No. 09-525

IN THE
Supreme Court of the United States

JANUS CAPITAL GROUP INC. AND
JANUS CAPITAL MANAGEMENT LLC,
Petitioners,
v.

FIRST DERIVATIVE TRADERS,
Respondent.

**On Writ of Certiorari
to the United States Court of Appeals
for the Fourth Circuit**

BRIEF OF JOHN P. FREEMAN AND JAMES D. COX AS *AMICI CURIAE* IN SUPPORT OF RESPONDENT

MICHAEL J. BRICKMAN
Counsel of Record
JAMES C. BRADLEY
NINA H. FIELDS
RICHARDSON, PATRICK,
WESTBROOK & BRICKMAN,
LLC
174 East Bay Street
Charleston, SC 29401
(843) 727-6500
(mbrickman@rpwb.com)

November 2, 2010

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page

CASES

STATUTES AND RULES

LEGISLATIVE MATERIALS

ADMINISTRATIVE MATERIALS

OTHER MATERIALS

INTEREST OF *AMICI CURIAE*[1]

Amicus John P. Freeman is the John T. Campbell Chair in Business and Professional Ethics Emeritus, and the Distinguished Professor of Law Emeritus, at the University of South Carolina School of Law. He has been analyzing and writing about legal issues affecting the mutual fund industry for more than 40 years. His major mutual fund publications include: John P. Freeman et al., *Mutual Fund Advisory Fees: New Evidence and a Fair Fiduciary Duty Test*, 61 Okla. L. Rev. 83 (2008); John P. Freeman, *The Mutual Fund Distribution Fee Mess*, 32 J. Corp. L. 739 (2007); John P. Freeman & Stewart L. Brown, *Fund Advisory Fees: The Cost of Conflicts of Interest*, 26 J. Corp. L. 610 (2001); John P. Freeman, *The Use of Mutual Fund Assets to Pay Marketing Costs*, 9 Loyola U. Chi. L.J. 533 (1978); John P. Freeman, *Marketing Mutual Funds and Individual Life Insurance*, 28 S.C. L. Rev. 1 (1976); Student Survey, *The Mutual Fund Industry: A Legal Survey*, 44 Notre Dame L. Rev. 732 (1969) (co-author). Professor Freeman has consistently spoken out about the duties that mutual fund advisers owe to fund shareholders and the funds that the advisers indisputably dominate and control, and he has commented on SEC rule proposals. He also testified before Congress on mutual fund regulatory issues. *See Oversight Hearing on Mutual Funds:*

---

[1] Pursuant to Supreme Court Rule 37.6, counsel for *amici* represents that no counsel for a party authored this brief in whole or in part and that none of the parties or their counsel, nor any other person or entity other than *amici* or their counsel, made a monetary contribution intended to fund the preparation or submission of this brief. Counsel for *amici* also represents that all parties have consented to the filing of this brief, and letters reflecting their blanket consent to the filing of *amicus* briefs have been filed with the Clerk.

Hidden Fees, Misgovernance and Other Practices that Harm Investors: Hearing Before the Subcomm. on Fin. Mgmt., the Budget, and Int'l Sec. of the S. Comm. on Governmental Affairs, 108th Cong. 70-72, app. at 266-75 (2004) (statement of John P. Freeman).[2] In addition, Professor Freeman's scholarship triggered the New York Attorney General's investigation into the mutual fund industry that ultimately uncovered the market-timing and late-trading scandals. *See* Brooke A. Masters, *Spoiling for a Fight: The Rise of Elliot Spitzer* 133-35 (2006) (discussing the role of Professor Freeman's 2001 article in the Journal of Corporation Law in inspiring the Office of the New York Attorney General to investigate the mutual fund industry); Henny Sender & Gregory Zuckerman, *Behind the Mutual-Fund Probe: Three Informants Opened Up*, Wall St. J., Dec. 9, 2003 (same).[3] Professor Freeman's curriculum vitae is available at http://www.law.sc.edu/faculty/freeman/cv.pdf.

