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 Petition For A Writ Of Certiorari
To The United States Court Of Appeals
For The Fourth Circuit**

REPLY BRIEF FOR PETITIONERS

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RULE 29.6 STATEMENT

The corporate disclosure statement included in the petition for a writ of certiorari remains accurate.

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REPLY BRIEF FOR PETITIONERS

In the decision below, the Fourth Circuit split with several other circuits in two important respects that warrant this Court's review. *First*, in holding that a service provider "made the misleading statements" contained in the prospectuses of a different company "by participating in the writing and dissemination of [those] prospectuses," the Fourth Circuit authorized secondary liability in a manner that directly conflicts with prior decisions of this Court and other courts of appeals. Pet. App. 18a (emphasis omitted). *Second*, in rejecting the "direct attribution" test for reliance and concluding that a service provider can be held liable for a statement in another company's prospectus "even if the statement on its face is not directly attributed" to the service provider, the Fourth Circuit adopted the minority side of a 3–2 circuit split. *Id.* at 24a.

I. THE COURTS OF APPEALS ARE DIVIDED ON BOTH QUESTIONS PRESENTED

Lead plaintiff First Derivative Traders contends that the Fourth Circuit's decision did not create a conflict among the courts of appeals. BIO 1. This is a remarkable approach in a case involving an *acknowledged* circuit split: The Fourth Circuit itself recognized that "[t]he courts of appeal have diverged over the degree of attribution required to plead reliance." Pet. App. 19a. And the Fourth Circuit also recognized that the majority rule would require affirmance of the dismissal in this case. *Id.* at 17a (concluding that "the individual fund prospectuses are unattributed on their face").

Lead plaintiff's attempt at misdirection rests primarily on limiting the conflicting cases to their *facts*, while ignoring the *legal* conclusions that compelled the results in those cases. It argues, for instance, that JCM's assistance with the Janus Funds' prospectuses was more substantial than a typical service provider's role in its client's statements. *E.g.*, BIO 2. Even if this were so, the cases rejecting service providers' liability for the misstatements of their clients reached that result because of the legal conclusion that participation in others' misstatements is not a basis for primary liability. However substantial the alleged participation, imposing liability on the sole basis that a service provider "helped draft the misleading prospectuses" (Pet. App. 17a) contravenes this Court's holdings in *Stoneridge Investment Partners, LLC* v. *Scientific-Atlanta, Inc.*, 552 U.S. 148 (2008), and *Central Bank of Denver, N.A.* v. *First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994), that there is no aiding-and-abetting liability in private actions brought under Section 10(b) of the Exchange Act.

Nothing in the opposition brief casts doubt on the importance of the questions presented. Indeed, the opposition brief all but concedes the profound practical implications of the Fourth Circuit's decision. Even lead plaintiff acknowledges that the relationship between JCM and the Janus Funds that led the Fourth Circuit to impose liability is "typical" of the entire mutual fund industry. BIO 22. Thus, even on lead plaintiff's (incorrect) view that the decision below does not apply to other service providers, that decision announces—at minimum—a sweeping new rule of aiding-and-abetting liability under which each investment adviser to a mutual fund can be held liable for statements in the fund's prospectuses.

In light of the irreconcilable circuit splits, the direct conflict with this Court's precedent, and the significant practical implications of the Fourth Circuit's decision, there is a compelling need for this Court to grant review.

A. THE COURTS OF APPEALS ARE DIVIDED ON WHETHER "PARTICIPATION" SUFFICES FOR PRIMARY LIABILITY

Lead plaintiff claims that the Fourth Circuit "did not create a circuit split when it concluded that respondent ple[aded] JCM's primary liability for statements that JCM participated in drafting and then filed with the SEC and disseminated publicly." BIO 12. According to lead plaintiff, the extent of JCM's alleged participation in the Janus Funds' prospectuses distinguishes this case from decisions rejecting liability for service providers that participated in others' misstatements. *Id.* at 12–14. Lead plaintiff is incorrect.

