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No. 09-525

In the Supreme Court of the United States

JANUS CAPITAL GROUP, ET AL.,
Petitioners,
v.
FIRST DERIVATIVE TRADERS,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF OF AARP AND NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC. AS *AMICI CURIAE* IN SUPPORT OF RESPONDENTS

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INTERESTS OF *AMICI CURIAE*[1]

AARP is a non-partisan, non-profit organization dedicated to representing the needs and interests of people age fifty and older. AARP is greatly concerned about fraudulent, deceptive and unfair business practices, many of which disproportionately harm older people. AARP thus supports laws and public policies designed to protect older people from such business practices and to preserve the legal means for them to seek redress. Among these activities, AARP advocates for improved access to the civil justice system and supports the availability of the full range of enforcement tools, including class actions.

A significant percentage of the age fifty and older population in general tends to compose the investing public in the United States markets, and AARP members in particular tend to be investors in those markets. Older persons are frequent targets of financial fraud because they often have significant assets and they look for investment opportunities that will supplement Social Security and other sources of retirement income. As a result, AARP has elevated the need to combat securities fraud and made this issue a high priority. The Association has regularly commented on legislative and regulatory

[1] In accordance with this Court's Rule 37.6, no party's counsel wrote this brief in whole or in part and no person other than *amici* or their counsel made a monetary contribution intended to fund the preparation or submission of the brief. The parties' letters consenting to the filing of this brief have been lodged with the Clerk of the Court.

proposals that address investment fraud, filed *amicus* briefs in cases involving the securities laws, and opposed legislative efforts to limit the remedies of defrauded investors.

The North American Securities Administrators Association, Inc. ("NASAA") is the non-profit association of state, provincial, and territorial securities regulators in the United States, Canada, and Mexico. It has sixty-seven (67) members, including the securities regulators in all fifty (50) states, the District of Columbia, Puerto Rico, and the U.S. Virgin islands. Formed in 1919, NASAA is the oldest international organization devoted to protecting investors from fraud and abuse in the offer and sale of securities.

NASAA's members are responsible for regulating securities transactions under state law, and their principal activities include registering local securities offerings; licensing the brokers and investment advisers who sell securities or provide investment advice; and initiating enforcement actions to address fraud and other misconduct. They are intimately familiar with the investment offerings and sales abuses confronting their state residents on a daily basis, including mutual fund market timing.

NASAA supports all of its members' activities and it appears as amicus curiae in important cases involving securities regulation and investor protection. Recognizing that private actions are an essential complement to governmental enforcement of the securities laws, NASAA and its members also

support the rights of investors to seek redress in court for investment-related fraud and abuse. NASAA and its members have an interest in this appeal because it will profoundly affect the ability of investors to seek redress in cases where unscrupulous companies and individuals seek to cloak their fraudulent acts through perverse uses of the corporate form.

The resolution of this case will have a significant impact on the integrity of the securities markets and the remediation of securities fraud in those markets. This is of particular concern at this time, to both AARP and NASAA, given the entry of many first-time investors into the market and the responsibility for retirement investing that pensioners have had to assume as a result of the shift in the retirement plan paradigm from defined benefit pension plans (under which employers bear the risk of loss) to defined contribution pension plans (under which plan participants bear the risk of loss).

SUMMARY OF ARGUMENT

Securities fraud litigation initiated by private parties is an essential means of enforcing the securities laws and protecting the integrity of the securities markets for investors and maintaining investor confidence in the markets. The limited resources of the Securities and Exchange Commission are selectively employed and are seldom directed at making securities fraud victims whole. Nowhere is this dynamic more pronounced and more important than in the mutual fund arena.

In this case, the only practical recourse for the complaining investors is against the mutual fund advisers who perpetrated the fraud that is undisputed. The mutual fund itself is a mere shell for the transaction of innocent shareholders' investment activity in the funds. Thus, the fund's advisers participated in the making of the fraudulent statements contained in the fund prospectuses to a greater extent than any other party. Their conduct in so doing constitutes the making of false statements under § 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5, 17 C.F.R. § 240.10(b), promulgated thereunder.

State securities laws offer no avenue for victims of a large-scale securities fraud of the sort involved in this case.

The involvement of Janus Capital Management ("Janus Management") in the conduct which constitutes securities fraud was sufficient to sweep that entity into the circle of primary actors with respect to the fraud perpetrated on the complaining shareholders. Under securities law statutory construction and common-law principles, Janus Management is accountable in damages for the securities fraud perpetrated upon Janus Capital Group ("Janus Group") investors.

ARGUMENT

I. A SECURITIES FRAUD CLAIM AGAINST JANUS MANAGEMENT IS THE ONLY AVENUE RESPONDENTS HAVE AVAILABLE TO REDRESS THEIR INJURIES.

The answer to the questions presented in this case will have immediate and potentially serious repercussions for the civil enforcement of securities law violations in this country, especially in the mutual fund industry. As financial crimes abound and alternative forums for aggrieved investors remain limited, it is especially important that the federal courts interpret federal law in a way that, to the extent possible, affords meaningful remedies to victims of securities fraud. Upholding the lower court's decision will help accomplish this objective.

