

When Will It Finally End: The Effectiveness of the Rule 10b-5 Private Action as a Fraud-Deterrence Mechanism Post-Janus

Justin Marocco

Repository Citation

Justin Marocco, *When Will It Finally End: The Effectiveness of the Rule 10b-5 Private Action as a Fraud-Deterrence Mechanism Post-Janus*, 73 La. L. Rev. (2013)
Available at: <https://digitalcommons.law.lsu.edu/lalrev/vol73/iss2/10>

This Article is brought to you for free and open access by the Law Reviews and Journals at LSU Law Digital Commons. It has been accepted for inclusion in Louisiana Law Review by an authorized editor of LSU Law Digital Commons. For more information, please contact kreed25@lsu.edu.

When Will It Finally End: The Effectiveness of the Rule 10b-5 Private Action as a Fraud-Deterrence Mechanism Post-*Janus*

*I wasted no time; I got some people in, we drafted a rule, we presented it to the Commission, and, without any hesitation, the Commission tossed the paper on the table saying they were in favor of it. One Commission member said, "Well, we're against fraud, aren't we?" So, before the sun was down, we had the rule that is now Rule 10b-5.*¹

The above is Milton Freeman's succinct description of the process behind the passage of Rule 10b-5. Known as the "father of Rule 10b-5,"² Freeman guided the effort that culminated in the rule's birth.² Passed pursuant to Section 10(b) of the Securities Exchange Act, Rule 10b-5 is a broad antifraud provision that essentially prohibits all fraud in connection with the purchase or sale of securities.³ At its birth, not even the "father of Rule 10b-5" could predict what his child would one day become.⁴ No one anticipated that Rule 10b-5 would give rise to a private right of action that would eventually become the subject of thousands of opinions attempting to define it.⁵ Neither Section 10(b) nor Rule 10b-5 contains language providing for a private cause of action under the rule.⁶ Instead, federal courts have implied it.⁷ Hence, when courts look at the 10b-5 private action, they are dealing with

Copyright 2013, by JUSTIN MAROCCO.

1. Milton V. Freeman, *Colloquium Foreword*, 61 FORDHAM L. REV. S1, S1-S2 (1993) (emphasis added). This occurred prior to the passage of the Administrative Procedure Act of 1946, so the procedure to pass a new rule was much more informal than in the present day. *See id.* at S2.

2. *See id.* at S1, S3.

3. Rule 10b-5 prohibits: (1) employing "any device, scheme, or artifice to defraud"; (2) making "any untrue statement of a material fact or [failing] 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"; and (3) engaging "in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security." 17 C.F.R. § 240.10b-5 (2011).

4. *See* Freeman, *supra* note 1, at S2.

5. *See* W. Taylor Marshall, Note, *Securities Law—The Securities Exchange Act of 1934—'Round and 'Round We Go: The Supreme Court Again Limits the Circumstances in Which Federal Courts May Hold Secondary Actors Liable Under Section 10(b) and SEC Rule 10b-5*, *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, 128 S. Ct. 761 (2008), 31 U. ARK. LITTLE ROCK L. REV. 197, 204 (2008); *see also* Freeman, *supra* note 1, at S2 (evinced that the future of Rule 10b-5 was unexpected at its inception).

6. *See* discussion *infra* Part I.A.

7. *See* discussion *infra* Part I.A.

“a judicial oak which has grown from little more than a legislative acorn.”⁸ The Securities Exchange Commission (SEC) passed Rule 10b-5 to prevent fraud in connection with the purchase and sale of securities, and, despite a lack of express language providing for it, the private right of action is the method used to implement this deterrence purpose.⁹

The Supreme Court’s recent holding in *Janus Capital Group, Inc. v. First Derivative Traders* puts the usefulness of the 10b-5 private action as a fraud-deterrence mechanism in serious doubt.¹⁰ In *Janus*, the Supreme Court clarified who “makes” a statement under Rule 10b-5.¹¹ The Court determined that “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.”¹² Additionally, in a footnote, the majority provided that attribution of a statement is key evidence regarding who “makes” the statement.¹³ Consequently, *Janus*’s holding opens the door for lower federal courts to absolve corporate officers of liability for statements attributed solely to the corporation, even if those statements were prepared and distributed by the officer on the corporation’s behalf.¹⁴ This Note argues that *Janus* has severely limited the 10b-5 private action’s effectiveness as a fraud-deterrence mechanism and, in so doing, has removed much of the disincentive for corporate officers to commit fraud. Therefore, the SEC or Congress must step forward and take action to reestablish the 10b-5 private action as a fraud-deterrence mechanism.

Part I of this Note provides a brief background regarding Section 10(b) and Rule 10b-5, as well as a discussion on how

8. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 737 (1975). Justice Rehnquist’s oft-repeated analogy refers to the inability to decipher Congress’s intent regarding the “contours of a private cause of action under rule 10b-5” based solely on the language of Section 10(b). *Id.*

9. See Freeman, *supra* note 1, at S1–S2; S. Michael Sirkin, *The Deterrence Paradox: How Making Securities Fraud Class Actions More Difficult for Plaintiffs Will More Strongly Deter Corporate Fraud*, 82 TEMP. L. REV. 307, 311 (2009) (quoting *Secs. & Exch. Comm’n v. Capital Gains Res. Bureau, Inc.*, 375 U.S. 180, 186 (1963)). Freeman recognizes that the primary impetus behind the passage of Rule 10b-5 was to prevent a company president from benefitting from his dishonest conduct. See Freeman, *supra* note 1, at S1.

10. 131 S. Ct. 2296 (2011).

11. See *id.* at 2301.

12. *Id.* at 2302.

13. See *id.* at 2302 n.6.

14. Federal courts have exclusive jurisdiction over the private 10b-5 right of action. See 15 U.S.C. § 78aa (Supp. V 2011); see also *Will v. Calvert Fire Ins. Co.*, 437 U.S. 655, 659 (1978).

federal courts have implied the 10b-5 private cause of action. The discussion then shifts to the Supreme Court's decision in *Central Bank of Denver v. First Interstate Bank of Denver* and its rejection of aiding-and-abetting liability for the 10b-5 private action. Part I ends with an examination of the Court's holding in *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, in which the Court rejected "scheme liability." Part II provides an in-depth discussion of *Janus*, including the case's intricate facts, the majority's holding, and the dissent's counterargument. Part II concludes with a discussion of the primary problem that *Janus* created: the potential for corporate officers to escape liability for their unattributed misstatements. Part III analyzes how the private action should primarily be used for fraud deterrence and how *Janus* eliminates much of this usefulness. Part III also argues that *Janus* potentially affects the SEC's ability to impose aiding-and-abetting liability through an enforcement action. Furthermore, even if *Janus* does not affect the SEC enforcement action, relying on the enforcement action as the primary means to prosecute fraud and deter conduct is a recipe for disaster. Finally, Part III recognizes that *Janus* could signal a revival for Section 20(b) as an instrument to impose liability on corporate officers who use their company as the vehicle to carry out their fraudulent schemes. In Part IV, this Note concludes by proposing a solution in the form of either a federal statute or SEC rule addressing the problems that *Janus* created, specifically the potential for corporate officers to escape liability for their fraudulent misstatements.

I. LEGAL BACKGROUND

A. Statutory and Regulatory Background

Congress enacted the Securities Exchange Act of 1934 to deal with the weaknesses in the national securities markets that were thought to have contributed to the market crash of 1929 and the ensuing Great Depression.¹⁵ The Act regulates the post-distribution trading of securities¹⁶ and seeks to institute a full-disclosure

15. See Robert J. Grubb, II, *Attorneys, Accountants, and Bankers, Oh My! Primary Liability for Secondary Actors in the Wake of Stoneridge*, 62 VAND. L. REV. 275, 281 (2009); Diana L. Hegarty, *Rule 10b-5 and the Evolution of Common-Law Fraud—The Need for an Effective Statutory Proscription of Insider Tradition by Outsiders*, 22 SUFFOLK U. L. REV. 813, 819 (1988).

16. *Cent. Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164, 171 (1994) (citing *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 752 (1975)). The Securities Act of 1933 regulates the initial distribution of securities to investors, whereas the Securities Exchange Act of 1934 regulates securities

philosophy in the markets.¹⁷ Pursuant to the Act, Congress created the SEC and granted it extensive rulemaking authority.¹⁸

Section 10(b) of the Securities Exchange Act prohibits the use of manipulative or deceptive devices in connection with the purchase or sale of registered securities in violation of SEC rules and regulations.¹⁹ In isolation, Section 10(b) is “nonself-operative”: It requires an SEC rule or regulation to give it effect.²⁰ Accordingly, the SEC drafted Rule 10b-5 pursuant to its authority under Section 10(b).²¹ Of specific relevance, Rule 10b-5 makes it unlawful “for any person, directly or indirectly . . . [t]o make any untrue statement of a material fact or to omit to state a material fact”²²

Although neither Section 10(b) nor Rule 10b-5 provide for it, federal courts have implied a private 10b-5 cause of action for private plaintiffs to pursue the rule’s violators.²³ The first court to do so was the Eastern District of Pennsylvania in *Kardon v. National Gypsum Co.*²⁴ The Supreme Court confirmed the private action’s existence in 1971 and has consistently reaffirmed it.²⁵

transactions after their initial distribution, both on stock exchanges and over-the-counter markets. Kenneth B. Orenbach, *A New Twist to an On-Going Debate About Securities Self-Regulation: It’s Time to End FINRA’s Federal Income Tax Exemption*, 31 VA. TAX REV. 135, 142 (2011).

17. Sirkin, *supra* note 9, at 310 (quoting Secs. & Exch. Comm’n v. Capital Gains Res. Bureau, Inc., 375 U.S. 180, 186 (1963)).

18. Grubb, III, *supra* note 15, at 281 (citing 15 U.S.C. § 78d (2006)).

19. 15 U.S.C. § 78j(b) (Supp. V 2011).

20. Brian S. Sommer, *The PSLRA Decade of Decadence: Improving Balance in the Private Securities Litigation Arena with a Screening Panel Approach*, 44 WASHBURN L.J. 413, 419 (2005) (quoting Joseph A. Grundfest, *Disimplying Private Rights of Action Under the Federal Securities Laws: The Commission’s Authority*, 107 HARV. L. REV. 961, 977 (1994)).

21. Hegarty, *supra* note 15, at 813.

22. 17 C.F.R. § 240.10b-5 (2011).

23. See *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 730 (1975). The elements of the 10b-5 private cause of action are: “(1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation.” *Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179, 2181 (2011) (quoting *Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309, 1317 (2011)).

