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Liability Under the Federal Securities Laws for Media Personalities

How statements in both traditional and new media outlets may catch the SEC's attention.

From music moguls and sports icons promoting cryptocurrencies and digital tokens,[1] to reality television stars bringing down the price of an old-fashioned stock with a single tweet,[2] the worlds of media and securities are more connected than ever before. The US Securities and Exchange Commission (SEC) has taken notice, recently warning the public about media celebrities promoting cryptocurrency and token sales that may be, in essence, securities offerings. Media personalities featured in both old and new media should be on guard: the federal securities laws apply to public statements regarding securities, and the SEC will not hesitate to bring enforcement actions if the agency believes that the media has been used to deceive investors.

This *Client Alert* explores two primary sources of potential liability for media personalities:

- The antifraud provisions in the Securities Act of 1933 (Securities Act) and the Securities Exchange Act of 1934 (Exchange Act)
- Certain provisions of the Investment Advisers Act of 1940 (Advisers Act)

These statutes may not jump out as applying to those in the media, who are more often associated with the First Amendment's protection of free speech. To be sure, most statements in the media do not trigger the federal securities laws. But some do, as described below.

Securities Fraud

Securities Act Section 17(a) and Exchange Act Section 10(b): Omissions and Misrepresentations of Material Fact

Both the Securities Act and the Exchange Act prohibit any person from, directly or indirectly, employing a device or scheme to defraud another person in connection with the sale of a security.[3] Liability under these statutory provisions arises from misstatements or omissions of "material fact" — statements that either distort or omit information that a reasonable investor would consider important in making an investment decision.[4]

Under Section 17(a)(1) and Section 10(b), the SEC must prove a defendant acted with scienter, or an intent to deceive. Different jurisdictions apply different standards to determine whether a person acted with scienter, but typically scienter requires actual knowledge that a statement is false or misleading, or that the person acted recklessly in disregarding the possibility that the statement is false or misleading. By contrast, Sections 17(a)(2) and 17(a)(3) do not require scienter — liability under those sections requires only that the defendant acted negligently in making a false or misleading statement, or engaging in a "scheme" to mislead.

Media personalities can face liability if they issue statements promoting investment opportunities without support. For instance, in 2012, the SEC charged Matthew Gagnon for statements on his website advertising what turned out to be a Ponzi scheme.[5] The website advertised itself as the "world's finest and largest opportunity review website," and one of the "opportunities" it described was an investment program offered by Legisi Holdings, LLC. Gagnon touted Legisi as "literally the greatest [business opportunity] I have ever seen." But Gagnon had not performed any due diligence about the profitability of the Legisi program, and either knew his claims were false or recklessly disregarded clear indications they were false. By advertising an investment opportunity without having done any diligence on it, Gagnon violated Section 17(a) and Section 10(b).

Similarly, in March 2016, the SEC alleged that Tobin Smith violated Section 17(a) and Section 10(b) based on a scheme to manipulate the price of a stock. Smith, along with the CEO of IceWeb, Inc. (IWEB) and a broker, agreed to manipulate the price of the IWEB stock through a series of false statements in various electronic media, including a blog.[6] Smith entered into two separate agreements as part of the scheme, and received cash and stock for promoting IWEB. Specifically, Smith made false and misleading statements on reports, updates, and social media blogs regarding IWEB. Smith also sent false advertisements to email subscriber lists, in which he described himself as a contributor and market analyst for Fox News and the Fox Business Network.

Efforts to manipulate stock price may also create liability if short-sellers or others make false statements intended to decrease a particular stock's price. For instance, in *SEC v. Craig*, the SEC sued James Alan Craig for tweeting false statements about two publicly traded companies, Audience, Inc. and Sarepta Therapeutics, Inc.[7] Craig posed as securities research firms on Twitter, and claimed that the DOJ and the FDA were investigating Audience and Sarepta. As a result of his false tweets, the share prices of both companies fell significantly — Nasdaq even temporarily stopped the trading of Audience's stock. After tweeting the false information, Craig bought and sold the shares of the companies to profit personally. The SEC alleged that the false tweets violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act.

Securities Act Section 17(b): The Anti-Touting Provision

Media personalities may also face liability for failing to disclose material conflicts of interest.[8] Specifically, Section 17(b) of the Securities Act — commonly known as the "anti-touting" provision — "prohibits the practice of publicizing securities in return for past or future undisclosed compensation from an issuer, underwriter, or dealer."[9]

The SEC has not hesitated to bring enforcement actions against public figures for violations of the anti-touting provision. For example, the SEC charged a television personality, Courtney Smith, for touting the stock of GenesisIntermedia (GENI) — in violation of the Securities Act's anti-touting provision — in various media, including several television appearances and in website postings.[10] The SEC alleged that Smith received secret payments from GENI's President and Chairman in exchange for touting GENI stock

during several television appearances.[11] Smith never disclosed that he received compensation in exchange for touting GENI stock.

