UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

In re ENRON CORPORATION SECURITIES LITIGATION	
This Document Relates To: MARK NEWBY, *et al.*, individually and on behalf of all others similarly situated, Plaintiffs, vs. ENRON CORP., *et al.* Defendants.	Civil Action No. H-01-3624 (Consolidated)
THE REGENTS OF THE UNIVERSITY OF CALIFORNIA, *et al.*, individually and on behalf of all others similarly situated, Plaintiffs, vs. KENNETH L. LAY, *et al.* Defendants.	

United States Courts
Southern District of Texas
JUL 31 2003
Michael N. Milby, Clerk of Court

REPLY IN SUPPORT OF THE MOTION OF DEFENDANTS LEHMAN BROTHERS HOLDINGS INC. AND LEHMAN BROTHERS INC. TO DISMISS THE FIRST AMENDED CONSOLIDATED COMPLAINT

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INTRODUCTION

In their Amended Complaint, plaintiffs have attempted, with obvious desperation but no support, to allege a Section 10(b)/Rule 10b-5 claim against Lehman Brothers Inc. ("LBI") that will avoid the fate of their first such effort against Lehman Brothers Holdings Inc. ("LBHI"). Plaintiffs' new Section 10(b)/Rule 10b-5 claim against LBI is based only on allegations previously found deficient by this Court and supposedly "new" allegations concerning equity forward contracts entered into between Lehman Brothers Finance S.A. ("LBF") and Enron. The Amended Complaint characterizes these equity forward contracts as "prepays," no doubt hoping to get the benefit of the negative connotation this term now invokes. But plaintiffs' opposition to the Lehman Defendants' motion to dismiss establishes they have no basis for their characterization. This is not itself surprising, because the equity forwards were not "prepays." To their credit, plaintiffs now seem to admit as much without saying it straight out. To their discredit, they persist in characterizing the equity forwards as "disguised loans." Plaintiffs do not explain the difference between "prepays" and "disguised loans" as they use these terms, nor do they provide any facts to support their claim that the equity forwards were in fact "disguised loans." Again, this is not surprising, since the equity forwards were not loans at all, disguised or otherwise. Instead, plaintiffs ask this Court to simply infer that the equity forwards were "disguised loans," even though the reality of the equity forwards is clearly to the contrary. Because there is no basis for such an inference, plaintiffs' Section 10(b)/Rule 10b-5 claims should again be dismissed for failure to plead any facts giving rise to "a strong inference of scienter."

Additionally, plaintiffs offer no valid excuse for their failure to pursue any claims against LBI until after the statute of limitations had run, particularly given the availability of information

about LBI's role and the very public and distinct separation between LBI and LBHI. Even if plaintiffs were entitled to a tolling of the statute of limitations as they argue, it came too late – plaintiffs' claims against LBI already were time-barred. Nor, contrary to plaintiffs' belief, does the Sarbanes-Oxley Act provide them with the basis for a "do-over." Finally, plaintiffs cannot "relate back" the addition of LBI to the filing of the Consolidated Complaint. It simply is not reasonable to believe that plaintiffs were unaware of LBI when the very documents upon which they based their Consolidated Complaint plainly list LBI as the actor. Plaintiffs are not entitled to any inference of "mistake" under these conditions.

Plaintiffs concede they lack standing to maintain a Section 12 claim against LBI but urge the Court to nevertheless allow them to litigate that claim through the class certification stage. The law could not be any clearer, however, that parties without standing must be dismissed.

Plaintiffs' control person liability claims against LBHI under Sections 15 and 20 fail for lack of a primary violation and failure to allege facts showing LBHI's culpable participation.

Finally, plaintiff the Washington Board implicitly concedes that it has failed to plead facts demonstrating that it was in privity with LBHI for purposes of its Texas Securities Act ("TSA") claim, but seeks to amend its claim without leave of Court by attaching documents to its opposition. This procedurally improper tactic should not be permitted to salvage the Washington Board's TSA claim.

Plaintiffs have now had nearly eighteen months and fourteen hundred pages to plead a claim against the Lehman Defendants. They still have not done so. The Amended Complaint should be dismissed as to the Lehman Defendants with prejudice.

ARGUMENT

I. LBF's Equity Forward Transactions With Enron Do Not Give Rise To "A Strong Inference Of Scienter."

In their opposition brief, plaintiffs spend a good amount of their time rehashing their old scienter allegations. (Pltfs.' Opp. at 66-68.) But the Court has already determined that those allegations are inadequate. *In re Enron Corp. Derivative, Sec. & ERISA Litig.*, 235 F. Supp. 2d 549, 703 (S.D. Tex. 2002). In light of its ruling, the only issue before the Court now is whether plaintiffs' "new" allegations regarding LBF's equity forward transactions with Enron give rise to "a strong inference of scienter" under the PSLRA. The answer is "no." Plaintiffs' allegations regarding LBF's equity forward transactions do not come close to satisfying the PSLRA's heightened pleading standard.

With regard to the equity forwards, plaintiffs' opposition is notable for the argument it does *not* make. Although plaintiffs allege in their Amended Complaint that LBF's equity forward transactions with Enron were improper "prepaid swap transactions similar to those executed through Mahonia and Delta" (Am. Compl. ¶ 770.1), plaintiffs' opposition brief abandons the comparison in apparent recognition that it is unsupportable. As the Lehman Defendants demonstrated in their opening brief using plaintiffs' own allegations, LBF's equity forward transactions were not at all like the Mahonia and Delta "prepay" transactions described by plaintiffs. (*See* Lehman Mem. at 15.) In fact, LBF's equity forward transactions were not "prepays" at all.

Notwithstanding plaintiffs' assertion that the Enron Bankruptcy Examiner shares their view of LBF's equity forward transactions (*see* Pltfs.' Opp. at 60), not a single one of the LBF equity forward transactions is even mentioned in the Enron Bankruptcy Examiner's report dealing with Enron's "prepay" transactions. The reason for this is clear – based on the

Examiner's analysis, LBF's equity forward transactions lack the salient characteristics of Enron's "prepay" transactions.

Plaintiffs' own allegations demonstrate that, unlike Enron's "prepay" transactions, LBF's equity forward transactions were *not* with an Enron affiliate, did *not* involve a "conduit entity" of any kind, much less one established or controlled by LBF (or any other Lehman entity), did *not* involve natural gas or crude oil (or any other commodity), were *not* three-step transactions, and did not involve three separate agreements (two forward contracts and one swap agreement). (*Compare* Am. Compl. ¶¶ 770.1, 770.2 *with* Second Interim Report of Neal Batson, Court Appointed Examiner, the relevant portions of which are attached hereto as Ex. 1, at 58-66; *id.*, Ex. E at 2-24.)[1] Even more importantly, as demonstrated below, the LBF equity forward transactions lacked the fundamental feature of all Enron "prepay" transactions – an alleged "prepayment" of some kind to Enron. (*See* Ex. 1.) In short, the LBF transactions *were nothing like* the "prepay" deals to which plaintiffs compare them in the Amended Complaint.

