Market Relief?

By Todd Gordinier

The Supreme Court's decision to review *Stoneridge Investment Partners LLC v. Scientific-Atlanta Inc.* provides the court with a much-needed opportunity to address and relieve the increasing litigation expenses that are imperiling America's historical pre-eminence in the world's capital markets.

The recent speech by Paul Atkins of the Securities and Exchange Commission was only the latest in a series of public expressions of concern about the costs imposed on the capital markets by the current securities regulatory environment. Enforcement of our securities laws is accomplished by a mix of public (SEC) and private (plaintiffs' class action bar) efforts. It is increasingly apparent that the resulting costs are eroding the traditional dominance of American capital markets in an increasingly globalized economy.

In November 2006, the Committee on Capital Markets Regulation released a report in which it concluded that the unpredictability and expense of securities litigation is a substantial barrier to the growth of the capital markets and recommended several reforms to address its concerns. A subsequent report commissioned by Sen. Charles Schumer, D-N.Y., and New York City Mayor Michael Bloomberg similarly concluded that unpredictability and expense impaired the growth of American capital markets.

Moreover, that report noted that litigation risk is the second most important factor for corporate executives when they decide which capital markets to enter. The U.S. Chamber of Commerce has echoed these views. The SEC has begun to consider whether public shareholder complaints might be more properly resolved through arbitration rather than the court system. In sum, there can be little question that the American litigation system is imposing costs on the capital markets that threaten to erode America's predominance in that area.

The Supreme Court has an important institutional role to play in this ongoing process; one that is perfectly consistent with its historical, constitutional role. *Stoneridge* presents the court with a chance to reduce wasteful litigation expenses that are incurred needlessly whenever the court system is beset by uncertainty and unpredictability. The court seems poised to take advantage of such an opportunity, and it is important that it does so.

The issue before the court in *Stoneridge* is the latest manifestation of the plaintiff securities bar's ever-creative attempts to find deep pockets. For example, in the early 1990s, the plaintiff bar's most visible personality, William Lerach, sought to meld the less stringent reliance requirements under the Federal Securities Laws with the "in terrorem" threat of punitive damages awards available under California state common law for fraud. This effort was precluded when, in *Mirkin v. Wasserman*, the California Supreme Court held that plaintiffs were required to allege and prove actual reliance on a misrepresentation if they wanted to take advantage of state common law fraud theories of relief.

Undeterred, plaintiffs' lawyers asserted ever-more tenuous claims under the Federal Securities Laws until Congress stepped in to enact the Private Securities Litigation Reform Act in 1995, raising the pleadings standards for private securities claims in federal courts and preventing plaintiffs from abusing the discovery process simply to leverage a settlement. Plaintiffs sought to avoid the PSLRA's heightened standards by turning once again to state courts. Congress stepped in and, with the enactment of the Securities Litigation Uniform Standard Act of 1998, effectively confined most securities class actions to the federal system.

Stoneridge represents the latest legal construct fashioned by plaintiff's lawyers in an effort to maximize the value of such litigation for themselves. In 1994 the Supreme Court held, in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, that secondary actors, such as attorneys and accountants, cannot be held liable in private securities actions for "aiding and abetting" another's actionable conduct. The court in that decision, however, left open the definition of "primary violator" and "primary liability." Latching onto that opening, plaintiffs have developed the concept of "scheme liability," a legal theory by which they have sought, with some success, to limit the scope of the *Central Bank* decision. Under such a theory, secondary actors, such as attorneys, accountants, banks, business partners and even, in some cases, vendors have been brought into securities claims on the theory that such secondary actors have committed a primary violation where they were part of a "scheme" to defraud investors.

The Supreme Court has elected to address the notion of "scheme liability" posed in *Stoneridge* because lower courts have taken two conflicting approaches. The 8th U.S. Circuit Court of Appeals, when it decided *Stoneridge*, followed what is clearly a majority view in adopting a bright line definition of "primary violation." It held that secondary actors are only liable as primary violators if they "make or affirmatively cause to be made a fraudulent misstatement or omission" or "directly engaged in manipulative securities trading practices." By contrast, in *Simpson v. AOL Time Warner Inc.*, the 9th Circuit adopted an uncertain and inherently unpredictable approach as to what constitutes a primary violation. It held that secondary actors are primary violators if their "conduct or role in an illegitimate transaction has the principal purpose and effect of creating a false appearance of fact in furtherance of a scheme to defraud."

