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## Rule 10b-5(b) Enforcement Actions in Light of Janus: Making the Case for Agency Deference

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## **RULE 10B-5(B) ENFORCEMENT ACTIONS IN LIGHT OF JANUS: MAKING THE CASE FOR AGENCY DEFERENCE**

*Matthew P. Wynne\**

*This Note addresses whether the Supreme Court's recent decision in Janus Capital Group, Inc. v. First Derivative Traders applies to the Securities and Exchange Commission (SEC), and, if not, whether the SEC's own interpretation of Rule 10b-5 should be entitled to deference in future SEC enforcement actions. Since its promulgation in 1942, Rule 10b-5 has been the subject of much debate, particularly regarding the scope of the private right of action that courts have interpreted the rule to imply. Having acknowledged that an implied right exists, the Supreme Court quickly began to limit Rule 10b-5 claims of private plaintiffs, citing concern over expanding a right of action not grounded in a statute or regulation. In contrast, the Court has instructed lower courts to construe Rule 10b-5 "not technically and restrictively, but flexibly to effectuate its remedial purposes" when dealing with SEC cases. In Janus—the latest curtailment of the private Rule 10b-5 action—the Court held that a defendant must have ultimate authority over a statement to make a misstatement with it that violates Rule 10b-5(b). Among other justifications, the Court reemphasized its concern over expanding the implied private right of action without congressional authorization. Today, confusion abounds in the lower courts about whether the Court's narrow interpretation applies to all Rule 10b-5 actions (including those brought by the SEC) or merely to private civil suits (as in Janus).*

*This Note contends that the underlying rationale for the Court's Janus decision is not applicable to SEC enforcement actions. While the Court's decision may fit the particular circumstances of Janus, the policy considerations cited by the Court do not apply to the SEC, and, therefore, the Court's narrow interpretation of Rule 10b-5 should not apply to actions brought by the SEC. Assuming Janus does not apply, this Note contends that the SEC's pre-Janus interpretation would withstand Chevron-style analysis of an agency interpretation and is therefore entitled to substantial judicial deference in future enforcement actions.*

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#### INTRODUCTION

“To make,” or not “to make”: that is the question.<sup>1</sup> Although Shakespeare surely did not contemplate the complexity of federal securities laws or mutual fund structures when he wrote his famous line, the U.S. Supreme Court recently attempted to answer a pressing question for actors in the capital markets: What does it take “to make” a materially misleading statement such that one is primarily liable for a violation of Securities and Exchange Commission (SEC) Rule 10b-5(b)?<sup>2</sup>

Imagine that a mutual fund advisor creates a fund for investors who own the fund entirely.<sup>3</sup> The advisor, under a management agreement with the fund, controls the day-to-day operations of the fund. All the officers of the fund are employees of the advisor. As a separate legal entity, the fund has a board of directors, all of whom are independent from the advisor except for one. The advisor, being in the best position to do so, provides all the information for the fund’s prospectus, chiefly, that the fund is not suitable for market timing trading strategies. Separately, and unbeknownst to the fund’s board, the advisor has entered into secret arrangements with third parties to permit market timing in the fund. Having no reason to suspect inaccuracies in the advisor’s information, the board approves the prospectus. The advisor then distributes the prospectus to potential investors. A state regulator uncovers the misstatement, causing the fund’s investors to flee. With the loss of assets under management, the fees collected by the advisor (and ultimately its publicly traded parent) plummet. The stock price of the parent drops. Shareholders of the parent company sue the advisor for the misstatement. Can the advisor be primarily liable for making those misstatements in the fund’s prospectus? Would the answer change if the SEC were the plaintiff instead of a private party?

In *Janus Capital Group, Inc. v. First Derivate Traders*,<sup>4</sup> a private securities lawsuit, the Supreme Court addressed the first question but failed to answer the second. The Court severely curtailed the scope of Rule 10b-5(b), holding that one must have “ultimate authority” over a statement in

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1. Apologies to William Shakespeare. See WILLIAM SHAKESPEARE, *HAMLET*, act 3, sc. 1 (“To be, or not to be: that is the question.”).

2. 17 C.F.R. § 240.10b-5(b) (2012). For the full text of the rule, see *infra* text accompanying note 22.

3. This hypothetical is based, at a high level, on the facts of *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011). For a more complete description of *Janus*, see *infra* Part I.A.3.a.

4. 131 S. Ct. 2296 (2011).

order “to make” a material misstatement with it.<sup>5</sup> The advisor in the above hypothetical, Janus Capital Management (JCM), did not have “ultimate authority,” and thus could not be primarily liable.<sup>6</sup> The fund and its board lacked the requisite scienter for primary liability.<sup>7</sup> As a result, no party was held liable for the misstatement that caused the plaintiff’s loss.

The Court, however, did not clearly articulate the reach of its holding. Because the facts and procedural stance of *Janus* are unique, lower courts have struggled to determine when the ultimate authority test applies and to whom it applies to. Specifically, courts are wrestling over whether *Janus* applies to SEC enforcement actions—indeed, the SEC itself is unsure.<sup>8</sup>

In *Janus*, the Court rejected the SEC’s position, set forth in an amicus brief, which argued for a broader interpretation of Rule 10b-5.<sup>9</sup> Nonetheless, the Court did not explicitly state that the holding applied to SEC enforcement actions, and language in the opinion indicates it may not. Since the *Janus* decision, the SEC has generally avoided the question and pursued enforcement actions against defendants lacking “ultimate authority” either by charging them with aiding and abetting the primary actor’s 10b-5(b) violation<sup>10</sup> or by pursuing other provisions imposing liability.<sup>11</sup> Although this strategy has been somewhat effective, the secondary liability approach only works if there is a separate primary violator to aid and abet.

In the face of the Court’s limitation on private securities litigation, many simply assumed that *Janus* applied to all Rule 10b-5 cases. Justice Thomas went to great lengths, however—both before and after stating the Court’s holding—to explain that the private right of action must be construed narrowly because it was implied in the statute. Although the facts, procedural stance, and policy reasons identified in *Janus* may have rightfully compelled the Court’s decision, such a limitation on Rule 10b-5 should not sweep so broadly as to incorporate cases where these facts and

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5. *Id.* at 2302.

6. *Id.* at 2302, 2304.

7. *Id.* at 2310 (Breyer, J., dissenting).

8. See Yin Wilczek, *Extent to Which Janus Applies to SEC Actions Not Clear*, *Official Says*, 44 Sec. Reg. & L. Rep. (BNA) 462 (March 5, 2012) (according to SEC Deputy Solicitor John Avery, “It is ‘not clear’ whether the decision covers SEC actions.”).

9. *Janus*, 131 S. Ct. at 2303–04 & n.8.

10. Securities Exchange Act of 1934 § 20(e), 15 U.S.C. § 78t(e) (2006 & Supp. V 2011) (“[A]ny person that knowingly or recklessly provides substantial assistance to another person in violation of a provision of this chapter . . . shall be deemed to be in violation of such provision to the same extent as the person to whom such assistance is provided.”).

11. For example, see *SEC v. Big Apple Consulting USA, Inc.*, No.6:09-cv-1963-Orl-28GJK, 2012 WL 3264512 (M.D. Fla. Aug. 9, 2012), which was in progress when the *Janus* decision was handed down. The SEC withdrew its primary liability claims against some defendants under Rule 10b-5 and added claims that the defendants instead aided and abetted other primary violators. *Id.* at \*2; see also Jean Eaglesham, *At SEC, Strategy Changes Course*, WALL ST. J., Sept. 30, 2011, at C1; Yin Wilczek, *SEC Looking to Aiding/Abetting Claims in Wake of Janus Decision*, *Official Says*, 44 Sec. Reg. & L. Rep. (BNA) 457 (March 5, 2012).

policy considerations are not present. Specifically, *Janus* should not apply to SEC enforcement actions.

This Note will argue that the *Janus* decision is limited to private securities litigation and does not apply to Rule 10b-5(b) SEC enforcement actions. Additionally, the SEC's interpretation of the Rule, arguing for a "creation" standard, is reasonable. Since the Court's 1945 decision in *Bowles v. Seminole Rock & Sand Co.*,<sup>12</sup> the Court has given an agency's interpretation of its own regulation "controlling weight unless it is plainly erroneous."<sup>13</sup> While the Court has refined the "*Seminole Rock* deference" standard over the years, it has reaffirmed the underlying principle in recent cases.<sup>14</sup> Therefore, courts should defer to the SEC's reasonable interpretation of Rule 10b-5(b) in future SEC enforcement actions.

Part I of this Note will first provide a background discussion of the Securities Exchange Act of 1934 and its section 10(b), Rule 10b-5, and the SEC's enforcement authority. Next, Part I will provide background on the history of private actions under Rule 10b-5, ending with a discussion of the Supreme Court's recent decision in *Janus*. Last, it will discuss the background of agency deference in general and as it applies to an agency's interpretation of its own regulation.

Part II will first discuss whether *Janus* applies to the SEC, reviewing the *Janus* decision itself as well as subsequent lower court decisions. Part II will then discuss whether the SEC's interpretation should be entitled to judicial deference if *Janus* does not apply. This will include a discussion of the competing interpretations of Rule 10b-5 expressed in pre-*Janus* cases, the *Janus* majority, the *Janus* dissent, and the SEC's amicus brief in *Janus*.

Part III will argue that *Janus* was indeed limited to private actions and does not apply in SEC enforcement actions. Finally, it will argue that the SEC's interpretation of Rule 10b-5(b) is reasonable and a permissible construction of the Rule, satisfying the concerns expressed by the *Janus* court while allowing the SEC to carry out its essential task of protecting investors. Therefore, the SEC's interpretation should be entitled to substantial deference from courts in future enforcement actions.

## I. THE BEGINNINGS: SECURITIES LAWS AND AGENCY DEFERENCE

This part provides a brief history of the securities laws and regulations underlying the *Janus* case, as well as an overview of the bedrock principles of agency deference found in the Supreme Court's jurisprudence. Part I.A briefly surveys the circumstances leading to the federalization of securities laws, the relevant securities laws and regulations, and the SEC's authority

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12. 325 U.S. 410 (1945).

13. *Id.* at 414.

14. *See, e.g.,* *Auer v. Robbins*, 519 U.S. 452 (1997); *Thomas Jefferson Univ. v. Shalala*, 512 U.S. 504 (1994). *See generally* Matthew C. Stephenson & Miri Pogoriler, *Seminole Rock's Domain*, 79 GEO. WASH. L. REV. 1449 (2011) (surveying the current scope of *Seminole Rock* deference).

to enforce them. Part I.A concludes with a brief history of the private right of action under Rule 10b-5, up to and including the *Janus* case.

Part II.B then lays out the oft-cited *Chevron* analysis, which courts apply to determine when to defer to a federal administrative agency's interpretation of a statute. Part II.B then describes an analogous line of cases defining *Seminole Rock* deference, which dictates when a court should defer to an agency's interpretation of its own regulation. Finally Part II.B concludes by introducing the potential interaction of agency deference with stare decisis.

### A. History of Relevant Securities Laws

This section describes the development of federal securities laws, the history of SEC Rule 10b-5, and the SEC's enforcement authority. It then provides a brief history of the Rule 10b-5 private action and concludes with a discussion of the *Janus* case.

#### 1. History of SEC Rule 10b-5

The history of federal securities law begins with the bull market of the 1920s and the subsequent Great Depression, which was caused in part by the dramatic stock market crash of 1929.<sup>15</sup> At the time, only a patchwork of state "blue sky laws" regulated the market for securities.<sup>16</sup> Seizing on the moral and ethical failings of Wall Street at the time, President Franklin D. Roosevelt used his New Deal platform to push for the restoration of investor confidence in the financial markets.<sup>17</sup> In 1933, Congress passed the Securities Act<sup>18</sup> ('33 Act), and, in the following year, the Securities Exchange Act<sup>19</sup> ('34 Act), federalizing the regulation of securities.<sup>20</sup> The combined purpose of the Acts was to prevent fraud and create full disclosure to allow investors to make informed decisions.<sup>21</sup>

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15. See Steve Thel, *The Original Conception of Section 10(b) of the Securities Exchange Act*, 42 STAN. L. REV. 385, 407–08 (1990) (describing the process leading to enactment of the Securities Exchange Act of 1934).

16. See 1 THOMAS LEE HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION § 1.2[2] (6th ed. 2009).

17. Ronald J. Colombo, *Cooperation with Securities Fraud*, 61 ALA. L. REV. 61, 65–66 (2009).

18. Securities Act of 1933, Pub. L. No. 73-22, 48 Stat. 74 (codified as amended at 15 U.S.C. §§ 77a–77zzz (2006 & Supp. V 2011)). The Securities Act requires issuers to register securities offerings with the SEC and to disclose material information in a securities registration statement and prospectus. See 1 HAZEN, *supra* note 16, § 2.0.

19. Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881 (codified as amended at 15 U.S.C. §§ 78a–78pp (2006 & Supp. V 2011)). See generally 1 LOUIS LOSS, JOEL SELIGMAN & TROY PAREDES, FUNDAMENTALS OF SECURITIES REGULATION 57–60 (6th ed. 2011) (providing an overview of the Acts).

