No. 06-43

In the

Supreme Court of the United States

STONERIDGE INVESTMENT PARTNERS, LLC.,

Petitioner,

v.

SCIENTIFIC-ATLANTA, INC. AND MOTOROLA, INC.,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

BRIEF OF THE WASHINGTON LEGAL FOUNDATION AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

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August 15, 2007

QUESTION PRESENTED

Whether this Court should imply a private cause of action under Section 10(b) of the Securities Exchange Act against vendors whose transactions with a publicly-traded company were improperly accounted for by the public company in its financial statements, when the vendors did not use or employ a deceptive device in connection with the purchase or sale of a security and the plaintiff—an investor in the public company—did not rely on the transactions or on any statement by the vendors.

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INTEREST OF *AMICUS CURIAE*[1]

The Washington Legal Foundation ("WLF") is a non-profit public interest law and policy center based in Washington, D.C., with supporters in all fifty States. WLF devotes a substantial portion of its resources to defending and promoting free enterprise, individual rights, and a limited and accountable government. To that end, WLF has appeared before this and other federal and state courts in numerous cases raising issues relating to the proper scope of the federal securities laws. *See, e.g., Credit Suisse Serv. LLC v. Billing*, 127 S. Ct. 2383 (2007); *Kircher v. Putnam Funds Trust*, 126 S. Ct. 2145 (2006); *Asher v. Baxter Int'l, Inc.*, 377 F.3d 727 (7th Cir. 2004), *cert. denied*, 544 U.S. 920 (2005); *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336 (2005); *In re Stock Exchs. Options Trading Antitrust Litig.*, 317 F.3d 134 (2d Cir. 2003).

WLF is submitting this brief out of concern about abusive securities class-action litigation and the substantial costs it imposes on the United States' economy and the shareholders who invest in our Nation's publicly traded corporations.

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[1] Petitioners and respondents have consented to the filing of this brief in letters on file with the Clerk's office. Pursuant to S. Ct. R. 37.6, *amicus* states that no counsel for a party authored this brief in whole or in part. No person or entity, other than *amicus* and its counsel, contributed monetarily to the preparation or submission of this brief.

INTRODUCTION AND SUMMARY OF ARGUMENT

A generation ago, Justice Powell warned in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975), that "subjective" and "open-ended" liability standards under federal securities laws are likely to prompt more frauds inside the judicial system than the frauds outside the system they aim to deter and redress. *Id.* at 761 (Powell, J., concurring). Justice Powell joined the majority's opinion in *Blue Chip Stamps*, but also separately concurred, emphasizing that the Court "should strike a balance between the opportunities for fraud" presented by the "contending" liability standards from which the Court was obliged to choose. *Id.* at 760. Justice Powell described the very real risks that, under the legal standard favored by the *Blue Chip Stamps* dissent, "an honest offeror could be confronted with subjective claims by plaintiffs" that, while fraudulent, would be difficult to disprove. *Id.* at 761. He warned that the types of suits the dissent would encourage "could result in large damage claims, costly litigation," and "generous settlements to avoid such cost." *Id.* at 761 n.5. And he noted that "the shareholders of the defendant corporations—the 'investing public'—would ultimately bear the burden of this litigation, including the fraudulent suits that would not be screened out" under the dissent's malleable liability standard. *Id.* Justice Powell concluded, with characteristic succinctness, that a rule allowing "open-ended litigation" would "itself be an invitation to fraud." *Id.* at 761.

Today, 32 years after *Blue Chip Stamps*, and thirteen years after the Court's analogously reasoned

decision in *Central Bank of Denver, N.A. v. First Interstate Bank*, 511 U.S. 164 (1994), Stoneridge Investment Partners, LLC and its *amici* present the same types of arguments—and commit the same fallacies—that *Blue Chips Stamps* exploded. Like the *Blue Chip Stamps* dissenters, Stoneridge and its *amici* fail to grapple seriously with the problem of striking "a balance between the opportunities for fraud" entailed by contending liability standards now being urged upon this Court. Like the *Blue Chip Stamps* dissenters, Stoneridge and its *amici* fail to appreciate the close correlation between subjectivity in securities law liability standards and opportunities for plaintiffs to inflict real injustice—including the injustice of outright fraud—through "open-ended litigation" that is not easily avoided or resolved. Finally, Stoneridge and its *amici* repeatedly lapse into presuming there is some necessary and inevitable tension between the interests of "defendant corporations" and those of the "investing public," overlooking what Justice Powell saw so clearly: because "defendant corporations" are owned by the "investing public," the investing public "ultimately" bears the burden of lawsuits filed against those corporations. *Blue Chip Stamps*, 421 U.S. at 761 n.5.

This case is about fraud. But the issues and risks of fraud it principally concerns have little to do with the fraud perpetrated by the management of Charter Communications, Inc. on Charter's investors, or the supporting role in that fraud that Stoneridge alleges was played by Scientific-Atlanta and Motorola. The real question of fraud presented here is the danger that, distracted by the arguments of Stoneridge and its *amici*, the Court might overlook that the

investing public ultimately bears the burden of any further increase in potentially abusive litigation enabled by subjective liability standards. For the reasons set forth below, the Eighth Circuit's decision dismissing Stoneridge's complaint should be affirmed.

