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

**BRIEF OF LAW PROFESSORS
WILLIAM A. BIRDTHISTLE, TAMAR FRANKEL,
LYMAN P.Q. JOHNSON, DONALD C.
LANGEVOORT, AND MANNING G. WARREN III
AS *AMICI CURIAE*
IN SUPPORT OF RESPONDENT**

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November 2, 2010

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INTEREST OF *AMICI CURIAE*[1]

Amici are law professors[2] whose scholarship focuses on federal securities regulation and investment funds. William A. Birdthistle is Assistant Professor of Law at Chicago-Kent College of Law; Tamar Frankel is the Michaels Faculty Research Scholar and Professor of Law at Boston University School of Law; Lyman P.Q. Johnson is the Robert O. Bentley Professor of Law at Washington and Lee University School of Law and LeJeune Distinguished Chair in Law at the University of St. Thomas (Minneapolis) School of Law; Donald C. Langevoort is the Thomas Aquinas Reynolds Professor of Law at Georgetown University Law Center; and Manning G. Warren III is the H. Edward Harter Endowed Chair of Commercial Law at the Louis D. Brandeis School of Law, University of Louisville.

Amici have no financial stake in the outcome of this case but are interested in ensuring a uniform and coherent interpretation of the Securities Exchange Act of 1934 and the regulations promulgated thereunder. We file our brief to urge this Court to clarify the proper scope of liability in private litigation under Section 10(b) of the Exchange Act. We are prompted to submit our brief because the decision in this case may have significant consequences for all American shareholders and their investments.

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[1] No counsel for any party has authored this brief in whole or in part, and no person or entity other than *amici curiae* has made a monetary contribution to the preparation or submission of this brief. *See* Sup. Ct. R. 37.6. Counsel for petitioners and counsel for respondent have filed letters with the Clerk of the Court granting blanket consent to the filing of *amicus* briefs. *See* Sup. Ct. R. 37.3.

[2] *Amici* join this brief as individuals and not as representatives of any institutions with which they are affiliated.

SUMMARY OF ARGUMENT

Petitioners seek a novel exception from liability under Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") for investment managers who manipulate or deceive their shareholders. So long as those managers perpetrate their malfeasance through a business trust, petitioners contend, such defendants ought to be impervious to lawsuits brought by shareholders. To succeed upon this theory – and thereby to immunize all fund managers – petitioners must persuade this Court to believe two untruths: that the lifeless funds created and controlled by managers enjoy meaningful independent existence; and that managers are simply minions of those funds. In each case, the opposite is true.

When an investment manager suborns market timing in its mutual funds while lying to the public about doing so, the manager misleads both purchasers of its funds and the manager's own investors, whose shares rise or fall upon revenues from fund assets. Yet petitioners argue that investment managers should not be liable for any such violations of Section 10(b) and, consequently, that their investors may never recover: not from the funds, petitioners persuaded the trial court, because those entities are empty shells with "no assets separate and apart from those they hold for shareholders," *In re Mutual Funds Inv. Litig.*, 384 F. Supp. 2d 845, 853 n.3 (D. Md. 2005); nor from the managers, petitioners assert before this Court (at 9), because any false and misleading statements were made solely by the funds, which petitioners now insist are autonomous entities.

The scope of petitioners' Janus-faced, heads-I-win-tails-you-lose theory may apply at present only to the unique structure of mutual funds, but success before this Court would furnish a blueprint for widespread impunity from securities violations. Any corporation that publicly claims to police the quality of its products while surreptitiously soliciting douceurs to compromise that quality – as an investment manager does in a market-timing fraud – would receive a tutorial on how to evade legal liability. Following petitioners' example, such perpetrators would need only to replicate the structure of mutual funds by forming "another," "different" (Pet. Br. 8, 9), and judgment-proof entity to furnish – via contract – all management functions externally.

This Court can avoid such a perverse and pernicious result by applying the principles of duty and proximity set forth in *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148 (2008). The vital holding of *Stoneridge* is that liability turns on concrete connections between the defendants, the plaintiffs, and the fraud – such as those between investment managers, their shareholders, and market timing – not upon stage-managed formalisms.