The vague *Simpson* standard not only fails to provide any predictability to secondary actors about what conduct is lawful, but will also certainly result in substantial litigation expenses for such secondary actors forced to litigate the question of whether their actions had the "principal purpose and effect" of furthering an alleged scheme, even if they themselves made no statement to the investing public. This unpredictability results in precisely the kind of wasteful expense, with no concomitant benefit, that is increasingly leading companies to seek access to markets outside of the United States.

Predictably, the plaintiffs' bar is intent on maximizing its freedom to assert claims against a wide spectrum of actors. Indeed, the media recently reported that Mr. Lerach met with the SEC staff this spring to urge them to support his position. Such an approach would further impair the ability of American capital markets to compete with increasing global competition. It is critical that the Supreme Court use this opportunity to create a bright line test and eliminate the threat currently existing for "secondary" participants, so that all participants in the capital markets can perform their respective roles with the knowledge that such conduct will not be subject to expensive and wasteful litigation mainly benefiting plaintiff's attorneys.

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Student Speech Rights on Internet Cry Out for Supreme Court Review

By Clay Calvert and Robert D. Richards

As the media spotlight fades from the factually intriguing, yet quirky and somewhat silly scenario at issue in the "Bong Hits 4 Jesus" case of *Morse v. Frederick*, 127 S. Ct. 2618 (2007), it is time for the U.S. Supreme Court to tackle a student speech case that deals with a far more common situation that will arise repeatedly for years to come.

In particular, the nation's high court must hear a case — and there are many cropping up across the country — in which a high school or middle school student, using his or her own home computer during non-school hours, creates and posts Internet content that attacks, criticizes or otherwise offends school officials, teachers or fellow students. In retaliation, the school punishes the student for this off-campus expression, asserting that its authority stretches beyond the geographic borders of the campus and deep into the realm of cyberspace.

A trio of critical and complex questions arise from this fact pattern now familiar to many principals and superintendents: 1) When, if ever, do schools possess jurisdiction over students for such off-campus, high-tech speech?; 2) If schools do indeed have such jurisdiction, then when can they permissibly punish students without running afoul of the First Amendment guarantee of free expression?; and 3) In determining whether punishment is permissible, should courts modify or adopt rules from the Supreme Court's aging trilogy of pre-*Morse* cases on student speech — *Tinker v. Des Moines Independent Community School District*, 393 U.S. 503 (1969), *Bethel School Dist. No. 403 v. Fraser*, 478 U.S. 675 (1986), and *Hazelwood School District v. Kuhlmeier*, 484 U.S. 260 (1988) — none of which involved either the Internet or off-campus expression?

Granting certiorari in the near future in what might be called an "off-campus speech, on-campus punishment" case involving the Internet would go a long way toward resolving these issues.

Students' use of technology has simply outstripped controlling legal precedent, as messages that once were posted on bathroom walls, scrawled in notebooks and passed from classmate to classmate on spiral-bound paper are suddenly going online off-campus, waiting for all to see and read.

Although *Morse* was helpful both in jumpstarting the court's moribund student-speech jurisprudence and revealing how the current crop of justices generally feel about the speech rights of public school students — Clarence Thomas' concurrence, for instance, reveals his belief they have no First Amendment rights whatsoever — the case did nothing to address the trio of issues raised above. Indeed, the concurrence of Justices Samuel Alito and Anthony Kennedy in *Morse* basically confines the majority's opinion in favor of principal Deborah Morse and against the banner-hoisting student, Joseph Frederick, to the narrow context of non-political, pro-drug speech that transpires while a student is under school supervision.

