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Lies Without Liars? *Janus Capital* and Conservative Securities Jurisprudence

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Lies Without Liars? *Janus Capital* and Conservative Securities Jurisprudence

*Donald C. Langevoort*

In *Janus Capital Group Inc. v. First Derivative Traders*, the Supreme Court held that a mutual fund advisory firm did not “make” a misrepresentation—even though it allegedly created the lie in question—because the prospectus in which the lie appeared was filed by and in the name of the mutual fund, not the adviser or its publicly-held parent company. According to the Court, the word “make” in Rule 10b-5 refers only to a statement by the person with ultimate legal authority over the filing and public dissemination of the document. In so holding, Justice Clarence Thomas joined a seemingly short list of judges who suggest that legal formalism is a particularly good weapon with which to fight securities fraud.

To some, *Janus* may be just another float in the current Court’s long pro-business parade, celebrating its contempt for securities and other kinds of class actions. But that reading doesn’t quite work. *Janus* was one of three securities class action cases decided in 2011, the other two of which held for the plaintiffs in ways that disappointed the defense-side community. *Matrixx Inc. v. Siricusano*, for instance, passed on an opportunity to rein in the otherwise fact-intensive approach to materiality on which defense motions to dismiss often stumble, and applied the heightened pleading requirement for scienter fairly liberally.

*Janus*’ punch line is the “ultimate authority” test, applied formally. But its defining image is the distinction between a speaker and a speechwriter: only the former, according to the Court, can reasonably be deemed the maker of any misrepresentation contained therein. Even if all the ideas—including any deliberate deception—come from the speechwriter, he is

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* Thomas Aquinas Reynolds Professor of Law, Georgetown University Law Center. My thanks to Bob Thompson, Victoria Nourse ... for helpful comments, and to Min Choi and Elaine Ellis for excellent research assistance.

1 131 S.Ct. 2296 (2011).


3 131 S.Ct. at 2302.
still not the speech’s maker and so bears no primary liability for the fraud. That means that we might well have a deceptive speech with no fraud liability at all. If the speaker does not know of or recklessly disregard the fraud, she has no scienter. The person with the scienter isn’t the maker. So far as Rule 10b-5 is concerned, we can have lies without liars.

In terms of any purposive effort to fight securities fraud, that simply cannot be right. There is no reason derivable from the language or history of Rule 10b-5 that the SEC would ever have intended for its words to have such limited effect, failing to reach the person or entity with the greatest causal responsibility for a misrepresentation or actionable omission. The puzzle of Janus is how the majority came to the conclusion that Rule 10b-5 means otherwise. As noted earlier, it has to be something more than just hostility to private securities class actions, or reflexively doing the business lobby’s bidding.

My Essay tries to answer that question. I do not presume to know what Justice Thomas was thinking but doubt that it matters much for how the opinion is read, given postmodern sensibilities. The Janus opinion is a text woven from many different threads, including a basketful handed to the Court by the skilled appellate advocates who represented the business interests and know particularly well how to speak to the current justices. Understanding it requires that we enter into the interpretive milieu of conservative public law jurisprudence. While its bold outlines—textualism and strict interpretation—are familiar enough to most securities lawyers and academics, the nuances

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5 A similar point is made by Norman Poser, who criticizes Janus for tolerating a right without an effective remedy. See Norman S. Poser, The Supreme Court’s Janus Capital Case, 44 REV. SEC. & COMMOD. REG. 205 (2011).

6 Along similar lines, see A.C. Pritchard, Securities Law in the Roberts Court: Agenda or Indifference?, 37 J. CORP. L. 105, 135-38 (2011).

7 Petitioners were represented (quite effectively, obviously) by Mark Perry of Gibson, Dunn & Crutcher, who after law school at the University of Chicago clerked for Judge Alex Kozinski on the Ninth Circuit and Justice Sandra Day O’Connor on the Supreme Court. For an exploration of the specialized Supreme Court bar, see Richard Lazarus, Advocacy Matters Before and Within the U.S. Supreme Court: Transforming the Court by Transforming the Bar, 90 GEO. L.J. 1487 (2008). Lazarus shows that advocacy before the Supreme Court is increasingly in the hands of a relatively small number of specialists, and that—even though the political affiliations of the lawyers are on both sides—this expertise tilts strongly toward aiding business interests because the advocates’ firms do extensive corporate work, and thus are commonly conflicted out from representing challengers.
within this genre are not of much interest. Whatever their ideological preferences, those who work entirely in the supposedly “private law” domain of corporate-securities law seem instinctively to evaluate legal issues in terms of instrumental outcomes—good or bad for whatever the preferred policy reference, usually investor protection or some form of efficiency. Heated disagreements arise, but they remain debates about optimal strategy. But conservative interpretivism can be deliberately indifferent to policy effects; even seemingly absurd consequences may not necessarily be a reason to depart from a faithfully text-driven reading of a statute or rule.\footnote{See John Manning, The Absurdity Doctrine, 116 HARV. L. REV. 2387 (2003); see also Frank Easterbrook, Statutes’ Domains, 50 U. CHI. L. REV. 533 (1983).} Out of this milieu, \textit{Janus} reflects a distinct interpretive style, joined with a simplistic vision of corporate personhood more akin to the Court’s recent decision in the \textit{Citizens United} case—dealing with the First Amendment rights of corporations—than to many of its securities law precursors.\footnote{Citizens United v. FEC, 130 S.Ct. 876 (2010). There has been an outpouring of commentary on the corporate law assumptions underlying the strong grant of First Amendment protection to corporations, including assumptions that suggest a superficial impression of corporate personhood. E.g., Reuven Avi-Yonah, \textit{Citizens United and the Corporate Form}, 2010 WISC. L. REV. 999; Anne Tucker, \textit{Flawed Assumptions: A Corporate Law Analysis of Free Speech and Corporate Personhood in Citizens United}, 61 CASE WESTERN L. REV. 495 (2011). For an article connecting \textit{Janus} and \textit{Citizens United}, see Virginia Harper Ho, \textit{Theories of Corporate Groups: Corporate Identity Reconceived}, 42 SETON HALL L. REV. --- (forthcoming, 2012) } 

My aim here is not to take on the myriad contemporary public law debates about textual interpretation as applied to administrative agency rule-making so much as just to suggest that understanding precedent like \textit{Janus} requires a wider lens than securities academics normally use. Through that lens, we might see better how and why the case law has come to be, and perhaps more importantly, other taken-for-granted issues that might be contested.

\section{I. Reading \textit{Janus} Carefully}

The question presented in \textit{Janus} was whether the mutual fund advisor—Janus Capital Management (JCM)—rather than the mutual fund itself—Janis Investment Fund (JIF)—made the misrepresentation that appeared in JIF’s prospectuses.\footnote{To be clear, defendants contested that JCM controlled the preparation of the prospectus, even though in-house lawyers employed by JCM did the drafting, emphasizing that the board of trustees of JIF met to review the filing and were represented by separate independent counsel in the review process. See Brief, supra.} From that way of styling the question, one would think that the lawsuit here was being brought by JIF investors who say they...
relied to their detriment on the falsity.\textsuperscript{11} But that was not how the case arose at all, which is important to reading the opinion critically. This was a fraud-on-the-market class action brought by investors in a third entity—Janus Capital Group (JCG), JCM’s publicly-traded parent company—after JCM was sanctioned by federal and state authorities for breach of fiduciary duty relating to the market timing scandals of the mid-2000’s.\textsuperscript{12} The penalties and attendant reputational damage from its subsidiary’s behavior caused JCG’s stock price to drop, for which the class-period investors wanted compensation. The only supposed misrepresentation was in JIF’s prospectuses.

This one-off nature of the case is extremely important. This is the kind of litigation where the claim is based on a failure to reveal a breach of fiduciary duty directed at third parties (JIF shareholders). Yet under the securities laws, there is no automatic duty to reveal cheating or other fiduciary breaches.\textsuperscript{13} So, plaintiffs had to scour what was said by JCG to find statements made materially misleading by the omission of the cheating. Apparently, plaintiffs could find nothing of the sort in any of JCG’s own disclosures or publicity. All they could find were the allegedly misleading statements in JIF’s prospectuses, which were disclosures made to mutual fund investors considering an investment in JIF to use.