A. Investment Managers Exert an Extraordinary Degree of Control over Their Mutual Funds

All three branches of the U.S. government recognize that managers exert an extraordinary degree of control over their funds, in marked contrast to petitioners' characterization of managers as distant and subservient third parties. Just last Term, in *Jones v. Harris Associates L.P.*, 130 S. Ct. 1418, 1422 (2010), this Court noted that it is "typical" for a fund manager to "create[] the mutual fund," "select[] the fund's directors, manage[] the fund's investments, and provide[] other services." The U.S. Senate has noted "the unique structure of this industry" in which funds are typically "formed, sold, and managed by external organizations, that are separately owned and operated"; that managers "select the funds' investments and operate their businesses" and provide "almost all management services"; and therefore, "a mutual fund cannot, as a practical matter sever its relationship with the adviser." S. Rep. No. 91-184, at 4 (1969), *reprinted in* 1970 U.S.C.C.A.N. 4897, 4901. The Securities and Exchange Commission ("SEC") has stated that "the term 'investment adviser' is to some extent a misnomer" because "[t]he so-called 'adviser' is no mere consultant. He is the fund's manager. Hence the investment adviser almost always controls the fund." *In re Steadman Sec. Corp.*, 46 S.E.C. 896, 920 n.81 (1977) (citations omitted).

Petitioners nevertheless insist that investment managers are, as a categorical matter, "secondary actors" and that any of their alleged malfeasance is therefore too attenuated to trigger liability (at 15-21). Having begged the central question of this dispute by labeling themselves taxonomically too remote to be held liable, petitioners then conclude at each step in their fraud-on-the-market analysis that they are in fact too remote to be held liable.

Yet for proof of this inviolable status, petitioners rely upon a Potemkin array of formalities. Central to all their arguments is the contention that investment managers are merely subaltern "service providers" orbiting funds at great distance, tethered only by the flimsiest thread of contract (at 8). Very much to the contrary, investment managers are prime movers who reign from the center of the mutual fund universe. In the beginning, managers create, incubate, and hold their funds as wholly owned subsidiaries. *See* William A. Birdthistle, *Compensating Power: An*

Analysis of Rents and Rewards in the Mutual Fund Industry, 80 Tul. L. Rev. 1401, 1423-1424 (2006) (noting that managers sustain funds on "life support" by externally providing all fund management). During this period of infancy, when the manager owns every share and every dollar in a fund, the manager and fund execute a contract – which petitioners produce as evidence of independence – whose two signatories are each controlled by the manager. *See generally* 2 Tamar Frankel & Ann Taylor Schwing, *The Regulation of Money Managers* § 12 (2d ed. 2001).

This Court can determine the appropriate extent of liability in these circumstances by applying the guiding principles crystallized in its most recent ruling on Section 10(b) liability, *Stoneridge*, *supra*. In *Stoneridge*, this Court emphasized the primacy of proximity and duty – rather than empty labels manipulable by *soi-disant* "service providers" – when determining the reach of private rights of action under Section 10(b). 552 U.S. at 158.

B. Investment Managers "Make" the Statements Contained in the Prospectuses of Their Mutual Funds

The dominant role of investment managers helps to explain the two central rulings of the court below: that defendants made the alleged misstatements and that plaintiff-shareholders relied to their detriment upon those statements. In both *Stoneridge* and *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994), this Court chose not to confine Section 10(b) liability to the entity to which a public misrepresentation is expressly attributed. To issue such a categorical rule would have been to invite gamesmanship in categorization, whereby perpetrators could escape liability merely by interposing separate but subservient entities between themselves and their fraud. This case is an archetypal illustration of the circumstances understood but unruled upon in *Stoneridge*, in which one entity may so dominate another that it must be recognized to have made any misrepresentations and therefore to be held liable as a primary violator.

The complaint alleges, and industry practice supports the contention, that the fund manager "wrote and represented [its] policy against market timers," Pet. App. 69a; that it "publicly issu[ed] false and misleading statements" concerning that policy, *id.* at 109a; and that petitioners "caused mutual fund prospectuses to be issued for Janus mutual funds and made them available to the investing public, which created the misleading impression that [petitioners] would implement measures to curb market timing in the Janus Funds," *id.* at 60a. Accordingly, the Fourth Circuit reasonably concluded that "[t]hese statements, taken together, allege that [petitioners], by participating in the writing and dissemination of the prospectuses, *made* the misleading statements contained in the documents." *Id.* at 18a.

