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IN THE COURTS

Litigation Risks Remain for Private Equity Sponsors Even After *Janus*

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Two recent decisions out of the Southern District of New York have reintroduced uncertainty about what constitutes "primary" conduct under the federal securities laws, an area that the Supreme Court recently attempted to clarify in the *Janus Capital* case.[1] In *Janus*, the Supreme Court adopted a bright-line rule that one "makes" a statement for purposes of Section 10(b) when the statement is attributed to them or they have ultimate authority over the statement. In one recent Southern District decision involving a company called EnergySolutions, the court refused to dismiss Section 10(b) and other primary liability claims against the one-hundred percent shareholder of the company on the grounds that the complaint adequately alleged that the parent company exercised "ultimate control" over the portfolio company's registration and prospectus and hence could be liable as a primary actor.[2]

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In a subsequent Southern District decision involving the Madoff litigation, the court disagreed with the *EnergySolutions* reasoning, holding that under *Janus*, "shareholder control" could not be equated with "ultimate control" over the publication of disclosure documents.[3]

EnergySolutions treatment of *Janus* rests on an unconvincing and erroneous distinction of the Supreme Court's decision—and therefore is likely to have a limited impact and shelf-life. It would be a mistake, however, to conclude that private equity sponsors or venture capital investors face little or no potential liability under the federal securities laws when their portfolio companies issue stock to the general public. Both before and after *Janus*, the litigation risks to such investors are significant, primarily due to the potential for "control person" liability under both Section 20(a) of the Securities Exchange Act of 1934 (Exchange Act) and Section 15 of the Securities Act of 1933 (Securities Act). Although the potential for "control person" liability will exist regardless of *Janus* and case law on similar matters, there are a number of steps that sponsors and controlling shareholders can take to help mitigate the risk of liability.

Overview of Potential Causes of Action

As a threshold matter, in the context of public stock offerings, the federal securities laws provide a number of potential causes of action to shareholder plaintiffs.

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Potential Theories of Primary Liability

Section 11. Section 11 of the Securities Act makes an issuer strictly liable for any untrue statement of material fact in a registration statement. Directors of the issuer as well as every person who signs the registration statement, every expert (*e. g.*, an accountant) and every underwriter are also liable, though all persons other than the issuer have a so-called "due diligence" defense if they can establish that they had reasonable grounds for belief in the truth of the alleged misstatements or omissions. This "due diligence" defense, however, is not available at the motion to dismiss stage of litigation and ordinarily will only come into play after discovery is complete, at summary judgment or following a trial on the merits.

Section 12(a)(2). Section 12(a)(2) creates liability for any person who offers or sells a security through a prospectus or an oral communication containing a material misstatement or omission. A defendant who violates Section 12(a)(2) is liable to the purchaser for either rescission of the purchase or damages, provided that the purchaser did not know about the misstatement or omission at the time of the purchase. In some circumstances, such as in a secondary offering, a private equity sponsor itself or other upstream entity might be the actual seller and thereby potentially directly liable. In addition, some courts have held that those who take actions to promote the sale of the securities for their own financial gain (*e.g.*, participate in road shows, etc.) may fall within Section 12(a)(2)'s definition of a seller, even if there is no privity of contract.

Section 10(b). Section 10(b) of the Exchange Act is a catch-all anti-fraud provision which prohibits the use of manipulative or deceptive devices in any purchase or sale of securities. In general, a plaintiff must prove that a defendant: (1) made a false statement or omission of a material fact; (2) with scienter; (3) in connection with the purchase or sale of a security; (4) upon which the plaintiff justifiably relief; and which (5) proximately caused the plaintiff an economic loss. Section 10(b) applies to all transactions in securities.

Potential Theories of Secondary Liability

Section 15/Section 20(a). Section 15 of the Securities Act and Section 20(a) of the Exchange Act impose joint and several liability on controlling persons for violations of the securities laws by any person or entity they control, directly or indirectly. Because of its importance as a potential source of liability to private equity sponsors in portfolio company securities offerings, we discuss "control person" liability in greater detail below.