20. See Colombo, *supra* note 17, at 65.

21. See Frank H. Easterbrook & Daniel R. Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 VA. L. REV. 669, 669 (1984) (“[The Acts] had and still have two basic components: a prohibition against fraud, and requirements of disclosure when securities are issued periodically thereafter.”); see also *Santa Fe Indus., Inc. v. Green*, 430

Section 10(b) of the '34 Act provides, in pertinent part:

It shall be unlawful for any person, directly or indirectly . . . [t]o use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.<sup>22</sup>

Although the Acts explicitly listed numerous civil and criminal penalties, Congress recognized that a rigid statutory framework would impede the efficient regulation of securities trading.<sup>23</sup> As part of the '34 Act, Congress created the SEC<sup>24</sup> and delegated to it an “arsenal of flexible enforcement powers,”<sup>25</sup> including the power to promulgate rules and regulations to enforce the provisions of section 10(b).<sup>26</sup>

In 1942, a company president in Boston was buying shares from his investors without disclosing to them the latest improved earnings.<sup>27</sup> Milton Freeman, then an Assistant Solicitor at the SEC, was tasked with drafting a rule that would prohibit such activity. Freeman quickly drafted a rule and presented it to the Commission the same day. Without any hesitation, the Commission unanimously approved the rule.<sup>28</sup> That rule, SEC Rule 10b-5, states:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

- (a) To employ any device, scheme, or artifice to defraud,
- (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
- (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

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U.S. 462 (1977) (“[T]he fundamental purpose of the [’34] Act [is] ‘to substitute a philosophy of full disclosure for the philosophy of *caveat emptor*. . . .” (quoting *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 151 (1972))). *But see* Thel, *supra* note 15, at 388–94 (critiquing the Supreme Court’s conception of section 10(b) and offering an alternative view).

22. 15 U.S.C. § 78j(b) (2006).

23. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 195 (1976).

24. *See* 15 U.S.C. § 78d. The '34 Act transferred to the SEC the administration of the '33 Act, formerly administered by the Federal Trade Commission. *See* 17 C.F.R. § 200.1 (2012).

25. *Ernst & Ernst*, 425 U.S. at 195.

26. *See* 15 U.S.C. § 78j(b) (making it unlawful to act “in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors”).

27. *See* Milton V. Freeman, *Foreword*, 61 *FORDHAM L. REV.* S1, S1 (1993).

28. *See id.* at S1–S2; *see also* Milton V. Freeman, *Administrative Procedures*, 22 *BUS. LAW.* 891, 922 (1967) (recounting Commissioner Sumner Pike, the only person to say anything at the meeting, stating: “Well, we are against fraud, aren’t we?”).

in connection with the purchase or sale of any security.<sup>29</sup>

This rule has not changed since 1942. Section 10(b) has been characterized as a “catchall,”<sup>30</sup> and Rule 10b-5, similarly, as “a sort of long-arm provision in which the SEC forbids everything the statute gives it power to forbid.”<sup>31</sup> The language of Rule 10b-5 has also been praised as open-ended and adaptable, allowing a degree of flexibility to reach new schemes and tactics.<sup>32</sup>

## 2. SEC Enforcement Authority

The SEC consists of five Commissioners, appointed by the President, who collectively oversee five separate divisions, including a Division of Enforcement.<sup>33</sup> Section 21 of the '34 Act authorizes the SEC to enforce the Acts.<sup>34</sup> This authority includes the express power to enforce the rules and regulations promulgated by the Commission under the '34 Act—specifically, Rule 10b-5.<sup>35</sup> In its enforcement role, the SEC is a “statutory guardian charged with safeguarding the public interest in enforcing the securities laws.”<sup>36</sup> The SEC’s enforcement decisions must balance the multidimensional nature of the SEC’s mission of protecting investors; maintaining fair, orderly, and efficient markets; and facilitating capital formation.<sup>37</sup>

The SEC has several options and venues available to carry out its enforcement duties.<sup>38</sup> First, the SEC has the power to bring actions in federal court to seek temporary and permanent injunctive relief against possible violators,<sup>39</sup> to request that a court prohibit persons from serving as officers or directors of registered companies,<sup>40</sup> to seek civil monetary

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29. 17 C.F.R. § 240.10b-5.

30. *Chiarella v. United States*, 445 U.S. 222, 234–35 (1980) (“Section 10(b) is aptly described as a catchall provision, but what it catches must be fraud.”).

31. *Thel*, *supra* note 15, at 462–63; *see Colombo*, *supra* note 17, at 66 (“Rule 10b-5 attempts to circumscribe the widest range of conduct subject to prohibition under § 10(b) by broadly enjoining any fraud or deceit in connection with the purchase or sale of any security.”).

32. *See* Donald C. Langevoort, *Rule 10b-5 As an Adaptive Organism*, 61 FORDHAM L. REV. S19–S21 (1993) (describing the benefits of the ambiguity of Rule 10b-5’s language).

33. *See* About the SEC: What We Do, SEC, <http://www.sec.gov/about/whatwedo.shtml> (last visited Feb. 15, 2013) [hereinafter About the SEC].

34. Securities Exchange Act of 1934 § 21, 15 U.S.C. § 78u (2006).

35. *See* *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71, 78–79 (2006); *see also* Paul S. Atkins & Bradley J. Bondi, *Evaluating the Mission: A Critical Review of the History and Evolution of the SEC Enforcement Program*, 13 FORDHAM J. CORP. & FIN. L. 367, 371 (2008) (listing the federal securities laws that the SEC is tasked with enforcing).

36. *SEC v. Mgmt. Dynamics, Inc.*, 515 F.2d 801, 808 (2d Cir. 1975).

37. *See* Atkins & Bondi, *supra* note 35, at 369.

38. *See generally* 15 U.S.C. § 78u; 17 C.F.R. § 202.5 (2012). For a general overview of available enforcement options, *see* 1 HAZEN, *supra* note 16, § 1.4[6].

39. 15 U.S.C. § 78u(d)(1).

40. *Id.* § 78u(d)(2).

penalties for securities law violations,<sup>41</sup> and to request equitable relief.<sup>42</sup> Second, the SEC can bring administrative action against alleged violators.<sup>43</sup> In these administrative proceedings, the SEC may impose monetary penalties after notice and opportunity for a hearing.<sup>44</sup> An administrative law judge (ALJ), who is independent of the SEC, presides over these hearings.<sup>45</sup> The ALJ issues an initial decision, which can be appealed to the Commission.<sup>46</sup> The Commission's decision can be appealed to federal circuit courts.<sup>47</sup> Third, the SEC can refer cases to the Department of Justice for criminal prosecution.<sup>48</sup>

### 3. A Brief Overview of the Private Right of Action Under Rule 10b-5

The '34 Act does not explicitly provide for a private right of action under section 10(b) or Rule 10b-5, whereby a private citizen (as opposed to a government agency) may bring a civil action against a violator in court.<sup>49</sup> Nevertheless, soon after the SEC first promulgated the rule, federal district courts, starting in 1946 with *Kardon v. National Gypsum Co.*,<sup>50</sup> began finding an implied private remedy for Rule 10b-5 violations.<sup>51</sup> However, the Supreme Court did not officially recognize this implied right of action in section 10(b) and Rule 10b-5 until 1971.<sup>52</sup>

Following the Court's recognition, Rule 10b-5 became a popular and powerful tool for the securities plaintiff's bar.<sup>53</sup> Besides their popularity, private actions under section 10(b) and Rule 10b-5 "play a vital role in protecting the integrity of our securities markets."<sup>54</sup> The combination of SEC enforcement efforts and private rights of action under federal securities laws helps to provide a "high level of investor confidence in the integrity and efficiency of our markets."<sup>55</sup> As an Associate Justice, William H.

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41. *Id.* § 78u(d)(3).

42. *Id.* § 78u(d)(5).

43. *Id.* §§ 78u-2, 78d-1 (delegation to ALJ).

44. *Id.* § 78u-2(a).

45. See About the SEC, *supra* note 33.

46. *See id.*

47. 15 U.S.C. § 78y(a)(1); *see Office of Administrative Law Judges, SEC*, <https://www.sec.gov/alj.shtml> (last visited Feb. 15, 2013).

48. *See* 1 HAZEN, *supra* note 16, § 1.4[6].

49. *See* Colombo, *supra* note 17, at 67.

50. 69 F. Supp. 512 (E.D. Pa. 1946).

51. *Id.* at 513-14.

52. *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 13 n.9 (1971) ("It is now established that a private right of action is implied under § 10(b).").

53. *See* 3 HAZEN, *supra* note 16, § 12.3[3], at 528 ("[T]here are hundreds of reported cases each year involving the rule.").

54. *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta*, 552 U.S. 148, 174 (2008).

55. S. REP. NO. 104-98, at 8 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 687 (providing background for the Private Securities Litigation Reform Act of 1995); *see also* *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 310 (1985) ("[W]e repeatedly have emphasized that implied private actions provide 'a most effective weapon in the enforcement' of the securities laws and are 'a necessary supplement to Commission action.'" (citations omitted) (quoting *J.I. Case Co. v. Borak*, 377 U.S. 426, 432 (1964))).

Rehnquist once referred to the Rule as a “judicial oak which has grown from little more than a legislative acorn.”<sup>56</sup>

Only four years after recognition of the implied right, however, the Court began, in *Blue Chip Stamps v. Manor Drug Stores*,<sup>57</sup> to express reservations about continuing to imply a private right not grounded in any tangible congressional intent.<sup>58</sup> Later, in *Central Bank of Denver v. First Interstate Bank of Denver*,<sup>59</sup> the Supreme Court held that private civil liability under Rule 10b-5 did not extend to those who only aided and abetted the manipulative practice but did not themselves engage in the violation.<sup>60</sup> The Court held that the implied right of action did not extend beyond the language of the statute.<sup>61</sup>

Soon thereafter, fearing that *Central Bank* might also preclude the SEC from bringing aiding and abetting charges, Congress passed the Private Securities Litigation Reform Act of 1995 (PSLRA).<sup>62</sup> The PSLRA explicitly amended the '34 Act to authorize the SEC to bring actions against persons who aid and abet securities violations<sup>63</sup> but did not include a provision authorizing private suits for similar conduct.<sup>64</sup>

In *Stoneridge Investment Partners v. Scientific-Atlanta*,<sup>65</sup> the Court sought to clarify the now important distinction between primary and secondary liability. In that case, the defendants, Scientific-Atlanta and Motorola, knowingly falsified contracts with Charter Communications, who then used those contracts to falsify its own financial statements.<sup>66</sup> Charter was the undisputed primary violator of Rule 10b-5, but the private-party plaintiffs sought to hold the defendants liable as well.<sup>67</sup> The Court acknowledged that “[c]onduct itself can be deceptive,”<sup>68</sup> but the plaintiffs could not establish reliance, an essential element in a private Rule 10b-5 action, because the defendants’ statements were never actually made to the plaintiffs.<sup>69</sup> Additionally, none of the defendants’ acts made it “necessary or inevitable” that Charter would fraudulently record the transactions as it

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56. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 737 (1975).

57. 421 U.S. 723 (1975).

58. *Id.* at 737 (“When we deal with private actions under Rule 10b-5 . . . it would be disingenuous to suggest that either Congress in 1934 or the [SEC] in 1942 foreordained the present state of the law with respect to Rule 10b-5.”).

59. 511 U.S. 164 (1994).

60. *Id.* at 191.

61. *Id.* (“Because the text of § 10(b) does not prohibit aiding and abetting, we hold that a private plaintiff may not maintain an aiding and abetting suit under § 10(b).”).

62. Pub. L. No. 104-67, 104 Stat. 737 (codified as amended in scattered sections of 15 U.S.C.).

63. *Id.* § 104 (codified as amended at 15 U.S.C. § 78t(e) (2006)).

64. *See Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 158 (2008); Colombo, *supra* note 17, at 78.

65. 552 U.S. 148.

66. *Id.* at 153–55.

67. *Id.* at 155.

68. *Id.* at 158.

69. *Id.* at 159.

did.<sup>70</sup> Lastly, acknowledging judicial creation of the private right of action, the Court cautioned against its expansion.<sup>71</sup>

Most recently, the Court further narrowed the scope of private Rule 10b-5 actions in *Janus*. The next section will provide background on mutual funds relevant to the *Janus* case.

#### *a. Background on Mutual Funds*

The *Janus* case involved misrepresentations in the prospectus of a mutual fund. This section will provide a brief background on mutual funds, their structure, how they are managed, and how they are regulated. The next section will cover the specific facts of *Janus*.

A mutual fund, in general, is a legal entity that pools money from investors and invests in a portfolio of securities.<sup>72</sup> The fund is created by a sponsor, which contracts with the fund, often through a subsidiary, to provide subsequent operational management of the fund.<sup>73</sup> The fund is owned entirely by investors who purchase shares in the fund, with each share representing proportionate ownership of the fund's portfolio of securities.<sup>74</sup> As a stand-alone legal entity, mutual funds have their own board of directors, distinct from the sponsor or its subsidiaries.<sup>75</sup> The primary role of the fund's board of directors is to oversee the delegation of management to the contracted manager.<sup>76</sup> The sponsor or its subsidiary, through its management contract with the fund, usually provides investment advisory, brokerage, and custodial services for the fund, among other things.<sup>77</sup> Mutual funds rarely have their own employees and are therefore externally managed and operated by the sponsor or its subsidiary. This contractual manager is often referred to as an investment advisor or management company.<sup>78</sup> The management company is typically paid a percentage of the assets under management held in the fund and does not share directly in the gains and losses of the fund's investments.<sup>79</sup> To attract investors, mutual funds issue a prospectus, which details the fund's investment strategy, objectives, fees, expenses, risks, and methods for purchasing or redeeming shares, among other things.<sup>80</sup>

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70. *Id.* at 161.

71. *Id.* at 165 (“Concerns with the judicial creation of a private cause of action caution against expansion. The decision to extend the cause of action is for Congress, not for us.”).

72. ROBERT C. POZEN, *THE MUTUAL FUND BUSINESS* 16 (Sandra D. Crane ed., 1998).

73. Donald C. Langevoort, *Private Litigation To Enforce Fiduciary Duties in Mutual Funds: Derivative Suits, Disinterested Directors and the Ideology of Investor Sovereignty*, 83 WASH. U. L.Q. 1017, 1019 (2005).

74. *See* POZEN, *supra* note 72, at 17.

75. *See id.* at 4.

76. *See* Langevoort, *supra* note 73, at 1020.

77. *See id.*

78. *See* POZEN, *supra* note 72, at 4.

79. *See id.* at 6; *see also* Langevoort, *supra* note 73, at 1020.

80. *See* POZEN, *supra* note 72, at 20.