First, securities class action litigation presents special opportunities for abuse. The essential building blocks of a securities class action—eligible plaintiffs, perceptible harms, a plausible tale of fraudulent misrepresentation, and willing counsel—are present *every* time a public company experiences a drop in share price. Moreover, the path to recovery in securities class actions is paved by fraud-on-the-market theories of reliance, plus the settlement pressures brought to bear by even small possibilities of large liabilities. Against this backdrop, fuzzy liability standards amount to an open "invitation to fraud" accomplished through the federal courts. (*See* Section I, below).

Second, unless shaped and limited with care, the litigation vehicle of the judicially-crafted private securities action threatens to undermine the benefits of law enforcement by the Securities and Exchange Commission, by the Department of Justice, by state law enforcement officials, and by private parties proceeding under less abuse-prone theories of liability. In light of the explosive growth in securities litigation in the last ten years, and the ever-present potential for abuse, the Court should be especially wary of Stoneridge's invitation to impose liability on third-party vendors lacking any tangible participation or financial interest in the relevant securities market activity. Such expansive liability

does not deter fraud, but it does undermine the credibility of the justice system and it inevitably harms the very investors the law is supposed to protect. (*See* Section I.B., below.)

Third, abusive securities class action litigation harms the economy more generally, by reducing the competitiveness of the United States' public securities markets. Studies show that the Nation's public markets are losing their position as global leaders in large part due to the growing international perception that the United States' legal system is costly, unpredictable, and out of control. Opening the door for class action litigation against these third-party vendors, who dealt in set-top boxes not securities, would exacerbate the reputational decline of our legal system in the eyes of foreign nations. (*See* Section II, below.)

Finally, because Motorola and Scientific-Atlanta entered into arm's-length, non-financial transactions with Charter, the Eighth Circuit correctly determined that they should be excused outright from any liability under section 10(b) of the Securities Exchange Act. Arm's length transactions involving ordinary goods cannot give rise to a federal *securities* fraud. Drawing a bright line that leaves such transactions (even fraudulent ones) outside the remedial scope of the securities laws is essential if abuse of the private securities class action is to be avoided. (*See* Section III, below.)

ARGUMENT

I. Private Securities Class Litigation Is Especially Susceptible To Abuse, In Ways That Undermine Its Goals of Protecting Investors And Deterring Fraud.

The Court should affirm the judgment below and reject Stoneridge's invitation to employ the securities laws to impose potential section 10(b) liability on activities that do not involve the securities markets. Expanding liability, as Stoneridge requests, would open the door to the most egregious forms of abusive litigation, while providing few (if any) benefits.

A. Abusive Securities Litigation Is A Well-Recognized Problem.

This Court has recognized the problems of abusive litigation in a wide variety of contexts. *See, e.g., Bell Atl. Corp. v. Twombly*, 127 S. Ct. 1955 (2007) (class actions); *Leegin Creative Leather Prods. v. PSKS, Inc.*, 127 S. Ct. 2705 (2007) (antitrust); *BMW of N. Am., Inc. v. Gore*, 517 U.S. 559 (1996) (tort law). Although intended to provide justice, at least to the extent practicable, the American litigation system may also create opportunities that, "if not adequately contained, can be employed abusively to impose substantial costs on companies and individuals whose conduct conforms to the law." *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 127 S. Ct. 2499, 2504 (2007).

The danger of abusive litigation is especially acute in this case. In the context of securities class actions, a variety of factors combine to ensure that (i) class litigation is routinely brought in the wake of large or precipitous drops in the stock price of a

publicly traded company, and (ii) a large portion of filed actions that survive motions to dismiss settle before their merits are ever tested before a neutral trier of fact. In today's litigation environment, once a company's share price declines, putative class representatives are easy to find (any shareholder will do); a large figure supposedly representing harms to a class of investors is easy to allege (the decline in share price multiplied by the relevant number of shares); a putative "fraud" is easy to articulate (fraudulently concealing whatever information prompted the decline in share price); and a willing lawyer is inevitably at hand. As this Court noted three decades ago, private securities actions "present[] a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general." *Blue Chip Stamps*, 421 U.S. at 739.

Public companies recognize that, unlike other class actions they might encounter from time to time, comparatively fewer abusive securities actions can be weeded out at the class certification stage. The requirement that a class be certified almost always poses a meaningful barrier to abusive litigation in the context of suits arising from a company's alleged misstatements made to customers, employees, or business partners. Most importantly, the substantive theories of recovery grounding such actions typically require class-wide proof of reliance—a requirement that frequently permits companies to contest successfully the class treatment of a plaintiff's claims. *See, e.g., Castano v. American Tobacco Co.*, 84 F.3d 734 (5th Cir. 1996) (reversing certification of consumer class action based on concerns about the possibility of class-wide proof of

reliance on alleged misstatements); *Patterson v. Mobil Oil Corp.*, 241 F.3d 417 (5th Cir. 2001) (reversing certification of employee class action based on concerns about the possibility of class-wide proof of reliance on alleged misstatements); *Broussard v. Meineke Discount Muffler Shops, Inc.*, 155 F.3d 331 (4th Cir. 1998) (reversing certification of business tort class action based on concerns about the possibility of class-wide proof of reliance on alleged misstatements); *Heffner v. Blue Cross & Blue Shield of Ala.*, 443 F.3d 1330 (11th Cir. 2006) (reversing certification of ERISA class action because of concerns about the possibility of class-wide proof of reliance).