Section 20(b). Another little-noticed potential source of liability is Section 20(b) of the Exchange Act. Section 20(b) provides that "[i]t shall be unlawful for any person, directly or indirectly, to do any act or thing which it would be unlawful for such person to do under the provisions of this title or any rule or regulation thereunder through or by means of any other person." A critical difference between Section 20(b) and the control person provisions of Section 20(a) is that Section 20(b) does not appear to require a shareholder plaintiff to demonstrate "control" of the primary violator; rather, it only requires the defendant to have taken some "unlawful" action through another entity. In *Janus*, the Supreme Court expressly declined to address whether Section 20(b) gives rise to a private right of action, noting "[w]e do not address whether Congress created liability of entities that act through innocent intermediaries in [Section 20(b)]."[4] So far, no other court has held that Section 20(b) provides a private remedy, though given the Supreme Court's acknowledgement that the issue is at least unsettled, shareholder plaintiffs may try to bring such a claim in the future against third party actors.

Potential SEC/Government Enforcement Theories of Liability

Section 20(e)/Aiding and Abetting Liability. All of the theories discussed above can be brought directly by the SEC or other government entity. In addition, pursuant to Section 20(e) of the Exchange Act, the SEC has the power to bring actions against those who "provide[] substantial assistance to another person" in violation of the federal securities laws (*i.e.*, aid and abet primary violations).

Section 17(a). Another potential theory of liability available to the SEC—but probably not to private plaintiffs[5]—is Section 17(a) of the Securities Act, which makes it unlawful for any person to use any scheme or artifice to defraud in connection with an offering of securities, to obtain money or property by means of any untrue statement (or omission) of material fact in any offering of securities or to engage in any transaction, practice or course of business which operates or would operate as a fraud or deceit upon the purchaser. Section 17(a) operates very much like Section 10(b) of the Exchange Act, but applies only to offerings of securities and does not apply to aftermarket trading in securities or to purchases or sales that are exempt from registration under the Securities Act.

The *EnergySolutions* and *Optimal* Decisions

EnergySolutions, Inc. (ES) was formed by three investment companies to provide radioactive waste disposal services to nuclear power plants and other similar commercial facilities. The investment companies controlled ES through an upstream entity, ENV Holdings, Inc. (ENV), which was the sole stockholder of ES. In 2007 and 2008, ES undertook an initial public offering followed by a subsequent secondary offering. As a result of these two offerings, ENV sold approximately 80 percent of its shares of ES in return for roughly $1.2 billion. After the disclosure of certain negative business-related events, ES's stock declined some 60 percent. Predictably, a federal securities lawsuit followed.

The defendants moved to dismiss the shareholder plaintiffs' complaint. Notably, ENV moved to dismiss the Section 10(b) claim against it on the grounds that the Supreme Court's decision in *Janus* barred a Section 10(b) claim against all but ES. In *Janus*, the issue presented was whether the investment advisor and administrator of a mutual fund could be primarily liable for statements made in the mutual fund's investment prospectus.[6] Drawing a bright line rule, the Supreme Court held that the investment adviser—which was a separate legal entity from the registrant (the fund)—could not be held liable under Section 10(b) because the statements in the prospectus were not "attributed" to the adviser and were only made by the registrant (the fund). In so holding, the Court rejected the plaintiff's position that to "make" a statement should be synonymous with to "create" that statement.[7]

The district court in *EnergySolutions* denied the defendants' motion to dismiss. As to ENV, the district court upheld both the primary and secondary (control person) claims, reasoning that ENV could be held primary liable because ENV could be said to have "made" the statements in the registration statement because it was the sole owner of ES stock at the time of the IPO and was a selling stockholder in both offerings. In addition, the court pointed to a number of places in the registration statement where it was disclosed that the sponsors "controlled" ES, *e.g.*, by "control[ling] all matters requiring stockholder approval" and by having the ability to "cause the Company to issue additional shares of common stock." The court found that these statements and circumstances created "significant differences" between the plaintiffs' claims against ENV and those rejected by the Supreme Court in *Janus*.

On close examination, however, the *EnergySolutions* court's treatment of *Janus*and its effect on the claims against ENV is unconvincing. The *EnergySolutions* decision effectively disregards the corporate distinction between a sponsor/holding company and a wholly-owned subsidiary. The result is that the portfolio company—the actual registrant and issuer filing the documents with the SEC—is treated as merely a conduit of ENV and, by extension, ultimately the sponsor. This is inconsistent with *Janus*, which clearly equated "ultimate control" with the actual dissemination of the securities filings and the express attribution of statements to particular persons.

