

The Shareholder Strikes Back: Varied Approaches to Civil Litigation Claims Are Available to Help Make Shareholders Whole¹

Introduction

In recent months, burgeoning corporate fraud scandals have eradicated a vast amount of shareholder value as well as public confidence in corporate financial governance. Amidst an economic downturn, these mass frauds have wreaked havoc in the equities markets, particularly with respect to the cratering values of high-tech and telecom companies. These breakdowns are partially the consequence of the federal government's recurring failure on a several levels: weak enforcement of existing law (inadequate SEC resources combined with conflicts of interest across government); failed deregulation of the telecommunications industry (paralleling the failed deregulation of S&Ls in the 1980s); and the unanticipated (or inevitable, depending on one's point of view) Congressionally imposed securities litigation reform from the 1990s -- *the 1995 Private Securities Litigation Reform Act (PSLRA)* and the *Securities Litigation Uniform Standards Act of 1998 (SLUSA)* – legislation that self-consciously weakened private enforcement by limiting shareholder options for combating corporate fraud.

Professor John C. Coffee, Jr. has written several seminal articles incisively addressing the benefits and disadvantages of private enforcement. He concludes that private enforcement does confer an overall benefit to society by helping to make shareholders whole. In a May 1986 article in the *Columbia Law Review*, he examined a commonly held belief that "hyperlexia" ("an

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excessive reliance on law and lawyers" in his words) has pervaded American society.² Indeed, in contrast to these public perceptions, he asserted "that the legal rules governing the private attorney generals have created misincentives that unnecessarily frustrate the utility of private enforcement."³

In the past decade, new "misincentives" for shareholder claims have arisen as the result of hand-tying tort reform. Nevertheless, in the wake of Enron and WorldCom, the perception that society relies too extensively on lawyers will likely abate as society recognizes that public enforcement has been grossly inadequate and that the shareholder needs and deserves the right and economic ability to fight back.

So what weapons remain in the shareholder's arsenal? Application of the SEC's Rule 10b-5⁴ is, of course, the most conventional anti-fraud recourse for the shareholder. And, because of SLUSA, it is generally the exclusive remedy for shareholders. A significant limitation is that it does not allow recovery beyond actual damages⁵ and therefore lacks force in terms of creating significant economic disincentives to committing fraud in the first instance. There are, however, additional claims potentially available to plaintiffs that allow recovery in securities fraud cases beyond actual damages. For example, employing federal RICO or state law (state RICO statutes, other statutes, and common law) under special circumstances or for specially situated clients, plaintiffs can bring suit for recovery in excess of actual damages. Such damages include treble damages for RICO and punitive or exemplary damages for fraud. Clients in these exceptional cases would include state pension plans (exempted from SLUSA and hard hit by recent events), shareholders using federal RICO to pursue executives convicted in connection with the underlying securities fraud,⁶ and parties injured by a fraud-ridden bankruptcy who can bring a federal RICO suit because they do not have recourse through a securities claim (e.g., certain creditors).

The Vindication of the Shareholder Class Action Suit

In the 1990s, the American people were widely told that plaintiffs' lawyers were the bane of society, creating an annoying and counter-productive nuisance for America's brilliantly performing corporations. The shell-shocked public now realizes that a significant portion of this corporate performance was based on ingeniously inflated earnings numbers, which rested on a

² John C. Coffee, Jr., *Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions*, 86 COLUM. L. REV. 669, 672 (1986).

³ *Id.* at 671.

⁴ 17 CFR § 240.10b-5.

⁵ 15 U.S.C.S. § 78bb(a) (2002).

⁶ 18 U.S.C.S. § 1964(c) (2002).

pillar of fraud (e.g., fraudulent statements and practices of Enron and WorldCom). With the emergence of the Enron-Andersen and WorldCom scandals, the public now perceives that corporate fraud has become pervasive. The growth of shareholder lawsuits from 1996 to 2001 -- in the wake of (and in spite of) the *Private Securities Litigation Reform Act of 1995*,⁷ which sought to impose new barriers to shareholder fraud suits -- attests to the point that private enforcement was viewed by the corporate world, and perhaps the public, as overly effective or excessively employed.⁸ Today, however, it is easier to accept the proposition that the growth of shareholder suits is necessary and effective to redress the unprecedented investor losses accompanying 2002's revelations of unprecedented levels of fraud.

Private enforcement is particularly important given the fact that governmental enforcement policies have been an insufficient deterrent to corporate malfeasance. The median federal sentence for fraud in 1999 and 2000 was a mere year (only recently have sentencing guidelines been stiffened).⁹ Further, criminal prosecutions have a higher bar than civil litigation. In criminal cases, for example, corporate officers can often successfully hide behind data and findings of accountants and other professionals (e.g., lawyers). Such stratagems are more vulnerable in a civil setting.

Public enforcement, for potentially legitimate reasons, may fall short of imposing adequate punishment. In a recent *Fortune* magazine article, the author commented on this prospect in reference to alleged fraudulent behavior by major banks in recent financial scandals: "Politically ambitious prosecutors may pull their punches even if they have a good case against the banks. They must consider the effect that allegations of fraud at one of the world's largest banks would have on the banking system, the global equity markets, and the economy."¹⁰ Absent some alternative, such as shareholder litigation, any such hesitation to proceed with criminal charges shortchanges justice and incentives against fraudulent behavior. Civil litigation allows the shareholder a chance to recover his investment -- and punish the wrongdoer -- without destabilizing an economically critical entity through a criminal indictment.

Private attorneys general can examine accountants, lawyers, investment bankers, and commercial bankers for complicity. In the Enron case, for example, the law firm of Milberg Weiss Bershad Hynes & Lerach was appointed by the federal court to serve as counsel to the "lead plaintiff" (the Regents of the University of California -- the investor with the largest loss) who brought suit on behalf of all shareholders against numerous financial institutions: Citigroup,

⁷ Selected subsections of 15 U.S.C.S. § 78 (2002).

⁸ See *Indices of Securities Class Action Filings*, Stanford Law School Securities Class Action Clearinghouse in Connection with Cornerstone Research, available at http://securities.stanford.edu/litigation_activity.html.

⁹ See Walter Hamilton, *Crisis in Corporate America; More Time for Executive Crime; Already Tougher Sentencing Rules May Play Big Role in Latest Scandals*, Los Angeles Times, July 13, 2002, Business section, part 3, at 1.

¹⁰ Julie Creswell, *Banks on the Hot Seat*, *Fortune*, September 2, 2002, at 79.

