY 25, 1937 (2d ed. 1934)). Given the definitions that Justice Breyer provided, the dissemination of false information could clearly be construed as a 10b-5(c) "act, practice, or course of business which operates . . . as a fraud or deceit." 17 C.F.R. § 240.10b-5 (2020); *see also Lorenzo*, 139 S. Ct. at 1101.

[86] *Lorenzo*, 139 S. Ct. at 1101–03.

[87] *Id.* at 1102 (internal quotation marks omitted) (quoting SEC v. Cap. Gains Rsch. Bureau, Inc., 375 U.S. 180, 198 (1963)).

[88] *Id.* (quoting *Cap. Gains Rsch.*, 375 U.S. at 198–199).

[89] However, as Justice Thomas pointed out, *id.* at 1108–09 (Thomas, J., dissenting), this arguably goes against the "rule against superfluity," a canon of statutory interpretation which commands "that one section of a statute should not be construed in a manner that renders another section superfluous." Anita S. Krishnakumar, *Dueling Canons*, 65 DUKE L.J. 909, 923 n.51 (2016). Justice Breyer responded by invoking the statutory text once again, stating that "[t]he idea that each subsection of Rule 10b-5 governs a separate type of conduct is . . . difficult to reconcile with the language of subsections (a) and (c)," as "at least some conduct amounts to 'employ[ing]' a 'device, scheme, or artifice to defraud' under subsection (a) as well as 'engag[ing] in a[n] act . . . which operates . . . as a fraud' under

Justice Breyer also feared that if Rule 10b-5 was not interpreted to allow overlap among its subsections, then "those who disseminate false statements with the intent to cheat investors might escape liability under the Rule altogether."[90] In his view, this would reflect an illogical gap in the SEC's enforcement capabilities—one not easily explainable given that "false representations to induce the purchase of securities would seem a paradigmatic example of securities fraud"[91] and that "the securities laws were designed 'to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits.'"[92] Justice Breyer therefore held that "[t]hat is not what Congress intended. Rather, 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."[93]

Justice Breyer also addressed how his opinion fits with the Court's past decisions. He claimed that *Janus* did not discuss Rule 10b-5's "application to the dissemination of false or misleading information" but rather made the specific finding that "subsection (b) did not (under the circumstances) cover an investment adviser who helped *draft* misstatements issued by a *different* entity that controlled the statements' content."[94] Given these parameters, Justice Breyer wrote, "we can assume 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."[95]

Justice Breyer then explained how the Court's decision bears on the separation between primary and secondary liability articulated in *Central Bank*. He rejected Lorenzo's concerns about "eras[ing] . . . what is otherwise a clear

subsection (c)." *Id.* at 1102 (majority opinion) (alterations in original) (quoting 17 C.F.R. § 240.10b-5 (2018)).

[90] *Id.* at 1102–03.

[91] *Id.*

[92] *Id.* (quoting SEC v. W. J. Howey Co., 328 U.S. 293, 299 (1946)).

[93] *Id.* at 1104.

[94] *Id.* at 1103 (citing Janus Cap. Grp. v. First Derivative Traders, 564 U.S. 135, 146–48 (2011)).

[95] *Id.*

distinction between primary and secondary (*i.e.*, aiding and abetting) liability."[96] He instead claimed that the majority's distinction is as administrable as the lines drawn in *Janus*, *Stoneridge*, and *Central Bank*, for "[t]hose who disseminate false statements with intent to defraud are primarily liable under Rules 10b-5(a) and (c), [section] 10(b), and [section] 17(a)(1), even if they are secondarily liable under Rule 10b-5(b)."[97]

C. Justice Thomas's Dissent

While Justice Breyer believed that the line drawn between primary and secondary liability can be maintained in spite of the Court's extension of 10b-5's reach, Justice Thomas believed that the case "eviscerate[d]" the *Central Bank* distinction between primary and secondary liability.[98] Thus, he regarded the decision as an improper interpretation of the securities laws "likely to have far-reaching consequences."[99] For example, he wrote, "the majority does precisely what we declined to do in *Janus*: impose broad liability for fraudulent misstatements in a way that makes the category of aiders and abettors in these cases 'almost nonexistent.'"[100] He therefore worried this would expand the Rule 10b-5 private right of action in general, claiming that "[i]f Lorenzo's conduct here qualifies for primary liability under [section] 10(b) and Rule 10b-5(a) or (c), then 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."[101]

---

[96] *Id.*

[97] *Id.* at 1104.

[98] *Id.* at 1105–06 (Thomas, J., dissenting).

[99] *Id.* at 1106.

[100] *Id.* at 1110 (quoting Janus Cap. Grp. v. First Derivative Traders, 564 U.S. 135, 143 (2011)).

[101] *Id.* He also doubted that misstatement and scheme claims are overlapping offenses, believing that unlike "when someone illegally sells a gun to help another person rob a bank. . . .[,] this case does not involve two distinct crimes." *Id.* He found this especially problematic given his belief that subsections (a) and (c) are meant to cover specific conduct that does not include misstatements. *Id.* at 1110–11.

Justice Thomas specifically came to the conclusion that subsections (a) and (c) are meant to cover a narrower category of conduct than the majority envisioned. With regard to subsection (a), he wrote that

> [t]he act of knowingly disseminating a false statement at the behest of its maker, without more, does not amount to "employ[ing] any device, scheme, or artifice to defraud" . . . . As the contemporaneous dictionary definitions cited by the majority make clear, each of these words requires some form of planning, designing, devising, or strategizing.[102]

Thus, because Lorenzo did not participate in the plan to defraud the investors in the sense of designing the plan, his conduct should fall outside of the scope of subsection (a).[103]

Similarly, Justice Thomas stated of subsection (c) that, while it "seems broader at first blush," it needs to viewed within the context of its statutory scheme and the presence of a "prohibition specifically addressing primary liability for false statements."[104] The presence of subsection (b) makes scheme liability for misstatements superfluous, allowing a "a person who has not 'made' a fraudulent misstatement within the meaning of Rule 10b-5(b)" to "be held primarily liable for facilitating that same statement; the SEC or plaintiff need only relabel the person's involvement as an 'act,' 'device,' 'scheme,' or 'artifice' that violates Rule 10b-5(a) or (c)."[105]

Justice Thomas also invoked the canon of construction that the "specific governs the general," which states that a general provision of a regulation or statute should be interpreted in light of the more specific provisions accompanying it.[106]

---

[102] *Id.* at 1107 (second alteration in original) (quoting 17 C.F.R. § 240.10b-5 (2018)) (citing *id.* at 1101 (majority opinion)).

[103] *Id.* at 1108.

[104] *Id.*

[105] *Id.* (quoting 17 C.F.R. § 240.10b-5).

[106] *Id.* at 1108–09 (quoting RadLAX Gateway Hotel v. Amalgamated Bank, 566 U.S. 639, 645–46 (2012)). He specifically stated that "[t]his canon of construction applies not only to resolve 'contradiction[s]' between general and specific provisions, but also to avoid 'the superfluity of a specific provision that is swallowed by the general one.'" *Id.* (second alteration in original) (quoting *RadLAX*, 566 U.S. at 645).

Because "liability for false statements is 'specifically dealt with' in 10b-5(b)," he found that "the provisions specifically addressing false statements 'must be operative' as to false-statement cases, and that the more general provisions should be read to apply 'only [to] such cases within [their] general language as are not within the' purview of the specific provisions on false statements."[107]

Justice Thomas then addressed Justice Breyer's concerns about the SEC being unable to hold culpable actors liable despite participating in a fraudulent scheme, arguing that "the person's conduct would be appropriately assessed as a matter of secondary liability . . . . And if a person engages in *other* acts prohibited by the Rule, such as developing and employing a fraudulent scheme, the person would be primarily liable for that conduct."[108] He ultimately advocated for the dissemination of misstatements to be interpreted solely as "aiding and abetting" a misstatement under 10b-5(b), meaning such conduct could only be litigated under section 20(e) by the SEC.[109]

Justice Thomas also expressed concern that *Lorenzo* would undermine the Court's precedents limiting the scope of 10b-5. In particular, he claimed that the "majority's opinion renders *Janus* a dead letter" by "find[ing] primary liability under different provisions of Rule 10b-5, without any real effort to reconcile its decision with *Janus*."[110] He also noted that "[a]lthough it 'assume[s] that *Janus* would remain relevant (and preclude liability) where an individual neither *makes* nor *disseminates* false information,' in the next breath the

[107] *Id.* at 1109 (alterations in original) (internal quotation marks omitted) (citing *RadLAX*, 566 U.S. at 646).

[108] *Id*. He also called the majority's concern about secondary liability in cases where the primary actor did not act with scienter as being "misplaced," noting that "§ 17(a)(2) does not require scienter, so the maker of the statement may still be liable under that provision. Moreover, an ongoing, 'egregious' fraud is likely to independently constitute a primary violation of the conduct-based securities laws, wholly apart from the laws prohibiting fraudulent misstatements." *Id.* at 1109–10. (internal citation omitted) (citing Aaron v. SEC, 446 U.S. 680, 695–97 (1980)).

[109] *Id.* at 1109.

[110] *Id.* at 1110.

majority states that this would be true only if 'the individual is not involved in some other form of fraud,'" and such fraud, on the majority's view, would embrace a wide range of conduct including "administrative acts."[111]

D. The Legal Community's Reaction to *Lorenzo*

The broad consensus of the legal community after *Lorenzo* came down was that it represented a significant victory for the SEC and would expand its ability to bring cases under 10b-5 instead of section 20(e).[112] This is significant because "[t]o the extent that the SEC now may charge conduct as a primary violation of 10b-5(a) and (c), rather than as aiding-and-abetting a 10b-5(b) violation, the new primary charge may well result in higher penalties even though the underlying fraudulent conduct is the same."[113] It is also significant because any aiding and abetting violation requires there to be some sort of primary violation, which

> creates a potential gap where, for example, the disseminator of a statement knows it is false but the maker of a statement does not. Under these circumstances, the innocent maker of the statement cannot be held primarily liable, which means that the

[111] *Id*. (second alteration in original) (quoting *id.* at 1103 (majority opinion)).

[112] *See, e.g.*, Aaron W. Lipson et al., *Supreme Court Affirms Lorenzo v. SEC, Expanding the Scope of Primary Liability for Securities Fraud*, KING & SPAULDING (Apr. 4, 2019), https://www.kslaw.com/news-and-insights/supreme-court-affirms-lorenzo-v-sec-expanding-the-scope-of-primary-liability-for-securities-fraud [https://perma.cc/RZ8V-T5V7]; Ivan P. Harris et al., *Supreme Court Adopts Broad Interpretation of Primary Liability in SEC Antifraud Case*, MORGAN LEWIS (Mar. 28, 2019), https://www.morganlewis.com/pubs/supreme-court-adopts-broad-interpretation-of-primary-liability-in-sec-antifraud-case [https://perma.cc/3M36-CCC4]; MARK A. PERRY ET AL., SUPREME COURT HOLDS THAT SECURITIES FRAUD LIABILITY EXTENDS BEYOND "MAKER" F FALSE STATEMENTS 2 (2019), https://www.gibsondunn.com/wp-content/uploads/2019/03/supreme-court-holds-that-securities-fraud-liability-extends-beyond-maker-of-false-statements.pdf [https://perma.cc/JG6K-3RSM].

