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The United States Supreme Court Declines to Expand the Scope of Primary Liability Under Rule 10b-5 to Service Providers Who Do Not Have Ultimate Authority Over Statements

In *Janus Capital Group, Inc. v. First Derivative Traders,*[1] the Supreme Court addressed the scope of primary liability in private actions under Rule 10b-5[2] (promulgated pursuant to Section 10(b) of the Securities Exchange Act of 1934 ("1934 Act"))[3] of persons and entities that assist in the preparation or dissemination of a separate entity's prospectus or other public statements for misstatements in such documents.

In a five-to-four decision authored by Justice Thomas, the Court on June 13, 2011 took a narrow approach to the implied private right of action under Rule 10b-5, holding that persons and entities involved in the preparation and dissemination of public statements and filings do not "make" a false statement unless they have "ultimate authority over the [false] statement, including its content and whether and how to communicate it."[4] Accordingly, the Court held that persons and entities lacking such authority cannot be held liable as primary violators of Section 10(b) of the 1934 Act and Rule 10b-5 thereunder.

Although the decision addressed a claim of primary liability against an investment adviser of a registered investment company, the bright-line test the Court endorsed seems certain to narrow the exposure of other service providers, such as attorneys, accountants and administrators, to registered funds and other registrants to private civil actions for securities fraud under Rule 10b-5 relating to their involvement with statements and filings subject to the federal securities laws.

Discussion

Background

Petitioner/defendant Janus Capital Management LLC ("JCM") is the investment adviser to the Janus funds. Respondent/plaintiff First Derivative Traders ("First Derivative"), representing a putative class of shareholders in JCM's publicly traded corporate parent, Janus Capital Group Inc. ("JCG"), alleged that JCM had "made" certain misleading statements regarding market timing practices in the prospectuses for the Janus Investment Fund (the "Fund") based on its participation in writing and disseminating the prospectuses that contained the allegedly misleading statements.

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1 No. 09-525, slip op. at 8 (U.S. June 13, 2011).

2 17 C.F.R. 240.10b-5. The relevant portion of Rule 10b-5 prohibits the "mak[ing] of any untrue statement of a material fact . . . in connection with the purchase or sale of securities."

3 15 U.S.C. § 78j(b).

4 *Janus Capital Group, Inc. v. First Derivative Traders*, No. 09-525, slip op. at 6 (U.S. June 13, 2011).

First Derivative alleged that those statements falsely represented that the Fund's investment adviser did not permit, and took active measures to prevent, market timing activities by investors in the Funds. Contending that the plaintiffs had bought JCG shares at inflated prices and thereafter lost money when market timing practices authorized by JCG and JCM became known to the public, First Derivative sought to hold JCM liable for fraud under Section 10(b) of the 1934 Act and Rule 10b-5. In addition, the plaintiffs alleged that JCG was liable under Section 20(a) of the 1934 Act as a control person of JCM.

The district court granted the defendants' motion to dismiss pursuant to Rule 12(b)(6), holding that the plaintiffs had failed to state a claim against JCM under Section 10(b) of the 1934 Act. The district court also ruled that the plaintiffs' claim of control person liability against JCG pursuant to Section 20(a) of the 1934 Act had to be dismissed because the plaintiffs had failed to plead a viable Section 10(b) claim against JCM.[5]

On appeal, the Fourth Circuit reversed the district court's ruling, holding that an adviser who "helped draft the misleading prospectuses" of a mutual fund could be held primarily liable under Section 10(b) of the 1934 Act.[6] Thus, the Fourth Circuit permitted the plaintiffs' Section 10(b) primary liability claim against JCM and Section 20(a) control person liability claim against JCG to continue.[7]

The Supreme Court reversed the decision of the Fourth Circuit, holding that, for purposes of Rule 10b-5, any false statements in the Fund's prospectuses were made by the Fund, not by JCM. The Court reasoned that, while JCM may have been significantly involved in preparing the Fund's prospectuses, "this assistance, subject to the ultimate control of the Janus Investment Fund, does not mean that JCM 'made' any statement in the Janus Investment Fund's prospectuses."[8] This is so, the Court held, because JCM did not have "ultimate authority over the statement, including its content and whether and how to communicate it."[9]

The Court "decline[d] [the] invitation to disregard the corporate form"[10] and noted that "JCM and Janus Investment Fund remain legally separate entities."[11] Further, the Court observed that "[a]ny reapportionment of liability in the securities industry in light of the close relationship between the investment advisers and mutual funds is properly the responsibility of Congress and not the courts."[12]

A Bright Line Test for Primary Liability under Rule 10b-5

Because the private right of action recognized under Section 10(b) and Rule 10b-5 is only implied and not expressly provided by statute,[13] the Supreme Court was "mindful that [the Court] 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."[14]

Consistent with that view, in recent years the Court has repeatedly declined to expand the scope of the private right of action under Section 10(b) and Rule 10b-5 to include claims against persons other than those who are primary violators (i.e., those who "make" a false statement as opposed to those who aid and abet the maker of the false statement).[15] *Janus* continues this

5 *In re Mutual Funds Inv. Litigation*, 487 F. Supp. 2d 618, 620 (D. Md. 2007).