Bank America, Lehman Brothers, Credit Suisse First Boston, among others.¹¹ Some of these institutions were allegedly influential in the formation of Enron's off-the-book partnerships. Damaging information on Citigroup emerged recently concerning the corporation's efforts to carefully craft loans -- by setting up offshore corporations -- to disguise some of Enron's loans and misdeeds, thereby publicly concealing Enron's true debt levels.¹² Numerous investors and their counsel actually vied for leadership in pursuing the investors' private claims against these defendants. In contrast to robust civil legal action, public enforcers have been slow to act. The first charges against an Enron official came on August 21, 2002, when Michael Kopper pled guilty to fraud charges.¹³

Additionally, the government has a credibility issue vis-à-vis its regulatory role of corporate financial governance. This condition is underscored by several key facts, including President Bush's and Vice President Cheney's relationships (whether former or current) with troubled business enterprises. Notable among these relationships is that Ken Lay, the former Enron Chairman, recently acted as President Bush's main political financial backer.¹⁴ President Bush also faces serious questions about his former directorship at Harken Energy, including his much-scrutinized and belatedly reported sale of Harken stock during a critical period.¹⁵ Vice President Cheney, a former CEO of Halliburton, faces a shareholder fraud suit initiated by Judicial Watch on behalf of three individual plaintiffs.¹⁶

Moreover, Congress has a record of failing to impose strict measures policing corporate governance, as evidenced by its permissive stand vis-à-vis corporations and underscored by its passage of the *Private Securities Litigation Reform Act of 1995*.¹⁷ The Act contains, among other anti-shareholder provisions, a safe harbor provision that makes it much more difficult to establish liability if a carefully worded (cautionary) "forward-looking" disclaimer is used.¹⁸ The person in charge of WorldCom hearings in the House is Representative Billy Tauzin of Louisiana, chairman of the House Committee on Energy and Commerce, who was an author of

¹¹ See Melvyn Weiss Asks Billions From Wall Street in IPO Civil Suits, Bloomberg Markets, December issue, available at http://www.milberg.com/mil-cgi-bin/mil?templ=news/IPO_pr.html.

¹² See *Robert Rubin's role*, The Washington Times, July 29, 2002, Editorial section, at A18.

¹³ Former Enron Exec Pleads Guilty, CNNmoney, August 21, 2002, available at <http://money.cnn.com/2002/08/21/news/companies/enron/index.htm>.

¹⁴ See Howard Gleckman, *Can Bush Walk His Talk?*, Business Week Online, July 10, 2002, Daily Briefing Section.

¹⁵ *Id.*

¹⁶ See complaint from Judicial Watch, *Stephens v. Halliburton Co.*, No. 3-02CV1442-L (N.D.T.X., filed 2002), available at www.judicialwatch.org/cases/92/complaint.htm.

¹⁷ Selected subsections of 15 U.S.C.S. § 78 (2002).

¹⁸ *Id.* at § 78(u)(5).

the *Private Securities Litigation Reform Act of 1995*.¹⁹ In addition, another shareholder obstacle has appeared on Capitol Hill: Senator Richard Shelby has been unable to arrange a hearing for an investor protection bill.²⁰

Then there is the issue of the now beleaguered SEC, which has lost no small measure of its prestige and credibility. Chairman Harvey Pitt, for example, is under fire (as to whether he is the right man to lead) since he made a living as an accounting firm defense lawyer (including representation of Arthur Andersen) prior to his appointment at the Commission.²¹ President Bush has also been criticized for stacking the SEC with commissioners who are strongly tied to the Big-5 accounting firms (unprecedented level of Big-5 representation among the Commissioners).²² Lastly, and perhaps most importantly, the SEC, as always, is understaffed and lacks resources for adequate inspection and enforcement.²³

All of these issues have clearly impacted public sentiment. Polling data published by CBS on July 17, 2002 showed a growing concern about the stance of President Bush and his administration on corporate responsibility. While the poll showed that 80% of Americans believed that President Bush shared their moral values, 58% noted that he was too heavily influenced by big business.²⁴ The poll similarly showed that 61% believed that the members of the Bush Administration are more interested in "protecting big business" than "ordinary Americans." Americans have come to accept the premise put forward by Fed Chairman Alan Greenspan -- to wit, that an "infectious greed" had found its way into corporate America in the late 1990s.²⁵

In light of the deficiencies of government enforcement, the role of private enforcement takes on heightened importance. This import is compounded by the now commonly held realization that corporate fraud (on occasion euphemistically referred to as "accounting errors") is occurring in numerous instances, sometimes on the scale of billions of dollars. Plaintiffs'

¹⁹ See Lisa Girion, *Crisis in Corporate America; 1995 Tort Reform Act Said to Provide Safe Harbor for Fraud; Legislation: Critics Say Curbs on Shareholder Suits Have Contributed to the Rash of Scandals, But Some Lawmakers Still Stand Behind the Law*, Los Angeles Times, July 21, 2002, at part 1, page 3 (Business section).

²⁰ Id.

²¹ See James Toedtman, *Pitt Against All Odds*, Newday.com, February 12, 2002, available at <http://www.newsday.com/business/printedition/ny-bzpitt122585272feb12.story>.

²² See *Lessons of the S&L Debacle. Companies fell. Shareholders Lost. What Do the '80s Say About Enron Law Firms?*, Legal Times, February 4, 2002, at 10.

²³ See *Congress Staying Cozy With Corporate Bandits*, The Palm Beach Post, July 1, 2002, Opinion Section, at 14A; see also Commissioner Isaac C. Hunt, Jr., *Remarks at "SEC Speaks,"* (February 22, 2002), available at <http://www.sec.gov/news/speech/spch541.htm>.

²⁴ *Poll: Economy Worries on the Rise*, CBS News, July 17, 2002, available at <http://www.cbsnews.com/stories/2002/07/17/opinion/polls/main515481.shtml>.

²⁵ See Greg Ip, *Greenspan Issues Hopeful Outlook As Stocks Sink*, Wall Street Journal, July 17, 2002, at A1.

attorneys need to be tough and persistent as private attorneys general, in much the same manner as public attorneys general or local prosecutors.

Contrary to accusations that appeared rampantly in the 1990s against securities lawsuits, plaintiffs' lawyers do not run roughshod over the legal system. Federal securities class action cases are highly structured and subject to detailed, often suffocating, rules: cases are brought subject to prerequisites stipulated under Rule 23²⁶ of the Federal Rules of Civil Procedure; the class must be certified by a federal judge (additional proof of orderliness and structure)²⁷; cases are subject to *the Private Securities Litigation Reform Act of 1995*, including a provision requiring that a determination be made at the end of trial whether a Rule 11 infraction took place²⁸; Rule 9(b) of the Federal Rules of Civil Procedure requires that accusations of fraud be stated with particularity²⁹; and the *Private Securities Litigation Reform Act of 1995* brought into being heightened pleading standards for the mental component of fraud.³⁰ To the extent that frivolous suits are brought, federal judges have the power to retaliate against plaintiffs and their counsel.

History Repeats: Common Characteristics of Corporate Scandals

Government regulation has caused -- or is intimately tied to -- many of the problems now facing certain industries where fraud issues have arisen. WorldCom exemplifies the economic depression into which the telecom sector has stumbled. Its recent collapse follows on the heels of the Telecommunications Act of 1996,³¹ formulated by lawmakers to trigger competition through deregulation of the telecom marketplace. Theoretically, increased competition would aid the consumer and spur economic growth as carriers offer more (and improved) products and services. The Act, inter alia, opened up the local telephone service market -- beyond the ambit of the Baby Bell local-service monopolies -- by dissolving or weakening the barriers of who could provide long distance service and who could provide local service.³² On Tuesday, July 30, 2002, during a Capitol Hill hearing, FCC Chairman Michael Powell came under tough questioning from Democratic senators regarding the FCC's regulatory approach to the telecom industry. The

²⁶ Fed.R.Civ.P. 23(a)-(b).

