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LIES WITHOUT LIARS? *JANUS CAPITAL* AND CONSERVATIVE SECURITIES JURISPRUDENCE

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In *Janus Capital Group, Inc. v. First Derivative Traders*,[1] the Supreme Court held that even if a mutual fund advisory firm had caused a lie about its late trading and market timing policies to appear in a prospectus issued by a mutual fund that it managed, it did not *make* a misrepresentation within the meaning of Rule 10b-5 because the prospectus in which the lie appeared was filed by and in the name of the mutual fund, not the adviser. According to the Court, the word "make" in Rule 10b-5 refers only to a statement by the person with ultimate legal authority over the filing and public dissemination of the document.[2] In so holding, Justice Clarence Thomas and the rest of the majority joined a seemingly short list of judges who suggest that legal formalism is a particularly good weapon with which to fight securities fraud.

To some, *Janus* may be just another float in the current Court's tiresome pro-business parade, one that celebrates the Court's contempt for securities class actions. But that impression may be unfair. *Janus* was one of three securities class action cases decided in 2011, the other two of which held for the plaintiffs in ways that disappointed those on the defense side. *Matrixx Initiatives Inc. v. Siracusano*,[3] for instance, passed on an opportunity to rein in the otherwise fact-intensive approach to materiality on which defense motions to dismiss often stumble, and applied the heightened pleading requirement for scienter fairly liberally.

Janus's punch line is the "ultimate authority" test, but its defining image is the distinction between a speaker and a speechwriter[4]: Only the speaker, according to the Court, can reasonably be deemed the maker of any misrepresentation contained in the speech. Even if all the ideas, and even the exact language—including any deliberate deception—come from

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1. 131 S. Ct. 2296 (2011).
2. *Id.* at 2302.
3. 131 S. Ct. 1309 (2011). The other pro-plaintiff outcome was *Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179 (2011) (holding that class certification does not require a finding that there was loss causation).
4. *Janus*, 131 S. Ct. at 2302.

the speechwriter, she does not "make" the speech and thus is not primarily liable for the fraud.[5] That means that we might well have deliberately deceptive speech with no liability at all under Rule 10b-5. The speaker does not know of or recklessly disregard the fraud, and thus has no scienter. The person acting with scienter is not the maker. So far as Rule 10b-5 is concerned, we can have lies without liars.[6]

This disconnect surely frustrates any purposive effort to fight securities fraud. There is nothing in the language or history of Rule 10b-5, a straightforward prohibition against securities fraud, to suggest that the SEC intended for its words to be limited so that the person or entity with the greatest causal responsibility for a misrepresentation or actionable omission escapes its reach. *Janus* leaves legal scholars and practicing lawyers to explain how the majority so confidently came to the conclusion that Rule 10b-5 means otherwise.

Besides the purely political account noted earlier, a common explanation is that the Court simply failed to appreciate the unfortunate consequences of its rigid ruling, especially in the mutual fund context.[7] My argument is entirely different.[8] The *Janus* opinion is a text woven from many different threads, including many made by the skilled appellate advocates who represented the business interests and knew particularly well how to resonate with the current Justices.[9] Understanding the Court's

5. The speaker-speechwriter distinction was offered initially in petitioner's brief in the case. *See* Brief for Petitioners at 11, Janus Capital Group, Inc. v. First Derivative Traders, 131 S. Ct. 2296 (No. 09-525), 2010 WL 3501188, at *11. In oral argument, Justice Scalia repeatedly invoked the speechwriter analogy. *See* Transcript of Oral Argument, Janus Capital Group, Inc. v. First Derivative Traders, 131 S. Ct. 2296 (No. 09-525), *available at* http://www.supremecourt.gov/oral_arguments/argument_transcripts/09-525.pdf.

6. A similar point is made by Norman Poser, who criticizes *Janus* for tolerating a right without an effective remedy. *See* Norman S. Poser, *The Supreme Court's* Janus Capital *Case*, 44 REV. SEC. & COMMOD. REG. 205 (2011).

7. *See id.*; *see also* Elizabeth Cosenza, *Is the Third Time the Charm?* Janus *and the Proper Balance Between Primary and Secondary Actor Liability Under Section 10(b)*, 33 CARDOZO L. REV. 1019 (2012). With respect to its understanding of how mutual funds work, see William A. Birdthistle, *The Supreme Court's Theory of the Fund*, 37 J. Corp. L. 771 (2012).

8. Along similar lines, see A.C. Pritchard, *Securities Law in the Roberts Court: Agenda or Indifference?*, 37 J. CORP. L. 105, 135–38 (2011).

9. Petitioners were represented (quite effectively, obviously) by Mark Perry of Gibson, Dunn & Crutcher, who after law school at the University of Chicago clerked for Judge Alex Kozinski on the Ninth Circuit and Justice Sandra Day O'Connor on the Supreme Court. *Mark A. Perry*, GIBSON DUNN, http://www.gibsondunn.com/lawyers/mperry (last visited Oct. 1, 2012). For an exploration of the specialized Supreme Court bar, see Richard J. Lazarus, *Advocacy Matters Before and Within the U.S. Supreme Court: Transforming the Court by Transforming the Bar*, 96 GEO. L.J. 1487 (2008). Lazarus shows that advocacy before the Supreme Court is increasingly in the hands of a relatively small number of specialists, and that—even though the political affiliations of the lawyers are on both sides—this expertise tilts strongly toward aiding business interests because the advocates' firms do

opinion requires that we willingly enter into the interpretive milieu of conservative public law jurisprudence. While the rough outlines of conservative thinking—textualism and strict interpretation—are familiar enough to most securities lawyers and academics, its nuances tend to be of little interest. Those who work entirely in the "private law" domain of corporate-securities law instinctively evaluate legal issues in terms of instrumental outcomes, asking what is best in terms of protecting investors, capital formation or some form of economic efficiency. Conservatism in this domain reflects the law and economics legacy that has influenced this field for the last three decades, with its strong preference for private ordering.[10] Ideologically heated disagreements often arise about the law's proper scope, but these remain debates ultimately about strategy. This instrumentalist form of conservatism is amply visible in recent case law interpreting Rule 10b-5. There are repeated references to unnecessary litigation and preserving the competitiveness of American business, which infuriates those who instinctively look to the courts to help advance the cause of investor protection.

By contrast, *Janus* comes from an entirely different vision of legal analysis, where simply being against fraud is not enough. Genuine conservative interpretivism can be deliberately indifferent to policy effects; even seemingly absurd consequences may not necessarily be a reason to depart from a faithfully text-driven reading of a statute or rule.[11] This philosophy is about respecting strict separation of powers, appreciating the complexities of law-making, and preserving individual freedom and autonomy (economic and otherwise) absent legitimate governmental intervention.[12] My aim here is not to take on any of the myriad contemporary public law debates about textualism as applied to administrative agency rulemaking, but instead simply to suggest that understanding decisions like *Janus* requires a different lens than the one securities academics and litigators normally use. By taking the

extensive corporate work, and thus are commonly conflicted out from representing challengers. *See id.* at 1562.

10. The classic text is FRANK EASTERBROOK & DANIEL FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW (Harvard Univ. Press 1996).

11. *See* John F. Manning, *The Absurdity Doctrine*, 116 HARV. L. REV. 2387 (2003). Justice Scalia has written extensively on a conservative theory of interpretation, with a heavy emphasis on the dictionary, in ways that seem to describe much of the analysis in *Janus*. *See generally* ANTONIN SCALIA & BRYAN A. GARNER, READING LAW: THE INTERPRETATION OF LEGAL TEXTS (Thomson/West 2012). Manning suggests that purposivism has declined as authority—and respect for text increased—even in the eyes of justices not entirely committed to the conservative view. *See* John F. Manning, *The New Purposivism*, 2012 SUP. CT. REV. 113, 146–48.

12. *See* Frank H. Easterbrook, *Statutes' Domains*, 50 U. CHI. L. REV. 533 (1983).

conservative view more seriously, we might better understand how and why the case law has come to be as it is, and perhaps more importantly, anticipate other issues that are currently taken for granted but might similarly be contested.

To this end, Part I analyzes *Janus*'s interpretive methodology, arguing that it is more persuasive even within a faithfully conservative textualist framework if read as addressing only the implied private right of action under Rule 10b-5, not SEC enforcement proceedings or criminal prosecutions. Part II then traces the route to *Janus* in terms of precedent—both the more recent cases defining secondary liability and the early battles over the text of the "in connection with" requirement under Rule 10b-5. It claims that there are underappreciated historical links between secondary liability and the "in connection with" language, and that *Janus* is likely to prompt a reexamination of the scope of that language, too, at least as applied in private litigation. Part III surveys the open questions that are being litigated after *Janus*, such as how to address liability where there is no obvious sense of "authority" over more informal corporate publicity, what scheme liability means apart from making particular misstatements, and how to address cases where the deception was not directly aimed at investors but instead targeted at other parties, such as auditors or independent directors on an audit committee. Part IV offers a brief conclusion.

I. READING *JANUS* CAREFULLY

The question presented in *Janus* was whether Janus Capital Management (JCM), an investment advisor, "made" a misrepresentation about the market timing and late trading policy that appeared in prospectuses issued and filed by Janus Investment Fund (JIF), which JCM was advising.[13] Given that phrasing of the question, one would think that

13. Janus Capital Group, Inc. v. First Derivative Traders, 131 S. Ct. 2296, 2299 (2011). These policies had to do with whether large investors would be given special privileges that might hurt fund performance (thereby harming JIF's other investors) but increase the size of the fund (and hence JCM's management fee, which is based on assets under management). *See* Stephen Choi & Marcel Kahan, *The Market Penalty for Mutual Fund Scandals*, 87 B.U. L. REV. 1021 (2007). According to plaintiffs, JCM administered this policy, and so would be the only party with direct knowledge of the truthfulness of the statements in the prospectus. *Janus*, 131 S. Ct. at 2312 (Breyer, J., dissenting). In the typical mutual fund setting, the advisor does all the day-to-day work of managing the fund; the fund itself has an independent board of directors (or, as here, board of trustees) whose job it is, for all practical purposes, to oversee the adviser. *Id.* To be clear, defendants contested that JCM controlled the preparation of the prospectus, even though in-house lawyers employed by JCM did the drafting, emphasizing that the board of trustees of JIF met to review the filing and were represented by separate independent counsel in the review process. *Id.*

the lawsuit here was being brought by JIF investors who said they relied to their detriment on the falsity.[14] Instead, and essential to a critical reading of the opinion, this was a "fraud-on-the-market" class action brought by investors in a separate legal entity, Janus Capital Group (JCG), JCM's publicly-traded parent company, after JCM was sanctioned by federal and state authorities for breach of fiduciary duty in the well-publicized market timing scandals of the mid-2000s.[15] The penalties and attendant reputational damage from its subsidiary's behavior caused JCG's stock price to drop, for which the class-period purchasers wanted compensation.[16]