Moreover, the *EnergySolutions* decision rests upon vague assertions of general "control"—especially stock ownership and the ability to control in the future. It ignores whether there were any allegations of control with respect to the specific challenged disclosed. Indeed, the district court's truncated finding of "control" would render entirely superfluous the requirements in Section 15 of the Securities Act and Section 20(a) of the Exchange Act for finding control. In particular, in the Second Circuit, with respect to Section 20(a), proof of "culpable participation" in the fraud is required. By transforming conduct that is most clearly covered by Section 20(a) into primary conduct under Section 10(b), the court's ruling discards these pre-requisites altogether and creates what is effectively "control person" liability without a plaintiff having to plead or prove the elements of control person liability.[8]

Aside from *Janus*, the *EnergySolutions* decision is also inconsistent with recent Second Circuit precedent in this area. In the *Refco* case, the Second Circuit—presaging the rule adopted in *Janus*— held that one who merely participates in or even approves a statement is not a primary actor.[9] Rather, "[t]o be cognizable, a plaintiff's claim against a secondary actor must be based on that actor's own 'articulated statement,' or on statements made by another that have been *explicitly* adopted by the secondary actor." The district court's decision here is in tension with that holding as well: ENV was undoubtedly involved in the transaction, and the public may well have understood that it played a significant role behind the scenes; *but*, ENV never articulated any statement or explicitly adopted the statements of ES.

Indeed, in a decision issued just weeks after *EnergySolutions*, another judge in the Southern District of New York interpreted *Janus* very differently, and we believe, correctly.[10] That case involved misleading statements made by Optimal Multiadvisors in a prospectus for the Optimal Strategic U.S. Equity Fund, which invested one-hundred percent of its assets with Madoff Securities. Optimal was one-hundred percent owned by Optimal Investment Management Services (OIS), a subsidiary of Banco Santander. The complaint sought to hold OIS liable for primary fraudulent conduct in connection with the allegedly misleading prospectus because OIS had "ultimate control" of Multiadvisors. The "ultimate control," according the complaint, derived for OIS's one hundred percent ownership, its ability to appoint and remove Multiadvisor directors at will, and the service of the OIS CEO on the board of Multiadvisors.

Judge Scheindlin rejected plaintiffs' attempt "to avoid *Janus* by conflating shareholder control with 'ultimate authority.'"[11] She held that Janus stood for the proposition that "a statement is 'made' not by the entity that drafted it—here OIS—but rather by the entity that delivers it—here Multiadvisors."[12] Thus, according to the *Optimal* court, notwithstanding that OIS had the authority to select the board of Multiadvisors, it was still the board of Multiadvisors—which, the court was quick to note, was statutorily entrusted to "manage[] the business and affairs" of Multiadvisors—that had the "ultimate authority" to publish the statement.[13] The court also noted that it was reluctant to expand Rule 10b-5 liability "where Congress already imposed liability under other statutory provisions, such as those found in section 20."[14] Accordingly, the court found no primary conduct that could form the basis of a Section 10(b) claim against OIS. Nevertheless, the court went on to deny the motion to dismiss the Section 20(a) "control person" claim against OIS, holding that the complaint adequately pleaded facts necessary to state a prima facie case.

Although largely for the reasons stated by the *Optimal* court, it would appear that *Energy Solutions* was wrongly decided, the likelihood of reversal in that particular case is not high because a ruling denying a motion to dismiss is not appealable as a matter of right. The only way that ENV could take an immediate appeal from the district court's denial of its motion to dismiss is to seek an interlocutory appeal under 28 U.S.C. § 1292(b).[15] The defendants in *EnergySolutions* do not appear to have sought such an interim appeal. And while the Optimal court did grant the motion to dismiss, it did so only in part, including denying the motion to dismiss the Section 20(a) claims against OIS. Even in that case, then, there is no final judgment from which an appeal could be taken.[16] Accordingly, while the Second Circuit may eventually be forced to decide between these differing interpretations of Janus, that resolution is unlikely to come soon.

Control Person Liability

Even if *EnergySolutions* is ultimately discredited, it serves as an important reminder of the potential litigation risks posed to private equity sponsors in connection with public stock offerings by their portfolio companies. Chief among these risks in the civil litigation arena is the potential for "control person" liability. Section 20(a) of the Exchange Act makes those who "control" primary violators of the

Exchange Act jointly and severally liable. Likewise, Section 15 of the Securities Act creates control person liability where the controlled entity violated Sections 11 and 12 of the Securities Act.

