
Max Schatzow
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I. Introduction

“It has come to my attention that a more definite and more highly organized drive is being made against effective legislation to this end [federal securities regulation] than against any similar recommendation made by me during the past year,” President Roosevelt wrote to Senator Fletcher and Representative Rayburn prior to the enactment of the 1934 Securities Exchange Act.1 To which Representative Rayburn responded, “Few bills have ever had such thorough consideration as this stock-exchange bill…[w]e have worked out the terms of this bill under the pressure of the most vicious and persistent lobby that any of us have ever known in Washington.”2 While Congress may have effectively beat back lobbyists attempting to water down the reaches of The Exchange Act of 1934, members belonging to that Congress would have been appalled when the Supreme Court handed down its decision in *Janus Capital v. First Derivative Traders*.3 It has been said that, “Janus set the pleading bar even higher in private securities fraud actions seeking to hold defendants primarily liable for the misstatements of others.”4

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4 Reese v. BP Exploration Inc., 643 F.3d 681, n.8 (9th Cir. 2011).
As of 1989, the federal courts were inundated with more Rule 10b-5 litigation than all of the other provision of the federal securities law combined.5 The Securities Enforcement Commission’s (“SEC”) Rule 10b-5 (“Rule 10b-5,” “the rule,” or “10b-5”) makes it unlawful for certain persons to make material misrepresentations.6 On June 12, 2011, The Supreme Court in Janus Capital held that those certain persons were those who have the “ultimate authority” over a statement. The Supreme Court in Janus left many litigators and regulators in the securities field grasping for answers. A progeny of cases have been tried under Rule 10b-5 since Janus was decided on June 12, 2011.7 This article will focus on explaining the history of §10(b) of the Securities Exchange Act and Rule 10b-5, the opinion of the Supreme Court in Janus, and the multitude of directions Rule 10b-5 litigation may take in the wake of the Janus opinion. It also offers recommendations to restore sense in the field of securities regulation.

Section I briefly introduced you to the Supreme Court’s Janus decision. This article will proceed as follows. Section II of this article will discuss the authority for SEC Rule 10b-5 and the language of the rule itself. Then in Section III the article will examine the history and interpretation of the rule and the required elements for a claim under the Rule. In Section IV,

5 11A EDWARD N. GADSBY, BUSINESS ORGANIZATIONS-FEDERAL SECURITIES EXCHANGE ACT 1, at v (1989).
6 17 C.F.R. § 240.10b-5.
this article will analyze the main case of Janus Capital. It will provide the relevant facts and the procedural posture of Janus, with a specific attention to the opinions of the majority and the dissent. Section V will proceed to show the confusion that Janus has caused the lower federal courts attempting to apply the decision, including the varying opinions on the scope of Janus. Section VI will provide a non-exhaustive practitioner’s guide to pleading Rule 10b-5 claims in the wake of Janus. Then in Section VII this article will examine possible solutions for the Supreme Court to limit their holding in Janus to be more consistent with the aims of Rule 10b-5 or at a minimum conforming to the policy behind the securities laws. Lastly, Section VIII concludes the article and reminds practicing securities law attorneys to be cognizant that even though the Supreme Court may have limited liability with respect to Rule 10b-5 claims, Blue Sky laws and other provisions of The Securities Exchange Act may be more pertinent then ever before.

II. History of Rule 10b-5 Actions Prior to and After Janus Capital

The 1934 Exchange Act was enacted by Congress to prevent the rampant speculation and fraud that led to the crash of 1929 and the great depression. And Section 10 of the Exchange Act was no exception.

a. Rule 10b-5

Section 10(b) of the 1934 Exchange Act makes it unlawful for a person or entity to “use or employ, in connection with the purchase or sale of any security…any manipulative or deceptive device or in contravention of such rules and regulations as the [SEC] may prescribe as

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8 See Thel, supra note 1, at 409.
9 Id.
necessary or appropriate in the public interest or for the protection of investors.”

With this grant of power, the SEC promulgated Rule 10b-5:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

III. The History and Interpretation of Rule 10b-5

The Securities Act of 1933 and the Securities Exchange Act of 1934 provide many express private causes of actions, however Rule 10b-5 contains no express provision for private civil actions. Beginning in 1946, federal courts extended private causes of action to Rule 10b-5, and courts continue to grant private actors standing to sue. The rationale for extending

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Rule 10b-5 to private plaintiffs is that private enforcement of SEC rules may serve as a “necessary supplement to Commission action.”\(^{15}\) Because the courts have implied a private right of action under Rule 10b-5,\(^{16}\) the Supreme Court has had “to infer how the 1934 Congress would have addressed the [proper elements] had the 10b–5 action been included as an express provision in the 1934 Act.”\(^{17}\)

\textbf{a. Central Bank of Denver v. First Interstate Bank of Denver}

While the Supreme Court has upheld private causes of action, it holds steadfast to the text of Rule 10b-5 in determining the activities that are forbidden.\(^{18}\) In 1994 in \textit{Central Bank of Denver}, the Supreme Court held that §10(b) did not allow private lawsuits against aiders and abettors of the securities law.\(^{19}\)

In this landmark decision the Supreme Court granted certiorari to determine whether §10(b) allows for private actions for aiding and abetting. The Central Bank of Denver was the indenture trustee for $26 million in bonds.\(^{20}\) A public building authority issued these bonds in 1986 and once again in 1988 for residential and commercial construction.\(^{21}\) The creditors secured these bonds with landowner assessment liens covering roughly 250 acres of the 1986


\(^{15}\) See Blue Chip Stamps \textit{v.} Manor Drug Stores, 421 U.S. 723, 730 (1975) (quoting J. I. Case Co. \textit{v.} Borak, 377 U.S. 426, 432 (1964)).

