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The Supreme Court's Theory of the Fund

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The Supreme Court’s Theory of the Fund

William A. Birdthistle*

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The facts of [Janus Capital Group v. First Derivative Traders] are outrageous. 1
– New York Times Editorial Board

I. INTRODUCTION

Just as the firm has long served as the foundational molecule of the U.S. capitalist economy, 2 theories of the firm have for more than a century dominated legal and economic discourse. 3 Ever since Ronald Coase published The Nature of the Firm in 1937 and asked why firms should exist in an efficient market, 4 classicists and neoclassicists have competed to develop theories—predominantly managerialist 5 and contractual 6—

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* Associate Professor of Law, Chicago–Kent College of Law. I thank Alison LaCroix, Todd Henderson, Tamar Frankel, Jim Cox, Lyman Johnson, Don Langevoort, and Manning Warren, as well as the participants in roundtables on investment funds at Boston University School of Law and workshops at the University of Iowa College of Law and Chicago–Kent College of Law. I am also grateful to Robert Ennesser and Claire Willis for their research assistance. Portions of this Article are based on my blog postings and an amicus brief I wrote on behalf of law professors in support of the respondent in Janus Capital Group v. First Derivative Traders.

2. See ADAM SMITH, THE WEALTH OF NATIONS 1 (1986) (setting forth his postulate that the division of labor—and therefore the firm—serves as the central analytical unit in a market).
that best explain the structure and behavior of business organizations. Those theories, in turn, provide support to competing sides in the adjudication of important public policy decisions, such as the propriety of allowing corporations to make independent expenditures on behalf of political campaigns in *Citizens United v. Federal Election Commission*.7

The investment fund, by contrast, has languished at the margins of corporate theory, relegated as simply a minor, if somewhat curious, example of the firm. But as the flow of assets into funds has swollen dramatically in recent years,8 so too has the relevance of the question whether funds are, in fact, best considered a subspecies of the firm or instead ought to be evaluated as independent phenomena. Mutual funds now hold more than $12 trillion in assets under management,9 a figure expected to rise considerably as private and public employers rapidly shed their pension plans.10 With corporate and governmental budgets buckling under the strain of promises to pay indefinite annuities and ever-increasing health care premiums, one widespread solution has been to shift the responsibility of investing from employers to employees.11 Those individuals, in turn, primarily select funds as their vehicle of choice for investing for their future retirement, healthcare, and education.12

Perhaps not surprisingly, the rise in the use of funds has brought with it a concomitant increase in fund-related litigation.13 After more than a quarter century of


9. *See id*. (listing total net assets of all U.S. mutual funds as $11.8 trillion as of 2010).


11. *See id.* at 10 (discussing various states’ efforts to implement risk sharing pension plans); see also James Dao, *Does Debt Bill “Gut” Military? Depends Whom You Ask*, N.Y. TIMES, Aug. 1, 2011, http://atwar.blogs.nytimes.com/2011/08/01/does-debt-bill-gut-military-depends-whom-you-ask/ (discussing an “internal Pentagon panel” that “has proposed revamping military retirement benefits,” such as by converting the existing pension plan to a defined contribution plan).

12. *See* ICI FACT BOOK, *supra* note 8, at 105 (referencing Figure 7.7, which illustrates the widespread use of mutual funds in the asset allocations of 401(k) plans).

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The Supreme Court has heard and ruled upon two notable fund disputes in the past two Terms. In the October 2009 Term, the Court in *Jones v. Harris Associates L.P.* reaffirmed—with minor alterations—a fiduciary standard for excessive fees under which no plaintiff has ever been able to prevail at trial. Then, in the October 2010 Term, the Court ruled in *Janus Capital Group v. First Derivative Traders* that a fund advisor is not liable for fraud in the prospectus of one of the advisor’s funds because the advisor is not the “maker” of those statements, notwithstanding the fact that the advisor forms and incubates the fund, furnishes all management to the fund, drafts and publishes the fund’s prospectuses, and perpetrates the fraudulent scheme.

In both these decisions, the ruling justices applied a neoclassical conception of the firm in their analysis of the business operations and legal issues of investment funds. Perhaps more surprising, however, was the justices’ admitted lack of comprehension and facility regarding funds, which was revealed at oral argument in *Janus*. Justice Stephen Breyer at one point said to an advocate, “No, you have to explain it to me more. I’m not being difficult. I understand this less well than you think I do, and I want to know.” Justice Sonia Sotomayor, inquiring about the structure of funds, asked what it means for them to be formed as entities distinct from advisors. Then, with oral argument almost concluded after an hour-long discussion, Justice Samuel Alito and Justice Ruth Bader Ginsburg inquired about recovery for shareholders in the fund itself, which seemed to surprise the oral advocate and much of the audience because the case concerned recovery only for shareholders in the fund’s advisor—an entirely different and unrelated group of investors.

Though the justices may be proficient with the direct relationship between firms and their shareholders, that simple dyad is increasingly being exploded by the interposition of.

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14. Previously, the most recent Supreme Court case involving a mutual fund was *Daily Income Fund v. Fox*, 464 U.S. 523 (1984).
19. *See id. at 2299 (“Although JCG created Janus Investment Fund, Janus Investment Fund is a separate legal entity owned entirely by mutual fund investors.”); Jones*, 130 S. Ct. at 1427 (identifying “scrutiny of investment advisor compensation by a fully informed mutual fund board” as the “cornerstone . . . of the effort to control conflicts of interest within mutual funds” (internal citations omitted)).
21. *Id. at 24*.
22. *Id. at 62–64.*
financial intermediaries. Today, hedge funds, mutual funds, private equity funds, and similarly managed investment vehicles dominate the global economic playing field through their possession of both huge amounts of money and powerful systemic risk. In a recent analysis of the rise of intermediated financial investments, Professor Jill Fisch pointed out that institutional (primarily fund) investors now own “an unprecedented 76.4% of the largest 1000 corporations.” And by many accounts, the U.S. economy suffered distress at the hands of systemic risk exacerbated by highly leveraged hedge funds during the 2008 financial crisis and then teetered towards greatest jeopardy in September of that year with the breaking of the buck in money market funds.

Yet funds sit uncomfortably within the neoclassical theoretical framework of business firms, which posits that any potential managerial power is counterbalanced by interlocking systems of market discipline. First, the robust set of mechanisms that discipline the behavior of firm managers—such as markets for corporate control, labor, and products—are notably absent or diminished in the context of investment funds. Second, unlike shareholders in firms, the shareholders of funds experience a rigidly intermediated relationship with their investments. Third, because of the wholesale shift from defined benefit pensions to defined contribution plans by both corporate and governmental employers, many fund shareholders have come to hold their investments involuntarily.

