



2019

## Justice Kavanaugh, *Lorenzo v. SEC*, and the Post-Kennedy Supreme Court

Matthew C. Turk  
*Indiana University*

Karen E. Woody  
*Washington and Lee University School of Law, kwoody@wlu.edu*

Follow this and additional works at: <https://scholarlycommons.law.wlu.edu/wlufac>



Part of the [Administrative Law Commons](#), [Banking and Finance Law Commons](#), [Business Organizations Law Commons](#), and the [Supreme Court of the United States Commons](#)

---

### Recommended Citation

Matthew C. Turk & Karen E. Woody, Justice Kavanaugh, *Lorenzo v. SEC*, and the Post-Kennedy Supreme Court, 71 Admin. L. Rev. 193 (2019).

This Article is brought to you for free and open access by the Faculty Scholarship at Washington and Lee University School of Law Scholarly Commons. It has been accepted for inclusion in Scholarly Articles by an authorized administrator of Washington and Lee University School of Law Scholarly Commons. For more information, please contact [christensena@wlu.edu](mailto:christensena@wlu.edu).

# RECENT DEVELOPMENTS

## JUSTICE KAVANAUGH, *LORENZO V. SEC*, AND THE POST-KENNEDY SUPREME COURT

MATTHEW C. TURK & KAREN E. WOODY\*

*This Article analyzes a recent Supreme Court case, Lorenzo v. Securities and Exchange Commission, and explains why it provides a valuable window into the Court's future now that Justice Kennedy has retired and his seat filled by Justice Brett Kavanaugh. Lorenzo is an important case that raises fundamental interpretative questions about the reach of federal securities statutes. But most significant is its unique procedural posture: when the Supreme Court issues its decision on Lorenzo in 2019, Justice Kavanaugh will be recused while the other eight Justices rule on a lower court opinion from the D.C. Circuit in which he wrote separately in an extensive dissent.*

*That dissent is quite remarkable. It contains a scathing assessment of securities fraud enforcement and adjudication at the SEC, the majority opinion's interpretation of deceptive financial conduct under Rule 10b-5, and the SEC's overall role in the development of federal securities law doctrine. Judge Kavanaugh's dissent also goes on to identify how the legal deficiencies specific to Lorenzo motivate his broader skepticism towards the constitutional legitimacy of the administrative and regulatory state as a whole; a view that represents his signature contribution as a federal judge. Thus, in Lorenzo, the defining judicial philosophy of the newest Supreme Court Justice is on full display.*

*More broadly, this Article demonstrates that the deeper import of Lorenzo is not what it reveals about the views of Justice Kavanaugh. Rather, it is in the reception those views will meet from the other eight Justices on the Court. In addressing the argument set forth in the Lorenzo dissent, the current members of the Court will be confronting the positions of their newest peer and colleague. By necessity, they will also signal their openness to be-*

---

\* Matthew C. Turk and Karen E. Woody are both Assistant Professors of Business Law at Indiana University's Kelley School of Business. We would like to thank Andy Vollmer for his thoughtful comments on early drafts.

ing persuaded by Justice Kavanaugh on the issues where he speaks with greatest authority and can be expected to act as forceful advocate for his vision of the law at the Court. Lorenzo can therefore be seen as a bellwether for Justice Kavanaugh's influence as judicial entrepreneur on behalf of his trademark theory of the Constitutional separation of powers in administrative law. Most importantly, the case bears directly on the area of administrative law where the stakes are highest of all—the role that Justice Kavanaugh may play in the demise of the Chevron doctrine and the collapse of judicial deference toward the administrative state.

I. Introduction.....	195
II. <i>Lorenzo</i> Case Background .....	199
A. Facts .....	199
B. Lorenzo Before the SEC.....	201
1. The ALJ Decision .....	202
2. The SEC Commission Decision .....	203
C. The D.C. Circuit Opinion.....	205
1. The Majority Opinion by Judge Srinivasan .....	206
a. Lorenzo's Scierter .....	206
b. Misstatements Liability.....	206
c. Scheme Liability.....	208
2. The Dissenting Opinion by Judge Kavanaugh.....	209
a. Act 1: The Administrative Law Judge: " <i>Mens Rea</i> 101" .....	209
b. Act 2: The SEC Commission: "So Much For A Fair Trial" .....	210
c. Act 3: The Majority Opinion: Falling for the SEC's "Legal Jujitsu" .....	211
III. Securities Fraud Under Rule 10b-5 After <i>Lorenzo</i> .....	213
A. The Parties' Briefing to the Supreme Court.....	214
B. Potential Legal Resolutions .....	217
1. Scenario #1: Agency Fact-Finding Under the Microscope.....	217
2. Scenario #2: The <i>Janus</i> "Ultimate Authority" Test Revisited.....	220
3. Scenario #3: Scheme Liability Versus Misstatement Liability .....	222
a. The Scope of Scheme Liability .....	222
b. Implications for Securities Fraud Doctrine .....	224
c. Implications for Securities Fraud Enforcement.....	225
C. The Supreme Court's Eight-Justice Decision in <i>Lorenzo</i> .....	226
IV. The Supreme Court's Securities Law Jurisprudence After <i>Lorenzo</i> .....	227
A. More of the Same? Maintaining the Roberts Court's Enthusiastic Minimalism .....	228
1. The Roberts Court Status Quo .....	228
2. How the Court's Ruling in <i>Lorenzo</i> Would Fit .....	230
B. Or, Back to the Future? A Return to Judicial Activism.....	231

1. The “Counter-Revolution” Under Justice Powell .....	232
2. How the Court’s Ruling in <i>Lorenzo</i> Would Fit .....	233
V. The Regulatory & Administrative State After <i>Lorenzo</i> .....	234
A. Judge Kavanaugh’s Theory of Administrative Law .....	235
1. The Separation of Powers Constraint.....	237
2. The Critique of Agency Adjudication .....	239
3. The Critique of Agency Rulemaking.....	241
B. Farewell, <i>Chevron</i> ? .....	246
VI. Conclusion.....	249

## I. INTRODUCTION

When Justice Anthony Kennedy announced his retirement on June 27, 2018, after thirty years on the U.S. Supreme Court, the inevitable guessing game began as to who his replacement might be.<sup>1</sup> After President Trump nominated D.C. Circuit Court of Appeals Judge Brett Kavanaugh on July 9, 2018,<sup>2</sup> speculation quickly turned to how the future decisionmaking of the Court will be impacted once Judge Kavanaugh arrived, given his likelihood of being confirmed by the Senate.<sup>3</sup> Early commentary on the legal direction that a post-Kennedy Supreme Court featuring Judge Kavanaugh would take did not get very far, however. Most discussion of Brett Kavanaugh’s record as a federal judge was set aside after the explosive revelation of several sexual assault allegations, which, understandably, turned the confirmation process into a referendum on his personal history and character.<sup>4</sup>

The nomination hearing held by the Senate Judiciary Committee prior to the allegations against Judge Kavanaugh was not particularly enlightening either.<sup>5</sup> In addition to the standard political grandstanding, the ques-

1. See Robert Barnes, *Justice Kennedy, the Pivotal Swing Vote on the Supreme Court, Announces His Retirement*, WASH. POST (June 27, 2018), [https://www.washingtonpost.com/politics/courts\\_law/justice-kennedy-the-pivotal-swing-vote-on-the-supreme-court-announces-retirement/2018/06/27/a40a8c64-5932-11e7-a204-ad706461fa4f\\_story.html?utm\\_term=.8959c419812a](https://www.washingtonpost.com/politics/courts_law/justice-kennedy-the-pivotal-swing-vote-on-the-supreme-court-announces-retirement/2018/06/27/a40a8c64-5932-11e7-a204-ad706461fa4f_story.html?utm_term=.8959c419812a).

2. See *Trump Announces Brett Kavanaugh as Supreme Court Nominee: Full Video and Transcript*, N.Y. TIMES (July 9, 2018), <https://www.nytimes.com/2018/07/09/us/politics/trump-supreme-court-announcement-transcript.html>.

3. See Sheryl Gay Stolberg et al., *Senate Democrats Come Out Swinging in Long-Shot Fight to Block Kavanaugh*, N.Y. TIMES (July 10, 2018), <https://www.nytimes.com/2018/07/10/us/politics/democrats-brett-kavanaugh-supreme-court.html>.

4. See Sheryl Gay Stolberg, *Kavanaugh Is Sworn In After Close Confirmation Vote in Senate*, N.Y. TIMES (Oct. 6, 2018), <https://www.nytimes.com/2018/10/06/us/politics/brett-kavanaugh-supreme-court.html>.

5. Judge Kavanaugh’s nomination hearings began on September 4, 2018. See *Confirmation Hearings for U.S. Top Court Nominee Kavanaugh Open Sept. 4*, REUTERS (Aug. 10, 2018), <https://www.reuters.com/article/us-usa-court-trump/confirmation-hearings-for-u-s-top-court-nominee-kavanaugh-open-sept-4-idUSKBN1KV2BB>.

tioning itself revolved exclusively around Supreme Court precedents concerning hot-button social issues, such as affirmative action, abortion, LGBT rights, and the Second Amendment's protection of gun ownership. And while the interests those cases affect are no doubt important, anticipating Justice Kavanaugh's position in controversial culture-war decisions provides a limited perspective on the influence he will have on the Court. That is because, by most accounts, his views on those issues do not stand out relative to the other two-dozen individuals that were on President Trump's shortlist of potential nominees.<sup>6</sup> Along with the other members of that group, Justice Kavanaugh was an utterly conventional GOP nominee with respect to the usual ideological litmus tests.

Yet, as this Article will explain, Justice Kavanaugh *does* have a distinguishing brand of jurisprudence that separates him from the other rising legal stars who were considered for the nomination.<sup>7</sup> When it comes to cases on regulatory policymaking—and the relationship between the federal courts and administrative agencies more generally—Justice Kavanaugh has developed an elaborate, sophisticated critique of the current state of the law

---

6. See, Carole Joffe, *With the Appointment of Brett Kavanaugh, Roe v. Wade Is Likely Dead*, WASH. POST (July 10, 2018), [https://www.washingtonpost.com/news/made-by-history/wp/2018/07/10/with-the-appointment-of-brett-kavanaugh-roe-v-wade-is-likely-dead/?utm\\_term=.2ee47f92e106](https://www.washingtonpost.com/news/made-by-history/wp/2018/07/10/with-the-appointment-of-brett-kavanaugh-roe-v-wade-is-likely-dead/?utm_term=.2ee47f92e106) (recognizing that President Trump “promise[d] to only nominate ‘pro-life’ judges to the court” and asserting that “[m]uch of the debate over the nomination of Brett Kavanaugh to succeed Anthony M. Kennedy on the Supreme Court will center on the fate of *Roe v. Wade* and the future of abortion rights in America”); Mark Joseph Stern, *Anthony Kennedy Just Destroyed His Legacy as a Gay Rights Hero*, SLATE (June 27, 2018), <https://slate.com/news-and-politics/2018/06/anthony-kennedy-destroyed-his-gay-rights-legacy-by-retiring-under-trump.html> (“Trump is all but assured to replace Kennedy with a judge who shares the conservatives’ opposition to gay rights. . . . Brett Kavanaugh of the U.S. Court of Appeals for the District of Columbia Circuit is a top contender.”); Eric Lesh, *Judge Kavanaugh Will Take a Sledgehammer to Justice Kennedy’s LGBTQ Rights Legacy*, REWIRE.NEWS (July 12, 2018), <https://rewire.news/article/2018/07/12/judge-kavanaugh-will-take-sledgehammer-justice-kennedys-lgbtq-rights-legacy/>.

7. For a selection of Justice Kavanaugh’s published speeches and other writings, see generally Brett M. Kavanaugh, *Keynote Address: Two Challenges for the Judge as Umpire: Statutory Ambiguity and Constitutional Exceptions*, 92 NOTRE DAME L. REV. 1907 (2017) [hereinafter Kavanaugh, *Keynote Address*]; Brett M. Kavanaugh, *Fixing Statutory Interpretation: Book Review of Robert A. Katzmann: Judging Statutes*, 129 HARV. L. REV. 2118 (2016) [hereinafter Kavanaugh, *Fixing Statutory Interpretation*]; Brett M. Kavanaugh, *Separation of Powers During the Forty-Fourth Presidency and Beyond*, 93 MINN. L. REV. 1454 (2009) [hereinafter Kavanaugh, *Separation of Powers*]; Brett M. Kavanaugh, *The President and the Independent Counsel*, 86 GEO. L.J. 2133 (1997) [hereinafter Kavanaugh, *The President and the Independent Counsel*]; Brett M. Kavanaugh, Note, *Defense Presence and Participation: A Procedural Minimum for Batson v. Kentucky Hearings*, 99 YALE L.J. 187 (1989) (Justice Kavanaugh’s student note) [hereinafter Kavanaugh, Note]; Brett M. Kavanaugh, *The Role of the Judiciary in Maintaining the Separation of Powers*, HERITAGE FOUND. LECTURE (Oct. 25, 2017), <https://www.heritage.org/sites/default/files/2018-02/HL1284.pdf> [hereinafter Kavanaugh, *Maintaining the Separation of Powers*].

that is all his own.<sup>8</sup> If he has a signature impact on the Court, it will be in that area.<sup>9</sup> As this Article further argues, one of the best ways to understand what that impact may be is by taking a closer look at a case that Justice Kavanaugh heard last year as a judge on the D.C. Circuit: *Lorenzo v. Securities & Exchange Commission*.<sup>10</sup>

*Lorenzo* is an important case in its own right, and it raises fundamental interpretative questions about the reach of federal securities statutes dealing with financial fraud.<sup>11</sup> In his dissenting opinion, then-Judge Kavanaugh lays out his view on those questions as well as their place within the broader landscape of securities law doctrine.<sup>12</sup> The dissent in *Lorenzo* goes far beyond technical questions of securities regulation, though. In discussing the Securities and Exchange Commission's (SEC's) enforcement and adjudicative record in *Lorenzo*, Judge Kavanaugh also presents a comprehensive statement of his philosophy on the federal administrative-and-regulatory structure—the same philosophy that is likely to be his defining contribution as a Supreme Court Justice.<sup>13</sup> A careful reading of *Lorenzo* therefore turns up invaluable insights into the judicial perspective that Justice Kavanaugh will bring to the post-Kennedy Supreme Court.

Even more significant than the particular legal questions presented in *Lorenzo* is its unique procedural posture. On June 18, 2018, the Supreme Court granted Lorenzo's petition for certiorari (cert) and placed the case on the docket for its October 2018 Term.<sup>14</sup> When the Court's current eight Justices issue an opinion on the case,<sup>15</sup> they will be responding to Justice Kavanaugh as a peer, who they will be persuaded by and seek to persuade for the remainder of his presumably multi-decade tenure at One First Street.<sup>16</sup> As a consequence, *Lorenzo* will reveal much more than how Justice

8. See generally Kavanaugh, *Keynote Address*, *supra* note 7; Kavanaugh, *Fixing Statutory Interpretation*, *supra* note 7; Kavanaugh, *Separation of Powers*, *supra* note 7; Kavanaugh, *The President and the Independent Counsel*, *supra* note 7; Kavanaugh, Note, *supra* note 7; Kavanaugh, *Maintaining the Separation of Powers*, *supra* note 7.

9. Cf. Jonathan H. Adler, *Will Kavanaugh Curb Sloppy White House Deregulation?*, N.Y. TIMES (July 16, 2018), <https://www.nytimes.com/2018/07/16/opinion/brett-kavanaugh-supreme-court-administrative-state.html> (noting Kavanaugh's extensive collection of opinions on administrative law principles); Jonathan H. Adler, *Judge Kavanaugh and the Administrative State*, VOLOKH CONSPIRACY (July 16, 2018), <https://reason.com/volokh/2018/07/16/judge-kavanaugh-and-the-administrative-s>.

10. 872 F.3d 578 (D.C. Cir. 2017).

11. See *id.* at 580; see *infra* Section I (providing an overview of the case).

12. *Lorenzo*, 872 F.3d at 597–602 (Kavanaugh, J., dissenting).

13. *Id.* at 602.

14. Order Granting Certiorari, *Lorenzo v. SEC*, 138 S. Ct. 2650 (June 18, 2018) (granting Lorenzo's petition for certiorari).

15. *October 2018 Term Calendar*, U.S. SUP. CT., [https://www.supremecourt.gov/oral\\_arguments/2018TermCourtCalendar.pdf](https://www.supremecourt.gov/oral_arguments/2018TermCourtCalendar.pdf) (last visited Oct. 12, 2018) (providing the Court's schedule for this coming term, which is set to conclude on June 20, 2019).

16. In the empirical literature on judicial decisionmaking, there is a well-established set

Kavanaugh tends to vote, or the fact that his opinions on the D.C. Circuit often receive weighty consideration when reaching the Court. For the other four conservative Justices especially, *Lorenzo* presents an occasion to gauge the Court's receptiveness to Judge Kavanaugh's judicial philosophy on administrative law, the area where he speaks with greatest authority and can be expected to function as a "judicial entrepreneur" who will actively advocate for his preferred vision of the law over the coming years.<sup>17</sup>

Accordingly, the broader goal of this Article's analysis is to demonstrate how *Lorenzo* functions as a predictive device that reflects the future course of the Court now that Justice Kennedy has been replaced by Justice Kavanaugh. Specifically, it identifies two areas where *Lorenzo* may come to mark a turning point. The first is securities law proper. With respect to the merits of the case itself, *Lorenzo* could force the Court's hand in articulating concrete answers to some foundational yet murky open questions in securities fraud doctrine.<sup>18</sup>

*Lorenzo* also may operate as a barometer for the future course of the Supreme Court's securities law jurisprudence as a whole. In concluding his dissent, then-Judge Kavanaugh extends his critique of the SEC's specific enforcement practices at issue in *Lorenzo* to make a compelling call for an end to the judicial complacency which has characterized the Court's incremental decisionmaking in securities cases since the appointment of John Roberts as Chief Justice in 2005.<sup>19</sup> If the other Justices prove receptive to

of findings on "panel effects" at circuit courts—a phenomenon where one judge's vote is influenced by the composition of his or her colleagues on the same judicial panel or court. Reframed in the jargon of this literature, the question is what panel effect Justice Kavanaugh's will have on the Court now that he has been confirmed. See generally Joshua B. Fischman, *Interpreting Circuit Court Voting Patterns: A Social Interactions Framework*, 31 J.L. ECON. & ORG. 808 (2013) (surveying the various theoretical explanations for panel effects); Pauline T. Kim, *Deliberation and Strategy on the United States Court of Appeals: An Empirical Exploration of Panel Effects*, 157 U. PA. L. REV. 1319 (2009) (documenting the extent to which panel effects appear when judges sit on the same court but not on the same case).

17. Cf. A.C. Pritchard, *Justice Lewis F. Powell, Jr., and the Counterrevolution in the Federal Securities Laws*, 52 DUKE L.J. 841 (2003) (detailing how Justice Powell exemplified the role of judicial entrepreneur by leveraging his expertise on securities law during his tenure on the Court in the 1970s and 1980s); see also Frank B. Cross & Stefanie Lindquist, *Judging the Judges*, 58 DUKE L.J. 1383, 1419–22 (2009) (citing Stephen Choi & Mitu Gulati, *A Tournament of Judges*, 92 CAL. L. REV. 299 (2004)) (discussing two particular judicial styles: the entrepreneur and minimalist).

18. These include the forms of deceptive conduct that can give rise to a claim for securities fraud, as well as the relationship between primary and secondary (aiding-and-abetting) liability that determines the availability of those claims in SEC enforcement actions and for private investor securities plaintiffs. See *infra* Section I (analyzing the future of securities fraud doctrine and enforcement after *Lorenzo*).

19. *Lorenzo v. SEC*, 872 F.3d 578, 601 (D.C. Cir. 2017). See generally Matthew C. Turk & Karen E. Woody, *Leidos and the Roberts Court's Improvident Securities Law Docket*, 70 STAN. L. REV. ONLINE 89 (2017) (analyzing the Roberts Court's decisionmaking in securities law cas-

that call, *Lorenzo* would lead a return to the more activist mode of judging that defined the “counter-revolution” in Supreme Court securities decisions during the tenure of Justice Powell in the Burger and Rehnquist Court eras.<sup>20</sup>

The second area where *Lorenzo* may be a leading indicator relates to the dissent’s exposition of Judge Kavanaugh’s trademark separation-of-powers critique of administrative law. In his opinion, Judge Kavanaugh is openly skeptical of the “agency-centric process”<sup>21</sup> that has become the focal point of the modern regulatory state and suggests that it “is in some tension”<sup>22</sup> with the judicial prerogatives established under Article III of the U.S. Constitution.<sup>23</sup> Once Judge Kavanaugh’s critique of agency decisionmaking in those passages is fully unpacked, it becomes clear that the *Lorenzo* dissent has wide-ranging implications which touch on nearly every area of existing administrative law doctrine.