Amicus James D. Cox is the Brainerd Currie Professor of Law at Duke University School of Law. He has also taught law at the Hastings College of Law at the University of California, Stanford Law School, the University of San Francisco School of Law, and Boston University School of Law. Professor Cox is co-author of a leading treatise on corporate law and a leading casebook on securities regulation. *See* James D. Cox & Thomas L. Hazen, *Cox & Hazen on Corporations: Including Unincorporated Forms of Doing Business* (2d ed. 2003); James D. Cox et al., *Securi-*

---

[2] Available at http://www.access.gpo.gov/congress/senate/pdf/108hrg/92686.pdf.

[3] Available at http://www.latrobefinancialmanagement.com/Research/Money_Management/Behind%20the%20Mutual-Fund%20Probe.pdf.

ties Regulation: Cases and Materials (6th ed. 2009). Professor Cox has been analyzing and writing about issues involving corporate governance and securities regulation for over 35 years, including issues affecting the mutual fund industry. Examples of such articles include: James D. Cox et al., *Lying and Getting Caught: An Empirical Study of the Effect of Securities Class Action Settlements on Targeted Firms*, 158 U. Pa. L. Rev. 1877 (2010); James D. Cox, *Coping in a Global Marketplace: Survival Strategies for a 75-Year-Old SEC*, 95 Va. L. Rev. 941 (2009); James D. Cox et al., *Do Differences in Pleading Standards Cause Forum Shopping in Securities Class Actions?: Doctrinal and Empirical Analyses*, 2009 Wis. L. Rev. 421 (2009); James D. Cox & John W. Payne, *Mutual Fund Expense Disclosures: A Behavioral Perspective*, 83 Wash. U. L.Q. 907 (2005); James D. Cox & Randall S. Thomas, *Public and Private Enforcement of the Securities Laws: Have Things Changed Since Enron?*, 80 Notre Dame L. Rev. 893 (2005); James D. Cox et al., *SEC Enforcement Heuristics: An Empirical Inquiry*, 53 Duke L.J. 737 (2004); James D. Cox, *Managing and Monitoring Conflicts of Interest: Empowering the Outside Directors With Independent Counsel*, 48 Vill. L. Rev. 1077 (2003). Professor Cox has testified before Congress on securities-regulation issues on several occasions. *See, e.g.*, *The Insider Trading Proscriptions Act of 1987: Hearings on S. 1380 Before the Subcomm. on Sec. of the S. Comm. on Banking, Housing, and Urban Affairs*, 100th Cong. 78-83 (1987) (statement of James D. Cox);[4] *Illegal Insider Trading: How Widespread Is the Problem and Is There Adequate Criminal Enforcement?: Hearing Before the S. Comm. on the Judiciary*, 109th Cong.

[4] Available at http://www.archive.org/stream/insidertradingp00secugoog#page/n0/mode/1up.

17-18, 77-87 (2007).[5] Professor Cox's curriculum vitae is available at http://www.law.duke.edu/fac/cox/cv.

Professors Freeman and Cox have over 70 years of combined experience teaching about corporate governance practices and SEC compliance issues, including those related to the preparation and filing of registration statements. As close observers and students of the mutual fund industry, they have a thorough understanding of the industry's structure and management practices. In addition, Professors Freeman and Cox served as disinterested mutual fund directors for the First Phoenix Fund, Inc. This service informs their perspective on the issues in this case.

INTRODUCTION

Petitioner Janus Capital Management LLC (JCM) is the investment adviser to the Janus family of mutual funds (Janus Funds). Petitioner Janus Capital Group Inc. is JCM's publicly traded parent corporation. Petitioners repeatedly characterize JCM as a mere "service provider" to the Janus Funds and downplay JCM's role with respect to the Funds' registration statements.[6] Petitioners also characterize the Fourth Circuit's opinion below as an unauthorized and unnecessary expansion of liability under § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b). These characterizations are at complete odds with practical reality.

