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THE NEED FOR A FORMIDABLE PRIVATE RIGHT OF ACTION IN THE MUTUAL FUND CONTEXT: AN ANALYSIS OF *JANUS*' CATEGORICAL LIMITATION ON PRIMARY LIABILITY UNDER RULE 10B-5

INTRODUCTION

Mutual funds are a dominating force in the American economy. At the end of 2009, the mutual fund industry held assets worth more than \$11 trillion and comprised approximately one-fifth of America's household financial assets and retirement savings.¹ These numbers are only expected to grow.² From soccer moms to CEOs, the investors in mutual funds range from all socioeconomic backgrounds. These investors choose a particular mutual fund, not because of the mutual fund—the fund itself is merely a shell corporation—but because they trust the investment adviser managing the fund.³ Investors willingly risk their personal earnings because they trust no fraud is occurring; and they presume that even if fraud did occur, they would be able to hold the proper fraudulent parties liable.

Janus Capital Group, Inc. v. First Derivative Traders (Janus),⁴ however, is the latest in a series of U.S. Supreme Court decisions that erode the scope of civil liability under § 10(b) of the Securities and Exchange Act of 1934⁵ and Securities and Exchange Commission (SEC) Rule 10b-5.⁶ In holding that only the person or entity with “ultimate authority” can be held liable in a private right of action under Rule 10b-5,⁷ the Court frustrates the statutory intent of the Exchange Act. The Exchange Act was designed to protect the integrity of the markets, provide investor confidence, and compensate victims by limiting private causes of action for fraud or misrepresentation.⁸ *Janus* continues the pattern in *Central Bank of Denver*

1. See John Morley & Quinn Curtis, *Taking Exit Rights Seriously: Why Governance and Fee Litigation Don't Work in Mutual Funds*, 120 YALE L.J. 84, 87 (2010); see also INV. CO. INST., 2010 INVESTMENT COMPANY FACT BOOK (50th ed. 2010), available at http://www.ici.org/pdf/2010_factbook.pdf.

2. See Amy Y. Yeung & Kristen J. Freeman, *Gartenberg, Jones, and the Meaning of Fiduciary: A Legislative Investigation of Section 36(b)*, 35 DEL. J. CORP. L. 483, 483–84 (2010) (noting that “[w]ith the liquidity of redeemable shares and the potential for higher yields with comparatively low monitoring costs, the allure of mutual fund investment has undeniably caught the eye—and wallets—of investors”).

3. “Trust . . . is the cornerstone of effectively functioning markets.” *Mutual Funds: Trading Practices and Abuses that Harm Investors, Hearing Before the Subcomm. on Fin. Mgmt, the Budget, and Int'l Sec. of the S. Comm. on Gov't Affairs*, 108th Cong. 5 (2004) (opening statement of Sen. Akaka), available at <http://www.access.gpo.gov/congress/senate/pdf/108hr/91038.pdf>.

4. *Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011).

5. 15 U.S.C. § 78j(b) (2000).

6. 17 C.F.R. § 240.10b-5.

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

8. *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 175 (2008) (Stevens, J., dissenting) (“A theme that underlies the Court’s analysis is its mistaken hostility

v. *First Interstate Bank of Denver (Central Bank)*⁹ and *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc. (Stoneridge)*¹⁰ of insulating culpable corporate actors from private action liability when they did not directly participate in the sale of securities. In *Janus*, the Court went even further in its limitation by narrowly defining who can “make” a fraudulent statement and allowed corporate formalities to shield fraudulent mutual fund advisers from being held liable to deceived investors.¹¹ The Court’s strict adherence to corporate formalities is incongruous with the intent of the Exchange Act and ignores the way a mutual fund corporation is actually run. When a mutual fund makes a statement, investors reasonably “attribute” these statements to the fund adviser, despite the advisers being separate legal entities from the mutual funds.¹² Limiting an investor’s right to recover from culpable parties will inevitably erode investor confidence in mutual fund investments.

The *Janus* majority states, “Any reapportionment of liability . . . in light of the close relationship between investment advisers and mutual funds is properly the responsibility of Congress and not the courts.”¹³ Thus, the Court recognizes the unique situation in the mutual fund context but punts on the issue, choosing instead to safely rely upon arguably unsound precedent. In this note, I argue that the *Janus* Court erred in deciding that only those that have “ultimate authority” can “make” fraudulent statements and be held primarily liable under Rule 10b-5. It is now the responsibility of Congress to amend the Exchange Act to expand primary liability in the mutual fund context to prevent fraudulent actors from hiding behind corporate formalities. As our financial markets struggle to recover from a near collapse, a formidable private right of action for defrauded investors is pivotal in restoring trust in our markets and increasing economic efficiency.¹⁴ By expressly expanding liability to mutual fund investment

towards the § 10(b) private cause of action.”); see S. Rep. No. 73-792, at 12 (1934) (noting that in regards to the Exchange Act, “if an investor has suffered loss by reason of illicit practices, it is equitable that he should be allowed to recover damages from the guilty party”).

9. *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994).

10. *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148 (2008).

11. *Janus*, 131 S. Ct. at 2302, 2304.

12. See Floyd Norris, *A Novel Way to Sidestep Investor Suits*, N.Y. TIMES, Dec. 2, 2010, <http://www.nytimes.com/2010/12/03/business/03norris.html>.

One of the great legal fictions of Wall Street is that mutual funds are independent of the companies that create and run them In the real world, the fact that Janus controls the funds it runs is so obvious as to hardly merit a mention, any more than one would emphasize that General Motors or General Electric control their subsidiaries.

Id.

13. *Janus*, 131 S. Ct. at 2304.

14. See KENNETH R. GRAY ET AL., *CORPORATE SCANDALS: THE MANY FACES OF GREED* 3 (1st ed. 2005).

advisers, defrauded investors will be properly recompensed and egregious fraudulent actors will be held culpable for their actions.

This note explores the Court's categorical limitation of an investors' ability to seek a private right of action under Rule 10b-5 when the investor has relied upon misstatements from a mutual fund, but the statements are reasonably attributable to a separate legal entity—the mutual fund adviser. Part I describes the unique relationship between mutual funds and their advisers. This note then briefly introduces the private right of action doctrine and summarizes the securities laws prior to *Janus*. Finally, the facts of *Janus* are presented, followed by both the *Janus* majority and dissent's reasoning. Part II argues that the *Janus* holding conflicts with dicta in previous Supreme Court cases and well-reasoned lower court determinations. Part III argues that the Supreme Court shortsightedly refuses to acknowledge the uniquely close relationship between mutual funds and their advisers, essentially adhering to form over substance. Mutual fund advisers exhibit de facto control of the funds. Due to this domination, the Court undermines the legislative intent of § 10(b) by refusing to allow investors to pierce the corporate veil and by letting fund advisers insulate themselves via the corporate form. Finally, Part IV maintains that the *Janus* holding will inevitably lead to market inefficiency because it creates a moral hazard problem for mutual fund advisers. In order to foster market integrity, Congress must expressly provide a formidable private right of action to defrauded investors.

I. BACKGROUND

A. MUTUAL FUND STRUCTURE

“A mutual fund is a type of investment company that pools money from many investors [shareholders] and invests [their] money in [a diversified portfolio of] stocks, bonds, money-market instruments, and other securities.”¹⁵ Mutual funds “issue[] only redeemable common stock, [are] sold widely to the public,¹⁶ and [are] composed almost entirely of debt or minority equity holdings in many companies.”¹⁷ Mutual funds are popular because they provide small investors¹⁸ professional management and

15. *Mutual Funds*, SEC.GOV, <http://www.sec.gov/answers/mutfund.htm> (last visited Oct. 31, 2011).

16. Morley & Curtis, *supra* note 1, at 92. In order to sell shares widely to the public, mutual funds must register with the SEC and provide disclosure to investors at the time of initial sale and on a periodic basis. Jill E. Fisch, *Rethinking the Regulation of Securities Intermediaries*, 158 U. PA. L. REV. 1961, 1968 (2010).

17. Morley & Curtis, *supra* note 1, at 92.

18. Small investors may be characterized as “financially unsophisticated and of limited means.” Fisch, *supra* note 16, at 1964.

convenience while diversifying their holdings and reducing risk.¹⁹ Consequently, mutual funds have become a dominant form of investment. Even after the market collapse of 2008, “the mutual fund industry held assets worth more than \$11 trillion and comprised approximately one-fifth of America’s household financial assets and retirement savings.”²⁰

While mutual funds are independent legal entities owned by shareholders with voting rights and governed by a board of directors, their external management structure makes them uniquely different from other typical corporations.²¹ “[C]ommentators have described mutual funds as ‘captive shell[s],’ ‘spartan business organizations,’ and ‘rudimentary legal vessel[s]’ because, unlike typical corporations, mutual funds are externally managed.”²² The funds themselves have “no offices, no equipment, and no employees,” and “third parties perform all of the functions that the fund must perform to increase value.”²³

Although the mutual fund and its professional financial managers (advisers) are separate legal entities, the advisers are responsible for running the mutual funds’ day-to-day operations.²⁴ Technically, the funds contract with the advisers for management services, and the adviser then selects and employs individual portfolio managers.²⁵ Practically, however, “mutual funds do not hire investment advisers; rather, funds are typically organized by their advisers, and their boards of directors are initially selected by the advisers.”²⁶ The investment advisers “charge a percentage fee to their advisee funds for management services rendered.”²⁷ These fees are derived from the number of assets under the adviser’s management, and are paid regardless of good performance or bad performance by the advisers.²⁸ Since the fee amount is not contingent upon performance, an

19. Emily D. Johnson, *The Fiduciary Duty in Mutual Fund Excessive Fee Cases: Ripe for Reexamination*, 59 DUKE L.J. 145, 151 (2009).