This fact is further established by the very Enron document plaintiffs attach to their opposition brief. Plaintiffs claim that Enron document EC03520A0190485 (Pltfs.' Opp., Ex. 22), which is not mentioned anywhere in the Amended Complaint, shows that Enron has "classified" the LBF equity forward contracts with "other fraudulent debt financings." (Pltfs.' Opp. at 62.) Remarkably, plaintiffs only gave the Court the first page of that document. The second page, which plaintiffs withheld from the Court, contains a list of Enron's "prepay" transactions. (A complete copy of the Enron document, which consists of a total of four pages, is

[1] Plaintiffs "opened the door" to the Court's consideration of the Bankruptcy Examiner's reports by falsely proclaiming in their opposition brief that the Bankruptcy Examiner supports their conclusory characterization of LBF's equity forwards. While the Lehman Defendants take no position on the accuracy of the Examiner's analysis regarding Enron's "prepays," the Court should have the benefit of what the Examiner has actually said as opposed to only plaintiffs' assertions as to what he has said.

attached hereto as Ex. 2.) The LBF equity forwards are tellingly absent from that list. (*Id.* at 2.) Indeed, the only LBF equity forward transaction appears on the first page of the document where it is described not as a "prepay" but as precisely what it was – an "equity forward," which Enron itself distinguishes from a "prepay." (*Id.* at 1.)

Unable to substantiate their conclusory "prepay" characterization in the Amended Complaint, plaintiffs now take the position that whether LBF's equity forward transactions were in fact "prepays" is unimportant because, either way, the transactions' "*intrinsic character*" was still "fraudulent." (Pltfs.' Opp. at 64 (emphasis added).) That is so according to plaintiffs because those transactions were tantamount to "disguised loans." (*Id.*) But plaintiffs do not explain how that is any different than calling them "prepays." Indeed, plaintiffs characterize the Mahonia and Delta "prepays" as "disguised loans." (*See* Am. Compl. ¶¶ 44, 45, 559-68, 664-65, 684.)

In any event, calling an equity forward a "disguised loan" does not make it so, and plaintiffs concede that they have failed to provide any document that establishes that LBF (or any other Lehman-related entity) ever gave Enron any cash pursuant to any of the equity forward transactions. (*See* Pltfs.' Opp. at 65 (admitting that they have failed to provide the Court with a "smoking gun" document evidencing that "Lehman 'ever purchased stock from Enron or paid it any cash'").)[2] Accordingly, plaintiffs are forced to ask the Court to help them out and "*draw the inference*" that "Lehman made secret loans to Enron." (*Id.* (emphasis added).) They say the

[2] Plaintiffs' failure to provide any document showing a payment from LBF to Enron is very telling given that Enron's documents have been available in the Document Depository since December 14, 2002. In fact, there is no "smoking gun" document because, as the Lehman Defendants unequivocally have stated, no payment of any kind was ever made to Enron in connection with any of the equity forward transactions. (*See* Lehman Mem. at 16-17.)

Court should do so based solely on the following three innocuous facts, which is the most plaintiffs could wring from their documents:

- In November 2000, Enron and LBF entered into the ISDA Master Agreement governing equity forward contracts between them.
- In November 2001, Enron owed LBF $173+ million "pursuant to these equity forward agreements."
- In November 2001, LBF and Enron "agreed" that LBF "would 'transfer to Enron 2,434,339 common shares of Enron upon payment of that sum."

(*Id.*)

The inference that the equity forward transactions were really "disguised loans" is then apparently supposed to give rise to the previously absent "strong" interference of scienter. By stacking one inference on top of the other, plaintiffs hope to mislead the Court to a conclusion supported neither by the documents plaintiffs cite nor any of the factual allegations they make.

In affirming the dismissal of Rule 10b-5 claims in the *Worldcom* litigation, the Fifth Circuit just this week ruled that courts should not 'strain to find inferences favorable to the plaintiff[s].'" *Goldstein v. MCI Worldcom*, No. 02-60322, __ F.3d __, slip op. at 7 (5th Cir. July 28, 2003) (quoting *Westfall v. Miller*, 77 F.3d 868, 870 (5th Cir. 1996)). Nor is the Court required to consider only those inferences that are favorable to plaintiffs' position, as such a requirement would "eviscerate the PSLRA's strong inference [of scienter] requirement by allowing plaintiffs to plead in a vacuum." *Gompper v. VISX, Inc.*, 298 F.3d 893, 896 (9th Cir. 2002) (affirming dismissal of case for failure to state a claim). Instead, the Court "must consider *all* reasonable inferences to be drawn from the allegations, including inferences unfavorable to the plaintiffs." *Id.* at 897. "[T]he 'strong inference [of scienter]' requirement means that plaintiffs are entitled only to the most plausible of competing inferences." *Helwig v. Vencor,*

Inc., 251 F.3d 540, 553 (6th Cir. 2001) (en banc), *cert. denied*, 122 S. Ct. 2616 (2002).[3] Far from being the most plausible inference, the inference plaintiffs ask the Court to draw is wholly unreasonable.

First, plaintiffs blatantly misrepresent what an equity forward is. Contrary to plaintiffs' unsupported contention (*see* Pltfs.' Opp. at 65), an equity forward contract does *not* involve one party giving the other party money for shares of stock that the other party agrees to buy back at a later date. Instead, an equity forward contract involves an agreement on the part of one party to buy or sell a specified quantity of securities to or from the other party at a specified price (the "delivery price") at a fixed future date (the "delivery date"). *See* Jarrow & Turnbull, Derivative Securities (2d ed., Southwestern Coll. Publ'g 2000), the relevant portions of which are attached hereto as Ex. 3, at 3. Unlike a "prepay" transaction, "*[n]o cash exchange occurs prior to the delivery date.*" *Id.* (emphasis added); *see also* Dubofsky & Miller, Derivatives, Valuation and Risk Assessment (Oxford Univ. Press 2003), the relevant portions of which are attached hereto as Ex. 4, at 4 ("Typically no money changes hands on the origin date of a forward contract."). Indeed, in his most recent report, the Bankruptcy Examiner confirms that an equity forward does *not* involve a "prepayment" of any kind. (*See* Third Report of Neal Batson, Court-Appointed Examiner, the relevant portions of which are attached hereto as Ex. 5, at 10 n.22.)[4] Without a

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[3] *See also Greebel v. FTP Software, Inc.*, 194 F.3d 185, 195-96 (1st Cir. 1999) ("inferences of scienter survive a motion to dismiss only if they are both reasonable and 'strong' inferences"); *Commercial Data Servs., Inc. v. IBM*, 262 F. Supp. 2d 50, 79 (S.D.N.Y. 2003) (rejecting plaintiff's request to draw a nefarious inference from innocent behavior); *In re Northpoint Communications Group, Inc.*, 221 F. Supp. 2d 1090, 1095 (N.D. Cal. 2002) ("allegations in a securities-fraud complaint do not give rise to a strong inference of scienter if the facts pled more strongly support an inference of no wrongdoing"); *In re Sec. Litig. BMC Software, Inc.*, 183 F. Supp. 2d 860, 898-901 (S.D. Tex. 2001) (citing First and Sixth Circuits with approval in discussion of PSLRA's scienter pleading requirements).