In addition to the '33 Act and '34 Act, mutual funds are subject to additional federal laws that specifically address investment companies and their advisors. The Investment Company Act of 1940<sup>81</sup> requires all funds to register with the SEC and follow certain operating standards.<sup>82</sup> The fund's advisor is also subject to the Investment Advisors Act of 1940.<sup>83</sup> Lastly, the '33 Act requires specific disclosures by the fund, and the '34 Act sets out antifraud provisions regarding the purchase and sale of fund shares.<sup>84</sup>

*b. The Facts of Janus*

First Derivative Traders, the lead plaintiff in this class-action suit, represented shareholders of Janus Capital Group (JCG). First Derivative sued JCG and its wholly owned subsidiary Janus Capital Management (JCM) for alleged misstatements in the prospectus of Janus Investment Fund (JIF).<sup>85</sup> JCM and JCG, the sponsors, had created JIF, a mutual fund, as a separate legal entity owned entirely by investors.<sup>86</sup> JIF contractually retained JCM to be its investment advisor, underwriter, and administrator.<sup>87</sup> All JIF employees were also officers of JCM, but only one member of JIF's board was associated with JCM.<sup>88</sup>

Seeking to attract investors, JIF issued prospectuses that detailed the investment strategy and operation of its mutual funds.<sup>89</sup> The prospectuses for several funds stated that the mutual funds were not suitable for market timing trading strategies.<sup>90</sup> Shortly thereafter, the New York Attorney General filed a complaint against JCG and JCM, alleging that JCG entered into secret arrangements to permit market timing in certain funds managed by JCM, contrary to the disclosures in the JIF prospectus.<sup>91</sup> Following the Attorney General's complaint, JIF fund investors withdrew substantial amounts of money from JIF.<sup>92</sup> JCM earned money from JIF based on JIF's assets under management, so the decrease in JIF's assets reduced JCM's advisory revenues, which in turn decreased revenues for JCM's parent, JCG.<sup>93</sup> First Derivative, a JCG shareholder, alleged that if the truth had been known about permitting market timing strategies, the Janus mutual

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81. 15 U.S.C. § 80a-1 to 80a-64 (2006).

82. See POZEN, *supra* note 72, at 21.

83. 15 U.S.C. §§ 80b-1 to 80b-21; see Pozen, *supra* note 72, at 21.

84. See POZEN, *supra* note 72, at 21.

85. Janus Capital Grp., Inc. v. First Derivative Traders, 131 S. Ct. 2296, 2301–02 (2011).

86. *Id.* at 2299.

87. *Id.*

88. *Id.* at 2299–2300.

89. *Id.* at 2300.

90. *Id.* Market timing, while not illegal, *id.*, is “an investment strategy by which sophisticated short-term traders take advantage of delays in the pricing of mutual funds, to the detriment of other fund investors.” Norman S. Poser, *The Supreme Court's Janus Capital Case*, 44 REV. SEC. & COMMODITIES REG. 205, 205 (2011).

91. *Janus*, 131 S. Ct. at 2300.

92. *Id.*

93. *Id.*

funds would have been less attractive to investors, thus reducing the price of JCG stock that the plaintiffs would have paid to purchase it.<sup>94</sup>

First Derivative alleged that JCM “caused mutual fund prospectuses to be issued for Janus mutual funds and made them available to the investing public, which created the misleading impression that [JCG and JCM] would implement measures to curb market timing in the Janus [mutual funds].”<sup>95</sup> The District of Maryland dismissed the complaint, finding that the plaintiffs failed to state a claim.<sup>96</sup> On appeal, the Fourth Circuit found that “JCG and JCM, by participating in the writing and dissemination of the prospectuses, *made* the misleading statements contained in the documents.”<sup>97</sup> The Fourth Circuit also held that investors could infer that JCM “played a role in preparing or approving the content of the Janus fund prospectuses.”<sup>98</sup>

### c. *The Janus Holding*

The Supreme Court granted certiorari to address whether JCM could be held liable in a private action under Rule 10b-5 for false statements included in JIF prospectuses.<sup>99</sup>

The Supreme Court held that, “[f]or purposes of Rule 10b-5, the maker of a statement is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it.”<sup>100</sup> The board of JIF had final approval of the prospectus. Therefore, JCM—which had provided substantive information for the fund’s prospectus, drafted the misstated prospectus, and distributed it—did not “make” a false statement under Rule 10b-5(b) because the fund, JIF, and not the advisor, JCM, had “ultimate authority” over the prospectus.<sup>101</sup>

### d. *The SEC’s Amicus Brief*

The SEC filed an amicus brief<sup>102</sup> contending that, for purposes of Rule 10b-5(b), “make” should be defined as “create.”<sup>103</sup> The SEC argued that its position was “controlling” as long as it the interpretation was not “plainly

94. *Id.* at 2300–01.

95. *Id.* at 2300.

96. *Id.* at 2301 (citing *In re Mut. Funds Inv. Litig.*, 487 F. Supp. 2d, 618, 620 (D. Md. 2007), *rev’d*, 566 F.3d 111 (4th Cir. 2009), *rev’d sub nom.* *Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011)).

97. *Id.* at 2301 (quoting *In re Mut. Funds Inv. Litig.*, 566 F.3d 111, 121 (4th Cir. 2009), *rev’d sub nom.* *Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011)).

98. *Id.* (quoting *In re Mut. Funds Inv. Litig.*, 566 F.3d 111, 127 (4th Cir. 2009), *rev’d sub nom.* *Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011)).

99. *Id.*

100. *Id.* at 2302. For a full discussion of the conflicting interpretations of “to make,” see *infra* Part II.B.3.

101. *Janus*, 131 S. Ct. at 2302.

102. Brief for United States As Amicus Curiae Supporting Respondent, *Janus*, 131 S. Ct. 2296 (No. 09-525), 2010 WL 4339892 [hereinafter SEC *Janus* Brief].

103. *Id.* at 12–17.

erroneous or inconsistent with the regulation.”<sup>104</sup> The Court was quick to dismiss the SEC’s position, noting that the Commission was not entitled to deference where the meaning of the rule was not ambiguous and expressed skepticism over affording deference to the SEC in a private right of action to which the SEC was not a party.<sup>105</sup> The *Janus* majority opinion, and its conflict with the dissenting Justices and SEC, will be discussed in greater detail in Part II.

### B. Agency Deference

Federal administrative agencies are tasked with carrying into effect the will of congressional statutes.<sup>106</sup> Agency duties vary, but generally include promulgating rules based on such statutes and enforcing both the statutes and rules.<sup>107</sup> This frequently requires the interpretation of imprecise or unclear statutes and regulations.<sup>108</sup> Often, the agency’s interpretation might be a choice between reasonable alternatives, even where one interpretation might appear “better” than another to those outside the agency.<sup>109</sup> Nonetheless, for decades, courts have shown varying degrees of deference to reasonable agency interpretations of statutes, rules, and regulations.

This Note will focus on judicial deference to an agency’s interpretation of its own regulation. However, it is important first to understand the underlying rationale for agency deference,<sup>110</sup> articulated by the Supreme Court in the seminal case, *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*<sup>111</sup> After discussing the basic principles, this section will narrow its focus to deference to an agency’s interpretation of its own rule, as laid out first in *Seminole Rock*<sup>112</sup> and more recently reaffirmed in *Auer v. Robbins*.<sup>113</sup>

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104. *Id.* at 13–14 (quoting *Auer v. Robbins*, 519 U.S. 452, 461 (1997)).

105. *Janus*, 131 S. Ct. at 2303 n.8 (“[W]e have previously expressed skepticism over the degree to which the SEC should receive deference regarding the private right of action. . . . [T]he SEC’s presumed expertise ‘is of limited value’ when analyzing ‘whether a cause of action should be implied by judicial interpretation in favor of a particular class of litigants.’ This also is not the first time this Court has disagreed with the SEC’s broad view of § 10(b) or Rule 10b-5.” (citations omitted)).

106. See JOHN F. MANNING & MATTHEW C. STEPHENSON, LEGISLATION AND REGULATION 358–60 (2010) (providing an introduction to the federal administrative state).

107. See *id.*

108. See *id.*

109. See *Pauley v. BethEnergy Mines, Inc.*, 501 U.S. 680, 703–06 (1991).

110. John F. Manning, *Constitutional Structure and Judicial Deference to Agency Interpretations of Agency Rules*, 96 COLUM. L. REV. 612, 619 (1996) (“Although *Seminole Rock* preceded *Chevron* by almost four decades, the Court in *Seminole Rock* did not offer any detailed rationale for binding deference. When the Supreme Court finally supplied a substantial explanation for *Seminole Rock* deference, it incorporated *Chevron*’s more fully developed premises.”).

111. 467 U.S. 837 (1984).

112. *Bowles v. Seminole Rock & Sand Co.*, 325 U.S. 410 (1945).

113. 519 U.S. 452 (1997).

### 1. *Chevron* Deference

*Chevron* deference is commonly understood to include two “steps.”<sup>114</sup> *Chevron* Step One asks “whether Congress has directly spoken to the precise question at issue.”<sup>115</sup> If Congress’s intent is clear, the inquiry ends because the court, as well as the agency, must follow the “unambiguously expressed intent of Congress.”<sup>116</sup> If Congress has not directly addressed the issue, however, the court does not impose its own construction of the statute,<sup>117</sup> rather, it moves to *Chevron* Step Two.

If the statute is silent or ambiguous on the issue, Step Two requires the court to ask “whether the agency’s answer is based on a permissible construction of the statute.”<sup>118</sup> To administer the congressional scheme, agencies must formulate policy and promulgate rules to fill the gaps left by Congress.<sup>119</sup>

There are two types of delegation gaps: explicit and implicit.<sup>120</sup> Certain statutes may be explicit (e.g., “The SEC shall define X”) or implicit (e.g., “The SEC shall have the authority to make regulations to enforce this provision”). With an express delegation, agency interpretations are given controlling weight unless they are “arbitrary, capricious, or manifestly contrary to the statute.”<sup>121</sup> With an implicit delegation, a court may not substitute its own construction for a reasonable interpretation made by the agency.<sup>122</sup>

While the *Chevron* analysis has remained consistent, a question eventually arose as to when this analysis should apply. The Court attempted to answer that question in *United States v. Mead Corp.*<sup>123</sup> The Court’s answer has been referred to as “*Chevron* Step Zero.”<sup>124</sup>

In *Mead*, the Court noted that there were times when Congress did not intend to delegate authority to an agency to fill a gap.<sup>125</sup> In those cases, *Chevron* deference would not apply, and a court should instead consider

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114. See generally Thomas W. Merrill & Kristin E. Hickman, *Chevron’s Domain*, 89 GEO. L.J. 833 (2001) (providing a detailed overview of the scope of *Chevron* deference leading up to *United States v. Mead*, 533 U.S. 218 (2001), which was decided shortly after the article’s publication).

115. *Chevron*, 467 U.S. at 842.

116. *Id.* at 842–43.

117. *Id.* at 844.

118. *Id.* at 843.

119. *Id.*

120. *Id.* at 843–44.

121. *Id.* at 844; see Administrative Procedure Act, 5 U.S.C. §§ 500–706 (2006).

122. *Chevron*, 467 U.S. at 845 (“If this choice represents a reasonable accommodation of conflicting policies that were committed to the agency’s care by the statute, we should not disturb it unless it appears from the statute or its legislative history that the accommodation is not one that Congress would have sanctioned.” (quoting *United States v. Shimer*, 367 U.S. 374, 382, 383 (1961))).

123. 533 U.S. 218, 226 (2001) (“We granted certiorari . . . in order to consider the limits of *Chevron* deference owed to administrative practice in applying a statute.”).

124. See Cass R. Sunstein, *Chevron Step Zero*, 92 VA. L. REV. 187 (2006).

125. See *Mead*, 533 U.S. at 234–39.

applying a less deferential form of “*Skidmore*<sup>126</sup> deference,” a pre-*Chevron* standard.<sup>127</sup> The court should only apply *Chevron* deference when Congress expresses intent to delegate rulemaking authority, either explicitly or implicitly.<sup>128</sup> A good indicator of such intent is “express congressional authorizations to engage in the process of rulemaking or adjudication that produces regulations or rulings for which deference is claimed.”<sup>129</sup> The Court noted that such formalized procedures “foster the fairness and deliberation that should underlie a pronouncement” with the force of law.<sup>130</sup> Thus, *Chevron* Step Zero requires judicial review of the process that yielded the agency interpretation demanding deference before proceeding through the traditional *Chevron* two-step analysis.<sup>131</sup>

## 2. *Chevron*’s Cousin: *Seminole Rock* Deference for an Agency’s Interpretation of Its Own Regulation

The Supreme Court has long recognized strong judicial deference toward an agency’s interpretation of its own regulations. This form of deference—developed separately from the *Chevron* line of cases—is commonly referred to as *Seminole Rock* deference.<sup>132</sup> In *Seminole Rock*, the Court held that an agency’s interpretation of its own regulation “becomes of controlling weight unless it is plainly erroneous or inconsistent with the regulation.”<sup>133</sup>

Despite the different lines of cases, there are substantial parallels between the two doctrines.<sup>134</sup> Both are grounded in a form of implied delegation.<sup>135</sup> Both provide for “mandatory” deference in that an agency’s interpretation is controlling, so long as it is a permissible construction.<sup>136</sup> Accordingly,

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126. *Skidmore v. Swift & Co.*, 323 U.S. 134, 140 (1944) (“The weight of such a judgment in a particular case will depend upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control.”).

127. *Mead*, 533 U.S. at 228, 235.

128. *Id.* at 229.

129. *Id.*

130. *Id.* at 230 (“Thus, the overwhelming number of our cases applying *Chevron* deference have reviewed the fruits of notice-and-comment rulemaking or formal adjudication.”).

131. *Nat’l Cable & Telecomms. Ass’n v. Brand X Internet Servs.*, 545 U.S. 967, 986 (2005) (“*Chevron* established a familiar two-step procedure for evaluating whether an agency’s interpretation of a statute is lawful.”).