²⁷ Fed.R.Civ.P. 23(c)(1).

²⁸ 15 U.S.C. §78u-4(c).

²⁹ Fed.R.Civ.P. 9(b).

³⁰ 15 U.S.C.S. § 78u-4(b)(2) (2002).

³¹ 47 U.S.C.S. § 151 et seq. (2002).

³² See Harvey L. Zuckman, Robert L. Corn-Revere, Robert M. Frieden, and Charles H. Kennedy, *Modern Communications Law*, 700 (1999).

flack taken by Powell included an attack from U.S. Senator Max Cleland, a Georgia Democrat, who argued that more regulation would benefit the nation.³³

In general across the telecom arena, companies engaged in expansive capital expenditure without generating the intended positive results.³⁴ Such problems have contributed to monumental industry financial losses. Think tank pundit George Gilder has referred to this phenomenon as the "telechasm."³⁵ Perhaps a better term is "teleplosion." In addition to the Telecommunications Act of 1996, specific decisions of regulators have burdened the telecom industry. The Federal Trade Commission, for instance, blocked JDS Uniphase's efforts to upgrade the Internet into a broadband system.³⁶ The strong actions of the government in telecom obviously failed to protect and buoy the industry.

What is the connection between the regulatory failures of government and the recent flurry of securities fraud? The precipitous sector downturn, arguably triggered in part by the government's regulatory regime, has the tendency to foster a sense of desperation. Analysts have speculated that such desperation was behind the accounting fraud at WorldCom. Some elements of the alleged fraud at WorldCom emerged after the peak of the telecom bubble, when Bernie Ebbers faced worries about his personal debt load and a decline in WorldCom's business prospects, concurrent with the depreciation of WorldCom's once lofty stock price.³⁷ Accounting "errors" on the scale of over one billion dollars have more recently emerged at Qwest,³⁸ also a failing (or at least declining) telecom and a descendent of the original Bell system. On the other end of the telecom sector, the cable television industry has its own case of fraud, the matter of Adelphia Communications. It is interesting note that the charged fraud at Adelphia allegedly commenced in 1999 -- around the time of the initiation of WorldCom's fraud -- after the company was left under a mountain of debt following an acquisition spree.³⁹

The Savings & Loan crisis of the 1980s -- highlighted by the role of Lincoln Savings & Loan owner Charles Keating -- has remarkable parallels to contemporary crises. S&Ls (as with telecoms in 1996) were deregulated in the early 1980s, opening up new avenues of investment and allowing them to invest in riskier securities, such as high-yielding debt instruments ("junk

³³ Christopher Stern, *FCC Chief Urged to Shift View*, Washington Post, July 31, 2002, at E01.

³⁴ Paul Craig Roberts, *Our Policy Challenged Economy*, Creators Syndicate, August 21, 2002, available at www.townhall.com/columnists/paulcraigroberts/pcr20010821.shtml.

³⁵ See George Gilder, *Tumbling Into the Telechasm*, The Wall Street Journal, August 6, 2001, available at <http://www.discovery.org/viewDB/index.php3?program=George%20Gilder%20Archives&command=view&id=827>.

³⁶ See Roberts, *supra*, note 34.

³⁷ See Bruce Myerson, *Ebbers' Woes Mounted With WorldCom*, Associated Press, July 26, 2002.

³⁸ See Anitha Reddy, *Qwest Move Puts Focus on Trades*, Washington Post, July 30, 2002 at E1.

³⁹ See Tally Goldstein, Jonathan Moules, Peter Spiegel, Peter Thal Larsen, *Adelphia ex-Chiefs Charged with Fraud*, FT.com (Financial Times), July 25, 2002, front page -first section.

bonds"). Deregulation commenced with the rescission of Regulation Q in 1980, which removed the limit on interest rates payable to depositors and increased investment options for S&Ls, and then was followed by the passage of the *Garn-St. Germain Depository Institutions Act of 1982*, which further expanded the range of investments that could be made by S&Ls.⁴⁰ Deregulation moved S&Ls out of their traditional and exclusive role as lenders for local home construction and mortgages. This deregulation of the thrift industry is very similar to the deregulation of the telecommunications arena, which allowed long-distance providers, such as WorldCom, to delve into new (and, yes, risky) areas of commercial pursuit (e.g., the realm of providing local service).⁴¹ In reference to the fallout from Enron, New York University Law School Dean Stephen Gillers commented that "S&L is the most obvious parallel because of the enormity of the financial loss."⁴²

In the 1980s, S&Ls were struck by a further problem -- rising interest rates in the marketplace, contrasted with their portfolios of long-term housing loans, largely consisting of loans dating back to the 1960s with relatively low fixed interest rates.⁴³ This maturity gap further enticed S&Ls into risky investments.⁴⁴ Beyond the issue of risk-inducing deregulation, management perpetrated fraud at a number of S&Ls, including Lincoln Savings & Loan. Lincoln Savings precipitated investor class action litigation when its collapse wiped out the savings of thousands of its "bondholders," who in reality were elderly passbook savings customers who had been inducted by a management-designed high pressure campaign to swap federally insured savings accounts for uninsured Lincoln Savings junk bonds.⁴⁵ Fraud, rising interest rates, and the effects of deregulation jointly contributed to the fall of various S&Ls.⁴⁶ It appears that fraud was responsible for about 25%⁴⁷ of this impact -- not the primary effect but enough to make a huge difference. Much the same characterizes the telecom sector, where negative industry economic forces (e.g., over-capacity and lower billing rates and margins for long-distance calls) were substantial causes of the telecom depression, although fraud (e.g., WorldCom accounting fraud uncovered in June 2002) clearly contributed to the problem. The

⁴⁰ See Alex M. Azar II, Note, *FIRREA: Controlling Savings and Loan Association Credit Risk Through Capital Standards and Asset Restrictions*, 100 YALE L.J. 149, 153 (1990).

⁴¹ See Zuckman, *supra*, note 32.

⁴² See *Lessons of the S&L Debacle*, *supra*, note 22.

⁴³ See Michael N. Neltner, Comment, *Government Scapegoating, Duty to Disclose, and the S&L Crisis: Can Lawyers and Accountants Avoid Liability in the Savings and Loan Wilderness?*, 62 U. CIN. L. REV. 655, 662-663 (1993).

⁴⁴ *Id.*

⁴⁵ This scheme is described in detail in the federal court discussion on class certification of the bondholders' claims. *In re: American Continental Corp./Lincoln Savings and Loan Securities Litigation*, 140 F.R.D. 425 (D.Ariz. 1992).

