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Big-Money Battle Pits Business vs. Trial Bar

Supreme Court Case Could Open More Firms To Lawsuits Over Fraud

By KARA SCANNELL

The Supreme Court is wading into one of the most intense battles ever waged between two deep-pocketed enemies: the trial bar and big business.

Today, the justices will hear arguments in a case that hinges on whether defrauded shareholders should be allowed to sue not just the company that committed the crime, but also its advisers, lawyers, accountants and vendors.

Dan Newman

A ruling for the plaintiffs could significantly expand the power of defrauded shareholders to sue -- and could dramatically increase monetary paybacks. It could spark a host of new shareholder suits and expand the multibillion-dollar field of securities class-action lawsuits.

Since last April, when the justices agreed to hear Stoneridge Investment Partners LLC v. Scientific-Atlanta Inc., big business and big law have been waging a high-profile legal and public-relations battle that some observers say is unprecedented for a securities-law case. People on both sides plotted strategy and chased down former Securities and Exchange Commission officials in hopes of winning their support. In one instance, a representative of the plaintiffs won a last-minute meeting with the SEC by threatening to issue an unflattering press release.

Supporters of the plaintiffs have "been running this more like a political campaign than a Supreme Court brief," says Joseph Grundfest, a former SEC commissioner retained by the defendants.

Both sides have lined up support from some of the most important names in politics and the economy. Siding with the trial bar: two House committee chairmen, 18 pension funds, 32 state attorneys general, and the SEC itself. Backing big business: the U.S. Chamber of Commerce; the Nasdaq and NYSE Euronext exchanges; seven high-profile New York lawyers; and the Justice Department's solicitor general, who represents the views of the White House.

Stoneridge is "a critically important case for all investors, markets, and victims of corporate fraud," says Dan Newman, a public-relations strategist working for the plaintiffs.

The showdown comes at a time when the plaintiffs bar is losing ground. In June, the Supreme Court sided with business when deciding what standard of proof plaintiffs must meet to file securities lawsuits against

companies. Earlier this year, the justices essentially inoculated Wall Street firms from antitrust claims. The Bush administration says it is working with regulators on a series of recommendations to "balance" the U.S.'s competitive position with shareholder litigation.

The Stoneridge case revolves around an obscure episode that occurred at the tail end of the 1990s dot-com bubble, when companies were under increasing pressure to keep reporting spectacular earnings growth. Charter Communications Inc., a St. Louis cable provider, engaged in accounting fraud to meet analyst expectations. Four former Charter employees were indicted and pleaded guilty to conspiracy. The company also agreed to pay $144 million to settle a class action suit led by one of its shareholders, Stoneridge Investment Partners of Malvern, Pa.

But Stoneridge also sued Motorola Inc. and Scientific-Atlanta, now a unit of Cisco Systems Inc. Both vendors agreed to charge artificially high prices for cable boxes they sold to Charter. Then they used the extra money to "buy" advertising from Charter -- money Charter used to inflate its bottom line.

A federal judge dismissed Stoneridge's lawsuit against Motorola and Scientific-Atlanta, citing a 1994 Supreme Court case that said shareholders can't sue third-party companies for aiding and abetting. Stoneridge lost again in the federal appeals court in St. Louis in April 2006. But another appeals court ruled in an unrelated case that shareholders could sue third-parties under certain circumstances. Stoneridge asked the justices to rehear the issue. This past April, the High Court agreed, putting it on the docket for this month.

The Tort King

The Stoneridge investors are represented by Stanley Grossman, a New York class-action securities lawyer. But much of the political strategy was driven by William Lerach, the famed -- and tainted -- tort king. Mr. Lerach's firm is representing former Enron Corp. shareholders in their bid to hold the fallen firm's investment banks liable, a suit that could greatly benefit from a favorable Supreme Court ruling.

But Mr. Lerach faced a Justice Department investigation into whether he and others financially induced plaintiffs to participate in numerous securities class-action suits. With the exception of expenses and incidentals, it is illegal for a lead plaintiff in a federal securities class action to receive more compensation than other members of the class.