20. Morley & Curtis, *supra* note 1, at 87; see INV. CO. INST., 2010 INVESTMENT COMPANY FACT BOOK 22 (50th ed. 2010), available at http://www.ici.org/pdf/2010_factbook.pdf.

21. See Fisch, *supra* note 16, at 2010–15 (“Although mutual fund directors can, in theory, terminate the advisory contract [with the mutual fund adviser] . . . such a decision is of little practical value because it effectively terminates the fund.”).

22. Johnson, *supra* note 19, at 151 (citations omitted).

23. *Id.* (citation omitted).

24. Morley & Curtis, *supra* note 1, at 92. Typical day-to-day management duties include researching “which securities to buy and sell[,] . . . portfolio management[,] . . . procuring office space and overseeing administrative staff.” Johnson, *supra* at note 19, at 152.

25. Morley & Curtis, *supra* note 1, at 92.

26. *Id.* “The investment advisor is often the fund’s initial sponsor and initial shareholder . . . [and] [t]he close nexus between the investment advisor and the fund remains over time because after the advisor ‘gives birth to the fund . . . the umbilical cord is never cut.’” Johnson, *supra* note 19, at 152.

27. Samuel S. Kim, *Mutual Funds: Solving the Shortcomings of the Independent Director Response to Advisory Self-Dealing Through Use of the Undue Influence Standard*, 98 COLUM. L. REV. 474, 480 (1998).

28. Johnson, *supra* note 19, at 155.

investment adviser has a strong incentive to increase the number of investors by attracting new investors through promotion.²⁹

As with any corporate board, the board of a mutual fund has a fiduciary duty to serve the interests of its shareholders.³⁰ The mutual fund, however, is merely a pool of assets without the adviser's operational elements.³¹ Although the board can theoretically terminate the adviser's contract, such a decision has little value because it effectively terminates the fund.³² The "absence of an effective mechanism for influencing the adviser's behavior imposes a critical limit on a director's ability to act as an effective fiduciary."³³ In formation, the adviser appoints officers, affiliated directors, and unaffiliated independent directors to serve on the board.³⁴ In comparison, the shareholders typically elect a normal corporate board. In terms of responsibilities, "[m]utual fund boards are much less involved in strategy than are ordinary company boards . . . spending the overwhelming majority of their time on compliance matters rather than on investing strategy."³⁵

B. BRIEF HISTORY OF SECURITIES LAWS AND RECENT SUPREME COURT DECISIONS

1. Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5

The high prevalence of securities fraud was a major contributing cause of the 1929 economic crash and resulting depression.³⁶ Thus, the 73rd Congress passed the Securities Act of 1933 and the Securities Exchange Act of 1934 (the Exchange Act) in order to restore investor confidence by limiting fraud in the securities market.³⁷ A Senate Report explained:

The purpose of this bill is to protect the investing public The aim is to prevent further exploitation of the public by the sale of unsound,

29. *Id.* Advisers are not responsible for promotional fees. Rather, the current investors of the fund must bear these costs. *Id.* (citation omitted).

30. *Id.* at 152.

31. Fisch, *supra* note 16, at 2011.

32. *Id.*

33. *Id.* at 2011–12.

34. Johnson, *supra* note 19, at 152–53. Section 10(a) of the Investment Company Act of 1940 stated that at least 40 percent of each board's members must be independent. *See* 15 U.S.C. § 80a-10(a) (2006). Currently, a majority of the board must be independent. Role of Independent Directors of Investment Companies, 66 Fed. Reg. 3734, 3736 (Jan. 16, 2001) (to be codified at 17 C.F.R. pts. 239, 240, 270, 274).

35. Morley & Curtis, *supra* note 1, at 95.

36. Gary J. Aguirre, *The Enron Decision: Closing the Fraud-Free Zone on Errant Gatekeepers?*, 28 DEL. J. CORP. L. 447, 460 (2003).

37. *Id.*; *see also* Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 171 (1994) ("The 1933 Act regulates initial distributions of securities, and the 1934 Act for the most part regulates post-distribution trading.").

fraudulent, and worthless securities through misrepresentation; to place adequate and true information before the investor; . . . to restore the confidence of the prospective investor in his ability to select sound securities; to bring into productive channels of industry and development capital which has grown timid to the point of hoarding; and to aid in providing employment and restoring buying and consuming power.³⁸

Thus, eight underlying policies supported the creation of § 10(b) and Rule 10b-5: “(1) maintaining free securities markets; (2) equalizing access to information; (3) insuring equal bargaining strength; (4) providing for disclosure; (5) protecting investors; (6) assuring fairness; (7) building investor confidence; and (8) deterring violations while compensating victims.”³⁹

Section 10(b) of the Exchange Act prohibits fraud in connection with the purchase or sale of securities.⁴⁰ Under § 10(b), it is unlawful for any person to “use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe as necessary or appropriate in the public interest or for the protection of investors.”⁴¹

Rule 10b-5, promulgated by the SEC under the rulemaking authority granted to it by Congress in § 10(b), provides that “it is unlawful for ‘any person, directly or indirectly, . . . [t]o *make* any untrue statement of material fact’ in connection with the purchase or sale of securities.”⁴² To state a claim for relief under Rule 10b-5, a plaintiff must allege that “in connection with the purchase or sale of securities, the defendant, acting with scienter, made a false material representation or omitted to disclose material information and that plaintiff’s reliance on defendant’s action caused [plaintiff] injury.”⁴³ Thus, a successful claim for securities fraud requires five elements: “(1) scienter,⁴⁴ (2) materiality,⁴⁵ (3) loss causation,⁴⁶ (4)

38. Aguirre, *supra* note 36, at 460 (citing S. REP. NO. 73-47, at 1 (1933)).

39. ARNOLD S. JACOBS, 5B DISCLOSURE AND REMEDIES UNDER THE SECURITIES LAWS § 6:4 (West 2011).

40. 15 U.S.C. § 78(j) (2010).

41. *Id.*

42. Janus Capital Grp., Inc. v. First Derivative Traders, 131 S. Ct. 2296, 2301 (2011) (emphasis added) (citing 17 C.F.R. § 240.10b-5(b)).

43. Press v. Chem. Inv. Servs. Corp., 166 F.3d 529, 534 (2d Cir. 1999).

44. The scienter needed to state a claim is the “intent to deceive, manipulate, or defraud.” Ernst & Ernst v. Hochfelder, 425 U.S. 185, 194 (1976).

45. A fact is material “if there is a substantial likelihood that a reasonable shareholder would consider it important [in making a voting decision].” Elizabeth A. Nowicki, *10(b) or Not 10(b)?: Yanking the Security Blanket for Attorneys in Securities Litigation*, 2004 COLUM. BUS. L. REV. 637, 643 (2004).

46. “To establish loss causation under Section 10(b), plaintiffs ‘must allege that they would not have suffered a loss on their investment if the facts were as they believed them to be at the time they purchased the securities.’” *Id.* at 645 (citing *In re VMS Sec. Litig.*, 752 F. Supp. 1373, 1399 (N.D. Ill. 1990)).

[reliance],⁴⁷ and (5) that the fraud occurred ‘in connection with the purchase or sale of securities.’⁴⁸

2. Implied Private Right of Action

When a person is injured by a violation of Rule 10b-5, he can sue to enforce his rights.⁴⁹ This is a fundamental aspect in upholding securities laws. While breaches of Rule 10b-5 can result in criminal penalties or sanctions and fines by the SEC, these remedies alone cannot efficiently regulate Rule 10b-5 infractions.⁵⁰ Criminal sanctions for each infraction would chill the financial markets and “stifle the raising of capital[,]” while budgetary and staffing constraints limit the SEC’s ability to police all Rule 10b-5 breaches.⁵¹ Thus, the main source of enforcement for Rule 10b-5 violations is the ability of the defrauded investor to recover his losses.

Yet, § 10(b) of the Exchange Act does not expressly confer a private right of action for its violation. Despite being a recognized and much discussed doctrine today, an implied right of action under § 10(b) and Rule 10b-5 was not initially acknowledged by the courts.⁵² It was not until 1971, in *Superintendent of Insurance of New York v. Bankers Life & Casualty Co.*,⁵³ that the Court found an implied right of action under the provisions of the federal securities law.⁵⁴ The Court, however, “abruptly reversed a forty-year trend of federal decisions liberally construing the antifraud provisions to protect investors”⁵⁵ with the triumvirate of narrow holdings: *Central Bank*, *Stoneridge*, and now, *Janus*.

47. “[T]he damage complained of [must] be one of the foreseeable consequences of the misrepresentation.” *Id.* (citing *AUSA Life Ins. Co. v. Ernst & Young*, 206 F.3d 202, 216 (2d Cir. 2000)).

48. *Id.* at 642.

