SECURITIES REGULATION

Seventh Edition

2021 Supplement

Marc I. Steinberg
Radford Professor of Law
SMU Dedman School of Law

CAROLINA ACADEMIC PRESS
Durham, North Carolina

Carolina Academic Press
700 Kent Street
Durham, North Carolina 27701
Telephone (919) 489-7486
Fax (919) 493-5668
E-mail: cap@cap-press.com
www.cap-press.com

CONTENTS

Chapter 3

Primary Issuer Transactional Exemptions from Registration

§§ 3.06 – 3.07 2020 Amendments to the Exempt Offering Framework

On page 138, add:

OVERVIEW — THE SEC'S 2020 AMENDMENTS TO THE EXEMPT OFFERING FRAMEWORK

In 2020, the SEC adopted major amendments to the exempt offering rules. The following discussion summarizes the amendments.[1]

1. TEST THE WATERS COMMUNICATIONS — NEW RULE 241

Pursuant to Rule 241, issuers are permitted to use general solicitation of interest materials to "test the waters" for an exempt offer of securities prior to determining which exemption it will use for the sale of the securities. These "testing the waters" communications are meant to gauge preliminary market interest and may be made orally or in writing to determine whether there is any interest in a contemplated offering of securities exempt from registration. Furthermore, no solicitation or acceptance of money nor any commitment from any person is permitted until the issuer makes a determination as to the exemption on which it will rely and commences the offering in compliance with the exemption.

Under Rule 241, the testing the waters communication must state that:

- (1) The issuer is considering an offering of securities exempt from registration under the Act, but has not determined a specific exemption from registration the issuer intends to rely on for the subsequent offer and sale of the securities;

[1] This discussion quotes in part the adopted rules themselves and the SEC releases that adopted these rules. See Securities Exchange Act Release Nos. 10824, 10884 (2020).

- (2) No money or other consideration is being solicited, and if sent in response, will not be accepted.
- (3) No offer to buy the securities can be accepted and no part of the purchase price can be received until the issuer determines the exemption under which the offering is intended to be conducted and, where applicable, the filing, disclosure, or qualification requirements of such exemption are met; and
- (4) A person's indication of interest involves no obligation or commitment of any kind.

2. DEMO DAYS EXEMPTION — NEW RULE 148

The Rule 148 "demo days" exemption from general solicitation provides that a communication will not be deemed to constitute general solicitation or general advertising if made in connection with a seminar or meeting in which more than one issuer participates that is sponsored by a college, university, or other institution of higher education, state or local government or instrumentality thereof, nonprofit organization, or angel investor group, incubator, or accelerator, provided that:

- (1) No advertising for the seminar or meeting references a specific offering of securities by the issuer;
- (2) The sponsor of the seminar or meeting does not:
  - (i) Make investment recommendations or provide investment advice to attendees of the event;
  - (ii) Engage in any investment negotiations between the issuer and investors attending the event;

- (iii) Charge attendees of the event any fees, other than reasonable administrative fees;
- (iv) Receive any compensation for making introductions between event attendees and issuers or for investment negotiations between such parties; and
- (v) Receive any compensation with respect to the event that would require registration of the sponsor as a broker or a dealer under the Securities Exchange Act or an investment adviser under the Investment Advisers Act;

- (3) The type of information regarding an offering of securities by the issuer that is communicated or distributed by or on behalf of the issuer in connection with the event is limited to a notification that the issuer is in the process of offering or planning to offer securities, the type and amount of securities being offered, the intended use of proceeds of the offering, and the unsubscribed amount for the offering; and
- (4) If the event allows attendees to participate virtually, rather than in person, online participation in the event is limited to:
  - (i) Individuals who are members of, or otherwise associated with the sponsor organization;
  - (ii) Individuals that the sponsor reasonably believes are accredited investors;
  - (iii) Individuals who have been invited to the event by the sponsor based on industry or investment-related experience reasonably selected by the

sponsor in good faith and disclosed in the public communications about the event.

3. EXPANDED DEFINITION OF ACCREDITED INVESTOR

In 2020, the SEC adopted amendments to the definition of "accredited investor" to add new categories of natural persons and entities who qualify as accredited investors. Under the new definition, all of the following persons are considered accredited investors: (1) persons holding certain professional certifications and designations, such as FINRA Series 7, Series 65, and Series 82 licensees, as well as persons with credentials issued by an accredited educational institution; (2) knowledgeable employees of private investment funds; (3) registered investment advisers; (4) limited liability companies with $5 million in assets; (5) any entity that owns investments in excess of $5 million and that was not formed for the specific purpose of investing in the securities offered; (6) family offices with at least $5 million in assets under management and their family clients; and (7) spousal equivalents who pool their finances to qualify as accredited investors.

4. LIMITATION OF NUMBER OF NON-ACCREDITED PURCHASERS DURING A NINETY-DAY PERIOD — RULE 506(b)

The number of non-accredited purchasers pursuant to the traditional Rule 506 exemption is limited to (or the issuer must have a reasonable belief that there are no more than) 35 during a 90-calendar-day period — even if the issuer conducts two or more Rule 506(b) offerings during that time span.

5. ADDITIONAL METHOD OF ACCREDITED INVESTOR VERIFICATION UNDER RULE 506(c)

The SEC added another method by which an issuer may verify the accredited status of a purchaser in Rule 506(c) offerings. For investors that the issuer had previously taken reasonable steps to verify as an accredited investor, issuers may now confirm such investor's accredited status by obtaining a written representation from such person at the time of sale that it remains an accredited investor, provided that the issuer is not aware of information to the contrary. This new verification method will suffice for a period of five years from the date the person was previously verified as an accredited investor.

6. INCREASE OF REGULATION A TIER 2 MONETARY LIMITS

The maximum annual amount an issuer may raise pursuant to Regulation A Tier 2 was increased from $50 million to $75 million, and sales by affiliated security holders was increased from $15 million to $22.5 million.

7. INCREASE OF MONETARY LIMITS UNDER RULE 504

The maximum annual amount an issuer may raise pursuant to Rule 504 has been increased from $5 million to $10 million.

8. REGULATION CROWDFUNDING AMENDMENTS

The maximum amount an issuer may raise pursuant to the crowdfunding exemption was increased from $1.07 million to $5 million during a twelve-month period.

The maximum amount investors may purchase was amended. Accredited investors now have no monetary ceiling that they may invest in a crowdfunding offering. The maximum amount that may be purchased by a non-accredited investor during a twelve-month period in all crowdfunding offerings shall not exceed: (i) the greater of $2,200, or 5 percent of the greater of the investor's annual income or net worth, if either the investor's annual income or net worth is less than $107,000; or (ii) 10 percent of the greater of the investor's annual income or net worth, not to exceed an amount sold of $107,000, if both the investor's annual income and net worth are equal to or more than $107,000.

9. NEW INTEGRATON OF OFFERING FRAMEWORK — RULE 152

The SEC revamped the integration framework and adopted safe harbors from integration pursuant thereto. See Rule 152.

Rule 152(a) — General Principle

If the safe harbors in Rule 152(b) do not apply, in determining whether two or more offerings are to be treated as one for the purpose of registration or qualifying for an exemption from registration under the Securities Act, offers and sales will not be integrated if, based on the particular facts and circumstances, the issuer can establish that each offering either complies with the registration requirements of the Act, or that an exemption from registration is available for the particular offering.

For an exempt offering prohibiting general solicitation, the issuer pursuant to Rule 502(a)(1) must have a reasonable belief, based on the facts and circumstances, with respect to each purchaser in the exempt offering prohibiting general solicitation, that the issuer (or any person acting on the issuer's behalf) either:

- (i) Did not solicit such purchaser through the use of general solicitation; or
- (ii) Established a substantive relationship with such purchaser prior to the commencement of the exempt offering prohibiting general solicitation.

Under Rule 152(a)(2), for two or more concurrent exempt offerings permitting general solicitation, in addition to satisfying the requirements of the particular exemption relied on, general solicitation offering materials for one offering that includes information about the material terms of a concurrent offering under another exemption may constitute an offer of securities in such other offering, and therefore the offer must comply with all the requirements for, and restrictions on, offers under the exemption being relied on for such other offering, including any legend requirements and communications restrictions.

Rule 152(b) — Safe Harbors

Rule 152(b) provides four non-exclusive safe harbors from the integration of offerings:

- Rule 152(b)(1) provides a safe harbor for any offering made more than 30 calendar days before the commencement of any other offering, or more than 30 calendar days after the termination or completion of any other offering, will not be integrated with such other offering, provided that for an exempt offering for which general solicitation is not permitted that follows by 30 calendar days or more an offering that allows general solicitation, the provisions of Rule 152(a)(1) shall apply.
- Rule 152(b)(2) provides that offers and sales made in compliance with Rule 701, pursuant to an employee benefit plan, or in compliance with Regulation S will not be integrated with other offerings.
- Rule 152(b)(3) provides a safe harbor from integration with respect to an offering for which a registration statement has been filed under the Securities Act if made subsequent to specified other offerings. Hence, under Rule 152(b)(3), an offering for which a registration statement has been filed will not be integrated if it is made subsequent to: (i) a terminated or completed offering for which general solicitation is not permitted; (ii) a terminated or completed

offering for which general solicitation is permitted that was made only to qualified institutional buyers (QIBs) and institutional accredited investors; or (iii) an offering for which general solicitation is permitted that terminated or completed more than 30 calendar days prior to the commencement of the registered offering.

- Rule 152(b)(4) provides that offers and sales made in reliance on an exemption for which general solicitation is permitted will not be integrated if made subsequent to any terminated or completed offering.

---

§ 3.07 The Limited Offering Exemptions

[C] Rule 701

On page 144, add:

In 2018, the Economic Growth Regulatory Relief and Consumer Protection Act was enacted. Pursuant to that legislation, the SEC is directed to increase the monetary threshold in Rule 701 offerings where no mandated disclosure is specified from the previous $5 million to $10 million during any 12-month period. The legislation also requires the Commission to index for inflation this $10 million amount every five years.

Chapter 4

The Registration Process

§ 4.02 Framework of Section 5

[B] The Pre-Filing Period

[3] Rules 163 and 163A and Emerging Growth Companies

On page 229, add:

Adoption of Rule 163B

In 2019, the SEC adopted Rule 163B. This rule allows all issuers during the pre-filing period to communicate with qualified institutional buyers (QIBs) and institutional accredited investors to test the waters. *See* Securities Act Release No. 10699 (2019). As the SEC stated in the adopting release: We are "adopting a new communications rule under the Securities Act of 1933 that permits issuers to engage in oral or written communications with certain potential investors [i.e., QIBs and institutional accredited investors], either prior to or following the filing of a registration statement, to determine whether such investors might have an interest in a contemplated securities offering."

Chapter 7

Due Diligence and Securities Act Liability

§ 7.02 The Registered Offering — Framework of Section 11

[B] Elements of the Section 11 Right of Action

On page 412, add:

CALPERS v. ANZ SECURITIES, INC.

United States Supreme Court

____ U.S. ____, 137 S. Ct. 2042, 198 L. Ed. 2d 584 (2017)

JUSTICE KENNEDY delivered the opinion of the Court.

The suit giving rise to the case before the Court was filed by a plaintiff who was a member of a putative class in a class action but who later elected to withdraw and proceed in this separate suit, seeking recovery for the same illegalities that were alleged in the class suit. The class-action suit had been filed within the time permitted by statute. Whether the later, separate suit was also timely is the controlling question.

I

A

The Securities Act of 1933 "protects investors by ensuring that companies issuing securities . . . make a 'full and fair disclosure of information' relevant to a public offering." . . . Companies [ordinarily] may offer securities to the public only after filing a registration statement, which must contain information about the company and the security for sale. Section 11 of the Securities Act "promotes compliance with these disclosure provisions by giving purchasers a right of action against an issuer or designated individuals," including securities underwriters, for any material misstatements or omissions in a registration statement.

The Act provides time limits for § 11 suits. These time limits are set forth in a two-sentence section of the Act, § 13. It provides as follows:

> "No action shall be maintained to enforce any liability created under [§ 11] unless brought within one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence . . . . In no event shall any such action be brought to enforce a liability created under [§ 11] more than three years after the security was bona fide offered to the public . . . ."

So there are two time bars in the quoted provision; and the second one, the 3-year bar, is central to this case.

B

Lehman Brothers Holdings Inc. formerly was one of the largest investment banks in the United States. In 2007 and 2008, Lehman raised capital through a number of public securities offerings. Petitioner, California Public Employees' Retirement System (sometimes called CalPERS), is the largest public pension fund in the country. Petitioner purchased securities in some of these Lehman offerings; and it is alleged that respondents, various financial firms, are liable under the Act for their participation as underwriters in the transactions. . . .

In September 2008, Lehman filed for bankruptcy. Around the same time, a putative class action concerning Lehman securities was filed against respondents in the United States District Court for the Southern District of New York. The operative complaint raised claims under § 11, alleging that the registration statements for certain of Lehman's 2007 and 2008 securities offerings included material misstatements or omissions. The complaint was filed on behalf of all persons who purchased the identified securities, making petitioner a member of the putative class. Petitioner, however, was not one of the named plaintiffs in the suit. The class action was consolidated with other securities suits against Lehman in a single multidistrict litigation.

In February 2011, petitioner filed a separate complaint against respondents in the United States District Court for the Northern District of California. This suit was filed more than three years after the relevant transactions occurred. The complaint alleged identical securities law violations as the class-action complaint, but the claims were on petitioner's own behalf. The suit was transferred and consolidated with the multidistrict litigation in the Southern District of New York. Soon thereafter, a proposed settlement was reached in the putative class action. Petitioner, apparently convinced it could obtain a more favorable recovery in its separate suit, opted out of the class.

Respondents then moved to dismiss petitioner's individual suit alleging § 11 violations as untimely under the 3-year bar in the second sentence of § 13. Petitioner countered that its individual suit was timely because that 3-year period was tolled during the pendency of the class-action filing. The principal authority cited to support petitioner's argument that the 3-year period was tolled was *American Pipe & Constr. Co. v. Utah*, 414 U.S. 538 (1974).

The District Court disagreed with petitioner's argument, holding that the 3-year bar in § 13 is not subject to tolling. The Court of Appeals for the Second Circuit affirmed. In agreement with the District Court, the Court of Appeals held that the tolling principle discussed in *American Pipe* is inapplicable to the 3-year time bar. . . .

II

The question then is whether § 13 permits the filing of an individual complaint more than three years after the relevant securities offering, when a class-action complaint was timely filed, and the plaintiff filing the individual complaint would have been a member of the class but for opting out of it. The answer turns on the nature and purpose of the 3-year bar and of the tolling rule that petitioner seeks to invoke. Each will be addressed in turn.

A

As the Court explained in *CTS Corp. v. Waldburger*, [134 S. Ct. 2175] (2014), statutory time bars can be divided into two categories: statutes of limitations and statutes of repose. Both "are mechanisms used to limit the temporal extent or duration of liability for tortious acts," but "each has a distinct purpose."

Statutes of limitations are designed to encourage plaintiffs "to pursue diligent prosecution of known claims." In accord with that objective, limitations periods begin to run "when the cause of action accrues"—that is, "when the plaintiff can file suit and obtain relief." In a personal-injury or property-damage action, for example, more often than not this will be "'when the injury occurred or was discovered.'"

In contrast, statutes of repose are enacted to give more explicit and certain protection to defendants. These statutes "effect a legislative judgment that a defendant should be free from liability after the legislatively determined period of time." For this reason, statutes of repose begin to run on "the date of the last culpable act or omission of the defendant."

The 3-year time bar in § 13 reflects the legislative objective to give a defendant a complete defense to any suit after a certain period. From the structure of § 13, and the language of its second sentence, it is evident that the 3-year bar is a statute of repose. In fact, this Court has already described the provision as establishing "a period of repose," which "'impose[s] an outside limit'" on temporal liability. *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 363 (1991).

The statute provides in clear terms that "[i]n no event" shall an action be brought more than three years after the securities offering on which it is based. This instruction admits of no exception and on its face creates a fixed bar against future liability. . . . The statute, furthermore, runs from the defendant's last culpable act (the offering of the securities), not from the accrual of the claim (the plaintiff's discovery of the defect in the registration statement). . . .

This view is confirmed by the two-sentence structure of § 13. In addition to the 3-year time bar, § 13 contains a 1-year statute of limitations. The limitations statute runs from the time when the plaintiff discovers (or should have discovered) the securities-law violation. The pairing of a shorter statute of limitations and a longer statute of repose is a common feature of statutory time limits. . . . The two periods work together: The discovery rule gives leeway to a plaintiff who has not yet learned of a violation, while the rule of repose protects the defendant from an interminable threat of liability. . . .

The history of the 3-year provision also supports its classification as a statute of repose. It is instructive to note that the statute was not enacted in its current form. The original version of the 1933 Securities Act featured a 2-year discovery period and a 10-year outside limit, see § 13, 48 Stat. 84, but Congress changed this framework just one year after its enactment. The discovery period was changed to one year and the outside limit to three years. See Securities Exchange Act of 1934, § 207, 48 Stat. 908. The evident design of the shortened statutory period was to protect defendants' financial security in fast-changing markets by reducing the open period for potential liability.

B

The determination that the 3-year period is a statute of repose is critical in this case, for the question whether a tolling rule applies to a given statutory time bar is one "of statutory intent." The purpose of a statute of repose is to create "an absolute bar on a defendant's temporal liability," and that purpose informs the assessment of whether, and when, tolling rules may apply.

In light of the purpose of a statute of repose, the provision is in general not subject to tolling. Tolling is permissible only where there is a particular indication that the legislature did not intend the statute to provide complete repose but instead anticipated the extension of the statutory period under certain circumstances.

For example, if the statute of repose itself contains an express exception, this demonstrates the requisite intent to alter the operation of the statutory period. See . . . 29 U.S.C. § 1113 (establishing a 6-year statute of repose, but stipulating that, in case of fraud, the 6-year period runs from the plaintiff's discovery of the violation). In contrast, where the legislature enacts a general tolling rule in a different part of the code—*e.g.*, a rule that suspends time limits until the plaintiff reaches the age of majority—courts must analyze the nature and relation of the legislative purpose of each provision to determine which controls. In keeping with the statute-specific nature of that analysis, courts have reached different conclusions about whether general tolling statutes govern particular periods of repose.

Of course, not all tolling rules derive from legislative enactments. Some derive from the traditional power of the courts to "'apply the principles . . . of equity jurisprudence.'" The classic example is the doctrine of equitable tolling, which permits a court to pause a statutory time limit "when a litigant has pursued his rights diligently but some extraordinary circumstance prevents him from bringing a timely action." . . .

The purpose and effect of a statute of repose, by contrast, is to override customary tolling rules arising from the equitable powers of courts. By establishing a fixed limit, a statute of repose implements a "'legislative decisio[n] that as a matter of policy there should be a specific time beyond which a defendant should no longer be subjected to protracted liability.'" The unqualified nature of that determination supersedes the courts' residual authority and forecloses the extension of the statutory period based on equitable principles. For this reason, the Court repeatedly has stated in broad terms that statutes of repose are not subject to equitable tolling.

C

Petitioner contends that the 3-year provision is subject to tolling based on the rationale and holding in the Court's decision in *American Pipe*. The language of the 3-year statute does not refer to or impliedly authorize any exceptions for tolling. If *American Pipe* had itself been grounded in a legislative enactment, perhaps an argument could be made that the enactment expressed a legislative objective to modify the 3-year period. If, however, the tolling decision in *American Pipe* derived from equity principles, it cannot alter the unconditional language and purpose of the 3-year statute of repose.

In *American Pipe*, a timely class-action complaint was filed asserting violations of federal antitrust law. Class certification was denied because the class was not large enough, see Fed. Rule Civ. Proc. 23(a)(1), and individuals who otherwise would have been members of the class then filed motions to intervene as individual plaintiffs. The motions were denied on the grounds that the applicable 4-year time bar had expired. The Court of Appeals reversed, permitting intervention.

The Court affirmed. It held that individual plaintiffs' motions to intervene were timely because "the commencement of a class action suspends the applicable statute of limitations as to all asserted members of the class." The Court reasoned that this result was consistent "both with the procedures of Rule 23 and with the proper function of the limitations statute" at issue. First, the tolling furthered "the purposes of litigative efficiency and economy" served by Rule 23. Without the tolling, "[p]otential class members would be induced to file protective motions to intervene or to join in the event that a class was later found unsuitable," which would "breed needless duplication of motions." Second, the tolling was in accord with "the functional operation of a statute of limitations." By filing a class complaint within the statutory period, the named plaintiff "notifie[d] the defendants not only of the substantive claims being brought against them, but also of the number and generic identities of the potential plaintiffs who may participate in the judgment."

As this discussion indicates, the source of the tolling rule applied in *American Pipe* is the judicial power to promote equity, rather than to interpret and enforce statutory provisions. Nothing in the *American Pipe* opinion suggests that the tolling rule it created was mandated by the text of a statute or federal rule. Nor could it have. The central text at issue in *American Pipe* was Rule 23, and Rule 23 does not so much as mention the extension or suspension of statutory time bars.

The Court's holding was instead grounded in the traditional equitable powers of the judiciary. The Court described its rule as authorized by the "judicial power to toll statutes of limitations." . . . The Court also relied on cases that are paradigm applications for equitable tolling principles, explaining with approval that tolling in one such case was based on "considerations 'deeply rooted in our jurisprudence.'" . . .