[4] In his Third Report, the Bankruptcy Examiner corrects the description of an equity forward contained in his first report, which erroneously provided that such a contract involves "a sale by an issuer of equity securities to a counterparty coupled with the issuer's obligation to repurchase the equity securities from the counterparty in the future for the original purchase price plus a premium." (Ex. 5 at 10 n.22.) The Bankruptcy

"prepayment" component, an equity forward cannot possibly be characterized as a loan, much less a "disguised" one.[5]

Second, the facts upon which plaintiffs rely are fully consistent with LBF and Enron having entered into a typical equity forward transaction. The November 14, 2000 Confirmation, which is part of the ISDA Master Agreement upon which plaintiffs rely in the Amended Complaint, establishes that Enron and LBF entered into a transaction where Enron agreed to purchase (not repurchase) a certain number of shares of its own stock from LBF on the delivery date at the delivery price. (Lehman Mem., Ex. E at 2 ("On the Equity Payment Date, [Enron] shall pay to [LBF] an amount equal to the Equity Notional Amount and [LBF] shall deliver to [Enron] shares in an amount equal to the Number of Shares.").)[6] On the delivery date, therefore, Enron was obligated to pay LBF the delivery price, and LBF, in turn, was obligated to transfer the requisite number of shares to Enron. Accordingly, there is nothing sinister about the mere fact that Enron ended up owing LBF money in connection with the equity forward transactions. It is the natural result of such transactions.[7]

(continued...)

Examiner has thus confirmed that an equity forward is *not* a "disguised loan." This is, of course, the exact opposite of what plaintiffs' say he "acknowledged." (*See* Pltfs.' Opp. at 60.)

[5] The fact that an equity forward transaction is listed in Enron document EC03520A0190485, which is entitled "Off Balance Sheet Debt," does not make it a "disguised loan." Indeed, that document also lists building and furniture and fixture leases, none of which could reasonably be characterized as a "disguised loan." (*See* Ex. 2 at 1.) In addition, there is nothing in and of itself problematic about "off balance sheet" transactions, as the Bankruptcy Examiner himself appears to acknowledge in his reports. And even if there were, the Amended Complaint is bereft of any allegations that LBF (or any other Lehman-related entity) knew that Enron was carrying the equity forward "off balance sheet," if in fact it was.

[6] Plaintiffs allege that "Lehman Brothers" and Enron entered into the first of their equity forward transactions on November 14, 2000. (Am. Compl. ¶ 770.1.) The ISDA Master Agreement provides that LBF and Enron shall "exchange[]" a written "Confirmation" confirming the terms of any equity forward transaction between them and that the Confirmation shall automatically become a part of the Master Agreement and shall govern the parties' transaction. (Lehman Mem., Ex. D at 1.) In keeping with the ISDA Master Agreement, LBF and Enron confirmed the terms of their November 14 equity forward transaction in the written Confirmation of that same date.

[7] Less than one month after plaintiffs claim Enron first owed LBF the money (Pltfs.' Opp. at 60), Enron filed for bankruptcy, which explains why LBF never was paid. It also explains why a proof of claim was filed in the Enron bankruptcy action seeking to recover the money owed on the equity forward transaction.

Finally, it is well-settled that "when parties reduce their agreement to writing, the written instrument is presumed to embody the entire contract." *Danciger Oil & Ref. Co. of Tex. v. Powell*, 154 S.W.2d 632, 635 (Tex. 1941); *see also Burks v. Colonial Life & Accident Ins. Co.*, 192 F.2d 643, 646 n.1 (5th Cir. 1951) ("when any contract is reduced to writing, ... said contract is conclusively presumed to contain all the terms thereof"); *Malcom Pirnie, Inc. v. City of Del Rio, Texas*, No. SA-99-CA-614-OG, 2003 U.S. Dist. LEXIS 12352, at *16 (W.D. Tex. Mar. 28, 2003) ("If the written agreement clearly defines the parties' obligations, nothing may be left to implication.") (citation omitted); *Perry v. Vanteon Corp.*, 192 F. Supp. 2d 93, 99 (W.D.N.Y. 2002) (there is a "'heavy presumption' that a written agreement accurately reflects the true intention of the parties") (citation, quotation omitted). Here, LBF and Enron reduced the referenced equity forward agreement to writing.[8] By plaintiffs' own admission, however, *nowhere in any of the documents does it provide that LBF was supposed to or did pay any money to Enron*. Accordingly, the "heavy presumption" should be that that LBF did *not* make any payment to Enron in connection with the equity forward transactions. *See Perry*, 192 F. Supp. 2d at 99. Plaintiffs' naked assertions to the contrary are insufficient to overcome this presumption.[9]

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[8] The November 14, 2000 Confirmation between LBF and Enron provides that "[t]he purpose of this letter agreement (this 'Confirmation') is to confirm the terms and conditions of the transaction entered into between us on the Trade Date specified below (the 'Transaction'). This letter constitutes a 'Confirmation' as referred to in the ISDA Master Agreement specified below." (Lehman Mem., Ex. E at 1.) The Confirmation further provides that it "evidences a complete binding agreement between [LBF] and [Enron] as to the terms of the Transaction to which this Confirmation relates." (*Id.*)

[9] Plaintiffs' barnyard argument about the bull's "hindquarters" proving it necessarily once had a head is a logical fallacy. (Pltfs.' Opp. at 66.) Bulls are not equity forwards. That much should be common ground. Plaintiffs apparently are attempting to suggest that simply because Enron owed LBF money on the equity forward when it went into bankruptcy means that LBF made a "disguised loan" to Enron. This is illogical and also palpably false. LBF could have agreed (and did agree) to sell Enron shares on a future date for a set price without purchasing the shares from Enron. LBF could then have purchased (and did purchase) the shares in the market in order to have them to deliver to Enron on that future date. Such trades are commonplace when a company needs its own shares on a future date (so as to have them to distribute pursuant to stock option plans, for example) and is concerned that if it waits to purchase the shares in the market when it needs them, the stock price will have increased, making the shares more expensive for the company to acquire. By utilizing an equity forward, Enron

For all of these reasons, plaintiffs' conclusory characterizations of LBF's equity forward transactions are insufficient to resurrect plaintiffs' Section 10(b)/Rule 10b-5 claim against the Lehman Defendants. Indeed, plaintiffs' scienter allegations remain as deficient as the Court found them to be the first time around. Accordingly, plaintiffs' Section 10(b)/Rule 10b-5 claim against the Lehman Defendants should be dismissed once again.

II. Plaintiffs' Claims Against LBI Are Time-Barred.

Plaintiffs do not seriously dispute either LBI's argument that they had actual notice of their claims against it as of the filing of the Consolidated Complaint on April 8, 2002 (Lehman Mem. at 7-10) or that the addition of LBI occurred more than one year after that date on May 14, 2003.[10] Thus, plaintiffs are reduced to offering up three excuses for their untimely filing. First, plaintiffs argue that the statute of limitations was tolled by their own letter to this Court on January 14, 2003 requesting guidance regarding the addition of new parties. Second, plaintiffs argue that the Sarbanes-Oxley Act extended the statute of limitations even though this proceeding had already commenced when the Act became effective. Finally, plaintiffs contend that the addition of LBI "relates back" to the date of the filing of the Consolidated Complaint notwithstanding overwhelming evidence that plaintiffs committed no mistake in omitting to name LBI until after the statute of limitations had lapsed. As demonstrated below, none of plaintiffs' excuses has any merit.

(continued...)

would have been (and was) protecting itself from an increase in its stock price. This scenario is far more logical than plaintiffs' fictitious "disguised loan" theory.

[10] The three year statute of repose governing this action bars the newly-added Section 12 claim based upon the 1999 Osprey offering. That offering occurred more than three years before the filing of the May 14, 2003 Amended Complaint and is no longer actionable.

A. Plaintiffs Were At Least On Inquiry Notice Of The Facts Underlying Their Claims And LBI's Alleged Involvement More Than One Year Before Their January 14, 2003 Letter.