Plaintiffs' claim was based on the failure by JCG to reveal JCM's misconduct and the threat that it posed. Yet under the securities laws, there is no automatic duty to reveal cheating or other fiduciary breaches simply because of their materiality.[17] So, the plaintiffs had to look for affirmative misstatements that might have been made materially misleading by the omission of the cheating. The plaintiffs came up empty with respect to JCG's own public disclosures, but did find what they believed were misleading statements in the JIF prospectuses.[18]

The core of plaintiffs' fraud-on-the-market argument was that what was stated in JIF's mutual fund prospectuses distorted the market price of JCG securities. This was something of a stretch. To be sure, if the prospectus had revealed JCM's inclination to allow market timing by favored fund investors, there might have been unfavorable publicity and an adverse price effect. But since neither JIF nor JCM had an explicit duty to reveal these intentions, liability could have been avoided simply by silence or vagueness. Plaintiffs were thus fortunate to find something in a document for which they were not the intended beneficiaries—otherwise they would have had no case under Rule 10b-5, even assuming the market timing misbehavior occurred. The *Janus* Court likely sensed that there was some overreaching by the plaintiffs, which could well have affected how it viewed the ultimate question of who "made" the statements in the JIF

14. In fact, such an action was brought and settled. Before the Court, defendants acknowledged that JIF shareholders had a legitimate cause of action because, as the district court found, JCM had an independent fiduciary disclosure duty owed at least indirectly to JIF's shareholders. *See* Transcript of Oral Argument, *supra* note 5, at 64.

15. *Janus*, 131 S. Ct. at 2300.

16. *Id.*

17. *See* JAMES D. COX ET AL., SECURITIES REGULATION: CASES AND MATERIALS 653–56 (6th ed. 2009); Robert B. Thompson & Hillary A. Sale, *Securities Fraud as Corporate Governance: Reflections on Federalism*, 56 VAND. L. REV. 859, 879 (2003).

18. *Janus*, 131 S. Ct. at 2300.

disclosures. This was hardly the ideal factual scenario, from the perspective of the plaintiffs' bar, for testing the limits of primary liability.

In other work, I have stressed that the presumption of reliance that supports the fraud-on-the-market theory is an entitlement—an act of juristic grace[19]—afforded to investors in order to promote the truth-telling goals of the securities laws. But any such entitlement goes only as far as courts think is necessary or just. One can easily see how the Court might doubt both the necessity and justice of creating massive liability where the alleged misstatements were directed at an entirely different group of investors than the ones bringing suit, especially when the prospectus appeared to reflect the sincere (if inaccurate) belief on the part of JIF's independent directors that the anti-timing redemption policy statements were true. This was the odd context in which *Janus* was decided, which was heavily stressed by JCM's counsel at oral argument.[20]

Janus has to be read as a fraud-on-the-market case, with all the baggage that such a cause of action implies. That takes us to the biggest mystery about the Court's opinion. The opinion concentrates on a single word—"make"—in Rule 10b-5(b), and, as such, appears to be interpreting the Rule itself. If this is right, then the Court is defining that word for all cases invoking that subsection, whether brought by a private plaintiff, the SEC, or a criminal prosecutor. Yet the Court explicitly framed the question before it as "whether JCM can be held liable *in a private action*" under Rule 10b-5.[21] The Court's interpretive methodology then repeatedly invokes the (fairly recent) directive that the courts are to "give 'narrow dimensions . . . to a *right of action* Congress did not authorize when it first enacted the statute and did not expand when it revisited the law.'"[22] And it refuses to defer to the SEC's reading of the word "make" because of the Court's "skepticism over the degree of" deference owed "*regarding the private right of action.*"[23] So is the Court construing the Rule, or just the right of action?

19. *See* Donald C. Langevoort, Basic *at Twenty: Rethinking Fraud on the Market*, 2009 WIS. L. REV. 151, 161.

20. *See* Transcript of Oral Argument, *supra* note 5.

21. *Janus*, 131 S. Ct. at 2301 (emphasis added).

22. *Id.* at 2302 (emphasis added) (alterations in original).

23. *Id.* at 2303 n.8 (emphasis added). This is especially important because, traditionally, the Court has readily deferred to the SEC's own construal of the language of Rule 10b-5 outside the private litigation context, assuming reasonableness in light of the statutory grant of authority. *See* SEC v. Zandford, 535 U.S. 813, 819–20 (2002). There is an emerging issue in administrative law about the validity of such deference (often referred to as "Auer" deference, after *Auer v. Robbins*, 519 U.S. 452 (1997)) where the agency's interpretation arises outside of (or inconsistently with) the process by which rulemaking is expected to occur—in other words, concern about using interpretation as a de

Many lower courts have applied *Janus* to SEC enforcement actions, at least "*arguendo*."[24] Some historical background is important. In two prior Supreme Court cases involving different aspects of Rule 10b-5, *Central Bank of Denver v. First Interstate Bank*[25] and *Morrison v. National Australia Bank*,[26] similarly restrictive decisions were quickly followed by Congressional determinations to leave untouched the Court's rulings as applied to private litigation but to reestablish the SEC's broader enforcement authority.[27] Reading cases like these as not limited to private litigation, notwithstanding extensive language in the opinion to the contrary, may be becoming a habit.

If *Janus* is an authoritative reading of Rule 10b-5's text, however, its analysis is disturbing. The Court essentially offers four reasons for its narrow construction of "make." The first justification is a brief reference to the dictionary,[28] which is not particularly helpful because the word has so many possible meanings.[29] The second is the Court's own common sense or ordinary usage of the term, from which comes the speaker-speechwriter distinction.[30] The third is precedent—interpretive guidance

facto amendment to a rule. It is hard to see the relevance of this debate to a case like *Janus*, given that the Commission was offering an entirely plausible, if not inevitable, reading of a word of its own choosing. That said, Justice Thomas—implausibly—claims that the meaning of "make" was not ambiguous as a way of avoiding deference. *Janus*, 131 S. Ct. at 2303 n.8.

24. *E.g.*, SEC v. Landberg, 836 F. Supp. 2d 148 (S.D.N.Y. 2011); SEC v. Kelly, 817 F. Supp. 2d 340 (S.D.N.Y. 2011). *But see* SEC v. Boock, FED. SEC. L. REP. (CCH) ¶ 96,584 at *3 n.1 (S.D.N.Y. 2011) ("Wong also does not explain why *Janus Capital*, which found that the wording of the relevant statutes did not permit private actors to sue those who may be liable for misstatements of others in violation of Rule 10b-5, has any bearing on the SEC's capacity to sue secondary violators . . . ."); SEC v. Pentagon Capital Mgmt. PLC, 844 F. Supp. 2d 377 (S.D.N.Y. 2012) (language in *Janus* specifically directed at private litigation, not the SEC). SEC Commissioner Elisse Walter discussed *Janus* critically in a speech without contesting its application to the Commission's enforcement work. *See* Commissioner Elisse Walter, Remarks Before the FINRA Institute at Wharton Certified Regulatory and Compliance Professional Program (Nov. 8, 2011). An SEC administrative law judge applied *Janus* in *In re John Flannery*, Initial Dec., Oct. 28, 2011, *available at* http://www.sec.gov/alj/aljdec/2011/id438bpm.pdf.

25. 511 U.S. 164 (1994) (holding that private plaintiffs could not maintain an aiding and abetting suit under Section 10(b) of the Securities Exchange Act).

26. 130 S. Ct. 2869 (2010). Morrison applied a "presumption against extraterritoriality" to hold that Rule 10b-5 does not apply to transactions occurring outside the borders of the United States.

27. *See* Section 20(e) of the Securities Exchange Act of 1934, 15 U.S.C. § 78t(e) (creating explicit aiding and abetting authority) and Section 27(b), 15 U.S.C. § 78aa(b) (granting government broader extraterritorial jurisdiction).

28. *Janus*, 131 S. Ct. at 2302.

29. This is a familiar criticism of strong-form textualism, even from within conservative theory. *See* Richard A. Posner, *The Incoherence of Antonin Scalia*, THE NEW REPUBLIC (Aug. 2012), *available at* http://www.tnr.com/article/magazine/books-and-arts/106441/scalia-garner-reading-the-law-textual-originalism?page=0,0; Caleb Nelson, *What is Textualism?*, 91 VA. L. REV. 347, 391–93 (2005).

30. *Janus*, 131 S. Ct. at 2302.

drawn from *Central Bank* and the Court's more recent decision in *Stoneridge*.[31] The fourth is the need to confine implied rights of action.[32]

Note what the Court does *not* do—ask what a reasonable person would think the SEC meant at the time by its chosen language.[33] The context in which the rule was adopted is well-known.[34] Until 1942, the SEC had relied on Section 17(a) of the Securities Act in fraud cases. Section 17(a) bars fraud and misrepresentation in the "offer or sale" of a security. But the agency had recently uncovered a case of fraud by a buyer of securities, not a seller, and was not sure that 17(a) would bar the on-going conduct.[35] The Commission plugged the gap by modifying the language of 17(a) to apply to buyer fraud, in the form of a rule adopted pursuant to Section 10(b) of the Securities Exchange Act. The second prong of 17(a) included a prohibition against "obtaining money or property by means of" a material misrepresentation or omission. Without any explanation, the drafters of Rule 10b-5 chose the simpler word "make" in crafting the desired symmetry.

That is not a trivial bit of history. Consider if the SEC had brought a case under Section 17(a) against JCM. The question would be whether JCM was obtaining money or property by means of a misrepresentation or actionable omission. There is a compelling textual argument that that is exactly what it was doing. JCM was allowing the late trading by favored investors to inflate its management fee,[36] and it was doing so by causing the false impression, in JIF's prospectuses, that such trading was not being allowed. "By means of" seems quite well suited to catch this sort of deception. If that is right, however, then what the Court is effectively saying in *Janus* is that "make" was meant by the SEC to have a more restrictive meaning than what was in the statutory text from which the Rule was drawn. That is implausible given the context of the Rule's adoption. More likely, the drafters chose "make" in order to avoid the unnecessary complications of having to prove motive in fraud cases, while remaining at least as expansive and flexible as the original statutory

31. *Id.* at 2302–03.
32. *Id.* at 2303.
33. Nor does the Court defer to the SEC's interpretation of its own word. *See supra* note 23.
34. *See* Milton V. Freeman, *Colloquium Foreword: Happy Birthday Rule 10b-5*, 61 FORDHAM L. REV. S1 (1993) (recollections of rule's principal drafter).
35. *Id.* at S1–S2.
36. On the applicability of *Janus* in Section 17(a) cases, see *infra* Part III.A.

language, because serious damage can be done by misrepresentations even when there is no overt intention to obtain money or property.[37]

Having failed to make any inquiry into the context of the Rule's adoption, the Court then goes on for much of the remainder of the opinion to invoke the policy goal of confining private litigation.[38] Once again, originalism is ignored, because that policy could not have had any usefulness at the time the SEC's words were written. There was no private litigation under Rule 10b-5 until years after its adoption.[39] Unless *Janus* is read as limited to private actions, the Court is giving policy-based meaning to a word that could not possibly have contemplated that policy when it was written by the SEC in 1942. This sort of interpretation usually provokes loud conservative protest.[40] On the other hand, the holding is perfectly coherent if read as limited to private actions. The SEC has never been deemed authoritative on the scope of the judicially implied right of action under Section 10(b), and restraining the scope of the implied right has been a judicial mission for almost two decades.

