The Practical and Legal Implications of Janus for Non-Issuers: Limiting Primary Rule 10b-5 Liability for Offering Document Misstatements to the Person with Ultimate Authority over the Statement

Rule 10b-5 makes it unlawful, among other things,

"(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading...in connection with the purchase or sale of any security." (emphasis added)

In Janus, Justice Thomas writing the 5/4 majority opinion focused on the meaning of the word “make” in Rule 10b-5, holding that only the “person or entity with ultimate authority over the statement, including its content and whether and how to communicate it” has “made” or “make[s]” a statement and can thus be held liable in a private action under Rule 10b-5.
by Janus to prevent trades based on market timing that were made in the prospectuses of the Janus Investment Fund (“Janus Fund”), a series fund organized as a business trust. Janus Advisors assisted Janus Fund in preparing its SEC filings, but the prospectus was approved and filed with the SEC by Janus Fund. The plaintiffs alleged that Janus had accepted payments to permit favored Janus Fund investors to make market timing trades in the Janus Fund in contravention of the language in its prospectus. The market timing scandal led to substantial losses and adverse publicity for Janus which materially adversely affected Janus Capital’s stock price.

The plaintiffs in Janus brought their class action complaint under Section 10 of the Exchange Act and Rule 10b-5 and also under Section 20(a) of the Exchange Act which provides for control person liability on the theory that Janus Capital controlled Janus Advisors. While the alleged market timing misstatements were made in large part in registration statements of Janus Fund filed under the Securities Act of 1933 (the “Securities Act”), plaintiffs were shareholders of Janus Capital as a result of purchases in the secondary market and were not suing as shareholders of Janus Fund. Consequently, plaintiffs could not sue under Section 11 or Section 12 of the Securities Act and were forced to rely on Section 10 and Rule 10b-5 along with Section 20(a) to bring their action.1

The Fund Context
The mutual fund structure strongly contributed to the result in Janus as Janus Capital derived substantially all of its revenue from funds in which it owned no equity stake and which had disinterested boards of directors. Therefore, in a strict legal sense it did not control Janus Fund. In an operating business, this structure does not exist. A holding company may operate through subsidiaries and controlled affiliates but it would generally have either primary or controlling person liability for the statements made by its subsidiaries even if those subsidiaries are separate public companies.2 In the mutual fund context, Janus could argue that it did not have legal control over the disclosures made by Janus Fund in its prospectuses. Nevertheless, in the mutual fund context, the advisor is typically significantly involved in fund operations and in the preparation of its client fund’s prospectus and other SEC filings although the fund would typically have its own counsel review the filings. The prospectus and most significant SEC filings would generally be approved by the fund’s board of directors. In the private fund context, the advisor/sponsor is also heavily involved in preparing the fund offering documents. In the hedge fund and private equity fund arena, the advisor or its principals often are or control the general partner or the managing member of the fund. Offshore fund managers are typically separate entities but an offshore fund may not have an independent majority on its board of directors. As such, depending upon the individual fund structure, both domestic and foreign private fund advisors are likely to be significantly more susceptible to controlling person liability than in the public mutual fund context.3 In both contexts, the funds themselves are vehicles that receive investor money but rarely have large staffs as the personnel involved in each fund’s activities are typically employees of affiliated third parties such as the advisor, the administrator and any distributor.

In addressing problems created by the fund structure, plaintiffs had argued that Janus Advisors had acted in a manner similar to a playwright writing a play, and
Janus Fund had acted in the role of an actor in the play by speaking the alleged prospectus misstatements. Justice Thomas on the other hand likened the acts of Janus Advisors to that of a speechwriter. While Janus Advisors may have prepared the text, the person speaking the words must be the one who makes, controls and takes public responsibility for them. The Court wrote that, "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."