---

[5] Available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=109_senate_hearings&docid=f:31445.pdf.

[6] The registration statements include the Funds' prospectuses and statements of additional information. *See Registration Form Used by Open-End Management Investment Companies*, SEC Release No. 33-7512, 63 Fed. Reg. 13,916 (Mar. 13, 1998).

Like other mutual fund advisers, JCM is no mere "service provider" to the funds it controls, and JCM did much more than "help draft" the Janus Funds' misleading registration statements. JCM was fully responsible for the registration statements, which described JCM's activities and which JCM used to market fund shares to potential investors. Affirming the Fourth Circuit's opinion below would not expand § 10(b) liability. Rather, *amici* herein urge this Court to recognize this case for what it is: a claim against a primary actor for making misleading statements in a registration statement for which it was responsible and which the investing public would attribute to it.

SUMMARY OF ARGUMENT

The mutual fund industry's structure is unique. Unlike other businesses, mutual funds typically have no employees of their own and are controlled by external investment advisers who set them up and manage their day-to-day business affairs, including preparing registration statements to market shares of the funds to potential investors, all in an effort to profit from charging advisory and other fees to the funds' shareholders. The control advisers exert over their funds is widely recognized by lawmakers, courts, regulators, and commentators. In addition, publicly filed documents and discovery in this case confirm that JCM was responsible for preparing the registration statements at issue, and the SEC has already determined that JCM was responsible for the misrepresentations contained in the registration statements. Accordingly, the investing public would attribute the registration statements to JCM. Indeed, there is no one else to whom the investing public *could* attribute the registration statements. Furthermore, because JCM was responsible for the registration statements, Respondent's claim is a claim against a primary actor that would require no expansion of § 10(b) liability. Indeed, Respondent's claim represents a necessary and otherwise unavailable remedy against investment advisers who defraud their own shareholders by making misrepresentations in the registration statements for the funds they control.

ARGUMENT

I. MUTUAL FUND ADVISERS ARE NO MERE "SERVICE PROVIDERS" TO THE FUNDS THEY CONTROL

Mutual funds have a unique management structure and do not function like normal businesses. Instead of being operated by internal management, mutual funds are operated by external investment advisers who have de facto control over the funds. *See* John P. Freeman et al., *Mutual Fund Advisory Fees: New Evidence and a Fair Fiduciary Duty Test*, 61 Okla. L. Rev. 83, 87 (2008). The relationship between an investment adviser and the funds it controls is thus fundamentally different than the funds' relationship with service providers such as lawyers, accountants, and banks (e.g., custodians). Unlike these traditional secondary actors,[7] fund advisers are in charge of the day-to-day operations of the funds. In fact, mutual funds typically have no employees or offices themselves; instead, the adviser furnishes all employees and facilities necessary for the adviser to carry out the funds' daily operations. *See* Investment Company Institute, *2010 Investment Company Fact*

---

[7] *See Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 191 (1994) (identifying "lawyer[s], accountant[s], [and] bank[s]" as secondary actors).

Book app. A, at 189 (2010) ("Unlike other companies, … a mutual fund is typically externally managed; it is not an operating company and it has no employees in the traditional sense.") To be sure, there is a contractual relationship between the adviser and the funds, and a comprehensive set of regulations exists to ameliorate conflicts of interest inherent in this relationship. But this legal regime does not eliminate the conflicts of interest, nor does it obscure the practical reality that the adviser controls the funds. In fact, the legal regime exists for the very reason that mutual funds are not self-effectuating entities in any real sense. And advisers' control over the funds they manage is well known and understood by lawmakers, courts, regulators, and commentators.