[113] Lipson et al., *supra* note 112.

> more culpable disseminator could not have aided and abetted anything.[114]

Lorenzo ensured that "the Commission is now clear to charge such persons as primary violators without demonstrating the person who actually made the statement also violated the federal securities laws."[115] The case will therefore likely lead to an increase in scheme liability claims.[116]

However, it is less clear whether the case will have broader impacts beyond expanding the SEC's ability to bring suits under 10b-5. For instance, it remains an open question whether the case will apply solely to dissemination of false statements or whether it will encompass a broader range of conduct. The SEC believes in a broader reading and would extend the holding to reach "those who direct somebody to draft a false statement or make a false statement or disseminate a false statement, and so on."[117] This could even extend to the conduct covered by *Janus*, since a plaintiff might argue that a defendant corporation has "engaged in a scheme or artifice to defraud by creating a separate entity, drafting

---

[114] Harris et al., *supra* note 112.

[115] *Id.* This has also given the SEC "a sharper weapon" and likely "means that anyone, including investment bankers acting as underwriters or placement agents, could be held liable through their active and knowing participation in the distribution of a misstatement made by a different person." Andrew Reilly & Alberto Pacchioni, *The Implications of Lorenzo v. SEC on Rule 10b-5*, BAKER MCKENZIE (July 24, 2019), https://www.baker mckenzie.com/en/ insight/publications/2019/07/the-implications-of-lorenzo [https://perma.cc/6P4S-MPRC].

[116] *See* PERRY ET AL., *supra* note 112, at 2; PAUL HASTINGS LLP, THE SUPREME COURT'S DECISION IN LORENZO: LAYING THE GROUNDWORK FOR EXPANSIVE THEORIES OF "SCHEME LIABILITY" UNDER THE SECURITIES LAWS 1 (2019), https://webstorage.paulhastings.com/Documents/Default%20 Library/stay-current-supreme-court-decision-in-lorenzo.pdf [https://perma.cc/53M9-FEUK].

[117] Rachel Graf, *SEC Expects Lorenzo To Extend Beyond Dissemination*, LAW360 (April 8, 2019, 7:58 PM) (on file with the Columbia Business Law Review), https://www.law360.com/articles/1147825. Joseph Brenner, Chief Counsel of the SEC's Enforcement Division, asserted that "[y]ou're going to face a fair bit of skepticism from the folks up here if you're arguing that the court's reasoning doesn't extend to other kinds of deceptive conduct in connection with misstatements." *Id.* (internal quotation marks omitted).

misleading disclosures, and then leaving the investors to deal with the entity alone."[118] Others are more skeptical of such a reading, claiming that the most pertinent questions surrounding the case involve the scope of dissemination liability.[119]

Many commentators emphasized the unique factual scenario present in *Lorenzo* to support a limited view of *Lorenzo*'s scope, noting that "Lorenzo did not challenge the D.C. Circuit's holding that he had the requisite scienter."[120] This is significant because, as other commentators noted, "courts are rarely presented with cases where falsity and

[118] Jessica Ortiz, Caleb Hayes-Deats & Michelle Parthum, *How Broad Is "Scheme" Liability Under Rule 10b-5 Following Lorenzo v. SEC?*, AM. BAR ASS'N (Apr. 5, 2019), https://www. americanbar.org/groups/litigation/committees/securities/practice/2019/scheme-liability-rule-10b-5-lorenzo-v-sec [https://perma.cc/S7P4-VSMH]. Another set of commentators similarly noted that "one could imagine certain cases where plaintiffs may assert Rule 10b-5(a) or (c) primary scheme liability claims against defendants where, for example, the 'maker' of the statement under *Janus* is unclear or there are defendants who acted in close concert with the maker in disseminating the alleged fraudulent statements." PAUL HASTINGS LLP, *supra* note 116, at 3.

[119] For instance, attorneys from Ropes & Gray noted that *Janus* and *Lorenzo*

> represent the guardrails [in terms of primary liability], and the battleground over the next few years will be defining just how far *Lorenzo* expands Rule 10b-5 liability. What amount of control over a fraudulent statement is enough, and what level of involvement in distribution is required—these are the questions that the courts will need to address.

Martin J. Crisp, David Hennes & R. Daniel O'Connor, *Lorenzo v. SEC: Expanded Scope of Securities Fraud Liability*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Apr. 14, 2019), https://corpgov.law.harvard.edu/2019/04/14/lorenzo-v-sec-expanded-scope-of-securities-fraud-liability [https://perma.cc/C37N-5V5N]. Another set of commentators likewise noted that "[t]he Court's focus on the term 'dissemination' in its decision, however, will surely spur litigation about the meaning of the term. Lorenzo's behavior may not have been 'borderline,' but someone else's will be." Jennifer L. Achilles, *Lorenzo v. SEC: Restoring Primary Liability for Misstatements*, REED SMITH (Apr. 3, 2019), https://www.reedsmith.com/en/perspectives/2019/04/lorenzo-v-sec [https://perma.cc/8KH3-GDNY].

[120] PERRY ET AL., *supra* note 112, at 2.

scienter are as clear as in *Lorenzo*."[121] Therefore, while "*Lorenzo* may be seen as expanding the types of conduct within the reach of Rule 10b-5, it does not lighten the SEC's burden in showing that an individual engaged in the conduct with an intent to deceive investors."[122]

The scienter issue illustrates a broader point about the case especially relevant to private litigation: while plaintiffs are likely to bring "claims that test the line between primary and secondary liability, and to pursue claims against individual defendants not previously named in securities class actions,"[123] there still are barriers that will reduce the number of successful claims and therefore prevent a surge of frivolous private actions. For example, at the pleading level "*Lorenzo* does not affect the various hurdles the [PSLRA] imposes on private Section 10(b) class action claims, including the requirements that plaintiffs plead a strong inference of scienter and state their falsity claims with particularity."[124] Further, private litigants will also have to show reliance, which under *Stoneridge* "cannot be based on 'undisclosed deceptions upon which the plaintiffs could not have relied.'"[125]

---

[121] JIM BEHA, MICHAEL BIRNBAUM, JINA CHOI & MARK FOSTER, HIGH COURT EXTENDS REACH OF SECURITIES FRAUD RULE 10B-5 (2019) (emphasis added), https://media2.mofo.com/documents/190329-lorenzo-sec-court-defendant-liable.pdf [https://perma.cc/R2MV-UEUL].

[122] *Id.* (emphasis added). This means that "*Lorenzo* perhaps provides the SEC with a little more bark, but not much (if any) more bite, as it pursues enforcement actions." *Id.* (emphasis added).

[123] Lipson et al., *supra* note 112.

[124] *Id.*

[125] CHRISTOPHER R. CONTE & ALEXANDREA RAHILL, SUPREME COURT RULES IN LORENZO V. SEC , STEPTOE CLIENT ALERTS (April 3, 2019) (quoting Lorenzo v. SEC, 139 S. Ct. 1094, 1104 (2019)), https://www.steptoe.com/print/content/33183/Supreme-Court-Rules-in-Lorenzo-v-SEC.pdf?q= [https://perma.cc/G8S4-2HNQ]. Expanding on this idea, some commentators noted that "[w]hile reliance on public statements made by or on behalf of public companies with efficiently traded stock is presumed in class actions, there is no similar presumption applicable to alleged 'schemes' or other forms of deceptive conduct." BEHA ET AL., *supra* note 121. This will make it especially difficult to bring class action suits under the scheme liability provisions because without some presumption of reliance, individual issues of reliance will predominate, precluding class certification.

Therefore, while the case raises the specter of "blur[ring] the line between primary liability and secondary (*i.e.* aiding and abetting) liability,"[126] its effective scope will likely be narrowed by the requirements that remain in place for a successful 10b-5 claim.

IV. DEFINING THE "MODIFIED CREATOR STANDARD"

Having examined the *Lorenzo* decision and the legal community's initial reaction to it, I move onto the heart of my argument: *Lorenzo* should be read expansively to encompass conduct beyond dissemination of false information. In particular, it should be read to reach those who participate in the creation of false statements so that culpable secondary actors can be held primarily liable for violations of 10b-5 (a) and (c) if they employ a "device, scheme, or artifice to defraud" or an "act, practice, or course of business which operates or would operate as a fraud or deceit upon any person."[127]

At the same time, drawing the line determining when participation is significant enough to warrant primary liability is difficult if the distinction between primary and "aiding and abetting" liability set out in *Central Bank* is to be maintained.[128] For that reason, the proposed "modified creator standard" would ensure that primarily liable actors must effectively be an author of the misstatement or directly responsible for an omission. Admittedly, this is a workaround for *Janus*, as it would mean that one could be liable under the scheme liability provisions for drafting a false statement despite not being the person or entity to whom the false statements are attributed. However, justification can be found in Justice Breyer's *Lorenzo* opinion, which describes the scheme liability and misstatement liability provisions as overlapping, not regulating mutually exclusive spheres of

Id.; *see also* Stoneridge Inv. Partners v. Scientific-Atlanta, 552 U.S. 148, 159 (2008).

[126] Crisp et al., *supra* note 119.

[127] 17 C.F.R. §§ 240.10b-5(a), (c) (2020).

[128] *See supra* notes 28–30 and accompanying text.

conduct.[129] The standard also would better effectuate the deterrence rationale at the heart of Rule 10b-5. While the legal community may be correct that *Lorenzo* will be read by the courts as being limited to dissemination liability,[130] it should encompass the creation of misstatements as well. This would correct *Janus*'s flaws while ensuring that the restrictions set forth by *Central Bank*,[131] the PSLRA,[132] and *Stoneridge*,[133] remain in place.

A. Why Choose the "Creator Standard" as the Framework?

The test set out here, referred to as the "modified creator standard," has its origins in the period after *Central Bank*, when the courts were attempting to define the scope of primary and secondary liability and to decide when secondary actors could be held liable for primary violations of Rule 10b-5(b). The federal courts set out three different tests to resolve these issues: the bright-line standard, the substantial participation test, and the creator standard.

The bright-line standard held that "a secondary actor can be liable under section 10(b) only if that actor actually 'made' a misrepresentation on which the plaintiff relied," which requires the defendant to "(1) be named in the document containing the misrepresentation; (2) have signed such document; or (3) be identified to investors at the time of the misrepresentation's dissemination to the public."[134] *Janus* is a permutation of the bright-line rule that narrowly defines who is the "maker" because the decision bases primary liability solely on control over and attribution of the misstatement.[135]

[129] *See Lorenzo*, 139 S. Ct. at 1102–03.

[130] *See supra* notes 119–22 and accompanying text.

[131] *See supra* notes 28–30 and accompanying text.

[132] *See supra* notes 31–34 and accompanying text.

[133] *See supra* notes 35–38 and accompanying text.