⁴⁶ *Id.*

⁴⁷ See Fred Case, *Symposium: Financial Institutions and Regulations, the S&L Crisis: Death and Transfiguration: Deregulation: Invitation to Disaster in the S&L Disaster*, 59 FORDHAM L. REV. 93 (1991).

S&L crisis also involved accounting deficiencies related to inadequacies in GAAP (Generally Accepted Accounting Principles), with the effect that accounting standards were not robust enough to allow S&L management to understand the full panoply of financial problems.⁴⁸ In the case of the telecom sector, specifically WorldCom, accounting problems were clearly at the heart of certain important issues.

If government action and influence caused or exacerbated such serious industry problems -- sufficiently acute to impose seriously adverse macroeconomic consequences -- through its regulatory regime, how can government reasonably tell shareholders that they should be restrained in the suits they bring against corporations? Being in large measure the cause of the problem (conflicts of interest, insufficient resources for enforcement, and inept regulation), how can government occupy a position (the moral high ground) to deride private enforcement?

The S&L crisis of the 1980s also has some national political parallels to the current matter of Enron's bankruptcy. Enron was, to put it mildly, a politically connected corporation, having donated generously to prominent political candidates. Its chairman, Ken Lay, had been George W. Bush's key financial backer over the course of his political career.⁴⁹ Senator Phil Gramm's wife, herself a former political appointee, served on Enron's board.⁵⁰ Following a similar pattern of tying captains of industry to politicians, Charles Keating, the notorious S&L figure, was closely linked to five U.S. Senators -- the so-called Keating 5 -- who received campaign money from Keating. After they acted on Keating's behalf, four of the five senators were chided by the Senate for bad judgment. One of the Senators, Alan Cranston, was actually formally reprimanded by the Senate Ethics Committee for his ties to Keating and efforts to influence regulators on Keating's behalf, an action many considered unfair.⁵¹ Suspicions abounded that Keating donated to the five senators in order to thwart governmental investigations of Keating's financial operations.⁵² The monetary-political influence of Keating and Lay is a common bond that cannot be dismissed in an analysis of the similarities of the two debacles.

Enron and the S&L scandals have another link: allegations of law firm complicity. There is an estimate that law firms shelled out at least \$125,000,000 in settlement money over the course of the thrift crisis.⁵³ Jones, Day, Reavis & Pogue and the Kaye Scholer law firm are

⁴⁸ Id.

⁴⁹ See Gleckman, *supra*, note 14.

⁵⁰ See David Ivanovich, *Enron Debacle Could Bring Problems for Gramms*, HoustonChronicle.com, January 22, 2002, available at <http://www.chron.com/cs/CDA/story.hts/special/enron/1222539>.

⁵¹ See *A Foe of Hitler and Friend of Keating*, The San Francisco Chronicle, January 3, 2001, Editorial, at A19.

⁵² See Lisa Babish Forbes, Note, *Federal Election Regulation and the States: An Analysis of the Minnesota and New Hampshire Attempts to Regulate Congressional Elections*, 42 CASE W. RES. 509 (1992).

⁵³ See *Lessons of the S&L Debacle*, *supra*, note 22.

reported to have made settlements in the tens of millions of dollars.⁵⁴ While Keating's investors recovered nothing from Keating personally, they were able to secure seventy percent of their losses from various professionals, including lawyers and accountants.⁵⁵ Enron's counsel, Texas powerhouse Vinson & Elkins, is fighting for its survival against the Enron shareholder suits, which assert that Vinson & Elkins was deliberately involved with Enron in fraudulent activities that were at the heart of the Enron collapse.⁵⁶

While Lincoln Savings' investors ultimately received a measure of recovery through the private securities litigation, which included sizable settlements with attorneys and accountant defendants, and a largely uncollectible civil RICO judgment against Keating himself,⁵⁷ Keating's jail time was substantially limited by the fact that state court convictions were thrown out on a jury instruction technicality.⁵⁸ This is another sign that criminal prosecution does not engender full justice. Keating had been pursued under a number of causes of action -- racketeering, conspiracy, bank fraud, securities fraud, and wire fraud.⁵⁹

Old Faithful: the Broad Applicability of Rule 10b-5

Rule 10b-5⁶⁰ is a far-reaching anti-fraud weapon with both criminal and civil applicability. Derived from authority delegated to the "Commission" under section 10(b) of the Securities and Exchange Act of 1934,⁶¹ in the wake of the Great Depression, it has been widely used in a variety of securities cases. Section 10(b) forbids "any manipulation or deceptive device or contrivance in contravention of such rules and regulations...."⁶² Under the authority of

⁵⁴ *Id.*

⁵⁵ E. Scott Reckard, *O.C. Business Plus; High Court Leaves Keating's Victory in S&L Case Intact; Fraud: Former Executive of Irvine-Based Lincoln Savings Wins His Bid Against State's Attempt to Reinstate Convictions*, Los Angeles Time, October 3, 2000, Business Section, Part C, at 1.

⁵⁶ See Miriam Rozen (contributing reporter for the Texas Lawyer), *Enron Shareholders Go After More Lawyers*, Fulton County Daily Report, June 18, 2002.

⁵⁷ See *In re: American Continental Corp./Lincoln Savings and Loan Securities Litigation*, 49 F.3d 541 (9th Cir. 1995).

⁵⁸ Greg Risling, *No Retrial for S&L Figure Keating*, The Associated Press (AP File), November 9, 2000, Business News section.

⁵⁹ *U.S. v. Keating*, 147 F.3d 895, 897 (1998).

⁶⁰ 17 CFR § 240.10b-5.

⁶¹ 15 U.S.C.S. § 78j(b) (2002).

⁶² *Id.*

Section 10(b), Rule 10b-5 specifically forbids fraudulent activity (scheming, material untrue statements, material omissions, etc.).⁶³

Rule 10b-5 has been extensively applied to cases involving material and deliberate misstatements and omissions (i.e., incorrect financial statements based on fraud), as well as to the realm of insider trading. Of benefit to the plaintiff, under the Supreme Court ruling in *Basic v. Levinson*, the plaintiff need not necessarily establish reliance (the traditional subsection causation element of common law fraud) to prove liability in a Rule 10b-5 case.⁶⁴ The fraud-on-the-market theory substitutes the objective standard of the materiality of omissions or misrepresentations in offering securities or public filings, and the markets' reasonable reactions to the assumed veracity of such information, for subjective reliance.⁶⁵ Overall, Rule 10b-5 allows legitimately wronged shareholders a chance to challenge corporations committing different types of fraud without having to prove reliance, an obsolete concept in the context of a mass market. It is a highly flexible rule, covering corporate fraud of the conventional type (e.g., material misstatements) and more exotic frauds such as Ponzi schemes.