While plaintiffs largely concede that they were on actual notice of their claims against LBI more than one year before adding LBI as a defendant, they argue that their January 14, 2003 letter seeking to amend the Consolidated Complaint tolled the statute of limitations. (Pltfs.' Opp. at 4-5.)[11] Even if a unilateral letter to the Court could toll the statute, however, it would not salvage plaintiffs' federal securities law claims against LBI because those claims already were stale by that time.[12]

Plaintiffs admit that under the pre-Sarbanes-Oxley Act statute of limitations, they were obligated to file their federal securities law claims against LBI within one year of discovering the facts constituting the alleged violation. (Pltfs.' Opp. at 14.) The law is well-settled that "discovery occurs when a potential plaintiff has inquiry or actual notice of a violation." *Kauthar SDN BHD v. Sternberg*, 149 F.3d 659, 670 (7th Cir. 1998) (citation omitted, emphasis added), *cert. denied*, 525 U.S. 1114 (1999). "Inquiry notice is the term used for knowledge of facts that would lead a reasonable person to begin investigating the possibility that his legal rights had

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[11] Plaintiffs also attempt to ascribe an estoppel effect to this Court's January 27, 2003 Order that called for certain motions to be filed regarding the misnaming of parties. (Pltfs.' Opp. at 5.) This Order does not work an estoppel because the plaintiffs were on actual notice that LBHI believed that it had been misnamed as a party. Estoppel would only lie if plaintiffs reasonably relied upon a representation by LBHI to plaintiffs' detriment. However, in LBHI's initial motion to dismiss, it informed plaintiffs that LBHI did not engage in the allegedly culpable conduct. (Lehman Mem. in Support of Mot. to Dismiss Cons. Compl. at 4 n.1.) It would not be reasonable for plaintiffs later to assume that LBHI did not mean what it said simply because it did not file a motion immediately following the January 27, 2003 Order. Moreover, the fact that plaintiffs amended their theory of responsibility, naming LBI and relegating LBHI to a secondary role, demonstrates that plaintiffs understood the nature of LBHI's argument. Thus, there was no estoppel because plaintiffs never relied upon the omission of the filing of a motion to which they now refer. In any event, as with the January 14 letter, any estoppel effect came too late – plaintiffs' claims had already lapsed by the time the Court issued its January 27 Order.

[12] Equitable tolling or estoppel does not apply in any event to plaintiffs' Section 10(b)/Rule 10b-5 claim. *See Lampf, Pleva Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 363 (1991); *see also Friedman v. Wheat First Sec., Inc.*, 64 F. Supp. 2d 339, 344-45 (S.D.N.Y. 1999); *Borden v. Spoor, Behrins, Campbell & Young, Inc.*, 778 F. Supp. 695, 698 (S.D.N.Y. 1991) (analyzing *Lampf* and holding that equitable tolling and estoppel are both unavailable).

been infringed." *Id.* (quotation omitted, emphasis added). "[I]nquiry notice is triggered by evidence of the possibility of fraud, not by complete exposure of the alleged scam." *Martinez Tapia v. Chase Manhattan Bank, N.A.*, 149 F.3d 404, 410 (5th Cir. 1998) (emphasis added) (quoting *Brumaugh v. Princeton Partners*, 985 F.2d 157 (4th Cir. 1993)). "The plaintiff need only possess a low level of awareness; he need not fully learn of the alleged wrongdoing. Knowledge of all facts is not required to set off the prescriptive clock. Thus, the clock begins to tick when a plaintiff senses 'storm warnings,' not when he hears thunder and sees lightning." *Jensen v. Snellings*, 636 F. Supp. 1305, 1309 (E.D. La. 1986) (citation omitted), *rev'd in part on other grounds*, 841 F.2d 600 (5th Cir. 1988). As the Tenth Circuit recently explained, "[p]laintiff need not ... have fully discovered the nature and extent of the fraud before [he is] on notice that something may have been amiss. Inquiry notice is triggered by evidence of the possibility of fraud, not full exposition of the scam itself." *Sterlin v. Biomune Sys.*, 154 F.3d 1191, 1203 (10th Cir. 1998) (quotation omitted).

As detailed in the Lehman Defendants' opening brief, the facts giving rise to plaintiffs' claims against LBI were well known to plaintiffs at least by the end of 2001. (Lehman Mem. at 8-9 & n.4.) By November 2001, Enron had already taken a "massive" charge related to the special purpose entities; by December 2, 2001, Enron had declared bankruptcy and numerous securities fraud lawsuits were filed. (*Id.*) LBI's involvement and separate existence from LBHI also were matters of public record at that time. LBI was disclosed as the underwriter on the face of public filings, *see Menowitz v. Brown*, 991 F.2d 36, 42 (2d Cir. 1993) (plaintiffs placed on inquiry notice by "the very SEC-mandated disclosure documents they rely upon in their complaints"), and as an equity analyst in research reports. Moreover, LBI and LBHI had filed numerous separate reports with the SEC further demonstrating their separate existence. Thus,

before January 2002, plaintiffs not only had access to the facts that form the core of their Amended Complaint but also to information establishing which Lehman-related entity allegedly engaged in the activities. Any purported estoppel effect of plaintiffs' January 2003 letter came too late.[13]

B. The Sarbanes-Oxley Act Does Not Apply.

1. This Action Was Already Pending At The Time The Sarbanes-Oxley Act Was Enacted.

Plaintiffs next argue that the extended limitations period in Section 804(b) of the Sarbanes-Oxley Act applies to this case. (Pltfs.' Opp. at 7-10.) But this Court already has ruled to the contrary. *See In re Enron Sec. Litig.*, No. H-01-3624, 2003 U.S. Dist. LEXIS 3786, at *48 n.20 (S.D. Tex. Mar. 12, 2003) (noting that the Sarbanes-Oxley Act applies to "suits commenced on or after July 30, 2002" and concluding that "[t]his amended limitations period does *not* apply to *Newby*") (emphasis added).[14]

Plaintiffs argue that the Court's ruling does not control here because the Court "did not address whether Sarbanes-Oxley applied to Lead Plaintiff's amendment," which was filed after the effective date of the Sarbanes-Oxley Act. (Pltfs.' Opp. at 8.) Plaintiffs' argument overlooks the fact that Section 804 applies only to "*proceedings* ... commenced on or after the date of

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[13] Apparently trying to curry some sympathy, plaintiffs claim that "*most*" bank defendants did not divulge the identity of their allegedly-culpable subsidiaries. (Pltfs.' Opp. at 24; *see also id.* at 25, 35.) However, on May 8, 2002, though it was not its burden to do so, LBHI did just that, stating that LBHI had not engaged in any of the alleged conduct and identifying LBI by name. (*See* Lehman Mem. in Support of Mot. to Dismiss Cons. Compl. at 4 n.1 ("Plaintiffs have not even sued the correct party. Defendant [LBHI] did not in fact engage in any of the activities described in the Complaint. Rather, as the Complaint itself acknowledges, banking and advisory services are provided only by its subsidiaries ([Cons.] Compl. ¶ 108), in this case, [LBI].").)