The biggest target in Justice Kavanaugh’s crosshairs on administrative law matters is hard to miss. By announcing that the SEC’s legal positions in *Lorenzo* “deserve[] judicial repudiation, not judicial deference or respect,”<sup>24</sup> the dissent questions the underlying function of judicial review in the modern administrative state, including its embodiment in the *Chevron* doctrine.<sup>25</sup> Thus, the ultimate legacy of *Lorenzo* as bellwether for the post-Kennedy Supreme Court may be to ring the death knell for the standard theories of judicial deference in administrative law.

The discussion below proceeds as follows: Section II provides case background on *Lorenzo*. Section III analyzes the import of *Lorenzo* for securities-fraud doctrine and discusses the possible ways in which the Court may resolve those issues with its decision in the case next summer. Section IV explores *Lorenzo* as a possible reorientation of the Court’s securities law jurisprudence as a whole. Section V addresses Justice Kavanaugh’s *Lorenzo* dissent in relation to his overall theory of administrative law, and its implication for the future of *Chevron* deference. A final section briefly concludes.

## II. LORENZO CASE BACKGROUND

### A. Facts

*Lorenzo* turns on a relatively colorful set of facts, at least as far as securities litigations go. The case centers around two financial professionals, Francis

---

es).

20. See *infra* Section IV.B.1.

21. *Lorenzo*, 872 F.3d at 602.

22. *Id.*

23. *Id.* (referencing the Fifth Amendment Due Process Clause and the Seventh Amendment right to a civil trial).

24. *Id.* at 600.

25. *Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837 (1984).



V. Lorenzo (Lorenzo) and Gregg Lorenzo, who happen to share the same last name but are unrelated.<sup>26</sup> Both Lorenzos worked at Charles Vista, LLC, a registered broker-dealer that Gregg Lorenzo owned and operated after opening the firm in February of 2009.<sup>27</sup> Lorenzo worked under Gregg Lorenzo since joining Charles Vista in the summer of 2009, where his formal job title was Director of Investment Banking.<sup>28</sup>

As Director of Investment Banking, Lorenzo was responsible for managing the account of the Charles Vista's largest client, a renewable energy start-up called Waste2Energy Holdings, Inc. (Waste2Energy).<sup>29</sup> Waste2Energy had an interesting business model. The value of the company turned almost entirely on a single piece of intellectual property, which was a technology that it believed could transform "solid waste" (i.e. garbage) into electricity.<sup>30</sup> This attempt at modern day alchemy turned out to be about as hard as it sounds. Eventually, Waste2Energy recognized it would never be able to successfully develop the technology, and publicly wrote down the value of its intellectual property (previously estimated to be worth \$10 million) to essentially zero on October 1, 2009.<sup>31</sup>

Due to its worsening financial condition, Waste2Energy was in need of additional funding and turned to Charles Vista in order to escape financial ruin.<sup>32</sup> The plan was for Charles Vista to act as the placement agent for an upcoming debt offering by Waste2Energy, which sought to issue \$15 million worth of convertible debentures (a kind of corporate bond).<sup>33</sup> In exchange, Charles Vista would receive twenty percent of the proceeds.<sup>34</sup>

Lorenzo worked at the direction of his boss Gregg Lorenzo as the point person for Waste2Energy's debt offering. On October 14, 2009, Gregg Lorenzo drafted an email regarding the Waste2Energy bonds and asked Lorenzo to send it to a pair of Charles Vista clients, William Rothe and Vishal Goolcharan.<sup>35</sup> Both emails contained the same language concerning finan-

---

26. Gregg C. Lorenzo, Francis V. Lorenzo, and Charles Vista LLC, Exchange Act Release No. 544, 2013 WL 6858820, at \*2 (ALJ Dec. 31, 2013) (initial decision) [hereinafter ALJ Decision].

27. Gregg C. Lorenzo, Exchange Act Release No. 9480, 2013 WL 6087352, at \*2 (Nov. 20, 2013) [hereinafter Charles Vista & Gregg Lorenzo SEC Settlement Order].

28. ALJ Decision, 2013 WL 6858820, at \*2.

29. *See id.* at \*1-2; Charles Vista & Gregg Lorenzo SEC Settlement Order, 2013 WL 6087352, at \*2.

30. ALJ Decision, 2013 WL 6858820, at \*3.

31. Waste2Energy announced the write-down in a Form 8-K, released on October 1, 2009. *Id.*

32. *Id.*

33. *Id.* at \*3 ("In September 2009, W2E was preparing to offer up to \$15 million in 12% convertible debentures, and Charles Vista was the placement agent for this offering.")

34. Francis V. Lorenzo, Exchange Release No. 9762, 2015 WL 1927763, at \*3 (Apr. 29, 2015) [hereinafter SEC Commission Decision].

35. *Id.* at \*4.

cial details of the Waste2Energy debt offering, which we have consolidated here for comparison:

Dear Sir: **At the request of . . . Gregg Lorenzo**, the Investment Banking division of Charles Vista has summarized several key points of the Waste2Energy Holdings, Inc. Debenture Offering. . . .

There are 3 levels of protection: (I) **The Company has over \$10 mm in confirmed assets**; (II) The Company has purchase orders and LOI's [Letters of Intent] for over \$43 mm in orders; (III) Charles Vista has agreed to raise additional monies to repay these Debenture holders (if necessary).<sup>36</sup>

The two emails also included text indicating that the recipients should contact Lorenzo with any questions and signed off with a footer that listed Lorenzo's name and title as Vice President of Investment Banking at Charles Vista.<sup>37</sup> Lorenzo sent the emails to Rothe and Goolcharan on the same day that Gregg Lorenzo instructed him to do so.<sup>38</sup>

Rothe decided not to invest and may have never opened the email.<sup>39</sup> Goolcharan took the Lorenzos up on their offer and purchased \$15,000 worth of Waste2Energy debentures through Charles Vista's brokerage department.<sup>40</sup> The fee earned by Lorenzo from the entire affair, which was based on his standard one-percent commission, came to \$150.<sup>41</sup>

### B. Lorenzo Before the SEC

On February 15, 2013, the SEC's enforcement division commenced an action against Gregg Lorenzo, Francis Lorenzo, and Charles Vista based on their involvement with the Waste2Energy debt offering. All three were charged with civil securities fraud in violation of Section 17(a) of the 1933 Securities Act,<sup>42</sup> Section 10(b) of the 1934 Exchange Act,<sup>43</sup> and Rule 10b-

---

36. ALJ Decision, 2013 WL 6858820, at \*4 (emphases added).

37. *Id.* at \*4.

38. *Id.*

39. *Id.*

40. SEC Commission Decision, 2015 WL 1927763, at \*5.

41. *Id.* Lorenzo's total take-home pay while working for Charles Vista was not much better. He earned \$120,000 in salary during his tenure, but may have netted closer to \$40,000, because Charles Vista never made good on its promise to reimburse the roughly \$80,000 in business expenses that Lorenzo allegedly accrued during that time. *Id.* at \*2.

42. 15 U.S.C. § 77q(a) (2012). Section 17 states in relevant part:

It shall be unlawful for any person in the offer or sale of any securities or any security-based swap agreement by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

5.<sup>44</sup> Gregg Lorenzo and Charles Vista entered into a settlement with SEC, which was finalized on November 20, 2013.<sup>45</sup> Lorenzo did not settle. The SEC's charges against him were therefore adjudicated within the SEC's administrative courts, first before an Administrative Law Judge (ALJ), and then on appeal to the SEC Board of Commissioners (the SEC Commission).<sup>46</sup>

### 1. *The ALJ Decision*

The ALJ issued an order on December 31, 2013, holding Lorenzo liable on all the SEC's charges.<sup>47</sup> In the decision, the ALJ described the falsity of Lorenzo's emails to Rothe and Goolcharan "staggering,"<sup>48</sup> and found that he had knowingly sent the statements they contained with "at least a reckless degree of scienter."<sup>49</sup>

The most notable feature of the ALJ decision, particularly for purposes of the D.C. Circuit's subsequent ruling, was the evidentiary basis for its fact conclusion on the issue of scienter. In considering Lorenzo's charges, the ALJ primarily relied upon testimony that Lorenzo provided during a two-day hearing that was held at the SEC in September of 2013.<sup>50</sup> After quoting a number of excerpts from the hearing, the ALJ decision sums up Lorenzo's testimony as suggesting that "Frank Lorenzo sent the emails without even thinking about the contents."<sup>51</sup> For the ALJ, such neglect was

*Id.*

43. 15 U.S.C. § 78j(b). Section 10(b) states in relevant part:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

[ . . . ]

(b) [t]o use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe as necessary or appropriate in the public interest or for the protection of investors.

*Id.*

44. 17 C.F.R. § 240.10b-5 (2018). Rule 10b-5 was promulgated pursuant to Section 10(b) by the SEC in 1942.

45. Charles Vista & Gregg Lorenzo SEC Settlement Order, Exchange Act Release No. 9480, 2013 WL 6087352, at \*1 (Nov. 20, 2013).

46. See generally SEC Commission Decision, 2015 WL 1927763, at \*1; ALJ Decision, Exchange Act Release No. 544, 2013 WL 6858820, at \*1 (ALJ Dec. 31, 2013).

47. ALJ Decision, 2013 WL 6858820, at \*5.

48. *Id.* at \*7.

49. *Id.* at \*8.

50. *Id.* at \*1.

51. *Id.* at \*5 (Lorenzo testified as follows: "I just didn't give it much thought at the time. My boss asked me to send these e-mails out and I sent them out. . . . The guy owns the firm.

sufficiently unjustifiable that it amounted to willful violation of the securities laws: “Had [Lorenzo] taken a minute to read the text, he would have realized that it was false and misleading and that [Waste2Energy] was not worth anything near what was being represented to potential investors.”<sup>52</sup> Lorenzo’s attempts to emphasize his subordinate position within Charles Vista was also to little avail. As the ALJ concluded: “[Lorenzo] cannot escape liability by claiming that Gregg Lorenzo ordered him to send the emails. The fact that Gregg Lorenzo contributed to the misrepresentation does not relieve Frank Lorenzo from responsibility.”<sup>53</sup>

In light of what the ALJ characterized as Lorenzo’s “egregious and repeated”<sup>54</sup> conduct—which was further “aggravat[ed]” by his “attempt to displace blame onto both Gregg Lorenzo and [Waste2Energy]”<sup>55</sup>—the ALJ imposed a three-part sanction. Specifically, the decision ordered that Lorenzo: (a) cease-and-desist from committing future violations of the securities laws at issue; (b) pay a \$15,000 civil money penalty; and (c) be subject to a lifetime bar against future participation in the securities industry.<sup>56</sup>

## 2. *The SEC Commission Decision*

Lorenzo’s appeal to the SEC Commission was also to no avail. On April 29, 2015, the Commission issued a decision which upheld the prior ALJ order in full.<sup>57</sup> The Commission substantially developed both the factual and legal bases for Lorenzo’s liability.

On the question of scienter, the SEC Commission treads through additional portions of Lorenzo’s testimony and comes to a conclusion that is notably more adamant than the ALJ.<sup>58</sup> Specifically, the Commission’s decision concludes that “Lorenzo was well aware that the emails falsely represented crucial facts about [Waste2Energy] and its debenture offering.”<sup>59</sup> It also goes on to state that Lorenzo’s “claim that he nevertheless

He just asked me to send out an e-mail for him. I am going to tell him no?” (internal citations omitted).

52. *Id.* at \*7 (“[T]he evidence shows that [Lorenzo] was reckless - although he knew that [Waste2Energy] was in terrible financial shape, he sent the emails without thinking.”).

53. *Id.*

54. *Id.* at \*8.

55. *Id.*

56. *See id.* at \*10 (explaining the sanctions imposed on Lorenzo).

57. *See* SEC Commission Decision, Exchange Release No. 9762, 2015 WL 1927763 (Apr. 29, 2015). The SEC Division of Enforcement cross-appealed, requesting that Lorenzo’s penalty be raised from \$15,000 to \$100,000, but was not successful either. *See id.* at \*17. The SEC’s Commission was in part divided along a 3-2 vote, with Commissioners Gallagher and Piwowar concurring with Chair White and Commissioners Aguilar and Stein on the merits but dissenting with respect to the order of sanctions that placed a lifetime bar on Lorenzo from the securities industry. *Id.*

58. *See id.* at \*5–9 (summarizing Lorenzo’s testimony).

59. *Id.* at \*9.

‘didn’t give sending the emails much thought’ is therefore implausible,”<sup>60</sup> adding that, “if Lorenzo did send the emails without ‘thinking about it one way or the other,’ as he claims, such a dismissive attitude . . . would be equally troubling and still constitute acting with extreme recklessness.”<sup>61</sup>

The SEC Commission also elaborated on the legal theory behind Lorenzo’s violation of Rule 10b-5. Because Rule 10b-5 sets forth the central prohibition for securities fraud claims generally and also serves as the key legal source for Lorenzo’s ultimate appeal to the Supreme Court, its three-part language is worth quoting in full. It provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

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

(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, in connection with the purchase or sale of any security.<sup>62</sup>

In applying Rule 10b-5, the Commission determined there are two distinct legal bases for holding Lorenzo liable.

First, the SEC determined that Lorenzo’s conduct ran afoul of Rule 10b-5’s prohibition on false statements laid out in subsection (b) (known in securities regulation as “misstatements liability”). The lynchpin of the Commission’s conclusion on that point was its interpretation of a 2011 Supreme Court case, *Janus Capital Group v. First Derivative Traders*.<sup>63</sup> *Janus* held that, with respect to the conduct prohibited under subsection (b), primary liability only applies to the individual or entity who “makes” the misstatement.<sup>64</sup> The test for identifying which party has “made” the misleading statement at issue, the *Janus* decision further explained, turns on who exercised “ultimate authority” with respect to the statement, meaning that:

For purposes of Rule 10b-5, the maker of a statement is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it. Without control, a person or entity can merely suggest what to say, not “make” a statement in its own right. One who prepares or publishes a statement on behalf of another is not its maker.<sup>65</sup>

In applying *Janus*, the Commission addressed and rejected Lorenzo’s ar-

60. *Id.*

61. *Id.*

62. 17 C.F.R. § 240.10b-5(a)-(c) (2018).

63. 564 U.S. 135 (2011).

64. *See id.* at 148 (holding that primary liability falls on the “maker” of the misstatement).

65. *Id.* at 142.

gument that he was not the “maker” of the statements in the emails, but rather “merely helped to distribute the statements by sending the email that Gregg Lorenzo drafted.”<sup>66</sup> The Commission’s decision notes that Lorenzo provided “at best” conflicting and ambiguous testimony about his role in drafting the emails.<sup>67</sup> And it goes on to find that Lorenzo was the “maker” of the statements in the two emails he sent because he was “ultimately responsible for the emails’ content and dissemination.”<sup>68</sup>

Second, the SEC Commission also determined that Lorenzo’s conduct separately constituted a violation of the so-called “scheme liability” prohibition set forth in subsection (a) and (c) of Rule 10b-5,<sup>69</sup> “[i]ndependently” of whether he could be considered the maker of the misleading statements sent to Rothe and Goolcharan for purposes of misstatement liability under *Janus*.<sup>70</sup> In a brief, paragraph-long discussion of the question, the Commission’s decision concludes that “Lorenzo’s role in producing and sending the emails constituted employing a deceptive ‘device,’ ‘act,’ or ‘artifice to defraud’ for purposes of liability under . . . Rule 10b-5(a) and (c) . . . .”<sup>71</sup>

Lorenzo extended his time in administrative law court slightly by filing a motion for reconsideration with the SEC, but that motion was denied.<sup>72</sup> He then challenged the SEC Commission’s April 2015 decision in federal court with an appeal to the D.C. Circuit.

### C. *The D.C. Circuit Opinion*

By a 2-1 vote, the D.C. Circuit issued its decision on Lorenzo’s appeal on September 29, 2017.<sup>73</sup> The majority opinion, written by Judge Sri Srinivasan and joined by Judge Thomas Griffith, upheld the SEC Commission in part, vacated its order of sanctions on Lorenzo, and remanded the case back to the agency to consider what new penalty would be appropriate in light of its partial reversal.<sup>74</sup> In an extensive dissenting opinion, Judge Brett Kavanaugh laid out a number of grounds for why the SEC’s decision should have been reversed in full.<sup>75</sup>

66. SEC Commission Decision, 2015 WL 1927763, at \*10.

67. *See id.* (noting the ambiguity in the testimony).

68. *Id.*

69. Scheme liability is discussed in the D.C. Circuit’s opinion, and refers to liability under Rule 10b-5(a) and (c) as a result of being involved in a “scheme,” rather than liability as a result of being the “maker” of the statement, as defined in Rule 10b-5(b). *See infra* Section I.C and accompanying notes.

70. *See* SEC Commission Decision, 2015 WL 1927763, at \*11.

71. *Id.*

72. *See* *Lorenzo v. SEC*, 872 F.3d 578, 582 (D.C. Cir. 2017) (showing that the motion for reconsideration was denied).

73. *See id.* at 578.

74. *See id.* at 578, 580.

75. *See id.* at 600–02 (Kavanaugh, J., dissenting) (explaining why the order should have been vacated by the SEC).

### 1. *The Majority Opinion by Judge Srinivasan*

Writing for the D.C. Circuit's majority, Judge Srinivasan upheld the SEC Commission's decision with respect to its conclusion that Lorenzo was liable under Section 17, Section 10(b), and the scheme liability provisions in subsections (a) and (c) of Rule 10b-5. The court also affirmed the SEC's finding that Lorenzo had sent the two misleading emails with the requisite scienter for committing securities fraud. On the other hand, the D.C. Circuit determined that the SEC Commission had erred in its conclusion that Lorenzo "made" the statements at issue (per the *Janus* ultimate authority test), and therefore reversed the agency as to Lorenzo's misstatement liability under subsection (b) of Rule 10b-5.

#### a. *Lorenzo's Scienter*

The majority opinion first addressed the factual question of whether Lorenzo had acted with the necessary scienter required for a violation of the three of the securities fraud provisions in the SEC's charges.<sup>76</sup>

At the outset, Judge Srinivasan explained that the SEC Commission's "factual findings are conclusive if supported by substantial evidence . . . [which] we have repeatedly described . . . as a very deferential" standard.<sup>77</sup> The court then proceeded to explain why the SEC's findings on that point were supported by substantial evidence in the record. After observing that Lorenzo's testimony to the SEC included a number of conflicting statements regarding his mental state that are difficult to reconcile with one another, Judge Srinivasan states that "[t]he Commission justifiably credited his more inculpatory rendition of events."<sup>78</sup> In response to Lorenzo's procedural objection that the Commission's decision does not develop the factual record with sufficient specificity, Judge Srinivasan once again invokes the deferential posture of the D.C. Circuit's review, explaining that "we 'uphold a decision of less than ideal clarity if the agency's path may be reasonably discerned.'"<sup>79</sup> The majority opinion therefore leaves the fact-finding portion of the SEC Commission's decision fully intact.

#### b. *Misstatements Liability*

Judge Srinivasan's opinion then turned to the legal issue of Lorenzo's misstatements liability under Rule 10b-5(b), and whether Lorenzo's challenge that he did not "make" the statements in the email as that term is in-

---

76. *See id.* at 582–83 (citing *Dolphin & Bradbury, Inc. v. SEC*, 512 F.3d 634, 639 (D.C. Cir. 2008)) (setting forth the relevant standard for scienter).

77. *Id.* at 583 (internal quotations omitted).

78. *Id.* at 584 (stating further that "We perceive no basis for setting aside the Commission's conclusions as unsupported by substantial evidence.").

79. *Id.* at 585–86 (quoting *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983)).

terpreted in *Janus*.<sup>80</sup> In *Janus*, the Supreme Court held that an investment advisor firm—which had assisted in the preparation of prospectuses that were later issued to investors by a separate mutual fund entity on its own behalf—lacked primary liability under 10b-5(b) because the advisory entity did not itself make the statements therein.<sup>81</sup> As applied to the emails that were drafted and sent by Charles Vista, the D.C. Circuit found that Lorenzo played an ancillary role that was analogous to the advisory firm in *Janus*, and that it was the boss, Gregg Lorenzo, who exercised ultimate authority over the receipt of those statements by Rothe and Goolcharan.<sup>82</sup>

In departing from the SEC's contrary conclusion on this point, the D.C. Circuit emphasized that the Commission Decision relied on a single piece of Lorenzo's testimony, in which he referred to himself as the author of the emails but in a slightly equivocal manner.<sup>83</sup> Against that quasi-admission, Judge Srinivasan's opinion noted the multiple times that Lorenzo consistently testified to having done no more than "cut and paste[]" the email that Gregg Lorenzo drafted and then sending it out, as asked, "at the request of my superior."<sup>84</sup> The majority opinion also dismissed the significance which the SEC Commission attached to Lorenzo's name appearing on the emails, explaining that "[t]hat sort of signature line . . . can often exist when one person sends an email that 'publishes a statement on behalf of another.'"<sup>85</sup>

In summing up its analysis, the D.C. Circuit stated that Gregg Lorenzo had "ultimate authority over the substance and distribution of the emails: Gregg Lorenzo asked Lorenzo to send the emails, supplied the central content, and approved the messages for distribution."<sup>86</sup> The D.C. Circuit's reversal of the Commission on this point also motivates the *vacatur* of Lorenzo's sanctions that is announced at the close of its decision. The rationale, as Judge Srinivasan writes, is that the court has "no assurance that the Commission would have imposed the same level of penalties in the absence of its finding of liability for making false statements under Rule 10b-5(b)."<sup>87</sup>

80. See *id.* at 583–88 (comparing Lorenzo's activities to those in *Janus*).

81. See *Janus Capital Grp., Inc. v. First Derivative Traders*, 564 U.S. 135, 148 (2011).

82. See *Lorenzo*, 872 F.3d at 587 ("[W]e find that Lorenzo was not the 'maker' of the pertinent statements set out in the email messages he sent to potential investors, even viewing the record in the light most favorable to the Commission. . . . We cannot sustain the Commission's conclusion that Lorenzo had 'ultimate authority' over the false statements under *Janus*. Gregg Lorenzo, and not Lorenzo, retained ultimate authority.") (internal citations omitted).