For all these reasons, and notwithstanding a brief footnote reference to textual unambiguity in the course of explaining why it was giving the SEC no interpretive deference,[41] I prefer to take the Court's statement of its holding literally: we are being told what "make" means *in the context of private securities litigation* under Rule 10b-5, leaving open how it is to be construed in the context of public enforcement. This is not an insignificant matter, though it might not be all that important in the particular context of *Janus*. Worth noting, though unmentioned in the Court's opinion, is that the SEC did take enforcement action against JCM in 2004, which settled.[42]

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37. It is, however, the conclusion in one pre-*Janus* case, *SEC v. Tambone*, 597 F.3d 436 (1st Cir. 2010) (en banc). The court accepts a broader reading of Section 17(a), but then cannot identify a reason why the SEC substituted "make" for "by means of" other than to impose a different, *narrower* meaning. *Id.* That latter inference seems quite strained given the simple desire to expand the reach of the antifraud prohibition through the adoption of Rule 10b-5. Two of the six First Circuit judges concurred in this result, but seemed to distance themselves from some of their colleagues' literalism. *Id.* at 450. Two other judges dissented. *Id.* at 453.

38. *Janus*, 131 S. Ct. at 2303.

39. *See* COX ET AL., *supra* note 17, at 662–63. Similarly, it would be strange to construe the word "make" in light of the teachings of *Central Bank* and *Stoneridge*, neither of which involved the use of that word. Here again, the interpretive methodology makes more sense as to the scope of the private right of action for misstatements made by a defendant, which those two cases plainly addressed.

40. One is tempted to suggest that the real technique of statutory interpretation at work here is a simple presumption against a statute's reach. *See* Easterbrook, *supra* note 12. For an analysis of *Morrison*, as disguising a particularly activist form of statutory interpretation, see Lea Brilmayer, *The New Extraterritoriality:* Morrison v. National Australia Bank, *Legislative Supremacy, and the Presumption Against Extraterritorial Application of American Law*, 40 SW. U. L. REV. 655 (2011).

41. *See supra* note 23.

42. *See In re* Janus Capital Mgmt., Rel. No. IA-2277, Aug. 18, 2004.

The complaint did not invoke Rule 10b-5 at all. Instead, the claims were all brought under the Investment Advisors Act of 1940, with its distinctive antifraud prohibition, and the Investment Company Act of 1940.[43] The Commission's action claims that JCM actually filed the misleading prospectuses for JIF[44]—a fact that was particularly important to the plaintiffs' case in *Janus*, but which the majority ignores.

That takes us to a final, perhaps obvious, introductory point. If, contrary to my reading, the Court was construing the SEC's chosen wording, then the Commission can reverse *Janus* simply by amending Rule 10b-5 to be clearer about its meaning, assuming that it stays faithful to the statutory grant of rulemaking authority in Section 10(b).[45] That may be the Court's goal here, invoking something akin to a penalty default interpretation, like *contra proferentem* in contract law, simply to provoke the Commission or Congress to clarify its intent through an amendment to Section 10(b) or Rule 10b-5. In this regard, *Janus* bears a substantial affinity to both *Central Bank* and *Morrison*, both of which did provoke a congressional response.[46] Such a penalty default reading would lead us into relatively new territory in the law of statutory (or administrative rule) interpretation, though it is not all that far removed from the conservative vision of separation of powers that insists that the legislature step up and take responsibility for hard policy choices.[47]

On the other hand, if *Janus* is just about the scope of liability in the implied right of action, the message is entirely different. While there is some debate about the SEC's authority with respect to private rights,[48] the

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43. *Id.*

44. *Id.* ¶ 21.

45. Adam Pritchard sees the presence of the twin Section 20 provisions as impediments to the Commission's freedom here. *See* Pritchard, *supra* note 8, at 137. I am less convinced, but the point is well taken. On the text and history of Congress' broad grant of authority in Section 10(b), see Steve Thel, *The Original Conception of Section 10(b) of the Securities Exchange Act*, 42 STAN. L. REV. 385 (1990).

46. *See* Section 20(e) of the Securities Exchange Act (giving the SEC the ability to pursue aiding and abetting cases), and Section 27(b) of the Securities Exchange Act (giving the SEC broader extraterritorial jurisdiction).

47. There is scholarly literature addressing the use of these kinds of strategies in statutory interpretation. *See, e.g.*, Einer Elhauge, *Preference-Eliciting Statutory Default Rules*, 102 COLUM. L. REV. 2162 (2002); Scott Baker & Kimberly D. Krawiec, *The Penalty Default Canon*, 72 GEO. WASH. L. REV. 663 (2004); *see also* Nelson, *supra* note 29, at 391–93 (describing use of formalist interpretive rules as a means of facilitating clearer communication between Congress and the courts). At oral argument in *Janus*, counsel for petitioners opened with the point that Congress has consistently responded to prior Court decisions when it wished to change the law—the only argument he was able to make before questions began. *See* Transcript of Oral Argument, *supra* note 5, at 3.

48. *See generally, e.g.*, Joseph A. Grundfest, *Disimplying Private Rights of Action Under the Federal Securities Laws*, 107 HARV. L. REV. 963 (1994).

impression given by the Court here and in other recent cases is that the responsibility to adopt a new private litigation standard if it wishes is for Congress, not the SEC.[49] Although legislative expansion of private rights is unlikely to happen in the current political environment, that prediction is of no concern to judges who care more about limiting the scope of judicial authority than optimal investor protection.

II. THE ROAD TO *JANUS*

A. Central Bank *and* Stoneridge

Justice Thomas's majority opinion in *Janus* justifies a narrow reading of "make" as implicit in two prior decisions dealing with the secondary liability question under Rule 10b-5: *Central Bank of Denver v. First Interstate Bank of Denver* and the more recent *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*[50] Justice Breyer's dissent shows the hollowness of Thomas's argument based on precedent. He notes that *Central Bank* was entirely about aiding and abetting (which the Court rejected), as distinct from the kind of primary liability claim being made in *Janus*,[51] and that *Stoneridge* was solely about how private plaintiffs demonstrate reliance on an alleged misrepresentation, which says nothing at all about primary liability.[52]

I have nothing much to add to Breyer's point about *Central Bank*. *Stoneridge* deserves more emphasis, however, because it was such a surprising turn in the law. Observers thought that *Stoneridge* would at last address the standard for primary liability and choose from the various tests—attribution, creator, substantial participant—developed by lower courts to deal with the question left open after *Central Bank*. Attribution was the odds-on, defendant-friendly favorite. It required that the victim of the fraud be able to attribute the misleading statement to the particular defendant, thereby insulating most behind-the-scenes actors from liability.[53]

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49. As will be discussed *infra*, the Commission could work within *Janus*'s framework to expand liability by requiring more public certifications of filings by significant behind the scenes actors, like mutual fund advisors.

50. 552 U.S. 148 (2008).

51. Janus Capital Group, Inc. v. First Derivative Traders, 131 S. Ct. 2296, 2307–08 (2011) (Breyer, J., dissenting).

52. *Id.* at 2309.

53. *See, e.g.*, Wright v. Ernst & Young LLP, 152 F.3d 169 (2d Cir. 1998). For a review of various formulations, see COX ET AL., *supra* note 17, at 769–72.

The surprise was that the *Stoneridge* Court addressed the issue before it in terms of reliance instead of primary liability, holding that plaintiffs cannot show reliance on deception that is too remote or attenuated from the ultimate public misrepresentations.[54] A prime mover behind this shift appears to have been the Solicitor General (SG), who presumably has an interest in protecting government enforcement actions, civil and criminal, from an overly restrictive reading of Rule 10b-5. Public enforcers are not required to prove reliance in a 10b-5 case, and so the shift to reliance had the effect of making the case one solely about private litigation. It is hard to imagine any other reason for not treating the case as raising the more palpable issue of whether the defendants (Scientific-Atlanta and Motorola) had themselves made the misrepresentations on which plaintiffs say they relied.

The SG's brief in *Stoneridge* is worth revisiting.[55] The plaintiff community remembers it as political anathema: a last-minute repudiation by the Bush Administration of the SEC's decision to file a brief on the plaintiffs' side in that case. However, the first portion of the SG's brief is a remarkably plaintiff-friendly effort to defend Rule 10b-5 from the Eighth Circuit's oddly narrow reading of deception through non-verbal acts. After explaining why non-verbal deception is well within the scope of the Rule's coverage, the brief argues that what the defendant vendors did *was* a form of deception directly prohibited by Section 10(b): their obfuscation and falsifications misled the issuer's auditor and others who were not in on the scheme. In the SG's words, defendants' conduct "constituted a 'deceptive device or contrivance' . . . . because [it] not only was likely to, but allegedly did, mislead Charter's outside accountant, Arthur Andersen, into believing that the two sets of transactions [at issue in the fraud] were discrete."[56] The brief then explains why this interpretation of Section 10(b) is entirely consistent with *Central Bank*.[57] Only after giving this wider scope to primary liability did the government then switch sides and support the defendants by arguing lack of actionable reliance.

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54. *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 (2010). The case involved public misrepresentations by an issuer (Charter) that, according to plaintiffs, were enabled by false statements and invoices made by two set-top box manufacturers (Scientific-Atlanta and Motorola), ultimately reflected in Charter's financial reports.

55. *See* Brief for the United States as Amicus Curiae Supporting Affirmance, Stoneridge Investment Partners LLC v. Scientific-Atlanta Inc., No. 06–43 (2007). The Solicitor General at the time was Paul Clement.

56. *Id.* at 16–17.

57. *Id.* at 14–15.