In that sense, the claim by public company investors that what was briefly stated in JIF’s mutual fund prospectuses distorted the market price of JCG securities was something of a stretch. True, if the prospectus had revealed JCM’s inclination to allow market timing by favored fund investors, there might have been unfavorable publicity and an adverse price effect. But since there was no duty to reveal that, liability could have been avoided simply by silence or vagueness. So in a sense, plaintiffs were fortunate to find something in a document for which they were not the intended beneficiaries—otherwise they have no case under Rule 10b-5, even assuming that the market timing misbehavior was real. I suspect that the Janus Court sensed that there was some reaching here, which easily could affect how it viewed the question of who “made” the statements in the documents plaintiffs found.

In other work, I have stressed that the presumption of reliance that supports the fraud-on-the-market theory is an entitlement—an act of juristic

\textsuperscript{11} In fact, such an action was brought and settled. Defendants before the Court acknowledged that JIF shareholder had a legitimate cause of action because, as the district court found, JCM had an independent fiduciary disclosure duty owed at least indirectly to JIF’s shareholders. See Transcript, supra.

\textsuperscript{12} 131 S.Ct. at 2300. On the market impact of these kinds of cases, see Stephen Choi & Marcel Kahan, \textit{The Market Penalty for Mutual Fund Scandals}, 87 B.U. L. Rev. 1021 (2007).

\textsuperscript{13} See \textsc{James D. Cox et al.}, \textsc{Securities Regulation: Cases and Materials} 653-656 (6th ed. 2009); Robert B. Thompson & Hillary A. Sale, \textit{Securities Fraud as Corporate Governance: Reflections on Federalism}, 56 \textsc{Vand. L. Rev.} 859 (2003).
afforded to investors in order to promote the truth-telling goals of the securities laws. But any such entitlement goes only so far as courts think necessary or just. One can easily see how the Court might wonder about the necessity of protecting reliance by a class of investors on a prospectus issued for the benefit of an entirely different group, especially when that document appears to reflect the sincere (if inaccurate) belief on the part of the directors of the fund itself that what was being said about anti-timing redemption policy was true. This is the odd context in which Janus was decided, and was heavily stressed by JCM’s counsel at oral argument.

If that is right, then Janus must be read as a fraud-on-the-market case, with all the baggage that implies. And that takes us to the biggest mystery about the Court’s opinion. The opinion concentrates on a single word in Rule 10b-5, and as such appears to be interpreting the Rule itself. If so, it defines that word without regard to the party bringing suit—private plaintiff, the SEC or a criminal prosecutor. Yet the explicit framing of the question by the Court is “whether [JCM] can be held liable in a private action” under Rule 10b-5. Its interpretive methodology then repeatedly invokes the (fairly recent) direction that the courts are to “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.” And it refuses to defer to the SEC’s reading of the word make because no deference is owed “regarding the private right of action.” So is the Court construing the Rule or just the right of action?

I will have more to say about this later on; for now note that most—though not all—lower courts have applied Janus to SEC enforcement actions at least “arguendo,” often with the Commission’s lawyers not contesting its applicability. Maybe this will change, but historical context is important. In

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15 131 S.Ct. at 2301 (emphasis added).
16 Id. at 2302 (emphasis added).
17 Id. at 2303 n. 8 (emphasis added). This is especially important because the Court has readily deferred to the SEC’s own construal of the language of Rule 10b-5 outside the private litigation context, assuming reasonableness in light of the statutory grant of authority. See SEC v. Zandford, 535 U.S. 813, 819-20 (2002).
18 E.g., SEC v. Landberg, 2011 WL 5116512 (S.D.N.Y. 2011); SEC v. Kelly, 2011 WL 4431161 (S.D.N.Y. 2011); but see SEC v. Boock, Fed. Sec. L. Rep. (CCH) par. 96,584 (S.D.N.Y. 2011);“Wong also does not explain why Janus Capital, which found that the wording of the relevant statutes did not permit private actors to sue those who may be liable for misstatements of others in violation of Rule 10b-5, has any bearing on the SEC’s capacity to sue secondary violators . . . “); SEC v. Pentagon Cap. Mgt. PLC, 2012 U.S. Dist. LEXIS 18504 (S.D.N.Y 2012)(language in Janus specifically directed at private litigation, not the SEC). SEC Commissioner Elisse Walter discussed Janus critically in a recent speech without contesting its application to the Commission’s enforcement work. See REMARKS BEFORE THE
two other Supreme Court cases involving different aspects of Rule 10b-5, *Central Bank of Denver* and *Morrison*, similarly restrictive decisions were followed very quickly by Congressional determinations to leave the Court’s rulings as applied to private litigation but reestablish the SEC’s broader enforcement authority. Reading cases like these as not limited to private litigation, notwithstanding extensive language in the opinion to the contrary, may be becoming a habit.

If *Janus* is an authoritative reading of Rule 10b-5’s text, however, its interpretive methodology is jarring. The Court essentially offers four reasons for its narrow construction of “make.” The first is a glancing reference to the dictionary, which is unhelpful because there are multiple possible definitions. The second is its own common sense of the term, wherein we get the speaker-speechwriter distinction. The third is precedent—interpretive guidance drawn from *Central Bank* and *Stoneridge*. Fourth is the need to confine implied rights of action. Note what the Court does not do—ask what a reasonable person would think the SEC meant to accomplish with its chosen language. Any sense of original intent is ignored, and the interpretation comes to turn heavily on a policy (confining private litigation) that could not have existed at the time the SEC’s words were written, because there was no private litigation under Rule 10b-5 until nearly a decade after its adoption. Unless *Janus* is read as limited to private actions, what Court is doing is giving policy-based meaning to a word that could not possibly have contemplated that policy when it was written by the SEC in 1942. It would be a form of anti-originalist interpretation of the sort that usually provokes conservative revulsion.

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20 *Morrison v. National Australia Bank*, 130 S.Ct. 2869 (2010). *Morrison* applied a “presumption against extraterritoriality” to hold that Rule 10b-5 does not apply to transactions occurring outside the borders of the United States.
21 See COX ET AL., at 662-63. Similarly, it would be strange to construe the word “make” in light of the teachings of *Central Bank* and *Stoneridge*, neither of which involved the use of that word. Here again, the interpretive methodology makes more sense as to the scope of the private right of action for misstatements made by a defendant, which those two cases plainly addressed.
For these reasons—precedent, habit and occasional language in the opinion to the contrary—I prefer to read the Court’s holding literally: we are being told what “make” means in the context of private securities litigation under Rule 10b-5, leaving open how it is to be construed in the context of public enforcement. As we shall see later on, this is not an insignificant matter, though it might not be that important in the particular context of this case. Very much worth noting, though strangely unmentioned in the Court’s opinion, is that the SEC did take enforcement action against JCM in 2004, which settled.23 As styled by the SEC, the complaint did not invoke 10b-5 at all. Instead, the claims are all under the Investment Advisors Act of 1940 (with its distinctive antifraud prohibition) and the Investment Company Act of 1940. On the other hand, the Commission’s action claims that JCM actually filed the misleading prospectuses for JIF24—a fact that was particularly important to plaintiff’s case, but which Justice Thomas largely throws aside.

That takes us to a final introductory point, perhaps obvious. If, contrary to my reading, what was being construed was the SEC’s chosen wording, then the Commission can reverse Janus simply by amending its own rule to be clearer about its meaning, assuming that it stays faithful enough to the statutory grant of authority in Section 10(b).25 Indeed, there is some sense in Janus—as well as in Central Bank and Morrison, to which it bears substantial affinity in this regard—that the Court is adopting a penalty default interpretation, akin to contra proferentem in contract law, simply to provoke the Commission or Congress to clarify its intent. That would take us into relatively new territory in the law of statutory (or administrative rule) interpretation, though it is not all that far removed from a conservative vision of separation of powers.26

On the other hand, if Janus really is just about the scope of liability in the implied right of action, the message is different. While there is some debate about the SEC’s authority with respect to private rights, the impression

24 Id. at par. 21.
25 Adam Pritchard sees the presence of the twin Section 20 provisions (see pp. --- infra) as impediments to the Commission’s freedom here. See Pritchard, supra, at 137. I am less convinced, but the point is well taken. On the text and history of Congress’ broad grant of authority in Section 10(b), see Steven Thel, The Original Conception of Section 10(b) of the Securities Exchange Act, 42 STAN. L. REV. 385 (1990).
26 There is a scholarly literature addressing the use of penalty defaults in statutory interpretation. See, e.g., Einer Elhauge, Preference Eliciting Statutory Default Rules, 102 COLUM. L. REV. 2162 (2002); Scott Baker & Kimberly D. Krawiec, The Penalty Default Canon, 72 GEO. WASH. L. REV. 663 (2004). At oral argument in Janus, counsel for petitioners opened with the point that Congress has consistently responded to prior Court decisions when it wished to change the law—the only argument he was able to make before questions began. See Transcript of Oral Argument, supra, at 3.
given by the Court here and in other recent cases is that the responsibility to adopt a new private litigation standard if it wishes is for Congress, not the SEC.\textsuperscript{27} That expanding private rights is unlikely to happen in this political environment is of no concern to judges who are committed to a vision of the proper scope of judicial authority rather than what will produce optimal investor protection or capital formation.