Perhaps for these reasons, this Court has referred to *American Pipe* as "equitable tolling." . . . It is true, however, that the *American Pipe* Court did not consider the criteria of the formal doctrine of equitable tolling in any direct manner. It did not analyze, for example, whether the plaintiffs pursued their rights with special care; whether some extraordinary circumstances prevented them from intervening earlier; or whether the defendant engaged in misconduct. . . . The balance of the Court's reasoning nonetheless reveals a rule based on traditional equitable powers, designed to modify a statutory time bar where its rigid application would create injustice.

D

This analysis shows that the *American Pipe* tolling rule does not apply to the 3-year bar mandated in § 13. As explained above, the 3-year limit is a statute of repose. And the object of a statute of repose, to grant complete peace to defendants, supersedes the application of a tolling rule based in equity. No feature of § 13 provides that deviation from its time limit is permissible in a case such as this one. To the contrary, the text, purpose, structure, and history of the statute all disclose the congressional purpose to offer defendants full and final security after three years.

Petitioner raises four counterarguments, but they are not persuasive. First, petitioner contends that this case is indistinguishable from *American Pipe* itself. If the 3-year bar here cannot be tolled, petitioner reasons, then there was no justification for the *American Pipe* Court's contrary decision to suspend the time bar in that case. *American Pipe*, however, is distinguishable. The statute in *American Pipe* was one of limitations, not of repose; it began to run when "'the cause of action accrued.'" The statute in the instant case, however, is a statute of repose. Consistent with the different purposes embodied in statutes of limitations and statutes of repose, it is reasonable that the former may be tolled by equitable considerations even though the latter in most circumstances may not.

Second, petitioner argues that the filing of a class-action complaint within three years fulfills the purposes of a statutory time limit with regard to later filed suits by individual members of the class. That is because, according to petitioner, the class complaint puts a defendant on notice as to the content of the claims against it and the set of potential plaintiffs who might assert those claims. It is true that the *American Pipe* Court, in permitting tolling, suggested that generic notice satisfied the purposes of the statute of limitations in that case. While this was deemed sufficient in balancing the equities to allow tolling under the antitrust statute, it must be noted that here the analysis differs because the purpose of a statute of repose is to give the defendant full protection after a certain time.

If the number and identity of individual suits, where they may be filed, and the litigation strategies they will use are unknown, a defendant cannot calculate its potential liability or set its own plans for litigation with much precision. The initiation of separate individual suits may thus increase a defendant's practical burdens. . . . The emergence of individual suits, furthermore, may increase a defendant's financial liability; for plaintiffs who opt out have considerable leverage and, as a result, may obtain outsized recoveries. . . . These uncertainties can put defendants at added risk in conducting business going forward, causing destabilization in markets which react with sensitivity to these matters. By permitting a class action to splinter into individual suits, the application of *American Pipe* tolling would threaten to alter and expand a defendant's accountability, contradicting the substance of a statute of repose. All this is not to suggest how best to further equity under these circumstances but simply to support the recognition that a statute of repose supersedes a court's equitable balancing powers by setting a fixed time period for claims to end.

Third, petitioner contends that dismissal of its individual suit as untimely would eviscerate its ability to opt out, an ability this Court has indicated should not be disregarded. See *Wal-Mart Stores, Inc. v. Dukes*, 564 U.S. 338, 363 (2011). It does not follow, however, from any privilege to opt out that an ensuing suit can be filed without regard to mandatory time limits set by statute.

Fourth, petitioner argues that declining to apply *American Pipe* tolling to statutes of repose will create inefficiencies. It contends that nonnamed class members will inundate district courts with protective filings. Even if petitioner were correct, of course, this Court "lack[s] the authority to rewrite" the statute of repose or to ignore its plain import. . . .

And petitioner's concerns likely are overstated. Petitioner has not offered evidence of any recent influx of protective filings in the Second Circuit, where the rule affirmed here has been the law since 2013. This is not surprising. The very premise of class actions is that "'small recoveries do not provide the incentive for any individual to bring a solo action prosecuting his or her rights.'" Many individual class members may have no interest in protecting their right to litigate on an individual basis. Even assuming that they do, the process is unlikely to be as onerous as petitioner claims. A simple motion to intervene or request to be included as a named plaintiff in the class-action complaint may well suffice. . . . District courts, furthermore, have ample means and methods to administer their dockets and to ensure that any additional filings proceed in an orderly fashion. . . .

III

Petitioner makes an alternative argument that does not depend on tolling. Petitioner submits its individual suit was timely in any event. Section 13 provides that an "action" must be "brought" within three years of the relevant securities offering. Petitioner argues that requirement is met here because the filing of the class-action complaint "brought" petitioner's individual "action" within the statutory time period.

This argument rests on the premise that an "action" is "brought" when substantive claims are presented to any court, rather than when a particular complaint is filed in a particular court. The term "action," however, refers to a judicial "proceeding," or perhaps to a "suit"—not to the general content of claims. . . . Whether or not petitioner's individual complaint alleged the same securities law violations as the class-action complaint, it defies ordinary understanding to suggest that its filing—in a separate forum, on a separate date, by a separate named party—was the same "action," "proceeding," or "suit."

The limitless nature of petitioner's argument, furthermore, reveals its implausibility. It appears that, in petitioner's view, the bringing of the class action would make any subsequent action raising the same claims timely. Taken to its logical limit, an individual action would be timely even if it were filed decades after the original securities offering—provided a class-action complaint had been filed at some point within the initial 3-year period. Congress would not have intended this result.

. . . .

Tolling may be of great value to allow injured persons to recover for injuries that, through no fault of their own, they did not discover because the injury or the perpetrator was not evident until the limitations period otherwise would have expired. This is of obvious utility in the securities market, where complex transactions and events can be obscure and difficult for a market participant to analyze or apprehend. In a similar way, tolling, as allowed in *American Pipe*, may protect plaintiffs who anticipated their interests would be protected by a class action but later learned that a class suit could not be maintained for reasons outside their control.

The purpose of a statute of repose, on the other hand, is to allow more certainty and reliability. These ends, too, are a necessity in a marketplace where stability and reliance are essential components of valuation and expectation for financial actors. The statute in this case reconciles these different ends by its two-tier structure: a conventional statute of limitations in the first clause and a statute of repose in the second.

The statute of repose transforms the analysis. In a hypothetical case with a different statutory scheme, consisting of a single limitations period without an additional outer limit, a court's equitable power under *American Pipe* in many cases would authorize the relief petitioner seeks. Here, however, the Court need not consider how equitable considerations should be formulated or balanced, for the mandate of the statute of repose takes the case outside the bounds of the *American Pipe* rule.

The final analysis, then, is straightforward. The 3-year time bar in § 13 of the Securities Act is a statute of repose. Its purpose and design are to protect defendants against future liability. The statute displaces the traditional power of courts to modify statutory time limits in the name of equity. Because the *American Pipe* tolling rule is rooted in those equitable powers, it cannot extend the 3-year period. Petitioner's untimely filing of its individual action is ground for dismissal.

The judgment of the Court of Appeals for the Second Circuit is affirmed.

***

JUSTICE GINSBURG, with whom JUSTICE BREYER, JUSTICE SOTOMAYOR, and JUSTICE KAGAN join, dissenting.

A class complaint was filed against respondents well within the three-year period of repose set out in § 13 of the Securities Act of 1933, 15 U.S.C. § 77m. That complaint informed respondents of the substance of the claims asserted against them and the identities of potential claimants. Respondents, in other words, received what § 13's repose period was designed to afford them: notice of their potential liability within a fixed time window.

The complaint also "commence[d] the action for all members of the class." *American Pipe*, 414 U.S., at 550. Thus, when petitioner California Public Employees' Retirement System (CalPERS) elected to exercise the right safeguarded by Federal Rule of Civil Procedure 23(c)(2)(B)(v), *i.e.*, the right to opt out of the class and proceed independently, CalPERS' claim remained timely. . . . Given the due process underpinning of the opt-out right, I resist rendering the right illusory for CalPERS and similarly situated class members. I would therefore reverse the judgment of the Second Circuit. Accordingly, I dissent from today's decision, under which opting out cuts off any chance for recovery.

I

CalPERS' claim against respondents was timely launched when the class representative filed a complaint pursuant to § 11 of the Securities Act, on behalf of all members of the described class, CalPERS among them. . . . Filing the class complaint within three years of the date the securities specified in that complaint were offered to the public also satisfied § 13's statute of repose. . . . [W]hether CalPERS stayed in the class or eventually filed separately, respondents would have known, within the repose period, of their potential liability to all putative class members.

A class complaint "notifies the defendants not only of the substantive claims being brought against them, but also of the number and generic identities of the potential plaintiffs who may participate in the judgment." . . . quoting *American Pipe*. The class complaint filed against respondents provided that very notice: It identified "the essential information necessary to determine both the subject matter and size of the prospective litigation," the class of plaintiffs, the offering documents, and the alleged untrue statements and misleading omissions in those documents. "[A] defendant faced with [such] information about a potential liability to a class cannot be said to have reached a state of repose that should be protected."

When CalPERS elected to pursue individually the claims already stated in the class complaint against the same defendants, it simply took control of the piece of the action that had always belonged to it. CalPERS' statement of the same allegations in an individual complaint could not disturb anyone's repose, for respondents could hardly be at rest once notified of the potential claimants and the precise false or misleading statements alleged to infect the registration statements at issue. CalPERS' decision to opt out did change two things: (1) CalPERS positioned itself to exercise its constitutional right to go it alone, cutting loose from a monetary settlement it deemed insufficient; and (2) respondents had to deal with CalPERS and its attorneys in addition to the named plaintiff and class counsel. Although those changes may affect how litigation subsequently plays out, they do not implicate the concerns that prompted § 13's repose period: The class complaint disclosed the same information respondents would have received had each class member instead filed an individual complaint on the day the class complaint was filed.

II

Today's decision disserves the investing public that § 11 was designed to protect. The harshest consequences will fall on those class members, often least sophisticated, who fail to file a protective claim within the repose period. Absent a protective claim filed within that period, those members stand to forfeit their constitutionally shielded right to opt out of the class and thereby control the prosecution of their own claims for damages. . . . Because critical stages of securities class actions, including the class-certification decision, often occur years after the filing of a class complaint, the risk is high that class members failing to file a protective claim will be saddled with inadequate representation or an inadequate judgment.

The majority's ruling will also gum up the works of class litigation. Defendants will have an incentive to slow walk discovery and other precertification proceedings so the clock will run on potential opt outs. Any class member with a material stake in a § 11 case, including every fiduciary who must safeguard investor assets, will have strong cause to file a protective claim, in a separate complaint or in a motion to intervene, before the three-year period expires. Such filings, by increasing the costs and complexity of the litigation, "substantially burden the courts."

Today's decision impels courts and class counsel to take on a more active role in protecting class members' opt-out rights. As the repose period nears expiration, it should be incumbent on class counsel, guided by district courts, to notify class members about the consequences of failing to file a timely protective claim. "At minimum, when notice goes out to a class beyond [§ 13's limitations period], a district court will need to assess whether the notice [should] alert class members that opting out . . . would end [their] chance for recovery." . . .

* * *

For the reasons stated, I would hold that the filing of the class complaint commenced CalPERS' action under § 11 of the Securities Act, thereby satisfying § 13's statute of repose. Accordingly, I would reverse the judgment of the Second Circuit.

Chapter 8

Section 10(b) and Related Issues

§ 8.05 Causation and Related Issues

[B] "Fraud on the Market" Theory

On page 613, add:

GOLDMAN SACHS GROUP, INC. v. ARKANSAS TEACHER RETIREMENT SYSTEM
United States Supreme Court
2021 WL 2519035 (2021)

JUSTICE BARRETT delivered the opinion of the Court.

The case involves a securities-fraud class action filed by several pension funds against The Goldman Sachs Group, Inc., and three of its former executives (collectively, Goldman). Plaintiffs allege that Goldman maintained an artificially inflated stock price by making generic statements about its ability to manage conflicts—for example, "We have extensive procedures and controls that are designed to identify and address conflicts of interest." Plaintiffs say that Goldman's generic statements were false or misleading in light of several undisclosed conflicts of interest, and that once the truth about Goldman's conflicts came out, Goldman's stock price dropped and shareholders suffered losses.

Below, this securities-fraud class action proceeded in typical fashion. Plaintiffs sought to certify a class of Goldman shareholders by involving the presumption endorsed by this Court in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988). The *Basic* presumption is premised on the theory that investors rely on the market price of a company's security, which in an efficient market incorporates all of the company's public misrepresentations. For its part, Goldman sought to defeat class certification by rebutting the *Basic* presumption through evidence that its alleged misrepresentations actually had no impact on its stock price. After determining that Goldman had failed to carry its burden of proving a lack of price impact, the District Court certified the class, and the Second Circuit affirmed.

In this Court, Goldman argues that the Second Circuit erred twice: first, by holding that the generic nature of its alleged misrepresentations is irrelevant to the price impact inquiry; and second, by assigning Goldman the burden of persuasion to prove a lack of price impact.

On the first question, the parties now agree, as do we, that the generic nature of a misrepresentation often is important evidence of price impact that courts should consider at class certification. Because we conclude that the Second Circuit may not have properly considered the generic nature of Goldman's alleged misrepresentations, we vacate and remand for the Court of Appeals to reassess the District Court's price impact determination. On the second question, we agree with the Second Circuit that our precedents require defendants to bear the burden of persuasion to prove a lack of price impact by a preponderance of the evidence. We emphasize, though, that the burden of persuasion should rarely be outcome determinative.

I

A

Section 10(b) of the Securities Exchange Act of 1934 and its implementing regulation, Rule 10b-5, prohibit material misrepresentations and omissions in connection with the sale of securities. We have inferred from these provisions an implied private cause of action permitting the recovery of damages for securities fraud. To recover damages, a private plaintiff must prove, among other things, a material misrepresentation or omission by the defendant and the plaintiff's reliance on that misrepresentation or omission.

The "fundamental premise" of the fraud-on-the-market theory underlying *Basic*'s presumption is "that an investor presumptively relies on a misrepresentation so long as it was reflected in the market price at the time of his transaction." To invoke the *Basic* presumption, a plaintiff must prove: (1) that the alleged misrepresentation was publicly known; (2) that it was material; (3) that the stock traded in an efficient market; and (4) that the plaintiff traded the stock between the time the misrepresentation was made and when the truth was revealed. The defendant may then rebut the presumption through "[a]ny showing that severs the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff, or his decision to trade at a fair market price."

Although the *Basic* presumption "can be invoked by any Rule 10b-5 plaintiff," it has "particular significance in securities-fraud class actions." The presumption allows class-action plaintiffs to prove reliance through evidence common to the class. That in turn makes it easier for plaintiffs to establish the predominance requirement of Federal Rule of Civil Procedure 23, which requires that "questions of law or fact common to class members predominate" over individualized issues. Fed. Rule Civ. Proc. 23(b)(3). Indeed, without the *Basic* presumption, individualized issues of reliance ordinarily would defeat predominance and "preclude certification" of a securities-fraud class action.

As a result, class-action plaintiffs must prove the *Basic* prerequisites before class certification—with one exception. In *Amgen*, we held that materiality should be left to the merits stage because it does not bear on Rule 23's predominance requirement. The remaining *Basic* prerequisites—publicity, market efficiency, and market timing—"must be satisfied" by plaintiffs "before class certification."

Satisfying those prerequisites, however, does not guarantee class certification. We held in *Halliburton II* that defendants may rebut the *Basic* presumption at class certification by showing "that an alleged misrepresentation did not actually affect the market price of the stock."

If a misrepresentation had no price impact, then *Basic*'s fundamental premise "completely collapses, rendering class certification inappropriate."

B

Respondents here—whom we'll call Plaintiffs—are Goldman shareholders. They brought this securities-fraud class action against Goldman in the Southern District of New York, alleging violations of § 10(b) and Rule 10b-5.

The specific theory of securities fraud that Plaintiffs allege is known as inflation maintenance. Under this theory, a misrepresentation causes a stock price "to remain inflated by preventing preexisting inflation from dissipating from the stock price."[2]

Plaintiffs allege here that between 2006 and 2010, Goldman maintained an inflated stock price by making repeated misrepresentations about its conflict-of-interest policies and business practices. The alleged misrepresentations are generic statements from Goldman's SEC filings and annual reports, including the following:

- "We have extensive procedures and controls that are designed to identify and address conflicts of interest."
- "Our clients' interests always come first."
- "Integrity and honesty are at the heart of our business."

According to Plaintiffs, these statements were false or misleading—and caused Goldman's stock to trade at artificially inflated levels—because Goldman had in fact engaged in several allegedly conflicted transactions without disclosing the conflicts. Plaintiffs further allege that once the market learned the truth about Goldman's conflicts from a Government enforcement action and

[2] Although some Courts of Appeals have approved the inflation-maintenance theory, this Court has expressed no view on its validity or its contours. We need not and do not do so in this case.

subsequent news reports, the inflation in Goldman's stock price dissipated, causing the price to drop and shareholders to suffer losses.

….

II

Goldman argues that the Second Circuit erred in two respects: first, by concluding that the generic nature of alleged misrepresentations is irrelevant to the price impact question; and second, by placing the burden of persuasion on Goldman to prove a lack of price impact. We address these arguments in turn.

A

1

On the first question—whether the generic nature of a misrepresentation is relevant to price impact—the parties' dispute has largely evaporated. Plaintiffs now concede that the generic nature of an alleged misrepresentation often will be important evidence of price impact because, as a rule of thumb, "a more-general statement will affect a security's price less than a more-specific statement on the same question." The parties further agree that courts may consider expert testimony and use their common sense in assessing whether a generic misrepresentation had a price impact. And they likewise agree that courts may assess the generic nature of a misrepresentation at class certification even though it also may be relevant to materiality, which *Amgen* reserves for the merits.

We share the parties' view. In assessing price impact at class certification, courts "'should be open to *all* probative evidence on that question—qualitative as well as quantitative—aided by a good dose of common sense.'" … That is so regardless whether the evidence is also relevant to a merits question like materiality. As we have repeatedly explained, a court has an obligation before certifying a class to "determin[e] that Rule 23 is satisfied, even when that requires inquiry into the merits." And under *Halliburton II*, a court cannot conclude that Rule 23's requirements are satisfied without considering *all* evidence relevant to price impact. See 573 U.S., at 284.[3]

The generic nature of a misrepresentation often will be important evidence of a lack of price impact, particularly in cases proceeding under the inflation-maintenance theory. Under that theory, price impact is the amount of price inflation maintained by an alleged misrepresentation—in other words, the amount that the stock's price would have fallen "without the false statement." Plaintiffs typically try to prove the amount of inflation indirectly: They point to a negative disclosure about a company and an associated drop in its stock price; allege that the disclosure corrected an earlier misrepresentation; and then claim that the price drop is equal to the amount of inflation maintained by the earlier misrepresentation.

But that final inference—that the back-end price drop equaled front-end inflation—starts to break down when there is a mismatch between the contents of the misrepresentation and the corrective disclosure. That may occur when the earlier misrepresentation is generic (*e.g.*, "we have faith in our business model") and the later corrective disclosure is specific (*e.g.*, "our fourth quarter earnings did not meet expectations"). Under those circumstances, it is less likely that the specific disclosure actually corrected the generic misrepresentation, which means that there is less reason to infer front-end price inflation—that is, price impact—from the back-end drop.

2

[3] We recognize that materiality and price impact are overlapping concepts and that the evidence relevant to one will almost always be relevant to the other. Bur "a district court may not use the overlap to refuse to consider the evidence." Instead, the district court must use the evidence to decide the price impact issue "while resisting the temptation to draw what may be obvious inferences for the closely related issues that must be left for the merits, including materiality.

The parties do not dispute any of this. They disagree only about whether the Second Circuit properly considered the generic nature of Goldman's alleged misrepresentations. Because the Second Circuit's opinions leave us with sufficient doubt on this score, we remand for further consideration. On remand, the Second Circuit must take into account *all* record evidence relevant to price impact, regardless whether that evidence overlaps with materiality or any other merits issues.

B

Goldman also argues that the Second Circuit erred by requiring Goldman, rather than Plaintiffs, to bear the burden of persuasion on price impact at class certification. Goldman relies exclusively on Federal Rule of Evidence 301, which provides in full:

> "In a civil case, unless a federal statute or these rules provide otherwise, the party against whom a presumption is directed has the burden of producing evidence to rebut the presumption. But this rule does not shift the burden of persuasion, which remains on the party who had it originally."

According to Goldman, Rule 301 applies to the *Basic* presumption at class certification, and, as a result, a plaintiff's satisfaction of the *Basic* prerequisites shifts only the burden of *production* to the defendant. Once a defendant discharges that burden by producing any competent evidence of a lack of price impact, Goldman says, the *Basic* presumption is rebutted and the plaintiff must carry the burden of *persuasion* to show price impact.

We disagree. We have held that Rule 301 "in no way restricts the authority of a court … to change the customary burdens of persuasion" pursuant to a federal statute. And we have at times exercised that authority to reassign the burden of persuasion to the defendant upon a prima facie showing by the plaintiff.

Goldman does not ask us to revisit these precedents. So the threshold question here is not whether we have the authority to assign defendants the burden of persuasion to prove a lack of price impact, but instead whether we already exercised that authority in establishing the *Basic* framework pursuant to the securities laws. We conclude that *Basic* and *Halliburton II* did just that.