The disagreement between the courts of appeals is not over *how much* participation in a third party's misstatement suffices for primary liability. It is, instead, whether such participation can *ever* give rise to primary liability. Consistent with this Court's decision in *Stoneridge*, which rejected liability for "providing assistance" to a company that made false statements (552 U.S. at 162), the courts of appeals other than the Fourth Circuit have rejected liability for service providers who did not themselves make any misstatements. *See Regents* v. *CSFB*, 482 F.3d 372, 390 (5th Cir. 2007) (rejecting liability for banks who "participat[ed]" in transactions that made a third party's misstatements "more plausible"); *In re Charter Commc'ns, Inc. Sec. Litig.*, 443 F.3d 987, 992 (8th Cir. 2006) (rejecting liability for equipment vendors who "knowingly aided and abetted" another company's misstatements but "did not issue any misstatement"), *aff'd sub nom. Stoneridge*, 552 U.S. 148; *Fidel* v. *Farley*, 392 F.3d 220, 235 (6th Cir. 2004) (rejecting liability for an auditor that permitted its client to report misleading unaudited financial results because the auditor "itself did not make a material misstatement or omission with regard to the unaudited financials").

Lead plaintiff's attempt to limit these decisions to their respective facts ignores the critical, undisputed point that the misstatements alleged in this case, as in each of those cases, were contained in the prospectuses of a third party—here, the Janus Funds. *See* Pet. App. 8a. The Fourth Circuit did not hold that any statement by the Janus Funds was, in fact, a statement by JCM, nor could it have done so: The Janus Funds are separate legal entities from JCM and are governed by a board of trustees that must satisfy federal standards of independence from JCM. *See*, *e.g.*, *Burks* v. *Lasker*, 441 U.S. 471, 482 (1979). Instead, the Fourth Circuit held that, by "*participating* in the writing and dissemination of the prospectuses," JCM "*made* the misleading statements contained in the documents." Pet. App. 18a (first emphasis added).

In allowing this "participat[ion]" to transform the Janus Funds' alleged misstatements into misstatements "made" by JCM, the Fourth Circuit split with its sister circuits. Its conclusion that lead plaintiff's allegation that JCM "*helped* draft the misleading prospectuses" (Pet. App. 17a (emphasis added)) is sufficient directly contravenes this Court's repeated holdings that there is no private aiding-and-abetting ("helping") liability for securities fraud. Tellingly, lead plaintiff nowhere even tries to explain how "helping" to draft another company's prospectus could be anything *other than* secondary liability.

B. THE COURTS OF APPEALS ARE DIVIDED ON WHETHER "DIRECT ATTRIBUTION" IS REQUIRED TO PLEAD RELIANCE

The Fourth Circuit acknowledged that "[t]he courts of appeal have diverged over the degree of attribution required to plead reliance." Pet. App. 19a. Lead plaintiff ignores this express recognition of a circuit split and claims that the Fourth Circuit somehow "harmonized" its decision with the conflicting approaches adopted by other courts of appeals. BIO 15. It is unclear how the Fourth Circuit could have achieved such "harmon[y]" by taking sides in an existing split, and in any event it did not claim to do so. Instead, the Fourth Circuit rejected the "direct attribution" requirement applied by the Second, Tenth, and Eleventh Circuits (which would require affirmance of the dismissal order) and, to reverse, adopted instead the Ninth Circuit's erroneous "substantial participation" test. Pet. App. 23a–24a. The circuit split thus is not just implicated but outcome-determinative in this case.

The Fourth Circuit acknowledged that the majority approach "requires direct attribution of the allegedly misleading statement to the defendant." Pet. App. 20a. That test is not met on the facts of this case. The court below concluded, however, that the appropriate inquiry was instead "whether interested investors would attribute to the defendant a substantial role in preparing or approving the allegedly misleading statement." *Id.* at 24a. In the Fourth Circuit's view, "[d]irect attribution of a public statement, while undoubtedly sufficient to establish fraud-on-the-market reliance, is an inexact proxy for determining whether investors will attribute a publicly available statement to a particular person or entity." *Ibid.* Thus, "a plaintiff can plead fraud-on-the-market reliance by alleging facts from which a court could plausibly infer that interested investors would have known that the defendant was responsible for the statement at the time it was made, *even if the statement on its face is not directly attributed to the defendant.*" *Id.* at 23a–24a (emphasis added).