The elements of "control person" liability are, at least, (1) an underlying violation; and (2) "control." Control is defined very broadly under the Securities Act and Exchange Act as the direct or indirect "power to direct or cause the direction of the management and policies of [the primary violators], whether through the ownership of voting securities, by contract, or otherwise."[17] Some circuits also require that a plaintiff plead and prove the controlling entity's "culpable participation" in the underlying fraud.[18] In contrast, other circuits merely require pleading that the controlling entity had the *general* power to control the downstream entity and the *potential* to control the actual transaction at issue, even if they did not exercise any actual control specifically with respect to that transaction (the so-called "potential control" test).[19]

In practice, if a primary violation is adequately pled, it will be difficult, if not impossible, for a private equity sponsor (particularly, a majority-owning private equity sponsor) to have a control person claim dismissed outright, thus likely subjecting the sponsor to the costs, burdens and risks of significant discovery. The potential reach of "control person liability" is exemplified by the *America West Holding Company* case out of the Ninth Circuit.[20] In *America West*, the court was faced with allegations that America West made misleading statements to artificially inflate the value of its stock and that America West's private equity owner, and Continental Airlines,—as a group—"controlled" America West and were jointly and severally liable along with America West. The Ninth Circuit found the following "indicia of control" sufficient to survive a motion to dismiss: (1) the private equity sponsor and Continental had a shareholder relationship with America West, which began in 1994; (2) the private equity sponsor and Continental were the largest stockholders of America West, together controlling approximately 57.4 percent of the total voting power; and (3) the private equity sponsor and Continental had the power to elect the majority of the members of America West's board.[21]

Best Practices for Private Equity Sponsors in Public Stock Offerings

While one reaction private equity sponsors and venture capital investors might have to *EnergySolutions* is to migrate to a more a hands-off approach, we think that would be a mistake. For one thing, it probably would not do much to protect private equity sponsors or other upstream entities from being named as "control" persons—particularly where the private equity sponsor has a majority of the votes at the portfolio company structure.[22] Indeed, in courts where "culpable participation" is not required to be pleaded, the mere *potential* of control may suffice to impose liability, subject of course to any defenses the upstream firm might have.[23] And even in courts where "culpable participation" is a required element, given the relatively liberal pleading rules, it may not be a high bar for plaintiffs to overcome at the motion to dismiss stage.[24]

Secondly, leaving aside civil liability to shareholder plaintiffs, securities regulators may well also become interested in any offering that leads to shareholder litigation. A "head-in-the-sand" approach to defending private plaintiff shareholder litigation would almost certainly underwhelm a securities regulator and thereby increase the costs, burdens, and risks of responding to a enforcement investigation arising out of a problematic portfolio company securities offering.

In light of the potential risks posed by public stock offerings, there are a number of steps private equity firms might take to help mitigate litigation risk in such situations.

1. "*The Best Defense is a Good Offense.*" Not surprisingly, the best way to prevent liability is to avoid the disclosure problem at the outset. The most effective way to do this is with carefully crafted, thoughtful disclosure. Deal professionals within the private equity sponsor or venture capital investor often have insightful views and deep perspective on the business, but sponsors, in our experience at least, take varying approaches to the leveling their involvement in the disclosure documents relating to a portfolio company's offering. Some sponsors are intimately involved in the process while others allow the process to be almost entirely directed at the portfolio company level, with minimal oversight by the deal professionals or the sponsor's in-house or outside legal advisors. Such a "hands-off" approach may prove shortsighted in the event of litigation or an inforcement investigation.

Among other things, it may be worth considering the following proactive, "hands-on" approaches to securities offerings:

- The deal professionals at the private equity sponsor or venture capital firm most involved with the portfolio company may wish to review draft disclosures and generate comments and questions.[25]
- In addition to focusing on the proposed text of any disclosure documents, the deal team may wish to conduct their own assessment of material risks, trends and uncertainties to the portfolio company's business and discuss with disclosure counsel and/or the sponsor's own in-house counsel.
- The sponsor may wish to consider establishing a point person within in-house counsel at the sponsor firm to review draft offering documents and disclosures for legal issues (although business issues, and therefore issues with which the deal team is most familiar, are the issues most likely to give rise to the risk of potential federal securities liability).
- The sponsor and portfolio company should cooperate in creating a reporting-up-the-chain policy within the portfolio company and its legal, financial and audit advisors for any red-flag disclosure issues that generate discussion; and
- The sponsor should consider requiring a briefing session shortly before filing in which the portfolio company issuer, senior management and their counsel and auditors outline areas of difficult disclosure decisions and review areas of actual or potential comment by the SEC.