Arguably, the Supreme Court’s recent opinions concerning funds are overly formalistic, contradict the functional realities of investment funds, and rely upon unsatisfying theoretical paradigms. The question thus arises: what is the Supreme Court’s theory of the fund? Moreover, is that theory grounded in an accurate understanding of the nature and operation of investment funds? The answers to these questions, combined with normative critiques and counterarguments, might provide coherence to a growing body of jurisprudence that is sure to be tested further in the decades ahead. As more Americans come to use and to rely upon investment funds for their direct financial welfare now as well as their future retirement, more litigation and regulation is sure to follow. The

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25. See, e.g., PRESIDENT’S WORKING GROUP ON FINANCIAL MARKETS, MONEY MARKET FUND REFORM OPTIONS 1 (2010), available at http://www.treasury.gov/press-center/press-releases/Documents/10.21%20PWG%20Report%20Final.pdf (identifying the inability of certain money market funds to repay their investors 100 cents on each dollar invested, which triggered a run on such funds, as one of “several key events during the financial crisis” that “underscored the vulnerability of the financial system to systemic risk”).


moment to test the soundness of this intellectual framework is before greater weight is balanced upon it.

Part II of this Article discusses the shortcomings of the recent ruling in Janus Capital Group v. First Derivative Traders, taking particular exception with the remarkable formalism of the majority’s reasoning, which appears to ignore or misapprehend the actual operations of mutual funds. If operating companies follow the lead of investment funds and use Janus as a model for immunity against securities litigation, deterrence of financial fraud is likely to drop substantially. Part III considers the potentially deleterious implications of the Court’s fund jurisprudence and predicts that substantial mischief will flow from the decision should its lessons be taken advantage of in other sectors of the economy. Part IV considers the theoretical lens—the theory of the fund—that justices of the Supreme Court appear to use to examine investment funds, and it identifies mistaken assumptions and problems with that lens and its use in the pair of recent rulings in Janus and Jones v. Harris. This Article considers whether alternative theories of the firm might inform a more useful theory of the fund for both the judicial and legislative branches in the future.

II. FORMALISM & DAMAGE IN THE JANUS RULING

The Supreme Court’s ruling in Janus is, in the words of Professor Jeffrey Gordon, “one of those cases that takes your breath away.”28 In this 5–4 decision, Justice Clarence Thomas held that an investment advisor cannot be held liable for fraudulent statements in the prospectus of one of the advisor’s investment funds.29 Although the advisor formed, incubated, operated, and managed the fund, and drafted and filed the prospectus in question, the Court nevertheless ruled that the advisor did not “make” the fraudulent statement.30 Indeed, the Court was untroubled by the uncontested allegation that the advisor was wholly responsible for the fraud because it permitted market-timing arbitrage in its funds after filing a prospectus that explicitly banned that activity.31 Instead, the Court ruled that the maker of the statement is the fund itself, a distinct legal entity with “ultimate authority over the statement, including its content and whether and how to communicate it.”32

Nice legal formalities such as this are not new in the world of corporate law and their bright lines are often intended to sacrifice a modicum of equity for the comforts of predictability. But several problems exist with respect to the doctrinal reasoning itself in Janus. Perhaps more importantly, because formalities also tend to encourage highly strategic behavior, the implications of the Janus ruling threaten significant and broader damage in the future, both in the world of funds and the greater economy.

30. Id.
31. Id. at 2300, 2306.
32. Id. at 2302.
A. The Majority’s Reasoning in Janus

The facts in Janus arose from allegations made by prosecutors in 2003 that several mutual fund complexes permitted market timing in their funds, in violation of express restrictions against such behavior published in those funds’ public securities filings.\(^{33}\) As a general concept, market timing is simply the practice of attempting to execute investment decisions to benefit from positive market developments or to avoid deleterious ones—certainly a very widespread phenomenon in the investment world and not at all legally suspect.\(^{34}\) But in this particular context, the term has a more precise and somewhat more pernicious valence.\(^{35}\)

An investment advisor orchestrates a market-timing ruse first by attracting individual, long-term, buy-and-hold investors to its funds with the promise of safety—that is, an explicit policy barring market timing.\(^{36}\) The market timers are sophisticated institutional traders, such as hedge-fund traders, who move large sums of money rapidly in and out of mutual funds to arbitrage the unusual pricing system of those funds.\(^{37}\) The fact that mutual funds are priced only once a day rather than continuously creates this opportunity for exploiting economic developments occurring around the world. Again, the practice is not illegal, but rapid trades in and out of a mutual fund can dilute the returns of long-term investors and drive up transaction costs for the entire fund. For that reason, many advisors of mutual funds voluntarily impose their own bans on market timing.\(^{38}\) Janus Capital Management, as advisor to the Janus funds, promulgated and published such a ban in the prospectus to the Janus funds. The plaintiffs in the Janus litigation contended that Janus subsequently entered into profitable, undisclosed arrangements with certain hedge funds to permit market timing.\(^{39}\) Throughout the entirety of these dealings, the investment advisor collected fees from both the winners and losers of the market timing.\(^{40}\) This allegation of fraud was at the root of the dispute in Janus.\(^{41}\)

An illustrative case of market timing involves time-zone arbitrage.\(^{42}\) Because mutual fund shares are priced only once a day, usually just after the primary stock markets close at 4:00 p.m. Eastern, the accuracy of those prices quickly deteriorates. Subsequent events on the other side of the world may move the price of securities of

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\(^{34}\) See id. at 236 (defining market timing).

\(^{35}\) See id.

\(^{36}\) See id.


\(^{38}\) See id. at 1453 (noting incentives for advisors to impose their own ban on market timing).


\(^{40}\) See id.


foreign companies. Thus, the actual net asset value of any U.S. mutual fund holding those foreign securities in its portfolio will fluctuate even before the fund’s shares are re-priced the next day. During those periods when a fund’s price and its value no longer correspond, a sophisticated market timer can arbitrage the difference by moving large sums of cash into (to realize gains) or out of (to avoid losses) the fund. Of course, the market timer’s gains are necessarily other investors’ losses:

By moving large blocks of cash into a fund in anticipation of a rise in the fund’s value, the market timer dilutes the worth of each individual share of the fund. Although the timer’s new cash was not invested in the underlying securities whose value has risen, the investment has increased the number of fund shares outstanding. Thus, with a greater denominator, the [Net Asset Value] pricing equation results in profits from positive market movements being shared by a greater number of shareholders.43

In addition to dilution, market timing generates material transaction costs for a fund and thus for each of the fund’s shareholders. The quick inflow and outflow of large sums of money creates inefficiencies in the management of the fund as portfolio managers must accommodate large redemptions by either maintaining greater liquidity cushions (which are likely to impose drag upon fund returns) or by executing unanticipated trades to liquidate portfolio holdings (which increase fund fees).44

Investment managers are, of course, well aware of these costs and, accordingly, demand compensation from the market timers.