[14] Plaintiffs weakly claim that this Court's statement is "dicta" because it did not arise in the context of adjudicating the application of Section 804(b) to newly-added parties. (Pltfs.' Opp. 8.) But, this Court's characterization of *Newby* as a case to which Section 804(b) did not apply necessarily required a determination that *Newby* was a "proceeding" "commenced" before July 30, 2002. The addition of new defendants does not alter the intrinsic character of the *Newby* action nor does it change the conclusion voiced by this Court last March. *Newby* remains a proceeding commenced before July 30, 2002 to which Section 804(b) does not apply.

enactment of this Act." *See* Pub. L. No. 107-204, § 804(b), 116 Stat. 745, 801 (July 30, 2002) (emphasis added). Because plaintiffs "commenced" this "proceeding" before the date of enactment of the Sarbanes-Oxley Act, the Act does not apply. *See De La Fuente v. DCI Telecomms., Inc.*, No. 01 Civ. 3365, 2003 WL 832009, at *6 n.5, 8-12 (S.D.N.Y. Mar. 4, 2003) (imposing sanctions and dismissing complaint filed before July 30, 2002 because "the statute of limitations established by the Sarbanes-Oxley Act applies only to *proceedings* commenced on or after July 30, 2002") (emphasis added); *see also Gerber v. MTC Elec. Techs. Co.*, 329 F.3d 297, 309-10 (2d Cir. 2003) (applying similar "effective date" provision in PSLRA and holding that newly-added parties do not change applicability of statute to action). Indeed, the Second Circuit in *Gerber* rejected the same type of argument plaintiffs are making here. *Gerber*, 329 F.3d at 310 ("In the absence of any indication to the contrary, we doubt that Congress intended that courts would apply different sets of substantive and procedural rules to groups of plaintiffs asserting identical claims in a single action, depending on when those plaintiffs were added to the complaint.").[15]

This proceeding was commenced when the first complaint was filed in this action, prior to July 30, 2002, the effective date of the Sarbanes-Oxley Act. As a result, the Sarbanes-Oxley

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[15] *Friedman v. Rayovac Corp.*, No. 02-C-308-C, slip op. at 20-23 (W.D. Wis. May 29, 2003), upon which plaintiffs exclusively rely, is premised on an argument that runs directly afoul of the well-settled proscription that plaintiffs with a pending case cannot file a new complaint to accomplish that which they could not do by amending their pending pleading. *See Central Trust Co. v. Official Creditors' Comm. of Geiger Enters., Inc.*, 454 U.S. 354 (1982) (holding that a party could not dismiss a pending bankruptcy case and refile to take advantage of new bankruptcy code); *Curtis v. Citibank, N.A.*, 226 F.3d 133, 140 (2d Cir. 2000) (affirming district court's dismissal of a second suit based on an amendment that plaintiff feared the court would not allow in his first suit); *Serlin v. Arthur Andersen & Co.*, 3 F.3d 221, 223-224 (7th Cir. 1993) (finding no abuse of discretion in dismissing a second complaint despite the possibility that the first would be dismissed for untimely service); *Oliney v. Gardner*, 771 F.2d 856 (5th Cir. 1985) (dismissing second suit in which plaintiff sought nothing more than to amend allegations in the initial action relating to diversity jurisdiction); *Walton v. Eaton Corp.*, 563 F.2d 66 (3d Cir. 1977) (filing of a second complaint would not be allowed to result in a greater right to trial by jury, where plaintiff filed the second complaint to evade waiver of jury trial in her first complaint). For this reason, *Friedman* should not be followed.

Act's extended limitations period does not apply to the claims against LBI, and those claims are time-barred.

2. Plaintiffs' Claims Under Sections 11 and 12 Are Outside The Scope Of The Sarbanes-Oxley Act.

The extended limitations period of the Sarbanes-Oxley Act does not apply to plaintiffs' Section 11 and 12 claims for an additional reason. Section 804 of the Sarbanes-Oxley Act expands the limitations period for securities claims involving "fraud, deceit, manipulation, or contrivance...." Sarbanes-Oxley Act § 804(a)(2) (emphasis added). This statutory language, under the title, "Statute of Limitations for Securities Fraud," could not more plainly state that the new limitations period applies only to fraud claims. *See* § 804(b), 116 Stat.; *see also INS v. Nat'l Ctr. For Immigrants' Rights, Inc.*, 502 U.S. 183, 189 (1991) ("the title of a statute or section can aid in resolving an ambiguity in the legislation's text").[16]

Claims under Sections 11 and 12 do not require the involvement of "fraud, deceit, manipulation or contrivance, *see Shapiro v. UJB Fin. Corp.*, 964 F.2d 272, 288 (3d Cir. 1992) ("It is clear that neither fraud nor mistake is a necessary element of either [a Section 11 or 12] cause of action."), and plaintiffs have expressly disavowed fraud as a basis for their Section 11 claim (*see* Am. Compl. ¶ 1005) and have made it clear that their Section 12 claim is predicated upon LBI's alleged negligence (*see id.* ¶ 1016.3). Nevertheless, plaintiffs argue that the extended limitations period of Section 804 applies here because Section 804 contains the term "securities laws," which is defined in Section 3(a)(47) of the Securities Exchange Act of 1934 to include both the Securities Act of 1933 and the Securities Exchange Act of 1934. (*See* Pltfs.' Opp. at 6-7.) This argument misses the point.

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[16] The touchstone for statutory construction is the text itself. *See Saks v. Franklin Covey Co.*, 316 F.3d 337, 345 (2d Cir. 2003) ("[e]very exercise in statutory construction must begin with the words of the text").

Section 804 is inapplicable to claims under Sections 11 and 12 because such claims do not require a showing of "fraud, deceit, manipulation or contrivance." If Congress had intended the statute of limitations for all securities law claims to be modified by Section 804, the qualifying language in Section 804 about fraud would have been superfluous. *See In re Merrill Lynch & Co., Inc. Research Reports Sec. Litig.*, No. 02 MDL 1484, 2003 WL 21518833, at *19 (S.D.N.Y. July 2, 2003) (referencing the Sarbanes-Oxley Act only in the context of the Section 10(b) statute of limitations, not in the context of Sections 11 or 12); *Friedman*, slip op. at 3 ("[t]he longer statute of limitations does not apply to all securities laws, it applies to securities laws 'that involv[e] a claim of fraud, deceit, manipulation, or contrivance'").

Moreover, the Sarbanes-Oxley Act's extended limitations period is intended to provide a default limitations period for private securities fraud actions that are not otherwise subject to an express statute of limitations (*e.g.*, Section 10(b) of the 1934 Act). Actions under Sections 11 or 12 are governed by their own express statute of limitations provision: Section 13, 15 U.S.C. § 77(m). Had Congress intended to expand the statute of limitations for Section 11 or 12 claims as part of the wide-ranging statutory amendments contained in the Sarbanes-Oxley Act, Congress certainly could have done so. It chose, however, to leave Section 13 intact. Indeed, the legislative history of the Sarbanes-Oxley Act indicates clearly that the extended statute of limitations provision "is not intended to conflict with existing limitations periods for any express private rights of action under the federal securities laws." *See* Senate Comm. on the Judiciary, The Corporate and Criminal Fraud Accountability Act of 2002, Report Together with Additional Views, S. Rep. No. 107-146, at 29 (May 6, 2002). As a result, Section 13's one year limitations

period applies to plaintiffs' Sections 11 and 12 claims against LBI, and those claims must therefore be dismissed.[17]

C. The Claims Against LBI Do Not Relate Back To The Filing Of The Original Complaint.

As anticipated, plaintiffs also now claim that the addition of LBI "relates back" to the date of the Consolidated Complaint.[18] Plaintiffs do not dispute that they must show a mistake in not naming LBI, but they never explain how they could have been mistaken as to LBI's identity. To make a mistake is "[t]o err in knowledge, perception, opinion, or judgment; to commit an *unintentional* error." Webster's Revised Unabridged Dictionary (1996) (emphasis added). Plaintiffs' naming of LBHI (and concomitant omission of LBI) was anything but an unintentional error. It was a clear strategic decision to attempt to hold a perceived deep pocket liable. Therefore, Rule 15 does not permit relation back.

