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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 *AMICI CURIAE* G. ERIC BRUNSTAD, JR., ROBERT W. HELM, AND JANE A. KANTER IN SUPPORT OF PETITIONERS

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INTEREST OF THE *AMICI CURIAE*[1]

Amicus G. Eric Brunstad, Jr., teaches courses at the Yale Law School on commercial law and other subjects. He began teaching at Yale in 1990 and has also taught at the Harvard Law School. He is a partner at the law firm of Dechert LLP. He has previously prepared and filed *amicus* briefs in matters involving the regulation of the mutual fund industry, including *Jones v. Harris Associates L.P.*, 130 S. Ct. 1418 (2010); and *Northstar Financial Advisers, Inc. v. Schwab Investments*, No. 09-16347, 2010 WL 3169400 (9th Cir. Aug. 12, 2010). He has also prepared and filed with the Court *amicus* briefs in various other matters, including *United Student Aid Funds, Inc. v. Espinosa*, 130 S. Ct. 1367 (2010); *Howard Delivery Serv., Inc. v. Zurich Am. Ins. Co.*, 547 U.S. 651 (2006); *Tennessee Student Assistance Corp. v. Hood*, 541 U.S. 440 (2004); *Archer v. Warner*, 538 U.S. 314 (2003); and *Things Remembered, Inc. v. Petrarca*, 516 U.S. 124 (1995). In addition, he has briefed and argued numerous matters before the Court on behalf of a party, including *Schwab v. Reilly*, 130 S.

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[1] No counsel for any party has authored this brief in whole or in part, and no party or counsel for a party has made a monetary contribution to the preparation or submission of this brief. *See* Sup. Ct. R. 37.6. Both Petitioners and Respondent have filed a blanket consent with this Court to the filing of all *amicus* briefs.

Ct. 2652 (2010); *Milavetz, Gallop & Milavetz, P.A. v. United States*, 130 S. Ct. 1324 (2010); *Florida Dep't of Revenue v. Piccadilly Cafeterias, Inc.*, 554 U.S. 33 (2008); *Kentucky v. Davis*, 553 U.S. 328 (2008); *Travelers Cas. & Sur. Co. v. Pacific Gas & Elec. Co.*, 549 U.S. 443 (2007); *Marrama v. Citizens Bank*, 549 U.S. 365 (2007); *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004); and *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1 (2000). He has otherwise participated as counsel for one of the parties in matters before the Court, including *Hamilton v. Lanning*, 130 S. Ct. 2464 (2010); *Central Va. Cmty. College v. Katz*, 546 U.S. 356 (2006); *Rousey v. Jacoway*, 544 U.S. 320 (2005); *Lamie v. United States Trustee*, 540 U.S. 526 (2004); *Kontrick v. Ryan*, 540 U.S. 443 (2004); *FCC v. NextWave Personal Commc'ns Inc.*, 537 U.S. 293 (2003); and *Connecticut Nat'l Bank v. Germain*, 503 U.S. 249 (1992).

Amicus Robert W. Helm is a partner at Dechert LLP and a leader of the firm's Financial Services Practice Group. He represents mutual funds, boards of directors, and investment advisers. He served as co-chairman of the Practicing Law Institute's program on "The Revolution in Mutual Fund Governance" (2004) and serves on the advisory committees of the Mutual Fund Directors Forum and the Independent Directors Council. He has published articles on mutual fund governance and aspects of financial services

regulation. He has served as chairman of the annual policy conference of the Mutual Fund Directors Forum.

Amicus Jane A. Kanter is a senior member and partner in the Financial Services Practice Group at Dechert LLP and has more than 30 years of experience in federal securities matters. She represents numerous investment companies, boards of trustees of such investment companies, and registered investment advisers. She serves on the Board of Directors of the Investment Lawyer and has been responsible for the D.C. Bar Association's continuing legal education program regarding registered investment companies and registered investment advisers for more than a decade. She has written extensively on various topics regarding the governance and regulation of registered investment companies and registered investment advisers. She is a frequent speaker at conferences in the United States and abroad involving securities law issues and has acted as a consultant to foreign governments and regulatory bodies on matters relating to the regulation of securities, securities markets, and specialized issuers such as registered investment companies.

Amici are deeply interested in mutual fund regulation and have written, taught, and lectured on the subject. The purpose of this brief is to address matters that bear on the Court's de-

termination of an important question of law affecting the mutual fund industry: does implied liability under section 10(b) of the Securities and Exchange Act of 1934 exist for the benefit of a plaintiff shareholder of the corporate parent of a mutual fund adviser based on an allegedly misleading mutual fund prospectus where the plaintiff did not actually purchase shares of the mutual fund in question? The undersigned present this brief to address matters bearing on this question, particularly the consequences of Respondent's theory of liability on the regulation of mutual funds and the relevant process by which mutual funds make disclosures to investors.

STATEMENT

The Janus family of mutual funds (the "Janus Funds") are investment companies registered under the Investment Company Act of 1940 ("ICA"). Petitioner Janus Capital Management LLC ("JCM") is the investment adviser to the Janus Funds. Petitioner Janus Capital Group Inc. ("JCG") is the publicly traded corporate parent of JCM.