Were one to conclude that the manager does not make the statements, misleading or otherwise, in a fund prospectus, one would be left to wonder who does. To answer that the fund makes such statements would be to admit circuitously that the manager does so, inasmuch as the fund has no employees and its only officers are employees of the manager, who pays their salaries. To answer that the board of trustees makes such statements would be to misunderstand fundamentally the process by which hundreds of pages of mandatory disclosure are created for each fund every year, a production from which trustees are almost entirely absent. In fact, the detailed and extensive content of fund disclosure is furnished almost exclusively by the only entity who knows that information: the investment manager actually operating the fund.

In a revealingly inapt analogy, petitioners argue that the President, not his speechwriters, "makes" a speech (at 11). No one familiar with the operation of this industry would ever confuse a mutual fund for the President. In such a comparison, funds are far more akin to a microphone and speakers: necessary instrumentalities that insentiently broadcast the principal's message. The investment manager, of course, is always the principal, writing and broadcasting the communications of its funds. And courts have long since ceased to find inanimate objects guilty for the wrongdoings of those who wield them. *See Calero-Toledo v. Pearson Yacht Leasing Co.*, 416 U.S. 663, 682 (1974) ("Deodands did not become part of the common-law tradition of this country.").

C. Statements in Mutual Fund Prospectuses Are Attributable to the Funds' Investment Managers

Petitioners argue that putative plaintiffs cannot demonstrate reliance upon any misleading statements in a prospectus unless those statements are "directly attributed" to the manager (at 11-12). Such a strict attribution rule accords with neither the rationale of the fraud-on-the-market theory nor this Court's ruling in *Stoneridge*. Indeed, such a rule would automatically eliminate the possibility of review for a vast universe of fraud and, in so doing, render the *Stoneridge* inquiry into remoteness and attenuation largely irrelevant. Without direct attribution, cases would be disposed of prior to a *Stone-*

ridge analysis; with direct attribution, *Stoneridge* would almost necessarily be satisfied. *See* Donald C. Langevoort, *Reading* Stoneridge *Carefully: A Duty-based Approach to Reliance and Third Party Liability Under Rule 10b-5*, 158 U. Pa. L. Rev. 2125, 2157-2161 (2010).

Consider the numerous cases in which a corporate executive intentionally misleads a journalist or financial analyst, who in turn publishes highly favorable reports without identifying the executive as a source. *See id.* at 2159. Even in the absence of direct attribution, the executive has nevertheless perpetrated a clear fraud on the market. Courts have reasonably responded to such cases by finding the executive liable, yet petitioners' rule would overturn such decisions. *See id.* (citing, *e.g.*, *Cooper v. Pickett*, 137 F.3d 616, 624 (9th Cir. 1997); *Freeland v. Iridium World Commc'ns, Ltd.*, 545 F. Supp. 2d 59, 74-76 (D.D.C. 2008)). The sensible approach, set forth by this Court in *Stoneridge*, is instead to inquire whether the executive engaged in a deceptive scheme and, if so, whether that deception was sufficiently proximate to the statements upon which investors relied. *See id.* A strict attribution rule would senselessly abort the sound analysis of *Stoneridge*.

In this case, however, any notion of public attribution is readily satisfied. Investment managers themselves strive consciously to form a public connection between themselves and their funds. When forming a new fund, the manager typically selects a name that blazons the manager's brand upon the new fund by incorporating the manager's name into the fund's name. Hence, each of the putatively autonomous funds at issue here features "Janus" in its name. Investment managers take direct and voluntary measures to persuade the marketplace to attribute the performance of their funds to the operations of their managers.

The marketplace, in turn, reasonably does so. Sophisticated investors familiar with the structure and operation of mutual funds know that statements published by a mutual fund flow from the will of its manager. Less sophisticated investors unaware of any separation between managers and their funds may simply assume that mutual fund shares are products purchased directly from the manager. In either case, the acts of funds are widely attributed to their managers. One wonders to whom else they could meaningfully be attributed. Indeed, were an investment manager to make an exculpatory statement in a fund prospectus, one would readily expect the manager to argue that such statements sufficiently placed the manager's own investors on notice.

