A Recent District Court Decision Undermines the Supreme Court's Ruling in *Janus*

In its June 13, 2011 decision in *Janus Capital Group, Inc. v. First Derivative Traders,* the Supreme Court adopted a bright line test to determine who is a primary actor for the purposes of Rule 10b-5, expressly holding that only the actual maker of the statement may be held liable. In a September 30 decision released by the United States District Court in the Southern District of New York in *City of Roseville Employees' Retirement System v. EnergySolutions*, the court seized on the Supreme Court's phrase "ultimate control" to deny a motion to dismiss a complaint seeking to hold a parent corporation liable for alleged misrepresentations in a registration statement issued by its subsidiary. In doing so, the district court has potentially created a huge exception to *Janus* that is inconsistent with the Supreme Court's ruling.

Under the district court's analysis, a parent that is the sole owner of the issuer could be per se liable under *Janus*. The district court has adopted a standard that is substantially weaker than the standard for veil piercing as well as the requirements under Section 20 of the 1934 Act, potentially making any controlling shareholder liable. This client alert discusses the implications of this decision and the liability risks created for parent corporations or controlling shareholders.

In June 2011, the United States Supreme Court issued *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011), in which the Court held that a party could not be held liable under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder unless the defendant alleged to have made misrepresentations is the party to whom the statement is attributed — the Supreme Court expressly held that parties who assist in the making of such statements cannot be held liable under these provisions. *Id.* at 2302-03. In a September 30 decision released by the United States District Court in the Southern District of New York in *City of Roseville Employees' Retirement System v. EnergySolutions*, No. 09 Civ. 8633 (S.D.N.Y. Sept. 30, 2011), the court seized on the Supreme Court's phrase "ultimate control" to deny a motion to dismiss a complaint seeking to hold a parent corporation liable for alleged misrepresentations in a registration statement issued by its subsidiary. In doing so, the district court has potentially created a huge exception to *Janus* that is inconsistent with the Supreme Court's ruling.

Following its earlier decisions with respect to secondary liability, the Supreme Court set forth a clear test in *Janus*:

> For purposes of Rule 10b-5, the maker of a statement is the person or entity with ultimate control <u>over the statement, including its content and whether and how to communicate it.</u> Without 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 a maker. And 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. *Id.* at 2302 (emphasis added).

In the *City of Roseville* case, the plaintiff sued, among others, the parent corporation of EnergySolutions, Inc. in connection with an IPO by EnergySolutions. The district court held that the claim against the parent under Rule 10b-5 could be sustained under *Janus*, even though the parent was not the maker of the statement. The district court seized on the ultimate "control" phrase in *Janus*, and found that the parent exercised control.

Specifically, the district court relied on allegations that (i) the parent was the sole owner of EnergySolutions stock and was the selling shareholder; (ii) the registration statement contained a corporate structure chart that showed EnergySolutions to be wholly owned by the parent; (iii) statements that the parent would continue to retain a controlling interest after the IPO; and (iv) statements that the Sponsors and Management (which owned 100% of the parent) would have the ability to effectively control all matters requiring stockholder approval, including the issuance of additional shares.[1] The district court held that these statements about shareholder control made the situation in *City of Roseville* different than the facts before the Supreme Court in *Janus*, even though in *Janus* the Supreme Court held that the plaintiff could not assert claims against the investment fund's affiliate (which provided all administrative and advisory services to the fund).

The district court's decision is completely disconnected from the Supreme Court's ruling in *Janus*. In effect, the district court has ignored the specific language in the Supreme Court's holding that control had to be exercised over "the statement, including its content and whether and how to communicate it." None of the allegations to which the district court pointed, however, indicates that the parent exercised any such control over the statements in the registration statement. Instead, the district court erroneously held that the ability to exercise control as a shareholder by itself was sufficient for the purposes of the Supreme Court's holding in *Janus*.

The district court's decision has the potential for causing great mischief, as it has severed the nexus between control and the making of statements. Indeed, the district court has adopted a standard that is substantially weaker than the standard for veil piercing, as it does not require any allegations that the control was exercised in an inappropriate manner.

At a minimum, under the district court's analysis, a parent that is the sole owner of the issuer could be per se liable under *Janus*. Potentially by the district court's logic, any controlling shareholder would be liable. In effect, the district court had read the requirements in Section 20 of the 1934 Act out of the statute by eliminating the need to satisfy that section's controlling person requirements when addressing a parent's liability for a subsidiary's disclosures.

To the extent that other courts choose to follow this decision, the rule established in *Janus* will be eviscerated with respect to claims involving a subsidiary's publicly traded securities. There is serious doubt, however, whether other courts, including Courts of Appeal, will follow the district court's logic. At no point does the district court come to the conclusion, as *Janus* expressly requires, that the complaint alleges with the requisite particularity required under *Tellabs* that the parent corporation exercised ultimate control over the making of the statements. Given the Supreme Court's desire to circumscribe the

[1] Although the district court relies on these statements, there is nothing special or out of the ordinary about those disclosures. Any subsidiary such as EnergySolutions is required to make such disclosures about its controlling shareholder or parent.

ability to assert claims under Rule 10b-5, it is unlikely that the Supreme Court used the phrase "ultimate control" to create a basis to hold a parent corporation or a controlling shareholder liable for the misrepresentations made by its subsidiary merely because of its power as a shareholder.

Since the district court's decision is an interlocutory decision at the earliest stage of the case, appellate review of their decision will not occur in the near future. It will probably take some time before there is any clarity regarding the willingness of other courts to adopt the district court's reasoning.

For further information, please contact:

H. Peter Haveles, Jr.
T: 212.836.7604
peter.haveles@kayescholer.com

Aaron Rubinstein
T: 212.836.8412
arubinstein@kayescholer.com

Vincent A. Sama
T: 212.836.8765
vincent.sama@kayescholer.com