UNITED STATES DISTRICT COURT
DISTRICT OF MARYLAND

CHAMBERS OF
J. FREDERICK MOTZ
UNITED STATES DISTRICT JUDGE

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January 3, 2007

Memo to Counsel Re: MDL-15863, Janus Subtrack
Chasen v. Whiston, et al.,
Civil No. JFM-04-855

Dear Counsel:

I have reviewed the memoranda submitted in connection with defendants' motion to dismiss the Amended Verified Derivative Complaint ("AVDC") pursuant to Fed. R. Civ. P. 23.1. The motion will be granted.

As you know, on August 25, 2005, I dismissed certain claims in the Janus Fund Derivative case after finding that the failure to make demand upon the fund trustees was not excused. *In re Mut. Funds Inv. Litig.*, 384 F. Supp. 2d 873, 877-80 (D. Md. 2005). I explained that for presuit demand to be excused under Delaware law, a plaintiff must plead facts raising a reasonable doubt that a majority of the members of the board are disinterested and independent. *Id.* at 878 (citing *Aronson v. Lewis*, 473 A.2d 805, 814 (Del. 1984)). Alternatively, where a plaintiff alleges a failure of oversight by the board, demand is also excused where the "'particularized factual allegations of a derivative stockholder complaint create a reasonable doubt that, as of the time the complaint is filed, the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand.'" *Id.* (quoting *Rales v. Blasband*, 634 A.2d 927, 934 (Del. 1993)).

Although I accepted the proposition that one could satisfy this second prong by pleading specific facts establishing that a majority of the board faced a substantial likelihood of liability, I concluded that the plaintiffs in that case had not satisfied their burden. *Id.* at 879. The plaintiffs had alleged that market timing and late trading occurred throughout the industry, but there were no allegations that the trustees knew that these activities "were occurring within the Janus funds themselves." *Id.* at 879-80. The absence of such particularized allegations distinguished the Fund Derivative case from a Seventh Circuit decision in which "an extensive paper trail" over a six-year period gave the board notice of wrongdoing throughout the corporation for which it was responsible. *Id.* at 880 (citing *In re Abbott Labs. Derivative S'holders Litig.*, 325 F.3d 795 (7th Cir. 2003)). Similarly, where plaintiffs in another case alleged that a board had received a series of "unmistakable signs" of corporate misconduct, the Sixth Circuit found that the directors faced a substantial likelihood of liability. *Id.* (citing *McCall v. Scott*, 239 F.3d 808 (6th Cir. 2001)). Without any "red flags" evidencing wrongdoing within the Janus funds themselves, however, the trustees' failure to detect late trading and market timing activities merely amounted to

negligence and did not expose them to the substantial likelihood of liability required to excuse presuit demand. *Id.*

In the current shareholder derivative action, plaintiff admits his failure to make demand upon the nine defendant board members, but maintains that such a demand would have been futile. (AVDC ¶ 197.) Plaintiff attempts to distinguish his action from my earlier decision by arguing that four of these directors were insiders at Janus Capital Group Inc. and therefore beholden to the company for their income. (Pls.' Mem. Opp'n Defs.' Mot. Dismiss at 1, 24.) However, a demand futility analysis focuses on the board's ability to act impartially at the time of the filing of the complaint, *Rales*, 634 A.2d at 934, and of the four directors identified by plaintiff, only CEO Mark B. Whiston was an insider when plaintiff initially filed suit in September 2003. (AVDC ¶ 22.) As a result, even if an insider is automatically interested for demand futility purposes, plaintiff has not demonstrated that any other board members, let alone a majority, would have been incapable of objectively considering a presuit demand.[1]

Like the shareholders in the Janus Fund Derivative case, plaintiff also fails to allege sufficient facts raising a reasonable doubt that a majority of the board faces a substantial likelihood of liability on the failure of oversight claim. For example, plaintiff states that the mutual fund industry has long been aware of market timing, particularly in light of the many articles and reports discussing the problem generally. (*Id.* ¶¶ 72-118.) As in the Janus Fund Derivative case, however, these industry-wide "red flags" do not demonstrate that the directors were on notice of any wrongdoing within the Janus funds themselves. *See In re Mut. Funds Inv. Litig.*, 384 F. Supp. 2d at 879-80.