Like all publicly offered mutual funds, the Janus Funds offer and sell shares to investors by means of a prospectus filed with the Securities and Exchange Commission ("SEC" or "Commission"). The content of the mutual fund prospectus is highly regulated and carefully designed to

provide, in a clear and understandable format, the information investors need in order to make informed investment decisions about a fund. In this case, respondent First Derivative Traders ("First Derivative") alleges that the prospectuses for the Janus Funds were misleading and harmed First Derivative. Critically, however, First Derivative is a shareholder of *JCG*, not the Janus Funds, and does not allege that it ever purchased or sold any shares in the Janus Funds. The issue in this case is whether an implied private right of action under section 10(b) of the Securities and Exchange Act of 1934 extends to these circumstances. It does not.

First Derivative is the wrong plaintiff suing under the wrong disclosure materials. The court below stated that a service provider who "helped draft the misleading prospectuses" of a mutual fund may be held impliedly liable under section 10(b). Pet. App. 17a-18a. This Court, however, has held that there is no aiding-and-abetting implied private liability under this statute. *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 191 (1994). First Derivative seeks an exception for mutual fund advisers on the theory that the relationship between advisers and mutual funds is close. Pet'rs Br. 2. But regardless of whatever proximity may exist in the relationship between a mutual fund adviser and its client, First Derivative's theory encounters an even more fun-

damental problem: there is simply no basis to conclude that Congress intended to create implied liability under section 10(b) for the benefit of a plaintiff shareholder of the corporate parent of a mutual fund adviser based on an allegedly misleading mutual fund prospectus where the plaintiff did not actually purchase shares of the mutual fund in question. Moreover, if permitted, First Derivative's expanded theory of liability would have profoundly negative effects on mutual fund prospectus disclosure.

When mutual funds prepare their prospectuses, they and their advisers properly focus on the interests of the investors in the *funds*. Emphatically, they do not properly focus on the interests of the *advisers'* shareholders (let alone the shareholders of an adviser's corporate parent). First Derivative proposes a novel liability rule that would fundamentally change this mandate by expanding dramatically the parties who may sue on the basis of a mutual fund prospectus. Unavoidably, such an expanded liability rule would misdirect the attention of mutual fund boards and their advisers in a manner at odds with the interests of the funds and their shareholders. An implied right of action is the least appropriate vehicle for such an unfortunate novelty. The decision below should be reversed.

SUMMARY OF THE ARGUMENT

The issue before the Court is the proper scope of the implied private right of action under section 10(b) of the Securities Exchange Act of 1934 (the "'34 Act").[2] The expansion of section

[2] Section 10(b) provides that:

> [I]t is unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . . [t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j. Rule 10b-5 provides that:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange . . . (a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) To engage in any act, practice, or course of business which operates or would operate as a

10(b) liability that First Derivative seeks would unavoidably undermine decades of efforts by the SEC and other industry participants to reform mutual fund prospectus disclosure. These reforms have been motivated by the goal of ensuring that mutual fund prospectuses serve the primary purpose of providing investors in *mutual funds* with the information they need to make informed investment decisions regarding those funds. These reforms have been achieved, in part, through the use of streamlined disclosure forms designed to satisfy applicable regulatory and liability requirements and combat the tendency for "disclosure creep," *i.e.*, the packing of prospectuses with ever increasing amounts of information in an effort to reduce potential exposure to liability. In conflict with this trend, the novel theory of liability that First Derivative proposes would create a conflict of interest on the part of those who participate in preparing the contents of a fund prospectus by forcing them to consider the informational interests of the stockholders of the adviser's parent; would supply a new and compelling incentive for "disclosure creep" in order to avoid liability to those parent

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> fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5.

company stockholders; and generally would divert the focus of the fund prospectus away from those for whose benefit it is designed.

The erosion of decades of reform is particularly ill-advised here because the alleged misrepresentations in the fund prospectuses are too remote to support implied liability for the benefit of a shareholder of the parent company of the investment adviser. This Court has been reluctant to expand the implied private cause of action under section 10(b), and this case does not present a compelling reason to depart from that cautious approach.

Historically, the Court has placed particular emphasis on the practical ramifications and policy considerations of attempted expansions of the implied 10(b) private cause of action, and it is likewise appropriate to consider them here. The expansion of liability under section 10(b) that First Derivative seeks would impose substantial costs on the mutual fund prospectus process to the detriment of ordinary investors who rely on prospectuses to make informed investment decisions. In addition to inviting a return of the "disclosure creep" that the SEC and others have worked hard to counteract, such an expansion of liability would, among other things, increase uncertainty for market participants, increase frivolous litigation, and ultimately increase costs for individual mutual fund inves-

tors. These substantial negative consequences counsel against the proposed further expansion of section 10(b) liability. In any event, the requisite fact-finding and policy choices necessary to support this kind of expanded liability properly fall within the purview of Congress, and it is there that First Derivative should make its case, not here through its inventive litigation theory.

