# Supreme Court Forecloses Primary Liability for Secondary Actors in Securities Offerings

The Supreme Court today held in *Janus Capital Group, Inc. v. First Derivative Traders* that investors cannot sue a mutual fund's investment adviser for misrepresentations in a mutual fund prospectus, even though it was alleged to have participated in drafting the disclosure document. According to the Court, only the issuer of the prospectus "makes" a statement within the meaning of the antifraud laws. The Court rejected arguments by investors and the SEC that the close relationship between a mutual fund and its adviser, and the externalization of the fund's management and operations, meant that a fund's prospectus disclosures could be attributed to those entities. To "make" a statement, the Court held, literally means only to actually "make" a statement – but does not embrace drafting, preparation, or anything else. The decision means that the plaintiffs' bar will not be able to sue peripheral players as primary violators in prospectus disclosure cases.

The case arises out of the mutual fund market timing scandal that erupted some eight years ago. Prospectuses issued by Janus mutual funds stated that the funds had policies in place to discourage market timing and that the funds took action to deter such behavior. When the New York Attorney General complained that those representations were false, investors withdrew from the mutual funds, and the adviser and its parent lost substantial fees as assets under management fell, causing the market price of the management company to fall substantially. Stockholders sued, claiming that the adviser and parent "made" the false statements in the mutual fund prospectus upon which they relied to their detriment.

The District Court dismissed the complaint. It held that the plaintiffs failed to allege that Janus Capital Management "actually made or prepared the prospectuses, let alone that any statements . . . [were] directly attributable to it." According to the District Court, participating in the preparation and dissemination of a misleading document is not "tantamount to making a misstatement for securities fraud purposes." The Fourth Circuit Court of Appeals reversed. It held that Janus Capital Management "made" the misleading statements by participating in the writing, preparation, and dissemination of the prospectuses. The Supreme Court granted Janus Capital Management's petition for certiorari and heard oral argument on December 7, 2010.

In a long-awaited decision issued this morning, a sharply divided Supreme Court rejected the Fourth Circuit's interpretation of the word "made" in favor of a strict, literal application of the word. Only the prospectus issuer – in this case the mutual fund – "made" any false statement. Justice Clarence Thomas wrote for the Court, which was divided 5–4 along ideological lines.

Because the Securities Exchange Act of 1934 does not create an express private right of action for shareholders under Section 10(b), the Court stated it was "mindful" that it must give the implied authority to sue "narrow dimensions." Accordingly, the Court defined the verb "make" very strictly: "For purposes of Rule 10b-5, the maker of a statement is the person or entity with ultimate authority of the statement, including its content and whether and how to communicate it." The Court specified that a person who merely "prepares" or "publishes" a statement "on behalf of another" is not "its maker." And the Court stated that "attribution within a statement or implicit from surrounding circumstances is strong evidence that

a statement was made by – and only by – the party to whom it is attributed." It therefore appears that, at least in the ordinary case, the *Janus* decision limits 10b-5 liability in private rights of action to the person or entity under whose name a false or misleading statement is disseminated.

In reaching its decision, the Court rejected the contention of the Solicitor General and the SEC that "make" was congruent with "create." Justice Thomas wrote that expansion of the word "make" in that fashion would "permit private plaintiffs to sue a person who 'provides the false or misleading information that another person then puts into the statement.'" The Court noted that it had rejected just such a theory of liability for "providing" false information in *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148 (2008), which refused to adopt so-called "scheme" liability. The Court likewise discarded the investors' argument that, because of the "uniquely close relationship between a mutual fund and its investment adviser," the adviser should be understood to be the "maker" of its client's statements. In the Court's view, such attribution would "disregard the corporate form." The Court suggested that any such "reapportionment of liability in the securities industry" should be left to Congress.

Justice Breyer dissented, contending that the "maker" of a statement cannot be limited to those with "'ultimate authority' over a statement's content." In Justice Breyer's view, "a management company, a board of trustees, individual company officers, or others, separately or together, might 'make' statements contained in a firm's prospectus – even if aboard of directors has ultimate content-related responsibility." But that interpretation could not command a majority.

The *Janus* ruling carries tremendous implications for both the financial services industry and for securities litigation generally.

First, it confirms that only a mutual fund and its own directors or trustees who actually "make" prospectus statements can be liable to investors for misrepresentations and omissions. Other mutual fund industry participants – including advisers, distributors, lawyers and others – cannot be held to have "made" prospectus misstatements merely because of their participation in the preparation and distribution of disclosure documents. That relieves substantial players in the industry of a risk of liability the Fourth Circuit's decision had created.

Second, the decision more generally extinguishes the danger that private lawsuits can be brought to allege *primary* violations of the antifraud laws against *secondary* actors. Since "aiding and abetting" and other forms of secondary liability are not privately enforceable by investors – but may only be pursued by the SEC – the *Janus* decision makes clear that this avenue of relief is not available to the private plaintiffs' bar. Remote participants in securities offerings remain at peril as "control persons" under the statute – usually only if they can be accused of "culpable participation" in an underlying violation. But the blurry line between primary and secondary misconduct that the plaintiffs' bar threatened to exploit based upon the lower court's decision has now been made bright-line clear. The Supreme Court's decision to give resolution to that fuzzy distinction imposes an important restriction on private securities litigation.

## Contact Information

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