83. See *id.* (explaining the basis of the SEC decision).

84. *Id.*

85. *Id.* at 588.

86. *Id.* at 587–89 (concluding that the person with ultimate authority "was Gregg Lorenzo, and not (or not also) Lorenzo").

87. *Id.* at 595.



c. *Scheme Liability*

The final portion of the D.C. Circuit’s substantive analysis is an extensive discussion of why the SEC Commission was correct to find Lorenzo liable for perpetrating a deceptive “scheme” under subsections (a) and (c) of Rule 10b-5.<sup>88</sup> More specifically, much of that discussion is directed at (rejecting) Lorenzo’s contention that—if he did not “make” any misleading statement for purposes of subsection (b), it logically follows that he cannot be liable for participating in a scheme to deceive the Charles Vista clients who received his emails.<sup>89</sup>

In support of its conclusion, Judge Srinivasan’s majority opinion argues that, although Lorenzo was not legally the maker of misstatements, he nonetheless played an active role in “producing” and “vouch[ing] for” the emails in the course of “directly” sending and “conveying” them to Waste2Energy’s investors.<sup>90</sup> Taking a largely textualist approach that focuses on the plain meaning of the language found in subsections (a) and (c)—which refers to “employing” an “artifice” or “device” and “engaging” in deceptive conduct<sup>91</sup>—the D.C. Circuit decision states that “Lorenzo’s conduct fits comfortably within the ordinary understanding of those terms,”<sup>92</sup> which “readily encompass[] [his] actions.”<sup>93</sup>

Judge Srinivasan also counters Lorenzo’s argument regarding the broader structure of Rule 10b-5. To that end, the majority opinion stakes out the view that the coverage of subsections relating to misstatements liability and scheme liability “may overlap in certain respects.”<sup>94</sup> The majority opinion further references a number of lower court opinions which, it argues, stand for the proposition that “securities-fraud allegations involving misstatements can give rise to liability under related provisions even if the conduct in question does not amount to ‘making’ a statement under *Janus*.”<sup>95</sup> Judge Srinivasan succinctly explains the nub of the D.C. Circuit’s ruling on scheme liability: “[w]e know of no blanket reason . . . to treat the various provisions [of Rule 10b-5] as occupying mutually exclusive territory, such

88. *See id.* at 588–95 (explaining why the court agreed with the SEC decision).

89. *See id.* at 590 (rejecting any argument that Lorenzo was not the maker of the e-mails).

90. *Id.* at 589–91.

91. *See supra* note 62 and accompanying text (quoting the three subsections of Rule 10b-5 in full).

92. *Lorenzo*, 872 F.3d at 589.

93. *Id.* at 590–91 (distinguishing Lorenzo’s conduct from that performed by the advisory firm in *Janus*, along with another recent Supreme Court case, *Stoneridge Invest. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148 (2008)).

94. *Id.* at 591 (citing *Chadbourne & Parke LLP v. Troice*, 571 U.S. 377 (2014)).

95. *Id.* at 592 (citing *SEC v. Big Apple Consulting USA, Inc.*, 783 F.3d 786, 795–96 (11th Cir. 2015); *SEC v. Monterosso*, 756 F.3d 1326, 1334 (11th Cir. 2014); *SEC v. Bengier*, 931 F.Supp.2d 904, 905–06 (N.D. Ill. 2013); *SEC v. Familant*, 910 F.Supp.2d 83, 93–95 (D.D.C. 2012); *SEC v. Stoker*, 865 F.Supp.2d 457, 464–65 (S.D.N.Y. 2012)).

that false-statement cases must reside exclusively within the province of Rule 10b-5(b).”<sup>96</sup>

## 2. *The Dissenting Opinion by Judge Kavanaugh*

Judge Kavanaugh’s dissent opens with the rhetorical engine running at full speed. Its headline conclusion: that Lorenzo should not be liable under any of the three subsections of Rule 10b-5 because he merely passed on a message from the boss to the clients.<sup>97</sup> Judge Kavanaugh then takes a shot at the excessive severity of Lorenzo’s sanction: “According to the SEC . . . in essence forwarding emails after being told to do so by your boss—warrants a *lifetime suspension* from the securities profession, on top of a monetary fine.”<sup>98</sup> The final target of the dissent’s prefatory remarks is the D.C. Circuit’s majority decision, which Judge Kavanaugh characterizes as “invoking a standard of deference that, as applied here, seems akin to a standard of ‘hold your nose to avoid the stink.’”<sup>99</sup>

The body of the dissent lays out an extensive line of argument in support of these claims, while also touching on larger themes about the proper relationship between federal courts and administrative adjudication. In literal dramatic fashion, Judge Kavanaugh gives his take on the full procedural history of the case, restating it in the form of a three-act play. “Act 1” of the dissent covers the ALJ decision, “Act 2” discusses the SEC Commission’s ruling on Lorenzo’s appeal from the ALJ, and “Act 3” turns to the majority opinion of Judge Srinivasan.

### a. *Act 1: The Administrative Law Judge: “Mens Rea 101”*

Judge Kavanaugh sets the stage for his drama by declaring that the proceedings before Lorenzo’s ALJ were “not your usual trial.”<sup>100</sup>

For starters, the dissent finds it “surprising[]” that the SEC did not adduce testimony from Gregg Lorenzo or anyone else besides Lorenzo at its hearing in September 2013.<sup>101</sup> Judge Kavanaugh then questions the ALJ’s interpretation of Lorenzo’s testimony to the SEC, stating that “[t]he administrative law judge’s factual findings and legal conclusions do not square up.”<sup>102</sup> According to the dissent, “[t]hose factual findings were very favorable to Lorenzo and should have cleared Lorenzo of any serious wrongdoing under the securities laws. At most, the judge’s factual findings may have shown some mild negligence on Lorenzo’s part.”<sup>103</sup> For Judge Ka-

---

96. *Id.* at 591.

97. *See id.* at 596–97 (Kavanaugh, J., dissenting).

98. *Id.*

99. *Id.* at 597.

100. *Id.*

101. *Id.*

102. *Id.*

103. *Id.*

vanaugh, there is really only one possible reading of the factual record for purposes of Lorenzo's scienter, calling it "*Mens Rea* 101" that "[i]f Lorenzo did not draft the emails, did not think about the contents of the emails, and sent the emails only at the behest of his boss, it is impossible to find that Lorenzo acted 'willfully.'"<sup>104</sup>

The dissent does not stop there. "The administrative law judge's decision in this case contravenes basic due process," it states, because "[a] finding that a defendant possessed the requisite *mens rea* is essential to preserving individual liberty."<sup>105</sup> And, by failing "*Scienter* 101," "[t]he administrative law judge's opinion in this case did not heed those bedrock *mens rea* principles."<sup>106</sup> Act 1 of the dissent closes by concluding that, "[g]iven the judge's pro-Lorenzo findings of fact, a legal conclusion that Lorenzo 'willfully' violated the securities laws makes a hash of the term 'willfully,' and of the deeply rooted principle that punishment must correspond to blameworthiness based on the defendant's *mens rea*."<sup>107</sup> As Act 1 makes apparent, Judge Kavanaugh sees much more hanging in the balance with Lorenzo's appeal than the technical niceties of securities law doctrine.

*b. Act 2: The SEC Commission: "So Much For A Fair Trial"*

The tone set in Act 1 does not let up for the remainder of the dissent. "Fast forward to the Securities and Exchange Commission," begins Act 2.<sup>108</sup> "Surely the Commission would realize that the administrative law judge's factual findings did not support the judge's legal conclusions and sanctions?"<sup>109</sup> Judge Kavanaugh's answer to his own question immediately follows:

And indeed, the Commission did come to that realization. But instead of vacating the order against Lorenzo, the Commission did something quite different and quite remarkable. In a Houdini-like move, the Commission rewrote the administrative law judge's factual findings to make those factual findings correspond to the legal conclusion that Lorenzo was guilty and deserving of a lifetime suspension.<sup>110</sup>

The Commission's rewrite of the ALJ's factual conclusions was unwarranted, according to the dissent, because the ALJ "reached those conclusions only after hearing Lorenzo testify and assessing his credibility in person."<sup>111</sup> Given the ALJ's closer proximity to the factual record, it was especially troubling that the Commission "simply swept the judge's factual

---

104. *Id.*

105. *Id.* at 598 (citing *Morissette v. United States*, 342 U.S. 246 (1952)) (emphasis added).

106. *Id.* (emphasis added).

107. *Id.* (emphasis added).

108. *Id.*

109. *Id.*

110. *Id.*

111. *Id.*

and credibility findings under the rug.”<sup>112</sup>

The dissent’s stinging final assessment of the Commission’s performance on the question of Lorenzo’s scienter is also worthy of a quotation in full. As Judge Kavanaugh writes:

The Commission’s handiwork in this case is its own debacle. Faced with inconvenient factual findings that would make it hard to uphold the sanctions against Lorenzo, the Commission—without hearing any testimony—simply manufactured a new assessment of Lorenzo’s credibility and rewrote the judge’s factual findings.<sup>113</sup>

The closing remark for Act 2: “So much for a fair trial.”<sup>114</sup>

*c. Act 3: The Majority Opinion: Falling for the SEC’s “Legal Fujitsu”*

Act 3 opens peaceably enough. “Fast forward to this Court. To its credit . . . the majority opinion . . . vacates the grossly excessive lifetime suspension of Lorenzo and sends the case back to the SEC for reconsideration of the appropriate penalties. So far, so good.”<sup>115</sup> Then things quickly take a more critical turn. The dissent identifies two separate grounds for its disagreement with Judge Srinivasan’s majority opinion.

First, Judge Kavanaugh parts ways with the majority’s ruling on the question of scienter. The main critique here is that the “majority opinion does not heed the administrative law judge’s factual conclusions,” and instead “relies on the SEC’s alternative facts, which the SEC devised on its own without hearing from any witnesses.”<sup>116</sup> This represents a mistaken application of administrative law doctrine, the dissent argues, because “an agency does not have carte blanche to rewrite an administrative law judge’s factual determinations. Rather, an agency must act reasonably when it disregards an administrative law judge’s factual findings.”<sup>117</sup> The D.C. Circuit’s decision therefore conflicts with what Judge Kavanaugh describes as a black-letter law principle on this point, since “the SEC had no reasonable basis to run roughshod over the administrative law judge’s findings of fact and credibility assessments.”<sup>118</sup> In an allusion to the “very deferential” standard of review adopted by Judge Srinivasan’s majority opinion, the dissent’s rebuttal on scienter closes by stating in pointed fashion that the SEC’s exercise of discretion in that respect “deserves judicial repudiation, not ju-

112. *Id.*

113. *Id.* at 598–99.

114. *Id.* at 599.

115. *Id.*

116. *Id.*

117. *Id.* at 599–600 (citing RONALD M. LEVIN & JEFFREY S. LUBBERS, ADMINISTRATIVE LAW AND PROCESS: IN A NUTSHELL 101 (6th ed. 2017)) (explaining that “here is the key principle that speaks directly to this case: ‘When the case turns on eyewitness testimony . . . the initial decision should be given considerable weight: the ALJ was able to observe the demeanor of the witnesses and assess their credibility and veracity first hand.’”).

118. *Id.* at 600.

dicial deference or respect.”<sup>119</sup>

Second, the dissent disagrees with the majority opinion’s application of the scheme liability provisions in Rule 10b-5. Judge Kavanaugh asserts that the D.C. Circuit’s decision “creates a circuit split by holding that mere misstatements, standing alone, may constitute the basis for so-called scheme liability.”<sup>120</sup> The consensus among other circuit courts of appeals, as understood in the dissent, is that “scheme liability must be based on conduct that goes beyond a defendant’s role in preparing misstatements or omissions made by others.”<sup>121</sup> Requiring that such conduct takes place is important, Judge Kavanaugh writes, because “[o]therwise, the SEC would be able to evade the important statutory distinction between primary and secondary (aiding and abetting) liability.”<sup>122</sup>

Moving beyond the immediate misapplication of Rule 10b-5 that Judge Kavanaugh sees in the majority opinion, the dissent goes on to place a large part of the blame for that alleged legal error at the feet of the SEC. In fact, the dissent argues that *Lorenzo* is but the latest attempt of the SEC to distort the coherence of securities regulation jurisprudence on a more or less wholesale basis. The complete bill of particulars is this:

The distinction between primary and secondary liability matters, particularly for private securities lawsuits. For decades, however, the SEC has tried to erase that distinction so as to expand the scope of primary liability under the securities laws. For decades, the Supreme Court has pushed back hard against the SEC’s attempts to unilaterally rewrite the law. . . . Still undeterred in the wake of that body of Supreme Court precedent, the SEC has continued to push the envelope and has tried to circumvent those Supreme Court decisions. . . . I agree with the other courts that have rejected the SEC’s persistent efforts to end-run the Supreme Court. I therefore respectfully disagree with the majority opinion[.]<sup>123</sup>

Thus, from a bigger picture perspective on the scheme liability issue in *Lorenzo*, Judge Kavanaugh’s dissent paints the D.C. Circuit as an unwitting victim of SEC’s trademark “kind of legal jujitsu.”<sup>124</sup>

Judge Kavanaugh’s final point concerns a critique about administrative adjudication in general, and is emblematic of his overall theory about the administrative state.<sup>125</sup> He acknowledges that the agency-centric process is in tension with the due process clause and the right to a jury trial.<sup>126</sup> He

119. *Id.* at 599–600.

120. *Id.* at 600.

121. *Id.* at 600–01 (citing *Pub. Pension Fund Grp. v. KV Pharm. Co.*, 679 F.3d 972, 987 (8th Cir. 2012); *WPP Luxembourg Gamma Three Sarl v. Spot Runner, Inc.*, 655 F.3d 1039, 1057 (9th Cir. 2011); *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 177 (2d Cir. 2005)).

122. *Id.* at 601.

123. *Id.* (internal citations omitted).

124. *Id.*

125. *See infra* Section I.C.2.

126. *Lorenzo*, 872 F.3d at 602.

writes, “[t]hat tension is exacerbated when, as here, the agency’s political appointees—without hearing from any witnesses—disregard an administrative law judge’s factual findings.”<sup>127</sup> Because of this structural setup, Judge Kavanaugh asserts, Lorenzo, though he may not “tug at the judicial heart-strings” nevertheless did not receive a fair process.<sup>128</sup>

\*\*\*

Judge Kavanaugh’s presentation of his dissent in the mold of a tragic drama may appear to be a bit over-stylized for a judicial opinion. But it is also revealing of his overall attitude toward the case. As the dissenting opinion clearly reflects, this is not merely a series of objections about obscure matters of securities regulation doctrine. Instead, it would be fair to say that Judge Kavanaugh views *Lorenzo* as a familiar, worrying tale of judicial abdication (Act 3) in the face of bureaucratic malfeasance (Acts 1 & 2). The dramatic format is his vehicle for telling the tale. As will be shown, that narrative is not specific to the idiosyncratic facts of *Lorenzo*. Rather, Judge Kavanaugh’s rebuke of the ALJ process, the SEC, and the majority opinion in his dissent is a microcosm of his signature critique of the current state of the law as a whole.<sup>129</sup>

### III. SECURITIES FRAUD UNDER RULE 10B-5 AFTER *LORENZO*

In order to avoid sitting in judgment of his own lower court decision, Justice Kavanaugh formally recused himself from the case on October 19. Thus, an initial curiosity of *Lorenzo* arises from the obvious procedural complications that an eight-Justice vote entails.

More substantively, another interesting aspect of the case is that it may be resolved on any number of grounds, and it is far from clear at this point which of those the Court will choose. Perhaps the most straightforward option is to simply uphold the D.C. Circuit’s decision in full, according to the same rationale as was articulated in Judge Srinivasan’s majority opinion. But a wide menu of plausible alternative rulings remains, many of which are previewed in the multi-pronged critique served up in Judge Kavanaugh’s dissent. As detailed below, the various alternate grounds for resolving *Lorenzo* which appear in that dissent fall along a spectrum, from relatively narrow to aggressive and sweeping. The future of securities fraud doctrine under Rule 10b-5 hinges on whether any of those theories are well-received by the other eight Justices at the Court.

This Section analyzes the road to a Supreme Court decision in *Lorenzo* and the case’s broader significance for the law of securities fraud. Part A reviews arguments that the parties have thus far presented to the Court in

---

127. *Id.*

128. *Id.*

129. *See infra* Section I.

their briefing on Lorenzo's *Petition for a Writ of Certiorari* (Cert Petition). Part B surveys the possible legal theories that the Court may rely upon in order to resolve the case. Part C closes with some speculation as to what the outcome of *Lorenzo* may be when the Court issues its decision in 2019.

#### A. *The Parties' Briefing to the Supreme Court*

One of the best indicators of the path that the Court may take in resolving *Lorenzo* can be found in the parties' own briefings of the case to the Justices, particularly Lorenzo's Cert Petition.<sup>130</sup> Presumably, the Court selected the case from its vast pool of annual cert petitions because at least four of the Justices found one of the legal questions presented in that briefing to be compelling.<sup>131</sup> A review of those briefs is therefore a key entry point for identifying the parameters of debate when the case is heard by the Court.

Lorenzo's opening brief in support of his petition to the Court frames the legal question on appeal in the following terms:

The question presented is whether a misstatement claim that does not meet the elements set forth in *Janus* can be repackaged and pursued as a fraudulent scheme claim. The Circuits have split 3-2 on this question. The Second, Eighth and Ninth Circuits have held that a misstatement alone cannot be the basis of a fraudulent scheme claim, while the DC Circuit and the Eleventh Circuit have held that a misstatement standing alone can be the basis of a fraudulent scheme claim.<sup>132</sup>

Although this language highlights the presence of a circuit split, Lorenzo's petition is more about the split within the D.C. Circuit in his case, between Judge Srinivasan's majority opinion and Judge Kavanaugh's dissent. In fact, the Cert Petition references Judge Kavanaugh, or otherwise cites to his dissent, on no less than seventeen occasions.<sup>133</sup> As its extensive reliance on that dissent makes clear, the grounds for petitioning the Supreme Court are essentially one and the same as the grounds for reversing the SEC Commission, which Judge Kavanaugh laid out in the court of appeals.

Lorenzo's briefing first repeats Judge Kavanaugh's contention that the D.C. Circuit erred in finding Lorenzo's conduct satisfied the standard for

---

130. See generally *Petition for a Writ of Certiorari, Lorenzo v. SEC*, No. 17-1077 (U.S. Jan. 26, 2018) [hereinafter *Cert. Pet.*]; *Brief for Respondent in Opposition, Lorenzo*, No. 17-1077 (U.S. May 2, 2018) [hereinafter *SEC Cert. Opp.*]; *Reply Brief for Petitioner in Support of Petition for a Writ of Certiorari, Lorenzo*, No. 17-1077 (U.S. May 23, 2018) [hereinafter *Lorenzo Reply* iso *Cert. Pet.*].

131. See Adam Bonica, Adam Chilton, & Maya Sen, *The "Odd Party Out" Theory of Certiorari* 4-9 (Oct. 19, 2018) (unpublished paper) (on file with authors), <https://www.law.umich.edu/centersandprograms/lawandeconomics/workshops/Documents/Paper%209.%20Adam%20Chilton.%20The%20%27Odd%20Party%20Out%27%20Theory%20of%20Certiorari.pdf> (providing a survey of common explanations for what motivates the Court's cert decisions).

132. *Cert. Pet.*, *supra* note 130, at i.