ARGUMENT

A. First Derivative's Theory of Liability Is Contrary to the Evolution of Mutual Fund Disclosure Practice.

The relevant history of mutual fund disclosure practice is one of a narrowing process to make disclosure more accessible and to better serve the interests of mutual fund investors. Through the adoption of a series of more streamlined disclosure forms and practices, the SEC has sought to reduce the quantity and improve the quality of information supplied to fund shareholders. The goal has been to deliver shorter, simpler, and more effective prospectuses that convey information directly material to these shareholders, and not others. First Derivative's theory of liability is contrary to that history and the values that undergird it.

1. The General Regulatory Structure

Mutual funds are subject to a variety of regulatory requirements.[3] To begin with, they must register with the SEC under the ICA. 15 U.S.C. § 80a-8(b). If they offer shares to the public, they must also comply with the Securities Act of 1933 (the "'33 Act"), 15 U.S.C. § 77a, et seq., as well as the '34 Act, 15 U.S.C. § 78a, et seq. Further, a mutual fund's adviser must comply with the Investment Advisers Act of 1940 (the "IAA"). 15 U.S.C. §§ 80b-2(a)(11), 80b-3. In addition, because mutual funds are established under state corporate law, they are also subject to applicable state law requirements.

A mutual fund is governed by either a board of directors or a board of trustees,[4] a majority of which must be entirely independent of the fund's adviser to rely on common exemptive rules under the ICA.[5] The federal securities

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[3] For ease of reference, the term "mutual fund" is used to refer to registered open-end management investment companies subject to the ICA and governed by a board of directors or a board of trustees.

[4] "Director" is defined by the ICA to include trustees. 15 U.S.C. § 80a-2(a)(12).

[5] *See* Role of Independent Directors of Investment Companies, Securities Act Release No. 7932, Exchange Act Release No. 43,786, Investment Company Act Release No. 24,816, 66 Fed. Reg. 3734, 3736 (Jan. 16, 2001). Even for

laws impose numerous requirements on mutual fund boards, including responsibilities regarding the process by which fund disclosure is prepared, reviewed, and updated. *See, e.g.,* 15 U.S.C. § 77k(b)(3) (providing that a director is liable for misstatements of material fact or omissions of material fact in the mutual fund's registration statement unless a director can demonstrate that he or she exercised due diligence in determining that there were no material omissions or misstatements). The independent directors of a mutual fund serve as "watchdogs" for the interests of fund shareholders. *Burks v. Lasker*, 441 U.S. 471, 484 (1979) (quoting *Tannenbaum v. Zeller,* 552 F.2d 402, 406 (2d Cir. 1977)). They do not answer to the stockholders of the adviser

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funds not relying on these exemptive rules, Section 10(a) of the ICA (15 U.S.C. § 80a-10(a)) requires that at least 40 percent of a mutual fund's board must consist of individuals who are not "interested persons." The term "interested persons" is defined in section 2(a)(19) of the ICA (15 U.S.C. § 80a-2(a)(19)) to include persons who have close family or substantial financial or professional relationships with, among other parties, the fund's investment advisers. In practice, independent directors frequently hold a significant majority of board seats. For example, independent directors held 75 percent of board seats in nearly 90 percent of fund complexes participating in the Investment Company Institute/Independent Directors Council Directors Practices Study. *See Overview of Fund Governance Practices* ***1994-2006***, INV. CO. INST., at 1 (2007), *available at* http://www.ici.org/pdf/rpt_07_fund _gov_practices.pdf.

or of its parent company; indeed, it is their very mission to be independent of those stockholders and look out solely for the interests of the fund and its investors.

2. The Registration of Mutual Funds and the Early History of Form N-1A

Pursuant to section 7 of the ICA (15 U.S.C. § 80a-7), mutual funds must register in order to engage in the sale of their securities through the mails or by any means or instrumentality of interstate commerce. Mutual funds themselves register under section 8 of the ICA (15 U.S.C. § 80a-8) and register their securities under the '33 Act pursuant to section 24 of the ICA (15 U.S.C. § 80a-24). Among other requirements, mutual funds must prepare a prospectus in order to offer and sell shares. Mutual funds may register and offer their shares using Form N-1A. Form N-1A, Registration Statement of Open-End Management Investment Companies, 17 C.F.R. §§ 239.15A, 274.11A (2010). Notably, the relevant registrant using Form N-1A is the mutual fund itself, not its adviser. *See* Registration Form Used by Open-End Management Investment Companies, Securities Act Release No. 7512, Exchange Act Release No. 39,748, Investment Company Act Release No. 23,064, 63 Fed. Reg. 13916, 13946 (Mar. 23, 1998) ("1998 N-1A Adopting Release") (defining "Registrant" as "an open-

end management investment company registered under the Investment Company Act").

Over the years, mutual fund prospectuses grew to be cumbersome and unwieldy, containing large amounts of complex data of limited use to the average investor. The inclusion of such voluminous amounts of data was due in no small measure to concerns over liability in the event a particular item of omitted information was determined subsequently to have been a material omission. As is relevant here, in 1983, the SEC adopted the first of a series of reforms designed to streamline and simplify mutual fund prospectus disclosure, resulting in the initial creation of Form N-1A (replacing the original Form N-1) and its subsequent revision. Registration Form Used by Open-End Management Investment Companies; Guidelines, Securities Act Release No. 6479, Investment Company Act Release No. 13,436, 48 Fed. Reg. 37928 (Aug. 22, 1983) ("1983 N-1A Adopting Release").