49. JACOBS, *supra* note 39, § 6:14.

50. *Id.*; *see* S. REP. NO. 73-792, at 12 (1934) (stating criminal penalties as the sole sanction are inadequate because customers are usually reluctant to report such fraud and without such reports, identification of fraud is extremely difficult).

51. JACOBS, *supra* note 39, § 6:14.

52. *See* Alan S. Ritchie, *The Proposed “Securities Private Enforcement Reform Act”: The Introduction of Proportionate Liability into Rule 10b-5 Litigation*, 42 CLEV. ST. L. REV. 339, 344 (1994).

53. *Superintendent of Ins. of N.Y. v. Bankers Life and Casualty Co.*, 404 U.S. 6 (1971) (finding “[s]ection 10(b) must be read flexibly, not technically and restrictively”).

54. *See* E. Thomas Sullivan & Robert B. Thompson, *The Supreme Court and Private Law: The Vanishing Importance of Securities and Antitrust*, 53 EMORY L.J. 1571, 1580–81 (2004).

55. Aguirre, *supra* note 36, at 452; *see, e.g.*, *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975) (finding that plaintiff must be a purchaser or seller); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976) (finding that defendant must have acted with scienter); *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462 (1977) (finding that defendant must have acted deceptively); *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994) (denying liability for aiders and abettors); *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336 (2005) (imposing a strict loss-causation requirement); *Stoneridge Inv. Partners, LLC v. ScientificAtlanta, Inc.*, 552 U.S. 148 (2008) (holding that defendant must have made a misleading statement that was relied upon by plaintiffs).

Relying on *Central Bank* and *Stoneridge* to justify its holding, the *Janus* Court promulgated its new rule that only entities with “ultimate authority” can “make” a statement. A “broader reading of ‘make’ . . . would [have] substantially undermine[d] *Central Bank*.”⁵⁶ The Court’s analysis pertaining to these two cases is worth further scrutiny.

3. *Central Bank of Denver*

Central Bank involved a bond issuer accused of making materially false statements, a defendant bank serving as an indenture trustee who was supposed to check the bond issuer’s valuations, and a plaintiff claiming the bank delayed its valuation checks and thus *helped* the issuer make its false statements credible.⁵⁷ The legal issue was one of secondary liability. Specifically, “whether private civil liability under § 10(b) extends . . . to [the bank] who d[id] not engage in the manipulative or deceptive practice, but who aid[ed] and abet[ted] the [bond issuer’s] violation.”⁵⁸ The Court held that an aider and abettor of another person who violates Rule 10b-5 cannot be held liable in a private suit.⁵⁹

4. *Stoneridge*

After *Central Bank*, the lower courts differed on how to differentiate between a primary violator and an aider and abettor, who could not be liable under Rule 10b-5.⁶⁰ *Stoneridge* resolved this problem. Scientific-Atlanta (Scientific), a supplier of electronic equipment, entered into a series of fraudulent sales and purchase agreements with Charter, a cable television company.⁶¹ Charter purchased Scientific’s cable boxes for \$20 more than market price, and, in return, Scientific purchased more advertisements from Charter with additional capital.⁶² Scientific and Charter then exchanged letters and backdated contracts indicating Scientific had raised the price for cable boxes by \$20 for all customers for that particular year.⁶³ This arrangement enabled Charter to mislead its accountants and the public into

56. *Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 2302–04 (2011).

57. *Cent. Bank*, 511 U.S. at 168.

58. *Id.* at 166.

59. *Id.* at 177 (“[T]he text of the 1934 Act does not itself reach those who aid and abet a § 10(b) violation It is inconsistent . . . to extend liability beyond the scope of conduct prohibited by the statutory text.”).

60. *Compare, e.g., Simpson v. AOL Time Warner Inc.* 452 F.3d 1040, 1048 (9th Cir. 2006) (holding that “substantial participation or intricate involvement” was sufficient to hold defendants primarily liable under Rule 10b-5 liability), *with Regents of Univ. of Cal. v. Credit Suisse First Boston (USA), Inc.*, 482 F.3d 372, 390 (5th Cir. 2007) (finding that substantial participation was not sufficient to be primarily liable).

61. *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 153 (2008).

62. *Id.* at 154.

63. *Id.*

believing Charter had more revenue than it actually had.⁶⁴ Investors sued Charter, seeking to include Scientific, under Rule 10b-5.⁶⁵

The *Stoneridge* Court held that a person who intentionally participates with another in a fraudulent scheme by creating false documents cannot be held liable as a primary violator unless that person actually makes a misstatement on which the plaintiff relies.⁶⁶ Thus, Scientific was absolved from liability. Despite Scientific knowing its false contracts and letters would be used to mislead the public, the public was not able to see the actual false documents themselves, and thus there was insufficient reliance to support a private right of action.⁶⁷

C. THE FACTS OF *JANUS*

In this class action, First Derivative Traders (First Derivative), the lead plaintiff, represented shareholders of Janus Capital Group (JCG).⁶⁸ JCG was the publicly traded parent company of Janus Capital Management (JCM), who was the investment adviser, underwriter and administrator of Janus Investment Fund (JIF), a mutual fund.⁶⁹ “Although JCG created [JIF], [JIF was] a separate legal entity . . . [and] ha[d] no assets apart from those owned by the investors.”⁷⁰ Thus, there were three separate legal entities in JCG, JCM, and JIF.

As mandated by the securities laws, “[JIF] issued prospectuses describing the investment strategy and operations of its mutual funds to investors.”⁷¹ These prospectuses indicated that the mutual funds were “not suitable for market timing⁷² and . . . that JCM would implement policies to curb the practice.”⁷³ Yet, in 2003, the Attorney General of the State of New York filed a complaint against JCG and JCM alleging that JCG secretly cut deals with some hedge funds to permit market timing in funds run by JCM.⁷⁴ After these allegations became public, investors withdrew large amounts of money from JIF. Since “[JIF] compensated JCM based on the total value of the funds and JCM’s management fees comprised a

64. *Id.* at 154–55.

65. *Id.* at 155.

66. *Id.* at 166–67.

67. *Id.* at 167.

68. *Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 2300 (2011).

69. *Id.* at 2299.

70. *Id.*

71. *Id.* at 2300.

72. Although not illegal, market timing is “an investment strategy by which sophisticated short-term traders take advantage of delays in the pricing of mutual funds, to the detriment of other fund investors.” Norman S. Poser, *The Supreme Court’s Janus Capital Case*, 44 REV. OF SEC. & COMMODITIES REG. 205, 205 (2011).

73. *Janus*, 131 S. Ct. at 2300 (footnote added).

74. In 2004, JCG and JCM settled these allegations with the SEC and paid \$100 million in penalties. *Id.* at 2300 n.2.

significant percentage of JCG's income, JIF's loss of value affected JCG's value as well."⁷⁵

First Derivative asserted that JCM "caused mutual fund prospectuses to be issued for Janus mutual funds and made them available to the investing public, which created the misleading impression that [JCG and JCM] would implement measures to curb market timing in the Janus [mutual funds]."⁷⁶ Furthermore, First Derivative purported that, "had the truth been known, [JIF] would have been less attractive to investors, and consequently [JCG] would have realized lower revenues, so [JCG's] stock would have traded at lower prices."⁷⁷

While the relationship between JIF and JCM would be unusual in most business structures, it is typical for a mutual fund.⁷⁸ JIF was a mere shell company with no employees or assets.⁷⁹ It was created, managed, and administered by JCM, and all of JIF's seventeen officers were vice-presidents at JCM.⁸⁰ Most notably, JCM drafted and reviewed JIF's prospectuses, including language pertaining to "market timing."⁸¹ Yet, the Court found that the facts showed JCM could not "make" fraudulent statements because JIF's board of directors had "ultimate authority."⁸²

D. THE *JANUS* DECISION AND ANALYSIS

1. The Majority Opinion

The Court held that "[f]or purposes of Rule 10b-5, the maker of a statement is the person or entity with *ultimate authority* over the statement, including its content and whether and how to communicate it."⁸³ The Court explained that "[w]ithout control, a person or entity can merely suggest what to say, not 'make' a statement in its own right. One who prepares or publishes a statement on behalf of another is not its maker."⁸⁴ The Court, analogizing JCM and JIF's relationship to one between a speechwriter and a speaker, stated that "[e]ven when a speechwriter drafts a speech, the content is entirely within the control of the person who delivers it. And it is the

75. *Id.* at 2300 ("JCG's stock price fell nearly 25 percent, from \$17.68 on September 2 to \$13.50 on September 26.").

76. *Id.* (alterations in original) (citation omitted) (internal quotation marks omitted).

77. *Id.*

78. "A [mutual] fund rarely employs its own officers and staff. Instead, an external investment adviser sponsors the fund and provides for its day-to-day management. In exchange . . . the adviser earns a percentage of fund assets." Kristen J. Freeman & Amy Y. Yeung, *Jones v. Harris: A Fresh Approach to the Gartenberg Standard*, 35 DEL. J. CORP. L. 959, 962 (2010).

79. *Janus*, 131 S. Ct. at 2299.

80. *Id.*

81. *Id.* at 2300-01.

82. *Id.* at 2302.

83. *Id.* (emphasis added).

84. *Id.*

speaker who takes credit—or blame—for what is ultimately said.”⁸⁵ In other words, even though JCM actually prepared and drafted the misrepresented prospectuses, because it was done on behalf of the shell entity, JIF, JCM was not liable to the victims of the fraud. The Court never expressed how it determined the bright-line definition of “make” to require “ultimate authority.”

