Supreme Court Rebuffs Attempt to Impose "Scheme" Liability on Secondary Actors

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In the most significant securities liability case in more than a decade, the Supreme Court sent a clear message today that investors may not bring class action and other securities fraud claims against secondary actors -- investment banks, auditors, vendors, and law firms -- that did not themselves make misleading disclosures but allegedly assisted companies and individuals that did so. The Court's 5-3 decision in *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, rejected the expansive theory of "scheme liability" that plaintiffs' lawyers have pressed in order to sue underwriters, accountants, lawyers, and others that work with public companies.

Plaintiff investors argued that two cable box suppliers -- Scientific-Atlanta, Inc., and Motorola, Inc. -- committed securities fraud by conspiring with cable television operator Charter Communications, Inc., to allow Charter to book $17 million in false revenue. The investors contended that Charter overpaid Scientific-Atlanta and Motorola for cable boxes with the understanding that the suppliers would later return that money by purchasing advertising from Charter, also at inflated rates. According to the plaintiff investors, the suppliers' participation in these "sham" transactions turned them into "primary violators" responsible for the misstatements made by Charter.

The Supreme Court disagreed. Writing for the majority, Justice Anthony Kennedy stated that investors' right to sue for securities fraud "does not reach the customer/companies because the investors did not rely upon their statements or misrepresentations." Although perhaps Charter's misstatements were a "natural and expected consequence" of Scientific-Atlanta and Motorola's participation in the transactions, the Court ruled that the suppliers could not be held liable because they "had no duty to disclose; and their deceptive acts were not communicated to the public." As a result, Scientific-Atlanta and Motorola's conduct was "too remote for liability." With respect to the "scheme liability" theory, Justice Kennedy -- who was joined by Chief Justice Roberts and Justices Alito, Scalia, and Thomas -- added: "Were this concept of reliance to be adopted, the implied cause of action would reach the whole marketplace in which the issuing company does business; and there is no authority for this rule."

The *Stoneridge* holding is a welcome rejection of "gatekeeper liability" for investment banks, accounting firms, and legal professionals that provide services to companies that are later accused

of defrauding their investors. The Securities and Exchange Commission (SEC) does, however, have statutory power to bring suit against "aiders and abettors." As the Court noted, over the last five years SEC enforcement actions alone have collected over $10 billion in disgorgement and penalties. The Court reaffirmed that Congress had not authorized private civil litigation against such defendants.

WilmerHale filed an amicus brief on behalf of Business Roundtable in this important case.

For more information on this or other securities litigation matters, please contact us.