In exchange for the ability to move $25 million rapidly in and out of a particular fund, for instance, a market timer might offer to leave untouched $50 million of “sticky” assets in a different fund in the advisor’s complex. Such an arrangement, of course, pits the interests of the shareholders of the timed fund against those of the shareholders in the fund with sticky assets.45

If we assume that an allegation of market-timing fraud is true, then the investment advisor has masterminded an intricate deception against two different groups of investors simultaneously: the long-term purchasers of shares in the advisor’s mutual funds who are vulnerable to market timing, as well as the holders of equity in the advisor itself. This second population of investors defrauded by the scheme—which would include the plaintiffs in Janus—comprises the advisor’s equity holders who invest in the advisor in reliance upon public assurances that the advisor disallows market timing in the funds that it manages and from whom the advisor generates its primary profits. When allegations of advisors’ complicity in market timing came to light in 2003, those investors suffered the greatest collapse in their investments as stock prices in advisors such as Janus plummeted by more than 20% in just a few weeks.46

43. Birdthistle, supra note 37, at 1455.
44. See id. at 1455–56 (outlining these steps managers must take).
45. Id. at 1456.
For certain theoretical objections, the precise nature of the underlying fraud alleged might be of little relevance to the Court’s analysis in *Janus*, but the far-reaching mechanics of market timing reveal the central role that investment advisors play in both operating mutual funds and engineering this particular violation of section 10(b) of the Securities Exchange Act of 1934 (Exchange Act). To accommodate institutional market timers, an investment advisor needs—and indeed arrogates for itself—control over all aspects of mutual fund operations: the advisor advertises its funds to new purchasers through an affiliated distributor (which is the fund equivalent of an underwriter); the advisor determines the policies that govern those funds and publicizes them in fund prospectuses that its attorneys write and publicly file; the advisor monitors trading activity in the shares of its funds through an affiliated transfer agent or administrator responsible for back-office infrastructure; and the advisor negotiates special arrangements for favored clients such as hedge funds who engage in the actual market timing.\(^{47}\) In sum, to engineer a practice of market timing, an investment advisor must coordinate all major aspects and operations of a mutual fund.

Securities and Exchange Commission Rule 10b-5 prohibits “mak[ing] any untrue statement of material fact” in connection with the purchase or sale of securities.\(^{48}\) The petitioners in *Janus* sought a novel exception from liability under section 10(b) of the Exchange Act for investment managers who manipulate or deceive their shareholders.\(^{49}\) So long as those advisors conduct their activities through a distinct business trust, petitioners contended, such defendants ought to be impervious to lawsuits brought by shareholders. To succeed upon this theory—and thereby to immunize fund advisors—the *Janus* petitioners had to persuade the Supreme Court to accept two dubious contentions: (1) lifeless funds created and controlled by advisors enjoy meaningful independent existence; and (2) advisors are simply minions of those funds. In each case, the opposite is far closer to the truth. But, in *Janus*, the Court did indeed adopt those two arguments as premises for its ruling.\(^{50}\)

*Janus* argued—and the Court agreed—that investment advisors should not be liable for any such violations of section 10(b).\(^{51}\) One of the most troubling and perverse consequences of this ruling is that the investors can now never recover, even though no one disputes that they were defrauded. *Janus* persuaded the district court at trial that the plaintiffs cannot recover from the funds, because those entities are empty shells with “no assets separate and apart from those they hold for shareholders”;\(^{52}\) nor can they recover from the advisors, as *Janus* insisted successfully before the Supreme Court,\(^{53}\) because any false and misleading statements were made solely by the funds, which *Janus* insisted are autonomous entities.


\(^{48}\) 17 C.F.R. § 240.10b-5 (2010).


\(^{50}\) Janus Capital Grp., Inc. v. First Derivative Traders, 131 S. Ct. 2296, 2304–05 (2011).

\(^{51}\) Id. at 2299.

\(^{52}\) In re Mut. Funds Inv. Litig., 384 F. Supp. 2d 845, 853 n.3 (D. Md. 2005).

\(^{53}\) Brief for Petitioner at 9, Janus Capital Grp., Inc. v. First Derivative Traders, 131 S. Ct. 2296 (2011) (No. 09-525), 2010 WL 3501188.
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The scope of this heads-I-win-tails-you-lose theory may, in the immediate aftermath of Janus, apply only to the unique structure of mutual funds, but the Court’s endorsement may well furnish a blueprint for more widespread impunity from securities violations.\(^5^4\) A corporation that publicly claims to police the quality of its products while soliciting douceurs that jeopardize that quality—as may occur with market timing, tainted medication, or faulty tires—has received a tutorial on how to evade legal liability. Following the Janus example, such corporations would need only to replicate the structure of mutual funds by forming “another,”\(^5^5\) “different,”\(^5^6\) and judgment-proof entity to furnish—via contract rather than internal employment—all management functions externally.\(^5^7\) Indeed, dozens of defendants in federal cases have already invoked Janus to immunize their alleged wrongdoings, and the courts have largely been receptive.\(^5^8\)

The Supreme Court could have avoided such a result while also maintaining doctrinal consistency, by instead applying the principles of duty and proximity set forth in prominent and recent decisions such as Stoneridge Investment Partners, LLC v. Scientific–Atlanta, Inc.\(^5^9\) The vital holding of Stoneridge was that liability turns on concrete connections between the defendants, the plaintiffs, and the fraud—such as those between investment advisors, their shareholders, and market timing—not upon stage-managed formalisms.\(^6^0\) The justices therefore have a more finely tuned and arguably more sophisticated analytical instrument in their toolbox than the categorical formalism of the majority’s opinion in Janus would suggest.

1. Control

The federal judicial, legislative, and executive branches have each recognized that managers exert an extraordinary degree of control over their funds. This dominance

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54. Senator Patrick Leahy characterized the decision as giving corporations a “license to lie” and a “roadmap for fraud.” See, e.g., Simon Lazarus, Hertz or Avis? Progressives’ Quest to Reclaim the Constitution and the Courts, 72 OHIO ST. L.J. 1201, 1217 (2011) (citing Barriers to Justice and Accountability: How the Supreme Court’s Recent Rulings Will Affect Corporate Behavior: Hearing Before the S. Comm. on the Judiciary, 112th Cong. 1 (2011) [hereinafter Hearing on Corporate Behavior] (statement of Sen. Patrick Leahy, Chairman, S. Comm. on the Judiciary)).