Basic held that defendants may rebut the presumption of reliance if they "*show* that the misrepresentation *in fact* did not lead to a distortion of price." To do so, *Basic* said, defendants may make "[a]ny *showing* that *severs the link* between the alleged misrepresentation and … the price received (or paid) by the plaintiff." Similarly, *Halliburton II* held that defendants may rebut the *Basic* presumption at class certification "by *showing* … that the particular misrepresentation at issue did not affect the stock's market price."

Goldman and Justice Gorsuch argue that these references to a defendant's "showing" refer to the defendant's burden of production. On this reading, *Basic* and *Halliburton II* require a defendant merely to offer "evidence that, if believed, would support a finding" of a lack of price impact. But *Basic* and *Halliburton II* plainly require more: The defendant must "in fact" "seve[r] the link" between a misrepresentation and the price paid by the plaintiff—and a defendant's mere production of *some* evidence relevant to price impact would rarely accomplish that feat.

Accepting Goldman and the dissent's argument would also effectively negate *Halliburton II*'s holding that plaintiffs need not directly prove price impact in order to invoke the *Basic* presumption. If, as they urge, the defendant could defeat *Basic*'s presumption by introducing *any* competent evidence of a lack of price impact—including, for example, the generic nature of the alleged misrepresentation—then the plaintiff would end up with the burden of directly proving price impact in almost every case. And that would be nearly indistinguishable from the regime that *Halliburton II* rejected.

Thus, the best reading of our precedents—as the Courts of Appeals to have considered the issue have recognized—is that the defendant bears the burden of persuasion to prove a lack of price impact.… We likewise agree with the Courts of Appeals that the defendant must carry that burden by a preponderance of the evidence.

Although the defendant bears the burden of persuasion, the allocation of the burden is unlikely to make much difference on the ground. In most securities-fraud class actions, as in this one, the plaintiffs and defendants submit competing expert evidence on price impact. The district court's task is simply to assess all the evidence of price impact—direct and indirect—and determine whether it is more likely than not that the alleged misrepresentations had a price impact. The defendant's burden of persuasion will have bite only when the court finds the evidence in equipoise—a situation that should rarely arise.

* * *

The Second Circuit correctly placed the burden of proving a lack of price impact on Goldman. But because it is unclear whether the Second Circuit properly considered the generic nature of Goldman's alleged misrepresentations in reviewing the District Court's price impact determination, we vacate the judgment of the Second Circuit and remand the case for further proceedings consistent with this opinion.

It is so ordered.

JUSTICE SOTOMAYOR, concurring in part and dissenting in part.

I agree with the Court's answers to the questions presented, and I accordingly join Parts I, II-A-1, and II-B of the Court' opinion. Under *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), securities plaintiffs may demonstrate reliance by invoking the rebuttable presumption that investors rely on any misrepresentations reflected in a security's market price. The *Basic* presumption is particularly useful to class-action plaintiffs who, without the presumption, ordinarily could not demonstrate that questions common to the class predominate over individual ones. Defendants, for their part, may rebut the *Basic* presumption by demonstrating that the alleged misrepresentations did not in fact affect the security's price. So-called "price impact" may be disproved with a variety of evidence, alone or in combination. As the Court holds today, one potentially relevant piece of evidence may be the "generic nature" of the misrepresentation.

I do not, however, join the Court's judgment to vacate and remand because I believe the Second Circuit "properly considered the generic nature of Goldman's alleged misrepresentations." On appeal, Goldman did not contend that the District Court improperly refused to consider the generic nature of the alleged misstatements as evidence of price impact (or lack thereof). Instead, Goldman argued that "general statements, like those challenged here, are incapable of impacting a company's stock price as a matter of law" because they are "'too general to cause a reasonable investor to rely upon them.'" Goldman reasoned that "the challenged statements are incapable of maintaining inflation to a stock price for the same reasons that those statements are immaterial as a matter of law (as well as fact)."

The Second Circuit properly rejected Goldman's argument. The court explained that although "Goldman is not formally asking for a materiality test," its proposed rule would "essentially requir[e] courts to ask" at the class-certification stage "whether the alleged misstatements are, in Goldman's words, 'immaterial as a matter of law.'" But "materiality is irrelevant at the Rule 23 stage." "If general statements cannot maintain price inflation *because* no reasonable investor would have relied on them, then the question of inactionable generality is common to the class."

In declining to adopt Goldman's proposed rule that generic misstatements cannot have a price impact (as a matter of law), the Second Circuit nowhere held that the generic nature of an alleged misstatement could not serve as evidence of price impact (as a matter of fact). Nor did the Second Circuit refuse to consider such evidence in affirming the District Court's finding that Goldman failed to rebut the *Basic* presumption….

In short, the Second Circuit did not address whether the generic nature of a misstatement may be used as evidence to disprove price impact for a simple reason: Goldman identified no error in the District Court's treatment of such evidence. Goldman did not press the argument in the Second Circuit that it now urges here, and the Second Circuit did not reject the proposition that this Court now adopts. Thus, the argument Goldman seeks to press on remand is unpreserved, and nothing in the Second Circuit's opinion misstates the law….

JUSTICE GORSUCH, with whom JUSTICE THOMAS and JUSTICE ALITO join, concurring in part and dissenting in part.

I join all but Part II-B of the Court's opinion. There, the Court holds that the defendant, rather than the plaintiff, "bear[s] the burden of persuasion on price impact."…. Respectfully, I disagree.

Before us, the only meaningful dispute concerns what burden a defendant bears when it comes to rebutting the *Basic* presumption. Does the defendant carry only a burden of *production*, or does the defendant sometimes carry a burden of *persuasion*? In my view, only a burden of production is involved.

…[P]resumptions operate by allowing the plaintiff to prove only certain specified "predicate fact[s]" at the outset. If the plaintiff does so, an inference of "presumption" arises that the plaintiff has met its burden of persuasion, at least "in the absence" of some competing "explanation." At that point, the defendant bears a burden of production to present evidence that, if "taken as true," would "permit the conclusion" that the presumption in the plaintiff's favor is mistaken. If the defendant produces such evidence, the presumption "drops from the case." "[T]he trier of fact" then "proceeds to decide the ultimate question." Throughout this whole back-and-forth process, the burden of persuasion never shifts: The "plaintiff at all times bears the ultimate burden of persuasion" to prove all aspects of its cause of action…

The process *Basic* outlined matches traditional understandings too. The Court explained that a plaintiff's ability to prove certain "threshold facts"—about market operations and the publicity of the misstatement—gives rise to a "presumption" of reliance. After such a showing, the Court continued, a defendant may then proceed to "rebut the presumption." Nowhere in any of this did *Basic* suggest the order of operations governing its presumption should differ in any way from those governing others commonly found in the law and subject to Rule 301. Nor is there any doubt which party has the burden of persuasion on the question of reliance in securities fraud cases like ours. From start to finish, the plaintiff has the burden to satisfy that essential element of its claim. *Basic*'s presumption of reliance thus "does not shift" any burden of persuasion—that always "remains" with the plaintiff.

….

Perhaps recognizing the incongruity of its conclusion, the Court goes out of its way to downplay its significance. We're told that "on the ground" today's holding "is unlikely to make much difference" because "[i]n most securities-fraud class actions … the plaintiffs and defendants submit competing expert evidence on price impact." And in cases like these, "[t]he district court's task," according to the Court, "is simply to assess all the evidence of price impact" and "determine whether it is more likely than not that the alleged misrepresentations had a price impact."

This is a curious disavowal. Obviously, the Court thinks the issue important enough to spend the time and effort to rejigger the burden of persuasion. Now, though, it says none of this matters because most cases come down to a dispute over evidence of price impact irrespective of the presumption. The Court's suggestion that the burden of persuasion will "rarely" make a "difference" misses the point too. The whole reason we allocate the burden of persuasion is to resolve close cases by providing a tie breaker where the burden *does* make a difference. That close cases may not be common ones is no justification for indifference about how the law resolves them.

Respectfully, I dissent.

---

§ 8.09 Defenses and Strategic Considerations

[B] Statute of Limitations

On page 646, add:

CHINA AGRITECH, INC. v. RESH

United States Supreme Court

___ U.S. ___, 138 S. Ct. 1800, 201 L. Ed. 2d 123

Justice GINSBURG delivered the opinion of the Court.

This case concerns the tolling rule first stated in *American Pipe & Constr. Co. v. Utah*, 414 U.S. 538 (1974). The Court held in *American Pipe* that the timely filing of a class action tolls the applicable statute of limitations for all persons encompassed by the class complaint. Where class-action status has been denied, the Court further ruled, members of the failed class could timely intervene as individual plaintiffs in the still-pending action, shorn of its class character. Later, in *Crown, Cork & Seal Co. v. Parker*, 462 U.S. 345 (1983), the Court clarified *American Pipe*'s tolling rule: The rule is not dependent on intervening in or joining an existing suit; it applies as well to putative class members who, after denial of class certification, "prefer to bring an individual suit rather than intervene . . . once the economies of a class action [are] no longer available." . . .

The question presented in the case now before us: Upon denial of class certification, may a putative class member, in lieu of promptly joining an existing suit or promptly filing an individual action, commence a class action anew beyond the time allowed by the applicable statute of limitations? Our answer is no. *American Pipe* tolls the statute of limitations during the pendency of a putative class action, allowing unnamed class members to join the action individually or file individual claims if the class fails. But *American Pipe* does not permit the maintenance of a follow-on class action past expiration of the statute of limitations.

The instant suit is the third class action brought on behalf of purchasers of petitioner China Agritech's common stock, alleging violations of the Securities Exchange Act of 1934. In short, the successive complaints each make materially identical allegations that China Agritech engaged in fraud and misleading business practices, causing the company's stock price to plummet when several reports brought the misconduct to light. The Exchange Act has a two-year statute of limitations that begins to run upon discovery of the facts constituting the violation. 28 U.S.C. § 1658(b). The Act also has a five-year statute of repose. The parties agree that the accrual date for purposes of the two-year limitation period is February 3, 2011, and for the five-year repose period, November 12, 2009.

Theodore Dean, a China Agritech shareholder, filed the first class-action complaint on February 11, 2011, at the start of the two-year limitation period. As required by the Private Securities Litigation Reform Act of 1995 (PSLRA), Dean's counsel posted notice of the action in two "widely circulated national business-oriented publication[s]," and invited any member of the purported class to move to serve as lead plaintiff. Six shareholders responded to the notice, seeking to be named lead plaintiffs; other shareholders who had filed their own class complaints dismissed them in view of the *Dean* action. On May 3, 2012, after several months of discovery and deferral of a lead-plaintiff ruling, the District Court denied class certification. The plaintiffs, the District Court determined, had failed to establish that China Agritech stock traded on an efficient market—a necessity for proving reliance on a classwide basis. Dean's counsel then published a notice informing shareholders of the certification denial and advising: "You must act yourself to protect your rights. You may protect your rights by joining in the current Action as a plaintiff or by filing your own action against China Agritech." The *Dean* action settled in September 2012, occasioning dismissal of the suit. See 857 F.3d 994, 998 (C.A.9 2017).

On October 4, 2012—within the two-year statute of limitations—Dean's counsel filed a new complaint (*Smyth*) with a new set of plaintiffs and new efficient-market evidence. Eight shareholders responded to the PSLRA notice, seeking lead-plaintiff appointment. The District Court again denied class certification, this time on typicality and adequacy grounds. Thereafter, the *Smyth* plaintiffs settled their individual claims with the defendants and voluntarily dismissed their suit. Because the *Smyth* litigation was timely commenced, putative class members who promptly initiated *individual* suits in the wake of the class-action denial would have encountered no statute of limitations bar.

Respondent Michael Resh, who had not sought lead-plaintiff status in either the *Dean* or *Smyth* proceedings and was represented by counsel who had not appeared in the earlier actions, filed the present suit on June 30, 2014, styling it a class action—a year and a half after the statute of limitations expired. The other respondents moved to intervene, seeking designation as lead plaintiffs; together with Resh, they filed an amended complaint. The District Court dismissed the class complaint as untimely, holding that the *Dean* and *Smyth* actions did not toll the time to initiate class claims.

The Court of Appeals for the Ninth Circuit reversed: "[P]ermitting future class action named plaintiffs, who were unnamed class members in previously uncertified classes, to avail themselves of *American Pipe* tolling," the court reasoned, "would advance the policy objectives that led the Supreme Court to permit tolling in the first place." 857 F.3d, at 1004. Applying *American Pipe* tolling to successive class actions, the Ninth Circuit added, would cause no unfair surprise to defendants and would promote economy of litigation by reducing incentives for filing protective class suits during the pendency of an initial certification motion.

We granted certiorari, in view of a division of authority among the Courts of Appeals over whether otherwise-untimely successive class claims may be salvaged by *American Pipe* tolling. . . .

II

A

American Pipe established that "the commencement of the original class suit tolls the running of the statute [of limitations] for all purported members of the class who make timely motions to intervene after the court has found the suit inappropriate for class action status." "A contrary rule," the Court reasoned in *American Pipe*, "would deprive [Federal Rule of Civil Procedure] 23 class actions of the efficiency and economy of litigation which is a principal purpose of the procedure." This is so, the Court explained, because without tolling, "[p]otential class members would be induced to file protective motions to intervene or to join in the event that a class was later found unsuitable." In *Crown, Cork*, the Court further elaborated: Failure to extend the *American Pipe* rule "to class members filing separate actions," in addition to those who move to intervene, would result in "a needless multiplicity of actions" filed by class members preserving their individual claims—"precisely the situation that Federal Rule of Civil Procedure 23 and the tolling rule of *American Pipe* were designed to avoid." . . .

American Pipe and *Crown, Cork* addressed only putative class members who wish to sue individually after a class certification denial. . . .

What about a putative class representative, like Resh, who brings his claims as a new class action after the statute of limitations has expired? Neither decision so much as hints that tolling extends to otherwise time-barred class claims. We hold that *American Pipe* does not permit a plaintiff who waits out the statute of limitations to piggyback on an earlier, timely filed class action. The "efficiency and economy of litigation" that support tolling of individual claims do not support maintenance of untimely successive class actions; any additional *class* filings should be made early on, soon after the commencement of the first action seeking class certification.

American Pipe tolls the limitation period for individual claims because economy of litigation favors delaying those claims until after a class-certification denial. If certification is granted, the claims will proceed as a class and there would be no need for the assertion of any claim individually. If certification is denied, only then would it be necessary to pursue claims individually.

With class claims, on the other hand, efficiency favors early assertion of competing class representative claims. If class treatment is appropriate, and all would-be representatives have come forward, the district court can select the best plaintiff with knowledge of the full array of potential class representatives and class counsel. And if the class mechanism is not a viable option for the claims, the decision denying certification will be made at the outset of the case, litigated once for all would-be class representatives.

Rule 23 evinces a preference for preclusion of untimely successive class actions by instructing that class certification should be resolved early on. . . .

The PSLRA, which governs this litigation, evinces a similar preference, this time embodied in legislation, for grouping class-representative filings at the outset of litigation. When the *Dean* and *Smyth* timely commenced actions were first filed, counsel put any shareholder who might wish to serve as lead plaintiff on notice of the action. Several heeded the call—six in *Dean* and eight in *Smyth*. The PSLRA, by requiring notice of the commencement of a class action, aims to draw all potential lead plaintiffs into the suit so that the district court will have the full roster of contenders before deciding which contender to appoint. . . . With notice and the opportunity to participate in the first (and second) round of class litigation, there is little reason to allow plaintiffs who passed up those opportunities to enter the fray several years after class proceedings first commenced.

Ordinarily, to benefit from equitable tolling, plaintiffs must demonstrate that they have been diligent in pursuit of their claims. . . . Even *American Pipe*, which did not analyze "criteria of the formal doctrine of equitable tolling in any direct manner," observed that tolling was permissible in the circumstances because plaintiffs who later intervened to pursue individual claims had not slept on their rights. . . . Those plaintiffs reasonably relied on the class representative, who sued timely, to protect their interests in their individual claims. A would-be class representative who commences suit after expiration of the limitation period, however, can hardly qualify as diligent in asserting claims and pursuing relief. Her interest in representing the class as lead plaintiff, therefore, would not be preserved by the prior plaintiff's timely filed class suit.

Respondents' proposed reading would allow the statute of limitations to be extended time and again; as each class is denied certification, a new named plaintiff could file a class complaint that resuscitates the litigation. . . . This prospect points up a further distinction between the individual-claim tolling established by *American Pipe* and tolling for successive class actions. The time to file individual actions once a class action ends is finite, extended only by the time the class suit was pending; the time for filing successive class suits, if tolling were allowed, could be limitless. Respondents' claims happen to be governed by 28 U.S.C. § 1658(b)(2)'s five-year statute of repose, so the time to file complaints has a finite end. Statutes of repose, however, are not ubiquitous. . . . Most statutory schemes provide for a single limitation period without any outer limit to safeguard against serial relitigation. Endless tolling of a statute of limitations is not a result envisioned by *American Pipe*.

B

. . . .

The watchwords of *American Pipe* are efficiency and economy of litigation, a principal purpose of Rule 23 as well. Extending *American Pipe* tolling to successive class actions does not serve that purpose. The contrary rule, allowing no tolling for out-of-time class actions, will propel putative class representatives to file suit well within the limitation period and seek certification promptly. For all the above-stated reasons, it is the rule we adopt today: Time to file a class action falls outside the bounds of *American Pipe*.

Accordingly, the judgment of the Court of Appeals for the Ninth Circuit is reversed, and the case is remanded for further proceedings consistent with this opinion.

It is so ordered.

JUSTICE SOTOMAYOR, concurring in the judgment.

I agree with the Court that in cases governed by the Private Securities Litigation Reform Act of 1995 (PSLRA), like this one, a plaintiff who seeks to bring a successive class action may not rely on the tolling rule established by *American Pipe & Constr. Co. v. Utah*. I cannot, however, join the majority in going further by holding that the same is true for class actions not subject to the PSLRA.

. . . .

Although there is ample support for denying *American Pipe* tolling to successive class actions subject to the PSLRA, the majority's reasoning does not justify denying *American Pipe* tolling to other successive class actions. The majority could have avoided this error by limiting its decision to the issues presented by the facts of this case.

Despite the Court's misstep in adopting an unnecessarily broad rule, district courts can help mitigate the potential unfairness of denying *American Pipe* tolling to class claims not subject to the PSLRA. Where appropriate, district courts should liberally permit amendment of the pleadings or intervention of new plaintiffs and counsel.

Because I agree with the majority's conclusion just as applied to class actions governed by the PSLRA, like this one, I concur only in the judgment.

Chapter 9

Alternative Provisions

§ 9.08 State Securities and Common Law Remedies

On page 759, add:

CYAN, INC. v. BEAVER COUNTY EMPLOYEES RETIREMENT FUND

United States Supreme Court

____ U.S. ____, 138 S. Ct. 1061, 200 L. Ed. 2d 332 (2018)

Justice KAGAN delivered the opinion of the [unanimous] Court.

This case presents two questions about the Securities Litigation Uniform Standards Act of 1998 (SLUSA). . . . First, did SLUSA strip state courts of jurisdiction over class actions alleging violations of only the Securities Act of 1933 (1933 Act)? And second, even if not, did SLUSA empower defendants to remove such actions from state to federal court? We answer both questions no.

I

A

In the wake of the 1929 stock market crash, Congress enacted two laws, in successive years, to promote honest practices in the securities markets. The 1933 Act required companies offering securities to the public to make "full and fair disclosure" of relevant information. And to aid enforcement of those obligations, the statute created private rights of action. Congress authorized both federal and state courts to exercise jurisdiction over those private suits. . . . More unusually, Congress also barred the removal of such actions from state to federal court. . . . So if a plaintiff chose to bring a 1933 Act suit in state court, the defendant could not change the forum.

Congress's next foray. The Securities Exchange Act of 1934 (1934 Act) operated differently. That statute regulated not the original issuance of securities but instead all their subsequent trading, most commonly on national stock exchanges. The 1934 Act, this Court held, could also be enforced through private rights of action. But Congress determined that all those suits should fall within the "exclusive jurisdiction" of the federal courts. So a plaintiff could never go to state court to litigate a 1934 Act claim.

In 1995, the Private Securities Litigation Reform Act (Reform Act) amended both the 1933 and the 1934 statutes in mostly identical ways. Congress passed the Reform Act principally to stem "perceived abuses of the class-action vehicle in litigation involving nationally traded securities." . . . Some of the Reform Act's provisions made substantive changes to the 1933 and 1934 laws, and applied even when a 1933 Act suit was brought in state court. For instance, the statute created a "safe harbor" from federal liability for certain "forward-looking statements" made by company officials. . . . Other Reform Act provisions modified the procedures used in litigating securities actions, and applied only when such a suit was brought in federal court. To take one example, the statute required a lead plaintiff in any class action brought under the Federal Rules of Civil Procedure to file a sworn certification stating, among other things, that he had not purchased the relevant securities "at the direction of plaintiff's counsel." . . .

But the Reform Act fell prey to the law of "unintended consequence[s]." . . . As this Court previously described the problem: "Rather than face the obstacles set in their path by the Reform Act, plaintiffs and their representatives began bringing class actions under state law." . . . That "phenomenon was a novel one"—and an unwelcome one as well. . . . To prevent plaintiffs from circumventing the Reform Act, Congress again undertook to modify both securities laws.

The result was SLUSA, whose amendments to the 1933 Act are at issue in this case. Those amendments include, as relevant here, two operative provisions, two associated definitions, and two "conforming amendments" to the 1933 law's jurisdictional section. . . . The added material—now found in §§ 77p and 77v(a) and set out in full in this opinion's appendix—goes as follows.