In stark contrast, companies defending abusive securities suits find themselves facing an onerous, often insurmountable, uphill battle. Under the "fraud-on-the-market theory," reliance is presumed when alleged misrepresentations purportedly impair the value of securities traded in an efficient market. Because misinformation to a market generally may affect a company's stock price, courts are willing to find injury even in the absence of direct reliance on, or even knowledge of, an allegedly fraudulent statement. *See, e.g., Basic Inc. v. Levinson*, 485 U.S. 224, 226, 235 n.12 (1988). Although the presumption of reliance is "rebuttable," *see id.*, overcoming the presumption is, in practice, very difficult and "hardly ever done." Jeffrey L. Oldham, *Taking "Efficient Markets" Out of the Fraud-on-the-Market Doctrine After The Private Securities Litigation Reform Act*, 97 Nw. U. L. Rev. 995, 1013 n.124 (2003).

Equally significant, damages in securities actions are initially calculated based on investors'

cumulative market losses, as opposed to the benefit a defendant may have derived from an alleged fraud. Based on this simple damages formula, plaintiffs typically seek astronomical recoveries that impose overwhelming pressures to settle. Accordingly, even when a complaint "by objective standards may have very little chance of success at trial," *Blue Chip Stamps*, 421 U.S. at 740, if the defendant does not win an early dismissal of the case, the "economics of litigation may dictate a settlement." S. Rep. No. 104-98, at 7 (1995).

Finally, as both legislative and judicial observers have noted, most securities litigation entails enormous discovery costs regardless of whether it is meritorious. *See* H.R. Rep. No. 104-50, at 15 (the costs of discovery in a securities class action will often push corporate defendants to "agree to a substantial settlement out of court"); *see also In re Rhone-Poulenc Rorer Inc.*, 51 F.3d 1293, 1298 (7th Cir. 1995) (citing Henry J. Friendly, Federal Jurisdiction: A General View 120 (1973) (discussing the problem of "blackmail settlements")). Because large defendants have "warehouses full of files," litigants with weak cases are able to "heap" costs on their adversary and there is little that the corporate defendant can do to fight back. Frank Easterbrook, *Discovery As Abuse*, 69 B.U. L. Rev. 635, 636, 643 (1989); *Twombly*, 127 S. Ct. at 1967 (noting in a different context that "the threat of discovery expense will push cost-conscious defendants to settle even anemic cases"). Even the least meritorious of cases have substantial settlement value because the "very pendency of the lawsuit may frustrate or delay normal business activity of the defendant which is totally unrelated to the lawsuit." *Blue Chip Stamps*,

421 U.S. at 740 (citations omitted); *see also Merrill Lynch, Pierce Fenner & Smith, Inc. v. Dabit*, 126 S. Ct. 1503, 1510 (2006).

These dynamics, present to a large extent in all securities class-action litigation, would be greatly magnified if plaintiffs were permitted to impose large discovery costs and threatened liability on companies, like these defendants, with no participation or financial interest in the relevant sales of securities. In such circumstances, by merely alleging a class action, and without proving reliance, plaintiffs would have an open-ended ability to impose potentially overwhelming settlement pressures on tangential actors only remotely connected to an alleged fraud.

In a case such as this one, it will be the rare company that can withstand pressures to settle. Here, the damages alleged by plaintiffs, computed as the loss of value in Charter's stock from its class period high to its October 2002 low, total approximately $7 billion—although plaintiffs seem curiously abashed in mentioning this fact, which is omitted from their briefing. A rational businessperson defending this $7 billion case who has, say, 95 percent confidence of a win on the merits, will nonetheless settle so long as the proffered settlement costs $350 million or less—the expected price of a trial judgment involving a five percent chance of paying $7 billion. It is little wonder, then, that defendants in cases like this one, even cases of dubious merit, almost invariably resolve to silently grit their teeth, crucify their sense of fair play, and hold their collective noses, as they pay out undeserved dollars by the millions. Seldom

can securities class action defendants afford the high price of justice.

