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'Scheme liability' can put professional firms at risk

As the developing "credit crunch" places more businesses under financial stress, and as the investors in these businesses grow restless, Oregon firms that provide financial and related services to those businesses should be watchful.

In recent years, banks, financial institutions and others who provide professional services to business clients have increasingly found themselves to be the deep-pocketed defendants in lawsuits brought against the clients by their investors. In almost all of these cases, the servicing firms (often referred to as "secondary actors") were not directly involved in the investment relationship or the investment decision between the client business and its investors, but merely provided support to the client company in the form of financial, legal or accounting services.

These secondary actors have usually been protected by a 1994 U.S. Supreme Court decision that held under federal law that there is no private lawsuit liability for "aiding and abetting" securities law violations committed by others. However, some disappointed investors and some courts have recently tried another way to hold these secondary defendants liable: "scheme liability."

Under "scheme liability," a defendant, such as a bank, could be held liable under federal securities law for the client company's illegal acts, even if the defendant did not itself engage in any illegal or deceptive acts. If the client company's deceptive acts were the "natural and expected consequence" of the defendant's acts, that itself might suffice to create liability for the defendant.

For example, a bank that engaged in a transaction with a client company might be held liable in a securities lawsuit against the client company, if it were shown the bank could have expected that the company would use that transaction to help perpetrate a fraud against



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the investors, such as booking loan proceeds as income.

It was this "scheme liability" that was the basis of the lawsuits against the banks, lawyers, investment banks and others who did business with Enron.

Scheme liability posed enormous risk to those firms providing services to companies whose business faltered and whose share price plummeted. Legitimate work done out of the public eye became a basis for a lawsuit when it was the business' customer who had violated the securities laws. This new "cost of doing business" was a serious concern for every corporate services firm in the nation.

However, the Supreme Court's very recent decision in *Stoneridge Investment Partners LLC v. Scientific-Atlanta Inc.*, put an end to scheme liability under federal law. In *Stoneridge*, the court reaffirmed that under the federal securities fraud laws, a defendant can be found liable for securities fraud only if the plaintiff-investor relied upon the defendant's supposed deceptive acts. Thus, legitimate nondeceptive actions taken by businesses servicing publicly traded companies cannot form the basis of liability in

a securities fraud suit.

However, the reprieve from scheme liability provided by the *Stoneridge* decision may be of limited comfort to firms doing business in Oregon. Even if they are protected from scheme liability in federal court, these firms remain in jeopardy under the strongly pro-investor Oregon securities laws.

Under those laws, "scheme liability" (as well as "aiding and abetting" liability) seems to remain viable. This is due to the differences in the way the federal and Oregon securities fraud statutes are worded.

For example, under Oregon law, any person or company who "participates or materially aids" in the sale of a security is liable for securities fraud to the same extent as the seller. Oregon courts have interpreted "participates or materially aids" broadly, to extend to acts that are not directly tied to the actual sale of the securities. And the definition of a "security" in Oregon is likewise extremely broad.

Under the Oregon law, it is not necessary that the servicing firm actually commit any unlawful act. It is sufficient that the seller committed a securities law violation and that the servicing firm "participated or materially aided" in the offending sale.

Thus, "behind the scenes" actors who are engaged in legitimate securities-related transactions with a company that violates Oregon securities laws remain exposed under the Oregon law, even in a post-*Stoneridge* world.

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