washingtonpost.com

High Court's Fraud Case Widely Seen as Stand-In for Enron

By Carrie Johnson and Robert Barnes
Washington Post Staff Writers
Friday, October 5, 2007; D01

The largest corporate frauds in recent history could not have happened without the brainpower of accountants, bankers and lawyers who partnered with executives at the troubled firms. Often, these third-party businesses are the only wealthy sources left for investors to tap after such schemes unravel in massive collapse.

That's why Robert Van Der Volgen, whose pension fund invests the retirement savings of 750,000 teachers, says the outcome of a dispute to be heard by the Supreme Court on Tuesday will help determine nothing less than the integrity of the financial system.

"The security of our members really depends in a large part on having some honesty as to the statements being made by large corporations," said Van Der Volgen, a lawyer at the California State Teachers Retirement System. "All these fraud cases really have been attempts to mask the returns of a company."

On one side of the Supreme Court case are resourceful plaintiff lawyers trying to recoup money that their clients lost through fraud and who see other businesses as accessories to the crime. On the other side are some of the nation's most powerful industry lobbyists, who argue that regulators already have the authority to punish lawbreakers and say that allowing investors to expand the targets of their lawsuits will only put U.S. companies at a global disadvantage.

The fight has unleashed so much passion and so many opportunities for fundraising that a Washington law professor calls it the business community's equivalent of *Roe v. Wade*.

Indeed, the dispute is widely viewed as a stand-in for one of the most notorious frauds of the past decade -- Enron. In ruling on this case, the high court also could tip the balance of a lawsuit that Enron shareholders filed against Credit Suisse, Merrill Lynch and other banks that allegedly helped the Houston energy firm disguise its financial problems. That case is on hold, but a judgment in support of investors could revive it.

"It's 11 on a scale of one to 10," said Donald C. Langevoort, a Georgetown University law professor. "Enron is the 800-pound gorilla shadowing this case."

At issue in the case, *Stoneridge Investment Partners v. Scientific-Atlanta*, is whether a group of investors (Stoneridge) can seek damages against two technology companies (Scientific-Atlanta and Motorola) for allegedly helping a St. Louis firm called Charter Communications inflate its revenue through a series of sham deals in 2000. A lower court ruled that because Scientific-Atlanta and Motorola did not make public statements about the deals on which investors based their decision to buy or sell Charter stock, the third-party companies were not on the hook for fraud when it came to light.

The Supreme Court case has been marked by numerous unusual twists, including personal intervention earlier this year by President Bush and Treasury Secretary Henry M. Paulson Jr., who is a former chief executive of Goldman Sachs, one of the country's biggest investment banks. Both men prodded the solicitor general, who speaks on the administration's behalf at the court, to reject the judgment of the independent Securities and Exchange Commission, which sets policy to protect investors and which had voted to support the plaintiffs in the case.

Two justices recused themselves, but last summer Chief Justice John G. Roberts Jr. apparently sold stock he owned in order to participate in the Stoneridge argument.

Court analysts have noted that in general, the Supreme Court took a remarkable pro-business stance in its most recent term, even as the justices sharply divided on social issues. Justice Anthony M. Kennedy, whose vote last term proved critical in a series of cases, last month told the Economic Club of New York that previous court decisions that went against business interests accounted for some of the reason that U.S. markets were losing ground to international competitors.

Roy T. Englert Jr., an appellate lawyer and antitrust litigator, said it is "not entirely clear how predictive" the court's recent rulings are for Stoneridge. But the court heard four antitrust cases and one securities law case, and all but one were decided in favor of business by "very lopsided margins." Some of the most important decisions were written by members of the so-called liberal wing of the court.

"It is a court that is very mistrustful of lawyer-driven litigation," Englert said. By that he means "counsel finding soft spots in the system rather than clearly injured persons bringing actions against companies that do wrong."

Englert said he isn't sure, though, if that description fits here. "If not in Stoneridge, at least in Enron, there were real injured parties and real wrongdoing," he said. "The question is how far the liability is going to extend." Thirty groups have filed briefs in the case on both sides. More than half the states, including Maryland and the District but not Virginia, support the investors.

The Council of Institutional Investors, whose members include the country's largest pension funds, said a Supreme Court ruling in support of third-party businesses could tempt accountants and bankers to curry favor with wayward clients and could offer safe harbor for fraud "so long as they do not publicly announce their involvement" with a client company's financial mistakes.

But business groups say that to support plaintiffs would expose U.S. and foreign companies to untold numbers of lawsuits, many of which are settled to avoid the high costs of litigation. The total dollar value of claims asserted in securities class-action lawsuits skyrocketed from about $150 million in 1997 to more than $9.6 billion in 2004, according to the Washington Legal Foundation, a business-friendly interest group. Joseph A. Grundfest, a Stanford University law professor who supports businesses in the case, said the SEC and the Justice Department already have the power to sue third parties for their involvement in a fraud scheme. He noted that Congress repeatedly has rejected attempts to expand the rights of investors to sue. "There's a question of real principle here: Which decisions should be made by the courts, and which should be made by Congress?" Grundfest said.

Yet a retired SEC enforcement lawyer who spent more than a quarter-century at the agency questions whether resource-strapped regulators can police the markets adequately without help.

"The commission can't be everyplace at once," said the lawyer, James T. Coffman. "There simply isn't enough money. The commission is never going to be in a position to take up the slack if the court rules against private plaintiffs in Stoneridge."