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Whatever Happened To ...?

In this issue of CUG.COMments, we look at how the stories subsequently unfurled on items we featured in previous editions.

Qwest & Joseph Nacchio[1]

The trial of Joe Nacchio, former CEO of Qwest, highlighted the use and possible misuse of 10b5 trading plans. Mr. Nacchio, who had initiated such a plan - but then curtailed it in order to trade at will - was found guilty of 19 counts of securities fraud and insider trading.

Update

In July 2007, Mr. Nacchio was sentenced to six years in prison, fined $19 million and ordered to forfeit $52 million that he allegedly made from illegal insider stock sales (prosecutors had asked for over $100 million to be forfeited). Mr. Nacchio appealed, and remained free on bail pending the appeal. The appeal was heard on December 18, 2007 before a panel of three federal judges from the 10th Circuit.

In contrast to the original trial where Nacchio's team faced a judge who appeared to have little sympathy for the defendant - for example refusing Nacchio a final word to the court after sentencing - the appeals panel seemed less inclined to condemn Nacchio's actions. The hour-long hearing focused on two issues: whether the $900 million revenue shortfall that Nacchio allegedly kept from investors was material in a company with revenues of $21 billion and second, the appropriateness of not allowing testimony from a defense witness who might have commented on that materiality.

The panel has yet to issue its decision. It can acquit Nacchio of the charges, order a new trial, or affirm the conviction. If the conviction is upheld, the panel will rule on the request for a reduced sentence. Affirmation would leave Nacchio with three options: He could request a rehearing by the same panel, seek a new hearing by all of the 10th Circuit judges, or take his case to the U.S. Supreme Court.

Tellabs[2]

In this Supreme Court case, the Court rejected the 7th Circuit Court of Appeals' interpretation of "strong inference" [of scienter] which required only that a "reasonable person" could infer scienter to be present. Because the 7th Circuit had overturned the dismissal of a securities class action by a lower court, the Supreme Court's ruling was seen as a victory, albeit minor, for the defendant. The Supreme Court then laid out a three-step process for determining scienter and sent the case back to the 7th Circuit for them to apply it to the case.

Update: The 7th Circuit Decision[3]

Armed with the Supreme Court's road-map for finding scienter, the 7th Circuit once more addressed the Tellabs case. But while their approach would be different, the outcome was unchanged. On January 17, 2008 the Court again found that the plaintiffs in the case had successfully pleaded scienter in accordance with the Private Securities Litigation Reform Act (PSLRA) and the new guidelines handed to them. The original dismissal by the district court was reversed and the lawsuit could therefore proceed. Any "victory" won by the defendants has proved to be short-lived.

Stoneridge[4]

Widely viewed as the most significant securities case heard by the Supreme Court for many years, the Stoneridge plaintiffs had filed suit under Section 10 (b) of the 1934 Securities Exchange Act against

secondary participants in an alleged securities fraud perpetrated by Charter Communications. In doing so, plaintiffs challenged a 1994 Supreme Court decision, *Central Bank*, which held that secondary participants - aiders and abettors to the primary fraud - were not subject to private actions brought under the federal securities laws.

Update: The Stoneridge Opinion[5]

Delivered on January 15, 2008, the Court drew strongly upon the *Central Bank* precedent and rejected by a 5-3 majority the attempt by the plaintiffs to snare secondary participants. The Court focused on the importance of reliance: the secondary participants had made no public statements upon which investors could rely in making investment decisions. The Court further commented that Section 10 (b) "...should not be interpreted to provide a private cause of action against the entire marketplace in which the issuing company operates." In other words, if this case were allowed to proceed, who would be safe?

The minority opinion written by Justice Stevens made some pointed comments: "The Court's view of reliance is unduly stringent and unmoored from authority," and threw out some general barbs: "...I respectfully dissent from the Court's continuing campaign to render the private cause of action under §10 (b) toothless."

However, the majority was not interested in breaking new ground to embrace the concept of "scheme liability" put forward by the plaintiffs. That would be for another time, or preferably, the legislative branch: "The decision to extend the cause of action is for Congress, not for us."

For now, secondary participants who quietly "aid and abet" out of public view may be protected from private securities actions brought under Section 10 (b) - although not from prosecution by the Securities and Exchange Commission. However, Stoneridge addressed a one-time strategy to artificially perk up revenue numbers; a continuous complicity by professional advisors over many years may yet find its way to the Supreme Court. And as the Court said, there is always Congress. ❖

Notes:

1. *CUG.COMments May 2007: http://www.cug.com/img/pdf/ISSUE50.pdf*
2. *CUG.COMments July 2007: http://www.cug.com/img/pdf/ISSUE51.pdf*
3. *http://www.cug.com/ments/55/Tellabs_ii.pdf*
4. *CUG.COMments September 2007: http://www.cug.com/ments/ISSUE52.pdf*
5. *http://www.cug.com/ments/55/SCotUS_Stoneridge.pdf*