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Re-arming investors

Staten Island Advance Editorial

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Congress is being urged to restore the ability of investors to sue knowing wrongdoers in an effort to recover financial losses.

The proposal is being billed as a simple way to impose needed regulation on Wall Street at no cost to taxpayers. The goal is to deter investment fraud and abuse.

It merits full consideration by the Obama administration and on Capitol Hill.

In the years from the Great Depression until the boom in government deregulation that began in the 1990s, the fear of lawsuits by fleeced investors played a vital role in keeping Wall Street honest.

So say the backers of the proposal to erase current U.S. restrictions that make it nearly impossible for those who lose money to fraud and abuse to sue financial executives along with their lawyers, accountants and investment bankers.

Such wrongdoing is alleged to have been a key factor in last year's collapse of the economy.

The worry is that unless Congress restores a level playing field, so to speak, white-collar crooks will be free to cash in again, using phony manipulations to pump up another fake frenzy on Wall Street.

Housing bubble redux? No, thank you.

Under the current laws, those who helped to market junk subprime mortgage-backed securities as triple-A investments might be judgment-proof.

The same goes for those suspected of improperly aiding jailed Ponzi schemer Bernie Madoff steal \$50 billion from thousands of duped investors.

Not even in cases of such obvious fraud as the Enron debacle that began in 2001 has it been easy for those who lose money to sue to recover their losses.

Why?

Enactment of the Private Securities Litigation Reform Act (PSLRA) of 1995 over President Clinton's veto is said by opponents to have gone too far in favor of defendants in cases of securities fraud.

It came on the heels of what remains a controversial pro-Wall Street legal decision by the Supreme Court, a ruling that went against investors. The Central Bank decision by the high court in 1994 eliminated private liability for knowing aiders and abettors of financial wrongdoing.

Before that, the right of private action had, for decades, helped the often understaffed Securities and Exchange Commission to police Big Business.

It was a deterrent to corporate executives and their Wall Street advisors from deliberately engaging in unscrupulous financial practices.

Then came the PSLRA. Under the law, victims of financial schemers must prove that perpetrators acted with intent to defraud, something that is required in no other field of civil justice, including common law. In cases other than securities fraud, it's enough to demonstrate the crime was committed and the victims were hurt.

Furthermore, the 2005 ruling by the Supreme Court in the Dura Pharmaceuticals case allows lawsuits to be dismissed when executives do not explicitly announce they engaged in fraud. That's an absurdly high standard of proof.

In 2008, the Supreme Court's decision in the Stoneridge case curtailed private liability for other knowing participants in cases of fraud and abuse.

Calling for the restoration of private rights of action is an array of regulatory experts, pension fund investors and law school educators.

Professor James D. Cox of Duke University recently said Congress should roll back the Supreme Court rulings "that have been needlessly destructive of private enforcement and fraud deterrence."

Last month, former SEC chief accountant Lynn Turner warned Congress that the right of investors to file private suits has been "seriously eroded," and that federal watchdogs don't have the resources to enforce securities law in all cases.

The debate over whether shareholder litigation is actually an effective deterrent isn't new. Critics claim that most securities lawsuits are frivolous, result in big-money payments to attorneys for the plaintiffs and bring only minimal compensation to shareholders. But the validity of a suit can always been determined by the courts. It's no reason to ban all such lawsuits and thus prevent legitimate ones from going forward.

It's high time to consider whether to restore the effective ability of investors to sue to recover their fraud losses from deliberate wrongdoers.

Today's hard times demand a hard look at how to prevent crimes and misdemeanors on Wall Street.

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