133. *Id.* at 5, 5 n.1, 9 (twice), 10 (twice), 11 (four times), 12 (five times), 13, & 28.

scheme liability under Rule 10b-5(a) and (c).<sup>134</sup> The Cert Petition further argues that the scope of scheme liability for securities fraud is an important question for the Court to address more generally by expanding on the assertion, proposed in Judge Kavanaugh's dissent, that there is a split among the circuit court of appeals on this point.<sup>135</sup> According to Lorenzo, one side of that split consists a "majority view," espoused by the Second, Eighth, and Ninth Circuit, which holds that scheme liability requires conduct beyond the mere making of misstatements that would otherwise trigger liability under Rule 10b-5(b).<sup>136</sup> On the other side is a "minority view," embraced by both the Eleventh Circuit and, after Judge Srinivasan's opinion, the D.C. Circuit.<sup>137</sup> Lorenzo's briefing also picks up on the claim in Judge Kavanaugh's dissent that his treatment within the agency adjudicatory system was so procedurally flawed that it violated his due process rights.<sup>138</sup> Finally, the Cert Petition closes by suggesting that the SEC would be standing on much firmer legal ground had it chosen to charge him for aiding and abetting the frauds of Charles Vista under Section 20(e) of the Exchange Act, rather than pursuing a theory of primary liability under Rule 10b-5.<sup>139</sup>

The SEC's opposition briefing to the Court closely tracks the rationale provided in Judge Srinivasan's majority opinion.<sup>140</sup> On the question of scienter, it focuses on Lorenzo's ambiguous testimony to the ALJ, and argues that he later "disavowed" the more exculpatory aspects of those statements in his appellate briefing to the D.C. Circuit.<sup>141</sup> The SEC defends the view

134. *Id.* at 23–32 (claiming that "[t]he DC Circuit's [d]ecision is [w]rong").

135. *Id.* at 13–14 (alleging a circuit split); *id.* at 21–23 (explaining why that circuit split is a significant source of confusion for the lower courts and arguing that Lorenzo's case presents "an ideal vehicle to resolve the circuit split").

136. *Id.* at 17–20 (citing *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 177 (2d Cir. 2005); *SEC v. Kelley*, 817 F. Supp. 2d 340, 343–44 (S.D.N.Y. 2011); *WPP Luxembourg Gamma Three Sarl v. Spot Runner, Inc.*, 655 F.3d 1039 (9th Cir. 2011); *Desai v. Deutsche Bank Sec., Ltd.*, 573 F.3d 931, 939 (9th Cir. 2009)).

137. *Id.* at 20–21 (citing *SEC v. Big Apple Consulting USA, Inc.*, 783 F.3d 786 (11th Cir. 2015); *SEC v. Monterosso*, 756 F.3d 1326, 1334 (11th Cir. 2014)).

138. *See Lorenzo Reply iso Cert. Pet.*, *supra* note 130, at 7–8 (citing *Lorenzo* and quoting dissenting opinion of Judge Kavanaugh).

139. *Cert. Pet.*, *supra* note 130, at 27–28 ("While Lorenzo would have factual defenses to an SEC action for aiding and abetting, such a claim would not have raised any of the problematic legal questions that are the subject of this petition.").

140. *SEC Cert. Opp.*, *supra* note 130, at i ("Question Presented: Whether, in an enforcement proceeding brought by the Securities and Exchange Commission, a person who knowingly disseminates false or misleading statements in connection with a securities transaction can be found to have violated Section 17(a)(1) of the Securities Act of 1933, 15 U.S.C. 77q(a)(1) (2006); Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b) (2006); and Rule 10b-5(a) and (c), 17 C.F.R. 240.10b-5(a) and (c), even if the person does not 'make' false or misleading statements for purposes of Rule 10b-5(b), 17 C.F.R. 240.10b-5(b).").

141. *See id.* at 15–16.



that the D.C. Circuit's decision does not undermine the Court's opinion in *Janus*, as Lorenzo claims, but rather is entirely consistent with the holding in that case.<sup>142</sup> The heart of the SEC's argument, however, is that the D.C. Circuit got the relationship between scheme and misstatement liability right. In doing so, it follows Judge Srinivasan's conclusion that Lorenzo's conduct "fits comfortably within the ordinary understanding" of Rule 10b-5, and further explains why a finding of liability is supported by the background history and purpose of the rule's prohibition on securities fraud.<sup>143</sup> A final theme of the SEC's briefing is to emphasize the overlap between the three subsections of Rule 10b-5 and to provide further support for Judge Srinivasan's point that those provisions do not occupy "mutually exclusive territory."<sup>144</sup>

The SEC's briefing also presents a number of arguments to the effect that, aside from the merits of *Lorenzo*, the case is a poor vehicle for courts to weigh in with its interpretation of Rule 10b-5. First, the SEC argues that, regardless of how the scienter issue should be decided, it is a minor, fact-specific question that does not warrant the Court's review.<sup>145</sup> Second, the SEC claims that the circuit split which Lorenzo's petition attempts to draw out is either non-existent or greatly overstated.<sup>146</sup> Third, the SEC pushes back on the Cert Petition's assertion that the D.C. Circuit's *Lorenzo* decision "will open the door to private suits"—by identifying a number of heightened procedural hurdles that apply to private securities plaintiffs which seek to plead a claim under Rule 10b-5.<sup>147</sup> Lastly, the SEC claims that the

---

142. *Id.* at 13–14 (discussing *Janus*).

143. *See id.* at 9 (citing *Lorenzo v. SEC*, 872 F.3d 578, 589 (D.C. Cir. 2017)). The brief also cites several Supreme Court cases that note that the plain meaning of Rule 10b-5's text controls its interpretation and that the history and purpose of Rule 10b-5 favors a broad interpretation of its provisions. *See id.* at 10.

144. *Id.* at 11–12 (quoting Judge Srinivasan and citing other precedent to show that the SEC has not always "explicitly distinguish[ed] between subsections [when] finding violations of Rule 10b-5").

145. *Id.* at 16 ("In any event, a fact-specific dispute about the adequacy of the mental-state evidence in this case would not present any question of general importance warranting this Court's review.").

146. *Id.* at 8 ("Petitioner also contends that the courts of appeals are divided over whether conduct like his is actionable under the securities laws. But petitioner does not identify any conflict over the scope of liability under Section 17(a)(1).") (internal citations omitted); *id.* at 17–18 ("With respect to [the alleged circuit split over] Section 10(b) and Rule 10b-5(a) and (c) . . . all the cases that petitioner cites were initiated by private plaintiffs rather than by the Commission. That distinction is significant because different statutory and other standards govern private securities-fraud actions."); *id.* at 17 ("Petitioner identifies no sound reason to believe that any other circuit would have reached a different result under the circumstances presented here.").

147. *Id.* at 16–19 (explaining that these include heightened pleading standards set forth in the Private Securities Litigation Act of 1995 (PSLRA), along with additional elements that private litigants must plead in order to state a claim, such as reliance and loss causation); *see*

Court's review of the case would be inappropriate in light of what it describes as the interlocutory status of Lorenzo's appeal: technically, Lorenzo's case before the Commission is still ongoing, since the D.C. Circuit ordered the *vacatur* and reconsideration of his administrative sanctions, which have yet to be finalized.<sup>148</sup>

Despite the SEC's best efforts in its briefing, the Court granted Lorenzo's petition on June 18, 2018.<sup>149</sup> As of the time of this writing, the Court's review of the case is more or less complete. Oral argument was held at the Court before the eight presiding Justices on December 3.<sup>150</sup> A decision must be handed down, at latest, by the close of the Court's October 2018 Term on June 20, 2019.<sup>151</sup>

### B. Potential Legal Resolutions

The D.C. Circuit's decision can be summarized as turning on three central components: (1) the conclusion that Lorenzo did not "make" the misstatements at issue for purposes of fraud liability under Rule 10b-5(b), as determined by application of the "ultimate authority" test announced in *Janus*; (2) a determination that Lorenzo's emailing of those misstatements is conduct sufficient to satisfy the requirements for scheme liability under Rule 10b-5(a),(c); and (3) a finding that Lorenzo acted with the requisite scienter for liability under those same scheme liability provisions.<sup>152</sup> The Court's disposition of this trio of issues effectively covers the full range of possible legal resolutions to *Lorenzo*.

#### 1. Scenario #1: Agency Fact-Finding Under the Microscope

Perhaps the most limited grounds for reversing the D.C. Circuit would be to follow the line of reasoning in Judge Kavanaugh's dissent which argued that the SEC simply failed to meet its burden of proof as to whether Lorenzo knowingly or even recklessly defrauded Waste2Energy's investors

also Private Securities Litigation Act of 1995, Pub. L. No. 104-67, 109 Stat. 739 (codified as amended at 15 U.S.C. § 78u-4 (2012)); *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 152-54 (1972) (providing an early articulation of the reliance elements); *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 342 (2005) (discussing the "economic loss" and "loss causation" pleading requirements for private securities fraud plaintiffs).

148. Cert. Pet., *supra* note 130, at 20.

149. Order Granting Certiorari, *supra* note 14.

150. Marcia Coyle, *Brett Kavanaugh Recuses From Three Upcoming SCOTUS Arguments*, THE NAT'L L.J. (Oct. 19, 2018), <https://www.law.com/nationallawjournal/2018/10/19/brett-kavanaugh-recuses-from-three-upcoming-scotus-arguments/?slreturn=20181017150354> (explaining that Justice Kavanaugh will sit out of three cases, including *Lorenzo v. SEC*).

151. See *Search Results: No. 17-1077*, U.S. SUP. CT., <https://www.supremecourt.gov/search.aspx?filename=/docket/docketfiles/html/public/17-1077.html> (last visited Feb. 27, 2019).

152. See *supra* Section I.C.1.

when sending his two emails.<sup>153</sup> As the SEC intimates in its cert petition briefing, if the Court were to take such an approach, it would not really be opining on any open *legal* question concerning Rule 10b-5—or anywhere else in securities law.<sup>154</sup> Instead, it would be eyeballing a (admittedly intriguing) set of facts and agreeing whether or not they reflect a subjective intent to deceive on Lorenzo’s part. Although the D.C. Circuit could be overturned as a result, not much of that eyeballing exercise would be transferrable to other securities regulation disputes going forward.

Yet the scienter issue may also be resolved on a number of further grounds that are by no means narrow. On a more fundamental level, the SEC’s determination implicates the allocation of fact-finding authority among frontline ALJs and higher rungs of the agency hierarchy. Contrary to the standard procedure in federal court, the relevant appellate body within an agency has discretion to substitute its own findings of fact for that of the ALJ.<sup>155</sup> And in *Lorenzo*, the SEC Commission leveraged its authority to do just that.<sup>156</sup> But, as Judge Kavanaugh’s dissent contends, there may be circumstances where a departure from the black letter standard of unfettered discretion is recognized as inappropriate.<sup>157</sup> Thus, should the Court wade into a revision of the D.C. Circuit’s conclusion regarding scienter, it need not restrict itself to the factual dimensions of that question. It could also intervene either for or against Judge Kavanaugh’s interpretation on this broader issue of ALJ fact-finding relating to witness credibility.

The import of Judge Kavanaugh’s dissent for the Court’s resolution on Lorenzo’s scienter does not stop there. An even weightier issue turns on the degree of deference that federal courts of appeal must grant administrative fact-finding, whether by an ALJ or by the agency’s higher-level reviewing authority.<sup>158</sup> As Judge Srinivasan’s majority opinion recognizes, the “substantial evidence” standard that applies in those contexts represents one of the more deferential forms of judicial review vis-à-vis agency action that

---

153. See *Lorenzo v. SEC*, 872 F.3d 578, 596 (D.C. Cir. 2017) (Kavanaugh, J., dissenting).

154. See SEC Cert. Opp., *supra* note 130, at 16.

155. See Administrative Procedure Act, 5 U.S.C. § 557(b) (2012); *Universal Camera Corp. v. NLRB*, 340 U.S. 474, 492 (1951); cf. KEITH WERHAN, *PRINCIPLES OF ADMINISTRATIVE LAW* 223–25 (2d ed. 2014) (providing an overview of administrative review of ALJ decisions, including review of findings of fact).

156. See *Lorenzo*, 872 F.3d at 593.

157. See *id.* at 599–600 (Kavanaugh, J., dissenting). Notably, internal agency guidance at the SEC already places some modest, self-imposed limits on the circumstances in which the Commission is able to set aside factual findings of the ALJ. See SEC R. PRAC. 411(a), (d) (2018); see also Bandimere, Exchange Act Release No. 33-9512, 108 SEC Docket 4 (Jan. 16, 2014) (discussing the application of Rule 411).

158. See *Lorenzo*, 872 F.3d at 593 (explaining why this is a separate question and arguing that it has not been properly raised on appeal by Lorenzo).

appears in administrative law.<sup>159</sup> Thus, by proposing to overturn the SEC's finding of scienter, Judge Kavanaugh's dissent is also indirectly inviting the Court to reassess the bounds of the substantial evidence standard. If it were to take up that invitation, the Court would be announcing that the standard is not so unbendingly deferential as may often be thought.

Lastly, and most broadly of all, Judge Kavanaugh's dissent casts doubt on the procedural mechanisms that generated the SEC's *scienter* conclusion in the first place. For example, with skepticism over the way that the SEC conducted Lorenzo's hearing, which, as the Cert Petition highlights, Judge Kavanaugh interpreted as a contravention of "basic due process."<sup>160</sup> This essentially raises the legitimacy of agency adjudication—full stop. Typically, the use of such rhetoric in an appellate brief could be brushed aside as a detour into hyperbole. But that is not the case in light of the Court's recent decisions, in particular *Lucia v. SEC*,<sup>161</sup> decided just last term.<sup>162</sup> In *Lucia*, the Court held the SEC's entire ALJ apparatus to be unconstitutional, albeit for slightly technical reasons relating to procedural irregularities in the ALJ appointment process.<sup>163</sup> Given Judge Kavanaugh's dissent, *Lorenzo* might be seen as a vehicle to extend the constitutional inquiry ventured in *Lucia* to other basic aspects of the administrative adjudicatory process.<sup>164</sup>

---

159. Administrative Procedure Act § 706(2)(E); *Universal Camera*, 340 U.S. at 478–79; see also Securities Exchange Act of 1934, 15 U.S.C. § 78y(a)(4) (2012) (providing that the Commission's findings of fact are to be reviewed by federal courts pursuant to a substantial evidence standard); cf. RICHARD J. PIERCE, JR., *ADMINISTRATIVE LAW* 40–42 (2d ed. 2012) (providing an overview of the substantial evidence standard). Technically, the decision of the SEC to substitute its own findings of fact (apart from than the findings themselves) is reviewable on appeal in federal courts under a distinct, arbitrary and capricious standard. Administrative Procedure Act § 706(2)(A) (providing governing legal standard for arbitrary and capriciousness review); see also *Motor Vehicles Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (articulating a leading judicial gloss on the APA's statutory language for arbitrary and capricious review); *Citizens to Pres. Overton Park, Inc. v. Volpe*, 401 U.S. 402, 413–14 (1971) (same). But the two standards do not differ much, or at all, as applied in practice. See *Ass'n of Data Processing Serv. Orgs. v. Bd. of Governors*, 745 F.2d 677, 683–84 (D.C. Cir. 1984) (holding that judicial review under a substantial evidence or arbitrary and capricious test is functionally the same).

160. See Cert. Pet., *supra* note 130, at 12.

161. 138 S. Ct. 2044 (2018).

162. See, e.g., *id.*

163. *Id.* at 2055 (holding that the selection of SEC ALJs is inconsistent with requirements set forth in of the Appointments Clause found in U.S. CONST. art. II, § 2, cl. 2).

164. Cf. Christopher J. Walker, *Constitutional Tensions in Agency Adjudication*, 104 IOWA L. REV. (forthcoming 2019) (surveying a number of open questions in that area); John Gibbons, *Why Judicial Deference to Administrative Fact-Finding Is Unconstitutional*, 2016 BYU L. REV. 1485, 1487 (2017) (providing a skeptical view on the constitutionality of agency adjudication).

## 2. Scenario #2: The Janus “Ultimate Authority” Test Revisited

A pervasive view in the early commentary on *Lorenzo* seems to be that it has teed up a dramatic replay of *Janus*.<sup>165</sup> However the relevance of *Janus* is not as straightforward as it may appear at first glance. For one, Justice Thomas’s opinion for the majority in that case does not discuss the relationship between scheme liability and misstatement liability that ultimately drove a wedge between the D.C. Circuit panel in *Lorenzo*.<sup>166</sup> Moreover, both sides of the D.C. Circuit decision are in full agreement that the SEC committed reversible legal error for its failure to properly apply the “ultimate authority” test articulated in *Janus*.<sup>167</sup> That said, there are a few approaches that the Court could take in *Lorenzo* which would allow its review of the D.C. Circuit to become an occasion for reaffirming, extending, or cutting back on the ruling in *Janus*.

One possibility is a partial reversal of the D.C. Circuit’s decision, based on a determination that *Lorenzo* did in fact “make” the false statements at issue. The most direct way to do so would be to embrace some version of the alternative test proposed by Justice Breyer’s dissent in *Janus*, which suggested that the “specific relationships alleged among” the parties associated with a false statement should provide the relevant basis for evaluating which actor or actors “made” it.<sup>168</sup> But even taking the “ultimate authority” test in *Janus* as a given, dicta in Justice Thomas’s majority opinion, which provides a gloss on that test, maps awkwardly onto the facts in *Lorenzo*. The underlying problem is that—despite prefatory language which states that the ultimate authority test applies to both “persons or entities”—the way that test is fleshed out feels tailored to the financial firms at issue in *Janus* and does not necessarily fit with cases where natural persons are charged for making a false statement rather than legal entities.<sup>169</sup>

---

165. See, e.g., Daphne Morduchowitz et al., *Awaiting Supreme Court Clarification on Fraudulent Scheme Claims*, HARV. L. SCH. F. ON CORP. GOV’T. & FIN. REG. (July 20, 2018), <https://corpgov.law.harvard.edu/2018/07/20/awaiting-supreme-court-clarification-on-fraudulent-scheme-claims/> (“The Supreme Court’s decision to review this case implicates the scope and applicability of its decision in *Janus*[.]”); Roger Cooper et al., *Lorenzo v. SEC: Will High Court Further Curtail Rule 10b-5?*, LAW360 (July 18, 2018), <https://www.law360.com/articles/1064288>.

166. Indeed, at no point in that opinion is there an acknowledgement that such a distinction exists, or that Rule 10b-5 contains multiple subsections. See *Janus Capital Grp., Inc. v. First Derivative Traders*, 564 U.S. 135, 137–38 (2018) (“Rule 10b-5 prohibits ‘making any untrue statement of a material fact’ in connection with the purchase or sale of securities. 17 CFR § 240.10b-5 (2010).”)

167. See *Lorenzo v. SEC*, 872 F.3d 578, 580, 599 (D.C. Cir. 2017).

168. See *Janus*, 564 U.S. at 158 (Breyer, J., dissenting) (setting forth the four dissenting Justices’ proposed alternative test); see also *id.* at 144 (majority opinion) (identifying another candidate being the test put forward by the SEC in *Janus*, which proposed that whoever is responsible for “creating” a statement has also “made” it).

169. *Id.* at 142 (explaining that the Court’s reading of “make” in Rule 10b-5(b) applies

For example, *Janus* mentions how the advisory firm's participation in the mutual fund's misleading securities filings went "undisclosed" in those documents.<sup>170</sup> By contrast, Lorenzo's role as liaison and contact person for the Waste2Energy debt offering was explicitly disclosed in the emails he sent.<sup>171</sup> Furthermore, the *Janus* opinion states that an inherent feature of any actor who exercises "ultimate authority" over a false statement is that they also serve a "necessary or inevitable" role in its dissemination to third parties.<sup>172</sup> Yet arguably, the false statements issued on behalf of Charles Vista would not necessarily have reached a single client but-for the intervening fact that Lorenzo personally decided to send them. Therefore, in the Court's disposition of *Lorenzo*, the scope of misstatement liability could be broadened at the margins. Specifically, by interpreting the "ultimate authority" test in *Janus* so that it covers a larger population of statement "makers" than may have been envisioned by either of the D.C. Circuit opinions below.

The other possibility, of course, would be for the Court to uphold the D.C. Circuit's determination that Lorenzo cannot be held liable for "making" any false statement under *Janus*. This too would have relevance for the reach of securities fraud enforcement under Rule 10b-5 by consolidating the holding of *Janus*, which was otherwise a contested and controversial 5-4 decision.<sup>173</sup> In the process, the Court might also add further substance to the "ultimate authority" test, with dicta that provides more guidance about who wields that authority in the intra-firm context (where multiple individuals may be considered plausible candidates for securities liability due to their involvement in the making of a misstatement).<sup>174</sup> This would modestly expand the ambit of *Janus*, by expressly extending its logic to am-

---

to "person[s] or entit[ies]" with ultimate control over the content of a statement).

170. *Id.* at 145; see also *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 152-54 (2008) (focusing as well on the significance of a party being disclosed in connection with a false statement).

171. See *supra* Section I.A. (describing the factual context for Lorenzo's emails).

172. *Janus*, 564 U.S. at 144 ("Without such [ultimate] authority, it is not 'necessary or inevitable' that any falsehood will be contained in the statement.").

173. *Id.* at 158 (Breyer, J., dissenting) ("In sum, I can find nothing in § 10(b) or in Rule 10b-5, its language, its history, or in precedent suggesting that Congress, in enacting the securities laws, intended a loophole of the kind that the majority's rule may well create."); see also Donald C. Langevoort, *Lies Without Liars? Janus Capital and Conservative Securities Jurisprudence*, 90 WASH. U. L. REV. 933, 934 (2013) (asserting that *Janus* has left both legal scholars and practitioners with the task of analyzing how the *Janus* majority "so confidently came to the conclusion that Rule 10b-5 means otherwise"); C. Steven Bradford, "Make" Means "Make": Rejecting the Fourth Circuit's Two-Headed Interpretation of *Janus Capital*, 68 SMU L. REV. 645, 646, 648 (2012) (reviewing the lower courts' reception of the *Janus* decision and the complications in applying its holding).

