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SUPREME COURT DECISION IN *JANUS* LITIGATION

Court Sharply Limits Scope of Primary Liability under Section 10(b)

On June 13, 2011, the Supreme Court issued a long-awaited decision in the case of *Janus Capital Group, Inc. v. First Derivative Traders*, No. 09-525, 564 U.S. ___, slip op. (2011), holding that, for purposes of civil lawsuits under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5, the only party that may be held liable for making a false statement is "the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it." *Id.*, slip op. at 6. Under this holding, "[o]ne who prepares or publishes a statement on behalf of another is not its maker" and cannot be held liable in a private action under Section 10(b). *Id.* The decision promises to protect secondary actors such as financial advisors, accountants, and attorneys from civil liability under Section 10(b) in cases where they are alleged to have helped prepare false or misleading statements on behalf of others.

BACKGROUND

In *Central Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164 (1994), the Supreme Court ruled that there is no private right of action for aiding and abetting securities fraud under Section 10(b) of the 1934 Act. Accordingly, in order to hold a defendant liable, all of the elements of primary liability must be satisfied, including the requirement that the defendant make a misrepresentation or omission.

While the Court's decision in *Central Bank* eliminated private civil actions for aiding and abetting securities fraud, it left many questions unanswered about the scope of primary liability and under what circumstances a "secondary actor" such as a financial advisor, an accountant or an attorney, may be held liable as a primary violator. One such question was raised by the *Janus* litigation: does a defendant who actively assists in drafting and disseminating an allegedly fraudulent document "make" a misrepresentation for purposes of Section 10(b)?

The Supreme Court answered this question in the negative, holding that a defendant who merely participates in drafting or distributing a false statement made by another may not be held liable as a primary violator under Section 10(b).

THE JANUS LITIGATION IN THE LOWER COURTS

In *Janus*, the plaintiff brought securities fraud claims based on alleged misrepresentations concerning market timing that were contained in prospectuses for mutual funds. The funds were managed by Janus Capital Management ("JCM"), a subsidiary of Janus Capital Group ("Janus"). Although JCM did not own the mutual funds and was not publicly identified as the author of any of the allegedly misleading prospectuses, the plaintiffs brought Section 10(b) claims against JCM on the theory that it controlled the mutual funds, participated in the drafting of the prospectuses, and therefore could be held liable as a primary violator.

After the district court dismissed the plaintiffs' claims against JCM, the Fourth Circuit reversed. *See In re Mutual Funds Investment Litigation*, 566 F.3d 111, 114-15 (4th Cir. 2009). In sustaining the plaintiff's claims against JCM, the Circuit Court held that the allegations that JCM participated in drafting and distributing the prospectuses were sufficient to establish that it made a misrepresentation within the meaning of Section 10(b). *Id.* at 121.

The Fourth Circuit's decision was widely criticized as creating a vague and ambiguous standard under which a secondary actor could face the burden and expense of a lawsuit anytime it appeared that the actor may have played a role in drafting or approving a misrepresentation made by another party. Such a rule threatened to revive the aiding and abetting claims barred by *Central Bank* and its progeny by exposing numerous parties that might otherwise be thought of as mere "aiders and abettors" to primary liability claims.

THE COURT'S RULING

In a 5-4 decision written by Justice Thomas, the Court reversed the Fourth Circuit's holding that a party that participates in drafting and disseminating a false statement may be held liable as a primary violator for making the statement. The Court reasoned that the maker of a statement is not necessarily the party who created it, but rather

> the person or entity with ultimate authority over the statement, including its content and whether and how to disseminate it. Without control, a person or entity can merely suggest what to say, not "make" a statement in its own right. . . . This rule might best be exemplified by the relationship between a speechwriter and a speaker. Even when a speechwriter 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.

Janus, slip op. at 6-7.

Applying this reasoning, the Court ruled that JCM could not be held liable for making false and misleading statements in Janus Investment Fund prospectuses, because the prospectuses were statements of Janus Investment Fund. "Although JCM, like a speechwriter, may have assisted Janus Investment Fund with crafting what Janus Investment Fund said in the prospectuses, JCM itself did not 'make' those statements for purposes of Rule 10b-5." *Id.*, slip op. at 12.

The Court posited that a broader interpretation of what it means to "make" a false statement would substantially undermine its prior holding in *Central Bank*, by blurring the distinction between primary violators and aiders and abettors: "for *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)." *Id.*, slip op. at 7 n.6.

The Court also reasoned that protecting parties who assist in drafting statements made by others from primary liability was consistent with its recent decision in *Stoneridge Investment Partners, Inc.* v. *Scientific-Atlanta,* 552 U.S. 148 (2008). In *Stoneridge,* the Court rejected a private lawsuit under Rule 10(b) against customers and suppliers who allegedly engaged in certain undisclosed, deceptive transactions that allowed a company to publicly file false financial statements. The same logic which compelled the Court to conclude that the customers and suppliers in *Stoneridge* were aiders and abettors exempt from private civil lawsuits under Section 10(b) applied with equal force in *Janus*: "We see 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." *Janus*, slip op. at 9.

IMPLICATIONS

The Court's decision in *Janus* rejects the theory — advocated by the Fourth Circuit, the Government (which submitted an amicus curiae brief), and many commentators — that a party who creates a false or misleading statement for use by another may be held liable as a primary violator. In so doing, the decision draws a "clean line" separating primary violations of Section 10(b), which may result in private civil claims, from mere aiding and abetting, for which there is no private right of action. *Id.*, slip op. at 7 n.6.

Under the decision, a defendant will face liability as a primary violator only for those statements over which the defendant has ultimate control. In "the ordinary case," this means that only the party to whom a false statement is attributed will face exposure to private civil lawsuits under Section 10(b). *Id.*, slip op. at 6. Parties who merely assist in preparing a statement will not face liability as primary violators. Such parties will, however, continue to face exposure to enforcement actions brought by the Securities and Exchange Commission, which — unlike a private plaintiff — has the power to bring actions for aiding and abetting violations of the federal securities laws.[1]

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[1] Following the Court's decision in *Central Bank*, Congress passed legislation authorizing the SEC to bring aiding and abetting claims in civil enforcement actions. *See* 15 U.S.C. § 78t(e).