\(^{16}\) See Dura Pharm., Inc. \textit{v.} Broudo, 544 U.S. 336, 341 (2005) (proposing that courts have inferred a private right of action under Rule 10b-5 that “resembles, but is not identical to, common-law tort actions for deceit and misrepresentation)."

\(^{17}\) See Musick, Peeler & Garrett \textit{v.} Employers Ins. of Wausau, 508 U.S. 286 (1993).


\(^{20}\) \textit{Id.} at 167.

\(^{21}\) \textit{Id.}
bonds and 272 acres of the 1988 issue.\textsuperscript{22} In addition to the lien for the safety of the creditors, the bonds required AmWest Development to provide financial accounting to insure that the land at all times was worth more than the outstanding principal and interest.\textsuperscript{23} In early 1988 AmWest provided data showing that the value of the land remained unchanged, but the underwriter for the 1986 offering believed that the land value had diminished.\textsuperscript{24} Central Bank as a result requested its own appraiser re-examine the acreage in 1988 that recommended an outside opinion for external review.\textsuperscript{25} Discussion between Central Bank and AmWest delayed a review until the after the 1988 bond issue had closed.\textsuperscript{26} The independent appraisal could not be completed until it was too late, and the public building authority defaulted on its 1988 bonds.\textsuperscript{27} First Interstate Bank purchased the 1988 bonds.\textsuperscript{28} After the bonds were in default, First Interstate sued the public building authority, the firms responsible for underwriting the 1988 offering for allegedly violating §10(b) of the Exchange Act.\textsuperscript{29} First Interstate also alleged that Central Bank was “secondarily liable under §10(b) for its reckless conduct in aiding and abetting the fraud.”\textsuperscript{30}

Justice Kennedy, in a five to four majority opinion, used a strict textual interpretation to hold that §10(b) does not expose aiders and abettors to liability.\textsuperscript{31} The majority and Justice Kennedy relied on the canons of statutory interpretation in concluding that Congress had used language in other acts exposing actors to aiding and abetting liability, therefore Congress would

\begin{footnotesize}
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\item \textsuperscript{22} Id.
\item \textsuperscript{23} Id.
\item \textsuperscript{24} Id.
\item \textsuperscript{25} Id at 167-68.
\item \textsuperscript{26} Id at 168.
\item \textsuperscript{27} Id.
\item \textsuperscript{28} Id.
\item \textsuperscript{29} Id.
\item \textsuperscript{30} Id.
\item \textsuperscript{31} Id at 181.
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have included the specific provision if it had intended to in the Exchange Act.\[32\] The majority was quick to dispose of any ambiguous legislative history or common tort theory as well.\[33\]

**b. The Private Securities Litigation Reform Act of 1995**

Shortly after *Central Bank of Denver*, Congress passed the Private Securities Litigation Reform Act of 1995 (PSLR), which granted the SEC the power to prosecute aiders and abettors.\[34\] While Congress expressly granted powers to the SEC in PSLR, Congress intentionally raised the pleading bar for private suits brought under Rule 10b-5(b).\[35\] The passage of PSLR created a rift between the elements required between private litigants pleadings and litigation brought by the SEC in enforcing Rule 10b-5.

**c. Stoneridge Investment Partners LLC v. Scientific-Atlanta**

In 2008 the Supreme Court of the United States was again asked to interpret the scope of §10(b) of the Exchange Act in *Stoneridge Investment Partners*.\[36\] And again Justice Kennedy delivered the opinion of the court in a five to three decision.\[37\] The majority held that the implied private right of action does not reach the vendors/customers of a company who agree to mislead the vendee/corporation’s auditors.\[38\]

\[32\] Id at 176.
\[33\] Id at 181.
\[34\] See 15 U.S.C. § 78t(e).
\[35\] See 15 U.S.C §78u-4(b)(1) (West) (“In any private action arising under this chapter in which the plaintiff alleges that the defendant--(A) made an untrue statement of a material fact; or (B) omitted to state a material fact necessary in order to make the statements made, in the light of the circumstances in which they were made, not misleading; the complaint shall specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed.”). See also Stoneridge Inv. Partners LLC v. Scientific-Atlanta, Inc., 128 S. Ct. 761, 773 (2008) (stating that the PSLRA “imposed heightened pleading requirements” on private actions brought to enforce Rule 10b-5).
\[37\] Id.
Stoneridge involved a §10(b) claim against Charter Communications, Scientific-Atlanta, and Motorola. The plaintiffs were investors who had purchased stock in Charter. The plaintiffs alleged that Scientific and Motorola aided Charter in inflating Charter’s financial statements. Neither Scientific nor Motorola assisted Charter in the sale or distribution of their stock or with their submission of reports to the SEC. The plaintiffs claimed that all three entities were liable under §10(b) and Rule 10b-5. Charter reached a settlement agreement with Stoneridge in excess of $140 million for violating §10(b). The plaintiffs pressed forward with the suit seeking damages from Scientific and Motorola for scheming with Charter in creating fraudulent financial statements. Stoneridge alleged that Scientific and Motorola schemed with Charter to misrepresent Charter’s financial condition. The Supreme Court held that the plaintiff failed to state a claim under §10(b) or Rule 10b-5 against either defendant, because the plaintiffs failed to show the element of reliance, but discussed the possibility of scheme liability in dicta.