II. THE ROAD TO \textit{JANUS}

1. \textit{Central Bank} and \textit{Stoneridge}

Justice Thomas’ opinion tries to justify the narrow reading of “make” as implicit in two prior decisions dealing with the secondary liability question under Rule 10b-5, \textit{Central Bank} and the more recent \textit{Stoneridge} decision.\textsuperscript{28} Justice Breyer’s dissent shows the unpersuasiveness of this argument from precedent, noting that \textit{Central Bank} was entirely about aiding and abetting (which it rejected) as distinct from the kind of primary liability claim being made in \textit{Janus}, and \textit{Stoneridge} was solely about how private plaintiffs demonstrate reliance on an alleged misrepresentation—not primary liability at all.

I have nothing much to add to Breyer’s point about \textit{Central Bank} itself. \textit{Stoneridge} bears more emphasis, however. \textit{Stoneridge} was a surprising turn in the law—a case that people thought would finally address the standard for primary liability as from among the various tests—attribute, creator, substantial participant—that the lower courts had derived to deal with the question left open after \textit{Central Bank}. Attribution was the odds-on, defendant-friendly favorite—a standard that required that the victim of the fraud be able to attribute what was said to be misleading to the particular defendant.\textsuperscript{29}

The surprise was that the Court addressed the issue solely in terms of reliance instead of primary liability.\textsuperscript{30} A prime mover behind this shift appears to have been the Solicitor General, who would presumably have an interest in protecting government enforcement actions, civil and criminal, from a restrictive reading of Rule 10b-5. Neither the SEC nor criminal prosecutors have to prove reliance, and so the turn had the effect of making the case one

\textsuperscript{27} As will be discussed infra, the Commission could work within \textit{Janus}’ framework to expand liability by requiring more public certifications of filings by significant behind the scenes actors, like mutual fund advisors.


\textsuperscript{29} See, e.g., Wright v. Ernst & Young LLP, 152 F.3d 169 (2d Cir. 1998). For a review of various formulations, see COX ET AL., supra, at 769-72.

solely about private litigation. It is hard to imagine any other reason for not treating the case as raising the more palpable issue of whether the defendants (Scientific-Atlanta and Motorola) had “made” the misrepresentations in question.

The SG’s brief in *Stoneridge* is telling. The plaintiff community remembers it as political anathema: a last-minute repudiation by the Bush Administration of the SEC’s decision to argue on the plaintiffs’ side in that case. However, the first portion of the SG’s brief is a remarkably plaintiff-friendly effort to protect Rule 10b-5 from the Eighth Circuit’s oddly narrow reading on deception through non-verbal acts. After explaining why non-verbal deception is well within the scope of the Rule’s coverage, the brief says that what the defendant vendors did was a form of deception prohibited by Section 10(b): their obfuscation and falsifications misled the issuer’s auditor and others (i.e., directors) not in on the scheme. In other words, defendants’ conduct “constituted a deceptive device or contrivance because it not only was likely to but allegedly did mislead Charter’s outside accountant, Arthur Andersen, into believing that the two sets of transactions [at issue in the fraud] were discrete.” The brief explains why this interpretation of Section 10(b) is entirely consistent with *Central Bank*. Only after giving this wider scope to primary liability did the government then switch sides and argue that private plaintiffs’ case failed for lack of actionable reliance.

The Court in *Stoneridge* agreed with the government’s argument about non-verbal deception without taking the further step of agreeing that what the vendors did was deceptive vis-à-vis the independent auditors. But the argument as to what deception means in a case like this was styled in a way faithful to the Solicitor General’s conservative commitment: it is highly textualist, to the point (lost on many readers, I suspect) that the entire argument in the brief is grounded in the wording of Section 10(b), not Rule 10b-5.

The interesting question with respect to *Janus* would be why the case against JCM shouldn’t have been that it made a misrepresentation (or actionable omission) to JIF and its independent directors when it provided the information regarding timing policy and failed to reveal its true intentions? That would be a 10b-5 violation so long as the deception was “in connection with the purchase or sale of a security,” which is generally seen as satisfied the misstatement was reasonably calculated to influence investors—as here, where

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31 See BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING AFFIRMANCE, STONERIDGE INVESTMENT PARTNERS LLC v. SCIENTIFIC-ATLANTA INC., August 2007.
32 Id. at 17.
33 The issue was addressed by JCM in both the brief and oral argument, stressing simply that plaintiffs had failed to plead the case this way, and that any effort to recover by JCG investors would fail because of lack of duty. See pp. --- infra.
the information was made part of a statutory prospectus for mutual fund investors. 34 If that alternative styling of plaintiffs’ claim in Janus would be enough to avoid Justice Thomas’ holding, then maybe the case is not so troubling—a harsh outcome due to a pleading error by the plaintiffs and their lawyers. As we shall see, however, similar cases encountering Janus’ reasoning might not so easily plead their way around it.

We will come back to all of this in Part III. But for now, the crucial point is what happens if a court were to accept this alternative pleading of the 10b-5 claim in a private class action? Assuming the elements of fraud, materiality and scienter are all properly alleged, then the issue becomes one of reliance, as per Stoneridge. And although there are many possible readings of that decision, the test that Justice Kennedy uses asks whether the plaintiffs’ reliance is “too remote” or “too attenuated” from the lie to justify recovery, 35 something akin to a proximate cause inquiry. In explaining why the vendors’ lies in the form of bogus invoices, etc. were too remote and attenuated, he notes that these vendors were commercial actors, not part of the securities business, and never had the sort of involvement in, much less control over, the issuer’s financial reporting process to make the fraud “necessary or inevitable.” 36

Were that same standard to be applied to Janus, one could see a reasonable argument for the plaintiffs. 37 JCM had practical control over JIF’s disclosures, particularly as to the market timing practices over which it had exclusive knowledge. After all, letting late trading and market timing occur is the adviser’s (and the affiliated brokers’) business. And these were registered securities professionals, subject to intense federal and state regulation—not commercial salespeople. As a matter of proximate cause, the link between the JCM’s alleged lie and the resulting disclosure was tightly coupled, if there was any appreciable distance at all.

35 552 U.S. at 159.
36 Id. at 161.
37 For a discussion of this potential in Janus, see Langevoort, Reading Stoneridge, supra, at 2161-65. To be sure, lower courts after Stoneridge did not take up this potential, largely sticking closely to the attribution standard. E.g., Pacific Investment Management Co. v. Mayer Brown LLP (2d Cir. 2010). Although Janus clearly embraces a strong version of an attribution requirement, it is in the context of answering whether JCM bore responsibility for what JIF said in its prospectuses. It avoids addressing the indirect fraud possibility. 131 S.Ct. at 2304 n. 9 (“We do not address whether and in what circumstances statements [such as those from JCM to JIF] would qualify as ‘public’”).
Janus, then, can actually be read as inconsistent with the analytical structure of Stoneridge, and renders the analysis there meaningless if applied so as to hold that actors like either JCM or the set top vendors never even “made” a misstatement in the first place. Justice Kennedy joined the majority in Janus; whether he realized that his very different and more nuanced opinion in that earlier case was quickly being rendered obsolete is unclear.

