CARLTON FIELDS

Securities Fraud Update: Eleventh Circuit Clarifies Section 17(a) and Rule 10b-5 Analyses

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S.E.C. v. Radius Capital Corp., No. 15-12004, 2016 WL 3542235, ___ F. App'x ___ (11th Cir. June 29, 2016). The Eleventh Circuit last month explained the material similarities and differences between two kinds of securities fraud: violations of section 17(a) of the Securities Act of 1933 and section 10(b) of the Securities Exchange Act of 1934. Although the opinion in *SEC v. Radius Capital Corp.* is unpublished, it still merits study as one of the few recent appellate opinions in the circuit concerning a securities-fraud jury verdict. Radius Capital is a mortgage lender and issuer of mortgage-backed securities (MBS). The SEC brought two claims against the company and its former CEO: Count I alleged violations of Securities Act section 17(a); and Count II alleged violations of Exchange Act section 10(b) [2] and Exchange Act Rule 10b-5.[3] The SEC alleged that the defendants made numerous misrepresentations in seeking Ginnie Mae guarantees on MBSs issued by Radius Capital, namely, that the defendants misrepresented in GinnieNET forms and in prospectuses that the underlying loans were FHA insured or eligible for FHA insurance. After a nine-day trial, the jury found the defendants liable on both counts, imposing a civil penalty of $1.29 million on the former CEO and ordering disgorgement of his gains. On appeal, the former CEO argued that section 17(a) and Rule 10b-5 both require: (1) that a material misrepresentation be disseminated *to the public* in connection with the purchase or sale of any security; (2) that the defendant be the "*maker*" of the misrepresentations in the prospectuses; and (3) that the defendant acted with scienter equivalent to *actual knowledge*. The Eleventh Circuit rejected each of these arguments. First, the Eleventh Circuit held that unlike a private enforcement action, an SEC civil enforcement action does not require any actual reliance or dissemination to the public, and thus the misrepresentations constituted violations despite having been made only to Ginnie Mae. The court noted the Supreme Court's statement in *Chadbourne & Parke LLP v. Troice*, [4] that its holding there "did '*not* limit the Federal Government's authority to prosecute' frauds where there was no actual reliance." [5] Second, the court also rejected the defendant's argument that section 17(a) and Rule 10b-5 claims *both* require that the defendant be the one to "make" the misrepresentations. The defendant supported his argument with a federal court case from New York. [6] By contrast, the Eleventh Circuit's law on this issue "is

clear: the requirement that the defendant be the 'maker' of the misrepresentations on a document only applies to Rule 10b-5(b)" and not to a section 17(a) claim. [7] Third and finally, in reviewing the denial of a motion for a new trial, the Eleventh Circuit held that actual knowledge is not required to establish scienter under either section 17(a)(1) or Rule 10b-5, as severe recklessness can also establish scienter for either provision. By contrast, sections 17(a)(2) and (3) require only negligence. [8] Although the unpublished opinion in *Radius Capital* is not binding precedent, the decision gives practitioners additional clarity in analyzing potential section 17(a) and Rule 10b-5 violations.

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[1] 15 U.S.C. § 77q(a).
[2] 15 U.S.C. § 78j(b).
[3] 17 C.F.R. § 240.10b-5. [4] 134 S. Ct. 1058, 1062 (2014).
[5] *Radius Capital*, 2016 WL 3542235, at *4.
[6] *SEC v. Kelly*, 817 F. Supp. 2d 340 (S.D. N.Y. 2011).
[7] *Radius Capital*, 2016 WL 3542235, at *4.
[8] *Id.*, at *7 (citing *SEC v. Big Apple Consulting USA, Inc.*, 783 F.3d 786, 795 (11th Cir. 2015)).

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