132. See Merrill & Hickman, *supra* note 114, at 899.

133. *Bowles v. Seminole Rock & Sand Co.*, 325 U.S. 410, 414 (1945). See generally Russell L. Weaver, *Judicial Interpretation of Administrative Regulations: The Deference Rule*, 45 U. PITT. L. REV. 587 (1984).

134. See Merrill & Hickman, *supra* note 114, at 899; see also Manning, *supra* note 110, at 627.

135. See Merrill & Hickman, *supra* note 114, at 899.

136. See *id.*; see also Manning, *supra* note 110, at 627.

*Seminole Rock* deference has been referred to as the “cousin” of *Chevron* Step Two.<sup>137</sup>

There are three primary justifications for *Seminole Rock* deference. First, the Court has highlighted concerns for political accountability in such decisions, because they often entail policy judgments.<sup>138</sup> Second, the agency’s relative expertise favors binding deference to agency interpretations of regulations.<sup>139</sup> Third (and distinct from *Chevron*), the agency has unique and “superior competence to understand and explain its own regulatory text.”<sup>140</sup> The agency is in a better position to use its historical familiarity with the reasons for adopting the text to reconstruct the purpose of the regulation.<sup>141</sup>

Over the years, the doctrine has been refined but remains largely intact. An agency’s construction of its own regulation is entitled to substantial deference, so long as the interpretation “sensibly conforms to the purpose and wording of the regulations.”<sup>142</sup> An agency’s interpretation need not be the best or most natural one by grammatical or other standards.<sup>143</sup> A Court’s task is not to pick the interpretation that best serves the regulatory purpose;<sup>144</sup> rather, a court must defer to the agency’s interpretation unless an alternative reading is compelled by the regulation’s plain language or by other indicators of the agency’s intent at the time the regulation was promulgated.<sup>145</sup> Agencies are free to write regulations as broadly as they

137. See Victor L. Prial & Michael Kruse, *Administrative Law*, 58 SYRACUSE L. REV. 637, 637–38 (2008) (calling *Seminole Rock* deference “*Chevron*’s less widely known cousin”); see also John F. Coverdale, *Chevron’s Reduced Domain: Judicial Review of Treasury Regulations and Revenue Rulings After Mead*, 55 ADMIN. L. REV. 39, 59 (2003) (“Although this formulation differs in words, it seems in practice to be indistinguishable from *Chevron*’s step two.”).

138. See Manning, *supra* note 110, at 629; see also *Thomas Jefferson Univ. v. Shalala*, 512 U.S. 504, 512 (1994) (citing *Pauley v. BethEnergy Mines, Inc.*, 501 U.S. 680, 697 (1991)) (noting that deference is “all the more warranted” where the agency action requires judgment grounded in policy concerns); *Martin v. Occupational Safety & Health Review Comm’n*, 499 U.S. 144, 151 (1991) (referencing an agency’s unique policymaking prerogatives).

139. See Manning, *supra* note 110, at 629–30; see also *Thomas Jefferson Univ.*, 512 U.S. at 512 (“This broad deference is all the more warranted when, as here, the regulation concerns ‘a complex and highly technical regulatory program’ . . . .” (quoting *Pauley v. BethEnergy Mines, Inc.*, 501 U.S. 680, 697 (1991)); *Martin*, 499 U.S. at 151 (“[A]pplying an agency regulation to complex or changing circumstances calls upon the agency’s unique expertise . . . .”).

140. See Manning, *supra* note 110, at 630; see also *Martin*, 499 U.S. at 151 (“[W]e presume that the power authoritatively to interpret its own regulations is a component of the agency’s delegated lawmaking powers.”).

141. See Manning, *supra* note 110, at 630; see also *United States v. Cleveland Indians Baseball Co.*, 532 U.S. 200, 220 (2001) (“We need not decide whether the [informal] Revenue Rulings themselves are entitled to deference . . . . [T]he Rulings simply reflect the agency’s longstanding interpretation of its own regulations.”).

142. *Martin*, 499 U.S. at 151 (internal quotation marks omitted) (quoting *N. Ind. Pub. Serv. Co. v. Porter Cnty. Chapter of Izaak Walton League, Inc.*, 423 U.S. 12, 15 (1975)).

143. *Pauley v. BethEnergy Mines, Inc.*, 501 U.S. 680, 702 (1991).

144. *Thomas Jefferson Univ.*, 512 U.S. at 512.

145. *Id.*

wish, so long as they conform to the boundaries of the statute; therefore, a rule of statutory interpretation that required an agency to construe its regulations narrowly “would make little sense.”<sup>146</sup> Furthermore, agency interpretations put forth in amicus briefs can represent the agency’s fair and considered judgment.<sup>147</sup> The Supreme Court has also suggested that an agency’s interpretations should receive even greater deference when the statute combines rulemaking and enforcement powers in one agency.<sup>148</sup>

At times, the Court has limited when such deference should be accorded. In *Mead*, the Court required a more formalized process in order to receive *Chevron* deference.<sup>149</sup> *Mead* may apply to *Seminole Rock* deference in that a court would require evidence of a formalized process for agency interpretations before deferring to the agency.<sup>150</sup>

The combination of *Seminole Rock* deference and the interpretive rule exemption from notice-and-comment rulemaking has led to a line of restrictions on the doctrine known as an “antiplaceholder principle.”<sup>151</sup> In general, courts are wary of an agency’s ability to quickly promulgate vague regulations that receive little objection in notice-and-comment periods and then implement their true policy through subsequent interpretations.<sup>152</sup>

Along those lines, courts have warned that they will not defer to an agency interpretation when the underlying rule is so vague as to be meaningless or, in other words, when an agency “promulgate[s] mush.”<sup>153</sup> Furthermore, the Court held in *Gonzales v. Oregon*<sup>154</sup> that it would not treat an interpretive rule as an interpretation of the regulation if the regulation is merely “parrot[ing]” statutory language.<sup>155</sup> Instead, courts will treat it as an informal interpretation of the statute, which requires only *Skidmore* deference under *Mead*.<sup>156</sup> This “antiparrot[ing]” principle may only be designed, however, to prevent intentionally vague regulations that an agency may interpret as it sees fit later and then demand deference for such

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146. *Auer v. Robbins*, 519 U.S. 452, 462–63 (1997).

147. *Id.* at 462 (“There is simply no reason to suspect that the interpretation [in an amicus brief filed by the agency] does not reflect the agency’s fair and considered judgment . . .”).

148. *See Martin v. Occupational Safety & Health Review Comm’n*, 499 U.S. 144, 151–55 (1991) (comparing the SEC’s unitary structure to the split structure set up under the Occupational Safety and Health Act and analyzing the different Congressional purposes for doing so).

149. *See supra* note 130 and accompanying text.

150. *See Stephenson & Pogoriler, supra* note 14, at 1450–52.

151. *See id.* at 1467–72.

152. *See id.*

153. *See id.* at 1467 (citing *Mission Grp. Kan., Inc. v. Riley*, 146 F.3d 775, 781–83 (10th Cir. 1998); *Paralyzed Veterans of Am. v. D.C. Arena L.P.*, 117 F.3d 579, 584, 588 (D.C. Cir. 1997)).

154. 546 U.S. 243 (2006).

155. *Id.* at 257.

156. *See Stephenson & Pogoriler, supra* note 14, at 1467–68.

interpretation.<sup>157</sup> This was a major concern for the dissenting Justices in *Thomas Jefferson University v. Shalala*<sup>158</sup> and *Mead*.<sup>159</sup>

How do the two lines of cases fit together then? A regulation “must be consistent with the statute it implements”<sup>160</sup> and cannot be interpreted more broadly than the statute itself.<sup>161</sup> Thus, for an interpretation to receive *Seminole Rock* deference, a court must first determine if the agency regulation violates the statute, a straightforward *Chevron* question.<sup>162</sup> Only then will *Seminole Rock* apply and determine whether the agency’s interpretation is consistent with the regulation.<sup>163</sup>

### 3. Reconciling Agency Deference with Stare Decisis

Principles of agency deference, like those espoused in *Chevron* and *Seminole Rock*, are formal, interpretive guidelines backed by substantial judicial authority.<sup>164</sup> Courts often interpret statutes or rules and create precedent, however, when no agency is involved. When a court interprets a statute or rule, it declares to Congress and the public, “[T]his is what a statute means,” and this is what it will most likely mean in the future, barring a convincing need for change.<sup>165</sup> In later cases, courts will generally adhere to this precedent and apply it to the case before them, following the principle known as stare decisis.<sup>166</sup> The obligation to follow precedent recognizes that no judicial system could function properly if it approached each issue or case as one of first impression.<sup>167</sup> Conversely, the outer limit of stare decisis is marked by the recognition that prior decisions can be clear errors and, if so, should no longer be followed.<sup>168</sup> Thus, “stare decisis is not an inexorable command.”<sup>169</sup> Rather, when a court examines a prior holding, “its judgment is customarily informed by a series of prudential and pragmatic considerations designed to test the consistency of overruling a prior decision with the ideal of the rule of law, and to gauge

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157. *See id.*

158. *See* *Thomas Jefferson Univ. v. Shalala*, 512 U.S. 504, 525 (1994) (Thomas, J., dissenting).

159. *See* *United States v. Mead Corp.*, 533 U.S. 218, 246 (2001) (Scalia, J., dissenting) (“Agencies will now have high incentive to rush out barebones, ambiguous rules construing statutory ambiguities, which they can then in turn further clarify through informal rulings entitled to judicial respect.”).

160. *See* Manning, *supra* note 110, at 627 n.78.

161. *See, e.g.*, *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 214 (1976) (“[D]espite the broad view of . . . Rule [10b-5] advanced by the Commission in this case, its scope cannot exceed the power granted the Commission by Congress under § 10(b).”).

162. *See* Manning, *supra* note 110, at 627 n.78.

163. *See id.*

164. *See* Rebecca Hanner White, *The Stare Decisis “Exception” to the Chevron Deference Rule*, 44 FLA. L. REV. 723, 725 (1992).

165. *See id.* at 746–47.

166. *See id.* at 744; *see also* Richard J. Pierce, Jr., *Reconciling Chevron and Stare Decisis*, 85 GEO. L.J. 2225, 2237 (1997).

167. *Planned Parenthood of Se. Pa. v. Casey*, 505 U.S. 833, 854 (1992).

168. *Id.*

169. *Id.* (internal quotation marks omitted).

the respective costs of reaffirming and overruling a prior case.”<sup>170</sup> Like *Chevron* and *Seminole Rock* deference, stare decisis is a judicially crafted decision-making tool.<sup>171</sup> Part II.B.2 discusses what happens when these two principles collide.<sup>172</sup>

## II. THE TRANSITION: THE POST-*JANUS* CONFLICT

Now that the stage has been set, Part II of this Note will describe the conflict in the post-*Janus* realm of securities law. First, does the *Janus* holding apply to an SEC Rule 10b-5 enforcement action? Second, if it does not apply, should the SEC’s alternative interpretation of “to make” be entitled to judicial deference in a future enforcement action?

### A. Does *Janus* Apply to SEC Enforcement Proceedings?

The *Janus* Court did not specifically address whether its decision applied to all Rule 10b-5 actions, including SEC enforcement cases, or whether it was limited to the narrower class of private actions. Some courts have applied *Janus* in subsequent SEC actions. Conversely, others have expressed doubt about its application to SEC actions, and some have expressly stated it does not apply to SEC actions. This section describes the post-*Janus* landscape where lower federal courts struggle to decide: does *Janus* apply to SEC enforcement proceedings?

#### 1. The *Janus* Opinion

The *Janus* Court itself did not specifically address the scope of its holding. Some language in the opinion appears to apply to Rule 10b-5 in general, which may be evidence of a broader application for all parties bringing a Rule 10b-5 action. The wording of the holding, “[f]or purposes of Rule 10b-5, the maker of a statement is the person or entity with ultimate authority over the statement,”<sup>173</sup> seems to apply generally to Rule 10b-5, without consideration of the factual circumstances of its use. The majority’s detailed grammar exercise<sup>174</sup> is specific to the text of Rule 10b-

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170. *Id.* at 854–55 (“Thus, for example, [the Court] may ask whether the rule has proven to be intolerable simply in defying practical workability; whether the rule is subject to a kind of reliance that would lend a special hardship to the consequences of overruling and add inequity to the cost of repudiation; whether related principles of law have so far developed as to have left the old rule no more than a remnant of abandoned doctrine; or whether facts have so changed, or come to be seen so differently, as to have robbed the old rule of significant application or justification.” (citations omitted)).

171. See White, *supra* note 164, at 747.

172. For a complete discussion on the collision of *Chevron* and stare decisis, see generally Pierce, *supra* note 166, and White, *supra* note 164. While these articles discuss primarily *Chevron* deference, the principles, conflicts, and possible solutions are applicable to *Seminole Rock* deference.

173. *Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 2302 (2011).

174. See *infra* notes 270–71 and accompanying text.

5, focusing on the definition of “make” as used in the context of the rule.<sup>175</sup> Additionally, the Court declined to consider the SEC’s amicus brief in part because the meaning of the rule was not ambiguous.<sup>176</sup> The Court also expressed concerns for disregarding the corporate form, noting that JCM and JIF were two separate legal entities.<sup>177</sup> Last, the Court expressed concerns over blurring the line between primary and secondary liability because private litigants could pursue the former but not the latter.<sup>178</sup>

Alternatively, the *Janus* Court’s opinion provides several indications that the holding is limited to private rights of action. First, the Court was asked to decide the scope of liability in a private action under 10b-5.<sup>179</sup> Second, the Court cited concerns—both before and after its holding—over expanding an implied right of action; thus, the Court felt obligated to construe the statute and rule narrowly. After reaffirming the existence of the private action under Rule 10b-5, but before stating its holding, the Court noted:

“[C]oncerns with the judicial creation of a private cause of action caution against its expansion.” Thus, in analyzing whether JCM “made” the statements for purposes of Rule 10b-5, we are mindful that we must give “narrow dimensions . . . to a right of action Congress did not authorize when it first enacted the statute and did not expand when it revisited the law.”<sup>180</sup>

After explaining its holding, the Court once again asserted its desire to limit the scope of the implied private action: “Our holding also accords with the narrow scope that we must give the implied private right of action.