First, § 77p(b) altogether prohibits certain securities class actions based on state law. That provision—which we sometimes (and somewhat prosaically) refer to as the state-law class-action bar—reads:

> "No covered class action based upon the statutory or common law of any State . . . may be maintained in any State or Federal court by any private party alleging—
>
> "(1) an untrue statement or omission of a material fact in connection with the purchase or sale of a covered security; or
>
> "(2) that the defendant used or employed any manipulative or deceptive device or contrivance in connection with the purchase or sale of a covered security."

According to SLUSA's definitions, the term "covered class action" means a class action in which "damages are sought on behalf of more than 50 persons." . . . And the term "covered security" refers to a security listed on a national stock exchange. . . . So taken all in all, § 77p(b) completely disallows (in both state and federal courts) sizable class actions that are founded on state law and allege dishonest practices respecting a nationally traded security's purchase or sale.

Next, § 77p(c) provides for the removal of certain class actions to federal court, as well as for their subsequent disposition:

> "Any covered class action brought in any State court involving a covered security, as set forth in subsection (b) of this section, shall be removable to the Federal district

> court for the district in which the action is pending, and shall be subject to subsection (b) of this section."

The first chunk of that provision identifies the removable cases, partly by way of a cross-reference ("as set forth in subsection (b)") to the just-described class-action bar. The final clause of the provision ("and shall be subject to subsection (b)") indicates what should happen to a barred class suit *after* it has been removed: The "proper course is to dismiss" the action. . . . As this Court has explained, § 77p(c) "avails a defendant of a federal forum in contemplation not of further litigation over the merits of a claim brought in state court, but of termination of the proceedings altogether." . . . The point of providing that option, everyone here agrees, was to ensure the dismissal of a prohibited state-law class action even when a state court "would not adequately enforce" § 77p(b)'s bar. . . .

Finally, the 1933 Act's jurisdictional provision, codified at § 77v(a), now includes two new phrases framed as exemptions—SLUSA's self-described "conforming amendments." The less significant of the pair, for our purposes, reflects the allowance for removing certain class actions described above. Against the backdrop of the 1933 Act's general removal bar that added (italicized) material reads:

> "*Except as provided in section 77p(c) of this title*, no case arising under this subchapter and brought in any State court of competent jurisdiction shall be removed to any court of the United States."

The more important of the conforming amendments in this case expresses a caveat to the general rule . . . that state and federal courts have concurrent jurisdiction over all claims to enforce the 1933 Act. As amended (again, with the new material in italics), the relevant sentence now reads:

> "The district courts of the United States . . . shall have jurisdiction[,] concurrent with State and Territorial courts, *except as provided in section 77p of this title with respect to covered class actions*, of all suits in equity and actions at law bought to enforce any liability or duty created by this subchapter."

Throughout this opinion, we refer to the italicized words just above as the "except clause." Its meaning is at the heart of the parties' dispute in this Court.

B

The petitioners in this case are Cyan, a telecommunications company, and its officers and directors (together, Cyan). The respondents are three pension funds and an individual (together, Investors) who purchased shares of Cyan stock in an initial public offering. After the stock declined in value, the Investors brought a damages class action against Cyan in California Superior Court. Their complaint alleges that Cyan's offering documents contained material misstatements, in violation of the 1933 Act. It does not assert any claims based on state law.

Cyan moved to dismiss the Investors' suit for lack of subject matter jurisdiction. It argued that what we have termed SLUSA's "except clause"—*i.e.*, the amendment made to § 77v(a)'s concurrent-jurisdiction grant—stripped state courts of power to adjudicate 1933 Act claims in "covered class actions." The Investors did not dispute that their suit qualifies as such an action under SLUSA's definition, see § 77p(f)(2). But they maintained that SLUSA left intact state courts' jurisdiction over all suits—including "covered class actions"—alleging only 1933 Act claims. The California Superior Court agreed with the Investors and denied Cyan's motion to dismiss. The state appellate courts then denied review of that ruling. . . .

We granted Cyan's petition for certiorari to resolve a split among state and federal courts about whether SLUSA deprived state courts of jurisdiction over "covered class actions" asserting only 1933 Act claims.

In opposing Cyan's jurisdictional position here, the Federal Government as *amicus curiae* raised another question: whether SLUSA enabled defendants to remove 1933 Act class actions from state to federal court for adjudication. That question is not directly presented because Cyan never attempted to remove the Investors' suit. But the removal issue is related to the parties' jurisdictional arguments, and both Cyan and the Investors addressed it in briefing and argument. . . . Accordingly, we consider as well the scope of § 77p(c)'s removal authorization.

II

By its terms, § 77v(a)'s "except clause" does nothing to deprive state courts of their jurisdiction to decide class actions brought under the 1933 Act. And Cyan's various appeals to SLUSA's purposes and legislative history fail to overcome the clear statutory language. The statute says what it says—or perhaps better put here, does not say what it does not say. State-court jurisdiction over 1933 Act claims thus continues undisturbed.

A

SLUSA's text, read most straightforwardly, leaves in place state courts' jurisdiction over 1933 Act claims, including when brought in class actions. Recall that the background rule of § 77v(a)—in place since the 1933 Act's passage—gives state courts concurrent jurisdiction over all suits "brought to enforce any liability or duty created by" that statute. The except clause—once again, "except as provided in section 77p of this title with respect to covered class actions"—is drafted as a limitation on that rule: It ensures that in any case in which § 77v(a) and § 77p come into conflict, § 77p will control. The critical question for this case is therefore whether § 77p limits state-court jurisdiction over class actions brought under the 1933 Act. It does not. As earlier described, § 77p bars certain securities class actions based on *state* law. And as a corollary of that prohibition, it authorizes removal of those suits so that a federal court can dismiss them. But the section says nothing, and so does nothing, to deprive state courts of jurisdiction over class actions based on *federal* law. That means the background rule of § 77v(a)—under which a state court may hear the Investors' 1933 Act suit—continues to govern.

. . . .

. . . When Congress passed SLUSA, state courts had for 65 years adjudicated all manner of 1933 Act cases, including class actions. Indeed, defendants could not even remove those cases to federal court, as schemes of concurrent jurisdiction almost always allow. . . . State courts thus had as much or more power over the 1933 Act's enforcement as over any federal statute's. To think Cyan right, we would have to believe that Congress upended that entrenched practice not by any direct means, but instead by way of a conforming amendment to § 77v(a) (linked, in its view, with only a definition). But Congress does not make "radical—but entirely implicit—change[s]" through "technical and conforming amendments." . . . Or to use the more general (and snappier) formulation of that rule, relevant to all "ancillary provisions," Congress does not "hide elephants in mouseholes." . . . That is yet one more reason to reject Cyan's view of SLUSA's text.

B

Faced with such recalcitrant statutory language, Cyan stakes much of its case on legislative purpose and history. . . . Its claims come in two forms—one relating to the goals of SLUSA as a whole and the other relating to the aims of the except clause. Even assuming clear text can ever give way to purpose, Cyan would need some monster arguments on this score to create doubts about SLUSA's meaning. The points Cyan raises come nowhere close to that level.

. . . .

1

. . . .

. . . SLUSA ensured that federal courts would play the principal role in adjudicating securities class actions by means of its revisions to the *1934* Act. As explained earlier, SLUSA amended that statute in the same main way it did the 1933 Act—by adding a state-law class-action bar. But there, the change had a double effect: Because federal courts have exclusive jurisdiction over 1934 Act claims, forcing plaintiffs to bring class actions under the 1934 statute instead of state law also forced them to file in federal court. That meant the bulk of securities class actions would proceed in federal court—because the 1934 Act regulates all trading of securities whereas the 1933 Act addresses only securities offerings. . . . So even without Cyan's contrived reading of the except clause, SLUSA largely accomplished the purpose articulated in its Conference Report: moving securities class actions to federal court.

To be sure, "largely" does not mean "entirely"—but then again, we do not generally expect statutes to fulfill 100% of all of their goals. . . . Under our reading of SLUSA, all covered securities class actions must proceed under federal law; most (*i.e.*, those alleging 1934 Act claims) must proceed in federal court; some (*i.e.*, those alleging 1933 Act claims) may proceed in state court. We do not know why Congress declined to require as well that 1933 Act class actions be brought in federal court; perhaps it was because of the long and unusually pronounced tradition of according authority to state courts over 1933 Act litigation. But in any event, we will not revise that legislative choice, by reading a conforming amendment and a definition in a most improbable way, in an effort to make the world of securities litigation more consistent or pure. . . .

2

. . . .

. . . [W]e doubt that the except clause was really necessary to address mixed class actions. Even without that clause, a competent state court faced with such a suit would understand that § 77p requires dismissal of the state-law claims—and that § 77v(a)'s jurisdictional grant over 1933 Act suits is not to the contrary. But on the other hand . . ., Congress may have thought that class-action lawyers would still try to circumvent SLUSA by tacking a 1933 Act claim onto a forbidden state-law class action, on the off chance of finding an error-prone judge. (After all, the worst that could happen was that the court would throw out the state-law claims, leaving the plaintiff with a permissible 1933 Act suit.) To prevent such gamesmanship—to make clear beyond peradventure that courts could not entertain the state-law half of mixed class actions—Congress might have added the except clause.

But even if Congress never specifically considered mixed suits, it could well have added the except clause in a more general excess of caution—to safeguard § 77p's class-action bar come whatever might. This Court has encountered many examples of Congress legislating in that hyper-vigilant way, to "remov[e] any doubt" as to things not particularly doubtful in the first instance. . . . Heedful of that history of machinations, Congress may have determined to eliminate any risk—even if unlikely or at the time unknown—that a pre-existing grant of power to state courts could be used to obstruct SLUSA's new limitation on what they could decide. And so (this alternative explanation goes) Congress enacted the except clause—which, in insisting that the limitation prevailed, would function as the ultimate (though with any luck, unneeded) fail-safe device.

But the most important response to this purposive argument echoes what we have said before about the weaknesses of Cyan's own construction of the except clause. In the end, the uncertainty surrounding Congress's reasons for drafting that clause does not matter. Nor does the possibility that the risk Congress addressed (whether specific or inchoate) did not exist. Because irrespective of those points, we have no sound basis for giving the except clause a broader reading than its language can bear. And that is especially true in light of the dramatic change such an interpretation would work in the 1933 Act's jurisdictional framework. Whatever questions remain as to the except clause's precise purpose—and we do not gainsay there are some—they do not give us permission to devise a statute (and at that, a transformative one) of our own.

III

Our last task is to address the Federal Government's proposed halfway-house position. The Government rejects Cyan's view that SLUSA stripped state courts of jurisdiction over 1933 Act class actions, for roughly the same reasons we have given. But like Cyan, the Government believes that "Congress would not have been content to leave" such suits "stuck in state court," where the Reform Act's procedural protections do not apply. . . . So the Government offers a reading of SLUSA—in particular, of § 77p(c)—that would allow defendants to remove 1933 Act class actions to federal court, as long as they allege the kinds of misconduct listed in § 77p(b) (*e.g.*, false statements or deceptive devices in connection with a covered security's purchase or sale).

But most naturally read, § 77p(c)—SLUSA's exception to the 1933 Act's general bar on removal—refutes, not supports, the Government's view. Once again, § 77p(c) reads as follows:

> "Any covered class action brought in any State court involving a covered security, as set forth in subsection (b) of this section, shall be removable to the Federal district court for the district in which the action is pending, and shall be subject to subsection (b) of this section."

In other words, the covered class actions described in § 77p(b) can be removed to federal court (and, once there, shall be subject to dismissal . . .). . . . [W]hich are the covered class actions described in § 77p(b)? By this point, no one should have to be reminded: They are *state-law* class actions alleging securities misconduct. See § 77p(b) (prohibiting "class action[s] based upon the statutory or common law of any State"). So those state-law suits are removable. But conversely, *federal-law* suits like this one—alleging only 1933 Act claims—are not "class action[s] . . . as set forth in subsection (b)." So they remain subject to the 1933 Act's removal ban.

. . . .

At bottom, the Government makes the same mistake as Cyan: It distorts SLUSA's text because it thinks Congress simply must have wanted 1933 Act class actions to be litigated in federal court. But this Court has no license to "disregard clear language" based on an intuition that "Congress must have intended something broader." . . . If further steps are needed, they are up to Congress.

IV

SLUSA did nothing to strip state courts of their longstanding jurisdiction to adjudicate class actions alleging only 1933 Act violations. Neither did SLUSA authorize removing such suits from state to federal court. We accordingly affirm the judgment below.

It is so ordered.

After the Supreme Court's decision in *Cyan*, plaintiffs increasingly are bringing their Section 11 and other Securities Act claims in state courts. In reaction thereto, a number of corporations adopted charter provisions mandating that stockholders file these Securities Act claims exclusively in federal court. In *Salzberg v. Sciabacucchi*, 227 A.3d 102 (Del. 2020), the Delaware Supreme Court upheld the validity of such charter provisions. An excerpt of the opinion follows.

> FFPs [Federal forum provisions] can provide a corporation with certain efficiencies in managing the procedural aspects of securities litigation following the United States Supreme Court's decision in *Cyan, Inc. v. Beaver County Employees Retirement Fund*. There, the United States Supreme Court unanimously held that federal and state courts have concurrent jurisdiction over class actions based on claims brought under the 1933 Act, and that such claims are not removable to federal court. Following *Cyan*, in 2018, the filing of 1933 Act cases in state courts escalated. The 2018 Year in Review Report by Cornerstone Research found that, "[t]here were 55 percent more state-only filings than federal-only filings in 2018." Claims brought under Section 11 of the 1933 Act "decreased in federal courts as a portion of filing activity moved to state

courts." The 2018 report observed that, "[t]he uptick in state actions following the *Cyan* decision indicates a change in approach by plaintiffs."

The recently released Cornerstone 2019 Year in Review Report states that, "[t]he number of state 1933 Act filings in 2019 increased by 40 percent from 2018," and that "[a]bout 45 percent of all state 1933 Act filings in 2019 had a parallel action in federal court." In 2019, the combined number of federal Section 11 filings and state 1933 Act filings was 65, approximately a 59 percent overall increase from 2018. Of the 65 filings, 22 were parallel filings, 27 were state-only filings (a 69 percent increase from 2018), and 16 were federal-only filings. State-only and parallel filings made up over 75 percent of all federal Section 11 and state 1933 Act filings in 2019. Since *Cyan*, 43 parallel class actions have been filed in multiple jurisdictions. The 2019 report observes that, "[t]he 65 filings in 2019 was historically unprecedented," and that, "[p]rior to 2015, there were only a handful of state court filings, and the highest number of federal Section 11 filings previously was 57 in 1998."

When parallel state and federal actions are filed, no procedural mechanism is available to consolidate or coordinate multiple suits in state and federal court. The costs and inefficiencies of multiple cases being litigated simultaneously in both state and federal courts are obvious. The possibility of inconsistent judgments and rulings on other matters, such as stays of discovery, also exists. By directing 1933 Act claims to federal courts when coordination and consolidation are possible, FFPs classically fit the definition of a provision "for the management of the business and for the conduct of the affairs of the corporation." An FFP would also be a provision "defining, limiting and regulating the powers of the corporation, the directors and the stockholders," since FFPs prescribe where current and former stockholders can bring Section 11 claims against the corporation [and its] directors and officers.

….

Chapter 10

Secondary Liability

§ 10.03 Distinguishing Primary from Secondary Liability

[C] Reinvigorating "Scheme" Liability Under Rule 10b-5(a) and (c)

On page 833, add:

LORENZO v. SECURITIES AND EXCHANGE COMMISSION

United States Supreme Court

____ U.S. ____, 139 S. Ct. 1094, 203 L. Ed. 2d 484 (2019)

JUSTICE BREYER delivered the opinion of the Court.

Securities and Exchange Commission Rule 10b-5 makes it unlawful:

"(a) To employ any device, scheme, or artifice to defraud,

"(b) To make any untrue statement of a material fact . . . , or

"(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit . . .

in connection with the purchase or sale of any security."

In *Janus Capital Groups, Inc. v. First Derivative Traders*, 564 U.S. 135 (2011), we examined the second of these provisions, Rule 10b-5(b), which forbids the "mak[ing]" of "any untrue statement of a material fact." We held that the "*maker* of a statement is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it." We said that "[w]ithout control, a person or entity can merely suggest what to say, not 'make' a statement in its own right." And we illustrated our holding with an analogy: "[W]hen 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." On the facts of *Janus*, this meant that an investment adviser who had merely "participat[ed] in the drafting of a false statement" "made" by another could not be held liable in a private action under subsection (b) of Rule 10b-5.

In this case, we consider whether those who do not "make" statements (as *Janus* defined "make"), but who disseminate false or misleading statements to potential investors with the intent to defraud, can be found to have violated the *other* parts of Rule 10b-5, subsections (a) and (c), as well as related provisions of the securities laws, § 10(b) of the Securities Exchange Act of 1934, and § 17(a)(1) of the Securities Act of 1933. . . . We believe that they can.

I

A

For our purposes, the relevant facts are not in dispute. Francis Lorenzo, the petitioner, was the director of investment banking at Charles Vista, LLC, a registered broker-dealer in Staten Island, New York. Lorenzo's only investment banking client at the time was Waste2Energy Holdings, Inc., a company developing technology to convert "solid waste" into "clean renewable energy."

In a June 2009 public filing, Waste2Energy stated that its total assets were worth about $14 million. This figure included intangible assets, namely, intellectual property, valued at more than $10 million. Lorenzo was skeptical of this valuation, later testifying that the intangibles were a "dead asset" because the technology "didn't really work."

During the summer and early fall of 2009, Waste2Energy hired Lorenzo's firm, Charles Vista, to sell to investors $15 million worth of debentures, a form of "debt secured only by the debtor's earning power, not by a lien on any specific asset," Black's Law Dictionary 486 (10th ed. 2014).

In early October 2009, Waste2Energy publicly disclosed, and Lorenzo was told, that its intellectual property was worthless, that it had "'w]rit[ten] off . . . all [of its] intangible assets,'" and that its total assets (as of March 31, 2009) amounted to $370,552.

Shortly thereafter, on October 14, 2009, Lorenzo sent two e-mails to prospective investors describing the debenture offering. According to later testimony by Lorenzo, he sent the e-mails at the direction of his boss, who supplied the content and "approved" the messages. The e-mails described the investment in Waste2Energy as having "3 layers of protection," including $10 million in "confirmed assets." The e-mails nowhere revealed the fact that Waste2Energy had publicly stated that its assets were in fact worth less than $400,000. Lorenzo signed the e-mails with his own name, he identified himself as "Vice President—Investment Banking," and he invited the recipients to "call with any questions."

B

In 2013, the Securities and Exchange Commission instituted proceedings against Lorenzo (along with his boss and Charles Vista). The Commission charged that Lorenzo had violated Rule 10b-5, § 10(b) of the Exchange Act, and § 17(a)(1) of the Securities Act. Ultimately, the Commission found that Lorenzo had run afoul of these provisions by sending false and misleading statements to investors with intent to defraud. As a sanction, it fined Lorenzo $15,000, ordered him to cease and desist from violating the securities laws, and barred him from working in the securities industry for life.

Lorenzo appealed, arguing primarily that in sending the e-mails he lacked the intent required to establish a violation of Rule 10b-5, § 10(b), and § 17(a)(1), which we have characterized as "'a mental state embracing intent to deceive, manipulate, or defraud.'" *Aaron v. SEC*, 446 U.S. 680, 686, and n. 5 (1980). With one judge dissenting [now Justice Kavanaugh], the Court of Appeals panel rejected Lorenzo's lack-of-intent argument. 872 F.3d 578, 583 (CADC 2017). Lorenzo does not challenge the panel's scienter finding.

Lorenzo also argued that, in light of *Janus*, he could not be held liable under subsection (b) of Rule 10b-5. The panel agreed. Because his boss "asked Lorenzo to send the emails, supplied the central content, and approved the messages for distribution," it was the boss that had "ultimate authority" over the content of the statement "and whether and how to communicate it." *Janus*, 563 U.S., at 142. (We took this case on the assumption that Lorenzo was not a "maker" under subsection (b) of Rule 10b-5, and do not revisit the court's decision on this point.)

The Court of Appeals nonetheless sustained (with one judge dissenting [Kavanaugh, J]) the Commission's finding that, by knowingly disseminating false information to prospective investors, Lorenzo had violated other parts of Rule 10b-5, subsections (a) and (c), as well as § 10(b) and §17(a)(1).

Lorenzo then filed a petition for certiorari in this Court. We granted review to resolve disagreement about whether someone who is not a "maker" of a misstatement under *Janus* can nevertheless be found to have violated the other subsections of Rule 10b-5 and related provisions of the securities laws, when the only conduct involved concerns a misstatement. . . .

II

A

At the outset, we review the relevant provisions of Rule 10b-5 and of the statutes. As we have said, subsection (a) of the Rule makes it unlawful to "employ any device, scheme, or artifice to defraud." Subsection (b) makes it unlawful to "make any untrue statement of a material fact." And subsection (c) makes it unlawful to "engage in any act, practice, or course of business" that "operates . . . as a fraud or deceit."