24. *Blue Chip Stamps*, 421 U.S. at 730 (citing *Kardon v. Nat’l Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946)).

25. E.g., *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 157 (2008). The Supreme Court first recognized the private cause of action in *Superintendent of Insurance of the State of New York v. Bankers Life & Casualty Co.*, 404 U.S. 6, 13 n.9 (1971).

*B. Applicable Case Law**1. Central Bank of Denver v. First Interstate Bank of Denver*

After years of primarily expanding Rule 10b-5 and the private right of action, the Supreme Court in *Central Bank of Denver v. First Interstate Bank of Denver* rendered a decision limiting the effectiveness of the 10b-5 private action as a fraud-deterrence mechanism by eliminating aiding-and-abetting liability under Section 10(b).²⁶ Central Bank served as a trustee for bonds issued to finance improvements to a planned real estate development.²⁷ As part of the bond agreement, liens were imposed on the land where the planned development would be constructed.²⁸ The agreement required that the land be worth at least 160% of the bonds' remaining principal and interest amounts.²⁹ Each year, the real estate developer needed to furnish Central Bank with an annual report in order for Central Bank to determine whether the 160% test was being met.³⁰ From 1986 to 1988, the developer's annual report showed that the property value had not changed. As a result, Central Bank became concerned that the 160% test was not being satisfied.³¹ Central Bank initially decided to hire an outside appraiser to review the 1988 appraisal but subsequently decided to postpone the review until the end of 1988 after consulting with the

26. 511 U.S. 164 (1994); Scott M. Murray, Comment, *Central Bank of Denver v. First Interstate Bank of Denver: The Supreme Court Chops a Bough from the Judicial Oak: There is No Implied Private Remedy to Sue for Aiding and Abetting Under Section 10(b) and SEC Rule 10b-5*, 30 NEW ENG. L. REV. 475, 478 n.17 (1996) (citing 1 ALAN R. BROMBERG & LEWIS D. LOWENFELS, *SECURITIES FRAUD & COMMODITIES FRAUD* (1988)). According to Bromberg and Lowenfels, a period of expansion began in 1934 with the passage of Rule 10b-5 and lasted until 1975. Murray, *supra*, at 478 n.17 (citing 1 BROMBERG & LOWENFELS, *supra* § 2.2, at 461–530). Next, the Supreme Court went through a seven-year period of contraction, but this period ended in 1982 when the Court shifted from its restrictive trend. Murray, *supra*, at 478 n.17 (citing 1 BROMBERG & LOWENFELS, *supra* § 2.2, at 463; *Herman & MacLean v. Huddleston*, 459 U.S. 375 (1983); *Merrill Lynch, Pierce, Fenner & Smith v. Curran*, 456 U.S. 353 (1982)).

27. See *Cent. Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164, 167 (1994); see also Scott Siamas, Comment, *Primary Securities Fraud Liability for Secondary Actors: Revisiting Central Bank of Denver in the Wake of Enron, WorldCom, and Arthur Andersen*, 37 U.C. DAVIS L. REV. 895, 902 (2004).

28. See Carrie E. Goodwin, Note, *Central Bank v. First Interstate Bank: Not Just the End of Aiding and Abetting Under Section 10(b)*, 52 WASH. & LEE L. REV. 1387, 1399 (1995).

29. *Cent. Bank*, 511 U.S. at 167.

30. *Id.*

31. *Id.*

developer.³² Before Central Bank could complete the independent review, the issuer defaulted on the bonds.³³

First Interstate Bank had purchased a sizeable portion of the bonds.³⁴ Due to its losses, First Interstate sued Central Bank for violating Section 10(b) through recklessly aiding and abetting the developer's alleged fraudulent inflation of the property value.³⁵ First Interstate did not seek to hold Central Bank liable for violating the provisions of Section 10(b). Rather, it sought to hold Central Bank liable for assisting with the developer's alleged Section 10(b) violation.³⁶ After the lower courts focused on whether Central Bank had the requisite *scienter*³⁷ for imposing aiding-and-abetting liability, the Supreme Court granted certiorari but also requested that the parties brief the entirely new issue of whether there actually was an aiding-and-abetting cause of action under Section 10(b).³⁸

Surprisingly, the Supreme Court rejected 30 years of lower court precedent by holding that a private plaintiff could not sustain an aiding-and-abetting action under Section 10(b) and Rule 10b-5.³⁹ In reaching this conclusion, the Court relied on a strict construction of Section 10(b).⁴⁰ Looking at the text and history of Section 10(b), the

32. *Id.*

33. *Id.* at 168.

34. *See id.*

35. *See id.*; see also Charles W. Murdock, *Corporate Corruption and the Complicity of Congress and the Supreme Court—The Tortious Path from Central Bank to Stoneridge Investment Partners*, 6 BERKELEY BUS. L.J. 131, 164 (2009). First Interstate claimed that the developer was primarily liable under Section 10(b) because it “fraudulently inflated the value of the Colorado real estate.” Goodwin, *supra* note 28, at 1401.

36. *See* Goodwin, *supra* note 28, at 1398.

37. *Scienter* refers to the “intent to deceive, manipulate, or defraud.” Ernst & Ernst v. Hochfelder, 425 U.S. 185, 216 (1976). It is one of the elements of the 10b-5 private action. *See* discussion *supra* note 23.

38. Glen Shu, Comment, *Take a Second Look: Central Bank After the Private Securities Litigation Reform Act of 1995*, 33 Hous. L. Rev. 539, 552 (1996). “The Court directed the parties to brief and argue the following question: ‘Whether there is an implied private right of action for aiding and abetting violations of Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5.’” *Id.* at 552 n.60 (quoting Cent. Bank of Denver v. First Interstate Bank of Denver, 508 U.S. 959, 959 (1993) (mem.)).

39. Robert A. Prentice, *Locating That “Indistinct” and “Virtually Nonexistent” Line Between Primary and Secondary Liability Under Section 10(B)*, 75 N.C. L. Rev. 691, 691 (1997); Murdock, *supra* note 35, at 163; Marshall, *supra* note 5, at 211.

40. *See* Cent. Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164, 173 (1994); John W. Avery, *Securities Litigation Reform: The Long and Winding Road to the Private Securities Litigation Reform Act of 1995*, 51 BUS. LAW. 335, 341 (1996).

Court found that Section 10(b) and the 10b-5 private action do not impose aiding-and-abetting liability.⁴¹ Nevertheless, the *Central Bank* majority limited its holding to maintain the possibility for secondary actors⁴² to be primarily liable under Section 10(b) and Rule 10b-5.⁴³ After *Central Bank*, because secondary actors could be primarily liable under Section 10(b) but not secondarily liable, the Court would need to establish the line between primary liability and secondary-aiding-and-abetting liability.⁴⁴

2. Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.

Fourteen years after its *Central Bank* decision, the Supreme Court began to define the line between primary and secondary liability in *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*⁴⁵ The fraudulent scheme in *Stoneridge* involved three parties: Charter Communications (Charter), Scientific-Atlanta, and Motorola.⁴⁶ After Charter realized that it would fall short of its yearly projected operating cash flow, it enlisted the help of its suppliers, Scientific-Atlanta and Motorola, to help erase the shortfall.⁴⁷ Charter agreed to overpay \$20 for each cable box, and in return Motorola and Scientific-Atlanta agreed to use the overpayments to purchase additional advertising from Charter.⁴⁸ Charter executed its nefarious scheme through deceptive contracts that were intentionally backdated in an attempt to hide their connectivity.⁴⁹ As a result of these contracts, Charter was able to inflate its revenue and operating cash flow by \$17 million, a figure that was included in Charter's SEC filings and reports to the

41. See *Cent. Bank*, 511 U.S. at 183.

42. The term *secondary actors* refers to every entity or individual who is not the direct issuer of securities. *Securities Exchange Act of 1934—Scope of Secondary Actor Liability: Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, 122 HARV. L. REV. 485, 485 n.3 (2008) (citing Taavi Annus, Note, *Scheme Liability Under Section 10(b) of the Securities Exchange Act of 1934*, 72 MO. L. REV. 855, 858 & n.25 (2007)).

43. See *Cent. Bank*, 511 U.S. at 191.

44. *Securities Exchange Act of 1934—Scope of Secondary Actor Liability*, *supra* note 42, at 485. See also Siamas, *supra* note 27, at 902. Primary liability involves violating the provisions of Section 10(b) or Rule 10b-5. See *Cent. Bank*, 511 U.S. at 191.

45. 552 U.S. 148 (2008).

46. See *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 153–54 (2008).

47. *Id.* at 153.

48. *Id.* at 154.

49. See *id.* at 154–55.

public.⁵⁰ Despite actively engaging in the fraud, neither Scientific-Atlanta nor Motorola aided in preparing, filing, or distributing Charter's financial statements.⁵¹

After the scheme came to light, Stoneridge filed a class action lawsuit against Scientific-Atlanta and Motorola, alleging that their participation in the fraudulent scheme was a violation of Section 10(b) and Rule 10b-5.⁵² Stoneridge sought to impose "scheme liability" (not aiding-and-abetting liability) on Motorola and Scientific-Atlanta, on the grounds that their conduct helped further Charter's fraudulent scheme.⁵³ Eventually, the Supreme Court granted certiorari to resolve a split between the Eighth and Ninth Circuits regarding the validity of scheme liability.⁵⁴

50. *Id.* at 155; Grant T. Maynard, Comment, *Catch Me if You Can: An Analysis of the Reduction of Secondary Actors' Private Liability in § 10(b) Cases in Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, 128 S. Ct. 761 (2008), 88 NEB. L. REV. 561, 569–70 (2010).

51. *Stoneridge*, 552 U.S. at 155.

52. *See id.*; Nelson Waneka, *Stoneridge Investment Partners v. Scientific-Atlanta: Rethinking the Fraud-on-the-Market Presumption and the Policy Considerations Permeating the Court's Decision*, 86 DENV. U. L. REV. 303, 314 (2008).

53. *Stoneridge*, 552 U.S. at 159–60. Scheme liability provides that a secondary actor who engages "in deceptive acts can be liable if [he] participate[s] in a scheme to defraud investors, which results in misrepresentations being made to investors." Charles J. Wilkes, *Secondary-Actor Liability in a Post-Stoneridge World: Yes, a Successful Suit Against Secondary Actors Is Still Possible*, 40 SETON HALL L. REV. 1811, 1822 (2010) (citing *Simpson v. AOL Time Warner Inc.*, 452 F.3d 1040, 1043 (9th Cir. 2006), *vacated sub nom. Simpson v. Homestore.com, Inc.*, 519 F.3d 1041 (9th Cir. 2008)). The court in *Simpson* stated:

[T]o be liable as a primary violator of § 10(b) for participation in a "scheme to defraud," the defendant must have engaged in conduct that had the principal purpose and effect of creating a false appearance of fact in furtherance of the scheme. It is not enough that a *transaction* in which a defendant was involved had a deceptive purpose and effect; the defendant's *own conduct* contributing to the transaction or overall scheme must have had a deceptive purpose and effect.

