Janus Inapplicable to Criminal Cases — Non-"Makers" of Statements Can Still be Criminally Liable for Violations of SEC Rule 10b-5

On May 7, 2014, in *Prousalis v. Moore*,[1] the Fourth Circuit held that the willful creation of a materially false statement of fact, intended to be disseminated in connection with the sale or purchase of a security, can be a criminal violation of SEC Rule 10b-5 even if the creator of the statement was not the one who disseminated it, holding that the Supreme Court's decision in *Janus Capital v. First Derivative Traders* did not apply to criminal cases.[2]

I. Background and Procedural History

"Making" an untrue statement of material fact in connection with the purchase or sale of a security is prohibited by Rule 10b-5. In 2011, the Supreme Court held in *Janus* that the "*maker* of a statement is the person or entity with the ultimate authority over the statement, including its content and whether and how to communicate it."[3] As a result, the creator of a false statement is not rendered directly liable to *private plaintiffs* because of the repetition of false statements by another, even if the creator intended to cause the repetition.[4]

In 2007, Thomas Prousalis—a lawyer who had assisted Busybox.com, Inc. through its IPO—plead guilty to securities fraud predicated on the omission of material information from Busybox's registration statement, in violation of Rule 10b-5.[5]

Four years later, after the *Janus* decision, he brought a new lawsuit (nominally against his probation officer) seeking to overturn the portion of his conviction predicated on a violation of Rule 10b-5, on the theory that only Busybox was the "maker" of the violative statements, not him. The government argued that *Janus* did not apply to criminal violations involving Rule 10b-5, and the district court agreed, leaving the conviction intact. The Fourth Circuit affirmed.

II. The Fourth Circuit's decision

Writing for the Court of Appeals, Judge J. Harvie Wilkinson III offered five reasons for not extending the *Janus* holding to criminal cases. First, the *Janus* decision relied heavily on *Central Bank of Denver*,[6] which held that there is no private right of action under Rule 10b-5 for aiding and abetting violations, even though aiding and abetting a 10b-5 violation is a crime. Second, in *Janus*, *Central*

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[1] No. 13-6814 (4th Cir. May 7, 2014). Available at http://www.ca4.uscourts.gov/Opinions/Published/136814.P.pdf.

[2] 131 S. Ct. 2296 (2011). For a summary of *Janus* see *The Supreme Court Holds That Mutual Fund Investment Advisers Are Not Statement "Makers" for the Purposes of Rule 10b-5 Liability* (June 14, 2011), available at http://www.cahill.com/publications/firm-memoranda/101284.

[3] *Id*. at 2302 (emphasis added).

[4] It is still possible for there to be secondary liability under § 20 of the Exchange Act.

[5] 15 U.S.C. § 78ff criminalizes willful violations of the Exchange Act or regulations thereunder, including Rule 10b-5.

[6] *Central Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164 (1994).

Bank and *Stoneridge*,[7] the Court discussed its desire to limit the private right of action under Rule 10b-5 because it was implied without specific congressional authorization (making it a relic of a bygone era of statutory interpretation). Third, the Court in *Janus* (as it had in *Central Bank*) was very clear that the question formally before the Court related only to private actions. Fourth, there was no mention in *Janus* of the decision's potential ramifications on criminal liability. Fifth, the Fourth Circuit was aware of no lower court cases applying *Janus* in the criminal context.

The Fourth Circuit concluded that to extend *Janus*, in light of those considerations, "would represent a stark assertion of judicial will, the very thing against which *Janus* itself inveighed."[8]

In his short opinion concurring in the result, Chief Judge Traxler stated: "I believe 'make' has the same meaning in the criminal context as it does in the context of a private right of action."[9] Notwithstanding his disagreement with majority's reasoning, the Chief Judge voted to uphold Mr. Prousalis' conviction because of a broad federal law, 18 U.S.C. § 2(b), which makes it a crime to "willfully cause[] an act to be done which if directly performed by him or another would be an offense against the United States."

III. Significance

Willfully creating materially false or misleading statements intended to be disseminated by others in connection with the purchase or sale of a security can be a crime, either because *Janus* is not applicable to criminal prosecutions or because 18 U.S.C. § 2(b) can accomplish the same end.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Jon Mark at 212.701.3100 or jmark@cahill.com; John Schuster at 212.701.3323 or jschuster@cahill.com; or Samuel I. Levin at 212.701.3153 or slevin@cahill.com.

[7] *Stoneridge Investment Partners v. Scientific-Atlanta*, 552 U.S. 148 (2008).

[8] Slip op. at 15.

[9] *Id*. at 17 (Traxler, CJ concurring in the result). *Accord Leocal v. Ashcroft*, 543 U.S. 1, 11 n.8 (2004) ("we must interpret the statute consistently, whether we encounter its application in a criminal or noncriminal context.").