Under the Janus holding, only Janus Fund which had authority over its own prospectus could be sued under Rule 10b-5 for statements included in Janus Fund’s prospectus. Thus, ironically, in the mutual fund context, shareholders of the parent company, Janus Capital, are left with no remedy while an investor in Janus Fund was essentially reduced to having to sue the fund he has himself invested in as a remedy for misstatements and is left to recover for the wrong in part from the investor’s own assets. This seems particularly anomalous, since Janus Advisors was the only entity which had a motivation to hide the market timing investments. Janus Advisors received additional management fees based on these investments. Janus Fund on the other hand was only hurt and not helped by the market timing trades which sent a disproportionate share of Janus Fund gains out to the market timers. In fact, the dissenting opinion in Janus suggests that the directors of Janus Fund may have been wholly innocent of knowledge of the wrongdoing. Janus Advisors, on the other hand, would have been highly motivated to keep these matters from the Janus Fund Board.

The Janus case holds that a mutual fund advisor cannot be sued under Rule 10b-5 for misstatements in its fund’s prospectuses because it did not “make” those misstatements, even though the advisor was significantly involved in preparing the prospectuses. The Supreme Court stated that only the "person or entity with ultimate authority over the statement, including its content and whether and how to communicate it" has "made" or "make[s]" a statement and can thus be liable under Rule 10b-5. In Janus (and probably in most other instances that are likely to arise) that entity was the issuer (Janus Fund) that filed the prospectus with the SEC and was a legally separate entity from the advisor with its own largely disinterested Board of Directors.

The Janus case is consistent with the prior elimination of aiding and abetting liability in Rule 10b-5 actions under Central Bank of Denver in 1994 and the elimination of Rule 10b-5 liability for scheme participants in Stoneridge in 2008 and further limits the liability of secondary actors and advisors to the issuer. In Janus, the Court was clearly concerned about not taking a position counter to the rule against aiding and abetting liability in private actions that it had enunciated in Central Bank of Denver. It is not clear why the Court did not consider the failure to disclose the market timing issues in Janus Capital’s own Exchange Act filings, sufficient basis for a primary violation of Rule 10b-5.

While the result in Janus may run counter to many practitioners’ previous understanding of Rule 10b-5, it is entirely consistent with the Supreme Court’s efforts to limit the application of Rule 10b-5’s implied private right of action to the narrowest possible set of circumstances and to eliminate liability for secondary actors. After Janus, it is hard to see how almost anyone other than the issuer,
including underwriters, placement agents, dealers and banks acting as initial purchasers or resellers distributing securities in Rule 144A transactions, could be held liable in a private action under Rule 10b-5 for statements made in a prospectus or private placement memorandum. Hedge fund managers, distributors, administrators, accountants, lawyers and other advisors could not be liable under Rule 10b-5 unless they actually “make” the statement within the meaning of Janus under their own authority, had the statement directly or indirectly attributed to them or were liable as control persons. A statement in an accountant’s opinion or an express recommendation of a security by an investment bank, or a law firm’s statement in a legal opinion included in a prospectus would likely be actionable against the author. But after Janus, a statement merely drafted, prepared or commented upon by an outside advisor and included in the prospectus would not be deemed to have been “made” by the advisor and would thus not be actionable against anyone other than the issuer.

After Janus, the only Rule 10b-5 remedy available for Janus’s market timing wrongs would be held by Janus Fund shareholders. Janus Capital shareholders would be left with no remedy under the Federal securities laws. Janus Fund shareholders on the other hand would have a wealth of remedies and could almost certainly have sued and prevailed under Section 11, Section 12 and Section 15 of the Securities Act as well as under Rule 10b-5 if they could prove damages. Janus Fund would have been strictly liable to its shareholders for any material prospectus misstatements or omissions regarding market timing under Section 11 of the Securities Act. The Janus entity that was distributor of Janus Fund shares would also have been liable to Janus Fund shareholders under Section 11 as an underwriter of those shares. In addition, Janus Capital would have been liable to Janus Fund shareholders as a controlling person of the Janus distributor or underwriter under the control person liability provisions of Section 15 of the Securities Act. Further, any director of Janus Fund would also be liable, absent a good due diligence defense, to Janus Fund shareholders under Section 11. All of this would have been in addition to any Rule 10b-5 and Section 20(a) liability of Janus Capital that the Court denied to Janus Capital shareholders in Janus.