Id. at 1048.

54. *See Stoneridge*, 552 U.S. at 156; Maynard, *supra* note 50, at 568. Court of appeals decisions were in conflict regarding whether an injured investor could rely on Section 10(b) to recover damages from a party who neither made a public misstatement nor violated a duty to disclose but did participate in the scheme that violated Section 10(b). *Stoneridge*, 552 U.S. at 156. The Eighth Circuit found that a plaintiff could not establish reliance if the secondary actor did not issue a statement to the public. Maynard, *supra* note 50, at 568 (citing *In re Charter Commc'ns, Inc., Sec. Litig.*, 443 F.3d 987 (8th Cir. 2006)). Counter to the Eighth Circuit's holding, the Ninth Circuit found that reliance could be established if the misstatement's introduction into the securities market "was the intended end result of a scheme to misrepresent revenue." *Id.* (quoting *Simpson v. AOL Time Warner Inc.*, 452 F.3d 1040 (9th Cir. 2006), *vacated sub nom.*

As in *Central Bank*, Justice Kennedy wrote the majority opinion.⁵⁵ In its decision, the Court rejected Stoneridge's scheme-liability theory.⁵⁶ Citing the outside investors' lack of reliance, the majority found that neither Scientific-Atlanta nor Motorola could be liable in a 10b-5 private class action.⁵⁷ As the Court noted, reliance is essential to the 10b-5 private action.⁵⁸ During the relevant time period, no public investor had knowledge of Scientific-Atlanta's or Motorola's deceptive conduct.⁵⁹ Charter deceived its auditors and filed the financial statements, not Scientific-Atlanta or Motorola.⁶⁰ Nothing Scientific-Atlanta or Motorola did led to the necessary or inevitable consequence that Charter would record the transactions in the way that it did.⁶¹ Thus, their acts were too remote to establish reliance.⁶² Stoneridge unsuccessfully argued that reliance could be established because issuance of Charter's deceptive financial statements was the natural consequence of Scientific-Atlanta's and Motorola's fraudulent conduct.⁶³ However, the Court found this causal progression too remote and indirect to impose liability.⁶⁴ Accordingly, neither Scientific-Atlanta nor Motorola were liable for their blatant and unconscionable fraudulent conduct.⁶⁵

As in *Central Bank*, the Court took certain steps to limit the reach of its decision. To avoid any misconception that *Stoneridge* established an oral or written statement requirement, the majority emphasized that conduct itself can be deceptive and can be the basis for imposing liability in a 10b-5 private action.⁶⁶ Thus, *Stoneridge* began to clarify the line between primary and

Simpson v. Homestore.com, Inc., 519 F.3d 1041 (9th Cir. 2008)). The Supreme Court granted certiorari to resolve the circuit split. *Stoneridge*, 552 U.S. at 156.

55. Cent. Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164, 166 (1994); *Stoneridge*, 552 U.S. at 151.

56. See *Stoneridge*, 552 U.S. at 159–64.

57. *Id.* at 159.

58. See *id.* The Court used the phrase “§10(b) private cause of action,” which is the same thing as the private Rule 10b-5 cause of action. *Id.* See also discussion *supra* note 23 (regarding elements of the Rule 10b-5 private action).

59. *Id.*

60. *Id.* at 161.

61. *Id.*

62. *Id.*

63. See *id.* at 160.

64. See *id.* at 159.

65. See *id.* at 160; Murdock, *supra* note 35, at 196.

66. See *Stoneridge*, 552 U.S. at 159.

secondary aiding-and-abetting liability.⁶⁷ After *Stoneridge*, it appears that if a plaintiff is attacking a material misstatement, then the defendant needs to “make” that statement for liability to be imposed in a 10b-5 private action and not simply aid in a behind-the-scenes scheme resulting in the statement’s dissemination. This of course leads to the obvious question: Who actually “makes” a statement under Rule 10b-5? Unlike the 14-year delay between *Central Bank* and *Stoneridge*, the financial and legal community would have to wait a mere two years for the Court to clarify the meaning of *make* under Rule 10b-5 and, as a result of this clarification, to further limit the effectiveness of the 10b-5 private action as a fraud-deterrence mechanism.

II. THE *JANUS* DECISION

A. Majority and Dissenting Opinions

1. Background Facts

The Supreme Court in *Janus Capital Group, Inc. v. First Derivative Traders* confronted the question of whether a closely-related investment advisor could be liable in a 10b-5 private action for false statements that it incorporated into its client’s mutual fund prospectuses.⁶⁸ Janus Capital Group, Inc. (Janus Capital) created a family of mutual funds known as the Janus Investment Fund (JIF).⁶⁹ JIF was a separate legal entity that investors entirely owned.⁷⁰ JIF retained Janus Capital Management (JCM), a wholly-owned subsidiary of Janus Capital, to be its investment advisor.⁷¹ At all relevant times, JCM and JIF were closely connected.⁷² Every JIF employee was also a JCM officer, and all of JIF’s officers were vice presidents of JCM.⁷³ Yet, because only a single JIF board member was associated with JCM, JIF had the requisite independence for a mutual fund.⁷⁴

67. WILLIAM O. FISHER, VENTURE CAPITAL & PUBLIC OFFERING NEGOTIATION *36–39 (2011), available at Westlaw VCPON CH 36 S 5 D.

68. 131 S. Ct. 2296.

69. *Id.* at 2299.

70. *Id.*

71. *Id.*

72. *See id.* at 2306.

73. *Id.* at 2306, 2312.

74. *See id.* at 2299. According to the relevant federal statute, 60% of a mutual fund’s board of directors can be comprised of “interested persons.” 15 U.S.C. § 80a-10(a) (2006).

Nonetheless, when the substance of the relationship between a mutual fund and its investment advisor is scrutinized, it appears doubtful that JIF and JCM were truly independent. In a mutual fund, the investment advisor establishes the fund's structure.⁷⁵ The advisor acts as the operational life-support system for the mutual fund, providing it with substantially all of its management and business infrastructure.⁷⁶ Ordinarily, the investment advisor appoints the mutual fund's board of trustees, who, as a result, consistently retains him to manage the fund.⁷⁷ Combining these realities regarding investment advisors with the relationship between JIF and JCM, it seems that any conclusion that JIF and JCM were independent is based more on form and technicalities rather than the actual substance of their relationship.

Acting through its officers, JCM managed the mutual funds' investments; prepared, modified, and implemented long-term strategies; and conducted day-to-day activities.⁷⁸ As required by federal law, JIF had to issue and file prospectuses outlining both strategy and operations for each mutual fund.⁷⁹ JCM's employees drafted and reviewed the prospectuses and distributed them through the Janus Capital website.⁸⁰ Yet, it was JIF who was credited with filing the prospectuses.⁸¹ Interestingly, because all JIF employees were also JCM officers, it was actually JCM officers who filed the JIF prospectuses.⁸² These prospectuses stated that several of the JIF mutual funds were not meant for market timing and could have been interpreted to represent that JCM would establish rules to restrain the market timing practice.⁸³

75. William A. Birdthistle, *Investment Indiscipline: A Behavioral Approach to Mutual Fund Jurisprudence*, 2010 U. ILL. L. REV. 61, 69 (2010).

76. *Id.*

77. *Id.* at 70. A board of trustees is another name for a mutual fund's board of directors. *Frequently Asked Questions About Mutual Fund Directors*, INV. CO. INST., http://www.ici.org/pubs/faqs/ci.faq_fund_gov_idc.idc (last visited Oct. 26, 2012).

78. *Janus*, 131 S. Ct. at 2306.

79. *Id.* at 2300.

80. *Id.* at 2312.

81. *Id.* at 2304.

82. *See id.* at 2306.

83. *Id.* at 2300. According to the court in *Janus*:

Market timing is a trading strategy that exploits time delay in mutual funds' daily valuation system. The price for buying or selling shares of a mutual fund is ordinarily determined by the next net asset value (NAV) calculation after the order is placed. The NAV calculation usually happens once a day, at the close of the major U.S. markets. Because of certain time delays, however, the values used in these calculations do not always accurately reflect the true value of the underlying assets. For example, a fund may value its foreign securities

However, these statements were not entirely truthful. In a subsequent complaint filed against both Janus Capital and JCM, the New York Attorney General alleged that Janus Capital secretly entered into agreements to permit market timing in numerous mutual funds run by JCM, contrary to the previous statements in the prospectuses.⁸⁴

After the Attorney General filed the complaint, numerous investors withdrew their money from JIF.⁸⁵ As JIF's investment advisor, JCM received compensation from JIF proportionate to the total value of the mutual funds.⁸⁶ This compensation made up a large portion of Janus Capital's income.⁸⁷ Consequently, due to JIF's losses, Janus Capital and its investors suffered financial harm.⁸⁸ As a result, Janus Capital stockholders, represented by First Derivate Traders, filed a class action lawsuit against Janus Capital and JCM.⁸⁹

In its complaint, First Derivative Traders averred that both Janus Capital and JCM materially misled investors through statements contained in the prospectuses.⁹⁰ Initially, the Maryland District Court dismissed the complaint for failure to state a claim.⁹¹ The district court absolved Janus Capital of liability because it did not "make" the misstatements.⁹² On the other hand, the court found

based on the price at the close of the foreign market, which may have occurred several hours before the calculation. But events might have taken place after the close of the foreign market that could be expected to affect their price. If the event were expected to increase the price of the foreign securities, a market-timing investor could buy shares of a mutual fund at the artificially low NAV and sell the next day when the NAV corrects itself upward.

Id. at 2300 n.1 (citing Disclosure Regarding Market Timing and Selective Disclosure of Portfolio Holdings, 68 Fed. Reg. 70402 (proposed Dec. 17, 2003) (to be codified at 17 C.F.R. pts. 239 and 274)). "Although market timing is legal, it harms other investors in the mutual fund." *Id.* at 2300. Because it is currently a legal practice, one of the few ways to prevent market timing is for the mutual fund to institute policies and procedures against it, which is what JCM implied it was doing in the prospectuses. *Id.*

84. *Id.*

85. *Id.*

86. *Id.* See also Birdthistle, *supra* note 75, at 70. The investment advisor's fee is a percentage of the underlying mutual fund assets. Birdthistle, *supra* note 75, at 69.

