LATHAM & WATKINS

Number 1207 June 20, 2011

Client Alert

Latham & Watkins
Litigation Department

US Supreme Court Limits Private Liability Under Rule 10b-5 By Defining the "Maker" of A Statement Narrowly

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On Monday, a closely-divided Supreme Court held in *Janus Capital Group Inc. v. First Derivative Traders*, No. 09-525, that the "maker" of a statement for purposes of liability under Rule 10b-5 is "the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it."[1] The decision abrogates numerous circuit decisions — most notably in the Fourth and Ninth Circuits — that extended primary liability to persons who participated in some respect in the preparation or drafting of statements that were "made" by someone else. The Supreme Court thus has provided some comfort to the professional community providing services to public companies — including bankers, lawyers, accountants, investment and financial advisers, and others — that they will not unwittingly expose themselves to liability for their clients' statements in private Rule 10b-5 suits.

The Janus Litigation

Janus Capital Management LLC (JCM) is a registered investment adviser that, among other things, advises the Janus family of mutual funds, organized as a trust called the Janus Investment Fund. The Fund is governed by an independent Board of Trustees, and is not owned or controlled by JCM, although all of the officers of the Fund are also officers of JCM. Plaintiff, First Derivative Traders, invested in the stock of JCM's parent company, Janus Capital Group Inc. (JCG).

The JCG shareholders sued both JCG and JCM under §§ 10(b) and 20(a), alleging that the price of JCG's stock had been artificially inflated as a result of misleading statements in the Janus Funds' prospectuses. As alleged in the complaint, neither JCG nor JCM issued the allegedly misleading prospectuses; instead, the Fund was responsible for drafting the prospectuses, and the prospectuses also were made available through links on the Janus Web site, which was jointly maintained by JCG, JCM and the Fund.

The district court dismissed the suit, holding that the plaintiff-investors had failed to state a claim against JCG under § 10(b), because the complaint did not allege "that JCG actually made or prepared the prospectuses, let alone that any statements contained therein were directly attributable to it."[2]

The district court found it unnecessary "to decide whether JCM made the alleged misstatements," because even "a mutual fund investment adviser that allegedly made representations to mutual fund shareholders cannot be liable under section 10(b) to its parent's shareholders who purchased no mutual fund shares."[3] That was so, the district court explained, because an investment adviser "owe[s] no duty to its parent's shareholders, because the latter never purchased or sold … mutual funds."[4]

The Fourth Circuit's Decision

On appeal, the Fourth Circuit upheld the dismissal of § 10(b) liability as to JCG, holding instead that JCG could be liable only as a control person under § 20(a). The Fourth Circuit reversed the district court's holding as to JCM, however, holding that, "by participating in the writing and dissemination of the prospectuses," JCM "*made* the misleading statements contained in [those] documents."[5]

Rejecting two competing approaches adopted by other courts of appeals, the Fourth Circuit fashioned its own standard for determining whether secondary actors could be liable for statements they had "participat[ed]" in, but not actually made. It settled on a standard that would require plaintiffs to "allege facts from which a court could plausibly infer that interested investors would have known that the defendant was responsible for the statement at the time it was made, even if the statement on its face is not directly attributable to the defendant."

Because the Fund's allegedly misleading statements had not been attributed to JCM, the Fourth Circuit needed to address the element of "reliance" and the Supreme Court's decision in *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta Inc.*[6] In *Stoneridge*, the Supreme Court held that a secondary actor could not be held liable for engaging in conduct that led to or caused a misstatement where investors had not relied upon the secondary actor's conduct in making their investment decision (*i.e.*, "that in an efficient market investors rely not only upon the public statements relating to a security but also upon the transactions those statements reflect"). The Fourth Circuit held that, unlike in *Stoneridge*, the Janus plaintiffs had satisfied the reliance element because investors would have inferred that JCM "played a role in preparing or approving" the Fund's statements.

The Supreme Court's Decision

The Supreme Court reversed the Fourth Circuit's judgment in a 5-4 opinion authored by Justice Thomas. Taking a strict definitional approach to the term "to make," and relying both on the plain meaning of the text and its prior decisions, the Court held that "the maker of a statement is the person or entity with ultimate authority over the statement."[7] "Without control," the Court explained, "a person or entity can merely suggest what to say, not 'make' a statement in its own right," and therefore "[o]ne who prepares or publishes a statement on behalf of another is not its maker."[8]

The Court explained that this interpretation of "makes" is consistent with its decision in *Central Bank of Denver, N. A. v. First Interstate Bank of Denver, N. A.*[9], in which the Court held that Rule 10b–5's private right of action does not include suits against aiders and abettors. The Court in *Central Bank* had distinguished "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)."[10] To ensure that this distinction "ha[s] any meaning," the *Janus* Court explained, it "dr[e]w a clean line between the two — the maker is the person or entity with ultimate authority over a statement and others are not."[11]

The Court also explained that its decision in *Stoneridge*, which the Fourth Circuit had nimbly side-stepped in reaching its contrary holding, supported, if not compelled, this interpretation of "makes." The Court further noted that this test "accords with the narrow scope that we must give the implied private right of action."[12]

