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A License To Commit Fraud

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Just as the Enron scandal has faded into the back of the financial pages, the conservative movement has score a major victory in its push to make it harder for people victimized by the Enrons of the world and their enablers to obtain justice. Thanks to two Reagan appointees to the U. S. Court of Appeals for the Fifth Circuit, investment banks now have a way to legally profit from showing their clients how to defraud investors, without fear of those investors banding together to fight back.

Those two judges—E. Grady Jolly and Jerry Edwin Smith—virtually said as much in their ruling earlier this month against defrauded Enron investors and 30 state attorneys general—the plaintiffs in a class action suit against three large investment banks and their subsidiaries that were advising Enron. Jolly and Smith just didn't say it as bluntly as the third judge in the case, James L. Dennis, a Clinton appointee, who wrote in his partial dissent that the ruling “immunizes a broad array of undeniably fraudulent conduct from civil liability ... effectively giving secondary actors license to scheme with impunity, as long as they keep quiet.”

Al Meyerhoff, one of the plaintiff lawyers in the case, agreed. “Participation in fraud has thus been elevated by the Fifth Circuit to simply another line of business,” he wrote in an analysis of the ruling. “The effect of the opinion is to allow investment banks to both charge fees and escape liability for constructing and carrying out transactions that they understand have no other purpose than to falsify financial results reported to investors.”

This is the fruit of a longstanding campaign by conservative groups such as the Federalist Society to limit the ability of ordinary people to obtain redress in the courts against corporate miscreants. These groups provided the intellectual firepower behind such laws as the Class Action Fairness Act, approved by the Republican Congress and signed by President Bush in 2005, shifting most class action cases to federal courts and making it harder for aggrieved parties to successfully pursue those cases. Laws such as CAFA, combine with Bush's stacking of the federal courts with judges who seem ideologically opposed to even the mildest discipline on bad actors in the free market. In these ways, Bush-era conservatism is allowing the wealthy and the powerful to pillage ordinary people.

Judges Jolly and Smith acknowledged in their opinion that the three banks—Merrill Lynch & Co., Credit Suisse Group and Barclays Bank—“entered into partnerships and transactions that allowed [Enron] to take liabilities off of its books temporarily and to book revenue from the transactions when it was actually incurring debt. The common feature of these transactions is that they allowed Enron to misstate its financial condition.”

Yet, the judges concluded that because the banks themselves did not engage in “misrepresentations” to the investors being defrauded—only facilitating Enron's misrepresentations—Enron shareholders could not band together and pursue a case against the banks. As plaintiff attorney [William Lerach said](#), his clients are enjoined from suing as a class, “even if the banks participated knowingly in a scheme to defraud investors in Enron's collapse.”

Showing tender concern for the banks, the court opined, “class certification may be the

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backbreaking decision that places 'insurmountable pressure' on a defendant to settle, even when the defendant has a good chance of succeeding on the merits." The court said essentially that the mere presence of a class action suit, regardless of its merits, puts too much pressure on the defendants—which are almost always by nature big and rich—to settle before trial. This, said the court, is not a good thing. Tellingly, conservatives crusading under the Orwellian banner of "tort reform" are cheering the result. "This is a fantastic result," wrote one commenter on the [Wall Street Journal Law Blog](#) "Not that many people really lost any money due to the actions of these defendants anyway. This is just another sign that our tort reform efforts are really paying off."

This is not the first time that Jolly has risen to the defense of Enron enablers. In 2006, Jolly ruled that Merrill Lynch could not be prosecuted as a co-conspirator in a fraud case involving its purchase of a barge from Enron in 1999 for the sole purpose of goosing up its quarterly earnings. In what has become known as the "Nigerian barge case," prosecutors argued that Merrill Lynch deprived Enron and its investors of its "honest services" by facilitating a scheme that made Enron's financial statement to appear healthier than it actually was. Jolly and Harold R. DeMoss, an appointee of President George H. W. Bush, essentially said that Enron was not defrauded because Merrill Lynch was delivering what Enron's chief executives were asking for. "The employer itself," Jolly wrote, "created among its employees an understanding of its interest that, however benighted ... was thought to be furthered by a scheme involving a fiduciary breach."

In his analysis of the case *Fortune* magazine senior editor [Roger Parloff](#) wrote: "The problem with Judge Jolly's theory, as dissenting judge Thomas Reavley noted, is that corporate executives are distinct from the corporation, which is owned by shareholders. Executives owe honest services to those shareholders, and one of the most basic is to report finances accurately."

The tragedy is that now the notion that bankers should not engage in fraudulent behavior that harms investors is now a dissenting opinion, rather than an inviolate principle of law. It is a stunning example of how badly polluted the legal and economic playing field has become for ordinary people under the Bush administration—and it needs to be brought from the backs of the financial pages to the front lines of our fight for fairness.