A. Private Securities Litigation Is Essential To Deterring And Redressing Securities Fraud.

This Court has long recognized the vital importance of legitimate private securities litigation to the federal enforcement regime for securities fraud. *See, e.g.*, *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350 (1991); *Pinter v. Dahl*, 486 U.S. 622 (1988); *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 310 (1985) (observing that "implied private actions are a most effective weapon in the enforcement of the securities laws"); *J.I. Case Co. v. Borak*, 377 U.S. 426, 432

(1964). *See also Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 730 (1975) (stating that "private enforcement" of Rule 10b-5 is "a necessary supplement to Commission action."). In these and other decisions, the Court has recognized a strong Congressional policy of favoring private actions as a means of achieving the fundamental goals of our securities laws: fraud deterrence, victim compensation, and the promotion of investor confidence.

At the front end, private securities actions are essential to inspiring compliance with securities laws. As the Commission has explained, "given the limited enforcement resources of the Commission, the private right of action is vital to effective enforcement of Section 10(b)." Brief for the Securities and Exchange Commission as Amicus Curiae in Support of Partial Affirmance at 6, *Herman & MacLean v. Huddleston*, 459 U.S. 375 (1983). Former SEC Chairman David Ruder noted in 1989 that in earlier years less than ten percent of cases involving securities or commodities had been brought by the government. *See* DAVID S. RUDER, *The Development of Legal Doctrine through Amicus Participation: The SEC Experience*, 1989 WIS. L. REV. 1167, 1168 (1989).

William R. McLucas, former Director of the Commission's Enforcement Division, has argued that the private right of action under §10(b) and Rule 10b-5 is necessary to supplement federal enforcement of securities laws, based on "the continued growth in the size and complexity of our

securities market, and the absolute certainty that persons seeking to perpetuate financial fraud will always be among us." *Private Litigation of the Federal Securities Laws: Hearings Before the Subcomm. on Securities of the Senate Comm. on Banking Housing & Urban Affairs*, 103d Cong., 1st Sess. 113 (June 17, 1993) [hereinafter *Hearings*] (testimony of William R. McLucas).

Government agencies are generally strangers to the transactions that give rise to allegations of fraud. Private participants in allegedly fraudulent transactions thus have an informational advantage over government agencies and have stronger incentives to prosecute certain alleged frauds because they stand to profit from any recovery. Statistics show that "private enforcement . . . dwarf[s] public enforcement," and thus private litigants are much more successful in terms of recovery than the Commission. JOHN C. COFFEE, JR., *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation*, 106 COLUM. L. REV. 1534, 1542-43 tbls. 2 & 3 (2006). In fact, "even in major scandals where the [Commission] has brought its own action, the damages paid in securities class actions are usually (but not always) a multiple of those paid to the [Commission]." *Id.*

Private actions are also able to reach a much broader range of perpetrated frauds. The Congressional mandate and funding for the Commission only allows it reach to prosecute the most flagrant abuses of securities laws. The Commission "does not have the resources to

investigate every instance in which a public company's disclosure is questionable," an issue that would "continue to be the case even if the Commission's resources were substantially increased." *Berner v. Lazzaro*, 730 F.2d 1319, 1322-23 (9th Cir. 1984). *See also* H.R. REP. NO. 355, 98th Cong., 1st Sess., at 6 (1983) ("In recent years, the securities markets have grown dramatically in size and complexity, while Commission enforcement resources have declined."). Nowhere have the limits of the Commission's abilities to stop and prevent fraud been more apparent than the case of Bernard Madoff, who managed to operate a Ponzi scheme for nearly half a century in spite of continuous oversight from the Commission. Further, probing violations in the mutual fund industry has not been a top priority for the Commission. Marcia Vickers, Commentary, *How Eliot Spitzer Makes the SEC Look Stodgy*, BUSINESSWEEK (September 15, 2003) [hereinafter BUSINESSWEEK], *available at* http://www.businessweek.com/magazine/content/03_37/b3849047.htm. ("The real failure has been on the enforcement side. The SEC has done nothing to show that it really means business.").

Private enforcement actions are also an essential tool in compensating victims. Private actions afford victims of fraud the best and often only hope of recovering their losses, something for which government enforcement actions are ill-equipped. As the Commission has explained,

> "When the Commission files an enforcement action, its principal

> objectives are to enjoin the wrongdoer from future violations of the law, to deprive violators of their profit by seeking orders of disgorgement, and generally to deter other violations by seeking civil money penalties. Although the Commission usually makes disgorged funds available for the compensation of injured investors, the amount of investor losses often exceeds the wrongdoer's ill-gotten gains. Private actions, by contrast, enable defrauded investors to seek compensatory damages and thereby recover the full amount of their losses.

Hearings, *supra*, at 113. Thus, while the Commission may seek monetary relief, its remedies are designed primarily to deter violations by making them unprofitable, rather than to make investors whole. And with good reason: the damages in major securities fraud cases can and often do run into the billions of dollars. *See, e.g.*, *Regents of the Univ. of California v. Credit Suisse First Bos.*, 482 F.3d 372, 379 (2007); *In re Global Crossing*, 225 F.R.D. 436, 460 (2004); *see also* Coffee, *supra*, at 1555 (cataloguing settlement amounts in major securities fraud cases). Accordingly, the primary means of compensating injured investors remains the private action.