But the Supreme Court held that Janus Capital shareholders were out of luck even though they had been more severely and demonstrably damaged by the market timing scandal than Janus Fund shareholders were.6 Perhaps Janus Capital shareholders in the case could have successfully sued solely in reliance on the Form 10-Ks and Form 10-Qs of Janus Capital, alleging the omission of the material fact that Janus Capital and its subsidiaries were permitting market timing in Janus Fund resulting in a huge public scandal and hundreds of millions of dollars in losses. Instead, the case became focused on whether misstatements in Janus Fund prospectuses could be attributed to Janus Capital. Arguably, plaintiffs should not have needed to establish attribution to prove primary liability under Rule 10b-5. Janus was a public company that failed to disclose in its own SEC filings that the principal businesses from which substantially all of its revenues were derived had secretly engaged in improper market timing arrangements. That omission was arguably a material omission by Janus Capital in its own filings not just by Janus Fund in its prospectuses.

Control Person Liability – Exchange Act Section 20(a)
Section 20(a) of the Exchange Act imposes liability on controlling persons for violations of Rule 10b-5. The control person is liable to the same extent as those who directly committed the offense, unless the control person can establish that it “acted in good faith and did not induce the act or acts constituting the violation.” The Janus Court held that plaintiffs had failed to establish control person liability under Section 20(a) of the Exchange Act because Janus Fund had a separate board of directors consisting primarily of disinterested persons. After Janus, there may be control person liability in circumstances where control exists and there is a primary violation of Section 10, but in Janus the Court indicated that corporate formalities had been observed between Janus Advisors and Janus Fund such that control by Janus Advisors (and hence Janus Capital) was not demonstrated. Janus Fund had more than the required number of disinterested directors (in fact all but one director was disinterested) and was not in a strict legal sense controlled by Janus Advisors, notwithstanding Janus Advisors’ obvious and pervasive influence in the operations of Janus Fund.7

**Securities Act Section 17(a)**
The SEC may continue to bring enforcement actions under Securities Act Section 17 (a), a general anti-fraud provision that applies to all securities transactions, including any secondary market transaction. Section 17(a) is similar in wording to Rule 10b-5 but, interestingly, does not use the word “make” in regard to a material misstatement as Rule 10b-5 does. Instead, it says to get “money or property “by means of” a material misstatement. Therefore the Janus case which focuses on the word “make” may not be applicable to Section 17(a) which focuses on sellers who use misstatements to defraud purchasers. But, after Janus, it is possible that the courts may read the “make” requirement into the statute by implication although the language of the statute by no means compels that reading as Section 17(a) focuses on sellers of securities not on “makers” of misstatements.

Although the Securities Act primarily deals with public offerings, the Supreme Court has held that Section 17(a) is applicable to secondary market trading. However, most courts have held that Section 17(a) does not provide a private right of action and that only the SEC may enforce Section 17(a).8

**The Private Placement and Rule 144A Context**
Federal anti-fraud remedies that can be brought by private parties under the securities laws are quite limited in cases involving unregistered securities offerings conducted outside the United States under Regulation S or pursuant to an exemption under Securities Act Section 4, such as the private placement exemption in Section 4 (2) or Rule 144A offerings to qualified institutional buyers. Actions under Section 11 and Section 12(a)(2) of the Securities Act are not available in such offerings.9 After the Morrison10 case, Rule 10b-5 is not available in Regulation S offerings or for cases involving any purchase or sale of securities outside the United States. After Central Bank of Denver and Stoneridge, there is no liability for aiders and abettors or scheme participants. After Janus, Rule 10b-5 is available against the issuer in private offerings made in the United States, but would not generally be available for misstatements in an issuer’s offering documents against private placement agents, underwriters or initial purchasers or other advisors, accountants and consultants unless a misstatement could be attributed to them or a separate predicate for liability—such as market manipulation—were held to be available.
In a large institutional private offering or in a Rule 144A offering made by a business corporation where the offer is exempt under Section 4 of the Securities Act, the offering document would typically be prepared by the issuer and its attorneys with substantial input from the underwriters or placement agents and their counsel. In large international offerings exempt under Section 4 of the Securities Act where there is only one international legal counsel, the international counsel may draft large portions of the material disclosures with substantial input from the underwriters. In smaller private placements, the investment bank itself may prepare the offering document with some assistance from the issuer and its counsel. However, in each case the offering memorandum would typically provide that all statements in that document are made only on authority of, and are attributed to, the issuer and would also state that the investment banks disclaim responsibility for such statements. Offering documents also almost always state that no statements made outside the offering document may be relied upon by any purchaser. Therefore, non issuer participants and advisors in the transaction could only be liable for public statements attributed to them which were not included in the prospectus or which are made on the express or implied authority of such private placement agent, underwriter, initial purchaser or other advisor. Since almost any statement included in the offering document would be a statement attributed to the issuer not the underwriters or placement agents, these secondary actors could not be responsible for any such statement under Rule 10b-5.