There are also two statutes at issue. Section 10b) makes it unlawful to "use or employ . . . any manipulative or deceptive device or contrivance" in contravention of Commission rules and regulations. By its authority under that section, the Commission promulgated Rule 10b-5. The second statutory provision is § 17(a), which, like Rule 10b-5, is organized into three subsections. Here, however, we consider only the first subsection, §17(a)(1), for this is the only subsection that the Commission charged Lorenzo with violating. Like Rule 10b-5(a), 17(a)(1) makes it unlawful to "employ any device, scheme, or artifice to defraud."

B

After examining the relevant language, precedent, and purpose, we conclude 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, as well as the relevant statutory provisions. In our view, that is so even if the disseminator did not "make" the statements and consequently falls outside subsection (b) of the Rule.

It 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. By 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. Recall that Lorenzo does not challenge the appeals court's scienter finding, so we take for granted that he sent the emails with "intent to deceive, manipulate, or defraud" the recipients. Under the circumstances, it is difficult to see how his actions could escape the reach of those provisions.

Resort to dictionary definitions only strengthens this conclusion. A "'device,'" we have observed, is simply "'[t]hat which is devised, or formed by design'"; a "'scheme'" is a "'project,'" "'plan[,] or program of something to be done'"; and an "'artifice'" is "'an artful stratagem or trick.'" . . . (quoting Webster's International Dictionary . . .). By these lights, dissemination of false or misleading material is easily an "artful stratagem" or a "plan," "devised" to defraud an investor under subsection (a). See Rule 10b-5(a) (making it unlawful to "employ any device, scheme, or artifice to defraud")' § 17(a)(1) (same). The words "act" and "practice" in subsection (c) are similarly expansive. Webster's Second 25 (defining "act" as "a doing" or a "thing done")' *id.*, at 1937 (defining "practice" as an "action" or "deed")' see Rule 10b-5(c) (making it unlawful to "engage in a[n] act, practice, or course of business" that "operates . . . as a fraud or deceit").

These provisions capture a wide range of conduct. Applying them may present difficult problems of scope in borderline cases. Purpose, precedent, and circumstance could lead to narrowing their reach in other contexts. But we see nothing borderline about this case, where the relevant conduct (as found by the Commission) consists of disseminating false or misleading information to prospective investors with the intent to defraud. And while one can readily imagine other actors tangentially involved in dissemination—say, a mailroom clerk—for whom liability would typically be inappropriate, the petitioner in this case sent false statements directly to investors, invited them to follow up with questions, and did so in his capacity as vice president of an investment banking company.

C

Lorenzo argues that, despite the natural meaning of these provisions, they should not reach his conduct. This is so, he says, because the only way to be liable for false statements is through those provisions that refer *specifically* to false statements. Other provisions, he says, concern "scheme liability claims" and are violated only when conduct other than misstatements is involved. Thus, only those who "make" untrue statements under subsection (b) can violate Rule 10b-5 in connection with statements. (Similarly, § 17(a)(2) would be the sole route for finding liability for statements under § 17(a).) Holding to the contrary, he and the dissent insist, would render subsection (b) of Rule 10b-5 "superfluous." . . . .

The premise of this argument is that each of these provisions should be read as governing different, mutually exclusive, spheres of conduct. But this Court and the Commission have long recognized considerable overlap among the subsections of the Rule and related provisions of the securities laws. . . . As we have explained, these laws marked the "first experiment in federal regulation of the securities industry." *SEC v. Capital Gains Research Bureau, Inc*., 375 U.S. 180, 198 (1963). It is "understandable, therefore," that "in declaring certain practices unlawful," it was thought 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." "Each succeeding prohibition" was thus "meant to cover additional kinds of illegalities—not to narrow the reach of the prior sections." We have found "'no warrant for narrowing alternative provisions . . . adopted with the purpose of affording added safeguards.'". . . And since its earliest days, the Commission has not viewed these provisions as mutually exclusive. *See, e.g.*, *In re R. D. Bayly & Co.*, 19 S. E. C. 773 (1945) (finding violations of what would become Rules 10b-5(b) and (c) based on the same misrepresentations and omissions). . . .

The idea that each subsection of Rule 10b-5 governs a separate type of conduct is also difficult to reconcile with the language of subsections (a) and (c). It should go without saying that 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 subsection (c). In *Affiliated Ute*, for instance, we described the "defendants' activities" as falling "within the very language of one or the other of those subparagraphs, a 'course of business' or a 'device, scheme, or artifice' that operated as a fraud." 406 U.S., at 153. (The dissent, for its part, offers no account of how the superfluity problems that motivate its interpretation can be avoided where subsections (a) and (c) are concerned.)

Coupled with the Rule's expansive language, which readily embraces the conduct before us, this considerable overlap suggests we should not hesitate to hold that Lorenzo's conduct ran afoul of subsections (a) and (c), as well as the related statutory provisions. Our conviction is strengthened by the fact that we here confront behavior that, though plainly fraudulent, might otherwise fall outside the scope of the Rule. Lorenzo's view that subsection (b), the making-false-statements provisions, *exclusively* regulates conduct involving false or misleading statements would mean those who disseminate false statements with the intent to cheat investors might escape liability under the Rule altogether. But using false representations to induce the purchase of securities would seem a paradigmatic example of securities fraud. We do not know why Congress or the Commission would have wanted to disarm enforcement in this way. And we cannot easily reconcile Lorenzo's approach with the basic purpose behind these laws: "to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry.”….

III

Lorenzo and the dissent make a few other important arguments. They contend that applying subsections (a) or (c) of Rule 10-5 to conduct like his would render our decision in *Janus* . . . . “a dead letter.” But we do not see how that is so. In *Janus*, we considered the language in subsection (b), which prohibits the “mak[ing]” of “any untrue statement of a material fact.” We held that the “maker” of a “statement” is the “person or entity with ultimate authority over the statement.” And we found 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. We said nothing about the Rule’s application to the dissemination of false or misleading information. And we can assume that *Janus* would remain relevant (and preclude liability) where an individual neither *makes* nor *disseminate*s false information—provided, of course, that the individual is not involved in some other form of fraud.

Next, Lorenzo points to the statute’s “aiding and abetting” provision. 15 U.S.C. § 78t(e). This provision, enforceable only by the Commission (and not by private parties), makes it unlawful to “knowingly or recklessly . . . provid[e] substantial assistance to another person” who violates the Rule. . . . Lorenzo claims that imposing primary liability upon his conduct would erase or at least weaken what is otherwise a clear distinction between primary and secondary (*i.e.*, aiding and abetting) liability. He emphasizes that, under today’s holding, a disseminator might be a primary offender with respect to subsection (a) of Rule 10b-5 (by employing a “scheme” to “defraud”) and also secondarily liable as an aider and abettor with respect to subsection (b) (by providing substantial assistance to one who “makes” a false statement. . . .

We do not believe, however, that our decision creates a serious anomaly or otherwise weakens the distinction between primary and secondary liability. For one thing, it is hardly unusual for the same conduct to be a primary violation with respect to one offense and aiding and abetting with respect to another. John, for example, might sell Bill an unregistered firearm in order to help Bill rob a bank, under circumstances that make him primarily liable for the gun sale and secondarily liable for the bank robbery.

For another, the cases to which Lorenzo refers do not help his cause. Take *Central Bank*, where we held that Rule 10b-5's private right of action does not permit suits against secondary violators. The holding of *Central Bank*, we have said, suggests the need for a "clean line" between conduct that constitutes a primary violation of Rule 10b-5 and conduct that amounts to a secondary violation. Thus, in *Janus*, we sought an interpretation of "make" that could neatly divide primary violators and actors too far removed from the ultimate decision to communicate a statement. The line we adopt today is just as administrable: Those who disseminate false statements with intent to defraud are primarily liable under Rules 10b-5(a) and (c), § 10(b), and § 17(a)(1), even if they are secondarily liable under Rule 10b-5(b). Lorenzo suggests that classifying dissemination as a primary violation would inappropriately subject peripheral players in fraud (including him, naturally) to substantial liability. We suspect the investors who received Lorenzo's e-mails would not view the deception so favorably. And as *Central Bank* itself made clear, even a bit participant in the securities markets "may be liable as a primary violator under [Rule] 10b-5" so long as "all of the requirements for primary liability . . . are met." . . .

Lorenzo's reliance on *Stoneridge* is even further afield. There, we held that private plaintiffs could not bring suit against certain securities defendants based on *undisclosed* deceptions upon which the plaintiffs could not have relied. 552 U.S., at 159. But the

Commission, unlike private parties, need not show reliance in its enforcement actions. And even supposing reliance were relevant here, Lorenzo's conduct involved the direct transmission of false statements to prospective investors intended to induce reliance—far from the kind of concealed fraud at issue in *Stoneridge*.

As for Lorenzo's suggestion that those like him ought to be held secondarily liable, this offer will, far too often, prove illusory. In instances where a "maker" of a false statement does *not* violate subsection (b) of the Rule (perhaps because he lacked the necessary intent), a disseminator of those statements, even one knowingly engaged in an egregious fraud, could not be held to have violated the "aiding and abetting" statute. That is because the statute insists that there be a primary violator to whom the secondary violator provided "substantial assistance." 15 U. S. C. § 78t(e). And the latter can be "deemed to be in violation" of the provision only "to the same extent as the person to whom such assistance is provided." In other words, if Acme Corp. could not be held liable under subsection (b) for a statement it made, then a knowing disseminator of those statements could not be held liable for aiding and abetting Acme under subsection (b). And if, as Lorenzo claims, the disseminator has not primarily violated other parts of Rule 10b-5, then such a fraud, whatever its intent or consequences, might escape liability altogether.

That 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.

* * *

For these reasons, the judgment of the Court of Appeals is affirmed.

So ordered.

JUSTICE THOMAS, with whom JUSTICE GORSUCH joins, dissenting.

In Janus Capital Group, Inc. v. First Derivative Traders, 564 U. S. 135 (2011), we drew a clear line between primary and secondary liability in fraudulent-misstatement cases: A person does not "make" a fraudulent misstatement within the meaning of Securities and Exchange Commission (SEC) Rule 10b-5(b)—and thus is not primarily liable for the statement—if the person lacks "ultimate authority over the statement." Such a person could, however, be liable as an aider and abettor under principles of secondary liability.

Today, the Court eviscerates this distinction by holding that a person who has not "made" a fraudulent misstatement can nevertheless be primarily liable for it. Because the majority misconstrues the securities laws and flouts our precedent in a way that is likely to have far-reaching consequences, I respectfully dissent.

. . . .

The majority's approach contradicts our precedent in two distinct ways.

First, the majority's opinion renders *Janus* a dead letter. In *Janus*, we held that liability under Rule 10b-5(b) was limited to the "make[r]" of the statement and that "[o]ne who *prepares* or *publishes* a statement on behalf of another is not its maker" within the meaning of Rule 10b-5(b). It is undisputed here that Lorenzo was not the maker of the fraudulent misstatements. The majority nevertheless finds primary liability under different provisions of Rule 10b-5, without any real effort to reconcile its decision with *Janus*. Although 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 majority states that this would be true only if "the individual is not involved in some other form of fraud." Given that, under the majority's rule, administrative acts undertaken in connection with a fraudulent misstatement qualify as "other form[s] of fraud," the majority's supposed preservation of *Janus* is illusory.

Second, the majority fails to maintain a clear line between primary and secondary liability in fraudulent-misstatement cases. Maintaining this distinction is important because, as the majority notes, there is no private right of action against mere aiders and abettors. . . . Here, however, 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." If Lorenzo's conduct here qualifies for primary liability under § 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.

. . . .

The Court attempts to cabin the implications of its holding by highlighting several facts that supposedly would distinguish this case from a case involving a secretary or other person "tangentially involved in disseminat[ing]" fraudulent misstatements. None of these distinctions withstands scrutiny. The fact that Lorenzo "sent false statements directly to investors" in e-mails that "invited [investors] to follow up with questions," puts him in precisely the same position as a secretary asked to send an identical message from her e-mail account. And under the unduly capacious interpretation that the majority gives to the securities laws, I do not see why it would matter whether the sender is the "vice president of an investment banking company" or a secretary—if the sender knowingly sent false statements, the sender apparently would be primarily liable. To be sure, I agree with the majority that liability would be "inappropriate" for a secretary put in a situation similar to Lorenzo's. But I can discern no legal principle in the majority opinion that would preclude the secretary from being pursued for primary violations of the securities laws.

* * *

Instead of blurring the distinction between primary and secondary liability, I would hold that Lorenzo's conduct did not amount to a primary violation of the securities laws and reverse the judgment of the Court of Appeals. Accordingly, I respectfully dissent.

Chapter 12

Insider Trading

§ 12.08 "Tipper-Tippee" Liability

On page 968, add:

Securities Fraud Criminal Statutes (Title 18 U.S. Code) — No Personal Benefit Required to be Proven. In perhaps a surprising decision, *United States v. Blaszczak*, 947 F.3d 19 (2d Cir. 2019), the Second Circuit held that the *Dirks* personal benefit test does not apply in criminal prosecutions under the (Title 18 U.S. Code) securities fraud and wire fraud statutes. Reasoning that these criminal statutes have a more expansive scope than Section 10(b) of the Securities Exchange Act, the court therefore concluded that prosecutors have a broader enforcement arsenal to address securities fraud, including insider trading. Accordingly, the Second Circuit declined "to graft the *Dirks* personal benefit test onto the elements of Title 18 securities fraud." Hence, to a prosecutor's delight, the "government may avoid the personal benefit test altogether by prosecuting insider trading with less difficulty under the Title 18 fraud statues — particularly the Title 18 securities fraud statute …." *Id.* at 37. Subsequently, the Supreme Court on other grounds reversed and remanded this case to the Second Circuit. *See* 141 S. Ct. 1040 (2021). If this rationale ultimately is upheld, the consequence is that, with respect to tipper-tippee liability, it would be easier for the Department of Justice to procure a criminal conviction than it would be for the SEC or a plaintiff in private litigation to win its case. An excerpt of the Second Circuit's decision follows.

> These consolidated appeals require us to consider whether the federal wire fraud, securities fraud, and conversion statutes, codified at 18 U.S.C. §§ 1343, 1348, and 641, respectively, reach misappropriation of a government agency's

confidential non-public information relating to its contemplated rules. Defendants David Blasczak, Theodore Huber, Robert Olan, and Christopher Worrall were charged with violating these statutes — and with engaging in securities fraud in violation of Section 10(b) of the Securities and Exchange Act, 15 U.S.C. § 78j(b), and SEC Rule 10b-5 ("Title 15 securities fraud") — by misappropriating confidential nonpublic information from the Centers for Medicare & Medicaid Services ("CMS"). The indictment principally alleged that CMS employees, including Worrall, disclosed the agency's confidential information to Blaszczak, a "political intelligence" consultant for hedge funds, who in turn tipped the information to Huber and Olan, employees of the healthcare-focused hedge fund Deerfield Management Company, L.P. ("Deerfield"), which traded on it. After a one-month trial before the United States District Court for the Southern District of New York (Kaplan, J.), a jury found Defendants guilty of wire fraud, conversion, and, with the exception of Worrall, Title 18 securities fraud and conspiracy. The jury acquitted Defendants on all counts alleging Title 15 securities fraud.

Defendants now challenge their convictions on various grounds. For the reasons set forth below, we reject these challenges. In doing so, we hold, *inter alia*, that (1) confidential government information such as the CMS information at issue here may constitute "property" in the hands of the government for purposes of the wire fraud and Title 18 securities fraud statutes, and (2) the "personal-benefit" test established in *Dirks v. SEC*, 463 U.S. 646 (1983), does not apply to these Title 18 fraud statutes. Because we also discern no prejudicial error with respect to the remaining issues raised on appeal, we affirm the judgments of the district court.

….

B. Whether Dirks v. SEC Applies to 18 U.S.C. §§ 1343 and 1348

Under *Dirks*, an insider may not be convicted of Title 15 securities fraud unless the government proves that he breached a duty of trust and confidence by disclosing material, nonpublic information in exchange for a "personal benefit." Similarly, a tippee may not be convicted of such fraud unless he utilized the inside information knowing that it had been obtained in breach of the insider's duty. Here, Defendants claim that the district court erred by not instructing the jury that *Dirks*'s personal-benefit test also applied to the wire fraud and Title 18 securities fraud counts. In essence, Defendants argue that the term "defraud" should be construed to have the same meaning across the Title 18 fraud provisions and Rule 10b-5, so that the elements of insider-trading fraud are the same under each of these provisions. We disagree.

We begin by noting what the Title 18 fraud statutes and Title 15 fraud provisions have in common: their text does not mention a "personal benefit" test. Rather, these provisions prohibit, with certain variations, schemes to "defraud." … For each of these provisions, the term "defraud" encompasses the so-called "embezzlement" or "misappropriation" theory of fraud … According to this theory, "[t]he concept of "fraud" includes the act of embezzlement, which is "the fraudulent appropriation to one's own use of the money or goods entrusted to one's care by another." The undisclosed misappropriation of confidential information, in breach of a fiduciary or similar duty of trust and confidence, "constitutes fraud akin to embezzlement."

While the Title 18 fraud statutes and Title 15 fraud provisions thus share similar text and proscribe similar theories of fraud, these common features have little to do with the personal-benefit test. Rather, the personal-benefit test is a judge-made doctrine premised on the Exchange Act's statutory purpose. As *Dirks* explained, in order to protect the free flow of information into the securities markets, Congress enacted the Title 15 fraud provisions with the limited "purpose of … eliminat[ing] [the] use of insider information for *personal advantage*." 463 U.S. at 662 (emphasis added). *Dirks* effectuated this purpose by holding that an insider could not breach his fiduciary duties by tipping confidential information unless he did so in exchange for a personal benefit….

But once untethered from the statutory context in which it arose, the personal-benefit test finds no support in the embezzlement theory of fraud recognized [by the Supreme Court]. In the context of embezzlement, there is no additional requirement that an insider breach a duty to the owner of the property, since "it is impossible for a person to embezzle the money of another without committing a fraud upon him" … Because a breach of duty is thus inherent in [the Supreme Court's] formulation of embezzlement, there is likewise no additional requirement that the government prove a breach of duty in a specific manner, let alone through evidence that an insider tipped confidential information in exchange for a personal benefit …. In short, because the personal-benefit test is not grounded in the embezzlement theory of fraud, but rather depends entirely on the purpose of the Exchange Act, we decline to extend *Dirks* beyond the context of that statute.

Our conclusion is the same for both the wire fraud and Title 18 securities fraud statutes. While it is true that Section 1348 of Title 18, unlike the wire fraud statute, concerns the general subject matter of securities law, Section 1348 and the Exchange Act do not share the same statutory purpose. Indeed, Section 1348 was added to the criminal code by the Sarbanes-Oxley Act of 2002 in large part to overcome the "technical legal requirements" of the Title 15 fraud provisions. S. Rep. No. 107-146, at 6. In particular, Congress intended for Section 1348 to "supplement the patchwork of existing technical securities law violations with a more general and less technical provision, with elements and intent requirements comparable to current bank fraud and health care fraud statutes." S. Rep. No. 107-146, at 14. Given that Section 1348 was intended to provide prosecutors with a different — and broader — enforcement mechanism to address securities fraud than what had been previously provided in the Title 15 fraud provisions, we decline to graft the *Dirks* personal-benefit test onto the elements of Title 18 securities fraud.

Finally, Defendants argue that we should extend *Dirks* beyond the Title 15 fraud provisions because otherwise the government may avoid the personal-benefit test altogether by prosecuting insider-trading fraud with less difficulty under the Title 18 fraud statutes — particularly the Title 18 securities fraud statute, which (unlike the wire fraud statute) does not require proof that wires were used to carry out the fraud. But whatever the force of this argument as a policy matter, we may not rest our interpretation of the Title 18 fraud provisions "on such enforcement policy considerations." … "The Federal Criminal Code is replete with provisions that criminalize overlapping conduct," and so "[t]he mere fact that two federal criminal statutes criminalize similar conduct says little about the scope of either." … Congress was certainly authorized to enact a broader securities fraud provision, and it is not the place of courts to check that decision on policy grounds.

Accordingly, we hold that the personal-benefit test does not apply to the wire fraud and Title 18 securities fraud statutes, and thus the district court did not err by refusing to instruct the jury on the personal benefit test for those offenses.

….

IV. CONCLUSION

In upholding the jury's verdict, we pause to reject Defendants' thematic claim that the government's positions, if accepted, would herald an unprecedented expansion of federal criminal law. It is Defendants who ask us to break new ground by rejecting well-recognized theories of property rights and by adding, in effect, a "personal benefit" element to the Title 18 fraud statutes. We decline these requests, holding instead that (1) a government agency's confidential information relating to its contemplated rules may constitute "property" for purposes of the wire fraud and Title 18 securities fraud statutes, and (2) *Dirks*'s "personal-benefit" framework does not apply to these Title 18 fraud statutes. Our remaining holdings confirm that Defendants' misappropriation of CMS's predecisional information, as proven at trial, fall comfortably within the Title 18 securities fraud, wire fraud, conversion, and conspiracy statutes. To the extent that the government's decision to prosecute any or all of these crimes in this case raises broader enforcement policy concerns, that is a matter for Congress and the Executive, not the Judiciary. Our inquiry is a more limited one, and having now completed it, we AFFIRM the judgments of the district court.