Finally, and especially important in our current financial downturn, private securities litigation performs a significant role in maintaining

of investor confidence by enforcing the mandatory disclosure system. As this Court recently noted, "The magnitude of the federal interest in protecting the integrity and efficient operation of the market for nationally traded securities cannot be overstated." *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 78 (2006). Investor confidence in the integrity of the securities markets is crucial to helping businesses raise the capital they need to expand and keep the lights on. See *Basic v. Levinson*, 485 U.S. 224, 235 n.12 (1988). If investors are prevented from holding corporate actors accountable for their frauds, investors will be far less willing to participate in our securities markets. *See Hearings*, *supra*, at 145.

Investor confidence takes on particular importance in the mutual fund industry. Speaking of the market timing allegations at the core of this case, an industry analyst stated that "[i]f these charges are proven true, there has been a breach of law that cuts close to the heart of what protects all mutual-fund shareholders." BUSINESSWEEK, *supra* (quoting Russel Kinnel, Director of Fund Analysis, Morningstar). "One of the reasons that funds are so popular is the perception that they're very ethical – they supposedly treat the little guy like the big guy. But clearly, they haven't done that here." *Id.* (quoting Russel Kinnel, Director of Fund Analysis at Morningstar). Adds a hedge fund manager, "Hardly anyone has a clue about all the games mutual funds play." The exodus of investors from the Janus Funds upon learning of the secret market timing deals speaks volumes.

B. The Direct Attribution Standard Promoted By Petitioners Would Severely Restrict The Ability Of Investors To Seek Redress For Their Injuries While Simultaneously Creating Perverse Incentives For Corporate Actors To Engage In Fraud.

If the Exchange Act is to serve as the "indispensable tool with which defrauded investors can recover their losses" that Congress intended, H.R. CONF. RPT. 104-369, 104th Cong., 1st Sess., at 31 (1995); *see Dabit*, 547 U.S. at 81, then actors must be held accountable when their conduct violates the explicit language of § 10(b) and Rule 10b-5, as has occurred in this case involving Janus Management. A strict attribution requirement would instead "place a premium on concealment and subterfuge rather than on compliance with the federal securities laws." *In re Global Crossing, Ltd. Sec. Litig.*, 322 F. Supp. 2d 319, 333 (S.D.N.Y. 2004) (quoting *In re Enron Corp. Sec. Derivative & ERISA Litig.*, 235 F. Supp. 2d 549, 587 (S.D. Tex. 2002)).

Without recourse against Janus Management, Janus Group shareholders will have nowhere to obtain redress for their injuries. Unlike with previous cases that have come before this court, there are no other "adequate remedies" available to the investors in this case that could "attenuate[]" the heavy disadvantages posed by the restrictive interpretation of securities laws advocated by

Petitioners. *See Blue Chip Stamps*, 421 U.S. at 738 n.9. The Janus Funds may not be sued directly because they "do not 'conduct any operating - activities on their own'" and "recovery would simply impose on present shareholders of the funds (entirely innocent parties) liability for a payment to shareholders of the funds during the class period." *In re Mut. Funds Inv. Litig*, 384 F. Supp. 2d 845, 853 n. 3 (D. Md. 2005). At the same time, Janus Management, who as investment adviser is ultimately responsible for formulating and disseminating the misleading prospectuses, will escape liability simply by keeping its name off the prospectuses. Finally, the government actors in this case have been primarily concerned with compensating the injured shareholders of the Janus Funds. None of the fines Janus Group paid as part of its government settlement have been used to compensate Janus Group shareholders. Thus, private action against the investment adviser is the only option parent company shareholders have, making paramount the need for federal courts to afford relief in this case.

Private securities litigation has proven itself a valuable tool in the protection of investors and the deterrence of securities fraud. Applying § 10(b) to the deceptive conduct that occurred between Janus Management, Janus Group and the Janus Funds will not impose duties or uncertainties other than those that arise from the universal and entirely fitting obligation to refrain from making misrepresentations and committing securities fraud. In fact, no policy reason exists to allow persons who

directly participate in transactions designed to mislead investors to escape liability under §10(b). Indeed, such a result would do great harm to investor interests, as it would leave them with no viable means to recover damages sustained as a result of even intentionally deceptive conduct, so long as the wrongdoer avoids making a false statement or assuming a duty of disclosure. Given the complexity of corporate frauds, this will create a significant and unwarranted loophole in Rule 10b-5.

II. PROVIDING INVESTORS WITH MEANINGFUL REMEDIES UNDER FEDERAL LAW IS VITAL GIVEN THE LACK OF AVAILABLE REMEDIES UNDER STATE LAW.

