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# Supreme Court Holds Adviser Who Participated in Drafting Statements Did Not "Make" Them for Purposes of Rule 10b-5 Liability

On June 13, 2011, the United States Supreme Court rendered a 5-4 decision ruling that only a mutual fund, and not its investment adviser, can be held liable in a private right of action under Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") and SEC Rule 10b-5 promulgated thereunder for false statements in a fund prospectus. The case, *Janus Capital Group, Inc. v. First Derivative Traders,*[1] limits liability under Rule 10b-5 by holding that only the party ultimately responsible for the disclosure is the actual "maker" of a false statement within the meaning of the Rule.

The defendants were Janus Capital Group, Inc. ("JCG"), a publicly traded company that created the Janus family of funds, and its wholly-owned subsidiary, Janus Capital Management LLC ("JCM"), the investment adviser for the funds. As is typical, the Janus funds were organized in a business trust, called the Janus Investment Fund (the "Fund"), which is a separate legal entity from JCM, owned entirely by mutual fund investors and which has no assets apart from those owned by the investors (although all of the officers of the Fund were also officers of JCM). Lead Plaintiff First Derivative Traders, on behalf of a class, alleged that JCG and JCM violated Section 10(b) and Rule 10b-5 by causing mutual fund prospectuses to be released that created the misleading impression that JCG and JCM would implement policies to prevent the practice of "market timing" in its funds. Plaintiffs also sought to impose "control person" liability on JCG, pursuant to Section 20(a) of the Exchange Act, for the acts of JCM.

After the lower court dismissed the complaint, the Court of Appeals for the Fourth Circuit reversed, holding that the complaint had sufficiently alleged that both JCG and JCM "made" the misleading statements because they participated in writing and disseminating the prospectuses.[2]

The Supreme Court reversed, holding that Rule 10b-5 liability is limited to those who actually "make" any untrue statement of a material fact or an omission of a material fact in a public disclosure. Mindful of concerns about expanding the private right of action under Section 10(b) and Rule 10b-5, which is a "judicial creation," the majority held that because the Fund, and not JCM, had ultimate control and authority over the statements in its public disclosures, JCM could not have "made" the statements at issue. The Court analogized the relationship between the Fund and JPM to that between a speechwriter and a speaker, in that "[e]ven when a speechwriter drafts a speech, the content is entirely within the control of the person who delivers it." The Court held that extending Rule 10b-5 liability beyond those with ultimate authority over a statement would be inconsistent with its prior precedent in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver N.A.,*[3] which precluded a private right of action under Rule 10b-5 against aiders and abettors.

In interpreting Rule 10b-5, the Court focused on the plain meaning of the word "make" and found that the phrase at issue, "[t]o make any … statement" was the equivalent of "to state." It rejected an argument that the word "make" should be defined more broadly as "create." The Court also rejected the plaintiffs' argument, based on the "well-recognized and uniquely close relationship between a mutual fund and its investment adviser," that the adviser is generally "understood to be the 'maker' of statements by its client mutual fund." Noting that all required corporate formalities were observed here and that the Fund's board of trustees was more than sufficiently independent, the Court declined to "disregard the corporate form."

The decision has important implications not only for mutual fund investment advisers, but also for attorneys, accountants and others who advise or provide assistance to those with disclosure obligations. The combination of the *Central Bank of Denver* Court's prohibition of aiding and abetting liability and the *Janus* holding provides a powerful tool to the securities litigation defense bar in seeking dismissal of a Rule 10b-5 case against any person or entity not ultimately in control of the publication or omission of a material statement. At the same time, the decision reaffirms that mutual fund companies must be vigilant to ensure that investment advisers, investment managers and their funds are separate legal entities, that a fund's board is independent from the adviser and/or manager and that all other required corporate formalities are strictly followed. To do otherwise may jeopardize the benefits of the *Janus* decision.

1. No. 09-525, 564 U.S. __ (2011).
2. The Fourth Circuit ruled, however, that JCG could only be liable as a "control person" under Section 20(a) because it found the element of reliance under Rule 10b-5 lacking.
3. 511 U.S. 164 (1994).


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