55. Hearing on Corporate Behavior, supra note 54, at 8.

56. Id. at 9.


58. See, e.g., Reese v. BP Exploration (Alaska) Inc., 643 F.3d 681, 694 (9th Cir. 2011) (“The insufficiency of [plaintiff’s] pleadings is reinforced by the Supreme Court’s recent opinion in Janus . . . which sets the pleading bar even higher in private securities fraud actions seeking to hold defendants primarily liable for the misstatements of others.”); In re Coinstar Inc. Sec. Litig., 2011 WL 4712206, at *10 (W.D. Wash. Oct. 6, 2011) (“While the Supreme Court in Janus considered whether a business entity could be held liable for a prospectus issued by a separate entity, its analysis applies equally to whether Kaplan, Rench, and Smith may be held liable for the misstatements of their co-defendants.”).

59. See Stoneridge Inv. Partners, LLC v. Scientific–Atlanta, Inc., 552 U.S. 148, 152 (2008) (explaining that in order to be liable under section 10(b) there must have been a duty to disclose, and if this duty is breached, the plaintiff-investor must show a detrimental reliance).

60. Id.
stands in marked contrast to the arm’s-length relationship of business arrangements in other segments of the economy and, of course, to the characterization by Janus in this case of managers as merely distant and subservient third parties.

The Supreme Court addressed the topic of mutual funds just one year before Janus in Jones v. Harris Associates L.P. 61 when it noted that it is “typical” for a fund manager to “create[] the mutual fund,” “select[] the fund’s directors, manage[] the fund’s investments, and provide[] other services.” In its previous rulings concerning mutual funds, the Court also remarked on the unusual proximity of managers to their funds. 62 Also, in perhaps the most well-known federal decision on mutual funds, the Second Circuit noted that Congress “recognized . . . the potentially incestuous relationships between many advisors and their funds.”63

The congressional recognition to which the Second Circuit referred exists in a United States Senate Report accompanying the passage of the Investment Company Amendments Act of 1970. 64 The report noted “the unique structure of this industry” in which funds are typically “formed, sold, and managed by external organizations, that are separately owned and operated”; that managers “select the funds’ investments and operate their businesses,” and provide “almost all management services”; and therefore, “a mutual fund cannot, as a practical matter sever its relationship with the advisor.”65

In the executive branch, the Securities and Exchange Commission has on several occasions reiterated the domination of funds by their advisors. For instance, the SEC stated that “the term ‘investment advisor’ is to some extent a misnomer” because “[t]he so-called ‘advisor’ is no mere consultant. He is the fund’s manager. Hence the investment advisor almost always controls the fund.”66

Indeed, even the advisors’ own trade association, the Investment Company Institute, has in Supreme Court pleadings acknowledged the extensive degree to which managers run their funds, prepare fund prospectuses, and incur consequent liability: “Mutual fund advisors . . . prepare prospectuses, shareholder reports and other disclosures for which they have liability under the securities laws.”67 The advisor in the Janus litigation nevertheless insisted that investment advisors are, as a categorical matter, only “secondary actors” and that any of their alleged malfeasance was therefore too attenuated to trigger legal liability.68 Having begged the central question of the dispute in this case by labeling themselves taxonomically too remote to be held liable, Janus then concluded at each step in their fraud-on-the-market analysis that they were in fact too remote to be held liable.

Yet, as evidence of their self-asserted inviolable status, Janus proffered an array of

68. Brief for Petitioner, supra note 53, at 15–21.
formalities, which the Court ultimately and surprisingly chose to adopt. Central to this argument is the contention that investment managers are merely subaltern “service providers” orbiting funds at great distance, tethered only by the flimsiest thread of contract. Very much to the contrary, investment managers are prime movers who reign from the center of the mutual fund universe. In the beginning, managers create, incubate, and hold their funds as wholly owned subsidiaries.69 During this genesis, when the advisor is the sole shareholder and investor in a fund, the advisor and the fund enter into the advisory agreement—which the Court relied upon as evidence of independence—whose two signatories are both under the control of a single entity: the advisor.70

2. To “Make” a Statement

One of the more interesting aspects of the majority and dissenting opinions in Janus was their dispute over the definition of “to make,”71 which was central to their interpretation of Rule 10b-5’s prohibition against the making of any material misstatement or omission.72 Indeed, one wit compared the Court to the Council of Nicaea and the arguments to the Arian controversy in fourth century Christianity.73

The Fourth Circuit, whose decision was appealed to the Supreme Court in this case, concluded that Janus made the alleged misstatements and that plaintiff-shareholders relied to their detriment upon those statements because of the dominant role of investment managers.74 In both Stoneridge and Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.,75 the Supreme Court chose not to confine section 10(b) liability to the entity to which a public misrepresentation is expressly attributed.76 To issue such a categorical rule would have been to invite game playing in categorization, the majority reasoned, whereby perpetrators could escape liability merely by interposing separate but subservient entities between themselves and their fraud.77 The facts of Janus turned out to be an illustration of the very circumstances understood but unruled upon in Stoneridge, in which one entity could so dominate another that it ought to be recognized to have made the relevant misrepresentations and therefore to be held liable as a primary violator.78

The industry practice in mutual funds supports the contention that the fund advisor “wrote and represented its policy against market timers”,79 that it “publicly issu[ed] false
and misleading statements” concerning that policy,\textsuperscript{80} and that petitioners “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 [petitioners] would implement measures to curb market timing in the Janus Funds.”\textsuperscript{81} Based upon this analysis, the Fourth Circuit concluded that “[t]hese statements, taken together, allege that [Janus], by participating in the writing and dissemination of the prospectuses, \textit{made} the misleading statements contained in the documents.”\textsuperscript{82}

Indeed, investment managers of mutual funds satisfy each of the \textit{Stoneridge} criteria that mere aiders and abettors or other secondary actors cannot.\textsuperscript{83} First, investment managers clearly owe a duty to disclose their true management policies to their own shareholders, whereas Scientific–Atlanta and Motorola owed nothing of the kind to the plaintiff–shareholders of Charter Communications.\textsuperscript{84} Second, managers play a central role in preparing and disseminating public disclosures for their funds, whereas the defendants in \textit{Stoneridge} had no involvement with Charter’s financial statements.\textsuperscript{85} Third, fraud of the sort alleged in this case centers upon “the realm of financing business,” and thereby triggers the strictures of section 10(b) for any perpetrators, unlike the dealings in \textit{Stoneridge}, which occurred only within the “realm of ordinary business operations.”\textsuperscript{86}