Chapter 13

Financial Intermediaries — Broker-Dealers and Investment Advisers

§ 13.04 The Shingle and Related Theories

On page 1010, add:

Adoption of Regulation Best Interest

SEC Securities Exchange Act Release No. 86031 (2019)

In 2019, the SEC adopted Regulation Best Interest (BI), having a compliance date of June 30, 2020. The Commission rejected a fiduciary standard for broker-dealers and individuals associated with a broker-dealer. In the SEC's view, the Regulation "enhances the broker-dealer standard of conduct existing beyond suitability obligations, and aligns the standard of conduct with retail customers' reasonable expectations …." Disagreeing with the Commission, several state attorneys general have brought suit seeking to invalidate the Regulation. They argue that the Regulation neglects to harmonize norms of conduct that apply to investment advisers and broker-dealers and also fails to mandate that brokers serve their clients' best interests regardless of the brokers' own financial interests. *See 8 Attorneys General Sue SEC Over Regulation Best Interest*, CCH Fed. Sec. L. Rep. No. 2889, at 1-3 (Sept. 19, 2019).

In addition, the Commission adopted Form CRS (client relationship summary) requiring registered broker-dealers and investment advisers to provide a brief relationship summary in plain English to retail investors. This relationship summary is to be provided to retail investors at the commencement of a client's relationship with the firm as well as upon certain other material events. This relationship summary should inform retail investors regarding the following: "The types of client and customer relationships and services the firm offers; the fees, costs, conflicts of interest, and required standard of conduct associated with those relationships and services; whether the firm and its financial professionals currently have a reportable legal or disciplinary history; and how to obtain additional information about the firm." Securities Exchange Act Release No. 86032 (2019).

An excerpt of the SEC adopting release for Regulation Best Interest follows.

Summary

The Securities and Exchange Commission (the "Commission") is adopting a new rule under the Securities Exchange Act of 1934 ("Exchange Act"), establishing a standard of conduct for broker-dealers and natural persons who are associated persons of a broker-dealer (unless otherwise indicated, together referred to as "broker-dealer") when they make a recommendation to a retail customer of any securities transaction or investment strategy involving securities ("Regulation Best Interest"). Regulation Best Interest enhances the broker-dealer standard of conduct beyond existing suitability obligations, and aligns the standard of conduct with retail customers' reasonable expectations by requiring broker-dealers, among other things, to: Act in the best interest of the retail customer at the time the recommendation is made, without placing the financial or other interest of the broker-dealer ahead of the interests of the retail customer; and address conflicts of interest by establishing, maintaining, and enforcing policies and procedures reasonably designed to identify and fully and fairly disclose material facts about conflicts of interest, and in instances where we have determined that disclosure is insufficient to reasonably address the conflict, to mitigate or, in certain instances, eliminate the conflict. The standard of conduct established by Regulation Best Interest cannot be satisfied through disclosure alone. The standard of conduct draws from key principles underlying fiduciary obligations, including those that apply to investment advisers under the Investment Advisers Act of 1940 ("Advisers Act"). Importantly, regardless of whether a retail investor chooses a broker-dealer or an investment adviser (or both), the retail investor will be entitled to a recommendation (from a broker-dealer) or advice (from an investment adviser) that is in the best interest of the retail investor and that does not place the interests of the firm or the financial professional ahead of the interests of the retail investor.

. . . .

I. Introduction

We are adopting a new rule under the Exchange Act ("Regulation Best Interest") that will improve investor protection by: (1) Enhancing the obligations that apply when a broker-dealer makes a recommendation to a retail customer and natural persons who are associated persons of a broker-dealer ("associated persons") (unless otherwise indicated, together referred to as "broker-dealer") and (2) reducing the potential harm to retail customers from conflicts of interest that may affect the recommendation. Regulation Best Interest enhances the broker-dealer standard of conduct beyond existing suitability obligations, and aligns the standard of conduct with retail customers' reasonable expectations by requiring broker-dealers, among other things, to: (1) Act in the best interest of the retail customer at the time the recommendation is made, without placing the financial or other interest of the broker-dealer ahead of the interests of the retail customer; and (2) address conflicts of interest by establishing, maintaining, and enforcing policies and procedures reasonably designed to identify and fully and fairly disclose material facts about conflicts of interest, and in instances where we have determined that disclosure is insufficient to reasonably address the conflict, to mitigate or, in certain instances, eliminate the conflict. Regulation Best Interest establishes a standard of conduct under the Exchange Act that cannot be satisfied through disclosure alone.

A. Background

Broker-dealers play an important role in helping Americans organize their finances, accumulate and manage retirement savings, and invest toward other important long-term goals, such as buying a house or funding a child's college education. Broker-dealers offer a wide variety of brokerage (*i.e.*, agency) services and dealer (*i.e.*, principal) services and products to both retail and institutional customers. Specifically, the brokerage services provided to retail customers range from execution-only services to providing personalized investment advice in the form of recommendations of securities transactions or investment strategies involving securities to customers.

Investment advisers play a similarly important, though distinct, role. As described in the Fiduciary Interpretation, investment advisers provide a wide range of services to a large variety of clients, from retail clients with limited assets and investment knowledge and experience to institutional clients with very large portfolios and substantial knowledge, experience, and analytical resources.

As a general matter, broker-dealers and investment advisers have different types of relationships with investors, offer different services, and have different compensation models when providing investment recommendations or investment advisory services to customers. Broker-dealers typically provide transaction-specific recommendations and receive compensation on a transaction-by-transaction basis (such as commissions) ("transaction-based" compensation or model). A broker-dealer's recommendations may include recommending transactions where the broker-dealer is buying securities from or selling securities to retail customers on a principal basis or recommending proprietary products. Investment advisers, on the other hand, typically provide ongoing regular advice and services in the context of broad investment portfolio management, and are compensated based on the value of assets under management ("AUM"), a fixed fee or other arrangement ("fee-based" compensation or model). This variety is important because it presents investors with choices regarding the types of relationships they can have, the services they can receive, and how they can pay for those services. It is also common for a firm to provide both broker-dealer and investment adviser services.

Like many principal-agent relationships—including the investment adviser-client relationship—the relationship between a broker-dealer and a customer has inherent conflicts of interest, including those resulting from a transaction-based (*e.g.*, commission) compensation structure and other broker-dealer compensation. These and other conflicts of interest may provide an incentive to a broker-dealer to seek to increase its own compensation or other financial interests at the expense of the customer to whom it is making investment recommendations.

Notwithstanding these inherent conflicts of interest in the broker-dealer-customer relationship, there is broad acknowledgment of the benefits of, and support for, the continuing existence of the broker-dealer business model, including a commission or other transaction-based compensation structure, as an option for retail customers seeking investment recommendations. For example, retail customers that intend to buy and hold a long-term investment may find that paying a one-time commission to a broker-dealer recommending such an investment is more cost effective than paying an ongoing advisory fee to an investment adviser merely to hold the same investment. Retail customers with limited investment assets may benefit from broker-dealer recommendations when they do not qualify for advisory accounts because they do not meet the account minimums often imposed by investment advisers. Other retail customers who hold a variety of investments, or prefer differing levels of services (*e.g.*, both episodic recommendations from a broker-dealer and continuous advisory services including discretionary asset management from an investment adviser), may benefit from having access to both brokerage and advisory accounts. Nevertheless, concerns exist regarding (1) the potential harm to retail customers resulting from broker-dealer recommendations provided where conflicts of interest exist and (2) the insufficiency of existing broker-dealer regulatory requirements to address these conflicts when broker-dealers make recommendations to retail customers. More specifically, there are concerns that existing requirements do not require a broker-dealer's recommendations to be in the retail customer's best interest.

B. Overview of Regulation Best Interest

On April 18, 2018, we proposed enhancements to the standard of conduct that applies when broker-dealers make recommendations to retail customers. . . .

The Commission has crafted Regulation Best Interest to draw on key principles underlying fiduciary obligations, including those that apply to investment advisers under the Advisers Act, while providing specific requirements to address certain aspects of the relationships between broker-dealers and their retail customers. Regulation Best Interest enhances the existing standard of conduct applicable to broker-dealers and their associated persons at the time they recommend to a retail customer a securities transaction or investment strategy involving securities. This includes recommendations of account types and rollovers or transfers of assets and also covers implicit hold recommendations resulting from agreed-upon account monitoring. When making a recommendation, a broker-dealer must act in the retail customer's best interest and cannot place its own interests ahead of the customer's interests (hereinafter, "General Obligation"). The General Obligation is satisfied only if the broker-dealer complies with four specified component obligations. The obligations are: (1) Providing certain prescribed disclosure before or at the time of the recommendation, about the recommendation and the relationship between the retail customer and the broker-dealer ("Disclosure Obligation"); (2) exercising reasonable diligence, care, and skill in making the recommendation ("Care Obligation"); (3) establishing, maintaining, and enforcing policies and procedures reasonably designed to address conflicts of interest ("Conflict of Interest Obligation"), and (4) establishing, maintaining, and enforcing policies and procedures reasonably designed to achieve compliance with Regulation Best Interest ("Compliance Obligation").

First, under the Disclosure Obligation, before or at the time of the recommendation, a broker-dealer must disclose in writing, all material facts about the scope and terms of its relationship with the customer. This includes a disclosure that the firm or representative is acting in a broker-dealer capacity; the material fees and costs the customer will incur; and the type and scope of the services to be provided, including any material limitations on the recommendations that could be made to the retail customer. Moreover, the broker-dealer must disclose all material facts relating to conflicts of interest associated with the recommendation that might incline a broker-dealer to make a recommendation that is not disinterested, including, for example, conflicts associated with proprietary products, payments from third parties, and compensation arrangements.

Second, under the Care Obligation, a broker-dealer must exercise reasonable diligence, care, and skill when making a recommendation to a retail customer. The broker-dealer must understand potential risks, rewards, and costs associated with the recommendation. The broker-dealer must then consider those risks, rewards, and costs in light of the customer's investment profile and have a reasonable basis to believe that the recommendation is in the customer's best interest and does not place the broker-dealer's interest ahead of the retail customer's interest. A broker-dealer should consider reasonable alternatives, if any, offered by the broker-dealer in determining whether it has a reasonable basis for making the recommendation. Whether a broker-dealer has complied with the Care Obligation will be evaluated as of the time of the recommendation (and not in hindsight). When recommending a series of transactions, the broker-dealer must have a reasonable basis to believe that the transactions taken together are not excessive, even if each is in the customer's best interest when viewed in isolation.

Third, under the Conflict of Interest Obligation, a broker-dealer must establish, maintain, and enforce reasonably designed written policies and procedures addressing conflicts of interest associated with its recommendations to retail customers. These policies and procedures must be reasonably designed to identify all such conflicts and at a minimum disclose or eliminate them. Importantly, the policies and procedures must be reasonably designed to mitigate conflicts of interest that create an incentive for an associated person of the broker-dealer to place its interests or the interest of the firm ahead of the retail customer's interest. Moreover, when a broker-dealer places material limitations on recommendations that may be made to a retail customer (*e.g.*, offering only proprietary or other limited range of products), the policies and procedures must be reasonably designed to disclose the limitations and associated conflicts and to prevent the limitations from causing the associated person or broker-dealer from placing the associated person's or broker-dealer's interests ahead of the customer's interest. Finally, the policies and procedures must be reasonably designed to identify and eliminate sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sale of specific types of securities within a limited period of time.

Fourth, under the Compliance Obligation, a broker-dealer must also establish, maintain, and enforce written policies and procedures reasonably designed to achieve compliance with Regulation Best Interest as a whole. Thus, a broker-dealer's policies and procedures must address not only conflicts of interest but also compliance with its Disclosure and Care Obligations under Regulation Best Interest.

The enhancements contained in Regulation Best Interest are designed to improve investor protection by enhancing the quality of broker-dealer recommendations to retail customers and reducing the potential harm to retail customers that may be caused by conflicts of interest. Regulation Best Interest will complement the related rules, interpretations, and guidance that the Commission is concurrently issuing. Individually and collectively, these actions are designed to help retail customers better understand and compare the services offered by broker-dealers and investment advisers and make an informed choice of the relationship best suited to their needs and circumstances, provide clarity with respect to the standards of conduct applicable to investment advisers and broker-dealers, and foster greater consistency in the level of protections provided by each regime, particularly at the point in time that a recommendation is made.

At the time a recommendation is made, key elements of the Regulation Best Interest standard of conduct that applies to broker-dealers will be similar to key elements of the fiduciary standard for investment advisers. Importantly, regardless of whether a retail investor chooses a broker-dealer or an investment adviser (or both), the retail investor will be entitled to a recommendation (from a broker-dealer) or advice (from an investment adviser) that is in the best interest of the retail investor and that does not place the interests of the firm or the financial professional ahead of the interest of the retail investor.

There are also key differences between Regulation Best Interest and the Advisers Act fiduciary standard that reflect the distinction between the services and relationships typically offered under the two business models. For example, an investment adviser's fiduciary duty generally includes a duty to provide ongoing advice and monitoring, while Regulation Best Interest imposes no such duty and instead requires that a broker-dealer act in the retail customer's best interest *at the time* a recommendation is made. [Note, however, if the broker-dealer agrees to monitor the client's account, Regulation BI applies to any recommendations that ensue from the account monitoring services. By engaging in these account monitoring services, the broker-dealer incurs the obligation to periodically review the client's account and make recommendations thereto. In situations where a broker-dealer declines to make a recommendation during such a periodic review, an implicit "hold" recommendation is deemed under Regulation BI to have been provided to the client. *See* Bradley Berman, et. al, *Regulation Best Interest*, Harv. Law School Forum on Corporate Governance (June 19, 2018)]. In addition, the new obligations applicable to broker-dealers under Regulation Best Interest are more prescriptive than the obligations applicable to investment advisers under the Advisers Act fiduciary duty and reflect the characteristics of the generally applicable broker-dealer business model.

. . . .

We have declined to subject broker-dealers to a wholesale and complete application of the existing fiduciary standard under the Advisers Act because it is not appropriately tailored to the structure and characteristics of the broker-dealer business model (*i.e.*, transaction-specific recommendations and compensation), and would not properly take into account, and build upon, existing obligations that apply to broker-dealers, including under FINRA rules. Moreover, we believe (and our experience indicates), that this approach would significantly reduce retail investor access to differing types of investment services and products, reduce retail investor choice in how to pay for those products and services, and increase costs for retail investors of obtaining investment recommendations.

We have also declined to craft a new uniform standard that would apply equally and without differentiation to both broker-dealers and investment advisers. Adopting a "one size fits all" approach would risk reducing investor choice and access to existing products, services, service providers, and payment options, and would increase costs for firms and for retail investors in both broker-dealer and investment adviser relationships. Moreover, applying a new uniform standard to advisers would mean jettisoning to some extent the fiduciary standard under the Advisers Act that has worked well for retail clients and our markets and is backed by decades of regulatory and judicial precedent.

. . . .

The U.S. Court of Appeals has upheld the validity of Regulation Best Interest. *See XY Planning LLC v. SEC*, 963 F.3d 244 (2d Cir. 2020).

Chapter 15

Securities Law Enforcement

§ 15.04 Injunctions

[A] Standards for Imposition

On page 1173, add:

Pursuant to congressional legislation, the statute of limitations for SEC actions for injunctive relief now is ten years.

[D] Other Relief

On page 1175, add:

LIU v. SECURITIES AND EXCHANGE COMMISSION

United States Supreme Court

140 S. Ct. 1936 (2020)

JUSTICE SOTOMAYOR delivered the opinion of the Court.

In Kokesh v. SEC, [137 S. Ct. 1635] (2017), this Court held that a disgorgement order in a Securities and Exchange Commission (SEC) enforcement action imposes a "penalty" for the purposes of 28 U.S.C. § 2462, the applicable statute of limitations. In so deciding, the Court reserved an antecedent question: whether, and to what extent, the SEC may seek "disgorgement" in the first instance through its power to award "equitable relief" under 15 U.S.C. § 78u(d)(5), a power that historically excludes punitive sanctions. The Court holds today that a disgorgement award that does not exceed a wrongdoer's net profits and is awarded for victims is equitable relief permissible under § 78u(d)(5). The judgment is vacated, and the case is remanded for the courts below to ensure the award was so limited.

I

A

Congress authorized the SEC to enforce the Securities Act of 1933 and the Securities Exchange Act of 1934 … and to punish securities fraud through administrative and civil proceedings. In administrative proceedings, the SEC can seek limited civil penalties and "disgorgement." … In civil actions, the SEC can seek civil penalties and "equitable relief." See, *e.g.*, § 78u(d)(5) ("In any action or proceeding brought or instituted by the Commission under any provision of the securities laws, … any Federal court may grant … any equitable relief that may be appropriate or necessary for the benefit of investors"); see also § 78u(d)(3) ("Money penalties in civil actions" ….).

Congress did not define what falls under the umbrella of "equitable relief." Thus, courts have had to consider which remedies the SEC may impose as part of its §78u(d)(5) powers.

Starting with *SEC v. Texas Gulf Sulphur Co.*, 446 F.2d 1301 (CA2 1971), courts determined that the SEC had authority to obtain what it called "restitution," and what in substance amounted to "profits" that "merely depriv[e]" a defendant of "the gains of … wrongful conduct." … Over the years, the SEC has continued to request this remedy, later referred to as "disgorgement," and courts have continued to award it….

In *Kokesh*, this Court determined that disgorgement constituted a "penalty" for the purposes of 28 U.S.C. § 2462, which establishes a 5-year statute of limitations for "an action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture." The Court reached this conclusion based on several considerations, namely, that disgorgement is imposed as a consequence of violating public laws, it is assessed in part for punitive purposes, and in many cases, the award is not compensatory. But the Court did not address whether a § 2462 penalty can nevertheless qualify as "equitable relief" under § 78u(d)(5), given that equity never "lends its aid to enforce a forfeiture or penalty." … The Court cautioned, moreover, that its decision should not be interpreted "as an opinion on whether courts possess authority to order disgorgement in SEC enforcement proceedings." This question is now squarely before the Court.

B

The SEC action and disgorgement award at issue here arise from a scheme to defraud foreign nationals. Petitioners Charles Liu and his wife, Xin (Lisa) Wang, solicited nearly $27 million from foreign investors under the EB-5 Immigrant Investor Program (EB-5 Program). The EB-5 Program, administered by the U.S. Citizenship and Immigrant Services, permits noncitizens to apply for permanent residence in the United States by investing in approved commercial enterprises that are based on "proposals for promoting economic growth." … Investments in EB-5 projects are subject to the federal securities laws.

Liu sent a private offering memorandum to prospective investors, pledging that the bulk of any contributions would go toward the construction costs of a cancer-treatment center. The memorandum specified that only amounts collected from a small administrative fee would fund "'legal, accounting and administration expenses.'" An SEC investigation revealed, however, that Liu spent nearly $20 million of investor money on ostensible marketing expenses and salaries, an amount far more than what the offering memorandum permitted and far in excess of the administrative fees collected…. The investigation also revealed that Liu diverted a sizable portion of those funds to personal accounts and to a company under Wang's control. Only a fraction of the funds were put toward a lease, property improvements, and a proton-therapy machine for cancer treatment.

The SEC brought a civil action against petitioners, alleging that they violated the terms of the offering documents by misappropriating millions of dollars. The District Court found for the SEC, granting an injunction barring petitioners form participating in the EB-5 Program and imposing a civil penalty at the highest tier authorized. It also ordered disgorgement equal to the full amount petitioners had raised from investors, less the $234,899 that remained in the corporate accounts for the project….

Petitioners objected that the disgorgement award failed to account for their business expenses. The District Court disagreed, concluding that the sum was a "reasonable approximation of the profits causally connected to [their] violation." The court ordered petitioners jointly and severally liable for the full amount that the SEC sought.

The Ninth Circuit affirmed. It acknowledged that *Kokesh* "expressly refused to reach" the issue whether the District Court had the authority to order disgorgement. 754 Fed. Appx., at 509. The court relied on Circuit precedent to conclude that the "proper amount of disgorgement in a scheme such as this one is the entire amount raised less the money paid back to the investors." …

We granted certiorari to determine whether § 78u(d)(5) authorizes the SEC to seek disgorgement beyond a defendant's net profits from wrongdoing.

II

Our task is a familiar one. In interpreting statutes like § 78u(d)(5) that provide for "equitable relief," this Court analyzes whether a particular remedy falls into "those categories of relief that were *typically* available in equity." … The "basic contours of the term are well known" and can be discerned by consulting works on equity jurisprudence….

These works on equity jurisprudence reveal two principles. First, equity practice long authorized courts to strip wrongdoers of their ill-gotten gains, with scholars and courts using various labels for the remedy. Second, to avoid transforming an equitable remedy into a punitive sanction, courts restricted the remedy to an individual wrongdoer's net profits to be awarded for victims.

A

Equity courts have routinely deprived wrongdoers of their net profits from unlawful activity, even though that remedy may have gone by different names….

No matter the label, this "profit-based measure of unjust enrichment" … reflected a foundational principle: "[I]t would be inequitable that [a wrongdoer] should make a profit out of his own wrong"…. At the same time courts recognized that the wrongdoer should not profit "by his own wrong," they also recognized the countervailing equitable principle that the wrongdoer should not be punished by "pay[ing] more than a fair compensation to the person wronged."…

Decisions from this Court confirm that a remedy tethered to a wrongdoer's net unlawful profits, whatever the name, has been a mainstay of equity courts….

Subsequent cases confirm the "'protean character' of the profits-recovery remedy." In *Tull v. United States*, 481 U.S. 412 (1987), the Court described "disgorgement of improper profits" as "traditionally considered an equitable remedy." … While the court acknowledged that disgorgement was a "limited form of penalty" insofar as it takes money out of the wrongdoer's hands, it nevertheless compared disgorgement to restitution that simply "'restor[es] the status quo,'" thus situating the remedy squarely within the heartland of equity….