The Court rejected the Government's argument that "make" should be defined as "create." The Court explained that the government's preferred definition, "although perhaps appropriate when 'make' is directed at an object unassociated with a verb (*e.g.*, 'to make a chair'), fails to capture its meaning when directed at an object expressing the action of a verb."[13] The Court also pointed out that the Government's definition is inconsistent with *Stoneridge*, because it "would permit private plaintiffs to sue a person who 'provides the false or misleading information that another person then puts into the statement.'"[14] In *Stoneridge*, the majority reminded, the Court had "rejected a private Rule 10b–5 suit against companies involved in deceptive transactions, even when information about those transactions was later incorporated into false public statements."[15] The *Janus* Court saw "no reason to treat participating in the drafting of a false statement differently from engaging in deceptive transactions, when each is merely an undisclosed act preceding the decision of an independent entity to make a public statement."[16]

The Court concluded that "JCM did not 'make' any of the statements in the [Janus Funds] prospectuses" because its alleged "involvement in preparing the prospectuses" was "subject to the ultimate control" of the Janus Funds.[17] Although First Derivative Traders argued that JCM had a "uniquely close relationship" with the Janus Funds, the Court "decline[d] this invitation to disregard the corporate form,"[18] and explained 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."[19]

Implications

JCM's briefing and argument urged the Court to adopt a "bright line" test for primary liability, and the Court delivered. As JCM argued, neither the investors nor the United States had articulated a workable rule: "They can't articulate the distinction between primary and secondary, between principal and agent, between aiders and abettors and anyone else."[20] Those arguments obviously resonated with the majority, which went about as far towards providing, in its words, a "clear line" as defendants could hope for.

The Court's decision in *Janus* provides much-needed clarification to *Stoneridge*'s "reliance" rationale for liability. As we and other commentators have noted elsewhere, *Stoneridge* was decided on reliance grounds, although the Court could have decided that case on the ground that the defendants did not "make" the allegedly false statements. In *Janus*, the Court agreed: "If *Stoneridge* had addressed whether the [defendants] were 'makers,' today's decision would be unnecessary. . . . *Stoneridge*'s analysis suggests that they were not ['makers']."[21] This is significant because, as the Fourth Circuit's decision demonstrates, *Stoneridge* left open an argument to extend Rule 10b-5 liability to persons who did not actually make the alleged misstatement. Janus now provides a bright-line rule limiting liability to the makers regardless of whom investors may believe was involved in preparing the statement.

Janus also clarifies, in a footnote, that a defendant does not face private Rule 10b-5 liability merely by including a reference or link, on the defendant's Web site, to another's statement. "Merely hosting a document on a Web site does not indicate that the hosting entity adopts the document as its own

statement or exercises control over its content."[22] This may have ramifications in litigations based on a theory that an entity that merely cites to another's statement — for example, an underlying loan provider's underwriting standards — necessarily endorses and thus is liable if those statements are misleading.

The decision profoundly alters the legal landscape in the Ninth Circuit, in particular, where secondary actors have been subject to Rule 10b-5 liability for their "substantial participation" or "substantial assistance" in the creation of statements ultimately adopted and published by their client issuers — a standard that left much to be desired in terms of predictability and risk management, and was always in tension with the Supreme Court's decision in *Central Bank* (and the Court's general trend towards narrowing the implied private cause of action under Rule 10b-5).

Although the Court in *Janus* plainly rejected the plaintiff-investors' argument "that an investment adviser should generally be understood to be the 'maker' of statements by its client mutual fund," financial advisors and others within the same corporate family as the underlying issuer of the statements should pay heed to the majority's note that it was "undisputed that the corporate formalities were observed here."[23] "JCM and Janus Investment Fund remain legally separate entities, and Janus Investment Fund's board of trustees was more independent than the statute requires."[24] That said, the Court ultimately concluded that JCM did not "make" the statements in the Fund's prospectuses notwithstanding the plaintiffs' points that JCM "exerted significant influence" over the Fund, and that the Fund enjoyed a "close relationship" and shared officers with JCM.

The Court's decision may shift more suits against secondary actors to the SEC based on theories of mere participation in the making of another's statement. *Janus* — as with *Stoneridge* — makes clear that only the SEC has the authority to bring suits against aiders and abettors or "entities that contribute 'substantial assistance' to the making of a statement but do not actually make it."[25]

Janus now makes clear that public companies' service providers cannot be held liable to private plaintiffs for a statement made by their client issuer, no matter how significant a role they are alleged to have played in advising or even drafting that statement. That confirms the bright-line rule already recognized by various circuits and is a significant change in the law in others — one that generally should make it easier for secondary actors to prevail on a motion to dismiss in such suits.

Endnotes

[1] Slip op. at 6

[2] *Wiggins v. Janus Capital Group Inc.* (In re Mut. Funds Inv. Litig.), 487 F. Supp. 2d 618, 621 (D. Md. 2007).

[3] *Id*. at 624.

[4] *Id*. at 622-23.

[5] Slip op. at 4 (emphasis in original).

[6] 552 U.S. 148 (2008).

[7] Slip op. at 6.

[8] *Id*. at 6.

[9] 511 U. S. 164, 180 (1994).

[10] Slip op. at 7 n.6.

[11] *Id*.

[12] *Id*. at 8.

[13] *Id*.

[14] *Id*.

[15] *Id*. at 9

[16] *Id*.

[17] Slip op. at 11-12.

[18] *Id*. at 9.

[19] *Id*. at 10.

[20] Dec. 7, 2010 Tr. of Oral Arg. at 62.

[21] Slip op. at 8 n. 7.

[22] Slip op. at 12 n. 12

[23] Slip op. at 9.

[24] *Id*.

[25] Slip op. at 7.

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