Saint Louis University Law Journal

Volume 66
Number 1 *Misinformation, Disinformation, and the Law (Fall 2021)*

Article 10

2021

The Duty to Correct Another's Material Misrepresentations: A Contextual Approach for Analyzing Fraudulent Behavior Under Rule 10b-5

Jenna Koleson

THE DUTY TO CORRECT ANOTHER'S MATERIAL MISREPRESENTATIONS: A CONTEXTUAL APPROACH FOR ANALYZING FRAUDULENT BEHAVIOR UNDER RULE 10B-5

ABSTRACT

Section 10(b) of the 1934 Securities and Exchange Act is the broadest anti-fraud provision within securities laws and is enforced through Rule 10b-5, which makes it unlawful for any person, in connection with the purchase or sale of any security, to defraud, misrepresent material facts, omit material facts, or engage in any practice which operates as fraud or deceit upon any person. In promulgating Section 10(b) and Rule 10b-5, Congress, and the SEC by way of Congressional authority, designed these laws to encompass the infinite variety of devices by which undue advantage could be taken of investors and corporations. Another goal of Section 10(b) and Rule 10b-5 is the need to protect the security market's integrity from abuses by those with access to material nonpublic information that would affect the price of a corporation's securities upon public disclosure.

Individuals are capable of finding creative ways to manipulate the market, and in turn, courts must also be creative in holding those individuals accountable for their fraudulent behavior. While the concept that an issuer has a duty to correct their own *statements has widespread judicial and academic acceptance, when does an issuer have a duty to correct misleading statements made by* third parties*, such as reporters and financial analysts? What about statements made by coworkers or fellow executive officers? The diversity of circuit opinions demonstrates that any given Rule 10b-5 claim is unique and rarely allows for a single coherent answer. Thus, this Note proposes that the Supreme Court should adopt a case-by-case, contextual approach for analyzing Rule 10b-5 violations.*

INTRODUCTION

Less than one month into 2021, in addition to the Covid-19 pandemic and political turmoil, the financial markets experienced a societal shift when GameStop Corp. quickly became the center of the financial world.[1] Internet retail investors publicly joined together using Reddit, a popular online forum, in an attempt to undermine a hedge fund that shorted this outdated brick-and-mortar video game retailer's stock.[2] GameStop's stock price surged from less than twenty dollars in early January to nearly $500 on January 28th for no apparent reason beyond thousands of Reddit users' efforts to force a "short squeeze."[3] Then, unexpectedly, the Robinhood Financial, LLC trading platform brazenly restricted GameStop stock purchase orders, triggering public outcry from politicians, celebrities, and government agencies.[4] Without the ability to purchase additional shares of GameStop, the Reddit users could not continue with the short squeeze.[5]

Section 10(b) of the 1934 Securities and Exchange Act is the broadest anti-fraud provision within securities laws and is enforced through Rule 10b-5, which makes it unlawful for any person, in connection with the purchase or sale of any security, to defraud, misrepresent material facts, omit material facts, or engage in any practice which operates as fraud or deceit upon any person.[6] While the concept that an issuer has a duty to correct *their own* statements has widespread judicial and academic acceptance, when does an issuer have a duty to correct misleading statements made by *third parties*, such as reporters and financial analysts? What about statements made by coworkers or fellow executive officers? How could the previously mentioned Reddit users be liable for manipulating the market?[7]

This Note discusses the circuit split in federal courts regarding the correlation between fiduciary duty and primary liability for remaining silent and failing to correct another's misrepresentation in violation of Section 10(b) and corresponding Rule 10b-5. The Second, Third, and Ninth Circuit each have conflicting opinions on the matter.

Part I of this Note discusses the formation of the Securities and Exchange Commission ("SEC") and the applicable provisions of Section 10(b). Part II

1. Joshua F. Bautz, *What is the SEC Going to do About GameStop?*, NYSBA (Feb. 4, 2021), https://nysba.org/what-is-the-sec-going-to-do-about-gamestop/.

2. *Id*.

3. *Id*. A short squeeze occurs when a stock jumps sharply higher, forcing traders who had bet that its price would fall to buy it to prevent greater losses. *Short Squeeze*, INVESTOPEDIA, https://www.investopedia.com/terms/s/shortsqueeze.asp (last visited Feb. 20, 2021).

4. Bautz, *supra* note 1.

5. *Short Squeeze*, *supra* note 3.

6. Securities Exchange Act of 1934, § 15 U.S.C. § 78j (2018); 17 C.F.R. § 240.10b-5 (2020).

7. Bautz, *supra* note 1.

explains a detailed history of relevant Rule 10b-5 litigation, including Supreme Court decisions and the current circuit split regarding primary liability for material misrepresentations. Part III provides a critique of the circuit split, recommends an appropriate standard for future Supreme Court decisions, and discusses the potential impact such a standard could have on the SEC's ability to hold individuals accountable for fraud.

I. BACKGROUND

During the 1920s, confidence in business rose with the stock market, prompting an unprecedented economic boom, but after Black Tuesday,[8] Congressional investigations revealed that the Great Depression stemmed in part from a great betrayal of trust—having encouraged investor faith in the free market, financiers and stock traders manipulated it to their own ends.[9] As the government was concerned about continued fraudulent activity,[10] President Roosevelt turned to politicians and academics to frame new legislation that tempered ideology with practicality.[11] This resulted in the Securities Act of 1933 ("the Securities Act"), which aimed to help prevent securities fraud, stated that investors must receive truthful financial data about public securities, and gave the Federal Trade Commission ("FTC") the power to block securities sales.[12] Passing this Act created new issues for progressive reformers and economic conservatives to confront in administrative agencies, like the FTC, and in the halls of Congress over the ultimate shape of the ongoing reform.[13] From the tumult of politics emerged an elegant solution: the creation of the Securities and Exchange Commission under the umbrella of the 1934 Securities and Exchange Act ("the Exchange Act").[14] This Act gave the SEC extensive power to regulate

8. On Black Tuesday, October 29, 1929, the stock market crashed, along with public confidence as investors and banks lost billions of dollars in just one day. The stock market crash caused nearly 5,000 banks to close and led to bankruptcies, rampant unemployment, wage cuts, and homelessness, which triggered the Great Depression. *SEC: Securities and Exchange Commission*, HIST. (Dec. 6, 2019), https://www.history.com/topics/us-government/securitiesandexchangecommission#:~:text=Securities%20Exchange%20Act%20of%201934,the%20New%20York%20Stock%20Exchange [hereinafter *SEC History*].

9. *431 Days: Joseph P. Kennedy and the Creation of the SEC*, SEC HIST. SOC'Y, http://www.sechistorical.org/museum/galleries/kennedy/index.php (last visited Nov. 10, 2020) [hereinafter *431 Days*].

10. To help determine the cause of the Great Depression and prevent a future stock market crash, the U.S. Senate Banking Committee held hearings in 1932, known as the Pecora hearings, named for the committee's lead counsel, Ferdinand Pecora. The hearings determined that numerous financial institutions had misled investors, acted irresponsibly, and participated in widespread insider trading. *SEC History*, *supra* note 8.

11. *431 Days*, *supra* note 9.

12. *SEC History*, *supra* note 8.

13. *431 Days*, *supra* note 9.

14. *Id.*

the securities industry and allowed the agency to bring civil charges against individuals and companies that violated securities laws.[15]

A. The Securities and Exchange Act of 1934

The SEC was created in 1934 as an independent federal regulatory agency tasked with protecting investors and capital, overseeing the stock market, and proposing and enforcing federal securities laws.[16] Prior to the SEC's creation, oversight of trade in stocks, bonds, and other securities was virtually nonexistent, which led to widespread fraud, insider trading, and other abuses.[17] Joseph Kennedy, one of the SEC's first Commissioners and the first Chairperson, declared the SEC a partner of honest capital that would help all businesses by establishing new checks and setting up positive standards.[18] But to recover from the Great Depression, the SEC faced a tougher job of encouraging capital since the crash had driven investors out of the market, and many believed that tough FTC registration rules helped keep them out.[19] Essentially, the American people needed a reboot of confidence in the market and business.

The SEC attempted to restore market integrity through registration and disclosure regimes for corporations selling securities. The corporate registration process envisioned by the Exchange Act requires companies to provide essential information that enables investors to make informed judgments about whether to purchase a company's securities, which in turn minimizes the burden and expense of complying with the law.[20] Further, the SEC began requiring periodic reporting of information by companies with publicly traded securities.[21] For example, the Form 10-K annual report provides a comprehensive overview of a company's business and financial condition and includes audited financial statements, and the Form 8-K is a "current report" that companies must file with the SEC to keep shareholders informed of major events.[22] Independently, many public companies also often schedule conference calls to discuss their earnings or share other information with investors and stock exchanges.

In addition to, and in support of, the SEC's disclosure and reporting requirements, securities laws broadly prohibit fraudulent activities of any kind

15. *SEC History*, *supra* note 8.

16. *Id.*

17. *Id.*

18. *431 Days*, *supra* note 9.

19. *Id*.

20. U.S. SEC. & EXCH. COMM'N, THE LAWS THAT GOVERN THE SECURITIES INDUSTRY, https://www.sec.gov/answers/about-lawsshtml.html (last visited Dec. 12, 2020).

21. *Id.*

22. *Form 10-K*, INVESTOR.GOV, https://www.investor.gov/introduction-investing/investing-basics/glossary/form-10-k (last visited Dec. 12, 2020).

in connection with the sale of securities through Section 10(b) of the Exchange Act and SEC Rule 10b-5.