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39 Id.
40 Id at 152-53.
41 Id at 153-56.
42 Id at 155.
43 Id.
46 Id.
47 Id at 166-67.
48 Id at 156-60.
While Stoneridge was decided on the basis that the plaintiffs did not plead reliance on the parts of Motorola and Scientific, §10b and Rule 10b-5 have several other elements. In the next section, the elements required in §10(b) and Rule 10b-5 action will be discussed.

d. The Elements of §10b and Rule 10b-5

The elements of a private securities fraud claim based on violations of § 10(b) and Rule 10b–5 are:

(1) A material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation.49

A well-plead material misrepresentation or omission requires plaintiff to plead a "fact," and excludes "statements of subjective analysis or extrapolation, such as … motives, and intentions, or forward looking statements, such as projections, estimates, and forecasts."50 The scienter element of a Rule 10b-5 action requires a plaintiff to prove that a defendant either knew that a representation was untrue or was made with a “reckless disregard for the truth.”51 Plaintiffs may show reliance by two differing methods. First, plaintiff may show that he had knowledge of the company’s misstatement and committed a transaction based on that misstatement.52 The other course plaintiffs can demonstrate reliance is by the “fraud-on-the-market” theory which "permit[s] plaintiffs to invoke a rebuttable presumption of reliance’

51 See Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193.
based on the theory that the market price of shares traded on well-developed markets reflects all publicly available information, and, hence, any material misrepresentations." The Supreme Court has held to the common law version of loss for securities purposes. The last element of a Rule 10b-5 action is loss causation, which is the “causal connection between the material misrepresentation and the [economic] loss” suffered by investors. Interestingly enough, the Supreme Court has recently held that loss causation may no longer be necessary for securities fraud plaintiffs to prove to obtain class certification.

IV. Main Case: Janus Capital Group v. First Derivative Traders

a. Facts of the Case

Janus Investment Fund is a Massachusetts business trust that hired Janus Capital Management LLC (“JCM”) to be its mutual fund investment adviser. Janus Capital Group (“JCG”) is a publicly traded company that created the Janus mutual funds at issue. While JCG created the mutual funds, the funds were a “separate legal entity owned entirely by the mutual fund investors.” In addition, the mutual fund in question complied with the law which prohibits “interested persons” to exceed four-fifths of the board of any given mutual fund.

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54 See Dura Pharmaceuticals, Inc. v. Broudo, 544 U.S. 336, 344 (2005) (quoting § 548A, Comment b, at 107. Rest. of Torts) (“[I]n setting forth the judicial consensus, [the Restatement] says that a person who “misrepresents the financial condition of a corporation in order to sell its stock” becomes liable to a relying purchaser “for the loss” the purchaser sustains “when the facts . . . become generally known” and “as a result” share value “depreciate[s].”.
57 Janus Capital Group, Inc. v. First Derivative Traders, 131 S. Ct. 2296, 2299-300 (2011)
58 Janus Capital Group, Inc. v. First Derivative Traders, 131 S. Ct. 2296, 2299-300 (2011)
59 Janus Capital Group, Inc. v. First Derivative Traders, 131 S. Ct. 2296, 2299-300 (2011)
60 Janus Capital Group, Inc. v. First Derivative Traders, 131 S. Ct. 2296, 2299-300 (2011)
In accordance with current securities laws and regulations, Janus Investment Fund issued prospectuses that detailed its investment strategy. These prospectuses suggested that an investment strategy known as “market timing” could be dangerous to the fund and an investor could infer from the prospectus that JCM would ensure this practice did not occur. The Plaintiff is a class of investors who owned JCG stock. Plaintiffs allege that JCG and JCM violated Rule 10b-5 by assisting with the creation of mutual fund prospectus and delivering them to the investing public, which led investors in to the mistaken belief that JCG and JCM would prohibit market timing in Janus mutual funds. In addition, Plaintiff also alleged that JCG was liable as a “controlling person” of JCM.

b. Procedural Posture

The District Court in Maryland dismissed the action for failure to state a claim. The Fourth Circuit Court of Appeals overturned that decision, and held that the Plaintiff had properly “alleged that ‘JCG and JCM, by participating in the writing and dissemination of the prospectuses, made the misleading statements contained in the documents.’” The Supreme Court of the United States granted certiorari to resolve whether JCM—the investment adviser—