In 1982, the SEC observed that "[u]nder existing requirements prospectuses provide extensive disclosure about all aspects of a [mutual fund's] operations." Registration Form Used By Open-End Management Investment Companies; Proposed Guidelines, Securities Act Release No. 6447, Investment Company Act Release No. 12,927, 48 Fed. Reg. 813, 814 (Jan. 7, 1983) ("1982 N-1A Proposing Release"). Remarking on

the complexity of these disclosures, the SEC commented that it believed "that in practice [mutual fund] prospectuses may not be effective disclosure documents for most investors." *Id.* The Commission recognized that most of the information contained in these prospectuses could be defended as arguably material to some investors under some circumstances, but worried that "the size and complexity" of mutual fund prospectuses would "discourage many fund investors from reading and understanding the entire document." *Id.* The Commission opined further that existing prospectuses appeared to "contain more detail than [was] necessary for most investors to make an informed investment decision." *Id.* The Commission believed that investors would be better served if they were provided with "substantially" shorter and simpler disclosure materials. *Id.*

In order to achieve this goal, the SEC determined that it was "necessary to eliminate certain types of information from the prospectus, so that only matters of fundamental importance to most mutual fund investors [would] be included in the prospectus." *Id.* On the other hand, the SEC recognized that some fund investors, such as institutional investors (*e.g.*, pension funds), might want more extensive information. In order to provide useful information to the majority of individual investors, while also addressing the informational needs of institutional investors,

the Commission invoked its authority under section 10 of the '33 Act and proposed new Form N-1A. Under the new form, investors would receive simplified prospectuses, with more extensive information available on request in the form of a Statement of Additional Information. *Id.*

Comments submitted to the SEC in response to its proposal were "overwhelmingly in favor of the Commission's goals" of, among other things, "simplifying the disclosure provided to investors." 1983 N-1A Adopting Release at 37930. At the same time, the Commission recognized that "some [mutual funds] using Form N-1A may be concerned that omitting information from the simplified prospectus could expose them to liability" for the use of a prospectus that fails to state a material fact. *Id.* at 37930. The Commission noted:

> In addition to the specific private rights of action provided in sections 11 and 12 of the 1933 Act, section 17(a) (15 U.S.C. [§] 77g(a)) of the 1933 Act and rule 10b-5 (15 U.S.C. [§] 78j(b)) under the Securities Exchange Act of 1934 may also need to be considered if a person includes in a prospectus an untrue statement of a material fact or omits to state a material fact that is necessary in order to make the infor-

> mation required in the prospectus not misleading.

1982 N-1A Proposing Release at 818 n.4.

To help quell such liability concerns and encourage use of the new form in spite of the liability risks it potentially entailed, the Commission determined that the simplified prospectus would "meet the standard of section 10(a) of the 1933 Act." 1983 N-1A Adopting Release at 37930. The SEC intended that, notwithstanding its brevity, "the simplified prospectus [would] contain all the information that is 'necessary or appropriate in the public interest or for the protection of investors.'" *Id.* In August of 1983, the Commission formally adopted new Form N-1A. *Id.*

3. The 1998 Revisions

In spite of the SEC's efforts to simplify disclosure, prospectuses under the new form nevertheless "gradually fell victim to 'disclosure creep,' and the so-called 'simplified prospectus' became bloated and unwieldy." Paul Schott Stevens, President & CEO, Inv. Co. Inst., ICI President's Remarks at the Mutual Funds and Investment Management Conference: Less and More: A Better Approach for Informing Fund Investors, (Mar. 17, 2008), *available at* http://www.ici.org/pressroom/speeches/ci.08_mfim_stevens_spch.

print ("ICI Speech"); *see also* Matthew P. Fink, President, Inv. Co. Inst., ICI President's Keynote Address at the Mutual Funds and Investment Management Conference (Mar. 17, 1997), *available at* http://conferences.ici.org/pressroom/speeches/ci.97_MFIMC_FINK_SPCH.print ("Time and again the SEC and the industry have tried to simplify the fund prospectus. But it seems that disclosure creep always sets in, and the 'simplified' prospectus soon becomes as unwieldy as its predecessor.").

As a result, less than fifteen years after the adoption of Form N-1A, the Commission sought to revise the form. *See* Registration Form Used by Open-End Management Investment Companies, Securities Act Release No. 7398, Exchange Act Release No. 38,346, Investment Company Act Release No. 22,528, 62 Fed. Reg. 10898 (Mar. 10, 1997), corrected 62 Fed. Reg. 24160 (May 2, 1997) ("1997 N-1A Proposing Release"). According to the summary accompanying the 1997 N-1A Proposing Release, the amendments to the form sought, "in keeping with the purpose of Form N-1A, to focus prospectus disclosure on essential information about a particular fund that would assist an investor in deciding whether to invest in that fund." *Id.* In March of 1998, the SEC adopted the proposed amendments to Form N-1A. 1998 N-1A Adopting Release at 13916.

