

Court of Appeals Rejects SEC's Expansive Interpretation of Rule 10b-5

BY SCOTT SHINE

In *SEC v. Tambone*, the U.S. Court of Appeals for the First Circuit recently dismissed fraud charges brought by the SEC against two senior executives of a broker-dealer.

The SEC alleged that the executives violated Rule 10b-5 under the Exchange Act by using mutual fund prospectuses containing prohibitions against market timing while simultaneously allowing preferred customers to engage in the activity. Rule 10b-5 deems it unlawful to make any untrue statement of material fact in connection with the purchase or sale of a security.

The opinion focused on what it means to “make a statement.” The SEC argued that the executives “made” misrepresentations by using the prospectuses to sell the funds and by implying to investors that they had a reasonable basis for believing that key representations were truthful and complete. The court rejected the SEC’s “expansive interpretation” as inconsistent with the definition of the word “make.”

The court ultimately concluded that a person does not “make” a statement when he merely “uses” a statement created entirely by another. As support, the court noted that the drafter’s of 10b-5 faithfully tracked the language in Section 17(a) of the Exchange Act but eschewed the more expansive word “use” in 17(a) in favor of the word “make,” suggesting a deliberate legislative and regulatory intent to confine the liability under Rule 10b-5 to actions that fall only within the use of the narrower word “make.”



SEC interpretation too expansive?

While the court did allow the SEC to proceed with its claims under Section 17(a) and for aiding and abetting primary violations under Section 10(b), the court also based its decision on the concern that ruling in favor of the SEC’s expansive interpretation of 10b-5 would have blurred the line between primary and secondary liability, thus opening the flood gates to private shareholder litigation.



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Karen Benson, Associate in the Miami office, was named Co-Chair of the Executive Board of the South Florida Chapter of ACAMS. The Association of Certified Anti-Money Laundering Specialists (ACAMS) is an international membership organization dedicated to enhancing the knowledge and skills of AML professionals from a wide range of industries. It serves in excess of 10,000 members in more than 140 countries. Ms. Benson has previously served as Secretary and Co-Secretary of the Executive Board of the South Florida Chapter.