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Rough road to recovery

Criminal charges, bankruptcy impede securities fraud class-action case

By: Douglas Levy in News Stories October 15, 2010

E. Powell Miller (left) and Marc L. Newman of The Miller Law Firm PC in Rochester, who specialize in commercial and class-action litigation, had a contentious battle against former Collins & Aikman Corp. CEO David A. Stockman in a securities fraud lawsuit.

As E. Powell Miller and Marc L. Newman can attest, pursuing a class-action lawsuit involving securities fraud can become difficult when the company being sued files for bankruptcy.

Naturally, Newman said, "it limits the source of available proceeds to fund a settlement."

But there were other arduous elements for the attorneys when they helmed a recent suit against a private equity firm and upper management at defunct auto supplier Collins & Aikman Corp.

First was strife between Heartland Industrial Partners and former Collins & Aikman CEO David A. Stockman, as the latter was suing the former for his firing in May 2005, following allegations of accounting schemes to inflate stock value.

"There was a big power struggle," Newman said, "not just plaintiff versus defendant, but the defendants were fighting among themselves, and that always makes it much more difficult for us to settle."

As well, Stockman was facing federal criminal prosecution for allegedly misleading Collins & Aikman investors when he was CEO. He was indicted in 2007, when Miller and Newman's securities fraud class-action suit was pending.

But two years later, the charges against Stockman were dismissed – and the securities fraud suit was still pending.

"That emboldened him," Miller said, adding that he's never had a criminal law matter such as this transpire within a case he was handling.

Indeed, at a status conference at U.S. District Court for the Eastern District of Michigan, where Gerald E. Rosen required all parties to appear, Miller said the other defendants were congratulating Stockman upon his arrival.

"When we got the indictment dismissed, it sent a message to everyone, including Judge Rosen and plaintiff's counsel, that a more intensive look at the evidence would lead to a different result," said Andrew B. Weissman, of Washington, D.C.-based Wilmer Cutler Pickering Hale and Dorr LLP, who served as co-counsel for Stockman. "We were moving in that direction when we settled the case; we'd completed discovery and were drafting our papers for summary judgment."

But, Newman said, just because Stockman wouldn't face criminal sanctions, "that doesn't mean he didn't commit civil fraud."

He added, "It's a different standard; our theory is, we don't have to prove beyond a reasonable doubt in a civil case, just a preponderance of the evidence, which is a much lower standard."

Miller said the fact that Stockman's reputation was at stake following his dismissed indictment meant the former CEO wasn't going to cave in – even if Heartland and the other former Collins & Aikman executives were open to settlement talks.

"It was a battle of wills," Miller said. "He could see we were never going to back down. We answered all the discovery, did all the depositions, and were very well prepared for trial."

Miller and Newman of The Miller Law Firm PC in Rochester, along with Thomas H. Burt of New York-based Wolf Haldenstein Adler Freeman & Herz LLP, asserted that the value of Collins & Aikman's stock was artificially inflated to make the company appear more valuable than it was worth.

When the market learned of improper accounting and the company's actual financial situation, its stock and publicly traded fixed-income securities fell precipitously. And a month after the class action was filed, Collins & Aikman filed for bankruptcy protection, then liquidated.

"Once an auto supplier starts to show it doesn't have sufficient cash flow or financial backbone," Newman said, "then customers don't want to business with them, because they're fearful that they'll file for bankruptcy.

"Our theory is, a lot of the accounting tricks they did were to make it appear this was a viable entity, when in fact it wasn't. And when the house of cards fell down, they filed for bankruptcy."

Stockman, meanwhile, was charged with defrauding company investors by issuing false financial reports and engaging in a phony rebate scheme to raise capital and avoid defaulting on credit agreements.

Because of confidentiality matters, specific evidence could not be discussed, but Miller did say that there were thousands of documents reviewed, and depositions taken from industry experts and accounting/financial witnesses.

"The way you prove fraud, you very rarely have a smoking gun," he said. "People don't just come out and say, 'I did it.' But each piece of the puzzle is put together relentlessly, and as those pieces came together, we were confident we could persuade a fact finder that a fraud was committed."

Finally, in June, the parties agreed to a $12 million-plus settlement for class members who were Collins & Aikman stockholders.

In retrospect, Weissman said, "We were confident that there wasn't any basis for a claim against Mr. Stockman, and that the case really involved the downward spiral of the auto industry and Tier One providers everywhere. But settlements are settlements; you do it to put them behind you."

But there still are legal matters ahead for Stockman, a former Republican U.S. representative for Michigan who also served as budget director in the Reagan Administration. The Securities and Exchange Commission is seeking civil sanctions against him; if successful, it would preclude him from serving on the board of any publicly traded company in the future.

For the class-action members he represented, Miller said he believes that justice was served.

"Motivated attorneys pursuing claims of securities fraud can be successful even in a difficult economic environment," Miller said. "The bad economy excuse isn't a defense to the prosecution of cases we believe have merit."

"A recession is not a license to commit fraud," Newman added.

A Verdicts & Settlements report on *Epstein, et al. v. Heartland Industrial Partners, L.P., et al.* can be found at www.milawyersweekly.com.

If you would like to comment on this story, please contact Douglas J. Levy at (248) 865-3107 or douglas.levy@mi.lawyersweekly.com.

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