In a companion release to the 1997 N-1A Proposing Release, the SEC also proposed a new rule to allow investors to purchase mutual fund shares based on an optional "fund profile" that would provide a summary of key information about the particular fund. Proposed New Disclosure Option for Open-End Management Investment Companies, Securities Act Release No. 7399, Investment Company Act Release No. 22,529, 62 Fed. Reg. 10943 (Mar. 10, 1997), corrected 62 Fed. Reg. 24160 (May 2, 1997). The SEC adopted this proposal the following year. New Disclosure Option for Open-End Management Investment Companies, Securities Act Release No. 7513, Investment Company Act Release No. 23,065, 63 Fed. Reg. 13968 (Mar. 23, 1998). The mutual fund industry, however, did not embrace the optional fund profile approach, among other reasons due to fear of potential liability. *See* ICI Speech (explaining that "[t]he Commission provided no insulation from shareholder lawsuits complaining that the document – by design, of course, a profile – omitted some information. . . . As a result, fund companies chose not to use the Profile").

4. The 2009 Revisions

The modest 1998 reform efforts did not achieve their purpose, and fund disclosures remained cumbersome and unwieldy. Although many recognized the potential value to investors

of shorter, more focused prospectuses, the industry continued to fear that truncated disclosures could in and of themselves lead to liability. As explained by Andrew J. Donohue, Director of the Division of Investment Management of the SEC, "the potential for 'disclosure creep' can create disclosure documents that are so dense that the information simply serves as methods for firms to avoid liability, rather than assisting investors in making investment decisions." Andrew J. Donohue, Director, Div. of Inv. Mgmt. U.S. SEC, Speech by SEC Staff: Luncheon Address Before a Meeting of the Business Law Section of the American Bar Association Committee on Federal Regulation of Securities (Apr. 24, 2010), *available at* http://www.sec.gov/news/speech/2010/spch042410ajd.htm.

Following the 1998 amendments, investor advocates and representatives of the mutual fund industry renewed their criticisms of mutual fund prospectuses as "long and complicated." Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies, Securities Act Release No. 8861, Investment Company Act Release No. 28,064, 72 Fed. Reg. 67790, 67810 (Nov. 30, 2007). In November of 2007, the Commission responded by proposing once again a reworked disclosure framework intended to provide investors with information that is "easier to use and more readily accessible." *Id.* at 67812.

To implement this framework, the SEC proposed amendments to Form N–1A to require prospectuses to provide a summary containing key information, identified "as information that is important to most investors in selecting mutual funds." *Id.* at 67792. Intending to avoid the mistake that doomed the profile prospectus (*i.e.*, the lack of insulation from shareholder lawsuits alleging that the shortened document omitted certain information required to be in a prospectus pursuant to section 10 of the '33 Act), the SEC conceived its summary document proposal as part of the prospectus delivery process itself, supplying "a new option for satisfying the prospectus delivery obligations with respect to mutual fund securities under the Securities Act." *Id.* Under this regime, investors receive the summary in connection with their purchase of shares in the fund. Upon request, they may also receive the longer form prospectus, as well as the supplemental Statement of Additional Information, both of which may be incorporated by reference into the summary prospectus. These amendments were adopted in January of 2009. Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies, Securities Act Release No. 8998, Investment Company Act Release No. 28,584, 74 Fed. Reg. 4546 (Jan. 26, 2009).

As the Commission stated, the point of all of this was to counteract "disclosure creep" and "help investors who are overwhelmed by the choices among thousands of available funds described in lengthy and legalistic documents to access readily key information that is important to an informed investment decision." *Id.* at 4549. Consistent with this purpose, it would be illogical and counterproductive to layer on top of this evolved disclosure regime an implied liability scheme designed to focus the disclosure activities of mutual fund investment companies and their advisers on persons *other than* the investors in the mutual funds themselves. To do so would simply serve to distort the disclosure process and encourage "disclosure creep" as a means to avoid the new liability. Inevitably, of course, that is precisely what First Derivative's proposed liability rule would accomplish. First Derivative's proposal is unsound.[6]

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[6] The danger of this approach is magnified in a case like this one, where the complaint at issue is fundamentally an omissions claim, that is, where the complaint alleges not that the statements made in the fund prospectus were false in themselves, but rather that they should have been accompanied by additional disclosure to prevent creating a misleading impression. *Cf. In re Mut. Funds Inv. Litig.*, 384 F. Supp. 2d 845, 864 (D. Md. 2005) (a case brought by Janus fund shareholders based on the same disclosure, which required analysis of whether the claims alleged can be characterized primarily as omissions or misrepresentations) ("The gravamen of plaintiffs' claim is

B. The Section 10(b) Private Cause of Action Should Not Be Extended in the Manner that First Derivative Advocates Because Allegedly Misleading Fund Prospectuses Are Too Remote to Create Liability in Favor of Purchasers of Stock in the Adviser's Corporate Parent.

