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Outside Service Providers Are Not Liable Under Federal Securities Laws, Says US Supreme Court

Can an investment adviser be held liable in a private action under Securities and Exchange Commission (SEC) Rule 10b-5 for false statements included in its clients' mutual funds' prospectuses? On June 13, 2011 the US Supreme Court said "no" in [*Janus Capital Group, Inc. v. First Derivative Traders*](#). That answer brought a huge sigh of relief from not only investment advisers but also other outside professional service providers.

Background

Janus Capital Group, Inc. (JCG) is a publicly traded company that created the Janus family of mutual funds, which are organized in a business trust as the Janus Investment Fund. The Janus Investment Fund retained JCG's wholly owned subsidiary, Janus Capital Management LLC (JCM), to serve as its investment adviser. JCG, which issued prospectuses, was sued in federal district court, along with JCM, on allegations that both entities violated federal securities laws because statements in prospectuses for certain individual Janus funds were misleading.

The district court dismissed the case, rejecting the argument that JCM could be liable whether or not it drafted the misleading prospectuses. The US Court of Appeals for the Fourth Circuit reversed, holding that "although the individual fund prospectuses are unattributed on their face, the clear essence of

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Contacts:

[Joseph C. Weinstein](#)
+1.216.479.8426

[Joseph P. Rodgers](#)
+1.216.479.8465

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plaintiffs' complaint is that JCG and JCM helped draft the misleading prospectuses."

Supreme Court Weighs In With Bright-Line Rule

The Supreme Court granted *certiorari* to address whether JCM, as an advisor, could be held liable in a private securities action for false statements included in the prospectuses.

Justice Thomas delivered the Court's opinion, which Justices Roberts, Scalia, Kennedy and Alito joined. The Court focused on the word "make." Rule 10b-5, promulgated by the SEC pursuant to authority granted under §10(b) of the Securities Exchange Act of 1934, prohibits "*mak[ing]* any untrue statement of a material fact" in connection with the purchase or sale of securities.

According to the Court, "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. . . . One who prepares or publishes a statement on behalf of another is not its maker." The Court looked to speechwriting for comparison, noting this "rule might best be exemplified by the relationship between a speechwriter and a speaker. Even when a speechwriter 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."

The Court rejected the argument that both JCM and JCG might have "made" the misleading statements within the meaning of Rule 10b-5 because JCM was significantly involved in preparing the prospectuses: "This assistance, subject to the ultimate control of Janus Investment Fund, does not mean that JCM 'made' any statements in the prospectuses. Although JCM, like a speechwriter, 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."

Had the Court not created much needed clarity with a bright-line rule, many service providers – accountants, bankers, lawyers, investment advisers and the like – who are involved in preparing documents disseminated to investors would have remained at risk. The Court had previously held that there is no secondary "aiding and abetting" liability under Rule 10b-5 against those who do not "make" a statement, but contribute "substantial assistance." And now, given the Court's opinion in

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Janus, service providers can rest even easier, with a better understanding of what it actually means to "make" a statement under Rule 10b-5.

If you have questions about this Alert, the issues implicated by the *Janus* case or securities litigation more generally, please contact Joe Weinstein, chair of the Squire Sanders [Securities Litigation practice](#), or Joe Rodgers, a principal in the Squire Sanders Cleveland office.



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