For the few defendants who do refuse to compromise, the costs can be dear. The attempts of a prominent plaintiff's firm to drive Lexecon, Inc. out of business, after it testified in support of a securities defendant, and Lexecon's ten-year battle to clear its name, provides a cautionary tale. *See, e.g.*, Melody Peterson, *Law Firm to Pay Longtime Foe $50 Million*, N.Y. Times, Apr. 4, 1999, at C2 (discussing jury verdict finding Nation's largest class-action plaintiffs' firm liable for abuse of process); *see also Lexecon, Inc. v. Milberg Weiss Bershad Hynes & Lerach*, 523 U.S. 26 (1998) (describing history of litigation). As the recent indictment of the Milberg Weiss firm suggests, much securities class-action litigation over the last decade has been driven, not by securities investors, but by entrepreneurial lawyers and the national litigation industry they have come to embody. *See, e.g., U.S. Indictment for Big Law Firm in Class Actions*, N.Y. Times, May 19, 2006, at A1 (indicting class-action- securities firm with making more than $11 million in secret payments to individuals who served as plaintiffs in more than 150 lawsuit, generating $216 million in legal fees); *see also* Mukesh Bajaj, *et al.*, Securities Class Action Settlements: An Empirical Analysis, at 13 (Nov. 16, 2000) (Milberg Weiss accounted for 32% of all securities class-action settlements analyzed from 1988 to 1999). Justice Powell's concern, voiced 32 years ago, that "open-ended litigation" would "itself be an invitation to fraud" has proven remarkably prescient. *Blue Chip Stamps*, 421 U.S. at 761 (Powell, J., concurring).

B. Other Remedies Are Adequate to Protect Investors And Deter Fraud.

Notwithstanding Congress's efforts to curb securities litigation and its abuses in the Private Securities Litigation Reform Act of 1995, the last ten years have seen staggering increases in the costs of securities fraud suits and settlements.

The total dollar value of claims asserted in securities class-action lawsuits skyrocketed from approximately $150 million in 1997 to more than $9.6 billion in 2004. *See* Charles E. Schumer & Michael R. Bloomberg, *To Save New York, Learn from London*, Wall St. J., Nov. 1, 2006, at A18. Moreover, the value of securities class action settlements in 2006 alone exceeded the total value of all settlements concluded from 1996 through 2005. *See, e.g.*, Laura E. Simmons & Ellen M. Ryan, Securities Class Action Settlements: 2006 Review and Analysis Cornerstone Research 1 (2007) ("*Securities Class Action Settlements*"); Michael R. Bloomberg & Charles E. Schumer, *Sustaining New York's and the U.S.'s Global Fin. Servs. Leadership*, at 74 (Dec. 2006) ("Bloomberg & Schumer Study"). Even excluding the massive Enron and WorldCom settlements, the value of cases settled in 2006 grew to some $10.6 billion, surpassing the previous yearly record, $3.5 billion in 2005, by more than 300 percent. *Securities Class Action Settlements*, at 1. Analysts estimate that, not including defense expenses, and amounts paid in SEC actions, fines, and penalties, American businesses paid more than $42 billion in securities class-action settlements between 1996 and 2006. *See id.* And one analyst reports that the "securities class action settlement

pipeline remains strong in 2007, with over $20 billion in tentative and pending settlements active in June." Institutional Shareholder Services, Securities Class Action Services, *at* http://www.issproxy.com/scas (last visited August 14, 2007).

Notwithstanding the extraordinary amounts of money changing hands, securities class litigation has provided no significant benefits to shareholders, nor has it deterred fraud. *See* John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and its Implementation*, 106 Colum. L. Rev. 1534, 1535-36 (2006) (securities class actions inevitably "produce wealth transfers among shareholders that neither compensate nor deter"). Settlement amounts are largely untethered to a defendant's ascertained culpability or the benefits it may have received as a result of its allegedly fraudulent conduct. Rather, the size of a settlement is invariably driven by the size of the defendant's ability to pay. For these reasons, the deterrent effects of large class action payouts is minimal.

Although most securities class suits settle for only a very small percentage of each investors' alleged losses, a large percentage of overall settlement amounts are pocketed by plaintiffs' attorneys. *See, e.g.*, Janet C. Alexander, *Rethinking Damages in Securities Class Actions*, 48 Stan. L. Rev. 1487, 1503 (1996) ("payments by the corporation to settle a class action amount to transferring money from one pocket to the other, with about half of it dropping on the floor for lawyers to pick up"). This means that of the more than $42 billion in settlements from 1996 to 2006, as much as $10 to $20 billion went to pay for legal fees. *Cf.* Bloomberg & Schumer Study, at 1.

More fundamentally, because public companies are owned by the investing public, virtually all of the costs of a modern securities class-action lawsuit fall on the corporation and its insurer and, therefore, are ultimately borne by the defendant corporation's shareholders. *See Interim Report of the Committee on Capital Markets Regulation*, at 78, 71 (Nov. 30, 2006) ("*Interim Report*"); *see also* Coffee, *Reforming the Securities Class Action*, 106 Colum. L. Rev. at 1538 ("securities litigation imposes costs on investors because of harm done to investors—without recognizing that the victim is ... bearing the costs of its own injury"). Because a securities class action is a suit by shareholders victimized by fraud against shareholders who happen to own the company at the time the suit is brought, "shareholders, and particularly institutional investors," are often "on both sides." *Interim Report*, at 11. Investors are always "the ultimate losers when extortionate 'settlements' are extracted" in class-action securities litigation. *Id.* Empirical data suggest that the mere filing of securities litigation decreases the equity value of the defendant company; in fact, it is estimated that at least "$24.7 billion in shareholder wealth" has been wiped out due to litigation. Anjan V. Thakor, *The Unintended Consequences of Securities Litigation*, at 14 (U.S. Chamber of Commerce Institute for Legal Reform 2005).