2. A Longer History

If we stop here, then, there is still no persuasive explanation for the outcome in Janus, at least by reference to contemporary precedent. But I think we can go back further in history to explain how we get there, by tracing the conservative impulse as it applies to these issues under Rule 10b-5.

As noted earlier, conservative ideology is generally seen as embodied in the law and economics movement that gained momentum in the late 1970’s. That movement has indeed been extremely influential, including its surprising intellectual support for fraud-on-the-market litigation in its early days. But neoclassical law and economics is policy-oriented, a form of instrumentalism that tends to favor market solutions over legal interventions on efficiency grounds.

In the case law under Rule 10b-5, the instrumentalist form of conservatism has been amply visible—we see it vividly in the references to business competitiveness and the plague of litigation in Central Bank and Stoneridge, and (with a little less rhetorical flourish) in Janus, too. That makes it seem like it is the driving force, infuriating those who doubt the assumptions or inferences from which orthodox economics draws. But my sense is that the form of conservatism that looks to separation of powers rather than economic efficiency is largely ignored by those who do not share a commitment to it, and who instinctively look to the courts to help carry out good public policy. Janus has its roots more deeply in that vision.

The idea that courts erred in recognizing aiding and abetting liability gained intellectual currency in 1981 when Dan Fischel published a law review article so suggesting, explicitly relied upon a little more than a decade later in

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The article repays careful attention, partly because it bears none of the markers of the sophisticated law and economics on which Fischel was contemporaneously working (and which would soon mark his collaboration with Frank Easterbrook at the University of Chicago). Rather, the article begins with the blunt claim that the justification for implied private rights of action had now been repudiated by the Supreme Court. While the Supreme Court was allowing the implied right under Rule 10b-5 to remain for a variety of pragmatic reasons, he treats it as the illegitimate child of judicial activism, a jurisprudential bastard. Hence the need to confine it to a carefully limited space, regardless of policy arguments for or against the public’s interest in compensation or deterrence, until Congress does its job and creates express rights of action. While it may seem odd that Fischel was at the same time fervently embracing fraud-on-the-market litigation, that is somewhat more understandable when seen as a way of transferring decision-making power from unruly judges and juries to experts in econometrics, who could satisfactorily resolve the hard issues of materiality, reliance and causation.

The core of Fischel’s law review argument was that Rule 10b-5 was circumscribed by the text of Section 10(b) and that only tangible evidence of legislative intent to create liability had any legitimacy in justifying recovery beyond the explicit confines of the words in the statute. Legislative silence or inaction in the face of opportunity to address an issue means no statutory reach, unless there is a clear direction to the administering agency to fill the gap. So, he argued that three widely-embraced doctrines—aiding and abetting, conspiracy, and respondeat superior—had to go even if the core of antifraud liability survived.

Fischel addressed whether those doctrines had to be excised even as to SEC enforcement, for which there is express statutory authority. Yes, he said, because a corollary of the conservative approach is structuralist restraint: when Congress has addressed an issue somewhere in the statute, the political choices made therein should not be upset by inventiveness elsewhere, particularly when courts are doing the inventing. And, Fischel stressed, Congress came to a highly political but nonetheless dispositive conclusion in

defendant greater and emphasizes that careful attention should be given to the identification of the elements required for securities liability"). Ruder, however, was more interested in reining in secondary liability than dismissing it as illegitimate, presumably because he was writing in the day when implied rights were still being embraced. For a tribute to Ruder’s influence, see Douglas Branson, Prescience and Vindication: Federal Courts, Rule 10b-5 and the Work of David S. Ruder, 85 NW. U. L. REV. 613 (1991).

40 See Langevoort, Basic at Twenty, supra, at 178-79.
41 69 CAL. L. REV. at 99-100.
Section 20(a) about when—and when not—to impose liability on secondary actors.  

We can debate the accuracy of Fischel’s history with respect to Section 20. But the instinct comes through clearly enough in Janus. For all practical purposes, plaintiffs were arguing that JCM controlled JIF’s prospectus disclosures. If so, someone channeling Fischel would readily say—as Justice Thomas does later in the opinion—that Section 20 is the right place to look to impose liability or not. In other words, courts should not recognize any direct liability under Rule 10b-5 that might frustrate the political bargain in this portion of the statute. As such, Justice Breyer’s dissent—saying that we should disregard Section 20(a) because it will not produce liability unless someone else is primarily liable—misses the point.

I am not at all persuaded by this; to me, there is a big difference between control over a violator and control that deliberately causes a violation, with the latter fitting snugly enough within Section 10(b)’s grant of rulemaking authority. But the conservative impulse does not rest entirely on the shadow of Section 20 as a reason to be suspicious of plaintiff’s argument in Janus. There is another sore spot, and that is with respect to the statutory requirement that any deception be “in connection with” the purchase or sale of a security. The textual ambiguity is palpable: does the need to connect the fraud to a securities transaction mean that the defendant must have been buying or selling, or can it be something broader? The Second Circuit in SEC v. Texas Gulf Sulphur famously stressed the latter in the late 1960’s—any misstatement or omission violates Rule 10b-5 if reasonably calculated to influence investors, whether or not the defendant is itself trading. That led directly to the invention of the fraud-on-the-market class action. But while the total abandonment of privity won the day, it was a frustration to conservative critics. Fischel touches on

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42 He emphasizes that original language for secondary participants was broader but this effort was resisted by the business community, leading to the language of Section 20 as a political compromise. Id. at 98-99.
44 See text accompanying note --- supra. That was soon followed by the Supreme Court’s Bankers Life case, 404 U.S. 6 (1971)—perhaps the height of tort-style reasoning, in a way that made the in connection with requirement almost an afterthought. For an exploration, see James D. Cox, Fraud is in the Eye of the Beholder: Rule 10b-5’s Application to Corporate Mismanagement, 47 N.Y.U. L. REV. 647 (1972).
45 David Ruder’s view here about the dangers associated with the abandonment of privity reflect this unease. See David S. Ruder, Texas Gulf Sulphur—The Second Round: Privity and State of Mind in Rule 10b-5 Purchase and Sale Cases, 63 NW. U. L. REV. 423 (1968). For earlier work, see David S. Ruder, Civil Liability Under Rule 10b-5: Judicial Revision of
this briefly in his article, though his affection for fraud-on-the-market litigation probably caused him to hold back a bit. In explaining why aiding and abetting is illegitimate, he points out that the kinds of persons sued under Rule 10b-5—bankers and lawyers, for example—are usually persons not engaged in the purchase or sale of a security.\textsuperscript{46}

A clear expression of the conservative antipathy came in \textit{Basic Inc. v. Levinson}, the Court’s endorsement of fraud-on-the-market. We tend to remember Justice White’s dissent (joined in by Justice O’Connor) for its skepticism about market efficiency as justification for a presumption of reliance. But in the midst of this invective, the two dissenters say explicitly that the better course of action might well be to repudiate \textit{Texas Gulf Sulphur} entirely, as one amicus party was urging.\textsuperscript{47}

This incipient revisionism resurfaced in \textit{Stoneridge}. A number of amici on the defense side wanted the Court to rule against plaintiffs on “in connection grounds,”\textsuperscript{48} taking a strong stance in favor of a standard (requiring “coincidence” between the fraud and the purchase or sale) that would be mystifying to anyone who simply assumes \textit{Texas Gulf Sulphur} is good law. Perhaps persuaded by the Solicitor General, the Court does not go there.\textsuperscript{49} But its twice-emphasized observation that it would be inappropriate to hold vendors who inhabit the world of commerce and are not anything close to being purchasers and sellers to Section 10(b) liability is precisely the point conservatives had been making for forty years.