A. Congress

Congress enacted the Investment Company Act to mitigate the conflicts of interest inherent in the relationship between investment advisers and their captive mutual funds. A critical premise of the Act and its 1970 amendments is that mutual funds are not in any practical sense independent from the advisers that create and operate them. The Senate Committee on Banking and Currency elaborated on this concept in reporting on what would ultimately become the 1970 amendments to the Act:

> Mutual funds, with rare exception, are not operated by their own employees. Most funds are formed, sold, and managed by external organizations, that are separately owned and operated. These separate organizations are usually called investment advisers. The advisers select the funds' investments and operate their businesses. ….

> Because of the unique structure of this industry the relationship between mutual funds and their investment advisers is not the same as that existing between buyers and sellers or in conventional corporate relationships. Since a typical fund is organized by its investment adviser which provides it with almost all management services and because its shares are bought by investors who rely on that service, a mutual fund cannot, as a practical matter server its relationship with the adviser.

S. Rep. No. 91-184, at 5 (1969), *reprinted in* 1970 U.S.C.C.A.N 4897, 4901. This premise has since informed this Court's decisions involving the Investment Company Act.

B. This Court and Other Federal Courts

This Court acknowledged the practical non-severability of the relationship between mutual funds and their advisers over thirty years ago. *See Burks v. Lasker*, 441 U.S. 471, 480-81 (1979) (quoting S. Rep. No. 91-184, at 5). And this Court has since continued to recognize the attendant control advisers exert over their funds. In *Daily Income Fund, Inc. v. Fox*, 464 U.S. 523 (1984), the Court observed: "Unlike most corporations, [a mutual fund] is typically created and managed by a pre-existing external organization known as an investment adviser … [that] generally supervises the daily operations of the fund …." 464 U.S. at 536 (citing *Burks*, 441 U.S. at 481). Just recently, this Court echoed that observation, stating that the investment adviser typically "creates the mutual fund, … selects the fund's directors, manages the fund's investments, and provides other services." *Jones* v. *Harris Assocs. L.P.*, 130 S. Ct. 1418, 1422 (2010).

The Second Circuit, home to a large portion of the mutual fund industry, has also recognized that "[c]ontrol of a mutual fund … lies largely in the hands of the investment adviser." *Tannenbaum v. Zeller*, 552 F.2d 402, 405 (2d Cir. 1977). As the Second Circuit has explained, "[a] mutual fund is a 'mere shell,' a pool of assets," whose management "is largely in the hands of an investment adviser, an independent entity which generally organizes the fund and provides it with investment advice, management services, and office space and staff." *Id.* In addition to providing investment advice, the adviser "operates or supervises most of the other phases of the fund's business." *Id.* Judge Posner of the Seventh Circuit has also acknowledged the "captive" nature of the typical adviser-fund relationship. *See Jones v. Harris Assocs. L.P.*, 537 F.3d 728, 731 (7th Cir. 2008) (Posner, J., dissenting from denial of rehearing en banc) ("And there is no doubt that the captive funds are indeed captive.").

C. The SEC

The SEC, the agency responsible for regulating the mutual fund industry, has long held the view that investment advisers control their funds. As the SEC reported to Congress in 1966, "mutual funds are formed by, and generally remain under, the effective control of their advisers." *Report of the SEC on the Public Policy Implications of Investment Company Growth*, H.R. Rep. No. 89-2337, at 12 (1966) [hereinafter *SEC Report*]; *see also id.* at 74 ("Although the funds are legally separate entities, they are under the effective control of their advisers and principal underwriters."). The SEC recognized that there is a "virtually complete merger" between mutual funds and their advisers, *id.* at 126-27, and that mutual funds are "without an identity and an organization separate from [their advisers]," *id.* at 74. At the 1967 hearings before the Senate on proposed amendments to the Investment Company Act, SEC Chairman Manuel Cohen made the following remarks in response to testimony by industry witnesses:

> They [industry witnesses] also made the point that the investment adviser creates the fund, and operates it in effect as a business. Many of them stated that "It is our fund, we run it, we manage it, we control it," and I don't think there is anything wrong with them saying it. They were just admitting what is a fact of life. The investment adviser does control the fund.

