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CENTER FOR JUSTICE & DEMOCRACY **NEWS**

Dear Friends,

While the pressure to enact anti-consumer restrictions on victims' rights may have died down somewhat in Congress, the battle rages on elsewhere. The U.S. Supreme Court has unfortunately become one arena where civil justice issues are heating up in ways we have never seen before.

One area where the law has been changing in recent years, first by Congress and then by the courts, concerns the rights of investors who have been defrauded.

We believe the most important thing for consumer advocates to do is to find ways to remind opinion leaders, lawmakers and others about what is at stake. It is critical to remind all stakeholders about how important it is for the integrity of our economy that our civil justice stays strong.

The legal system is the last line of defense against corporate misconduct and abuse. Let us know how we can help do more to spread that message.

Sincerely,

Joanne Doroshow
Executive Director

IN THIS ISSUE: INVESTOR RIGHTS IN JEOPARDY

STONERIDGE, ENRON AND THE SUPREME COURT

The eyes of former Enron shareholders are on the U.S. Supreme Court these days, as anxious plaintiffs await the court's decision in on an otherwise little-known case titled *Stoneridge Investment Partners v. Scientific-Atlanta, Inc., et al.*

The question before the Court is, will it uphold years of Securities and Exchange Commission precedent, help protect the integrity of the American marketplace, and give thousands of former Enron shareholders a chance to recoup their lost life savings. Or will it give unjustified credence to a school of thought that not only protects wrongdoers, but also harms American business by reducing the confidence investors have in our stock markets.

The specific question before the Supreme Court in *Stoneridge* is: Does liability exist for participating in a scheme to defraud under section 10(b) and rule 10b-5(a) and (c), where the actors engaged in contrived financial transactions with a public corporation to distort and falsify its financial statements, but where those actors themselves made no public statements concerning those transactions?

It's the same question that Enron plaintiffs brought before the 5th U.S. Circuit Court of Appeals, which unwisely held that because the defendant banks did not themselves make any "false statements" about their conduct, they could not be liable to the victims even if they knowingly participated in the scheme to defraud Enron's shareholders.

The doctrine of scheme liability isn't some arcane footnote known only to law junkies. It's one of the foundations of investor confidence in the American stock market. In 2002, when the Enron plaintiffs had just begun their journey through the courts, a coalition of 27 state attorneys general submitted an amicus brief supporting scheme liability.

The coalition of AGs wrote: "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 both the broad language and purposes of the antifraud provisions. Indeed one could argue that it is precisely with respect to such scheme that the anti-fraud provisions are needed the most."

The 2002 AG's *amicus* wasn't a one-off, either. In 2007, a 33-member team of state AGs reiterated the main themes of the 2002 brief:

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STONERIDGE, ENRON AND THE SUPREME COURT continued ...

"Our nation's sysyem of monitoring fraud and eliminating it from the securities market relies on two fundamental presumptions: (1) wrongdoers disrupting the market should be held accountable for their bad acts and (2) those wronged should be compensated for their losses.… Over time, this system has promoted market integrity, bolstered investor confidence, and made American markets what they are today: the global leaders 'set[ting] the standard for the rest of the world'.… [N]o defendant should be immune from scheme liability when that defendant possesses the requisite intent to deceive and actually engages in conduct that does in fact deceive investors."

A similarly forceful brief was also filed in *Stoneridge* by former SEC Chairman William H. Donaldson and Arthur Levitt, Jr., and former SEC Commissioner Harvey Goldschmid.

Current SEC Chairman Christopher Cox would have weighed in himself-the commission, in fact, voted to do so-had he not been prevented from filing such a brief by the Bush Administration.

That latest fact, needless to say, causes concern among those who value investor confidence and basic notions of fair play. The Bush Administration, instead, weighed in against the investors in *Stoneridge*, although saying they supported scheme liability.

For the sake of the millions of defrauded Enron shareholders, and for the millions of other Americans looking for a secure place to invest their life savings, and, indeed, for the health and well-being of American business, let's hope the Supreme Court comes out, this time, on the side of the little guy.

George Maddox, Van, TX

George Maddox, a 74-year-old Enron retiree, had 13,744 shares of Enron stock-worth over $1.2MM-when medical problems forced him into early retirement. As a former Houston Natural Gas employee, his HNG stock was automatically converted to Enron stock when HNG was bought out. He trusted Ken Lay when Lay told him not to sell his Enron stock, because it "would be worth $100 a share soon." He believed management's lies until he was locked out of his accounts in October 2001, and unable to sell his shares - unlike the people who bought Enron shares on the Street. After the stock fell he was forced to lease his dream home in Tomball, a Houston suburb, and move to east Texas. And to support their grandson, George mows pastures and his wife, now 70, has gone back to teaching grade school.

WHAT BANKS DID WRONG IN ENRON

In 2002, shareholders who were defrauded in the Enron debacle brought a lawsuit to recover their losses, which were estimated to be between $40 billion and $45 billion. The shareholders charged certain Enron executives and directors, its accountants, law firms, and banks with violations of federal securities laws specifically, that certain Enron executives and directors engaged in massive insider trading while making false and misleading statements about Enron's financial performance.