[134] Elizabeth Cosenza, *Is the Third Time the Charm?* Janus *and the Proper Balance Between Primary and Secondary Actor Liability Under Section 10(b)*, 33 CARDOZO L. REV. 1019, 1037 (2012).

[135] *See supra* notes 46–49 and accompanying text.

The substantial participation test "sets forth a theory of liability based on the secondary actor's knowing participation in the preparation of material misrepresentations for inclusion in its client's public disclosures regardless of whether the secondary actor is identified to the investing public."[136]

"Under the 'creator' standard . . . a secondary actor is subject to primary liability under section 10(b) when it 'creates' a false and misleading statement, even if the statement is not attributable to that secondary actor."[137] The plaintiff must

> prove that: (1) the secondary actor was aware of the misrepresentation; (2) the secondary actor could fairly be characterized as the author or co-author of the misrepresentation; (3) the secondary actor knew that the misrepresentation would be relied on by investors; and (4) the other requirements for liability have been met.[138]

To illustrate the distinctions among the three approaches, consider a hypothetical. A misstatement regarding the value of a recently acquired asset is made in an email sent to investors. Assume it was done knowingly by all parties and any other liability requirements are met. The email was drafted by two mid-level managers, who came up with its contents based on research and information provided to them by a lower-level employee. After that, it was reviewed and edited by a vice president, who then sent it out from his work email with his name in the byline. Under the bright-line standard, only the vice president could be primarily liable because his name is the one that is found in the byline: recipients would attribute the email to him. Under the substantial participation test, everyone would be primarily liable—including the lower-level employee who conducted the research—so long as everyone knew that the information was misleading and would be presented to the public. Meanwhile,

[136] Cosenza, *supra* note 134, at 1044.
[137] *Id.* at 1047.
[138] *Id.*

under the creator standard, the mid-level managers and the vice president could be liable, as they would all be authors of the misstatement: the managers first wrote the statement, and the vice president edited and reviewed the email before sending it out to the public. The low-level employee, despite having assisted them with research, is not one of the authors of the statement because he did not write, edit, or send it.

The primary issue with the bright-line standard as adopted by the court in *Janus* is that it prevents litigants from imposing direct liability on actors who are clearly culpable yet otherwise not within the scope of 10b-5. As the *New York Times* editorial board noted after *Janus* came down, "[t]here is no doubt that Janus Capital Group is responsible. It used legal ventriloquism to speak through the business trust and Janus funds. Janus Capital Management does everything for the funds, which have no employees."[139] Yet, under the *Janus* rule, "[o]nly the business trust set up to hold the funds can be held liable, though it has no assets of its own to compensate plaintiffs in the lawsuit. Which means that there is no one to sue for the misleading prospectuses."[140] This type of gap in the regulatory scheme incentivizes negative behavior, allowing companies to utilize clever tactics to avoid primary liability while engaging in fraudulent conduct. The *Janus* ruling was especially disconcerting because the board of directors of the Janus Fund had no culpability in drafting the misstatement, so "[i]f only the board of directors is deemed to make the statement because of its ultimate authority, and if the board is unaware of the truth, then there is no primary violation."[141] The inability to bring fraud claims despite such brazen behavior by the drafters of the prospectus "is not what Congress intended. Rather, Congress intended to root out all

[139] Editorial, *So No One's Responsible?*, N.Y. TIMES (June 14, 2011), https://www.nytimes.com/2011/06/15/ opinion/15wed2.html [https://perma.cc/EY34-HTG7].

[140] *Id.*

[141] Charles W. Murdock, Janus Capital Group, Inc v. First Derivative Traders*: The Culmination of the Supreme Court's Evolution from Liberal to Reactionary in Rule 10b-5 Actions*, 91 DENV. U. L. REV. 369, 432 (2014). This "mean[s] that, even in an SEC proceeding, there could be no aiding and abetting liability because of the lack of a primary violation." *Id.*

manner of fraud in the securities industry."[142] Expanding the scope of scheme liability provides an opportunity to rectify this, ensuring that *Janus*'s narrow definition of "maker" still stands while also covering blatantly fraudulent conduct under Rule 10b-5.

Even if maintaining the bright-line standard is not the proper course of action, the question remains whether the "creator standard," rather than the "substantial participation test," should be adopted. The concern with the latter is that "substantial participation" is difficult to differentiate from aiding and abetting, undermining the Court's decision in *Central Bank*, which was designed to prevent excessive litigation and simplify a system where the "rules . . . are unclear, in 'an area that demands certainty and predictability.'"[143] Allowing for such an expansion of primary liability would also contravene Congress's will, given that the PSLRA was passed in order both to reduce the incidence of frivolous litigation and to provide the SEC with the sole authority to bring aiding and abetting suits under section 20(e).[144] There are, of course, arguments that *Central Bank* and the PSLRA alike had negative consequences[145] and that adopting a substantial participation standard would "provide investors with the most avenues to pursue when they seek redress for securities fraud. . . . [and] would best deter outside advisers from engaging in shenanigans that harm

[142] Lorenzo v. SEC, 139 S. Ct. 1094, 1104 (2019).

[143] Cent. Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164, 188 (1994) (quoting Pinter v. Dahl, 486 U.S. 622, 652 (1988)).

[144] *See supra* notes 31–34 and accompanying text.

[145] For example, some scholars have "charge[d] that restrictions on the implied right imposed by the [PSLRA] and decisions such as [*Central Bank*], reaffirmed in *Stoneridge*, have led to *under*deterrence, contributing to a climate of corporate permissiveness that led to scandals like Enron and Worldcom." Amanda M. Rose, *Reforming Securities Litigation Reform: Restructure the Relationship Between Public and Private Enforcement of Rule 10b-5*, 108 COLUM. L. REV. 1301, 1303 (2008) (footnotes omitted).

unsuspecting investors in the marketplace."[146] But such a remedy would require congressional action.[147]

By contrast, the creator standard fits much more neatly into the federal judicial framework. It provides a more restrictive test for determining primary liability than the substantial participation test by confining it to situations where, on top of pleading requirements, there is awareness of the misrepresentation, authorship, and knowledge of reliance (although such knowledge would not override plaintiffs' need to demonstrate reliance). This would mean that only those who could be considered authors would be liable for their participation in a scheme, ensuring that claims against lesser participants would still be litigated under section 20(e). Such an approach would serve as a balance between the stringency of the *Janus* test, which fails to include genuinely fraudulent behavior, and the lack of clarity presented by the substantial participation test.

B. The Textual Justification from *Lorenzo* for Adopting the Test

Although the debate regarding which test to adopt for 10b-5(b) liability was settled by the Court's adoption of the bright-line standard in *Janus*, that does not mean that the scheme liability provisions must be interpreted in the same way. Given the broader language present within the scheme liability provisions, the test utilized for scheme liability could plausibly differ from that used in subsection (b). In this reading, 10b-5(b) is meant to cover a specific subset of fraudulent activity by those with "ultimate control" over misstatements,[148] while the scheme liability provisions cover a broader category of conduct. Subsection 10b-5(a), which outlaws "employ[ing] any device, scheme, or artifice to

[146] Cosenza, *supra* note 134, at 1077–78 (footnote omitted).

[147] Elizabeth Cosenza in fact advocates for a legislative remedy utilizing the substantial participation standard, but legislative solutions are outside the bounds of this analysis, which is confined to the judiciary. *See id.* at 1075–82.

[148] *See* 17 C.F.R. § 240.10b-5(b) (2020).

defraud,"[149] is meant to cover those who engage in conduct that could be considered (per *Lorenzo*) "an 'artful stratagem' or 'a plan,' 'devised' to defraud an investor."[150] And 10b-5(c)—which prohibits "engag[ing] in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person"[151]—covers "a thing done" or a "deed" that "operates . . . as a fraud or deceit."[152] The above definitions of fraudulent conduct are broad enough to encompass those who actually draft and create misstatements.

Admittedly, Justice Breyer addressed this issue in *Lorenzo* by noting that "we can assume 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."[153] But the assumption he made is quite arbitrary—an attempt, without an explanation, to mollify concerns about *Janus* being nullified. Even the word "assume" seems to suggest acquiescence without justification, which makes sense given that Justice Breyer wrote the dissent in *Janus*.

There is little reason why dissemination of a statement should be considered an "artful stratagem" to defraud an investor or a "deed" that acts "as a fraud or deceit" upon an investor while drafting a false statement should not; both have the same impact on investors, and, assuming scienter, both are done with similar levels of culpability. Anyway, Justice Breyer's comment on *Janus* should be considered dicta, as it goes beyond the dissemination liability at issue in *Lorenzo*.[154] Indeed, his point about the overlapping nature of

[149] *Id.* § 240.10b-5(a).

[150] Lorenzo v. SEC, 139 S. Ct. 1094, 1101 (2019).

[151] 17 C.F.R. § 240.10b-5(c).

[152] *Lorenzo*, 139 S. Ct. at 1101 (internal quotation marks omitted) (first quoting WEBSTER'S NEW INTERNATIONAL DICTIONARY, *supra* note 85, at 25, 1937; and then quoting 17 C.F.R. § 240.10b-5(c) (2018)).

[153] *Id.* at 1103.

[154] According to Judge Leval, dictum is

> an assertion in a court's opinion of a proposition of law which does not explain why the court's judgment goes in favor of the winner. . . . The dictum consists essentially of a comment

the regulatory scheme in *Lorenzo*[155] is just as applicable to the preparation of the false statements as it is to the dissemination of those statements. In either case, a person who actively participates in preparing a false statement could be held both primarily liable under the scheme liability provisions and secondarily liable for aiding and abetting the "maker's" misstatements under subsection (b).[156] And much like the dissemination present in *Lorenzo*, the drafting of a misstatement is "behavior that, though plainly fraudulent, might otherwise fall outside the scope of the Rule."[157]

This reading could be construed as stretching of the confines of the opinion, but it does not stretch the opinion any further than a bright-line rule that protects unattributed drafters of false statements from primary liability but not disseminators who did not write the statements.[158] The more expansive reading fits better with the opinion itself and the regulatory scheme as a whole. The SEC has also adopted a similar reading of the scheme liability provisions, holding that "primary liability under Rule 10b-5(a) and (c) . . . encompasses the 'making' of a fraudulent misstatement to investors, as well as the drafting or devising of such a misstatement."[159] While administrative law issues such as *Auer* deference[160] are

> on how the court would decide some other, different case, and has no effect on its decision of the case before it.

Pierre Leval, *Judging Under the Constitution: Dicta About Dicta*, 81 N.Y.U. L. REV. 1249, 1256 (2006).

[155] *See Lorenzo*, 139 S. Ct. at 1102–03.

[156] *Id.* at 1103.

[157] *Id.* at 1102.

[158] For a discussion of the bright-line standard, see *supra* Section IV.A.

[159] John P. Flannery, Exchange Act Release No. 73,840, 2014 WL 7145625, at *12 (Dec. 15, 2014), *vacated on other grounds sub nom.* Flannery v. SEC, 810 F.3d 1 (1st Cir. 2015).