The trial record amply demonstrated that Janus effectively merged the existence of the funds into their own: regarding control of “business affairs,”\textsuperscript{87} officers (all seventeen officers of the Janus funds were Janus Capital Management Vice Presidents),\textsuperscript{88} office space (provided by Janus Capital Management),\textsuperscript{89} business address (shared by the funds, Janus Capital Management, and Janus Capital Group),\textsuperscript{90} and even signature (the prospectuses were signed simply by “Janus”).\textsuperscript{91}

With the Supreme Court concluding that the investment advisor does not make the statements, misleading or otherwise, published in a fund prospectus, one is left to wonder who does. To answer that the fund makes such statements is to admit circuitously that the advisor does so, inasmuch as the fund has no employees and its only officers are

\begin{flushleft}
\textsuperscript{80} Id. at *111a.
\textsuperscript{81} Id. at *63a.
\textsuperscript{82} \textit{In re Mut. Funds Inv. Litig.}, 566 F.3d 111, 121 (4th Cir. 2009), rev’d, 131 S. Ct. 2296, 180 L. Ed. 2d 166 (2011) (emphasis in the original).
\textsuperscript{85} Id. at 160–61.
\textsuperscript{86} Id. at 161.
\textsuperscript{87} Appendix at *143a, Janus Capital Grp., Inc. v. First Derivative Traders, 131 S. Ct. 2296, 2302 (2011) (No. 09-525), 2010 WL 3501716.
\textsuperscript{88} Id. at *23a–24a.
\textsuperscript{89} Id. at *143a.
\textsuperscript{90} Id. at *165a.
\textsuperscript{91} Id. at *42a.
\end{flushleft}
employees of the manager, who pays their salaries. To answer instead that the Janus fund’s board of trustees makes such statements is to misunderstand fundamentally the process by which hundreds of pages of mandatory disclosure are created for each fund every year, a production from which trustees are almost entirely absent. In fact, the detailed and extensive content of fund disclosure is furnished almost exclusively by the only entity who knows that information: the investment advisor actually operating the fund. For all the inquiry into circumstances and definitions, Janus itself answered the central question in this case: Janus Capital Management admitted in an interrogatory asking who drafted the prospectuses that it was its own in-house attorneys, “Kelley Howes, Bonnie Howe, and other members of JCM’s legal department,” who drafted the prospectuses.

In a particularly inapt analogy, the Court adopted the petitioners’ argument that the giver of a speech, not the speechwriters, “makes” a speech. No one familiar with the operation of this industry would ever confuse a mutual fund for the giver of a speech. In such a comparison, funds are far more akin to the microphone and speakers: necessary instrumentalities that insentiently broadcast the principal’s message. The investment manager, of course, is always the principal, writing and broadcasting the communications of its funds. And courts have long since ceased to find inanimate objects guilty for the wrongdoings of those who wield them.

3. Attribution

Although the Court did not reach the issue of reliance expressly, the 10b-5 doctrine in this area illustrates further the discord and disruption of the Janus ruling. Whereas Janus argued that putative plaintiffs cannot demonstrate reliance upon any misleading statements in a prospectus unless the prospectus “directly attributed” those statements to the manager, such a strict attribution rule would accord with neither the rationale of the fraud-on-the-market theory itself nor the Court’s rulings in Stoneridge and Basic Inc. v. Levinson. Indeed, such a rule would automatically eliminate the possibility of review for a vast universe of fraud and, in so doing, render the Stoneridge inquiry into remoteness and attenuation largely irrelevant. Without direct attribution, the courts would dispose of cases prior to any Stoneridge analysis, whereas with direct attribution, Stoneridge would almost necessarily be satisfied.

Consider the numerous cases in which a corporate executive, for instance, intentionally misleads a journalist or financial analyst, who in turn publishes highly

93. Appendix, supra note 87, at *507a.
96. Brief for Petitioner, supra note 53, at 11–12.
favorable reports without identifying the executive as a source.\textsuperscript{99} Even in the absence of direct attribution, the executive has nevertheless perpetrated a clear fraud on the market. Courts have reasonably responded to such cases by finding the executive liable, yet petitioners’ rule would overturn such decisions.\textsuperscript{100} A strict attribution rule would senselessly abort the sound analysis of \textit{Stoneridge} and needlessly replace realism with formalism. A better approach, and one more consistent with the Court’s approach in \textit{Stoneridge}, would instead inquire whether the executive engaged in a deceptive scheme and, if so, whether that deception was sufficiently proximate to the statements upon which investors relied.\textsuperscript{101}

On the \textit{Janus} facts, however, any notion of public attribution is readily satisfied. Investment advisors themselves strive consciously to form a public connection between themselves and their funds. When forming a new fund, the advisor typically selects a name that blazons the advisor’s brand upon the new fund by incorporating the advisor’s own name into the fund’s name. Hence, each of the putatively autonomous funds at issue in this dispute featured “Janus” in its name. Investment advisors take direct and voluntary measures to persuade the marketplace to attribute the performance of their funds to the operations of their managers.

The marketplace, in turn, reasonably does so. Sophisticated investors familiar with the structure and operation of mutual funds know that statements published by a mutual fund flow from the will of its advisor. Less sophisticated investors unaware of any separation between advisors and their funds are likely to assume that mutual fund shares are simply products purchased directly from the manager. In both cases, the acts of funds are widely attributed to their advisors. One wonders to whom else they could meaningfully be attributed. Indeed, were an investment advisor to make an exculpatory statement in a fund prospectus (rather than the incriminating one at issue in \textit{Janus}), one would fully expect the manager to argue that such statements sufficiently placed the manager’s own investors on salutary notice. Indeed, as an empirical matter, the marketplace demonstrated its widespread attribution of fund statements to investment managers: upon the public allegation of market timing in mutual funds, stock prices of the accused advisors fell rapidly, including more than 20% in Janus itself.\textsuperscript{102}

Had the Court endorsed Janus’s effort to substitute “express” for actual attribution in this analysis, then a critical element of proving section 10(b) liability would have fallen within the direct manipulation of perpetrators. As the government noted in its arguments to the Court in \textit{Janus}, to avoid liability, a violator would need only be discreet enough to avoid speaking aloud what the marketplace already knows.\textsuperscript{103} When the Court next evaluates its 10b-5 doctrine, it should refrain from creating a unique exemption from

\textsuperscript{99}. See id. at 2159 (identifying indirect methods of attribution that would avoid the strict attribution standard).