B. Section 10(b)'s Applicability & Provisions

Within the Exchange Act, Section 10(b) makes it unlawful for any person, directly or indirectly, to use or employ any manipulative or deceptive device in connection with the purchase or sale of securities.[23] The SEC intended Section 10(b) to act as a "catch-all" clause to prevent fraudulent practices within the securities markets.[24] Section 10(b) is enforced through Rule 10b-5 which makes it unlawful for any person, directly or indirectly, in connection with the purchase or sale of any security, (a) to employ any device, scheme, or artifice to defraud; (b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or (c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.[25]

These general antifraud provisions appear reasonably straightforward: "tell the truth and don't leave out any important information."[26] However, courts, scholars, securities issuers, and market participants continuously examine whether these provisions are violated by telling half-truths, lying, or saying nothing at all.[27] This area of securities law is muddled by two duties that arise under Section 10(b) and Rule 10b-5: the duty to correct and the duty to update.[28] An issuer has a duty to correct a statement that it discovers was misleading when made, and an issuer has a duty to update a statement that was accurate when made but later became misleading.[29]

A fiduciary duty is a special type of relationship between parties who are vulnerable to each other; it requires one party to act in the interest of the other and not for their own benefit.[30] For example, directors of corporations are charged with certain fiduciary duties for fulfilling their managerial responsibilities, primarily the duty of care which requires that directors inform themselves, prior to making a business decision, of all material information

23. 15 U.S.C. § 78j (2018).

24. Elizabeth A. Odian, SEC v. Dorozhko*'s Affirmative Misrepresentation Theory of Insider Trading: An Improper Means to A Proper End*, 94 MARQ. L. REV. 1313, 1319 (2011).

25. 17 C.F.R. § 240.10b-5 (1951).

26. Robert H. Rosenblum, *An Issuer's Duty Under 10b-5 to Correct and Update Materially Misleading Statements*, 40 CATH. U.L. REV. 289, 289 (1991).

27. *Id*.

28. *Id*.

29. *Id*. An issuer is a legal entity that develops, registers, and sells securities to finance its operations.

30. *Fiduciary Duty*, CORNELL L. SCH., https://www.law.cornell.edu/wex/fiduciary_duty (last visited Feb. 17, 2021).

reasonably available to them.[31] In abiding by their duty of loyalty, corporate officers and directors are not permitted to use their position of trust and confidence to further their private interest, or in other words, must act without personal economic conflict.[32]

Corporate insiders and individuals with access to inside information clearly have affirmative duties to disclose or abstain from trading on the information, and failure to comply with these duties can result in prosecutions under Section 10(b) and Rule 10b-5 for fraud and insider trading by the SEC or Department of Justice.[33] Some courts have extended liability where there is a material omission if the parties to the transaction have a fiduciary relationship—which seems counterintuitive because ordinarily a failure to act does not trigger liability in the common law regime.[34] However, when an individual remains silent while another individual misrepresents material information, there is considerable confusion over an individual's duty to correct another's misstatement.[35]

Eighty years after the Exchange Act was enacted, the scope of liability under Section 10(b) continues to evolve with Supreme Court and lower court decisions.[36] This Note focuses on when an individual can say nothing at all,[37] or avoid their duty to correct, based on their fiduciary relationship, or lack thereof, to the issuer of securities and/or to those who would value the information.

II. RULE 10B-5 LITIGATION

At its heart, federal securities law and regulation are about disclosure, and thus, the central question in most litigation is whether someone had a duty to disclose information.[38] The hardest duty questions have been addressed under the rubric of fraud, with Rule 10b-5 being the principal antifraud provision

31. Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985), *overruled by* Gantler v. Stephens, 965 A.2d 695 (Del. 2009).

32. Guth v. Loft, 5 A.2d 503, 510 (Del. 1939).

33. Damian P. Gallagher, *Duties, Disclosure, and Discord: Necessity to Resolve Circuit Split and Certainty Leidos Could Have Clarified for Litigation Strategy and Risk Allocation*, 11 WM. & MARY BUS. L. REV. 255, 258 (2019).

34. *Id*.

35. Materiality is a factual question that refers to whether a piece of information would likely be important to the reasonable investor, and by contrast, duty is usually a question of law that refers to whether there is an obligation to disclose a certain category of information. Donald C. Langevoort & G. Mitu Gulati, *The Muddled Duty to Disclose Under Rule 10b-5*, 57 VAND. L. R. 1639, 1640, 1644 (2019) [hereinafter Langevoort & Gulati, *The Muddled Duty*].

36. *Section 10(b) Litigation: The Current Landscape*, AM. BAR ASS'N (Oct. 20, 2014), https://www.americanbar.org/groups/business_law/publications/blt/2014/10/03_kasner/#:~:text =Section%2010(b)%20makes%20it,%C2%A7%2078j(b).

37. Sometimes referred to as omissions liability because a defendant's failure to correct a misleading statement in violation of Rule 10b-5 constitutes an "omission" of material information. *Id.*

38. Langevoort & Gulati, *The Muddled Duty*, *supra* note 35, at 1640.

within securities law.[39] To establish a case under Section 10(b) and Rule 10b-5, there must be a deceptive device in connection with the purchase or sale of securities.[40] Plaintiffs bring claims under this general prohibition arguing two theories of fraud: nondisclosure or material misrepresentation.[41]

Nondisclosure cases are traditionally referred to as insider trading. Insider trading involves the nondisclosure of material nonpublic information gained through the investor's relationship to the issuing company, its shareholders, or the source of nonpublic information.[42] The "deceptive device" requirement is the trader's breach of that fiduciary relationship.[43] The fiduciary duty requirement reflects the principles that mere possession of nonpublic information does not trigger a duty of disclosure, and federal securities laws target the inappropriate and deceptive use of special relationships.[44]

Material misrepresentation cases fall into a general category of securities fraud that prohibit all fraud in connection with securities trades.[45] The misrepresentation is made by the defendant to induce someone else to enter into a securities transaction, rather than to inform their own securities matter.[46] Here, the "deceptive device" requirement is the material misrepresentation of fact rather than a breach of fiduciary duty.[47] Thus, a misrepresentation action under Rule 10b-5 requires (1) a false representation or misleading omission to occur for there to be a possibility of liability, and (2) the defendant have an affirmative

39. *Id.*

40. *In re* Fed. Nat'l Mortg. Ass'n Sec., 503 F. Supp. 2d 25, 32 (D.D.C. 2007). Complaints brought under Section 10(b) and Rule 10b-5 are governed by special pleading standards adopted by Congress in the Private Securities Litigation Reform Act ("PRSLA"). *Id.* at 36. Congress enacted two heightened pleading requirements in the PSLRA: (1) the statute requires the plaintiff's complaint to specify each misleading statement or omission and specify why the statement or omission was misleading; and (2) Congress stated in the PSLRA that a plaintiff's complaint must state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind. *Id.* at 36. Similarly, Rule 9(b) of the Federal Rules of Civil Procedure has long required that "[i]n all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity." *Id.* at 36–37. The text of the PSLRA was designed "to embody in the Act itself at least the standards of Rule 9(b)." *Id.* at 37.

41. Odian, *supra* note 24, at 1332.

42. *Id.* Information is 'material' if a reasonable investor would view the information as important to make an investment decision. H. Tomas Gomez-Arostegui, Note, *A Comparative Fault Framework for Rule 10b-5 Direct Misrepresentation Actions*, 70 S. CAL. L. REV. 1407, 1417 (1997).

43. Odian, *supra* note 24, at 1332.

44. *Id.* By contrast, for example, Section 10(b) and Rule 10b-5 do not forbid trades where an investor receives nonpublic information through permissible channels and without an obligation to keep the information confidential or where the investor discloses the information to his fiduciary prior to trading. *Id.*

45. *Id.*

46. *Id.* at 1332–33.

47. *Id*.

duty to disclose the nonpublic material information.[48] Whether a misstatement or misleading omission has occurred is typically a question of fact.[49]

The elements of a Rule 10b-5 cause of action are: (1) a false and misleading statement or omission of material fact; (2) scienter; (3) reliance;[50] and (4) damages.[51] However, materiality, scienter, reliance, and causation are additional elements, currently separate and distinct from the question of duty.[52]

A. The Supreme Court Discusses the Fiduciary Duty Element

Under the traditional reading, a claim for fraudulent non-disclosure arises from a fiduciary's failure to disclose material information to a principal with whom the fiduciary is engaged in a transaction.[53] The Supreme Court assessed the legislative intent behind Section 10(b) and determined that claims of fraud and fiduciary breach may form a cause of action under Rule 10b-5 only if the conduct alleged can be fairly viewed as "manipulative or deceptive" within the meaning of the statute.[54] In *Santa Fe Industries Co. v. Green*, the Court held that Rule 10b-5 required something more than just a garden-variety state fiduciary duty claim.[55] In *Santa Fe*, the minority shareholder plaintiffs objected to a merger price on the ground that it undervalued the corporation's assets and brought suit in federal court claiming that this low valuation of their shares was fraud actionable under Rule 10b-5.[56] The minority shareholder's claim failed because there was no affirmative misrepresentation or fraudulent non-disclosure as the information that the majority shareholders used to establish the merger

48. "An omission is the failure to state a fact necessary to make other statements not misleading." These affirmative misrepresentations can manifest themselves in the form of oral, written, or electronic representations. Gomez-Arostegui, *supra* note 42, at 1414.

49. *Id.* Optimistic, soft, or "puffing" statements made by a company are generally in-actionable. Heather Elayne Davis, *Rule 10b-5 and the Private Securities Litigation Reform Act of 1995: Ninth Circuit Law*, ORANGE COUNTY LAW, 26, 31 (1999). Vague and amorphous statements are also not actionable because reasonable investors do not consider 'soft' statements or loose predictions important in making investment decisions. *Id.* "General statements of optimism may be actionable in limited circumstances. A projection or statement of belief contains at least three implicit factual assertions: (1) that the statement is genuinely believed; (2) that there is a reasonable basis for that belief; and (3) that the speaker is not aware of any undisclosed facts tending to seriously undermine the accuracy of the statement. A projection or statement of belief may be actionable to the extent that one of these implied factual assertions is inaccurate." *Id.* at 36–37.