As an empirical matter, the marketplace demonstrated its widespread attribution of fund statements to investment managers: upon the public allegation of market timing in mutual funds, stock prices of the accused managers fell rapidly. *See*, *e.g.*, Riva D. Atlas, *Janus Capital Meets the Enemy And It Is Janus*, N.Y. Times, Nov. 13, 2003, at C1 (noting that Janus Capital lost "more than 20 percent of market value of its shares in recent weeks").

If petitioners were to succeed in their effort to substitute "express" for actual attribution in this analysis, then a critical element of proving Section 10(b) liability would fall within the direct manipulation of perpetrators. As the government noted, to avoid liability, a violator would need only be discreet enough to avoid speaking aloud what the marketplace already knows. U.S. Cert. Br. 16. This Court should refrain from creating a unique exemption from Section 10(b) liability for investment managers or any future violators who follow their example.

ARGUMENT

I. INVESTMENT MANAGERS EXERT AN EXTRAORDINARY DEGREE OF CONTROL OVER THEIR MUTUAL FUNDS

An investment manager that perpetrates a market-timing scheme in its mutual funds does far more than simply make an untrue statement of material fact in violation of SEC Rule 10b-5. *See* 17 C.F.R. § 240.10b-5(b). Rather, the manager masterminds an intricate fraud upon two different groups of investors simultaneously: the vulnerable long-term purchasers of shares in the manager's mutual funds and the holders of equity in the manager itself. The far-reaching mechanics of market timing reveal the primary role of managers in both operating mutual funds and engineering this particular violation of Section 10b of the Exchange Act.

A. Market-Timing Fraud Involves Control by Investment Managers of an Expansive Array of Mutual Fund Operations

An investment manager orchestrates a market-timing ruse first by luring prey, then by setting predators upon it. The bait are individual, long-term, buy-and-hold investors, whom the manager attracts to its funds with false promises of safety; *viz.*, explicit policies barring market timing. The hunters are institutional traders, such as hedge funds, who move large sums of money rapidly in and out of mutual funds to arbitrage the unusual pricing system of those funds. Market timers' gains come from the dilution of long-term investors' returns. Throughout, the investment manager collects fees from both groups. *See* Tamar Frankel & Lawrence A. Cunningham, *The Mysterious Ways of Mutual Funds: Market Timing*, 25 Ann. Rev. Banking & Fin. L. 235, 258-259 (2006).

A separate population of investors defrauded by this scheme – which includes the plaintiff in the current dispute – comprises the manager's equity holders, who invested in reliance upon public assurances that the manager disallowed market timing in its funds. When allegations of managers' complicity in market timing came to light, those investors suffered the greatest collapse in their investments as stock prices in managers such as Janus plummeted. *See, e.g.*, Atlas at C1.

To choreograph a market-timing ruse, an investment manager needs – and arrogates for itself – control over all aspects of mutual fund operations: the manager advertises its funds to new purchasers through an affiliated distributor; the manager determines the policies that govern those funds and publicizes them in fund prospectuses that it writes; the manager monitors trading activity in the shares of its funds through an affiliated transfer agent or administrator; and the manager negotiates special arrangements for favored clients such as hedge funds who engage in market timing. *See generally* Frankel & Schwing §§ 12, 21-22, 27, 32.

One prominent example of market timing involves time-zone arbitrage. *See* Jonathan R. Macey, *The Distorting Incentives Facing the U.S. Securities and Exchange Commission*, 33 Harv. J.L. & Pub. Pol'y, 639, 662-665 (2010). Because mutual fund shares are priced only once a day, those prices can quickly become stale. Events on the other side of the world may cause securities of foreign companies to fluctuate in price. Accordingly, the true value of any U.S. mutual fund holding those foreign securities will change even before the fund's shares are repriced the next day. During those intervals when a fund's price and value do not correspond, a sophisticated market timer can arbitrage the variance by moving large sums of cash into (to capture gains) or out of (to avoid losses) the fund. Of course, the market timer's gains and losses must come from somewhere:

> By moving large blocks of cash into a fund in anticipation of a rise in the fund's value, the market timer dilutes the worth of each individual share of the fund. Although the timer's new cash was not invested in the underlying securities whose value has risen, the investment has increased the number of fund shares outstanding. Thus, with a greater denominator, the NAV [pricing] equation results in profits from positive market movements being shared by a greater number of shareholders.