Notwithstanding the Fourth Circuit's recognition that the majority rule requires "direct attribution," lead plaintiff claims that a later case from the Southern District of New York "suggest[s] that direct attribution is not required" in the Second Circuit. BIO 17 (citing *In re Global Crossing Ltd. Sec. Litig.*, 322 F. Supp. 2d 319, 334 (S.D.N.Y. 2004)). This district court decision could not, of course, overrule the Second Circuit's decision in *Wright* v. *Ernst & Young LLP*, 152 F.3d 169, 175 (2d Cir. 1998), nor could it undermine application of the direct-attribution test in the Tenth and Eleventh Circuits. *See Ziemba* v. *Cascade Int'l, Inc.*, 256 F.3d 1194, 1205 (11th Cir. 2001); *SEC* v. *Wolfson*, 539 F.3d 1249, 1258–60 (10th Cir. 2008). And lead plaintiff's argument that direct attribution is no longer required in the Second Circuit is foreclosed in any event by *Lattanzio* v. *Deloitte & Touche LLP*, 476 F.3d 147 (2d Cir. 2007), which dismissed private securities-fraud claims on direct-attribution grounds.

Lead plaintiff claims that "*Lattanzio* is quite different" from this case because "there was no public proclamation concerning the role Deloitte [the auditor-defendant] might have played in drafting or even reviewing Warnaco's [the client's] public statements." BIO 18–19. This is inaccurate. The misstatements at issue there were contained in a public company's quarterly financial statements, and a public proclamation—a federal regulation—"required Deloitte, as Warnaco's outside accountant, to conduct a review of Warnaco's quarterly statements." 476 F.3d at 154. As the Second Circuit recognized, this "requirement that an issuer's accountant review interim financial statements supports an understanding among the investing public that such reviews are in fact conducted." *Id.* at 155. The Second Circuit nonetheless rejected liability because, "[u]nless the public's understanding is based on *the accountant's* articulated statement, the source for that understanding—whether it be a regulation, an accounting practice, or something else—does not matter." *Ibid.* (emphasis added).

Lead plaintiff also contends that the direct attribution requirement adopted by the Second, Tenth, and Eleventh Circuits has been displaced by this Court's decision in *Stoneridge*. According to lead plaintiff, "[f]ar from requiring direct attribution as a predicate for liability, this Court noted in *Stoneridge* that no statements are necessary, *so long as* the defendants' actions are a necessary part of the fraud, and *investors relied on defendants' conduct*." BIO 15 (emphasis added). The italicized qualification destroys lead plaintiff's effort to enlist *Stoneridge* in its cause, however, because "the attribution requirement ... stems directly from the *need for private litigants to prove reliance* on an alleged fraud to succeed on a private cause of action." *Wolfson*, 539 F.3d at 1258–60 (emphasis added); *see also, e.g.*, *Wright*, 152 F.3d at 175 (failing to require direct attribution would "circumvent the reliance requirements of the [Exchange] Act, as '[r]eliance only on misrepresentations made by others cannot itself form the basis of liability'" (quoting *Anixter* v. *Home-Stake Prod. Co.*, 77 F.3d 1215, 1225 (10th Cir. 1996))).

Lead plaintiff is conflating two distinct elements of Section 10(b) liability: the requirement that a plaintiff prove a "material misrepresentation or omission by the defendant," and the separate requirement that it prove "reliance upon the misrepresentation or omission." *Stoneridge*, 552 U.S. at 157. This Court recognized in *Stoneridge* that the former element can be satisfied even without a "specific oral or written statement" because "[c]onduct itself can be deceptive." *Id.* at 158. But this does not eliminate the plaintiff's need to prove the latter element—reliance. Indeed, in *Stoneridge* itself, the Court ultimately rejected liability precisely because "th[e] deceptive acts were not communicated to the public." *Id.* at 159. Because the relevant disagreement among the courts of appeals is "over the degree of attribution required to plead reliance" (Pet. App. 19a), that circuit split is not undermined, or even affected, by this Court's acknowledgment that "[c]onduct itself can be deceptive." 552 U.S. at 158.*

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* Lead plaintiff is similarly misguided in attempting to distinguish *Stoneridge* by repeatedly emphasizing that JCM allegedly played a role in disseminating the Janus Funds' prospectuses. *E.g.*, BIO 16. That was Judge Shedd's view below, but he wrote only for himself. Pet. App. 40a–41a (Shedd, J., concurring). The majority, by contrast, expressly rejected that view in concluding that only JCM, and not JCG, could be held primarily liable: "Although JCG, like JCM, played a role in the dissemination of the fund prospectuses on the Janus website, this fact, taken by itself, is insufficient in this case for us to infer that interested investors would believe JCG had prepared or approved the Janus fund prospectuses." *Id.* at 32a. Instead, the Fourth Circuit reasoned that, "[i]n light of the publicly

