The New York Times
nytimes.com

SPONSORED BY STARBUCKS.COM

December 21, 2002

Ruling Leaves Most Players Exposed to Suits on Enron

By KURT EICHENWALD

In a decision that broke new legal ground, a federal judge in Houston ruled yesterday that banks, law firms and investment houses that helped construct Enron's off-the-books partnerships could be sued by investors seeking to regain billions of dollars they lost when the company collapsed.

The long, complex ruling dismissed claims against only two defendants — Deutsche Bank and Kirkland & Ellis, the Chicago law firm — while allowing the suit to proceed against almost a dozen other institutions and firms, including Citigroup, J.P. Morgan Chase, Merrill Lynch and Vinson & Elkins.

The decision wrestled with numerous novel and disputed issues involving the liability of corporate advisers under the federal securities statutes, eventually framing standards that allowed the case to proceed.

The judge in the case, Melinda Harmon, ruled that the defendants could be construed as having "substantial participation" in the preparation of false statements about Enron's finances because the evidence supported claims that they acted with an intent to deceive. That was a critical element of the decision because the Supreme Court has ruled that corporate advisers cannot be held liable for "aiding and abetting" a securities fraud, only for participation in it.

Indeed, in her decision, Judge Harmon set out the clearest standard yet for interpreting the high court's 1994 ruling on aiding and abetting, which was handed down in a case known by securities lawyers as Central Bank, after the plaintiff in the case.

"Nobody has really addressed these issues this definitively or this exhaustively," said William Lerach, a partner with Milberg Weiss who is representing the plaintiffs in the case. "What it means is that Central Bank is going to receive a narrow application going forward, and not an expansive one."

As a result of the ruling, the plaintiffs in the case will be able to begin the discovery process against the remaining defendants. Judge Harmon did not rule on separate motions by former Enron executives that they be dismissed from the case.

In reaching her decision, Judge Harmon looked beyond the facts presented in the Enron case and instead examined the role played by the financial institutions as part of the larger breakdown of controls on Wall Street. Indeed, in her decision she cited allegations arising from the investigations of Wall Street research, which resulted in a settlement by many firms yesterday.

For the defendants, the ruling seemed a rebuke to one of their primary lines of defense: that the financial institutions and legal firms being accused of fraud were actually engaging in the normal practices of their business, like selling a security or making an investment.

But, in unusually strong language, Judge Harmon ruled that the actions of the defendants, when viewed in their totality, could support a claim that they had crossed the line from normal business into practices undertaken with the intent to defraud.

"These transactions were not isolated, one-of-a-kind instances of violations of the statutes," Judge Harmon wrote, "but deliberate, repeated actions with shared characteristics that were part of an alleged common scheme through which defendants all profited handsomely."

In a second ruling yesterday, Judge Harmon also held that the defendants in the case could not shield their records, testimony and other potential evidence from public view, denying their request for a sweeping protective order. That means that while the defendants can designate documents as confidential the plaintiffs and the news media will be able to challenge such restrictions as unnecessary.

The chief element of the decision involved Judge Harmon's interpretation of the Supreme Court's ruling in Central Bank of Denver v. First Interstate Bank of Denver, which held that federal law did not permit bringing lawsuits against corporate advisers for aiding and abetting in a securities fraud.

The questions raised by that ruling were easy to ask, but difficult to answer: Do defendants have to make false public statements to be deemed as participating in, as opposed to aiding, a securities fraud? And if not, can defendants be found to have done more than aid in a fraud if they themselves did not actually issue false statements?

In addressing those questions, Judge Harmon, following the reasoning of a brief submitted on the issue by the Securities and Exchange Commission, struggled with the possible meanings of the word "make"; ultimately, she concluded that the word did not mean that a false statement had to be uttered publicly by a particular defendant.

Instead, the judge adopted the language proposed by the S.E.C., ruling that defendants could be found to be primary participants in a fraud if they acted with the intent to deceive, even if the idea for a misrepresentation came from someone else.

In making her ruling, Judge Harmon said that she gave particular weight to the S.E.C.'s position on how to interpret the Central Bank decision because the agency had been expressly granted the power by Congress to construct the regulations under federal securities laws.

Copyright 2002 The New York Times Company | Permissions | Privacy Policy