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62 Janus Capital Group, Inc. v. First Derivative Traders, 131 S. Ct. 2296, 2299-300 (2011)
65 Id.
66 Id.
67 15 U.S.C.A. § 78t(a) (Feb. 2011 Supp.) (§ 20(a) of the Act)
68 Janus Capital Group, Inc. v. First Derivative Traders, 131 S. Ct. 2296, 2301 (2011)
69 Janus Capital Group, Inc. v. First Derivative Traders, 131 S. Ct. 2296, 2301 (2011)
could be liable in a private Rule 10b-5 action for misstatements in Janus Investment Fund’s prospectuses.\textsuperscript{70} The Supreme Court answered in the negative.\textsuperscript{71}

c. Majority’s Approach

The majority, led by Justice Thomas, favored a narrow reading of Rule 10b-5 that shielded JCM from liability and most, if not all, future investment adviser-defendants:

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. One who prepares or publishes a statement on behalf of another is not its maker. And in the ordinary case, 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.\textsuperscript{72}

Justice Thomas went on to analogize that the maker of a statement for purposes of Rule 10b-5 is much like the speaker of a prepared speech, while the speechwriter who happened to pen the speech would be free from liability under Rule 10b-5.\textsuperscript{73}

The majority’s rationale in Janus relied heavily on Central Bank of Denver, N.A. v. First Interstate Bank of Denver,\textsuperscript{74} albeit awkwardly, which held that a private plaintiff may not

\textsuperscript{70} Janus Capital Group, Inc. v. First Derivative Traders, 131 S. Ct. 2296, 2301 (2011)

\textsuperscript{71} Janus Capital Group, Inc. v. First Derivative Traders, 131 S. Ct. 2296, 2301 (2011)

\textsuperscript{72} Janus Capital Group, Inc. v. First Derivative Traders, 131 S. Ct. 2296, 2302 (2011).

\textsuperscript{73} See Id. See also Brief for the Respondents at P. 41 (“when the President delivers a speech, we say that he \textit{made} the speech - but it would stretch ordinary usage too far to say that the President's \textit{speechwriters} made the speech.”).
maintain an aiding and abetting suit under § 10(b).” The majority acknowledges that *Central Bank* dealt with secondary liability of a Securities Act violation, but insists that for *Central Bank* to continue to have 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).” In a footnote of all places, the majority then proceeds to create a bright-line rule: “We draw a clean line between the two—the maker is the person or entity with ultimate authority over a statement and others are not.”

Further, the Court reasoned that its prior holding in *Stoneridge Investment Partners v. Scientific–Atlanta* supported its decision. In *Stoneridge*, the United States Supreme Court affirmed a decision by the District Court for the Eastern District of Missouri, which dismissed claims against the vendors and customers who agreed to suspect transactions with a company that misstated its quarterly reports. The *Janus* Court then quotes to *Stoneridge*—“nothing [the defendants] did made it necessary or inevitable for [the company] to record the transactions as it did.” Justice Thomas then concluded that the above excerpt from Stoneridge “suggests the rule

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75 See id. See also David J. Baum, *The Aftermath of Central Bank of Denver: Private Aiding and Abetting Liability Under Section 10(b) and Rule 10b-5*, 44 AM. U. L. REV. 1817, 1833 (1995) (discussing the holding of Central Bank and the Supreme Court’s trend towards limiting liability for securities violations).


78 *Stoneridge Investment Partners, LLC v. Scientific–Atlanta, Inc.*, 552 U.S. 148, 128 S.Ct. 761 (2008) (”Respondents (vendors and customers) had no duty to disclose; and their deceptive acts were not communicated to the public. No member of the investing public had knowledge, either actual or presumed, of respondents' deceptive acts during the relevant times. Petitioner, as a result, cannot show reliance upon any of respondents' actions except in an indirect chain that we find too remote for liability.”).

79 Id.

80 Id.

81 See *Stoneridge Investment Partners*, 552 U.S. at 161; *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 2303 (2011).
we adopt today: that the maker of a statement is the entity with authority over the content of the statement and whether and how to communicate it. Without such authority, it is not “necessary or inevitable” that any falsehood will be contained in the statement.”

Applying these newly created judicial interpretations of Rule 10b-5, The Supreme Court held that JCM, the investment adviser, did not “make” any of the statements in the Janus Investment Fund prospectuses,” and was therefore not liable in a private Rule 10b-5 suit. The majority closes the door to liability and its opinion by saying that under no circumstance will an investment adviser be subject to liability for “making” a statement by merely “assist[ing]” with “crafting” a prospectus for a mutual fund.

d. Dissent’s Approach

Justice Breyer writing for the dissent would have held that “the allegations in the complaint… [were] legally sufficient.” The dissent begins its analysis by refuting the majority’s narrow dictionary definition of the word “make” that requires “ultimate authority” over a statement. After the dissent disposes of the restricted usage of the word, it alludes to the fact that prior case law defines the word “make” more broadly, and would not rush to rule out management companies, boards of directors, company officers, and any others from having “ultimate authority” over a statement for Rule 10b-5 pleading. The dissent then proceeds to verify that the original plaintiff’s in the action properly plead all of the elements of a Rule 10b-5
action prior to the majority’s ruling.\textsuperscript{88} This is followed up with the statement of the cases of both
Central Bank and Stonebridge, in which the dissent deftly displays their inapplicability to the
case at hand.\textsuperscript{89} Justice Breyer then relies on his own hypothetical to show the impracticality of
the majority’s bright line approach:

The possibility of guilty management and innocent board is the
13th stroke of the new rule's clock. What is to happen when guilty
management writes a prospectus (for the board) containing
materially false statements and fools both board and public into
believing they are true? \textsuperscript{90}

However, Justice Breyer and the dissent fail to offer guidance or a better interpretation of
who is the primary “maker” of a statement for Rule 10b-5 actions. The dissent, whether by
choice or desperation, prefers a malleable approach to determine a statement’s “maker,” and at a
minimum would find that in this case at hand, the investment adviser was the maker of the
statement.\textsuperscript{91}

V. The Recent Offspring of Janus Capital

\textsuperscript{88} Janus Capital Group, Inc. v. First Derivative Traders, 131 S. Ct. 2296, 2306 (2011) (citing Stoneridge Investment
private action”).
\textsuperscript{89} Id.
\textsuperscript{90} Id.
\textsuperscript{91} See id. (“Given these circumstances, as long as some managers, sometimes, can be held to have “ma[d]e” a
materially false statement, Janus Management can be held to have done so on the facts alleged here. 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.”).
Since the ruling by the Supreme Court in Janus, there has been confusion among the circuit courts and courts of appeal interpreting Janus and the questions it failed to answer.92 Courts have taken several approaches to analyzing Rule 10b-5 claims in the wake of Janus. The first question federal district courts were faced with was whether the Supreme Court’s “ultimate authority” language for primary liability fails to reach corporate insiders as noted by Justice Breyer and the dissent.93 Secondly, district courts were faced with the question whether or not the holding of Janus extends to all of Rule 10b-5 or is isolated only to Rule 10b-5(b).94

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94 17 C.F.R. § 240.10b–5 (“It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) To engage in any act, practice, or course of business which operates or would
Many courts have undertaken the issue of whether or not corporate insiders face liability under *Janus*, but there is no clear-cut consensus and no explanation is necessarily more legally sound than others.\(^95\) In *In re Merck & Co., Inc. Sec., Derivative & "ERISA" Litigation*, the United States District Court for the District of New Jersey held that corporate insiders may still face liability in light of the decision in *Janus*.\(^96\) In *Merck*, the company’s executive vice president and co-defendant signed registration statements that were filed with the SEC and was quoted in both articles and reports as Merck's Executive Vice President for Science and Technology and President of Merck Research Laboratories.\(^97\) The court there held that:

“[The vice president’s] role in the statements attributed to him is in no way analogous to Janus Capital Management's relationship to the statements issued by Janus Investment Fund...[The vice president] made the statements pursuant to his responsibility and authority to act as an agent of Merck, not as in *Janus*, on behalf of some separate and independent entity. *Janus* does not alter the well-established rule that a corporation can act only through its

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\(^95\) See id.


\(^97\) Id.
employees and agents. It certainly cannot be read to restrict liability for Rule 10b–5 claims against corporate officers to instances in which a plaintiff can plead, and ultimately prove, that those officers—as opposed to the corporation itself—had “ultimate authority” over the statement. Yet, this is the premise that underlies [the vice-president’s] argument that he may not be liable for statements actually attributed to him. Taken to its logical conclusion, [the defendant’s] position would absolve corporate officers of primary liability for all Rule 10b–5 claims, because ultimately, the statements are within the control of the corporation which employs them. 98

As such, the court was the first to address whether corporate officers could be subject to Rule 10b-5 liability after Janus, and the court answered in the affirmative. 99 However, it wasn’t the last court to weigh in on the issue and many other circuit courts and courts of appeals will have to grapple with interpreting the “ultimate authority” question.

The second issue left unanswered by Janus, was whether Janus is strictly limited to Rule 10b–5(b), and varying courts have also struggled answering this difficult question. The Circuit Court for the Northern District of Ohio was the first court to grapple with whether Janus dealt with liability for making false statements solely under Rule 10b–5(b) and not under Rule 10b–5(a) or (c). 100 In U.S. S.E.C. v. Geswein, the SEC amended its original complain against

98 Id.
99 Id.
defendant Miller who was the former Director of Corporate Accounting for a corporation. The SEC alleged that Miller committed violations of Generally Accepted Accounting Principles ("GAAP") with the "inten[t] to me[e][t] stock analysts' projections, which needless to say, have a strong impact on the sale of securities." The Government took the stance that “Miller knew or was reckless in not knowing that the actions she was taking violated GAAP and were improper, and resulted in false and misleading financial reporting.” Instead of relying on Rule 10b-5(b), the SEC argued for “scheme liability” under provisions (a) and (c) of Rule10b-5, noting that Miller “engaged in a scheme to misrepresent [the corporation’s] financial statements.” The court held that the “violations of GAAP on Miller's part sufficiently allege fraudulent intent, thus are sufficient to state a securities fraud claim as to the allegedly improper use of [an illegitimate accounting method].” Therefore, the Circuit Court for the Northern District of Ohio was the first court to hold that Janus’s holding, at least with respect to suits brought by the SEC, does not extend to Rule10b-5(a) and (c).