[160] *Auer* (or *Seminole Rock*) deference refers to "the doctrine that commands courts to defer to a federal agency's interpretation of its own regulation unless the agency's interpretation is 'plainly erroneous or inconsistent with the regulation.'" Christopher J. Walker, *What Kisor Means for the Future of Auer Deference: The New Five-Step Kisor Deference Doctrine*, YALE J. ON REGUL.: NOTICE & COMMENT (Jun. 26, 2019) (quoting *Kisor v. Wilkie*, 139 S. Ct. 2400, 2411 (2019) (plurality opinion)), https://www.yalejreg.com/nc/what-kisor-means-for-the-future-of-auer-

outside the scope of this Note, this does suggest that the broader reading makes more sense in the context of the Rule's language.[161] However, if courts were concerned about how much this approach would expand the scope of *Lorenzo*, they could instead adopt a revised version of the test.[162]

C. The Contours of the "Modified Creator Standard"

Having explained the justification for using the "creator standard" as the framework for approaching scheme liability in the wake of *Lorenzo*, it is now necessary to lay out the specifics of the "modified creator" test and its contours. Section IV.C.1 first defines the class of "creators" in, requiring either direct and voluntary participation in the drafting of the misstatement or supervisory authority over its contents. Section IV.C.2 explains why specific actors are covered as "authors" or "creators." Finally, Section IV.C.3 outlines why the test requires a reckless state of mind, rather than actual

deference-the-new-five-step-kisor-deference-doctrine [https://perma.cc/HXD6-X4X5].

[161] At least one court has cited the SEC's opinion in *John P. Flannery* even after *Lorenzo* was decided. *See* SEC v. Ustian, No. 16 C 3885, 2019 WL 7486835, at *40 (N.D. Ill. Dec. 13, 2019) (citing *John P. Flannery*, 2014 WL 7145625, at *12).

[162] My suggestion for a revised test is to apply the "modified creator standard" only when there are multiple sets of misstatements within a scheme. While admittedly less potent than my main proposal, it would still deter fraudulent conduct and would not run afoul of Justice Breyer's "assumption" in *Lorenzo*. This idea derives from lower court decisions that have come down since *Lorenzo*. For example, in *SEC v. Fiore*, Judge Karas of the Southern District of New York held that "a deceptive scheme involving multiple forms of market manipulation, as well as various misstatements or omissions . . . combined with a misleading promotional campaign" was within the coverage of 10b-5(a) and (c). 416 F. Supp. 3d 306, 321 (S.D.N.Y. 2019). This suggests that even if a single misstatement is not covered by the scheme liability provisions, a pattern of fraudulent conduct will be. Similarly, another judge used the claim "that defendants repeatedly made false or misleading statements in their research reports, press releases, and website" as partial justification for refusing to dismiss a scheme liability claim. SEC v. SeeThruEquity, LLC, No. 18 Civ. 10374, 2019 WL 1998027, at *5 (S.D.N.Y. Apr. 26, 2019).

knowledge, when participating in the creation of the misstatement..

1. Who Is a "Creator"?

Crafting a clear delineation between who is a "creator" and who is only "aiding" the creator is important for the modified creator standard to succeed; otherwise, there will not be clear boundaries between primary and secondary liability under the scheme liability provisions. One of the primary criticisms of the original creator test was "that the line-drawing that is necessary to determine who has 'created' a misrepresentation generates a great deal of uncertainty,"[163] especially given that "[t]he *Central Bank* Court expressly identified an unpredictable standard of liability for outside professionals as undesirable."[164] This uncertainty is exacerbated by the fact that "public disclosures are worked on by a number of people, including the company's senior management, its in-house legal, accounting and finance personnel[,] as well as its outside law firm, accounting firm, and other outside advisers."[165] As a result, "[a]ssigning the title of 'creator' to any or all of these individuals or entities masks the complex and multistep process by which public disclosures are drafted and finalized."[166] Given the complexity of public disclosures in modern securities practice, this means that only a specific subset of internal employees and outside advisors, such as lawyers and accountants, should be held primarily liable under Rule 10b-5(a) and (c). All other participants should be held secondarily liable as aiders and abettors.

With regard to insiders working for the issuer,[167] the line between being an author or just an "aider and abettor" of a misstatement should be drawn based on whether they

[163] Cosenza, *supra* note 134, at 1049.

[164] Jill E. Fisch, *The Scope of Private Securities Litigation: In Search of Liability Standards for Secondary Defendants*, 99 COLUM. L. REV. 1293, 1302 (1999) (citing Cent. Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164, 188 (1994)).

[165] Cosenza, *supra* note 134, at 1050.

[166] *Id.*

[167] By "issuer," I refer to the company or entity that is selling stock.

specifically created the misstatement or were otherwise responsible for supervising the originator of the misstatement. Thus, a lower-level employee who is not in a supervisory role would be liable only if they were responsible for the creation of the misstatement without any implicit or explicit direction from their boss. Creation requires the spark of independent thought, meaning that the idea for the misstatement itself (and not just the wording) needs to come from the lower-level associate. If a lower-level employee is directed to write the misstatement, they will not be held primarily liable. By contrast, someone in a supervisory role, such as an executive or a manager, would be liable if it can be shown that they were responsible for the finalized product containing a misstatement, whether by demanding its presence or else by deliberately ignoring and failing to correct the misstatement made by the original author. All other actors who participate in the scheme would only be secondarily liable.[168]

In addition to holding insiders of the issuer liable, the "modified creator standard" would hold liable specific outside advisors like attorneys and accountants. However, liability would be strictly limited to those persons responsible for a "final review" of the statement. As a result, primary liability for outside advisors would be restricted to high-level employees—likely the partner in charge of the issuer's account at a law firm or accounting firm.[169] This standard would keep the existing legal framework in place, with its concerns over extending liability too far, while still "imposing the threat of liability on a limited set of outside advisers who

[168] Those directly responsible for dissemination also would be liable per *Lorenzo*. *See* Lorenzo v. SEC, 139 S. Ct. 1094, 1104 (2019).

[169] This would ensure that gatekeepers, who "often could act to forestall massive securities fraud," are incentivized to do so without letting the scope of liability get out of hand to encompass junior law associates or accountants. Steven A. Ramirez, *The Virtues of Private Securities Litigation: An Historic and Macroeconomic Perspective*, 45 LOY. U. CHI. L.J. 669, 691 (2014) (citing John C. Coffee, Jr., *Understanding Enron: "It's About the Gatekeepers, Stupid"*, 57 BUS. LAW. 1403, 1404–05 (2002)).

also happen to be in the best position to prevent an issuer from making false disclosures to the market."[170]

2. Why These "Creators"?

Having laid out the modified creator standard, it is necessary to explain why it covers the actors it does. Although the role each of them plays in the drafting and dissemination process differs, they are covered because they are the most responsible for either making the misstatement or disseminating it to the public.

The reason for designating inside actors who write or supervise the writing of a misstatement as "creators" subject to primary liability is that they are most directly responsible for the contents of the misstatement. With regard to lower-level employees, it is necessary to restrict the scope of liability to ensure that primary liability is not expanded so far as to ensnare someone only "tangentially involved in [the fraud]—say, a mailroom clerk—for whom liability would typically be inappropriate."[171] At the same time, it is necessary to hold liable those responsible for coming up with the misstatements to ensure that they are deterred from such conduct and cannot hide behind negligent supervisors, as *Janus* would allow.[172] Requiring that they come up with the misstatement themselves, rather than at the urging of a boss or supervisor, ensures that the line between primary and secondary liability is clear, even if the subordinate employee knowingly and willingly participates in drafting the misstatement and is responsible for its wording.

While it could be argued that this standard allows employees to hide behind a supervisor, the concern with applying a more stringent standard to any "drafter" beyond the one responsible for the idea behind the misstatement is that it would blur the lines between secondary and primary liability. Otherwise, the subordinate could be liable as the

[170] Cosenza, *supra* note 134, at 1049 (discussing the traditional creator standard).

[171] *Lorenzo*, 139 S. Ct. at 1101.

[172] *See supra* Section II.C.

coauthor of a misstatement despite the fact that they act more like a research assistant following a faculty supervisor's direction rather than an independent actor originating the idea to make a misstatement.[173] This is not to excuse their behavior, but it makes sense to hold them liable as accomplices under section 20(e) given that the supervisor is directly responsible for the contents of the misstatement and that judicial application of the test requires clear lines to be drawn.

It also makes sense to hold supervisors overseeing misstatements liable as "creators" because they are effectively the authors of the statements. This is obviously true if they direct their employee to draft the misstatement. However, this is also the case if the supervisor reviews the statement and, despite knowing of the statement's falsity or disregarding whether it is true or not, passes it on to someone else at the company or disseminates it to the public or investors. By sharing the statement, these supervisors ratify it because they have reviewed it and determined that it was acceptable for public dissemination even if they did not create the false statement themselves. Given the significant role that supervisors play in the process of getting misstatements out to the investing public—whether by direct dissemination or by passage up the food-chain after review[174]—they need to be held accountable. Under this definition of "creator," the final person to review and send out the false statement to the public is not the only person held liable. Rather, anyone responsible for overseeing, editing, and reviewing the statement who is employed by the issuer is liable so long as they are acting in a supervisory capacity.[175]

[173] I would like to credit my faculty supervisor, Professor Joshua Mitts, for coming up with this analogy.

[174] *Cf.* Lewis D. Lowenfels & Alan R. Bromberg, *A New Standard for Aiders and Abettors Under the Private Securities Litigation Reform Act of 1995*, 52 BUS. LAW. 1, 12 n.59 (1996) (noting some of the parties involved in formulating corporate statements). In certain cases, attorneys must report issues upward as a matter of law, not just as a matter of company procedure. *See* 17 C.F.R. § 205.3(b)–(c) (2020).

[175] For instance, this means a middle manager who oversees a fraudulent report written by a lower-level employee would be liable as a

Finally, as will be explained later on, liability for outside advisors like lawyers and accountants is a crucial deterrence mechanism because these advisors can act as "third party gatekeepers" with an incentive to keep misstatements in their areas of responsibility from reaching the public.[176] However, adopting a broader scope of liability for these gatekeepers could blur the line between primary and accomplice liability. Plaintiffs could go after law firms and accounting firms and embroil them in long and expensive litigation, creating the situation the Court feared in *Central Bank*.[177] By contrast, limiting liability to "final reviewers" of documents containing misstatements ensures that lawyers and accountants are motivated to prevent their dissemination to the public, while at the same time preventing too many employees of the law firm or accounting firm from being swept up in litigation. Even if junior and mid-level associates at a law firm bear some responsibility for reviewing a document and allowing a misstatement to remain, valid concerns about vexatious litigation make it necessary to have only a narrow set of outside actors assume liability.[178] The partner overseeing the client's case is the person most responsible for overseeing the work of their subordinates and ensuring that their clients comply with the law.[179]

creator even if they then pass it on to a senior vice president. However, if a fellow lower-level employee edits that report, then they would only be an aider or abettor rather than a "creator" because they do not hold any authority over the drafter and cannot "ratify" the statement. Hence as the document containing a misstatement moves up the corporate ladder, each person who reviews and ratifies the misstatement would be held liable as a "creator," assuming they have the requisite scienter.