The need to insure that investors have meaningful remedies in federal court is all the more important when state law does not provide an alternative remedy. This is especially true for securities fraud cases in light of the fact that "federal law, not state law has long been the principal vehicle for asserting class-action securities fraud claims." Dabit, 547 U.S. at 88. Furthermore, this Court has observed that the disadvantages posed by a restrictive interpretation of federal securities law can be "attenuated" where adequate remedies are available under state law. *See Blue Chip Stamps*, 421 U.S. at 738 n.9 (weighing fact that class action in state court was an alternative remedy); *see also Santa Fe Industries, Inc. v. Green,* 430 U.S. 462, 478 (1977) (state cause of action under corporate law was a factor in determining whether to recognize federal

cause of action); *J.I. Case Co.,* 377 U.S. at 434-35 (1964) (noting that if federal jurisdiction is limited and state affords no relief, then the "whole purpose" of the statutory provision might be frustrated). Conversely, where state law does not offer a significant alternative forum for plaintiffs' claims, there is a correspondingly greater justification—and need—for the federal courts to afford relief.

In this case, state law offers limited recourse for investors in the Respondent's position. Congress has expressly limited the use of class action suits seeking recovery for securities fraud under state law. In 1998, Congress enacted the Securities Litigation Uniform Standards Act ("SLUSA") to address the concern that "securities class action lawsuits [had] shifted from Federal to state courts" as a means of circumventing the Reform Act. *See* 15 U.S.C.A. § 78a (findings set forth in Pub. L. 105-353, § 2, Nov. 3, 1998). With certain exceptions, SLUSA provides that no class action based upon state law may be maintained in any state court on behalf of more than 50 class members. *See* 15 U.S.C. § 77p(b). Moreover, state courts generally have not recognized the doctrine of fraud-on-the-market in cases seeking relief under state common law—a doctrine central to Respondent's case—further limiting the state courts as an alternative forum for investors aggrieved by misconduct of the sort alleged in this case. *See, e.g., Peil v. Speiser,* 806 F.2d 1154, 1163 (3rd Cir. 1986) (noting that no states have adopted fraud on the market theory); *Kaufman v. i-Stat Corp.,* 754 A.2d 1188, 1193-94 (N.J. 2000); *Mirkin v. Wasserman,* 858 P.2d 568, 584 (Cal. 1993).

Precisely because of the massive corporate frauds that have surfaced in recent years, some courts have recognized the need to re-evaluate barriers to civil actions alleging securities fraud. The California Supreme Court, for example, has cited the troubling increase in corporate fraud as a reason to recalibrate the balance between the interests of investors and the interests of corporations, in favor of providing greater judicial recourse to victims of fraud.

> When Congress enacted the Private Securities Litigation Reform Act of 1995 and the Uniform Standards Act of 1998, it was almost entirely concerned with preventing non-meritorious suits. But events since 1998 have changed the perspective. The last few years have seen repeated reports of false financial statements and accounting fraud, demonstrating that many charges of corporate fraud were neither speculative nor attempts to extort settlement money, but were based on actual misconduct. To open the newspaper today is to receive a daily dose of scandal, from Adelphia to Enron and beyond. Sadly, each of us knows that these newly publicized instances of accounting-related securities fraud are no longer out of the ordinary, save perhaps in scale alone. The victims of the reported frauds, moreover, are often persons who were induced to hold

> corporate stock by rosy but false financial reports, while others who knew the true state of affairs exercised stock options and sold at inflated prices. Eliminating barriers that deny redress to actual victims of fraud now assumes an importance equal to that of deterring non-meritorious suits.

See Small v. Fritz Companies, Inc., 65 P. 3d 1255, 1263-64 (Cal. 2003) (internal citations and quotation marks omitted).

III. THE UNIQUELY CLOSE RELATIONSHIP BETWEEN JANUS MANAGEMENT AND THE JANUS FUNDS MANDATES THAT JANUS MANAGEMENT BE HELD ACCOUNTABLE AS A PRIMARY ACTOR.

The Fourth Circuit properly emphasized the special relationship between Janus Management and its family of funds. Contrary to Petitioners' claim, Janus Management is no "mere[] service provider." App. to Pet. Cert 11. Rather, Janus Management is so central to the existence and continued operation of the Janus Funds that the two are practically indistinguishable. *See* Br. for U.S. as Amicus Curiae 9. ("Unlike more typical 'service provider[s] * * * such as an accountant, a lawyer, or a bank,' an investment adviser's unique and close relationship with the fund makes it essentially a corporate insider." (omission in original)).

Consequently, Janus Management's liability in this case should be on par with that of a high-level corporate insider or alter ego. *See* 1 W. FLETCHER, CYCLOPEDIA OF THE LAW OF CORPORATIONS § 41.10 (rev. ed. 2010) (stating that where there is "such unity" between two entities that their legal "separateness . . . has ceased," courts will "disregard the corporate entity" and hold each responsible for acts done in name of the other). Janus Management should therefore be held accountable as a primary actor for the alleged misstatements in the Fund prospectuses. *See McCoy v. Goldberg*, 748 F. Supp. 146, 154 n.5 (S.D.N.Y. 1990) ("Because plaintiff alleges that all representations were made by the individual defendant [Goldberg] and that the corporation is his mere alter ego, it is clear that the misstatements and omissions entail the collective actions of Goldberg and the entity, Goldberg and Co.").