VI. Post-Janus Predictions and Litigation to Expect
e. Dodd-Frank Amendments to the 1934 Exchange Act

While the above decisions demonstrate the apparent confusion that lower courts across the nation are facing in applying Rule 10b-5 and the Janus decision which limited liability for

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101 Id.
102 Id.
103 See id.
104 Id.
105 Id.
plaintiffs, the Dodd-Frank Act may provide new alternatives to practicing securities attorneys. The Dodd-Frank Act added Section 9(a)(4) and 9(f) to the Securities Exchange Act of 1934 and have been largely overlooked until the Janus decision. In the wake of Janus, these two provisions have the ability to create new avenues for litigators seeking to hold second party actors who sell securities liable including, broker-dealers, investment advisers, fund managers, and may be argued to extend to attorneys and accountants.

Section 9(a)(4) of the 1934 Exchange Act now reads:

It shall be unlawful for any person, directly or indirectly, by the use of the mails or any means or instrumentality of interstate commerce, or of any facility of any national securities exchange, or for any member of a national securities exchange…[for] a dealer or broker, or the person selling or offering for sale or purchasing or offering to purchase the security or a security-based swap agreement… with respect to such security, to make, regarding any security other than a government security or any security-based swap agreement… with respect to such security, for the purpose of inducing the purchase or sale of such security or such security-based swap agreement, any statement which was at the time and in the light of the circumstances under which it was made, false or misleading with respect to any material fact, and which he knew or had reasonable ground to believe was so false or misleading.107

Prior to the passage of the Dodd Frank Act, Section 9 of the 1934 act only reached exchange traded securities. The new language effectively reaches all securities with the exception of government offered securities. In conjunction with Section 9(f) of the 1934 Act, Janus could be overruled. Section 9(f) of the 1934 Act states:

Any person who willfully participates in any act or transaction in violation of subsections (a)… of this section, shall be liable to any person who shall purchase or sell any security at a price which was affected by such act or transaction, and the person so injured may sue in law or in equity in any court of competent jurisdiction to recover the damages sustained as a result of any such act or transaction. In any such suit the court may, in its discretion, require an undertaking for the payment of the costs of such suit, and assess reasonable costs, including reasonable attorneys' fees, against either party litigant. Every person who becomes liable to make any payment under this subsection may recover contribution as in cases of contract from any person who, if joined in the original suit, would have been liable to make the same payment. No action shall be maintained to enforce any liability created under this section, unless brought within one year after the discovery of the facts constituting the violation and within three years after such violation.108

After the passage of Dodd Frank and the decision in *Janus*, “willfully participates” will likely become a hotly litigated phrase. Absent from Section 9(f) is any mention that a willful participant must have an intent to misrepresent or omit a material fact or show scienter or display a reckless disregard of information given to purchasers. Dodd Frank litigation should effectively overturn the “ultimate authority” ruling from *Janus*.

Black’s Law Dictionary defines “willful” as “proceeding from a conscious motion of the will; intending the result which actually comes to pass; designed; intentional…Willful differs essentially from a negligent act… In common parlance, “willful” is used in the sense of “intentional,” as distinguished from “accidental” or “involuntary.” Therefore a willing participant could be viewed much more broadly then *Janus* would allow. Attorneys, accountants, bankers, brokers, mutual fund investment managers (Janus Capital Management) would all seem to face liability as willful participants in securities offerings under Dodd Frank.

Another reason that 9(f) would find mutual fund investment managers liable is because at first glance it seems to be a statute premised on joint and several liability. The relevant part refers to “[willing participants] who becomes liable to make any payment under this subsection may recover contribution as in cases of contract from any person who, if joined in the original suit, would have been liable to make the same payment.” The plain language of this provision seems to grant the plaintiff with a cause of action against any party who assisted in the registration process or drafting the prospectus. In addition, Item 510 of Regulation S-K exhibits

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109 BLACK'S LAW DICTIONARY.
the SEC’s stance against indemnification for related parties.\textsuperscript{111} Therefore, the SEC would be wise to be hesitant in accelerating or even approving of a start-up mutual fund that tried to indemnify its parent company that assisted with drafting their registration statement and prospectus.

Future courts should find that the “willing participant” language of Section 9(f) is sufficient to find liability on the part of an investment adviser, such as JCM, instead of requiring the higher standard of “knowledge” in Section 9(a)(4). Section 9(a)(4) requires that the alleged broker, dealer, or securities law violator had knowledge that a statement was either false or misleading and Section 9(f) finds liability where a person “willfully participates” in a transaction. First, under the rules of statutory interpretation conflicting statutes that are enacted at the same time should be read in harmony.\textsuperscript{112} Where that is not feasibly and the reading of the statute remains ambiguous, “the courts should defer to an agency's reasonable interpretation of the statute if Congress has explicitly or implicitly delegated the authority to issue interpretations to the agency.”\textsuperscript{113} Congress granted the SEC the power to promulgate “rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.”\textsuperscript{114} However, the \textit{Janus} opinion attacked the words “to make” in Section

\textsuperscript{111} Regulation S-K Item 510 (“Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to directors, officers or persons controlling the registrant pursuant to the foregoing provisions, the registrant has been informed that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Act and is therefore unenforceable.”). \textit{See also} Globus v. Law Research Serv. Inc., 418 F.2d 1276, 1288 (2d Cir. 1969) (\textit{cert. denied}).