Birdthistle, 80 Tul. L. Rev. at 1455.

Beyond dilution, however, market timing imposes significant transaction costs upon a fund and thus upon all of its shareholders. The rapid ingress and egress of large amounts of money creates inefficiencies in the management of the fund, as portfolio managers must accommodate large redemptions by either maintaining greater liquidity cushions (which may impose drag upon fund returns) or executing unanticipated trades to liquidate portfolio holdings (which increase fund fees). *See id.* at 1455-1456.

Investment managers, of course, are well aware of these costs and extract a form of payment from the market timers:

> In exchange for the ability to move $25 million rapidly in and out of a particular fund, for instance, a market timer might offer to leave untouched $50 million of "sticky" assets in a different fund in the adviser's complex. Such an arrangement, of course, pits the interests of the shareholders of the timed fund against those of the shareholders in the fund with sticky assets.

Id. at 1456.

In sum, to perpetrate a market-timing fraud, an investment manager must coordinate all major aspects of a mutual fund. The fund itself is little more than the manager's weapon of choice.

B. Investment Managers Dominate the Ordinary Operations of Their Mutual Funds

This Court, the United States Senate, and the Executive Branch have all noted the extraordinary degree of control that managers exert over their funds.

This Court revisited the topic of mutual funds just last Term, in *Jones v. Harris Associates*, and noted that it is "typical" for a fund manager to "create[] the mutual fund," "select[] the fund's directors, manage[] the fund's investments, and provide[] other services." 130 S. Ct. at 1422. In its previous rulings concerning mutual funds, this Court similarly remarked on the unusual proximity of managers to their funds. *See Daily Income Fund, Inc. v. Fox*, 464 U.S. 523, 536 (1984) (noting that mutual funds are "typically created and managed by a pre-existing external organization known as an investment adviser") (citing *Burks v. Lasker*, 441 U.S. 471, 481 (1979)). In perhaps the most well-known federal decision on mutual funds, the Second Circuit noted that Congress "recognized . . . the potentially incestuous relationships between many advisers and their funds." *Gartenberg v. Merrill Lynch Asset Mgmt., Inc.*, 694 F.2d 923, 929 (2d Cir. 1982).

The congressional recognition to which the Second Circuit referred exists in a United States Senate Report accompanying the passage of the Investment Company Amendments Act of 1970. The report notes "the unique structure of this industry" in which funds are typically "formed, sold, and managed by external organizations, which are separately owned and operated"; that managers "select the funds' investments and operate their businesses" and provide "almost all management services"; and, therefore, "a mutual fund cannot, as a practical matter sever its relationship with the adviser." S. Rep. No. 91-184, at 4, *reprinted in* 1970 U.S.C.C.A.N. 4901.

On several occasions, the SEC has reiterated the domination of funds by their managers. For instance, the SEC stated that "the term 'investment adviser' is to some extent a misnomer" because "[t]he so-called 'adviser' is no mere consultant. He is the fund's manager. Hence the investment adviser almost always controls the fund." *In re Steadman*, 46 S.E.C. at 920 n.81 (citations omitted).

Indeed, even the managers' own trade association has reported the extensive degree to which managers run their funds, prepare fund prospectuses, and incur consequent liability. *See* Investment Co. Inst. Amicus Brief at 18, *Jones v. Harris Assocs. L.P.*, *supra* ("Mutual fund advisers . . . prepare prospectuses, shareholder reports and other disclosures for which they have liability under the securities laws.").

Petitioners nevertheless protest that investment managers are, as a categorical matter, "secondary actors" and that any of their alleged malfeasance is therefore too attenuated to trigger liability (at 15-21). This argument ignores the relationship of the plaintiff to the defendants but, even on its own terms, it begs the central question of this dispute. By labeling themselves taxonomically too remote to be held liable, petitioners circumvent the substantive fraud-on-the-market analysis set forth in *Stoneridge*.

As proof of their status, petitioners cite an array of formalities in service of their central claim that investment managers are merely subaltern "service providers." And such service is provided, they contend, only pursuant to the same manner of contract entered into by any vendor.

