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The Biggest Securities Decisions Of 2019: Midyear Report

By **Rachel Graf**

Law360 (June 28, 2019, 8:48 PM EDT) -- So far this year, the U.S. Supreme Court decided two major securities cases. In one, the justices broadened the scope of liability for people involved in the spread of false information about investments. In the other, the court put off deciding whether private plaintiffs are able to bring lawsuits alleging false statements and omissions related to tender offers, although the issue could come back.

Here, Law360 examines those rulings and other developments that experts have deemed among the most significant of 2019.

An Investment Banker's Copy-Paste Fraud

In March, the Supreme Court voted 6-2 to side with the SEC and uphold the D.C. Circuit's finding that an investment banker could be held liable for sending clients emails drafted by his boss that contained false statements.

The high court found investment banker Francis V. Lorenzo liable for fraud through so-called scheme liability for forwarding his boss' misstatements about an energy investment. The justices affirmed the lower court's opinion that Lorenzo and others who disseminate — rather than author — false information can be held responsible.

The dissenters, Justices Clarence Thomas and Neil Gorsuch, argued the ruling extends the SEC's enforcement powers to "virtually any person who assists with the making of a fraudulent misstatement," but Paul Hastings LLP partner Nicolas Morgan said the concern is likely overblown.

The justices in the majority distinguished Lorenzo from a hypothetical mailroom clerk who is only "tangentially involved in dissemination." Lorenzo was the director of investment banking at his firm, signed the misleading emails himself and told investors to "call with any questions," according to court documents.

Morgan doesn't expect the SEC to push its luck in cases that aren't as clear-cut as Lorenzo's.

"I think if the SEC were to try to employ the scheme liability in a way that just sort of ran against common sense ... there'd be pushback, and I'm not sure the result would be the same if it found its way back to the Supreme Court," said Morgan, whose practice focuses on complex securities litigation.

The opinion was also notable because the justices' votes didn't necessarily match their political ideologies, said UCLA School of Law professor James Park.

Chief Justice John Roberts and Justice Samuel Alito, who were nominated by Republican President George W. Bush, sided with the more liberal justices in the majority. Justice Brett Kavanaugh, a Trump nominee, recused himself, after he wrote an underlying dissent at the D.C. Circuit.

"I think that the perception might be that the more conservative justices will cut back on litigation, but this is an example of that did not happen," Park said.

The case is Lorenzo v. SEC, case number 17-1077, in the Supreme Court of the United States.

Private Investors' Right to Bring Tender Offer Suits

Another significant Supreme Court ruling this year was just nine words long.

A month after the Lorenzo opinion, the justices punted a decision about the appropriate standard for alleging false statements and omissions related to tender offers and whether private plaintiffs can bring such lawsuits at all.

In a one-sentence order, the high court dismissed as improvidently granted Emulex Corp.'s challenge to a Ninth Circuit finding that investors must show the company was merely being negligent rather than intentionally engaging in wrongdoing when it allegedly misled shareholders about a merger offer.

Though they didn't explain the reasons for dismissal, the justices had questioned during oral arguments earlier that month whether the case was the best vehicle for the claims. Emulex told the Supreme Court in its October petition for a writ of certiorari that a private right of action for the investors' claims doesn't exist at all, but failed to raise that particular issue before any of the lower courts.

"As you well know, this is a court of review, not of first view," Justice Ruth Bader Ginsburg said during oral arguments.

The justices' focus on the question of a private right of action shows they'll probably decide there is none when an appropriate case makes its way to them, said Sean Baldwin, a partner at Selendy & Gay PLLC.

If the majority of justices thought a private right of action existed, they would have moved past the issue and considered the proper standard for the investors' allegations, Baldwin said. But they didn't.

"That suggests ... when the right case comes along there is at least at the moment a majority — probably the conservative majority — on the Supreme Court that's ready to strike down the private right of action," Baldwin said.

The case is Emulex Corp. v. Gary Varjabedian et al., case number 18-459, in the U.S. Supreme Court.

When an ICO Isn't a Security

The SEC has staked its jurisdictional claim over digital assets largely through enforcement actions, but

broke with this tradition in April, when it made a point of not bringing an action over an unregistered initial coin offering.

SEC staff issued the no-action letter to TurnKey Jet Inc., a provider of air charter services.

The agency has deemed digital assets securities when there is an "investment of money in a common enterprise with a reasonable expectation of profits to be derived from the efforts of others," as determined by the U.S. Supreme Court's 1946 Howey ruling. With the TurnKey decision, the SEC's Division of Corporation Finance highlighted the company's assurances that consumers aren't buying the tokens to profit, but rather to purchase air charter services.

"It's a step in the right direction in helping determine the boundaries for what is a security in the digital assets space," said Morgan of Paul Hastings. But he added, "I didn't really think the no-action letter broke much new ground."

SEC staff released the no-action letter in conjunction with guidance about digital assets that largely consolidated the agency's stance on them, which had been spread across a number of cases and speeches.

UCLA's Park said the no-action letter would have been more instructive if TurnKey's tokens hadn't so obviously been used as currency to buy goods and services. The SEC should focus instead on advice for companies selling tokens to raise money for a project that has yet to be built, Park said.

"It's very hard to avoid security status if your project is not completely functional," he said. "I think that the no-action letter doesn't really give any more leeway to entrepreneurial companies."

Can Investors Sue Over Corporate Codes of Conduct?

Courts have given mixed answers this year to the question of whether statements in corporate codes of conduct can amount to material misrepresentations over which investors can sue.

In March, the Second Circuit said Cigna Corp.'s assurances in SEC filings and a code of ethics that it complied with laws and regulations are "a textbook example of 'puffery'" and inactionable. The investors had claimed these statements were false, given the Centers for Medicare and Medicaid Services' findings that the health insurer actually didn't comply with a number of its requirements such as benefits administration.

But a few months later, U.S. District Judge Colleen McMahon rejected Signet Jewelers Ltd.'s argument that the Cigna ruling barred claims against its own contested statements in a corporate code of conduct.

The New York federal judge emphasized the context of Signet's statements. The investors alleged Signet's statements that it was "committed to a workplace free from sexual harassment" and made employment decisions based on merit alone were part of the company's efforts to minimize fallout from a 2008 lawsuit brought by a group of female employees alleging discrimination by Signet's subsidiary Sterling Jewelers Inc. based on their gender.

"It's a really interesting question: What is enough to bring a claim in this area?" said Selendy & Gay partner Maria Ginzburg, whose practice focuses on commercial and financial disputes.

Companies spanning the health care, energy and banking industries are heavily regulated and potentially affected by claims about their supposed compliance with these rules.

"It's an area that's really, I think, hot in terms of being an area for violations because these days everyone is regulated," Ginzburg said.

The cases are Singh v. Cigna Corp, case number 17-3484, in the U.S. Court of Appeals for the Second Circuit, and In re: Signet Jewelers Limited Securities Litigation, case number 1:16-cv-06728, in the U.S. District Court for the Southern District of New York.

--Editing by Kelly Duncan and Michael Watanabe.