174. For instance, in affirming the D.C. Circuit, the Court could further explain that—while Lorenzo held a nominally authoritative title (as Vice President of Investment Banking)—mid-level personnel should never be construed as "makers" of fraudulent statements when acting in their capacities as subordinates to more senior decisionmakers at the firm.

biguous circumstances which may not have otherwise been recognized in the lower courts or the SEC's enforcement division.<sup>175</sup>

### 3. Scenario #3: Scheme Liability Versus Misstatement Liability

The most direct route to an impactful ruling on the scope of securities fraud that *Lorenzo* presents the Court is to clarify the distinction, or lack thereof, between Rule 10b-5's provisions on scheme liability (subsections (a) and (c)) and misstatements liability (under subsection (b)).<sup>176</sup> While Judge Kavanaugh's dissent parts ways with the majority opinion regarding *Lorenzo's* scienter, that is a dispute over either a question of fact or a legal issue relating to administrative procedure. And on the application of the ultimate authority test set forth in *Janus* to the SEC's claim under subsection (b), the majority and dissent are in full accord. But the relationship between scheme and misstatement liability is a foundational question of securities law, and one that drives much of the disagreement in the D.C. Circuit panel's decision.

#### a. The Scope of Scheme Liability

One entry point on this issue is an assertion in Judge Srinivasan's majority opinion, which suggests that there is either a complete or near-complete consensus among the lower federal courts over the scope of scheme liability.<sup>177</sup> More specifically, according to the D.C. Circuit, the consensus is that scheme liability covers an expansive set of conduct that may include actions which are also covered by the prohibition on misleading statements in subsection (b).<sup>178</sup> Judge Kavanaugh pushes back on both prongs of that argument in his dissent. But the majority's framing of the relevant legal authority is mainly problematic because it is unhelpful, even if correct. Although the existence of at least partial overlap between scheme and misstatement liability is well-established,<sup>179</sup> that observation does not resolve the legal questions raised by the facts of *Lorenzo*. Instead, the dispositive issue is whether the overlap among Rule 10b-5's provisions is nearly complete or generally limited and incidental.

A review of the case law indicates that there is a genuine split among the

---

175. See GRACE A. CARTER ET AL., PAUL HASTINGS LLP, WHAT *JANUS* MEANT: THE FIRST WAVE OF COURT DECISIONS INTERPRETING THE SUPREME COURT'S "ULTIMATE AUTHORITY" TEST IN SECURITIES CASES, (Dec. 2011) (surveying how *Janus* has been received in the lower courts); cf. *In re James J. Pasztor*, 54 S.E.C. 398, 406–07, 411–13 (1999) (finding multiple individuals liable for the same underlying misstatement); *In re Charles K. Seavey*, 56 S.E.C. 357, 364–65, 368 (2003), *aff'd*, 111 F. App'x 911 (9th Cir. 2004) (same).

176. See *supra* note 62 and accompanying text (quoting Rule 10b-5 in full).

177. See *Lorenzo v. SEC*, 872 F.3d 578, 591–92 (D.C. Cir. 2017).

178. *Id.*

179. *SEC v. Nat'l Sec., Inc.*, 393 U.S. 453, 468 (1969) (explaining how there is "some overlap" among the prohibitions set forth in the three subsections of Rule 10b-5).

circuit courts on that question, which Lorenzo's Cert Petition labels as the "majority" and "minority" view.<sup>180</sup> One court for the so-called majority position is the Second Circuit. In its leading decision on point, *Lentell v. Merrill Lynch & Co.*,<sup>181</sup> the court states: "We hold that where the sole basis for such [securities fraud] claims is alleged misrepresentations or omissions, plaintiffs have not made out a market manipulation claim under Rule 10b-5(a) and (c)."<sup>182</sup> Similarly, the Ninth Circuit has held that, "[w]e must recognize, however, that manipulative conduct has always been distinct from actionable [false statements or] omissions."<sup>183</sup> Precedent from the Eighth Circuit accords with the Second and Ninth Circuit's line of thinking as well.<sup>184</sup>

What the Cert Petition terms the minority view is in fact best understood as originating from the SEC itself, rather than any federal court. In particular, with the Commission's 2014 decision in *In re Flannery*,<sup>185</sup> the SEC took the position that scheme liability under subsections (a) and (c) "would proscribe even a single act of making or drafting a material misstatement to investors."<sup>186</sup> *Flannery*, which the First Circuit overturned on other grounds, thereby sought to establish the principle that overlap between scheme and misstatement liability does not merely exist *sometimes*; rather, such overlap is more or less comprehensive. In other words, conduct that triggers misstatement liability should be considered a genre or subset of the broader range of behavior that falls under the other provisions of Rule 10b-5.

At least one federal court of appeals, the Eleventh Circuit, appears to have taken the SEC's lead with holdings that roughly track the interpretation of Rule 10b-5 in *Flannery*.<sup>187</sup> In *Lorenzo*, Judge Srinivasan's opinion

---

180. See *Lorenzo*, 872 F.3d at 600 (Kavanaugh, J., dissenting) (arguing that there is a circuit split); Cert. Pet., *supra* note 130, at 17–21 (summarizing these dueling positions).

181. 396 F.3d 161 (2d Cir. 2005).

182. *Id.* at 177 (citing *Schnell v. Conseco, Inc.*, 43 F. Supp. 2d 438, 447–48 (S.D.N.Y. 1999) (Parker, B.D., J.) (reaching the same conclusion).

183. *Desai v. Deutsche Bank Sec. Ltd.*, 573 F.3d 931, 939 (9th Cir. 2009); see also *WPP Luxembourg Gamma Three Sarl v. Spot Runner, Inc.*, 655 F.3d 1039, 1057 (9th Cir. 2011) (holding that there is only "liab[ility] as part of a fraudulent scheme based upon misrepresentations and omissions under Rules 10b-5(a) or (c) when the scheme also encompasses conduct beyond those misrepresentations or omissions").

184. See *Pub. Pension Fund Grp v. KV Pharm. Co.*, 679 F.3d 972, 987 (8th Cir. 2012) ("We join the Second and Ninth Circuits in recognizing a scheme liability claim must be based on conduct beyond misrepresentations or omissions actionable under Rule 10b-5(b).").

185. *In re Flannery*, Exchange Act Release No. 9689, 2014 WL 7145625 (Dec. 15, 2014), *vacated on other grounds*, *Flannery v. SEC*, 810 F.3d 1 (1st Cir. 2015).

186. See *id.* at \*18. See generally Andrew N. Vollmer, *SEC Revanchism and the Expansion of Primary Liability Under Section 17(a) and Rule 10b-5*, 10 VA. L. & BUS. REV. 273 (2016) (discussing *Flannery*).

187. See *SEC v. Big Apple Consulting USA, Inc.*, 783 F.3d 786, 796 (observing that "even a person . . . who is not the 'maker' of an untrue statement of material fact, nonethe-



never expressly signs on to the SEC's position that misleading statements are per se fraudulent schemes.<sup>188</sup> But it joins with the Eleventh Circuit by implicitly endorsing the same underlying logic. Because the culpable conduct that Lorenzo is alleged to have committed revolves almost entirely around the sending of two e-mails—which is about as close to a paradigm example of misleading statements as one can get—it is fair to say that the D.C. Circuit in effect adopted the SEC theory from *Flannery sub silentio*.<sup>189</sup>

*b. Implications for Securities Fraud Doctrine*

Unless the Court can find a creative way to review the D.C. Circuit's decision without reaching the issue of misstatement versus scheme liability, its ruling in *Lorenzo* will likely have to address some basic questions of securities fraud doctrine. There are two legal paths in particular that would allow for a potentially significant reversal of the D.C. Circuit's conclusion that Lorenzo is liable under Rule 10b-5.

The most direct route is to follow the reasoning in Judge Kavanaugh's dissent, by making a sharp distinction among the subsections of Rule 10b-5 which precludes the "repackaging" of misleading statements as fraudulent schemes. That is, there must be substantial conduct above and beyond that associated with the communication of a misleading statement—such as literal market manipulation, in the sense of covert pump-and-dump trading tactics that are meant to temporarily inflate the price of a particular asset.<sup>190</sup> Such a holding might leave open the possibility of applying overlapping liability to some courses of conduct, but nonetheless draw a conceptual bright line between the two theories of securities fraud for the kinds of misleading communications at issue in *Lorenzo*.<sup>191</sup>

---

less could be liable as a primary violator of Rule 10b-5(a) and (c)"); see also *SEC v. Monterosso*, 756 F.3d 1326, 1334 (11th Cir. 2014) (arguing that the "maker" of an untrue statement of material fact could be liable as a primary violator of Rule 10b-5(a) and (c)).

188. *Lorenzo v. SEC*, 872 F.3d 578 (D.C. Cir. 2017).

189. *Id.* at 591–92 (stating that scheme liability "may encompass certain conduct involving the dissemination of false statements" but declining to identify any hypothetical scenario where it may not).

190. This definition is also consistent with the existing Supreme Court precedents on point. See *Santa Fe Indus. v. Green*, 430 U.S. 464, 476 (1977) (holding that "[m]anipulation" under 10b-5(a), (c) is 'virtually a term of art when used in connection with securities markets. . . . The term refers generally to practices, such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity.'") (citation omitted); see also *Ernst & Ernst v. Hochfelder*, 425 U.S. 189, 199 (1976) ("[Manipulation] connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities.").

191. One justification for maintaining separate conceptual categories of securities fraud is that, without them, either the scheme or misstatements subsections of Rule 10b-5 become surplusage. See *Desai v. Deutsche Bank Sec. Ltd.*, 573 F.3d 931, 941 (9th Cir. 2009) (citing *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 158–59 (2008);

In the alternative, the Court could also reverse the D.C. Circuit with an opinion that is in full agreement with Judge Srinivasan's determination that Rule 10b-5's scheme liability provisions are sufficiently broad to cover false statements that defraud investors. The rationale there would be that the ultimate authority test in *Janus* applies to any claim regarding misleading representations, no matter which provisions of Rule 10b-5 are invoked.<sup>192</sup> In that case, even if the emails to Charles Vista's clients constitute a fraudulent scheme under subsections (a) and (c), the conclusion that Lorenzo lacked the decisionmaking authority to be held directly liable for that scheme remains the same.

*c. Implications for Securities Fraud Enforcement*

A holding that reverses the D.C. Circuit along either of the lines summarized above would have substantial implications for the way that securities fraud is enforced in practice. The same result under both theories would be to narrow the scope of primary versus secondary securities fraud liability for materially misleading statements.<sup>193</sup> Instead of the SEC pursuing primary claims under Rule 10b-5 as the default legal basis for its enforcement actions, that charge will be unavailable in many cases going forward; often, the SEC's only viable cause of action for some defendants will be a claim that they aided-and-abetted another party's direct violation of the securities laws.<sup>194</sup> In effect, the enforcement strategy that Lorenzo "recommends" to the SEC in his Cert Petition would become its only choice, rather than one of its two options.<sup>195</sup>

Shifting the fault line between primary and secondary liability under Rule 10b-5 would also have consequences for the private right of action available in securities class actions and for other investor plaintiffs. First, some background. Ever since the Court's decision in a 1994 case, *Central Bank of Denver v. First Interstate Bank of Denver*,<sup>196</sup> private plaintiffs cannot bring claims for aiding and abetting securities fraud.<sup>197</sup> Only the SEC can do so,

---

Cent. Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 166, 177 (1994)) (making this point in stating that "[w]e decline to read the Supreme Court's case law on manipulative conduct as little more than an entertaining, but completely superfluous, intellectual exercise").

192. See Brief of Amici Curiae Securities Law Professors Supporting Petitioner at 4–8, *Lorenzo*, 872 F.3d 578 (No. 17-1077), 2018 WL 4142633 (providing an argument along these lines).

193. See generally Elizabeth Consenza, *Is the Third Time the Charm? Janus and the Proper Balance Between Primary and Secondary Liability Under Section 10(B)*, 33 CARDOZO L. REV. 1019 (2012).

194. See 15 U.S.C. § 78j(b) (2012) (codification of Section 20(c)).

195. See Cert. Pet., *supra* note 130, at 28.

196. 511 U.S. 166 (1994).

197. *Id.* at 173.

under § 20(e) of 1995 Private Securities Litigation Reform Act (PSLRA).<sup>198</sup> This is where the real import of *Janus* lies.<sup>199</sup> In a pre-*Central Bank of Denver* world, the *Janus* plaintiffs could have invoked Rule 10b-5(b) to sue both the mutual fund entity (primarily, for making false statements) and its advisory firm (for aiding and abetting the mutual fund's misstatements), but that door closed as of 1994. Post-*Central Bank of Denver*, and after the passages of the PSLRA, the SEC alone would have a cause of action against the advisory firm in *Janus*.

The doctrinal thread that runs through *Central Bank of Denver*, *Janus*, and *Lorenzo* is classic securities law arcana, but ultimately it boils down to who can sue whom and for what. The takeaway is this: at least as of now, for private securities plaintiffs in the Eighth and D.C. Circuits, actions against advisory entities that assist another firm in the "making" of a statement under *Janus* might remain live so long as they are pled as scheme liability claims under subsections (a) and (c). If the Court follows Judge Kavanaugh's dissent in *Lorenzo*, however, the ability of private securities plaintiffs to rely on scheme liability as an alternative to secondary misstatement claims will be definitively foreclosed in every federal court.<sup>200</sup>

This may not sound like the most groundbreaking development, but its impact should not be underestimated. For one, uniformity across the circuit courts of appeals is important because forum shopping is relatively easy and common in securities litigation. And more fundamentally, because a central policy mechanism in securities regulation is its dual public-private enforcement regime, subtle changes in the allocation of public and private enforcement authority can potentially affect how the entire framework operates.<sup>201</sup> As a result, the legal theory suggested by Judge Kavanaugh's dissent in *Lorenzo* presents the Court with an opportunity to redraw some of the basic doctrinal contours of securities fraud.

### C. *The Supreme Court's Eight-Justice Decision in Lorenzo*

Predicting what the Court might decide is always risky, even after oral argument has been held, and the Justices' questioning at oral argument in *Lorenzo* was particularly open-ended and wide-ranging.<sup>202</sup> With the usual caveats aside, it is still worth speculating how *Lorenzo* is likely to be resolved

---

198. 15 U.S.C. § 78t(e).

199. See Consenza, *supra* note 193.

200. Thus, if the *Lorenzo* scenario were replayed after such a decision, the SEC could sue the Charles Vista entity and/or Gregg Lorenzo under Rule 10b-5, and Lorenzo under Section 20(e). Charles Vista's clients would have no claim against Lorenzo but could maintain a private cause of action for securities fraud against Gregg Lorenzo and Charles Vista.

201. See generally Amanda M. Rose, *The Multiplier Approach to Securities Fraud Deterrence: A Critical Analysis*, 158 U. PA. L. REV. 2173 (2010).

202. See generally Transcript of Oral Argument, *Lorenzo v. SEC*, No. 17-1077 (argued Dec. 3, 2018).

when a ruling comes down in 2019.

Perhaps the most plausible outcome is a 4-4 stalemate, split along the same partisan lines that were staked out in *Janus*. On one side of that split, the four Justices on the Court's liberal wing are likely to issue an opinion that would affirm the D.C. Circuit's decision in part, to the extent that it upholds the SEC fraud claims against Lorenzo.<sup>203</sup> On the other side, the four conservative Justices are likely to join an opinion that would: (a) reverse the D.C. Circuit in part, to the extent it finds Lorenzo liable on any of the SEC's fraud claims; and (b) endorse some or all of the reasoning articulated in Judge Kavanaugh's dissent when doing so.<sup>204</sup>

In the event the Court's review of *Lorenzo* ends in a tied vote, the legal result is for the D.C. Circuit ruling to stand untouched as the final merits decision in the case.<sup>205</sup> But there is good reason to believe its status as a controlling legal authority is only temporary. With Justice Kavanaugh available to cast the decisive swing vote in the next securities case that is granted cert, the 4-4 draw in *Lorenzo* will encourage a wave of appeals that may allow the Court to revisit the same issues within the next few years.

#### IV. THE SUPREME COURT'S SECURITIES LAW JURISPRUDENCE AFTER *LORENZO*

The doctrinal uncertainty that Justice Kavanaugh's confirmation implies is not limited to the legal controversy raised in *Lorenzo* and applies more broadly to the Court's securities law jurisprudence as a whole. With *Lorenzo*, the Court is potentially approaching a telling fork in the road. On one hand, there are the restrained, incremental opinions that have held sway over the past fourteen years on the Roberts Court. A narrow opinion in keeping with "business as usual" would signal some inclination on the part of the conservative Justices to stay the course for the indefinite future. On the other hand, a broader opinion, even one that does not carry the day due to a split vote, would indicate a willingness to follow the more activist direction laid out in Judge Kavanaugh's dissent. Under that latter scenario, *Lorenzo* could be seen as foreshadowing a return to the style of judging that typified the "counter-revolutionary era" of securities law, which took place during Justice Powell's tenure on the Court from 1972 to 1988. This sec-

---

203. It is also possible that the liberal Justices would rule for a reversal in part, with respect to portions of Judge Srinivasan's majority opinion that reject the SEC's Rule 10b-5(b) claim by applying *Janus*.

204. At oral argument, Justice Alito appeared to be the conservative Justice least inclined to follow this course. See Transcript of Oral Argument, *supra* note 202, at 12-13. The Justice whose comments were most directly in line with the Kavanaugh dissent's reasoning was Neil Gorsuch. See *id.* at 33-36.

205. For the only previous 4-4 Supreme Court split in a securities law case, see *Carpenter v. United States*, 484 U.S. 20 (1987); see also *United States v. Texas*, 136 S. Ct. 2271 (2016) (introducing another more recent 4-4 split, leaving a lower court decision in the Fifth Circuit intact).

tion proceeds in two parts and walks through each of those paths forward.

*A. More of the Same? Maintaining the Roberts Court's Enthusiastic Minimalism*

Since John Roberts became Chief Justice in 2005, the Court has issued roughly twenty-five decisions related to securities law. As a result, a sizeable academic commentary has developed, which attempts to characterize the defining aspects of that body of opinions.<sup>206</sup> That scholarship reflects a general consensus over three main trends which have emerged during the Roberts Court era and come to define its securities law jurisprudence.

*1. The Roberts Court Status Quo*

The first trademark of the Roberts Court is the volume of securities cases that it hears. Even with the Court's docket shrinking as a whole, the annual number of securities cases that have been granted cert since John Roberts's tenure began has risen in both absolute and relative terms.<sup>207</sup> Second, in deciding those cases, there has been a greater agreement among the Justices.<sup>208</sup> 9-0 securities law decisions at the Roberts Court are commonplace, which was not necessarily true of previous eras at the Court. Third, and most significant here, the actual securities opinions issued by the Roberts Court have been modest in terms of their doctrinal impact.

As Professor Eric Chaffee writes, the Court has acted as a "museum curator"<sup>209</sup> for existing precedents:

The vast majority of the cases that the Roberts Court has heard represent minor tinkering with key issues of securities regulation, procedural issues that might more easily be taught as part of a course in civil procedure, and issues on the outer limits of securities regulation. The bulk of the cases would at best be included within notes in securities law textbooks and treatises, rather than receiving lengthy, in-depth treatment.<sup>210</sup>

Thus, if the Roberts Court has distinguished itself in the securities area, it would be with its curious combination of enthusiastic case selection and constrained, minimalist holdings.

206. See, e.g., Eric C. Chaffee, *The Supreme Court as Museum Curator: Securities Regulation and the Roberts Court*, 67 CASE WESTERN L. REV. 847 (2017); John C. Coates IV, *Securities Litigation in the Roberts Court: An Early Assessment*, 57 ARIZ. L. REV. 1 (2015); Eric Alan Isaacson, *The Roberts Court and Securities Class Actions: Reaffirming Basic Principles*, 48 AKRON L. REV. 923 (2015); A.C. Pritchard, *Securities Law in the Roberts Court: Agenda or Indifference?*, 37 J. CORP. L. 105 (2011); Turk & Woody, *supra* note 19, at 90.

207. See Pritchard, *supra* note 206, at 107 (estimating that the Roberts Court has granted certiorari on approximately two securities law cases per term); cf. Ryan J. Owens & David A. Simon, *Explaining the Supreme Court's Shrinking Docket*, 53 WM. & MARY L. REV. 1219 (2012).

208. See Coates, *supra* note 206, at 22 tbl.5 (cataloguing the Court's voting patterns in securities cases).

209. Chaffee, *supra* note 206, at 854.

210. *Id.* at 854-55.