\textsuperscript{100}. See id. (citing Cooper v. Pickett, 137 F.3d 616, 624 (9th Cir. 1997); Freeland v. Iridium World Commc’ns, Ltd., 545 F. Supp. 2d 59, 74–76 (D.D.C. 2008)) (showing how executives can avoid liability under strict attribution).

\textsuperscript{101}. See Langevoort, supra note 98 (elaborating on how such an approach would operate).

\textsuperscript{102}. See, e.g., Atlas, supra note 46 (stating that Janus Capital lost over 20% of its value in a matter of weeks in 2003).

section 10(b) liability for investment managers or any future violators who are likely
to follow their example. Certainly, there are reasons for Congress and courts to be careful in
fashioning the scope of liability in securities class actions under section 10(b) of the
Exchange Act. Frank Easterbrook, Daniel Fischel, and many other commentators have
examined the problems of potential remedial overbreadth if shareholders are too readily
compensated in a system where securities fraud produces little, if any, net harm to
diversified investors.104

Yet even if accurate compensation did not entirely justify many securities class
action suits, effective deterrence does, and deterrence would be welcome in the mutual
fund advisory industry because of its recent track record. The past decade has seen
numerous revelations of fraud and other misconduct across many aspects of the mutual
fund advisory business beyond just market timing, such as late trading, unfair valuation,
and soft-dollar practices.105 When Congress limited the expansion of lawsuits with the
Private Securities Litigation Reform Act of 1995, Congress did not choose—then or
since—to eliminate section 10(b) liability altogether. The liability that remains applies
squarely to the investment advisors of mutual funds that perpetrate market-timing frauds.

III. IMPLICATIONS OF THE COURT’S RULING IN JANUS

The Supreme Court’s hostility to the implied private right of action under Rule 10b-
5 is well known, and its last three rulings in this field—Central Bank, Stoneridge, and
now Janus—each attempt to restrict that right without explicitly eliminating it and
thereby overruling the weighty precedent of Basic.106 Nevertheless, the Janus ruling does
more than merely narrow the scope of the right—it damages the very structure of private
deterrence of wrongdoing in the financial markets.

First, the decision appears to strain itself to find a way to immunize clear
perpetrators from accountability. One of the most troubling aspects of the Janus ruling is
that, even if one is willing to grant credence to the notion that the fund is endowed with
certain independence through its board of trustees, only the investment advisor is in a
position to run the business in accordance with—or in violation of—its prospectus. On
the facts of Janus, Janus drafted a prospectus that permitted no market timing, and then
Janus agreed to permit market timing.107 Even if the board of trustees had furnished
oversight, which is a dubious proposition in an industry with famously weak board

104. See Frank H. Easterbrook & Daniel R. Fischel, Optimal Damages in Securities Cases, 52 U. CHI. L.
REV. 611, 638–41 (1985) (considering aftermarket effects and potential remedies in securities cases); cf. Paul G.
(noting that Easterbrook and Fischel do not address the deterrent effect of social cost, such as where issuers are
forced to pay damages that are less than their net gains).

105. See, e.g., Josh Friedman, FleetBoston, B of A to Pay $675 Million, L.A. TIMES, Mar. 16, 2004, at C1;
Tom Lauricella, Alliance Offers Annual-Fee Cut as Part of Proposed Settlement, WALL ST. J., Dec. 16, 2003, at

106. Professor James Cox invokes this trilogy of cases as authority for the “truism” that “corporations pay
and individual wrongdoers get a pass.” James D. Cox, Securities Class Actions as Public Law, 160 U. PA. L.
U. PA. L. REV. 69 (2011)).

monitoring, nobody connected with the litigation made—or could seriously make—an argument that the board provided any managerial functions to the funds. The ruling thus turns a blind eye to “agency capitalism”\textsuperscript{108}—that is, the willingness of agents and intermediaries to satisfy their own interests at the expense of their principals—at a time when ever more investors are coming to rely upon these intermediaries for their financial well-being. Indeed, in the diverse array of things that went wrong during the recent financial crisis, one disturbing commonality in the poor performance of hedge funds, ratings agencies, money market funds, and beyond was precisely this willingness of gatekeepers to abdicate their duties to fiduciaries and others in favor of advancing their own immediate pecuniary interests. Surely, in the wake of such financial peril, the Supreme Court ought not provide immunity for such behavior.

Second, the formalistic nature of the ruling—both in its narrow-minded line drawing and its willful disregard of the functional realities of investments funds—would appear to encourage opportunistic game playing in the future. Surely, business firms will look at this decision, note well the very favorable immunity that investment funds have just won from the highest court in the land, and explore precisely how they might restructure their own affairs to enjoy the same effects.\textsuperscript{109} If Exxon Corporation, for example, created an external management firm, shifted all current Exxon assets to a newly formed shell company, and then provided all executive management of the business via contract between those two entities, then could it not also limit its exposure to securities suits by citing \textit{Janus}? If so, then the ruling would be an effective overruling of \textit{Basic} and a judicial invalidation of the Private Securities Litigation Reform Act. Indeed, in just the first handful of weeks and months following the \textit{Janus} ruling, the lower federal courts have already featured executives accused of malfeasance attempting to raise a “\textit{Janus}” defense pursuant to which they plead that it was their corporations, not themselves, who made the allegedly fraudulent statements in dispute.\textsuperscript{110}

Third, the ruling is not likely to bring with it the boon of clarity that is often the consoling virtue of highly formalistic, if somewhat inequitable, rulings. As Donald Langevoort has noted, several situations already exist in which courts find parties who do not have “ultimate authority” guilty for their wrongdoings: if an accountant admits to having provided false financial statements for a corporation, for instance, or an executive plants a false story about a corporation’s prospects to a news reporter, almost all courts have found—and are likely to continue to find—such a defendant guilty of a Rule 10b-5 violation.\textsuperscript{111}

\textsuperscript{108} See Gordon, supra note 28 (stating that the \textit{Janus} decision “exacerbates the problem of ‘agency capitalism’”).

\textsuperscript{109} Interestingly, this ruling may not be easy to characterize as merely a “pro-business” ruling by the Roberts court. Donald Langevoort has pointed out that other securities cases in the same term did not result in pro-business rulings. See Donald C. Langevoort, \textit{Lies Without Liars? Janus Capital and Conservative Securities Jurisprudence} 1 (Georgetown Pub. Law and Legal Theory Research, Paper No. 12-019, 2012), available at http://ssrn.com/abstract=2010745. Indeed, Erwin Chemerinsky has argued that \textit{Janus} is an example not so much of a pro-business ruling, but one of several in which the Supreme Court has evinced distrust of district courts. Erwin Chemerinsky, \textit{Closing the Courthouse Doors}, 14 \textit{GREEN BAG} 2d 375, 389 n.35 (2011); see also A.C. Pritchard, \textit{Securities Law in the Roberts Court: Agenda or Indifference?}, 37 J. CORP. L. 105, 135–39 (2011) (exploring the \textit{Janus} opinion in contrast with other securities cases under the Roberts court).


