SUPREME COURT ADOPTS RULE CURTAILING PRIVATE SECURITIES FRAUD ACTIONS AGAINST OUTSIDE ADVISORS WHO ASSIST IN THE PREPARATION OF DISCLOSURES

June 15, 2011

To Our Clients and Friends:

On June 13, 2011, the Supreme Court of the United States handed down its decision in the closely watched case of *Janus Capital Group, Inc. v. First Derivative Traders*. In a 5-4 opinion that will be welcome news to individuals and entities that provide services to issuers of securities, the Court held that a mutual fund investment adviser could not be held primarily liable in a private securities fraud action for helping to draft an allegedly misleading prospectus over which it did not have "ultimate authority." The decision adopts a bright-line rule that clarifies the scope of primary liability under the securities laws and eliminates a potential avenue for plaintiffs' attorneys to pursue claims against parties that participated in creating, but did not "make," the allegedly misleading statement.

The case arose from the wave of market timing lawsuits that swept the mutual fund industry in 2003. Stockholders of Janus Capital Group, Inc. ("JCG") brought suit against JCG and Janus Capital Management LLC ("JCM"), its wholly owned subsidiary that served as the investment adviser to the Janus family of mutual funds. The plaintiffs alleged that JCM knowingly made material misstatements in prospectuses for the Janus mutual funds regarding its curtailment of market timing activity and that those misstatements had the effect of artificially inflating the stock price of the parent company, JCG. The mutual fund prospectuses were issued by the Janus Investment Fund ("JIF"), a Massachusetts business trust and distinct legal entity in which the relevant funds were organized. JCG and JCM neither owned nor controlled the relevant mutual funds.

Rule 10b-5 makes it unlawful to "make any untrue statement of material fact" in connection with the purchase or sale of securities. The central issue before the Court was whether plaintiffs sufficiently alleged that JCM – which neither issued the prospectuses nor had any prospectus statements expressly attributed to it – had "made" allegedly false or misleading statements within the meaning of Rule 10b-5. The U.S. Court of Appeals for the Fourth Circuit had held that allegations that JCM "participat[ed] in the writing and dissemination of the prospectuses" were sufficient to state a claim that JCM "made" the statements at issue.

The Supreme Court disagreed. The Court held that the "maker" of a statement – and the only proper defendant in a private 10b-5 action – is the "person or entity with ultimate authority over the statement, including its content and whether and how to communicate it." Likening JCM's role to that of a speechwriter, the Court reasoned that an entity without control over content and publication "can merely suggest what to say," and under such circumstances "it is not 'necessary or inevitable' that any falsehood will be contained in the statement." The Court stressed that it would not "expand liability beyond the person or entity that ultimately has authority over a false statement."

The Court's ruling appears to be driven, like other recent decisions, by a desire to articulate bright-line rules for securities fraud actions and a continuing commitment to interpret narrowly the implied private right of action under Rule 10b-5.

Although the Court focused on the concept of "control" over a statement, it also noted that (i) JCM and JIF are legally distinct entities that observed corporate formalities at all times; and (ii) none of the prospectus statements at issue were attributed, directly or indirectly, to JCM. A difference in these factors could have affected the outcome.

POTENTIAL IMPLICATIONS OF THE DECISION

The Court's ruling is good news for the many third parties (such as bankers, accountants, lawyers, investment advisers and others) that regularly provide services to issuers and/or assist with the preparation of disclosures. Together with the Court's decision in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, which held that Rule 10b-5 does not provide a private right of action against aiders and abettors, this decision precludes 10b-5 liability for statements not "made" by such entities. These third parties will remain liable for their own statements, however, such as an auditor's certification of financial statements.

While the decision limits primary liability for third parties, it does not address claims against corporate insiders who participate in the making of statements. It does not purport to restrict claims against officers and directors who make individually attributed statements, such as at press conferences or analyst meetings, or who certify an entity's statements, but the Court's

emphasis on "control" may provide a defense for corporate insiders who play a role in the drafting process but do not have ultimate authority over the content or publication of disclosures.

* * *

Please feel free to contact us with any questions.

Maeve O'Connor
+1 212 909 6315
mloconnor@debevoise.com

Kenneth J. Berman
+1 202 383 8050
kjberman@debevoise.com

John S. Kiernan
+1 212 909 6692
jskiernan@debevoise.com

Gary W. Kubek
+1 212 909 6267
gwkubek@debevoise.com

Peter J. Loughran
+1 212 909 6375
pjloughran@debevoise.com

Joseph P. Moodhe
+1 212 909 6241
jpmoodhe@debevoise.com

Edwin G. Schallert
+1 212 909 6295
egschallert@debevoise.com

Colby A. Smith
+1 202 383 8095
casmith@debevoise.com