The great flexibility of Rule 10b-5 -- allowed by its broad language (e.g., the incorporation of the word "scheme," which covers vast realms of misdeeds) -- is exhibited in the case of Robert Brennan. With respect to Brennan, former head and sole shareholder of First Jersey Securities, Rule 10b-5 was used (based on prior court precedent) by prosecutors against his practice of exorbitantly marking up the price of securities peddled to the customers of his brokerage firm.⁶⁶ Prosecutors also utilized Section 17(a) of the Securities Act of 1933⁶⁷ against Brennan.⁶⁸ Brennan's firm would unbundle securities and then sell the separated components for substantially more than their market value.⁶⁹ He also limited the flow of information about the securities his company promoted and, furthermore, controlled the activities of brokers to the point of manipulation (brokers in certain branches could only sell certain stocks and could not talk about those stocks to brokers in the other branches).⁷⁰ Brennan settled with brokerage customers and paid even more out to the government in the form of disgorged profits. Fines

⁶³ 17 CFR § 240.10b-5.

⁶⁴ *Basic v. Levinson*, 485 U.S. 224, 241-247 (1988).

⁶⁵ *Id.*

⁶⁶ *SEC v. First Jersey SEC., Inc.*, 101 F.3d 1450, 1458 (1996).

⁶⁷ 15 U.S.C.S. § 77(q)(a) (2002).

⁶⁸ *SEC*, *supra*, note 66.

⁶⁹ *Id.*

⁷⁰ *Id.* at 1457.

assessed against Brennan and his company totaled 71 million dollars.⁷¹ This matter is an example of the use of 10b-5 as a catch-all regulatory provision.

Rule 10b-5, nonetheless, is not an all-powerful anti-fraud weapon. In a 1994 Supreme Court case, the Court ruled that a section 10(b) case cannot be maintained against those who aid and abet the commission of a securities fraud.⁷² Nonetheless, some courts have held that attorneys are not necessarily mere aiders and abettors and can be subject to primary liability in certain cases.⁷³ More consequential is the fact that punitive damages cannot be obtained under Rule 10b-5, although most states allow punitive damages for common law fraud.⁷⁴ State remedies, which will be addressed below, often provide more expansive means of recovery.

CIVIL RICO

Rule 10b-5 hardly provides an exclusive basis for pursuing a case of securities fraud. The *Racketeer Influenced and Corrupt Organizations Act (RICO)*⁷⁵ is an anti-fraud tool that can be utilized under certain very broad circumstances in a criminal context. Former junk bond king Michael Milken, previously an investment banker with Drexel Burnham Lambert, was targeted by a federal prosecutor (Rudy Giuliani) based overwhelmingly on racketeering charges under the RICO statute, with scant emphasis on actual securities violations.⁷⁶ Resulting federal fines of six hundred and fifty million dollars were sufficiently punitive to bankrupt Drexel Burnham Lambert.⁷⁷ Milken ended up accepting a guilty plea consisting of six counts -- after an indictment on 98 counts -- which surprisingly did not involve stock manipulation or insider trading.⁷⁸ Milken reportedly accepted the plea under the force of RICO threats against Milken, the Milken family, and his investment bank.⁷⁹ The unconventional powers of RICO include

⁷¹ See *Court Upholds First Jersey Fine*, The New York Times, December 11, 1996, at D2, column 6.

⁷² *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 180-188 (1994).

⁷³ Marc I. Steinberg, *Corporate/Securities Attorneys: Ethical and Legal Concerns*, Nuts & Bolts of Securities Law 2002, PLI Order No. BO-01 AT, May 16-17, 2002.

⁷⁴ 15 U.S.C.S. § 78bb(a) (2002).

⁷⁵ 18 U.S.C.S. § 1961-1968 (2002).

⁷⁶ See Gordon Crovitz, *Symposium Law and the Continuing Enterprise: Perspectives on RICO: How the RICO Monster Mauled Wall Street*, 65 NOTRE DAME L. REV. 1050, 1064-1065 (1990).

⁷⁷ See Obituaries, *I.W. Burnham II*, St Petersburg Times, July 5, 2002, at 7A.

⁷⁸ See Jude Wanniski, *Trial By Press: James B. Stewart vs. Michael Milken*, October 9, 1991, available at www.polyconomics.com/searchbase/10-09-91.html.

⁷⁹ George Gilder, *Mike Milken and the Two Trillion Dollar Opportunity*, first published April 10, 1995, at 7, available at www.seas.upenn.edu/~gaj1/trilgg.html.

restraints on the assets of the accused even in advance of trial.⁸⁰ Milken, incidentally, is not the only high-profile case associated with prosecution under RICO's criminal provisions. Fugitive billionaire Marc Rich, for example, was targeted under RICO in association with a tax fraud related to oil sales.⁸¹

While RICO is most commonly associated with criminal prosecutions, RICO has provided an immensely effective way of conducting a civil suit. Designed primarily to emasculate organized crime organizations (e.g., compel testimony of individuals under the threat of pre-trial asset seizures), RICO was initially sparingly employed in a civil context. Eventually, its civil application and popularity grew, and it was increasingly used in actions against legitimate (non-mafia) businesses. RICO, incidentally, is especially attractive from a civil litigation perspective in light of its treble-damages provision.⁸² As discussed below, civil RICO had especially effective provisions for civil suits concerning securities fraud until the mid-1990s, when it was drastically scaled down through federal tort reform, though civil RICO is still quite useful against securities fraud based on racketeering provisions in certain state statutes.

Federal RICO spans eight sections (§ 1961-1968) of Title 18 of the U.S. Code.⁸³ Subsection 1962(c) prohibits anyone, "employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce" from engaging in efforts to "conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt."⁸⁴ In *Sedima, S.P.R.L. v. Imrex Co.*, a case focused on a civil RICO dispute, the Supreme Court succinctly expressed the foundations of a 1962(c) claim: "A violation of 1962(c), the section on which Sedima relies, requires (1) conduct (2) of an enterprise (3) through a pattern (4) of racketeering activity. The plaintiff must, of course, allege each of these elements to state a claim."⁸⁵ Subsection 1962(d), additionally, prohibits the act of conspiring to participate in such activities.⁸⁶ Section 1963 is not directly applicable, as it defines penalties associated with criminal prosecution.⁸⁷ Subsection 1964(c), however, provides access to a civil cause of action for injured parties alongside

⁸⁰ See Crovitz, *supra*, note 76, at 1061.

⁸¹ *Id.* at 1058.

⁸² 18 U.S.C.S. § 1964(c) (2002).

⁸³ *Id.* at § 1961-1968.

⁸⁴ *Id.* at § 1962(c).

⁸⁵ *Sedima, S.P.R.L. v. Imrex CORP.*, 473 U.S. 479, 496 (1985).

⁸⁶ 18 U.S.C.S. § 1962(d) (2002).

⁸⁷ *Id.* at § 1963.

generous civil remedies, including treble damages and "the cost of the suit, including a reasonable attorney's fee...."⁸⁸

The establishment of a RICO claim requires that a racketeering activity have taken place. Subsection 1961(1) of RICO lists multiple acts that fall under the rubric of RICO activity. The enumerated acts include, among many others, murder, kidnapping, gambling, mail fraud, wire fraud, "financial institutions fraud," and fraud in the sale of securities.⁸⁹ Subsection 1961(5) specifies that a pattern of racketeering activity consists of "at least two acts of racketeering activity...."⁹⁰ Certain alleged activities between Enron and various institutions (investment banks, commercial banks, accounting firms, etc.) would seem to establish a pattern of recurrent activity consistent with racketeering. If the growing allegations are correct, multiple fraudulent acts -- fitting within the scope of enumerated acts in subsection 1961(1) -- would evidence a pattern (indeed a network) at Enron of racketeering and the commission of more than two acts of racketeering activity.