Securities Act Section 11
As noted above, the Janus holding does not affect statutory liability for non-issuers under Section 11 of the Securities Act, but that section applies only to registered public offerings. Section 11 specifies that underwriters, experts, directors of the issuer and signers of the registration statement are liable—subject to a “due diligence” defense—for material misstatements and omissions in Securities Act registration statements without any requirement that such persons “make” the misstatement.

Arguably the Janus case makes only the issuer subject to liability under Rule 10b-5 if the alleged misstatement is made in a registration statement, prospectus or other offering document that is filed by the issuer with the SEC. As we have seen, only the issuer is responsible for the statements in that document unless a statement is attributed to a third party expressly or by implication. Absent such attribution, this would make Section 11 and Section 12 the sole and exclusive private remedies against non-issuers (other than control persons) for misstatements included in Securities Act filings.

Securities Act Section 12(a)(2)
Section 12(a)(2) provides for liability for those who offer or sell a security by means of a written or oral communication that relates to a prospectus in a public offering which includes a material misstatement or omission. Under the Supreme Court decision in Gustafson v. Alloyd Co.,11 Section 12(a)(2) is not applicable to private offerings and is only applicable to registered public offerings and also to offerings exempt under Section 3 but not to offerings made under Section 4. Thus, Section 12 (a)(2) is not available against a placement agent or initial purchaser in a private placement or in secondary market transactions. Most Regulation D offerings and all Rule 144A sales and private placements are made under the exemption in Section 4
of the Securities Act. Plaintiffs could not have sued Janus Advisors under Section 12 (a)(2) which is generally not available to secondary market purchasers. And, this is true even though Janus Advisors, not Janus Fund, had the economic motive to permit the market timing trades due to the increased advisory fees those sales generated. Section 12(a)(2) liability would probably be limited to sales of Janus Fund shares which are always sold directly by the Janus Fund in a public offering.

**Exchange Act Section 20(b) – Indirect Statements**

Section 20(b) of the Exchange Act makes it unlawful to violate the Exchange Act “through or by means of any other person.” The *Janus* Court left open the possibility of “indirect” statements being attributed to a party other than the maker as a basis for liability. For example, if Party A speaks through Party B, but the statement is nevertheless attributed to Party A, Party A may have liability for the indirect statement under circumstances the *Janus* decision leaves open for further development by lower courts.

**Attribution**

As statements in a prospectus or offering memorandum are almost always explicitly attributed to the issuer (except for expertised portions or legal opinions or other third party reports on mineral or petroleum reserves and the like), and offering documents contain the only statements that the issuer permits purchasers to rely upon in connection with a securities offering, there most likely could not be statements that are attributed to anyone other than the issuer in the absence of an express indication to that effect. Of course an investment bank could make an explicit recommendation or public statement on its own authority in a research report or other public statement that could be actionable as a direct public statement. But for the overwhelming majority of public statements, including road show presentations and similar materials, the statements would not be attributed to the investment bank.12

Issuers currently expressly acknowledge responsibility for almost all statements in prospectuses and offering documents through a prominent legend in the forepart of the document. It remains to be seen whether issuers will attempt to reallocate attribution of some such statements to bankers, accountants, lawyers, industry research firms or other market participants in an effort to attribute Rule 10b-5 liability away from the issuer in certain cases. Bankers and other market participants can be expected to strongly resist any such efforts to attribute responsibility to them.