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175. *Janus*, 131 S. Ct. at 2302 (“The phrase at issue in Rule 10b-5, ‘[t]o make any . . . statement,’ is thus the approximate equivalent of ‘to state.’”); see also Elisse B. Walter, SEC Comm’r, Remarks Before the FINRA Institute at Wharton Certified Regulatory & Compliance Professional Program (Nov. 8, 2011), available at <http://www.sec.gov/news/speech/2011/spch110811ebw.htm> (“In its recent *Janus* decision, the Supreme Court focused simply on the language of Section 10(b) and Rule 10b-5, which of course apply to the Commission actions as well as private actions. This . . . may have the unfortunate and ironic result of throwing the proverbial baby out with the bathwater.”).

176. *Janus*, 131 S. Ct. at 2303 n.8; see Part II.B.1.

177. *Janus*, 131 S. Ct. at 2304 (“We decline this invitation to disregard the corporate form. Although First Derivative and its *amici* persuasively argue that investment advisers exercise significant influence over their client funds . . . it is undisputed that the corporate formalities were observed.”). The Court also noted that if “control” were to form the basis of liability, Congress provided a separate provision, section 20(a) of the ’34 Act, 15 U.S.C. § 78t(a) (2006), for “[e]very person who, directly or indirectly, controls any person liable” for violations of securities laws. *Janus*, 131 S. Ct. at 2304 (quoting section 20(a)).

178. *Janus*, 131 S. Ct. at 2302, n.6 (“[F]or *Central Bank* to have any meaning, there must be some distinction between those who are primarily liable (and thus may be pursued in private suits) and those who are secondarily liable (and thus may not be pursued in private suits).”).

179. *Id.* at 2301 (“We granted certiorari to address whether JCM can be held liable in a private action under Rule 10b-5 . . . .” (emphasis added)).

180. *Id.* at 2301–02 (citations omitted) (quoting *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 165, 167 (2008)).

. . . [For the private right of action], we will not expand liability beyond the person or entity that ultimately has authority over a false statement.”<sup>181</sup>

Beyond disagreeing with the “ultimate authority” rule announced by the majority, the dissent expressed concern for the consequences of applying this rule to the SEC going forward.<sup>182</sup> Although the dissent did not offer its opinion on the scope of the holding, it hypothesized that, if the majority’s rule applied to the SEC, it would hamper the SEC’s ability to pursue secondary liability under sections 20(a) (control person liability) and 20(e) (aiding and abetting).<sup>183</sup> Such secondary liability claims would fail because secondary liability requires a primary violator, and under the majority’s rule, none existed.<sup>184</sup>

Notably, neither the majority nor dissent mentioned that the SEC indeed brought an enforcement action against JCM, which was settled.<sup>185</sup> The SEC’s complaint did not invoke Rule 10b-5 but brought claims instead under the Investment Advisors Act of 1940 and Investment Company Act of 1940.<sup>186</sup>

181. *Id.* at 2303 (citing *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 167 (2008)).

182. *See id.* at 2310 (Breyer, J. dissenting).

183. *Id.* (“[U]nder the majority’s rule it seems unlikely that the SEC itself in such circumstances could exercise the authority Congress has granted it to pursue primary violators who ‘make’ false statements or the authority that Congress has specifically provided to prosecute aiders and abettors to securities violations. . . . That is because the managers, not having ‘ma[d]e’ the statement, would not be liable as principals and there would be no other primary violator they might have tried to ‘aid’ or ‘abet.’” (alternation in original)).

184. *Id.*; *Morrison v. Nat’l Austl. Bank, Ltd.*, 130 S. Ct. 2869, 2876 n.2 (2010) (“Liability under § 20(a) is obviously derivative of liability under some other provision of the Exchange Act.”); *SEC v. DiBella*, 587 F.3d 553, 566 (2d Cir. 2009) (prosecution for aiding and abetting requires “substantial assistance” of a primary violation). The dissent also postulated a hypothetical based on JCM duping the JIF board to make the misstatement:

What is to happen when guilty management writes a prospectus (for the board) containing materially false statements and fools both board and public into believing they are true? Apparently under the majority’s rule, in such circumstances *no one* could be found to have ‘ma[d]e’ a materially false statement—even though under common law the managers would likely have been guilty or liable . . . for doing so as *principals* (and not as aiders and abettors).

*Janus*, 131 S. Ct. at 2310 (Breyer, J., dissenting) (alternations in original); *see* Andrew Power, *The Thirteenth Stroke: An Approach to “Ultimate Authority” After Janus*, 45 SUFFOLK U. L. REV. 1297, 1324 (2012); Colin Talia, Note, *Janus Capital Group: How “Making” a Statement Leads to Insulation from Liability*, 38 J. CORP. L. 197, 210–16 (2012) (noting that the *Janus* decision might encourage companies to create corporate formalities to avoid liability and recommending possible legislative solutions).

185. *See In re Janus Capital Mgmt. LLC*, SEC Release No. 2277, Investment Company Act Release No. 26532, 83 SEC Docket 17666, 2004 WL 1845502 (Aug. 18, 2004); *Janus Capital Management Agrees to Pay \$100 Million to Settle SEC Fraud Charges for Undisclosed Market Timing Agreements*, SEC News Digest, 2004-159 (Aug. 18, 2004), 2004 WL 1842517, available at <http://www.sec.gov/news/digest/dig081804.txt>.

186. *See In re Janus Capital Mgmt. LLC.*, SEC Release No. 2277, 2004 WL 1842517, at \*1.

## 2. Lower Courts Since *Janus*

Since the *Janus* decision, district courts have struggled to define the boundaries of the case's reach.<sup>187</sup> Some have applied *Janus* to SEC enforcement actions; others have refused to expand the holding beyond the private right of action.

### a. *Janus Does Apply to the SEC*

The broadest application of *Janus* appears to be *SEC v. Kelly*,<sup>188</sup> in which the Southern District of New York not only applied *Janus* to an SEC Rule 10b-5(b) enforcement action,<sup>189</sup> but also extended the “ultimate authority” principle to sections (a) and (c) of the Rule 10b-5, as well as section 17(a) of the '33 Act.<sup>190</sup> These later sections address fraudulent schemes and deceptive practices but lack the operative phrase “to make” found in Rule 10b-5(b).<sup>191</sup>

In *SEC v. Das*,<sup>192</sup> the District of Nebraska applied the *Janus* “ultimate authority” standard where defendants, CFOs who signed and certified the fraudulent statements, were clearly the “makers” of such statements.<sup>193</sup> In another case, the Southern District of New York denied a motion to dismiss, finding that, even if *Janus* applied, the SEC had provided strong evidence that the defendant was the “maker” of the statements, thereby satisfying *Janus*.<sup>194</sup> Shortly after the *Janus* decision, an ALJ applied *Janus* to an SEC enforcement proceeding over the objections of the SEC.<sup>195</sup>

Some commentators agree that *Janus* applies to SEC enforcement actions. One commentator reasoned that the Court's decision is based on the text of Rule 10b-5, not merely policy considerations.<sup>196</sup> Others have

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187. See generally Edward B. Micheletti et al., *Federal Court Application of Janus Capital Group, Inc. v. First Derivative Traders*, 43 Sec. Reg. & L. Rep. (BNA) 2432 (Dec. 5, 2011) (discussing the early cases applying *Janus* and demonstrating their inconsistency).

188. 817 F. Supp. 2d 340 (S.D.N.Y. 2011).

189. *Id.* at 343.

190. See *id.* at 344–45.

191. See *id.*

192. No. 8:10CV102, 2011 WL 4375787 (D. Neb. Sept. 20, 2011)

193. *Id.* at \*6 (noting that the defendants “were the persons with ultimate authority and control over the content of the statements and whether and how they were communicated”).

194. *SEC v. Landberg*, 836 F. Supp. 2d 148, 154 (S.D.N.Y. 2011) (“Assuming *arguendo* that *Janus*'s holding applies to SEC enforcement actions, it does not require that the SEC's claim against [the defendant] under Rule 10b-5 be dismissed . . .”).

195. *In re Flannery*, SEC Release No. 438, 2011 WL 5130058, at \*34–35 (Oct. 28, 2011) (citing *Kelly*, 817 F. Supp. 2d 340) (initial decision).

196. See Bryan P. King, *The Effects of an Undefined “Ultimate Authority” Standard for Rule 10b-5 Claims: Janus Capital Group, Inc. v. First Derivative Traders*, 16 N.C. BANKING INST. 405, 430 (2012) (“[T]he Court did not provide one definition of the word ‘make’ for private actions, and a separate definition for SEC actions.”).

noted that the SEC itself has conceded the point in certain cases<sup>197</sup> and has failed in others to challenge the assertion<sup>198</sup> that *Janus* does indeed apply.

*b. Janus Does Not Apply to the SEC*

In contrast to the decisions discussed in the previous section, some district courts have refused to apply *Janus* to SEC enforcement actions and beyond Rule 10b-5(b). In *SEC v. Pentagon Capital Management PLC*,<sup>199</sup> the Southern District of New York highlighted the difference between *Janus* (a private suit) and the case before it (an SEC enforcement action).<sup>200</sup> Private Rule 10b-5 suits require a narrow holding because they are implied in the statute, unlike SEC actions.<sup>201</sup> The court highlighted the *Janus* Court's emphasis on the need to narrow the scope of implied rights of action.<sup>202</sup> Due to this important difference, "[t]here is no indication that the Court or Congress intended for actions brought by the SEC to be so limited."<sup>203</sup> In *SEC v. Stoker*,<sup>204</sup> the Southern District of New York refused to apply *Janus* to an SEC enforcement action when the concerns over the implied right of action were not present.<sup>205</sup> Last, several district courts have disagreed with *Kelly*'s expansion of *Janus* beyond Rule 10b-5(b), observing that *Janus* turned in part on interpreting "to make;" therefore, the scope of *Janus*' holding could not include other antifraud misstatement provisions that lack this phrase.<sup>206</sup>

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197. See Norman S. Poser, *Janus Revisited: The Lower Courts Wrestle with a Troubling Supreme Court Decision*, 44 REV. SEC. & COMMODITIES REG. 211, 215 (2012).

198. Donald C. Langevoort, *Lies Without Liars? Janus Capital and Conservative Securities Jurisprudence* 5 (Georgetown Pub. Law. & Legal Theory Research, Paper No. 12-019, 2012) (citing *Landberg*, 836 F. Supp. 2d 148), available at <http://ssrn.com/abstract=2010745>. In certain cases where the court did not conclude that *Janus* applies, but nonetheless found that the defendant had the requisite "ultimate authority" if such a standard were to apply, the SEC in subsequent motions or appeals has not pushed the court to definitively apply or reject *Janus*'s applicability to enforcement actions. See, e.g., Page Proof Brief of the SEC, Appellee at 33, *SEC v. Pentagon Capital Mgmt. PLC*, No. 12-1680-cv (2d Cir. Nov. 9, 2012), 2012 WL 5829091 ("Because the record supports the district court's finding that Defendants had the requisite 'ultimate authority' over the implied misrepresentations, this Court need not consider the alternative holding that *Janus* does not apply to Commission actions.").

199. 844 F. Supp. 2d 377 (S.D.N.Y. 2012).

200. *Id.* at 421–22; see also *SEC v. Big Apple Consulting USA, Inc.*, No. 6:09-cv-1963-Orl-28GJK, 2012 WL 3264512, at \*3 (M.D. Fla. Aug. 9, 2012) ("*Janus* . . . emphasized the difference between private actions and those brought by the SEC. . . . [U]nlike *Janus*, this case was brought by the SEC rather than a private party.>").

201. *Pentagon Capital Mgmt. PLC*, 844 F. Supp. 2d at 422.

202. *Id.* (citing *Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 2302, 2303 (2011)).

203. *Id.*

204. 865 F. Supp. 2d 457 (S.D.N.Y. 2012).

205. See *id.* at 465–66.

206. See *SEC v. Sells*, No. C 11-4941 CW, 2012 WL 3242551, at \*7 (N.D. Cal. Aug. 10, 2012) (holding that *Janus* did not apply sections (a) and (c) of Rule 10b-5); *SEC v. Big Apple Consulting USA, Inc.* No. 6:09-cv-1963-Orl-28GJK, 2012 WL 3264512, at \*3 (M.D. Fla. Aug. 9, 2012) (refusing to apply *Janus* to section 17(a) of the '33 Act, and noting that "the analysis in *Janus* closely focused on the 'to make' language in Rule 10b-5); *Stoker*, 865

### 3. Other Distinguishing Features

Courts often apply different standards to SEC Rule 10b-5 enforcement actions than they do to private actions for reasons going beyond the specific text of Rule 10b-5(b) at issue in *Janus*. First, a private Rule 10b-5 plaintiff must establish more elements of a defendant's violation compared to what the SEC must establish (e.g., the SEC need not prove reliance, economic loss, or loss causation).<sup>207</sup> Second, the heightened pleading standards of the PSLRA<sup>208</sup> may not be applicable to the SEC.<sup>209</sup> Different requirements, such as not needing to prove reliance, allow the SEC to charge primary liability even when the statements in question are not attributed in public to the defendant.<sup>210</sup> Similarly, courts may apply somewhat relaxed standards to SEC enforcement actions, despite claims based on the same statutory language, even in post-*Janus* cases.<sup>211</sup>

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F. Supp. 2d at 465 (refusing to apply *Janus* to section 17(a) because “by means of” language of section 17(a) covers a broader range of activity than “to make” and the *Janus* Court emphasized the word “make”); *Pentagon Capital Mgmt. PLC*, 844 F. Supp. 2d at 422 (refusing to apply *Janus* to Rule 10b-5(a) & (c) because those sections “utilize[] different and broader operative language” than Rule 10b-5(b)); *SEC v. Mercury Interactive, LLC*, No. 5:07-cv-02822-WHA, 2011 WL 5871020, at \*3 (N.D. Cal. Nov. 22, 2011) (“*Janus* may not be extended to statutes lacking the very language that *Janus* construed.”); *SEC v. Daifotis*, No. C 11-00137 WHA, 2011 WL 3295139, at \*5–6 (N.D. Cal. Aug. 1, 2011) (holding that *Janus* does not apply to SEC claims brought pursuant to section 17(a), stating that “[i]mportantly, the word ‘make,’ which was the very thing the Supreme Court was interpreting in *Janus*, is absent from the operative language of Section 17(a)”).