[176] *See infra* notes 221–226 and accompanying text.

[177] *See supra* notes 28–29 and accompanying text.

[178] While middle management employed by the issuer would be liable for ratification of misstatements, the final review standard for third-party advisors means that the highest level outside actor to review and ratify the misstatement (likely a law firm or accounting firm partner) is the only person held primarily liable under the modified creator standard.

[179] It is important to note that the "final review" standard is intended to apply only to outside parties responsible for reviewing the documents containing the misstatement, and it does not apply to insiders. Moreover, finding a law firm partner (or similar supervisor) liable for not correcting or

In sum, the term "creator" here is meant to apply broadly. Rather than referring to authorship in a narrow sense, it is meant to reflect responsibility over the contents of the misstatement and its dissemination. Holding (1) a drafter, but only if they are responsible for coming up with idea behind the misstatement, (2) an inside supervisor responsible for oversight of the misstatement, and (3) an outsider responsible for "final review" all primarily liable ensures that private litigants can only go after the actors who are most responsible for both the creation of the misstatement and its dissemination to the public.

3. Scienter Under the "Modified Creator Standard"

Having the "modified creator standard" function properly will require some tweaks to the traditional standard for the defendant's state of mind, as scienter is a crucial filtering mechanism to guard against frivolous suits.[180] The scienter requirement, beyond being a necessary component for a successful 10b-5 claim,[181] ensures that only actors directly responsible for writing or failing to correct a misstatement are liable. Innocent employees, including those who are only negligent, are not to be swept up into the scheme. However, the issue with imposing a "knowledge" standard as the "creator standard" originally envisioned[182] is that it makes it

---

reporting a misstatement during a final review would not preclude liability for any insider.

[180] *See* Christopher Davies et al., *Final Decision in Lorenzo v. SEC*, WILMERHALE (Mar. 28, 2019), https://www.wilmerhale.com/en/insights/client-alerts/20190328-final-decision-in-lorenzo-v-sec [https://perma.cc/BGU8-TGCD] ("The scienter requirement contained in Rule 10b-5(a) and (c), which requires proof that a violator acted with intent, will continue to limit the breadth of the expansion of liability under those provisions.").

[181] For a list of all the required elements of a 10b-5 claim, see *supra* text accompanying note 23.

[182] Recall that the creator test requires a showing that "the secondary actor was aware of the misrepresentation . . . knew that the misrepresentation would be relied on by investors." Cosenza, *supra* note 134, at 1047.

difficult—if not impossible—to impose liability without a fact-intensive inquiry and "smoking-gun" evidence during discovery that shows that the defendant specifically knew about the misstatement being made.[183] These difficulties are further exacerbated by the high pleading standards imposed by the PSLRA, "which requires a complaint to 'state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.'"[184] As the Supreme Court noted in *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, an inference is only strong "if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged."[185] Under these circumstances, requiring a showing of knowledge will make passing the pleading stage incredibly difficult, if not impossible, as it is likely that the defendant will come up with another explanation for its misstatement. That explanation will be incredibly difficult to rebut absent an email or phone call making bad intentions explicit.[186] Thus, to combat this difficulty, recklessness should be the standard used to determine scienter.

Although the Supreme Court itself has never made a ruling on the issue, every federal circuit has adopted some form of recklessness standard for scienter under Rule 10b-5.[187]

---

[183] *Cf.* Michael J. Kaufman & John M. Wunderlicht, *Messy Mental Markers: Inferring Scienter from Core Operations in Securities Fraud Litigation*, 73 OHIO ST. L.J. 507, 516 (2012) ("[D]irect evidence of a person's state of mind is rare because this evidence is usually limited to an actual admission by the defendant under oath or the testimony of a witness based upon personal knowledge, both of which are unlikely to be available without discovery, which is stayed in securities litigation pending any motion to dismiss." (footnote omitted) (citing 15 U.S.C. § 78u-4(b)(3) (2006))).

[184] Julia Dimitriadis et al., *Securities Fraud*, 56 AM. CRIM. L. REV. 1379, 1392 (2019) (quoting Private Securities Litigation Reform Act of 1995 (PSLRA), Pub. L. No. 104-67, § 21D(b)(2), 109 Stat. 737, 747 (codified as amended at 15 U.S.C. § 78u-4(b)(2)(A) (2018))).

[185] Tellabs, Inc. v. Makor Issues & Rts., Ltd., 551 U.S. 308, 324 (2007).

[186] *Cf.* Kaufman & Wunderlich, *supra* note 183, at 516 (describing the weaker evidence on which plaintiffs ordinarily must rely).

[187] *Tellabs*, 551 U.S. at 319 n.3 ("Every Court of Appeals that has considered the issue has held that a plaintiff may meet the scienter requirement by showing that the defendant acted intentionally or

Using a recklessness standard would greatly improve the efficacy of the "modified creator standard" since plaintiffs would not have to find direct evidence of the defendant's state of mind. Take, for example, the Seventh Circuit's approach to recklessness in *Sundstrand Corp. v. Sun Chemical Corp.*, which requires that "the danger of misleading buyers must be actually known or so obvious that any reasonable man would be legally bound as knowing, and the omission must derive from something more egregious than even 'white heart/empty head' good faith."[188] Applying the Seventh Circuit's test in the context of the "modified creator" standard, the plaintiffs would need to show that it would be obvious to "any reasonable man" that the statement is misleading, that it would be similarly obvious that investors would likely rely on the misstatement, and that there is some hint of nefarious intent rather than genuine negligence. While this is still a very high threshold to clear, it makes getting a case successfully through both the pleading stage and a trial much more feasible. Rather than having to make a specific showing of knowledge or intent that would be unrealistic in most cases, courts could focus on the nature of the offense and the circumstances around it to determine whether or not they meet the threshold.[189]

recklessly, though the Circuits differ on the degree of recklessness required." (citing Ottmann v. Hanger Orthopedic Grp., 353 F.3d 338, 343 (4th Cir. 2003))).

[188] Sundstrand Corp. v. Sun Chem. Corp., 553 F.2d 1033, 1045 (7th Cir. 1977) (footnote omitted).

[189] Parsing out how recklessness would apply in each circuit is beyond the scope of my inquiry. It is helpful to note that multiple circuits have adopted the *Sundstrand* approach. For example, the Fourth Circuit defined recklessness as "an act so highly unreasonable and such an extreme departure from the standard of ordinary care as to present a danger of misleading the plaintiff to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it." *Ottmann*, 353 F.3d at 343 (internal quotation marks omitted) (quoting Phillips v. LCI Int'l, Inc., 190 F.3d 609, 621 (4th Cir. 1999)). The Ninth Circuit similarly held that

> "if no reasonable person could deny that the statement was materially misleading, a defendant with knowledge of the relevant facts cannot manufacture a genuine issue of material fact merely by denying (or intentionally

V. THE "MODIFIED CREATOR STANDARD" AND THE PRIVATE RIGHT OF ACTION

This Part discusses the implications of the "modified creator standard" for the private right of action, expanding on the discussion in Part IV of the balance between expanding 10b-5 liability and preventing a flood of litigation. A discussion of SEC enforcement follows in Part VI.

Section V.A discusses criticisms of the existence of the private right of action that have taken root in legal academia. Section V.B then explains why, despite flaws, the private right of action (in addition to SEC enforcement) is necessary as a means of deterring fraud. It also provides specific justification for the "modified creator standard" and its expansion of primary liability. Lastly, Section V.C discusses the ways in which the "modified creator standard" would preserve guardrails against frivolous and wasteful litigation, specifically by showing how it would fit into the rest of the legal regime put in place by Rule 10b-5.

A. Criticisms of the Private Right of Action

This Section discusses the major criticisms of the private right of action, which some prominent commentators in legal academia have advocated should be narrowed or eliminated.[190] Given that the "modified creator standard"

> disregarding) what any reasonable person would have known." Essentially, the standard requires the defendant to show that the statement was objectively not misleading.

Ninth Circuit Holds that Scienter May Be Established Through an Objective Evaluation of a Defendant's Deliberate Recklessness, SHEPPARD MULLIN (Aug. 13, 2010) (quoting SEC v. Platforms Wireless Int'l Corp., Nos. 07-56542 & 09-55039, 2010 U.S. App. LEXIS 15328, at *41 (9th Cir. July 27, 2010)), https://www.corporatesecuritieslawblog .com/2010/08/ninth-circuit-holds-that-scienter-may-be-established-through-an-objective-evaluation-of-a-defendants-deliberate-recklessness [https://perma.cc/RQH2-UDUU].

[190] *See* Rose, *supra* note 145, at 1363–64 (advocating greater SEC oversight); *cf. also* Joseph A. Grundfest, *Disimplying Private Rights of Action Under the Federal Securities Laws: The Commission's Authority*, 107 HARV. L. REV. 961, 1023–24 (1994) (arguing that the SEC should clarify

expands the reach of the private right of action, it is necessary to outline these criticisms and how they have shaped the current discourse around the private right of action.

The private right of action is usually justified on two grounds: compensating the victims of securities fraud and deterring fraudulent behavior.[191] However, the compensatory rationale has been generally discredited,[192] meaning that the efficacy of private actions is measured by whether or not they are an effective deterrent. The issue is that, in the words of Vanderbilt professor Amanda Rose, "the *optimal* level of deterrence is less than the *maximum* level of deterrence," meaning that too broad a scope for private suits can lead to over-deterrence.[193] For instance, she claims that

> Rule 10b-5 seeks to prompt the corporation to take adequate precautions to ensure that its officers do not engage in fraud. But the rule necessarily also captures cases where a corporation *has* taken appropriate care[,] [and the] corporation's failure to prevent a Rule 10b-5 violation . . . [is] the result of negligent oversight.[194]

Because of "ambiguities in the legal standard [of liability] . . . corporate officers may find it difficult to comply despite the

---

expressly the private right of action to address controversies around its interpretation).

[191] *See* John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation*, 106 COLUM. L. REV. 1534, 1538 (2006) ("From a policy perspective, the securities class action has two potential rationales: compensation and deterrence.").

[192] For example, Professor John Coffee has noted that "[s]ettlements recover only a very small share of investor losses. NERA Economic Consulting annually prepares a table showing the ratio of settlements to investor losses, and between 1991 and 2004, this ratio has never exceeded 7.2% (which it hit in 1996)." *Id.* at 1545 (citing ELAINE BUCKBERG, TODD FOSTER & RONALD I. MILLER, RECENT TRENDS IN SHAREHOLDER CLASS ACTION LITIGATION: ARE WORLDCOM AND ENRON THE NEW STANDARD? 6 tbl.Investor Losses Have Risen More Rapidly than Settlements (2005), https://www.nera.com/content/dam/nera/publications/archive1/Recent_Trends_07.2005.pdf [https://perma.cc/2E2W-X46P]).

[193] Rose, *supra* note 145, at 1331–32.