50. To succeed on a claim under Rule 10b-5 for a direct affirmative misrepresentation, as opposed to an omission, the plaintiff must also demonstrate that they actually and justifiably relied on the misstatement. Gomez-Arostegui, *supra* note 42, at 1417.

51. Paracor Fin. v. Gen. Elec. Cap. Corp., 96 F.3d 1151, 1157 (9th Cir. 1996).

52. Langevoort & Gulati, *The Muddled Duty*, *supra* note 35, at 1681.

53. Zachary J. Gubler, *Insider Trading as Fraud*, 98 N.C. L. REV. 533, 543–44 (2020).

54. Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 473–74 (1977).

55. *Id.* at 479.

56. *Id.* at 466–67.

price was the same that the shareholders relied on to demonstrate that the merger price was too low.[57] Since the minority shareholders could either accept or reject the price offered for their shares, the transaction was neither deceptive or manipulative in violation of Rule 10b-5.[58] The Court held that instances of corporate mismanagement resulting in unfair treatment of shareholders by a fiduciary are not within the statute or rule, and without more, there could be no liability under Rule 10b-5.[59]

In 1976, the Supreme Court held, in *Ernst & Ernst v. Hochfelder*, that a plaintiff claiming a Rule 10b-5 violation must prove that the defendant acted with scienter, or the "intent to deceive, manipulate, or defraud."[60] While the holding seems broad, the majority of lower courts subsequently read the decision to hold merely that negligent misrepresentations were not actionable under Section 10(b) or Rule 10b-5.[61] According to the Court, the phrases "manipulative or deceptive" in Section 10(b) suggested that Congress intended to merely forbid intentional or knowing conduct.[62] Thus, the Court expressly approved Rule 10b-5 liability in cases where the defendant had actual knowledge that the matters represented were false, but recommended a subjective standard for measuring whether a misrepresentation is intentional, willful, or knowing.[63] In other words, the Court reasoned that merely proving an average reasonable person would have harbored the intent or knowledge is legally insufficient, only evidence which directly refers to the defendant's state of mind is relevant.[64]

In *Chiarella v. United States*, the Supreme Court endorsed a theory of primary liability for insider trading consistent with the statute's focus on fraud as set forth in *Santa Fe*.[65] The Court held that silence in connection with the sale of securities may operate as fraud actionable under Section 10(b) despite the absence of statutory language or legislative history specifically addressing the legality of nondisclosure, but such liability is premised upon a duty to disclose arising from a relationship of trust and confidence between parties to a transaction.[66] This classical theory of fraud only applied to corporate insiders and failed to reach cases where a person trades on the basis of material nonpublic

57. *Id.* at 468. The majority shareholders in the transaction accurately disclosed all the information they used to value the target firm's assets prior to the merger vote. *Id.* at 474.

58. *Id.* at 474.

59. Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 479–80 (1977).

60. 425 U.S. 185, 193 (1976).

61. Gomez-Arostegui, *supra* note 42, at 1423.

62. *Hochfelder*, 425 U.S. at 197.

63. *Id.* at 199.

64. *Id.* at 200.

65. Gubler, *supra* note 53, at 544.

66. Chiarella v. United States, 445 U.S. 222, 230 (1980). This is known as the traditional or classic theory of insider trading.

information in the stock of a corporation with which the trader has no fiduciary relationship.[67]

In his dissenting opinion of *Chiarella*, Chief Justice Burger proposed a broader reading of Section 10(b) and Rule 10b-5 that would extend liability to any person who *misappropriated* nonpublic information using any "deceptive device."[68] Burger argued that liability should attach when a person obtains an informational advantage "not by superior experience, foresight, or industry, but by some unlawful means" because silence is generally permitted during business transactions unless the parties have a fiduciary relationship.[69] Building on this principle, he advocated holding all persons to the same standard as insiders, requiring any person who misappropriated material nonpublic information to disclose or abstain from trading on it altogether.[70]

However, the Supreme Court in *United States v. O'Hagan* articulated a new ground for primary liability that would reach corporate "outsiders."[71] In *O'Hagan*, the law firm of Dorsey & Whitney was representing a company called Grand Met in a tender offer for Pillsbury, a transaction that, once announced publicly, would cause the price of Pillsbury stock to increase significantly.[72] James O'Hagan, a partner at the firm, obtained information by virtue of his relationship with his law firm and purchased a substantial amount of Pillsbury stock that netted him millions of dollars in profit, which he then used to conceal prior embezzlements.[73] The Court found O'Hagan liable, holding that a person who trades in securities for personal profit, using confidential information misappropriated in breach of a fiduciary duty to the information's source, is liable for violating Section 10(b) and Rule 10b-5.[74]

The *O'Hagan* Court had to come to terms with the statutory requirement that the fraud be "in connection with" the sale of a security, and thus a new guideline regarding Rule 10b-5 and fiduciary duty arose: fraud is not consummated when the fiduciary gains the confidential information, but when

67. Langevoort & Gulati, *The Muddled Duty*, *supra* note 35, at 1659.

68. *Chiarella*, 445 U.S. at 240. The misappropriation theory of insider trading makes it illegal to trade securities based on misappropriated, nonpublic information. However, Justices Blackmun and Marshall noted in their dissent that stealing information from an employer was fraudulent within the meaning of Section 10(b) because the statute was designed as a "catchall" provision to protect investors from unknown risks, and the majority opinion's confinement of the meaning of fraud "by imposition of a requirement of a 'special relationship' akin to fiduciary duty before the statute gives rise to a duty to disclose or to abstain from trading upon material, nonpublic information." *Id*. at 246 (Blackmun, J., dissenting).

69. *Chiarella*, 445 U.S. at 240.

70. *Id.*

71. 521 U.S. 642, 653 (1997).

72. *Id.* at 647–48.

73. *Id.*

74. *Id*. at 647. O'Hagan's failure to disclose his actions to Grand Met and Dorsey & Whitney was deceptive because he had a duty to of nondisclosure to his employer. *Id.* at 660.

they use the information to purchase or sell securities without disclosure to their principal.[75] Had O'Hagan used the nonpublic information for purposes unrelated to a securities transaction, he would not be subject to Rule 10b-5 because the rule does not capture all forms of fraud involving nonpublic information.[76] The Court reasoned that O'Hagan's conduct was "in connection with the purchase or sale of a security" because O'Hagan completed the fraud when he used the information to purchase and sell Pillsbury stock without disclosure to his law firm—not when he received the confidential information.[77]

The Supreme Court has also addressed whether there is Rule 10b-5 liability when the trader has neither a fiduciary nor contractual relationship with the source of the information but innocently obtains information and uses it to trade. In *Dirks v. SEC*, Dirks received notice from a former officer at Equity Funding of America that the company grossly overstated its assets by engaging in fraudulent practices.[78] Neither Dirks nor his firm owned or traded in the insurance company's securities, but Dirks disclosed this information to a number of clients and investors who did in fact own Equity Funding securities, and in turn elected to sell their share of the company, avoiding huge losses incurred by uninformed shareholders as news of the fraud became public.[79] The SEC charged Dirks for insider trading in violation of Section 10(b) and Rule 10b-5, but, adhering to its decision in *Chiarella*, the Court held that one's duty to disclose material nonpublic information prior to trading arises not from possessing the information, but rather from the relationship between the parties.[80] Therefore, despite aiding and abetting investors by tipping them off about the fraud allegations, Dirks was not liable under Section 10(b) and Rule 10b-5 because he owed no duty to Equity Funding or its shareholders.[81]

Finally, and most recently, in a 6–2 decision, the Supreme Court laid out a bright-line rule in which those who disseminate false statements with the intent to defraud are primarily liable under Section 10(b) and Rule 10b-5 ***even if*** they are also secondarily liable under Rule 10b-5.[82] In *Lorenzo v. SEC*, the Court held that an investment banker could be liable for securities fraud under Rule 10b-5 for disseminating two emails that contained false statements, even though the emails were drafted and sent on behalf of his boss, and he merely "cut and pasted" the contents into an email.[83] In doing so, the Court partially resolved a

75. *Id*. at 655–56.
76. *Id*. at 656.
77. United States v. O'Hagan, 521 U.S. 642, 659, 661 (1997).
78. 463 U.S. 646, 649 (1983).
79. *Id.* at 649, 670.
80. *Id*. at 654–55.
81. *Id*. at 667.
82. Lorenzo v. Sec. & Exch. Comm'n, 139 S. Ct. 1094, 1104 (2019).
83. *Id.* at 1099; *but see* Janus Capital Grp., Inc. v. First Derivative Traders, 564 U.S. 135, 141 (2011).

split among the circuits over Rule 10b-5(b)'s prohibition against "mak[ing] any untrue statement," which applies only to "makers" of false statements or those with "ultimate authority" over the false statement's contents.[84] Francis Lorenzo, the director of investment banking at an SEC-registered brokerage firm, sent two emails to prospective investors that described a potential investment in a company with confirmed assets of $10 million supplied and approved by his boss, but in reality Lorenzo knew that the company had much less in total assets.[85]

According to the Court, by sending emails he undisputedly understood to contain material and false statements, Lorenzo employed a device, scheme, or artifice to defraud and engaged in an act, practice, or course of business that operated as a fraud.[86] Lorenzo argued that his conduct instead fell under the aiding and abetting provisions of the securities laws, which provides secondary liability for those who knowingly or recklessly provide substantial assistance to another person who violates Rule 10b-5, and imposing primary liability upon his conduct would "erase or at least weaken" the distinction between primary and secondary liability.[87] The Court rejected this argument and expressed concern that under an alternative reading of Rule 10b-5, the "plainly fraudulent" behavior exhibited by Lorenzo might fall outside the scope of the rule.[88] If Rule 10b-5(b) were the *exclusive* regulator of conduct involving false or misleading statements, and only "makers" of such statements could be held liable, then those who disseminate false statements with the intent to cheat investors might escape liability under the Rule altogether—Congress could not have intended such a result.[89]

Significantly, the Supreme Court cases that address when a duty to disclose material information arises under Rule 10b-5 stress that the rule does not itself impose a general affirmative duty to disclose material information, and instead present a circular framework for the Circuits to apply: an individual has an affirmative duty to disclose material information only if they have a fiduciary or similar relationship that gives rise to an affirmative duty to disclose the omitted information, and if the failure to disclose that information would be fraudulent.[90]

84. Brian D. Koosed et al., *Supreme Court Wages into Circuit Split, Endorses Broaded View of "Scheme Liability" for Disseminating False Statements*, K&L GATES (Apr. 4, 2019), https://www.klgates.com/Supreme-Court-Wades-Into-Circuit-Split-Endorses-Broader-View-of-04-04-2019.