The Court reasoned that its holding flows from *Central Bank*, where Rule 10b-5's scope of civil liability did not include aiders and abettors.⁸⁶ According to the majority, if a broader reading of “make” were incorporated,⁸⁷ then “aiders and abettors would be almost nonexistent,” undermining *Central Bank*'s holding.⁸⁸ From this reasoning, it is evident that the Court is determined to maintain a distinction between primary and secondary liability, where a private right of action is not permitted for the latter situation.⁸⁹ This concern, however, seems ill-placed with respect to *Janus*. In *Janus*, the issue was seemingly one of primary liability as opposed to secondary liability. JCM was not a mere peripheral actor, as in *Central Bank*, but the drafter and distributor of JIF's prospectuses.⁹⁰

The majority draws further support for its holding from *Stoneridge*. According to *Stoneridge*, if a deception is undisclosed to the public, it could not have been relied upon by the public, despite an entity agreeing to knowingly participate in a fraud on the market.⁹¹ Thus, the *Stoneridge* Court concluded that “nothing [the entity] did made it unnecessary or inevitable for [the company] to record the transactions as it did.”⁹² *Janus* took this one step further by “absolv[ing] the drafter of false documents that were intended to—and did—reach the public directly.”⁹³ Since JCM did not have ultimate authority, “it [was] not ‘necessary or inevitable’ that any falsehood [would] be contained in the statement.”⁹⁴ Further, the *Janus* Court saw no reason to differentiate between engaging in deceptive transactions (as in *Stoneridge*) and participating in the drafting of a false statement (as in *Janus*) because “each is merely an undisclosed act

85. *Id.*

86. *Id.*

87. The Court construed a “broader reading of ‘make’” to include “persons or entities without control over the content of a statement” but still “considered primary violators who ‘made’ the statement.” *Id.*

88. *Id.* The majority did note that the SEC is still able to bring suit against aiders and abettors pursuant to 15 U.S.C.A. § 78t(e). *Id.*

89. *Id.* at 2302 n.6 (“[F]or Central Bank to have any meaning, there must be some distinction between those who are primarily liable (and thus may be pursued in private suits) and those who are secondarily liable (and thus may not be pursued in private suits).”).

90. *Id.* at 2312 (Breyer, J., dissenting).

91. *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 166–67 (2008).

92. *Id.* at 161.

93. Poser, *supra* note 72, at 206.

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

preceding the decision of an independent entity to make a public statement.”⁹⁵

Finally, the majority declined to recognize the “uniquely close relationship between a mutual fund and its investment advisor,” rigidly adhering to the corporate form.⁹⁶ First Derivative argued that, unlike a typical secondary actor such “as a lawyer, accountant, or bank,”⁹⁷ in light of mutual-fund-industry practice an investment adviser almost always controls the fund like “a playwright whose lines are delivered by an actor.”⁹⁸ Despite recognizing the significant control of a mutual fund adviser over its funds, the majority refused to disregard the corporate form.⁹⁹

The majority noted that since private rights of action under Rule 10b-5 were implied by the courts, the scope of liability should not be expanded.¹⁰⁰ Whether a contrary decision in *Janus* would have necessarily expanded the scope of Rule 10b-5 is not sufficiently evident though.¹⁰¹ What is evident, however, is that the Court’s adoption of a new bright-line rule of “ultimate authority” narrows the scope of liability beyond what has been previously established.

2. The Dissenting Opinion

The dissenting opinion¹⁰² took issue with the majority’s interpretation of the word “make.”¹⁰³ The dissent argued that neither common English nor prior precedent supported the notion that only those with “ultimate authority” may be liable under Rule 10b-5, stating that “depending on the circumstances, a management company, a board of trustees, individual company officers, or others, separately or together, might ‘make’ statements contained in a firm’s prospectus—even if a board of directors has ultimate content-related responsibility.”¹⁰⁴ The dissent concluded that, given the particular facts, JCM should be held liable under a private right of action.¹⁰⁵

First, the dissent explained that the “English language does not impose upon the word ‘make’ boundaries of the kind the majority finds determinative.”¹⁰⁶ The dissent listed several examples: cabinet officials often make statements about items that the Constitution places within the

95. *Id.*

96. *Id.* at 2304.

97. *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 191 (1994).

98. *Janus*, 131 S. Ct. at 2304.

99. It is undisputed that all corporate formalities were observed by JCM and JIF. *Id.*

100. *Id.* at 2303.

101. Poser, *supra* note 72, at 206.

102. The dissent was written by Justice Breyer, with whom Justices Ginsburg, Sotomayor, and Kagan joined. *See Janus*, 131 S. Ct. at 2305.

103. *Id.* at 2306 (Breyer J., dissenting).

104. *Id.*

105. *Id.*

106. *Id.* at 2307.

ultimate authority of the President; corporate officials make statements about the company where the board of directors has ultimate authority; and generally, employees make statements “that, as to content, form, or timing, are subject to the control of another.”¹⁰⁷ As a result, the dissent reasoned that “[n]othing in the English language prevents one from saying that several different individuals, separately or together, ‘make’ a statement that each has a hand in producing.”¹⁰⁸ The dissent concluded, “[p]ractical matters related to context, including control, participation, and relevant audience, help determine who ‘makes’ a statement and to whom that statement may properly be ‘attributed’”¹⁰⁹

Next, the dissent examined prior precedent, namely *Stoneridge* and *Central Bank*, and refuted the majority’s assertion that either case supported its holding. The dissent argued that *Central Bank* was different from *Janus* because it pertained to “secondary liability, liability attaching, not to an individual making a false statement, but to an individual helping *someone else* do so.”¹¹⁰ The dissent further noted that *Central Bank* held that “any person or entity, including a lawyer, accountant, or bank, who employs a manipulative device or makes a material misstatement . . . may be liable as a primary violator under 10b-5, assuming all of the requirements for primary liability . . . are met.”¹¹¹ Thus, the dissent maintained that the majority’s holding did not follow *Central Bank*. Instead, it undermined *Central Bank* by extending its holding “into new territory that *Central Bank* explicitly placed outside that holding.”¹¹² As for *Stoneridge*, the dissent pointed out that *Stoneridge*’s holding was based upon whether the investors could prove sufficient *reliance* on fraudulent misstatements.¹¹³ No one in *Stoneridge* argued that the fraudulent equipment suppliers were the *makers* of the cable company’s misstatement, and thus that case adds little support or relevance to the majority’s holding.¹¹⁴

Finally, the dissent surmised that in these particular circumstances, JCM should be held liable for “making” fraudulent statements.¹¹⁵ The dissent stressed that “[t]he relationship between [JCM] and [JIF] could hardly have been closer” and that JCM’s “involvement in preparing and writing the relevant statements could hardly have been greater.”¹¹⁶

107. *Id.*

108. *Id.*

109. *Id.* (citation omitted).

110. *Id.* (emphasis in original).

111. *Id.* at 2308 (emphasis omitted) (quoting *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.* 511 U.S. 164, 191 (1994)).

112. *Id.*

113. *Id.* at 2309 (citing *Stoneridge Inv. Partners LLC v. Scientific-Atlanta, Inc.* 552 U.S. 148, 159 (2008)).

114. *Id.*

115. *Id.*

116. *Id.* at 2312.

Distinguishing prior precedent upon which the majority relied and noting that lower courts have oft-held “that at least *sometimes* corporate officials and others can be held liable under Rule 10b-5 for having ‘ma[d]e’ a materially false statement even when that statement appears in a document (or is made by a third person) that the officials do not legally control[.]”¹¹⁷ the dissent concluded that a proper holding should have permitted a private right of action against JCM.¹¹⁸

II. THE *JANUS* RULING IS INCONSISTENT WITH REASONING FROM PRIOR CASES AND CIRCUIT DECISIONS

As the dissent properly notes, the Supreme Court and several U.S. circuit courts of appeals had previously imposed primary liability on individuals or entities who draft, edit, and review financial reports and other documents that ultimately reach investors or impact securities markets.¹¹⁹ Although dicta, the *Central Bank* Court explained that a “lawyer, accountant, or bank, who . . . makes a material misstatement (or omission) on which a purchaser or seller of securities relies, *may be liable as a primary violator* under 10b-5.”¹²⁰ Thus, while the defendants in *Central Bank* did not commit a manipulative or deceptive act within the meaning of § 10(b), the Court did not categorically prohibit primary liability from being found in separate entities.¹²¹

In *Herman & MacLean v. Huddleston*, plaintiff investors sued, among other defendants who had participated in the fraudulent offering document, the accounting firm Herman & MacLean, which had issued an opinion concerning financial statements that were included in the prospectus and registration statement.¹²² The Court noted that Herman & MacLean could be held primarily liable under § 10(b) for preparing the fraudulent registration statement, even if there was no specific attribution to the accounting firm, because “Section 10(b) extends to ‘any person’ who engages in fraud in connection with a purchase or sale of securities.”¹²³ Curiously, the *Janus* court seems to completely ignore this decision. Similar to the facts in *Herman & MacLean*, JCM participated in the drafting of the statements. While there is no specific attribution in a mutual fund context, it

117. *Id.* at 2311 (emphasis in original).