To be sure, the “in connection with” issue is nowhere to be seen in \textit{Janus}. But it would have been had plaintiffs tried the alternative theory that JCM had deceived JIF and its directors. And I suspect that Justice Thomas’ instinct was that liability under Section 10(b) should be tightly confined (if not erased) when the defendant in question is not itself buying or selling. If so, his “ultimate authority” test achieves technical precision, at least here, because JIF was the seller of the securities to which the misleading prospectus related. And to the extent that its effect is to narrow primary 10b-5 liability to a smaller class of actors in the securities markets, it nudges the law a little bit back in the

\textit{Legislative Intent?}, 57 NW. U. L. REV. 627 (1963). Ruder was later appointed Chairman of the SEC by President Reagan.
\textsuperscript{46} 69 CAL. L. REV. at 101.
\textsuperscript{47} See 485 U.S. at 261. Justice Thomas himself displayed a suspicion about the statutory “in connection with” requirement in \textit{United States v. O’Hagan}, 521 U.S. 642 (1997), a criminal insider trading case. He wrote at length about how the law firm partner’s misappropriation, even if seen as deceptive and done for the purpose of enabling trading, was not itself a purchase or sale and so could not legitimately satisfy the in connection with standard. His dissent is a zealous claim for a very strict construction of the nexus language.
\textsuperscript{48} See Langevoort, \textit{Reading Stoneridge}, supra, at 2150.
\textsuperscript{49} See note --- supra.
direction of privity, maybe undoing a little of Texas Gulf Sulphur’s damage. We will take this up again in Part III.

Formalism is no way to fight fraud, and to those (like me) who are steeped in the ambition of Texas Gulf Sulphur and believe that courts should construe the securities laws purposively to protect investors from foreseeable harm, Justice Thomas’ reasoning is deeply disturbing. But if we bring forward the doctrinal back-stories, the opinion becomes more readable, if not more satisfying. To the majority, text-driven formalism dampens the creative impulses that long ago illegitimately turned Rule 10b-5 into a judicial policy-making tool.

*Janus* does offer plaintiffs (and maybe the SEC) a strong hint, pointing to the almost entirely unused Section 20(b)—prohibiting indirect violations “through or by means of” another person—as a possibility for avoiding the worst effects of a narrow construction of “make.” Given that Rule 10b-5 proscribes conduct that is directly or indirectly fraudulent and the Court disposed of an argument derived from the rule, it is hard to see exactly what this adds, which makes it seem like a relatively uninteresting footnote. Moreover, it is far from clear that Section 20(b) would by itself support an implied right of action, because it only makes conduct unlawful. But perhaps its statutory pedigree—in no way the product of judicial inventiveness—will invite judges to fold it into the already implied right of action under Rule 10b-5. We will come back to this shortly.

III. *Janus* Applied: The Way Forward

So, *Janus* is deeply conservative, in a way profoundly different from the preference for private ordering and regulatory competition characteristic of the kind of policy analysis found in conventionally conservative law and economics. Both kinds of conservatism resonate with a majority of the current Supreme Court, and many other judges, but it is important to understand the duality and not confuse one kind of conservative move with the other.

But other judges, on the Supreme Court and elsewhere, have different ideologies and preferences, and even within any single justice or judge inclined toward one or both conservative impulses, there are varying commitments that

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50 See Thomas H. Burt & Daniel Tepper, *Section 20(b): A New Face for Control Person Liability*, N.Y.L.J., Sept. 29, 2011. In their brief and argument, counsel for JCM described Section 20(b) as applicable when the behind the scenes actor is acting as ventriloquist and the speaker is his dummy. They resisted any inference that JIF here was nothing more than a dummy, which is far from obvious given the realities of how mutual funds are created and sponsored.
play out differently based on the facts before them. Thus, we cannot say that Janus’ deep conservatism will necessarily hold as similar issues are decided in future cases, mainly by lower courts. Many Supreme Court decisions are implicitly revised or superseded—the law of insider trading from Chiarella to O’Hagan illustrates a notably dramatic change in doctrine over time toward liberalization. We shouldn’t extrapolate too excitedly, out of either hope or fear. At the same time, the instincts underlying the opinion deserve to be taken seriously.

For the reasons discussed in Part I, the applicability of Janus to SEC enforcement actions (and criminal prosecutions) is more debatable than currently assumed. How much this matters, given the SEC’s other statutory remedies and ability to revise its own rule if it so chooses, is not clear. It may well be better for private plaintiffs, at least, if the SEC continues to be held to Janus, because I suspect that courts will be less likely to extend it mindlessly in the public enforcement context, which in turn should push the case law toward a more moderate equilibrium.

A. Disclosure Filings

Janus is clear enough that the issuer or other person who has the responsibility and legal authority to file a document with the SEC is the maker of the statements contained therein. Attorneys, advisers, and the like who act behind the scenes to cause the disclosure to read as it does are not—even if, as in Janus, their participation could reasonably be inferred.

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53 For a discussion of the early cases applying Janus, which have been far from consistent, see Edward B. Micheletti et al., Federal Court Application of Janus Capital Group Inc. v. First Derivative Traders, 43 SEC. REG. & L. REP. (BNA) 2432 (Dec. 5, 2011).
54 See Reese v. BP Exploration, 643 F.3d 681 (9th Cir. 2011)(party to a contract not liable for contractual representations when the contract was filed with the SEC by another entity).
55 This is the key distinction between Janus and the “attribution” standard that had prevailed in a number of courts of appeals. The Fourth Circuit decision reversed by the Supreme Court had essentially conceded application of that rule but said that a reasonable investor could reasonably understand the involvement of the adviser in the marketing of the fund to be an implicit attribution. In re Mutual Funds Inv. Litigation, 566 F.3d 111 (4th Cir. 2009). Compare SEC v. Tambone, 597 F.3d 436 (1st Cir. 2010)(en banc)(rejecting such an approach as applied to the underwriter of mutual fund shares). For all practical purposes, Janus creates a formalist application of an attribution standard.
Issuer officers and directors pose a much harder problem. The defendants’ brief and oral argument pretty much conceded that the issuer’s senior managers cannot be deemed secondary actors in a corporate fraud. After Sarbanes-Oxley, moreover, the CEO and CFO must certify 10-K’s and 10-Q’s at the time of filing. Still, the issuer is the only person with ultimate legal authority over the filing itself, and one could plausibly argue that—especially in the context of a statute that studiously avoided creating increased private liability as a solution to the financial misreporting problem—that the certification is simply a device to produce greater top-down attentiveness to reporting and internal controls, and so should be enforceable by the government alone. The argument in favor of primary liability here is that this is a powerful form of public attribution, and there is some evidence that investors find the certifications themselves informative. The early post-

Janus case law tends to preserve exposure for the company’s highest executives with respect to issuer filings, assuming sufficient attribution.

As we move down the corporate hierarchy, attribution typically disappears, and so the case for declaring the deceptive actions of, say, a vice president to be a violation of Rule 10b-5 gets harder. Indeed, it was difficult even before Janus, in courts that applied a strict version of the bright-line attribution standard, including in SEC enforcement cases. Janus would seem only to exacerbate the difficulty, with its emphasis that ultimate authority typically involves attribution.

We can, of course, ask why this should be of much concern. Private class actions rarely focus on non-trading individual defendants below the CEO/CFO level. This is an important area for the SEC to police, but it has tools like aiding and abetting, cease and desist (with ancillary relief), Rules 13b2-1, Rule 13b2-2, Section 17(a) of the Securities Act and the like that make reliance on Rule 10b-5 less important. Because these are not enforceable


through private litigation, Janus’ interpretive principle would seem to have less applicability. True, the SEC does enhance the ability to seek more severe penalties when fraud is demonstrated, but even here it is not clear that Rule 10b-5 is the only route to proving fraud.⁵⁹

My sense is that both the SEC and private plaintiffs still have some space to argue the alternative theory of indirect fraud. Nothing in Janus rules out what the Solicitor General’s brief in Stoneridge claimed: that persons engage in a deceptive act or practice within the strict (conservative) meaning of Section 10(b) that is directed at an issuer’s audit, internal controls or disclosure system. The brief does not take on when such deception is in connection with a purchase or sale, and we shall say much more about this shortly. Suffice it to say that unless there is a radical reorientation of that requirement, deception specifically intended to game the ’34 Act public disclosure system should suffice.⁶⁰ For private plaintiffs, the reliance inquiry then follows, but as I suggested earlier, there are many cases where the nexus between the fraud and the reliance is significantly less remote or attenuated that what we saw in Stoneridge.