Under this Court's precedents, First Derivative's theory is also unsound as an unwarranted extension of potential liability in private actions brought under section 10(b). First Derivative seeks recovery pursuant to Section 10(b) of the '34 Act, 15 U.S.C. § 78j, and Rule 10b-5(b) promulgated thereunder, which proscribes fraud "in connection with the purchase or sale" of securities, 17 C.F.R. § 240.10b-5(b). While the text of the statute does not provide for a private cause of action, "the Court has found a right of action implied in the words of the statute and its implementing regulation." *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 157 (2008) (citing *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 13 n.9 (1971)). This judicially created private cause of

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not for specific misrepresentations but for the funds' failure to disclose that they were permitting favored customers to engage in late trades and market-timed transactions.").

action is not limitless, however, and the Court has explained that it must be "judicially delimited" because "the inexorable broadening of the class of plaintiff who may sue in this area of the law will ultimately result in more harm than good." *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 747-49 (1975). Accordingly, "[t]hough it remains the law, the § 10(b) private right should not be extended beyond its present boundaries." *Stoneridge*, 552 U.S. at 165; *see also Marine Bank v. Weaver*, 455 U.S. 551, 556 (1982) ("Congress, in enacting the securities laws, did not intend to provide a broad federal remedy for all fraud.").

Consistent with these principles, the Court has frequently curtailed efforts to expand the scope of liability under the implied section 10(b) private cause of action. For example, in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, the Court declined to extend its reach to include aiding and abetting liability. 511 U.S. 164, 184 (1994) ("Even assuming . . . a deeply rooted background of aiding and abetting tort liability, it does not follow that Congress intended to apply that kind of liability to the private causes of action in the securities Acts"). In *Stoneridge*, the Court also declined to extend the implied cause of action to the statements by companies that were purchase and supply contractors to the issuer of the securities purchased by the plaintiff because of the risk that it would

infringe upon "areas already governed by functioning and effective state-law guarantees." 552 U.S. at 161. Likewise, in its recent decision of *Morrison v. Nat'l Australia Bank, Ltd.*, the Court declined to extend the reach of section 10(b) to foreign plaintiffs suing foreign and American defendants in connection with securities traded on foreign exchanges. 130 S. Ct. 2869, 2881 & n.5 (2010).

As the Court explained in *Stoneridge*, "[i]n a typical § 10(b) private action a plaintiff must prove (1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation." 552 U.S. at 157. This case, however, is not "typical," and because the relevant liability is implied, careful inquiry should also be made into whether the particular circumstances here fit the paradigm for which implied liability even exists. *See Central Bank*, 511 U.S. at 178. As the Court explained in *Blue Chip*, a virtue of its approach in handling implied private causes of action under section 10(b) "is that it limits the class of plaintiffs to those who have at least dealt in the security to which the prospectus, representation, or omission relates." *Blue Chip*, 421 U.S. at 747. First Derivative, of course, cannot lay claim to this kind of defining connection.

To begin with, First Derivative has not bought or sold the securities described in the allegedly misleading prospectuses at issue – namely, those filed in connection with the issuance of securities in the Janus Funds. Pet. App. 59a. Instead, it has purchased stock in the parent company of the investment adviser of those funds, JCG, an entity that is separate and distinct with its own registration statement and disclosure materials. Pet. App. 59a. First Derivative alleges, and Petitioners dispute, that JCM "made" misrepresentations in violation of Rule 10b-5(b) in connection with the securities of the separate Janus Funds, an issue that *amici* offer no view on. Pet. App. 17a-18a. But even if JCM is deemed one of the makers of the statements in the Janus Fund prospectuses, First Derivative never purchased or sold the securities being offered through the prospectuses alleged to have been false or misleading. Pet. App. 60a. As discussed above, the purpose of the mutual fund prospectus is to provide information to *potential investors of the mutual fund* that issues it; the prospectus is not intended to be hijacked by investors of separate and distinct entities in order to facilitate recovery for declines in the value of their separate investments. First Derivative's theory of liability lies outside the scope of a properly framed implied cause of action under section 10(b).

As the Court explained in *Stoneridge*, "[r]eliance by the plaintiff upon the defendant's deceptive acts is an essential element of the § 10(b) private cause of action [because] [i]t ensures that, for liability to arise, the 'requisite causal connection between a defendant's misrepresentation and a plaintiff's injury' exists as a predicate for liability." 552 U.S. at 159 (quoting *Basic Inc. v. Levinson*, 485 U.S. 224, 243 (1988)). While the "fraud-on-the-market" theory can generate a presumption of reliance on the part of investors who purchase shares of a misrepresented company, *Stoneridge*, 552 U.S. at 159, "[a] presumption of reliance upon market-price signals is not a presumption of knowledge of all public information," *Merck & Co. v. Reynolds*, 130 S. Ct. 1784, 1803 (2010) (Scalia, J., concurring), and the presumption should not apply where the alleged misstatements/omissions do not concern the security that the plaintiff purchased.

