

**Business Law Monthly Practice Tip**  
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**Fourth Circuit Declines to Create Exception for Disinterested Publishers from § 10(b) of the Exchange Act and Rule 10b-5; Supreme Court Denies Defendant's Cert. Petition.**

U.S. Securities & Exchange Comm'n v. Pirate Investor LLC, 580 F.3d 233 (4th Cir. 2009), *cert. denied*, 130 S. Ct. 3506 (June 28, 2010) (No. 09-1176).

**Facts of the case:**

- Frank Porter Stansberry and Pirate Investor LLC offered and sold a stock tip concerning a company called USEC, Inc., a provider of uranium-enrichment services. Stansberry was the editor-in-chief of Pirate, which wrote and published investment newsletters.
- In May 2002, Stansberry conducted a telephone interview with USEC's Director of Investor Relations. Shortly following that conversation, Stansberry and Pirate sent a "Super Insider Tip E-mail" to over 800,000 individuals purporting to contain information obtained from a senior executive of the subject company that the company would be announcing a very favorable contract on May 22, 2002. The Super Insider Tip E-mail also solicited investors to pay \$1,000 in exchange for the name of the stock tip's subject company, which was contained in Pirate's USEC Special Report. Investors purchased 1,217 copies of the USEC Special Report, resulting in \$1,005,000 in net proceeds.
- Following a bench trial, the district court concluded that the USEC representative had not told Stansberry that USEC would be announcing a favorable contract on May 22, and the Court determined that Stansberry and Pirate had violated § 10(b) of the Securities and Exchange Act of 1934, as amended, and Rule 10b-5 promulgated thereunder, by offering and selling the stock tip. The district court ordered the disgorgement of defendants' profits from the sales of the stock tip, imposed civil penalties and issued an injunction against future violations of § 10(b) and Rule 10b-5.
- Stansberry and Pirate appealed, and were supported by an *amici* brief filed by several publishers and First Amendment advocates such as Forbes, Hearst Corporation, the American Society of Newspaper Editors and the Thomas Jefferson Center for the Protection of Free Expression. Stansberry and Pirate raised three issues on appeal: (1) whether the conduct in the case constituted a violation of § 10(b) and Rule 10b-5; (2) whether, if the conduct does fall within the purview of § 10(b), the First Amendment entitles Stansberry and Pirate to the heightened protections it affords the media in other contexts; and (3) whether the permanent injunction entered by the district court is an improper restraint on speech. **This practice tip focuses on the First Amendment issues raised by Stansberry, Pirate and the amici.**

**Analysis:**

- The SEC must establish in a civil enforcement action under § 10(b) that the defendant (1) made a false statement or omission (2) of a material fact (3) with scienter (4) in connection with the purchase or sale of securities.
- The Court found that the district court correctly determined that the defendants' conduct constituted a violation of § 10(b) and Rule 10b-5. The Court held that Stansberry and Pirate made a misrepresentation of a material fact and did so with an intent to defraud. The Court then determined that the defendants' misrepresentations were made "in

connection with” the purchase or sale of securities because (1) purchases were necessary to complete the fraudulent scheme (as investors made purchases, the stock price rose, lending credibility to the defendants’ claims and encouraging more investors to purchase the USEC Special Report), (2) the defendants made the misrepresentations with the intent to induce securities transactions and (3) the defendants directed their misrepresentations to investors that were likely to rely on them.

- Defendants and *amici* argued on appeal that the Court’s broad treatment of the “in connection with” requirement raises First Amendment issues because it expands the application of § 10(b) and Rule 10b-5 beyond fiduciaries and brokers to “all statements about securities by anyone who cared to speak to anyone who cared to listen,” which could result in a chilling effect on publishers of financial news and commentary. The *amici* urged the Court to recognize “an exception from the coverage of § 10(b) [and Rule 10b-5] for publishers of nonpersonalized financial news and commentary who do not possess a financial interest in the securities that they discuss.”
- The Court declined to adopt a blanket exception for “disinterested publishers” citing § 10(b)’s purpose as a “flexible regime for addressing new, perhaps unforeseen, types of fraud.” The Court found that § 10(b) applies to any person and “excepts no one from its reach.”
- The Court also rejected the defendants’ argument that the statements at issue were pure expression, and therefore entitled to the heightened protections given publishers of expressive speech. Granting such protection would require the SEC to prove by clear and convincing evidence that the statements at issue were published with “actual malice.” In rejecting this approach, the Court found that “[p]unishing fraud, whether it be common law fraud or securities fraud, simply does not violate the First Amendment.” Accordingly, the Court also found that the injunction imposed on the defendants by the district court did not constitute an unlawful prior restraint because it only enjoins the defendants from “engaging in securities fraud, which we have held is unprotected speech.”

#### **Takeaway:**

- While the facts at issue in this case lend themselves to little sympathy for Stansberry or Pirate, the issue of whether a First Amendment argument is colorable in a § 10(b) / Rule 10b-5 civil action was important enough to mobilize various publishers and First Amendment champions to argue in support of the defendants.
- Although the Court refused to adopt a blanket exception for disinterested publishers, it is worth noting that the SEC must still establish each of the elements of a § 10(b) civil enforcement action by a preponderance of the evidence. While publishers and First Amendment advocates may perceive a chilling effect from this decision, only publishers who make a misstatement of a material fact in connection with the purchase or sale of securities *with an intent to deceive, manipulate or defraud* need be concerned.
- The Court upheld the ability of the SEC to use § 10(b) and Rule 10b-5 to punish anyone, including publishers, who knowingly lie about a security with an intent to defraud, however, under the Court’s analysis, had Stansberry or Pirate not published statements that they knew to be false in order to sell a bogus stock tip, the SEC would not have been able to establish the elements of the § 10(b) cause of action.

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