Although the precise analysis varies by jurisdiction, courts generally characterize the insider or alter ego relationship by the presence of three factors. Chief among them is the domination and control of core operational functions by one entity over the other. *See* 1 Fletcher § 41.10 (stating that courts will typically disregard corporate formalities upon a showing of an insider's "complete domination" over the policy and business practices of the entity). *See also In re Blesi*, 43 B.R. 45, 48 (Bankr. D. Minn. 1984) (defining an insider as a person "so tied to or controlled by" an entity as to constitute "an alter ego"); John D. Wilmore, *The Bankruptcy Trustee: Can An Alter Ego Sue In Alter*

Ego?, 65 S. CAL. L. REV. 705, 715 (Nov. 1991) ("The simple domination of a corporation by an insider can be enough to make the insider liable to all those damaged in their dealings with the corporation."). Here it cannot be disputed that liability on the part of the fund is unwarranted so the focus must be solely on the fund adviser, Janus Management.

A related but potentially distinct factor is the lack of an arm's length relationship between the parties. *See, e.g.*, *Pepper v. Litton*, 308 U.S. 295, 306-07 (1939) ("The essence of the [alter ego] test is whether or not under all the circumstances the transaction carries the earmarks of an arm's length bargain. If it does not, equity will set it aside.") (footnote omitted); *Bridas S.A.P.I.C. v. Gov't of Turkmenistan*, 447 F.3d 411, 418-20 (5th Cir. 2006) (holding that the lower court's skepticism that the entities in question had interacted at arm's length was "critical" to their finding of an alter ego relationship); *Midwest Precision Heating and Cooling, Inc. v. N.L.R.B.*, 408 F.3d 450, 458-59 (8th Cir. 2005). *See also* H.R. REP. NO. 95-595, 95th Cong., 2d Sess., at 312 (1977) (defining "insider" as individuals or entity with a "sufficiently close relationship" to another that its conduct should be subject to closer scrutiny than that of those dealing at arm's length). Earnest scrutiny of the parties' relationships here commands the inclusion of Janus Management within the circle of primary actors for purposes of liability.

Finally, although *amici* agree with Respondent that the facts of this case do not require

it, alter ego liability is generally reserved for cases in which the failure to recognize the economic reality of the relationship between the entities would perpetrate a fraud or injustice against the complaining third party. 1 Fletcher § 41.10 ("If an interoperate affiliation is devised for or is being used to accomplish an improper or unlawful purpose, equity has the authority to tear down technical legal barriers and reach beyond them to impose liability or grant proper relief.") *See, e.g.*, C*arpenters Dist. Council of Kansas City Pension Fund v. JNL Constr. Co.*, 596 F.3d 491, 494-95 (8th Cir. 2010); *Gallagher v. Reconco Builders, Inc.*, 415 N.E.2d 560, 563-64 (Ill. App. Ct. 1980). Although not directly applicable here, the alter ego analysis is instructive and further supports the Fourth Circuit's decision.

> In line with well-settled common law approaches to allocating responsibility among related corporate entities, the inquiry into an alter ego relationship is very fact-intensive and thus peculiar to the circumstances of the case at hand. *Keffer v. H.K. Porter Co., Inc.*, 872 F.2d 60, 64 (4th Cir. 1989). No single factor is determinative, so the analysis rests on a careful assessment of the actual relationship between the entities. . *See Ost-West-Handel Bruno Bischoff v. Project Asia Line, Inc.*, 160 F.3d 170, 174-76 (4th Cir. 1998). Although the typical alter ego case is that of an overreaching corporate officer or a close parent-subsidiary relationship, courts

have not shied away from applying the doctrine outside that traditional context. *See Id.* at 172-74 (applying alter ego theory to explore the relationship between record owner of a shipping vessel and the vessel's manager); *Camofi Master LDC v. College Partnership Inc.*, 452 F. Supp. 2d 462, 465 (S.D.N.Y. 2006) (denying an investment adviser summary judgment where a reasonable juror could find that the adviser was an alter ego of its affiliated lending funds).

A. Janus Management Exerts Total Control Over Operations Of The Janus Funds.

Respondent's allegations, bolstered by common understanding of the relationship between mutual funds and their advisers, provide ample support for a claim for primary securities fraud liability against Janus Management.[2] To begin, the control and discretion Janus Management exerted over the policies and core operations of the Janus

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[2] Janus Management, a wholly owned subsidiary of Janus Capital, is the investment adviser to the Janus Funds. J.A. 62a. Janus Management is responsible for the day-to-day management of the Janus Funds investment portfolio and the funds' business affairs; Janus Management provides advice and recommendations regarding the funds' investments; and, Janus Management provides administrative, compliance, and accounting services to the Janus Funds. J.A. 67a-68a.