The claims asserted against LBI under Sections 11 and 12 arise from allegedly false and misleading statements in certain Enron offering documents. *On the front page of those documents in large, bold type*, LBI is identified as an underwriter. (*See, e.g.*, Lehman Mem.,

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[17] Plaintiffs also mistakenly argue that the Sarbanes-Oxley Act applies retroactively and revives stale claims for further litigation. The Fifth Circuit has made it clear that a statute extending a period of limitations will not be deemed to revive claims that were time-barred before the statute was enacted unless the statute expressly states an intent to revive such claims. *See Resolution Trust Corp. v. Seale*, 13 F.3d 850, 853 (5th Cir. 1994); *FDIC v. Belli*, 981 F.2d 838, 842 (5th Cir. 1993); *Trizec Props., Inc. v. U.S. Mineral Prods. Co.*, 974 F.2d 602, 606-08 (5th Cir. 1992). Section 804(b) of the Sarbanes-Oxley Act does not come close to the "clear statement" required by the Fifth Circuit before a newly-extended limitations period will be held to revive formerly time-barred claims. On the contrary, the statute says nothing whatsoever about reviving time-barred claims. Had Congress intended to revive time-barred claims, it could readily have done so, as it has done in other federal statues. *See Nehme v. INS*, 252 F.3d 415, 432 (5th Cir. 2001) ("In contrast to § 104, the effective date provisions contained in Title II explicitly provide that the amendments related to voting apply to past conduct and shall be effective as if they had been enacted in 1996. Had Congress intended that the amendments to § 320 of the INA have the broad retroactive effect Nehme advocates, it would have used similar retroactive language in § 104."); *Resolution Trust Corp. v. Artley*, 28 F.3d 1099, 1103 n.6 (11th Cir. 1994) ("Congress is clearly aware of its ability to revive stale claims; and, if it wished, Congress could have provided a lengthy limitations period which explicitly revived stale claims....").

[18] Rule 15(c) cannot be a vehicle for adding new claims based upon a new set of facts. *See Pruitt v. United States*, 274 F.3d 1315, 1318 (11th Cir. 2001). Plaintiffs' attempts to add claims relating to the Osprey offering and the Enron Credit Linked Notes offering are simply beyond the scope of relation back under Rule 15(c). *See In re Coastal Plains, Inc.*, 179 F.3d 197, 216 (5th Cir. 1999) (holding that newly added claim differed too significantly from prior allegations to be related back).

Ex. A at 1, S-5; *id.*, Ex. B at 1, S-5.) Similarly, with regard to their Section 10(b) claims, LBI is identified as the issuer of the analyst reports in question. (Lehman Mem., Ex. C at 4.)[19] Thus, contrary to plaintiffs' contention, there was no point after the plaintiffs filed their Consolidated Complaint when the correct identities were "revealed" for the first time. Plaintiffs were aware of that information all along. In fact, the documents revealing LBI's involvement were publicly available long before plaintiffs filed their Consolidated Complaint, revealing plaintiffs' complaint about the "limited information then available" to be disingenuous at best. (Pltfs.' Opp. at 24.)[20] There is no mystery here. Plaintiffs intentionally elected to sue only LBHI. They wanted to sue what they believed to be the deepest pocket. Indeed, in their Opposition to LBHI's Motion to Dismiss the Consolidated Complaint, in which LBI was identified as having been the only Lehman-related entity involved with Enron, plaintiffs, rather than relent, wrote: "Lehman suggests we sued the wrong party. We think not. ... One man's deep pocket is another's legitimate defendant." (Pltfs.' Opp. to Mot. to Dismiss Cons. Compl. at 3, n.6 and 41.)

These particular circumstances make plaintiffs' cases relating to mistakes of fact readily distinguishable.[21] In the case cited most extensively by plaintiffs on this point, *Berrios v. Sprint Corp.*, No. CV-97-0081(CPS), 1997 U.S. Dist. LEXIS 19259, at *18 (E.D.N.Y. Nov. 13, 1997), the plaintiff understandably found it "difficult to tell which corporation is ultimately

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[19] Further, the ISDA Master Agreement, upon which plaintiffs predicate their "new" scienter allegations, specifically lists LBF as the only Lehman-related entity involved. Yet, even now plaintiffs are waiting to see if the Court will accept their strategy of holding LBHI or LBI liable for LBF's role in the alleged equity forward contracts, rather than seeking to add LBF as a party. (*See* Pltfs.' Opp. at 64 n.52 ("If [LBF] is a culpable entity, it too will be named a defendant in due course, as provided in the Court's schedule.").)

[20] Although, plaintiffs also refer to documents and testimony later obtained and released by the Senate and by Enron's Bankruptcy Examiner, they make no claim that any of this is relevant to their claims against LBI.

[21] Though plaintiffs claim that defendants' cases are consistent with plaintiffs position, plaintiffs reference only two cases cited by the Lehman Defendants, choosing to ignore the others. (*See* Pltfs.' Opp. at 27 & n.20.)

responsible," given that either the parent or subsidiary had sent plaintiff a debt collection letter using the letterhead of another company. This is wholly inapposite to the facts here, where LBI is identified on the face of the relevant documents that plaintiffs had to consult to bring their claims against LBHI.[22]

The complexity of this case is not a shield that plaintiffs can protectively invoke to excuse themselves from established pleading rules. In their brief, plaintiffs discuss at length their difficulty in identifying which CSFB-related entity employed a former Enron employee and his team. (Pltfs.' Opp. at 27-29.) Plaintiffs claim similar mistakes with regard to numerous other banks, but the Lehman Defendants are noticeably absent from the list. (Pltfs.' Opp. at 29.) This is no doubt because there is only one Lehman-related entity that acted as an underwriter or issued research reports. Plaintiffs make no attempt to explain how there was any mistake of fact as to the Lehman Defendants.[23]

Plaintiffs' claim of a "mistake of law" fares no better. Plaintiffs rely on one decision from the Seventh Circuit that broadly defines mistake to include a legal theory of responsibility

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[22] Plaintiffs' other cases are similarly distinguishable. In *Zimmer v. United Dominion Industries, Inc.*, 193 F.R.D. 620 (W.D. Ark. 2000), the defendant actively concealed the identity of the proper party. In *Graham v. Gendex Medical X-ray, Inc.*, 176 F.R.D. 288 (N.D. Ill. 1997), the newly-added defendant had been the subject of the EEOC complaint, making plaintiffs' mistake obvious. Further, plaintiffs in this case have attempted to justify their decision to sue LBHI, as discussed below. In *De Coelho v. Seaboard Shipping Corp.*, 535 F. Supp. 629 (D.P.R. 1982), plaintiffs sought to substitute a party (showing the original defendant was not intended) and the defendants failed to alert plaintiffs to the error until it was too late. In *Aerotel, Ltd. v. Sprint Corp.*, 100 F. Supp. 2d 189 (S.D.N.Y. 2000), it was not clear to the plaintiff which entity engaged in the disputed conduct. And in *Lynn v. JER Corp.*, 573 F. Supp. 17 (M.D. Tenn. 1983), not only was it unclear which entity was the relevant actor, but the parties did not even raise mistake for the court's consideration.