[194] *Id.* (footnote omitted).

best of intentions."[195] Private securities litigation presents special concerns: "Whereas the Commission might exercise its discretion and choose not to sanction a corporation for its agent's violation when it has taken appropriate care, or when the challenged disclosure or omission presents a close question on liability, private enforcers lack the incentive to exercise similar restraint."[196] This lack of restraint stems from the fact that

> the plaintiffs' securities bar is enticed to bring suit by the prospect of financial reward—an intuitive observation that is bolstered by evidence showing a correlation between an issuer's market capitalization (which is related to the size of the potential damage award and, in turn, the potential contingency fee) and the likelihood of being sued in a Rule 10b-5 class action.[197]

Rose's concerns speak to one of the most prominent objections to an expanded private right of action, namely the possibility that the profit motive of the plaintiffs' bar leads to frivolous suits that fail to genuinely deter fraud.[198] This problem is exacerbated by the fact that the "prototypical Rule 10b-5 case became a class action brought on behalf of thousands of investors" in the wake of the Supreme Court's approval of presumed reliance in *Basic*.[199] These class action suits were "based on misstatements or omissions made in public disclosure documents that most class members never read, against a deep-pocketed corporate defendant that did

[195] *Id.* at 1333 (citing A.C. Pritchard, *Markets as Monitors: A Proposal To Replace Class Actions with Exchanges as Securities Fraud Enforcers*, 85 VA. L. REV. 925, 937–37 (1999)). Rose specifically notes that the "threat of liability may cause [corporate officers] to omit to disclose information that would benefit society (for fear that its disclosure will be deemed materially misleading), or to disclose information that costs more to produce than it is worth (for fear that its omission will be deemed materially misleading)." *Id.*

[196] *Id.* at 1334.

[197] *Id.* at 1304.

[198] *See supra* Section II.B (discussing limits imposed on the private right of action aimed at reducing frivolous suits).

[199] Rose, *supra* note 145, at 1312. For a brief discussion of *Basic*, see *supra* note 38.

not itself profit from the fraud"[200] rather than genuinely punishing or deterring the people and entities who profited off of the plaintiffs' misfortune. Given the Supreme Court's concerns about private litigation expressed in *Central Bank* and *Janus*,[201] any expansion of the private right of action must ensure that guardrails against a flood of litigation remain in place.

Another set of critiques of the private right of action emphasizes "the critical question [of] who gets sued and who actually bears the costs of a securities class action."[202] In theory, "if insiders face an expected penalty that exceeds their expected gain, this should be sufficient to remove any incentive for them to inflate the corporation's stock price."[203] In practice, however, the most culpable actors are often not the ones paying the penalties or the costs of litigation. As Professor John Coffee has noted, "the costs of such litigation fall on innocent shareholders, not the responsible parties,"[204] and the "full costs that investors bear . . . [include] plaintiffs' attorneys' fees and expenses, defense counsels' fees and expenses, [and] Directors' and Officers' (D&O) insurance premiums."[205] This leads, in part, to a situation referred to as "circularity," critics of which "hold[] that shareholder class actions amount to 'shareholders suing themselves'"[206] because "many members of the plaintiff class will also be shareholders

[200] Rose, *supra* note 145, at 1312. However, there are suggestions that the fear of strike suits does not bear out in reality. For example, Professor John Coffee has noted that "the economic evidence that strike suits predominate . . . seems unpersuasive" and instead attributes the "positive stock price reaction to political developments seeking to curtail such litigation" to shareholders bearing the cost of the litigation rather than the merits of the cases themselves. Coffee, *supra* note 191, at 1536 n.5.

[201] *See supra* Sections II.B–.C.

[202] Coffee, *supra* note 191, at 1549.

[203] *Id.* at 1548.

[204] *Id.* at 1537.

[205] *Id.* at 1545–46.

[206] James Cameron Spindler, *We Have a Consensus of Fraud on the Market—and It's Wrong*, 7 HARV. BUS. L. REV. 67, 69 (2017) (quoting Hal Scott, *How To Improve Five Important Areas of Financial Regulation*, *in* RULES FOR GROWTH: PROMOTING INNOVATION AND GROWTH THROUGH LEGAL REFORM 113, 145 (2011)).

of the defendant corporation."[207] This means that "recovery will result largely in 'pocket shifting.'"[208]

The circularity critique has undergone some criticism, as Professor James Cameron Spindler has argued that "[t]he circularity critique fails mathematically" because, on his "economic model, penalties on the firm effectively come out of the pockets of non-plaintiff shareholders, and actually do compensate plaintiffs."[209] However, even if the circularity critique is overstated, the issue goes beyond the "pocket transfer" aspects of settlements; if the costs are borne by non-plaintiff shareholders, they still end up falling on shareholders rather than the actors responsible for fraud. This issue undercuts much of the deterrent impact of private litigation, for responsible corporate insiders "are regularly sued, [but] rarely appear to contribute to the settlement."[210] It also has a negative impact on the market, which "reacts adversely to the filing of [securities litigation] because it expects that the eventual settlement of [an] action will be borne by the shareholders as a group."[211] Thus, shareholders not only bear the costs of litigation in a literal sense but also may incur "the . . . costs of disruption, stigma, and adverse publicity."[212]

B. The "Modified Creator Standard" as an Effective Fraud Deterrent

Despite the issues with the private right of action, expanding its scope by adoption of the "modified creator standard" for scheme liability would play an important role in

[207] Rose, *supra* note 145, at 1313.

[208] *Id.* (first citing Janet Cooper Alexander, *Rethinking Damages in Securities Class Actions*, 48 STAN. L. REV. 1487, 1503–04 (1996); and then citing Coffee, *supra* note 191, at 1558).

[209] Spindler, *supra* note 206, at 70.

[210] Coffee, *supra* note 191, at 1550. This often due to corporations buying D&O insurance, which ensures that "[i]n the more typical case of the solvent corporation . . ., the likelihood is that the insurer will cover everything—i.e., the settlement plus litigation expenses—up to its policy limits, and the corporation will pick up the balance." *Id.* at 1553.

[211] *Id.* at 1537.

[212] *Id.* at 1546.

deterring securities fraud. The private right of action itself promotes investor confidence, and the "modified creator standard" will ensure a more optimal level of deterrence relative to the current regime by placing outside advisors like lawyers and accountants within the scope of primary liability. This provides an additional layer of deterrence, mindful of the prevalence of D&O insurance,[213] which prevents direct imposition costs on management.

Despite the perceived flaws of the private right of action and fears of over-deterrence, the reality is that private litigation provides an essential supplement to SEC enforcement. Even if the compensatory rationale does not bear out, private securities litigation ensures there are more deterrents against fraud, especially "because of the phenomenal growth of the securities industry during a time when the Commission's staff and budget levels have remained relatively constant."[214] Even the Supreme Court has noted that "meritorious private actions . . . enforce federal antifraud securities laws [and] are an essential supplement to criminal prosecutions and civil enforcement actions,"[215] indicating that the issue is more about the merits of the cases being brought by private plaintiffs than the private right of action as a whole.

Similarly, the private right of action promotes investor confidence by ensuring there are ways to hold those who commit fraud liable for their transgressions without relying entirely on the SEC. The impact of fraud on investor confidence can be shown by the rise in the "cost of equity capital" in the wake of "Enron, WorldCom, and a host of other scandals in the 2000 to 2002 era," which "made stockholders

---

[213] *Id.*

[214] Cosenza, *supra* note 134, at 1027 n.33 (internal quotation marks omitted) (quoting *Securities Litigation Uniform Standards Act of 1997: Hearing on S. 1260 Before the Subcomm. on Sec. of the S. Comm. on Banking, Hous. & Urb. Affs.,* 105th Cong. 5–6 (1998) (statement of Hon. Arthur Levitt, Jr., Chairman, SEC & Hon. Isaac C. Hunt, Comm'r, SEC)). This is consistent with my personal experience interning with the SEC's New York Regional Office during the summer of 2019, as the office had not hired attorneys for over two years and generally had leanly staffed teams.

[215] Tellabs, Inc. v. Makor Issues & Rts., Ltd., 551 U.S. 308, 313 (2007).

wary, chilled the initial public offering market, and caused investors to demand a higher return based on the perceived higher risks."[216] The impact goes beyond financial markets, for "[w]hen the cost of capital rises, the economy as a whole suffers, as Gross National Product declines or stagnates, and unemployment may increase. As a result, not only investors, but also citizens throughout society experience a loss."[217]

The fundamental issue with the restrictions on primary liability imposed by *Janus* is that they do nothing to solve the deterrence issues with private securities litigation. For example, by restricting private suits against "non-maker" participants in the creation of false statements, *Janus* does not solve the problems associated with shareholders bearing litigation costs; it allows many of the most culpable actors (namely insiders and outside advisors) to escape liability. This curtails the private right of action without addressing its systemic problems, which is why Coffee's desired reforms "would require plaintiffs' attorneys to sue the corporate insiders and the corporation's gatekeepers (e.g., its investment bankers, auditors, and attorneys), not the issuer, in order to obtain their recovery."[218] *Janus*, by contrast, makes it more likely that the issuer corporation will be the main entity held liable. While the highest-level executives may be liable as "makers," "[e]xplicit attribution typically disappears as we move down the corporate hierarchy . . ., and so it becomes harder to declare the deceptive actions of, say, a vice president to be a violation of Rule 10b-5."[219] By focusing litigation on officers whose costs are likely to be covered by D&O insurance or by the corporation, the Court is undermining the deterrent impact of private suits.[220]

[216] Coffee, *supra* note 191, at 1565.

[217] *Id.*

[218] *Id.* at 1582.

[219] Donald C. Langevoort, *Lies Without Liars:* Janus Capital *and Conservative Securities Jurisprudence*, 90 WASH. U. L. REV. 933, 955–56 (2013).

[220] It is important to note here that even without the current D&O insurance scheme, having insiders down the corporate ladder be liable would make sense as a means of deterrence. It would cause every person who participates in the creation and dissemination of a statement to pause

Janus also ensures that "gatekeepers" and outside advisers, such as attorneys and accountants, mostly can escape primary liability[221] despite the fact that "[i]f the gatekeepers are adequately deterred, they will block transactions, even though the primary violator would willingly proceed with them."[222] This means that, without a corresponding increase in the reach of the scheme liability provisions, *Janus* serves to "give . . . gatekeepers immunity from private liability" and therefore "abandon[s] what logically is the most efficient technique for deterrence: namely, [a] focus on the party who has both the ability to block the illicit transaction and the weakest incentive to engage in it."[223] Using the "modified creator standard" to expand scheme liability will further the deterrent aims of 10b-5 without contributing to some of the main issues that underly private litigation, like the issue of who bears litigation costs. While other reforms perhaps should be pursued,[224] the point is that limiting liability to persons with "ultimate control"[225] over

prior to drafting, ratifying, or sending out such information to the investing public. However, the prevalence of D&O insurance does heighten the benefits of holding more actors down the corporate ladder liable because it will ensure that at least some of the participants are not covered by D&O insurance and therefore will be deterred.

[221] *See supra* Section II.C.