Funds was virtually unrestrained. Unlike the assistance offered by an outside counsel or financial auditor, control by an investment adviser involves much more than the mere provision of a critical service. *See Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490, 494 (7th Cir. 1986) (holding that an attorney's ability to persuade and give counsel is not the same thing as "control," which generally means the practical ability to direct the actions of an entity or securities issuer); *Wright v. Schock*, 571 F. Supp. 642, 664 (N.D. Cal. 1983) (holding that providing indispensable services to a broker does not establish a bank or title company as a "control" party), *aff'd*, 742 F.2d 541 (9th Cir. 1984); *In re Commonwealth Oil/Tesoro Petroleum Sec. Litig.*, 484 F. Supp. 253, 268-69 (W.D. Tex. 1979) (holding that giving independent accounting advice does not by itself establish control liability).

The Securities and Exchange Commission defines "control" as "the power to direct or cause the direction of the management and policies of a person" by ownership, contract, or otherwise. *See* 17 C.F.R. §§ 230.405, 240.12b–2 (2008). The analysis must therefore focus on the level of control evidenced by the actual relationship between the entities, rendering the existence or absence of a formal ownership agreement necessarily inconclusive. *See, e.g.*, *United States v. Scherping*, 187 F.3d 796 (8th Cir. 1999) (applying Minnesota law); *Gardemal v. Westin Hotel Co.*, 186 F.3d 588 (5th Cir. 1999); *Shades Bridge Holding Co. v. United States*, 880 F.2d 342 (11th Cir. 1989)). *See also Paracor Fin., Inc. v. Gen. Elec. Capital Corp.*, 96 F.3d 1151, 1162 (9th

Cir. 1996) (stating that the question of control involves scrutiny of the defendant's "participation in the day-to-day affairs" and power to control the "management and policies" of the entity). Operational control is generally characterized by such factors as the overlap in ownership and management personnel, the ability to make hiring and firing decisions, and the amount of discretion left to the dominated entity. *See, e.g.*, *Wm. Passalacqua Builders, Inc. v. Resnick Developers S., Inc.*, 933 F.2d 131, 139 (2d Cir. 1991); *In re City of Columbia Falls, Mont., Special Imp. Dist. No. 25*, 143 B.R. 750, 765-66 (Bankr. D. Mont. 1992).

The domination and control an investment adviser typically exerts over its managed funds is universally acknowledged. *See Daily Income Fund v. Fox*, 464 U.S. 523, 536 (1984); *Tannenbaum v. Zeller*, 552 F.2d 402, 405 (2d Cir. 1977) ("Control of a mutual fund ... lies largely in the hands of the investment adviser."); *In re Steadman Sec. Corp.*, 46 S.E.C. 896, 920 n.81 (1977) ("The term investment adviser is to some a misnomer. The so called adviser is no mere consultant. He is the fund's manager. Hence, the investment adviser almost always controls the fund" and is normally "the only audible voice in day to day management of the fund.); JOHN C. BOGLE, THE BATTLE FOR THE SOUL OF CAPITALISM 142, n.15 (Michael O'Malley ed., Yale Univ. Press 2005) (contending that the structure of mutual funds give investment managers "near-total dominion" over the funds); Investment Company Act Release No. 24082, 64 Fed. Reg. 59,826, 59,827 (Nov. 3, 1999) [hereinafter Release No. 24082] ("An investment

adviser typically organizes a mutual fund and is responsible for its day-to-day operations. As a result of this extensive involvement, and the general absence of shareholder activism, investment advisers typically dominate the funds they advise.").

With rare exception, mutual funds do not operate with their own employees *Cambridge Fund, Inc. v. Abella*, 501 F. Supp. 598, 614 (S.D.N.Y. 1980). Rather, the day-to-day management of the fund is exclusively in the hands of the investment adviser, which provides the fund with management services, office space, and a staff along with its substantive investment advice. *Id.*; *Tannenbaum*, 552 F.2d at 405; BIBB L. STRENCH, *Understanding The Relationship Between the Mutual Fund and Its Adviser*, ABCS OF MUTUAL FUNDS, 72, 74 (P.L.I., New York, N.Y., June 11, 2008) [hereinafter *Understanding Mutual Funds*] ("The mutual fund does not even have its own office but rather 'resides' at the office of the investment adviser.") Officers of the funds are typically employees of, and paid by, the investment adviser. *Id.* at 74. Although the funds have their own directors or trustees, the role of the fund board is merely one of oversight, to approve policies and monitor fund performance for compliance with stated objectives in the prospectus; the boards are not typically involved in day-to-day management, leaving that task to the investment adviser.[3] 2010 INVESTMENT COMPANY FACTBOOK,

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[3] In fact, a 1992 Commission report emphasized that mutual fund directors should not be required to "micro-manage" a fund's daily operations. As a practical matter, fund advisers or administrators typically have compliance officers responsible

APPENDIX A: *How Mutual Funds and Investment Companies Operate*, 191-92 (Investment Company Institute, Washington, D.C., 2010) [hereinafter FACTBOOK], *available at* http://www.ici.org/pdf/2010_factbook.pdf.