[23] Plaintiffs' claim that similar entity names was a justifiable cause for confusion should be disregarded. While such an argument may have merit if plaintiffs had sued a non-existent legal entity, such as a generic company called Lehman Brothers, plaintiffs did at least some investigation to determine that one Lehman-related entity is LBHI. There is no reason plaintiffs could not have named LBI as well or instead. Several cases have concluded that adding a parent or subsidiary of an original party is a strategic decision for which no relation back is proper. *See, e.g., Powers v. Graff*, 148 F.3d 1223, 1227 (11th Cir. 1998) (refusing to allow relation back for claims against control persons of original defendant); *Gutierrez v. Raymond Int'l, Inc.*, 86 F.R.D. 684, 685 (S.D. Tex. 1980) (refusing to allow relation back for addition of two corporate affiliates of original defendant on the grounds that it was "a deliberate tactical decision" to sue only one company based on alter ego theory when plaintiffs had notice of the other potential defendants).

so groundless that all parties should have understood that a party had been misnamed. *See Woods v. Ind. Univ.-Purdue Univ. at Indianapolis*, 996 F.2d 880, 887 (7th Cir. 1993).[24] Unlike in *Woods*, plaintiffs have never argued that their initial claims against LBHI were so legally deficient that it was patently obvious that LBI was the proper party. In fact, plaintiffs' refusal to name LBI, even once LBHI raised the issue, suggests that plaintiffs did not and do not view their naming of LBHI as a clearly established legal error.[25]

III. Plaintiffs' Section 12(a)(2) Claim Against LBI Fails Because Plaintiffs Admit They Lack Standing.

In their opposition brief, plaintiffs concede that none of them actually purchased any of the Enron Credit Linked Notes or the Osprey II Notes (Pltfs.' Opp. at 47), and, thus, no plaintiff suffered any damages as a result of such non-existent purchases. Plaintiffs, having suffered no injury-in-fact, lack standing to assert a Section 12(a)(2) claim against LBI relating to the Enron Credit Linked Notes and the Osprey II Notes. *See Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560 (1992) (plurality opinion).[26]

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[24] Plaintiffs' citation to *Simpson v. Borg-Warner Automotive, Inc.*, No. 97 C 1911, 1997 U.S. Dist. LEXIS 19502 (N.D. Ill. Dec. 2, 1997), which relies only on *Woods* for authority, is similarly distinguishable because in *Simpson*, the plaintiff was seeking to substitute a party, further supporting that the error was unintentional. In *Simpson* there was also evidence suggesting that the parent was the proper party, such as a letter on its letterhead instead of that of the subsidiary, and this supported plaintiffs' legal theory that closely-related entities can be held liable for the acts of their subsidiaries. In contrast, plaintiffs here chose to proceed without any support for their legal theory and in the face of clear evidence showing that only LBI engaged in Enron-related conduct. Plaintiffs' other case, *Gaspard v. Highlands Insurance Co.*, No. 89-3385, 1991 U.S. Dist. LEXIS 3010 (E.D. La. Mar. 11, 1991), is far from analogous to plaintiffs' action here.

[25] Courts have narrowly circumscribed the applicability of "mistake of law." *See Delicandro v. Legalgard, Inc.*, No. 99-3778, 2003 WL 182942, at * 7 (E.D. Pa. Jan. 23, 2003) (discussing 1966 Advisory Committee Note to Rule 15, which allows relation back in instances where an individual mistakenly sues a state institution rather than the correct individual, holding that its circumstances were not sufficiently similar for relation back); *In re Brand Name Prescription Drugs Antitrust Litig.*, No. 94 C 987, MDL 997 1998 WL 474146, at *5 (N.D. Ill. Aug. 6, 1998) (limiting mistake of law argument to situations where a choice exists between naming an individual or governmental defendant and not to where plaintiffs made a miscalculation regarding the effect of precedent).

[26] Plaintiffs also fail meet the additional requirements that they have purchased the Enron Credit Linked Notes and the Osprey II Notes directly from LBI in an initial public offering. *See Pinter v. Dahl*, 486 U.S. 622, 647 (1988); *Cyrak v. Lemon*, 919 F.2d 320, 324-25 (5th Cir. 1990).

Plaintiffs do not dispute that they lack standing. Instead, plaintiffs argue that a lack of standing is "'trivial' nitpicking" and ask the Court simply to assume standing for the time being. (Pltfs.' Opp. at 39-40.)[27] Plaintiffs' request is contrary to well-settled law and should be rejected. *See, e.g., Lujan*, 504 U.S. at 570 n.5 ("standing is to be determined as of the commencement of suit"); *Lewis v. Casey*, 518 U.S. 343, 357 (1996) (explaining that "even named plaintiffs who represent a class must allege and show that they personally have been injured, not that injury has been suffered by other, unidentified members of the class to which they belong and which the purport to represent") (quotation omitted); *In re Taxable Mun. Bond Sec. Litig.*, 51 F.3d 518, 522 (5th Cir. 1995) ("It is well-established that to have standing to sue as a class representative it is essential that a plaintiff must be part of the that class....") (quotations, alterations omitted).

IV. Plaintiffs' Control Person Claims Against LBHI Are Insufficient.

Plaintiffs' "control person" claims against LBHI are entirely derivative of their claims against LBI. Accordingly, because, as demonstrated above, plaintiffs' primary liability claims against LBI fail, so too must plaintiffs' claims against LBHI under Sections 20 and 15. *See, e.g., Lone Star Ladies Inv. Club v. Schlotzsky's Inc.*, 238 F.3d 363, 370 n.33 (5th Cir. 2001); *Lewis v. Fresne*, 252 F.3d 352, 357 n.3 (5th Cir. 2001) (affirming dismissal of Section 15 claims because "[w]ithout a violation of [Section 11 or] 12, there is no claim under § 15"); *In re Enron Corp.*, 235 F. Supp. at 596 ("[C]ontrol person liability is derivative; a failure to plead a primary,

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[27] In this regard, plaintiffs rely on *Griffin v. PaineWebber Inc.*, 84 F. Supp. 2d 508, 515 (S.D.N.Y. 2000) and *Moskvowitz v. Mitcham Industries*, No. H-98-1244, 2000 U.S. Dist. LEXIS 22424, at *29 (S.D. Tex. Sept. 27, 2000). (Pltfs.' Opp. at 38-39.) Neither case helps plaintiffs however. To the contrary, both cases in fact support the well-established rule that plaintiffs, even in a class action, must have standing in order to maintain a claim. *See Griffin*, 84 F. Supp. 2d at 515 (requiring the plaintiff to replead within thirty days to allege that a member of plaintiffs purported class purchased at least one share from the defendant); *Moskvowitz*, 2000 U.S. Dist. LEXIS 22424, at *29 (dismissing Section 12(a)(2) claims where plaintiffs could not show facts to establish purchase of securities from individual defendants, and stating that "neither section 11 nor section 12 extends to securities purchases that are merely 'traceable' to the offering").

independent violation by the controlled person § 10(b) and Rule 10b-5 precludes such a claim for secondary liability against the controlling person under § 20 of the Exchange Act, or, a violation of §§ 11 or 12 for control person liability under section 15 of the Securities Act of 1933.").

