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SUPREME COURT DECISION LIMITS SCOPE OF PRIVATE SECURITIES-FRAUD ACTIONS

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This morning, the Supreme Court issued an important decision limiting the scope of private securities-fraud actions. The decision in *Janus Capital Group, Inc., et al. v. First Derivative Traders* (No. 09-525) will provide powerful protection to third-parties who assist issuers in the preparation of prospectuses and other public statements.

In this case, the Court addressed the question whether a third-party, who assists an issuer craft a disclosure, itself "makes" a statement within the meaning of Rule 10b-5. Ratifying too broad a definition of the term "make" would have undermined prior decisions of the Court that (1) foreclosed aiding-and-abetting liability under private lawsuits invoking Rule 10b-5, and (2) recognized that Congress had precluded judicial expansion of the private right of action to enforce Rule 10b-5.

Background

According to the complaint, Janus Capital Group, Inc. (JCG) sold shares in its mutual funds through prospectuses. A wholly owned subsidiary, Janus Capital Management LLC (JCM), was responsible for the funds' administrative and compliance services. During the relevant time period, the prospectuses stated that the funds were not intended for "market timing" transactions, which were purportedly harmful to the funds' long-term investors. Contrary to these representations, JCG secretly and knowingly allowed such transactions with 12 different market-timers yielding billions of dollars in trades. The revelation of these secret deals, according to the complaint, caused the funds' stock price to drop materially.

The 4th Circuit reversed the district court's dismissal of the complaint. In particular, the court held that JCM "made" the statements in JCG's prospectuses by participating in the drafting. The 4th Circuit went on to note that the public would reasonably attribute the prospectus statements to JCM given its close relationship with JCG.

Oral Argument

Questioning at oral argument suggested that several justices would be reluctant to define "make" broadly. Doing so would simply take away with one hand an immunity from suit that the Court had given with another hand. Justice Alito intimated as much when he asserted that, under a broad reading of "make," outside counsel would also be liable for any misstatements. Chief Justice Roberts and Justice Scalia did not hide their view that the only source possessing authority to make statements in the prospectus was JCG, the issuer, whereas JCM's role was akin only to that of a speechwriter. By contrast, the tenor of the questions posed by Justices Ginsburg, Sotomayor, and Kagen suggested that they all supported the 4th Circuit's judgment.

Today's Decision

This morning, the Court reversed the 4th Circuit in a 5-4 decision. Justice Thomas authored the majority opinion, which was joined by the "conservative" Justices (Scalia, Roberts, Alito, and Kennedy). In the key passage of the opinion, Justice Thomas wrote:

> 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.

[Slip op. at 6.] Picking up on the analogy from oral argument, Justice Thomas noted:

> 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.

[Slip op. at 6-7.]

The majority expressed concern that a broader definition of "make" would eviscerate prior holdings in which the Court had expressly foreclosed private rights of action under Rule 10b-5 against aiders and abettors [*Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 180 (1994)]: "A broader reading of 'make,' including persons or entities without ultimate control over the content of a statement, would substantially undermine *Central Bank*." [Slip op. at 7.]

In addition, the majority held that an expansive reading of Rule 10b-5 would be inconsistent with congressional intent. *See, e.g., Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 167 (2008) (emphasizing that Congress precluded judicial expansion of the private right of action to enforce Rule 10b-5). In particular, the majority noted that Congress specifically provided a different avenue for third-party liability – 15 U.S.C. § 78t(a) ["Section 20(a)"] – for any person "who, directly or indirectly, controls any person liable" for violating the securities laws. [Slip op. at 10.]

Justice Breyer wrote the dissenting opinion – joined by Justices Ginsburg, Sotomayor, and Kagan – in which he endorsed a more fact-specific inquiry that would permit, under circumstances like those here, a finding that a third-party "made" statements contained in a firm's prospectus despite its lack of ultimate authority.

Conclusion

Today's decision provides an additional bulwark against the expansion of private securities-fraud actions enforcing Rule 10b-5. To discuss the impact of this case to your work, feel free to contact any of the Cozen O'Connor professionals listed below.

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