\textsuperscript{112} 2B \textsc{Sutherland Statutory Construction} §51:5 (7th ed.)

\textsuperscript{113} 2B \textsc{Sutherland Statutory Construction} §49:5 (7th ed.) (quoting Sultan Chemists, Inc. v. U.S. E.P.A., 281 F.3d 73 (3d Cir. 2002)). \textit{See also} Water Keeper Alliance v. U.S. Dept. of Defense, 152 F. Supp. 2d 163 (D.P.R. 2001)).

10b and dispelled with it the Commission’s rulemaking authority under Rule 10b-5. The Supreme Court would have been wise to defer to the agency charged with ensuring full disclosure of public companies and protecting the investing public.

Second, while Section 9(f) could potentially expose mutual fund advisers to liability, Section 9(a)(4) may provide an avenue for plaintiffs to plead a question of fact for juries in determining liability. Section 9(a)(4) says that “any statement … [a person] knew or had reasonable ground to believe was so false or misleading” is a violation of the securities laws. Section 9(a)(4) therefore could be an extremely useful arrow in a plaintiff’s lawyers quiver because it would allow plaintiffs to bypass the judges determination of the legal meaning of “willful participant” if it is not read in conjunction with Section 9(f). Read alone, Section 9(a)(4) will put to the jury the question of whether or not the alleged violator had reasonable ground to believe that the alleged statement was false and could remove a substantial function from the judiciary in securities litigation.

Sections 9(a)(4) and 9(f) provide a clean canvas for the securities litigation field to paint on in the post-\textit{Janus} world. With clever legal arguments the securities bar can avoid the disastrous effects of \textit{Janus} and the corporate bar should be wary.

\textbf{VII. Amendments to Exchange Act Procedures}

While amendments to the Exchange Act would add to the already immense compliance costs for corporations and advisors, these new additions are a necessary evil required to protect consumers and develop truthful disclosure.\footnote{Anita Indira Anand, \textit{An Analysis of Enabling vs. Mandatory Corporate Governance: Structures Post-Sarbanes-Oxley}, 31 \textit{Del. J. Corp. L.} 229, 252 n.48 (2006) (“Most would agree that SOX is an example of costly mandatory legislation. A recent survey found that compliance costs will be US $5.5 billion in 2004. Costs of this legislation now include restructuring the board and finding CEOs and CFOs who will be prepared to certify financial} Publicly registered companies, investment
advisors, and mutual funds are already heavily counseled on the securities laws. As one law professor noted, “In an economically rational world we don’t want to prevent all fraud, because that would be too expensive. Instead, the goal should be to keep on spending on fraud prevention until the returns on a dollar invested in prevention are no more than a dollar. There is an optimal amount of fraud.” While that statement makes sense from a law and economics perspective, the Janus dilemma should consider solutions aside from efficiency.

Under Sarbanes Oxley the penalties for violating annual and quarterly reporting requirements have increased from ten years imprisonment and $1 million to as much as twenty years of imprisonment and fines as large as $5 million. A 2004 study gathered that thirty-six percent of companies employ a chief compliance officer on staff to manage reporting issues, adding to the already staggering costs of doing business. In addition, companies have reported

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116 See generally id


that their general counsels are spending a substantial amount of time handling compliance issues.\(^{120}\)

The increased cost of compliance for mutual fund investment advisors and their subsidiaries is an opportunity cost we, as a society ought to be able to recognize and accept. Failure to absorb these costs, even if not perfectly efficient, would allow investment advisors and corporations to escape liability for material misstatements and omissions that are commonly relied on by the investing public. Continuing to follow the *Janus* holding will allow securities lawyers to subterfuge the two chief aims of the securities laws: full disclosure and the protection of investors.

Two simple legislative solutions are to 1) force investment advisors and their subsidiaries to sign one another’s registration statement if they provide analytical, legal, or financial advice in order to create an interlocking of mutual funds and parent corporation so that business attorneys could no longer toe the fine line of legality, or alternatively 2) require full disclosure that the investment advisor is free from liability on the prospectus and registration statement.

**f. New Mandatory Signees on 10-K and 10-Q**

Ideally, Congress should propose amendments to the 1934 Securities Exchange Act and require that all persons who provide any assistance, either monetarily or professionally, and derive any benefit from providing these services (including profits from investment advice) to a company effectively registered or in the registration process must sign the registration statement, quarterly, and annual reports, and expose the signors to liability for material misstatements or omissions, if made in connection with the drafting of the registration statement or the reports. The new legislation should also include an explicit private right of action and base all procedural

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\(^{120}\) Foley & Lardner LLP, 7th Annual Report of Corporate Law Departments: Complete Survey Results, CORP. LEGAL TIMES, May 2004, at 48, 49
aspects on the already litigated Section 11, including the due diligence defense. This recommendation is a piggyback on the SEC rule proposals of 2002 that led to new rules mandating that a company's principal executive officer and principal financial officer must sign 10-K and 10-Q and vouch for the correctness of these statements.\textsuperscript{121} The result would be that Janus Capital Group would be forced to sign the registration statement of the mutual fund and would avail itself to liability for violating the market-timing clause.