\textsuperscript{111} See Langevoort, supra note 109, at 1 (discussing the formalistic application of the \textit{Janus} “ultimate
In addition, the formalism for which corporate law may be well noted is often permitted in circumstances quite unlike the facts of Janus. The typical formalism found in corporate law appears, for instance, when it is statutorily authorized (as in the de facto merger doctrine not applicable to the Janus facts) or restricted when fraud is involved (as in veil piercing and in Janus), so the Court’s recent embrace of formalism does not fit well within the existing corporate canon.

IV. The Court’s Theory of the Fund

Beyond the specific contours of the Janus ruling, the decision in Jones v. Harris sheds additional light upon the assumptions regarding the theoretical operations of investment funds that the Supreme Court appears to be making in this body of jurisprudence. In several instances at oral arguments and in their written opinions, the justices appear to assume that mutual funds operate within the same structure of competitive forces as conventional business firms. In doing so, they do not consider that the efficient operation of those firms is premised in theory upon several dynamics that are inapplicable to investment funds.

For instance, one of the arguments advanced by contractual theories of the firm in opposition to their managerial counterparts is that managerial power is checked in a firm by multiple independent layers of competing market forces: the markets for corporate control, for labor, and for products. Those forces are notably absent in investment funds. Investment funds also require shareholders to monitor both the underlying portfolio investments as well as the behavior of their paid intermediary. In addition, unlike typical firm shareholders, many of today’s investors in funds have not become investors voluntarily, but instead have experienced an involuntary conversion as a result of the elimination of their defined benefit plan.

A. Problems with the Court’s Theory of the Fund

The Supreme Court appears to be applying a conventional account of effective corporate governance in non-fund entities—such as regular C corporations—to the highly distinct milieu of investment funds. That standard account usually identifies and approves of the interlocking effects of a variety of self-supporting dynamics. More specifically, the discipline of short selling, incentive stock options, sophisticated shareholders, efficient capital markets, and a market for corporate control, among other forces, are thought to provide a positive reduction of agency costs upon corporate managers by forcing them to maximize returns to their shareholders. What the Supreme Court does not appear to consider thoughtfully, however, is the idea that such phenomena are largely absent in the setting of investment funds and therefore the relevance of such a theoretical

authority” test).

112. Note, also, that although the formality of the corporate form is often upheld against petitions for veil piercing, a common justification for that formalism is that other regimes—such as mandatory insurance—exist to protect victims. No such regime exists under the facts of Janus.

113. Langevoort, supra note 26, at 1030–32, 1037.


115. See id.
framework is substantially reduced. In a particularly trenchant observation, Donald Langevoort has noted that several of the most powerful of these devices are absent or impotent in the idiosyncratic arrangement of investment funds:

Because mutual funds are not traded in an organized market, arbitrage opportunities cannot work to keep prices in line with rational expectations. Mutual fund prices are simply the product of net asset value at the time of purchase or redemption. Insider compensation is largely based on assets as well, which creates the conflict rather than aligns insider–shareholder interests, and directors are typically paid all or mostly in cash. Institutional shareholder voice does not exist in the fund area, and there is no external market for corporate control at all because shareholders can only sell their shares back to the fund.116

Langevoort thus arrives at the conclusion that any judicial attempts to rely unthinkingly upon generic theories of corporate governance when considering the wholly different nature of investment funds are highly problematic. "Thinking about mutual funds by imagining them simply as a species of ‘corporations’ in a way that is directly informed by contemporary corporate law theory is completely misguided," he argues.117

Inasmuch as so many of the conventional menu of governance protections are missing, the only device that does remain to provide any sort of assistance to the governance of investment funds is the possibility of shareholder redemption.118 Again, the standard corporate governance account posits that fund sponsors will be reined in from governing their investment funds poorly (by extracting rents from their shareholders, for example) because fund shareholders will punish such poor management by exiting the fund through redemption of their shares or choosing not to invest in such funds in the first place. This analysis, however, does not sufficiently countenance the fact that investor exit is not just one of the only protections in mutual funds, but that in mutual funds this protection is unusually weak and thus does not work as well as it might in the usual setting for operating companies.

In a typical corporation (not an investment fund), sophisticated investors provide all manner of ancillary, fall-out benefits to less sophisticated investors. Only wealthy and powerful shareholders, for instance, have the capacity to launch proxy contests or other competitions for corporate control, to engage in share price arbitrage via short-selling or other financial strategies, or to launch expensive and time-consuming tender offers. These tactics will benefit not only the shareholder who engages in them but also the smaller, passive investors who also happen to hold those shares. With respect to the

116.  Langevoort, supra note 26, at 1031–32.
117.  Id.
118.  The array of effective mechanisms that Jonathan Macey catalogs also includes initial public offerings as a governance measure. See MACEY, supra note 114, at 127–29 (explaining the functionality and value of initial public offerings). In the corporate context, IPOs may indeed involve “rigorous monitoring by a cadre of lawyers, investment bankers, and financial analysts, all of whom face reputational and legal risks for failure to do an adequate job of protecting investors.” Id. at 127. In mutual funds, however, the public offering process is very different, as it is overseen primarily by the adviser and its affiliated distributor and is not shepherded by investment banks. See ICI FACT BOOK, supra note 8, at 195. Nor are the funds rated by financial analysts in the same manner as equity offerings.
possibility of simply selling the investment to exit the company, however, the actions of a sophisticated investor do not necessarily benefit the passivity of an unsophisticated investor, unless a corporation is represented by a mixture of both sorts of investors amongst its shareholders. If, indeed, the corporation in question does have a shareholder base comprising both sophisticated and unsophisticated investors, then the corporation’s managers must always attempt to manage the enterprise in a way that will benefit the most difficult to please. If such a dynamic were true in investment funds, for instance, the fund sponsors would be obliged to run their funds in such a way as to keep their largest institutional investors happy and invested in the fund, which would provide benefits simultaneously to smaller and weaker investors.

Yet studies repeatedly show that in the investment fund industry, fund sponsors work hard to segregate sophisticated and unsophisticated investors from one another such that funds rarely have a heterogeneous mix of the two. Instead, fund sponsors provide different investment products for those different kinds of investors and then separate them from one another. Typically, the sophisticated investors demand and receive distinct funds, which may be managed according to similar investment protocols but come with far lower prices and other terms. For less sophisticated investors in their own funds, the only way that exit will work as an effective corporate governance device is if those less sophisticated investors take action directly on their own behalf, in reliance upon the fund sponsor’s own disclosure. Yet evidence shows that less wealthy and less sophisticated investors simply do not possess the ability to digest that disclosure or to act upon it in an effective manner.

