

SEC COMPLAINT URGES JURISDICTION OVER PLAINTIFFS' LAWYERS

by
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As part of its new Investor Protection Program, Washington Legal Foundation (WLF) recently filed a complaint with the U.S. Securities and Exchange Commission (SEC) regarding the influence of private plaintiffs' lawyers in the securities markets. Specifically, the complaint raises important questions regarding the extent to which securities laws and regulations govern communications by plaintiff's attorneys who file major class actions against publicly-traded corporations with analysts, short-sellers, hedge funds, securities professionals, and other persons.

WLF's complaint is based on a January 7, 2003 WALL STREET JOURNAL article, *Suit Batters Penney Shares, But Serves Short-Sellers Well*. The article describes how short-sellers may have had prior knowledge of the filing of a multi-million dollar class action lawsuit against Eckerd Drug Stores. Once the suit was filed, the stock of J.C. Penney Co., the parent of Eckerd Drugs, dropped. WLF's complaint calls upon the SEC to conduct a full investigation of the facts in this case, and to take appropriate enforcement action for any violations of SEC laws or regulations.

One regulation that the Commission would likely consider relevant to its inquiry is 17 C.F.R. § 240.10b-5, or Rule 10b-5, which generally prohibits traditional "insider" trading as well as "misappropriation" of material information that is confidential and nonpublic. *See generally United States v. O'Hagan*, 521 U.S. 642 (1997). As one court described it, the "[m]isappropriation theory is targeted at 'outsider' trading, i.e., breaches that do not involve a duty to the traded company and its shareholders." *United States v. Kim*, 184 F. Supp. 2d 1006, 1012 (N.D. Cal. 2002). Rule 10b5-1 and Rule 10b5-2 may also be applicable in this case.

While there is no doubt that timing of the filing of a major class action lawsuit is material nonpublic information that can affect the price of the stock, the question is whether, absent fraud or false statements, Rule 10b-5 or other SEC rules can regulate selective disclosure of this information. Attorneys have a fiduciary relationship with their clients, including those in a class action case, but the question is whether information about the timing of the suit or other information about the merits of the case, such as evidentiary material, was misappropriated. If there is no jurisdiction over this conduct, Congress may consider remedial legislation.

The SEC Enforcement Division has indicated that due to limited resources, it is more likely to investigate complaints that have generated more public interest and support. Consequently, counsel are urged to contact the SEC Enforcement Division at 425 Fifth Street, N.W., Washington, D.C. 20549, and request that they investigate WLF's complaint. Counsel are also urged to contact WLF if they are aware of similar cases of possible market manipulation.

Paul D. Kamenar is Senior Executive Counsel of the Washington Legal Foundation. WLF's complaint to the SEC can be viewed on WLF's web site, www.wlf.org.

About WLF And The COUNSEL'S ADVISORY

The Washington Legal Foundation (WLF) is the nation's largest non-profit, free enterprise public interest law and policy center. WLF litigates *and* publishes in order to advocate legal policies that promote economic growth, job creation, and the civil liberties of business. As a 501(c)(3) tax exempt organization, WLF relies upon the charitable support of individuals, businesses, associations, and foundations to fund its programs.

This COUNSEL'S ADVISORY is one of WLF's six publication formats. Its purpose is to inform the free enterprise community about a development in the legal policy world that can be favorably influenced by the immediate involvement of legal experts and business and community leaders.

For more information on the Washington Legal Foundation, please contact Daniel J. Popeo, Chairman, at (202) 588-0302.

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