207. *Compare Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 157 (2008) (“In a typical § 10(b) private action a plaintiff must prove (1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation.”), with *SEC v. Monarch Funding Corp.*, 192 F.3d 295, 308 (2d Cir. 1999) (Noting that, to prove a violation of section 10(b) and Rule 10b-5, the SEC must establish that the defendant “(1) made a material misrepresentation or a material omission as to which he had a duty to speak, or used a fraudulent device; (2) with scienter; (3) in connection with the purchase or sale of securities.”).

208. *See* 15 U.S.C. § 78u-4(b) (2006). “The PSLRA requires plaintiffs to state with particularity both the facts constituting the alleged violation, and the facts evidencing scienter . . . .” *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 313 (2007).

209. *See Sells*, 2012 WL 3242551, at \*8 (“[T]he SEC [is not] subject to the heightened pleading standard required by the PSLRA.”); *Pentagon Capital Mgmt.*, 612 F. Supp. 2d at 263–64; *SEC v. Dunn*, 587 F. Supp. 2d 486, 501 (S.D.N.Y. 2008) (not applying to the SEC). *But see SEC v. Boling*, Civ. A. No. 06-1329(RMC), 2007 WL 2059744, at \*4 n.1 (D.D.C. July 13, 2007) (applying PSLRA’s heightened pleading standard to the SEC).

210. *See SEC v. KPMG*, 412 F. Supp. 2d 349, 374–76 (S.D.N.Y. 2006) (“It is unnecessary, however, to decide whether primary liability could be imposed on the [defendants] on this basis in a private securities action. The SEC, unlike a private plaintiff, is not required to prove reliance when it brings enforcement actions under the securities laws. Accordingly, in an SEC enforcement action, there appears to be no reason to impose a requirement that a misstatement have been publicly attributed to a defendant for liability to attach, at least so long as the SEC is able to show that the defendant was sufficiently responsible for the statement—in effect, caused the statement to be made—and knew or had reason to know that the statement would be disseminated to investors.” (citations omitted)).

211. *See Poser, supra* note 197, at 215.

*B. Is the SEC's Interpretation Entitled to Judicial Deference?*

Assuming *Janus* does not apply to SEC enforcement actions, should the SEC's "creation" standard be entitled to deference in future enforcement actions? This section takes the debate through a *Chevron/Seminole Rock* agency deference analysis. First, it will analyze the congressional intent to delegate rulemaking and interpretative authority to the SEC, a *Mead/Chevron* Step Zero question. Next, it will discuss competing views on whether the Supreme Court has spoken directly to application of the *Janus* standard to the SEC, a *Chevron* Step One analysis. Finally, this section will analyze the competing interpretations of Rule 10b-5 found in pre-*Janus* case law, as well as *Janus* itself, including the majority opinion, dissenting opinion, and the SEC's position. This analysis assesses the reasonableness of the varying interpretations for purposes of *Chevron* Step Two.

1. *Mead/Chevron* Step Zero

Under *Mead*, the first step of the interpretive analysis is to ask whether there is evidence of congressional intent to delegate rulemaking authority.<sup>212</sup> The *Mead* Court listed several strong indicators of such intent, including "express congressional authorizations to engage in the process of rulemaking or adjudication."<sup>213</sup> In our inquiry, the question is whether Congress intended to delegate such authority to SEC interpretations (i.e., has the SEC's interpretive process for Rule 10b-5 demonstrated the necessary "fairness and deliberation" to command *Chevron* style analysis?).<sup>214</sup> Opponents could argue that the interpretations were not made through notice-and-comment rulemaking and are exactly the type of interpretations against which the dissenting justices in *Mead* and *Thomas Jefferson University* cautioned.<sup>215</sup> In contrast, the SEC could argue that Congress specifically tasked it with authority to engage in rulemaking, enforcement, and adjudications, which necessarily require interpretation.<sup>216</sup> Therefore, Congress surely must have intended for the SEC to interpret its own rules in exercise of the delegated enforcement and adjudicatory powers. In addition, the Court stated in *Auer* that an agency's amicus brief reflected the agency's fair and considered judgment and should be entitled to deference.<sup>217</sup>

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212. See *supra* note 128 and accompanying text.

213. See *supra* note 129 and accompanying text.

214. See *supra* note 130 and accompanying text.

215. See *supra* notes 158–59 and accompanying text.

216. See *supra* Part I.A.2.

217. *Auer v. Robbins*, 519 U.S. 452, 462 (1997) ("There is simply no reason to suspect that the interpretation [in an amicus brief filed by the agency] does not reflect the agency's fair and considered judgment.").

## 2. *Chevron* Step One: Did Congress or the Court Speak Directly to this Issue?

*Chevron* Step One requires the court to ask whether Congress or the Supreme Court spoke directly to this issue.<sup>218</sup> The Step One analysis requires a few additional inquiries, however, because the question at hand is dealing with an agency's interpretation of a rule, which is itself an interpretation of a statute.<sup>219</sup> A court should ask first whether the rule being interpreted is a practical construction of the statute.<sup>220</sup> If the rule is indeed a practical construction of the statute, the next question is whether the rule speaks directly to the definition of "to make."<sup>221</sup> If not, the final Step One question is whether the Court has spoken directly to the issue (i.e., whether its interpretation of "to make" in *Janus* applies to the SEC).<sup>222</sup>

Rule 10b-5 has been enforced and unchanged since its promulgation in 1942.<sup>223</sup> There should be no doubt that Rule 10b-5 is a permissible construction of section 10(b). Accordingly, the analysis should then turn to Rule 10b-5 itself.<sup>224</sup> Neither the text of section 10(b) nor that of Rule 10b-5 defines "make" or expressly delegates authority to the SEC to define it.<sup>225</sup>

In any event, the *Janus* Court ruled on the scope of Rule 10b-5, and Supreme Court precedent always trumps the deference owed under *Chevron*.<sup>226</sup> The question then becomes: Is this decision limited to private actions, creating no precedent for the SEC, or does it apply to all interpretations of Rule 10b-5—including SEC enforcement actions—barring an alternative SEC interpretation under the principle of stare decisis?

Questions arise then about what is precedent.<sup>227</sup> Can the holding be isolated from the dicta? Is it the rule, but not the underlying rationale?<sup>228</sup> The interaction of these two doctrines is far from settled, and the Supreme Court has even acknowledged that confusion abounds.<sup>229</sup> It has been suggested that, to resolve this conflict, the court should first ask whether the statute or rule has spoken to the precise issue.<sup>230</sup> If it has not, then the court

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218. See *supra* note 115 and accompanying text.

219. See *supra* notes 160–63 and accompanying text.

220. See *supra* notes 160–63 and accompanying text.

221. See *supra* notes 160–63 and accompanying text.

222. See White, *supra* note 164, at 758.

223. See *supra* notes 27–31 and accompanying text.

224. See *supra* notes 160–63 and accompanying text.

225. See *supra* text accompanying notes 22, 29.

226. See *Pierce*, *supra* note 166, at 2226.

227. See White, *supra* note 164, at 757; see, e.g., Roscoe Pound, *What of Stare Decisis?*, 10 *FORDHAM L. REV.* 1 (1941); Frederick Schauer, *Precedent*, 39 *STAN. L. REV.* 571, 576–97 (1987).

228. See White, *supra* note 164, at 757–58.

229. *Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs.*, 545 U.S. 967, 985 (2005) ("There is genuine confusion in the lower courts over the interaction between the *Chevron* doctrine and stare decisis principles . . ."). Unfortunately, the Court did not go on to provide much clarity on the topic.

230. See White, *supra* note 164, at 758.

should ask if a judicial ruling has addressed the precise issue.<sup>231</sup> When the reach of such precedent is not clear, the court should defer to the agency's reasonable interpretation of the precedent.<sup>232</sup>

In our inquiry, after concluding above that neither section 10(b) nor Rule 10b-5 addressed this precise issue, the next question is, did the *Janus* Court decide the precise issue: Does the "ultimate authority" holding apply to all Rule 10b-5 actions? If so, the Court's interpretation has become a de facto part of the statute.<sup>233</sup> If not, then the Court should proceed to *Chevron* Step Two<sup>234</sup> (or, with an agency interpretation, a *Seminole Rock* analysis). Justice Scalia once wrote, "How clear is clear? It is here [at *Chevron* Step One] that future battles over acceptance of agency interpretations of law will be fought."<sup>235</sup> The following subsections will discuss the debate over the scope of the *Janus* decision.

*a. Yes: The Court Decided the Scope of Rule 10b-5 for All Parties*

If *Janus* decided the scope of Rule 10b-5 for all parties,<sup>236</sup> *stare decisis* bars the SEC from pursuing its alternative interpretation.<sup>237</sup> An agency cannot simply reinterpret a rule after a court has determined its meaning.<sup>238</sup>

When the Court declined to follow the SEC's position set forth in its brief, the Court noted that the rule was not ambiguous.<sup>239</sup> When lower courts have found that *Janus* applies, they have uniformly applied the "ultimate authority" standard to the SEC's Rule 10b-5(b) enforcement claims.<sup>240</sup>

231. *See id.*

232. *See id.*

233. *See id.*

234. *See id.* at 759.

235. Antonin Scalia, *Judicial Deference to Administrative Interpretations of Law*, 1989 DUKE L.J. 511, 520–21. *See generally* Note, "How Clear Is Clear" in *Chevron Step One?*, 118 HARV. L. REV. 1687 (2005).

236. *See supra* Part II.A.

237. *See* *Golden State Transit Corp. v. City of L.A.*, 493 U.S. 103, 112 (1989) ("A rule of law that is the product of judicial interpretation of a vague, ambiguous, or incomplete statutory provision is no less binding than a rule that is based on the plain meaning of a statute."); *see also* *Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs.*, 545 U.S. 967, 982–83 (2005) ("Only a judicial precedent holding that the statute unambiguously forecloses the agency's interpretation, and therefore contains no gap for the agency to fill, displaces a conflicting agency construction.")

238. *See* *Maislin Indus., U.S., Inc. v. Primary Steel, Inc.*, 497 U.S. 116, 131 (1990) ("Once we have determined a statute's clear meaning, we adhere to that determination under the doctrine of *stare decisis*, and we judge an agency's later interpretation of the statute against our prior determination of the statute's meaning.")

239. *Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 2303 n.8 (2011) ("Because we do not find the meaning of 'make' in Rule 10b-5 to be ambiguous, we need not consider the Government's assertion that we should defer to the SEC's interpretation of the word elsewhere."). *But see* *Langevoort*, *supra* note 32, at S7, S19–S21 (attributing the effectiveness of Rule 10b-5 over time to its *ambiguous* language).

240. *See supra* notes 189–97 and accompanying text.

*b. No: The Court's Holding Is Limited to Private Actions*

It can be argued that the Court's holding was limited to private rights of action and does not apply to SEC actions.<sup>241</sup> Although *Janus* held that the rule was not ambiguous, merely concluding it is unambiguous does not make it so. Judge Posner has written that “[a] text is clear if all or most persons, having the linguistic and cultural competence assumed by the authors of the text, would agree on its meaning.”<sup>242</sup> Applying that logic, the text of Rule 10b-5 may not be as clear as Justice Thomas concluded. Indeed, the four dissenting justices disagreed that it was unambiguous.<sup>243</sup> Furthermore, several federal courts in pre-*Janus* cases also held that the SEC's interpretation was reasonable.<sup>244</sup> While the majority cited two dictionaries,<sup>245</sup> the SEC cited other dictionaries that supported their interpretation.<sup>246</sup> In addition, the majority's reasoning, which relied on the text of the rule, was still heavily influenced by policy considerations for confining private litigation, considerations that are not and should not be considered in a public SEC enforcement action.<sup>247</sup> Therefore, there is no precedent to which to adhere, a stare decisis challenge would be moot, and the analysis should proceed to *Chevron* Step Two.

3. *Chevron* Step Two/*Seminole Rock*: Competing Interpretations of Rule 10b-5(b)

Assuming that *Janus* does not apply, would the SEC's interpretation be a permissible construction of the Rule?

In SEC enforcement actions, the Supreme Court has directed lower courts to interpret section 10(b) of the '34 Act “not technically and restrictively, but flexibly to effectuate its remedial purposes.”<sup>248</sup> The statute was designed as a “catch-all”<sup>249</sup> to prevent not only “garden type variet[ies] of fraud” but also “unique form[s] of deception” involving “[n]ovel or atypical methods.”<sup>250</sup> This interpretive principle similarly applies to Rule 10b-5 actions,<sup>251</sup> as the elements of the Rule and the statute are the same. The question remains: what is the proper interpretation of Rule 10b-5(b) to apply in an SEC enforcement action?

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241. See also *supra* Part II.A.

242. Richard A. Posner, *Legal Formalism, Legal Realism, and the Interpretation of Statutes and the Constitution*, 37 CASE W. RES. L. REV. 179, 187 (1986).

243. See *infra* notes 287–94 and accompanying text.

244. See *infra* Part II.B.3.a.

245. See *infra* note 270 and accompanying text.

246. See *infra* notes 276–77 and accompanying text.

247. See Langevoort, *supra* note 198, at 6.

248. SEC v. Zandford, 535 U.S. 813, 819–20 (2002) (internal quotation marks omitted) (according *Chevron* deference to an SEC interpretation of the text of section 10(b) adopted in a formal adjudication).

249. Chiarella v. United States, 445 U.S. 222, 226 (1980).

250. Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 11 n.7 (1971).