85. Lorenzo v. Sec. & Exch. Comm'n, 139 S. Ct. 1094, 1099 (2019).

86. *Id*. at 1101.

87. *Id*. at 1101, 1103.

88. *Id*. at 1102.

89. *Id.* at 1102–1103. Justices Thomas and Gorsuch warned in dissent that the Court's opinion could mean "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." *Id*. at 1109.

90. Rosenblum, *supra* note 26, at 293.

Nonetheless, the framework suggests three issues to determine when a duty to disclose arises: (1) when does a fiduciary relationship exist; (2) under what circumstances does that relationship give rise to an affirmative disclosure duty; and (3) when is a breach of that duty fraudulent for purposes of Rule 10b-5?[91]

B. The Circuit Split

Unsurprisingly, the Circuits each set different standards for determining the correlation between fiduciary duty and liability for failure to correct material misrepresentations. The following section presents significant opinions regarding this issue that collectively provide a foundation for potential future Supreme Court review.

1. Second Circuit: A Fiduciary Relationship is not Required for an Actionable Section 10(b) claim

Prosecution under Section 10(b) has been limited to cases of nondisclosure fraud involving breach of a fiduciary duty to the corporation, its shareholders, or the source of the material nonpublic information. The *O'Hagan* decision expanded Section 10(b) and Rule 10b-5 liability to corporate outsiders who owe no fiduciary duty to the corporation or its shareholders because the Court elected to base liability upon the fiduciary duty owed to the source of the material information.[92] In *SEC v. Dorozhko*, the Second Circuit attempted to assuage critics that insisted this overly restrictive version of misappropriation liability frustrates the prosecution of defendants who trade on misappropriated information acquired through other means by holding that the breach of a fiduciary duty is not a *required* element of "deceptive device" for purposes of liability under Section 10(b).[93]

In October 2007, Defendant Oleksandr Dorozhko deposited $42,500 into an online trading account with Interactive Brokers LLC.[94] Shortly after, IMS Health, Inc. announced that it would release its third-quarter earnings during an analyst conference call scheduled for 5PM on October 17, 2007, after the securities markets in New York City closed.[95] Thomson Financial, Inc., an investor relations and web-hosting firm, managed IMS Health's earning report release.[96] Beginning early in the morning on October 17, and continuing several times during the morning and early afternoon, an anonymous computer hacker attempted to gain access to the IMS earnings report by hacking into a secure

91. *Id*. at 293–94.
92. United States v. O'Hagan, 521 U.S. 642, 665–67 (1997).
93. 574 F.3d 42, 49–50 (2d Cir. 2009).
94. *Id*. at 44.
95. *Id*.
96. *Id*.

server at Thomson.[97] Minutes after Thomson actually received the IMS data, but before the report's official release, the hacker successfully located and downloaded the IMS data from Thomson's secure server.[98]

Within an hour of the Thomson hack, Dorozhko—who had not previously used his Interactive Brokers account to trade—purchased $41,670.90 worth of IMS "put" options which represented approximately ninety percent of all put option purchases for IMS stock in the previous six-week period.[99] In purchasing these options, which the SEC describes as "extremely risky," Dorozhko was betting that IMS's stock price would decline by greater than twenty percent within a two-day expiration period.[100] Slightly before the scheduled analyst call, IMS announced that its earnings per share were twenty-eight percent below many Wall Street analysts' expectations, and when the market opened the next morning, October 18, IMS's stock price sank as expected from $29.56 to $21.20 per share.[101] Within six minutes of the market opening, Dorozhko sold his IMS options, realizing a $286,456.59 net profit overnight.[102]

Interactive Brokers reported the irregular trading activity to the SEC, and the SEC successfully sought a temporary restraining order preventing Dorozhko from accessing the funds in his brokerage account.[103] The United States District Court for the Southern District of New York held that computer hacking was not "deceptive" within the meaning of Section 10(b) as defined by the Supreme Court.[104] The District Court stated that "a breach of a fiduciary duty of disclosure is a required element of any 'deceptive' device under section 10(b)."[105] Thus, because Dorozhko was a corporate outsider with no special relationship to either IMS Health shareholders or Thomson Financial, Dorozhko was not liable under Section 10(b) and Rule 10b-5 without an accompanying breach of fiduciary duty.

On appeal, the SEC maintained its theory that Dorozhko's fraud was the alleged computer hacking but urged the court to recognize the hacking as an affirmative misrepresentation, which would not require breach of a fiduciary duty to be fraudulent.[106] The Second Circuit noted that the SEC's claim against a corporate outsider, who owed no fiduciary duties to the source of the information, was not based on either the classical or misappropriation theories

97. *Id*.
98. Sec. & Exch. Comm'n v. Dorozhko, 574 F.3d 42, 44 (2d Cir. 2009).
99. *Id*.
100. *Id*.
101. *Id*.
102. *Id*.
103. Sec. & Exch. Comm'n v. Dorozhko, 574 F.3d 42, 44–45 (2d Cir. 2009).
104. *Id*. at 45.
105. *Id*.
106. *Id*.

of insider trading—the two generally accepted theories,[107] but accepted the SEC's argument and remanded the case for further proceedings to determine whether computer hacking was "deceptive" or mere theft.[108]

In holding that a fiduciary relationship was not required for computer hacking to be "deceptive" under Section 10(b), the court distinguished fraudulent nondisclosure from fraudulent misrepresentation.[109] The court explained that previous Supreme Court decisions dealt only with cases of mere nondisclosure which requires a breach of fiduciary duty, while the theory of fraudulent misrepresentation does not.[110] In *Chiarella*, the Court held that the defendant's "silence," or nondisclosure, was not fraud because he was under no obligation to disclose his knowledge of inside information: "When an allegation of fraud is based upon nondisclosure, there can be no fraud absent a duty to speak. We hold that a duty to disclose under § 10(b) does not arise from the mere possession of nonpublic market information."[111] In *O'Hagan*, the government's liability theory centered on deception through nondisclosure, and the Court determined that if the fiduciary discloses to the source that they plan to trade on any nonpublic information, there is no "deceptive device," and thus no federal securities law violation under Section 10(b).[112] In *SEC v. Zandford*, the Court, in a unanimous opinion, clarified that while not every common-law fraud that involves securities is a violation of Section 10(b), it "should be construed not technically and restrictively, but flexibly to effectuate its remedial purposes."[113]

The District Court concluded that the *Chiarella*, *O'Hagan*, and *Zandford* opinions explained any "deceptive device" requires a breach of fiduciary duty and ruled that although the defendant may have broken the law, he was not liable in a civil action under Section 10(b) because he owed no fiduciary duty either to the information source or to those he transacted with in the market.[114] However, on appeal, the Second Circuit determined that this interpretation was misguided, and none of the opinions established fiduciary duty as a *required* element of every Section 10(b) violation because the theory of fraud was only silence or nondisclosure, not an affirmative misrepresentation—which is a "distinct theory" of fraud.[115] Thus, although the Supreme Court in *Chiarella*, *O'Hagan*,

107. *Id*. The classical theory of insider trading involves a corporate insider trading in the securities of his own corporation on the basis of material, non-public information; and the misappropriation theory involves a person trading in knowing possession of material, non-public information that has been gained in violation of a fiduciary duty to its source. *Id.*

108. Sec. & Exch. Comm'n v. Dorozhko, 574 F.3d 42, 45–46 (2d Cir. 2009).

109. *Id*. at 48.

110. *Id*.

111. *Id.* at 47 (citing Chiarella v. United States, 445 U.S. 222, 235 (1980)).

112. *Id*. (citing United States v. O'Hagan, 521 U.S. 642, 654–55 (1997)).

113. Sec. & Exch. Comm'n v. Dorozhko, 574 F.3d 42, 47 (2d Cir. 2009) (citing Sec. & Exch. Comm'n v. Zandford, 535 U.S. 813, 819 (2002)).

114. *Id.* at 48.

115. Odian, *supra* note 24, at 1316, 1326, 1331.

and *Zandford* held that remaining silent is actionable only where there is a duty to speak arising from a fiduciary relationship, the Second Circuit stated these cases all stood for the proposition that nondisclosure in breach of a fiduciary duty is *sufficient* for Section 10(b)'s "deceptive device" requirement but not *necessary*.[116]

Thus, the *Dorozhko* court held that although a fiduciary relationship is not a required element for an actionable Section 10(b) securities claim, there is nonetheless an affirmative obligation not to mislead in commercial dealings. The Second Circuit took a step in the right direction.