87. *Janus*, 131 S. Ct. at 2300.

88. See *id.*

89. *Id.*

90. See *id.* at 2301.

91. *Id.* (citing *In re Mut. Funds Inv. Litig.*, 487 F. Supp. 2d 618, 620 (D. Md. 2007), *rev'd*, 566 F.3d 111, 121 (4th Cir. 2009)).

92. *In re Mut. Funds Inv. Litig.*, 487 F. Supp. 2d at 622.

that JCM did “make” the misstatements, but it could not be liable to Janus Capital’s shareholders because it did not actually purchase any mutual fund shares.⁹³ The Fourth Circuit reversed, finding that both Janus Capital and JCM did “make” the misleading statements by participating in the writing and dissemination of the prospectuses.⁹⁴ The Supreme Court granted writs specifically to determine whether JCM “made” the misstatements and thus could be liable in a 10b-5 private action for the misstatements regarding market timing.⁹⁵

2. Majority Reasoning

The majority absolved JCM of liability because it did not “make” the material misstatements in the prospectuses.⁹⁶ Writing for the majority, Justice Thomas relied on the Oxford English Dictionary to show that the phrase “to make any . . . statement” was approximately equivalent to the phrase “to state.”⁹⁷ Concluding that the meaning of *make* was unambiguous,⁹⁸ the majority ruled that “[f]or 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.”⁹⁹ Individuals or entities without ultimate control can only give suggestions regarding a statement; they cannot actually “make” the statement.¹⁰⁰ Furthermore, “attribution within a statement or implicit from surrounding circumstances is strong evidence that a statement was made by—and only by—the party to whom it is attributed.”¹⁰¹ According to Justice Thomas, JIF, and not JCM, did “make” the misstatements because JIF solely bore the obligation to file the prospectuses and because it was the party that filed them.¹⁰²

93. *Id.* at 624.

94. *Janus*, 131 S. Ct. at 2301 (quoting *In re Mut. Funds Inv. Litig.*, 566 F.3d 111, 121 (4th Cir. 2009)).

95. *See id.* Despite finding that Janus Capital did “make” the misstatements, the Fourth Circuit determined that Janus Capital could only be liable under Section 20(a) for being a “control person” of JCM. *Id.* As a result, they were not involved in the case upon it reaching the Supreme Court.

96. *Id.*

97. *Id.* at 2302.

98. *Id.* at 2303 n.8.

99. *Id.* at 2302.

100. *Id.*

101. *Id.*

102. *Id.* at 2304–05. However, it was truly JCM officers who filed the prospectuses because every employee of JIF was a JCM officer. *See discussion supra* Part II.A.1.

To emphasize the point, Justice Thomas analogized the situation to the relationship between a speaker and a speechwriter.¹⁰³ The speechwriter drafts the speech, but the speaker has ultimate control over its content and bears ultimate responsibility for what is said.¹⁰⁴ According to the Court, its definition of *make* followed from its prior holdings in *Central Bank* and *Stoneridge*.¹⁰⁵ The majority found that there would be no distinction between primary violators and those who aid and abet if they adopted a broader view of *make* to include persons or entities lacking ultimate authority over a statement.¹⁰⁶ In the majority's view, the dissent's argument for a broader definition would undercut *Central Bank* because a broader definition would eliminate most of the distinction between primary and secondary aiding-and-abetting liability.¹⁰⁷ Turning its attention to *Stoneridge*, the Court focused on its language that the defendants could not be liable because their actions did not make it necessary or inevitable that Charter would record the transactions in the way it did.¹⁰⁸ In its opinion, the *Janus* majority's definition of *make* flowed from *Stoneridge*, because only with ultimate authority over a statement's content and means of communication does it become necessary and inevitable that a misrepresentation will appear in the statement.¹⁰⁹ Finally, in an attempt to remove any uncertainty regarding the definition, the Court rejected the Government's argument that *make* is the equivalent of *create*.¹¹⁰ Therefore, despite JCM's substantial involvement in creating and distributing the prospectuses, JCM did not "make" the material misstatements because JIF actually controlled the content and distribution of the prospectuses.¹¹¹ Effectively, JCM was the speechwriter, and JIF was the speaker.¹¹²

3. Dissent

In his dissent, Justice Breyer argued that both language and precedent prove that numerous individuals can make a statement that appears in a firm's prospectus, even though the board of

103. *Id.* at 2302.

104. *Id.*

105. *Id.* at 2302–03.

106. *Id.* at 2302.

107. *See id.* at 2302 n.6.

108. *Id.* at 2303.

109. *Id.*

110. *Id.*

111. *See id.* at 2305.

112. *Id.*

directors has ultimate control over its content.¹¹³ Thus, JCM should have been liable for making the material misstatements incorporated into the prospectuses.¹¹⁴

To refute the rigid boundaries that the majority imposed, Justice Breyer relied on everyday examples to argue that an individual can “make” a statement even if he is not the person with ultimate authority.¹¹⁵ For example, cabinet officials regularly make statements on subjects over which the president has ultimate authority under the Constitution.¹¹⁶ Similarly, company employees make statements over which other individuals within the corporation have control.¹¹⁷

Additionally, the dissent asserted that the majority incorrectly relied on *Central Bank* and *Stoneridge*.¹¹⁸ *Central Bank* dealt with secondary aiding-and-abetting liability, whereas *Janus* involved primary liability.¹¹⁹ According to Justice Breyer, the majority’s rule extended *Central Bank* to new and rejected territory.¹²⁰ Furthermore, he argued that *Stoneridge* was distinguishable from *Janus*.¹²¹ The *Stoneridge* Court analyzed whether investors could rely on Scientific-Atlanta’s and Motorola’s behind-the-scenes actions.¹²² In Justice Breyer’s opinion, that was a much different inquiry than the *Janus* majority’s evaluation concerning whether a particular actor “makes” a material misstatement.¹²³

Finally, the dissent recognized a potential problem with *Janus*: the fact that, in certain situations, neither corporate officers composing the statements nor the corporation’s board of directors can be held liable in a 10b-5 private action.¹²⁴ This is one of the problems arising from separating the person that “makes” the statement from the person who actually drafts it knowing it to be false. If the speechwriter drafts the statement knowing that it is false and the innocent speaker delivers it under the belief that it is true, the speaker will be the person who “makes” the statement under *Janus*. However, because the speaker lacks any knowledge regarding the statement’s falsity, will courts be willing to impute

113. *Id.* at 2306 (Breyer, J., dissenting).

114. *See id.*

115. *Id.* at 2307.

116. *Id.*

117. *Id.*

118. *See id.* at 2307–10.

119. *See id.* at 2307–08.

120. *See id.* at 2308. *Janus* is doing precisely what *Central Bank* claimed it was not doing: immunizing secondary actors. *See* discussion *supra* Part I.B.1.

121. *See Janus*, 131 S. Ct. at 2308–09 (Breyer, J., dissenting).

122. *See id.*

123. *See id.* at 2309–10.

124. *Id.* at 2310.

the speechwriter's scienter to the speaker?¹²⁵ In Justice Breyer's opinion, both parties could escape liability in this scenario, which seems to imply that he believes that courts will not impute the speechwriter's scienter to the officer.¹²⁶

B. Critique of the Janus Majority's Reasoning

1. Potential Absolution of Corporate Officers

The *Janus* majority has made it possible for corporate officers and other corporate agents to escape liability for deliberately fraudulent actions.¹²⁷ In *Janus*, the Supreme Court held that "the maker of a statement is the person or entity with ultimate authority over the statement."¹²⁸ The Supreme Court acknowledged that the attribution of a statement, whether express or implicit, "is strong evidence that a statement was made by—and only by—the party to whom it is attributed."¹²⁹ Additionally, the majority explicitly rejected the SEC's argument that equated *make* with *create*, stating that this would be inconsistent with precedent.¹³⁰ Combined, these legal assertions could lead to disastrous results. Potentially, corporate officers and agents could escape liability for their fraudulent actions in creating and distributing a material misstatement to the public, so long as that misstatement is attributed to the corporation rather than to the agents and officers personally.

While it is true that this attribution presumption could be overcome, the plaintiff would still need to prove that the person—to whom the statement was not attributed—was "the person or entity with ultimate authority" over it.¹³¹ Justice Thomas gives no indication regarding what he means by "ultimate authority."¹³² However, in absolving JCM of liability, he does imply that "the person or entity with ultimate authority" is the person or entity with formal control over the statement rather than the person or

125. See discussion *supra* note 37 (regarding scienter).

126. See *Janus*, 131 S. Ct. at 2310 (Breyer, J., dissenting).

127. While an argument can be made that *Janus*'s definition of *make* should be limited to cases involving legally separate entities, at least one court has acknowledged that nothing in *Janus* limits the language to just those cases; thus, it can be applied to corporate insiders. See *Haw. Ironworkers Annuity Trust Fund v. Cole*, 2011 WL 3862206, at *3 (N.D. Ohio Sept. 1, 2011).

128. *Janus*, 131 S. Ct. at 2302.

129. *Id.*

130. *Id.* at 2303.

131. *Id.* at 2302.

132. *Id.*

entity with substantive control. Based on the facts of *Janus*, as well as the nature of the relationship between an investment advisor and a mutual fund, JCM had substantive control over JIF and thus had ultimate authority over JIF's statements.¹³³ Nonetheless, Justice Thomas focused on the fact that JCM and JIF were formally independent because only a single JIF director was associated with JCM.¹³⁴ In his opinion, because JIF was a separate legal entity, JCM did not "make" the misstatements contained in the prospectuses because JCM did not have ultimate control over them.¹³⁵ Therefore, based on the majority's opinion, "ultimate authority" should be viewed as synonymous with formal authority.

It will be a rare case when a corporate officer will be deemed to have "ultimate authority" over a statement that is not attributed to him. In a corporation, "the board of directors is the ultimate decision-making body."¹³⁶ Thus, under the plain language of *Janus*, the board of directors would always be the entity with ultimate authority over any statements issued by the company because it is "the ultimate decision-making body" and has formal authority over the corporation and its officers.¹³⁷ Even if, in reality, the officer has control over the statement due to his experience and position within his company, the *Janus* majority appears unwilling to look past formal control when determining which person or entity has ultimate authority over a statement. Consequently, *Janus*'s plain language does not leave open the possibility for corporate officers to "make" statements that are not attributed to them because the board of directors has formal authority over all officers and all statements.