[222] Cosenza, *supra* note 134, at 1078 n.342 (internal quotation marks omitted) (quoting *Evaluating S.1551: The Liability for Aiding and Abetting Securities Violations Act of 2009: Hearing Before the Subcomm. on Crime and Drugs of the S. Comm. on the Judiciary*, 111th Cong. 4 (2009) [hereinafter *Evaluating S.1551*] (statement of John C. Coffee, Jr., Adolf A. Berle Professor of Law, Colum. Univ. L. Sch.)).

[223] *Id.* (internal quotation marks omitted) (quoting *Evaluating S.1551*, *supra* note 222, at 4 (statement of John C. Coffee, Jr., Adolf A. Berle Professor of Law, Colum. Univ. L. Sch.)).

[224] See, for example, generally Coffee, *supra* note 191, Rose, *supra* note 145, and Steve Thel, *Taking Section 10(b) Seriously: Criminal Enforcement of SEC Rules*, 2014 COLUM. BUS. L. REV. 1 for differing ideas regarding reforming private securities actions.

[225] *See* Janus Cap. Grp. v. First Derivative Traders, 564 U.S. 135, 143 (2011).

misstatements does not solve some of the most significant issues with the private right of action.[226]

C. Guardrails Against Vexatious Litigation and the Issue of Reliance

For those who fear a wave of increased litigation due to the expansion of the private right of action, there still are plenty of hurdles for private plaintiffs to ensure that only a limited set of cases—those with merit—go forward. Using a "modified creator standard" rather than a "substantial participation test" limits primary liability to coauthors and those who are otherwise directly responsible for misstatements, meaning that a large number of potential defendants will be shielded from private suits.[227] The procedural hurdles discussed by the legal community after *Lorenzo* came down also will remain in place.[228] For example, a more expansive reading of *Lorenzo* will "not affect the various hurdles the Private Securities Litigation Reform Act imposes on private Section 10(b) class action claims, including the requirements that plaintiffs plead a strong inference of scienter and state their falsity claims with particularity."[229] The scienter requirement will be particularly difficult to overcome since a defendant's scienter will generally be less clear-cut than it was in *Lorenzo*[230] even under a recklessness standard.[231] The required showing of an expectation of reliance on the misstatements would further limit claims.[232]

[226] Although it could be argued that this increased deterrence comes at the cost of allowing more frivolous litigation to go forward, the major issue with such an emphasis on preventing vexatious suits is that it allows corporations and their employees (especially management) to get away with fraudulent conduct that harms shareholders and the investing public as a whole.

[227] *See supra* text accompanying notes 176–79.

[228] *See supra* Section III.D.

[229] Lipson et al., *supra* note 112.

[230] *See supra* text accompanying notes 120–21.

[231] *See supra* Section IV.C.3.

[232] This would not replace the usual reliance element of a 10b-5 claim because "[r]eliance is a separate element from fraudulent intent . . . and reliance in private litigation is looked at not from the defendant's

Admittedly, the issue of reliance is more complicated because *Stoneridge* required a showing of direct reliance on a defendant's misstatements.[233] This would be a substantial barrier for many private litigants, mollifying flood of litigation concerns. However, this could also make scheme liability much less potent than is desirable. Showing class-wide reliance is nearly impossible unless the fraud-on-the-market (FOTM) presumption is applicable, for otherwise individual class members would have to individually show that they relied on the defendant's misstatement.[234] After *Lorenzo*, a group of commentators noted that "the Supreme Court in [*Stoneridge*] held that . . . . [w]hile reliance on public statements made by or on behalf of public companies with efficiently traded stock is presumed in class actions, there is no similar presumption applicable to alleged 'schemes' or other forms of deceptive conduct."[235] Although some restrictions on the ability to bring suits, like scienter, are necessary, this reading of *Stoneridge* would make the "modified creator standard" mostly irrelevant since almost no class actions would make it past the class certification stage. The point here is not just balancing deterrence and frivolous litigation: without the application of the FOTM presumption to scheme liability, the "modified creator standard" will do nothing to expand the scope of liability in practice except in cases brought by a small number of plaintiffs.

perspective, but from the perspective of the investor." Susan E. Hurd & Evan Glustrom, *Securities Litigation Advisory: Lorenzo v. SEC: The Supreme Court Rules on Scheme Liability Under the Federal Securities Laws*, ALSTON & BIRD (Mar 28, 2019), https://www.alston.com/en/insights/publications/2019/03/the-supreme-court-rules-on-scheme-liability [https://perma.cc/2AAW-P4C9]. Rather, it would require an *additional* showing as to scienter while still ensuring that "it does not matter for *reliance* purposes whether the defendant 'intended' for shareholders to rely— . . . [only] whether they in fact did rely." *Id.* (emphasis added). The recklessness standard would apply this "expectation of reliance" prong of the scienter test.

[233] *See* Stoneridge Inv. Partners v. Scientific-Atlanta, 552 U.S. 148, 158–59 (2008).

[234] *See* Nili, *supra* note 38.

[235] BEHA ET AL., *supra* note 121.

However, *Stoneridge* does not have to be read to preclude application of the FOTM presumption to scheme liability. After all, unlike the conduct in *Stoneridge*,[236] the type of conduct at issue in *Lorenzo*[237] and *Janus*[238] involved direct participation in the creation or dissemination of false statements on which investors relied. The *Stoneridge* court's objection to the plaintiffs' invocation of scheme liability in that case came from the fact that "this approach does not answer the objection that petitioner did not in fact rely upon respondents' own deceptive conduct,"[239] rather than any specific limitation on FOTM reliance when litigating scheme liability. So long as the scheme at issue directly involved public misstatements rather than the transactions underlying the misstatements, the FOTM presumption could apply.

Of course, all of this depends on how *Stoneridge* is read. Some courts have adopted a more limited reading of *Stoneridge* that is restricted to public attribution. For example, one federal judge held that "the key element of reliance under Section 10(b) is not satisfied simply because corporate insiders or professionals working behind the scenes allegedly caused fraudulent statements to be made as part of a scheme."[240] However, this reading does not make sense, as parties who actually participated in the creation of misstatements are responsible for those statements going out to the public and the markets, even if their role is not disclosed. In fact, a court applying the "modified creator standard" would necessarily reject the idea of attribution.

---

[236] The misconduct at issue in *Stoneridge* involved "entities who, acting both as customers and suppliers, agreed to arrangements that allowed the investors' company to mislead its auditor and issue a misleading financial statement affecting the stock price." 552 U.S. at 152–53.

[237] *See* Lorenzo v. SEC, 139 S. Ct. 1094, 1099 (2019).

[238] *See* Janus Cap. Grp. v. First Derivative Traders, 564 U.S. 135, 140 (2011).

[239] *Stoneridge*, 552 U.S. at 159–60.

[240] George Borden & John S. Williams, *Scheme Liability After Stoneridge*, LAW360 (July 18, 2008, 12:00 AM) (on file with the Columbia Business Law Review), https://www.law360.com/articles/63032/scheme-liability-after-stoneridge (citing *In re* DVI Inc. Sec. Litig., 249 F.R.D. 196, 217–18 (E.D. Pa. 2008)).

Donald Langevoort rejected this approach as well, stating that suing persons beyond the attributed author that are "integrally involved in the preparation of the public disclosure" is "the opposite of [the] attenuation" that troubled the *Stoneridge* Court.[241] Courts that apply *Stoneridge* in a limited manner therefore engage in an analysis that the "Supreme Court squarely rejected."[242] On this view, *Stoneridge* is consistent with a presumption of reliance in scheme liability class actions so long as the conduct at issue is directly related to the misstatements released to the public.[243] This would ensure that reliance serves as a barrier to cases where the defendant's connection to the plaintiff is too attenuated while allowing meritorious suits to go forward when a more direct connection can be found.

The policy analysis of this Part ultimately balances deterring fraud and safeguarding issuers against vexatious lawsuits. The cost of implementing the "modified creator standard" is that it expands the scope of primary liability, increasing the potential for defendants to face wasteful litigation. However, the current system imposed by *Janus*, by focusing so much on filtering out cases, does little to deter fraudulent conduct. It primarily imposes liability on issuers and high-level managers, both which are either insured or indemnified against lawsuit, thereby ensuring that shareholders rather than fraudsters bear litigation costs.[244] By contrast, opening liability up to lower-level employees, middle managers, and third-party gatekeepers ensures that more participants in the creation and dissemination of false statements will be penalized. These participants then have an incentive to ensure all public disclosures for which they are

[241] Langevoort, *supra* note 38, at 2156.

[242] *Id.* at 2164 (discussing reasoning ignoring the degree of the defendant's involvement in a misrepresentation).

[243] In my view, this would entail requiring the plaintiffs to show the connection between the misconduct alleged and the dissemination of the misstatement to the public. Thus, even if the defendant's role in crafting the misstatement is not publicly known, the fact that they contributed to the creation and dissemination of a statement to the investing public means that reliance on their conduct can be presumed.

[244] *See supra* notes 202–08 and accompanying text.

responsible are truthful. The "modified creator standard," even if the FOTM presumption applies, embraces this incentive but tempers it by retaining many of the threshold requirements to for pleading and class certification—especially the scienter and reliance requirements.

VI. THE "MODIFIED CREATOR STANDARD" AND SEC ENFORCEMENT

Using *Lorenzo* to expand the scope of scheme liability to include coauthorship of false statements also allows the SEC to better carry out its mission of "[p]rotect[ing] investors[,] [m]aintain[ing] fair, orderly, and efficient markets[,] [and] [f]acilitat[ing] capital formation."[245] Although the SEC is able to bring aiding and abetting actions under section 20(e),[246] the *Janus* decision unnecessarily constrained its ability to bring enforcement actions. The *Janus* decision itself left it open to interpretation whether or not the court's definition of "make" would apply to SEC enforcement,[247] but the D.C. Circuit found that *Janus* was binding on the SEC, a presumption that went

[245] U.S. Sec. & Exch Comm'n, *The Role of the SEC*, INVESTOR.GOV (bullet points omitted), https://www.investor. gov /introduction-investing/basics/role-sec [https://perma.cc/G7ZD-N963] (last visited Nov. 17, 2020).

[246] *See* note 31 and accompanying text.

[247] *See* Langevoort, *supra* note 219, at 941 ("[W]e are being told [by *Janus*] what 'make' means *in the context of private securities litigation* under Rule 10b-5, leaving open how it is to be construed in the context of public enforcement.").

unchallenged in the Supreme Court.[248] This also lines up the SEC's interpretation of the scope of *Janus*'s holding.[249]

Yet, *Janus*'s logic does not make sense in the context of SEC enforcement: the "policy concerns that le[d] the *Janus* Court to acknowledge the 'narrow scope' it must give the implied private right of action are nonexistent when the SEC is the plaintiff."[250] Reading *Lorenzo* more expansively would allow the federal courts to continue to apply *Janus* to the SEC without having to justify why the SEC's enforcement should be curtailed (or else why a different definition of "make" should apply to it), allowing *Janus* to remain formally intact while eliminating the bizarre results it has produced.