In considering the reliance inquiry in *Stoneridge*, the Court noted that the "in connection with" requirement of section 10(b) "on a purchase or sale of securities does provide some insight into the deceptive acts that concerned the enacting Congress." 552 U.S. at 160. The requisite reliance is "tied to causation, leading to the inquiry whether respondents' acts were immediate or remote to the injury." *Id.* While the Court acknowledged that the "in connection with" and causation requirements are "analytically dis-

tinct," it considered them "related to each other, and discussion of the first requirement may merge with discussion of the second." *Id.* at 161 (citation omitted). In this case, the causal connection between First Derivative's alleged injury and the alleged misstatements/omissions in the Janus Funds prospectuses is simply too remote to demonstrate legally legitimate reliance on the part of *shareholders of the investment adviser's parent* – particularly in light of the negative consequences such an expansion of the implied private cause of action would entail. *See id.* at 165 ("Concerns with the judicial creation of a private cause of action caution against its expansion.").

As explained above, there have been great strides in recent decades to reform the mutual fund prospectus. These advances have empowered thousands of potential mutual fund investors by providing them with readily accessible information about their potential investments, enabling them more easily to compare and contrast their options. Expanding the judicially created implied private cause of action under section 10(b) to include liability in favor of the adviser's or parent company's stockholders would derail this beneficial trend and jeopardize the integrity of fund prospectus disclosures. Such an expansion of a judicially-created private cause of action is unwarranted.

C. The Expansion of Liability Under Section 10(b) Sought by First Derivative Would Impose Other Improvident Costs.

The fund prospectus disclosure process exists as it does for good reason – it serves the needs of the investors of *mutual funds*. The consequences of permitting the expanded liability First Derivative seeks would distort the carefully balanced prospectus process, at once contravening this Court's prior precedents and undermining decades of efforts to combat "disclosure creep." Moreover, the expansion of liability First Derivative seeks would come with a hefty price tag in the form of other increased costs – "costs that may disserve the goals of fair dealing and efficiency in the securities markets," *Central Bank*, 511 U.S. at 188, and which inevitably must be passed on to the investing public.

First, expanding liability to reach new fact patterns and new classes of litigants runs the risk of injecting securities laws into other markets. *See, e.g., Stoneridge*, 552 U.S. at 161; *Santa Fe Indus. v. Green*, 430 U.S. 462, 478-79 (1977). Second, "[o]verseas firms with no other exposure to our securities laws could be deterred from doing business here." *Stoneridge*, 552 U.S. at 164; *see generally* Hon. Ralph K. Winter, *Paying Lawyers, Empowering Prosecutors, and Protecting Managers: Raising the Cost of Capital in*

America, 42 DUKE L.J. 945, 946 (1993) ("The international competition for capital is for high stakes. Trillions of dollars are involved. Moreover, the flow of capital among nations is independent of the desires of governments. Capital cannot be captured, hoarded, or reproduced; it must be attracted on a continual basis. The swiftness of modern communication and the sophistication of international securities markets result in instantaneous responses to events affecting the return to investors.").

Third, First Derivative's position would lead "to the undesirable result of decisions 'made on an ad hoc basis, offering little predictive value' to those who provide services to participants in the securities business." *Central Bank*, 511 U.S. at 188 (quoting *Pinter v. Dahl*, 486 U.S. 622, 652 (1988)). In an area that "demands certainty and predictability," *Pinter*, 486 U.S. at 652, a "shifting and highly fact-oriented disposition of the issue of who may [be liable for] a damages claim for violation of Rule 10b-5" fails to provide a "satisfactory basis for a rule of liability imposed on the conduct of business transactions." *Central Bank*, 511 U.S. at 188 (quoting *Blue Chip*, 421 U.S. at 755 and *Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1106 (1991) ("The issues would be hazy, their litigation protracted, and their resolution unreliable. Given a choice, we would reject any theory . . . that raised such prospects.")). Endorsement of

First Derivative's theory would require any putative "maker" of statements in a securities offering to consider not only the materiality and impact of the statements on the investors to whom the statement is directed but on an uncertain universe of other investors who claim that their investments were affected by a fraud on the market with respect to an entirely distinct security. The resulting uncertainty, particularly with respect to alleged omissions, will impose added costs without the benefit of improving disclosure to the intended audience of investors.

Fourth, in class actions such as this one, if liability is expanded to new fact patterns and new groups of litigants, *see Stoneridge*, 552 U.S. at 163-64, parties subjected to new forms of liability "may find it prudent and necessary, as a business judgment, to abandon substantial defenses and to pay settlements in order to avoid the expense and risk of going to trial." *Central Bank*, 511 U.S. at 189. Aside from the threat of damages, the costs of discovery and attorneys' fees can be crippling. *Id.* ("Litigation under 10b-5 thus requires secondary actors to expend large sums even for pretrial defense and the negotiation of settlements. *See* 138 Cong. Rec. S12605 (Aug. 12, 1992) (remarks of Sen. Sanford)"). And where, as here, plaintiffs pursue the wrong party on the wrong disclosure materials, companies and their insurers pay the costs of settlement, which then get passed on to shareholders. *See*

Central Bank, 511 U.S. at 189 ("the increased costs incurred by professionals because of the litigation and settlement costs under 10b-5 may be passed on to their client companies, and in turn incurred by the company's investors."); *Malack v. BDO Seidman, LLP*, No. 09-4475, 2010 WL 3211088, at *10 (3d Cir. Aug. 16, 2010) ("An increase in frivolous litigation drives up the overall costs of issuing securities, ultimately harming everyone involved. . . .); *SEC v. Tambone*, 597 F.3d 436, 452-53 (1st Cir. 2010) (Boudin, J., concurring) ("No one sophisticated about markets believes that multiplying liability is free of cost. And the cost, initially borne by those who raise capital or provide audit or other services to companies, gets passed along to the public."); Winter, *supra*, 42 DUKE L.J. at 949-51.