Investment Company Act Amendments of 1967: Hearings on H.R. 9510 and H.R. 9511 Before the Subcomm. on Commerce and Fin. of the H. Comm. on Interstate and Foreign Commerce, 90th Cong. 674 (1968) (statement of Manuel F. Cohen, Chairman, SEC).

The SEC has continued to espouse the view that investment advisers control their mutual funds. In a 1977 Investment Company Act Release, the SEC stated that "the term 'investment adviser' is to some extent a misnomer. … The so-called 'adviser' is no mere consultant. … [T]he investment adviser almost always controls the fund." *In re Steadman Sec. Corp.*, Exchange Act Release No. 13695, Investment Company Act Release No. 9830, Investment Advisers Act Release No. 593, 46 S.E.C. 896, 920 n.81 (June 29, 1977) (citation omitted). In fact, the SEC found that, because the investment adviser "manages the fund's affairs and … is normally the only audible voice in day-to-day management," the investment adviser's status as such "is normally enough in itself" to establish control under the Investment Company Act. *See id.* And the SEC has advanced its view that advisers control their funds before this Court for over twenty-five years. *See* Brief for the SEC as Amicus Curiae in Support of Affirmance at 10, *Daily Income Fund, Inc. v. Fox*, 464 U.S. 523 (1984) (No. 82-1200) ("[T]he adviser of an investment company typically exercises at least as much control over the company as internal management does in other corporations."); U.S. Cert. Br. 8-10.

D. Commentators

Observers of the mutual fund industry have written extensively about the unique external management structure of mutual funds and the control advisers exert over the funds they manage. *See*, *e.g.*, John P. Freeman et al., *Mutual Fund Advisory Fees: New Evidence and a Fair Fiduciary Duty Test*, 61 Okla. L. Rev. 83, 87-89 (2008); Lyman Johnson, *A Fresh Look at Director "Independence": Mutual Fund Fee Litigation and Gartenberg at Twenty-Five*, 61 Vand. L. Rev. 497, 504 (2008) ("For the most part, the investment adviser runs the company and, for a variety of reasons, stands in a dominant and controlling position with respect to the fund."); Donald C. Langevoort, *Private Litigation To Enforce Fiduciary Duties in Mutual Funds: Derivative Suits, Disinterested Directors and the Ideology of Investor Sovereignty*, 83 Wash. U. L.Q. 1017, 1031-32 (2005); John P. Freeman & Stewart L. Brown, *Mutual Fund Advisory Fees: The Cost of Conflicts of Interest*, 26 J. Corp. L. 609, 614-18 (2001); John C. Bogle, *Bogle on Mutual Funds* 300 (1994) ("Ordinary corporations do not need to go out and hire other corporations, with separate owners, to manage their affairs. Mutual funds do precisely that ….")

An adviser's control over a fund it manages starts at the fund's inception and is strong and enduring. As one early observer explained:

> The fund is conceived by a bunch of people whom we call advisers or managers. … This group gives birth to the fund. The fund is manned by the advisers. If I may carry this figure of speech, the umbilical cord is never cut after birth, as would be true in ordinary biological life.

University of Pennsylvania Law School Conference on Mutual Funds, *The Mutual Fund Management Fee*, 115 U. Pa. L. Rev. 726, 739 (1967) (statement of Abraham L. Pomerantz); *see also* Freeman & Brown, *supra*, at 615 ("The external manager typically controls all facets of fund life, from the fund's incorporation through the selection of the initial board."). Importantly, advisers tend not to relinquish control given the financial stakes at issue. As John C. Bogle, founder of the Vanguard Group, explained:

> "[Mutual funds] are operated by external ... management companies which seek to earn high returns for fund investors, to be sure, but seek at the same time to earn the highest possible returns for themselves. Some of these companies are publicly held, in which case their shares are held by investors who own their shares for the same reason that investors own Microsoft or General Motors: To make money for themselves."

