

LOONEY & GROSSMAN LLP

Attorneys at Law

101 Arch Street
Boston, Massachusetts 02110
Telephone (617) 951-2800
Facsimile (617) 951-2819
www.lgllp.com

SUPREME COURT CLARIFIES NARROW SCOPE OF LIABILITY FOR SECONDARY ACTORS IN SECURITIES FRAUD CASES

By: Joseph S. Berman, Esq.



Joseph S. Berman, Esq.
jberman@lgllp.com

June 2011

In a decision issued earlier this month, the United States Supreme Court narrowly interpreted Securities and Exchange Commission (SEC) Rule 10b-5 to protect investment advisors from statutory fraud suits. Although the decision addressed the liability of investment advisors, the reasoning should apply to secondary actors such as lawyers and accountants. *Janus Capital Group, Inc. v. First Derivative Traders*, 524 U.S. ____ (June 13, 2011).

SEC Rule 10b-5 makes it unlawful for a person to “directly or indirectly ... make any untrue statement of material fact” in connection with the purchase or sale of securities. Beginning with the 1994 decision in *Central Bank of Denver, N.A. v. First Interstate Bank*, 511 U.S. 164 (1994), the Supreme Court has narrowly interpreted the rule to preclude private suits against those whose role was only as an “aider or abettor” of the false statement. While the SEC may bring an enforcement action against persons who contribute “substantial assistance” to the making of a false statement, private litigants enjoy no such right. Left open by the Central Bank case was whether persons such as investment advisors, lawyers or accountants could be liable as primary actors under the securities laws.

The issue arose again in 2008. In *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148 (2008), the Court held that there is no secondary liability under Section 10(b) for aiding and abetting a securities fraud, and that primary liability requires the defendant to have performed a public role in the making of a misstatement such that investors can establish reliance upon that defendant's conduct in making their investment decisions. Merely assisting “behind the scenes” would not establish liability. After *Stoneridge*, the circuit courts of appeal differed on the appropriate test for primary liability, i.e., what an actor must do to “make” a misstatement or engage in a manipulative act under *Stoneridge*. The Supreme Court has now answered that question.

In the *Janus* case, a class of stockholders sued a mutual fund's

Looney & Grossman

Practice Areas:

Bankruptcy & Insolvency
Business
Family Law
Litigation
*Professional Liability Defense
& Insurance*
Real Estate
Transportation & Maritime

Attorneys at Law

101 Arch Street
Boston, Massachusetts 02110
Telephone (617) 951-2800
Facsimile (617) 951-2819
www.lgllp.com

The *Janus* decision ends any uncertainty about attorney liability under Rule 10b-5, even where the lawyer drafts a statement that he knows is false. Since the client—not the lawyer—would have the “ultimate authority” over the statement, only the client would face primary liability under Rule 10b-5.

Looney & Grossman

Practice Areas:

Bankruptcy & Insolvency
Business
Family Law
Litigation
*Professional Liability Defense
& Insurance*
Real Estate
Transportation & Maritime

investment advisor. While the funds and the advisor were closely aligned and shared common management, they maintained separate boards, and the Court majority found that they were separate legal entities. In the lawsuit, the plaintiffs alleged that the investment advisor had falsely stated that it had taken steps to curb the unlawful practice of “market timing,” whereby a seller of securities seeks to exploit the time delay in mutual funds’ daily valuation system. In a prospectus, the advisor represented that it had taken steps to prevent this practice. The Attorney General of New York sued the advisor and the fund, alleging that they had not curbed the practice, causing a decline in the value of the funds and in the stock price of the advisor. A class of plaintiffs sued both the fund and the investment advisor under Rule 10b-5, alleging material misrepresentations to the investing public.

Affirming the dismissal of the case, Justice Thomas focused on the word “make” in Rule 10b-5. He reasoned that to “make” a statement requires that the defendant be the person or entity with “ultimate authority over the statement, including its content and whether and how to communicate it.” He distinguished situations where a person prepares a statement on behalf of another. In those circumstances, there is no 10b-5 liability on the person who simply prepares the material for another. For example, Justice Thomas distinguished a speechwriter who drafts a speech for another person. Even when the speechwriter prepares the speech, its content is “entirely within the control of the person who delivers it.” A broader definition of “make,” the majority reasoned, would eviscerate the distinction between primary and secondary actors under the securities law.

The majority’s reasoning should apply to others who are secondary actors, particularly lawyers who draft prospectuses and other offering documents. Indeed, in a dissenting opinion, Justice Breyer noted that the investment advisor had played an integral role in drafting the prospectus. Although not explicit in the debate among the justices, it seems clear that the Supreme Court would reach a similar conclusion if presented with a case against an attorney. The *Janus* decision ends any uncertainty about attorney liability under Rule 10b-5, even where the lawyer drafts a statement that he knows is false. Since the client—not the lawyer—would have the “ultimate authority” over the statement, only the client would face primary liability under Rule 10b-5.

To discuss your situation, and to learn how Looney & Grossman may be able to assist you, please contact Joseph S. Berman, Esq. at (617) 951-2800 or jberman@lgllp.com.