Given the exponential growth in securities class-action litigation, the Court should be especially wary of petitioner's invitation to impose liability on vendors with no participation or financial interest in the relevant securities market activity. The investor losses that purportedly concern Stoneridge and its *amici* are much more appropriately addressed

through enforcement mechanisms other than private securities class actions—mechanisms that pose far fewer risks of picking the pockets of investors they were established to protect.

For example, Congress has given the SEC numerous statutory and administrative tools for preventing and punishing fraud. The SEC may obtain injunctive relief, issue administrative orders, and impose large civil penalties, including disgorgement remedies, on any companies engaged in or aiding and abetting fraud. *See, e.g.*, 15 U.S.C. §§ 78u, 78u-3. Exercising this authority in fiscal year 2006, the Commission initiated 914 investigations, 218 civil proceedings, and 356 administrative proceedings. *See U.S. Securities and Exchange Commission: 2006 Performance and Accountability Report*, at 8 (2006). In that same year, the Commission recouped more than $3.3 billion in disgorgement and other penalties. And over the last five years, it has recouped a total of approximately $8 billion for distribution to harmed investors. *See id.*

Other government entities have likewise responded with vigor to securities-related fraud. The Department of Justice's Corporate Fraud Task Force, created in 2002, has as its mission restoring "public and investor confidence in America's corporations following a wave of major corporate scandals." Department of Justice, *Fact Sheet: President's Corporate Fraud Task Force Marks Five Years of Ensuring Corporate Integrity* (Jul. 17, 2007). Since its inception, the Task Force has "compiled a strong record of combating corporate fraud and punishing those who violate the trust of employees and

investors," obtaining 1,236 corporate fraud convictions as of July 17, 2007. *See id.* Similarly, the Department's Asset Forfeiture and Money Laudering Section has obtained more than $1 billion in fraud-related forfeitures, which it has distributed to victims of fraud. *See id.*

II. Expansive Liability Discourages Foreign Companies From Investing In United States' Public Markets.

In addition to harming investors, securities class-action abuse reduces the overall competitiveness of United States securities markets, as fear of potential liability discourages foreign companies from listing on American stock exchanges. *See Common Sense Legal Reform Act: Hearings on H.R. 10 Before the Subcomm. on Telecommunications and Finance of the H. Comm. on Commerce*, 104th Cong., 1st Sess. 221, 224 (1995) (statement of former SEC Chairman Richard C. Breeden) (based "on conversations with potential issuers of securities all over the world, the fear of litigation inhibits foreign firms from participating in the U.S. market[s]"). Vague, unpredictable, and expansive liability rules harm the financial services sector and deter foreign investment.

Like many parts of the economy, the financial services sector "has become increasingly subject to the forces of globalization and international competition." Bloomberg & Schumer Study, at 31; *see also id.* at 39. The United States historically has had the deepest, most liquid, financial markets in the world. But, as technology has eliminated barriers to the flow of capital, investors have increasingly focused on competitive differences

between markets. The United States can "no longer take" its "preeminence in the financial services industry for granted." *Id.* at i ("if we do nothing, within ten years ... we will no longer be the financial capital of the world").

A leading indicator of the competitiveness of the United States public equity markets is their ability to attract listings of foreign companies engaged in initial public offerings ("IPOs"). *See Interim Report*, at 29; *see also* Bloomberg & Schumer Study, at 43 (IPOs "are the first in a series of events that generate substantial recurring revenues for the host market"). By that measure, the United States' markets' recent performance is disturbing. From 2000 to 2005, the percentage of global IPOs listing in the United States declined from 37 percent to 10 percent. *See Interim Report*, at 29; *see also* Bloomberg & Schumer Study, at 43 (in 2006, U.S. exchanges captured one-third of the amounts captured in 2001). In sharp contrast, the global share of IPO volume "captured by European exchanges has expanded by more than 30 percent over the same period, while non-Japanese Asian markets have doubled their equivalent market share since 2001." Bloomberg & Schumer Study, at 43. In short, whether considering the relative percentage of global IPOs taking place on U.S. exchanges, or the relative value of those offerings, "the U.S. exchanges are rapidly losing ground to foreign rivals." *Id.*

The decline of the U.S. public exchanges in an increasingly international market is closely tied to the growing global perception of the United States' legal system as costly and unpredictable. *See* Bloomberg & Schumer Study, at 16; *see also* Ian

Swanson, *Foreign Executives Press for Reform of Litigation in the United States*, The Hill, May 17, 2007. Notwithstanding recent efforts to "curb class action abuses, such lawsuits are still viewed by foreign investors as sources of significant uncertainty." Robert E. Litan, *Through Their Eyes: How Foreign Investors View and React to the U.S. Legal System*, at 14 (Aug. 2007); *see also* Survey, *Obstacles to TransAtlantic Trade and Investment*, at 11 (June 2005) ("legal liabilities or the fear of legal action ... deters European companies from doing business in/with the United States").