"[N]otwithstanding the title, the [a]dviser provides not just advice to the fund, but also discretionary management services." JENNIFER S. TAUB, *Able But Not Willing: The Failure Of Mutual Fund Advisers To Advocate For Shareholders' Rights*, 34 J. CORP. L. 843, 849 (2009) [hereinafter *Able But Not Willing*]. In addition to managing the fund's portfolio, the adviser often serves as the fund administrator, which is specifically charged with various "back office services," including the preparation and filing of reports with the Securities and Exchange Commission. FACTBOOK, *supra*, 191-92. Fund administrators also help maintain compliance procedures and internal controls. *Id.* at 192. Naturally, all of the investment decisions for the funds—including the types and amounts of instruments to be purchased or sold, the execution of these transactions, and the general strategy for the fund—are made by portfolio managers, who are under the employ of the investment adviser.

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for performing the day-to-day compliance checks demanded by the many rules that govern mutual funds, and directors frequently rely on compliance officers to help them fulfill their oversight role. These compliance officers, however, are still typically employed by the investment adviser. UNDERSTANDING THE ROLE OF MUTUAL FUND DIRECTORS, 17 (Investment Company Institute, Washington, D.C., 1999), *available at* http://www.ici.org/pdf/bro_mf_directors.pdf.

UNDERSTANDING MUTUAL FUNDS, *supra*, at 73-74. *Able But Not Willing*, *supra*, at 883.

The allegations in Respondent's complaint align closely with this common understanding of the mutual fund industry. Most notably, Respondent alleges that Janus Management, in its capacity as investment adviser to the Funds, "is responsible for the funds' day-to-day management" and that "as a practical matter" Janus Management runs the funds. J.A. 62a, 73a. In addition to Janus Management sharing physical real estate with the Funds, the prospectuses for the Funds—the Funds' key marketing tool—are most readily available to potential investors via the Janus website, which is run by Janus Group. J.A. 74a. Notably, the Funds lack their own independent websites. Finally, in addition to employing portfolio managers for the Funds, as well as the executives to whom they report, Janus Management "furnishes advice and recommendations concerning the funds' investments, as well as *administrative*, compliance and accounting services for the funds." J.A. 67a. (emphasis added). These allegations state not only a strong claim for Janus Management's essential control over the funds operations but, even more to the point, they describe Janus Management's direction of the market timing policies at issue in this case and the marketing of false statements regarding those policies to potential investors.

B. Janus Management Is So Intimately Involved With The Janus Funds That It Does Not Interact With Them At Arm's Length.

Respondent's allegations also strongly support the notion that Janus Management does not interact at arm's length in asserting its relationship with the Janus Funds.[4] In this case, as is common practice, the mutual funds at issue were actually launched by the investment adviser by and through its parent corporation, Janus Group. *See* Release No. 24082 59,827; UNDERSTANDING MUTUAL FUNDS, *supra*, at 72. As sponsor to the Funds, Janus Group provided the initial seed capital of $100,000 required to start a mutual fund under the Investment Company Act of 1940, 15 U.S.C. § 80-1. FACTBOOK, *supra*, at 190. The sponsor is also involved with registering the fund with the SEC and generally hand-selects all of the third parties needed to launch and operate the fund, including its initial board of trustees.[5] *Id.*; WILLIAM

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[4] As this Court recently noted in *Jones v. Harris*, "because of the relationship between a mutual fund and its investment adviser, the fund often 'cannot, as a practical matter sever its relationship with the adviser. Therefore, the forces of arm's-length bargaining do not work in the mutual fund industry in the same manner as they do in other sectors of the American economy.'" *Jones v. Harris*, 130 S. Ct. 1418, 1422 (2010) (S. REP. NO. 91-184, 91st Cong., 1st Sess., at 5 (1969)).

[5] Although the Investment Company Act requires a certain percentage of the board to be "independent," the SEC has recognized that the legal standard for "independence" is fairly low. "Persons who have served as executives of the fund

A. BIRDTHISTLE, *Compensating Power: An Analysis of Rents and Rewards in the Mutual Fund Industry*, 80 TUL. L.REV. 1401, 1422 (2006). The board of trustees is then charged with "negotiating" the investment contract with the adviser on behalf of the mutual fund. However, proprietary "families" of funds created by a given sponsor generally share administrative and distribution systems, which further increases the likelihood of domination of the sponsor over the funds. *See* Release No. 24082. Not surprisingly, the fund's initial sponsor or an affiliate is nearly always hired by the board to manage the fund. *Id.* Although a fund's board could theoretically fire its investment adviser, such an event is rare in practice and referred to as the "nuclear option" within the industry. *Able But Not Willing*, *supra*, at 883 (citing Meyrick Payne, *Managed Fund Governance*, *in* GOVERNANCE AND RISK: AN ANALYTICAL HANDBOOK FOR INVESTORS, MANAGERS, DIRECTORS AND STAKEHOLDERS 263 (George S. Dallas, McGraw-Hill 2004)). Losing the relationship with the investment adviser would mean that proprietary funds, like the Janus Funds, would have to give up their namesake, making them less easily recognizable and marketable to consumers. Thus,

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adviser or who are close family members of employees of the fund, its adviser or principal underwriter . . . may meet the minimum statutory requirements." Investment Company Governance, Investment Company Act Release No. 26,520, 83 SEC Docket 1384 (July 27, 2004). The SEC further noted that "a fund adviser is frequently in a position to dominate the board because of the adviser's monopoly over information about the fund and its frequent ability to control the board's agenda." *Id.*

mutual funds are essentially captive to their creators. *Id.*; *Gallus v. Ameriprise Fin., Inc.*, 561 F.3d 816, 820 (8th Cir. 2009). *See also Burks v. Lasker*, 441 U.S. 471, 480-81 (1979).