This is one place where Section 20(b) might help, though the statutory language surely is opaque. It addresses using other persons as conduits for a violation, something that works well enough when misinformation is disseminated through an innocent intermediary—precisely what was going on in Janus. On the other hand, a false filing is not something any person but the issuer has the authority to do, so it is hardly clear that the executive is somehow accomplishing a false filing “through” (or “by means of”) the issuer. The important point here, however, is that this is statutory liability-creating language and hence not subject to the kind of strict interpretation designed to frustrate judicial or administrative creativity. We might expect to see reasonably moderate application of this language, even from more conservative judges.⁶¹

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⁵⁹ Section 17(a) is a particularly important tool that can reach both intentional and negligent forms of deception. As to whether to apply Janus to Section 17(a) even though the word “make” is used in one of its prongs (indeed, Rule 10b-5’s language is derived from Section 17(a)), compare SEC v. Daifotis, 2011 WL 3295139 (N.D. Cal. 2011)(Janus doesn’t apply) with SEC v. Kelly, 2011 WL 4431161 (S.D.N.Y. 2011)(Janus applies).

⁶⁰ See pp.---- infra.

⁶¹ In Janus, the Court does obliquely take note of cases where an issuer’s management misleads securities analysts, who incorporate the lies into their forecasts and recommendations, though the most specific reference is where the issuer then touts those forecasts. 131 S.Ct. at 2304 n.9, citing In re Aetna Inc. Sec. Litig., 617 F.3d 272, 275 (3d Cir. 2010). It specifically leaves open the possible use of Section 20(b) where misleading information is routed through an innocent intermediary, which certainly could describe what happened in the case. Id. at n.10; see also id. at 2310-11 (Breyer, J., dissenting)(suggesting that if so, the case should be remanded).
Section 20(a) is another obvious possibility. Executives who can be deemed controlling persons—a term that has long been interpreted in terms of practical power, not formal authority—become liable for the violation of the controlled person unless they acted in good faith and did not directly or indirectly induce that violation.  There is a large amount of case law on Section 20(a), not all of which is entirely consistent, particularly with regard to the good faith/no inducement defense. A full-scale restatement is beyond the scope of this Essay, but we need once again to emphasize that this is statutory text, which we shouldn’t assume faithfully conservative judges will read unduly narrowly. In fact, the glosses on Section 20(a) so far in the case law have been anti-textualist: the occasional insistence that plaintiffs have to prove “culpable participation” in the fraud, or that lack of scienter automatically confers immunity to the controlling person. The word “or” indicates disjunction, so that even a controlling person who acts in good faith remains liable if he or she somehow induced the violation.

These interpretive issues aside, however, Section 20(a) has a big stumbling block, which is that there must be a primary violation before controlling person liability even become an issue. That brings us back to the lies without liars problem. One might reasonably argue (at least with a practical construction of “control”) that JCM and JCG were controlling persons vis-à-vis JIF. But unless JIF violated Rule 10b-5, it wouldn’t matter.

That, in turn, takes us to one of the greatly under-theorized subjects in all of securities litigation: corporate scienter. As the entity with ultimate legal authority over its prospectuses, JIF plainly made the material misrepresentations on which plaintiffs supposedly relied. The scienter requirement is what stands most immediately in the way of its liability. And here we come to what is meant by an entity’s state of mind. Obviously, entities cannot think or sense, so that corporate scienter necessarily comes by attribution from the awareness of the entity’s agents and employees. The idea often invoked here is respondeat superior, which should immediately make us nervous. Fischel included respondeat superior in his list of the three doctrines that must be jettisoned in a faithfully conservative reading of Section 10(b), and the dissent in Central Bank acknowledged that it was at risk under the majority’s reasoning.

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62 See COX ET AL., supra, at 773-81.
63 The persistence of a “culpable participation” requirement (see id. at 778-79) beyond what the text of Section 20(a) demands remains a curiosity, and one wonders whether the text-oriented conservatism of cases like Janus will cause courts to revisit the issue.
65 See pp. --- supra.
But the hyper-textualist Fischel missed something. Section 10(b) confers rulemaking authority to bar “any person” from engaging in manipulative or deceptive devices or contrivances. And “person” has been defined by statute since 1975 to included entities as well as natural persons. So if the conservative article of faith that Section 10(b) reaches only intentional misconduct is right—as the Court has held—then Congress must have contemplated the possibility of corporate scienter. Some form of attribution, in turn, is essential to carry out this statutory direction.66 That corporate scienter has survived untouched long after *Central Bank* is an indication that the courts appreciate that it is an essential weight-bearing beam in the structure of the antifraud prohibition.

Even with this appreciation, corporate scienter has never been coherently articulated. There is case law to support at least three variations of what must be shown: (1) that the speaker himself on behalf of the corporation must have been aware of the truth, or recklessly disregarded it; (2) that some other corporate official knew or recklessly disregarded the truth, even if the speaker was entirely innocent; or (3) that knowledge of multiple corporate actors can be attributed to the corporation, even if no single actor within the firm knew the truth.67

The third possibility has relatively little direct support in the 10b-5 case law,68 though on the conceptually separate question of what plaintiffs have to plead about corporate scienter to survive a motion to dismiss, there is precedent for drawing inferences from information likely to be in the hands of officials connected to the firm’s core operations.69 The first two are more authoritative, and actually blend together. When an entity is the defendant, who is the speaker? If we assume that corporate filings and publicity are a group effort, then there can be more than one “speaker” for knowledge purposes. And if we further assume that recklessness suffices for scienter, any one of those speakers can act with the requisite intent by willfully disregarding the likelihood that someone else knows the truth. So it is not surprising that the most common articulation of the corporate scienter principle is actually a hybrid, looking “to the state of mind of the individual corporate official or

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officials who make or issue the statement (or order or approve it or its making or issuance, or who furnish information or language for inclusion therein, or the like) . . .”70

We need not resolve the precise articulation of the standard here, because Janus says nothing about this when it is an entirely intra-corporate matter. It is enough to emphasize the necessity of an attribution principle if any serious notion of corporate personhood (which Janus does take seriously) is to work. What is interesting, however, is the following conundrum, suggested by Jack Coffee.71 Is it possible that JIF could be deemed, by attribution, to know what JCM knew about the market timing policy? If so, then the door would be open to a suit against both JCM and JCG as controlling persons under Section 20(a), because JIF would have committed an intentional violation of Rule 10b-5 by misrepresenting that policy in its prospectuses.

My reaction is not: I cannot imagine any court (much less this Supreme Court) wanting to suggest that JIF could be liable to JCG’s investors based on undisclosed conduct in which JCG’s wholly owned subsidiary (JCM) was breaching a fiduciary duty owed to JIF. That turns common sense on its head. But why not, at least as a formal legal matter? Agency law offers a route for plaintiffs to pursue. The knowledge of an agent is imputed to the principal, and JCM was certainly acting in a fiduciary capacity vis-à-vis the day to day management of JIF, in which the market timing misbehavior occurred. There is an exception to this rule of attribution, however, when the agent is acting faithlessly, which is what is happening here. So maybe there is no attribution after all. But agency law then has an exception to the exception, when the suit is brought by an innocent third party (e.g., JCG investors) based on fraud or deceit.72

I have written elsewhere that agency law’s attribution of knowledge does too much work of various sorts to be applied automatically in the securities law context,73 and so I would not be inclined to follow any of the above threads without immense care. To me, the scienter question is simpler: when is it fair to conclude that what is said by an entity is actually in bad faith (which includes the subjective version of recklessness)? The legal standards discussed above capture this reasonably well, looking to the knowledge or recklessness of the core group involved in the disclosure.

70 Southland Sec. Corp. v. INSpire Ins. Solutions Inc., 365 F.3d 353, 366 (5th Cir. 2004); Tellabs, supra. Bondi, supra, provides a good overview of the case law.
71 See John C. Coffee, Jr., U.S. Supreme Court and Securities Litigation, N.Y.L.J., July 21, 2011. Sciente on the part of JIF might also come from some knowledge or awareness on the part of JIF directors connected to JCM.
72 For an excellent discussion of the common law principles, see Deborah DeMott, When is a Principal Charged With an Agent’s Knowledge?, 35 DUKE J. COMP. & INT’L L. (2003).
73 See Langevoort, Agency Law, supra, at 1228-30/
That doesn’t end the inquiry in *Janus* if JIF had, as plaintiffs claimed, effectively delegated the disclosure preparation task to JCM. But here Justice Thomas’ determination is clear enough. Formal responsibility for the prospectus remained in JIF’s hands, as opposed to its allegedly faithless agent. Automatic attribution of the agent’s knowledge would blur the distinction that the Court is trying to preserve.74

So I don’t think a theory that depends on finding a violation by JIF works, even if the ultimate goal is simply Section 20(a) liability for JCG as a controlling person. But that underscores the instrumental problem of having lies without liars. Is it really a faithful reading of Rule 10b-5 to have the party who caused the lie not be liable as the “maker” and the maker not be liable because of its innocence? The only ways out of such an unappealing conclusion have already been addressed—read *Janus* as limited to private securities litigation, which at least allows the SEC more freedom to police, and/or recognize the legitimacy of the alternative route suggested by the Solicitor General in *Stoneridge*, buttressed by an expansive reading of Section 20(b).