A brief tour of securities regulation decisions at the Roberts Court is sufficient to illustrate the point. Consider, for example, the opinion in *Salman v. United States*;<sup>211</sup> a 2016 decision that was anticipated by many to bring about a major reformulation of insider trading law.<sup>212</sup> *Salman* involved an insider providing stock tips to his brother's brother-in-law under an ambiguous set of circumstances that put in question the pivotal "personal benefit" test—a test that has raised thorny issues for the law of insider trading ever since it was announced by the Court in a seminal opinion of 1983, *Dirks v. SEC*.<sup>213</sup> The end result, however, was an underwhelming opinion that merely restated the longstanding test from *Dirks* in a way that neither illuminated how the personal benefit test ought to be applied, nor otherwise moved the needle on existing insider trading doctrine.<sup>214</sup>

Along with *Salman*, a number of other recent entries in the Roberts Court securities law docket can be found, which involve perfunctory unanimous decisions that make marginal the prior doctrinal landscape. For instance, in the 2010 decision *Jones v. Harris Associates*,<sup>215</sup> the Court handed down a ruling with the reasonable yet unremarkable holding that investment advisors may violate their fiduciary duties when they charge clients disproportionately large fees.<sup>216</sup> Likewise in a 2011 decision, *Matrixx Initiatives v. Siracusan*,<sup>217</sup> the Court held that, under certain circumstances, information omitted from corporate disclosures be considered material to investors as a legal matter, even if the underlying data in question falls short of textbook definitions of statistical significance in other respects.<sup>218</sup> Further

---

211. 137 S. Ct. 420 (2016).

212. See, e.g., *All Eyes on Salman: The Supreme Court's Newest Blockbuster Insider Trading Case*, DEBEVOISE & PLIMPTON: INSIDER TRADING & DISCLOSURE UPDATE, Aug. 2016, at 17, [https://www.debevoise.com/~media/files/insights/publications/2016/08/insider\\_trading\\_update\\_vol3issue1.pdf](https://www.debevoise.com/~media/files/insights/publications/2016/08/insider_trading_update_vol3issue1.pdf).

213. 463 U.S. 648, 663–64 (1983).

214. See Jonathan R. Macey, *The Genius of the Personal Benefit Test*, 69 STAN. L. REV. ONLINE 64, 72 (2016) ("*Salman* breaks no new ground and presents no issues that are either novel or complex."); see also *id.* at 67, 71.

215. 559 U.S. 335 (2010).

216. *Id.* at 354; see *Supreme Court Decides Jones v. Harris Associates and Establishes Standard for Mutual Fund Excessive Fee Claims*, ROPES & GRAY LLP (Mar. 26, 2010), <https://www.ropesgray.com/en/newsroom/alerts/2010/03/supreme-court-decides-jones-v-harris-associates-and-establishes-standard-for-mutual-fund-excessive-fee-claims> ("[I]t is expected that the decision will not fundamentally change the process by which boards of mutual funds review and approve adviser fees. . . . The Court acknowledged in today's opinion that the standard it adopted has been the 'consensus' view of courts for over 25 years.").

217. 563 U.S. 27 (2011).

218. *Id.* at 30–31; see Ronald Mann, *Opinion Analysis: Chalk One Up for the Ninth Circuit*, SCOTUSBLOG (Mar. 24, 2011), <http://www.scotusblog.com/2011/03/opinion-analysis-chalk-one-up-for-the-ninth-circuit/> ("[T]he opinion in [*Matrixx*] is more likely to stand for its generous review of allegations in complaints than it is to make any important contribution to

examples along these lines are easy to find.<sup>219</sup>

Indeed, a handful of Roberts Court securities cases have failed to yield a decision altogether, having been withdrawn from the Court's docket because either the Court or the parties determined the issues were not worth litigating to a final determination on the merits. For example, the Court removed a 2014 case, *Public Employees' Retirement System v. IndyMac MBS, Inc.*,<sup>220</sup> from its calendar just a week prior to its scheduled argument, with an order which held that the petition for certiorari had been improvidently granted. In a 2013 case before the Court, *UBS Financial Services, Inc. v. Union de Empleados de Muelles*,<sup>221</sup> it was the parties themselves who pulled the plug, by settling two months after certiorari was granted. And in the Court's prior October 2017 term another securities case, *Leidos, Inc. v. Indiana Public Retirement System*,<sup>222</sup> failed to yield a decision, as the parties settled before oral argument was held.<sup>223</sup>

## 2. How the Court's Ruling in *Lorenzo* Would Fit

It is entirely possible that, when *Lorenzo* is decided in 2019, it will represent the latest entry in the Roberts Court's crowded yet lackluster securities law docket. After all, from the most literal perspective, the case turns on a collection of curious trivialities: an afternoon's worth of blatantly unscrupulous behavior, a \$15,000 lost investment, and a head-scratching set of questions about who is most to blame. Despite the vehement tone throughout much of Judge Kavanaugh's dissent, even he concludes on an agnostic note about what exactly took place, conceding that "maybe *Lorenzo* really is guilty of negligence (or worse)."<sup>224</sup> And as detailed in Section III above,

---

the substance of securities law."); *Decision in Matrixx Initiatives v. Siracusano Rejects Bright-Line Rule in Securities Fraud Action Based on Pharmaceutical Company's Failure to Disclose Adverse Event*, DAVISPOLK: CLIENT NEWSFLASH (Mar. 22, 2011), <https://www.davispolk.com/publications/decision-matrixx-initiatives-inc-v-siracusano-rejects-bright-line-rule-securities-fraud> (stating that the Court's decision "does not change the status quo regarding the standard for evaluating materiality and does not provide more definitive guidance to companies concerned with when and what to disclose").

219. See, e.g., *Merrill Lynch v. Manning*, 578 U.S. 1566 (2016) (unanimous opinion) (upholding federal question jurisdiction for claims that require a court to confront interpretative issues relating to the federal securities statutes); *Gabelli v. SEC*, 568 U.S. 442, 454 (2013) (unanimous opinion) (declining to extend the "discovery rule" exception in private securities fraud actions to the statute of limitations period that applies in government enforcement actions).

220. 135 S. Ct. 42 (2014) (mem.).

221. 134 S. Ct. 40 (2013) (mem.).

222. 137 S. Ct. 1395–96 (2017) (mem.) (cert granted).

223. For an overview of the events leading to the *Leidos* settlement, see generally Matthew C. Turk & Karen E. Woody, *The Leidos Mixup and the Misunderstood Duty to Disclose in Securities Law*, 75 WASH. & LEE L. REV. 957 (2018); Turk & Woody, *supra* note 19.

224. *Lorenzo v. SEC*, 872 F.3d 578, 602 (D.C. Cir. 2017) (Kavanaugh, J., dissenting).

there are a number of legal resolutions that would allow the Court to duck the fundamental doctrinal questions regarding the scope of scheme liability.

Part of this Article's thesis of *Lorenzo* as bellwether, however, is that an anticlimactic ending to the case would nonetheless have big picture implications. Namely, it would suggest a reluctance by the other eight Justices to join with bolder theories that Justice Kavanaugh may be inclined to pursue in future securities cases. And more broadly, a narrow opinion would further indicate that the Roberts Court's status as "museum curator" of the Supreme Court's existing securities law jurisprudence is likely to persist for the foreseeable future.<sup>225</sup>

### B. Or, Back to the Future? A Return to Judicial Activism

The Roberts Court's incrementalism stands out because the Court's securities law decisions in prior eras were anything but light touch. Specifically, the Supreme Court's jurisprudence has been defined by two periods of activism since the modern regulatory framework was established with the 1933 Securities Act and 1934 Securities Exchange Act.

The first period, which began in 1940 with one of the Supreme Court's very first securities-related decisions, was characterized by an aggressive judicial expansion of securities law.<sup>226</sup> The heyday of this expansionist era took place during the tenure of Chief Justice Earl Warren, from 1953 to 1969, a period in which it was commonplace for the Court's holdings to emphasize the "broad remedial purposes"<sup>227</sup> of federal securities statutes and the related need to interpret their provisions "not technically . . . but flexibly."<sup>228</sup> That theme, in fact, appeared in nearly all of the Warren Court's decisions. According to an empirical study of the Supreme Court securities docket from 1936–1971 by Professors Thomas Sullivan and Richard Thompson, the Justices voted in favor of expansive (rather than restrictive) interpretations of the securities laws in twenty-one of twenty-four cases.<sup>229</sup> As a classic securities regulation casebook memorably put it, this was a time when the Court saw "securities law as savior of all humanity."<sup>230</sup>

---

225. See generally Chaffee, *supra* note 206.

226. See generally *SEC v. U.S. Realty & Improvement Co.*, 310 U.S. 434 (1940). Technically, the first ever Supreme Court securities decision came in 1936 with *Jones v. SEC*, 298 U.S. 1 (1936). The holding in *Jones* is a lone outlier with respect to the Court's post-1940 cases, as it was decided by a majority of anti-New Deal holdouts who were replaced by Roosevelt soon after. See E. Thomas Sullivan & Robert B. Thompson, *The Supreme Court and Private Law: The Vanishing Importance for Securities and Antitrust*, 53 EMORY L.J. 1571, 1585 n.58 (2004) (making this observation).

227. *J.I. Case v. Borak*, 377 U.S. 426, 431 (1964).

228. *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 195 (1963).

229. Sullivan & Thompson, *supra* note 226, at 1580–81.

230. DAVID RATNER, *SECURITIES REGULATION* (2d ed. 1980).



### 1. The “Counter-Revolution” Under Justice Powell

The expansionist revolution of the federal securities laws came to an end when Justice William Rehnquist and Justice Lewis Powell both joined the Court in January of 1972.<sup>231</sup> This marked the beginning of a so-called “counter-revolution” in Supreme Court securities jurisprudence,<sup>232</sup> in which the Court consistently took a skeptical view of its prior case law. That skepticism was epitomized in Justice Rehnquist’s majority opinion in an important 1975 decision, *Blue Chip Stamps v. Manor Drug Stores*,<sup>233</sup> when he famously described the state of securities fraud doctrine under Rule 10b-5 as “a judicial oak which has grown from little more than a legislative acorn.”<sup>234</sup>

However, it was Justice Powell, rather than Justice Rehnquist, who truly drove the counter-revolution by leveraging his corporate law background to advocate a more constrained brand of securities law doctrine to his other colleagues on the Court.<sup>235</sup> As documented in the Sullivan & Thompson study, those efforts were highly successful.<sup>236</sup> The Court came to relatively restrictive legal conclusions about the scope of securities regulation in twenty-four of the twenty-five cases decided during Justice Powell’s tenure from 1972 to 1987.<sup>237</sup> Many of the landmark opinions from that body of law—such as the foundational insider trading cases, *Chiarella v. United States*<sup>238</sup> and the aforementioned *Dirks*—were penned by Justice Powell himself.<sup>239</sup> Perhaps even more remarkable was the way in which other members of the Court followed Justice Powell’s lead. Nearly every Justice during the counter-revolutionary era authored a far-reaching securities law opinion on behalf of the Court’s majority.<sup>240</sup> This, despite the fact that most of those Jus-

231. See Sullivan & Thompson, *supra* note 226, at 1581–82.

232. A.C. Pritchard, *Justice Lewis F. Powell, Jr., and the Counterrevolution in the Federal Securities Law*, 52 DUKE L.J. 841 (2003); cf. VINCENT BLASI, *THE BURGER COURT, THE COUNTER-REVOLUTION THAT WASN’T* (1987) (arguing that the Burger Court’s story was not as conservative counter-revolutionary as some suggest).

233. 421 U.S. 723 (1975).

234. *Id.* at 737.

235. See generally Pritchard, *supra* note 232.

236. See Sullivan & Thompson, *supra* note 226.

237. *Id.* at 1581–82.

238. 445 U.S. 222 (1980).

239. *Dirks v. SEC*, 463 U.S. 646 (1983); see also *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976) (Powell, J.); *United Hous. Found. v. Forman*, 421 U.S. 837 (1975) (Powell, J.); *Int’l Bhd. of Teamsters v. Daniel*, 439 U.S. 551 (1979) (Powell, J.). See generally Adam C. Pritchard, *Dirks and the Genesis of Personal Benefit*, 68 SMU L. REV. 857 (2015).

240. See e.g., *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438 (1976) (Marshall, J.); *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462 (1977) (White, J.); *Coopers & Lybrand v. Livesay*, 437 U.S. 463 (1978) (Stevens, J.); *Touche Ross & Co. v. Redington*, 442 U.S. 560 (1979) (Rehnquist, J.); *Burks v. Lasker*, 441 U.S. 471 (1979) (Brennan, J.); *Aaron v. SEC*, 446 U.S. 680 (1980) (Stewart, J.).

tices did not write any notable securities opinions (whether restrictive or expansionist) either before or after they shared the bench with Justice Powell.<sup>241</sup> The counter-revolutionary posture of the Court was therefore nowhere to be found in the years from 1988 to 2004, when William Rehnquist was Chief Justice, as the Court essentially lost interest in securities regulation, shrinking its caseload substantially and alternating at random between expansionist and restrictive decisions.<sup>242</sup>

The one exception came in 1994, with the Court's decision in *Central Bank of Denver*,<sup>243</sup> which can be considered the last gasp of the counter-revolution. In an opinion by Justice Kennedy—who was not otherwise a major figure in restrictive securities decisions<sup>244</sup>—the Court once again pruned back the judicial oak of securities fraud doctrine by holding that there was no right of action for aiding-and-abetting claims under Rule 10b-5.<sup>245</sup> While the impact of that holding was itself highly consequential on the merits, even more notable was the legal backdrop in which it arrived. Rather than intervening in a circuit split, the Court's decision instead overturned what had been a unanimous, multi-decade consensus across all twelve federal courts of appeals as to the availability of aiding-and-abetting claims for private securities plaintiffs.<sup>246</sup> In doing so, *Central Bank of Denver* typified the counter-revolutionary era jurisprudence, in which the Court actively imposed a textualist, limited theory of the securities laws and did not hesitate to overrule any long-standing doctrinal understanding to the contrary.<sup>247</sup>

## 2. *How the Court's Ruling in Lorenzo Would Fit*

Judge Kavanaugh's dissent in *Lorenzo* spends a good deal of time framing the case in terms of the broader history of securities law jurisprudence at the Court. His argument, that the majority should have articulated a limited scope for the scheme liability provisions in Rule 10b-5, is in part motivated by what he describes as a decades-long campaign by the SEC to “expand the scope of primary liability under the securities laws”<sup>248</sup> through its

241. Sullivan & Thompson, *supra* note 226, at 1592–97.

242. *Id.* at 1582–84.

243. 511 U.S. 164 (1994).

244. Sullivan & Thompson, *supra* note 226, at 1596.

245. *Central Bank of Denver*, 511 U.S. at 173; *see infra* Section III.B.3.c. (discussing the significance of *Central Bank of Denver*); *see also* Paul Dmitri Zier, *Central Bank of Denver v. First Interstate Bank: Pruning the Judicial Oak by Severing the Aiding and Abetting Branch*, 72 DENVER U. L. REV. 191 (1994) (examining the build up to and the decision in *Central Bank of Denver*).

246. *See id.* at 196; *see also* Donald C. Langevoort, *Words from on High About Rule 10b-5: Chiarella's History, Central Bank's Future*, 20 DEL. J. CORP. L. 865 (1995).

247. *See Zier, supra* note 245, at 192 (“Prior to *Central Bank*, many commentators felt the doctrine had become so established that the Supreme Court would never reject it.”).

248. *Lorenzo v. SEC*, 872 F.3d. 578, 601 (D.C. Cir. 2017) (Kavanaugh, J., dissenting).

“persistent efforts to end-run the Supreme Court”<sup>249</sup> precedents. The dissent’s narrative on this point is underscored by its reference to a recent article by Professor Andrew Vollmer, which analyzes the SEC’s litigation positions in *Flannery* and a related line of cases which lead up to *Lorenzo*.<sup>250</sup> Professor Vollmer argues that those positions represent a strategy of “revanchism,” through which the SEC has sought to regain the doctrinal ground that was lost in cases from the counter-revolutionary era, such as *Central Bank of Denver*, by developing creative legal theories in its internal adjudications or otherwise adopting similar positions as a litigation strategy in the federal district courts.<sup>251</sup>

If the Court decides *Lorenzo* by reversing the D.C. Circuit with an opinion that sharply circumscribes bounds of primary liability for securities fraud, it will be hard pressed to do so without also signing on to the broader narrative which animates Judge Kavanaugh’s disagreement with the majority opinion. It will also be heeding the dissent’s call to forcefully push back against the SEC’s revanchist strategy as it percolates through the lower courts.<sup>252</sup> Looking back from 2019, it is possible that such a decision would be seen as a turning point for the Roberts Court in which it abandons the role of museum curator and adopts a more aggressive mode of decisionmaking that is reminiscent of the Court’s counter-revolutionary opinions under Justice Powell.

## V. THE REGULATORY & ADMINISTRATIVE STATE AFTER *LORENZO*

After narrating the procedural history of *Lorenzo* in three dramatic acts, Judge Kavanaugh’s dissent concludes with a final section which presents the denouement. In those closing paragraphs, he turns to the implications the case carries for some fundamental questions about the relationship between the modern regulatory state, the federal courts, and the separation of powers principles which structure the U.S. Constitution. Specifically, Judge Kavanaugh writes that the standards of judicial review which are enshrined

---

249. *Id.*

250. Vollmer, *supra* note 186.

251. *Id.*; see also A.C. Pritchard, *The SEC, Administrative Usurpation, and Insider Trading*, 69 STAN. L. REV. ONLINE 55 (2016) (discussing the various legal theories the Court applied in securities cases after the counter-revolutionary era).

252. The SEC’s briefing to the Court on *Lorenzo*’s Cert Petition gets close to inviting this outcome itself by repeatedly relying on dicta from expansionist era cases at the Warren Court which embraced a broadly purposive philosophy of statutory interpretation, which was roundly rejected by the counter-revolutionary Court. See SEC Cert. Opp. *supra* note 130, at 10, 12 (citing SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963)); see also *id.* at 9, 11 (citing *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128 (1972)). It also provided further fodder for Professor Vollmer’s “revanchist” narrative in its briefing to the D.C. Circuit, by relying on its own adjudicative decision in *Flannery* as the relevant legal interpretation of Rule 10b-5 that it proposes in that case. See *Lorenzo*, 872 F.3d at 599 (Kavanaugh, J., dissenting).

in administrative law doctrine have produced an “agency-centric process [which] is in some tension with Article III of the Constitution, the Due Process Clause of the Fifth Amendment, and the Seventh Amendment right to a jury trial in civil cases.”<sup>253</sup> The dissent continues:

That tension is exacerbated when, as here, the agency’s political appointees—without hearing from any witnesses—disregard an administrative law judge’s factual findings. That said, the Supreme Court has allowed administrative adjudication ever since *Crowell v. Benson*, 285 U.S. 22 [additional reporters omitted] (1932). But the premise of *Crowell v. Benson* is that, putting aside any formal constitutional problems with the notion of administrative adjudication, the administrative adjudication process will at least operate with efficiency and with fairness to the parties involved. This case, among others, casts substantial doubt on that premise.<sup>254</sup>

As these passages make clear, Judge Kavanaugh’s underlying critique in *Lorenzo* is not really about the SEC per se, but instead applies with equal force across the administrative state. Indeed, Judge Kavanaugh highlights the *Lorenzo* dissent’s continuity with his overarching perspective on administrative law, by citing to a number of other opinions in which he has written separately to address the overall legitimacy of agency decisionmaking.<sup>255</sup> Because Judge Kavanaugh’s views on regulatory matters are arguably his singular contribution as a jurist, the *Lorenzo* dissent goes a long way toward defining his judicial philosophy as a whole, and further clarifies the impact he will have upon joining the post-Kennedy Supreme Court.

#### A. Judge Kavanaugh’s Theory of Administrative Law

The best way to understand what is unique about Judge Kavanaugh’s theory of administrative law is to compare his dissent in *Lorenzo* with Judge Srinivasan’s majority opinion for the court. In many respects, the D.C. Circuit’s decision reflects the prevailing view of the administrative state which Judge Kavanaugh rejects. That conventional wisdom is defined by a few working assumptions.<sup>256</sup>

First, it takes for granted that there is no inherent problem with the

---

253. *Lorenzo*, 872 F.3d at 602.

254. *Id.*

255. *Id.* at 598 (citing *United States v. Burwell*, 690 F.3d 500, 527 (D.C. Cir. 2012) (Kavanaugh, J., dissenting); *Bluman v. FEC*, 800 F. Supp. 2d 281 (D.D.C. 2011) (Kavanaugh, J.); *United States v. Moore*, 612 F.3d 698, 702–04 (D.C. Cir. 2010) (Kavanaugh, J., concurring)).