2. *Building a Diligence Defense.* Another effective way to reduce the risk of liability for sponsor or venture capital firms and their deal professionals—particularly those deal professionals who serve on the board of the portfolio company—is to build a record of disclosure "due diligence" on the part of the private equity sponsor, as well as its director nominees on the board of the portfolio company. Many of the strategies described above are also the best way to build a "due diligence" defense under Section 11 and Section 12(a)(2). Other suggestions are:

- Create a record of sponsor participation in the disclosure process and other diligence steps taken to ensure a carefully crafted, thoughtful disclosure.
- Above all, have a deal professional review the draft disclosure documents and, if the deal professional reviewing the disclosures is not on the portfolio company's board, have the deal professional discuss the disclosures with the board representative and flag any potentially significant disclosure issues.
- Require the portfolio company's auditors to address their comfort letters to the Board as well as the underwriters.
- Have a sponsor representative participate in due diligence calls and auditor diligence session, and if the deal professional participating in the diligence calls and sessions is not the deal professional serving on the board of the portfolio company, require the deal professional to report to the board representative regularly concerning the diligence process and any potentially significant disclosure issues; and
- The sponsor's internal legal team or outside advisers may wish to evaluate periodically the internal records (briefings within deal team or to investment committee) from the offering process to ensure that key themes are not missed.

3. *Play an Active Role in Choosing Advisors.* The quality of the advisors to the issuer and the underwriters can prove to be critically important to the quality of the disclosure, in addition to the successful execution of the offering. We believe it is in the sponsor's interest for the portfolio company's disclosure counsel to be willing to raise issues directly to the sponsor as necessary and understand the sponsor's level of risk tolerance. This objective can be achieved in different ways.

- The sponsor may wish to be directly involved in selecting securities counsel, investment bankers and outside auditors for the portfolio company and may wish to play an active role in setting clear expectations and risk parameters with the issuer's advisors.

- The sponsor may want to retain its own outside counsel to monitor, real-time issuer's counsel and financial and accounting advisors to ensure that disclosure decisions made real-time align with the sponsor's goal and risk tolerance.
- The sponsor may wish to designate a regular point person or persons at the sponsor's legal and accounting advisors to field difficult questions concerning disclosure decisions so that there is an institutional knowledge base at the sponsor's outside advisors for making timely decisions on disclosure issues.
- The sponsor may want to designate a point person on the deal team to liaise with the portfolio company's securities counsel, the sponsor's in-house legal team and any outside advisors to the sponsor to ensure that the sponsor is kept current with significant decision being made on disclosure and is able to respond real-time to such decisions.
- Designating a point person—whether a deal professional, in-house legal or outside legal advisor—to monitor disclosure decisions and the drafting and diligence process of an initial public offering, can then lay the groundwork (and experience and knowledge base at the sponsor) for managing risks around secondary or other follow-on offerings when the level of issuer diligence and risk management may be marginally less rigorous than during an initial public offering.

4. *Document "Good Faith."* As described above, Section 20(a) of the Exchange Act establishes a statutory defense of good faith. In many ways, this will resemble a negligence standard—did the controlling entity act in good faith and in the reasonable belief that its disclosures were accurate? As the Second Circuit stated, "to meet the burden of establishing good faith, the controlling person must prove that he exercised due care in his supervision of the violator's activities in that he maintained and enforced a reasonable and proper system of supervision and internal controls."[26] Having robust processes—like those described above—in place and formally documented is important in building a record of reasonable care for purposes of the "good faith" defense under Section 20(a). Moreover, having a robust formal review and compliance process could be especially helpful in the event that regulatory agencies, such as the SEC, conduct an investigation into a trouble securities offering.

