# SECURITIES ALERT

## JANUARY 2008

*The below Securities Alert highlights the U.S. Supreme Court's decision in Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc., which should curtail efforts by plaintiffs' lawyers to target "deep pocket" defendants who allegedly facilitated someone else's fraudulent misrepresentations.*

The U.S. Supreme Court issued a significant decision last week that should curtail efforts by plaintiffs' lawyers to target "deep pocket" defendants who allegedly facilitated someone else's fraudulent misrepresentations. In *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, No. 06-43 (Jan. 15, 2008), the Court rejected the concept of "scheme liability" and held that the alleged participants in a fraudulent scheme—who did not make any misrepresentation to investors—could not be sued in a private action under the federal securities laws. Although such "secondary actors" remain subject to criminal penalties and civil enforcement actions by the SEC, the Court held that private plaintiffs cannot establish reliance on a defendant's fraudulent conduct where the defendant owed no duty of disclosure and its deceptive acts were not communicated to the investing public.

***The Case***

Charter Communications, Inc., a major publicly owned cable television company, issued fraudulent financial statements that overstated the company's operating cash flow. Several investors in Charter (led by Stoneridge, a hedge fund) sued Charter and its suppliers, Scientific-Atlanta, Inc. and Motorola, Inc. The plaintiffs alleged that Charter arranged to overpay its suppliers for cable converter boxes with the understanding that they would return the overpayments by purchasing advertising from Charter. Charter recorded the return payments as advertising revenue, in violation of generally accepted accounting principles. The companies drafted various documents to make the transactions appear unrelated, which were used to mislead Charter's auditor.

***The Ruling***

The Court, 5-3, dismissed the suit against the suppliers. It held that plaintiffs could not prove their reliance on the suppliers' fraudulent conduct because the suppliers had no duty to disclose the arrangement with Charter and their deceptive acts were not communicated to the investing public. The Court rejected the theory of "scheme liability," which some courts have used to extend liability to defendants whose fraudulent conduct had the purpose and effect of furthering a primary actor's fraud. The Court observed that "Charter, not [the suppliers]… misled its auditor and filed fraudulent financial statements; nothing [the suppliers] did made it necessary or inevitable for Charter to record the transactions as it did." The suppliers, at most, aided and abetted Charter's fraud. A contrary ruling, the Court held, would "undermine Congress' determination that this class of defendants should be pursued by the SEC and not by private litigants."

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