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The Stoneridge ruling

The US Supreme Court decided on 15 January 2008 that fraud claims are not allowed against third parties that did not directly mislead investors but were business partners with those who did.

The 5-3 ruling came in Stoneridge Investment Partners v. Scientific-Atlanta (06-43). The Court said investors may only sue those who issued statements or otherwise took direct action that the investors had relied upon in buying or selling stock, whether that involved public statements, omissions of key facts, manipulative trading, or conduct that was itself deceptive.

Justice Anthony M. Kennedy, who wrote the Stoneridge ruling, said the private right to sue for securities fraud "does not reach the customer/companies because the investors did not rely upon their statements or misrepresentations."

The ruling upheld a decision by the Eighth Circuit Court rejecting claims against Scientific Atlanta, Inc., and Motorola, Inc. The investors contended that those two companies helped a giant cable TV firm, Charter Communications, inflate artificially its financial staements in order to bolster its stock's price. The investors contended that the two companies should be treated as "primary violators," even though they had not themselves issued any public statements to advance the alleged manipulation plot.
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The private right to sue at issue is one that has been created by court decisions, not by a direct federal statute. Justice Kennedy said that the Stoneridge ruling limiting the range of such a lawsuit was "consistent with the narrow dimensions we must give to a right of action Congress did not authorize when it first enacted the [Securities Exchange Act of 1934] and did not expand when it revisited the law."

In ruling that Scientific Atlanta and Motorola could not be sued, Kennedy wrote that the two outside companies "had no duty to disclose; and their deceptive acts were not communicated to the public. No member of the investing public had knowledge, either actual or presumed, of [the two companies'] deceptive acts during the relevant times. [Stoneridge], as a result, cannot show reliance upon any of [the companies'] actions except in an indirect chain that we find too remote for liability."

Noting that the investors had argued that Scientific Atlanta and Motorola had done what they did with the aim, and the result, that a false appearance was created about Charter's revenues, and that what Charter said publicly was "a natural and expected consequence" of the suppliers' deception, the Court said this was not a sufficient link in the chain toward liability.

"In effect," Kennedy wrote, Stoneridge "contends that in an efficient market investors rely not only upon the public statements relating to a security but also upon the transactions those statements reflect. Were this concept of reliance to be adopted, the implied cause of action would reach the whole marketplace in which the issuing company does business; and there is no authority for this rule."