5. *Pay Attention to Insurance.* In many cases, private equity and venture investors will have representatives serving as directors of the portfolio company. The sponsor should see that the portfolio company has adequate D&O coverage to insure the company and its directors and officers from the risks of litigation. The D&O policy of the portfolio company should be considered the "primary" policy. But the investor also should see that it has appropriate fund-level liability insurance as an "excess" policy for the directors and the funds themselves for "control person" or other claims. In addition, there are specific coverage issues that are particularly applicable in the context of a public offering—for example, coverage issues around the insurability of Securities Act claims—and it is very important to fully address those coverage issues in procuring coverage in advance of an offering.

6. *Respect Corporate Formalities*—As always, it is important for the sponsor to maintain the proper boundaries between itself and the portfolio company. In the event that the sponsor elects to be more directly involved in the offering process, it will be important to balance an active role in the offering process with an overall high level of respect for corporate formalities. This includes:

- Maintaining strict compliance with all organizational documents;
- Holding regular board meetings of the portfolio company, documenting the meetings with minutes;
- Considering and addressing any board independence requirements; and
- Maintaining clearly separate finances, capitalization and books and records for the portfolio company.

Conclusion

The dispute over the scope of primary conduct under Section 10(b) is, to a large extent, merely a minor chapter in assessing the underlying litigation risks posed by private equity sponsors in public stock offerings. However that dispute plays out in future cases, the prospect of "control person" liability—which in many cases will be difficult to have dismissed outright where an underlying primary violation is stated—will remain a significant sword in the arsenal of the plaintiffs' bar. The foregoing best practices hopefully will help to mitigate—though not eliminate—the risk of ultimate liability on such claims.

Notes

1. *Janus Capital Group v. First Derivative Traders*, __ U.S. __, 131 S. Ct. 2296, 180 L. Ed. 2d 166 (2011).
2. City of Roseville Employees' Retirement System v. EnergySolutions, Inc., No. 09-8633, 2010 WL 4527328 (S.D.N.Y. Sept. 30, 2011).
3. *In re Optimal U.S. Litig.*, No. 10-4095, 2011 WL 4908745 (S.D.N.Y. Oct. 14, 2011).
4. *Janus*, 131 S. Ct. at 2304 n.10.
5. *See, e.g., Maldanado v. Dominguez*, 137 F.3d 1, 6-8 (1st Cir. 1998) (holding that no private right of action exists under Section 17(a) and noting that "every circuit to have addressed the issue has refused to recognize a private right of action under section 17(a), including four circuits which originally had held otherwise").
6. *Janus*, 131 S. Ct. at 2296.
7. The Supreme Court—consistent with its earlier decisions in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.,* 511 U.S. 164 (1994) and *Stoneridge Investment Partners, LLC v. Scientific-Atlantica, Inc.*, 552 U.S. 148 (2008)—rejected the argument that one who is "significantly involved in preparing the prospectus" should be liable as a primary actor even where a separate legal entity has final control over the filing. The Court noted that where corporate formalities were observed, "[a]ny 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."
8. Moreover, a truncated finding of "control" in this manner would render entirely superfluous the requirements in Section 15 of the Securities Act and Section 20 of the Exchange Act for finding control. In particular, in the Second Circuit, with respect to Section 20, proof of "culpable participation" in the fraud is required. By transforming conduct that is most clearly covered by Section 20 into primary conduct under Section 10(b), the court's ruling discards these pre-requisites altogether.
9. *Pacific Investment Management Co. LLC v. Mayer Brown LLP*, 603 F.3d 144, 155 (2d Cir. 2010).
10. *In re Optimal U.S. Litig.,* 2011 WL 4908745.
11. *Id.* at *5.
12. *Id.*
13. Interestingly, Judge Scheindlin expressly noted that OIS's in-house counsel made various suggested changes to the prospectus, which Multiadvisors adopted. The court did not view this as supporting a finding of "ultimate control." To the contrary, the court viewed this as a strong point in favor of dismissal, as it reflected a process in which changes were expressly adopted by Multiadvisors and ultimately attributed to them. *Id.*
14. *Id.* On this point, the *Optimal* court found the *EnergySolutions* decision lacking. Judge Scheindlin noted that *EnergySolutions* did "not address the discussion in *Janus* that imposing liability on an entity that influenced or controlled the 'maker' of the statement would improperly broaden the scope of Rule 10b-5 liability, where Congress has already enacted a provision for such a scenario—section 20(a)." *Id.* at *5, n.50.
15. Section 1292(b) permits appeals of non-final orders where: (1) the district court agrees that the order may be immediately appealed; (2) the issue to be raised on appeal involves a "controlling question of law"; and (3) the court of appeals decides in its discretion to hear the appeal. 28 U.S.C. § 1292(b).
16. Although it is possible that the plaintiffs in Optimal could seek to have the disposition of the Section 10(b) claims against OIS deemed a "final" judgment by the district court pursuant to Fed. R. Civ. P. 54(b)—which applies to judgments involving multiple claims or multiple parties—they have not done so and would probably be unlikely to succeed in getting the district court to do so, given that Rule 54(b) requires that the claim be totally "separable" from the rest of the litigation. *See Ginnett v. Computer Task Group, Inc.*, 962 F.2d 1085, 1094-95 (2d Cir. 1992) (claims are inseparable where, in reviewing the appealed claim, the appellate court "would necessarily have to reach the merits of one

