News Release

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# WLF, KENNETH STARR URGE COURT TO PROTECT INVESTORS FROM UNWARRANTED SECURITIES FRAUD SUITS

***(Stoneridge Investment Partners v. Scientific-Atlanta)***

The Washington Legal Foundation (WLF) this week urged the U.S. Supreme Court to protect investors by imposing restraints on the ability of plaintiffs' attorneys to bring unwarranted securities fraud lawsuits that, although nominally filed for the purpose of protecting investors, actually harm investors by transferring wealth from stockholders to the pockets of lawyers.

In a brief filed in *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, WLF argued that a company should not be subject to a securities fraud lawsuit based solely on having entered into an arm's-length, non-financial transaction with another company alleged to have engaged in fraud. WLF's brief was written with the *pro bono* assistance of Kenneth Starr, the Dean of Pepperdine University School of Law and a former federal judge, U.S. Solicitor General, and Independent Counsel. Assisting Starr were other attorneys associated with the law firm of Kirkland & Ellis LLP, including Robert R. Gasaway, Ashley C. Parrish, Derek S. Bentsen, and Angela M. Butcher.

"The public should not be fooled by the plaintiffs' bar into thinking that allowing suits of this sort to go forward will somehow help investors," said WLF Chief Counsel Richard Samp after filing WLF's brief. "The open-ended liability standards the plaintiffs are pressing for are likely to prompt more frauds inside the judicial system than the frauds outside the system they claim to be combatting. We must not overlook the fact that the investing public ultimately bears the burden of any further increase in potentially abusive litigation enabled by subjective liability standards," Samp said.

The case involves claims brought against Scientific-Atlanta and Motorola, two manufacturers of digital set-top boxes used by cable-television subscribers. The companies sold large numbers of the boxes in 2000 to Charter Communications, Inc., a cable-television operator. At Charter's request, the companies submitted invoices to Charter that included inaccurate information regarding prices Charter paid for boxes, advertising purchased from Charter by the companies, and the dates of the sales transactions. Scientific-Atlanta and Motorola accurately recorded the transactions on their own books. Charter, however, issued financial reports that inaccurately recorded the transactions in a manner that fraudulently inflated its cash flow. Charter also released other, unrelated financial information that provided an inaccurate and overly optimistic picture of its financial position. When the truth regarding its financial position was revealed, Charter's stock plummeted.

Attorneys purporting to represent Charter shareholders then filed suit not only against Charter and its executives but also against Scientific-Atlanta and Motorola. The trial court dismissed claims against the two manufacturers, noting that (per a 1994 Supreme Court decision) securities law does not permit private suits against those alleged merely to have aided and abetted another company's securities fraud. The appeals court affirmed the dismissal, rejecting the plaintiffs' claim that the defendants could be held liable for a *primary* violation of the securities laws. The appeals court held that such liability is limited to cases in which there is evidence that the defendant either made a misstatement that was relied on by the plaintiffs or that it failed to disclose something that it owed a duty to disclose to the plaintiffs. The Supreme Court later agreed to review the appeals court decision.

In its brief urging affirmance, WLF argued that arm's-length transactions involving ordinary goods cannot give rise to *securities* fraud. WLF noted that neither Scientific-Atlanta nor Motorola ever made any statements to the plaintiffs and, accordingly, argued that they cannot be said to have deceived the plaintiffs in any way "in connection with" the purchase or sale of a security -- a prerequisite to any securities fraud claim.

WLF also argued that securities fraud litigation has not deterred fraud and, in fact, generally works against the best interests of shareholders. Because securities lawsuits that can survive a motion to dismiss are generally settled without regard to the defendants' culpability (because the economics of such suits generally demand settlement), they have minimal deterrent effect and serve simply to transfer wealth from shareholders (who, of course, own the companies being sued) to the plaintiffs' bar. WLF argued that enforcement actions by the SEC (which is empowered to pursue not only primary securities law violators but also aiders and abetters) are much more effective than private actions in deterring fraud and compensating victims of fraud.

WLF is a public interest law and policy center with supporters in all 50 states. It devotes a substantial portion of its resources to promoting tort reform and reining in excessive litigation.

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For further information, contact WLF Chief Counsel Richard Samp, (202) 588-0302. A copy of WLF's brief is posted on its website, www.wlf.org.