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SECURITIES LITIGATION & CONSULTING GROUP

The "Issuer Fraud" Defense in Securities Arbitrations

Introduction

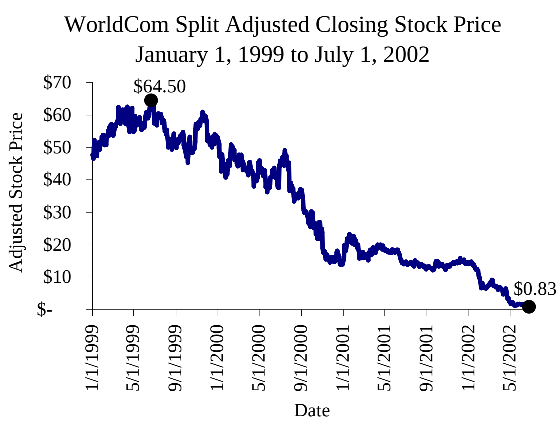
Finding an investor's portfolio imprudently concentrated, arbitrators must not care whether the risk materialized was of an accounting fraud, discovery of a toxic dump or the failure of a bet-the-ranch strategy.[1] Such losses are significant only because of imprudent concentration.

Respondents' attempts to shift blame for losses in retail accounts to issuer fraud at companies like WorldCom and Enron are misguided.

Anti-Climatic Announcements -WorldCom

Anti-climactic announcements of fraud often come at the end of a long march to bankruptcy.

WorldCom was down 98.7% from its June 21, 1999 peak of $64.50 and was teetering on the verge of bankruptcy when it announced an accounting restatement on June 25, 2005.



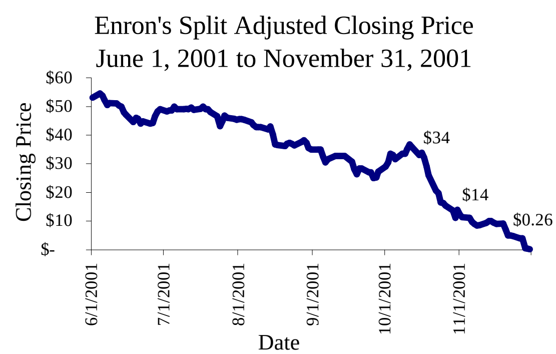
Investors who bought WCOM on June 21, 1999 and held until June 25, 2002 lost 98.7% during a period when there was no disclosure of fraud. WorldCom's failure was because of a failed business strategy *not* because of the accounting fraud which surfaced later.

WorldCom's SEC filings may or may not have slowed the market's recognition of WorldCom's deterioration but they definitely did not *cause* the deterioration. For assessing damages in concentration securities arbitrations, an investor who lost money in WorldCom might as well have been holding any other failing company.

Dramatic Announcements - Enron

Sometimes a dramatic announcement causes a high-flying stock to fall precipitously.

Enron came apart in the last two weeks of October 2001 after it disclosed losses on its fraudulent partnerships and the SEC investigation. Enron fell from $34 on October 16 to $14 on October 31 and then to $0.26 on November 30.



Investors with concentrated Enron stock or employee stock option positions suffered heavy losses. Even in such cases where losses closely followed disclosure of a fraud, brokerage firms should not be able to shift blame to issuers.

Prudent investors with limited resources diversify precisely to protect against large single-stock losses. Financial advisors must advise their retail clients to diversify.

Conclusion

Investors with substantial firm-specific losses in retail accounts necessarily held concentrated portfolios. If Respondents would otherwise be liable for the Claimant's losses they should be no less liable because the losses were in the stock of a WorldCom or an Enron.

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[1] This note deals only with arbitrations over the suitability of concentrated stock and option positions and does not address analyst conflict, omissions and misrepresentations or other claims.

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