6 *In re Mutual Funds Inv. Litigation*, 566 F. 3d 111, 121 (4th Cir. 2009).

7 *Id.* at 115.

8 *Janus Capital Group, Inc. v. First Derivative Traders*, No. 09-525, slip op. at 12 (U.S. June 13, 2011).

9 *Id.* at 6.

10 *Id* at 9.

11 *Id.* at 10.

12 *Id.*

13 *Superintendent of Ins. of N. Y. v. Bankers Life & Casualty Co.*, 404 U.S. 6, 13 n.9 (1971).

14 *Janus Capital Group, Inc. v. First Derivative Traders*, No. 09-525, slip op. at 6 (quoting *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 167 (2008)).

15 *See Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 191 (1994) (stating that "[b]ecause 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)"); *see also Stoneridge Inv. Partners, LLC v Scientific-Atlanta, Inc.*, 552 U.S. 148, 158, 166 (2008) (stating that Section 10(b)'s private right of action "does not extend to aiders and abettors," but it "continues to cover secondary actors who commit primary violations.").

trend, drawing a "clean line" between those who are primarily liable and those who are secondarily liable, by limiting the scope of persons who may be sued for "making" allegedly false statements to those "with ultimate authority" over the statements.[16]

In affirming its bright-line test for liability under Rule 10b-5, the Court rejected the more flexible, fact-specific test previously adopted by the Fourth Circuit and supported by the Department of Justice ("DOJ") and the Securities and Exchange Commission ("SEC") on behalf of the United States as *amicus curiae.* The SEC and DOJ argued that the term "make" should provide for primary liability when "a person 'creates' a misrepresentation either by writing or speaking it, providing false or misleading information for another to put into it, or allowing it to be attributed to him."[17] The Court concluded that this view was inconsistent with its prior rulings limiting the scope of primary civil liability.[18]

Corporate Form Respected

In support of its arguments that JCM should be primarily liable for the alleged false statements in the Fund's prospectus, First Derivative contended that, because of the "'well recognized and uniquely close relationship' between a mutual fund and its investment adviser[,] . . . an investment adviser should generally be understood to be the 'maker' of statements by its client mutual fund, like a playwright whose lines are delivered by an actor."[19] The DOJ and SEC again supported First Derivative, arguing to the Court that "[a]lthough JCM was subject to oversight by the [Fund's] trustees, it allegedly performed the 'insider' functions that corporate officers and employees ordinarily would, rather than the advisory role typically associated with outside service providers. Thus, JCM can be held liable for its own statements to the market, made 'directly or indirectly' through the prospectuses of the Funds over which it exercised managerial control."[20]

The Court turned these arguments aside as well because they "disregard the corporate form"[21] and "would also lead to results inconsistent with our precedent."[22] The Court stated that "JCM and [the Fund] remain legally separate entities and [the Fund's] board of trustees was more independent than the statute requires."[23] The Court added that "[a]ny reapportionment of liability in the securities industry in light of the close relationship between investment advisers and mutual funds is properly the responsibility of Congress and not the courts."[24]

Implications of *Janus Capital*

Janus Capital raises the bar for claims of primary liability in private civil actions under Section 10(b) and Rule 10b-5 for misleading statements, by limiting the potential defendants to those that actually "make" the misleading statement at issue. Persons or entities that assist or participate in the preparation or dissemination of filings or statements by public registrants, but who lack the "ultimate authority" over a statement made, cannot be held liable under the decision's bright-line test.

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16 *Janus Capital Group, Inc. v. First Derivative Traders*, No. 09-525, slip op. at 7 n.6 (U.S. June 13, 2011).

17 Brief for United States as *Amicus Curiae* Supporting Respondents at 8, *Janus Capital Group, Inc. v. First Derivative Traders*, No. 09-525, slip op. (U.S. June 13, 2011).

18 *Janus Capital Group, Inc. v. First Derivative Traders*, No. 09-525, slip op. at 9 (U.S. June 13, 2011).

19 *Id.* (citation omitted).

20 Brief for United States as *Amicus Curiae* Supporting Respondents at 10, *Janus Capital Group, Inc. v. First Derivative Traders*, No. 09-525, slip op. (U.S. June 13, 2011).

21 *Janus Capital Group, Inc. v. First Derivative Traders*, No. 09-525, slip op. at 9 (U.S. June 13, 2011).

22 *Id.* at 8.

23 *Id.* at 10.

24 *Id.*

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