The question arises as to what constitutes a pattern of racketeering. In *Sedima*, the Supreme Court refers to a test involving "continuity plus relationship"⁹¹ pulled from an applicable Senate Report.⁹² The cited text of the Senate Report, which isolated this test, consisted of two critical sentences: "The infiltration of legitimate business normally requires more than one 'racketeering activity' and the threat of continuing activity to be effective. It is this factor of continuity plus relationship which combines to produce a pattern."⁹³

In a civil RICO case, the plaintiff need not establish that the two requisite acts are related to the issuance or sale of securities. Mail and wire fraud, for example, fit within the limits of section 1961. Occurrences of fraud incorporating two instances of telephone calls or mailings (or presumably one of each) would constitute the two requisite acts.⁹⁴ In Justice Marshall's *Sedima* dissent, he noted that "[u]nder the Court's opinion today, two fraudulent mailings or uses of the wires occurring within 10 years of each other might constitute a 'pattern of racketeering activity,' 1961(5), leading to civil RICO liability. See 1964(c)."⁹⁵ In the Notre Dame Law

⁸⁸ Id. at § 1964(c).

⁸⁹ Id. at § 1961(1).

⁹⁰ Id. at § 1961(5).

⁹¹ *Sedima*, 473 U.S. at 496 (Footnote 14).

⁹² Id.

⁹³ Id.

⁹⁴ See Richard L. Bourgeois, Jr., S.P. Hennessey, Jon Moore, and Michael E. Tschupp, *Racketeer Influenced and Corrupt Organizations*, 37 AM. CRIM. L. REV., 880, 885 (Spring 2000).

⁹⁵ *Sedima*, 473 U.S. at 502 (Marshall, J., dissenting).

Review, L. Gordon Crovitz eloquently expressed how the use of mail fraud and wire fraud facilitates sweeping a matter into the scope of RICO:

Allegations of mail or wire fraud are nothing more than allegations that some "fraud" was committed through the mails or telephone wires.... Almost no business -- legitimate or illegitimate -- is done without letters, FAXes or modems. This means that nearly any allegation of "fraud" can now become RICO case.⁹⁶

This flexibility (use of mail fraud or wire fraud) means that in the context of securities fraud on a large scale, it is likely to be easy to establish the two necessary (at least two) predicate acts that constitute an essential element of a RICO cause of action.

A critical civil change, however, was imposed on RICO through the *Private Securities Litigation Reform Act of 1995*. Restrictive wording was added to subsection 1964(c), establishing "that no person may rely upon any conduct that would have been actionable as fraud in the purchase or sale of securities to establish a violation of section 1962."⁹⁷ The securities exception "does not apply to an action against any person that is criminally convicted in connection with the fraud...."⁹⁸ Consequently, a civil action for securities fraud, under federal RICO, can only be brought where the defendant has first been criminally convicted in connection with the securities fraud. This provision was conceived within a Congressional intent to prohibit civil RICO for securities fraud,⁹⁹ but still leaves the doors open for certain types of litigation since a RICO cause of action, along with a remedy of treble damages, could be available in suits against Enron, WorldCom, Adelphia, or their executives should they be convicted of securities fraud. Such suits can be brought against both convicted individuals and business entities since RICO's definition of "person" extends beyond natural persons.¹⁰⁰ Subsection 1964(c) is known, incidentally, as the "private attorney general" provision of RICO,¹⁰¹ as it allows "[a]ny person injured in his business or property by reason of a violation of section 1962 of this chapter" to sue.¹⁰²

While most applications of federal RICO for securities fraud cases were negated by the changes to subsection 1964(c), not all is lost in pursuit of a racketeering cause of action. Many

⁹⁶See Crovitz, *supra*, note 76, at 1050, 1054-1055 (1990).

⁹⁷ 18 U.S.C.S. § 1964(c) (2002).

⁹⁸ *Id.*

⁹⁹ 141 CONG. REC. H2770-79 (daily ed., March 7, 1995).

¹⁰⁰ 18 U.S.C.S. § 1961(3) (2002).

¹⁰¹ Gary B. Lynch & Thomas P. Ogden, *The Private Securities Litigation Reform Act of 1995: Civil RICO Reform*, Practising Law Institute, February-March 1996, at 636.

¹⁰² 18 U.S.C.S. § 1964(c) (2002).

states have RICO statutes, employing much the same verbiage and essentially the same logic as federal RICO. Consequently, much of the aforementioned analysis of federal RICO is widely applicable to state racketeering statutes. In some cases, state RICO remains much like federal civil RICO as it applied to securities fraud before the enactment of the PSLRA. Consequently, assuming the claims do not fall within the preemptive provisions of “SLUSA,” suits can be brought in some states for securities fraud wherein the plaintiff can invoke the civil provisions of state RICO and therefore pursue treble damages.

The state of Colorado, for example, has a statute that is substantially similar to federal RICO and, at the same time, allows for a racketeering action to be brought in a civil case involving securities fraud. The statute is known as the *Colorado Organized Crime Control Act*.¹⁰³ Under the Colorado statute, racketeering activity includes “[a]ny conduct defined as ‘racketeering activity’ under 18 U.S.C. 1961 (1)(A), 1(B), (1)(C), and (1)(D). . . .”¹⁰⁴ Subsection (1)(D), of course, includes “fraud in the sale of securities” as a predicate act.¹⁰⁵ Racketeering activity, under Colorado law, also includes “[s]ecurities offenses, as defined in . . . 11-51-501 and 11-51-603 (fraud and other prohibited practices). . . .”¹⁰⁶ Section 11-51-501 makes it unlawful “[t]o employ any device, scheme, or artifice to defraud”¹⁰⁷ and also forbids efforts “[t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading. . . .”¹⁰⁸ The civil remedies section of the Colorado RICO statute allows the recovery of treble damages, attorneys fees, and certain other costs.¹⁰⁹ In all, this statute is very broad, flexible, and generous for the plaintiff who has been defrauded in a securities matter. A 1996 court ruling found that aiding and abetting liability and a respondeat superior claim are properly rooted under this Colorado statute.¹¹⁰

Unfortunately, one other federal statutory roadblock exists. The *Securities Litigation Uniform Standards Act of 1998 (SLUSA)* disallows “covered class actions” -- brought under state law for securities fraud -- from being “maintained” in state or federal court.¹¹¹ Covered class actions include lawsuits where more than 50 individuals or class members seek damages; lawsuits where one or more named parties “seek to recover damages on a representative basis”;

¹⁰³ COLO. REV. STAT. ANN. § 18-17-101 (West 1999).