The Court in *Stoneridge* agreed with the government's argument about non-verbal deception without taking the further step of holding that what the vendors did was deceptive vis-à-vis the independent auditors.[58] But the Solicitor General had styled the argument over what deception means in a way faithful to conservative orthodoxy. The argument is perfectly textualist in its treatment of Congress' grant of rulemaking authority; indeed, the fact that the entire argument is grounded in the wording of Section 10(b) rather than Rule 10b-5 is, I suspect, lost on many readers.

One therefore has to wonder why the plaintiffs in *Janus* didn't follow the SG's lead in *Stoneridge* and argue that JCM made a misrepresentation (or actionable omission) *to JIF and its independent directors* when it provided the information regarding timing policy and failed to reveal its true intentions.[59] That would constitute a 10b-5 violation so long as the deception was "in connection with the purchase or sale of a security," which is generally thought to be satisfied if the misstatement was "reasonably calculated" to influence investors.[60] Such would seem to be the case in *Janus*, since the information was made part of a statutory prospectus for mutual fund investors, and investors relied on that deception.[61] If that alternative styling of plaintiffs' claim in *Janus* would be enough to avoid Justice Thomas's holding, then maybe the case is not so troubling—a harsh outcome due to a strategic error by the plaintiffs and their lawyers.

What would happen if a court were to accept this alternative pleading of the 10b-5 claim in a private class action? Assuming the other elements are properly alleged, then the issue becomes one of reliance, just like in *Stoneridge*. The test that Justice Kennedy uses in *Stoneridge* asks whether the plaintiffs' reliance is "too remote" or too "attenuated" from the lie to justify recovery,[62] akin to a proximate cause inquiry. He explains that the vendors' lies in the form of bogus invoices, etc. were too remote and attenuated because these vendors were merely commercial actors. They were not part of the securities business and had never had the sort of

58. Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 552 U.S. 1478, 158 (2008).

59. The issue was addressed by JCM in both the brief and oral argument, stressing simply that the plaintiffs had failed to plead the case this way, and that any effort to recover by JCG investors would fail because of lack of *duty*.

60. 17 C.F.R. § 240.10b-5 (2012). The "reasonably calculated" standard comes from *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 862 (2d Cir. 1968).

61. The Solicitor General's brief in *Stoneridge* took no position with respect to the "in connection with" requirement.

62. *Stoneridge*, 522 U.S. at 159, 162.

involvement in, much less control over, the issuer's financial reporting process to make the fraud "necessary or inevitable."[63]

Were that same standard applied in *Janus*, one could see an easy way of distinguishing *Stoneridge* on its facts and hence a strong argument in favor of the plaintiffs.[64] JCM had practical control over JIF's disclosures, particularly as to the market timing practices over which it had exclusive knowledge. After all, letting late trading and market timing occur is at the adviser's (and the affiliated brokers') discretion. Moreover, these were registered investment advisers, inhabiting a world of intense federal and state regulation, rather than commercial salespeople. As a matter of proximate cause, the link between the JCM's alleged lie and the resulting disclosure was tightly coupled, if there was any appreciable distance at all.

Janus, then, could actually be read as inconsistent with the analytical structure of *Stoneridge*, and making its analysis meaningless if applied such that actors like the set-top vendors in that case never even "made" a misstatement in the first place. Justice Kennedy joined the majority in *Janus*; however, it is unclear whether he realized that his very different and more nuanced opinion in *Stoneridge* was quickly being rendered superfluous.

B. A Longer History

There is no compelling explanation for the outcome in *Janus* by reference to contemporary precedent. But tracing the conservative impulse further back in time as it applies to these issues under Rule 10b-5 may better explain the holding.

The idea that federal courts erred in recognizing liability for aiding and abetting gained intellectual currency in 1981 when Daniel Fischel suggested so in a law review article,[65] which the Court explicitly relied

63. *Id.* at 161.

64. For a discussion of this potential in *Stoneridge*, see Langevoort, *supra* note 54, at 2161–65. To be sure, lower courts after *Stoneridge* did not take up this potential, largely sticking closely to the attribution standard. *E.g.*, *In re* DVI Inc. Sec. Litig., 639 F.3d 623 (3d Cir. 2011); Pacific Inv. Mgmt. Co. v. Mayer Brown LLP, 603 F.3d 144 (2d Cir. 2010). Although *Janus* clearly embraces a strong version of an attribution requirement, it is in the context of answering whether JCM bore responsibility for what JIF said in its prospectuses. It avoids addressing the indirect fraud possibility. *Janus*, 131 S. Ct. at 2304 n.9 ("We do not address whether and in what circumstances statements [such as those from JCM to JIF] would qualify as 'public.'"). Clearly, however (and unfortunately), the window for a measured reading of *Stoneridge* seems to be closing.

65. Daniel R. Fischel, *Secondary Liability Under Section 10(b) of the Securities Exchange Act of 1934*, 69 CAL. L. REV. 80 (1981). Fischel clearly draws from prior work by his then-Dean, David S. Ruder, whose exploration of secondary liability anticipated many of these points. *See* David S. Ruder, *Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy*, In Pari Delicto,

upon a little more than a decade later in *Central Bank*.[66] The article repays careful attention, partly because it bears little evidence of the sophisticated law and economics on which Fischel was contemporaneously working (and which would soon mark his collaboration with Frank Easterbrook at the University of Chicago).[67] The article begins with the blunt claim that the Supreme Court had repudiated the justification for implied private rights of action generally, whether under the securities laws or otherwise.[68] While the Court was allowing the implied right under Rule 10b-5 to remain for a variety of pragmatic reasons, Fischel treats it as if it were a jurisprudential bastard, the surviving illegitimate child of judicial activism. Hence, Fischel perceives the need to confine the implied right to a carefully limited space unless and until Congress creates an express right, regardless of policy arguments for or against the public's interest in compensation or deterrence in the meantime.[69]

The core of Fischel's law review argument was that the text of Section 10(b) limits the scope of Rule 10b-5,[70] and that only tangible evidence of legislative intent to create liability could justify recovery beyond the strict confines of the words in the statute.[71] Legislative silence or inaction in the face of opportunity to address an issue means that there is no statutory reach, unless there is a clear direction to the administering agency to fill the gap. So, he argued that three widely embraced doctrines—aiding and abetting, conspiracy, and *respondeat superior*—had to go even if the core of antifraud liability survived.[72]

Fischel then addressed whether those doctrines had to be excised even as to SEC enforcement, for which there is express statutory authority. Yes,

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Indemnification, and Contribution, 120 U. PA. L. REV. 597, 620 (1972) ("Abolition of the privity requirement makes the potential damage for a secondary defendant greater, and emphasizes that careful attention should be given to identification of the elements required for secondary liability."). Ruder, however, was more interested in reining in secondary liability than dismissing it as illegitimate, presumably because he was writing in the day when implied rights were still being embraced without question. For a tribute to Ruder's influence, see Douglas M. Branson, *Prescience and Vindication: Federal Courts, SEC Rule 10b-5, and the Work of David S. Ruder*, 85 NW. U. L. REV. 613 (1991).

66. *Central Bank*, 511 U.S. at 169.

67. *See* EASTERBROOK & FISCHEL, *supra* note 10.

68. Fischel, *supra* note 65, at 91.

69. While it may seem odd that Fischel was at the same time fervently embracing fraud-on-the-market litigation, that is somewhat more understandable when seen as a way of transferring decision-making power from unruly judges and juries to experts in econometrics, who could satisfactorily resolve the hard issues of materiality, reliance, and causation. *See* Langevoort, *supra* note 19, at 178–79. He thought the volume of cases would drop considerably as a result.

70. Fischel, *supra* note 65, at 94.

71. *Id.* at 98.

72. *Id.* at 102.

he said,[73] because a corollary of the conservative approach is structuralist restraint: when Congress has addressed an issue somewhere in the statute, the political choices made therein should not be upset by inventiveness elsewhere, particularly when courts are doing the inventing.[74] Fischel stressed that Congress came to a highly political but nonetheless dispositive conclusion about when—and when not—to impose liability on secondary actors in Section 20(a).[75]

We can debate the accuracy of Fischel's history with respect to Section 20,[76] but his idea comes through clearly enough in *Janus*. For all practical purposes, the plaintiffs were arguing that JCM controlled JIF's prospectus disclosures. If so, Fischel would say—as Justice Thomas does—that Section 20 is the right place to look for whether or not to impose liability. In other words, courts should not recognize any direct liability under Rule 10b-5 that might frustrate the political compromise over secondary liability that Justice Thomas finds evident in this portion of the statute. A Fischel adherent would thus reject Justice Breyer's dissent, which says that we should dismiss Section 20(a) because it will not produce liability unless someone else is primarily liable, as missing the point.

I am not at all persuaded by Fischel's line of reasoning, however. There is a big difference between having control over a violator and deliberately causing a violation, and the latter fits snugly enough within Section 10(b)'s entirely distinct textual grant of rulemaking authority. But the conservative impulse does not rest entirely on the shadow of Section 20 as a reason to be suspicious of the plaintiffs' argument in *Janus*. The statutory requirement that any deception be "in connection with" the purchase or sale of a security is another sore spot. The ambiguity in this phrase is palpable: does the need to connect the fraud to a securities transaction mean that the defendant must have been buying or selling, or can it be something broader? The Second Circuit, in *SEC v. Texas Gulf Sulphur Co.*,[77] famously stressed the latter in the late 1960s, and established the test that is still used today. The court held that *any* misstatement or omission violates Rule 10b-5 if it is "reasonably

73. Fischel, *supra* note 65, at 99–100.

74. *Id.*

75. Fischel emphasizes that original language for secondary participants was broader but this effort was resisted by the business community, leading to the language of Section 20 as a political compromise. *Id.* at 98–99.

76. *See infra* note 117 and accompanying text; Robert A. Prentice, *Conceiving the Inconceivable and Judicially Implementing the Preposterous: The Premature Demise of* Respondeat Superior *Liability Under Section 10(b)*, 58 OHIO ST. L.J. 1325 (1997).

