CARLTON FIELDS

Must the "Maker" of a False Statement have "Ultimate Authority" over that Statement to be Subject to Liability for Securities Fraud?

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The Eleventh Circuit Interprets *Janus* in *SEC v. Big Apple Consulting*.

This case involved a civil enforcement action by the Securities and Exchange Commission (SEC) against certain public relations companies and their principals, alleging violations of—among other things—Section 17(a) of the Securities Act. The district court granted summary judgment in the SEC's favor, holding that liability under Section 17(a) of the Securities Act, which authorizes imposition of injunctive relief and/or criminal liability for false statements or omissions in the offer or sale of securities, attaches regardless of whether a defendant was in a position of "ultimate authority" such that it could control the statement being made to the market. In affirming, the Eleventh Circuit again demonstrated its reluctance to allow the expansion of the Supreme Court's 2011 *Janus* holding beyond a civil action under Rule 10b-5. **Background Significant to this Discussion**

Defendants were a conglomerate of public relations companies and their principals (the "Big Apple

Defendants"). The SEC's allegations stemmed from the Big Apple Defendants' relationship with a technology company in the business of selling USB drives with encryption capabilities. Over the course of several months, the tech company, CyberKey, made allegedly dubious claims of having landed various government contracts for its product, including a large contract with the Department of Homeland Security. During this time, the Big Apple Defendants used a call room to aggressively promote CyberKey to broker dealers. In return for its representation and promotion of CyberKey, the Big Apple Defendants (generally unbeknownst to the brokers to whom they were selling) were awarded stock in CyberKey. After regulatory inquiries suggested that the DHS contract was potentially fabricated, the SEC issued an order suspending the trading of CyberKey stock due to concerns regarding the accuracy of assertions made by the company in its press releases and other public statements to investors. Throughout this time period, the Big Apple Defendants sold nearly $8 million in CyberKey shares. **Contemplating the Impact of *Janus***

The SEC's complaint filed in federal district court alleged that the Big Apple Defendants committed securities fraud because they "knew, or were severely reckless in not knowing, that" CyberKey did not have a contract with DHS and had very little legitimate revenue. Among other things, the SEC claimed that the Big Apple Defendants were in violation of each of the three subsections of Section 17(a) of the Securities Act, which make it unlawful for any person in the offer or sale of any securities to:

> (1) Employ any device, scheme, or artifice to defraud; or (2) 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) Engage in any transaction, practice or course of business which operates or would operate as a fraud or deceit upon the purchaser.

The primary dispute here centered on whether the Big Apple Defendants "made" the inaccurate statements when they were merely conveying statements originally made by CyberKey. Defendants relied on the Supreme Court's 2011 decision in *Janus Capital Group, Inc, v. First Derivative Traders*, 131 S. Ct. 2296, 2302 (2011) (hereinafter, "*Janus*"), which defined what it means to "make" a false statement under SEC Rule 10b-5. In *Janus*, the Supreme Court held that the investment advisor to a mutual fund could not be held liable under Section 10(b) of the Exchange Act for statements in the fund's prospectus, because the advisor did not have "ultimate authority" over the statements. Several courts, including the U.S. Court of Appeals for the Ninth Circuit, were quick to recognize that *Janus* potentially sets the pleading bar even higher in securities fraud actions seeking to hold defendants liable for the misstatements of others rather than for a defendant's own misstatement. *See, e.g., Reese v. BP Exploration (Alaska) Inc.*, 643 F.3d 681, 693 n.8 (9th Cir. 2011). But since its issuance different circuit courts—indeed, even district courts within the same circuit—have reached various conclusions on the impact of *Janus*. The Eleventh Circuit has previously limited *Janus*' impact to securities fraud claims under 10b-5. *See, e.g., SEC v. Monterosso*, 756 F.3d 1326 (2014) (refusing to apply *Janus* to Section 17(a) claim). The trend continues here. The court rejected

defendants' arguments regarding subsections (1) and (3) of Section 17(a) out of hand, because, the court found, *Janus* only endeavored to define the term "make," a term which is not used in subsections (1) and (3) of 17(a) (or the similar provisions found in Rule 10b-5 subjections (a) and (c)). But it likewise rejected *Janus*' import to subsection (2) of Section 17(a). Though recognizing the similarities to subsection (b) of Rule 10b-5, which prohibits the "mak[ing] of any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances they were made, not misleading …" the court centered its analysis on one particular difference in the language. Whereas Rule 10b-5 focuses squarely on the action of "making" the statement, the court noted that Section 17(a)(2)'s focus was on obtaining money or property "by means of any untrue statement." Employing a "natural meaning" analysis, the court agreed with the First Circuit that the text of Section 17(a)(2) suggests that "it is irrelevant for purposes of liability whether the seller uses his own false statement or one made by another individual." *Big Apple* at *7, citing *SEC v. Tambone*, 597 F. 3d 436 (1st Cir. 2010). **The Takeaway**
The Eleventh Circuit's analysis—though ostensibly endeavoring to honor the "natural meaning" of the text—seemingly ignores a critical aspect of the text itself. Like Rule 10b-5, Section 17(a)(2) is centered on the premise that a statement has been "made," (indeed, the text reads, "… in order to make the statements made …") and one could easily conclude that someone obtaining money by means of any untrue statement should only be liable for violating the section if, as in *Janus*, that person had ultimate authority over the statement that was made. The Eleventh Circuit's parsing of the language in the manner it did could be viewed as an end justifying the means. While *Janus* plainly limits the expansion of liability, in the context of a *private* action under the federal securities laws, to those without authority over statements being made, the Eleventh Circuit suggests it will not so limit the *SEC*'s power to prosecute those same actors for the misstatements of others. *SEC v Big Apple Consulting USA, Inc.*, Case No. 13-11976, 2015 WL 1566925 (11th Cir. April 9, 2015).

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