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Financial Reform and Liability: Congress Must Ensure That All Wrongdoers Are Accountable

The U.S. Supreme Court has issued two decisions that are a direct blow to defrauded American investors and make it more likely fraud will occur. These decisions say that banks, accountants, law firms and other institutions that help companies mastermind fraud ("aiding and abetting" fraud) or even intentionally commit fraud themselves, are not liable to investors. These decisions have substantially weakened consumer protections and seriously compromised the integrity of American markets.

U.S. Senator Chris Dodd (D-CT)'s financial reform legislation originally contained provisions to correct some of these problems. However, they have since been dropped from the bill. They must be reinstated.

The following are the two problematic Supreme Court decisions that Congress must fix:

Central Bank of Denver, N.A. v. Interstate Bank of Denver, N.A.1 decided in 1994, where the Court ruled that shareholders could not sue "aiders and abettors" of corporate fraud.

- In 2009, U.S. Senator Arlen Specter (D-PA) called *Central Bank* an "errant" decision.2 Before that ruling, he noted, "[E]very circuit of the Federal Court of Appeals had concluded" that anyone who aids and abets a fraud should be liable.3

- Senator Specter noted that in the mid-1990s, "then-SEC chairman Arthur Levitt and others urged Congress to overturn *Central Bank*. Congress declined to do so." And massive frauds followed (Enron, Refco, Tyco, WorldCom, etc.), showing that "auditors, bankers, business affiliates, and lawyers … all too often actively participate in and enable the issuer's fraud." 4

- He also noted, and as we have particularly seen in recent years with the Madoff scandal and others, "Enforcement actions by the SEC have proved to be no substitute for suits by private plaintiffs."5

Stoneridge Investment Partners v. Scientific-Atlanta, Inc. et al.**,** decided in 2008,6 where the Court ruled that investment banks, lawyers, accountants, credit rating bureaus or other so-called "secondary actors" who knowingly help a public company deceive investors cannot be liable for the fraud if they did not make a material misrepresentation to shareholders.

- This decision broke with SEC precedent, and was opposed by members of Congress

from both parties and the views of 33 state attorneys general. State attorneys general wrote in their brief supporting liability: "The view that those crafty enough to benefit from participating in a securities fraud while carefully avoiding the public attribution of a false statement to them can escape liability directly conflicts with the broad language and purposes of the antifraud provisions. Indeed one could argue that it is precisely with respect to such a scheme that the anti-fraud provisions are needed the most."7

- Victims of Enron's massive fraud were directly hurt by *Stoneridge*, which immunized investment banks complicit in the scheme.8

- At least one federal judge has already criticized *Stoneridge* and called on Congress to overrule the Supreme Court's decision.9 In a March 2009 ruling, Judge Gerald Lynch (S.D.N.Y.) said:

It is perhaps dismaying that participants in a fraudulent scheme who may even have committed criminal acts are not answerable in damages to the victims of the fraud. …This [law] may be ripe for legislative re-examination."10

NOTES

1 511 U.S. 164 (1994).

2 Statement by U.S. Senator Arlen Specter on Introduced Bills and Joint Resolutions, *Congressional Record*, July 30, 2009, p. S8564.

3 *Ibid.*

4 *Ibid.*

5 *Ibid.*

6 552 U.S. 148 (2008).

7 Center for Justice & Democracy, *Impact: Investor Rights in Jeopardy* (Summer 2007)

8 *Id*.

9 *In re Refco, Inc. Securities Litigation*, 2009 WL 724378 (S.D.N.Y., March 17, 2009).

10 *Id.* at *318.

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