¹⁰⁴ Id. at § 18-17-103 5(a).

¹⁰⁵ 18 U.S.C.S. § 1961(D) (2002).

¹⁰⁶ COLO. REV. STAT. ANN. § 18-17-103 5(b)(XIII) (West 1999).

¹⁰⁷ Id. at § 11-501-501 1(a).

¹⁰⁸ Id. at § 11-501-501 1(b).

¹⁰⁹ Id. at § 18-17-106 (7).

¹¹⁰ F.D.I.C. v. First Interstate Bank of Denver, N.A., 937 F.Supp. 1461, 1470-1471 (1996).

¹¹¹ 15 U.S.C.S. § 77p(b)(2002).

and "any group of lawsuits filed in or pending in the same court and involving common questions of law or fact" where damages are sought for over 50 people and the "lawsuits are joined, consolidated, or otherwise proceed as a single action for any purpose."¹¹²

One strategy for partially circumventing this obstacle is to bring an action on behalf of 50 or fewer plaintiffs in a state that has a suitable state RICO statute or provides punitive damages for fraud. For that matter, a single client's case (e.g., investor with tens of millions of dollars of losses) could be pursued under state law absent a class action and with productive results (e.g., treble damages or punitive damages). However, efforts by the courts to force the joining or combination of parties could readily put the number of plaintiffs above the cap of 50, thereby obviating the state law claim. This predicament basically means that claims would likely end up being decided under federal law despite an intention to maintain a claim under state law.

There is one notable -- substantial from a monetary point of view -- exception to the limitations imposed by SLUSA. Specifically, state pension plans and other state entities are exempted from SLUSA. The pertinent SLUSA section states this point clearly:

Notwithstanding any other provision of this section, nothing in this section may be construed to preclude a State or political subdivision thereof or a State pension plan from bringing an action involving a covered security on its own behalf, or as a member of a class comprised solely of other States, political subdivisions, or State pension plans that are named plaintiffs, and that have authorized participation, in such action.¹¹³

This "carve-out" provision exempting state entities preserves state law remedies for such organizations as state pension funds. In a state where compensation is available beyond actual damages (exemplary damages for fraud or treble damages for state RICO), it would make sense for a pension plan to bring a state fraud claim as opposed to a strictly federal claim.

The issue of pension plans is significant when pursuing the highest levels of available damages. The Office of the President of the University of California, lead plaintiff in an Enron class action, issued a press release in which it identified its Enron losses at 144.9 million dollars.¹¹⁴ The release went on to mention losses for several state pension funds, including a 325 million dollar loss for the Florida state pension fund and a 127 million dollar loss for the Georgia

¹¹² 15 U.S.C.S. § 77p(f)(2)(A)(i)(I-II) (2002).

¹¹³ 15 U.S.C.S. § 77p(d)(2)(A) (2002).

¹¹⁴ Press Release, Office of the President News Room, The University of California, *Update on UC's Enron Investment and Lawsuit: University of California named lead plaintiff in Enron class action suit*, available at www.ucop.edu/news/enron/art1202.htm.

state pension fund.¹¹⁵ Texas, Enron's nerve center, and the forum in which the key Enron suits have been filed, permits exemplary damages for stock fraud as well as the recovery of various fees, including attorney's fees.¹¹⁶ In the case of Enron, any effort by a state entity (e.g., state pension fund) to rely on federal claims only would unnecessarily limit the potential recovery.

With the provision of treble or multiple damages, a state RICO securities claim is potentially far more attractive than a claim under Rule 10b-5. The provision of multiple damages, attorney fees, and other expenses may be attractive to the plaintiff who is aware of the specific applicability and copious benefits of civil RICO. The key constraints with this approach concern choice of law and judicial disfavor. Only certain states have RICO statutes and, among those jurisdictions, only a subset have flexible provisions allowing civil RICO cases for securities fraud (e.g., no conviction requirement). Moreover, there may be a residual judicial resistance or skepticism toward RICO claims, as an artifact of perceived over-utilization of the federal RICO statute in the pursuit of grander variety commercial claims in the late 1980s through mid-1990s.

In the case of a mass corporate fraud, despite limitations imposed in 1995, federal RICO might still play a major role for plaintiffs' attorneys. As discussed, those already criminally convicted in connection with the underlying securities fraud could be targeted in a federal civil RICO suit. Secondly, a federal RICO case would be feasible in a framework where the plaintiff's injury was not actionable as securities fraud. That parameter raises to mind such injured parties as creditors who did not securitize their debt (e.g., convert them into bonds). Creditors directly targeted by racketeering activity do have standing to sue.¹¹⁷ Federal civil RICO could also be utilized on behalf of a contracting party that sustained losses because of the fraud. Many of these parties may have entered into business arrangements with companies like Enron assured (detrimentally relying on the company's direct assurances of financial stability) that they were financially stable. The predicate RICO acts for such parties could fall into the arena of mail or wire fraud.

In the recent whirlwind of revelations about corporate fraud scandals, what are the potential applications for civil RICO? Enron offers an illustration. As an initial matter, Enron's numerous fraudulent activities are likely sufficient in number and scope to establish more than the required two minimum qualifying racketeering actions; securities fraud, mail fraud (the mailing of fraudulent financial data), and wire fraud (the electronic dissemination of fraudulent information) are all strong candidates for the predicate acts. As a multi-year fraud apparently involving numerous employees and myriad contacts with outside organizations (investment bankers and accountants), it is highly probable that a pattern of RICO activity, on Enron's part,

¹¹⁵ Id.

¹¹⁶ TX BUS & COM § 27.01; see also earlier discussion about common law fraud.

¹¹⁷ See *Maiz v. Virani*, 253 F.3d 641, 655 (11th Cir. 2001).

can readily be established if the facts and allegations frequently referenced by the mass media hold true. On the other end of the alleged fraud, and for the same reasons enumerated above, civil RICO claims are potentially applicable to those organizations that are widely reported to have been complicit with Enron in disguising its debt and thus deceiving Enron shareholders: Arthur Andersen, Citigroup, and J.P. Morgan, among others. A securities fraud claim under federal RICO, however, can only be brought if the wrongdoer has been convicted in connection with the underlying offense.

In the case of Enron, the more interesting potential civil RICO claims appear to be those not related to securities fraud. The Supreme Court ruled that a RICO injury must be proximately caused by the RICO activity and may not flow "merely from the misfortunes visited upon a third person."¹¹⁸ Hence, there must be a direct effect. Employees who relied on internally distributed reports of sound financials at Enron as a basis for not looking for other employment, for instance, conceivably would be positioned to pursue a RICO claim, as they are directly injured parties. This point would be particularly true if employees were repeatedly assured by management (e.g., company touting stock to employees), in communication directed specifically to employees, that company conditions were favorable. Any supplier or contractor who was deceived by Enron (relying detrimentally on Enron's direct assurances) -- and is now a creditor or has suffered other damage -- may have grounds for a RICO suit. These could be viable RICO cases as they are not actionable as securities fraud. It is not clear -- for employees, creditors, and contractors -- whether reliance upon public financial statements is sufficiently direct to allow a RICO cause of action against the company.