256. The conventional wisdom, at least, for the D.C. Circuit, the Supreme Court’s post-New Deal jurisprudence, and most administrative law scholars. *But cf.* Abbe R. Gluck & Richard A. Posner, *Statutory Interpretation on the Bench: A Survey of Forty-Two Judges on the Federal Courts of Appeals*, 131 HARV. L. REV. 1298, 1312–13, 1320 (2018) (reporting its conclusion from a survey of federal judges that the “D.C. Circuit is different”—one of the findings of the study is that the D.C. Circuit, which “acts essentially as a specialized court when it comes to administrative law” and handles the bulk of *Chevron* cases, has “drunk the *Chevron* Kool-Aid”).

combination of governmental functions—legislative, executive, and judicial—that takes place at administrative agencies.<sup>257</sup> The *Lorenzo* majority has no qualms about the fact that the SEC promulgated Rule 10b-5, applied it in an enforcement action against Lorenzo, and then adjudicated those claims in its own court. Second, the prevailing view presumes that the default posture of federal courts when reviewing agency decisionmaking will be some form of deference.<sup>258</sup> From that perspective, Judge Srinivasan’s repeated disclaimers about the court’s “very deferential” standard of review are not only a technically accurate statement of the law based on the particular posture of that case; they are also affirming the D.C. Circuit’s general orientation with respect to regulatory bodies such as the SEC.<sup>259</sup>

A final premise of the standard administrative law paradigm is that the pervasive reliance on judicial deference is justified on two related grounds. One is that, when the federal courts reverse an agency action, they are indirectly encroaching on the discretion of *other* branches of the government. That is because the agency has not acted on its own behalf; rather, it is implementing a policy decision that has already been made by either Congress or the President, which then enlisted the agency to complete the task.<sup>260</sup> The other justification for judicial deference follows from the first but is more pragmatic. The reason why Congress or the President delegate policymaking discretion to an agency in the first place, the argument goes, must be that it has the technical expertise or access to information necessary to exercise that authority most effectively.<sup>261</sup> The regulator enjoys a comparative advantage in terms of institutional competence. Thus, if courts are able to easily substitute their less informed judgments for those of

---

257. See generally M. Elizabeth Magill, *Beyond Powers and Branches in Separation of Powers Law*, 150 U. PA. L. REV. 603 (2001) (arguing that traditional separation of powers concerns are misplaced in the context of administrative agencies).

258. See generally ADRIAN VERMEULE, *LAW’S ABNEGATION: FROM LAW’S EMPIRE TO THE ADMINISTRATIVE STATE* (2016) (chronicling the shift toward judicial deference with respect to agency decisionmaking since the New Deal).

259. *Lorenzo*, 872 F.3d. at 583, 593.

260. According to the non-delegation doctrine, Congress delegates its Article I legislative authority to agencies. U.S. CONST. art. I, § 1 (“All legislative Powers herein granted shall be vested in a Congress of the United States, which shall consist of a Senate and a House of Representatives.”); see *Whitman v. Am. Trucking Ass’n*, 531 U.S. 457, 488–90 (2001) (Stevens, J., concurring); see also Kathryn Watts, *Rulemaking as Legislating*, 103 GEO. L.J. 1003 (2013). Under another view, the President is delegating the authority vested in Article II in furtherance of its constitutional responsibility to “take care that the laws be faithfully executed.” U.S. CONST. art. II, § 1. See generally Jack Goldsmith & John F. Manning, *The President’s Completion Power*, 115 YALE L.J. 2280 (2006) (noting that the presidential completion power is the justification for a broad range of presidential prerogatives); see also Eric Posner & Adrian Vermeule, *Interring the Nondelegation Doctrine*, 69 U. CHI. L. REV. 1721 (2002).

261. See generally JAMES M. LANDIS, *THE ADMINISTRATIVE PROCESS* (1938) (articulating the seminal case for why agencies have an institutional advantage in many policymaking contexts).

the agencies, there will tend to be bad results.

### 1. *The Separation of Powers Constraint*

The *Lorenzo* dissent shows how Judge Kavanaugh systematically departs from the standard theory of administrative law by questioning all of the core assumptions listed above. Particularly revealing is the dissent's approving reference to Professor Philip Hamburger's recent book, *Is Administrative Law Unlawful?*<sup>262</sup> Professor Hamburger's answer to the question posed in his title is an unequivocal "yes." He explains why over the course of six-hundred pages, which argue that the modern administrative state is fundamentally incompatible with Anglo-American rule of law tradition.<sup>263</sup> The *Lorenzo* dissent is therefore invoking a wholesale constitutional critique. Its grudging "that said" citation to *Crowell v. Benson* is revealing as well.<sup>264</sup> The specific holding in *Crowell* ruled that a maritime agency's adjudication of workers' compensation claims did not violate those workers' Fifth Amendment due process.<sup>265</sup> But the case has since taken on a larger significance and come to stand as the historical marker for when the Supreme Court accepted the basic constitutional legitimacy of the administrative state and never looked back.<sup>266</sup>

A recurring theme in Professor Hamburger's book is that the underlying problem with the administrative state is that it is in conflict with separation of powers principles.<sup>267</sup> To a large extent, that is Judge Kavanaugh's master theme as well. In his *Joseph Story Lecture*, delivered at the Heritage Foundation in 2017, Judge Kavanaugh stated: "Every case is a separation of powers case. . . . 'Who decides?' is the basic separation of powers question . . . ."<sup>268</sup> In Judge Kavanaugh's view, the separation of powers is not a loose metaphor from high school civics and has real substantive content. A careful reading of the constitutional text—which he refers to in the *Story Lecture* as a "document of majestic specificity"<sup>269</sup>—shows that it sets forth detailed, discernable boundaries for the three branches of government.

---

262. *Lorenzo*, 872 F.3d at 602 (Kavanaugh, J., dissenting) (citing PHILIP HAMBURGER, *IS ADMINISTRATIVE LAW UNLAWFUL?* 227–57 (2014)).

263. See HAMBURGER, *supra* note 262, at 227–57 (2014). For other prominent arguments similar to those set forth in Philip Hamburger's book, see Richard A. Epstein, *Why the Modern Administrative State is Inconsistent with the Rule of Law*, 3 N.Y.U. J.L. & LIBERTY 491 (2008); Gary Lawson, *The Rise and Rise of the Administrative State*, 107 HARV. L. REV. 1231 (1994); and Jeremy Waldron, *Separation of Powers in Thought and Practice?*, 54 B.C. L. REV. 433 (2013).

264. *Lorenzo*, 872 F.3d. at 602.

265. 285 U.S. 22, 41 (1932).

266. VERMEULE, *supra* note 258, at 23–34.

267. See HAMBURGER, *supra* note 262, at 222, 334.

268. Kavanaugh, *Maintaining the Separation of Powers*, *supra* note 7, at 4 (internal quotations omitted).

269. *Id.* at 3.

Judge Kavanaugh's critique of the administrative state is that it often upsets those constitutionally-mandated boundaries.

The most direct way that can happen is for agencies to occupy a fourth branch of the government unto themselves. This is potentially the case for so-called "independent agencies," which are established by statutes that build-in some degree of autonomy from the Executive Branch, primarily with "good cause" removal provisions that limit the President's authority to replace top agency personnel at-will.<sup>270</sup> Judge Kavanaugh has written multiple opinions for the D.C. Circuit concluding that agency independence creates a constitutional problem.

Perhaps the most important of those is his dissent from a 2008 decision *Free Enterprise Fund v. Public Co. Accounting Oversight Board*.<sup>271</sup> The dissent in *Free Enterprise Fund* addresses separation of powers issues throughout.<sup>272</sup> In fact, it spends nearly thirty pages in support of the proposition that an independent agency established under the Sarbanes-Oxley Act of 2002—the Public Company Accounting Oversight Board—placed barriers on the removal process, which violated the President's executive authority under Article II. The same line of argument reappears in another notable Judge Kavanaugh case, *PHH Corp. v. Consumer Financial Protection Bureau*.<sup>273</sup> There he wrote the majority opinion for a D.C. Circuit panel decision (later reversed when reheard en banc) which held that the Consumer Financial Protection Bureau—an independent agency established under the Dodd-Frank Act of 2010—was unconstitutional because its director enjoyed "unilateral authority" within the Executive Branch.<sup>274</sup>

Judge Kavanaugh's opinions in both *Free Enterprise Fund* and *PHH* take pains to detail how the regulatory bodies at issue in those cases were structured in an unusual way, even relative to other independent agencies.<sup>275</sup> But the *Free Enterprise Fund* dissent also entertains the argument that independent agencies can never be constitutional, since no intrusion on Presidential control of administrative bodies is permissible, even at the margin.<sup>276</sup> Interestingly, there is no point in the dissent where that argument

---

270. See Lisa Schultz Bressman & Robert B. Thompson, *The Future of Agency Independence*, 63 VAND. L. REV. 599, 600, 610 (2010).

271. 537 F.3d 667 (2008).

272. See *id.* at 685, 715 (Kavanaugh, J., dissenting). Judge Kavanaugh has labeled this his most significant case, and his dissent was adopted by the Supreme Court when it granted cert and reversed the D.C. Circuit. See *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477 (2010).

273. 839 F.3d 1 (D.C. Cir. 2016).

274. See *id.* at 7; see also *PHH Corp. v. Consumer Fin. Prot. Bureau*, 881 F.3d 75, 165 (D.C. Cir. 2018) (en banc) (Kavanaugh, J. dissenting).

275. See *Free Enter. Fund*, 537 F.3d at 685–715 (Kavanaugh, J., dissenting); *PHH Corp.*, 839 F.3d at 5–55.

276. See *Free Enter. Fund*, 537 F.3d at 697 (Kavanaugh, J., dissenting); cf. Elena Kagan, *Presidential Administration*, 114 HARV. L. REV. 2245 (2001); Geoffrey P. Miller, *Independent Agen-*

gets rebutted. Judge Kavanaugh only drops the idea after stating that it is not “[f]or this Court” to say whether the Supreme Court’s approval of independent agencies in its landmark 1935 case—*Humphrey’s Executor*—was rightly decided.<sup>277</sup> Because there are over a hundred such agencies, this casts doubt on a substantial swath of the administrative state.

## 2. *The Critique of Agency Adjudication*

Separation of powers concerns also underlie Judge Kavanaugh’s skepticism toward agency adjudication. The *Lorenzo* dissent provocatively suggests that the SEC’s internal adjudication of securities law claims is “in some tension” with several constitutional provisions—Article III, Fifth Amendment due process, and the Seventh Amendment right to a civil trial—without expanding on what that might mean.<sup>278</sup> Upon a closer look, all three of those alleged constitutional defects can be traced back to Judge Kavanaugh’s separation of powers perspective.

The *Lorenzo* dissent’s allusion to Article III is most straightforward. Those provisions vest the federal courts with jurisdiction over all justiciable cases-or-controversies that arise under federal law.<sup>279</sup> This makes agency adjudication problematic, as it represents an encroachment by the Executive on the judiciary’s constitutionally-assigned role.

Administrative courts also raise a Fifth Amendment problem for related reasons. The independence of federal judges is secured by the fact that their exclusive responsibility is to exercise the judicial power, along with a potential lifetime tenure and other protections provided under Article III.<sup>280</sup> By contrast, the SEC Commissioners who decided *Lorenzo*’s case are, in Judge Kavanaugh’s words, “political appointees” beholden to the President and Congress, and are responsible for implementing their policy goals.<sup>281</sup> Because an essential element of due process is a neutral decisionmaker, the political loyalties of agency adjudicators run afoul of the Fifth Amendment’s

*cies*, 1986 SUP. CT. REV. 41, 73 (1986).

277. See *Free Enter. Fund*, 537 F.3d at 697; see also *Morrison v. Olson*, 487 U.S. 654 (1988); *Humphrey’s Ex’r v. United States*, 295 U.S. 602 (1935).

278. *Lorenzo v. SEC*, 872 F.3d. 578, 602 (D.C. Cir. 2017).

279. See U.S. CONST. art. III, § 1 (“The judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish.”); *id.* § 2 (“The judicial Power shall extend to all Cases, in Law and Equity, arising under this Constitution, the Laws of the United States, and Treaties made, or which shall be made, under their Authority . . .”).

280. U.S. CONST. art. III, § 1 (providing that “Judges, both of the supreme and inferior Courts, shall hold their Offices during good Behaviour, and shall, at stated Times, receive for their Services, a Compensation, which shall not be diminished during their Continuance in Office”)

281. *Lorenzo*, 872 F.3d at 602; cf. Andrew N. Vollmer, *Accusers as Adjudicators in Agency Enforcement Proceedings*, 52 U. MICH. J.L. REFORM (forthcoming 2018) (analyzing the potential conflicts of interest that arise from Executive Branch adjudication).



guarantees.<sup>282</sup>

The Seventh Amendment right to a civil trial carries implications for agency adjudication in a few ways. Most directly it appears to allocate the judicial fact-finding function to juries rather than bureaucratic tribunals.<sup>283</sup> This too rolls up into a separation of powers theory at a deeper level. When taken together with Article III, the Seventh Amendment's guarantee is that findings of fact in federal cases or controversies will be the product of a jury's deliberation as they are made in conjunction with the procedural protections and judicial supervision of the federal courts.<sup>284</sup> As such, the potential Seventh Amendment problem for administrative adjudication is an Article III problem as well.

There is at least one good explanation for why the *Lorenzo* dissent does not delve into the constitutional tensions it identifies. As Judge Kavanaugh is aware, well-established Supreme Court precedent explicitly rejects all of the arguments outlined above.<sup>285</sup> Those constitutional arguments still hold sway in the dissent's reasoning indirectly, however, by negating the standard justifications for providing deference to agency decisions.

Under Judge Kavanaugh's separation of powers critique, federal courts are not aggrandizing the Judicial Branch with respect to Congress or the President when they decline to give deference to administrative courts. Instead, they are upholding the proper balance established under Article III, because neither of those branches have constitutional authorization to exercise the judicial power. It also follows that federal courts do not owe administrative adjudicators deference on account of their comparative institutional competence. Without the neutrality and procedural safeguards secured under Article III, the standard narrative of technocratic expertise no longer applies. If anything, the separation of powers critique suggests that decisions by administrative courts will be relatively biased and error-prone compared to those of federal courts. Although this line of theorizing is highly generalized and abstract, it then feeds directly into Judge Kavanaugh's review of the SEC decision in *Lorenzo*.

From the dissent's perspective, Judge Srinivasan is right that substantial

---

282. See *Goldberg v. Kelly*, 397 U.S. 254, 271 (1970) ("Of course, an impartial decision maker is essential" to the requirements of due process).

283. U.S. CONST. amend. VII. See generally *Gibbons*, *supra* note 164 (arguing that the practice of judicial fact-finding is unconstitutional under the Seventh Amendment's historical test and legislative history approach).

284. See *Gibbons*, *supra* note 164 (detailing the interaction between jury deliberation and procedural supervision); see also *Walker*, *supra* note 164 (discussing related issues).

285. See, e.g., *Goldberg*, 397 U.S. at 271 (holding that agency adjudicators can be considered impartial for due process purposes); *CFTC v. Schor*, 478 U.S. 833, 858 (1986) (holding that agency adjudication does not conflict with the scope of judicial power vested in Article III); *Atlas Roofing, Inc. v. Occupational Safety Comm'n*, 430 U.S. 442, 461 (1977) (holding that agency adjudication may be consistent with the Seventh Amendment right to a jury trial).

evidence review of agency fact-finding is a “very deferential” standard on paper, but wrong that it must also be deferential in practice. The SEC’s “so much for a fair trial” performance in *Lorenzo* exemplifies how an agency’s fact-finding process can be so deficient that even the low bar of substantial evidence may not be cleared in many cases. The same is true for judicial review of other aspects of administrative proceedings to the extent they are scrutinized under an arbitrary and capricious standard.<sup>286</sup> The arbitrary and capricious standard is equally deferential on its face. But that does not necessarily tie the federal court’s hands so long as it is also the case that administrative adjudications are in fact conducted in a manner that is arbitrary and capricious a good deal of the time. Judge Kavanaugh adopts this exact view when he writes that the SEC’s treatment of *Lorenzo* contradicts the “premise” that administrative courts can be expected to “operate with efficiency and with fairness.”<sup>287</sup> Thus, in *Lorenzo*, Judge Kavanaugh lays out a roadmap for his broader commitment to the judicial philosophy that courts may forego deference to agency adjudications in favor of a much more searching “hard look” review.

### 3. *The Critique of Agency Rulemaking*

Judge Kavanaugh’s skepticism toward the regulatory state does not stop with administrative courts and is no less pronounced in the rulemaking context, where agencies serve a quasi-legislative function. Since an agency’s authority to promulgate regulatory rules ultimately stems from the fact that it is implementing or “filling in the gaps” of a particular Congressional statute, the rulemaking process implicitly requires an agency to interpret what those background statutory provisions mean. Here again, judicial deference to agency decisionmaking is a cornerstone principle of administrative law. Most importantly, with the *Chevron* doctrine.<sup>288</sup>

The precise meaning of *Chevron* is probably the most over-debated topic in all of law; but usually the doctrine is broken down into two steps.<sup>289</sup> In

---

286. ALJ conclusions of law are technically subject to de novo review under the APA. Administrative Procedure Act, 5 U.S.C. § 706 (2012). But many other aspects of the adjudicative process are reviewed for arbitrary and capriciousness. See WERHAN, *supra* note 155, at 357–61 (explaining the relationship between substantial evidence review and arbitrary-and-capricious review).

287. *Lorenzo v. SEC*, 872 F.3d 578, 602 (D.C. Cir. 2017).

288. Technically, agencies can also perform an equivalent form of rulemaking within its adjudicative decisions as well. See *SEC v. Chenery Corp.*, 332 U.S. 194, 209 (1947) (holding that agencies have discretion to choose the procedural forum they use to announce rules).

289. See, e.g., Matthew Stephenson & Adrian Vermeule, *Chevron Has Only One Step*, 95 VA. L. REV. 597 (2009) (reducing the traditional two-step framework to a single criterion); Cass R. Sunstein, *Chevron Step Zero*, 92 VA. L. REV. 187 (2006) (analyzing the threshold question of how to decide whether *Chevron* should apply at all); Thomas W. Merrill & Kristen E. Hickman, *Chevron’s Domain*, 89 GEO. L.J. 833 (2001) (questioning the scope of *Chevron’s* domain in connection with the Sunstein “Step Zero” analysis).

step one, the court asks whether the meaning of the statutory provision at issue is ambiguous and susceptible to multiple interpretations.<sup>290</sup> If so, it moves on to step two. In step two, the court asks whether the agency's proposed interpretation is "reasonable."<sup>291</sup> A court must defer to the agency's statutory interpretation whenever it makes it to the end of step two and the answer is yes.<sup>292</sup> *Chevron* is just one variation on the theme of deference to agency's legal interpretations. When an agency interprets its own regulation, as opposed to a statute, essentially the same analytical framework applies but is called *Auer* deference.<sup>293</sup> When an agency's statutory interpretation arises in connection with one of its guidance documents or other informal policy statements—rather than more formal rules which carry the "force of law"—those interpretations receive slightly less weight, under a standard of review known as *Skidmore* deference.<sup>294</sup>

Judge Kavanaugh has criticized the *Chevron* doctrine in a number of speeches and non-judicial writings. In a 2016 article published in the *Harvard Law Review*, *Fixing Statutory Interpretation*, he wrote that "judges should strive to find the best reading of the statute . . . [and] should not be diverted by an arbitrary initial inquiry into whether the statute can be characterized as clear or ambiguous."<sup>295</sup> The same sentiment was echoed in Judge Kavanaugh's *Story Lecture*, when he stated that, "courts should determine whether the agency's interpretation is the best reading of the statutory text."<sup>296</sup> As should be clear, these propositions are antithetical to *Chevron*: the entire premise of that doctrine is that statutory ambiguity matters, and makes the court's "best reading" irrelevant so long as the agency has proposed a different reading that is reasonable.<sup>297</sup>

At times, Judge Kavanaugh's writings on *Chevron* are more equivocal. A passage in his *Harvard Law Review* article concedes that "*Chevron* makes a lot

---

290. See *Chevron U.S.A., Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 842 (1984).

291. *Id.* at 844.

292. *Id.*

293. *Auer v. Robbins*, 519 U.S. 452, 461 (1997); see *Perez v. Mortg. Bankers Ass'n*, 135 U.S. 1199, 1208 n.4 (2015) (listing qualifications for *Auer* deference); *Bowles v. Seminole Rock & Sand Co.*, 325 U.S. 410, 414 (1945); see also John F. Manning, *Constitutional Structure and Judicial Deference to Agency Interpretations of Agency Rules*, 96 COLUM. L. REV. 612 (1996); Cass R. Sunstein & Adrien Vermeule, *The Unbearable Rightness of Auer*, 84 U. CHI. L. REV. 297 (2017).

294. *Skidmore v. Swift & Co.*, 323 U.S. 134, 140 (1944); see also *United States v. Mead Corp.*, 533 U.S. 218, 237 (2001) (laying out the test for when *Chevron* versus *Skidmore* deference applies); cf. David Zaring, *Reasonable Agencies*, 96 VA. L. REV. 135 (2010) (analyzing how much the different standards vary as applied in practice).