2. Third Circuit: High Corporate Executives

A reinvigorated approach to duty involves reliance and essentially says that a person is not liable in a Rule 10b-5 lawsuit unless that person owes a duty of honesty or candor to the victims of fraud.[117] How might that duty arise? In *United States v. Schiff*, the Third Circuit refused to impose a general fiduciary obligation on "high corporate executives" to the company's shareholders.[118]

Frederick Schiff and Richard Lane were executives at Bristol-Myers Squibb charged with violating Section 10(b) and Rule 10b-5 in a massive securities fraud scheme related to Bristol's wholesale pharmaceutical distribution channels in the early 2000s.[119] The court dismissed the Government's omission liability theories under Rule 10b-5 that attempted to hold Schiff accountable for Lane's misstatements in Bristol's quarterly conference calls.[120] As the relevant legal grounding, Rule 10b-5(b) states in pertinent part: "It [is] unlawful . . . (b) [t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading[.]"[121] The court's patience with the Government's "game of musical chairs" pursuing primary liability under Rule 10b-5 grew thin and regarded the Government's legal theories as "designed to find creative ways to hold Schiff and Lane liable for those SEC filings."[122]

Bristol is a public corporation and leading pharmaceutical manufacturer.[123] Schiff was promoted to Bristol's Chief Financial Officer ("CFO") in April

116. Sec. & Exch. Comm'n v. Dorozhko, 574 F.3d 42, 48–49 (2d Cir. 2009).

117. Donald C. Langevoort, *Reading Stoneridge Carefully: A Duty-Based Approach to Reliance and Third-Party Liability Under Rule 10b-5*, 158 U. PA. L. REV. 2125, 2154 (2010).

118. *See generally* United States v. Schiff, 602 F.3d 152 (3d Cir. 2010).

119. *Id.* at 155–56.

120. *Id*. at 156.

121. 17 C.F.R. § 240.10b-5.

122. *Schiff*, 602 F.3d at 161.

123. *Id*. at 156.

2001,[124] and later left the company mid-April 2002.[125] As CFO, the SEC filings were Schiff's primary responsibility.[126] Lane was the president of Bristol's Worldwide Medicines Group, and left the company in early-April 2002.[127] Both Schiff and Lane represented Bristol on quarterly public conference calls with Wall Street analysts.[128] From 2000 through 2001, Bristol implemented the sales strategy that was the subject of this litigation.[129]

Bristol primarily uses wholesalers to sell and distribute its pharmaceutical products to supply pharmacies, hospitals, and other health care providers; the wholesalers buy and maintain an inventory based on a projected customer demand for the products, known as a "prescription demand."[130] Wholesalers generally try to target their purchases to the prescription demand because more inventory results in higher carrying costs and, when wholesalers purchase in excess of demand, it reduces Bristol's later sales as the wholesalers must "work down" excess inventory to normal demand levels before purchasing more product.[131] For the new sales strategy, Bristol gave its wholesalers financial incentives to buy products exceeding prescription demand projections.[132] For example, in August 2001, Schiff and Lane approved $47 million in sales incentives for the third quarter, and in November 2001, Lane approved $85 million in sales incentives for the fourth quarter.[133] These incentives allegedly covered the wholesalers' carrying costs and guaranteed return on their investment until they sold the products.[134] The Government characterized this "channel stuffing scheme" as a deceptive strategy.[135]

124. "The CFO of a publicly traded corporation is entrusted with control of the firm's financial reporting and public disclosure and is required by federal law to disclose to the firm's auditors and audit committee any fraud that involves management or other employees who have a significant role in the issuer's internal controls." Craig Ehrlich, *When Minding Your Own Business Means Speaking Up: Criminally Punishing a Corporate Executive for Failing to Blow the Whistle on the Illegal Misconduct of a Colleague*, 32 J.L. & COM. 255, 257 (2014).

125. United States v. Schiff, 602 F.3d 152, 156 (3d Cir. 2010).

126. *Id.*

127. *Id.*

128. *Id.* Public companies often schedule conference calls to discuss their earnings or share other information with investors.

129. *Id.*

130. United States v. Schiff, 602 F.3d 152, 156 (3d Cir. 2010).

131. *Id.*

132. *Id.*

133. *Id.*

134. *Id.* at 156–57.

135. United States v. Schiff, 602 F.3d 152, 156–57 (3d Cir. 2010). A channel stuffing scheme involves temporarily increasing the corporation's apparent revenues by selling excess inventory to distributors who neither needed nor wanted it, and paying them to accept it. The corporation uses channel stuffing near the end of each quarter in order to give the appearance that it is meeting its revenue targets. *What is channel stuffing?*, CFI, https://corporatefinanceinstitute.com/resources/knowledge/strategy/channel-stuffing/ (last visited Feb. 21, 2021).

During several quarterly conference calls with stock analysts, Schiff remained silent although he knew that Lane made material misrepresentations concerning the corporation's financial statements.[136] The Government alleged that Schiff and Lane used the analyst calls to conceal these practices from shareholders and potential investors by making "materially false and misleading statements and omissions of material fact" during the analyst calls, press releases, and meetings with investors.[137] Upon disclosure of the scheme months later, the corporation's stock price quickly fell twenty-five percent, providing evidence of the material information misrepresented by Lane and suggesting that the fraud could have been nipped in the bud but for Schiff's silence, which allowed it to grow and the resulting damage to multiply.[138]

Absent a duty to disclose, silence is not fraudulent or misleading under Rule 10b-5 because a company has no general duty to provide the public with all material information, however when discussing material information, one is bound to speak truthfully.[139] Thus, if Schiff owed a fiduciary duty to Bristol's shareholders to correct any statements by Lane on the analyst calls, then Schiff's failure to correct those statements in subsequent SEC filings would be actionable under Rule 10b-5. The District Court concluded, and the Third Circuit agreed, that prior precedent, *Oran v. Stafford*, determined that a duty to disclose under Rule 10b-5 may only arise in three circumstances: (1) insider trading, (2) a statute requiring disclosure, or (3) an inaccurate, incomplete, or misleading prior disclosure.[140] However, the Government suggested that *Oran* did not create an

136. *Schiff*, 602 F.3d at 169 n.22.

137. *Id.* at 157. The government supplied four pertinent actionable statements, each made while both Schiff and Lane were on the calls in 2001. On April 25, in the first quarter, Schiff stated, "We look at, very closely, the wholesaler stocking inventories. . . . [T]here are no unusual items that we see in the inventory levels." *Id*. On July 25, in the second quarter, Schiff stated, "[W]e don't see anything unusual" in the "wholesaler inventories," and Lane, later on the same call, responded "no" when asked whether there were inventory issues. *Id.* On October 23, in the third quarter, Schiff stated that inventory was "up a couple of weeks" and expected "to be lower in the fourth quarter." *Id.* And finally, on December 13, which is outside of the quarterly call cycle, Schiff stated, "We don't see any significant changes" in the prior call's statements that "inventory levels are slightly higher" and "would be reduced by the end of the year." *Id*. Lane was allegedly involved in the analyst calls dating back to 2000, and Schiff participated in the calls after his promotion to CFO. *Id*.

138. *Id.*

139. Chiarella v. United States, 445 U.S. 222, 235 (1980).

140. *See* Oran v. Stafford, 226 F.3d 275, 286 (3d Cir. 2000). *Oran* was a civil class action brought by investors against a pharmaceutical company for alleged misrepresentations and omissions regarding connection between the company's weight loss medications and information related to heart valve problems of patients using those drugs. *Id.* at 279. Among other things, the plaintiffs argued that the company's failure to disclose the dates on which it first learned of adverse data and reports was a material omission because of the light it would have cast on the company's potential liability exposure. *Id.* at 285. The *Oran* Court concluded that none of the three circumstances to create a duty under Rule 10b-5 were present, and thus there was no duty to disclose

exhaustive list, and there is a fourth circumstance in which Schiff's duty to disclose in the SEC filings arose: a general fiduciary obligation of "high corporate executives" to the company's shareholders.[141]

The court criticized the Government's generalized corporate fiduciary duty theory as vague and having few logical boundaries, questioning what the limiting principle would be if this duty were imposed on corporations and its employees.[142] Next, the court turned to Schiff's brief that discussed whether a fiduciary would owe shareholders a duty "to rectify" public misstatements *of others* when they are made, for example, on a conference call or in a written report or on the internet, and whether it mattered who made the statements, such as a coworker or news reporter, or how the fiduciary discovered the discrepancy.[143] The Third Circuit was unwilling to create a fiduciary obligation to rectify others' statements when it simply "gilds the lily" because there are other plausible theories to hold these individuals criminally liable for their statements and omissions.[144]

The court further argued that Section 10(b)'s plain language and corresponding Rule 10b-5 do not contemplate the general failure to rectify another's misstatements.[145] The Rule's plain language presents two bases for liability: (1) "[t]o make any untrue statement" or (2) "to omit to state a material fact necessary in order to make the statements made . . . not misleading."[146] The court supported this idea that the plain language allows for two specific bases for liability by referencing *In re Burlington Coat Factory Securities Litigation*, "a Section 10(b) plaintiff ordinarily is required to identify a specific statement made by the company and then explain either (1) how the statement was materially misleading or (2) how it omitted a fact that made the statement

the information. *Id.* at 286. The First Circuit also follows this precedent. *See* Roeder v. Alpha Indus., Inc., 814 F.2d 22, 26 (1st Cir. 1987).

141. United States v. Schiff, 602 F.3d 152, 162–63 (3d Cir. 2010). The Government cited to language in *Winer Family Trust v. Queen* to support their argument that the Third Circuit's prior opinions did not intend exclusivity: "As a general matter, an affirmative duty arises only when there is insider trading, a statute requiring disclosure, or an inaccurate, incomplete, or misleading disclosure." *Id.* at 163 (citing Winer Family Trust v. Queen, 503 F.3d 319, 329 (3d Cir. 2007)). The court explained that the "general matter" phrase was an introduction to the discussion of why the defendants had no disclosure duty and signaled to the use of "only." *Id.*

142. *Id*. at 164.