There remains the question of where to draw the line in terms of corporate separateness. Presumably *Janus* leaves room to disregard such separateness in the relatively rare situations where veil-piercing would be warranted—i.e., that separation is just a sham.75 A much harder question is the parent-subsidiary context, where the parent is the issuer but day-to-day business operations are all carried out through wholly owned subsidiaries, but with corporate formalities duly respected). One notable Seventh Circuit decision found the parent not liable under Rule 10b-5 for false disclosure caused by the subsidiary’s CEO, and then absolved the CEO as well based on reasoning that anticipates *Janus* in many respects.76 I am not entirely persuaded, however, and suspect that other courts will see a meaningful difference as corporate scienter questions are raised in the context of a single

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74 Compare Kerr v. Exobox Tech. Corp., 2012 WL 201872 (S.D. Tex. 2012)(attributing knowledge of majority owner who was heavily involved in the preparation of the offering materials, even though such person was not the “maker” under *Janus*). The Brief filed by the Solicitor General in *Janus* explicitly assumes that there could be no scienter on the part of JIF. See BRIEF, supra, at 24-25.

75 See In re Optimal U.S. Litig., 2011 WL 4908745 (S.D.N.Y. 2011)(no justification for veil piercing under the facts). *Optimal* applies *Janus* with respect to the parent company’s alleged primary liability where its subsidiary made the false filing, holding that Section 20(a) is the only way to reach the parent in that situation. For a case coming out the other way on whether a parent bears “maker” responsibility for its subsidiary’s falsities, see City of Roseville Emp. Ret. System v. EnergySolutions Inc., 2011 WL 4527328 (S.D.N.Y. 2011). Roseville emphasizes that the parent’s dominance was clearly communicated to investors in the prospectus, so that treating parent and subsidiary as separate entities made no sense.

76 See Pugh v. Tribune Co., 521 F.3d 686 (7th Cir. 2008).
business enterprise regardless of whether there is formal separation among business units. Where financial reporting responsibilities cross unit lines—as they must under the post-Sarbanes-Oxley internal controls regime—it is hard to justify thinking of the scope of the issuer’s knowledge or awareness in purely formalistic terms, somehow stopping abruptly at the legal boundary of the issuer.77

B. Informal Publicity

Fraud-on-the-market litigation often targets allegedly misleading corporate publicity—interviews in the press, conference calls with analysts, etc.—rather than formal SEC filings. Janus doesn’t fit especially easily here because it is hard to determine who has “ultimate responsibility” for making informal disclosures.

The admittedly small body of post-Janus case law has largely taken the position that the “makers” of informal publicity are the corporate managers who initiate the publicity as well as the issuer on whose behalf they are acting. In other words, they have distinguished Janus as being inapplicable to actions by the issuer’s own internal managers, as opposed to a distinct outside entity like JCM vis-à-vis JIF.78

To be sure, this is an uneasy distinction. If we see corporations in the (instrumentally) conservative fashion as a nexus of contracts,79 it is hardly obvious that the contractual relationship with the internal agent is conceptually different from the contractual relationship with an external investment adviser. But taking seriously the idea of a distinctive corporate personhood does necessitate that we identify certain actors who are empowered to give life to the firm, and so it is at least intuitive to treat the senior management team as speaking both as and for the issuer in terms of day-to-day corporate publicity. There may well be cases where informal publicity is initiated by an insider not in her official capacity on behalf of the firm but as speaking more personally, in which case the outcome might well be different. But in terms of the kinds of publicity most often invoked by plaintiffs in securities litigation—press

77 Financial reporting responsibilities under the SEC’s extensive rules are thoroughly anti-formalistic, including consolidated reporting for affiliates and a definition of “executive officer” of the issuer that can take in managers at the subsidiary level. See Rule 3(b)(7). For a case rejecting Janus in the parent-subsidiary context as helpful with respect to New York antifraud law, see Allstate Ins. Inc. v. Countrywide Fin. Corp., 2011 WL 5067128 (C.D. Cal. 2011).
79 See note --- supra.
releases and scripted conference calls especially—the maker is management on behalf of the issuer, so that both are properly named as defendants.

C. Scheme Liability

To this point, we have not addressed a fairly obvious way of distinguishing Janus in both SEC and private lawsuits. Justice Thomas concentrates on a single word—“make”—which appears in only one of the three distinct subparts of Rule 10b-5. The other two use different verbs, “engage” and “employ.” So maybe the opinion says nothing about 10b-5 more generally, and plaintiffs can thus restructure their complaints as alleging schemes to defraud or deceptive acts and practices rather than misrepresentations or omissions.

It can’t be that simple, though. If one goes through Justice Thomas’ argument—from the dictionary reference through the precedential progression—it is hard to find much about “make” that can’t be said about the other words and phrases. This is especially so with respect to the road from Central Bank through Stoneridge: the latter case arose directly out of plaintiffs’ efforts to develop a coherent vision of scheme liability that would evade the harsh effects that the bright-line attribution standard had in bringing cases against behind the scenes actors. Putting aside that the resolution in that case occurred by pushing the issue onto the side rail of reliance, the message was plainly directed to all three prongs of Rule 10b-5.

In recent years, even before Janus, courts have become sensitive to the temptation to invoke something akin to scheme liability to relitigate issue foreclosed under a straightforward misrepresentation claim.80 They hold that complaints that, in essence, are about misrepresentations or half-truths—as most securities cases are—must be treated as such, no matter which prong of the rule is invoked. This seems right, at least in private litigation. If it is not clear that the interpretive methodology used by the Court in Janus is meant to extend to SEC enforcement (and Stoneridge clearly does not so extend), it would not necessarily follow that this anti-evasion effort should apply to public enforcement.81

80 See WPP Luxembourg Gamma Three SARL v. Spot Runner Inc., 655 F.3d 1039, 1057-58 (9th Cir. 2011); Lentell v. Merrill Lynch, 396 F.3d 161, 177 (2d Cir. 2005)(loss causation). For a case applying Janus but concluding that the SEC’s complaint legitimately raised claims under subsections (a) and (c), see SEC v. Mercury Interactive LLC, Fed. Sec. L. Rep. (CCH) par. 94,604 (N.D. Cal. 2011)(options backdating scheme).
81 For a case so applying Janus, see SEC v. Kelly, 2011 WL 4431161 (S.D.N.Y. 2011); see also SEC v. Pentagon Cap. Mgt. PLC, 2012 U.S. Dist. LEXIS 18504 (S.D.N.Y 2012)(involving late trading claims under Rule 10b-5(a) and (c), and Section 17(a)).
IV. WHAT IS JANUS REALLY AIMING FOR?: THE “IN CONNECTION WITH” CONNECTION

To borrow a phrase from Ed Kitch, who some time ago made a similar point about another Supreme Court decision,\(^\text{82}\) Janus “doesn’t write.” Even if we accept the conservative interpretive framework, the formalism takes us to the conclusion that in 1942, the SEC wrote words that disable the rule from consistently reaching the liar whenever there is a lie, which cannot possibly be how a reasonable person would read the Commission’s intent. That problem partly goes away if—as I suggest—Janus is only addressing the scope of private litigation. But it still leaves the lingering distaste from seeing a case where allegedly there are investors who are victims of a serious securities fraud, but they have no one to sue. Justice Thomas’ treatment of “make” ultimately rings hollow to anyone with any lingering faith in the efficacy of private securities class actions.

While dealing with two very different elements of the cause of action, both Janus and Stoneridge are saying something very similar under the facts of those cases: the conduct complained of was sufficiently separate and distinct from the making of the public misrepresentation that the persons engaged in that conduct are out of plaintiffs’ reach. As I said in my commentary on Stoneridge, reliance is a poor choice for articulating that idea;\(^\text{83}\) “make” is no better.

