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# The Supreme Court Limits Rule 10b-5 Liability to Person or Entity Making Alleged Misstatement

*June 14, 2011*

Yesterday, in *Janus Capital Group, Inc. v. First Derivative Traders*, No. 09-525, the Supreme Court issued a 5-4 decision limiting the scope of liability under Section 10(b) and Rule 10b-5 for "mak[ing] any untrue statement of material fact." Rejecting the "creator" theory espoused by the Government, the Supreme Court held: "For purposes of Rule 10b-5, the maker of a statement is the person or entity with ultimate authority over the statement." The Court's holding offers a significant defense in a securities fraud suit for any number of other unattributed actors who may have had a role in preparing an allegedly false statement but did not actually "make" the statement.

## BACKGROUND

Plaintiffs in *Janus* alleged misstatements in prospectuses for funds in the Janus family of mutual funds ("the Funds"). Janus Capital Group Inc. ("JCG") created the Funds, which were managed by its wholly-owned subsidiary, Janus Capital Management LLC ("JCM"). JCM also served as the Funds' investment adviser and administrator. The Funds' prospectuses contained statements indicating that their fund managers discouraged and took measures to prevent market timing, which involves buying or selling a mutual fund to take advantage of inefficiencies in the manner in which the fund values its shares. In September 2003, the New York Attorney General filed a complaint alleging that JCG and JCM's executives permitted substantial market timing contrary to the Funds' express policies. The complaint triggered widespread withdrawals from the Funds, and JCG's stock price fell by 23 percent.

In late 2003, JCG shareholders brought suit against JCG and JCM under Section 10(b) and Rule 10b-5, alleging that they were injured by the fall in JCG's stock price after the alleged misstatements were revealed. The district court granted defendants' motion to dismiss, finding that the plaintiffs had failed to plead that JCG made material misstatements in the prospectuses or that those statements were directly attributed to it. The lower court also dismissed the claims against JCM because it held that JCM did not owe a duty to JCG's shareholders.

On appeal, the Fourth Circuit reversed and remanded, holding that plaintiffs had sufficiently pled that JCM "made" the allegedly misleading prospectus statements by participating in the drafting and dissemination of the prospectuses, and that JCG could be held liable as a control person of JCM. The Fourth Circuit also held that plaintiffs had adequately pled the public attribution element of the fraud-on-the-market theory, and thus were entitled to a presumption that they relied on the misstatements. Although the prospectuses did not explicitly name JCG and JCM as drafters, the court found that the statements in question were attributable to JCM because "interested investors would

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infer that JCM played a role in approving the content of the Janus fund prospectuses . . . ." *In re Mut. Funds Inv. Litig.*, 566 F.3d 111, 127 (4th Cir. 2009).

**SUMMARY OF THE DECISION**

In its opinion, written by Justice Thomas and joined by Chief Justice Roberts and Justices Scalia, Kennedy, and Alito, the Supreme Court held: "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."

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*OPINION OF THE COURT*

The Court first acknowledged the existence of a private right of action under Rule 10b-5, but observed consistent with prior decisions that the Court "must give 'narrow dimensions . . . to a right of action Congress did not authorize when it first enacted the statute and did not expand when it revisited the law.'"

Next, the Court construed "[t]o make . . . any statement" as the approximate equivalent of "to state." The Court reasoned: "When 'make' is paired with a noun expressing the action of a verb, the resulting phrase is 'approximately equivalent in sense' to that verb." Moreover, according to the Court, a person or entity without control can merely suggest what to say, and cannot make the statement itself. "One who prepares or publishes a statement on behalf of another," therefore, "is not its maker." The Court analogized the situation to a speechwriter and speaker: although the speechwriter drafts a speech, the speaker is responsible for what ultimately is said.

