

Rare Section 10(b) Jury Verdict Upheld: Injury without Damage

By Christopher Faille, Reporter

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BALTIMORE (HedgeWorld.com)—The fourth circuit court of appeals upheld the paradoxical outcome of a district court trial in a lawsuit against an investment research firm with ties to short-dedicated hedge funds.

A three-judge panel, in an opinion by the Hon. Diana Gribbon Motz issued April 14, upheld judgment on a jury verdict that on the one hand found the research firm Asensio & Co. Inc. civilly liable under the Securities Exchange Act of 1934, Section 10(b) but that on the other awarded damages of US\$0.00 for that injury. The plaintiffs appealed on the issue of damages, defendants cross-appealed on the issue of liability.

The plaintiffs in Miller vs. Asensio & Co. were shareholders in Chromatics Color Sciences International Inc., New York, a medical devices company that developed the Colormate III, which measures the bilirubin level of babies in a non-invasive manner. Bilirubin is a waste product of the breakdown of red blood cells. Sometimes, in newborns without fully functioning livers, this bilirubin builds up and produces jaundice.

The founder of Asensio & Co. and its co-defendant, Manuel Asensio, also is the principal of a short-dedicated hedge fund. He said in an interview April 20 that he believes the hedge fund industry, especially shorts, ought to be concerned about the verdict and its survival upon appeal. "I can't get into the minds of the jury," to understand why they decided as they did, but "the only thing that's clear about CCSI is that it's a fraud," he said. Keith Dutill, a partner with Stradley, Ronon, Stevens, & Young who represented the plaintiffs, didn't return a phone call asking for comment.

Between June 8 and June 26, 1998, defendant Asensio & Co. disseminated as widely as possible seven reports recommending that investors sell or take a short position on CCSI. The defendant's reports contended that the CCSI stock price had been inflated by questionable private sales, and that Colormate had little market potential.

When Asensio began issuing these reports, Chromatics' stock price on Nasdaq was US\$10.75. The stock lost value immediately, recovered that value within several months but then began a longer-term decline. On June 10, 1999, the plaintiffs filed a complaint in federal district court, Charleston, S.C.

Nasdaq delisted Chromatics late in 2001. At time of trial the following year, its stock was trading for pennies in the over-the-counter market. Plaintiffs identified six specific statements from Asensio's reports that they believed were misrepresentations. The jury's verdict implied that some or all of the statements were indeed misrepresentations and that they did harm to the stockholders. According to settled law, upon which the trial judge instructed the jury, liability for misrepresentation attaches only if plaintiffs have suffered a loss and there is a direct causal relationship between the misrepresentation and the loss.

Was it then illogical for the jury to attach a monetary value of zero dollars to this injury? The plaintiffs contended on appeal that it was, that the finding of liability requires an award of damages.

But the court of appeals for the fourth circuit, which includes North Carolina, South Carolina, Virginia and West Virginia, upheld the trial court's judgment on that verdict. Judge Motz wrote that the jury had a sound basis for this verdict available to it, because it could have found on the basis of the evidence that the loss was not *solely* the effect of these misrepresentations and that the plaintiffs had failed to provide them with a basis for discerning the *amount* of their loss attributable to the defendant.

The plaintiffs' complaint identified six specific statements from the defendant's reports as false. The defendant contended that the reports contained negative information about CCSI apart from those six statements and that those undisputed statements, along with various extraneous developments following the issuance of the reports, could have caused most or all of the damages.

The appellate opinion indicated in a footnote that the defendant company admitted that certain of its statements were "erroneous." But Mr. Asensio said April 20 that this was a misunderstanding, that he had never authorized his lawyers to make such an admission except "for the sake of argument." He also said that the jury verdict on liability came about because the defendants were, so to speak, outgunned.

"The trial lasted more than a month and cost us more than a million and a half dollars. We didn't know what we were facing in South Carolina until we actually got there."

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