Beyond solving textual irregularities, reading *Lorenzo* to encompass a broader range of conduct would be more effective from a policy perspective and reverse some of the damage *Janus* has done to the SEC's ability to protect investors. While the PSLRA explicitly provides the SEC with the ability to bring aiding and abetting suits under section 20(e), allowing for those suits is no substitute for being able to hold actors primarily liable. As noted by Justice Breyer in

---

[248] *See* Lorenzo v. SEC, 139 S. Ct. 1094, 1100 (2019) ("We took this case on the assumption that Lorenzo was not a 'maker' under subsection (b) of Rule 10b-5[.]"). Some saw this as being definitive: "The decision should put to rest any lingering question about whether *Janus* applies to Rule 10b-5(b) claims asserted by the SEC and the Department of Justice, not just by private plaintiffs." *Supreme Court Holds that Persons Who Do Not "Make" Misstatements Can Nevertheless Be Liable for Other Securities-Fraud Violations*, PROSKAUER (Mar. 27, 2019), https://www.proskauer.com/alert/supreme-court-holds-that-persons-who-do-not-make-misstatements-can-nevertheless-be-liable-for-other-securities-fraud-violations [https://perma.cc/5SNG-KEWF].

[249] SEC v. Kelly, 817 F. Supp. 2d 340, 343 (S.D.N.Y. 2011) ("The SEC concedes that *Janus* foreclosed its ability to assert a misstatement claim under subsection (b) of rule 10b-5[.]"), *abrogated on other grounds by Lorenzo*, 139 S. Ct. 1094.

[250] Greg Gaught, Note, *Rethinking* Janus*: Preserving Primary-Participant Liability in SEC Antifraud Enforcement Actions*, 65 DUKE L.J. 527, 542 (2015). This also lines up with the wording of Justice Thomas's opinion in *Janus*: "the Court explicitly framed the question before it as 'whether JCM can be held liable *in a private action*.'" Langevoort, *supra* note 219, at 938 (quoting Janus Cap. Grp. v. First Derivative Traders, 131 S. Ct. 2296, 2301 (2011)).

Lorenzo, the issue is that "the statute insists that there be a primary violator to whom the secondary violator provided 'substantial assistance,'"[251] meaning that the SEC could not bring suit against a secondary actor involved in the creation of a false statement unless the primary actor could be held liable as well. This limits the scope of enforcement in situations where the person defined as "the maker" does not meet one 10b-5 requirement (such as scienter) while the secondary actor does. On *Janus*'s facts, had the SEC brought the action, it would need to show that the Janus Fund itself (or the actors in charge of it) engaged in securities fraud with the requisite scienter in order to bring a secondary liability claim against JCM or the other defendants. This is especially disconcerting given that "[t]he essential nature of an SEC enforcement action is equitable and prophylactic; its primary purpose is to protect the public against harm, not to punish the offender."[252] In a case like *Janus*, the ability of the SEC to protect the public would be undermined since the parties who had committed fraud could not be held liable.

A broader reading of *Lorenzo* also would ensure that the gaps created by *Janus* in the SEC's enforcement capabilities could be filled without having to wait for congressional or agency action. In the wake of *Janus*, multiple law review articles came out discussing the need to pass a new Rule 10b-5 that would apply to SEC enforcement and eliminate the "make" language in 10b-5(b), or, at the very least, clarify the rule.[253] Donald Langevoort suggested that the decision may have been designed to coax a response from the Commission or even congressional action, much like congressional passage of the PSLRA in response to *Central Bank*.[254] While legislative or administrative clarity would still be preferable, *Lorenzo*

---

[251] *Lorenzo*, 139 S. Ct. at 1104 (quoting 15 U.S.C. § 78t(e) (2018)).

[252] SEC v. Coven, 581 F.2d 1020, 1027–28 (2d Cir. 1978).

[253] *See, e.g.*, Gaught, *supra* note 250, at 566–67; John Patrick Clayton, Note, *The Two Faces of* Janus*: The Jurisprudential Past and New Beginning of Rule 10b-5*, 47 U. MICH. J.L. REFORM 853, 878–80 (2014).

[254] *See* Langevoort, *supra* note 219, at 942–43 (noting, however, that SEC action would be insufficient if *Janus* is understood to interpret the Commission's statutory authority).

provides an avenue for the federal courts to remedy the gaps opened up by *Janus*. These gaps in the regulatory scheme become an issue especially when corporate insiders participate in the creation of fraudulent schemes but lower-level executives responsible for misstatements fall outside the ambit of primary liability.[255]

Admittedly, there may be reason to doubt the seriousness of these gaps given the other enforcement tools the SEC has at its disposal—particularly section 17(a). Although the language of 10b-5 was meant to directly parallel section 17(a),[256] section 17(a) does not include the word "make" in the provision corresponding to 10b-5(b). Instead, section 17(a)(2) states that its penalty is to be imposed on those who "obtain money or property by means of any untrue statement of a material fact or any omission,"[257] which has led many commentators to suggest that *Janus* does not apply to 17(a).[258]

---

[255] This is the case because it is more difficult to attribute liability as you move down the corporate ladder, and therefore, if the board of directors does not have the requisite scienter, there will be no primary violation to "aid and abet." For a more detailed discussion of the scope of liability, see *supra* Section IV.C.2.

[256] *See supra* notes 12–13 and accompanying text.

[257] 15 U.S.C. § 77q(a)(2) (2018).

[258] *See* Langevoort, *supra* note 219, at 955 ("Defendants in SEC enforcement actions have argued that *Janus*' 'ultimate authority' test implicitly confines the scope of Section 17(a) as well as l0b-5, and at least one court has agreed. That is nonsense. Statutory language has to be interpreted literally, and the relevant language in Section 17(a) asks whether the defendant obtained money or property 'by means of' a materially false or misleading statement or omission. None of the *Janus* Court's references to the dictionary, speechwriters, or precedent concerning the need to confine judicially-implied private rights of action are the least bit helpful for interpreting words written a decade before Rule 10b-5 came into existence." (footnotes omitted) (quoting 15 U.S.C. § 77q(a)(2) (2006)) (citing SEC v. Kelly, 817 F. Supp. 2d 340, 345–46 (S.D.N.Y. 2011), *abrogated on other grounds by* Lorenzo v. SEC, 139 S. Ct. 1094 (2019))); Wendy Gerwick Couture, *Prosecuting Securities Fraud Under Section 17(a)(2)*, 50 LOY. U. CHI. L.J. 669, 684 (2019) ("Because the reasoning in *Janus* does not apply to Section 17(a)(2), I agree with the vast majority of courts that *Janus*'s restrictions do not apply to Section 17(a)(2). Therefore, a person can violate Section 17(a)(2) by using a materially misleading misstatement or omission in the offer or sale of securities, even if he or she did not have ultimate authority over its content. As additional support for this

This has been borne out in the majority of federal courts, which "have declined to extend [*Janus*'s] holding to 17(a)(2)"[259] because "'to make a statement' is the equivalent of 'to state,' [but] to obtain money 'by means of' a statement plainly covers a broader range of activity."[260] This could suggest that the impact of *Janus* on the SEC is reduced, but that ignores the purpose of 10b-5, which was to close the gaps in 17(a) while reaching the same types of conduct.[261] Holding liable those who assist in the making of a false statement in relation to a sale but not those who assist in relation to a purchase is an arbitrary distinction.[262] The availability of section 17(a) is certainly beneficial for the SEC since *Janus* is less likely to apply and since it does not carry the baggage of criticisms of the private right of action,[263] but the federal courts should not allow a gap in Rule 10b-5 on such formalistic grounds.

There also are concerns that forcing the SEC to rely on section 17(a)(2) rather than Rule 10b-5 could undermine the SEC's power to deter fraudulent conduct because, unlike a violation of 10b-5, "[a] violation of Section 17(a)(2) does not require scienter and thus can be established if the defendant acted negligently."[264] Forcing the SEC to rely on 17(a)(2) could dilute the impact of a securities fraud violation in two ways: (1) "if the Commission's primary tool for prosecuting misleading statements requires only proof of negligence, there

conclusion, the Supreme Court recently held in *Lorenzo v. SEC* that *Janus*'s restrictive interpretation of 'maker' liability is inapplicable to claims under Section 17(a)(1), Rule l0b-5(a), and Rule l0b-5(c), which do not include the word 'make.'" (citing *Lorenzo*, 139 S. Ct. at 1104)).

[259] SEC v. Husain, No. 16-cv-03250, 2017 WL 810269, at *8 (C.D. Cal. Mar. 1, 2017) (collecting cases).

[260] SEC v. Stoker, 865 F. Supp. 2d 457, 465 (S.D.N.Y. 2012).

[261] *See supra* notes 12–18 and accompanying text.

[262] Langevoort mentions the same history in critiquing *Janus* Court's textualism: "Note what the Court does *not* do—ask what a reasonable person would think the SEC meant at the time by its chosen language" even though "[t]he context in which the rule was adopted is well-known." *See* Langevoort, *supra* note 219, at 940.

[263] *See id.* at 940–41.

[264] Couture, *supra* note 258, at 672 (citing Aaron v. SEC, 446 U.S. 680, 702 (1980)).

is a serious risk of diluting the social stigma associated with violating the securities law," and (2) "negligence-based violations carry smaller penalties than intentional violations."[265] Expanding scheme liability under 10b-5 would fill in the gaps *Janus* created, allow the SEC to use 10b-5 as a deterrent to fraud, and reinstate the SEC's pre-*Janus* enforcement arsenal.

VII. CONCLUSION

The adoption of a "modified creator standard" would be an effective way for federal courts to apply the *Lorenzo* decision going forward. With regard to the private right of action, it would further the goal of deterring fraud by ensuring that culpable actors are once again subject to suit by private plaintiffs while maintaining the many barriers that are in place to prevent strike suits and ensure that minor participants are not swept up in private litigation. It also would fill in the gaps in SEC enforcement created by *Janus*, allowing the Commission to use Rule 10b-5 to hold those who effectively "create" misstatements primarily liable and therefore prevent culpable actors from escaping liability based on legal technicalities.

I reiterate that this Note limits itself to a judicial analysis of *Lorenzo*—one which would, admittedly, increase the judiciary's reach but also would ensure investors are better protected from fraud and able to hold those who defraud them accountable without a concomitant flood of vexatious litigation. Legislative and regulatory solutions proposed to increase the effectiveness of Rule 10b-5 as a deterrent should still be considered on their merits and could compliment the judicial approach proposed in this Note.

Judicially, a new paradigm is needed in securities law. Specifically, courts should not unnecessarily curtail the SEC's enforcement capabilities in their attempts to limit the scope of the private right of action. Courts also should take a more

---

[265] Clayton, *supra* note 253, at 875 (citing 15 U.S.C. § 77t(d)(2) (2012)). As a result, in both a literal and figurative sense, "the cost of violating Section 17(a) (2) may decrease." *Id.*

nuanced view of private enforcement and consider how they can bolster private litigation as an effective deterrent, rather than arbitrarily cutting its scope. Adopting the "modified creator standard" or a similar test would, as to the scope and enforcement of Rule 10b-5, be a step in the right direction.