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CORPORATE COUNSEL

Individual Officer Liability After *Janus*

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Securities class actions generally assert massive amounts of damages based on shareholders' losses when a company's stock drops on bad news. The cases themselves can be enormous and go on for years. It is not surprising, then, that an important issue for corporate officers and employees, including in-house counsel, is whether they can be sued (and potentially held liable) under U.S. securities laws for their companies' statements. Although just two years ago it looked like the U.S. Supreme Court had answered this question "No," in some courts the situation is not so clear today.

For many years after the Supreme Court's 1994 ruling abolishing aiding-and-abetting liability in private suits under Rule 10b-5 in *Central Bank of Denver v. First Interstate Bank of Denver*, the courts debated what level of involvement was required before a party could be held liable for a misrepresentation. Was substantial participation in bringing about the statement enough, as the Ninth Circuit held, or did one actually have to be the attributed author, as the Second Circuit ruled?

The Supreme Court took up the issue and seemed to give a definitive answer in 2011 in *Janus Capital Group, Inc. v. First Derivative Traders*. In that case, the

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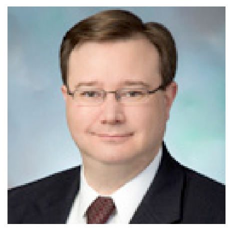

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Court held that in order to "make" a statement under Rule 10b-5, one must actually "state" it; preparing a statement that someone else makes is not enough. Individuals who assist in the preparation of SEC filings seemingly had reason to breathe easier.

Unfortunately, the limit of liability of individuals for corporate statements has turned out to be not so clear-cut, at least in the eyes of some lower court judges. The *Janus* opinion—which involved the different entities involved in the ownership and management of a mutual fund, not individual officers—has given rise to divergent district court rulings on individual liability that are anything but comforting.

One threshold issue is whether the so-called "group pleading" or "group-published" doctrine is viable. Under this doctrine, at the pleading stage a court is permitted to presume that certain "group-published" documents such as SEC filings and press releases are attributable to corporate insiders involved in the everyday affairs of the company. The Third, Fifth and Seventh Circuits have held that the doctrine is no longer good law; on the other hand, the Ninth and Tenth Circuits continue to recognize it. The Second Circuit has not addressed the issue, but a number of judges in the Southern District of New York have held that *Janus* abrogated the group pleading doctrine, including Judge Richard Sullivan and Judge Shira Scheindlin. On the other hand, Judge Jed Rakoff has held that the group pleading doctrine survives.

It is difficult to understand how any group-published presumption can be valid under *Janus* and the strict pleading standards of the Private Securities Litigation Reform Act of 1995. As the issue is presented to more courts of appeals, it is likely that fewer and fewer courts will recognize the presumption. In the courts where the group-published doctrine does remain viable, however, individual defendants who actually played minor or even non-existent roles in the filings in question may find it impossible to extricate themselves from burdensome litigation until the summary judgment stage.

Even at that stage, some lower courts' interpretation of *Janus* could put the result in doubt. The source of the problem is a few sentences in the Supreme Court's opinion in *Janus*. For whatever reason, the opinion did not stop with the clear rule that "make" means "state." The opinion went on and said that to make a statement, one must be "the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it." The Court also said that "in the ordinary case, attribution within a statement or implicit from surrounding circumstances is strong evidence that a statement was made by—and only by—the party to whom it is attributed."

The import of these pronouncements is not completely clear. For example, before *Janus*, in a series of cases involving accountants and lawyers, the Second Circuit had staked out a "bright line rule" that only parties to whom statements were attributed could be liable (although that court left open whether its rule applied to insiders as well as secondary actors). The Supreme Court's explanation of its ruling in *Janus* struck some as "actually more liberal than the existing Second Circuit 'attributed statement' rule because it expressly allows for attribution that is 'implicit from surrounding circumstances.' " *John C. Coffee Jr., U.S. Supreme Court and Securities Litigation*, New York L.J. (July 21, 2011).

Some judges have applied *Janus* strictly to bar claims against corporate insiders. For example, in *In re UBS*, Judge Sullivan of the Southern District of New York dismissed claims against individual defendants under *Janus*, despite allegations that their conduct went to the "very heart of the fraudulent scheme" because they had not actually made any statements. On the other hand, other judges have read *Janus* as not addressing the question of individual corporate insiders at all. In a case involving Lockheed Martin, Judge Rakoff expressed the view that *Janus* "addressed only whether third parties can be held liable for statements made by their clients" and "has no bearing on how corporate officers who work together in the same entity can be held jointly responsible on a theory of primary liability." This view is hard to square with what *Janus* actually did—which was to interpret a word ("make") in Rule 10b-5 that applies irrespective of who the defendant is.

Nonetheless, a number of district courts appear to have adopted similar views. In T*ouchstone Group, LLC v. Rink*, (D. Colo. 2012), an in-house chief legal counsel was caught in this trend toward allowing claims against individual officers. In that case, the plaintiffs alleged that the counsel "prepared or reviewed" his company's allegedly false offering memoranda. The court denied the individual officers' motion to dismiss on the vague ground that "it appears likely they possessed ultimate authority over any statement they prepared or for which they were otherwise responsible."

As one judge in the Southern District of New York in *In Re Fannie Mae* has summarized the expansive view of individual liability: "In the post-*Janus* world, an executive may be held accountable where the executive had ultimate authority over the company's statement; signed the company's statement; ratified and approved the company's statement; or where the statement is attributed to the executive." In that case, the court denied the motion to dismiss filed by the chief risk officer of Fannie Mae. Several post-*Janus* cases also have allowed claims against CFOs to proceed based on relatively vague allegations of involvement.

This unfortunate lack of clarity undermines one of the strongest points in favor of a bright line rule—the need for clarity about the limits of what can be crushing class-action liability. The Supreme Court repeatedly has emphasized that securities law "demands certainty and predictability." That is because class-action securities litigation presents "a danger of vexatiousness different in degree and in kind" from most other litigation, as the Supreme Court said in *Blue Chip Stamps v. Manor Drug Stores*. Now, however, corporate officials are once again uncertain of whether they can be dragged into long and expensive litigation, with the threat of ruinous potential liability, for statements they merely touched in the normal course of their jobs.

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