U.S. SUPREME COURT REJECTS ARGUMENT THAT "SCHEME LIABILITY" THEORY STILL APPLIES TO FINANCIAL INSTITUTIONS AND PROFESSIONALS

On January 22, 2008, the Supreme Court denied the certiorari petition of plaintiffs in the *Enron* class action securities litigation, *Regents of the University of California v. Credit Suisse First Boston (USA), Inc.*, No. 06-1341, *cert denied* (U.S. Jan. 22, 2008) ("*Enron*"). Following the recent decision of the Supreme Court in *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, No. 06-43, 2008 WL 123801 (U.S. Jan. 15, 2008) ("*Stoneridge*"), these two decisions effectively reject the theory of "scheme liability" (the theory of holding liable third parties for alleged securities violations) regardless of whether that third party was a financial institution, advisor, vendor, or other third party. Specifically, by denying certiorari in *Enron*, the Court explicitly rejected the plaintiff's argument that the holding of *Stoneridge* did not extend to "financial professionals" accused of facilitating securities fraud.[1] Thus, these two decisions together establish that liability for securities fraud turns on the nature of a third party's alleged malfeasance, and not on the identity (such as "financial professional") of that third party. As a result, the risk that a third party, who does business with an issuer of financial statements that violate the federal securities laws, would itself be held liable for violations of those laws is significantly reduced.

In *Enron*, the plaintiff alleged that banks and investment banks, with knowledge of Enron's alleged illicit purpose, entered into various transactions and partnerships with Enron that allowed Enron to misstate its financial condition. The Fifth Circuit Court of Appeals rejected class certification of these federal securities law claims because the banks at issue had no duty to disclose information to Enron's investors regarding these transactions, and, therefore, there was no basis to presume reliance by all class members upon the banks' failure to make such disclosures. Although plaintiff petitioned for certiorari of this decision on April 5, 2007, the Supreme Court did not rule on the writ until today, presumably because the Court delayed its decision on this motion until the issuance of its *Stoneridge* opinion.

In *Stoneridge*, the plaintiff, an investor in Charter Communications, Inc. ("Charter") brought suit against, among others, two vendors of cable boxes, contending that the vendors entered into transactions with Charter that allowed Charter to mislead its auditor and issue misleading financial statements. The issue, therefore, was, as in *Enron*, whether these third parties were liable to Charter's investors because they participated in a "scheme" to enable securities law violations.

The Supreme Court held that these third parties were not liable to Charter's investors. The Court explained that "[r]eliance by the plaintiff upon the defendant's deceptive acts is an essential element of the §10(b) private cause of action." Accordingly, the third-party vendors "had no duty to disclose; and their deceptive acts were not communicated to the public. No member of the

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[1] Supp. Br. of Pet'r at 2, *Stoneridge*, No. 06-1341 (U.S. Jan. 17, 2008) ("[T]his Court's decision in *Stoneridge* demonstrates critical differences between *Enron* and *Stoneridge*—differences that warrant a grant of certiorari to determine §10(b)'s scope not in the context of ordinary business transactions addressed by *Stoneridge*, but in the context of fraud perpetrated by financial professionals engaged in fraudulent dealings in our securities markets.").

investing public had knowledge, either actual or presumed, of respondents' deceptive acts during the relevant times. [Stoneridge], as a result, cannot show reliance upon any of respondents' actions except in an indirect chain that we find too remote for liability."[2]

By denying certiorari in *Enron* and refusing to remand to the lower courts for further proceedings, the Supreme Court has effectively ruled that the *Stoneridge* decision would not affect the outcome of the *Enron* case, which is, here, that the class action claims against the banks at issue were dismissed.[3] Essentially, the Court has decidedly rejected plaintiff's argument that the reach of *Stoneridge* does not extend to "financial professionals" and institutions. Accordingly, liability under the securities laws turns upon whether "deceptive acts" by a third party created "reliance" by investors in the market,[4] not upon whether that third party can be labeled a "financial professional."

Of note, Richard D. Bernstein of Willkie Farr & Gallagher LLP, as counsel for the Chamber of Commerce of the United States of America, submitted a brief as *amicus curiae* in support of the defendants in *Stoneridge*.

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[2] *Stoneridge*, 2008 WL 123801, at *6 (U.S. Jan. 15, 2008).

[3] *See Tyler v. Cain*, 533 U.S. 656, 666 n.6 (2001) (holding that after an intervening Supreme Court decision, cases will be remanded unless there is no "'reasonable probability' that the Court of Appeals would reject a legal premise on which it relied and which may affect the outcome of the litigation." (citation omitted)).

[4] *Stoneridge*, 2008 WL 123801, at *6 (U.S. Jan. 15, 2008).