Very much to the contrary, investment managers are prime movers who dominate the center of the mutual fund universe. In the beginning, managers create, incubate, and hold their funds as wholly owned subsidiaries. *See generally* 2 Frankel & Schwing § 12. During this period of infancy, when the manager owns every share and every dollar in a fund, the manager and fund execute a contract – which petitioners produce as evidence of independence – whose two parties are both controlled by the manager. *See* Birdthistle, 80 Tul. L. Rev. at 1423-1424 (noting that managers sustain funds on "life support" by externally providing all fund management).

C. Petitioners' Position Would, if Adopted, Create a Blueprint for Widespread Securities Fraud

In coordinating the elaborate deceptions and arrangements of a market-timing fraud, an investment manager uses its mutual funds as simple tools. Yet petitioners now argue that, because the manager elected to form those tools as distinct legal entities, the manager ought to enjoy a novel exception from liability under Section 10(b) of the Exchange Act. This argument is erroneous for two reasons.

First and foremost, the managers are primarily responsible for any fraud that at least "coincide[s]" with their own shareholders' purchase of shares. *SEC v. Zandford*, 525 U.S. 813, 825 (2002). The plaintiff in this case purchased shares in the defendant and alleges that the defendant made misleading statements concerning the manner in which the defendant operated its business "in connection with" that purchase. 17 C.F.R. § 240.10b-5. In *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975), this Court held that "one asserting a claim for damages based on the violation of Rule 10b-5 must be either a purchaser or seller of securities." *Id.* at 749. Again, the plaintiff here alleges it purchased stock reflecting a value that was fraudulently inflated by defendants' representations that their funds were patrolled and purged of market timers. Those representations attracted assets from customers who valued that safety, which in turn generated revenues to defendants, which in turn supported the share price. These facts constitute a clear allegation of primary liability under Section 10(b) and Rule 10b-5. *See* 17 C.F.R. § 240.10b-5.

Second, to indulge petitioners' claim that the action here is somehow secondary, one must willingly embrace a pair of falsehoods: that the lifeless funds created and controlled by managers exhibit meaningful independent existence; and that managers are simply minions of those funds. For each claim, the opposite is true.

If petitioners prevail in their argument that investment managers should not be liable for violations of Section 10(b) involving market timing, the consequences would be stark and inequitable: investors in managers would have no ability to recover fraud: they could not do so from the funds, petitioners persuaded the trial court, because those entities are empty shells with "no assets separate and apart from those they hold for shareholders," *In re Mutual Funds*, 384 F. Supp. 2d at 853 n.3; nor from the managers, petitioners assert before this Court (at 9), because any false and misleading statements were made solely by the funds, which petitioners now insist are autonomous entities.

The success of petitioners' heads-I-win-tails-you-lose theory would furnish a blueprint for widespread impunity from securities violations. Any corporation publicly claiming to police the quality of its products while secretly soliciting payments to compromise that quality – as an investment manager does in a market-timing fraud – would receive a clear path to evading legal liability. Following petitioners' example, such perpetrators would need only to reproduce the structure of mutual funds by forming "another," "different" (Pet. Br. 8, 9), and judgment-proof entity to furnish – via contract – all management functions externally.

II. INVESTMENT MANAGERS "MAKE" THE STATEMENTS CONTAINED IN THE PROSPECTUSES OF THEIR MUTUAL FUNDS

With a careful evaluation of the practice by which investment managers dominate their funds, the Fourth Circuit correctly conducted its analysis of plaintiff's fraud-on-the-market claim. Accordingly, it correctly concluded that defendants made the alleged misstatements and that plaintiff-shareholders relied to their detriment upon those statements.

In its two most prominent examinations of the private right of action under Section 10(b) of the Exchange Act, *Stoneridge* and *Central Bank*, this Court has declined to adopt the rule that petitioners crave: one that would confine Section 10(b) liability to the entity to which a public misrepresentation is expressly attributed. To issue such a categorical rule would have been to invite gamesmanship in categorization, whereby perpetrators could escape liability merely by interposing separate but subservient entities between themselves and their fraud. This case is an excellent illustration of the circumstances understood but unruled upon in *Stoneridge*, in which one entity may so dominate another that it must be recognized to have made any misrepresentations and therefore to be held liable as a primary violator.