The majority's opinion effectively rejects the Court's analysis in *Central Bank*. In *Central Bank*, the Court stated that secondary actors could still be primarily liable for their actions, just not responsible for secondary aiding-and-abetting liability.¹³⁸ Yet, after

133. See discussion *supra* Part II.A.1.

134. *Janus*, 131 S. Ct. at 2299.

135. See *id.* at 2304–05.

136. Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 290 (1999) (citing Robert C. Clark, *Agency Costs Versus Fiduciary Duties*, in PRINCIPALS AND AGENTS: THE STRUCTURE OF BUSINESS 56 (John W. Pratt & Richard J. Zeckhauser eds., 1985)). Additionally, the board of directors is generally characterized as "the corporation." *Id.* (citing Clark, *supra*, at 56).

137. See *id.*

138. See discussion *supra* Part I.B.1. The Court in *Central Bank* found that the 10b-5 private action could not impose aiding-and-abetting liability on secondary actors. *Cent. Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164, 183 (1994). Yet, secondary actors could still be primarily liable for violating Rule 10b-5. *Id.* at 191.

Janus, this is no longer the case. It is true that secondary actors could still be primarily liable for disseminated misstatements, if those statements are attributed to them. However, for all practical purposes, secondary actors will never be liable for the fraudulent statements that they construct because after *Janus*, no corporate officers will be foolish enough to voluntarily attribute a statement to themselves. Instead, all statements will be credited to the company, and the corporate officers who actually perpetrate the fraud will escape liability under Rule 10b-5.

Nevertheless, the *Janus* majority's definition of *make* and its statement regarding attribution are consistent with the *Stoneridge* holding regarding reliance. The Supreme Court in *Stoneridge* refused to impose liability on both Scientific-Atlanta and Motorola because no investors had knowledge of their unseen fraudulent acts, and thus no investor could show reliance on their fraudulent conduct.¹³⁹ If a corporate officer issues an unattributed statement, no one will have knowledge of his behind-the-scenes fraudulent acts; rather, investors will only be aware of the disseminated statement that is attributed to the company. Additionally, unless the person has ultimate authority over the statements, his actions do not make it necessary and inevitable that a statement will be written or disseminated in a particular manner.¹⁴⁰

However, consistency with *Stoneridge* does not erase the problems with the *Janus* decision. Consider the following hypothetical: A corporate officer, who has been working for several months on closing one of the company's operating divisions, composes a press release to deny that the company has any plans to do so. The release states that the company has no future plans to close any divisions. The officer does not attribute the press release to himself. The statement is attributed solely to the corporation. One week later, the company closes its most profitable operating division and lays off hundreds of workers. Later, the media discovers that the company had been planning to close this division for over a year. After a precipitous drop in the company's stock value, investors file a 10b-5 private class action against the corporation.

Taking *Janus* at face value, only the corporation is liable for the material misstatements, not the officer who created them. The press release was attributed to only the corporation, not the corporate officer, and attribution is strong evidence that the

139. See discussion *supra* Part I.B.2.

140. See *id.*

statement was only made by the entity to which it is attributed.¹⁴¹ The corporation has ultimate responsibility over the statement and whether to issue it, and the corporation would be the only party that made the misstatement under Rule 10b-5, based on the plain language of *Janus*.¹⁴²

Furthermore, scholars have already recognized that *Janus*'s attribution language is a distinct problem. In a hearing before the Senate Judiciary Committee, James Cox, Professor of Law at Duke University, acknowledged that, under *Janus*, statements are made only by the corporate entity, as opposed to any of the innumerable individuals who review a statement before it is issued.¹⁴³ Similarly, Joseph Franco, law professor at Suffolk University Law School, pointed out that even the person who drafts a disclosure with knowledge of its falsity will not be primarily liable for fraud, as long as another person distributes the disclosure in his own name.¹⁴⁴

141. *Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 2302 (2011).

142. The board of directors—which is generally characterized as “the corporation”—is the “ultimate decision-making body,” and consequently has ultimate authority over all statements issued by the corporation. See Blair & Stout, *supra* note 136, at 290 (citing Robert C. Clark, *Agency Costs Versus Fiduciary Duties*, in PRINCIPALS AND AGENTS: THE STRUCTURE OF BUSINESS 56 (John W. Pratt & Richard J. Zeckhauser eds., 1985)).

143. See *Barriers to Justice and Accountability: How the Supreme Court's Recent Rulings Will Affect Corporate Behavior: Hearing Before the S. Judiciary Comm.*, 112th Cong. 77 (2011) (statement of James Cox, Brainerd Currie Professor of Law at Duke University Law School) (“[F]inancial reports pass through multiple individuals, each of which provides the voice to the inanimate corporate entity. The reasoning of *Janus Capital* is that none of these actors makes a statement as the statement can only be understood to have been made by the entity, which, of course, is powerless to make any statement.”).

144. Joseph A. Franco, *Of Complicity and Compliance: A Rules-Based Anti-Complicity Strategy Under Federal Securities Law*, 14 U. PA. J. BUS. L. 1, 59 (2011). In his article, Franco argues:

Thus, according to the majority, merely drafting a false disclosure with knowledge of its falsity and subsequently deceiving another into believing that the statement is accurate, does not alone make an individual primarily liable for fraud, so long as the other person disseminates the statement in its own name. In trying to distinguish primary liability and aiding and abetting, the Court has actually crafted a rule insulating from liability those who in fact may be primarily responsible.

Id. at 59. When a corporate officer creates a statement attributed to the company, which is subsequently issued in the company's name, that officer will escape liability under *Janus*'s formalistic test because the other legal person (the company) issued the statement in its own name. See *id.*

2. Subsequent Lower Court Decisions

a. *In re Merck & Co., Inc. Securities, Derivative & “ERISA” Litigation*

Almost immediately after *Janus*, lower courts began to interpret and apply it.¹⁴⁵ In *In re Merck & Co.*, stockowners sued Merck and its executives for alleged overstatements regarding the commercial viability of the medication Vioxx.¹⁴⁶ The plaintiffs alleged that Merck downplayed the potential link between the medication and increased health risks, despite substantial evidence confirming the link.¹⁴⁷ Plaintiffs joined Edward Scolnick, the former Executive Vice President of Merck, as an individual defendant.¹⁴⁸ The plaintiffs credited seven public misstatements regarding Vioxx to Scolnick.¹⁴⁹ In defense, Scolnick argued that even though the statements were attributed to him, he could not be liable for them because the plaintiffs failed to allege that he possessed ultimate authority over those statements.¹⁵⁰ In Scolnick’s opinion, *Janus* established that attribution was necessary but not sufficient by itself for a 10b-5 claim.¹⁵¹ In essence, Scolnick argued that something in addition to attribution was required under *Janus*. The court found that Scolnick did “make” the attributed, public misstatements.¹⁵² Scolnick made each misstatement pursuant to his authority as a Merck officer.¹⁵³ According to the court, *Janus* did not change the rule that a corporation can only act through its agents.¹⁵⁴ The court then stated:

[*Janus*] certainly cannot be read to restrict liability for Rule 10b-5 claims against corporate officers to instances in which a plaintiff can plead, and ultimately prove, that those officers—as opposed to the corporation itself—had “ultimate authority” over the statement. Yet, this is the premise that underlies Scolnick’s argument that he may not be liable for statements actually attributed to him. Taken to

145. *In re Merck & Co., Inc. Sec., Derivative & “ERISA” Litig.*, 2011 WL 3444199 (D.N.J. Aug. 8, 2011).

146. *Id.* at *1.

147. *See id.*

148. *Id.* at *1 n.1, *25.

149. *See id.* at *23.

150. *See id.* at *24.

151. *See id.* at *25.

152. *See id.*

153. *See id.*

154. *See id.* (quoting *Suez Equity Investors, L.P. v. Toronto-Dominion Bank*, 250 F.3d 87, 101 (2d Cir. 2001)).

its logical conclusion, Scolnick's position would absolve corporate officers of primary liability for all Rule 10b-5 claims, because ultimately, the statements are within the control of the corporation which employs them.¹⁵⁵

Unlike *Janus*, the court in *In re Merck & Co.* dealt with statements actually attributed to the corporate officer. Nevertheless, the district court appeared to acknowledge that it would refuse to apply any interpretation of *Janus* that completely absolves corporate officers of liability for their fraudulent acts. The court balked at adopting Scolnick's argument because it would "absolve corporate officers of primary liability for all Rule 10b-5 claims."¹⁵⁶

b. City of Roseville Employees' Retirement System v. EnergySolutions, Inc.

In another post-*Janus* decision, *City of Roseville Employees' Retirement System v. EnergySolutions, Inc.*, the New York Southern District Court looked at which of the defendants made certain statements contained in registration statements.¹⁵⁷ The plaintiffs alleged causes of action against EnergySolutions, Inc. (ES), twelve of ES's officers and directors, and ENV Holdings, Inc. (ENV), ES's parent company.¹⁵⁸ The plaintiffs alleged that the registration statements filed by ES contained numerous false and misleading statements and that each defendant made the misstatements.¹⁵⁹ After citing *Janus*, specifically its language regarding attribution, the court ruled that ES and the defendants who actually signed the registration statements clearly made the misstatements.¹⁶⁰ The court absolved two of the other individual defendants for three primary reasons: (1) they did not sign the statements; (2) they were not directors in ES at the time the registration statements were filed; and (3) they did not have authority over the registration statements' content.¹⁶¹

The court's final evaluation focused on ENV, which was the sole owner of ES.¹⁶² ENV was solely owned by the "Sponsors and

155. *Id.*

156. *Id.*

157. *See City of Roseville Emps. Ret. Sys. v. EnergySolutions, Inc.*, 814 F. Supp. 2d 395, 416 (S.D.N.Y. 2011).

158. *See id.* at 401, 407.

159. *See id.* at 403-04.

160. *Id.* at 417.