In addition, the new amendments would require individuals providing advice or assistance to reconsider any moral or ethical obligations that were promised during registration or in periodic reports. While the true purpose of The Exchange Act is full disclosure and to insure that companies make information publicly available to investors on a continuing basis to aid in their investment and voting decisions, it would be extremely beneficial to add accountability to these goals. A mutual fund advisor would invest considerable time and thought before suggesting to a mutual fund whether to include language regarding market timing if they had any doubt as to whether they would partake in such activity. By requiring the mutual fund advisor to sign the statement it would create a binding agreement between the fund, investors, and the advisors and would maximize truthful disclosures to investors.

g. Required Disclosure of Non-liability for Mutual Fund Advisors

\textsuperscript{121} See Release No. 34–46079 (June 20, 2002) [67 FR 119] (“Our existing antifraud and disclosure rules are designed to elicit full and fair corporate disclosure. Questions have arisen as to whether senior corporate officials devote sufficient attention to the preparation of their companies’ quarterly and annual reports and to the internal procedures that generate the data from which they are prepared. We are concerned that investor confidence has suffered because of a real or perceived absence of such participation. We believe that it is important both to the quality of disclosure and investor confidence for senior executives to provide assurance that they have reviewed and evaluated the information contained in their companies’ quarterly and annual reports. We therefore propose to require a company’s principal executive officer and principal financial officer each to certify that, to his or her knowledge, the company’s quarterly and annual reports are true in all important respects and that the reports contain all information about the company of which he or she is aware that he he or she believes is important to a reasonable investor”).
If requiring mutual fund advisors to sign registration statements, annual reports, and quarterly reports is too brash a recommendation to the SEC and Congress then at the very least mutual funds ought to be forced to disclose the lack of remedies to investors on their registration statement and prospectuses. Also I argue that not including this statement on these forms ought to be a material omission that attaches liability on the offeror.

Why would disclosure be appropriate in light of Janus? First, not all investors are attuned with recent Supreme Court decisions and legal trends. Most investors in mutual funds chose these investment vehicles for simple diversification and the ease of investment. The typical mutual fund investor would not realize that they have no remedy for relying on material misstatements made by the parent advisor in the prospectus. This theory assumes that the typical investor actually reads the prospectus, but that is a topic for another article.

The Janus result might be more manageable to swallow moving forward if the mutual fund were required by the securities law to disclose to the legally unsophisticated investor that upon purchase of a mutual fund that the investor lacks a remedy when the mutual fund advisor or parent corporation misspeaks or fails to alert them to material omissions because they are not the ones with the ultimate authority. There are two potential consequences for forcing a mutual fund to disclose lack of liability. First, it would likely alter the current mutual fund preference rate and make them less viable options for investors. By alerting investors to the lack of remedy for omissions and misstatements by advisors, it may scare off investors. Second, it may not change investor behavior or the moral decisions that mutual funds make. However, at the very least investors would be presented with full and accurate disclosure and this is one of the key aims of the securities laws.
Further, by not disclosing the lack of remedies an investor has against a mutual fund, the fund is arguable omitting a material statement and submitting itself to Section 10 and Rule 10b-5 liability. A statement or omission is material where “a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available.” In the case of Janus, the omission would have significantly altered the “total mix” of information available to the class of investors. Janus failed to disclose in their registration statement that the investors of the mutual fund had no remedy, either legal or otherwise, if Janus reneged on their promise that the fund would not participate in market timing trading and the investors were harmed.

VIII. Conclusion

Senator Patrick Leahy described the Janus Capital decision at a recent Senate Judiciary Hearing aptly:

The Court held that investors have no remedy when a corporation knowingly issues false statements from a shell entity it created to "make" the false statement. Some have said that the Janus decision provides Wall Street companies with a "license to lie." Others have called the opinion "a roadmap for fraud." Whichever phrase you use, the decision allows Wall Street companies to design new ways to evade accountability from the harm inflicted on hardworking Americans who have seen their life savings ravaged over the past

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few years by fraudulent investment schemes and corporate misconduct.\textsuperscript{123}

While Senator Leahy’s political pandering and choice of language are alarming, he is not altogether misguided. The drawback from \textit{Janus} is that in most, if not all scenarios, investment advisors are no longer liable for the assistance they provide to mutual funds, so long as they are not legally interested persons. While I argue that mutual fund advisors would still be liable for scheme liability and for fraud or deceit in the course of the sale, the most obvious remedy for mutual fund investors was lost with \textit{Janus}.

Full disclosure and fair and efficient markets are the principle tertiary aims of the securities laws. Without forcing mutual fund advisors to disclose their immunity from litigation in the filings of their respective mutual funds, the investing public loses the battle on both the full disclosure and fairness front. The SEC and Congress must take measures to insure that mutual fund investors have a remedy for being misled. At the very least, the government owes it to investors to disclose that mutual funds have recently become a much riskier investment than they once were.

\textsuperscript{123} Statement of Senator Patrick Leahy (D-Vt.), Chairman, Senate Judiciary Committee, Hearing On "Barriers to Justice and Accountability: How the Supreme Courts Recent Rulings Will Affect Corporate Behavior." June 29, 2011.