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LEGAL ABANDON:
How Limiting lawsuits Led to The Financial Collapse And What To Do About It

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Executive Summary

Private civil lawsuits are as important as strong regulation and enforcement to properly manage any national capital market. Greatly compounding recent trends toward deregulation and lax regulatory enforcement has been the weakening of investors' and borrowers' private legal rights of action.

Beginning in the 1990s and into the early part of the next decade, the legal rights of defrauded shareholders were greatly restricted by Congress and the U.S. Supreme Court. The rights of mortgage borrowers are extremely limited, as well.

- Corporate fraud immediately increased after passage of the Private Securities Litigation Reform Act (PSLRA) and the Securities Litigation Uniform Standards Act of 1998 (SLUSA), and investor cases have been thrown out of court — cases that could have brought fraud to the attention of regulators and the public.
    - PSLRA bars investors from bringing fraud claims against a corporate entity without a very large amount of evidence in hand and stops all discovery until after a judge decides whether the case can go forward. As one legal scholar put it, "You can't get discovery unless you have a strong evidence of fraud, and you can't get strong evidence of fraud without discovery."
    - SLUSA says that federal courts are the exclusive jurisdiction for class actions based on state law fraud in relation to the purchase or sale of stock.

- The Class Action Fairness Act of 2005 (CAFA), which limited the rights of all class action plaintiffs, has resulted in a 24 percent decline in class action securities filings as of December 2009 compared to the same period in 2008.

Congress has balked at reversing or modifying U.S. Supreme Court decisions that substantially weakened consumer protections in the financial markets. These include:

- *Central Bank of Denver, N.A. v. Interstate Bank of Denver, N.A.* (1994), where the Court ruled that shareholders could not sue aiders and abettors to corporate fraud.

- *Stoneridge Investment Partners v. Scientific-Atlanta, Inc. et al.* (2007), where the Court ruled that investment banks, lawyers, accountants, credit rating bureaus or other so-called "secondary actors" who knowingly help a public company deceive investors cannot be liable for the fraud if they did not make a material misrepresentation to shareholders. This decision broke with SEC precedent, members of Congress from both parties and the views of 33 state attorneys general.

When it comes to Wall Street's accountability, victims of predatory mortgage loans that led to the subprime mortgage crisis have been largely left out in the cold due to certain decisions about "assignee liability" by Congress, the Clinton and Bush Administrations and the U.S. Supreme Court. Had the law been different from the start, victims could have held Wall Street firms accountable and many believe the subprime mortgage crisis would have been avoided.

Scholars and economists have loudly called for re-regulation of the capital markets. Many of their solutions emphasize the importance of being able to hold corrupt CEOs and underwriters legally responsible for fraudulent actions. Top priorities are addressing the roadblocks posed by federal legislation and by the Supreme Court decisions in *Central Bank* and *Stoneridge*.