118. *Id.* at 2312. The dissent noted, in *Herman & MacLean v. Huddleston*, that certain individuals who contribute to the preparation of the registration statement, “including corporate officers, lawyers, and accountants, may be primarily liable even where ‘they are not named as having prepared or certified’ the registration statement.” *Id.* at 2311 (citing *Herman & MacLean v. Huddleston*, 459 U.S. 375, 386 n.22 (1983)).

119. *See id.* at 2308–10.

120. *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 191 (1994) (emphasis added).

121. *See generally id.* at 192.

122. *Herman & MacLean v. Huddleston*, 459 U.S. 375, 378 (1983).

123. *Id.* at 386 n.22.

is widely accepted that a mutual fund's statements are the product of its investment advisers. Yet, despite such factual similarities, the *Janus* Court fails to distinguish the *Herman & MacLean* decision or expressly overrule it.

Prior to *Janus*, several circuit courts had found primary liability for actors without "ultimate authority" over issued statements.¹²⁴ For example, the Ninth Circuit had a "virtual 'field day' converting all that was secondary aiding and abetting liability at best in the *Central Bank* days into newfound 'primary' liability."¹²⁵ The Tenth Circuit, in *Anixter v. Home-Stake Production Co.*, found that an accountant was primarily liable when his knowingly fraudulent opinions were reproduced in prospectuses, registration statements, and annual reports, which were relied upon by investors.¹²⁶ *Anixter* affirmed that secondary actors could be held liable under § 10(b) so long as they themselves made a material misstatement or omission, in addition to the other required elements for liability.¹²⁷ In a later case decided after *Stoneridge*, the Tenth Circuit reaffirmed that a secondary actor, an accountant, could be primarily liable for having "made" false statements, where he drafted fraudulent SEC filings documents.¹²⁸ The court reasoned that primary liability was appropriate because it was reasonable to conclude the accountant *caused* the firm to make the relevant statements, and was aware that these statements would reach investors.¹²⁹

The reasoning in these cases respects and fulfills the legislative purpose underlying § 10(b) and Rule 10b-5.¹³⁰ By allowing investors to sue the secondary actors who "made" the fraudulent statements, but did not have "ultimate authority," the courts protected the defrauded investors and enabled them to recover their losses from those that knowingly participated in such fraud.

The *Janus* dissent also highlights that the circuit courts have held that corporate officials may be liable for "making" fraudulent statements "where those officials use innocent persons as conduits through which the false

124. See, e.g., *SEC v. Wolfson*, 539 F.3d 1249 (10th Cir. 2008); *Anixter v. Home-Stake Prod. Co.*, 77 F.3d 1215 (10th Cir. 1996); *McConville v. SEC*, 465 F.3d 780 (7th Cir. 2006); *In re Cabletron Systems, Inc.*, 311 F.3d 11 (1st Cir. 2002).

125. ROBERT J. HAFT, LIABILITY OF ATTORNEYS AND ACCOUNTANTS FOR SECURITIES TRANSACTIONS, SECURITIES LAW HANDBOOK SERIES § 3:9, at 3-41 (2003) (citing *Adam v. Silicon Valley Bancshares*, 884 F. Supp. 1398 (N.D. Cal. 1995); *Employers Ins. of Wausau v. Musick, Peeler, & Garrett*, 871 F. Supp. 381 (S.D. Cal. 1994); *In re ZZZZ Best Sec. Litig.*, 864 F. Supp. 960 (C.D. Cal. 1994)).

126. *Anixter*, 77 F.3d at 1227.

127. *Id.* at 1226; HAFT, *supra* note 125, § 3:8, at 3-38 ("All courts that have considered [primary liability] after *Central Bank* have held that the unqualified audit opinion of an independent accountant constitutes the making of a statement by that accountant for the purposes of Rule 10b-5.").

128. *Wolfson*, 539 F.3d at 1261.

129. *Id.*

130. "The purpose of [§ 10(b)] is protection of investors from fraudulent practices." *Id.* at 1257 (quoting *SEC v. Int'l Chem. Dev. Corp.*, 469 F.2d 20, 26 (10th Cir. 1972)).

statements reach the public (without necessarily attributing the false statements to the officials).”¹³¹ In *In re Cabletron Systems, Inc.*, a struggling firm provided false materials to analysts in order to lead them to believe the firm was doing better than it actually was.¹³² Based on the supplied fraudulent information, the market analysts published public statements that contained incorrect representations, which investors then relied upon.¹³³ The issue was whether the firm could be held liable for the analysts’ statements. The district court held that the firm was not liable because they did not “control” the analysts’ statements.¹³⁴

The First Circuit, however, reversed because “[a] test that required ‘control’ would give company officials too much leeway to commit fraud on the market by using analysts as their mouthpieces.”¹³⁵ Thus, despite the rationale and holding of *Central Bank*, the First Circuit determined that corporate officials could be primarily liable for statements made by third-party analysts.¹³⁶ To hold otherwise would have left the defrauded investors with no one to sue to remedy the economic harm suffered. Notably, analysts cannot satisfy the *scienter* requirement if they relied in good faith upon the information supplied by the corporate officials and did not intend to deceive anybody.¹³⁷

Just as in *Cabletron*, JIF’s board of trustees had no knowledge of the prospectuses’ false content and merely relied upon the prospectuses prepared by JCM when they were submitted to the public.¹³⁸ JCM’s actions were precisely what the First Circuit was concerned with when deciding *Cabletron*, since JCM was able to commit fraud on the market by using JIF as “their mouthpiece.” The *Janus* Court consciously ignored the primary legislative purpose of § 10(b), refusing to protect the investing public.

Given these well-reasoned holdings and, indeed, the Court’s own prior decisions, the result in *Janus* is confounding. The purpose of § 10(b) is

131. *Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 2312 (2011) (Breyer J., dissenting) (citing *In re Navarre Corp. Sec. Litig.*, 299 F.3d 735, 743 (8th Cir. 2002) (“The investors could also allege that the defendants used the analysts as a conduit, making false and misleading statements to securities analysts with the intent that the analysts communicate those statements to the market.”)).

132. *In re Cabletron Systems, Inc.*, 311 F.3d 11, 23–27 (1st Cir. 2002).

133. *Id.* at 38.

134. *Id.* at 37.

135. *Id.* at 38.

136. *Id.*

137. See Elizabeth A. Nowicki, *A Response to Professor John Coffee: Analyst Liability Under Section 10(b) of the Securities Exchange Act of 1934*, 72 U. CIN. L. REV. 1305, 1323 n.66 (2004) (“[I]f an analyst provided . . . an accurate summary of the information available to and known by him, yet the analyst made a recommendation in good faith based on diligently reached conclusions that proved in hindsight to be wrong, the analyst likely would not have liability concerns under Section 10(b).”).

138. *Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 2310 (2011) (Breyer J., dissenting) (“Here, it may well be that . . . [JIF’s] board of trustees knew nothing about the falsity of the prospectuses.”).

painfully clear. It “is a provision directed toward ensuring that when one speaks about a security, one speaks in a truthful, complete manner . . . regardless of the status of the speaker and his relationship (or lack thereof) to the listener.”¹³⁹ The *Janus* Court tacitly ignores this interpretation by adopting a new “ultimate authority” test, which lacks any clear precedent to support such a departure. In the face of such a misguided holding that undermines the very purpose of the Exchange Act, Congress must expressly overrule *Janus*' formalistic and unjust approach.

III. AN ARGUMENT FOR LIABILITY WITHIN THE UNIQUE MUTUAL FUND CONTEXT

A. DE FACTO CONTROL

Even assuming *arguendo* that the Supreme Court was justified in its general caution to expanding Rule 10b-5, the *Janus* Court could have narrowly tailored its decision to allow mutual fund investors, as well as others similarly situated, to bring actions because of the distinct role an investment adviser plays when managing the mutual fund.

Only one year prior to its *Janus* decision, the Supreme Court noted in *Jones v. Harris Associates* that it is “typical” for a fund adviser to “create the mutual fund,” “select the fund’s directors, manage the fund’s investments, and provide other services.”¹⁴⁰ Thus, the *Jones* court recognized that “the advisory firm exercises de facto control of the [fund].”¹⁴¹ Furthermore, as the Second Circuit articulated, because of the widely recognized¹⁴² close nexus between a mutual fund and its investment adviser, “the fund often ‘cannot, as a practical matter sever its relationship with the adviser.’”¹⁴³

In *Janus*, JCM was responsible for JIF’s registration statements because it exhibited de facto control of the fund. Even when considering the strict bright-line requirement of “ultimate authority,” the *Janus* Court ignores such obvious industry standard characterizations of control here. Unlike the traditional secondary actors such as lawyers, accountants, and banks, JCM

139. Nowicki, *supra* note 137, at 1314.

140. *Jones v. Harris Assoc. L.P.*, 130 S. Ct. 1418, 1422 (2010) (finding that investment advisers have a fiduciary duty regarding fees to mutual fund investors and thus investors have a private right of action for breach of that duty); see *Daily Income Fund, Inc. v. Fox*, 464 U.S. 523, 534–38 (1984) (noting the unusual proximity of managers to their mutual funds).