John C. Bogle, *Honing the Competitive Edge in Mutual Funds, Address Before the Smithsonian Forum*, Washington, D.C. 5 (Mar. 23, 1999) (on file with authors); *see also* 1 Tamar Frankel & Ann Taylor Schwing, *The Regulation of Money Managers: Mutual Funds and Advisers* § 1.01[B][1][b] (2d ed. 2001) ("The practice of external management does not weaken the outside adviser's control over the management company. … Besides, the company is dependent on the advisers' services."). Thus, advisers have every incentive to tightly control every aspect of their funds' operations. And this control tends not to be relinquished unless the adviser is bought by another external adviser, typically at a very nice profit.[8]

II. JCM WAS RESPONSIBLE FOR THE JANUS FUNDS' REGISTRATION STATEMENTS, AND THE INVESTING PUBLIC WOULD ATTRIBUTE THE REGISTRATION STATEMENTS TO JCM

Consistent with industry practice, the registration statements for the Janus Funds provide that JCM "is responsible for the day-to-day management of the … business affairs of the Funds," including providing "administrative, compliance and accounting services … [and] office space for the Funds." *E.g.*, J.A. 359a-60a; *see also* J.A. 250a-58a (indicating that all seventeen officers of the Janus Funds are also officers of JCM and that the Funds and JCM share the same general counsel). Indeed, the publicly filed Administrative Services Agreement for at least one of the Funds referenced in the Second Amended Complaint provides that JCM "shall perform or cause to be performed all … *registration functions* of the Funds, including the preparation of reports and returns inci-

---

[8] For a discussion on the extraordinary profitability of the fund management industry, see Freeman et al., *supra*, at 89-91.

dental thereto." *Janus Adviser Series, Administrative Services Agreement*, April 3, 2000, ¶ 1 (emphasis added).[9] At any rate, discovery in this case confirmed that JCM was specifically responsible for the registration statements at issue in this case. In particular, JCM admitted in its interrogatory responses that JCM's legal department drafted the registration statements and that JCM's General Counsel was one of the persons "ultimately responsible" for revisions and amendments to the registration statements. J.A. 507a-08a;[10] *see also In re Mutual Funds Inv. Litig.*, 590 F. Supp. 2d 741, 747 (D. Md. 2008) ("Janus defendants admit that 'it is undisputed that the Janus legal department drafted and edited certain prospectus language, which was then circulated among JCM and JCG employees for review.'"). These admissions are not surprising given the well-known captive nature of the typical adviser-fund relationship. *See supra* Part I.

The SEC has also determined that JCM, not the Janus Funds, was responsible for the registration statements at issue in this case. In a 2004 cease-and-desist order, the SEC found:

> JCM willfully violated Section 34(b) of the Investment Company Act in that *it* [i.e., not the Funds] made an untrue statement of material fact in a registration statement,

---

[9] Available at http://www.sec.gov/Archives/edgar/data/1110822/0001110822-00-000003.txt. The Agreement is between Janus Adviser Series, which includes the Janus Adviser Worldwide Fund, and Janus Capital Corporation (JCC). JCM is the successor in interest to JCC. *See* Pet. App. 28a n.3.

[10] The cited material refers to the Janus Funds' prospectuses, which are part of the Funds' registration statements. *See supra* n.6.

> application, report, account, record, or other document filed or transmitted pursuant to the Investment Company Act …. For example, JCM [i.e., not the Funds] filed several registration statements with the Commission containing prospectuses that falsely stated or otherwise represented that JCM did not permit frequent trading or market timing in its mutual funds.

In re Janus Capital Mgmt., LLC, Investment Advisers Act Release No. 2277, Investment Company Act Release No. 26532, 83 S.E.C. 1766, ¶ 26 (Aug. 18, 2004) (emphasis added), *reproduced at* J.A. 415a.