143. *Id.* at 165. The court zeroed in on its vagueness argument with several questions, "Moreover, for how long would this duty attach such that rectification would be required for an officer to absolve himself of this fiduciary liability? Would it be limited to the same day, a week, a month, or even one year? Would this duty potentially rope in all corporate officers based on a single misstatement by another individual, such that a case could be brought against all executives in a particular company under this theory?" *Id*.

144. *Id.*

145. *Id.* at 167.

146. 17 C.F.R. § 240.10b-5.

materially misleading."[147] Thus, the court agreed with Schiff's argument that the Government's contention that he "actually made the omissions" by not rectifying Lane's purported misstatements conflates the two independent grounds, denying the Government's contention that securities law should be interpreted broadly.[148]

Corporate officers and directors are fiduciaries to the issuer and its shareholders, and this relationship has long been recognized to include a duty of candor.[149] This should suffice to create the requisite duty to correct another executive's misrepresentations of their corporation's financial situation.

3. Ninth Circuit: The Flexible Duty Test

In *Paracor*, the Ninth Circuit used a flexible duty test to determine the presence of a fiduciary-type relationship prescribed by *Chiarella*.[150] At the bottom, the court's multifactor analysis asked whether the circumstances were such that the counterparty expected certain information, if possessed by the other side, would be disclosed.[151] But, in light of *Chiarella*'s insistence that a fiduciary-type relationship is necessary, its connotation is unclear: does the Ninth Circuit's approach operate as an independent source of the duty to disclose, or is it only applicable as a means to determine whether a fiduciary-type relationship exists?

Jordan Schnitzer, a Portland businessman, purchased Casablanca Industries, Inc., a California ceiling fan manufacturer, in a leveraged buyout.[152] In April 1989, General Electric Capital Corp. agreed to provide a $53 million bridge loan to finance Casablanca Acquisition Corp. with the condition that the Casablanca would immediately sell $27 million in high-yield subordinated debentures, or "junk bonds," to pay down the loan.[153]

In March 1989, Shearson Lehman Brothers, Inc. prepared a Private Placement Memorandum for Schnitzer that contained various representations about Casablanca, including sales projections of $83.3 million and earnings of $8.5 million for fiscal year 1989, and distributed it to various institutional

147. United States v. Schiff, 602 F.3d 152, 167 (3d Cir. 2010).

148. *Id.* at 168.

149. In the field of corporate law, the duty of candor refers to a fiduciary duty of a company's executives and board members to disclose all the material information required for evaluating the company to its shareholders. Jason Gordon, *Duty of Candor – Definition*, BUS. PROF. (updated Dec. 16, 2020), https://thebusinessprofessor.com/lesson/duty-of-candor-explained/#:~:text=In%20the%20field%20of%20corporate,its%20management%2C%20to%20its%20shareholders.

150. Paracor Fin. v. Gen. Elec. Cap. Corp., 96 F.3d 1151, 1157 (9th Cir. 1996).

151. Langevoort & Gulati, *The Muddled Duty*, *supra* note 35, at 1671.

152. *Paracor*, 96 F.3d at 1155. Schnitzer hired Bear, Stearns & Co. to locate a profitable corporation which he could purchase and merge with an unprofitable corporation he owned in order to utilize his corporation's net operating loss carryforwards and obtain certain tax benefits—a leveraged buyout. *Id.* at 1154–55.

153. *Id.* The bridge financing would later be replaced with permanent financing by GE Capital.

investors active in the subordinated debt market.[154] By early May, the Investors, Paracor Finance, Inc.,[155] Cargill Financial Services Corp., Lutheran Brotherhood, and Farm Bureau Life Insurance Co., decided to purchase the debentures after inspecting Casablanca's books, meeting with its management, visiting Casablanca's offices, and occasionally contacting GE Capital.[156]

By June, Schnitzer successfully completed his tender offer and merged with Casablanca, but Casablanca's fortunes were already declining.[157] Casablanca's April sales were only $7.88 million, compared with the $10.195 million projections, and May and June sales were also below projections.[158] During this time, Burton was Casablanca's CEO, and Jerry Holland was the President.[159] The Debenture Purchase Agreement negotiated between the Investors and Casablanca represented that "[s]ince March 31, 1989, Casablanca has not suffered any Material Adverse Effect[,]" and the Investors represented that they "had access to the information [they] requested from [Casablanca]" and that they "made [their] own investment decision with respect to the purchase of the Debentures . . . without relying on any other Person."[160] Casablanca defaulted after its first interest payment on the debentures and filed for bankruptcy a year later.[161] In March 1991, the Investors filed suit against Casablanca, GE Capital, and Schnitzer, Burton, and Holland, claiming, as relevant to this Note, primary Section 10(b) and Rule 10b-5 violations.[162]

On appeal, the Investors asserted that GE Capital and Burton were primarily liable under Section 10(b) and Rule 10b-5 for making affirmative misrepresentations and failing to disclose material facts about Casablanca's sales because they were not provided with the negative sales data from the three months immediately prior to the acquisition.[163] The heart of the Investors' Rule 10b-5 claim was that GE Capital knew about Casablanca's poor April–June quarter sales results and failed to disclose them.[164] However, Rule 10b-5 is violated by nondisclosure *only* when there is a duty to disclose. Like the Second Circuit, the Ninth Circuit cited *Chiarella* to explain that parties to an impersonal market transaction owe no duty of disclosure absent a fiduciary relationship, prior dealings, or circumstances such that one party has placed trust and

154. *Id*.
155. Previously Elders Finance, Inc.
156. Paracor Fin. v. Gen. Elec. Cap. Corp., 96 F.3d 1151, 1155 (9th Cir. 1996).
157. *Id.*
158. *Id.*
159. *Id.*
160. *Id.*
161. Paracor Fin. v. Gen. Elec. Cap. Corp., 96 F.3d 1151, 1155 (9th Cir. 1996).
162. *Id*.
163. *Id*. at 1156–57.
164. *Id*. at 1157.

confidence in the other.[165] The Ninth Circuit then presented factors to determine whether a party has a duty to disclose: (1) the relationship of the parties; (2) their relative access to information; (3) the benefit that the defendant derives from the relationship; (4) the defendant's awareness that the plaintiff was relying upon the relationship in making the investment decision; and (5) the defendant's activity in initiating the transaction.[166]

Taken together, the court determined that these factors show GE Capital initiated a financial transaction from which it stood to benefit, but not that GE Capital assumed a relationship of trust and confidence with the Investors.[167] Nonetheless, the Ninth Circuit's factor test remains useful, but requires additional clarification.

III. POTENTIAL SUPREME COURT INTERPRETATION & ANALYSIS OF IMPACT

Fraud is among the most costly, stigmatizing, and punitive forms of liability enforced against actors in modern corporations and financial markets.[168] Thus, when the law of securities fraud fails to generate judicial instruction on who deserves blame and why, it wastes a valuable resource.[169] The SEC is a massive sanctioning machine, but it cannot be mobilized without commitment from the legal system, which would undermine the purpose of securities laws and the

165. *Id.* (citing Chiarella v. United States, 445 U.S. 222, 232 (1980)).

166. Paracor Fin. v. Gen. Elec. Cap. Corp., 96 F.3d 1151, 1157 (9th Cir. 1996).

167. Upon application of these factors, the Court determined that the relationship between GE Capital and the Investors did not rise to the level at which GE Capital assumed a duty to disclose. First, GE Capital had no relationship with the Investors prior to the debenture transaction. In fact, it had no contact whatsoever with Lutheran Brotherhood and Farm Bureau Life Insurance, and its contact with the other two investors amounted to a couple of brief face-to-face meetings and a handful of telephone calls. Second, the Investors' access to information was comparable to GE Capital's because Casablanca was required to provide daily "Open Sales Order" reports and other weekly reports. Although the Investors did not receive these reports, they are "sophisticated institutions with competent analysts" that conducted their own due diligence and signed representations that they were provided with all information that they requested. Third, GE Capital certainly benefitted from the Investors' purchase of the debentures by having their exposure on the $53 million unsecured bridge loan effectively reduced. Fourth, GE Capital informed Cargill Financial Services and Elders Finance on more than one occasion and in writing that they could not rely on GE Capital, so when GE Capital provided Elders Finance with a copy of its business survey of Casablanca, it insisted that Elders Finance state in writing that it was not relying on GE Capital. Finally, GE Capital effectively initiated the debenture transaction because its bridge loan to Schnitzer was conditioned on the debenture offering being made. "[I]n a one-shot deal with GE Capital's participation," the Investors were expected to do their own due diligence and were carefully warned not to rely on the information GE Capital shared with them. In sum, the Court held that GE Capital cannot be held liable for its alleged omissions because it never had a duty to disclose to the Investors in the first place, and without actionable misrepresentations or omissions, the Investors' claim cannot be pursued. *Id*. at 1157–58.

168. Samuel W. Buell, *What is Securities Fraud?*, 61 DUKE L.J. 511, 521 (2011).

169. *Id*. at 519.

public interest it aims to serve.[170] The SEC needs judicial support to enforce disclosure, improve accuracy in disclosure, and deter fraudulent behavior.[171]

A. The Circuit Critique

Whether a court can find a basis in existing law to impose a duty to speak upon someone who has merely witnessed another make a material misrepresentation is a policy question.[172] There is already one person, the speaker of the misrepresentation, who is easily subject to prosecution, and in America, it is not criminally punishable to look the other way when one witnesses a legal violation as it evokes thoughts of a surveillance state where citizens must condemn each other.[173] Nevertheless, while there are persuasive arguments against punishing silence, the SEC's unique role in encouraging honest capital to benefit businesses, individual consumers, and the economy as a whole justifies judicial recognition of an appropriate framework for the circuits to resolve duty questions when fraudulent behavior violates Section 10(b) and Rule 10b-5—the SEC's "catchall" regulation to prevent fraudulent practices within the securities markets.

