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What To Make of 'Make'

Supreme Court decision in private securities fraud action turns on definition of simple word

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What does it mean to "make" a statement? This seemingly simple question was at the center of the U.S. Supreme Court's decision in *Janus v. First Derivative Traders* (09-525), one of the more closely watched securities fraud cases of the current term. At issue in *Janus* was whether an investment advisor to a mutual fund could be liable for allegedly false statements made in the mutual fund's prospectus. In its decision, the Supreme Court held that the advisor could not be liable because the advisor did not "make" any of the statements.

The decision in *Janus* is the latest in a series of cases from the Supreme Court defining the potential liability of so-called secondary actors — entities that are not accused of having actually committed securities fraud but are instead charged with having enabled the primary actor to do so. With this latest decision, the Supreme Court has again narrowed the universe of secondary actors who might find themselves named as a defendant in a complaint alleging violations of the securities laws. While undoubtedly unpopular with investors, the *Janus* decision is good news for other secondary actors, including lawyers and accountants, who are often intimately involved with the preparation of prospectuses and might have otherwise found themselves in the cross hairs of the next wave of securities lawsuits.

In *Janus*, the plaintiffs accused Janus Capital Management LLC (JCM) of violating Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5, both of which prohibit making false or misleading statements in connection with the purchase or sale of securities. JCM was the investment advisor and administrator for the Janus Investment Fund, a business trust organized to hold a family of mutual funds created by Janus Capital Group Inc. (JCG). Stated differently, JCG created a group of mutual funds, organized them in a trust called the Janus Investment Fund, and hired JCM, its wholly owned subsidiary, to advise JCG about the funds and administer the trust.

The underlying dispute arose when it was revealed that JCG permitted certain investors to engage in a trading strategy called "market timing," where investors "exploit the time delay in mutual funds' daily valuation system." Market timing, which is legal, allows those engaging in the practice to reap significant profits through high-volume trading in the shares of a mutual fund, but does so at the expense of other investors in the fund. The prospectuses for the Janus Investment Fund indicated that the funds were "not intended for market timing," and that JCM had adopted protections to ensure that it did not happen. Notwithstanding these representations, in September 2003, the New York attorney general sued JCG and JCM, alleging that JCG "entered into secret arrangements to permit market timing in several funds run by JCM." Once these allegations became public, "investors withdrew significant amounts of money from the Janus Investment mutual funds," which in turn caused the stock price of JCG to fall by nearly 25 percent in three weeks.

Following this precipitous drop, JCG and JCM were sued by investors who sought to hold them liable for issuing prospectuses suggesting that JCM would implement policies to curb market timing when JCG knew that it was expressly permitting certain traders to engage in market timing. The U.S. District Court for the District of Maryland dismissed the complaint for failure to state a claim, but the U.S. Court of Appeals for the Fourth Circuit reversed, holding that "JCG and JCM, by participating in the writing and dissemination of the prospectuses, *made* the misleading statement contained in the documents." The Supreme Court reversed the Fourth Circuit.

Justice Thomas, writing for a 5-4

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majority, began his opinion by noting that, under Rule 10b-5, it is unlawful for "any person, directly or indirectly, . . . [to] make any untrue statement of a material fact" in connection with the purchase or sale of securities. The majority then concluded that, for purposes of Rule 10b-5, the "maker" of a statement is the person 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." To help make his point, Justice Thomas analogized the relationship between one who "makes" a statement and one who merely prepares a statement for another to "make," to the relationship between a speech writer and a speaker: "Even when a speech writer 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."

Applying this standard to the case before the Court, the majority concluded that JCM did not "make" any of the statements in the prospectuses. Only Janus Investment Fund was required to file the prospectuses with the SEC, and nothing contained in these prospectuses indicated that any statements came from JCM rather than Janus Investment Fund. Returning to his speech writer/speaker analogy, Justice Thomas concluded: "Although JCM, like a speech writer, 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." Accordingly, JCM could not be liable for any alleged misstatements contained in the prospectuses.

Justice Breyer, joined by Justices Ginsburg, Sotomayor and Kagan, dissented. The dissenting justices took issue with both the majority's interpretation of the word "make" and its characterization of *Janus* as involving secondary liability, as opposed to primary liability. First, in the dissenters' view, neither "common English" nor case law limit the scope of the word *make* to only those with "'ultimate authority' over a statement's content." Rather, they suggested, "[n]othing in the English language prevents one from saying that several different individuals, separately or together, 'make' a statement that each has a hand in producing." Second, the dissenters chided the majority for discussing the case as if it involved secondary liability, asserting that the case was about primary liability — "individuals who allegedly themselves 'make' materially false statements, not about those who help *others* to do so." This criticism is essentially the flip side of the dissenters' position regarding the interpretation of the word *make*, however, as *Janus* can only be about primary liability if one first concludes that a party "makes" a statement simply by participating in the process leading up to its dissemination. The majority rejected this approach.

The *Janus* decision follows on the heels of two other Supreme Court decisions — *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.* and *Stoneridge Investment Partners v. Scientific-Atlanta* — that limited the liability of secondary actors in securities fraud lawsuits. In *Central Bank*, the Court concluded that the implied private right of action in Rule 10b-5 does not include lawsuits against aiders and abettors. In *Janus*, the Supreme Court noted that transforming "persons or entities without control over the content of a statement" into "primary violators who 'made' the statement" would eviscerate the distinction between primary actors and aiders and abettors.

In *Stoneridge*, the Court rejected so-called scheme liability, which would have extended liability under Section 10(b) of the Securities Exchange Act of 1934 to secondary actors who engaged in deceptive transactions behind the scenes that enabled a publicly traded company to issue misleading statements. In *Janus*, the Court concluded that there was no difference between "participating in the drafting of a false statement" and "engaging in deceptive transactions," because "each is merely an undisclosed act preceding the decision of an independent entity to make a public statement."

Just like *Central Bank* and *Stoneridge* before it, *Janus* was closely watched in the industry, particularly by putative secondary actors like lawyers and accountants who are closely involved with their clients' preparation and filing of prospectuses and other financial disclosures. Expanding the pool of potential defendants has been the goal of injured investors because secondary players are often the only viable entities remaining after corporate fraud destroys a company. While this was not the case in *Janus*, had the Supreme Court endorsed the plaintiffs' theory, it would have opened the door to future claims against any person or entity who, as the Fourth Circuit concluded, "participat[ed] in the writing and dissemination" of prospectuses. The consequences of the Supreme Court's adopting this broad standard were so acute for lawyers and accountants that groups representing both professions filed amicus briefs to voice their concerns about expanding the scope of secondary-actor liability even though *Janus* was not, on its face, a case about lawyer or accountant liability. Notwithstanding these concerns, the Supreme Court's decisions in *Central Bank*, *Stoneridge* and now *Janus*, make these potential consequences less likely than ever.

There is always a remedy for investors who are unsatisfied with the Supreme Court's approach to secondary actor liability — convince Congress to amend the law to provide for aiding and abetting liability or some other change that would allow such lawsuits to proceed. While the odds of this happening seem long, to say the least, given the ever-narrowing view the Supreme Court has taken toward secondary-actor liability, investors may have a better chance in Congress than in the courts. ■