Last month, Mr. Lerach reached an agreement with prosecutors to plead guilty to conspiracy. Scheduled to enter a guilty plea later this month, he declined to comment for this story.

When the Supreme Court put Stoneridge on its docket, lobbyists on both sides went into overdrive, searching for big names who would be willing to file amicus, or friend-of-the-court, briefs. Both sides looked for heavy hitters. The more important the brief writer, they reasoned, the more likely the justices would take notice.

In April, a Lerach partner ran into Duke law professor James Cox at a cocktail party and got him to help draft a brief and talking points. Mr. Cox in turn drafted securities-law professors from Georgetown and Berkeley, and the Lerach firm covered the costs of their brief.

Taking Sides

Should shareholders be able to sue third parties for fraud committed by another U.S. corporation?

YES (Filed for the petitioners)

William Donaldson
Former SEC Chairman, 2003-2005

- 2 former SEC chairmen
- 1 former SEC commissioner
- 18 large retirement funds

Barney Frank
U.S. Congressman

- 32 state attorneys general
- 8 university professors
- 7 large organizations and lobbying groups

NO (Filed for the respondents)

Harvey Pitt
Former SEC Chairman, 2001-2003

- U.S. solicitor general
- 3 former SEC chairmen
- 11 former SEC commissioners
- 2 former SEC general counsels
- 11 university professors

Joseph Grundfest
Former SEC Commissioner, 1985-1990

- 7 New York lawyers
- 3 business lobby groups
- 3 legal trade groups
- 3 international organizations
- 10 financial organizations

Photos (left to right): Bloomberg News/Landov (2); Reuters, Stanford University

To handle the press on his legal problems -- and to help with Enron -- Mr. Lerach had recently brought in Mr. Newman as his San Diego-based law firm's in-house communications and public-affairs director. A veteran Democratic political operative in California, 38-year-old Mr. Newman got to know Mr. Lerach -- a big donor to the party -- through various campaigns.

Heading to Capitol Hill

Mr. Newman and supportive lawyers headed to Capitol Hill. Pennsylvania Republican Sen. Arlen Specter, a longtime member of the Judiciary Committee, and Connecticut Democrat Sen. Christopher Dodd, chairman of the Banking Committee, wrote letters supporting the plaintiffs' position. Two House chairmen -- Massachusetts Democrat Barney Frank of the Financial Services Committee, and Michigan Democrat John Conyers of the Judiciary Committee -- filed a joint amicus brief on behalf of the plaintiffs.

Over the summer, a Web site sponsored by the American Association for Justice, the trial-bar lobby, posted form letters online and urged individuals to write to their local

newspapers. Letters ran in at least 17 news outlets from Michigan's Flint Journal to the Roanoke Times in Virginia.

An equally high-powered counter effort was percolating among the case's defendants. Motorola and Scientific-Atlanta had hired Mayer Brown, a Chicago-based law firm that had often squared off against Mr. Lerach in the past. Stephen Shapiro, the Mayer Brown lawyer arguing the case, has appeared before the Supreme Court 26 previous times.

Mayer Brown retained Mr. Grundfest, the former SEC Commissioner and Stanford law professor who had recently helped an executive at Dynegy Inc. -- the subject of another Enron-era corporate scandal -- reduce a fraud sentence from 24 years to six. Mayer Brown also hired Mark Corallo, a former Bush Justice Department spokesman who runs a crisis-communications firm. Mr. Corallo previously represented former Bush adviser Karl Rove in a federal investigation into who leaked the identity of a CIA agent.

Corporate trade and legal groups started contacting Mayer Brown to offer their support. After more than a dozen -- including the National Association of Manufacturers and the U.S. Chamber of Commerce -- signed on, their representatives joined a June conference call to coordinate efforts.

As the group strategized, potential legal arguments were discussed to try to limit repetition. "If we want to have an impact we can't all be in the same space repeating the same arguments," says one amicus filer who didn't want to be identified.

The first major battle broke out over the summer, as the two sides raced to recruit former high-ranking SEC officials.