295. Kavanaugh, *Fixing Statutory Interpretation*, *supra* note 7, at 2144.

296. Kavanaugh, *Story Lecture*, *supra* note 7, at 9.

297. See generally Cass R. Sunstein, *Beyond Marbury: The Executive's Power to Say What the Law Is*, 115 YALE L.J. 2580 (2006).

of sense in certain circumstances.”<sup>298</sup> But as that article goes on to explain, those circumstances are limited to two scenarios: (a) where the statutory text explicitly directs an agency to implement its provisions in any “reasonable” or “feasible” manner; or (b) when the procedural posture of an agency’s decision implies that, as applied, *Chevron* deference is the functional equivalent of arbitrary and capricious review and therefore redundant with the standard articulated under *Motor Vehicle Manufacturers Ass’n v. State Farm Auto Insurance Co.*<sup>299</sup> In effect, the *Chevron* doctrine makes a lot of sense whenever it resembles something else. As Judge Kavanaugh himself admits, the exceptions he identifies do not salvage anything from the doctrine.<sup>300</sup>

Underlying Judge Kavanaugh’s critique of *Chevron* is a familiar separation of powers logic. Deferential review of agency legal interpretations is inconsistent with Article III, which vests interpretative authority over the meaning of Congressional statutes exclusively with the federal judiciary. It is a “constitutional mandate,” he states, for the federal courts to prevent their monopoly over that interpretative authority from being diffused among the other branches.<sup>301</sup> And again, once the case for judicial deference fails as a legal matter of constitutional structure, the pragmatic justification collapses as well. Agencies have no institutional advantage when it comes to statutory interpretation because “that [is] what judges are trained to do.”<sup>302</sup>

The *Chevron* doctrine upsets the Constitution’s finely-tuned separation of powers structure on multiple fronts, in fact, not just Article III. According to Judge Kavanaugh, it also encroaches on the legislative power which Article I vests first and foremost with Congress. In the same *Harvard Law Review* article, he declares that, “[i]n many ways, *Chevron* is nothing more than a judicially orchestrated shift of power from Congress to the Executive Branch.”<sup>303</sup> He continues, “I can confidently say that *Chevron* encourages the Executive Branch (whichever party controls it) to be extremely aggressive in seeking to squeeze its policy goals into ill-fitting statutory authorizations and restraints.”<sup>304</sup> Executive Branch aggression aside, Judge Kavanaugh places ultimate blame with the federal courts. The doctrine has always been a legally flawed judicial fiction and the Court’s decision in

---

298. Kavanaugh, *Fixing Statutory Interpretation*, *supra* note 7, at 2152.

299. 463 U.S. 29 (1983); Kavanaugh, *Fixing Statutory Interpretation*, *supra* note 7, at 2153–54.

300. Kavanaugh, *Maintaining the Separation of Powers*, *supra* note 7, at 9 (“But that is not really the *Chevron* doctrine.”).

301. *Id.* at 4.

302. *Id.* at 9.

303. Kavanaugh, *Fixing Statutory Interpretation*, *supra* note 7, at 2150.

304. *Id.*; see also Kavanaugh, *Keynote Address*, *supra* note 7, at 1911 (“*Chevron* doctrine encourages agency aggressiveness on a large scale. Under the guise of ambiguity, agencies can stretch the meaning of statutes enacted by Congress to accommodate their preferred policy outcomes.”).

*Chevron* was an affront to Congressional authority in the first place: “it has no basis in the Administrative Procedure Act. . . . [I]f anything, *Chevron* seems to flout the language of the Act.”<sup>305</sup> Particularly in light of Judge Kavanaugh’s endorsement of textualist theories of statutory interpretation, this represents an independent ground for the Court to announce that *Chevron* is no longer good law.<sup>306</sup>

While there is no mention of *Chevron* (or *Auer*) in *Lorenzo*, the doctrine still hovers over the D.C. Circuit’s decision. When the SEC originally formulated its theory of scheme liability from *Lorenzo* in an early agency decision, the SEC Commission claimed its interpretation of Section 10(b) and Rule 10b-5 was entitled to *Chevron* deference.<sup>307</sup> The D.C. Circuit’s decision in *Lorenzo* reads as if it more or less agrees. Nowhere in Judge Srinivasan’s majority opinion does the court articulate its own “best reading” of the relevant anti-fraud provision and ask how the SEC’s version measures up. Instead, the majority opinion proceeds with the agency’s proposed interpretation as its starting point and then searches through the relevant case law and statutory materials until it feels assured that the SEC’s position is at least plausible.<sup>308</sup>

By contrast in the dissent, Judge Kavanaugh’s analysis does not seem to countenance the possibility that the SEC has any privileged insight into the meaning of the federal securities laws. After all, that is the court’s area of expertise. The dissent’s assertion that the SEC’s fact-finding “deserves judicial repudiation, not deference” effectively applies to its statutory interpretation as well.<sup>309</sup> And in calling for judicial pushback against the SEC’s revanchist interpretations of the securities laws in general, Judge Kavanaugh’s separation of powers critique can be seen at work. *Chevron* notwithstanding, the federal courts have a constitutional responsibility to actively police the SEC’s legal interpretations because they attempt an “end run” around the judiciary’s authoritative readings of the statutory commands issued by Congress.<sup>310</sup>

Judge Kavanaugh’s belief in the preeminent role of federal courts for questions of statutory interpretation has often translated into opinions that avoid *Chevron* deference in creative ways.<sup>311</sup> A noteworthy example is his

---

305. Kavanaugh, *Fixing Statutory Interpretation*, *supra* note 7, at 2150, 2150 n.161.

306. *See id.* at 2135 (“[C]lear statutes are to be followed. Statutory texts are not just common law principles or aspirations to be shaped and applied as judges think reasonable.”).

307. John P. Flannery, Exchange Act Release No. 3981, 2014 WL 7145625, at \*12 (Dec. 15, 2014).

308. *See Lorenzo v. SEC*, 872 F.3d 578, 588–92 (D.C. Cir. 2017).

309. *Id.* at 600 (Kavanaugh, J., dissenting).

310. *Id.* at 601.

311. For example, in *In re Aiken County*, Judge Kavanaugh’s majority opinion stated that the “policy is for Congress and the President to establish as they see fit in enacting statutes,” while the judiciary’s “more modest task” is to ensure that “agencies comply with the law as it

dissenting opinion in *United States Telecom Ass'n v. FCC*,<sup>312</sup> which urged the court to reverse its prior decision upholding a Federal Communications Commission (FCC) net neutrality regulation by deferring to the agency's interpretation of the 1934 Federal Communications Act.<sup>313</sup> The dissent argued that *Chevron* was inapplicable because "Congress ha[d] not clearly authorized the FCC to issue [such a] major rule."<sup>314</sup> By treating statutory ambiguity as a basis to forbid rather than accommodate agency discretion, the dissent's formulation is unusual and arguably flips *Chevron* on its head.

The most frequent way that Judge Kavanaugh shuts the door on judicial deference is by cutting the *Chevron* analysis short at "step one" with a finding that the statutory language in question is unambiguous.<sup>315</sup> One impressive application of that approach is his majority opinion for the D.C. Circuit in *Loving v. Internal Revenue Service*.<sup>316</sup> There, the court had to interpret a provision from an 1884 tax law, in particular its language granting the IRS authority to "regulate the practice of representatives of persons before the Department of Treasury."<sup>317</sup> After analyzing the "text, history, structure, and context of the statute," Judge Kavanaugh's majority opinion for the court explained why the meaning of that (seemingly opaque) language was unambiguous, and concluded that the IRS was not entitled to *Chevron* deference.<sup>318</sup>

\*\*\*

The overall vision here is bold, especially if Judge Kavanaugh's stronger statements are taken at face value. The thrust of those statements can be summed up as follows. All independent agencies are probably unconstitutional per se. The constitutional legitimacy of administrative adjudication is also suspect, at best. Even if lawful, agency adjudication is a poor substitute for the resolution of federal cases by judges in Article III courts because it generates decisions that are prone to bias or legal error. A partial solution is for federal courts to give those decisions a hard look upon review rather than deference. For administrative rulemakings, the reasonableness of an agency's substantive statutory interpretations has no independent legal significance and must be rejected to the extent it does not coincide with the best reading of the court. If the *Chevron* doctrine suggests otherwise, it is incompatible with the Constitution's separation of powers structure as well as the Administrative Procedure Act. All told, Judge Kavanaugh's theory of the modern regulatory state leaves very little of its legal foundations safe from a potentially fundamental reappraisal.

---

has been set by Congress." 725 F.3d 255, 257 (D.C. Cir. 2013).

312. 855 F.3d 381 (2017).

313. See *id.* at 417–18 (Kavanaugh, J., dissenting).

314. *Id.*

315. See Kavanaugh, *Fixing Statutory Interpretation*, *supra* note 8, at 2137, 2144.

316. 742 F.3d 1013 (D.C. Cir. 2014).

317. *Id.* at 1014 (citing 31 U.S.C. § 330(a)(1)).

318. *Id.* at 1015.

### B. Farewell, Chevron?

The biggest doctrinal question mark that Judge Kavanaugh's nomination raises in administrative law is the fate of *Chevron*. With the 2010 retirement of *Chevron*'s author, Justice Stevens,<sup>319</sup> and the passing in 2016 of its other intellectual architect, Justice Scalia,<sup>320</sup> the consensus that had coalesced around that case since it was announced in 1980s has weakened considerably.<sup>321</sup> Indeed, many have observed that the doctrine is affirmatively on the retreat.<sup>322</sup> As Professor Michael Kagan has put it, that retreat has taken place through a steady trickle of "anti-*Chevron*" opinions which vary in intensity from "soft" to "loud."<sup>323</sup>

The two loudest members of the Court in this respect have been Justice Thomas and Justice Gorsuch, both of whom have authored opinions that advocate for *Chevron* to be overruled in full. An important statement by Justice Thomas came in his concurrence to a 2015 decision, *Michigan v. EPA*,<sup>324</sup> where he wrote: "[T]he judicial power, as originally understood, requires a court to exercise its independent judgment in interpreting and expounding upon the laws. . . . *Chevron* deference precludes judges from exercising that judgment. . . . It thus wrests from Courts the ultimate interpretative authority to 'say what the law is.'"<sup>325</sup> Even before joining the Court, Justice Gorsuch had also endorsed a similar view as an appellate judge for the Tenth Circuit. In an influential concurrence to a 2016 case, *Gutierrez-Brizuela v. Lynch*,<sup>326</sup> Judge Gorsuch stated that *Chevron* is "difficult to square with the Constitution" and directly questioned its continuing viability as good law, declaring that "[m]aybe the time has come to face the behemoth."<sup>327</sup>

319. *Chevron U.S.A., Inc. v. Nat. Res. Def. Council, Inc.* 467 US. 837 (1984);

320. Antonin Scalia, *Judicial Deference to Administrative Interpretations of Law*, 1989 DUKE L.J. 511 (1989).

321. See Michael Kagan, *Loud and Soft Anti-Chevron Decision*, 53 WAKE FOREST L. REV. 37, 39 (2018) (arguing that "the *Chevron* doctrine will continue but that the consensus period of its history is finished"); see also Scalia, *supra* note 320.

322. See, e.g., Jonathan Adler, *Restoring Chevron's Domain*, 81 MO. L. REV. 983 (2016); Catherine M. Sharkey, *In the Wake of Chevron's Retreat* 1 (conference paper) (June 2, 2016) (on file with George Mason University) ("It is time to take stock of *Chevron's* retreat."); Carlos A. Hernandez, *From Arlington to Tennessee: The Beginnings of a Chevron Deference Farewell Tour?*, 47 SW. L. REV. 179 (2017).

323. Kagan, *supra* note 321, at 40.

324. 135 S. Ct. 2699 (2015).

325. *Id.* at 2712 (internal citations omitted); see also *Perez v. Mortg. Bankers Ass'n*, 135 S. Ct. 1199, 1213–25 (2015) (Thomas, J., concurring); *Tex. Dep't of Hous. & Cmty. Affairs v. Inclusive Cmty. Project, Inc.*, 135 S. Ct. 2507, 2529 (2015) (Thomas, J., dissenting); *Wyeth v. Levine*, 555 U.S. 555, 586, 582–604 (2009) (Thomas, J., concurring).

326. 834 F.3d 1142 (10th. Cir. 2016).

327. *Id.* at 1149 (Gorsuch, J., concurring); see also *Wis. Cent. Ltd. v. United States*, 138 S. Ct. 2067 (2018) (Gorsuch, J., concurring). See generally Trevor W. Ezell & Lloyd Marshall,

Several other Justices have issued softer anti-*Chevron* opinions, which do not call for the doctrine to be eliminated entirely but nonetheless seek to limit its reach in various ways.<sup>328</sup> One leading voice for this approach is Justice Breyer. In a number of opinions, Justice Breyer has asserted that the applicability of *Chevron* is a context-sensitive determination, which cannot be settled by the question of textual ambiguity alone and instead depends on a laundry list of other factors.<sup>329</sup>

Another active member of the soft anti-*Chevron* camp is Chief Justice Roberts, particularly in his opinions which develop the so-called “major questions” doctrine. That doctrine carves out an exception to *Chevron*, holding that federal courts do not owe deference to agency interpretations of ambiguous statutory language in cases that raise legal questions of great national importance.<sup>330</sup> The most notable recent use of the major questions doctrine came in the Chief Justice’s majority opinion for the Court in *King v. Burwell*,<sup>331</sup> a case which turned on the availability of tax credits for users of federal health insurance exchanges established under the Obama Administration’s Affordable Care Act.<sup>332</sup> After conceding that the relevant Affordable Care Act provisions were ambiguous, the majority opinion went on to state the IRS was not entitled to *Chevron* deference because *King* was an “extraordinary case” that raised a question of “deep economic and political significance.”<sup>333</sup>

Justice Kennedy has contributed to the canon of “soft” anti-*Chevron* opinions as well, most recently with a concurrence in one of his very final cases, *Pereira v. Sessions*.<sup>334</sup> There, Justice Kennedy wrote that “it seems necessary and appropriate to reconsider, in an appropriate case, the premises that underlie *Chevron* and how courts have implemented that decision.”<sup>335</sup> Justice Kennedy’s concurrence also specifically took issue with the tendency of

---

*If Goliath Falls: Judge Gorsuch and the Administrative State*, 69 STAN. L. REV. ONLINE 171 (2017).

328. Cf. Kent Barnett, *Why Bias Challenges to Administrative Adjudication Should Succeed*, 81 MO. L. REV. 1023, 1036 (2016) (noting the increasing tendency of courts to skip over *Chevron* in cases where it would otherwise seem to apply).

329. See, e.g., *City of Arlington v. FCC*, 569 U.S. 290, 308–09 (2013) (Breyer, J., concurring); see also *Christensen v. Harris Cty.*, 529 U.S. 576, 596–97 (2005) (Breyer, J., dissenting). The number of factors that Justice Breyer cites as weighing against *Chevron* deference is often sufficiently large that at least one of them could conceivably apply in any given case. See, e.g., *City of Arlington*, 569 U.S. at 308–09.

330. *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 159–61 (2000) (providing one of the earliest articulations of the major questions exception); see Sunstein, *supra* note 289, at 193 (discussing the Court’s reliance on the major questions doctrine).

331. 135 S. Ct. 2480 (2015).

332. See *id.* at 2488.

333. *Id.* at 2488–89 (“In extraordinary cases, however, there may be reason to hesitate before concluding that [*Chevron* applies because] Congress has intended such an implicit delegation. This is one of those cases.”) (internal citations and quotations omitted).

334. 138 S. Ct. 2105 (2018).

335. *Id.* at 2121 (Kennedy, J., concurring).



appellate courts to adopt a second-order form of “reflexive deference”—for example, by deferring to an agency’s position on whether *Chevron* is applicable to its interpretation in the first instance.<sup>336</sup>

Justice Alito also wrote separately in *Pereira*, with a dissent that described *Chevron* as a “once celebrated, and now increasingly maligned precedent.”<sup>337</sup> While Justice Alito declined to say if he thought *Chevron* was rightly maligned or not, his dissent emphasized its status as binding precedent by observing that unless there has been “a secret decision that has somehow escaped my attention, [*Chevron*] remains good law.”<sup>338</sup> Justice Alito can nonetheless be tentatively counted among the Court’s soft anti-*Chevron* coalition. The main data point on that count is his decision to join the dissent of Chief Justice Roberts in *City of Arlington v. FCC*,<sup>339</sup> an important statement on the limits of judicial deference, which the Court’s majority accused of having “*Chevron* itself as the ultimate target.”<sup>340</sup>

\*\*\*

Justice Kavanaugh no doubt favors overturning *Chevron* in full or otherwise redefining its holding out of existence. By replacing Justice Kennedy, that reshuffles the balance of “loud” versus “soft” critics at the Court and brings it to a three-three tie. However, the significance of Judge Kavanaugh’s nomination for the future of judicial deference to the administrative state is much greater than a shift in that tally of votes.

A bigger issue is how Justice Kavanaugh’s membership on the Court will affect the votes of other Justices.<sup>341</sup> The relevant model here is Justice Powell. By leveraging his corporate law background, he was able to single-handedly elevate the place of securities law issues on the Court’s docket and build a consensus around his own personal theory of how those issues should be decided.<sup>342</sup> Like Justice Powell, Justice Kavanaugh will bring a trademark philosophy to the Court that is backed by his particular area of expertise. This means that his positions on the administrative state will not only gain one more vote, but also a voice on the Court that may carry other votes along in its path. When the Justices meet in conference, the kinds of forceful arguments that Judge Kavanaugh presents in the *Lorenzo* dissent will be heard from his seat at the table. And he will stand ready to put those arguments in writing for his colleagues, with proposed opinions that draw upon the theoretical framework which Judge Kavanaugh has com-

336. *Id.* at 2120.

337. *Id.* at 2121 (Alito, J., dissenting).

338. *Id.* at 2129.

339. 569 U.S. 290 (2013).

340. *Id.* at 312, 327 (Roberts, C.J., dissenting) (“An agency cannot exercise interpretive authority until it has it; . . . whether an agency enjoys that authority must be decided by a court, without deference to the agency.”).

341. See *supra* note 16 (referencing the empirical literature on “panel effects” at appellate courts).

342. Sullivan & Thompson, *supra* note 226, at 1592–94.

prehensively developed in his speeches, writings, and opinions on the D.C. Circuit.<sup>343</sup>

This is why the Court's eventual decision in *Lorenzo* is even more intriguing with Justice Kavanaugh recused. It is already clear what opinions he holds on those issues. But it will be much clearer what the other members of the Court think of his views once they reach a decision on *Lorenzo* in 2019 and issue opinions that must unavoidably grapple with the arguments laid out in the dissent. The Court's reception of those arguments therefore promises some early suggestive evidence on the question of whether Justice Kavanaugh will be a successful judicial entrepreneur for his views on administrative law, in the way that Justice Powell was in securities regulation. This Article's reading of *Lorenzo* as the bellwether for the fate of *Chevron* and related administrative law doctrines of judicial deference stems from that dynamic. If Justice Kavanaugh can gain traction with other members of the Court, particularly Chief Justice Roberts or Justice Alito, he may be able to amplify his third vote in favor of a "loud" all-out repudiation of *Chevron* into a full majority.

## VI. CONCLUSION

This Article has provided an analysis of the Supreme Court's pending resolution to *Lorenzo v. SEC* which examines that case in light of Justice Kavanaugh's addition to the Court in the wake of Justice Kennedy's retirement. As has been shown, *Lorenzo* raises a number of weighty issues at the core of federal securities law doctrine. It also features a dissent by Judge Kavanaugh from the D.C. Circuit majority's decision which, upon a close reading, affords a uniquely in-depth perspective on his overall judicial philosophy. *Lorenzo* also represents a treasure trove of insights from a number of other angles. By anchoring Justice Kavanaugh's critique of the administrative state within the pragmatic realities of actual judicial decisionmaking, this Article avoids the empty abstractions which can sometimes accompany theoretical discussions of lofty concepts such as the constitutional separation of powers and demonstrates how the intellectual framework that underpins Justice Kavanaugh's dissent also informs his answers to specific questions of law.

---

343. Besides deliberative or rhetorical persuasion, there are many other ways that individual judges may affect the behavior of their colleagues on multi-member courts. See Fischman, *supra* note 16 (surveying the various theories); see, e.g., RICHARD POSNER, HOW JUDGES THINK 32–34 (2008) (arguing for a "dissent aversion" theory of judicial interaction); Frank B. Cross & Emerson H. Tiller, *Judicial Partisanship and Obedience to Legal Doctrine: Whistleblowing on the Federal Courts of Appeals*, 107 YALE L.J. 2155–76 (1998) (arguing that panel effects may be the result of judge's strategic "whistleblowing" tactics); CASS R. SUNSTEIN, ET AL., ARE JUDGES POLITICAL?: AN EMPIRICAL ANALYSIS OF THE FEDERAL JUDICIARY 71–78 (2006) (providing a "group polarization" model, in which like-minded judges push each other to extremes).

Lastly, the most significant contribution of this article is to interpret Justice Kavanaugh's dissent in *Lorenzo* through a framework that focuses on what that opinion will say about *other* Supreme Court Justices. The conclusions that a future Justice Kavanaugh will reach in cases that implicate his core concerns about the intersection of constitutional and administrative law are easy enough to discern from a survey of his overall judicial output at the D.C. Circuit. But what will ultimately determine Justice Kavanaugh's legacy on the Supreme Court, and what remains to be seen, is the extent to which other members of the Court will gravitate toward his views on those issues as well. Therein lies the broadest potential significance of *Lorenzo*, as bellwether of Justice Kavanaugh's success as a judicial entrepreneur for his distinct brand of counter-revolutionary jurisprudence on administrative law.