*"One who prepares or publishes a statement on behalf of another is not its maker."*

*OPINION OF THE COURT*

The Court stated that its holding followed from prior precedent. For instance, the Court observed that, "[i]f persons or entities without control over the content of a statement could be considered primary violators who 'made' the statement, then aiders and abettors would be almost nonexistent." Such a result would be inconsistent with the Court's holding in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994), that Rule 10b-5's private right of action does not extend to suits against aiders and abetters. Additionally, in *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148 (2008), the Court held that secondary actors are not subject to liability under Rule 10b-5 where plaintiffs cannot prove reliance upon such actor's statements. In issuing *Stoneridge*, the Court "emphasized that 'nothing [the defendants] did made it necessary or inevitable for [the company] to record the transactions as it did,'" suggesting that, as the Court held in *Janus*, "the maker of a statement is the entity with the authority over the content of the statement and whether and how to communicate it."

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*OPINION OF THE COURT*

The Court expressly rejected the Government's contention that "make" should be defined as "create." The Court concluded that interpreting "make" in such a manner would be grammatically inappropriate. Moreover, the Court observed that "creator" liability would be inconsistent with the Court's decision in *Stoneridge* rejecting a private Rule 10b-5 suit against companies involved in deceptive transactions with an issuer even when information about those transactions was later incorporated into allegedly false public statements. Although the Court acknowledges in a footnote plaintiffs' argument that JCM might be liable for making a statement "indirectly," the Court concluded that it need not at this time define what it means to make a statement indirectly because to hold JCM liable for indirectly making a statement requires, at the very least, attribution, an element not met by plaintiffs.

The Court therefore reversed the judgment of the Fourth Circuit, finding: "JCM did not 'make' any of the statements in the Janus Investment Fund prospectuses; Janus Investment Fund did." The Court observed that there is no allegation that it was JCM that had filed the prospectus, nor was there anything in the prospectus that suggested that JCM had made the statements contained therein.

Justice Breyer authored a dissenting opinion joined by Justices Ginsburg, Sotomayor, and Kagan. According to Justice Breyer: "[T]he majority has incorrectly interpreted the Rule's word 'make.' Neither common English nor this Court's earlier cases limit the scope of that word to those with 'ultimate authority' over a statement's content." Rather than establishing a bright-line rule, Justice Breyer would look to "[p]ractical matters related to context, including control, participation, and relevant audience" to determine who "makes" a statement.

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*JUSTICE BREYER, DISSENTING*

Justice Breyer noted that there was no support for the majority's decision, distinguishing the Court's precedent from the current case. *Central Bank* is a case about secondary liability, he explained, not about an individual's making a false statement. With regard to *Central Bank,* Justice Breyer observed: "The Court in *Central Bank* specifically wrote that its holding did 'not mean that secondary actors in the securities markets are always free from liability under the securities Acts. *Any person or entity, including a lawyer, accountant, or bank, who* employs a manipulative device or *makes a material misstatement* (or omission) on which a purchaser or seller of securities relies *may be liable as a primary violator under 10b–5,* assuming *all* of the requirements for primary liability under Rule 10b–5 are met." (Some emphasis added). In Justice Breyer's view "[t]he majority's rule does not protect, it *extends*, *Central Bank*'s holding of no liability into new territory that *Central Bank* explicitly placed outside that holding." Justice Breyer also noted that "proximate causation" and "reliance" were the primary issues in *Stoneridge*, and not who had made a false statement. Justice Breyer therefore concluded: "The specific relationships alleged among Janus Management, the Janus Fund, and the prospectus statements warrant the conclusion that Janus Management did 'make' these statements."

## IMPLICATIONS

The Court's decision in *Janus* limits Rule 10b-5 liability to the person or entity with ultimate authority over an alleged misstatement. In announcing this rule, the Court rejected the "creator" theory of liability espoused by the Government, which would have required a fact-intensive inquiry regarding whether a party drafted a statement for dissemination. The Court's decision—coming three years after *Stoneridge*—further limits private security fraud plaintiffs' recourse against actors who have not directly spoken to the market. The decision raises the possibility that a party may be held liable for making a "statement indirectly," but does not provide detail as to what would be required for liability under such a theory. However, the Court notes that the allegedly false statement must, at the very least, be attributed to a party before "indirect" liability attaches.

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