Indeed, investment managers of mutual funds satisfy each of the *Stoneridge* criteria that mere aiders and abettors cannot. First, investment managers clearly owe a duty to disclose their true management policies to their own shareholders, whereas Scientific-Atlanta and Motorola owed nothing of the kind to the plaintiff-shareholders of Charter Communications. 552 U.S. at 158-159. Second, managers play a central role in preparing and disseminating public disclosures for their funds, whereas the defendants in *Stoneridge* had no involvement with Charter's financial statements. *Id.* at 160-161. Third, fraud of the sort alleged in this case centers upon "the realm of financing business" and thereby triggers the strictures of Section 10(b) for any perpetrators, unlike the dealings in *Stoneridge*, which occurred only within the "realm of ordinary business operations." *Id.* at 161.

The complaint alleges, and industry practice supports the contention, that the fund manager "wrote and represented [its] policy against market timers," Pet. App. 69a; that it "publicly issu[ed] false and misleading statements" concerning that policy, *id.* at 109a; and that petitioners "caused mutual fund prospectuses to be issued for Janus mutual funds and made them available to the investing public, which created the misleading impression that [petitioners] would implement measures to curb market timing in the Janus Funds," *id.* at 60a. Moreover, the record amply demonstrates that petitioners effectively merged the existence of the funds into their own: regarding control of "business affairs," JA359a-360a, officers, JA250a-258a (all 17 officers of the funds were JCM Vice Presidents), office space (provided by JCM), JA360a, business address (shared by the funds, JCM, and JCG), JA359a, 403a, 431a, and signature, JA275a (the prospectuses were signed simply by "Janus").

In a revealingly inapt analogy, petitioners argue that the President, not his speechwriters, "makes" a speech (at 11). No one familiar with the operation of this industry would ever confuse a mutual fund for the President. In such a comparison, funds are far more akin to a microphone and speakers: necessary instrumentalities that insentiently broadcast the principal's message. The investment manager, of course, is always the principal, writing and delivering the communications of its funds.

Petitioners also offer a linguistic quibble to the contention that an investment manager "makes" a statement by "participating in its preparation, filing, and dissemination." "Participation," they argue, "is a signifier of secondary action" (at 11). Not so – one can readily use the word without secondary connotations: athletes participate in contests without any suggestion that they aid and abet someone else in doing so. Indeed, some uses of the word actually emphasize primary acts: to identify someone as a participant in a symposium, for example, is to distinguish that person's activity from the audience's passivity.

Yet such argumentation in the alternative is unnecessary. For all the inquiry into circumstances and definitions, petitioners have themselves already answered the central question in this case: JCM admitted in an interrogatory that its in-house attorneys, "Kelley Howes, Bonnie Howe, and other members of JCM's legal department," drafted the prospectuses. JA507a.

III. STATEMENTS IN MUTUAL FUND PROSPECTUSES ARE ATTRIBUTABLE TO THE FUNDS' INVESTMENT MANAGERS

Petitioners argue that putative plaintiffs cannot demonstrate reliance upon any misleading statements in a prospectus unless those statements are "directly attributed" to the manager (at 11-12). Such a strict attribution rule accords with neither the rationale of the fraud-on-the-market theory nor this Court's rulings in *Stoneridge* and *Basic Inc. v. Levinson*, 485 U.S. 224 (1988). Indeed, such a rule would automatically eliminate the possibility of review for a vast universe of fraud and, in so doing, render the *Stoneridge* inquiry into remoteness and attenuation largely irrelevant. Without direct attribution, cases would be disposed of prior to a *Stoneridge* analysis; with direct attribution, *Stoneridge* would almost necessarily be satisfied. *See* Langevoort, 158 U. Pa. L. Rev. at 2157-2161.

> To illustrate why an attribution rule makes no sense, consider a case (similar to many cases that have been litigated) in which a company executive deliberately misleads a securities analyst, who then issues an excessively optimistic buy recommendation without quoting or referring to the executive. The courts' standard and sensible response has been that the executive and, derivatively, the issuer are liable. But this would not follow if we applied a strict attribution test. The better approach – *Stoneridge*'s roadmap – is to ask whether the executive employed a deceptive device or contrivance and, if so, whether it was nonetheless too remote or attenuated from the recommendation on which investors relied.