Again, the specific allegations in Respondent's complaint clearly paint a picture of a relationship between Janus Management and its family of funds that lacks any meaningful indicia of functional independence for the funds. In its 10-K, Janus Group self-identifies as a company that "sponsors, markets and provides investment advisory, distribution and administrative services primarily to mutual funds." J.A. 67a. The February 28, 2003, prospectus for the Janus Mercury Fund supports the practical improbability of the "nuclear option," noting that Janus Management "has served as investment adviser to the Janus Funds since 1970, and currently serves as the investment adviser to all of the Janus Funds." J.A. 67a. The complaint cites to a Wall Street Journal article reporting that, as part of its settlement with the New York Attorney General, Janus Group essentially admitted that the Janus Fund boards had not been "truly independent." J.A. 105a-06a. Even months after the Attorney General launched its investigation into Janus, Tom Bailey, the founder and former CEO of Janus Group, was serving as Chairman on all of the Janus Fund boards. Under these circumstances, the Funds would hardly be able to steer a course independent from that which Janus Management and Janus Group had collectively laid out for it.

C. Janus Management And Janus Group Have Navigated The Legal Relationship Between Adviser And Fund So As To Visit A Disservice Upon Janus Group Shareholders.

Finally, a refusal to grant Janus Group shareholders recourse against the company and its wholly-owned investment adviser would surely operate as a grave inequity. The main factor courts have linked with a showing of fraud or injustice is the undercapitalization or insolvency of the dominated entity. *See Keffer*, 872 F.2d at 68. Insolvency and undercapitalization of the dominated entity are strong indicators that it will be unable to fully compensate a complaining party for his or her loss. The court in *Keffer*, for example, found that it would be "fundamentally unfair" for the subsidiary to escape liability where all of the proceeds from its assets, which when sold left the subsidiary insolvent, imbued to its controlling parent. *Id.*

Although the Janus Funds are not technically regarded as undercapitalized or insolvent, for the purposes of recovery in securities fraud actions, they may as well be. A mutual fund is a "mere shell," a pool for other people's assets. It holds no assets other than those belonging to the individual investors holding shares in the fund. *Tannenbaum*, 552 F.2d at 405. As the District Court in this case explained, recovery against the funds for § 10(b) liability "would be inappropriate because a recovery would simply impose on present shareholders of the funds (entirely innocent parties) liability for a payment to

shareholders of the funds during the class period." *In re Mut. Funds Inv. Litig*, 384 F. Supp. 2d at 853 n. 3. Finding otherwise would be "substituting shadow for substance and exalting form over substance in obvious violation of the equities of the situation." *See Wellman v. Dickinson*, 475 F. Supp. 783, 830 (S.D.N.Y. 1979) (internal citations omitted). Janus Management, however, according to the complaint's allegations, not only orchestrated the alleged fraud via its controlling relationship over the Janus Funds, it and its parent Janus Group were the sole beneficiaries of the poisonous fruits of that fraud, namely increased fees from the "sticky assets" the hedge funds pledged to them.

Furthermore, ascribing liability to Janus Management is perfectly consistent with the holding in *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta*, 552 U.S. 148 (2008), both as to the requirement that there must be a misrepresentation by the defendant and that the deceptive conduct is "necessary" and "proximate" to the alleged fraud. *Id.* at 158, 161.

Unlike the defendants in *Stoneridge*, Janus Management was intimately involved with and benefited from the alleged fraud. As asserted by the Respondents in their complaint, Janus Group Management made material misrepresentations in the prospectuses it prepared for various Janus Funds that explicitly addressed the policies designed to prohibit or otherwise limit market timing. Resp't Br. 19. The plaintiffs also alleged that Janus Group Management caused the prospectuses containing the

misrepresentations to be issued for the Janus Funds and made them available to the public. Resp't Br. 19. Petitioners' attempts to undermine these allegations, which at this stage in the litigation must be taken as true, seem disingenuous to say the least, especially in light of the numerous communications the New York Attorney General uncovered in which senior executives at Janus Group and Janus Management repeatedly reference "our prospectus" and "our funds. See J.A. 45a.

Regardless of whether statements in the Janus Fund prospectuses were directly attributable to Janus Management, Janus Management and Janus Group rendered those statements false by intentionally making secret market timing deals with numerous hedge funds in direct contradiction with the fund prospectuses. It may be fairly presumed that representing that the Funds did not allow market timing attracted investors to the Funds and the secret deals brought in the "sticky assets," thereby maximizing assets under management and increasing the fees that ultimately inured to the benefit of Janus Group. The fraud therefore directly and exclusively benefited Janus Management and its parent, making its participation both proximate and necessary to the fraud.

CONCLUSION

For all of the foregoing reasons, this Court should affirm the decision of the Fourth Circuit.

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