Since the fractured decision in *Morse* came down on June 25, two different federal courts have ruled in cases involving Internet-related expression that was created and/or transmitted by students on their own time and away from school grounds. And in both cases, the courts specifically observed that *Morse* did not control or help their reasoning.

In particular, a federal judge in Pennsylvania held July 10 in *Layshock v. Hermitage School District*, 2007 U.S. Dist. LEXIS 49709 (W.D. Pa. 2007), that the First Amendment speech rights of then-high school student Justin Layshock were violated when he was suspended for creating, on his grandmother's home computer during non-school hours, an offensive MySpace.com parody profile mocking his principal, Eric Trosch.

Calling it "an important and difficult case" that "began with purely out-of-school conduct which subsequently carried over into the school setting" when the MySpace profile was discovered and accessed by other students on campus, U.S. District Court Judge Terrence F. McVerry cited splits of judicial authority over whether schools can punish students for such out-of-school, Internet-based speech. He noted that *Morse* was "not controlling" because "the Justices unanimously agreed that *Morse* involved school-related speech," and added that "the five separate opinions in *Morse* illustrate the complexity and diversity of approaches to this evolving area of law."

Judge McVerry seemed hesitant in granting the school any authority over the speech, noting that "the mere fact that the internet may be accessed at school does not authorize school officials to become censors of the world-wide web" and adding that "on this threshold 'jurisdictional' question the Court will not defer to the conclusions of school administrators."

Just five days before the opinion in *Layshock*, the U.S. Court of Appeals for the 2nd Circuit ruled in a case that it described as "a First Amendment challenge to an eighth-grade student's suspension for sharing with friends via the Internet a small drawing crudely, but clearly, suggesting that a named teacher should be shot and killed." Specifically, the speech at issue in *Wisniewski v. Board of Education of Weedsport Central School District*, 2007 U.S. App. LEXIS 15924 (2d Cir. 2007), was an icon (or sender identifier) transmitted via an instant messaging system by the student from his parents' home computer to 15 fellow students on his buddy list.

As with *Layshock*, the court in *Wisniewski* noted that *Morse* was not helpful in resolving the case, writing that the high court "had no occasion to consider the circumstances under which school authorities may discipline students for off-campus activities."

The 2nd Circuit nonetheless upheld the school's punishment of student Aaron Wisniewski. On the jurisdictional issue, it held that "the fact that Aaron's creation and transmission of the IM icon occurred away from school property does not necessarily insulate him from school discipline." The court then applied the standard from the Supreme Court's decision in *Tinker* — a case that focused on the wearing of a black armband in school, not an IM icon communicated off-campus — and concluded the speech would "foreseeably create a risk of substantial disruption within the school environment."