The Second Circuit's interpretation of prior Supreme Court rulings is instructive: nondisclosure in breach of a fiduciary duty is *sufficient* for Section 10(b)'s "deceptive device" requirement but not *necessary*. By removing the fiduciary relationship requirement from an actionable Section 10(b) claim, the Second Circuit reiterated the affirmative obligation not to mislead in commercial dealings while also expanding the SEC's ability to hold individuals accountable for fraudulent behavior. While the fiduciary relationship requirement reflects the principle that mere possession of nonpublic information does not trigger a duty to disclose, removing the requirement does not undercut federal securities laws' disapproval of the inappropriate and deceptive use of special relationships. Rather, the removal supports the SEC's intention that Section 10(b) is to act as a "catchall" clause to prevent fraudulent practices within the securities markets by additionally holding those that misrepresented material information to another's demise accountable. Basically, it removes a loophole without removing an analytical consideration.

Further, the Second Circuit's categorization that affirmative representations are a distinct species of fraud supports the significance between the "deceptive device" requirement in nondisclosure versus misrepresentation cases.[174] The

170. *Id*. at 517.

171. *See id*. at 581.

172. Ehrlich, *supra* note 124, at 257.

173. *Id*. at 258.

174. This idea is also supported by scholars: "By far, insider trading and issuer disclosure questions dominate the law relating to the affirmative duty to disclose. Our suggestion is that they represent two distinct fields of inquiry, with unique interests at stake, so that precedent and dicta

"deceptive device" requirement in a nondisclosure case is the trader's breach of fiduciary duty to the source of the nonpublic information they fraudulently used, whereas the "deceptive device" requirement in affirmative misrepresentation cases is the fraudulent material misrepresentation of facts to induce another to trade. In both scenarios, there is reliance on the source of information, but the difference is how the fraudulent use of information presents liability.

While the Second Circuit took a step forward, the Third Circuit took a step back. The Third Circuit's criticism of a "high corporate executive" general fiduciary obligation as vague and illogical is ironic. The unique role played by a corporate executive deserves judicial acknowledgement of an affirmative duty to respond to misrepresentations by other corporate officers concerning the corporation's financial statement.[175] Schiff was not an "accidental passerby" but the CFO of a publicly traded corporation—the company's financial "high priest of integrity."[176] In this capacity, the executive board members and the stockholders who rely on Schiff have a reasonable expectation that he will be intolerant of deception, and thus the absolution of legal liability subsequent to his deliberate indifference to Lane's fraudulent statements goes too far.[177]

Notably, the Third Circuit's reasoning is in direct contradiction with the SEC's intention that Section 10(b) is to act as a "catchall" clause to prevent fraudulent practices within the securities markets. The Rule's plain language presents two bases for liability: (1) "[t]o make any untrue statement" or (2) "to omit to state a material fact necessary in order to make the statements . . . not misleading."[178] Schiff undoubtedly "omit[ted] to state [the] material fact[s] necessary" to make Lane's statements not misleading by remaining silent on the analyst calls.[179] The *Schiff* court's *In re Burlington* interpretation is misguided because the Supreme Court has clarified that Section 10(b) "should be construed not technically and restrictively, but flexibly to effectuate its remedial purposes."[180] Thus, while *In re Burlington* demonstrates pleading requirements for plaintiffs "to identify a specific statement . . . and then explain either (1) how the statement was materially misleading or (2) how it omitted a fact that made the statement materially misleading,"[181] it does not support a finding that Section 10(b)'s plain language and corresponding Rule 10b-5 do not contemplate the general failure to rectify another's misstatements.

---

developed within each should not automatically be applied to other kinds of duty questions." Langevoort & Gulati, *The Muddled Duty*, *supra* note 35, at 1681.

175. Ehrlich, *supra* note 124, at 258.

176. *Id*.

177. *Id*.

178. 17 C.F.R. § 240.10b-5(b).

179. *Id*.

180. Sec. & Exch. Comm'n v. Zandford, 535 U.S. 813, 819 (2002) (internal citations omitted).

181. *In re* Burlington Coat Factory Sec. Litig., 114 F.3d 1410, 1430 (3d Cir. 1997).

Rule 10b-5(b) declares it unlawful for any person, directly or indirectly, to make any untrue statement of a material fact.[182] Roughly one year after *Schiff*, the Supreme Court decided *Janus Capital Group, Inc. v. First Derivative Traders*, which turned on the meaning of the verb "to make" within the rule.[183] The Court held that only the maker of the statement can be held liable in a private action under Rule 10b-5(b) for material misstatements, and even one who prepares a statement on another's behalf is not its maker.[184] The *Janus* Court held that the maker of a statement is "the entity with authority over the content of the statement and whether and how to communicate it. Without such authority, it is not 'necessary or inevitable' that any falsehood will be contained in the statement."[185] *Janus* was recently overturned by the *Lorenzo* decision,[186] but the Court's reasoning provides for discussion: Could Schiff be regarded as the maker of the misleading statements under Rule 10b-5 since Schiff, as CFO, was entrusted with control of the firm's financial reporting and public disclosure, and thus, a plausible case could be made that he had ultimate authority regarding the statement made by Lane?[187]

Further, other areas of the law require those who have assumed a greater responsibility to report witnessed wrongdoing and to act for the protection of others: most states have laws that require mental health professionals to disclose information about patients who may become violent;[188] some states require auto repair garages to notify police when cars show evidence of having been in an accident or bullet holes;[189] and lawyers must inform the appropriate professional authorities when they have knowledge that another lawyer violated the Rules of Professional Conduct.[190] These duties apply to specific groups of people expected to come across certain circumstances by the nature of their professional knowledge, and the scope of their duty is limited to such.[191] It follows that professional status and expertise in the financial world creates an expectation that the person or entity appreciates the regulatory constraints in place to reduce the economic harm that flows from the spread of misinformation in the investment marketplace.[192] This supports a finding that high corporate

182. 17 C.F.R. § 240.10b-5.

183. Janus Cap. Grp., Inc. v. First Derivative Traders, 564 U.S. 135, 142 (2011).

184. *Id*. at 144.

185. *Id*.

186. *See* Lorenzo v. Sec. & Exch. Comm'n, 139 S. Ct. 1094, 1099 (2019).

187. *See* Ehrlich, *supra* note 124, at 314.

188. *Mental Health Professionals' Duty to Warn, 50 State Table*, NAT'L CONF. STATE LEGIS. (Jan. 2013), *available at* http://www.ncsl.org/issues-research/health/mental-health-professionals-duty-to-warn.aspx.

189. Gabriel D.M. Ciociola, *Misprision of Felony and Its Progeny*, 41 BRANDEIS L.J. 697, 730–31 (2003).

190. MODEL RULES OF PRO. CONDUCT r. 8.3(a) (AM. BAR ASS'N 2005).

191. *See generally* Ehrlich, *supra* note 124.

192. Langevoort, *supra* note 117, at 2154–55.

executives have a duty to correct material misrepresentations regarding their corporation's financial circumstances as suggested by the Government in *Schiff*.

While the Government cabined this duty by characterizing it as only requiring "high corporate officers" to rectify misstatements, the Third Circuit continued to push back and questioned what the limiting principle would be if this duty were imposed on corporations and its employees.[193] The Ninth Circuit's flexible duty test provides an elegant solution. In fact, some scholars characterize the courts' reluctance to use a version of the Ninth Circuit's flexible duty as an "unfortunate oversight."[194] However, rather than using the flexible duty test to determine whether a fiduciary relationship exists, the ideologies of securities regulation are better served by using the factors as an independent source of the duty to disclose, which in turn abandons some of *Chiarella*'s reasoning.

According to *Chiarella*'s dicta, the duty to disclose is central and arises only when there is a pre-existing fiduciary relationship between the parties. Read in context, this suggested an appropriate solution to the insider trading problem in a world where informational imbalances thrive and markets reward hasty information discovery.[195] The Court chose to impose the fiduciary principle because it is easily delineated, unlike overbroad fairness standards.[196] Thus, in the context of insider trading, the bright-line rule that those with a fiduciary duty must put their interests second to those to whom they owe that duty may be appropriate, but it remains confusing in other Rule 10b-5 contexts that involve a variety of interests. Similarly, the *O'Hagan* decision was highly criticized because one clear implication is that a trader in O'Hagan's position could avoid 10b-5 liability by notifying their information source of an intent to trade on its information.[197] But the *O'Hagan* rule is not actually meant to produce disclosure to the source because no employee is going to disclose to their boss that they are planning to steal from them.[198] However, the underlying ideology of both opinions can be served by a contextual approach for analyzing violations of Rule 10b-5.

B. The Contextual Approach for Analyzing Violations of Rule 10b-5

The most expansive conception of fraud would cover both statements and omissions, encompass all deceiving and misleading acts—including negligence, impose more demanding disclosure obligations—especially on those involved

193. *Id*. at 2156.

194. Langevoort & Gulati, *The Muddled Duty*, *supra* note 35, at 1686.

195. *Id*. at 1675.

196. *Id*.

197. Donna M. Nagy, *Reframing the Misappropriation Theory of Insider Trading Liability: A Post-*O'Hagan *Suggestion*, 59 OHIO STATE L.J. 1223, 1256 (1998).

198. *Id.* at 1257.

in special relationships, permit all forms of civil and criminal sanctioning, extend to economic and noneconomic interest deprivations, and apply to public and political interactions between private individuals and the government.[199] While that is ideal in theory, it is not as simple in practice. Yet, a future Supreme Court ruling that incorporates the ruling from *Dorozhko*, reconsiders the government's theory in *Schiff*, and clarifies how to apply the flexible duty test from *Paracor* is closer to the goal.