141. D. Bruce Johnsen, *Myths About Mutual Fund Fees: Economic Insights on Jones v. Harris*, 35 J. CORP. L. 561, 579 (2010); see *In re Steadman Sec. Corp.*, 46 SEC 896, 920 n.81 (1977) (“[T]he term ‘investment adviser’ is to some extent a misnomer” because “[t]he so-called ‘adviser’ is no mere consultant. He is the fund’s manager. Hence the investment adviser almost always controls the fund.”).

142. See, e.g., *Gartenberg v. Merrill Lynch Asset Mgmt.*, 694 F.2d 923, 929–30 (2d Cir. 1982) (“Congress . . . recognized . . . the potentially incestuous relationships between many advisers and their funds . . .”).

143. *Jones*, 130 S. Ct. at 1422 (quoting S. REP. NO. 91-184, at 5 (1969)).

was in charge of the day-to-day operations of the fund.¹⁴⁴ “JCM’s legal department drafted the registration statements and JCM’s General Counsel was one of the persons ‘ultimately responsible’ for revisions and amendments to the registration statements.”¹⁴⁵ Thus, it was not unreasonable nor against industry standard for the Fourth Circuit to conclude that JCM “participat[ed] in the writing and dissemination of the prospectuses . . . [and] *made* the misleading statements contained in the documents.”¹⁴⁶

B. ATTRIBUTION

Even assuming JCM did not exhibit *de facto* control of the fund, there is ample evidence to suggest that the investing public could attribute the fraudulent statements to JCM. The *Janus* Court requires “attribution within a statement or implicit from surrounding circumstances [because it is] strong evidence that a statement was made by—and only by—the party to whom it is attributed.”¹⁴⁷ Again, the Court compares this to a speechwriter, where despite who actually drafts the speech, it is the speaker who has control over what is ultimately said.¹⁴⁸

Yet, this analogy fails to adequately characterize the investment advisers’ role in relationship to the fund. While the fraudulent statements were never directly linked to JCM, surrounding circumstances provide a strong inference of attribution. First, as discussed in Part III.A above, it is widely held that mutual fund advisers have substantial control over their funds.¹⁴⁹ In particular, advisers are solely responsible for the investment strategy of the funds, including research regarding which securities to buy and sell and portfolio management.¹⁵⁰ Second, “[i]nvestors do not choose to invest in a fund because of the composition of the board; instead they invest with a particular investment advisor. After all it is the advisor’s name on the fund and not the board’s.”¹⁵¹ Because investors are aware that the advisers

144. *Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 2312 (2011) (Breyer, J., dissenting).

145. Brief of John P. Freeman and James D. Cox as *Amici Curiae* in Support of Respondent at 7, *Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011), (No. 09-525), 2010 WL 4380233 at *14.

146. *In re Mutual Funds Inv. Litig.*, 566 F.3d 111, 121 (4th Cir. 2009) (emphasis in original).

147. *Janus*, 131 S. Ct. at 2302. “The bright-line rule thus focuses the liability inquiry on the reliance element rather than on the conduct of the . . . actor.” David R. Allen, *A New Breadth of Life for Private Rule 10b-5(b) Litigation After Stoneridge: SEC v. Tambone and Implied Statements by Collateral Actors*, 32 CARDOZO L. REV. 2093, 2107 (2011).

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

149. See also *supra* Part I.D.2.

150. See Johnson, *supra* note 19, at 152; see also *Jones v. Harris Assoc. L.P.*, 130 S. Ct. 1418, 1422 (2010).

151. Johnson, *supra* note 19, at 154. For example, who advises the fund is so essential to investors that if the fund’s board fired the investment adviser, this would “nullify an essential reason many investors chose that fund.” *Id.*

are responsible for the financial management of the fund and ultimately choose a particular mutual fund based upon the specific investment adviser, it is implicit that any financial statements produced by the fund would be reasonably attributable to the investment adviser. Thus, after re-characterizing the *Janus* Court's analogy to consider practical mutual fund circumstances, this would mean that an audience chooses to listen to a particular speech, not because of who the speaker was, but because of who drafted the speech. Such analogy necessarily fails when considering the practical implications of an investment adviser managing the day-to-day functions of the fund.

C. PIERCING THE CORPORATE VEIL

Because of the close relationship between fund and adviser in a mutual fund context and despite JCM properly observing corporate formalities, investors should be able to pierce the corporate veil and hold JCM primarily liable. The granting of the corporate charter to JCM was a "privilege that carries with it the responsibility to operate the corporation in accordance with the public interest."¹⁵² Accordingly, it is appropriate to pierce the corporate veil, "whenever there is an 'abuse' of the corporate form, when the corporation is being operated in a manner that runs counter to the spirit of the grant of the privilege, and when, in short, the public weal is damaged, rather than enhanced by the operation of the corporation."¹⁵³

As a general rule, two separate corporations are regarded as distinct legal entities and "absent fraud or bad faith, a corporation will not be held liable for the acts of its subsidiaries or other affiliated corporations."¹⁵⁴ Thus, the law recognizes a strong presumption in favor of preserving limited liability and "disregarding the corporate form and imposing liability on affiliated corporate entities is an 'extreme remedy, sparingly used.'"¹⁵⁵ In essence, the purpose of allowing a plaintiff to pierce the corporate veil is "to prevent an independent corporation from being used to defeat the ends of justice, to perpetrate fraud, to accomplish a crime, or otherwise to evade the law."¹⁵⁶

Nevertheless,

[i]n order to pierce the corporate veil or establish alter ego liability,¹⁵⁷ it is generally necessary to show that a parent or affiliated entity¹⁵⁸ exercised

152. STEPHEN B. PRESSER, *PIERCING THE CORPORATE VEIL* § 1:2 (West 2011).

153. *Id.*

154. 1 WILLIAM M. FLETCHER, *FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS* ch. 2 § 43 (Thompson Reuters 2012).

155. Douglas G. Smith, *Piercing the Corporate Veil in Regulated Industries*, 2008 B.Y.U. L. REV. 1165, 1166, 1170 (2008) (citations omitted).

156. Dep't. of Envtl. Prot. v. Ventron Corp., 468 A.2d 150, 164 (N.J. 1983).

157. "Under the alter ego doctrine, when a corporation is the mere instrumentality or business conduit of another corporation, the corporate form may be disregarded." FLETCHER, *supra* note

domination or *control* over the entity at issue, that there was an element of fraud or abuse of the corporate form, and that the fraudulent abuse of the corporate form caused a tangible injury.¹⁵⁹

Domination or control is evidenced when, as a practical matter, the parent has “moved beyond the establishment of general policy and direction for the subsidiary and in effect [has] taken over the performance of the subsidiary’s day-to-day operations in carrying out that policy.”¹⁶⁰ Similarly, the SEC defines “control” as “the power to direct or cause the direction of the management and policies of a person” by ownership, contract, or otherwise.¹⁶¹

With this in mind, it is commonly acknowledged that in the mutual fund context, an investment adviser “dominates” and “controls” its managed funds.¹⁶² For example, the SEC has stated that “[a]n investment adviser typically organizes a mutual fund and is responsible for its day-to-day operations,” and due to this extensive involvement, “investment advisers typically *dominate* the funds they advise.”¹⁶³ Further, the Second Circuit has observed that “*control* of a mutual fund . . . lies largely in the hands of the investment adviser.”¹⁶⁴

The specific facts in *Janus* surpass the threshold requirement of domination and control to pierce the corporate veil. JCM not only managed the fund’s portfolio, but had virtually unrestrained control and discretion over the policies and day-to-day operations of JIF, including administrative, compliance, and accounting services.¹⁶⁵ Notably, JCM was responsible for drafting and reviewing JIF prospectuses—the fund’s key marketing tool—

154, § 41.10. This theory applies when two legal distinct corporations are in such unity that it is difficult to separate them. *See id.*

158. “Alter ego liability is not limited to the parent-subsidiary corporate relationship; rather . . . liability can [also] be found between sister [or affiliated] companies.” *Troyk v. Farmers Grp., Inc.*, 90 Cal. Rptr. 3d 589, 619 (Cal. Ct. App. 2009) (finding that one sister subsidiary worked as an alter ego for another sister subsidiary, and thus, it was appropriate to pierce the corporate veil and hold the fraudulent subsidiary liable for the other’s actions).

159. Smith, *supra* note 155, at 1171 (emphasis and footnotes added).

160. *Id.* at 1173. Factors to consider when determining “domination” include: whether the corporations have observed proper corporate formalities, whether the subsidiary has been adequately capitalized, whether there has been a commingling of assets, and the overlap of officers and directors. While no factor is dispositive of alter ego liability by itself, they all must be considered within the totality of the circumstances in determining whether the parent has exercised “exclusive domination and . . . control to the point that [the subsidiary] no longer has legal or independent significance of [its] own.” *Id.* at 1172–78 (citing *Outokumpu Eng’g Enters., Inc. v. Kvaerner Enviropower, Inc.*, 685 A.2d 724, 729 n.2 (Del. Super. Ct. 1996)) (alterations in original).

161. *See* 17 C.F.R. § 240.12b-2 (2008).

162. *See* John P. Freeman, Stewart L. Brown & Steve Pomerantz, *Mutual Fund Advisory Fees: New Evidence and a Fair Fiduciary Duty Test*, 61 OKLA. L. REV. 83, 84 (2008).

163. Role of Independent Directors of Investment Companies, 64 Fed. Reg. 112,59826, 112,59827 (proposed Nov. 3, 1999) (emphasis added).