As noted above, other direct public statements made by a mutual fund advisor, distributor of securities or other third party outside the prospectus or SEC filings made under its own authority or otherwise attributed to it may still be subject to private Rule 10b-5 liability. However, most market professionals are careful not to make any statements under their own authority and expressly do not permit reliance on any statement so made or on any other statements not set forth in the prospectus.

**Statements Made by Executives Under Authority of the Issuer**

The *Janus* case could also affect the responsibility of executives of the issuer who make statements that are ultimately given under the authority of the issuer.
Statements of executive officers in the course of their employment can usually be attributed to the issuer. However, under Janus, one might expect that an executive is in a role similar to an outside advisor when the executive prepares a statement for inclusion in a prospectus and thus could not be held personally liable except as a controlling person or for statements made publicly under the executive’s personal authority outside the course of the executive’s employment. The Janus Court’s statement that a person “who prepares...a statement on behalf of another is not its maker” may be used to support the argument that executives cannot be held liable in future cases. We will have to see how this idea develops in the lower courts in the future.

**Rule 10b-5 Disclosure Letters from Attorneys**
As underwriters and initial purchasers can no longer be held primarily liable in private actions under Rule 10b-5 based on statements included in the issuer’s private placement offering documents that are not attributed to them, issuers may be expected to question whether underwriters have a continuing need to require Rule 10b-5 disclosure opinions in connection with private offerings or otherwise where Section 11 and Section 12(a)(2) liability under the Securities Act may not exist. It has been market practice for underwriters to require such opinions in large Rule 144A securities offerings made in the United States and also to receive accountants’ comfort letters in connection therewith. Following Janus, issuers can be expected to strengthen their resistance to underwriters’ requests for Rule 10b-5 opinions and comfort letters in an effort to reduce their transaction costs in Rule 144A offerings. As the SEC has continuing authority to bring actions in these cases (including aiding and abetting cases) and because there are significant reputational aspects to an investment bank distributing securities broadly to important institutions in the United States without doing customary due diligence, banks may and should remain hesitant to change their current procedures without careful analysis until lower courts more fully develop the limits of the protection afforded by Janus—which is, after all, a case that arose in the public mutual fund context—with respect to underwriter liability.

**Comfort Letters**
It will be interesting to see the reaction of the large accounting firms to the Janus case. Currently, accounting firms require representations from investment banking firms involved in distributing private offerings to the effect that the banks, in order to avoid liability under the Federal securities laws for misstatements and omissions in the offering documents, have a need to establish a due diligence defense equivalent to what they would have in a registered offering under the Securities Act. That no longer appears to be the case under Rule 10b-5 (although liability in—and therefore a defense to—SEC actions under Section 17(a) remains). If accounting firms decline to provide comfort letters in Rule 144A transactions because they believe there is no longer a legal reason for underwriters to receive them, that position would result in a major departure for investment banking firms from their current due diligence procedures in large U.S. targeted institutional offerings.

**Conclusion**
The Janus case effectively eliminates primary liability under Rule 10b-5 for material misstatements in offering documents under Rule 10b-5 for anyone but the issuer. Secondary actors can no longer be held primarily liable under Rule 10b-5 unless (1)
they are control persons under Section 20(a) of the Exchange Act or Section 15 of the Securities Act, (2) the material misstatement was expressly or impliedly attributed to the secondary actor, (3) the secondary actor makes the misstatement indirectly under circumstances in which the misstatement can be attributed to it, or (4) the secondary actor makes the statement publicly under its own authority. After Janus, Central Bank of Denver and Morrison, a private right of action under Rule 10b-5 based on alleged misstatements or omissions in issuer prospectuses, offering documents, statements, publications or filings will be limited to actions against solvent issuers on securities transactions by the plaintiff inside the United States.

