PUBLICATION

Senator Specter Proposes Legislation To Drastically Change The Breadth of Section 10(b) and Rule 10b-5 Securities Fraud To Include Secondary Actor Liability

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On July 30, 2009, Senator Arlen Specter (Democrat, Pennsylvania) introduced legislation (S. 1551) in the United States Senate that would expand federal securities fraud liability under § 10(b) of the Securities Exchange Act of 1934 (Exchange Act) to entities such as law firms, accounting firms and investment banks that provide "substantial assistance" in a fraud on the investing public. If enacted, this legislation would shatter the current limits of securities fraud litigation to "primary actors," established in two landmark decisions over the last fifteen years by the United States Supreme Court, the 1994 decision in Central Bank v. First Interstate Bank of Denver, 511 U.S. 164 (1994) and the most recent 2008 decision in Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc. et. al, 552 U.S. 148 (2008).

Central Bank. In 1994, the United States Supreme Court held in Central Bank that a private plaintiff may not maintain an aiding and abetting action against secondary actors under § 10(b) of the Exchange Act. Central Bank involved a lawsuit by certain bond holders after the public authority that issued them defaulted on the bonds that had been secured by landowner assessment liens. The bondholder lawsuit was filed against the authority that issued the bonds, the bond underwriters, the owner of the land in question and the bank that was the indentured trustee for the bonds. The plaintiffs alleged that the bank was a secondary actor that should be held liable under § 10(b). The District Court granted summary judgment in favor of Central Bank, but the Court of Appeals overturned that ruling, holding that under that Circuit's precedent, plaintiff investors can bring aiding and abetting suits against secondary actors. Central Bank, 511 U.S. 164. Focusing on the text of § 10(b), the Supreme Court overturned the Court of Appeals' ruling and held that the law as currently written "prohibits only the making of material misstatement (or omission) or the commission of a manipulative act, and does not reach those who aid and abet a violation." Id. at 177.

Stoneridge. Roughly fourteen years later, the Supreme Court confronted a similar issue in Stoneridge. The case made national news, with the United States Securities and Exchange Commission weighing in on the side of the investors, and the Bush administration, along with Solicitor General Paul Clement, siding with the Respondents in its opposition to "scheme liability" alleged by Stoneridge. The company claimed that it purchased Charter Communications, Inc. common stock that was inflated due to financial improprieties of Charter, its suppliers and customers. Stoneridge alleged that after these purported improprieties were disclosed, Charter's stock price fell from a high of $26.31 to a low of $0.76 per share in October 2002. The company claimed that Scientific-Atlanta and Charter's other customers and suppliers "had agreed to arrangements that allowed Charter to mislead its auditor and issue a misleading financial statement affecting its stock price." Stoneridge, 552 U.S. at 148. Stoneridge admitted that Respondents had no role in preparing or disseminating Charter's financial statements. Nevertheless, the Supreme Court affirmed the ruling of the Eighth Circuit, dismissing the case against Charter's customers and suppliers on the grounds that they had not made any misstatements relied upon by the investing public or violated any duty of disclosure. In so ruling, the Supreme Court held that Stoneridge's § 10(b) and Rule 10b-5 claim against Respondents, for "scheme liability" was nothing more than a claim of aiding and abetting, and no private right of action exists for such claims under § 10(b) as the Supreme Court ruled in Central Bank.

Senator Specter Proposed Legislation. If Senator Spector's legislation becomes law, commentators agree securities fraud litigation will increase exponentially against the host of entities that work with public companies and their officers and directors. Recognizing this fact, Senator Spector has stated that the new law is still needed because "[i]mmunity under the two Supreme Court decisions has removed incentives for firms 'to avoid complicity in and even prevent securities fraud' . . . . and that a "public company's auditors, bankers, business affiliates, and lawyers 'all too often actively participate in and enable the issuer's fraud.'" "Spector Law Would Let Investors Sue Fraud Accomplices," Bloomberg.com, August 4, 2009.

The bill currently sits with the Committee on the Judiciary. Senator Specter serves on that committee. The bill has three co-sponsors, all Democrats, two that sit on the Senate Judiciary Committee and one that sits on the Senate Banking Committee, the latter of which is believed to be the committee that will lead financial services reform this year in the Senate. It is anticipated that this bill or a similar bill could be included as part of the broader financial regulatory reform legislation that Congress is under pressure to consider this fall. At this time, no member of the House of Representatives has proposed a similar bill.

For more information, please contact your Baker Donelson attorney.