or more of the claims not appealed" or where the "district court's disposition of one or more of the remaining claims could render [the appellate court's] opinion advisory or moot").

17. *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1472—73 (2d Cir. 1996) (quoting 17 C.F.R. § 240.12b—2).
18. The Second and Third Circuits—and perhaps the Sixth and Ninth Circuits as well—adhere to the "culpable participant" test, at least with respect to Section 20(a), while the Fifth, Seventh, Eighth, and Tenth Circuits reject it. *Compare Lanza v. Drexel & Co.*, 479 F.2d 1277, 1299 (2d Cir. 1973) *with G.A. Thompson & Co. v. Partridge*, 636 F.2d 945, 958 (5th Cir. 1981).
19. *Metge v. Baehler*, 762 F.2d 621 (8th Cir. 1985). The confusion over "culpable participation" is multiplied by the fact that the case law is unclear whether there is any "culpable participation" element in Section 15 claims, especially given the underlying strict liability nature of Sections 11 and 12 violations. Indeed, in a recent decision, the Second Circuit expressly declined to decide whether culpable participation should be required to establish the prima facie elements of a Section 15 violation. *See In re Lehman Bros. Mortgage Backed Sec. Litig.*, 650 F.3d 167, 186 (2d Cir. 2011). One influential district court opinion—reasoned that Section 15 does not include a "culpable participation" requirement because under the statutory language, "an allegation of negligence does not state a violation of § 20(a) if the negligence was in good faith; [but] the same is not true of § 15 [which does not include similar language regarding good faith]." *In re Refco Securs. Litig.*, 503 F. Supp. 2d 600 n.43 (S.D.N.Y. 2003).
20. *No. 84 Employer-Teamster Joint Council Pension Trust Fund v. America West Holding Corp.,* 320 F.3d 920 (9th Cir. 2003).
21. *Id. See also In re DDi Corp. Secur. Litig.*, 2005 WL 3090882, at *21 (C.D. Cal. July 21, 2005) (holding complaint stated valid control person claims where Bain Capital held 20.4 percent of DDi common stock and controlled 5 of 8 board seats).
22. Where a consortium arrangement exists, thorny issues of control could be raised. By comparison, where the private equity sponsor has a distinct minority investment—roughly speaking, less than 30%—a more hand's off approach may well make sense, because the risk of "control person" liability, in that case, may well be lower. At the same time, however, if the sponsor expects to be selling shares into the offering, there remains fairly broad, easily triggered exposure under Section 12(a)(2) of the Securities Act.
23. *Metge*, 762 F.2d at 630-31.
24. *See, e.g.*, *In re DDi Corp. Secur. Litig.*, 2005 WL 3090882, at *21 (C.D. Cal. July 21, 2005) (holding complaint adequately pleaded "culpable participation" by alleging that a private equity sponsor "control [led] the contents of the . . . Prospectus," but did not "ma[ke] a reasonable investigation or possess[ ] reasonable grounds for the belief that the statements contained in the . . . Prospectus were true and devoid of any omissions of material fact").
25. Mere advice and guidance does not necessarily establish control. *See In re Lehman Bros.*, 2011 WL 1778726, at *8 (holding that "allegations of advice, feedback, and guidance fail to raise a reasonable inference that the rating agencies had the power to direct, rather than merely inform, the banks' ultimate structuring decisions . . . Providing advice that the banks chose to follow does not suggest control").
26. *First Jersey*, 101 F.3d at 1473.