They also alleged that several large investment banks knowingly participated in the fraudulent scheme with Enron. The shareholders said that the banks structured contrived financial transactions to falsify Enron's financial statements, generating fake profits and hiding billions in debt.

Internal Enron documents and testimony of bank employees, including Andrew Fastow, former Chief Financial Officer of Enron, detailed how the banks engineered sham transactions to keep billions of dollars of debt off Enron's balance sheet and create the illusion of increasing earnings and operating cash flow. Fastow provided nine days of depositions in October of 2006

The Enron shareholders reached settlements of more than $7 billion with financial institutions, including Lehman Brothers, Bank of America, Citigroup, JP Morgan Chase and Canadian Imperial Bank of Commerce. Claims were still pending against a number of additional institutions in March of 2007, when a 2-1 Fifth U.S. Circuit Court of Appeals' decision granted the banks complete immunity from liability to the victims.

Although the Fifth Circuit acknowledged that the banks' conduct was "hardly praiseworthy," it ruled that because the banks themselves did not make any "false statements" about their conduct, they could not be liable to the victims even if they knowingly participated in the scheme to defraud Enron's shareholders.

In an extraordinary admission, the Court's two-member majority acknowledged that their ruling runs afoul of "justice and fair play." They stated, "We recognize, however, that our ruling … may not coincide, particularly in the minds of aggrieved former Enron shareholders who have lost billions of dollars in a fraud they allege was aided and abetted by the defendants at bar, with notions of justice and fair play."

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WHY U.S. MARKETS ARE THE STRONGEST IN THE WORLD

The U.S. financial markets are the strongest in the world and mounting evidence suggests that this is *because* of - and not despite - the strength of our legal and regulatory systems.

In a March 2007 speech in London, Securities and Exchange Commissioner Roel Campos stated, "I say that one of the great strengths of U.S. markets … is the system of high standards and protections of capital and protection of minority shareholder rights."

U.S. markets today make up roughly half of the total capital in the world stock markets, placing them far ahead of even their largest competitors.

Here are some other key facts:

- American markets see the highest participation by individual investors, with 57 million households - or nearly have the nation - invested in the stock market either through the holding of stocks or through a mutual fund in 2005, a figure far higher than that of Great Britain.
- The U.S. is a leader in attracting initial public offerings (IPOs), leading the world in 2005 in both IPO proceed and sheer number of IPOs.
- U.S. markets have dramatically out-performed those in London, which has less rigorous regulation, in both large and small stock indexes. Moreover, in 2006 alone, "financial fraud in the United Kingdom rose 40 percent."
- Studies have shown that as a result of our market's integrity, foreign companies who list on U.S. exchanges see their valuation rise by as much as 37 percent. In fact, by 2004, foreign investors held an astounding $1.9 trillion in U.S. equities, a figure that exceeds the entire worth of all other markets worldwide save for the UK and Japan.
- Wall Street investment banks have been doing particularly well in recent years. These banks pulled in banking fees in record numbers in 2006, with industry giant Citigroup's portion alone reaching $8.5 billion, an increase of over thirty percent from the previous year.

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Buddy and Louise Schwartz, Jonestown, PA

Mervin "Buddy" Schwartz is 67 years old and resides in Jonestown, Pennsylvania. In 1976, he received an associate's degree in Bible studies by attending night classes at Lancaster Bible College. He worked at Hershey Foods in Pennsylvania, as a maintenance mechanic, for 38 1/2 years, starting in 1961. He has no financial training. He was a union representative and an executive board member of the local union in Hershey. He retired in 1999 at the age of 60. Other than his 401(k), he never maintained an investment account. When he retired from Hershey Foods, he turned over all his money to his son, James Schwartz, who worked at Merrill Lynch. The total was approximately $284,000, a combination of his retirement fund from Hershey and his 401(k) plan. Through his purchase of 1,420 shares of Enron preferred securities, he lost his $30,000 initial investment. Schwartz is passionate and very bitter with the banks, especially Merrill Lynch.

WHAT BANKS DID WRONG IN ENRON continued . . .

After the 5th Circuit decision, the Enron shareholders petitioned the Supreme Court to hear their case. While the Court has not yet acted on Enron, it has acted - and granted cert in (agreed to hear) - another case, called *Stoneridge*, which will determine the outcome of the Enron case. *Stoneridge* is an appeal from an 8th Circuit opinion rejecting scheme liability.

If the U.S. Supreme Court rejects scheme liability in *Stoneridge*, banks, accountants, law firms, and others who intentionally commit fraud in order to deceive the investing public will be immune from any responsibility to their victims. This will reduce deterrence against fraud and seriously damage the integrity of U.S. markets. It will also deprive innocent Enron victims of their opportunity to seek full recovery from the banks who helped to orchestrate the Enron fraud.

Gary Kemper, Tim Ramsey, Roy Rinard
Oregon

Gary, Tim and Roy were long-time Portland General Electric employees, who, along with their buddies, believed the Enron story when it absorbed PGE in the mid-90s. They know many colleagues who refinanced houses and took second mortgages to buy Enron stock, aside from their retirement plan at PGE, because they believed what management was telling the market. Those colleagues will now have to work at PGE until they can't make it in anymore to pay off the debt that crushed them when Enron's scheme was revealed.