The SEC also brings enforcement actions against lesser-known individuals who have modest followings for their stock picks. For example, in one case the SEC brought an enforcement action for a violation of the anti-touting provision based on statements in a newsletter about various companies.[12] The newsletter positively discussed businesses' prospects, characterizing them as "picks" or "hot stocks."[13] The SEC alleged the defendants did not disclose that they received more than US$1.2 million in stock and cash from companies they identified as hot stocks.

The SEC recently invoked the anti-touting provision in a statement that took aim at media personalities using their platforms to promote securities and digital asset offerings. The SEC urged investors to use caution if considering celebrity-backed initial coin offerings (ICOs).[14] According to the SEC, "celebrities and others [who] are using social media networks to encourage the public to purchase stocks and other investments" must be careful to "disclose the nature, source, and amount of any compensation paid, directly or indirectly, by the company in exchange for the endorsement."[15] Failure to disclose this information, the SEC stated, could open up the celebrities to enforcement action. The SEC's statement suggests that the agency will scrutinize the conduct of celebrities pitching digital assets and securities, and media personalities can reasonably expect the SEC to bring enforcement actions for violations of the anti-touting provision.

Fraud and the First Amendment

The First Amendment has not been extended to protect the kinds of speech typically at issue in securities fraud cases. As one court summarized succinctly: "the First Amendment does not shield fraud."[16]

For media personalities who have made misrepresentations or omissions, First Amendment arguments have fallen on deaf ears. In *SEC v. Pirate Investor LLC,*[17] for example, the SEC brought an enforcement action against Pirate Investor, a limited liability company that published investment newsletters and sent email "blasts."[18] One of these blasts was a "Super Insider Tip E-mail" claiming that a senior executive at a company had provided Pirate Investor with insider information, which the company would reveal only after the reader payed a fee.[19] The SEC brought suit alleging that Pirate Investor's claims that it possessed inside information were untrue, violating Section 10(b) of the Exchange Act.[20] The Fourth Circuit rejected the defendant's claim that the First Amendment barred the SEC's enforcement action, holding that liability based on "[p]ublishing fraud, whether it be common law fraud or securities fraud, simply does not violate the First Amendment."[21]

Nor has the First Amendment proven an effective shield against prosecution for failure to disclose a quid pro quo. In *United States v. Wenger*, the host of a radio program called *The Next Superstock* was convicted of criminal securities fraud for failure to disclose that he agreed to receive 5.5 million shares of stock from one of the companies that he promoted.[22] The Tenth Circuit Court of Appeals rejected Wenger's defense that the First Amendment protected his speech. First, the court held that the disclosures required by the Securities Act are categorically considered forms of commercial speech, and therefore are subject to less constitutional protection.[23] Second, the court held that if scrutinizing commercial speech restrictions, the government's interest in preventing consumer deception is presumptively substantial. Moreover, that the disclosure of merely factual and uncontroversial information is not unduly burdensome.[24] In sum, "the promoter must provide a disclaimer as to each security he touts at the time he promotes the security," and this disclosure does not violate the First Amendment.[25]

Potential Liability Under The Investment Advisers Act

The Advisers Act was "the last in a series of acts designed to eliminate certain abuses in the securities industry, abuses which were found to have contributed to the stock market crash of 1929 and the depression of the 1930's."[26] The Advisers Act regulates "investment advisors," which it defines as:

"Any person who, for compensation, engaged in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and part of a regular business, issues or promulgates analyses or reports concerning securities …"[27]

Any person who meets the Advisers Act's definition of investment adviser, whether the person is registered with the SEC as an investment adviser or not, is subject to the Advisers Act's antifraud provision. This provision requires full disclosure of material facts to advisory clients.[28]

Courts and the SEC have generally taken a broad view of the *types* of communications that can establish an actor as an investment adviser. In *SEC v. Financial News Associates*,[29] for example, the court upheld the SEC's enforcement action against a monthly newspaper entitled "Investment Intelligence." The newspaper was subscription-based and served as a vehicle of "professional forecasting which renders 'specific recommendations on what, and when, to buy and sell."[30] The SEC alleged — and the court agreed — that through its newspaper, Financial News Associates functioned as an unregistered investment adviser in violation of the Advisers Act.

However, First Amendment considerations temper the Advisers Act's seemingly broad reach. In *Lowe v. SEC*,[31] the Court held that the Advisers Act was not intended to regulate the broad publication of *general* investment advice. According to the Court, Congress was "undoubtedly aware" of the First Amendment's broad protections for publications when it passed the Advisers Act, and did not intend to disturb those protections.[32] The Advisers Act's requirements, the Court held, were only meant to reach those engaged in "individual advice attuned to [a] specific portfolio or to [a] client's particular needs."[33] "As long as the communications between [the entity at issue] and their subscribers remain entirely impersonal and do not develop into the kind of fiduciary, person-to-person relationships that … are characteristic of investment adviser-client relationships," the Court reasoned, "we believe the publications are, at least presumptively, [outside of the scope of the Advisers Act]."[34]

In light of *Lowe*, most media personalities can rest easy when it comes to Advisers Act liability. Typically, securities commentary in the media is "circulated … to the public at large in a free, open market — a public forum in which typically anyone may express his views." That type of speech is a type of activity the Court expressly immunized from regulation under the Advisers Act. At the same time, however, media personalities should be cognizant of the fact that, as their advice becomes increasingly tailored to a particular client's needs, they risk running into SEC enforcement action.