161. *Id.*

162. *Id.*

Management” (sponsors).¹⁶³ Similar to the entities in *Janus*, ES and ENV were distinct legal entities that shared the same individuals in key management positions.¹⁶⁴ However, unlike *Janus*, the registration statements specified that the sponsors would control ES and that they controlled all matters requiring shareholder approval.¹⁶⁵ The sponsors controlled ES through ENV, which meant that ENV had ultimate authority over ES’s actions.¹⁶⁶ Despite ENV not signing the registration statements, the court found that ENV did “make” the misstatements due to their control over ES.¹⁶⁷ As the court concluded:

Here, where the Registration Statements contain so many indicia of control, the lack of an explicit statement that ENV was speaking through the Registration Statements does not control the answer to the question of whether it made those statements. A reasonable jury could find that, on the facts alleged here, ENV’s role went well beyond that of “a speechwriter draft[ing] a speech,” because, with regard to ES’s sales of shares owned by ENV, ENV had control over the content of the message, the underlying subject matter of the message, and the ultimate decision of whether to communicate the message.¹⁶⁸

Overall, *City of Roseville* should not be surprising. The court found that both ES and the other signing defendants did “make” the misstatements.¹⁶⁹ Clearly, by signing the statements, ES and the individuals attributed the statements to themselves. The potential shock in *City of Roseville* results from the court also holding ENV liable for the misstatements.¹⁷⁰ However, this, too, should not be surprising based on the language in *Janus*. The Court in *Janus* stated that the person or entity who “makes” a statement is “the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it.”¹⁷¹ Based on this language, ENV doomed themselves through the declarations contained in ES’s registration statements, specifically

163. *Id.* “Sponsors and Management” is the exact language contained in ES’s registration statement from November 2007. *Id.*

164. *Id.*

165. *See id.*

166. *See id.* at 418.

167. *Id.*

168. *Id.* (alteration in original) (citation omitted).

169. *See id.* at 417.

170. *See id.* at 418.

171. *Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 2302 (2011).

the statements regarding how the sponsors controlled ES.¹⁷² Because the sponsors owned 100% of ENV, and ENV owned 100% of ES, ENV controlled ES and thus would have ultimate authority over the registration statements issued by ES.¹⁷³ Therefore, using the language from *Janus*, ENV did “make” the misstatements because it was the person or entity with ultimate control over ES’s statements.

Despite these prior rulings, nothing prevents other federal courts from using an interpretation of *Janus* that completely absolves corporate officers of liability. Lower courts can interpret Supreme Court decisions in vastly different ways.¹⁷⁴ Hence, at this point in time, determining what lower courts will do is extremely difficult. Although one cannot predict all of the potential negative consequences of the *Janus* opinion’s attribution language, the majority’s reasoning clearly leaves open the possibility for far-reaching problems.

3. Examples of *Janus*’s Impact

Despite the potential for *Janus* to absolve corporate officers from liability, there are certain situations in which it is clear that an officer would “make” a statement. For instance, if a company officer signs a statement, he would be attributing the statement to himself, and thus he is deemed to “make” that statement, based on *Janus*.¹⁷⁵

A more complicated example involves a corporate officer verbalizing a prepared statement at a press conference. If the officer explicitly states that he is speaking solely for the corporation in his capacity as an officer, it is unlikely that a court could hold him liable as a maker of the statements, even if the

172. *City of Roseville*, 814 F. Supp. 2d at 418.

173. *See id.*

174. *See* Todd G. Cosenza, *Applying Stoneridge to Restrict Secondary Actor Liability Under Rule 10b-5*, 64 BUS. LAW. 59, 60 (2008). The ability for lower courts to interpret Supreme Court precedent in vastly different ways was evident in the aftermath of *Stoneridge*. After the Court rendered *Stoneridge*, the Pennsylvania Eastern District Court, pursuant to the decision, absolved a law firm that was deeply involved in preparing and advising a company on its public disclosures but whose name did not appear on the fraudulent disclosures. *See id.* (citing *In re DVI Inc. Sec. Litig.*, 249 F.R.D. 196 (E.D. Pa. 2008)). However, contrary to the Pennsylvania court’s holding, the California Eastern District Court imposed liability on a law firm that played a substantial role in composing a fraudulent disclosure despite no public identification of the firm. *See id.* (citing *Lopes v. Vieira*, 543 F. Supp. 2d 1149 (E.D. Cal. 2008)).

175. This is the same situation found in *City of Roseville*. *See City of Roseville*, 814 F. Supp. 2d 395.

officer fraudulently constructed the statements. This would be the corporation's statement, not the officer's statement. The corporation would be "the person or entity with ultimate authority over the statement," which means it would be the maker of the statement under Rule 10b-5.¹⁷⁶

Some may view the officer in this scenario as the speaker and speechwriter within Justice Thomas' speaker-speechwriter analogy.¹⁷⁷ However, this is not the case. If the officer created the statement, then clearly he would be the speechwriter within the analogy. Yet, he is not also the speaker. When giving the statement, the officer is speaking on behalf of the corporation, not on behalf of himself. The corporation is the speaker, and the officer is simply representing the corporation. As legal entities, corporations can only act through their officers and agents.¹⁷⁸ Justice Thomas' speaker-speechwriter analogy presumes two autonomous individuals, who each can act for themselves.¹⁷⁹ A corporation is not an entity that can act for itself.¹⁸⁰ Instead, it must act through others.¹⁸¹ The officer in this scenario is actually the mouthpiece of the company, which means that the company is still the speaker within the analogy.

However, what if the officer goes on to take questions from the press and provides unscripted answers? Under *Janus*, a court would likely still absolve the corporate officer of liability. When a corporate officer speaks on the company's behalf, he is speaking with the company's authority, and the company's instructions and information are shaping what he is saying. In other words, the corporate officer, despite the statement being unscripted, is still giving a statement that is ultimately within the control of and attributed to the company. Looking at this entire situation, it is almost comical that the officer could escape liability. Essentially, the officer would be arguing that he did not actually "make" the statements that, in common parlance, he made to the public. This is just one situation demonstrating the outrageousness of *Janus*.

Perhaps the greatest impact of the *Janus* decision will be its effect on the corporate press release. For a large corporation, issuing a press release will typically involve many individuals

176. *Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 2302 (2011).

177. *Id.*

178. See *In re Merck & Co., Inc. Sec., Derivative & "ERISA" Litig.*, 2011 WL 3444199, at *25 (D.N.J. Aug. 8, 2011).

179. See *Janus*, 131 S. Ct. at 2302.

180. See *id.*

181. See *id.*

looking at and revising it prior to distribution.¹⁸² What if one of those individuals puts a particular statement in it that he knows is false? Each individual officer will not sign the press release. Rather, the statement will be attributed to the corporation as a whole. Because the statement is not attributed to any particular corporate officer, but rather to the corporation as a whole, the corporation would be the maker of that statement. Under *Janus*, attribution “is strong evidence that a statement was made by—and only by—the party to whom it is attributed.”¹⁸³ Additionally, even though attribution may only be a rebuttable presumption of who “makes” a statement, it is unlikely that a corporate officer will be viewed as the individual with “ultimate authority” over a statement that is not attributed to him.¹⁸⁴ Thus, the perpetrating officer will likely escape liability for his fraudulent actions, and the corporation and its shareholders will be left bearing the financial burden for the officer’s unlawful acts. As is evident by these examples, outside of situations in which either the officer cannot legally escape attribution or the officer unintentionally attributes the statement to himself, the *Janus* decision will absolve corporate officers and other agents from liability for their fraudulent statements because they would not be the makers of those statements.

III. RAMIFICATIONS OF *JANUS*

A. Janus Contradicts the Deterrence Function of the Private 10b-5 Right of Action

Janus undercuts the use of the Rule 10b-5 private action as a deterrent to fraudulent conduct. When discussing the Rule 10b-5 private action, commentators generally provide two policy rationales for its existence: compensation and deterrence.¹⁸⁵ However, the 10b-5 private action should not be viewed as a compensation tool. Whether from judgments or settlements, the vast majority of compensation paid to investors is actually funded by the investors themselves.¹⁸⁶ Accordingly, securities litigation

182. Allowing one person, without any supervision, to issue an important press release would clearly be an unreasonable corporate procedure.

183. *Janus*, 131 S. Ct. at 2302.

184. See discussion *supra* Part II.B.1.

185. E.g., John A. MacKerron, *The Price Integrity Cause of Action Under Rule 10b-5: Limiting and Expanding the Use of the Fraud on the Market Theory*, 69 OR. L. REV. 177, 183–84 (1990).

186. Travis S. Souza, Comment, *Freedom to Defraud: Stoneridge, Primary Liability, and the Need to Properly Define Section 10(b)*, 57 DUKE L.J. 1179,

mostly involves moving money from some investors to pay other investors, a result sometimes referred to as “robbing Peter to pay Paul.”¹⁸⁷ Money will shift from the current investors to those investors who purchased stock in the affected period.¹⁸⁸ Typically, the investors who suffer are those long-term investors who still own shares in the company, while the short-term speculators benefit as a result of their coincidental purchase of shares during the relevant time period.¹⁸⁹ The short-term speculators will escape with the damages awarded to them, whereas the long-term investors who recover will have their damages netted out by the contemporaneous payment of damages and decrease in stock price.¹⁹⁰ Securities litigation tends to result in investors simply having to bear their own losses, which is inconsistent with a purported goal of compensation.¹⁹¹ Justice White echoed this anticompensation sentiment in *Basic Inc. v. Levinson*.¹⁹² In his dissent, Justice White advocated against using 10b-5 for compensatory purposes when he stated that the Securities Exchange Act did not support a conversion of Rule 10b-5 into “a scheme of investor’s insurance.”¹⁹³

Instead, the main purpose for the 10b-5 private action should be its prophylactic effect of deterring corporations and corporate officers from engaging in fraudulent conduct.¹⁹⁴ Through holding culpable actors liable and imposing a financial burden on them, those actors and other similarly situated individuals are less likely

1201 (2008) (citing John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation* 7, 14–15 (Columbia Law Sch. Ctr. for Law and Econ. Studies, Working Paper No. 293, 2006), available at http://www.law.columbia.edu/null/WP293?exclusive=filemgr.download&file_id=941958&showthumb=0)).

187. *Id.*; Adam Reiser, Note, *Compensating Defrauded Investors While Preserving the SEC’s Mission of Deterrence: A Call for Congress to Counteract the Troubling Consequences of Stoneridge*, 2009 UTAH L. REV. 257, 264 (2009).

188. Souza, *supra* note 186, at 1202.

189. See *Basic Inc. v. Levinson*, 485 U.S. 224, 262 (1988) (White, J., dissenting); see also Richard A. Booth, *The End of Securities Fraud Class Action?*, 29 REG. 46, 50 (2006), available at <http://ssrn.com/abstract=917393> (discussing how, in a securities fraud class action, wealth transfers from “buy-and-hold investors” to “stock-picking traders”).

190. See Souza, *supra* note 186, at 1201; Booth, *supra* note 189, at 50.

191. Souza, *supra* note 186, at 1203.

192. See *Basic*, 485 U.S. at 252 (White, J., dissenting).

193. *Id.*

194. Sirkin, *supra* note 9, at 311.

to commit fraud in the future.¹⁹⁵ Because people consistently act for their self-interest, an individual who knows that he could potentially bear financial responsibility for his conduct is likely to refrain from engaging in fraudulent conduct in order to avoid the negative consequences.¹⁹⁶ Compensating investors should only be used as a means to further the 10b-5 private action's primary goal of deterring fraud by holding corporations and officers financially responsible for their fraudulent acts.

