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Shareholders Bring Novel Suits Over Workforce

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LOS ANGELES - "Legalize Immigration" was the brazen statement printed on a popular line of pricey cotton t-shirts by clothing manufacturer American Apparel Inc. Now, shareholders are claiming company executives should have been less brazen in their hiring practices or more blatant in their disclosures to investors.

Several large shareholder suits - including a class action and derivative suit in federal court - take aim at the company for having used illegal workers in its downtown Los Angeles factory.

In what experts called a novel legal theory, securities plaintiffs' lawyers are accusing American Apparel's top management of securities fraud for not disclosing the risks associated with its immigrant workforce. They argue the company's stock dropped precipitously as a result of a U.S. Customs and Immigration Enforcement investigation in 2009 that forced American Apparel to fire nearly a third of its factory workforce, which the company later said led to a drop in revenues.

One suit also calls into question the advice of American Apparel's outside legal counsel, a high profile employment lawyer.

The company's legal woes offer an early look at new claims likely to arise as government crackdowns on employers increase, according to legal experts. More government enforcement means securities and immigration laws are likely to intersect more often, they said.

"Certainly, this securities fraud action is the first opportunity that I know of for a jury to judge the immigration policies of a company," said Stephen Yale-Loehr, a professor at Cornell Law School.

Yale-Loehr said the case is especially interesting because American Apparel has taken a more liberal - and publicized - stance on immigration policies than other public companies. At the same time, the company simultaneously asserted it tried to comply with immigration laws, he said.

A host of law firms are scrambling to bring the securities claims against the company. Darren J. Robbins, of Robbins Geller Rudman & Dowd LLP, and Ramzi Abadou, of Barroway Topaz Kessler Meltzer & Check LLP are competing to be appointed lead plaintiff in the federal securities class-action while Vahn Alexander, of Faruqi and Faruqi LLP, and Douglas J. Campion are litigating the shareholder derivative case.

They declined to comment.

Joyce E. Crucillo, American Apparel's chief litigation counsel and a defendant in the class action, did not return calls seeking comment.

The shareholder complaint argues management failed to warn of the risks related to its workforce immigration status. It cites an American Apparel news release from July 2009 quoting its outside counsel Howard D. Shapiro, of Mitchell Silberberg & Knupp LLP, calling the company in "substantial compliance" with immigration laws.

At the time, ICE officials had investigated the company's downtown Los Angeles factory and flagged nearly 1,800 of the 5,600 workers as potentially illegal. Ultimately, the company fired 1,500 workers.

The complaint alleges the disclosures caused a 41 percent plummet in the stock price by August 2010 to 81 cents a share from \$1.39.

Shapiro declined to comment on the allegations in the lawsuit. But he said American Apparel knew its progressive political stance on immigration opened its workforce to greater scrutiny. Thus it took extraordinary pains to verify its workers' work eligibility, he said.

"To blame a company for the fact that there's a good counterfeiting industry that produces damn good documents misses the boat," Shapiro said. "The law does not require the employer to become a forensic laboratory."

The securities actions, which seek class-action status, do not state how much damages they are seeking. Tens of millions of dollars could be at stake based on the company stock's high trading volume of more than 2.8 million shares - seven times higher than the average volume - before the largest stock plunge.

Ronald J. Gilson, a professor at Stanford Law School, said shareholders never brought a similar securities claim to his knowledge. Ultimately, the case will depend on the materiality of the company's statements about its workforce's immigration status, and whether the risks were public knowledge, Gilson said.

He recalled another case years ago that targeted Nike Inc. for its labor practices. That case involved unfair business practice claims, not a securities claims and concerned its labor practices in overseas factories.

One potential complication for the securities claims is proving it was immigration raids, and not other factors, that led to stock prices dropping.

A fight the company had with auditors over its accounting may point to other financial woes. Analysts pinpointed flagging sales as a problem for the company, which said it could be teetering on bankruptcy if the economy does not rebound quickly.