In fact, numerous studies and reports have found that the "United States is losing its leading competitive position as compared to stock markets and financial centers abroad" in part because of expanding "liability risks." *Interim Report*, at ix, x. Foreign companies are "staying away from U.S. capital markets for fear that the potential costs of litigation will more than outweigh any incremental benefits of cheaper capital." Bloomberg & Schumer Study, at 101. As Paul S. Atkins, an SEC Commissioner, recently emphasized, "abusive class actions that result in few or imaginary benefits for class members, but for which large cash fees are paid to plaintiffs' attorneys," are a significant problem that "add to the global perception that the U.S. legal system operates as a 'lottery-like' system of justice." Speech by Comm'r Paul S. Atkins, *Is Excessive Regulation and Litigation Eroding U.S. Financial Competitiveness* (Apr. 20, 2007). United States' "businesses are now being subjected to various class actions that previously would have ... been thought laughable." *Id.* The liability risks that even these "laughable" actions entail are "driving growing

international concern about participating in U.S. financial markets." Bloomberg & Schumer Study, at 16.

The large difference in the hard-dollar costs entailed by litigation risks in the United States as opposed to other markets is undeniable. In 2004, for example, private securities class actions in this country resulted in $3.5 billion in liability, and civil penalties amounted to an additional $4.74 billion. *See Interim Report,* at 11, 71. In contrast, in the United Kingdom, penalties for all financial sectors during the same period totaled a mere $40.48 million. *Id.* Reflecting these differences, the price of Directors and Officers' insurance in the United States is six times the cost of comparable insurance in Europe. *See id.* at 71, 78. Overall, "gross financial regulatory costs" are approximately 15 times larger in the United States than in Britain. *See* Schumer & Bloomberg, *To Save New York*, at A18.

Even beyond actual litigation costs, it has become increasingly clear to international investors that the mere threat of legal action in the United States can destroy a company. *See* Bloomberg & Schumer Study, at 76; *see also* Timothy Shipman, *Stoneridge Court Case Threatens Trade With US*, Sunday Telegraph, Jul. 7, 2007 ("British companies that conduct business in the United States or do deals with American companies could find themselves sued for billions of dollars"). The number of companies hobbled, forced into bankruptcy, or even liquidated in response to the threat of securities-related litigation, has reinforced the international perception of the United States legal system as unpredictable,

unfair, and unnecessarily punitive. *See* Bloomberg & Schumer Study, at 76.

III. Because The Vendors Entered Arm's-Length, Non-Financial Transactions, They Should Not Be Subjected To Expansive Liability.

Congress enacted the PSLRA because it recognized the problems of expansive liability and wanted to provide a "check against abusive litigation by private parties." *Tellabs*, 127 S. Ct. at 2504; *see also* H.R. Rep. No. 104-369, at 31 (1995) (noting the PSLRA was intended to curb perceived abuses of the section 10(b) private action). Instead of heeding calls for the restoration of private aiding-and-abetting liability, Congress sought to "remov[e] the plaintiffs' class action bar from the equation" by granting the Securities and Exchange Commission, but not private litigants, the authority to prosecute aiders and abetters who provide "substantial assistance" to those engaged in fraud. 4 Bromberg & Lowenfels, Securities Fraud & Commodities Fraud § 7:308, at 7-506 (2d ed. 2006).

Stoneridge and its *amici* nonetheless insist that, at least in cases of established fraud, there might well be instances (and they insist this is one) where actors such as accountants, lawyers, underwriters, bankers—and vendors—are so integrally intertwined in fraudulent conduct that they deserve to bear the brunt of private class litigation, however onerous that may be. *See* Stoneridge Br. at 36 (describing hypothetical situation in which attorney allegedly should be subject to securities law liability); AARP Br. at 3 (arguing for imposing liability on "accountants, bankers, lawyers, and others who are

not affiliated with the corporate issuer but who actively scheme with the issuer"); Br. of Ohio *et al.*, at 4-5 (arguing in favor of imposing liability on "unprincipled accountants, lawyers, and banks, as well as unscrupulous vendors").

An obvious problem with these arguments is that they obscure the question presently at issue by focusing on *other* types of secondary actors that might be sued in *other* types of cases. This case does not involve some faithless fiduciary or scheming capital-provider. It involves two vendors engaged in arm's-length sales of ordinary goods and services. Whatever issues tomorrow may bring, as the Eighth Circuit correctly recognized, there is and can be no claim that Scientific-Atlanta and Motorola occupy a fiduciary position with respect to Charter or its shareholders. *See In re Charter Commc'ns, Inc., Sec. Litig.*, 443 F.3d 987, 992 (8th Cir. 2006) (reasoning that the vendors were not "under a duty to Charter investors and analysts to disclose information useful in evaluating Charter's true financial condition"). And there also can be no claim that Scientific-Atlanta or Motorola invested their own capital in Charter and then schemed with management to protect or enhance that investment. All questions of liability standards for attorneys, accountants, other professionals, and unscrupulous capital providers can therefore await another day.