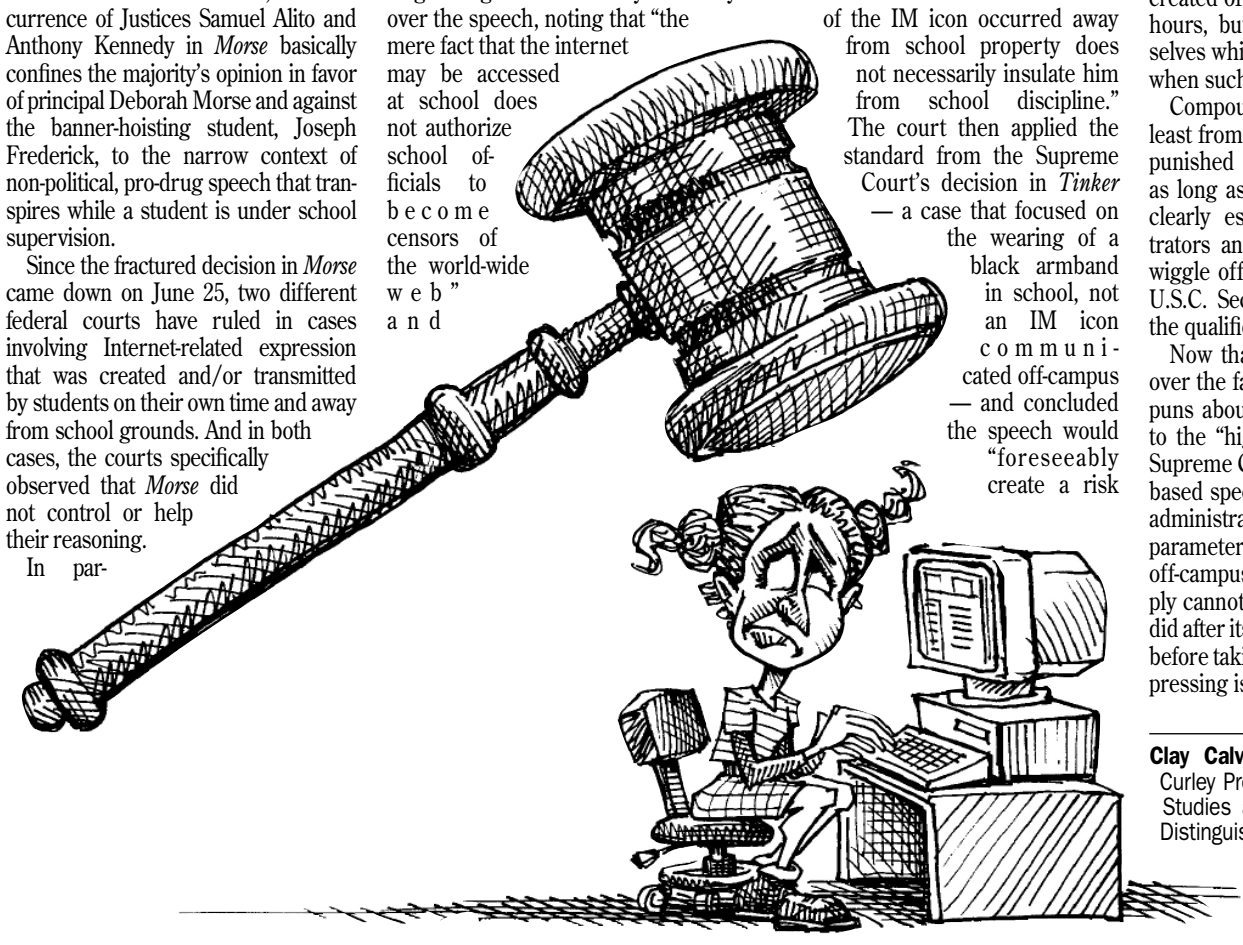
Within the 9th Circuit, a federal judge in *Emmett v. Kent School District,* 92 F. Supp. 2d 1088 (W.D. Wash. 2000), ruled in favor of a high school student who was suspended for creating and posting on his home computer a Web site featuring what the court described as "mock obituaries" of two friends at the school and that allowed students "to vote on who would 'die' next – that is, who would be the subject of the next mock obituary." Although satirically challenged school officials viewed this as a true threat of violence, Judge John C. Coughenour found the school had no such evidence and he openly questioned the school's initial authority over it, emphasizing that "the speech was entirely outside of the school's supervision or control" and therefore putting it squarely outside the reach of the Supreme Court's rulings in both *Bethel* and *Kuhlmeier.*

The *Layshock* and *Wisniewski* cases, coming less than one month after *Morse*, are illustrative of a larger problem that must be addressed quickly by the Supreme Court.

Lower courts, in brief, are left to their own devices to try to determine not only when schools have jurisdiction over Internet-based speech that is created off campus during non-school hours, but also to fathom for themselves which rules apply to determine when such speech can be punished.

Compounding the problem — at least from the perspective of students punished in this scenario — is that as long as the law in this area is not clearly established, school administrators and officials will continue to wiggle off the hook of liability for 18 U.S.C. Section 1983 violations under the qualified immunity doctrine.

Now that we've all had our laughs over the facts in *Morse* and made bad puns about the bong hits case going to the "high" court, it's time for the Supreme Court to take up an Internet-based speech case that will help both administrators and students know the parameters of school authority over off-campus expression. The court simply cannot wait another 18 years, as it did after its 1988 decision in *Kuhlmeier* before taking up *Morse*, to address this pressing issue.



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