77. 401 F.2d 833 (2d Cir. 1968).

calculated" to influence investors, regardless of whether or not the defendant is itself trading.[78] The Second Circuit's language led directly to the invention of the fraud-on-the-market class action. But while a total abandonment of privity won the day, it frustrated conservative critics because it created a tort-like remedy that could be invoked by nearly anyone.[79] Fischel expresses this "in connection with" frustration briefly in his article,[80] though his affection for the fraud-on-the-market theory probably caused him to hold back a bit. In explaining why aiding and abetting is illegitimate, he points out that the kinds of persons sued under Rule 10b-5, bankers and lawyers, for example, are usually persons who are not themselves engaged in the purchase or sale of a security.[81]

A clear judicial expression of the conservative antipathy came later on from the dissenters in *Basic Inc. v. Levinson*, the Supreme Court's 1988 endorsement of fraud-on-the-market.[82] We tend to remember Justice White's dissent, which was joined in by Justice O'Connor, for its skepticism about market efficiency as a justification for a presumption of reliance.[83] But in the midst of this invective, the two dissenters said explicitly that the better course of action might well have been to repudiate *Texas Gulf Sulphur* entirely, as at least one amicus party was urging.[84]

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78. *Id.* at 862. That was soon followed by the Supreme Court's decision in *Superintendent of Insurance of New York v. Bankers Life & Casualty Co.*, 404 U.S. 6 (1971)—perhaps the height of tort-style reasoning, in a way that made the "in connection with" requirement almost an afterthought. For an exploration, see James D. Cox, *Fraud is in the Eyes of the Beholder: Rule 10b-5's Application to Corporate Mismanagement*, 47 N.Y.U. L. REV. 674 (1972).

79. David Ruder's view here about the dangers associated with the abandonment of privity reflects this same unease. *See* David S. Ruder, Texas Gulf Sulphur—*The Second Round: Privity and State of Mind in Rule 10b-5 Purchase and Sale Cases*, 63 NW. U. L. REV. 423 (1968). For earlier work, see David S. Ruder, *Civil Liability Under Rule 10b-5: Judicial Revision of Legislative Intent?*, 57 NW. U. L. REV. 627 (1963). Ruder was later appointed Chairman of the SEC by President Reagan.

80. *See* Fischel, *supra* note 65, at 108 n.153.

81. *Id.* at 101. In drafting the opinion in the seminal case of *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), Justice Powell apparently considered raising doubts about the abandonment of privity particularly because of its effects on third-party liability, but ultimately only included a footnote about "policy questions" that supported the scienter requirement. *Id.* at 216 n.33; *see* A.C. Pritchard, *Justice Lewis F. Powell, Jr., and the Counterrevolution in the Federal Securities Laws*, 52 DUKE L.J. 841, 868–69 (2003).

82. 485 U.S. 224 (1988).

83. *Id.* at 254 (White, J., concurring).

84. *See* Basic, Inc. v. Levinson, 485 U.S. 224, 261 (1988). Justice Thomas himself displayed a suspicion about the statutory "in connection with" requirement in *United States v. O'Hagan*, 521 U.S. 642 (1997), a criminal insider-trading case. He wrote at length about how the law firm partner's misappropriation, even if seen as deceptive and done for the purpose of enabling trading, was not itself a purchase or sale and so could not legitimately satisfy the in connection with standard. *Id.* at 682–90 (Thomas, J., dissenting). His dissent is a zealous claim for a very strict construction of the nexus language.

This incipient conservative revisionism resurfaced in the *Stoneridge* litigation. A number of amici on the defense side wanted the Court to rule against the plaintiffs on the "in connection with" requirement.[85] The amici's strong stance in favor of a standard requiring "coincidence" between the fraud and the purchase or sale was mystifying to anyone who simply assumed *Texas Gulf Sulphur* was good law. Perhaps persuaded by the Solicitor General, the Court found it unnecessary to revisit the question.[86] But the Court's twice-emphasized observation that holding vendors who inhabit the world of commerce and do not in any way engage in buying or selling securities to Section 10(b) liability would be inappropriate[87] was precisely the point that conservatives had been making for forty years.

To be sure, the "in connection with" issue is nowhere to be seen in *Janus*. But it would have been present had plaintiffs tried the alternative theory, discussed earlier, that JCM had deceived JIF and its directors. And, I suspect that Justice Thomas's instinct was that liability under Section 10(b) should be tightly confined (if not erased) when the defendant in question is not itself buying or selling. If so, his "ultimate authority" test achieves technical precision—at least here—because JIF was the sole seller of the securities to which the misleading prospectus related. And to the extent that the test's effect is to narrow primary 10b-5 liability to a smaller class of actors in the securities markets, it nudges the law back in the direction of privity and so undoes some of *Texas Gulf Sulphur*'s perceived damage.

Formalism is an impractical way to fight fraud, however. Justice Thomas's reasoning is deeply disturbing to those who are steeped in the ambition of *Texas Gulf Sulphur* and believe that courts should construe securities laws purposively to protect investors from foreseeable harm. But, if we bring the doctrinal back-stories into the picture, the *Janus* opinion becomes more readable, if not more satisfying. To the majority, text-driven formalism dampens the creative impulses that long ago illegitimately turned Rule 10b-5 into a judicial policy-making tool.

Janus does offer plaintiffs (and maybe the SEC) a suggestion. Justice Thomas points to the almost entirely unused Section 20(b), which prohibits indirect violations "through or by means of" another person, as a possibility for avoiding the worst effects of a narrow construction of

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85. *See* Langevoort, *supra* note 54, at 2150.
86. *See supra* notes 55–56.
87. Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 552 U.S. 148, 161, 166 (2008).

"make."[88] Given that Rule 10b-5 proscribes conduct that is directly or indirectly fraudulent and the Court disposed of an argument derived from the rule, it is hard to see exactly what this adds to the legal arsenal. Moreover, it is far from clear that Section 20(b) would by itself support an implied right of action because it only makes conduct unlawful.[89] But, perhaps its statutory pedigree—in no way the product of judicial or administrative inventiveness—will invite judges to fold it into the already implied right of action under Rule 10b-5.

C. The Implicit Threat to "In Connection With"

Although dealing with two very different elements of the cause of action, both *Janus* and *Stoneridge* say something very similar under the facts of those cases: the conduct complained of was sufficiently separate and distinct from the "making" of the public misrepresentation such that the persons engaged in that conduct were out of the plaintiffs' reach. As stated earlier, reliance is a poor choice for articulating that idea;[90] "make" is no better.

Conceptually, the instinct behind the demand for something akin to proximate causation actually finds its best expression in the "in connection with" requirement.[91] This requirement has long been seen as doing the work of assuring sufficient proximity between the fraud and an investment decision. Critics of *Janus* are deeply disturbed, I suspect, by Justice Thomas's failure (or refusal) to recognize the core claim that JCM created a falsity that it placed in a document "reasonably calculated" to influence investors. This satisfies all that is usually asked of a securities fraud claim, which has been the law since *Texas Gulf Sulphur*.

On the other hand, as we have just seen, *Texas Gulf Sulphur* was a horribly wrong turn to deeply conservative judges and commentators, out of which grew the distaste for expansive secondary liability. They view the decision as the product of an illegitimate effort to create a federal tort law by implied right for all those victimized by securities fraud. We have

88. *Janus*, 131 S. Ct. at 2304 n.10.

89. *See* Thomas H. Burt & Daniel Tepper, *Section 20(b): A New Face for Control Person Liability*, N.Y. L.J., Sept. 29, 2011, *available at* www.newyorklawjournal.com/PubArticleNY.jsp?id=1202517180339. In their brief and argument, counsel for JCM described Section 20(b) as applicable when the behind-the-scenes actor is acting as ventriloquist and the speaker is his dummy. They resisted any inference that JIF here was nothing more than a dummy, which is far from obvious given the realities of how mutual funds are created and sponsored.

90. *See* Langevoort, *supra* note 54, at 2133.

91. *Id.*; *see also* Pritchard, *supra* note 8, at 132–35.

already traced some of that history. Today, however, we are at a point where the Court could not easily overrule *Texas Gulf Sulphur* and return to anything akin to a privity requirement, though I suspect that Justice Thomas would do so if he could. There is too much case law—*Basic Inc. v. Levinson*[92] and the entire fraud-on-the-market theory, plus other less familiar cases[93]—standing in the way, along with implicit statutory recognition. The Court has suggested elsewhere that the scope of the implied right of action was essentially "frozen" when Congress enacted the Private Securities Litigation Reform Act in 1995.[94] Though generally invoked by defense-side lawyers, that suggestion is plaintiff-friendly in so far as the converse is also true—that well-established doctrines in effect in 1995 and not abrogated by legislation are protected from judicial elimination.

The scope of the law could still be redefined, however, and my sense is that the more conservative justices on the Court and conservative lower court judges are trying to find a way to do just that. If this is right, we should not be surprised to see renewed efforts in this direction, armed with citations to *Janus* and *Stoneridge*. The most likely doctrinal hooks for limiting private litigation would be standing, by means of a reinvigoration of *Blue Chip Stamps*,[95] or maybe a limitation on the scope of "duty."[96] In the absence of some element of privity, such as fraud *by* a purchaser or seller of securities, the desired goal would be to limit primary 10b-5 liability to false filings or false publicity in the name of the issuer—those made by the issuer and senior management acting on its behalf, and directly for the benefit of its investors.[97] This revisionism might not seem so radical because it preserves *Texas Gulf Sulphur* and *Basic* on their facts while at the same time restoring a more conservative reading of the "in

92. 485 U.S. 224 (1988).

93. *E.g.*, Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit, 547 U.S. 71 (2006) (preemption of state class action because claim was sufficiently "in connection with" the purchase or sale of a security, indicating broad reach to the nexus). For a recent survey, see SEC v. Pirate Investor LLC, 580 F.3d 233 (4th Cir. 2009).

94. *See Stoneridge*, 522 U.S. at 165–67.

95. Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975). *Cf.* Erez Reuveni, *Extraterritoriality as Standing: A Standing Theory of Extraterritorial Application of the Securities Laws*, 43 U.C. DAVIS L. REV. 1071 (2010).

96. This is what the district court did in *Janus*. *See In re* Mutual Funds Inv. Litig., 487 F. Supp. 2d 618, 623–24 (D. Md. 2007), *rev'd*, 566 F.3d 111 (4th Cir. 2009), *rev'd sub. nom. Janus*, 131 S. Ct. 2296. The court also expressed discomfort with the broad "in connection with" standard. *Mutual Funds*, 487 F. Supp. 2d at 622 n.4. I have argued in favor of a duty approach, albeit one that is more expansive than this. *See* Langevoort, *supra* note 54, at 2152–56.

97. JCM's brief explicitly offered this reading, saying that only the issuer and its senior management can be primarily liable for issuer fraud. *See* Brief for Petitioners, *supra* note 5, at 14.

connection with" requirement short of strict privity. Issuers set the trading market in motion by issuing securities originally. Furthermore, issuers both repurchase and sell new securities often enough to presume that the issuer is a purchaser or seller. And there are ongoing disclosure obligations imposed by law that recognize these realities.

