BRYAN CAVE
A Broader Perspective

Alert

Securities Litigation and Enforcement

To: Our Clients and Friends June 15, 2011

Supreme Court Draws Bright Line Barring Securities Fraud Claims Against Advisers To Companies Who Do Not "Make" Statements At Issue

The U.S. Supreme Court this week issued a significant decision restricting the ability of plaintiffs to bring securities fraud actions against adviser defendants who merely play a role in preparing statements actually made by companies they are advising.

In *Janus Capital Group, et al. v. First Derivative Traders*, No. 09-525, the court held that an investment adviser to a mutual fund could not be sued in a private securities fraud action for false statements made in mutual fund prospectuses. Although the investment adviser may have played a key role in drafting the statements, it was the mutual fund itself that "made" the statements, and thus there could be no claim against the adviser.

The decision dismissed a lawsuit against an investment adviser to a mutual fund, but the rationale adopted by the Supreme Court would similarly bar private securities fraud lawsuits against other kinds of advisers to all manner of companies such as investment bankers, accountants and lawyers who help prepare statements ultimately made by their client companies.

Janus Capital was decided by a 5-4 vote; Justice Thomas wrote the majority opinion. The decision reversed the U.S. Court of Appeals for Fourth Circuit. It had held that the investor plaintiffs had sufficiently alleged that the adviser made the statements at issue, ruling the plaintiffs had stated a claim that the adviser, "by participating in the writing and dissemination of the prospectuses, *made* the misleading statements contained in the documents." *In re Mutual Funds Inv. Litigation*, 566 F. 3d 111, 121 (4th Cir. 2009) (emphasis in original).

The majority's approach refused to define the word "make" so broadly, but rather held that only the entity that had the formal authority to issue or not issue a statement can be said to make the statement. It also reflects the Court's hostility to expanding the implied private right of action under section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 issued under section 10(b), and its determination to give that right of action a "narrow scope," as the Court stated in *Janus Capital*.

This trend dates back at least to *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994), where the Court held that the private right of action did not include suits against aiders and abettors of securities frauds, although the Securities and Exchange Commission may bring such actions.

More recently, in *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 154 (2008), the Court held that no section 10(b) claim could be asserted against companies that were customers and suppliers of a public company that issued false financial statements. Although the customers and suppliers were alleged to have agreed to arrangements that enabled the public company to issue its false statements, the Court held that the public shareholders could not have relied on the customers' and suppliers' deceptive acts, but rather relied on the financial statements of the issuer company.

This week's decision involved the Janus family of mutual funds, which are organized in a business trust, the Janus Investment Fund. Janus Investment Fund issued the prospectuses describing the investment strategy and operations of the funds. But, as is typically the case with pooled investment vehicles such as mutual funds or hedge funds, the fund retained an investment adviser, Janus Capital Management LLC ("Janus Management") to manage and administer the fund. Janus Management is a wholly owned subsidiary of a publicly traded company, Janus Capital Group, Inc. ("Janus Inc.").

The plaintiffs in the action were investors in Janus Inc. They sued for fraud following a decline in its stock price after exposure of a market timing investigation into Janus Investment Fund mutual funds.

Janus Investment Fund issued prospectuses allegedly representing that the funds were not suitable for market timing and suggesting that Janus Management would implement policies to curb the practice. However, as alleged in a 2003 complaint brought by the Attorney General of the State of New York against Janus Inc. and Janus Management, Janus Inc. entered into secret agreements to permit market timing in several funds run by Janus Management.

After the public learned of the Attorney General's complaint, investors withdrew significant amounts of money from the Janus Investment Fund mutual funds, which led to a corresponding reduction in Janus Management's management fees (which were based on the total value of the funds), and Janus Inc.'s income. This loss affected Janus Inc.'s market value as well – its stock price fell nearly 25 percent in the month after the Attorney General's complaint was announced.[1]

[1] In 2004, Janus Inc. and Janus Management settled the allegations and agreed to reduce their fee by $125 million and pay $25 million in civil penalties and $50 million in disgorgement to the mutual fund investors.

In their complaint, the plaintiffs alleged that Janus Inc. and Janus Management "materially misled the investing public" and that class members relied "upon the integrity of the market price" of Janus Inc. securities.

Under Rule 10b-5, it is unlawful for "any person, directly or indirectly, … [t]o make any untrue statement of a material fact" in connection with the purchase or sale of securities." Here, the decision turned on whether Janus Management and Janus Inc. could be alleged to have "made" the alleged misstatements in the prospectuses. The Court held that they did not. Justice Thomas, writing for the majority, explained that:

> For 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. 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. …
>
> Although [its investment adviser], like a speechwriter, may have assisted Janus Investment Fund with crafting what Janus Investment Fund said in the prospectus, [the investment adviser] itself did not "make" those statements for the purposes of Rule 10b-5.

Justice Breyer, in dissent, focused on the functional reality of the investment adviser's role in preparing the prospectuses, rather than its formal authority to issue the prospectuses. He would have held that the class plaintiffs sufficiently alleged a claim given the investment adviser's close relationship with Janus Investment Fund. "The relationship between [Janus Management] and the Fund could hardly have been closer. [Janus Management's] involvement in preparing and writing the relevant statements could hardly have been greater."

Justice Thomas, by contrast, ruled that formal authority to issue the prospectuses was decisive. He stated that the close relationship did not matter, since Janus Investment Fund and its adviser were separate business entities, and "[w]e decline this opportunity to disregard the corporate form."

Contact Information:

Eric Rieder
(212) 541-2057
erieder@bryancave.com

John Bielema
(404) 572-4504
john.bielema@bryancave.com

John D. Kircher
(212) 541-3010
john.kircher@bryancave.com