Despite Rule 10b-5's main value being its prophylactic effects, the Court's holding in *Janus* eliminates much of its deterrence function. A system that absolves actors from possible liability removes much of the disincentive to engaging in fraudulent conduct.¹⁹⁷ Post-*Janus*, even actors, such as corporate officers who write the fraudulent statements and have them distributed, can escape liability under the 10b-5 private action as long as the issued statements are not attributed to them.¹⁹⁸ Due to this ability to escape liability, corporate officers could be more inclined to engage in fraudulent conduct in order to realize some of the beneficial effects of fraud, such as a potential short-term increase in stock prices through erroneous statements issued to the public. For example, as long as the misstatements are not attributed to him, an officer can realize the short-term gains through selling his stock, without any personal liability under a 10b-5 private action. After *Janus*, corporate officers will no longer make the mistake of attributing statements to themselves, unlike the defendant in *In re*

195. Souza, *supra* note 186, at 1203 (citing Donald C. Langevoort, *Capping Damages for Open-Market Securities Fraud*, 38 ARIZ. L. REV. 639, 651–52 (1996)).

196. Claire Andre & Manuel Velasquez, *Unmasking the Motives of the Good Samaritan*, SANTA CLARA UNIV., <http://www.scu.edu/ethics/publications/iie/v2n1/samaritan.html> (last visited Oct. 5, 2011).

197. See Siamas, *supra* note 27, at 917 (“Imposing liability only on those who make public misrepresentations . . . encourages concealment and subterfuge rather than conformity to the intent of the Acts.”); Maynard, *supra* note 50, at 579 (“Knowing that they are not liable in private suits, companies will engage in a decision-making calculus not unlike the taxpayer who decides whether to lie on his income tax statement.”); Mark Klock, Comment, *What Will It Take to Label Participation in a Deceptive Scheme to Defraud Buyers of Securities a Violation of Section 10(b)? The Disastrous Result and Reasoning of Stoneridge*, 58 U. KAN. L. REV. 309, 341 (2010) (citing Stuart Sinai, *Stoneridge—Escape from Securities Liability Notwithstanding Active, Intentional, Deceptive Conduct*, 8 J. BUS. & SEC. L. 170, 187 (2008)) (“If players in financial markets are always given the benefit of the doubt when they engage in questionable activities which are not clearly illegal, then financial market participants are effectively being encouraged with economic incentives to engage in shady conduct.”).

198. See discussion *supra* Part III.A.

Merck.¹⁹⁹ Therefore, through the narrow definition of *make* that *Janus* provides, the Supreme Court has destroyed the effectiveness of the 10b-5 action as a fraud-deterrence mechanism.

B. Ineffectiveness of SEC Enforcement Action

The Supreme Court's decision in *Janus* could also affect the SEC's ability to impose aiding-and-abetting liability through the SEC enforcement action. In order for the SEC to pursue aiding-and-abetting liability, there must be a primary violation of Rule 10b-5.²⁰⁰ However, in certain situations, there may be no primary violation. Under *Janus*, the corporation is considered to "make" the statements that are attributed to it, whereas the corporate officer who actually composed the statement does not "make" it.²⁰¹ However, often only the corporate officer knows the statement is deceptive, whereas the corporation's board of directors is completely in the dark. Will courts be willing to impute the officer's knowledge to the corporation and its board of directors?²⁰² Currently, no definitive theory regarding imputing scienter to a corporate defendant exists.²⁰³ Yet, it appears that if a single officer possesses the fraudulent intent and writes the statement, the court will impute his scienter to the corporation.²⁰⁴ However, in his dissent, Justice Breyer acknowledged that, as a result of the *Janus* majority's opinion, there could be a situation where no one would be liable: neither the guilty officers because they did not "make" the misstatement, nor the innocent board of directors who did not know of the misstatement. It is unlikely that Justice Breyer is implying that courts will not impute officers' scienter to their corporation. But, his statements in *Janus* do raise

199. See discussion *supra* Part II.B.2.ii.

200. See 15 U.S.C. § 78t(e) (Supp. V 2011).

201. See discussion *supra* Part II.

202. Fully evaluating this question is beyond the scope of this Note.

203. Currently, at least two different theories appear to impute scienter. First is the collective-scienter approach, which "aggregates the misstatements or omissions by one corporate player with the intent or knowledge of another that the statements were fraudulent." Heather F. Crow, Comment, *Riding the Fence on Collective Scienter: Allowing Plaintiffs to Clear the PSLRA Pleading Hurdle*, 71 LA. L. REV. 313, 326 (2010). The other approach that the courts have adopted only permits the imputation of the knowledge of the officer who made the misstatement. See, e.g., *Southland Secs. Corp. v. INSpire Ins. Solutions, Inc.*, 365 F.3d 353 (5th Cir. 2005); *Teamsters Local 445 Freight Div. Pension Fund v. Dynex Capital Inc.*, 531 F.3d 190 (2d Cir. 2008).

204. The collective-scienter doctrine only changes how to impute scienter when there is no single officer who created the statement and had the fraudulent intent behind the statement. See Crow, *supra* note 203, at 326.

questions regarding when courts will impute an officer's scienter to the corporation. If a court does not impute the officer's scienter, then there is no primary violation of Rule 10b-5 by the corporation, and not even the SEC enforcement action can be used to hold corporate officers liable. Nonetheless, despite Justice Breyer's statements, if a single officer composes a statement with fraudulent intent, a court will likely continue to impute the officer's guilty knowledge to the corporation.²⁰⁵ By imputing the officer's scienter to the corporation that "makes" the statement, there could still be a primary violation of Rule 10b-5, and thus the SEC could still impose aiding-and-abetting liability on the corporate officer.

Nevertheless, the SEC enforcement action should not be relied upon as the primary deterrence mechanism for fraudulent conduct. Due to its limited resources, the SEC cannot prosecute every reported securities violation.²⁰⁶ This would still be the case even if Congress provided the agency with substantially more resources and funding.²⁰⁷ Additionally, the SEC tends to pursue the larger, more highly visible actors rather than the smaller, less noticeable claims.²⁰⁸ Finally, both Congress and the courts have acknowledged that private securities litigation is a "necessary supplement" to the SEC enforcement action.²⁰⁹ In fact, the Supreme Court has recognized the implied private action as the most effective means of enforcing the securities laws.²¹⁰ The SEC has acknowledged that the private right of action is critical to the enforcement of Section 10(b);²¹¹ thus, it is also critical to enforcement of Rule 10b-5. It is unwise to rely on the SEC enforcement action to prevent fraudulent conduct because the 10b-5 private action provides a necessary complement to deliver the greatest deterrent effect.

205. See Crow, *supra* note 203, at 326.

206. Sommer, *supra* note 20, at 419 (citing *Berner v. Lazzaro*, 730 F.2d 1319, 1322 (9th Cir. 1984)).

207. See *id.* at 419 n.34 (quoting *Private Litigation Under the Federal Securities Laws: Hearings Before the Subcomm. on Sec. of the S. Comm. on Banking, Hous., & Urban Affairs*, 103d Cong. 36 (1993) (statement of William R. McLucas, Director, Division of Enforcement, SEC)).

208. See Reiser, *supra* note 187, at 264.

209. Joseph A. Grundfest, *Disimplying Private Rights of Action Under the Federal Securities Laws: The Commission's Authority*, 107 HARV. L. REV. 961, 969 (1994).

210. See *id.* at 969 (quoting *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 310 (1985)).

211. See *id.* at 969 (quoting Brief for the Sec. and Exch. Comm'n as Amicus Curiae in Support of Partial Affirmance at 6, *Herman & MacLean v. Huddleston*, 459 U.S. 375 (1983) (Nos. 81-680 & 81-1076), 1982 WL 608452 at *6).

Additionally, private investors are naturally the best individuals to monitor a company's activities. An investor has a personal interest in the company's actions.²¹² Acting in his own self-interest, the individual will monitor the company to ensure it is taking effective actions to make his investment profitable. It is true that not every investor has the time or financial acumen to actively monitor each of his or her investments.²¹³ However, overall, it is better to have private investors monitor a company's activities while the SEC supplements the investors' oversight. Furthermore, as the Bernie Madoff scandal demonstrates, the SEC has shown in recent years how ineffective it can be in catching even extremely large fraudulent endeavors.²¹⁴ Due to their vested interest in the company's performance, private investors, with support from the SEC, are the best line of defense against fraud and are more apt to provide stricter scrutiny of a company's activities.

C. Rise of Section 20(b)

In *Janus*, Justice Thomas alluded to the fact that Section 20(b) of the Securities Exchange Act could provide a remedy to prosecute defendants who engage in conduct similar to JCM.²¹⁵ However, he refused to analyze Section 20(b) any further, instead opting to state that *Janus* does not address it.²¹⁶ Section 20(b) makes it unlawful for a person to violate securities laws by using another person to carry out the prohibited acts.²¹⁷ Currently, few courts have interpreted Section 20(b).²¹⁸ Previously, Section 20(b) had been unnecessary in Rule 10b-5 cases because Rule 10b-5

212. *What Affects Stock Prices?*, HOWTHEMARKETWORKS.COM, <http://www.howthemarketworks.com/popular-topics/stock-price-factors.php> (last visited October 10, 2012) (discussing how company events affect stock prices).

213. Eli Martin Lazarus, *Viatical and Life Settlement Securitization: Risks and Proposed Regulation*, 29 YALE L. & POL'Y REV. 253, 281 (2010) (discussing how unsophisticated investors typically employ asset managers for investments).

214. See *Assessing the Madoff Ponzi Scheme and Regulatory Failures Before the H. Comm. of Fin. Serv.*, 111th Cong. 5 (2009) (statement of Harry Markopolos, CFA and CFE). In his testimony, Mr. Markopolos claimed to have provided evidence to the SEC regarding Bernie Madoff's Ponzi scheme as early as May 2000. *Id.* Additionally, he allegedly resubmitted his findings numerous times in 2000–2008. *Id.*

215. See *Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 2304 n.10, 2311 (2011).

216. *Id.*

217. Section 20(b) specifically provides: "It shall be unlawful for any person, directly or indirectly, to do any act or thing which it would be unlawful for such person to do under the provisions of this chapter or any rule or regulation thereunder through or by means of any other person." 15 U.S.C. § 78t(b) (2006).

