

## Commentary

### Daniel J. Popeo: Will the SEC empower the plaintiffs' bar?

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#### WASHINGTON -

The U.S. Supreme Court recently agreed to review a novel interpretation of the federal securities laws. The case won't be argued until this fall, but its outcome, and possibly the fate of America's dynamic securities market, may be determined in the next several weeks.

During that time, the Securities and Exchange Commission (SEC) must decide whether to take a formal position in this case, *Stoneridge v. Scientific-Atlanta*. The SEC's options: Support the securities laws as Congress intended, or endorse class action lawyers' efforts to drastically expand their litigation targets and reap millions more in fees.

The battle for the SEC's support has been fierce, with the notorious Bill Lerach leading the public relations offensive for the plaintiffs' bar. Lerach has enlisted powerful politicians and activists in the effort, and he even penned a rare op-ed in an influential legal publication arguing that the stakes for securities fraud suits have never been higher.

Mr. Lerach is right, the stakes are high, but investors and America's position in the global economy would not come out the winners if his view prevails.

To see why, consider this scenario: You run a company — say, a newspaper — that sells advertising space to a public company. One day you hear that this customer has run afoul of the securities laws.

It misreported its advertising spending in a way that inflated earnings. Executives have pled guilty. Securities fraud class action lawyers charge that your newspapers knew what this advertiser was up to. If the plaintiffs prevail in *Stoneridge*, you would likely be sued.

When Congress adopted the Securities Act of 1934, it drew a sharp distinction between those who made deceptive statements to the public and those who did not, even if those others were less than innocently involved. You might be the newspaper that sold ad space or you might be the accountant who dreamt up the scheme.

Either way, if it suspected wrongdoing, the SEC could investigate, fine and initiate criminal proceedings. If the SEC did not want to prosecute, it could sue, but private parties could not. In recent years, Congress has reviewed this distinction twice, and specifically rejected expanding liability to secondary actors.

The Supreme Court has also considered the primary-secondary distinction. In the 1994 *Central Bank* case, the Court ruled that "[t]here is no private aiding and abetting liability" in federal securities law. In other words, liability begins and ends with the party that makes deceptive statements.

The courts unanimously adhered to this view of the securities laws until last June, when a federal appeals court in California rewrote the securities law. Under the court's adventurous reasoning, even those whose actions were tangentially related to a public company's fraud were now exposed to the risk of huge damages in private lawsuits. This ruling is virtual green light to sue anyone who might plausibly have been

involved in a transgression — lawyers, banks and accountants, just for starters.

Because that interpretation of the securities laws conflicted with that of all other appeals courts — including the court that decided Stoneridge — the Supreme Court agreed to hear Stoneridge in order to resolve the conflict.

If the Supreme Court accepts the plaintiffs' bar's perspective in Stoneridge, the United States would become the only major industrialized country to turn its back on the primary-secondary distinction for securities fraud.

Expanding private liability suits for secondary actors would, as the Supreme Court stated in *Central Bank*, "disserve the goals of fair dealing and efficiency in the securities markets."

What would this mean to U.S. businesses if everyday sales or purchases (for example, of advertising space) with publicly traded companies could result in multimillion dollar lawsuits?

Recent studies by respected academics, market regulators, and elected officials have all concluded that America's uncertain legal environment is a deterrent to the growth of capital and new, U.S.-based public offerings.

Certain SEC commissioners have acknowledged the corrosive impact of litigation, and when he was a member of Congress, Chairman Christopher Cox led the effort to place reasonable limits on private securities suits.

The SEC's support, expressed through a U.S. government friend-of-the-court brief in Stoneridge, would well tip the balance in the Supreme Court.

For the sake of our capital markets and American shareholders, let's hope the commission does the right thing. The SEC's mission of "investor protection" cannot be achieved by further empowering plaintiffs' lawyers.

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