

## *Ethics Matters*

### **Corporations Receive Class Action Relief**

John D. Copeland

J.D., LL.M., Ed.D.

Merck recently settled the class action lawsuit filed against it for strokes and heart attacks allegedly connected to the company's pain medication, Vioxx. Although Merck won most of the Vioxx lawsuits its attorneys tried, the company still faced some 27,000 claims. Having spent \$1.2 billion in Vioxx-related legal fees, Merck decided to settle all the remaining claims for \$4.85 billion. Merck's case is just one example of class action lawsuits filed against U.S. corporations and the enormous costs of defending those cases.

Investors filed many securities class actions after the business scandals of the late 1990s and early 2000s. Corporations question, however, whether investor class action lawsuits are ethical. They contend the actions are too easy for investors to bring and win. The high financial costs of defending against class action claims, the negative publicity such lawsuits bring, and the fear of huge jury verdicts can blackmail corporations into making expensive out-of-court settlements. Corporations also resent plaintiff lawyers advertising for clients and suspect that some class action law firms hire plaintiffs to bring class actions.

Recent events should give corporations some relief from securities class action lawsuits. One case decided by the U.S. Supreme Court, and one currently before the court, will make class action cases more difficult to bring. Also, the indicting of some former securities class action attorneys may affect class action filings.

## **New standard of proof**

Investors sued executives of Tellabs Inc. for overstating revenue projections and product demands. The executives unsuccessfully sought dismissal of the class action during the trial and on appeal. The courts held the case should proceed because “a reasonable person” could infer the defendants acted with the intent of defrauding investors.

The U.S. Supreme Court, however, by an 8 to 1 vote, reversed the lower court decisions and raised the standard for proving corporate fraud. Now, investors must show “cogent and compelling evidence of intent to defraud,” which is a higher standard of proof. This new standard will restrict some securities class actions.

## **Passive bystanders**

Soon, the U.S. Supreme Court will announce its decision in *Stoneridge Investment Partners LLC vs. Scientific-Atlantic Inc.* Attorneys orally argued the case before the court in October. At issue is whether private investors can get compensation from suppliers or others who passively help a public company mislead the market. According to the plaintiffs’ class action, a cable television company overpaid suppliers for equipment. The suppliers then used the overpayments to inflate the company’s income by buying advertising time from the cable company. The suppliers made no public comments about the cable company’s earnings.

The plaintiffs contend the suppliers were not passive bystanders, but principals in the fraud. As principals, their silence was integral to the scheme.

The defendants argue that, at most, they aided and abetted the cable company’s fraud. In 1994 the Supreme Court held aiders and abettors immune from private lawsuits

for another party's stock fraud, unless they directly mislead the public. Only federal prosecutors and the Securities and Exchange Commission can bring actions against aiders and abettors.

During oral arguments, the Supreme Court justices expressed great skepticism about the plaintiffs' case. It seems unlikely the Court will find any defendant suppliers' silence about the fraud of a company with whom it did business directly misled the public.

### **Class action attorneys indicted**

The death of the Milberg Weiss law firm promises corporations some relief from securities class actions. William S. Lerach and Melvyn Weiss founded the firm in 1965 and it became the nation's leading securities class action firm. Described by its critics as creative and ruthless, the firm reportedly collected \$45 billion from corporations through securities class action lawsuits. After a seven-year federal investigation, the Department of Justice indicted Lerach, Weiss and other former Milberg Weiss firm members for paying \$11 million in secret kick-backs to plaintiffs in more than 150 class action and other shareholder lawsuits.

It is illegal for a class action plaintiff to receive a portion of the legal fees. A plaintiff sharing in the legal fees has an incentive to persuade others to settle, even if it is not in the class members' best interest.

A wealthy orthodontist admits to being a plaintiff-for-hire in several Milberg Weiss securities class actions. Two former Milberg Weiss partners entered guilty pleas to conspiracy and are cooperating with federal prosecutors. Lerach also made a plea agreement. Only Weiss continues to fight the federal charges.

Clearly some corporate executives were right. Unethical attorneys victimized the companies through illegal deals with plaintiffs hired to file class action lawsuits.

Prosecuting former Milberg Weiss partners helps stop such practices and could slow securities class action filings.