In contrast to petitioner's subjective and conveniently malleable "purpose and effect" standard, *see, e.g.*, Stoneridge Br. at 14-15, the Eighth Circuit's legal test involves a pair of inquiries that yield final, predictable, and just outcomes in thousands of real-world situations. *First*, did the

"business transaction" between a securities issuer and its alleged co-principal involve sales of ordinary goods and services, as opposed to the provision of capital or professional services used to obtain capital? *See* 443 F.3d at 992 (focusing on whether a transaction involved "goods and services other than securities"). *Second*, assuming the dealings involved ordinary goods and services, were the relevant sales concluded at "arm's length," in the sense that they occurred between entities not maintaining cross-holdings or other interests in one another's securities and not under common ownership? *See id.* As the Eighth Circuit recognized, satisfying both prongs of this test should be sufficient (although not necessary) to obtain a suit's dismissal under the securities laws. Where, as here, both prongs are met, dismissal is in order and the risk of vexatious litigation is eliminated. *Id.*

The fact that these two vendors' dealings with Charter are accurately described as an "arm's-length" vendor-buyer relationship involving "goods and services other than securities" is dispositive with respect to whether a federal *securities* fraud may have occurred. *See* 443 F.3d at 992. To violate section 10(b), a party must use or employ a manipulative or deceptive device "in connection with the purchase or sale" of any security. 15 U.S.C. § 78j(b) (2006). The Congress that enacted section 10(b) intended to target "unfair practices in speculation"—that is, practices engaged in by market actors in connection with the purchase or sale of securities. *See* S. Rep. No. 73-792, pt. II.4 (1934). Congress paid particular attention to practices such as stock pools, "wash" sales, stock price manipulation by market specialists, short sales, market letters,

and paid propaganda, because each of those practices involved transactions among market actors acting as such or conduct directed at the securities markets. *See id.*; *see also* S. Rep. No. 73-1455, pt. I.7, at 26-50 (1934). In short, the Securities Exchange Act sought "to regulate the stock exchanges and the relationships of the investing public to corporations which invite public investment by listing on such exchanges." H.R. Rep. No. 73-1383, at 2. The drafting history of section 10(b) thus confirms what its plain language makes clear: Congress did not intend for section 10(b) to impose liability for all securities market reverberations of all common fraud, but only to impose liability for frauds committed "in connection with" purchases and sales of securities.

Against this backdrop, this Court has, quite properly, been willing to find fraudulent behavior sufficiently "connect[ed] with the purchase or sale of any security" only where (i) the violating party directly purchases or sells securities, or (ii) the fraudulent or deceptive behavior "coincides" with the purchase or sale of a security. *SEC v. Zandford*, 535 U.S. 813, 819–20 (2002). By interpreting the "in connection with" requirement of section 10(b) as limiting liability only to those actors who themselves deal in securities or have a stake in others' dealings in securities (such as parties making disclosures, owing fiduciary duties to investors, engaging in insider trading, or otherwise acting in the public markets), the Court has properly respected Congress's decision to focus on wrongful conduct occurring in securities markets. *See Blue Chip Stamps*, 421 U.S. at 733-34 & n.5 (the "in connection with" requirement is "badly strained" when

construed to cover "the world at large"). There is not a shred of evidence in section 10(b)'s text or drafting history suggesting that it was intended to reach ordinary, arm's-length commercial transactions, even fraudulent transactions, engaged in with a securities issuer.

Stoneridge responds to the Eighth Circuit's analysis by subtly taking issue with its labeling of the vendors' dealings as "arm's length business transactions in goods or services other than securities." 443 F.3d at 992; *see* Stoneridge Br. at 14 ("This is not a case involving an 'arm's length transaction' in which a party acted honestly but perhaps with knowledge that the transaction would mislead investors."). But, of course, the probity or dishonesty of those participating in a transaction has nothing to do with whether the transaction is concluded at "arm's length." Black's Law Dictionary 116 (8th ed. 2004) (arm's-length transactions involve "dealings between two parties who are not related or on close terms"). So long as two parties are "not related," party A can sell party B the Brooklyn Bridge in an "arm's length" (albeit utterly fraudulent) transaction. Accordingly, in commercial contract, fraud, and negligence cases, courts have long recognized that parties who enter arm's-length transactions do so without forming a "confidential relationship," and that such transactions do not create "fiduciary duties between the parties." *Id.*; *see also Schulist v. Blue Cross of Iowa*, 717 F.2d 1127, 1132 (7th Cir. 1983) (no fiduciary relationship arises when parties transact at arm's length).