218. *Janus*, 131 S. Ct. at 2311.

used to impose liability on both corporations and officers.²¹⁹ Nevertheless, as a result of *Janus*, the majority seems to infuse life into Section 20(b).

To impose liability under Section 20(b), there must be control, culpable participation by the controlling person, and a securities law violation.²²⁰ It could be used to impose liability on corporate officers who intentionally act through another person or entity, such as the corporation for which they work, to violate securities laws. Section 20(b) would impose liability only on the person who is using the other person to commit the securities law violation.²²¹ Thus, it seems like a viable tool that could aid in correcting the problems that *Janus* created. However, due to the lack of jurisprudence or other authority regarding Section 20(b), it will take time to determine how effective Section 20(b) will be in fixing the *Janus* problem whereby corporate officers can escape liability for their intentional misstatements that are attributed to the company.²²²

The primary question with Section 20(b) is whether the Court will recognize an implied right of action for it. In *Janus*, the majority explicitly noted that it was not addressing whether Section 20(b) imposed liability on entities acting through innocent intermediaries.²²³ Section 20(b) does not contain explicit language providing for a private right of action.²²⁴ In recent years, the Court has taken a limiting approach regarding private rights of action, as evident in its recent treatment of the 10b-5 private action.²²⁵ Thus, whether the Supreme Court is willing to recognize a private right of action for Section 20(b) remains uncertain, and the *Janus* opinion gives no significant indication as to which way the Court is currently leaning.²²⁶

219. See *id.*; P. Gifford Carter, Note, *Originator Exposure To Federal Securities Law Liability When Structuring Asset Backed Securities Transactions*, 20 ANN. REV. BANKING L. 271, 293 (2001).

220. Carter, *supra* note 219, at 294.

221. See *id.*

222. See *id.*

223. *Janus*, 131 S. Ct. at 2304 n.10.

224. See 15 U.S.C. § 78t(b) (2006).

225. See *Janus*, 131 S. Ct. 2296, 2302–03; *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 165 (2008); *Cent. Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164, 191 (1994).

226. The Court could imply a private right of action like it did with Section 10(b) and Rule 10b-5. However, the more likely outcome is that the Supreme Court will follow the approach it used with Section 17(a) of the Securities Exchange Act and refuse to imply a private right of action. See *Touche Ross & Co. v. Redington*, 442 U.S. 560 (1979). In *Touche Ross & Co.*, the Supreme Court refused to imply a Section 17(a) private right of action due to the lack of

IV. LEGISLATIVE REMEDIES

Undoubtedly, reform is necessary. Based on *Central Bank*, *Stoneridge*, and *Janus*, clearly the Supreme Court will not be the avenue for this reform. The Court in *Janus* reaffirmed its position that any change regarding liability under a securities law must come from Congress and not the courts.²²⁷ Consequently, the two potential reform methods would be a congressional statute or an SEC rule, with the SEC rule being more feasible.

A. Congressional Action

Congress can pass a statute refining the definition of *make* to prevent the problems arising from *Janus*. The statute should clarify that the person who “makes” a misstatement is “any person or entity that substantially participates in the drafting or dissemination of the statement, regardless of the attribution of that statement.” This language would eliminate the potential for corporate officers to escape liability based solely on a lack of attribution. The courts would then bear the responsibility for determining the meaning of *substantially participates*. Because Congress is acting, there is no concern about reinstating aiding-and-abetting liability for the 10b-5 private action through the definition of *make*. Congress has the power to override a judicial interpretation of legislation by passing new legislation.²²⁸ The primary problem with legislative reform is that passing a new statute is a difficult task. Both houses

express language or legislative history evidencing an intent of Congress to provide for such an action. *See id.* at 571. Recent Supreme Court precedent reaffirms the Court’s unwillingness to imply private rights of action for federal statutes that do not expressly provide for such in either the statute’s language or the legislative history. *See Alexander v. Sandoval*, 532 U.S. 275, 286–87 (2001).

227. *Janus*, 131 S. Ct. at 2304 (“Any reapportionment of liability in the securities industry in light of the close relationship between investment advisers and mutual funds is properly the responsibility of Congress and not the courts.”). *See also* Lori Martin et al., *United States: Supreme Court Curtails Ability of Plaintiffs to Hold Secondary Actors Liable in Private Securities Fraud Actions*, MONDAQ BUSINESS BRIEFING (July 5, 2011), <http://www.mondaq.com/united-states/x/137642/Fund+Management+Hedge+Mutual+Investment/Supreme+Court+Curtails+Ability+Of+Plaintiffs+To+Hold+Secondary+Actors+Liable+In+Private+Securities+Fraud+Actions>.

228. For example, in 1995, Congress passed the Private Securities Litigation Reform Act (PSLRA), a portion of which was used to partially override *Central Bank*. Robert A. Prentice, *Stoneridge, Securities Fraud Litigation, and the Supreme Court*, 45 AM. BUS. L.J. 611, 648 (2008). Section 104 of the PSLRA restored the SEC’s ability to impose aiding-and-abetting liability under Section 10(b). *Id.*

of Congress must agree on one proposal—a task that has become exponentially more difficult due to Congress’s current polarized state.²²⁹

B. SEC Rulemaking

A new SEC rule would be much easier to pass because it only requires SEC action rather than a vote of Congress.²³⁰ Just like a statute, the rule should clarify the meaning of *make* to ensure that corporate officers could not possibly escape liability for their unattributed misstatements. Yet, unlike a statute, the rule could not bring back aiding-and-abetting liability for the 10b-5 private action. The Supreme Court in both *Central Bank* and *Stoneridge* engaged in statutory interpretation of Section 10(b).²³¹ The Court has already established that an administrative agency cannot override Supreme Court precedent that interprets a statute.²³² Thus, by conducting statutory interpretation in *Central Bank* and *Stoneridge*, the Supreme Court has foreclosed the possibility of using an SEC rule to reimplement aiding-and-abetting liability.²³³

In *Janus*, however, the Supreme Court only interpreted Rule 10b-5, so the SEC has the authority to override the interpretation.²³⁴ Nonetheless, in exercising its rulemaking authority, the SEC must walk the thin line between clarifying the definition of *make* and implementing aiding-and-abetting liability. Keeping this in mind, one potential version of the rule could be the following: For purposes of Rule 10b-5, to “make” a misstatement includes drafting or writing a statement with knowledge that it is false and

229. *The Legislative Branch*, THE WHITE HOUSE, <http://www.whitehouse.gov/our-government/legislative-branch> (last visited Oct. 10, 2012); Vic Fazio, *How Did Congress Get So Polarized?*, POLITICO (Sept. 11, 2011, 9:39 PM), <http://www.politico.com/news/stories/0911/63197.html>. See also Liz Sidoti, *A Polarized Congress in a Country Seeking Pragmatism*, HUFFINGTON POST (Jan. 5, 2011, 2:32 PM), <http://www.huffingtonpost.com/2011/01/05/new-congress-swearing-inn804872.html>.

230. Under the Administrative Procedure Act, rule passage involves: (1) a proposed rule; (2) notice of proposed rule published in the Federal Register; (3) public review period; and (4) final rule adoption and publication. See 5 U.S.C. § 553 (2006).

231. See *Cent. Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164 (1994); *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148 (2008).

232. See Grundfest, *supra* note 209, at 984 (quoting *Immigration & Naturalization Serv. v. Cardoza-Fonseca*, 480 U.S. 421, 446 (1987)).

233. See *Cent. Bank*, 511 U.S. 164.

234. See Grundfest, *supra* note 209, at 985 (quoting *Immigration & Naturalization Serv. v. Cardoza-Fonseca*, 480 U.S. 421, 446 (1987)); see also discussion *supra* Part II.A.

distributing or having that statement distributed to the public, irrespective of whether the statement is attributed to the individual drafting or writing it.

Regardless of the rule's language, it is likely that any new rule will be subject to legal challenges claiming that it is a roundabout attempt to reestablish aiding-and-abetting liability. In making their determination, courts will be looking at whether the rule is inconsistent with the Supreme Court's abolition of aiding-and-abetting liability in *Central Bank*.²³⁵ It should be noted that any challenge based on *Central Bank* would not affect the rule's applicability to SEC enforcement actions because Congress has already given the SEC the ability to pursue aiding-and-abetting liability.²³⁶ However, challenges based on reestablishing aiding-and-abetting liability will be a problem for the private cause of action because Congress has yet to reinstitute aiding-and-abetting liability for the private actions.

The SEC may choose to use expansive language that potentially contradicts the Court's prior holding in *Central Bank*. Whenever any litigation concerning the validity of the SEC Rule reaches the Supreme Court, the Court's ultimate decision regarding the validity of an expansive SEC Rule is uncertain. Currently, at least four Justices feel that a broader definition of *make* is warranted.²³⁷ Predicting how the Court would rule is difficult because this would partially depend on a case's factual circumstances. Thus, the SEC could draft an expansive rule regarding the definition of *make*, knowing that the Supreme Court may strike it down, yet all along hoping that a majority of the Court will side with them in any subsequent legal action.

V. CONCLUSION

As a result of *Janus*, the viability of the private 10b-5 cause of action as a fraud-deterrence mechanism has been undermined. The majority's narrow definition for *make* essentially absolves corporate officers of responsibility for their fraudulent acts under the 10b-5 private action, so long as their misstatements are not attributed to them. As a result, corporate officials will focus on organizing and distributing their statements in such a way as to escape potential liability under the private 10b-5 cause of action. Officers will no longer make the same mistake as the defendant in

235. *See id.*

236. 15 U.S.C. § 78t(e) (Supp. V 2011).

237. *See Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 2305 (2011) (Breyer, J., dissenting).

In re Merck & Co., a case in which the misstatements were attributed to the corporate officer individually, rather than the company.²³⁸

By absolving corporate officers of liability for their action, *Janus* eliminates much of the 10b-5 private action's prophylactic effect. Instead of increasing deterrence, the Supreme Court has removed much of the disincentives to engaging in fraudulent conduct. Consequently, either Congress or the SEC must take action because the Court refuses to be the engine for reform. Therefore, despite the potential far-reaching problems emanating from *Janus*, the decision may actually result in some of the most significant securities legislation in the last decade, as either the SEC, Congress, or both may finally take meaningful action regarding the future of the private 10b-5 cause of action.

*Justin Marocco**

238. See discussion *supra* Part II.B.2.a.

* J.D./D.C.L., 2013, Paul M. Hebert Law Center, Louisiana State University.

The author would like to thank Professor Morris for all of his assistance and revisions, as well as his mother, father, and the rest of his family for all of their support during this process.