If you have questions about this *Client Alert*, please contact one of the authors listed below or the Latham lawyer with whom you normally consult:

John J. Sikora Jr.
john.sikora@lw.com
+1.312.876.6580
Chicago

Eric R. Swibel
eric.swibel@lw.com
+1.312.777.7185
Chicago

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Endnotes

[1] Ricardo Esteves, *SEC May Pursue Celebrities Who Have Endorsed Alleged ICO Scam*, NEWS BTC (April 9, 2018, 1:47 P.M.) https://www.newsbtc.com/2018/04/09/floyd-mayweather-dj-khaled-risk-lawsuits-alleged-ico-scam/.

[2] Janko Roettgers, *Kylie Jenner Tweet, CEO Compensation Package News Drag Snap Stock Down 8%,* VARIETY (Feb. 22, 2018, 11:49 A.M.) https://variety.com/2018/digital/news/kylie-jenner-tweet-snap-stock-1202707865/.

[3] *See* SEC v. Gagnon, No. 10-cv-11891, 2012 WL 994892 at *9 (E.D. Mich. March 22, 2012) ("Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 are essentially coextensive."). *See also id.* (noting that "[s]cienter is a requirement to establish violation of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder" (citing Ernst & Ernst v. Hochfleder, 425 U.S. 185 (1976)).

[4] *See* T.S.C. v. Northway, Inc., 426 U.S. 438 (1976).

[5] *Gagnon*, No. 10-cv-11891, 2012 WL 994892 at *1 (E.D. Mich. March 22, 2012).

[6] Press Release: Former TV Commentator Settles Penny Stock Fraud Charges, U.S. SECURITIES AND EXCHANGE COMMISSION (Mar. 29, 2016),https://www.sec.gov/news/pressrelease/2016-60.html.

[7] Litigation Release No. 23401: SEC Charges: False Tweets Sent Two Stocks Reeling in Market Manipulation, U.S. Securities and Exchange Commission (Nov. 6, 2015), https://www.sec.gov/litigation/litreleases/2015/lr23401.htm.

[8] Investor Alert: Investment-Related Radio Programs Used to Defraud, U.S. SECURITIES AND EXCHANGE COMMISSION (Sept. 23, 2015), https://www.sec.gov/oiea/investor-alerts-bulletins/ia_radio.html.

[9] *See* 15 U.S.C. § 77q; *Gagnon*, No. 10-cv-11891, 2012 WL 994892 at *10 (E.D. Mich. March 22, 2012); SEC v. Gane, 2005 U.S. Dist. LEXIS 607 at *46-47 (S.D. Fla. Jan. 4, 2005).

[10] SEC v. Smith, 2008 WL 11336814 at *1 (C.D. Cal. Feb. 28, 2008).

[11] *Id.*

[12] Litigation Release No. 16559, U.S. SECURITIES AND EXCHANGE COMMISSION (May 22, 2000),https://www.sec.gov/litigation/litreleases/lr16559.htm.

[13] SEC v. Liberty Capital Group, Inc., 75 F. Supp. 2d 1160, 1161 (W.D. Wash. Feb. 18, 1999). *But see* SEC v. Mapp, 240 F. Supp. 3d 569 (E.D. Tex. 2017) (declining to find "anti-touting" liability in a case involving a single email and phone call to a potential investor).

[14] Public Statement: SEC Statement Urging Caution Around Celebrity Backed ICOs, U.S. SECURITIES AND EXCHANGE COMMISSION (Nov. 1, 2017), https://www.sec.gov/news/public-statement/statement-potentially-unlawful-promotion-icos.

[15] *Id.*

[16] Illinois ex rel. Madigan v. Telemarketing Assocs., Inc., 538 U.S. 600, 612 (2003).

[17] 580 F.3d 233, 239 (4th Cir. 2009).

[18] *Id.* at 238.

[19] *Id.*

[20] *Id.* at 239.

[21] *Id.* at 253.

[22] United States v. Wenger, 427 F.3d 840, 843 (10th Cir. 2005).

[23] *Id.* at 848.

[24] *Id.* at 849.

[25] *Id.*

[26] SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186 (1963).

[27] Investment Advisers Act of 1940, 15 U.S.C. § 80b-2(11). *See also* Regulation of Investment Advisers, U.S. SECURITIES AND EXCHANGE COMMISSION (March 2013), https://www.sec.gov/about/offices/oia/oia_investman/rplaze-042012.pdf .

[28] 15 U.S.C. § 80b-6 (2012).

[29] 1985 WL 25023 (E.D. Va. April 26, 1985)

[30] *Id.* at *1, *14.

[31] 472 U.S. 181 (1985).

[32] *Id.* at 204.

[33] *Id.* at 208.

[34] *Id.*