Stoneridge's more vigorous contention is that the Court should read the "in connection with"

requirement out of section 10(b) because to enforce that requirement would be to teach companies "that they can get away with fraud." Stoneridge Br. at 35. Stoneridge contends that expanding section 10(b)'s reach beyond its plain terms is essential because otherwise "a logistics company could hide inventory for customers during audits"; or a "testing lab could, for a fee, provide false 'proof' that a new invention worked or that a new drug was effective or safe." *Id.* at 36. But even if all this were true (and it is not), the Court still would have no warrant to overlook important limitations enacted by Congress. *See, e.g.*, *United States v. National Ass'n of Securities Dealers, Inc.*, 422 U.S. 694, 720 (1975) (Court is bound by statutory limitations defined by Congress). Securities actions are a class litigation vehicle of choice for plaintiffs' attorneys precisely because they offer almost limitless opportunities for imposing discovery costs, favorable methods for toting up damages, relatively easy methods for establishing reliance, and other attractive features. To disregard express limitations on the employment of this vehicle of choice would expand section 10(b), without warrant, beyond its intended scope.

In truth, the prospect of companies escaping liability after committing Stoneridge's hypothetical horribles is just that—entirely hypothetical. Criminal and civil sanctions for fraud were fixtures in Anglo-American jurisprudence for centuries before the Securities Act of 1933 and the Securities Exchange Act of 1934, and remain so today. *See, e.g.*, 3 William Blackstone, Commentaries on the Laws of England 431 (1768) ("[I]t hath been said, that fraud, accident, and trust are the proper and peculiar objects of a court of equity. But every kind of fraud

is equally cognizable, and equally adverted to, in a court of law."). Accordingly, the fact that a company may be immune from prosecution for *securities* fraud does not mean it is immune from prosecution for mail fraud, wire fraud, common law fraud, or the many other species of fraud the law prohibits. *See, e.g.*, 18 U.S.C. § 1341 (2002) (criminalizing mail fraud); *id.* § 343 (criminalizing wire fraud). In this case, as in the Stoneridge hypotheticals outlined above, there clearly was no fraud by vendors in connection with the purchase or sale of *securities*; hence, no *securities* fraud can properly be alleged.

A bright line recognizing that ordinary commercial transactions fall outside the federal prohibition of *securities* fraud is in the long-term interest of all investors. Companies engaged in ordinary business should be able to know in advance what will and will not expose them to the securities laws' potentially devastating liabilities. Fudging this line, by holding companies potentially liable for securities frauds committed by their arm's-length business partners, would pull companies in conflicting directions by forcing them to choose between, on the one hand, serving the interests of their own shareholders by entering into favorable transactions that enhance corporate wealth; and, on the other hand, declining to enter arm's-length transactions where there is some unquantifiable risk of being accused of complicity in someone else's fraud.

Finally, Stoneridge contends in passing that extending securities law liability to arm's-length vendors does not unduly risk outsized liability because, in the wake of the Private Securities

Litigation Reform Act, the securities laws now limit liability to amounts proportionate to fault. *See* Stoneridge Br. at 16 ("Congress imposed a system that made each actor responsible only for its proportionate share of damages absent a knowing violation."). This provision for proportionate liability is cold comfort, however, to parties like these defendants who bear only attenuated responsibility for potentially enormous losses. The most telling aspect of Stoneridge's briefing may well be its complete omission of any mention of the $7 billion potential damages entailed by the Charter stock drop. Stoneridge accounts almost to the penny for the $17,530,000 by which Scientific-Atlanta and Motorola allegedly inflated their invoices to Charter. *See* Stoneridge Br. at 8. And Stoneridge further contends that this $17,530,000 in "free" advertising actually may have been worth only one-fifth as much, or perhaps $3,506,000. *Id.* at 11. But by failing to mention any estimate of the Charter investors' total losses, Stoneridge effectively turns a blind eye to the very troubling *ratio* between these figures—the fact that the defendants' supposed receipt of some $3.5 million worth of undeserved free advertising has prompted their joinder in a suit in which claimed damages may well approach $7 billion, or 2,000 times as much.

Nor can these defendants find solace in the fact they might someday have an opportunity to contend that they should be held responsible for only a small share of an allegedly gigantic loss. If held responsible for *only one percent* of $7 billion, the defendants are in line for liability equal to $70 million or approximately 20 times the supposed value of the supposedly ill-gotten benefit they

received. Moreover, proportionate liability, while it can reduce the upper bound on a defendant's exposure, can make the imposition of that lesser liability more likely by inviting triers of fact and other decisionmakers to spread the blame and attendant pain. Proportionate liability, in this context, is not an effective antidote to the problem of litigation abuse; rather, it is a further example of the type of subjective and open-ended liability rule that invites plaintiffs to seek the deepest possible pockets into which they can dive for litigation riches.

As the Court has recognized in a different context, "[d]eciding what competing values will or will not be sacrificed to the achievement of a particular objective is the very essence of legislative choice." *Rodriguez v. United States*, 480 U.S. 522, 526 (1987). It "frustrates rather than effectuates legislative intent simplistically to assume" that more liability is inevitably better than less. *Id.* Here, Stoneridge assumes "simplistically" that more securities law liability is always better, even for equipment makers that dealt in set-top boxes, not stocks and bonds. Whatever penalties may or may not be warranted for the alleged actions of these defendants, assuming Stoneridge's allegations can be proven, those penalties certainly should not include an enormous potential liability for losses incurred by Charter's investors.

CONCLUSION

For these reasons, the judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

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August 15, 2007