Contrary to petitioners' argument, equity courts did not limit this remedy to cases involving a breach of trust or of fiduciary duty. As petitioners acknowledge, courts authorized profits-based relief in patent-infringement actions where no such trust or special relationship existed….

… Thus, as these cases demonstrate, equity courts habitually awarded profits-based remedies in patent cases well before Congress explicitly authorized that form of relief.

B

While equity courts did not limit profits remedies to particular types of cases, they did circumscribe the award in multiple ways to avoid transforming it into a penalty outside their equitable powers.

For one, the profits remedy often imposed a constructive trust on wrongful gains for wronged victims. The remedy itself thus converted the wrongdoer, who in many cases was an infringer, "into a trustee, as to those profits, for the owner of the patent which he infringes." …

Equity courts also generally awarded profits-based remedies against individuals or partners engaged in concerted wrongdoing, not against multiple wrongdoers under a joint-and-several liability theory….

Finally, courts limited awards to the net profits from wrongdoing, that is, "the gain made upon any business or investment, when both the receipts and payments are taken into the account." …

The Court has carved out an exception when the "entire profit of a business or undertaking" results from the wrongful activity. In such cases, the Court has explained, the defendant "will not be allowed to diminish the show of profits by putting in unconscionable claims for personal services or other inequitable deductions." …

Setting aside that circumstance, however, courts consistently restricted awards to net profits from wrongdoing after deducting legitimate expenses. Such remedies, when assessed against only culpable actors and for victims, fall comfortably within "those categories of relief that were *typically* available in equity." …

C

By incorporating these longstanding equitable principles into § 78u(d)(5), Congress prohibited the SEC from seeking an equitable remedy in excess of a defendant's net profits from wrongdoing. To be sure, the SEC originally endeavored to conform its disgorgement remedy to the common-law limitations in § 78u(d)5). Over the years, however, courts have occasionally awarded disgorgement in three main ways that test the bounds of equity practice: by ordering the proceeds of fraud to be deposited in Treasury funds instead of disbursing them to victims, imposing joint-and-several disgorgement liability, and declining to deduct even legitimate expenses from the receipts of fraud.[4] The SEC's disgorgement remedy in such incarnations is in considerable tension with equity practices.

Petitioners go further. They claim that this Court effectively decided in *Kokesh* that disgorgement is necessarily a penalty, and thus not the kind of relief available at equity. Not so. *Kokesh* expressly declined to pass on the question. To be sure, the *Kokesh* Court evaluated a version of the SEC's disgorgement remedy that seemed to exceed the bounds of traditional equitable principles. But that decision has no bearing on the SEC's ability to conform future requests for a defendant's profits to the limits outlined in common-law cases awarding a wrongdoer's net gains.

[4] See, *e.g.*, *SEC v. Clark*, 915 F.2d 439, 441, 454 (CA9 1990) (requiring defendant to disgorge the profits that his stockbroker made from unlawful trades); *SEC v. Brown*, 658 F.3d 858, 860-861 (CA8 2011) (*per curiam*) (ordering joint-and several disgorgement of funds collected from investors and concluding that "'the overwhelming weight of authority hold[s] that securities law violators may not offset their disgorgement liability with business expenses"); *SEC v. Contorinis*, 743 F.3d 296, 304-306 (CA2 2014) (requiring defendant to disgorge benefits conferred on close associates).

The Government, for its part, contends that the SEC's interpretation of the equitable disgorgement remedy has Congress' tacit support, even if it exceeds the bounds of equity practice. It points to the fact that Congress has enacted a number of other statutes referring to "disgorgement."

That argument attaches undue significance to Congress' use of the term. It is true that Congress has authorized the SEC to seek "disgorgement" in administrative actions…. But it makes sense that Congress would expressly name the equitable powers it grants to an agency for use in administrative proceedings. After all, agencies are unlike federal courts where, "[u]nless otherwise provided by statute, all … inherent equitable powers … are available for the proper and complete exercise of that jurisdiction."…

Congress does not enlarge the breadth of an equitable, profit-based remedy simply by using the term "disgorgement" in various statutes. The Government argues that under the prior-construction principle, Congress should be presumed to have been aware of the scope of "disgorgement" as interpreted by lower courts and as having incorporated the (purportedly) prevailing meaning of the term into its subsequent enactments. But "that canon has no application" where, among other things, the scope of disgorgement was "far from 'settled.'" …

At bottom, even if Congress employed "disgorgement" as a shorthand to cross-reference the relief permitted by § 78u(d)(5), it did not silently rewrite the scope of what the SEC could recover in a way that would contravene limitations embedded in the statute. After all, such "statutory reference[s]" to a remedy grounded in equity "must, absent other indication, be deemed to contain the limitations upon its availability that equity typically imposes." … Accordingly, Congress' own use of the term "disgorgement" in assorted statutes did not expand the contours of that term beyond a defendant's net profits—a limit established by longstanding principles of equity.

III

Applying the principles discussed above to the facts of this case, petitioners briefly argue that their disgorgement award is unlawful because it crosses the bounds of traditional equity practice in three ways: It fails to return funds to victims, it imposes joint-and-several liability, and it declines to deduct business expenses form the award. Because the parties focused on the broad question whether any form of disgorgement may be ordered and did not fully brief these narrower questions, we do not decide them here. We nevertheless discuss principles that may guide the lower courts' assessment of these arguments on remand.

A

Section 78u(d)(5) restricts equitable relief to that which "may be appropriate or necessary for the benefit of investors." The SEC, however, does not always return the entirety of disgorgement proceeds to investors, instead depositing a portion of its collections in a fund in the Treasury…. Congress established that fund in the Dodd-Frank Wall Street Reform and Consumer Protection Act for disgorgement awards that are not deposited in "disgorgement fund[s]" or otherwise "distributed to victims."… The statute provides that these sums may be used to pay whistleblowers reporting securities fraud and to fund the activities of the Inspector General. Here, the SEC has not returned the bulk of funds to victims, largely, it contends, because the Government has been unable to collect them.[5]

The statute provides limited guidance as to whether the practice of depositing a defendant's gains with the Treasury satisfies the statute's command that any remedy be

[5] According to the Government, petitioners "transferred the bulk of their misappropriated funds to China, defied the district court's order to repatriate those funds, and fled the United States." Brief for Respondent 36.

"appropriate or necessary for the benefit of investors." The equitable nature of the profits remedy generally requires the SEC to return a defendant's gains to wronged investors for their benefit. After all, the Government has pointed to no analogous common-law remedy permitting a wrongdoer's profits to be withheld from a victim indefinitely without being disbursed to known victims….

The Government maintains, however, that the primary function of depriving wrongdoers of profits is to deny them the fruits of their ill-gotten gains, not to return the funds to victims as a kind of restitution…. Under the Government's theory, the very fact that it conducted an enforcement action satisfies the requirement that it is "appropriate or necessary for the benefit of investors."

But the SEC's equitable, profits-based remedy must do more than simply benefit the public at large by virtue of depriving a wrongdoer of ill-gotten gains. To hold otherwise would render meaningless the latter part of § 78u(d)(5)….

The Government additionally suggests that the SEC's practice of depositing disgorgement funds with the Treasury may be justified where it is infeasible to distribute the collected funds to investors. It is an open question whether, and to what extent, that practice nevertheless satisfies the SEC's obligation to award relief "for the benefit of investors" and is consistent with the limitations of § 78u(d)(5). The parties have not identified authorities revealing what traditional equitable principles govern when, for instance, the wrongdoer's profits cannot practically be disbursed to the victims. But we need not address the issue here. The parties do not identify a specific order in this case directing any proceeds to the Treasury. If one is entered on remand, the lower courts may evaluate in the first instance whether that order would indeed be for the benefit of investors as required by § 78u(d)(5) and consistent with equitable principles.

B

The SEC additionally has sought to impose disgorgement liability on a wrongdoer for benefits that accrue to his affiliates, sometimes through joint-and-several liability, in a manner sometimes seemingly at odds with the common-law rule requiring individual liability for wrongful profits. See, *e.g.*, *SEC v. Contorinis*, 743 F.3d 296, 302 (CA2 2014) (holding that a defendant could be forced to disgorge not only what he "personally enjoyed from his exploitation of insider information, but also the profits of such exploitation that he channeled to friends, family, or clients"); *SEC v. Clark*, 915 F.2d 439, 454 (CA9 1990) ("It is well settled that a tipper can be required to disgorge his tippee's profits")….

That practice could transform any equitable profits-focused remedy into a penalty. And it runs against the rule to not impose joint liability in favor of holding defendants "liable to account for such profits only as have accrued to themselves … and not for those which have accrued to another, and in which they have no participation."…

The common law did, however, permit liability for partners engaged in concerted wrongdoing. The historic profits remedy thus allows some flexibility to impose collective liability. Given the wide spectrum of relationships between participants and beneficiaries of unlawful schemes—from equally culpable codefendants to more remote, unrelated tipper-tippee arrangements—the Court need not wade into all the circumstances where an equitable profits remedy might be punitive when applied to multiple individuals.

Here petitioners were married. The Government introduced evidence that Liu formed business entities and solicited investments, which he misappropriated. It also presented evidence that Wang held herself out as the president, and a member of the management team, of an entity to which Liu directed misappropriated funds. Petitioners did not introduce evidence to suggest that one spouse was a mere passive recipient of profits. Nor did they suggest that their finances were not commingled, or that one spouse did not enjoy the fruits of the scheme, or that other circumstances would render a joint-and-several disgorgement order unjust…. We leave it to the Ninth Circuit on remand to determine whether the facts are such that petitioners can, consistent with equitable principles, be found liable for profits as partners in wrongdoing or whether individual liability is required.

C

Courts may not enter disgorgement awards that exceed the gains "made upon any business or investment, when both the receipts and payments are taken into the account."… Accordingly, courts must deduct legitimate expenses before ordering disgorgement under § 78u(d)(5). A rule to the contrary that "make[s] no allowance for the cost and expense of conducting [a] business" would be "inconsistent with the ordinary principles and practice of courts of chancery."…

The District Court below declined to deduct expenses on the theory that they were incurred for the purposes of furthering an entirely fraudulent scheme. It is true that when the "entire profit of a business or undertaking" results from the wrongdoing, a defendant may be denied "inequitable deductions" such as for personal services. But that exception requires ascertaining whether expenses are legitimate or whether they are merely wrongful gains "under another name." Doing so will ensure that any disgorgement award falls within the limits of equity practice while preventing defendants from profiting from their own wrong.

Although it is not necessary to set forth more guidance addressing the various circumstances where a defendant's expenses might be considered wholly fraudulent, it suffices to note that some expenses from petitioners' scheme went toward lease payments and cancer-treatment equipment. Such items arguably have value independent of fueling a fraudulent scheme. We leave it to the lower court to examine whether including those expenses in a profits-based remedy is consistent with the equitable principles underlying § 78u(d)(5).

* * *

For the foregoing reasons, we vacate the judgment below and remand the case to the Ninth Circuit for further proceedings consistent with this opinion.

It is so ordered.

JUSTICE THOMAS, dissenting.

The Court correctly declines to affirm the Ninth Circuit's decision upholding the District Court's disgorgement order, but I disagree with the Court's decision to vacate and remand for the lower courts to "limi[t]" the disgorgement award. Disgorgement can never be awarded under 15 U.S.C. § 78u(d)(5). That statute authorizes the Securities and Exchange Commission (SEC) to seek only "equitable relief that may be appropriate or necessary for the benefit of investors," and disgorgement is not a traditional equitable remedy. Thus, I would reverse the judgment of the Court of Appeals.

….

One need look no further than the SEC's use of disgorgement to see the pitfalls of the majority's acquiescence in its continued use as a remedy. The order in Texas Gulf Sulphur did not depart too far from equitable principles. The award was limited to the defendants' net profits and the funds were held in escrow and were at least partly available to compensate victims, 446

F.2d, at 1307 [(2d Cir. 1968)]. It did not take long, however, for a district court to order a defendant to turn over both his profits and the investment "income earned on the proceeds." Manor Nursing Centers, 458 F.2d, at 1105 [(2d Cir. 1972)]. And in the case before us today, just a half century later, disgorgement has expanded even further. The award is not limited to net profits or even money possessed by an individual defendant when it is imposed jointly and severally. And not only is it not guaranteed to be used to compensate victims, but the imposition of over $26 million in disgorgement and approximately $8 million in civil monetary penalties in this case seems to ensure that victims will be unable to recover anything in their own actions. As long as courts continue to award "disgorgement," both courts and the SEC will continue to have license to expand their own power.

The majority's decision to tame, rather than reject, disgorgement will also cause confusion in administrative practice. As the majority explains, the SEC is expressly authorized to impose "'disgorgement'" in its in -house tribunals. It is unclear whether the majority's new restrictions on disgorgement will apply to these proceedings as well. If they do not, the result will be that disgorgement has one meaning when the SEC goes to district court and another when it proceeds in-house.

More fundamentally, by failing to recognize that the problem is disgorgement itself, the majority undermines our entire system of equity. The majority believes that insistence on the traditional rules of equity is unnecessarily formalistic, but the Founders accepted federal equitable powers only because those powers depended on traditional forms. The Constitution was ratified on the understanding that equity was "a precise legal system" with "specific equitable remed[ies]." The majority, while imposing some limits, ultimately permits courts to continue expanding equitable remedies. I would simply hold that the phrase "equitable relief" in § 78u(d)(5) does not authorize disgorgement.

….

After holding that disgorgement is equitable relief, the majority remands for the lower courts to reconsider the disgorgement order in this case. If the majority is going to accept "disgorgement" as an available remedy, it should at least limit the order to be consistent with the traditional rules of equity. First, the order should be limited to each petitioner's profits. Second, the order should not be imposed jointly and severally. Third, the money paid by petitioners should be used to compensate petitioners' victims.

….

I would reverse for the straightforward reason that disgorgement is not "equitable relief" within the meaning of § 78u(d)(5). Because the majority acquiesces in the continued use of disgorgement under that statute, I respectfully dissent.

§ 15.05 Administrative Enforcement Remedies

On page 1178, add:

LUCIA v. SECURITIES AND EXCHANGE COMMISSION

United States Supreme Court

___ U.S. ___, 138 S. Ct. 736, 199 L. Ed. 2d 602 (2018)

JUSTICE KAGAN delivered the opinion of the Court.

The Appointments Clause of the Constitution lays out the permissible methods of appointing "Officers of the United States," a class of government officials distinct from mere employees. Art. II, § 2, cl. 2. This case requires us to decide whether administrative law judges (ALJs) of the Securities and Exchange Commission (SEC or Commission) qualify as such "Officers." In keeping with *Freytag v. Commissioner*, 501 U.S. 868 (1991), we hold that they do.

I

The SEC has statutory authority to enforce the nation's securities laws. One way it can do so is by instituting an administrative proceeding against an alleged wrongdoer. By law, the Commission may itself preside over such a proceeding. But the Commission also may, and typically does, delegate that task to an ALJ. The SEC currently has five ALJs. Other staff members, rather than the Commission proper, selected them all.

An ALJ assigned to hear an SEC enforcement action has extensive powers—the "authority to do all things necessary and appropriate to discharge his or her duties" and ensure a "fair and orderly" adversarial proceeding. Those powers "include, but are not limited to," supervising discovery; issuing, revoking, or modifying subpoenas; deciding motions; ruling on the admissibility of evidence; administering oaths; hearing and examining witnesses; generally "[r]egulating the course of" the proceeding and the "conduct of the parties and their counsel"; and imposing sanctions for "[c]ontemptuous conduct" of violations of procedural requirements. As that list suggests, an SEC ALJ exercises authority "comparable to" that of a federal district judge conducting a bench trial.

After a hearing ends, the ALJ issues an "initial decision." That decision must set out "findings and conclusions" about all "material issues of fact [and] law"; it also must include the "appropriate order, sanction, relief, or denial thereof." The Commission can then review the ALJ's decision, either upon request or *sua sponte*. But if it opts against review, the Commission "issue[s] an order that the [ALJ's] decision has become final." At that point, the initial decision is "deemed the action of the Commission."

This case began when the SEC instituted an administrative proceeding against petitioner Raymond Lucia and his investment company. Lucia marketed a retirement savings strategy called "Buckets of Money." In the SEC's view, Lucia used misleading slideshow presentations to deceive prospective clients. The SEC charged Lucia under the Investment Advisers Act, § 80b-1 *et seq*., and assigned ALJ Cameron Elliot to adjudicate the case. After nine days of testimony and argument, Judge Elliot issued an initial decision concluding that Lucia had violated the Act and imposing sanctions, including civil penalties of $300,000 and a lifetime bar from the investment industry. In his decision, Judge Elliot made factual findings about only one of the four ways the SEC thought Lucia's slideshow misled investors. The Commission thus remanded for factfinding on the other three claims, explaining that an ALJ's "personal experience with the witnesses" places him "in the best position to make findings of fact" and "resolve any conflicts in the evidence." Judge Elliot then made additional findings of deception and issued a revised initial decision, with the same sanctions.

On appeal to the SEC, Lucia argued that the administrative proceeding was invalid because Judge Elliot had not been constitutionally appointed. According to Lucia, the Commission's ALJs are "Officers of the United States" and thus subject to the Appointments Clause. Under that Clause, Lucia noted, only the President, "Courts of Law," or "Heads of Departments" can appoint "Officers." See Art. II, § 2, cl. 2. And none of those actors had made Judge Elliot an ALJ. To be sure, the Commission itself counts as a "Head[] of Department[]." . . . But the Commission had left the task of appointing ALJs, including Judge Elliot, to SEC staff members. As a result, Lucia contended, Judge Elliot lacked constitutional authority to do his job.

The Commission rejected Lucia's argument. It held that the SEC's ALJs are not "Officers of the United States." Instead, they are "mere employees"—officials with lesser responsibilities who fall outside the Appointments Clause's ambit. The Commission reasoned that its ALJs do not "exercise significant authority independent of [its own] supervision." Because that is so (said the SEC), they need no special, high-level appointment.

Lucia's claim fared no better in the Court of Appeals for the D.C. Circuit. A panel of that court seconded the Commission's view that SEC ALJs are employees rather than officers, and so are not subject to the Appointments Clause. See 832 F. 3d 277, 283-289 (2016). Lucia then petitioned for rehearing en banc. The Court of Appeals granted that request and heard argument in the case. But the ten members of the en banc court divided evenly, resulting in a *per curiam* order denying Lucia's claim. See 868 F.3d 1021 (2017). That decision conflicted with one from the Court of Appeals for the Tenth Circuit. See *Bandimere v. SEC*, 844 F. 3d 1168, 1179 (2016).

Lucia asked us to resolve the split by deciding whether the Commission's ALJs are "Officers of the United States within the meaning of the Appointments Clause." Up to that point, the Federal Government (as represented by the Department of Justice) had defended the Commission's position that SEC ALJs are employees, not officers. But in responding to Lucia's petition, the Government switched sides. So when we granted the petition, we also appointed an *amicus curiae* to defend the judgment below. We now reverse.

II

The sole question here is whether the Commission's ALJs are "Officers of the United States" or simply employees of the Federal Government. The Appointments Clause prescribes the exclusive means of appointing "Officers." Only the President, a court of law, or a head of department can do so. See Art. II, § 2, cl. 2. And as all parties agree, none of those actors appointed Judge Elliot before he heard Lucia's case; instead, SEC staff members gave him an ALJ slot. So if the Commission's ALJs are constitutional officers, Lucia raises a valid Appointments Clause claim. The only way to defeat his position is to show that those ALJs are not officers at all, but instead non-officer employees—part of the broad swath of "lesser functionaries" in the Government's workforce. For if that is true, the Appointments Clause cares not a whit about who named them. . . .

Two decisions set out this Court's basic framework for distinguishing between officers and employees. *United States v. Germaine* held that "civil surgeons" (doctors hired to perform various physical exams) were mere employees because their duties were "occasional or temporary" rather than "continuing and permanent." [99 U.S. 508 at 511-512 (1879).] Stressing "ideas of tenure [and] duration," the Court there made clear that an individual must occupy a "continuing" position established by law to qualify as an officer. *Buckley* [*v. Valeo*, 424 U.S. 1 (1976)] then set out another requirement, central to this case. It determined that members of a federal commission were officers only after finding that they "exercise[ed] significant authority pursuant to the laws of the United States." The inquiry thus focused on the extent of power an individual wields in carrying out his assigned functions.

Both the *amicus* and the Government urge us to elaborate on *Buckley*'s "significant authority" test, but another of our precedents makes that project unnecessary. The standard is no doubt framed in general terms, tempting advocates to add whatever glosses best suit their arguments. . . . And maybe one day we will see a need to refine or enhance the test *Buckley* set out so concisely. But that day is not this one, because in *Freytag v. Commis*sioner, 501 U.S. 868 (1991), we applied the unadorned "significant authority" test to adjudicative officials who are near-carbon copies of the Commission's ALJs. As we now explain, our analysis there (sans any more detailed legal criteria) necessarily decides this case.