Given the well-known captive nature of the typical adviser-fund relationship, coupled with the public disclosures of JCM's responsibility for the day-to-day business affairs of the Janus Funds, including specifically responsibility for the registration statements at issue in this case (which the SEC has already found), there is no question the investing public would attribute the registration statements at issue to JCM. No inference is necessary.[11] Indeed, there is no one other than JCM to whom the investing public *could* attribute the registration statements. *See SEC Report* at 74 ("The fund remains, as it always was, without an identity and an organization separate from its adviser-underwriter.").

---

[11] *Amici* herein agree with Respondent and the United States that attribution is not required in the context of this case. But at any rate, any attribution requirement would be met here.

III. AFFIRMING THE FOURTH CIRCUIT WOULD NOT EXPAND § 10(b) LIABILITY AND WOULD PROVIDE A NECESSARY REMEDY AGAINST INVESTMENT ADVISERS THAT DEFRAUD THEIR OWN SHAREHOLDERS

As explained above, JCM controlled the Janus Funds, in particular with respect to preparing the registration statements at issue in this case. Thus, Respondent's claim against JCM is a claim against a primary actor for making misleading statements that the investing public would attribute to it. Accordingly, affirming the Fourth Circuit does not require an exception to or expansion of § 10(b) liability as Petitioners repeatedly suggest. *See* Pet. Br. 8, 9, 14, 26-27. Moreover, contrary to Petitioners' assertion that recognizing liability in the context of this case is "entirely unnecessary to the effective operation of the securities laws," Pet. Br. 26, Respondent's claim represents a necessary and otherwise unavailable remedy against investment advisers who defraud their own shareholders by making misrepresentations in the registration statements for the funds they control. Indeed, immunizing advisers against such liability, as Petitioners would have this Court do, would encourage unscrupulous advisers to commit just this sort of fraud. And the incentive would be particularly strong given that the funds' registration statements are the very vehicle advisers use to market fund shares to prospective shareholders from whom the advisers hope to reap additional advisory fees, the profits from which attract investors in the advisers' stock. The Investment Company and Investment Advisers Acts of 1940 do not protect against such fraud, and mutual fund directors are in no position to prevent it.

Petitioners argue that "[t]he 1940 Acts contain broad provisions … prohibiting fraud and other misconduct by investment advisers." Pet. Br. 27. But the Acts are designed to protect investors in mutual funds, not investors in the mutual funds' advisers. *See Jones*, 130 S. Ct. at 1422 ("[The Investment Company] Act created protections for *mutual fund shareholders*.") (emphasis added). Moreover, while the Acts were adopted because of Congress's concern with the "potential for abuse" inherent in the adviser-fund relationship, which is "fraught with potential conflicts of interest," *Daily Income Fund*, 464 U.S. at 536 (internal quotations and citations omitted), the Acts do not eliminate the potential abuse or conflicts. *See* S. Rep. No. 91-184, at 5 (1969), *reprinted in* 1970 U.S.C.C.A.N. 4901 ("[A] mutual fund cannot, as a practical matter, sever its relationship with the adviser."). Nor do the 1940 Acts eliminate the possibility that advisers will exploit these conflicts to defraud their own shareholders through use of the registration statements for the funds the advisers control.

Petitioners also seem to imply that review and approval of registration statements by disinterested fund directors offers some level of protection. But such protection is inadequate to protect against the fraud at issue in this case. *Amici* herein, having served as disinterested directors to a mutual fund, know from personal experience that the directors, as a practical matter, do not have the resources or control to prevent such fraud. As the SEC has explained:

> The unaffiliated directors … have no staff of officers and employees who work for and are

> compensated by the fund. … Hence the unaffiliated directors necessarily obtain most of their information about fund operations from persons who also owe allegiance to, and obtain the preponderance of their compensation from, the adviser-underwriters …. Indeed, in some cases all of the fund's records are maintained by the fund's adviser. Although the unaffiliated directors under state law have an unqualified right of access to these records, the adviser, as a practical matter, is in a position to seriously hamper any employment of that right which might interfere with or threaten the adviser's operation of or control over the fund.

