

# US Supreme Court continues pattern of pro-corporate rulings

Don Knowland  
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Last week the US Supreme Court issued two opinions sharply curtailing investor rights to sue for fraud and other abuses in the sale of corporate shares.

In the case *Credit Suisse Securities (USA) LLC v. Billing*, investors filed suit alleging that major investment banks acting as underwriters violated the federal antitrust laws when they formed syndicates to publicly sell initial shares in hundreds of companies during the 1990s technology bubble. In order to garner excessive commissions, the underwriters would not sell the shares unless the investors agreed to purchase at a later date additional shares at higher prices as well as other shares in less desirable companies, and to pay unusually high commissions rates.

The court did not dispute that such practices could violate the antitrust laws. But, in a 7-1 decision written by Justice Stephen Breyer, the court ruled that the lawsuit could not proceed because it raised the risk of an outcome that might be inconsistent with results in actions brought by the Securities and Exchange Commission (SEC) on investors under the federal laws regulating securities. According to the court, that threatened the efficient operation of securities markets.

The court reached its result based on this generalized concern even though it conceded that under its prior case law, the antitrust claims could be thrown out only if they were “plainly repugnant” to the securities laws. It also conceded that the SEC itself had forbidden the conduct in question.

In a rare dissent to his usual pattern of pro-corporate rulings, Justice Clarence Thomas pointed out that the federal securities laws specifically state that the remedies they provide are in addition to any and all remedies existing under other laws. Since the federal antitrust laws were passed in the 1890s, before passage in the 1930s (following the stock market crash that ushered in the Depression) of the federal securities laws, Thomas reasoned that Congress could not have meant to exclude application of the antitrust statutes to securities activity.

In *Tellabs, Inc. v. Makor Issues & Rights, LLC*, the court, in a case where plaintiffs alleged in their federal court complaint that a company and its officers had made false statements about company earnings and demand for its product, addressed the standard for alleging what is known in the law as “scienter”—the intention to deceive, manipulate or defraud. In an 8-1 decision authored by Justice Ruth Bader Ginsburg, the court adopted a high standard that will result in most securities fraud cases being tossed out by judges at the outset of a case.

In US federal court for decades, the standard for due process purposes for a complaint initiating a lawsuit has been that it need only provide a short and plain statement of facts sufficient to give fair notice of the claim. All factual allegations in a complaint are accepted as true for purposes of determining at the beginning of a lawsuit its legal sufficiency. If a case clears that initial hurdle, the plaintiff has the right to proceed to obtain discovery from opposing parties and witnesses of supporting facts prior to actual trial.

A special rule for fraud cases has also required that the allegedly fraudulent statements be pleaded with specificity or “particularity” In

securities fraud cases, however, many courts required only a general allegation of an intention to defraud, without factual substantiation, recognizing that usually only defendants themselves know why they did what they did.

These standards did not please Wall Street. It complained that defendants routinely faced—and often were forced to settle just to avoid—protracted and expensive proceedings in “frivolous” cases. In 1995, during the high-tech bubble, Congress responded by passing the Private Securities Litigation Reform Act of 1995, signed by President Bill Clinton, imposing heightened pleading requirements for securities fraud cases.

The 1995 law requires a complaint to set forth facts with particularity sufficient to explain the reasons why the allegedly fraudulent statements were false and misleading, and to permit a “strong inference” of the defendant’s intent to defraud. This has given trial court judges much more leeway, which they have widely exercised, to dismiss securities fraud cases at the outset, before corporate and investment banking defendants can be subjected to court-sanctioned discovery of documents and testimony relating to the alleged fraud.

The discouraging effect on such litigation has been pronounced. Shareholder class-action lawsuits filed in federal courts dropped from a high of 497 in 2001 to 57 so far this year. This decline was not due to a sudden wave of corporate adherence to scrupulous honesty. Quite the contrary. The Enrons, WorldComs and Tycos made it apparent just how large and pervasive corporate securities fraud had become. Workers have lost billions of dollars in retirement and investment accounts. But Congress did not amend the 1995 law to again liberalize pleading standards in response to these scandals.

In practice, it has proven quite difficult for plaintiffs to obtain the detailed facts that courts have required to meet the heightened pleading standards of the 1995 law. Naturally, corporate defendants typically do not freely make public the proof of their wrongdoing.

The appellate court that decided the *Tellab* case, the Seventh Circuit, joined other courts in interpreting the “strong inference” of an intent to deceive requirement of the 1995 law to require only that facts be alleged that would permit a reasonable person to form the inference that the defendant had an intention to defraud investors. The appellate court worried that any stricter standard could offend the jury trial guarantee of the Seventh Amendment of the Constitution, in that it would substitute the judge in place of the jury as the fact finder. Given that the federal courts have been stacked under the Bush presidency with judges hostile to those seeking relief against business, this concern is far from theoretical.

Under the 1995 law, other appellate courts have required that the inference of intent to deceive be at least as plausible as an inference that the defendant had innocent intent. The Supreme Court decision adopted this latter standard in *Tellabs*. Justice Ginsburg’s opinion states that the facts must be more than merely plausible or reasonable—they must be “cogent” and at least as compelling as any opposing inference of non-

fraudulent intent.

Ginsburg's opinion brushes off the right to a jury trial with the hollow and inapt observation that courts can always kick cases out short of trial when the facts alleged or proven do not permit a reasonable person to infer wrongdoing. But by definition, a case alleging facts that permit a reasonable inference of wrongdoing is not frivolous.

In an opinion concurring in the result, right-wing Justices Scalia and Thomas went even further. They would require that the inference of scienter must be more plausible than that of innocence. As they undoubtedly know, if adopted that would for all practical purposes eliminate securities fraud suits.