251. VanCook v. SEC, 653 F.3d 130, 138 (2d Cir. 2011).

*a. Pre-Janus Cases: The SEC's Creation Standard*

The '34 Act expressly gave the SEC authority to prescribe “rules and regulations . . . as necessary or appropriate in the public interest or for the protection of investors” to enforce section 10(b).<sup>252</sup> Shortly thereafter, the SEC promulgated Rule 10b-5.<sup>253</sup> Through its experience with enforcing Rule 10b-5, the SEC formulated its interpretation of the rule that it applied when bringing enforcement actions—the creation standard. Rule 10b-5(b) makes it unlawful for “any person, directly or indirectly” to “make any untrue statement of material fact . . . in connection with the purchase or sale of a security.”<sup>254</sup> According to the SEC, a person can create a statement when “the statement is written or spoken by him, or if he provides the false or misleading information that another person then puts into the statement, or if he allows the statement to be attributed to him.”<sup>255</sup> The SEC has understood Rule 10b-5 to encompass untrue statements that are created by someone other than the nominal speaker since 1998, when it first formally expressed that view in an amicus brief.<sup>256</sup> Primary liability will attach “when a person, acting alone or with others, [with the requisite scienter] creates a misrepresentation.”<sup>257</sup> The SEC adopted this interpretation in a formal adjudication in 2005<sup>258</sup> and has reiterated this view several times since.<sup>259</sup> In *SEC v. KPMG*,<sup>260</sup> a post-*Central Bank* case, the Southern District of New York found that an engagement partner at a public accounting firm could be liable for making misstatements in an audit opinion, despite not signing the opinion, assuming that he had the requisite scienter.<sup>261</sup> The audit opinion gave “reasonable assurance” that Xerox’s financial statements were presented in accordance with Generally Accepted Accounting Principles (GAAP) when they were not.<sup>262</sup> The court held that

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252. Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (2006); *see supra* notes 22–26 and accompanying text.

253. *See supra* Part I.A.1.

254. 17 C.F.R. § 240.10b-5 (2012).

255. Brief of the SEC As Amicus Curiae Supporting Plaintiffs-Appellants at 7, *Pac. Inv. Mgmt. Co, LLC v. Mayer Brown, LLP*, 603 F.3d 114 (2d Cir. 2010) (No. 09-1619-cv), 2009 WL 7768584 [hereinafter *PIMCO* Brief].

256. Brief of the SEC As Amicus Curiae at 17, *Klein v. Boyd*, Nos. 97-1143 & 97-1261 (3d Cir. Apr. 1998) [hereinafter *Klein* Brief], available at <http://www.sec.gov/litigation/amicusbriefts.shtml>.

257. *Id.* at 17.

258. *In re* Armstrong, SEC Release No. 34-51920, 85 SEC Docket 2321, 2005 WL 1498425, at \*7 (June 24, 2005) (“A person can be primarily liable under Section 10(b) and Rule 10b-5 for directly or indirectly making an untrue statement of fact if that person, acting alone or with others, creates a false statement that reaches investors.” (emphasis added)).

259. *See* SEC *Janus* Brief, *supra* note 102; *PIMCO* Brief, *supra* note 255.

260. 412 F. Supp. 2d 349 (S.D.N.Y. 2006).

261. *Id.* Rule 10b-5 requires scienter, or “intent to deceive, manipulate, or defraud.” *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193–94, 202 (1975). However, the Court left open the question “whether, in some circumstances, reckless behavior is sufficient for civil liability under Section 10(b) and Rule 10b-5.” *Id.* at 193 n.12.

262. Generally Accepted Accounting Principles are uniform minimum standards of, and guidelines to, financial accounting and reporting. The Financial Accounting Standards

the partner was “sufficiently responsible for” the opinion and, thus, primarily liable for “making” the misstatement if all the other elements of Rule 10b-5 were met.<sup>263</sup> Finding that the requisite intent to defraud may be inferred from recklessness,<sup>264</sup> the court applied a recklessness standard for the scienter requirement and held that mere misapplication of GAAP was insufficient.<sup>265</sup> The court noted that this formulation covered a narrower scope of conduct than the “substantial participation” test.<sup>266</sup>

### b. *The Janus Decision*

While the majority opinion in *Janus* announced the narrow “ultimate authority” standard for private Rule 10b-5 claims, it is not clear if this standard also applies to SEC enforcement cases.<sup>267</sup> Part III will attempt to resolve this question. This section will describe the competing interpretations found in the *Janus* majority’s opinion, the SEC’s amicus brief, and the dissent’s opinion.

#### i. The Majority Opinion

The majority held that “one ‘makes’ a statement by stating it.”<sup>268</sup> The majority identified five main reasons for its narrow holding. First, the court looked to the dictionary definition<sup>269</sup> of “make.”<sup>270</sup> Justice Thomas, writing for the Court, selected one definition and then engaged in a

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Board and the Governmental Accounting Standards Board are authorized by the SEC to establish these principles. See *Frequently Asked Questions*, AM. INST. OF CERTIFIED PUB. ACCOUNTANTS, <http://www.aicpa.org/About/FAQs/Pages/FAQs.aspx> (last visited Feb. 15, 2013).

263. *KPMG*, 412 F. Supp. 2d at 373–75; see *SEC v. Power*, 525 F. Supp. 2d 415, 420 (S.D.N.Y. 2007).

264. *KPMG*, 412 F. Supp. 2d at 378–79 (citing *Ernst & Ernst*, 425 U.S. at 193 n.12.).

265. *Id.*

266. *Id.* at 375.

267. See *supra* Part II.A.

268. *Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 2302 (2011).

269. For an analysis and critique of the increased use of dictionaries by the Supreme Court in statutory interpretation, see James Brudney & Lawrence Baum, *Oasis or Mirage: The Supreme Court’s Thirst for Dictionaries in the Rehnquist and Roberts Eras* (Fordham Univ. Sch. of Law Legal Studies Research Papers Series, Working Paper No. 2195644, 2013), available at <http://ssrn.com/abstract=2195644>. Judge Posner of the Seventh Circuit recently cautioned against the use of dictionaries as a source of statutory meaning. See *United States v. Costello*, 666 F.3d 1040, 1043–44 (2012) (citing a variety of sources and distinguished jurists such as Learned Hand and Frank Easterbrook who have also critiqued the use of dictionaries).

270. *Janus*, 131 S. Ct. at 2302 (“When ‘make’ is paired with a noun expressing the action of a verb, the resulting phrase is ‘approximately equivalent in sense’ to that verb. [6 OXFORD ENGLISH DICTIONARY 66 (def.59) (1933) (hereinafter OED); *accord*, WEBSTER’S NEW INTERNATIONAL DICTIONARY 1485 (def.43) (2d ed. 1934)] (‘Make followed by a noun with the indefinite article is often nearly equivalent to the verb intransitive corresponding to that noun’). For instance, ‘to make a proclamation’ is the approximate equivalent of ‘to proclaim,’ and ‘to make a promise’ approximates ‘to promise.’ [See 6 OED 66 (def.59)]. The phrase at issue in Rule 10b–5, ‘[t]o make any . . . statement,’ is thus the approximate equivalent of ‘to state.’”).

grammatical exercise to explain his interpretation of “to make” (i.e., “one ‘makes’ a statement by stating it”).<sup>271</sup> Second, the Court said that the “ultimate authority” test followed from *Central Bank*, which prohibited private actions against those who provided substantial assistance in making the statement; accordingly, the Court did not want to blur the line between primary and secondary liability.<sup>272</sup> Third, the Court cited *Stoneridge*, finding that, without ultimate authority, it would not be “necessary or inevitable” that any falsehood would be contained in the statement.<sup>273</sup> Fourth, the majority “decline[d] the invitation to disregard the corporate form” and hold JCM liable for misstatements in JIF’s prospectus.<sup>274</sup> Fifth, the Court expressed the need to limit the implied private right of action.<sup>275</sup>

## ii. The SEC’s Amicus Brief

The SEC’s amicus brief in *Janus* described the history of the SEC’s creation standard, its grammatical interpretation of “make,” and practical responses to many of the concerns raised by the *Janus* majority.<sup>276</sup> The SEC argued that its conclusion—that one can make a statement by “creating or writing it”—was consistent with the ordinary meaning of the term “make.”<sup>277</sup> Citing a variety of dictionary sources, the SEC laid out what it maintained to be reasonable grammatical interpretations of “make” as it was used for purposes of Rule 10b-5.<sup>278</sup>

The SEC then refuted the speechwriter analogy advanced by the plaintiffs and accepted by the Court’s majority. The majority stated, “even when a speech writer drafts a speech, the content is entirely within the control of the person who delivers it. And it is the speaker who takes credit—or blame—for what is ultimately said.”<sup>279</sup> The SEC argued that the analogy

271. *Id.*

272. *Id.*

273. *Id.* at 2303.

274. *Id.* at 2304.

275. *Id.* at 2301–02, 2303.

276. See SEC *Janus* Brief, *supra* note 102, at 13–17.

277. See *id.* at 14.

278. See *id.* (“[O]ne can ‘make’ a statement by ‘creat[ing]’ or ‘writ[ing]’ it, even if the statement’s creator is not expressly identified. That conclusion is fully consistent with the ordinary meaning of the term ‘make.’); see also, e.g., 1 SHORTER OXFORD ENGLISH DICTIONARY 1682 (6th ed. 2007) (def. I.1.c, transitive verb: ‘Compose, write as the author (a book, a poem, verses, etc. [ . . . ]); draw up (a legal document, esp. one’s will)’; def. I.2, transitive verb: ‘Cause the material or physical existence of; produce by action, bring about \*\*\*; create or take part in the creation of (a sound recording, film, etc.)’); WEBSTER’S NEW INTERNATIONAL DICTIONARY 1485 (2d ed. 1958) (def. III.17: ‘To cause to exist, appear, or occur’); see also SEC v. Tambone, 597 F.3d 436, 443 (1st Cir. 2010) (en banc) (referring to ‘several common and representative dictionary definitions of “make,” which include “create [or] cause”; “compose”; and “cause (something) to exist.”); see also Brudney & Baum, *supra* note 269, at 68–71 (criticizing the *Janus* Court’s selective dictionary use and calling it a “barrier to responsible judicial review.”).

279. *Janus*, 131 S. Ct. at 2302.

was “doubly flawed.”<sup>280</sup> First, the analogy refers to making a speech, which generally refers to an oral delivery by a single person at a specific point in time, while the JIF prospectuses were written documents disseminated through a variety of methods over a period of time.<sup>281</sup> Second, the prospectus was issued in the name of an artificial person, JIF, who “can act only through (and at the direction of) others.”<sup>282</sup> Thus, “those who drafted the statements in the document can naturally be described as their maker.”<sup>283</sup>

The SEC also argued that an investment adviser exercising day-to-day management over a mutual fund should be considered a primary, not secondary, actor.<sup>284</sup> Unlike outside consultants, such as lawyers, accountants, and banks, mutual fund managers are actually responsible for the issuer’s statements. Nonetheless, if an outside consultant were “sufficiently involved” in creating or disseminating the statement in the client’s name, that person may be said to have “made” the statement for purposes of Rule 10b-5.<sup>285</sup> If such an interpretation did not apply to the conduct at issue, and JCM was not considered a “maker,” the SEC had grave concerns for its own ability to pursue even secondary liability claims because there would be no primary violation to aid and abet; thus, investment advisors who create false statements in their funds prospectuses would escape liability under section 10(b) altogether.<sup>286</sup>

### iii. The *Janus* Dissent

The *Janus* dissent, written by Justice Breyer, expressed similar concerns as the SEC and chipped away much of the majority’s rationale for the “ultimate authority” interpretation. The dissent first addressed the majority’s grammatical exercise, arguing that the majority incorrectly interpreted “make” as it was used in Rule 10b-5(b), noting that the scope of

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280. See SEC *Janus* Brief, *supra* note 102, at 15; see also Browning Jeffries, *The Implications of Janus on the Liability of Issuers in Jurisdictions Rejecting Collective Scierter*, SETON HALL L. REV. (forthcoming) (manuscript at 36), available at <http://ssrn.com/abstract=2174604> (“[I]f it is only the speech giver who can be liable in that scenario, it becomes impossible to impose liability in the frequent circumstance where the equivalent of the speech giver (e.g., the CFO signing a public filing) does not have the requisite scierter. Using the creator standard, and abandoning the speechwriter analogy, would enable plaintiffs to hold accountable individual corporate insiders responsible for the wrongdoing and reflect the corporate reality that it is typically not just one person who has responsibility for a statement.”).

281. See SEC *Janus* Brief, *supra* note 102, at 15. Furthermore, some jurisdictions applying the “ultimate authority” test have abandoned the analogy. See *In re Flannery*, SEC Release No. 438, 2011 WL 5130058, at 38 (Oct. 28, 2011) (initial decision) (holding that a person who gave a presentation was not the one with ultimate authority over the content of the presentation because he was merely delivering a message created by another).