164. *Tannenbaum v. Zeller*, 552 F.2d 402, 405 (2d Cir. 1977) (emphasis added).

165. *Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 2312 (2011).

including language about “market timing.”¹⁶⁶ The fund’s prospectuses’ were then disseminated through the parent company’s (JCG) website.¹⁶⁷ Finally, every single one of JIF’s seventeen officers was also a vice president at JCM.¹⁶⁸ While the *Janus* majority properly recognized corporate formalities were observed,¹⁶⁹ “[this factor alone] is not dispositive given that mere failure upon occasion to follow all the forms prescribed by law for the conduct of corporate activities will not justify disregard of the corporate [form].”¹⁷⁰

If the *Janus* Court had considered all of the evidence in totality, it should have determined, as is typically the case within the mutual fund industry, that JCM had significant control and dominion of JIF, satisfying a necessary requirement to disregard the corporate form.

Through the control and dominion of JIF, JCM used the fund to perpetrate a fraud and misused the corporate form.¹⁷¹ As noted earlier, JCM drafted JIF’s prospectuses, which included language expressing that “market timing” activities would not occur within JIF.¹⁷² Although not illegal, one can surmise that the purpose of this prospectus language was to assure the public that these market-timing practices, which dilute the value of shares held by long-term mutual fund investors, were not occurring. This made the fund more attractive to investors, increasing JCM’s profit.¹⁷³ Despite specifically drafting such language, the fund still engaged in a market-timing scheme.¹⁷⁴ It is undisputed that this constituted a fraudulent misrepresentation.¹⁷⁵ Yet, even though JCM handled the actual management practices of the fund, including the market-timing scheme, and because the

166. *Id.*

167. *Id.*

168. *Id.*

169. The *Janus* majority specifically recognized that JIF’s board of trustees was more independent than 15 U.S.C. § 80a-10 requires. *Id.* at 2304. 15 U.S.C. § 80a-10 states “[n]o registered investment company shall have a board of directors more than 60 per centum of the members of which are persons who are interested persons of such registered company.” 15 U.S.C. § 80a-10(a) (2006).

170. Smith, *supra* note 155, at 1173 (internal quotations and citations omitted). “In assessing whether to pierce the corporate veil, courts generally apply a range of factors, none of which by itself is sufficient to establish liability.” *Id.* at 1171.

171. *Id.* at 1181 (internal citations and quotations omitted) (noting that “parties seeking to establish [alter ego] liability must show that the parent is employing the subsidiary to perpetrate a fraud or commit wrongdoing” and that “merely showing control is insufficient to overcome the presumption that corporate entities are separate”).

172. See *supra* note 72 and accompanying text.

173. GRAY ET AL., *supra* note 14, at 135. The investment adviser “can generate a greater fee by either growing the fund’s assets through successful investing or by attracting new investors through promotion.” Johnson, *supra* note 19, at 155.

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

175. In 2004, JCM agreed to pay \$50 million in civil penalties and \$50 million in disgorgement and settled its case with the Attorney General of New York for its market timing activities. *Id.* at 2300 n.2.

prospectus was technically issued by JIF, JCM effectively shielded itself from any liability via the corporate form.

Nonetheless, the *Janus* Court refused to disregard the corporate form.¹⁷⁶ In the majority's opinion, "the Court made no attempt to support its reason for not piercing the veil, nor did it suggest that the unique relationship of a mutual fund with its advisor may involve other considerations than whether corporate formalities were observed."¹⁷⁷ By strictly adhering to the corporate form, the *Janus* Court strengthened JCM's corporate shield and essentially endorsed a blueprint for widespread securities fraud to occur under the guise of corporate law.

The *Janus* Court's refusal to grant recourse against JCM operates as a grave inequity and is in contrast to the legislative intent of § 10(b). The Supreme Court has stated that § 10(b) should be "construed not technically and restrictively, but flexibly to effectuate its remedial purposes," one of which is victim compensation.¹⁷⁸ Private rights of action "afford victims of fraud the best and often only hope of recovering their losses, something for which government enforcement actions are ill-equipped."¹⁷⁹ If investors are unable to reach JCM, then by default, JIF is the only entity left to cover any remedies. But if "the [investors] were to recover their losses from JIF, the result would be that the public investors in a mutual fund would be paying damages to the public investors in the fund's investment advisor."¹⁸⁰ In other words, entirely innocent public investors of JIF would be forced to pay JCG's investors. Such a result would be grossly inequitable considering JIF was a "mere shell" that held no other assets other than those it held for shareholders.¹⁸¹ Thus, refusal to disregard the corporate form effectively leaves investors with no means of recovery.

Further, if JIF's board was deliberately deceived by JCM, then JIF lacks the requisite *scienter* requirement for Rule 10b-5, and investors would have no one to hold liable.¹⁸² "There is serious suggestion that [JIF's] board knew little or nothing about the falsity of what was said."¹⁸³ The *Janus* dissent poses the question, "[w]hat is to happen when guilty management writes a prospectus (for the board) containing materially false statements

176. *Id.* at 2304.

177. Poser, *supra* note 72, at 207.

178. *SEC v. Zandford*, 535 U.S. 813, 819–21 (2002).

179. Brief of AARP and North American Securities Administrators Association, Inc. as *Amici Curiae* in Support of Respondents at 7, *Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011) (No. 09-525), 2010 WL 4339893 at *8.

180. Poser, *supra* note 72, at 209.

181. *See id.* ("Such a result defies common sense and can hardly be justified on any basis."); *see also Janus*, 131 S. Ct. at 2312 (Breyer, J., dissenting) ("The Fund has no assets separate and apart from those they hold for shareholders.").

182. *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 194 n.12 (1976) (outlining the *scienter* requirement).

183. *Janus*, 131 S. Ct. at 2312 (Breyer, J., dissenting).

and fools both board and public into believing they are true?”¹⁸⁴ According to the *Janus* holding, *no one* has “made” the materially false statement in this scenario because by merely observing corporate formalities, only JIF’s board had “ultimate authority.”¹⁸⁵ Consequently, if no one has “made” the materially false statement, then no one can be liable to defrauded investors. In order to further § 10(b)’s tenet of victim recompense, the Court should have recognized that JIF was an alter ego identity of JCM. Considering that JCM had unrestrained dominion of JIF’s day-to-day activities, had perpetrated a fraud, and was using the corporate form as a liability shield, allowing investors to pierce the corporate veil and bring a private right of action against JCM would have been consistent with the intent of § 10(b).

IV. A PRIVATE RIGHT OF ACTION PROMOTES MARKET EFFICIENCY AND RESTORES INVESTOR CONFIDENCE

Economic theory suggests that expressly granting investors a private right of action against investment advisors in the mutual fund context will promote market efficiency, furthering the legislative intent of § 10(b).¹⁸⁶ The Supreme Court has recognized, “[t]he magnitude of the federal interest in protecting the integrity and efficient operation of the market for nationally traded securities cannot be overstated.”¹⁸⁷ In an efficient capital market, economic growth is fueled because of two significant occurrences: (1) investors are confident, on average, they will earn a fair rate of return; and (2) “entrepreneurs, small businesses, and corporations are able to obtain necessary capital at the lowest possible cost.”¹⁸⁸ Thus, market integrity is ensured.¹⁸⁹ Nevertheless, when investors feel that they “cannot rely upon the accuracy and completeness of issuer statements, they will be less likely to invest [capital], thereby reducing the liquidity of the securities markets to

184. *Id.* at 2310 (Breyer, J., dissenting).

185. If JIF’s board was unaware that the prospectuses were false and misleading, they lacked the scienter necessary to make them primarily liable. *See id.*

186. Congress’ aim in enacting the Exchange Act was not confined solely to compensating defrauded investors. Congress also intended to ensure honest markets for securities and to promote investor confidence. S. REP. NO. 73-792, at 3–5 (1934).

187. *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71, 78 (2006); *see* Bernard S. Black, *The Legal and Institutional Preconditions for Strong Securities Markets*, 48 UCLA L. REV. 781, 781 (2001) (“[In the U.S. securities market,] [i]nvestors pay enormous amounts of money to strangers for completely intangible rights, whose value depends entirely on the quality of the information that the investors receive and on the sellers’ honesty.”).

188. Mark Klock, *What Will it Take to Label Participation in a Deceptive Scheme to Defraud Buyers of Securities a Violation of Section 10(b)? The Disastrous Result and Reasoning of Stoneridge*, 58 U. KAN. L. REV. 309, 350 (2010).