The officials at issue in *Freytag* were the "special trial judges" (STJs) of the United States Tax Court. The authority of those judges depended on the significance of the tax dispute before them. In "comparatively narrow and minor matters," they could both hear and definitively resolve a case for the Tax Court. In more major matters, they could preside over the hearing, but could not issue the final decision; instead, they were to "prepare proposed findings and an opinion" for a regular Tax Court judge to consider. The proceeding challenged in *Freytag* was a major one, involving $1.5 billion in alleged tax deficiencies. After conducting a 14-week trial, the STJ drafted a proposed decision in favor of the Government. A regular judge then adopted the STJ's work as the opinion of the Tax Court. The losing parties argued on appeal that the STJ was not constitutionally appointed.

This Court held that the Tax Court's STJs are officers, not mere employees. Citing *Germaine*, the Court first found that STJs hold a continuing office established by law. They serve on an ongoing, rather than a "temporary [or] episodic[,] basis"; and their "duties, salary, and means of appointment" are all specified in the Tax Code. The Court then considered, as *Buckley* demands, the "significance" of the "authority" STJs wield. In addressing that issue, the Government had argued that STJs are employees, rather than officers, in all cases (like the one at issue) in which they could not "enter a final decision." But the Court thought the Government's focus on finality "ignore[d] the significance of the duties and discretion that [STJs] possess." Describing the responsibilities involved in presiding over adversarial hearings, the Court said: STJs "take testimony, conduct trials, rule on the admissibility of evidence, and have the power to enforce compliance with discovery orders." And the Court observed that "[i]n the course of carrying out these important functions, the [STJs] exercise significant discretion." That fact meant they were officers, even when their decisions were not final.

Freytag says everything necessary to decide this case. To begin, the Commission's ALJs, like the Tax Court's STJs, hold a continuing office established by law. Indeed, everyone here—Lucia, the Government, and the *amicus*—agrees on that point. . . . Far from serving temporarily or episodically, SEC ALJs "receive[ ] a career appointment." And that appointment is to a position created by statute, down to its "duties, salary, and means of appointment."

Still more, the Commission's ALJs exercise the same "significant discretion" when carrying out the same "important functions" as STJs do. Both sets of officials have all the authority needed to ensure fair and orderly adversarial hearings—indeed, nearly all the tools of federal trial judges. Consider in order the four specific (if overlapping) powers *Freytag* mentioned. First, the Commission's ALJs (like the Tax Court's STJs) "take testimony." More precisely, they "[r]eceiv[e] evidence" and "[e]xamine witnesses" at hearings, and may also take pre-hearing depositions. . . . Second, the ALJs (like STJs) "conduct trials." As detailed earlier, they administer oaths, rule on motions, and generally "regulat[e] the course of" a hearing, as well as the conduct of parties and counsel. Third, the ALJs (like STJs) "rule on the admissibility of evidence." They thus critically shape the administrative record (as they also do when issuing document subpoenas). And fourth, the ALJs (like STJs) "have the power to enforce compliance with discovery orders." In particular, they may punish all "[c]ontemptuous conduct," including violations of those orders, by means as severe as excluding the offender from the hearing. So point for point—straight from *Freytag*'s list—the Commission's ALJs have equivalent duties and powers as STJs in conducting adversarial inquiries.

And at the close of those proceedings, ALJs issue decisions much like that in *Freytag*—except with potentially more independent effect. As the *Freytag* Court recounted, STJs "prepare proposed findings and an opinion" adjudicating charges and assessing tax liabilities. Similarly, the Commission's ALJs issue decisions containing factual findings, legal conclusions, and appropriate remedies. And what happens next reveals that the ALJ can play the more autonomous role. In a major case like *Freytag*, a regular Tax Court judge must always review an STJ's opinion. And that opinion counts for nothing unless the regular judge adopts it as his own. By contrast, the SEC can decide against reviewing an ALJ decision at all. And when the SEC declines review (and issues an order saying so), the ALJ's decision itself "becomes final" and is "deemed the action of the Commission." . . . That last-word capacity makes this an *a fortiori* case: If the Tax Court's STJs are officers, as *Freytag* held, then the Commission's ALJs must be too.

The *amicus* offers up two distinctions to support the opposite conclusion. His main argument relates to "the power to enforce compliance with discovery orders"—the fourth of *Freytag*'s listed functions. The Tax Court's STJs, he states, had that power "because they had authority to punish contempt" (including discovery violations) through fines or imprisonment.

. . . By contrast, he observes, the Commission's ALJs have less capacious power to sanction misconduct. The *amicus*'s secondary distinction involves how the Tax Court and Commission, respectively, review the factfinding of STJs and ALJs. The Tax Court's rules state that an STJ's finding of fact "shall be presumed" correct. In comparison, the *amicus* notes, the SEC's regulations include no such deferential standard.

But those distinctions make no difference for officer status. To start with the *amicus*'s primary point, *Freytag* referenced only the general "power to enforce compliance with discovery orders," not any particular method of doing so. True enough, the power to toss malefactors in jail is an especially muscular means of enforcement—the nuclear option of compliance tools. But just as armies can often enforce their will through conventional weapons, so too can administrative judges. As noted earlier, the Commission's ALJs can respond to discovery violations and other contemptuous conduct by excluding the wrongdoer (whether party or lawyer) from the proceedings—a powerful disincentive to resist a court order. Similarly, if the offender is an attorney, the ALJ can "[s]ummarily suspend" him from representing his client—not something the typical lawyer wants to invite. And finally, a judge who will, in the end, issue an opinion complete with factual findings, legal conclusions, and sanctions has substantial informal power to ensure the parties stay in line. Contrary to the *amicus*'s view, all that is enough to satisfy *Freytag*'s fourth item (even supposing, which we do not decide, that each of those items is necessary for someone conducting adversarial hearings to count as an officer).

And the *amicus*'s standard-of-review distinction fares just as badly. The *Freytag* Court never suggested that the deference given to STJs' factual findings mattered to its Appointments Clause analysis. Indeed, the relevant part of *Freytag* did not so much as mention the subject (even though it came up at oral argument). . . . And anyway, the Commission often accords a similar deference to its ALJs, even if not by regulation. The Commission has repeatedly stated, as it did below, that its ALJs are in the "best position to make findings of fact" and "resolve any conflicts in the evidence." . . . And when factfinding derives from credibility judgments, as it frequently does, acceptance is near-automatic. Recognizing ALJs' "personal experience with the witnesses," the Commission adopts their "credibility finding[s] absent overwhelming evidence to the contrary." . . . That practice erases the constitutional line the *amicus* proposes to draw.

The only issue left is remedial. For all the reasons we have given, and all those *Freytag* gave before, the Commission's ALJs are "Officers of the United States," subject to the Appointments Clause. And as noted earlier, Judge Elliot heard and decided Lucia's case without the kind of appointment the Clause requires. This Court has held that "one who makes a timely challenge to the constitutional validity of the appointment of an officer who adjudicates his case" is entitled to relief. Lucia made just such a timely challenge: He contested the validity of Judge Elliot's appointment before the Commission, and continued pressing that claim in the Court of Appeals and this Court. So what relief follows? This Court has also held that the "appropriate" remedy for an adjudication tainted with an appointments violation is a new "hearing before a properly appointed" official. And we add today one thing more. That official cannot be Judge Elliot, even if he has by now received (or receives sometime in the future) a constitutional appointment. Judge Elliot has already both heard Lucia's case and issued an initial decision on the merits. He cannot be expected to consider the matter as though he had not adjudicated it before. To cure the constitutional error, another ALJ (or the Commission itself) must hold the new hearing to which Lucia is entitled.

We accordingly reverse the judgment of the Court of Appeals and remand the case for further proceedings consistent with this opinion.

It is so ordered.

---

§ 15.10 Statutes of Limitations

On page 1210, add:

KOKESH v. SECURITIES AND EXCHANGE COMMISSION

United States Supreme Court

____ U.S. ____, 137 S. Ct. 1635, 198 L. Ed. 2d 86 (2017)

Justice SOTOMAYOR delivered the opinion of the Court.

A 5-year statute of limitations applies to any "action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise." 28 U.S.C. § 2462. This case presents the question whether § 2462 applies to claims for disgorgement imposed as a sanction for violating a federal securities law. The Court holds that it does. Disgorgement in the securities-enforcement context is a "penalty" within the meaning of § 2462, and so disgorgement actions must be commenced within five years of the date the claim accrues.

I

A

After rampant abuses in the securities industry led to the 1929 stock market crash and the Great Depression, Congress enacted a series of laws to ensure that "the highest ethical standards prevail in every facet of the securities industry." The second in the series—the Securities Exchange Act of 1934—established the Securities and Exchange Commission (SEC or Commission) to enforce federal securities laws. Congress granted the Commission power to prescribe "'rules and regulations . . . as necessary or appropriate in the public interest or for the protection of investors.'" In addition to rulemaking, Congress vested the Commission with "broad authority to conduct investigations into possible violations of the federal securities laws." If an investigation uncovers evidence of wrongdoing, the Commission may initiate enforcement actions in federal district court.

Initially, the only statutory remedy available to the SEC in an enforcement action was an injunction barring future violations of securities laws. In the absence of statutory authorization for monetary remedies, the Commission urged courts to order disgorgement as an exercise of their "inherent equity power to grant relief ancillary to an injunction." Generally, disgorgement is a form of "[r]estitution measured by the defendant's wrongful gain." Restatement (Third) of Restitution and Unjust Enrichment § 51, Comment *a*, p. 204 (2010) (Restatement (Third)). Disgorgement requires that the defendant give up "those gains . . . properly attributable to the defendant's interference with the claimant's legally protected rights." Beginning in the 1970's, courts ordered disgorgement in SEC enforcement proceedings in order to "deprive . . . defendants of their profits in order to remove any monetary reward for violating" securities laws and to "protect the investing public by providing an effective deterrent to future violations." . . .

In 1990, as part of the Securities Enforcement Remedies and Penny Stock Reform Act, Congress authorized the Commission to seek monetary civil penalties. The Act left the Commission with a full panoply of enforcement tools: It may promulgate rules, investigate violations of those rules and the securities laws generally, and seek monetary penalties and injunctive relief for those violations. In the years since the Act, however, the Commission has continued its practice of seeking disgorgement in enforcement proceedings.

This Court has already held that the 5-year statute of limitations set forth in 28 U.S.C. § 2462 applies when the Commission seeks statutory monetary penalties. See *Gabelli v. SEC*, 568 U.S. 442 (2013). The question here is whether § 2462, which applies to any "action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise," also applies when the SEC seeks disgorgement.

B

Charles Kokesh owned two investment-adviser firms that provided investment advice to business-development companies. In late 2009, the Commission commenced an enforcement action in Federal District Court alleging that between 1995 and 2009, Kokesh, through his firms, misappropriated $34.9 million from four of those development companies. The Commission further alleged that, in order to conceal the misappropriation, Kokesh caused the filing of false and misleading SEC reports and proxy statements. The Commission sought civil monetary penalties, disgorgement, and an injunction barring Kokesh from violating securities laws in the future.

After a 5-day trial, a jury found that Kokesh's actions violated the Investment Company Act of 1940, the Investment Advisers Act of 1940, and the Securities Exchange Act of 1934. . . . The District Court then turned to the task of imposing penalties sought by the Commission. As to the civil monetary penalties, the District Court determined that § 2462's 5-year limitations period precluded any penalties for misappropriation occurring prior to October 27, 2004—that is, five years prior to the date the Commission filed the complaint. The court ordered Kokesh to pay a civil penalty of $2,354,593, which represented "the amount of funds that [Kokesh] himself received during the limitations period. Regarding the Commission's request for a $34.9 million disgorgement judgment—$29.9 million of which resulted from violations outside the limitations period—the court agreed with the Commission that because disgorgement is not a "penalty" within the meaning of § 2462, no limitations period applied. The court therefore entered a disgorgement judgment in the amount of $34.9 million and ordered Kokesh to pay an additional $18.1 million in prejudgment interest.

The Court of Appeals for the Tenth Circuit affirmed. It agreed with the District Court that disgorgement is not a penalty, and further found that disgorgement is not a forfeiture. The court thus concluded that the statute of limitations in § 2462 does not apply to SEC disgorgement claims.

This Court granted certiorari, to resolve disagreement among the Circuits over whether disgorgement claims in SEC proceedings are subject to the 5-year limitations period of § 2462.

Statutes of limitations "se[t] a fixed date when exposure to the specified Government enforcement efforts en[d]." Such limits are "'vital to the welfare of society'" and rest on the principle that "'even wrongdoers are entitled to assume that their sins may be forgotten.'" The statute of limitations at issue here—28 U.S.C. § 2462—finds its roots in a law enacted nearly two centuries ago. In its current form, § 2462 establishes a 5-year limitations period for "an action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture." This limitations period applies here if SEC disgorgement qualifies as either a fine, penalty, or forfeiture. *We hold that SEC disgorgement constitutes a penalty.*

[Nothing in this opinion should be interpreted as an opinion on whether courts possess authority to order disgorgement in SEC enforcement proceedings or on whether courts have properly applied disgorgement principles in this context. The sole question presented in this case is whether disgorgement, as applied in SEC enforcement actions, is subject to § 2462's limitations period. [Footnote moved to text — editor.]]

A "penalty" is a "punishment, whether corporal or pecuniary, imposed and enforced by the State, for a crime or offen[s]e against its laws." This definition gives rise to two principles.

First, whether a sanction represents a penalty turns in part on "whether the wrong sought to be redressed is a wrong to the public, or a wrong to the individual." Although statutes creating private causes of action against wrongdoers may appear — or even be labeled — penal, in many cases "neither the liability imposed nor the remedy given is strictly penal." This is because "[p]enal laws, strictly and properly, are those imposing punishment for an offense committed against the State." Second, a pecuniary sanction operates as a penalty only if it is sought "for the purpose of punishment, and to deter others from offending in like manner"—as opposed to compensating a victim for his loss.

The Court has applied these principles in construing the term "penalty." In *Brady v. Daly*, 175 U.S. 148 (1899), for example, a playwright sued a defendant in Federal Circuit Court under a statute providing that copyright infringers "'shall be liable for damages . . . not less than one hundred dollars for the first [act of infringement], and fifty dollars for every subsequent performance, as to the court shall appear to be just.'" The defendant argued that the Circuit Court lacked jurisdiction on the ground that a separate statute vested district courts with exclusive jurisdiction over actions "to recover a penalty." To determine whether the statutory damages represented a penalty, this Court noted first that the statute provided "for a recovery of damages for an act which violates the rights of the plaintiff, and gives the right of action solely to him" rather than the public generally, and second, that "the whole recovery is given to the proprietor, and the statute does not provide for a recovery by any other person." By providing a compensatory remedy for a private wrong, the Court held the statute did not impose a "penalty."

Similarly, in construing the statutory ancestor of § 2462, the Court utilized the same principles. In *Meeker v. Lehigh Valley R. Co.*, 236 U.S. 412 (1915), the Interstate Commerce Commission, a now-defunct federal agency charged with regulating railroads, ordered a railroad company to refund and pay damages to a shipping company for excessive shipping rates. The railroad company argued that the action was barred by Rev. Stat. § 1047, Comp. Stat. 1913, § 1712 (now 28 U.S.C. § 2462), which imposed a 5-year limitations period upon any "'suit or prosecution for a penalty or forfeiture, pecuniary or otherwise, accruing under the laws of the United States.'" The Court rejected that argument, reasoning that "the words 'penalty or forfeiture' in [the statute] refer to something imposed in a punitive way for an infraction of a public law." A penalty, the Court held, does "not include a liability imposed [solely] for the purpose of redressing a private injury." Because the liability imposed was compensatory and paid entirely to a private plaintiff, it was not a "penalty" within the meaning of the statute of limitations. See also *Gabelli*, 568 U.S., at 451-452 ("[P]enalties" in the context of § 2462 "go beyond compensation, are intended to punish, and label defendants wrongdoers").

B

Application of the foregoing principles readily demonstrates that SEC disgorgement constitutes a penalty within the meaning of § 2462.

First, SEC disgorgement is imposed by the courts as a consequence for violating what we described in *Meeker* as public laws. The violation for which the remedy is sought is committed against the United States rather than an aggrieved individual—this is why, for example, a securities-enforcement action may proceed even if victims do not support or are not parties to the prosecution. As the Government concedes, "[w]hen the SEC seeks disgorgement, it acts in the public interest, to remedy harm to the public at large, rather than standing in the shoes of particular injured parties." Brief for United States 22. Courts agree. See, *e.g.*, *SEC v. Rind*, 991 F.2d 1486, 1491 (C.A. 9 1993) ("[D]isgorgement actions further the Commission's public policy mission of protecting investors and safeguarding the integrity of the markets"); *SEC v. Teo*, 746

F.3d 90, 102 (C.A.3 2014) ("[T]he SEC pursues [disgorgement] 'independent of the claims of individual investors'" in order to "'promot[e] economic and social policies'").

Second, SEC disgorgement is imposed for punitive purposes. In *Texas Gulf*—one of the first cases requiring disgorgement in SEC proceedings—the court emphasized the need "to deprive the defendants of their profits in order to . . . protect the investing public by providing an effective deterrent to future violations." 312 F.Supp., at 92. In the years since, it has become clear that deterrence is not simply an incidental effect of disgorgement. Rather, courts have consistently held that "[t]he primary purpose of disgorgement orders is to deter violations of the securities laws by depriving violators of their ill-gotten gains." Sanctions imposed for the purpose of deterring infractions of public laws are inherently punitive because "deterrence [is] not [a] legitimate nonpunitive governmental objectiv[e]." *Bell v. Wolfish*, 441 U.S. 520, 539, n. 20 (1979).

Finally, in many cases, SEC disgorgement is not compensatory. As courts and the Government have employed the remedy, disgorged profits are paid to the district court, and it is "within the court's discretion to determine how and to whom the money will be distributed." Courts have required disgorgement "regardless of whether the disgorged funds will be paid to such investors as restitution." Some disgorged funds are paid to victims; other funds are dispersed to the United States Treasury. See, e.g., *Fishbach Corp*., 133 F.3d at 171 (affirming distribution of disgorged funds to Treasury where "no party before the court was entitled to the funds and . . . the persons who might have equitable claims were too dispersed for feasible identification and payment"); *SEC v. Lund*, 570 F.Supp. 1397, 1404-1405 (C.D.Cal. 1983) (ordering disgorgement and directing trustee to disperse funds to victims if "feasible" and to disperse any remaining money to the Treasury). Even though district courts may distribute the funds to the victims, they have not identified any statutory command that they do so. When an individual is made to pay a noncompensatory sanction to the Government as a consequence of a legal violation, the payment operates as a penalty.

SEC disgorgement thus bears all the hallmarks of a penalty. It is imposed as a consequence of violating a public law and it is intended to deter, not to compensate. The 5-year statute of limitations in § 2462 therefore applies when the SEC seeks disgorgement.

C

The Government's primary response to all of this is that SEC disgorgement is not punitive but "remedial" in that it "lessen[s] the effects of a violation" by "'restor[ing] the status quo.'" As an initial matter, it is not clear that disgorgement, as courts have applied it in the SEC enforcement context, simply returns the defendant to the place he would have occupied had he not broken the law. SEC disgorgement sometimes exceeds the profits gained as a result of the violation. Thus, for example, "an insider trader may be ordered to disgorge not only the unlawful gains that accrue to the wrongdoer directly, but also the benefit that accrues to third parties whose gains can be attributed to the wrongdoer's conduct." Individuals who illegally provide confidential trading information have been forced to disgorge profits gained by individuals who received and traded based on that information—even though they never received any profits. And, as demonstrated by this case, SEC disgorgement sometimes is ordered without consideration of a defendant's expenses that reduced the amount of illegal profit. App. To Pet. for Cert. 43a; see Restatement (Third) § 51, Comment *h*, at 216 ("As a general rule, the defendant is entitled to a deduction for all marginal costs incurred in producing the revenues that are subject to disgorgement. Denial of an otherwise appropriate deduction, by making the defendant liable in excess of net gains, results in a punitive sanction that the law of restitution normally attempts to avoid"). In such cases, disgorgement does not simply restore the status quo; it leaves the defendant worse off. The justification for this practice given by the court below demonstrates that disgorgement in this context is a punitive, rather than a remedial, sanction: Disgorgement, that court explained, is intended not only to "prevent the wrongdoer's unjust enrichment" but also "to deter others' violations of the securities laws." True, disgorgement serves compensatory goals in some cases; however, we have emphasized "the fact that sanctions frequently serve more than one purpose." "'A civil sanction that cannot fairly be said *solely* to serve a remedial purpose, but rather can only be explained as also serving either retributive or deterrent purposes, is punishment, as we have come to understand the term.'" *Austin v. United States*, 509 U.S. at 621; cf. *Bajakajian*, 524 U.S., at 331, n. 6 ("[A] modern statutory forfeiture is a 'fine' for Eighth Amendment purposes if it constitutes punishment even in part"). Because disgorgement orders "go beyond compensation, are intended to punish, and label defendants wrongdoers" as a consequence of violating public laws, they represent a penalty and thus fall within the 5-year statute of limitations of § 2462.

III

Disgorgement, as it is applied in SEC enforcement proceedings, operates as a penalty under § 2462. Accordingly, any claim for disgorgement in an SEC enforcement action must be commenced within five years of the date the claim accrued.

The judgment of the Court of Appeals for the Tenth Circuit is reversed.

Subsequently, Congress passed legislation lengthening the statute of limitations when the SEC seeks disgorgement for scienter-based violations (such as § 10(b) of the Exchange Act) to ten years. This ten-year limitations period also applies to cease and desist orders, injunctions, bars, and suspensions. The statute of limitations for disgorgement with respect to non-scienter-based violations (such as § 5 of the Securities Act) remains five years.