B. The Problems with Exit in Investment Funds

As so many of the Supreme Court’s assumed elements of corporate governance theory are inapposite to investment funds, shareholder exit remains as the only possibly viable one. When one considers how exit might—or might not—work in the context of funds, one must begin to consider the theoretical elements that are similar regarding corporate governance and markets for products.

Investors in mutual funds are more technically described as shareholders, which of course prompts an inquiry into the precise nature of the standard rights they enjoy as equity and residuary owners. Yet, unlike so many other equity shareholders, their sole mode of protection from deleterious anticompetitive tendencies in markets is their ability

119. See Birdthistle, supra note 37, at 1455 (discussing market timing); Langevoort, supra note 98, at 1034 (citing Mahoney, supra note 104, at 168–69) (positing a “suspicion that the market for mutual funds is indeed segmented into more and less sophisticated consumer groups, with funds (or even classes within the same fund) with different quality attributes appealing to different segments”).
120. See Birdthistle, supra note 37, at 1455.
121. See id.
122. See ICIFACT BOOK, supra note 8, at 184.
123. For a discussion of the weaknesses of informational intermediaries and conflicts of brokers in the mutual fund context, see Birdthistle, supra note 37. See also Jill E. Fisch, Fiduciary Duties and the Analyst Scandals, 58 ALA. L. REV. 1083, 1097–98 (2007) (discussing the conflicts of interests and questionable independence of mutual fund analysts).
124. See Langevoort, supra note 98, at 1036–40 (discussing hypotheses of product market competition ideologies).
to redeem their fund shares, which raises the broader question of how best to characterize such investors. Indeed, in the market for products, potential customers also are protected almost solely by their ability and willingness to buy or to sell a product—the fear that they will not buy or that they will sell provides some incentive for the producer of such products to perform its task well.

This debate found voice in *Jones v. Harris*, when several judges at different stages in the litigation bypassed the plaintiffs’ status as shareholders and instead reasoned that they were primarily the purchasers of products and should, accordingly, enjoy fewer legal protections. This curious rationale, however, rapidly eliminates many of the statutory provisions that Congress enacted precisely to safeguard the interests of those kinds of investors. Certain jurists, of course, might wonder why a mutual fund shareholder ought to enjoy greater protections from another market participant who is merely a consumer of products.

Of course, the most direct response is to point out that the structure of investment funds is largely the result of Congressional regulation via the Investment Company Act of 1940—thus, investors in investment funds are shareholders and not merely consumers because Congress has willed it so.125 Thus, unless and until Congress alters its legislation, courts are obliged to conduct their theoretical analyses of investment funds within the system of corporate governance, even if that model does not apply with satisfying relevance when contrasted with more conventional operating companies.

Certainly, as we have seen, the paradigm of governance in investment funds is remarkably weaker than that of conventional corporations, not simply because funds enjoy fewer devices that discipline fund managers, but also because the solitary device they do enjoy—shareholder exit—works far less well in the context of investment funds.

When one recalls that much of this past decade has witnessed the once-heralded mutual fund suffer from a regular series of investigations by prosecutors and lawsuits by investors, one finds a litany of how vulnerable funds find themselves across their array of operations: market timing, late trading, unfair valuation, 12b-1 fees, and so forth.126 As individuals find themselves beset with increasing responsibility for investing their own retirement assets as pensions give way to defined contribution plans throughout the public and private economies, there is no evidence that unsophisticated individuals have the ability or the willingness to allocate their investments wisely. Studies demonstrate repeatedly that large numbers of individuals do not enroll in their retirement plans,127 or that if they do, large percentages then fail to allocate those funds to anything beyond the standard cash investment.128 And even when investors do enroll and do invest, they appear to do so poorly, with little skill at the timing or risk of their investment decisions.


126. *See generally* Birdthistle, *supra* note 37 (explaining the participants and mechanisms involved in the mutual fund investment irregularities).


C. Other Theories of the Fund

Clearly the Supreme Court could enrich its fund jurisprudence by taking judicial notice of the important distinctions between firms and funds. Moreover, if the Court were to examine the managerial and neoclassical traditions of firm theory, in addition merely to its contractual predilection, the Court might be able to develop a more satisfying intellectual conception of the investment fund.

Not only would developing a better theory of the fund assist in the future resolution of litigation—which is surely destined to arrive as more public governments and state legislatures eliminate their pension plans in response to budgetary constraints—but it might also prove a useful tool for legislatures themselves, who may wish to address the subject either because of the broader economic growth of funds or because decisions such as Jones and Janus have explicitly punted the resolution of such issues back to lawmakers.

V. CONCLUSION

After a hiatus of almost a quarter-century, the Supreme Court has again considered the legal issues affecting investment funds, home to more than $12 trillion in U.S. savings. In two important rulings—Jones and Janus—in two consecutive Terms, the Court has misapplied conventional, neoclassical conceptions of the firm to the operations of funds. In so doing, the Court has produced unsatisfying and highly formalistic opinions that bear little resemblance to the functional realities of fund operations. Indeed, in Janus, Justice Thomas acknowledged the formalistic shortcomings of his ruling but simply identified Congress as the ultimate authority for ameliorating any unfortunate consequences of the ruling. Of course, as with any formalistic ruling that draws bright lines, the Janus ruling brings the possibility of great mischief if operating companies ever choose to emulate the structure of investment funds simply to enjoy similar immunities from Rule 10b-5 litigation. The Supreme Court must attempt to

132. MACEY, supra note 114.

Although First Derivative and its amici persuasively argue that investment advisers exercise significant influence over their client funds . . . it is undisputed that the corporate formalities were observed here. JCM and Janus Investment Fund remain legally separate entities, and Janus Investment Fund's board of trustees was more independent than the statute requires. 15 U.S.C. § 80a-10(f)(9). Any reapportionment of liability in the securities industry in light of the close relationship between investment advisers and mutual funds is properly the responsibility of Congress and not the courts.

Id.
develop a far richer, more nuanced theory of how funds operate and theoretical paradigm for their future governance. All signs suggest that massive new flows of retirement savings and former pension funds will soon be flowing into investment funds, which is sure to increase the flow of fund litigation throughout the federal courts. We must build a strong and sound intellectual foundation for these structures before that flow arrives and pours stress upon our defenses, not afterwards when the damage has already occurred.