This result effectively makes Section 11 and Section 12(a)(2) of the Securities Act the exclusive private remedies for actions against secondary actors based on misstatements in offering documents filed under the Securities Act. In the public mutual fund context, this means that shareholders are left to sue the fund they invested in under Rule 10b-5. In the private fund arena, control person liability may still have some vitality. In the private placement context, it generally means that only the issuer may be sued. In the securitization arena, Janus could leave security holders with no remedy except against the special purpose vehicle in which they invested.

The Janus case is good news for investment banks, fund advisors, accountants, lawyers, service providers and all other secondary actors who assist in the preparation of disclosure documents for securities offerings. It is very bad news for plaintiffs’ class action lawyers and investors in companies that have gone bankrupt or become insolvent who are searching for other deep pockets among secondary actors. Unless Congress acts to overrule Janus, those other deep pockets may now be irrevocably closed to them.

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1 Janus Fund shareholders, on the other hand, could have sued and presumably prevailed under Section 11 of the Securities Act but would have had difficulty proving damages because the amount and effect of the market timing trades would be very difficult to establish with any precision. Also, as Janus Fund shares were sold at net asset value, the share prices would not have fully reflected the reputational and financial damage suffered by Janus Capital due to the market timing scandal.

2 As the parent company in most public holding company structures is generally the listed company, the parent company would be responsible for statements in its prospectus, including those regarding its subsidiaries. If a publicly traded subsidiary were the issuer, then presumably that issuer would be the responsible party under Janus for statements in that issuer’s prospectus with regard to its parent as well as its own subsidiaries. Of course, in this context, the parent company would be separately liable for its own public statements and filings.

3 Because offshore and onshore private equity funds and hedge funds have many different possible structural variations it is very difficult to make general statements about the impact of Janus on private funds. Some private funds may wish to strengthen the independence of fund boards to try to take advantage of Janus; other sponsors may simply be happy to concede the controlling person liability they probably already thought they had. In any case, the many possible permutations of private fund structures under Janus are beyond the scope of this article.

4 Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164 (1994) held that there is no private right of action under Rule 10b-5 against aiders and abettors of a primary Rule 10b-
5 violation. The SEC may pursue aiders and abettors in enforcement actions, but private parties may not.  

5 Stoneridge Investment Partners, L.L.C. v. Scientific-Atlanta, Inc., 522 U.S. 148 (2008) held that customer and supplier entities that cooperated with a cable television company in transactions allowing it to falsify the cable company’s financial statements could not be held accountable under Rule 10b-5.  

6 The losses at the Janus Capital level were magnified because most of Janus Capital’s revenues consisted of management fees paid to Janus Advisors. The Janus Fund shareholders were harmed less as Janus Fund shares are sold at net asset value.  

7 The Court’s analysis ignored the practical operational control held by Janus Advisors and seems to confusingly merge concepts of control with those involved in establishing an action for disregard of a corporate entity or “piercing the corporate veil.”  

8 In addition, the Department of Justice may institute criminal proceedings for intentional violations. The SEC may also bring actions against others who “aid and abet” violations of Rule 10b-5 if they provide substantial assistance to others in committing the violation. As noted above, the language of Section 17(a) is very similar to that of Rule 10b-5. However, it also does not generally require proof of the defendant’s scienter. Instead, negligence in disclosure may suffice as a basis for imposing liability under Section 17(a). Also, for obvious reasons, Section 17(a) does not require proof of reliance by the SEC. Thus the elements of a Section 17(a) action are far easier for the SEC to establish than the elements of a private Rule 10b-5 suit.  


11 Gustafson v. Alloyd Company, Inc., 513 U.S. 561 (1995) which held that Section 12(a)(2) of the Securities Act is not applicable to transactions in securities that are exempt under Section 4, such as private placements, because no “prospectus” (a term which the Court interpreted to be limited to documents used in the Securities Act public offerings, or offerings exempt under Section 3) is used in such sales.  

12 Underwriters typically provide in underwriting agreements that the only statements attributable to them concern their name and address and the amount of the concession or reallowance in a public equity offering.  

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