189. “Market integrity’ is used here to refer to the maintenance of a set of broadly-accepted rules and norms that support the effective and efficient functioning of a free marketplace within a capitalistic framework.” Steven R. Salbu, *The Misappropriation Theory of Insider Trading: A Legal, Economic, and Ethical Analysis*, 15 HARV. J.L. & PUB. POL’Y 223, 241 n.105 (1992).

the detriment of investors and issuers alike.”¹⁹⁰ Further, if investors feel their expected returns are unfair, they will pull out their capital.¹⁹¹ This “flight of capital results in diminished business investment, fewer jobs, less tax revenue to fund government programs, and more economic hardship.”¹⁹² Once the integrity of the market fails, economic efficiency fails with it.¹⁹³

By failing to hold the fraudulent investment advisers (JCM) liable, the *Janus* Court perpetuates moral hazard within the mutual fund industry, hurting market efficiency. “Moral hazard exists when people are encouraged to engage in undesirable behavior because they are insulated from its consequences.”¹⁹⁴ In the financial markets context, if investment advisers are “always given the benefit of the doubt when they engage in questionable activities which are not clearly illegal, then financial market participants are effectively being encouraged with economic incentives to engage in shady conduct.”¹⁹⁵ In *Janus*, JCM was dishonest to the investing public in an effort to increase its overall profit. When that misrepresentation became public knowledge, investors quickly removed its capital from JIF, which was detrimental to the shareholders of JCG.¹⁹⁶ Yet, the *Janus* Court refused to allow the defrauded investors to recover its losses from the origins of the fraud, JCM.¹⁹⁷ *Janus* suggests, in the mutual fund context, investment advisers can risk drafting fraudulent fund prospectuses in hopes of larger profits because they are now insulated from any liabilities by mere observance of corporate formalities. Without a private right of action to threaten significant monetary damages, there are fewer disincentives for investment advisers to reduce avoidable risks created by their decisions. Thus, “unethical conduct that is profitable will be widespread.”¹⁹⁸

The presence of moral hazard inevitably results in market inefficiency.¹⁹⁹ Shielding the mutual fund advisers from private right of

190. *Basic Inc. v. Levinson*, 485 U.S. 224, 235 n.12 (1988) (citing *In re Carnation Co.*, Exchange Act Release No. 22214, 33 SEC Docket 1025, 1030 (1985)).

191. Klock, *supra* note 188, at 350–51.

192. *Id.*

193. “Systemic unfairness in the availability of information within securities markets reduces investor confidence, thereby discouraging participation in and undermining vital capital markets.” Salbu, *supra* note 189, at 241 n.105.

194. Klock, *supra* note 188, at 341. Unfortunately, our financial markets are no stranger to moral hazard. When Congress bailed out Bear Stearns because it was “too big to fail,” this generated moral hazard because the managers of the large banks believed they could take excessive risk, yet still be insulated from bankruptcy. Alison M. Hashmall, *After the Fall: A New Framework to Regulate “Too Big To Fail” Non-Bank Financial Institutions*, 85 N.Y.U. L. REV. 829, 841 n.51 (2010).

195. Klock, *supra* note 188, at 341.

196. *Janus Capital Grp. v. First Derivative Traders*, 131 S. Ct. 2296, 2300 (2011).

197. *Id.* at 2305.

198. Klock, *supra* note 188, at 340.

199. *See id.* at 343 (“If Scientific-Atlanta and Motorola were held liable for their actions, the moral hazard problem and the resulting economic inefficiency would vanish.”).

actions chills the mutual fund markets.²⁰⁰ The Supreme Court has noted “[i]nvestors likely would hesitate to venture their capital in a market where trading based on misappropriated nonpublic information is unchecked by law.”²⁰¹ Investors will not know which mutual fund advisers are honest and which are willing to take excessive risk to earn a larger profit for themselves, as JCM did.²⁰² As a result, investors will indiscriminately discount all of the mutual funds’ share prices.²⁰³ This result hurts honest mutual fund advisers who are unable to receive a fair price for its shares, which incentivizes them to either begin risky conduct themselves or leave the market altogether.²⁰⁴ With the average quality of honest mutual fund advisers significantly lowered, “[i]nvestors rationally react by further discounting share prices.”²⁰⁵ Unsurprisingly, even more honest advisers are then driven from the market.²⁰⁶ This deathward spiral towards market inefficiency is precisely why Congress intended § 10(b) to provide for strong investor protection. The availability of a private right of action to investors is a simple solution to deter dishonest behavior and avoid a mutual fund market collapse.²⁰⁷

Janus’ suggestion that SEC enforcement, by itself, is sufficient to deter dishonest conduct and promote market efficiency is faulty.²⁰⁸ Congress has stated that “private lawsuits promote public and global confidence in our capital markets and help to deter wrongdoing and to guarantee that corporate officers, auditors, directors, lawyers and others properly perform their jobs.”²⁰⁹ Further, the Supreme Court has “long recognized that meritorious private actions to enforce federal antifraud securities laws are

200. See Black, *supra* note 187, at 781.

201. *United States v. O’Hagan*, 521 U.S. 642, 658 (1997).

202. See Black, *supra* note 187, at 804; see also Grant Thomas Maynard, Note, *Catch Me if You Can: An Analysis of the Reduction of Secondary Actor’s Private Liability in § 10(b) Cases in Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, 128 S. Ct. 761 (2008), 88 NEB. L. REV. 561, 579 (2010) (“It is only basic economics . . . that leads to the assumption that if costs of fraudulent behavior or lowered, more companies will engage in that behavior.”).

203. See Black, *supra* note 187, at 804.

204. See *id.* at 805.

205. *Id.*

206. See *id.*

207. See *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 320–21 n.4 (2007) (citation omitted) (“[P]rivate securities litigation is an indispensable tool with which defrauded investors can recover their losses—a matter crucial to the integrity of domestic capital markets.”).

208. See *Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 2302 (2011) (citation omitted) (stating that “[s]uch suits—against entities that contribute ‘substantial assistance’ to the making of a statement but do not actually make it—may be brought by the SEC, . . . but not by private parties”); see also Robert A. Prentice, *The Inevitability of a Strong SEC*, 91 CORNELL L. REV. 775, 831–32 (2006) (finding that empirical evidence indicates mandatory disclosure rules, antifraud rules, and insider trading prohibitions enforced by both the SEC and private actors “serve to strengthen capital markets and encourage economic development”).

209. Maynard, *supra* note 202, at 574–75 (citing H.R. REP. NO. 104-269, at 31 (1995)).

an essential supplement to criminal prosecutions and civil enforcement actions brought . . . by the [SEC].”²¹⁰ Additionally, the SEC has stated,

[O]ur resources are *inadequate* to police all securities law violations which may take place. As a result, our enforcement activities are designed not only to address specific wrongdoings, but also to alert the private sector as to the kinds of activities which we believe violate the securities laws. Private actions . . . supplement the Commission’s own enforcement program, and significantly increase the likelihood that securities law violations will be challenged and corrected.²¹¹

Furthermore, though “the securities market is growing at a rapid rate, the SEC’s budget has remained fairly constant, meaning that the SEC is essentially being asked to regulate more firms with the same financial resources.”²¹² Even if the SEC’s funding and staff were substantially increased, there are still situations “in which the SEC is unable to recover anything for investors, leaving class action litigation as the only way injured investors can recover anything.”²¹³ Thus, private rights of action are a necessary supplement because the SEC’s finite amount of resources limits its ability to investigate and prosecute all securities violations.²¹⁴

CONCLUSION

In response to the *Janus* Court’s erroneous, categorical limitation on civil liability, Congress must expressly provide a private right of action for investors defrauded in the unique mutual fund context. Despite the advisers being separate legal entities from the mutual funds, primary liability should be granted here because of the advisers’ de facto control of the funds.²¹⁵ Without an express congressional provision, advisers will continue to be shielded from liability for fraudulent practices by merely adhering to the corporate form. This lack of accountability creates a moral hazard problem in the mutual fund industry. When motivation for risky behavior increases, it is not long before economic inefficiency follows. A strong private right of action, widely held to be a necessary supplement to the SEC, can deter the

210. *Tellabs*, 551 U.S. at 313; *see, e.g.*, *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 310 (1985) (“[I]mplied private actions are a necessary supplement to [SEC] action.”); *see also, e.g.*, *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 730 (1975) (discussing the same).

211. William W. Bratton & Michael L. Wachter, *The Political Economy of Fraud on the Market*, 160 U. PA. L. REV. 69, 150 (2011) (emphasis added) (citing 44 SEC Ann. Rep., at vii (1978), available at http://www.sec.gov/about/annual_report/1978.pdf).

212. Maynard, *supra* note 202, at 574 (citations omitted).

213. *Id.* at 573.

214. The SEC’s 2007 Annual Report exhibited a “dramatic 15% reduction in examinations of investment advisers and investment companies from the four-year running average . . . illustrat[ing] the inability of the SEC to be omnipresent and parallel[ing] how the SEC has struggled to keep up with regulating the rapidly expanding and evolving securities markets.” *Id.* at 574.

215. Johnsen, *supra* note 141, at 579.

prevalence of moral hazard and protect the economic efficiency so vital to our capital markets.²¹⁶ Nearly one-fifth of American households have invested over \$11 trillion in our mutual funds.²¹⁷ With those numbers only expected to grow, our already struggling economy cannot afford any market inefficiency, let alone a collapse of the mutual fund industry. Thus, now more than any other time, it is essential that Congress assure market confidence by stepping up and correcting the *Janus* decision.

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216. “If private actions are to be a useful deterrence supplement to SEC enforcement, then—just like the SEC—they have to be able to reach not only the issuers but also the human beings and firms that actually engineer the fraud.” Donald C. Langevoort, *Managing the “Expectations Gap” in Investor Protection: The SEC and the Post-Enron Reform Agenda*, 48 VILL. L. REV. 1139, 1162 (2003).

217. See Morley & Curtis, *supra* note 1, at 87; see also INV. CO. INST., 2010 INVESTMENT COMPANY FACT BOOK (50th ed. 2010), available at http://www.ici.org/pdf/2010_factbook.pdf.

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