



Portfolio Media. Inc. | 860 Broadway, Floor 6 | New York, NY 10003 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@portfoliomedia.com

Superseding Stoneridge

Law360, New York (March 02, 2010) -- During the State of the Union address, the president rebuked the Supreme Court for its recent decision invalidating part of the McCain-Feingold campaign-finance reform law and called on Congress "to pass a bill that helps to correct" the court's ruling.

It appears that President Obama and Justice Samuel Alito disagree on more than just corporate campaign contributions.

The president is also calling on Congress to "overrule" a 2008 decision, *Stoneridge Investment Partners LLC v. Scientific-Atlanta Inc.*, 552 U.S. 148 (2008), which held that there is no liability for aiding and abetting under federal securities laws and that, consequently, private parties have no right to sue those who aid and abet securities fraud.

In *Stoneridge*, shareholders in Charter Communication Inc. filed a securities fraud class action suit against Charter, its auditor, Arthur Anderson, and two of its vendors, Scientific-Atlanta Inc. and Motorola Inc., who manufactured digital cable boxes used by Charter.

The plaintiff shareholders alleged that Scientific-Atlanta and Motorola devised a scheme with Charter to boost Charter's cash flow so that its quarterly reports would meet Wall Street's expectations for cable subscriber growth.

In a typical federal securities suit, the plaintiff must prove that the defendant knowingly made a material misrepresentation in connection with the purchase or sale of a security and that the plaintiff, relying on the misrepresentation, suffered an economic loss as a result.

Although the text of the Securities Exchange Act of 1934 does not explicitly provide private parties with the right to bring a civil action for securities fraud, the courts have found that a right to sue for securities fraud is implied in the statute and regulations promulgated by the U.S. Securities and Exchange Commission under the statute.

But in *Stoneridge* the Supreme Court, by a vote of 5 to 3 (Justice Stephen Breyer took no part in the case), held that a plaintiff cannot sue secondary parties who aid and abet those who violate federal

securities laws. As a result, plaintiffs were permitted to sue only primary violators.

The Stoneridge decision was consistent with recent decisions by the Supreme Court in securities law cases such as *Central Bank of Denver v. First Interstate Bank of Denver*. With the Obama administration, however, the pendulum appears to be swinging through the legislative process, away from pro-corporate decisions.

There is new legislation that will, in effect, supersede part of the court's decision in Stoneridge. In July 2009, the Obama administration sent Congress a bill called the Investor Protection Act of 2009.

That act would have amended the Securities Act of 1933, the Investment Company Act of 1940, and the Investment Advisers Act of 1940 to allow the SEC to prosecute any person who "knowingly or recklessly provides substantial assistance to another person" in violation of federal securities laws.

The ideas from the Obama administration's bill, and much of its language on aiding and abetting, have been incorporated into a massive bill introduced by Congressman Barney Frank, D-Mass., the Wall Street Reform and Consumer Protection Act. On Dec. 11, 2009, this act passed the House by a vote of 223 to 202, without the support of a single Republican.

Passage of the Wall Street Act would reverse the trend toward reducing securities litigation put in place 15 years ago. In 1995, with strong bipartisan support, both houses of Congress overrode a veto by President Clinton of the Private Securities Litigation Reform Act. The PSLRA made it much more difficult for a securities suit to succeed because it established a heightened pleading standard in securities fraud suits.

Basically, a plaintiff in a securities fraud action must make very specific allegations in the complaint, creating a "strong inference" that fraud occurred. In contrast, most lawsuits merely require allegations without much factual support, if any.

The Wall Street Act would generally leave this heightened pleading standard in place, but would change the standard when a plaintiff sues a nationally recognized statistical rating organization, i.e., a credit rating agency such as Moody's or Standard & Poor's.

The Wall Street Act states that, when bringing an action against a credit rating agency, it shall be sufficient for the purposes of the complaint to allege facts giving rise to a strong inference that the ratings agency was "grossly negligent," which requires a lower standard of pleading than fraud.

In addition to the Wall Street Act, another piece of legislation, the Liability for Aiding and Abetting Securities Violations Act, introduced by Senator Arlen Specter, D-Pa., would explicitly create a private right of action to sue those who aid and abet in securities fraud. While the outcome of Sen. Specter's bill is uncertain, the tide is clearly turning.

If the Wall Street Act passes this year, not only will Congress and the Obama administration have superseded part of a recent Supreme Court decision by the slim conservative majority on the court, they will have also reversed the legislative and judicial trend favoring a reduction in federal securities suits. This could pave the way for more progressive legislation, such as Sen. Specter's bill. If that were to happen, we can expect a flood of new securities lawsuits.

--By Gregory J. Hindy, McCarter & English LLP

Gregory Hindy is a partner in the business and financial services litigation practice group at McCarter & English in the firm's Newark, N.J., office. Daniel W. Beebe, a law clerk at the firm and student at Seton Hall University School of Law, assisted with the research and drafting of this article.

The opinions expressed are those of the author and do not necessarily reflect the views of Portfolio Media, publisher of Law360.

All Content © 2003-2010, Portfolio Media, Inc.