Conceptually, the instinct behind that idea links up much more closely to the “in connection with” requirement.\(^\text{84}\) To those deeply familiar with securities litigation, it is that element of the cause of action that does the work of assuring sufficient proximity between the fraud and an investment decision. Critics of Janus are deeply disturbed, I suspect, by Justice Thomas’ failure (or refusal) to recognize the core claim that JCM created a falsity that it placed in a document “reasonably calculated” to influence investors, whether reasonably calculated means “actually intended” or “will foreseeably.” That meets all that is asked of a securities fraud claim as the law has been since Texas Gulf Sulphur. But to deeply conservative judges and commentators, Texas Gulf Sulphur was a wrong turn, the product of an illegitimate effort to create by implied right a federal tort law for all those victimized by securities fraud. We have already traced some of that history.

We are probably at a point where the Court could not easily overrule Texas Gulf Sulphur and return to anything akin to a privity requirement,

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83 See Langevoort, Reading Stoneridge, supra, at 2133.
84 Id.; see also Pritchard, supra.
though I suspect that Justice Thomas would do so if he could. There is too much case law—Basic Inc. v. Levinson\(^{85}\) and the entire fraud on the market theory, plus other less familiar cases\(^{86}\)—standing in the way, plus some implicit statutory recognition. But it could be limited, and my sense is that the more conservative justices on the Court, and conservative lower court judges as well, are trying to find a way to do so. If that is right, we should not be surprised to see this desire resurface, armed with citations to Janus and Stoneridge. With respect to private litigation, the most likely doctrinal hooks would be standing—a reinvigoration of Blue Chip Stamps\(^{87}\)—or maybe a limitation on the scope of duty.\(^{88}\)

Their desired goal would be this: in the absence of some element of privity (i.e., fraud by a purchaser or seller of securities), primary 10b-5 liability is limited to false filings or false publicity in the name of the issuer, made by the issuer and senior management acting on its behalf, for the benefit of its investors.\(^{89}\) This would preserve Texas Gulf Sulphur and Basic on their facts, and thus not seem quite so radical. Though not insisting on strict privity, some fidelity to the conservative reading of the “in connection with” requirement is kept—the issuer set the trading market in motion by issuing securities originally, and issuers both repurchase and sell new securities often enough to presume that the issuer is a purchaser or seller, and have on-going disclosure obligations imposed by law in recognition of all of this.

In fact, a skirmish like this erupted in the Second Circuit, though was beaten back. In Ontario Public Service Employees v. Nortel Networks Corp.,\(^{90}\) the Second Circuit held that investors in JD Uniphase did not have standing to sue Nortel for false filings and publicity regarding Nortel’s own financial condition (which indirectly affected JD Uniphase because it was one of Nortel’s biggest suppliers). That seems entirely inconsistent with at least a broad reading of Texas Gulf Sulphur—after all, false publicity by Nortel could foreseeably distort the market for JD Uniphase stock. Some litigators thus read

\(^{86}\) E.g., Merrill Lynch Pierce Fenner & Smith v. Dabit, 547 U.S. 71 (2006)(preemption of state class action because claim was sufficient “in connection with” the purchase or sale of a security, indicating broad reach to the nexus). For a recent survey, see SEC v. Pirate Investor LLC, 580 F.3d 233 (4th Cir. 2009).
\(^{88}\) This is what the district court did in Janus. See In re Mutual Funds Inv. Lit., 487 F.Supp.2d 618, 623-24 (D. Md. 2007). The court also expressed discomfort with the broad “in connection with” standard. I have argued in favor of a duty approach, albeit one that is more expansive than this. See Langevoort, Reading Stoneridge, supra, at 2152-56.
\(^{89}\) JCM’s brief explicitly offered this possibility, saying that only the issuer and its senior management can be primarily liable for issuer fraud.
\(^{90}\) 369 F.3d 27 (2d Cir. 2004).
into the decision an implicit limitation: only the issuer itself could be sued for fraud-on-the-market. A subsequent case, written by then-Judge Sotomayor, said that this was a misreading—and that non-issuers could indeed be sued—but without adequately explaining why then Nortel came out as it did. My sense is that Nortel was a step precisely in the direction I have articulated, thwarted by a Second Circuit panel more at home with the corrective justice framework of Texas Gulf. In the hands of some other judges—or the Supreme Court—however, Nortel might have been embraced rather than dismissed.

My point is simply that were this skirmish to resurface today, Janus would rightly be cited as consistent with Nortel, even though they involve entirely different issues. Janus is essentially saying that misstatements in JIF’s prospectuses are JIF’s responsibility alone, and that the intended beneficiaries of those prospectuses—mutual fund investors—are the only ones to whom an enforceable duty is owed, and who thus have standing to sue. Whether one agrees or disagrees with that outcome, the analysis is intellectually coherent in a way that the articulated logic of Janus is not. While I hope that a relatively broad scope to the “in connection with” requirement and the ancillary issues of duty and standing will be preserved, I suspect that Janus will encourage a more aggressive attack on what to so many seems to be received wisdom, precisely because it is so out of synch with Texas Gulf.

V. CONCLUSION

One of the most quoted phrases in the jurisprudence of securities litigation is the idea that the securities laws—particularly the antifraud prohibitions—should be read flexibly, not technically or restrictively. Yet in Janus, we have just the opposite: a rule of construction that insists on restrictiveness, not flexibility, even as to a text that was meant by its drafters to pragmatically extend the prohibition against securities fraud.

A majority of the Court now seems convinced that the relative inability of the plaintiff-side to gain more from Congress in terms of enhanced liability (particularly secondary liability) over the last two decades should be respected as a political outcome, not to be frustrated by an excess of flexibility. That is an inference about private securities litigation, however, and so I suspect that unless Janus is read to be just about private litigation, the unnecessarily cribbed reading of Rule 10b-5 was collateral damage from that battle. Yet even

91 See In re Salomon Analyst Metromedia Lit., 544 F.3d 474, 481 (2d Cir. 2008); In re NYSE Specialists Lit., 503 F.3d 89, 92 (2d Cir. 2007).

in the class action context, this is hard for someone steeped in the *Texas Gulf Sulphur* tradition to swallow—though maybe less so when we remember the unusual facts of the case, with JCG’s investors suing JCG based on statements made by a different issuer (JIF) to a different set of investors, finding nothing more direct in terms of JCG’s own disclosures on which to base their claim.

There could have been ways to address this without doing such violence to Rule 10b-5, leaving such a residuum of lies without liars. But none of the Supreme Court justices, liberal or conservative, is an expert craftsman in securities law, so that we should not be all that surprised when the handiwork is flawed. Without all that much sophistication in analyzing the difficult policy issues at stake, nor is it particularly surprising that the justices fall back on beliefs and intuitions about the proper role of the judiciary, led on by skilled advocates who know what notes to play to prompt the desired reactions.

Put that idea together with the recently-primed faith in the sanctity of corporate personhood, and *Janus* becomes more understandable, if not more persuasive. The *Citizens United* case is only the most recent outside the securities area where the Supreme Court has embraced a similarly simple vision of the corporation as a real entity,93 which implies that there are traditional legal boundaries deserving of respect. There may seem to be some irony here, because instrumentalist conservatives actually tend to contest the formalist vision of the corporation in favor of the familiar “nexus of contracts” in which these boundaries are highly negotiable. But as a default, at least, some minimalist bright line needs to set the norm. *Janus* does just this, suggesting that the legislative choice to speak of corporate liability implies an orthodox meaning to corporate personhood. Hence the traditional legal boundaries, however simplistic, should stand unless or until Congress is ready and willing to address corporate liability—and investor protection generally—in a more forthcoming and comprehensive way. For better or worse, that may be the main thing Justice Thomas was saying.

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93 See note --- supra. In United States v. Bestfoods, 524 U.S. 51, 61 (1998), for instance, the Court wrote in an environmental law case that “[i]t is a general principle of corporate law deeply ‘ingrained in our economic and legal systems’ that a parent corporation . . . is not liable for the acts of its subsidiaries,” thereby limiting derivative liability to veil-piercing situations.