In fact, a skirmish like this erupted a few years ago in the Second Circuit, though it was beaten back. In *Ontario Public Service Employees v. Nortel Networks Corp.*,[98] the Second Circuit held that JD Uniphase investors did not have standing to sue Nortel for false filings and publicity regarding Nortel's own financial condition, which indirectly affected JD Uniphase because it was one of Nortel's biggest suppliers. The ruling seems entirely inconsistent with a conventional reading of *Texas Gulf Sulphur*. After all, false publicity by Nortel could foreseeably distort the market for JD Uniphase stock. Some litigators thus read into the decision an implicit limitation that only the issuer itself could be sued for fraud-on-the-market. A subsequent case, written by then-Judge Sotomayor, said that this reading was wrong and that non-issuers could indeed be sued, without adequately explaining why *Nortel* came out as it did.[99] My sense is that *Nortel* was a step in precisely the conservative direction I have articulated and that a Second Circuit panel more aligned with the corrective justice framework of *Texas Gulf Sulphur* prevented it from going any further. Another panel or the Supreme Court, however, might have embraced rather than dismissed *Nortel*.

Were this skirmish to resurface today, *Janus* would rightly be cited as consistent with *Nortel*, even though they involve entirely different issues. *Janus* essentially holds that misstatements in JIF's prospectuses are JIF's responsibility alone, and that only the intended beneficiaries of those prospectuses have standing to sue because only they are owed an enforceable duty. Whether one agrees or disagrees with that outcome, the analysis is intellectually coherent in a way that the articulated logic of *Janus* is not. While I hope that a relatively broad scope to the "in connection with" requirement and the ancillary issues of duty and standing will be preserved, I suspect that *Janus* will encourage a more aggressive attack on what, to so many, seems to be received wisdom, precisely because *Janus*'s reasoning is so out of sync with *Texas Gulf Sulphur*.

98. 369 F.3d 27 (2d Cir. 2004).

99. *In re* NYSE Specialists Sec. Litig., 503 F.3d 89, 102 (2d Cir. 2007); *see also In re* Salomon Analyst Metromedia Litig., 544 F.3d 474, 481 (2d Cir. 2008).

III. *JANUS* APPLIED: THE WAY FORWARD

Janus is deeply conservative, in a way profoundly different from the instrumental preference for private ordering and regulatory competition found in conventional law and economics analysis. Both kinds of conservatism resonate with a majority of the current Supreme Court, but it is important to understand the duality and not to confuse one kind of conservative impulse with the other.

Other justices on the Supreme Court and judges in the lower courts, however, have different ideologies and preferences. And a judge inclined toward one or both conservative impulses might still have views that play out differently based on the facts before them.[100] Thus, we cannot say that *Janus*'s deep conservatism will necessarily hold as similar issues are decided in future cases, mainly by lower courts. Many Supreme Court decisions are implicitly revised or superseded—the law of insider trading from *Chiarella* to *O'Hagan* notably illustrates a gradual change in doctrine toward liberalization.[101] We should not extrapolate too hurriedly, then, either out of hope or fear. In this light, the following sections consider a number of questions left open by *Janus*.

A. SEC Enforcement

For the reasons discussed in Part I, the applicability of *Janus* to SEC enforcement actions (and criminal prosecutions) is far more debatable than currently assumed. How much this matters, given the SEC's other statutory remedies and ability to revise its own rule, is not clear. It might be better for private plaintiffs if the SEC continues to be held to *Janus* in 10b-5 cases, because courts will be less likely to extend the holding mindlessly in the public enforcement context. As we are already beginning to see, more cases involving the SEC rather than fraud-on-the-market plaintiffs will probably push the case law toward a more moderate equilibrium.

Assuming otherwise, the most direct way for the SEC to avoid *Janus* is to bring its cases wherever possible under Section 17(a) of the Securities

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100. This includes a relative lack of interest in the intricacies of the securities markets and hence fairly superficial thinking about them. G. Mitu Gulati & Stephen M. Bainbridge, *How Do Judges Maximize? (The Same Way Everybody Else Does—Boundedly): Rules of Thumb in Securities Fraud Opinions*, 51 EMORY L.J. 83 (2002); Pritchard, *supra* note 8, at 116.

101. *See* Donald C. Langevoort, *Words from on High About Rule 10b-5:* Chiarella*'s History,* Central Bank*'s Future*, 20 DEL. J. CORP. L. 865 (1995).

Act,[102] rather than Rule 10b-5, because the statute does not use the word "make" but otherwise operates as a broad antifraud standard with respect to the offer or sale of a security. There is no private right of action under Section 17(a), so the concerns about private liability have no application here.

Defendants in SEC enforcement actions have argued that *Janus*' "ultimate authority" test implicitly confines the scope of Section 17(a) as well as 10b-5, and at least one court has agreed.[103] That is nonsense. Statutory language has to be interpreted literally, and the relevant language in Section 17(a) asks whether the defendant obtained money or property "by means of" a materially false or misleading statement or omission.[104] None of the *Janus* Court's references to the dictionary, speechwriters, or precedent concerning the need to confine judicially-implied private rights of action are the least bit helpful for interpreting words written a decade before Rule 10b-5 came into existence. As we have seen, a reasonable application of Section 17(a)'s text to JCM's conduct would most plausibly lead to the conclusion that JCM *did* violate the statute, since it obtained inflated management fees by misstating its late-trading policy in JIF's prospectuses. It turns textualist statutory construction on its head to say that because the word "make" in a later-adopted administrative rule has a narrow formalistic meaning, Congress's earlier and different language in Section 17(a) must be similarly restricted.

B. Disclosure Filings

Janus says that the issuer or other person who has the legal responsibility and authority to file a document with the SEC is the maker of the statements contained therein.[105] Attorneys, advisers, and other third parties who act behind the scenes to create the disclosure are not

102. 15 U.S.C. § 778 (2006).

103. *Compare* SEC v. Daifotis, No. C 11-00137 WHA, 2011 WL 3295139, at *5–6 (N.D. Cal. Aug. 1, 2011) (*Janus* does not apply), *and* SEC v. Stoker, No. 11 Civ. 7388 JSR, 2012 WL 2017736, at *6 (S.D.N.Y. June 6, 2012) (same), *with* SEC v. Kelly, 817 F. Supp. 2d 340, 345–46 (S.D.N.Y. 2011) (*Janus* applies). Section 17(a) is a particularly important tool that can reach both intentional and negligent forms of deception. In a pre-*Janus* case that uses a similarly narrow definition of "make" in Rule 10b-5, the court stresses that Section 17(a) is entirely different and broader. *Tambone*, 597 F.3d at 444–45.

104. 15 U.S.C. § 77q(a)(2).

105. *See* Reese v. BP Exploration (Alaska) Inc., 643 F.3d 681 (9th Cir. 2011) (party to a contract not liable for contractual representations when the contract was filed with the SEC by another entity).

"makers"—even if, as in *Janus*, their participation in the drafting could be inferred by a reasonable investor.[106]

Issuer insiders pose a much harder problem. Even the defendants in *Janus* pretty much conceded that an issuer's senior managers cannot be treated as secondary actors in a corporate fraud that they perpetrated. After Sarbanes-Oxley, moreover, the CEO and CFO must certify 10-Ks and 10-Qs at the time of filing.[107] Nonetheless, defendants have invoked *Janus* to argue that the issuer is technically the only person with ultimate legal authority over the filing itself, and to say that certification should be enforceable by the government alone because it is simply a device to produce greater top-down attentiveness to reporting and internal controls. This is especially true, they continue, in the context of a statute like Sarbanes-Oxley, where Congress studiously avoided creating increased private liability as a solution to the financial misreporting problem. In response, the best argument in favor of primary liability is that certification is meant as a powerful form of public attribution, and there is some evidence that investors find the certifications themselves informative.[108] So far, plaintiffs are winning this debate. The early post-*Janus* case law tends to preserve exposure for the company's highest executives with respect to issuer filings, assuming sufficient attribution.[109]

Explicit attribution typically disappears as we move down the corporate hierarchy, however, and so it becomes harder to declare the deceptive actions of, say, a vice president to be a violation of Rule 10b-5.

106. This is the key distinction between *Janus* and the "attribution" standard that had prevailed in a number of courts of appeals. The Fourth Circuit decision reversed by the Supreme Court had essentially conceded application of that rule but said that a reasonable investor could reasonably understand the involvement of the adviser in the marketing of the fund to be an implicit attribution. *Mutual Funds*, 566 F.3d at 126–27. *But see Tambone*, 597 F.3d 436 (rejecting such an approach as applied to the underwriter of mutual fund shares). For all practical purposes, *Janus* creates a formalist application of an attribution standard.

107. *See* JAMES D. COX ET AL., *supra* note 17, at 373–74.

108. *Compare* Paul Griffin & David Lont, *Taking the Oath: Investor Response to SEC Certification Under Sarbanes-Oxley*, 1 CONTEMP. J. ACCT. & ECON. 27 (2005), *with* Utpal Bhattacharya et al., *Is CEO Certification of Earnings Numbers Value-Relevant?*, 14 J. EMPIRICAL FIN. 611 (2007). On the motivation for certification, see generally Lisa M. Fairfax, *Form Over Substance?: Officer Certification and the Promise of Enhanced Personal Accountability Under the Sarbanes-Oxley Act*, 55 RUTGERS L. REV. 1 (2002).

109. *See* City of St. Clair Shores Gen. Employees Ret. Sys. v. Lender Processing Servs., Inc., No. 3:10-CV-1073-J-32JBT, 2012 WL 1080953 (M.D. Fla. Mar. 30, 2012); *In re* Merck & Co. Sec., Deriv. & ERISA Litig., No. MDL No. 1658 (SRC), 2011 WL 3444199 (D.N.J. Aug. 8, 2011); Local 703 I.B. of T. Grocery & Food Employees' Welfare Fund v. Regions Fin. Corp., No. CV:10-2847-IPJ, 2011 U.S. Dist. LEXIS 93873 (N.D. Ala. Aug. 23, 2011); SEC v. Daifotis, No. C11-00137 WHA, 2011 WL 3295139 (N.D. Cal. Aug. 1, 2011); SEC v. Das, No. 8:10CV102, 2011 WL 4375787 (D. Neb. Sept. 20, 2011).

Indeed, attribution was difficult here even before *Janus* in courts that applied a strict version of the bright-line attribution standard.[110] *Janus* exacerbates the difficulty in reaching lower-level participants by emphasizing that ultimate authority typically involves attribution. We can, of course, ask why this should be of much concern. Private class actions rarely focus on non-trading individual defendants below the CEO/CFO level. This is an important area for the SEC to police, but it has additional tools like aiding and abetting, cease and desist, Rule 13b2-1, Rule 13b2-2, and perhaps Section 17(a) of the Securities Act that make reliance on Rule 10b-5 less important. True, the SEC does have the ability to seek more severe penalties when fraud is demonstrated, but even then it is not clear that Rule 10b-5 is the only route to proving fraud.