Prior to the *Paracor* decision, an Eighth Circuit case, *Arthur Young & Co. v. Reves*, also applied a flexible duty test to determine whether accountants had a duty to disclose to investors a fuller picture regarding a cooperative's fortunes.[200] *Reves* involved an Arkansas cooperative that issued notes to a large number of investors, and when the investment turned south, the disgruntled investors sued the accountants.[201] The court applied the flexible duty test and found that a duty had indeed been violated even though there was no pre-existing relationship between the accountants and investors.[202] The court assessed the transactional context in which the accountants were silent[203] and found that the overall picture suggested the accountants' silence was misleading.[204]

This flexible duty test should function as a case-by-case, contextual analysis, which recognizes prior Supreme Court precedent and further serves the SEC's intent to boost market integrity. Consequently, the courts must consider, as in *Reves*, whether the company, law firm, or accountants involved have created a reasonable expectation of disclosure,[205] rather than whether a fiduciary relationship exists. This approach is easily implemented because the current analytical approach is fact-intensive,[206] and it would help mitigate the courts' reluctance to create additional information disclosure obligations for companies.

Further, this approach should account for the principles of scienter and the business judgement rule to create logical boundaries that alleviate the Third Circuit's fears in *Schiff*. As to scienter, creative involvement with a scheme to defraud implies a duty because those schemes require planning and cleverness to avoid detection.[207] This boundary is further supported by the Supreme Court's

199. Buell, *supra* note 168, at 524.

200. Arthur Young & Co. v. Reves, 937 F.2d 1310, 1329 (8th Cir. 1991), *aff'd sub nom.* Reves v. Ernst & Young, 507 U.S. 170 (1993).

201. *Id.* at 1321.

202. *Id*. at 1330–31.

203. Among the factors that appeared to be important to the court were the facts that the investors were farmers in Arkansas, the prominent accountants had made multiple appearances at the cooperative's meeting, and the accountants were fully aware of the cooperative's problems, but said nothing to warn the investors. *Id*.

204. *Id*. at 1331.

205. Langevoort & Gulati, *The Muddled Duty*, *supra* note 35, at 1674.

206. Gomez-Arostegui, *supra* note 42, at 1414. ("Whether a misstatement or misleading omission has occurred is typically a question of fact.").

207. Langevoort, *supra* note 117, at 2155.

ruling in *Hochfelder* that recommended a subjective standard for measuring whether a misrepresentation is intentional, willful, or knowing.[208] Under the business judgement rule, courts are reluctant to substitute their judgment for the board of directors' unless the board's decisions are unreasonable. The rationale is that corporate executives enjoy the benefit of a presumption that their decisions were made in good faith and designed to promote their corporation's best interests.[209] Courts focus on how a board of directors makes a decision rather than whether the decision was correct.[210] The logic is that corporate executives understand their corporation's financial situations and the consequences of their decisions better than the judges hearing the case.[211] In combining these principles, courts can balance an executive's active engagement in creating a deception with the professional's expertise in the financial world to determine if there is, subjectively, evidence of fraud. This is further supported and restricted by *Santa Fe*'s dicta requiring more than a garden-variety state fiduciary claim because mere instances of corporate mismanagement resulting in unfair shareholder treatment by a fiduciary are not a violation of Rule 10b-5.[212]

The current framework suggests three issues to determine when a duty to disclose arises: (1) whether a fiduciary relationship exists; (2) under what circumstances that relationship gives rise to an affirmative disclosure duty; and (3) when a breach of that duty is fraudulent for purposes of Rule 10b-5.[213] The contextual approach removes the fiduciary relationship *requirement* from an actionable securities claim under Section 10(b), but the analysis still begins with determining whether a fiduciary relationship exists between the accused individuals and the source of the information or the corporation that was harmed. If there is a fiduciary relationship, the analysis expands the second step of the current framework to subjectively assess what role that individual plays within

208. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 197 (1976). Further, the scienter element alleviates the *Schiff* court's fear that the failure "to rectify" public misstatements of news reporters on the internet presents liability. The scienter element redirects the courts to focus on the intent behind the scheme to defraud a corporation, not the spread of misinformation itself. Additionally, a company would likely respond to any misinformation in the news. For example, the GameStop, Reddit, and Robinhood CEOs each responded to the GameStop investment frenzy. *See Robinhood CEO Delivers Opening Statement and Apologizes to Customers During GameStop Hearing*, CNBC (Feb. 18, 2021, 12:30 PM), https://www.cnbc.com/video/2021/02/18/robinhood-ceo-delivers-opening-statement-and-apologizes-to-customers-during-gamestop-hearing.html.

209. *See* Kamin v. Am. Express Co., 383 N.Y.S.2d 807, 812 (N.Y. Sup. Ct. 1976), *aff'd*, 387 N.Y.S.2d 993 (N.Y. App. Div. 1976); Shlensky v. Wrigley, 237 N.E.2d 776, 779 (Ill. App. Ct. 1968) (quoting Davis v. Louisville Gas & Electric Co., 142 A. 654, 659 (Del. Ch. 1928)).

210. *Shlensky*, 237 N.E.2d at 780.

211. *Id*. at 779, 780.

212. Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 478–79 (1977).

213. *See* Lorenzo v. Sec. & Exch. Comm'n, 139 S. Ct. 1094 (2019); Rosenblum, *supra* note 26, at 293–94.

the corporation and the requisite scienter analysis. The Ninth Circuit's factors are helpful, but not exhaustive: (1) the relationship between the parties; (2) their relative access to information; (3) the benefit that the defendant derives from the relationship; (4) the defendant's awareness that the plaintiff was relying upon the relationship in making the investment decision; and (5) the defendant's activity in initiating the transaction.[214]

Most importantly, the contextual approach considers the specific facts of the case at hand—analyzing the specific set of individuals, the specific circumstances that led to the violation, and the nature of their specific professional knowledge to determine the scope of an individual's duty. Per the *Lorenzo* Court, Congress could not have intended for those who engage in "plainly fraudulent" behavior to escape primary liability under Rule 10b-5.[215] Rather, the Supreme Court routinely observes Congress's intent that Section 10(b) is to act as a "catchall" clause to prevent fraudulent practices within the securities markets.[216] Consequently, the contextual analysis provides a "catchall" approach to resolving Rule 10b-5 violation claims and preventing fraudulent behavior from slipping through the cracks.

CONCLUSION

In promulgating Section 10(b) and Rule 10b-5, Congress, and the SEC by way of Congressional authority, designed these laws to encompass the infinite variety of devices by which undue advantage could be taken of investors and corporations.[217] Another goal of Section 10(b) and Rule 10b-5 is the need to protect the security market's integrity from abuses by those with access to material nonpublic information that would affect the price of a corporation's securities upon public disclosure.[218] As the GameStop scenario plainly suggests, individuals are capable of finding creative ways to manipulate the market, and in turn, courts must also be creative in holding those individuals accountable for their fraudulent behavior.

214. Paracor Finance v. General Electric Capital Corp., 96 F.3d 1151, 1157 (9th Cir. 1996).

215. *Id.* at 1097. Justices Thomas and Gorsuch warned in dissent that the Court's opinion could mean "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." *Id*. at 1110 (Thomas, J., dissenting).

216. *See Santa Fe*, 430 U.S. at 472; Sec. & Exch. Comm'n v. Zandford, 535 U.S. 813, 819 (2002); Dirks v. Sec. & Exch. Comm'n, 463 U.S. 646, 653 n.10 (1983); United States v. O'Hagan, 521 U.S. 642, 657 (1997); Chiarella v. United States., 445 U.S. 222, 246 (1980) (Blackmun, J., dissenting); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 202–03 (1976).

217. *In re* Cady, Roberts & Co., Exchange Act Release No. 6668, 1961 WL 60638 (Nov. 8, 1961).

218. Final Rule: Selective Disclosure and Insider Trading, Release Nos. 33-7881, 34-43154, 2000 WL 1201556 (Aug. 15, 2000).

The diversity of circuit opinions demonstrates that any given Rule 10b-5 claim is unique and rarely allows for a single coherent answer. Thus, the Supreme Court should adopt a case-by-case, contextual approach for analyzing Rule 10b-5 violations. Notably, this approach (1) incorporates the Second Circuit's rule from *Dorozhko* that a fiduciary relationship is not a *required* element for an actionable securities claim under Section 10(b), but there is nonetheless an affirmative obligation not to mislead in commercial dealings; (2) corrects the Third Circuit's oversight of the Government's "high corporate executive" theory from *Schiff*; and (3) clarifies the purpose of the Ninth Circuit's flexible duty test from *Paracor*. Because the securities market is the backbone of our American commercial system, integrity of the market is essential—and conduct that threatens market integrity should therefore violate Section 10(b) and Rule 10b-5.[219]

JENNA KOLESON*

219. *Id*.

* J.D. Candidate, 2022, Saint Louis University School of Law. Special thank you to Professor Karen Sanner for her guidance on this Note, to Professor Chad Flanders for his leadership on the Journal, to Susie Lee for her excellence in facilitating publication of this Volume, and to Chioma Chukwu-Smith for her mentorship during my time as Editor-in-Chief. I would also like to recognize the dedication and support from the Volume 66 Editorial Board: Jacquelyn Sicilia, Patrick Ganninger, Dylan Ashdown, Emma Lapp, Jamison Winters, Alex Beezley, Kaitlin Carpenter, Laura Daoud, Blake Stocke, and Ryan Gallagher. Finally, I must express love and gratitude for my father, David Koleson, as my success and work ethic are a direct consequence of his encouragement. Without these individuals, my time in law school would have less significance and fewer laughs.