Justice John Paul Stevens was the lone dissenter in *Tellabs*. He would instead apply a standard for pleading scienter of "probable cause," the same burden of proof used for obtaining criminal warrants and indictments. "It is most unlikely that Congress intended us to adopt a standard that makes it more difficult to commence a civil case than a criminal case," Stevens said.

The rulings issued the week of June 19 continued a pattern during the court term that started in October 2007 of decisions favoring the interests of large corporations against those of workers, consumers and small investors.

On January 10, in a unanimous decision in *Norfolk Southern Railway Co. v. Sorrell* authored by Chief Justice John Roberts, the court made it more difficult for injured railroad workers to prove that employer negligence caused injury in cases brought under the Federal Employer's Liability Act, a Progressive-era statute.

On February 20, in *Phillip Morris USA v. Williams* the court threw out \$72.5 million in punitive damages awarded by a jury in an Oregon state court in favor of the estate of a deceased smoker against the tobacco giant for knowingly and falsely leading the decedent to believe its cigarettes were safe. Justice Stephen Breyer wrote the opinion, joined in by Justices Souter, Alito, Roberts and Kennedy.

The court ruled that it violated the due process clause of the Constitution to permit such damages to be awarded based on harm to persons who were not plaintiffs in the lawsuit, such as person in other states. It reached this result even though it conceded that evidence of practices that harm the public generally can be relevant evidence of "reprehensibility" of the defendant, the criterion for permitting punishment of a defendant. Justices Ginsburg, Stevens, Scalia and Thomas dissented.

On May 14, the court returned to the lower court for reconsideration, in light of the *Phillip Morris* decision, a \$57 million award of punitive damages by a California state court jury against Ford Motor Company for not correcting known design defects that caused an SUV to roll over and kill its occupants.

In *Bell Atlantic Corp. v. Twombly*, decided May 21, the court addressed a complaint on behalf of a class of consumers of local phone and internet service. In 1996, Congress passed the Telecommunications Act, which ended monopolies over local telephone service by the "baby bell" phone companies and required them to share their networks with competitors.

The plaintiffs sued under the federal antitrust laws, alleging that the baby bells had conspired to restrict competition in order to inflate charges to their customers. Their complaint alleged that an agreement to restrict competition could be inferred from "parallel conduct" on the defendants' part—their inhibiting new entrants into the market, and themselves not entering into the other's market areas.

In an opinion authored by Justice David Souter and joined in by all justices save Stevens and Ginsburg, the court ruled that the case could not proceed because the complaint had not alleged specific facts showing that the defendants had actually met and conspired together. Of course, such defendants rub elbows all the time at industry conferences and when pooling their lobbying efforts. The majority opinion nevertheless reasoned that the conduct alleged was just as consistent with rational separate

business strategies on the part of the defendants as with their conspiring together to accomplish an illegal restraint of trade. As in the *Tellabs* case, the court again emphasized that the burden on defendants in having to face protracted discovery and other court proceedings warranted strict screening of antitrust cases at their outset.

In a dissenting opinion, Justices Stevens and Ginsburg pointed out that the majority ruling turned the usual rules of court litigation on their head to require plaintiffs to prove that defendants actually conspired, before having any opportunity to obtain discovery from the defendants in that regard. Thus, if defendants were successful in hiding conspiratorial conduct, they could not be hauled into court, rewarding the very conduct that was illegal. This result effectively gutted the longstanding federal procedural rule that a case may proceed to discovery unless it is beyond doubt that the plaintiff can prove no set of facts entitling it to recovery.

On May 29 in *Leadbetter v. Goodyear Tire & Rubber Company*, the court sharply curtailed the ability of workers to sue employers who engage in pay discrimination. (See "US Supreme Court curbs workers' ability to sue for pay discrimination").

On June 4, a unanimous court in *Safeco Insurance of America v. Burr*, in an opinion authored by Justice David Souter, sharply cut back on insurance company liability under the federal Fair Credit Reporting Act. That law requires insurance companies to notify customers if they deny, cancel, reduce or increase charges for insurance based on the contents of a consumer credit report and permits suit for damages for violation of these requirements.

A June 11 decision in *Long Island Care at Home v. Coke* concerned the Fair Labor Standards Act of 1974, which exempts from minimum wage and overtime requirements workers employed in domestic companion care of those unable to take care of themselves, such as the elderly and invalids. The Department of Labor by regulation extended the exemption to home companion care workers even if employed by agencies—often large companies, rather than by families or households. In a unanimous decision, authored by Justice Stephen Breyer, the court deferred to the Department of Labor interpretation of the statute.

The court has issued written opinions in 67 cases so far this term. By historical standards, the cases involving damage suits against corporations discussed in this article represent a very high percentage of cases decided. It is unusual for the court to choose to decide so many cases of this nature in the course of a single term. When coupled with the fact that all these cases were decided in favor of the defendants, a pronounced and deliberate pro-business shift is evident.

It is significant that this shift is not a product solely of the court's right-wing bloc of Justices Roberts, Scalia, Alito and Thomas, in alliance with "moderate" conservative Justice Anthony Kennedy. The so-called "liberal" justices, Breyer, Souter and Ginsburg, who wrote many of the majority opinions, are also instrumental in this development. More and more, aging Justice John Paul Stevens is an isolated dissenter in cases challenging corporate economic power, as he is in cases upholding attacks on fundamental constitutional rights of privacy and due process.

The court plainly has become more brazen about barring the courthouse door to plaintiffs who sue large corporations for damages. Longstanding procedures for challenging the sufficiency of lawsuits are cynically tossed aside, simply because the court no longer wishes to countenance any abridgment of what is perceived to be the right of the largest corporations and banks to operate without restriction. Ultimately, this refusal to adhere to the law must reflect a deeper decay in the economic and political foundations of society.



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