My sense is that both the SEC and private plaintiffs should give more thought to an alternative theory of indirect fraud. Nothing in *Janus* rules out what the Solicitor General's impeccably conservative brief in *Stoneridge* claimed: that persons engage in a deceptive act or practice within the strict textual meaning of Section 10(b) where the false statement is directed at an issuer's audit, internal controls, or disclosure system. The brief does not take a position of whether such deception was in connection with a purchase or sale. But, unless there is a radical reorientation of that requirement, deception specifically intended to game the public disclosure system should suffice for liability.[111] A reliance inquiry would follow in a private action, but as I suggested earlier, there are many cases where the nexus between the fraud and the reliance is significantly less remote or attenuated than that in *Stoneridge*.

This is also one place where Section 20(b) might aid plaintiffs, though the statutory language is very opaque. It addresses using other persons as conduits for a violation,[112] something that works well enough when

110. *See* SEC v. Lucent Techs., Inc. 610 F. Supp. 2d 342 (D.N.J. 2009). Post-*Janus*, see *Hawaii Ironworkers Annuity Trust Fund v. Cole*, No. 3:10CV371, 2011 WL 3862206, at *5 (N.D. Ohio Sept. 1, 2011) (no liability for officers acting under pressure from top management because they did not bear ultimate responsibility for the filings). All this assumes no attribution. With sufficient attribution, even third parties can take on "maker" responsibility, as in the case where the filing states that a third party has provided the information being disclosed. *See* Lopes v. Viera, No. 1:05-CV-01243 JLT, 2012 WL 691665 (E.D. Cal. Mar. 2, 2012). For a case that takes this idea quite far with respect to insiders, see *Red River Resources Inc. v. Mariner Sys. Inc.*, No. CV 11-02589-PHX-FJM, 2012 WL 2507517, at *6 (D. Ariz. June 29, 2012) (review and preparation of disclosure by chief technology officer sufficient based on "implied attribution"). *But see* SEC v. Wolfson, 539 F.3d 1249, 1259–60 (10th Cir. 2008) (declining to apply attribution standard pre-*Janus* in SEC enforcement cases).

111. *See supra* notes 95–97 and accompanying text.

112. Section 20(b) makes it unlawful for any person, directly or indirectly, "to do any act or thing which would be unlawful for such person to do . . . through or by means of any other person." 15

misinformation is disseminated through an innocent intermediary. On the other hand, a false filing is not something any person but the issuer has the authority to make, so it is hardly clear that the executive is doing something through or by means of the issuer that he or she is prohibited from doing directly. The important point, however, is that this is statutory language and is therefore not subject to the kind of strict interpretation designed to frustrate judicial or administrative creativity. We might expect to see reasonably expansive applications of this language, even from more conservative judges.[113]

Section 20(a) is another obvious possibility for plaintiffs to consider invoking against senior executives. Executives deemed to be "controlling persons" become liable for violations of a controlled person unless they acted in good faith and did not directly or indirectly induce that violation.[114] The term "controlling person" has long been interpreted in terms of substance over form—looking to practical power rather than formal authority. The voluminous case law on Section 20(a) is not entirely consistent, particularly with regard to the good faith/no inducement defense. A full-scale restatement of this body of law is beyond the scope of this Essay, but we need not assume that faithfully conservative judges will read the statutory text of Section 20(a) in an unduly narrow fashion. These interpretive issues aside, however, Section 20(a) has a big stumbling block: there must be a primary violation before controlling person liability even becomes an issue. That brings us back to the lies without liars problem. With a practical construction of "control," one might reasonably argue that JCM and JCG were controlling persons vis-à-vis JIF. But it would not matter unless JIF violated Rule 10b-5.

U.S.C. § 78t(b) (2006). As noted earlier, the fact that this provision makes no reference to private liability might raise doubts as to whether it can be invoked in private litigation.

113. In *Janus*, the Court does obliquely take note of cases where an issuer's management misleads securities analysts, who incorporate the lies into their forecasts and recommendations, though the most specific reference is where the issuer then touts those forecasts. *Janus*, 131 S. Ct. at 2304 n.9 (citing *In re* Aetna Inc. Sec. Litig., 617 F.3d 272, 275–77 (3d Cir. 2010)). For a case that picks up on this idea to create liability at least where the speaker specifically intends for the statements to be repeated, see *SEC v. Daifotis*, No. C11-00137 WHA, 2012 WL 2132389, at *8 (N.D. Cal. June 12, 2012) ("The Court is persuaded that in the wake of *Janus*, an executive who undisputably exercised authority over his non-casual statements with the intent and reasonable expectation that such statement would be relayed to the investing public, should be deemed to be the person who 'made' the statements to the investing public (so long as it is proven that the statement was made to the investing public)."). *Janus* also leaves open the possible use of Section 20(b) where misleading information is routed through an innocent intermediary, which certainly might describe what happened in the case. *Janus*, 131 S. Ct. at 2304 n.10; *see also id.* at 2310–11 (Breyer, J., dissenting) (suggesting that, if so, the case should be remanded).

114. *See* COX ET AL., *supra* note 17, at 773–81.

That, in turn, takes us to one of the greatly under-theorized subjects in all of securities litigation: corporate scienter. As the entity with ultimate legal authority over its prospectuses, JIF plainly made the material misrepresentations on which plaintiffs supposedly relied. The scienter requirement is what stands most immediately in the way of JIF's liability. Obviously, entities cannot think or sense, so corporate scienter necessarily comes by attribution from the awareness of the entity's agents and employees.[115] The idea often invoked here is *respondeat superior*, which should immediately draw suspicion in this context. Fischel included *respondeat superior* in his list of the three doctrines that must be jettisoned in a faithfully conservative reading of Section 10(b),[116] and the dissent in *Central Bank* acknowledged that it was at risk under the majority's reasoning.

But the hyper-textualist Fischel missed something. Section 10(b) confers rulemaking authority to bar "any person" from engaging in manipulative or deceptive devices or contrivances. The word "person" has been defined by statute since 1975 to included corporate entities as well as natural persons. So, Congress must have contemplated the possibility of corporate scienter. Some form of attribution, in turn, is essential to carry out this statutory directive.[117] That corporate scienter has survived untouched long after *Central Bank* is an indication that the courts appreciate that it is an essential weight-bearing beam in the structure of the statute's antifraud prohibition.

Even with this appreciation, however, corporate scienter has never been coherently articulated. There is case law to support at least three variations of what must be shown: (1) that the speaker himself on behalf of the corporation must have been aware of the truth, or recklessly disregarded it; (2) that some other corporate agent knew or recklessly disregarded the truth, even if the speaker was entirely innocent; or (3) that knowledge of multiple corporate actors can be attributed to the corporation, even if no single agent within the firm knew the truth.[118]

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115. *See, e.g.*, Makor Issues & Rights, Ltd. v. Tellabs Inc., 513 F.3d 702 (7th Cir. 2008) (Posner, J.).

116. *See supra* note 65 and accompanying text.

117. *See* Sharp v. Coopers & Lybrand, 649 F.2d 175, 182 n.8 (3d Cir. 1981); *In re* Centennial Technologies Litig., 52 F. Supp. 2d 178 (D. Mass. 1999). For my elaboration on these issues, see Donald C. Langevoort, *Agency Law Inside the Corporation: Problems of Candor and Knowledge*, 71 U. CIN. L. REV. 1227–29 (2003).

118. *See* Patricia S. Abril & Ann Morales Olazábal, *The Locus of Corporate Scienter*, 2006 COLUM. BUS. L. REV. 81; Langevoort, *supra* note 117.

The third of these variations has relatively little direct support in the 10b-5 case law,[119] though there is precedent for drawing inferences from information likely to be in the hands of officials connected to the firm's core operations on the conceptually separate question of what plaintiffs have to *plead* about corporate scienter to survive a motion to dismiss.[120] The first two definitions of corporate scienter are more authoritative, and actually blend together. When an entity is the defendant, who is the speaker? Assuming that corporate filings and publicity are a group effort, then there can be more than one "speaker" for knowledge purposes. And, further assuming that recklessness suffices for scienter, those participants can act with the requisite intent by willfully disregarding the likelihood that someone else knows the truth. So it is not surprising that the most common articulation of the corporate scienter principle is actually a hybrid that looks "to the state of mind of the individual corporate official or officials who make or issue the statement (or order or approve it or its making or issuance, or who furnish information or language for inclusion therein, or the like) . . . ."[121]

We need not resolve the precise articulation of the standard here, because *Janus* says nothing about this with respect to entirely intra-corporate matters. It is enough to emphasize the necessity of an attribution principle, without regard to whether the person whose knowledge is being attributed is also a "maker" of the misstatement,[122] if any serious notion of corporate personhood is to work.[123]

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119. For a critique, see Bradley J. Bondi, *Dangerous Liaisons: Collective Scienter in SEC Enforcement Actions*, 6 N.Y.U. J. L. & BUS. 1 (2009).

120. *See* Michael J. Kaufman & John M. Wunderlich, *Messy Mental Markers: Inferring Scienter from Core Operations in Securities Fraud Litigation*, 73 OHIO ST. L.J. 507, 525–26 (2012).

121. Southland Sec. Corp. v. INSpire Ins. Solutions Inc., 365 F.3d 353, 366 (5th Cir. 2004); Makor Issues & Rights, Ltd. v. Tellabs, Inc., 513 F.3d 702 (7th Cir. 2007). Bondi, *supra* note 119, provides a good overview of the case law.

122. *See* Kerr v. Exobox Technologies Corp., No. CIV. A. H-10-4221, 2012 WL 201872 at *14–15 (S.D. Tex. Jan. 23, 2012) (attributing knowledge of the majority owner who was heavily involved in the preparation of the offering materials, even though such person was not the "maker" under *Janus*).

123. John Coffee raises the interesting question of whether JIF might be deemed to know of JCM's faithlessness, either by attribution, knowledge, or awareness of certain of its directors, thereby making it the party primarily liable and JCM and JCG then exposed as controlling persons. *See* John C. Coffee, Jr., *U.S. Supreme Court and Securities Litigation*, N.Y. L.J., July 21, 2011, *available at* http://www.newyorklawjournal.com/PubArticleNY.jsp?id=1202503787586. While one might find a way of manipulating agency law to impose knowledge, I cannot imagine any court being inclined to do so when the result would be giving investors in JCG the ability to impose liability on JIF and its shareholders, who were the victims of JCG's alleged wrongdoing. The Brief filed by the Solicitor General in *Janus* explicitly assumes that there could be no scienter on the part of JIF. *See* Brief, *supra* note 55, at 24–25. On the limits of using agency law attribution principles to find scienter, see Langevoort, *supra* note 117, at 1228–30.