282. See SEC *Janus* Brief, *supra* note 102, at 15.

283. See *id.*

284. See *id.* at 17.

285. See *id.* at 22–23.

286. See *id.* at 24–25.

the word is in no way limited to “ultimate authority.”<sup>287</sup> In contrast, the language and previous case law demonstrated that circumstances of the case determine whether one could make statements contained in a firm’s prospectus, even if a board of directors has ultimate content-related responsibility.<sup>288</sup> Numerous people can and do make statements.<sup>289</sup> The dissent also challenged the majority’s reliance on *Central Bank*, noting that *Central Bank* did not define primary liability but held merely that the text of section 10(b) did not provide for secondary liability.<sup>290</sup> Unlike *Central Bank*, where the defendants did not make any statements, the defendant in *Janus*, JCM, did in fact make false statements.<sup>291</sup> The dissent also refuted the majority’s citations to *Stoneridge*’s “necessary and inevitable” test. The *Stoneridge* Court focused on whether investors could have relied on statements not made to the public. In contrast, the *Janus* facts show that a statement was made to the public in the prospectus because of JCM’s conduct. According to the dissent, the Court’s shift in focus from reliance to conduct made it difficult to see how *Stoneridge* supported an “ultimate authority” test.<sup>292</sup> The dissent also expressed concern that there would be no primary violator if the majority’s opinion were followed, because a guilty management company, acting through an innocent board that officially made the statement, would not be liable.<sup>293</sup> The dissent called this liability void the “13th stroke of the new rule’s clock”<sup>294</sup> Finally, the dissent pointed out that corporate officials and others have been held liable under Rule 10b-5 for having made false statements in documents that they do not legally control.<sup>295</sup> The dissent cited *Herman & MacLean v. Huddleston*,<sup>296</sup> where the Court found that “certain individuals who play a part in preparing the registration statement” were primarily liable even where they are not named in the registration statement.<sup>297</sup> The dissent also quoted *Central Bank*, where the Court found that “a lawyer, accountant, or bank, who . . . makes a material misstatement (or omission) on which a particular purchaser or seller of securities relies *may be liable as a primary*

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287. *Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 2306 (2011) (Breyer, J., dissenting) (“Neither the common English nor this Court’s earlier cases limit the scope of that word to those with ‘ultimate authority’ over a statement’s content.”); *id.* at 2307 (“The English language does not impose upon the word ‘make’ boundaries of the kind the majority finds determinative. . . . Nothing in the English language prevents one from saying that several different individuals, separately or together, ‘make’ a statement that each has a hand in producing.”).

288. *See id.* at 2306–07 (“Practical matters related to context, including control, participation, and relevant audience, help determine who ‘makes’ a statement . . .”).

289. *See id.* at 2310.

290. *See id.* at 2307.

291. *See id.* at 2308.

292. *See id.* at 2309–11.

293. *See id.* at 2310.

294. *See id.*

295. *See id.* at 2311–12.

296. 459 U.S. 375 (1983).

297. *See Janus*, 131 S. Ct. at 2311 (Breyer, J., dissenting) (quoting *Herman & MacLean*, 459 U.S. at 386 n.22).

violator under 10b-5, assuming all of the requirements for primary liability under Rule 10b-5 are met,” including the requisite scienter.<sup>298</sup>

### III. LOOKING FORWARD: “BY JANUS, I THINK NO”<sup>299</sup>

The *Janus* decision was limited to private Rule 10b-5 actions and, as such, does not apply to SEC enforcement actions. As a result, stare decisis should not block the SEC’s own interpretation. The *Janus* interpretation of “to make” may be one permissible construction, but it is not the only one. The SEC’s creation standard is also a permissible construction of the Rule and is thereby entitled to substantial deference from courts. The *Janus* Court’s concerns for blurring the line between primary and secondary liability are satisfied because, as demonstrated in *SEC v. KPMG*, the creation standard, premised on “sufficient responsibility,” is more exacting than the “substantial assistance” standard used for of aiding and abetting. The other policy reasons cited by the Court are not present in SEC enforcement actions, and, in contrast, there are policy factors in favor of deferring to the SEC; as a result, the interpretation of Rule 10b-5 need not be so narrow, and the SEC’s interpretation should be accorded deference under *Seminole Rock*.

#### A. *Janus Does Not Apply to SEC 10b-5 Enforcement Actions*

The *Janus* holding was limited to private rights of action and, accordingly, does not apply to SEC actions. Although the “ultimate authority” limitation might be necessary in a private suit, the considerations cited by the Court are not present in an SEC action. First, the Court explained that it granted certiorari to determine whether, in a *private action*, the advisor could be liable for making misstatements.<sup>300</sup> Second, if the proper interpretation merely turned on the dictionary definition of “make,” then the other rationale for the holding would be superfluous. Instead, it is the other rationales that drive the selection of the narrow dictionary definition from a variety of options. For example, the court twice highlights the need to accord a narrow interpretation to the implied private right of action.<sup>301</sup> This may have been a valid consideration for implied actions in the face of ever-expanding private securities litigation that Congress might not have intended.<sup>302</sup> There should be no corresponding concern in SEC actions, however, because they are expressly authorized in the statute.<sup>303</sup> Unlike its private action guidance, the Court has repeatedly

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298. *See id.* (omissions in original) (quoting *Cent. Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164, 191 (1994)).

299. William Shakespeare, *Othello* act 1, sc. 2.

300. *See supra* note 179 and accompanying text.

301. *See supra* notes 180–81 and accompanying text.

302. *See supra* notes 57–64 and accompanying text.

303. *See supra* notes 34–36 and accompanying text.

instructed lower courts in SEC enforcement actions to interpret section 10(b) and Rule 10b-5 flexibly to effectuate their remedial purposes.<sup>304</sup>

In addition, the Court expressed concern for blurring the line between primary and secondary liability because private plaintiffs cannot bring aiding and abetting suits.<sup>305</sup> In contrast, the SEC has express statutory authority to bring such claims,<sup>306</sup> making such concerns unfounded in an SEC enforcement action.

As the dissent and subsequent commentators point out, the SEC can only pursue control person liability and aiding and abetting when there is a primary violation.<sup>307</sup> Under the majority's view, there would be no primary violator for others to be secondarily liable for aiding and abetting. While the SEC has other avenues to prosecute fraudulent activity,<sup>308</sup> such an unnecessary limitation would impede the SEC's ability to carry out its role in "safeguarding the public interest in enforcing the securities laws."<sup>309</sup> If the "ultimate authority" standard is in fact a "13th stroke" of a clock that never occurs,<sup>310</sup> one must wonder if this could have been what Congress intended when it passed the '34 Act and subsequent legislation.

### B. *The SEC's Interpretation is Entitled to Judicial Deference*

This section will demonstrate why the SEC's interpretation of Rule 10b-5 is entitled to substantial judicial deference. Starting with *Mead*, then going through the traditional "*Chevron* two-step," the SEC's interpretation passes each step set forth in the Court's jurisprudence. Had the Court considered the SEC's interpretation in a separate proceeding that lacked concerns over implied private rights of action, the analysis would demand deference to the SEC's position.

#### 1. *Mead/Chevron* Step Zero

The '34 Act expressly delegated rulemaking authority to the SEC but is silent on the ability to interpret those rules.<sup>311</sup> But this authority can surely be inferred as a function of enforcing such rules and regulations. If the SEC expresses its interpretation in a formal adjudication, as it did in *In re Armstrong*,<sup>312</sup> it will pass the initial *Mead* test. Nonetheless, other proceedings that "foster . . . fairness and deliberation" could also be indicators of Congressional intent to delegate "force of law" authority.<sup>313</sup> In *Auer*, the Court stated that an agency's amicus brief reflected the

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304. See *supra* notes 248–51 and accompanying text.

305. See *supra* notes 61, 272 and accompanying text.

306. See *supra* notes 62–63 and accompanying text.

307. See *supra* notes 183–84 and accompanying text.

308. See *supra* notes 11, 35, 186 and accompanying text.

309. See *supra* note 36 and accompanying text.

310. See *supra* note 294 and accompanying text.

311. See *supra* notes 35–37 and accompanying text.

312. See *supra* note 258 and accompanying text.

313. See *supra* note 130 and accompanying text.

agency's fair and considered judgment.<sup>314</sup> The SEC has set forth its interpretation in several amicus briefs since 1998.<sup>315</sup> Thus, there is no doubt that the SEC's process for developing its interpretation passes Step Zero.

## 2. Neither Congress nor the Court Spoke Directly to This Issue: Passing *Chevron* Step One.

For many of the same reasons expressed in Part III.A, the *Janus* ruling should not set precedent for an SEC action, and therefore, neither Congress nor the Court has spoken to this direct issue. When the reach of the Court's holding is not clear, courts should not cut off the analysis,<sup>316</sup> particularly when it considers the policy reasons for agency deference.<sup>317</sup>

In the present case, Congress has not spoken, so the analysis turns to whether the Court has spoken to the precise question at issue.<sup>318</sup> If not, then the Court should not impose its own construction.<sup>319</sup> In *Janus*, the Court did not expressly hold that the ultimate authority rule applies in SEC enforcement actions,<sup>320</sup> so the analysis should proceed to *Chevron* Step Two.

## 3. A Practical Construction: Passing *Chevron* Step Two

The majority's interpretation does not have to be the only reasonable construction. One reasonable construction does not preclude all other reasonable constructions, especially in the realm of agency interpretations. The Court itself has stated that an agency's interpretation need not be the best or most natural one by *grammatical* or other standards.<sup>321</sup> The Court has also repeatedly instructed lower courts to interpret section 10(b) and Rule 10b-5 "not technically and restrictively, but flexibly to effectuate its remedial purposes."<sup>322</sup> The majority in *Janus* gave Rule 10b-5 "narrow dimensions" because of the party bringing the case;<sup>323</sup> likewise, one can infer that there are "broader" interpretations available—but not used—such as the SEC's interpretation.

Four Supreme Court Justices, several lower court judges, and several commentators have also offered alternative, yet reasonable interpretations of "to make."<sup>324</sup> The dissent argued that the English language does not

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314. See *supra* note 147 and accompanying text.  
 315. See *supra* notes 255–57, 259 and accompanying text.  
 316. See *supra* note 228 and accompanying text.  
 317. See *supra* notes 138–41 and accompanying text.  
 318. See *supra* notes 115, 231–34 and accompanying text.  
 319. See *supra* notes 115, 231–34 and accompanying text.  
 320. See *supra* Part II.B.2.  
 321. See *supra* note 143 and accompanying text.  
 322. See *supra* note 248 and accompanying text.  
 323. See *supra* notes 180–81 and accompanying text.  
 324. See *supra* Part II.3.b.ii–iii.

impose limitations such as “ultimate authority” on the word “make.”<sup>325</sup> While the majority cited dictionary definitions as support,<sup>326</sup> the SEC cited different dictionary definitions to support its position.<sup>327</sup> Surely, the scope of one of the most important federal securities laws should not turn on which dictionary one pulls from the library shelf.<sup>328</sup> Such disagreement over the meaning demonstrates that the text of Rule 10b-5 is far from “clear.”<sup>329</sup> When the answer is not clear, the uncertainty should yield to an agency’s own reasonable interpretation, consistent with Congress’s will to delegate such authority.

Additionally, the SEC has used the “creation” standard since 1998.<sup>330</sup> Courts should not disturb the agency’s “longstanding interpretation of its own regulations.”<sup>331</sup> Nor should a court interpose its own construction when the SEC’s expertise is more adept at dealing with the complex nature of mutual fund structures, market transactions, and unique or novel forms of fraud.<sup>332</sup>

The cases cited in Part I.B.2, discussing possible limits on *Seminole Rock* deference, deal with a court’s ruling on an agency’s action, followed later by a changed agency interpretation.<sup>333</sup> It would be fair to argue that an agency should not get two bites at the apple or be given the unchecked power simply to change its interpretation or to overturn a Supreme Court decision.<sup>334</sup> In any event, this would not be the case in a post-*Janus* SEC action. The SEC never got a full bite. As an amicus, it offered its opinion, which the Court was not obligated to follow; the SEC was not a party to the suit. However, the SEC was never afforded a chance to present its interpretation insulated from inapplicable policy considerations for limiting private actions. Were the SEC afforded an opportunity, it could present its interpretation, and, independent of private actions, a court could decide if that interpretation was a “practical construction” of section 10(b) and Rule 10b-5 consistent with Congressional intent.

The only limitation that should be placed on the scope of Rule 10b-5 in an SEC enforcement action is the text of the statute.<sup>335</sup> Unlike Rule 10b-5, section 10(b) does not include the word “make,” but instead lists “use or employ.” Such words encompass a broader range of conduct,<sup>336</sup> including that of JCM. Accountants, lawyers, bankers, underwriters, and others who unknowingly create misleading documents will not be liable if they, as the

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325. *See supra* note 287 and accompanying text.

326. *See supra* note 270 and accompanying text.

327. *See supra* note 278 and accompanying text.

328. *See supra* note 269 and accompanying text.

329. *See supra* notes 235, 240–47 and accompanying text.

330. *See supra* note 256 and accompanying text.

331. *See supra* note 141 and accompanying text.

332. *See supra* notes 140, 250 and accompanying text.

333. *See supra* notes 149–59 and accompanying text.

334. *See supra* note 237 and accompanying text.

335. *See supra* notes 31, 161 and accompanying text.

336. *See supra* note 206 and accompanying text.

board of JIF did, lacked the requisite scienter, or intent to deceive.<sup>337</sup> It should be difficult to formulate the policy argument that those who act with an intent to deceive should be excluded from the scope of Rule 10b-5, as JCM was. Instead, as proposed by the *Janus* dissent and consistent with pre-*Janus* precedents, a court should undertake a broader inquiry, beyond “ultimate authority,” into matters of context, control, participation, and relevant audience to determine who makes a statement for purpose of Rule 10b-5.<sup>338</sup>

#### CONCLUSION

The text of Rule 10b-5 has not changed since Milton Freeman wrote it in 1942. In contrast, the securities industry today would be almost unrecognizable to those from that early period of federal securities law. Although the industry is evolving every minute, with new products, markets, fund structures, and means of communication, the text of Rule 10b-5 has, so far, been sufficiently flexible to cover these evolutions.<sup>339</sup> The SEC, charged with the monumental task of not only promulgating rules to keep up with such change but also enforcing those rules to “protect[] investors, maintain fair, orderly, and efficient markets, and facilitate capital formation,” must be allowed the flexibility to use every possible tool at its disposal to “effect the remedial purpose” of our nations securities laws.<sup>340</sup> That flexibility encompasses the ability to interpret its own regulation in a reasonable and practical manner designed to keep up with the ever-changing market and root out fraud wherever it is found.

After all, “[W]e are against fraud, aren’t we?”<sup>341</sup>

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337. *See supra* note 261 and accompanying text.

338. *See supra* note 288 and accompanying text.

339. *See supra* note 32 and accompanying text.

340. *See supra* note 37 and accompanying text.

341. *See supra* note 28 and accompanying text.