Id. at 2159 (citing, *e.g.*, *Cooper*, 137 F.3d at 624 (stating that a corporation "cannot escape liability simply because it carried out its alleged fraud through the public statements of third parties") (quoting *Warshaw v. Xoma Corp.*, 74 F.3d 955, 959 (9th Cir. 1996)); *Freeland*, 545 F. Supp. 2d at 74-76 (discussing various judicial analyses of liability predicated on misleading analysts)).

In this case, however, any requirement of public attribution is easily satisfied. Investment managers themselves work energetically to form a public connection between themselves and their funds. When creating a new fund, the manager typically selects a name that sears the manager's brand upon the new fund by incorporating the manager's name into the fund's name. Hence, each of the putatively autonomous funds at issue here features "Janus" in its name. Investment managers take these direct measures to persuade the marketplace to attribute the performance of their funds to the operations of their managers.

The marketplace, in turn, reasonably does so. Sophisticated investors who are familiar with the structure and operation of mutual funds know that statements published by a mutual fund flow from the will of its manager. Less sophisticated investors who are unaware of any separation between managers and their funds may simply assume that mutual fund shares are products purchased directly from the manager. In both cases, the acts of funds will be widely attributed to their managers. One wonders to whom else they could meaningfully be attributed. Indeed, were an investment manager to make a disclosure of material information in a fund prospectus, one would readily expect the manager to argue that such disclosures adequately placed the manager's own investors on notice of that information.

As an empirical matter, the marketplace demonstrated the widespread attribution of fund statements to investment managers: upon the public allegation of market timing in mutual funds, stock prices of the accused managers fell rapidly. *See*, *e.g.*, Atlas at C1 (reporting that Janus Capital lost "more than 20 percent of market value of its shares").

If petitioners were to succeed in their effort to substitute "express" for actual attribution in this analysis, then a critical element of proving Section 10(b) liability would fall within the direct manipulation of the perpetrators. To avoid liability, a violator need only be discreet enough not to speak aloud what the marketplace already knows. This Court should refrain from creating a unique exemption from

Section 10(b) liability for investment managers or any future violators who follow their example.

IV. AN AFFIRMANCE OF THE DECISION BELOW WOULD NOT CONSTITUTE AN EXPANSION OF SECTION 10(b) LIABILITY

Certainly, there are reasons for Congress and courts to be careful in fashioning the scope of liability in securities class actions under Section 10(b) of the Exchange Act. Frank Easterbrook, Daniel Fischel, and many other commentators have examined the problems of potential remedial overbreadth if shareholders are too readily compensated in a system where securities fraud produces little, if any, net harm to diversified investors. *See* Frank H. Easterbrook & Daniel R. Fischel, *Optimal Damages in Securities Cases*, 52 U. Chi. L. Rev. 611, 638-641 (1985); *cf.* Paul G. Mahoney, *Precaution Costs and the Law of Fraud in Impersonal Markets*, 78 Va. L. Rev. 623, 628-629 (1992) (noting that Easterbrook and Fischel do not address the deterrent effect of social cost, such as where issuers are forced to pay damages that are less than their net gains).

Yet even if accurate compensation did not entirely justify many securities class action suits, effective deterrence does. And deterrence would be welcome in the mutual fund advisory industry. The past decade has seen numerous revelations of fraud and other misconduct across many aspects of the mutual fund advisory business beyond just market timing, such as late trading, fair valuation, and soft-dollar practices. *See*, *e.g.*, Josh Friedman, *FleetBoston, BofA to Pay $675 Million*, L.A. Times, Mar. 16, 2004, at C1; Tom Lauricella, *Alliance to Cut Fees 20%*, Wall St. J., Dec. 16, 2003, at C1.

When Congress limited the expansion of lawsuits with the Private Securities Litigation Reform Act of 1995, Congress did not choose – then or since – to eliminate Section 10(b) liability altogether. The liability that remains applies squarely to the investment managers of mutual funds that perpetrate market-timing frauds.

CONCLUSION

For these reasons, *amici* respectfully urge this Honorable Court to affirm the ruling of the United States Court of Appeals for the Fourth Circuit.

Respectfully submitted,

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November 2, 2010