OTHER MEANS OF PURSUING A CAUSE OF ACTION

Other methods exist for pursuing securities claims. A suit can be brought, for example, under state law. For example, suit could be brought under a relevant state securities (Blue Sky) law. While there is a Uniform Securities Act devised by NCCUSL (National Conference of Commissioners on Uniform State Laws), state courts on occasion issue differing interpretations despite the commonality of statutory provisions.¹¹⁹ State courts, for instance, differ on whether reliance is a compulsory element of a state securities fraud case.¹²⁰ This divergence means that a plaintiff's attorney has to be very attentive to local judicial interpretation despite many common themes across state laws.

Diverse statutory recourse is available at the state level. As discussed, most states have statutes, known as "Blue Sky" laws, protecting investors from fraudulent securities practices. Beyond codified securities laws, it is necessary to examine other statutory options in the state.

¹¹⁸ Holmes v. Sec. Investor Prot. Corp., 503 U.S. 258, 268 (1992).

¹¹⁹ See David O. Blood, *There Should Be No Reliance in the "Blue Sky,"* 1998 B.Y.U.L. REV. 177, 178 (1998).

¹²⁰ Id.

For example, the state in question might have a generic fraud statute with provisions extending beyond the scope of securities fraud. A more remote possibility is a consumer protection statute. As stated above, certain states have RICO statutes with pertinent civil applications. Also, a given state could have a professional (e.g., accountant) liability statute that may or may not prove to be helpful. Across the many states, different possibilities abound for sources of law to sustain a lawsuit

As well, a common law fraud claim can be brought against the perpetrators of securities fraud. Of course, a common law claim would require that all elements -- misrepresentation, mental culpability (scienter), intent to have plaintiff rely on the deceit, reliance, and resulting damage -- have to be established. Judicial Watch's case against Dick Cheney, Halliburton, and others associated with Halliburton asserted two sets of claims: (1) stock fraud and civil conspiracy, both under Texas statutory law (Texas Business & Commerce Code Section 27.01)¹²¹; and (2) common law fraud and civil conspiracy.¹²² The complaint accuses Halliburton of conspiring to count cost overruns, on fixed-price government contracts, in part as revenue even though there was allegedly no reliability in projecting what overruns would be recouped from the federal government through suit or negotiation.¹²³

This discussion of state law is important for different reasons. First, damages are limited under federal law; section 10b actions do not allow recovery of punitive damages.¹²⁴ In contrast, most states allow the granting of punitive damages, typically in cases involving fraud.¹²⁵ It makes sense, from a public policy perspective, that a tort that is frequently intentional and outrageous in nature be treated with extra force. Second, states often offer a more extensive statute of limitations than would be available under a federal case. For section 10b cases, the action must be brought within a year of discovery but no more than three years after the infraction.¹²⁶ Texas law, for example, can be more accommodating to the plaintiff, as the statute of limitations for common law fraud is four years.¹²⁷ State law can be more amenable to the plaintiff in other ways, including through more lenient pleading standards. Nonetheless, while state legal remedies may technically be available, they are highly questionable in light of the SLUSA restrictions (maximum of 50 class members regardless of how parties are joined or combined). But, as discussed in the previous section, SLUSA exempts state entities, to include

¹²¹ Judicial Watch, *supra*, note 16, at 39.

¹²² *Id.* at 42.

¹²³ *Id.* at 16.

¹²⁴ 15 U.S.C.S. § 78bb(a) (2002).

¹²⁵ See Thomas W. Antonucci, *The Private Securities Litigation Reform Act and the States: Who Will Decide the Future of Securities Litigation?*, EMORY L.J., 1237, 1271-1272 (1997).

¹²⁶ See *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 364 (1991).

¹²⁷ See *NAT'L Med. Enterprises, Inc. v. NME Specialty Hospitals, Inc.*, 962 S.W.2d 228, 233 (Tex.Civ.App.-- Fort Worth, 1998).

state pension funds. A state pension plan, therefore, could sue under a state fraud statute or common law fraud and attempt to obtain exemplary damages.

An additional point is that there might very well exist claims beyond the most salient identified injuries or prototypical causes of action. Such claims may rest on statutes outside the immediate purview of such anti-fraud weapons as Rule 10b-5 and securities law in general. Former Enron employees have brought an ERISA class action suit against Enron and Northern Trust, which administered Enron's 401(k) plan.¹²⁸ Plaintiffs' suit states that the defendants were, among other matters, imprudent in not advising account holders about the risks of investing in an asset class consisting of a single equity and then touting the prospects of that one equity, Enron stock.¹²⁹ The complaint additionally references the "lock-down" that occurred in Enron's 401(k) plan, when Enron employees were blocked from moving 401(k) assets out of Enron stock.¹³⁰ Plaintiffs brought suit under § 409 of ERISA¹³¹ (Employee Income Retirement Security Act), which requires that the party who breached a fiduciary duty make good on any losses.¹³²

CONCLUSION

The United States has moved into an era of new attitudes and assumptions about corporate conduct. After a backlash against shareholder lawsuits in the 1990s, the pendulum changed direction with the Enron/WorldCom/Adelphi revelations -- and is in full swing towards a more pro-shareholder position. Corporate fraud is now perceived as a real problem, and the current imbroglio has been exacerbated by the failure of the public sector: timid and understaffed enforcement; bias favoring top corporate management in the Executive Branch, Congress, and the SEC; a government regulatory regime that has arguably destabilized some key areas of the economy, such as telecom; and overly restrictive tort reform, passed before the emergence of the big scandals, that took some of the enforcement power out of shareholders' hands.

Private enforcement remains absolutely critical to the restitution of public confidence -- also thus public participation -- in other capital markets. Private enforcement provides an additional check against corporate executive misconduct, directly empowers those who have been wronged and increases the likelihood of an equitable outcome. The "infectious greed" that imperils the U.S. economy should be treated robustly with the medicines of both public and private enforcement. Fortunately, despite the securities litigation "tort reform" of the 1990s (PSLRA and SLUSA), state and federal laws are still available to help make the plaintiff whole.

¹²⁸ Class Action Complaint, *Rinard v. Enron. Corp.* (no civil action number listed) (S.D.T.X., filed November 20, 2001), available at news.findlaw.com/hdocs/docs/enron/enron112001cmp.pdf.

¹²⁹ *Id.*

¹³⁰ *Id.*

¹³¹ 29 U.S.C.S. § 1109 (2002).

¹³² Class Action Complaint, *supra*, note 128.

Civil actions under state RICO and other state laws may be the most attractive alternatives for plaintiffs. Unfortunately, SLUSA has imposed numeric limitations on how classes can be configured in cases rooted in state law, thereby interfering with judicial efficiency. Nonetheless, an action on behalf of SLUSA-exempted parties (e.g., pension funds) with major losses, pursuing treble damages under a state RICO law or punitive damages under common law fraud or state statutory fraud, could carry extraordinary punch.