

Supreme Court Affirms Limitations on Third-Party Liability for Securities Fraud

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On January 15, 2008, in *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, the Supreme Court affirmed in a 5-3 opinion the Eighth Circuit Court of Appeals' decision, which dismissed claims for alleged violations of the federal securities laws. These claims were brought against business partners of a cable company that purportedly issued misleading financial statements. The Supreme Court opinion has been widely hailed in the popular media as imposing limits on investors' ability to bring federal securities law claims against third parties such as banks, accountants, attorneys, and business partners.

In upholding the Eighth Circuit's ruling, the Supreme Court assumed that the plaintiff had adequately alleged that certain third parties engaged in transactions with the cable company that had no "economic substance." In particular, the Court described allegations contending that the cable company knowingly overpaid for cable boxes from the third parties and that the third parties then used those funds to overpay for advertising purchased from the cable company. The transactions were alleged to be inherently deceptive and to have been undertaken solely to allow the cable company to meet certain projected revenue and operating cash flow numbers. The Supreme Court, however, held that, even assuming that these facts were true, they still did not set forth a claim for securities fraud against the third parties.

The majority's opinion focused on the plaintiff's inability to allege that it had relied upon the conduct of the third parties. It found that the link between the business partners' alleged conduct was "too remote to satisfy the requirement of reliance." The majority opinion noted that "[i]t was [the cable company], not [the third parties] that misled its auditor and filed fraudulent financial statements; nothing [the third parties] did made it necessary or inevitable for [the cable company] to record the transactions as it did." The majority declined to endorse a rule that would expand the federal securities laws to encompass "the realm of ordinary business operations," stressing that Section 10(b) of the 1934 Securities Exchange Act "does not reach all commercial transactions that are fraudulent and affect the price of a security in some attenuated way." Thus, a third party that commits "a deceptive act in the process of providing assistance" is not liable under Section 10(b).

However, in dicta, the Supreme Court stated that a view that "there must be a specific oral or written statement before there could be liability under Section 10(b) or Rule 10b-5 . . . would be erroneous" because "[c]onduct itself can be deceptive." Thus, in jurisdictions that had previously required a specific misstatement or omission, the *Stoneridge* decision could potentially complicate liability