C. Corporate Separateness

There remains the question of where to draw this line in terms of corporate separateness—i.e., where knowledge of the truth resides outside the formal boundaries of the firm. Presumably, *Janus* leaves room to disregard such separateness in the relatively rare situations where veil piercing would be warranted.[124] A much harder question is whether separateness exists in the parent-subsidiary context, where the parent is the issuer but day-to-day business operations are all carried out through wholly-owned subsidiaries with due respect for corporate formalities. One notable Seventh Circuit decision found the parent not liable under Rule 10b-5 for false disclosures caused by the subsidiary's CEO. The court then absolved the CEO as well, based on reasoning that anticipated *Janus* in many respects.[125] I, however, suspect that other courts may see this differently when plaintiffs raise corporate scienter questions in the context of a single-business enterprise, regardless of whether there is formal separation among business units. Where financial reporting responsibilities cross unit lines—as they must under the post-Sarbanes-Oxley internal controls regime—it is hard to justify thinking of the issuer's knowledge or awareness in purely formalistic terms, as *Janus* does, by stopping abruptly at the legal boundary of the issuer.[126]

Still, if we connect *Janus* to the recently primed faith in the sanctity of corporate personhood in other decisions of the Court, the opinion becomes more understandable, if not more persuasive. The high-visibility *Citizens United* case is only the most recent outside the securities area where the Supreme Court has embraced an old-fashioned vision of the corporation as

124. *See In re* Optimal U.S. Litig., No. 10 CIV 4095 SAS, 2011 WL 4908745 (S.D.N.Y. Oct. 14, 2011) (no justification for veil piercing under the facts). *Optimal* applies *Janus* with respect to the parent company's alleged primary liability where its subsidiary made the false filing, holding that Section 20(a) is the only way to reach the parent in that situation. *Id.* at *4–5. For a case coming out the other way on whether a parent bears "maker" responsibility for its subsidiary's falsities, see *City of Roseville Employees' Ret. Sys. v. EnergySolutions, Inc.*, 814 F. Supp. 2d 395, 417–18 (S.D.N.Y. 2011). *Roseville* emphasized that the parent's dominance was clearly communicated to investors in the prospectus, so that treating parent and subsidiary as separate entities made no sense. *Id.*; *see also In re* Allstate Life Ins. Co. Litig., No. CV 09-8162-PCT-GMS, 2012 WL 1900560 (D. Ariz. May 24, 2012) (controlling entity's name "featured prominently" in disclosures).

125. *See* Pugh v. Tribune Co., 521 F.3d 686 (7th Cir. 2008).

126. Financial reporting responsibilities under the SEC's extensive rules are thoroughly anti-formalistic, including consolidated reporting for affiliates and a definition of "executive officer" of the issuer that can take in managers at the subsidiary level. 17 C.F.R. § 240.36–7. For a case rejecting *Janus* in the parent-subsidiary context as helpful with respect to New York antifraud law, see *Allstate Insurance Inc. v. Countrywide Financial Corp.*, 824 F. Supp. 2d 1164 (C.D. Cal. 2011).

a real entity.[127] The Court's embrace of this formalist vision of the corporation is ironic because it implies that there are distinct legal boundaries deserving of respect. Instrumentalist conservatives actually tend to contest the formalist vision of the corporation in favor of the familiar "nexus of contracts" in which these boundaries are highly negotiable.[128] But *Janus* at least sets a default here. The decision suggests that the legislative choice to speak of corporate liability implies the adoption of an orthodox meaning for corporate personhood. Hence, the traditional, simplistic legal boundaries should stand unless and until Congress is willing to address corporate liability—and investor protection generally—in a clearer and more comprehensive way. For better or worse, that may be the main point Justice Thomas made in *Janus*, and will probably not be the last word to that effect.

D. Informal Publicity

Fraud-on-the-market litigation often targets allegedly misleading corporate publicity—interviews in the press, conference calls with analysts, etc.—rather than formal SEC filings. *Janus* does not fit squarely into this setting because it is hard to determine who has "ultimate responsibility" for making informal disclosures. The post-*Janus* case law has largely taken the position that the "makers" of informal publicity are the corporate managers who initiate the publicity as well as the issuer on whose behalf they are acting. In other words, lower courts have distinguished *Janus* as being inapplicable to actions by the issuer's own internal managers, as opposed to a distinct outside entity like JCM vis-à-vis JIF.[129]

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127. Citizens United v. FEC, 130 S. Ct. 876 (2010). There has been an outpouring of commentary on the corporate law assumptions underlying the strong grant of First Amendment protection to corporations, including assumptions that suggest a superficial impression of corporate personhood. *E.g.*, Reuven S. Avi-Yonah, Citizens United *and the Corporate Form*, 2010 WIS. L. REV. 999; Anne Tucker, *Flawed Assumptions: A Corporate Law Analysis of Free Speech and Corporate Personhood in* Citizens United, 61 CASE W. RES. L. REV. 495 (2011). For an article connecting *Janus* and *Citizens United*, see Virginia Harper Ho, *Theories of Corporate Groups: Corporate Identity Reconceived*, 42 SETON HALL L. REV. 879, 927–32, 943–45 (2012). This formalism in imagining the corporate entity is not entirely new. In *United States v. Bestfoods*, 524 U.S. 51 (1998), for instance, the Court wrote in an environmental law case that "[i]t is a general principle of corporate law deeply 'ingrained in our economic and legal systems' that a parent corporation . . . is not liable for the acts of its subsidiaries," thereby limiting derivative liability to veil-piercing situations. *Id.* at 61.

128. *E.g.*, EASTERBROOK & FISCHEL, *supra* note 10.

129. *See* Merck & Co. Sec., Deriv. & ERISA Litig., 2011 WL 3444199, at 24–26 (D.N.J. 2011); SEC v. Carter, No. 10 C 6145, 2011 WL 5980966, at *1–3 (N.D. Ill. Nov. 28, 2011). In *Fulton County Employees' Ret. System v. MGIC Investment Corp.*, 675 F.3d 1047 (7th Cir. 2012), the court

To be sure, this is an uneasy distinction. If we see corporations in the instrumentally conservative fashion as a nexus of contracts,[130] it is hardly obvious that the contractual relationship with the internal agent is conceptually different from the contractual relationship with an external investment adviser. But taking the idea of a distinctive corporate personhood seriously does necessitate that we identify certain actors who are empowered to give life to the firm. So, it is intuitive to treat the senior management team as speaking both as and for the issuer in terms of day-to-day corporate publicity. There may be cases where informal publicity is initiated by an insider speaking personally and not in her official capacity on behalf of the firm, in which case the outcome might well be different. But, both senior management and the issuer are properly named as defendants when management assumes the role of "maker" on behalf of the issuer. This is the case for the kinds of publicity most often invoked by plaintiffs in securities litigation, such as press releases and scripted conference calls.

E. Scheme Liability

To this point, we have not addressed another fairly obvious way of distinguishing *Janus* in both SEC and private lawsuits. Justice Thomas concentrates on a single word—"make"—which appears in only one of three distinct subparts of Rule 10b-5. The other two subparts use the verbs "engage" and "employ." So maybe the opinion says nothing about Rule 10b-5 generally, which would encourage plaintiffs to restructure their complaints to allege schemes to defraud or deceptive acts and practices rather than misrepresentations or omissions.

It cannot be that simple, though. If one goes through Justice Thomas's argument from the dictionary reference through the precedential progression, it is hard to find much about "make" that cannot be said about "engage" or "employ." Even before *Janus*, courts had become sensitive to the temptation to invoke something akin to scheme liability to re-litigate issues foreclosed under a straightforward misrepresentation claim.[131]

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interpreted *Janus* so that the issuer hosting an analyst conference call was not deemed to "make" statements by the executives of an affiliated (but not controlled) entity who were invited to participate.

130. *See* EASTERBROOK & FISCHEL, *supra* note 127.

131. *See* WPP Luxembourg Gamma Three SARL v. Spot Runner, Inc., 655 F.3d 1039, 1057–58 (9th Cir. 2011) *cert. denied*, 132 S. Ct. 2713 (2012); Lentell v. Merrill Lynch, 396 F.3d 161, 177 (2d Cir. 2005) (loss causation). For a case applying *Janus* but concluding that the SEC's complaint legitimately raised claims under subsections (a) and (c) of Rule 10b-5, see *SEC v. Mercury Interactive, LLC*, Fed. Sec. L. Rep. (CCH) ¶ 96,604 (N.D. Cal. Nov. 21, 2011) (options backdating scheme).

These courts hold that complaints about misrepresentations or half-truths—as most securities cases are—must be treated as such, no matter which prong of the rule is invoked. This issue is another place where *Janus* makes much more sense as addressing only the contours of the implied private right of action under Rule 10b-5, because that now is essentially an exercise in policy-driven restraint.[132]

IV. CONCLUSION

One of the most quoted phrases in the jurisprudence of securities litigation is the idea that the antifraud prohibitions of the securities laws should be read flexibly, not technically or restrictively.[133] Yet *Janus* presents just the opposite: a rule of construction that insists on restricting a text that was meant by its drafters to pragmatically extend the prohibition against securities fraud. This outcome seems incomprehensible to those with any reasonably progressive vision of the administrative state, and this makes it easy to dismiss the Court's opinion with little more than a sad shake of the head.

A majority of the Court now seems convinced that the relative inability of the plaintiffs' bar to gain more from Congress in terms of enhanced liability (particularly secondary liability) over the last two decades should be respected as a political outcome not to be frustrated by judicial flexibility to promote a bastard doctrine from an earlier era. That inference, however, relates only to private securities litigation. Unless *Janus* is read to be just about private litigation, as I have suggested, its legacy will be an unnecessarily cribbed reading of Rule 10b-5 as collateral damage from the battle over securities class actions, leaving an inexplicable and unfortunate residuum of lies without liars.

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132. For a case so applying *Janus*, see SEC v. Kelly, 817 F. Supp. 2d 340, 343–45 (S.D.N.Y. 2011). *See also* SEC v. Pentagon Capital Mgmt. PLC, 844 F. Supp. 2d 377 (S.D.N.Y 2012) (involving late-trading claims under Rule 10b-5(a) and (c), and Section 17(a)).

133. The phrase originates with *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963). Adam Pritchard makes the case that this phrase has been in demise for a while, though it still makes occasional appearances. *See* A.C. Pritchard, *Launching the Insider Trading Revolution:* SEC v. Capital Gains Research Bureau, *in* RESEARCH HANDBOOK ON THE LAW AND ECONOMICS OF INSIDER TRADING (forthcoming) (Steven Bainbridge ed., 2012).