SECURITIES LITIGATION, ENFORCEMENT & REGULATION

Legal News Alert™

FOLEY
FOLEY & LARDNER LLP

JANUARY 15, 2008

Legal News Alert: Securities Litigation, Enforcement & Regulation is part of our ongoing commitment to providing up-to-the minute information about pressing concerns or industry issues affecting our clients and our colleagues.

Please contact the following attorneys if you would like further information about the progress of the legislation or want additional information regarding securities litigation, enforcement & regulation matters:

Practice Chair:

Gregory S. Bruch
Washington, D.C.
202.672.5460
gbruch@foley.com

Authors:

Michael P. Matthews
Milwaukee, Wisconsin
414.297.5556
mmatthews@foley.com

Max B. Chester
Milwaukee, Wisconsin
414.297.5573
mchester@foley.com

Supreme Court Further Restricts Private Securities Claims Alleging Deceptive Conduct

Today, the United States Supreme Court issued its much-anticipated decision in *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, Case No. 06-43, 552 U.S. ___ (2008). In a 5-3 opinion authored by Justice Kennedy, in which Chief Justice Roberts and Justices Thomas, Scalia, and Alito joined, the Court affirmed, albeit on different grounds, the decision of the Eighth Circuit Court of Appeals, which had affirmed the dismissal of claims under § 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5 against third parties who were alleged to have intentionally entered into fraudulent transactions with the issuer Charter Communications (Charter), allowing Charter to inflate its reported revenue and deceive its auditors.

Rather than affirm on the Eighth Circuit's grounds that "only misstatements, omissions by one who has a duty to disclose, and manipulative trading practices" trigger liability under Section 10(b) and Rule 10b-5, Slip Op. at 7, the Court affirmed on the basis that Charter investors "cannot show reliance" upon the third parties' statements or acts, because they were not communicated to the public. Slip Op. at 7-8. The Court further stated that the alleged deceptive acts were "too remote to satisfy the requirement of reliance," and that "[i]t was Charter, not respondents, that misled its auditor and filed fraudulent financial statements; nothing respondents did made it necessary or inevitable for Charter to record the transactions as it did." Slip Op. at 10.

Thus, the Court did not deal the decisive blow to so-called "scheme liability" as the Eighth Circuit had done and as some expected the Supreme Court would do, but the Court did continue down the path of what the dissenting Justices characterized as "the Court's continuing campaign to render the private cause of action under 10(b) toothless." (Stevens, J. dissenting, with whom Justices Souter and Ginsburg joined, (Dissent) at 9.) Specifically, the majority stated that if the Eighth Circuit's opinion were read to suggest that a specific oral or written statement is required, "it would be erroneous," because "[c]onduct itself can be deceptive," and "respondents' course of conduct included both oral and written statements" in any event (albeit not to the public). Slip Op. at 7. The Court instead chose to interpret the Eighth Circuit's opinion as holding that any alleged deceptive act or statement in this case "was not actionable because it did not have the requisite proximate relation to the investors' harm," and the Court affirmed on that ground. Slip Op. at 7. The dissenting Justices termed this a new kind of "super-causation" contrary to the U.S. Securities and Exchange Commission's (SEC) position and the Court's decision in *Basic, Inc. v. Levinson,* 485 U.S. 224 (1988), and also pointed out that the Court of Appeals only mentioned this issue in passing and that there was scarcely any briefing on this point before the Supreme Court. (Dissent at 2-4.)

The majority further stated that the third parties at most had aided and abetted Charter Communications to inflate its reported revenue and operating cash flow, for which no private cause of action under Rule 10b-5 exists. See Slip. Op. at 6-7 (citing *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.,* 511 U.S. 164, 191 (1994)). The Court opined that adoption of the investors' theory would undermine Congress' determination that aiders and abettors "should be pursued by the SEC and not by private litigants" and may have other deleterious effects such as allowing plaintiffs with weak claims to extort settlements from innocent companies and exposing a new class of defendants to these risks which, in turn, "may raise the cost of being a publicly traded company under our law and shift securities offerings away from domestic capital markets." Slip. Op. at 12-13.

In sum, the Supreme Court today delineated two barriers to private 10b-5 claims that are based upon allegedly deceptive conduct in the absence of misrepresentations, omissions with a duty to disclose, or manipulative trading practices: First, that the deceptive acts must be communicated to the public so that reliance may be presumed under the fraud-on-the-market doctrine, and second, that the deceptive acts must have made it "necessary or inevitable" for the issuer to make the misrepresentations or omissions it did. Slip Op. at 7-10.