Fifth, expanding liability will mean that parties subjected to new liability will require compensation for bearing the liability risk and will begin to expend more resources painstakingly reviewing statements in order to protect themselves from the risks of litigation. These costs will get passed along to shareholders as well. *See Central Bank*, 511 U.S. at 189.

If this sort of cost-shifting is to occur, it should be Congress that makes the relevant policy choice, not the courts. *See Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 327 (2007) ("It is the federal lawmaker's prerogative .

. . to allow, disallow, or shape the contours of . . . § 10(b) private actions."). To date, Congress has allowed expansion of liability in the context of Government intervention, but not in the realm of the private cause of action under section 10(b). After this Court held in *Central Bank* that a private plaintiff may not maintain an aiding and abetting suit under section 10(b), 511 U.S. at 191, then-SEC Chairman Arthur Levitt testified before the Senate Securities Subcommittee, citing *Central Bank* and arguing that aiding and abetting liability should be established in private actions brought under section 10(b). *Stoneridge*, 552 U.S. at 158 (citing *Abandonment of the Private Right of Action for Aiding and Abetting Securities Fraud/Staff Report on Private Securities Litigation: Hearing Before the Subcomm. on Securities of the S. Comm. on Banking, Housing, and Urban Affairs*, 103d Cong. 13-14 (1994)). Congress declined to take that course, *id.*, instead directing prosecution of aiders and abettors by the SEC in section 104 of the Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, § 104, 109 Stat. 737, 757 (codified at 15 U.S.C. § 78t(e)) ("PSLRA"). *Stoneridge*, 552 U.S. at 158; *Tambone*, 597 F.3d at 445-46 (citing PSLRA § 104) (noting that the SEC "exhorted Congress to extend the same right to private parties," but Congress has declined to do so).

The most recent efforts at introducing such legislation have not been successful.[7] Effecting First Derivative's desired change would thus "undermine Congress's determination that this class of defendants should be pursued by the SEC and not by private litigants." *Stoneridge*, 552 U.S. at 163.

First Derivative's efforts represent yet another attempt to "shoehorn" expanded private

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[7] For example, S.1551, 111th Cong. (2009), represented an effort by Senator Specter to attempt, once again, to amend section 20 of the Act to allow for a private civil action against a person that provides substantial assistance in violation of the Act. The bill has not moved from the Committee since September 17, 2009. *Bill Summary & Status 111th Congress (2009-2010) S. 1551*, LIBRARY OF CONG., http://thomas.loc.gov/cgi-bin/bdquery/z?d111:S1551: (last visited Sept. 10, 2010). More recently, when Congress enacted the Dodd-Frank Act, it once again declined to provide an expanded private right of action. *See Amicus Curiae* Br. of Chamber of Commerce of the United States 11-13 & n.4. Instead, the final Dodd-Frank Act provided that the Comptroller General would perform a study on the costs and benefits of expanding the private right of action under section 10(b). *Id.* at 10 (citing Pub. L. No. 111-203 at § 929A (2010)); *see also* Susan E. Hurd & Elizabeth P. Skola, *Still No Aiding and Abetting Liability Provision*, LAW360.COM (July 28, 2010), http://www.law360.com/print_article/181906 (last visited Sept. 10, 2010) (noting that the results of the study will be submitted to Congress within a year of the passage of the Dodd-Frank Act, and that the President signed the bill into law on July 21, 2010).

liability into a carefully delimited implied cause of action. *See id.* at 162-63. Such an attempt, if successful, would conflict with, among other things, the "deliberate legislative compromise, *see* S. Rep. No. 104-98, at 19 (1995)," that distinguishes the SEC's statutory authority to bring actions against individuals who aided and abetted a section 10(b) violation from the judicially created private remedy under section 10(b). *Tambone*, 597 F.3d at 452 (Boudin, concurring). The compromise struck makes sense because the SEC is better situated to enforce a broader range of liabilities inasmuch as it has no incentive to bring strike suits against well-heeled defendants. If First Derivative's plea for expanded liability became the law, the marked increase in securities class actions with attendant strike suit settlements, the cost of which would inevitably be passed on to shareholders, will not be worth the marginal benefit of expanded liability – meager improvement in deterrence beyond that afforded by existing SEC enforcement and criminal punishment. In the end, Congress's particular fact-finding expertise is best suited to balancing the complex economic considerations involved in this case.

CONCLUSION

For the foregoing reasons and the reasons contained in Petitioners' brief, the decision of the court below should be reversed.

Respectfully submitted,

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