Plaintiff's other allegations are also inadequate to support a finding that a majority of the board faces a substantial likelihood of liability. For instance, plaintiff maintains that the directors, particularly those who at one time or another served as officers at the company, should have known about the market timing activity, given their insider status, training, and experience. (AVDC ¶¶ 199-202, 204-10.) In particular, the AVDC alleges that it was "not credible that market timing arrangements of the size and scope rampant at Janus . . . occurred within [director and fund manager Helen Y. Hayes'] funds without her knowledge or, at a minimum, acquiescence." (*Id.* ¶¶ 150, 204.) Such conclusory statements, however, cannot support a failure of oversight claim and as a result do not expose a majority of the board to a substantial likelihood of liability. *See David B. Shaev Profit Sharing Account v. Armstrong*, No. Civ. A. 1449-N, 2006 WL 391931, at *5 (Del. Ch. Feb. 13, 2006) (rejecting as too conclusory the plaintiff's allegation that only reckless indifference could account for a board's failure to detect massive wrongdoing at the company); *see also In re Mut. Funds Inv. Litig.*, 384 F. Supp. 2d at 880 (explaining that although the fund trustees may have been negligent in failing to uncover late trading and market timing activities, plaintiffs' allegations fell "far short of the mark that is required to prevail on [a failure of oversight claim]").

In fact, plaintiff's only particularized factual allegation suggesting that the board actually

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[1] Plaintiff also states that demand would have been futile, because the directors would have lost the protection of their liability insurance had the company brought suit against them. (AVDC ¶ 221.) Plaintiff, however, makes no mention of this argument in his memorandum opposing the motion to dismiss, presumably because Delaware courts have found similar contentions meritless. *See, e.g.*, *Decker v. Clausen*, Civ. A. Nos. 10,684, 10,685, 1989 WL 133617, at *2 (Del. Ch. Nov. 6, 1989).

knew of the market timing activities relates to a report commissioned by CEO Whiston in November 2002 and "widely circulated at Janus." (AVDC ¶¶ 144-48.) The report, however, advocated *ending* all market timing activities. (*Id.* ¶ 146.) Furthermore, the report could not have served as a "red flag" alerting the board to company misconduct, because the AVDC contains no particularized allegations that any directors other than Whiston were aware of its existence. *Cf. In re Citigroup Inc. S'holders Litig.*, No. 19827, 2003 WL 21384599, at *2 (Del. Ch. June 5, 2003) ("'Red flags' are only useful when they are either waived [sic] in one's face or displayed so that they are visible to the careful observer."). In any event, this lone internal report does not compare to the "extensive paper trail" over a six-year period in *Abbott* and the "unmistakable signs" in *McCall* evidencing wrongdoing throughout those companies. Therefore, the November 2002 report does not subject the directors in this action to the substantial likelihood of liability necessary to excuse presuit demand.

Similarly, plaintiff's allegations regarding the members of Janus' Audit Committee do not raise a reasonable doubt that those four directors face a substantial likelihood of liability. Plaintiff's allegations include a description of the committee's members, their duties under the committee's charter, and the type of industry-wide information they would have received regarding market timing in general. (AVDC ¶¶ 211-14.) However, because plaintiff fails to allege with particularity that these four committee members had notice of the market timing, these allegations are insufficient to excuse presuit demand. *See David B. Shaev Profit Sharing Account*, 2006 WL 391931, at *5 (dismissing a derivative action for failure to make presuit demand where "the complaint includes no allegations that the board or audit committee . . . was ever presented with information pointing it towards the [wrongdoing within the company]"); *Guttman v. Huang*, 823 A.2d 492, 507 (Del. Ch. 2003) (dismissing a complaint for omitting particularized allegations showing that the audit committee had "clear notice" of corporate misconduct).

Although plaintiff argues that courts may infer knowledge of wrongdoing on the basis of audit committee membership, the cases he cites are distinguishable in that the plaintiffs in each offered considerably more particularized allegations. *See In re Veeco Instruments, Inc. Sec. Litig.*, 434 F. Supp. 2d 267, 276-78 (S.D.N.Y. 2006); *In re TASER Int'l S'holder Derivative Litig.*, No. CV-05-123-PHX-SRB, 2006 U.S. Dist. LEXIS 11554, at *9-11, 30-32 (D. Ariz. Mar. 17, 2006). For example, in *Veeco* the plaintiffs offered particularized allegations showing that the company's audit committee disregarded an internal audit that had uncovered violations of federal export control laws. 434 F. Supp. 2d at 278. In finding that presuit demand would have been futile, the court explained that this was a case in which the audit committee knew of serious misconduct and failed to investigate. *Id.* The plaintiffs in *TASER* provided particularized allegations detailing not only the company's audit committee, but also extensive insider trading and the issuance of misleading press releases by the company, all of which allowed the court to infer knowledge of non-public information. 2006 U.S. Dist. LEXIS 11554, at *9-11, 30-32. As explained above, plaintiff in this action does not offer similar particularized allegations.

For these reasons the AVDC will be dismissed with prejudice. Despite the informal nature of this letter, it should be flagged as an opinion and docketed as an order.

Very truly yours,

/s/
J. Frederick Motz
United States District Judge