[Footnote continued on next page]

II. THE DECISION BELOW HAS PROFOUND PRACTICAL IMPLICATIONS

Lead plaintiff does not dispute that this case presents pure questions of federal law regarding the proper interpretation of the implied private right of action under Section 10(b) of the Exchange Act or that it is an ideal vehicle to resolve the questions presented. It contends, however, that the Fourth Circuit's decision rests on the "unique" facts of this case and therefore "would not ... open the door to potential fraud liability on the part of all sorts of peripheral service providers to public corporations." BIO 2, 21. In practically the same breath, lead plaintiff admits that the relationship between JCM and the Janus Funds is "typical of mutual funds." *Id.* at 22. Because it is precisely this relationship that allegedly gives rise to liability, the Fourth Circuit's decision will—at minimum—result in a massive expansion of private securities-fraud liability in the mutual fund industry. *Cf. Jones* v. *Harris Assocs., L.P.*, No. 08-586 (reviewing circuit conflict on question of liability standards for mutual fund advisers).

According to lead plaintiff, mutual funds are typically "structure[d]" so that "the fund itself has no operations of its own." BIO 22. Thus, lead plaintiff claims, "most investors familiar with mutual funds have an expectation that the actual running of the Fund and preparing of the relevant documents is ac-

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available material, interested investors would have inferred that if JCM had not itself written the policies in the Janus fund prospectuses regarding market timing, it must at least have approved these statements." *Id.* at 31a.

complished by the Fund manager, not the Fund itself." *Id.* Under the Fourth Circuit's approach, this means that *every* investment adviser could be held primarily liable for statements in the prospectuses of the funds it advises, at least if those funds are structured in the "typical" manner. *See* BIO 22. This is a breathtaking expansion of liability in an industry that manages more than $10 trillion in assets.

Lead plaintiff is mistaken, moreover, in claiming that the decision below can be limited to the mutual fund context. The unwarranted expansion of secondary liability sanctioned by the court below will be implicated in every case in which a service provider—such as an accountant, a lawyer, or a bank—helps an issuer prepare its offering materials. Although lead plaintiff assets that "[g]enerally ... nothing in the public statements of the issuer ... gives investors any reason to believe that the service provider is 'making' those statements" (BIO 22–23), this is plainly wrong. When a public company includes unaudited financial statements in its quarterly SEC filings, there is just as much reason for "interested investors [to] attribute" to the company's auditor a "substantial role in ... approving" those statements (Pet. App. 24a), as there is for investors to attribute a mutual fund's prospectuses to its investment adviser: Federal law expressly provides that "interim financial statements included in quarterly reports on Form 10-Q ... must be reviewed by an independent public accountant using professional standards and procedures for conducting such reviews." 17 C.F.R. § 210.10-01(d). The direct-attribution test, unlike the decision below, would reject liability for the auditor in this context. *See Lattanzio*, 476 F.3d at 155.

Finally, lead plaintiff argues that it would be "imprudent" for the Court to consider this case because Senator Specter has introduced a bill that would create private securities-fraud liability for those who provide "substantial assistance" to other violators. BIO 24 (citing S. 1551, 111th Cong. (2009)). Of course, the fact that it would require a statutory amendment to ratify the result reached by the Fourth Circuit in this case is good evidence that the decision below does *not* accurately reflect existing law. Indeed, Senator Specter's bill is expressly designed to "overturn" this Court's decisions in *Stoneridge* and *Central Bank* "by amending the Securities Exchange Act of 1934 to authorize a private right of action for aiding-and-abetting liability." 155 Cong. Rec. S8564 (daily ed. July 30, 2009) (statement of Sen. Specter).

Legislation is frequently introduced in Congress but far more rarely enacted. This Court should not decline review of the important questions raised by the Fourth Circuit's decision merely because legislation has been introduced that, if passed by both houses of Congress and signed by the President, might (if it were applied to pending cases) provide an alternative basis for liability on the facts of this case. To the contrary, this Court should ensure fidelity to its precedents, and secure uniformity among the courts of appeals on important questions affecting the national securities markets, by granting review of the erroneous decision below. Otherwise, the Fourth Circuit will have supplanted the proper roles of both Congress and this Court.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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