SEC Report at 130-31; *see also id.* at 12 ("[Unaffiliated directors] are seldom free as a practical matter to terminate a long established management relationship …."); *A Study of Mutual Funds Prepared for the SEC by the Wharton School of Finance and Commerce*, H.R. Rep. No. 87-2274, at 34 (1962) ("[T]he independent director requirement may be of restricted value as an instrument for providing effective representation of mutual fund shareholders in dealings between the fund and its investment adviser."); Freeman & Brown, *supra*, at 617 ("In practice, while independent fund directors have the right … to fire the fund's advisor or underwriter, those rights are virtually never exercised."). Influential industry observer Warren Buffet has been particularly critical of mutual fund directors:

> I think independent directors have been anything but independent. The Investment Company Act, in 1940, made these provisions for independent directors on the theory that

> they would be the watchdogs for all these people pooling their money. The behavior of independent directors in aggregate since 1940 has been to rubber stamp every deal that's come along from management—whether management was good, bad, or indifferent. Not negotiate for fee reductions and so on. A long time ago, an attorney said that in selecting directors, the management companies were looking for Cocker Spaniels and not Dobermans. I'd say they found a lot of Cocker Spaniels out there.

Strougo v. BEA Assoc., 188 F. Supp. 2d 373, 383 (S.D.N.Y. 2002) (quoting Haywood Kelly, *A Quick Q & A with Warren Buffett*, *Morningstar* (May 6, 1998)); *see also* Berkshire Hathaway, Inc., *2002 Annual Report* 17 (Warren Buffett stating that "a monkey will type out a Shakespeare play before an 'independent' mutual-fund director will suggest that his fund look at other managers, even if the incumbent manager has persistently delivered substandard performance").[12]

This case is on point. The directors of the Janus Funds were never made aware of Janus's market-timing arrangements despite widespread knowledge of them among Janus employees and executives. *See In re Lammert*, Release No. 348, Admin. Proc. File No. 3-12386, at 25 (SEC Apr. 28, 2008) ("The existence of approved market timing relationships was widely known no later than the completion of the Beery Report [in 2002], which was circulated to dozens of Janus employees and executives. This know-

[12] Available at http://www.berkshirehathaway.com/2002ar/2002ar.pdf.

ledge was never shared with the Board.").[13] In fact, one long-term director did not learn of the market-timing arrangements until he read about them in the news. *See id.* at 12 ("Dennis Mullen (Mullen), a trustee since 1971, first learned about the allegations that Janus was allowing market timing in September 2003 from a news item he received via e-mail."). The idea that disinterested directors can police the kind of fraud at issue in this case is simply unrealistic. No one but the adviser is in a position to know whether the registration statements are fraudulent or not. Yet Petitioners disclaim responsibility for the registration statements and would have this Court immunize advisers from liability for fraudulent statements contained in registration statements. But no one else is behind the curtain.

[13] Available at http://www.sec.gov/litigation/aljdec/2008/id348cff.pdf.

CONCLUSION

Because of the unique structure of the mutual fund industry, whereby investment advisers exert virtually complete control over their funds, including with respect to preparing registration statements for the funds, Respondent's claim represents a necessary and otherwise unavailable remedy against advisers who defraud their own shareholders by making misrepresentations in the registration statements. Accordingly, the judgment of the court of appeals should be affirmed.

Respectfully submitted,

MICHAEL J. BRICKMAN
Counsel of Record
JAMES C. BRADLEY
NINA H. FIELDS
RICHARDSON, PATRICK,
WESTBROOK & BRICKMAN,
LLC
174 East Bay Street
Charleston, SC 29401
(843) 727-6500
(mbrickman @rpwb.com)

November 2, 2010