Harvey Goldschmid, a SEC commissioner until 2005, took an interest in the case, having shared the plaintiffs' view that third-parties should be held liable when he was at the commission. Over the summer, he ran into two former SEC chairmen who had cultivated reputations as investor allies: Arthur Levitt and William Donaldson. The three agreed to file a brief together.

News reports of that brief stirred concern among former SEC officials who opposed its position. "That sure prompted me to try to point out as much to the press as to the judges on the high bench that, 'Hey, this is not a one-way deal,' " says Edward Fleischman, a former SEC commissioner and now a securities lawyer. He contacted other former SEC officials.

Both sides reached out to Harvey Pitt, the first SEC chairman under President Bush. On June 20, Mr. Lerach met Mr. Pitt for breakfast at the Mayflower Hotel in downtown D.C., seeking support for the shareholders. But there was never any follow up, Mr. Pitt says. A few weeks later, Mr. Fleischman emailed Mr. Pitt. Traveling with his family in Barcelona, Spain, Mr. Pitt sent back edits from his hotel room and ultimately signed a brief backing the defendants.

Lining Up Support

Between them, the plaintiffs and defendants lined up a total of two former SEC general counsels, five former SEC chairmen and 12 former SEC commissioners. In all, 30 amicus briefs were filed in the case, a turnout usually reserved for hot-button national issues like civil rights or abortion.

But the brief both sides wanted to win most was one from Solicitor General Paul Clement, the legal voice of the White House.

Lerach's team knew winning over the White House was hopeless because of the Bush administration's pro-business, anti-litigation bent. But they took solace in the fact that administration positions are usually shaped by the lead agency on the matter. They felt they could persuade SEC Chairman Christopher Cox, who they believed was sensitive to public opinion and eager to be portrayed as a champion of individual investors.

On May 8, scores of letters from consumer groups -- organized by Mr. Newman -- began flowing into the SEC's office. The next morning, Mr. Newman organized a news conference with a group of Enron shareholders at a hotel near SEC headquarters. Mr. Newman knew he'd get far more attention if he tied the Stoneridge case to one of the biggest frauds in American business history.

Mr. Newman had been seeking to get the Enron group a private meeting with Mr. Cox. That morning, he heard his request was denied. Mr. Newman immediately pecked out a hypothetical news release on his BlackBerry: "Although we traveled thousands of miles...to tell our stories as victims of the Enron fraud, Chairman Cox refused our request for a brief meeting." He sent it to Mr. Cox's office, noting he planned to issue the statement shortly.

Mr. Newman's cellphone soon rang. A Cox aide said they should come that afternoon.

During the meeting, Mr. Cox's aides noted the more than $400 million in fines they had extracted from the Enron fraud. Mr. Cox didn't commit to a position in the Stoneridge case but told the investors they could be confident the SEC would do its part to see they could recover the maximum amount possible. Three weeks later, on May 30, the SEC commissioners voted to recommend to the solicitor general that the government file in support of the plaintiffs. Mr. Cox has said it was important for the SEC to be consistent in its interpretation of the law and maintain the same position it had taken in an amicus brief filed in an earlier, unrelated case.

That was an important victory for the plaintiffs. But it didn't guarantee the solicitor general's support.

Indeed, the SEC vote prompted a flurry of action among pro-business officials inside the administration. Treasury Secretary Henry Paulson directed his staff to caution the government against siding with the plaintiffs' position because by allowing private suits against third parties it would pose a "risk to our economy, to our competitiveness, to jobs." The White House counsel's office reminded the solicitor general of the administration's longstanding view that "unnecessary lawsuits" were driving business away from the U.S. and harming American financial markets' global competitiveness.

On Aug. 15, Mr. Clement filed a brief on behalf of the defendants. The solicitor general's brief said the plaintiffs' position would constitute a "sweeping expansion" of antifraud laws, "potentially exposing customers, vendors, and other actors far removed from the market to billions of dollars in liability."

Mr. Grundfest plans to attend the hearing today, voicing confidence his side will prevail.

Mr. Newman insists his six-month-long effort will tip the balance. To drive his campaign home, he'll also be in the courthouse, along with some of his Enron shareholders.