Even if plaintiffs' claims against LBI were permitted to stand, plaintiffs' control person claims against LBHI would still fail. To state a claim for control person liability, this Court has held that plaintiffs must allege "particularized facts as to the controlling person's culpable participation in (exercising control over) the 'fraud perpetrated by the controlled person.'" *In re Enron Corp.*, 235 F. Supp. 2d at 598 (citation omitted); *Collmer v. U.S. Liquids, Inc.*, No. H-99-2785, 2001 U.S. Dist. LEXIS 23518, at *10 (S.D. Tex. Jan. 23, 2001) (same). The Fifth Circuit also has required plaintiffs to show that the controlling person actually exercised control over the primary violator. *See Dennis v. Gen. Imaging, Inc.*, 918 F.2d 496, 509 (5th Cir. 1990) (demonstrating a *prima facie* violation of Section 15 requires plaintiff to show that the controlling person "had actual power or influence over the controlled person and [] induced or participated in the alleged violation").[28] To make such a showing, plaintiffs must "allege some facts beyond a defendant's position or title that show that the defendant had actual power or control over the controlled person." *In re Enron Corp.*, 235 F. Supp. 2d at 595 (citing *Dennis*, 918 F.2d at 509-10).

Instead of pleading specific facts regarding the relationship between LBHI and LBI, plaintiffs rely solely on undifferentiated boilerplate allegations as to all bank defendants.

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[28] Relying on *Abbott v. Equity Group*, 2 F.3d 613, 620 (5th Cir. 1993), plaintiffs suggest that the Fifth Circuit has held that the actual exercise of the power to control by the alleged control person need not be shown. (Pltfs.' Opp. at 55.) But plaintiffs misquote *Abbott*. Contrary to plaintiffs' contention, the Court did *not* hold that actual exercise of power need not be pleaded, but rather withheld judgment on that question: "We need not presently analyze the above distinction [whether there is a culpable participation requirement in the Fifth Circuit] because, even assuming that only the former applies, a reasonable jury could not so find based on the record before us." *Abbott*, 2 F.3d at 620.

Plaintiffs allege that "[e]ach of the bank holding company entities ... conducts its business affairs through a series of wholly owned and controlled subsidiaries where the bank holding company directly or indirectly owns 100% of the stock of the subsidiaries and completely directs and controls their business operations through the selection and appointment of their officers and, where necessary, directors." (Am. Compl. ¶ 99.1; *see also* Pltfs.' Opp. at 54.) Not only does this allegation not distinguish among the various bank holding company defendants, but it fails to explain how LBHI's ownership of LBI gave it the power "to direct or cause the direction of the management and policies" of LBI. *See Johnson v. Tellabs, Inc.*, 262 F. Supp. 2d 937, 958-59 (N.D. Ill. 2003) ("Although Plaintiffs generally allege that these Individual Defendants had direct and supervisory involvement in the day-to-day operations of the Company and, therefore, are presumed to have had the power to control or influence the particular transactions giving rise to the securities violations, this general allegation as to all the Individual Defendants is insufficient to establish control person liability."); *cf. Goldstein*, slip op. at 24 (holding that non-specific allegation that CEO was "hands on" manager was insufficient to infer intentional participation in accounting decision).[29]

Unlike the control person claims against some of the Andersen defendants that this Court upheld, plaintiffs' generalized and conclusory allegations regarding LBHI fall far short of pleading, much less demonstrating, that LBHI possessed the requisite power over or was involved in "initiating, ratifying, and implementing [LBI's] policies, or overseeing and

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[29] Plaintiffs assert that the culpable participation requirement is inconsistent with the statutory scheme of control person liability. (Pltfs.' Opp. at 56 n.48.) Plaintiffs assert that the Fifth Circuit, in *G.A. Thompson & Co., Inc. v. Partridge*, 636 F.2d 945, 958 (5th Cir. 1981), construed Section 20 as not requiring a showing of culpable participation (Pltfs.' Opp. at 56), but conveniently ignore that the Fifth Circuit subsequently held that the alleged controlling person's inducement of or participation in the purported violation is an element of a control person claim. *See Dennis*, 918 F.2d at 509. Contrary to plaintiffs' contention, it is entirely consistent with Congressional intent to require a showing of culpable participation. (*See* Lehman Mem. at 22-23 & n.20.)

monitoring those effectuating [LBI's] policies and decisions." *In re Enron Corp. Sec., Derivative & ERISA Litig.*, No. H-01-3624, 2003 WL 230688, at *19 (S.D. Tex. Jan. 28, 2003). Contrary to plaintiffs' apparent belief, every holding company and parent corporation is *not* automatically a control person of every subsidiary that it directly or indirectly owns. *See Novak v. Kasaks*, 997 F. Supp. 425, 435 (S.D.N.Y. 1998) (dismissing control person claim against parent corporation), *rev'd on other grounds*, 216 F.3d 300 (2d Cir. 2000). Indeed, even the court in *Paracor Financial Inc. v. GE Capital Corp.*, 96 F.3d 1151, 1163 (9th Cir. 1996), relied upon by plaintiffs (Pltfs.' Opp. at 56 n.48), concluded that a CEO is not automatically a controlling person; rather, the plaintiff must allege that the CEO exercised direct or indirect control over the transaction in question. (*See also* Lehman Mem. at 22-23.)[30]

Finally, contrary to plaintiffs' contention, control person liability does not involve a fact-intensive inquiry that is inappropriate on a motion to dismiss. Indeed, many courts have

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[30] According to plaintiffs, courts sustain control person liability claims where plaintiffs make a *prima facie* showing of abstract power. (Pltfs.' Opp. at 52-53.) The cases on which plaintiffs rely, however, are distinguishable. In *McNamara v. Bre-X Minerals Ltd.*, 46 F. Supp. 2d 628, 638 (E.D. Tex. 1999), which involved a motion to dismiss for lack of personal jurisdiction, plaintiffs alleged that the purported control corporation had involvement in the day-to-day operations of its subsidiary, "had the power to influence and control and did influence and control ... the decision-making of [the subsidiary], including the content and dissemination of the various statements which plaintiffs contend are false" and that the two companies had extensive overlap of directors and officers. Here, plaintiffs make no such detailed allegations regarding LBHI and LBI. Similarly, plaintiffs misinterpret this Court's decision in *In re Landry's Seafood Restaurant, Inc. Securities Litigation*, No. H-99-1948, (S.D. Tex. Feb. 20, 2001). They imply that, under *Landry's*, "liability attaches to one who directly or indirectly has the abstract power to 'control'" without more. (Pltfs.' Opp. at 52.) In fact, this Court stated that to survive a motion to dismiss a claim for controlling person liability under Section 15, "a plaintiff must allege (1) an underlying primary violation of § 11 by the controlled person, (2) control by the defendant over the controlled person, and (3) particularized facts as to the controlling person's culpable participation in (exercising control over) the [violation] perpetrated by the controlled person." Slip. op. at 11 n.14. The Court determined that the plaintiffs had adequately pled control over the corporation by its top executives who were "hands-on" managers, "constantly monitored the acquisitions, the performance of the restaurants, the managerial difficulties, and the EPS growth," received daily spreadsheets that informed them exactly how each restaurant was doing daily, and "had access to internal corporate documents, participated in conversations with other corporate officers and employees, attended management and Board meetings and thus knew all the problems detailed previously...." *Id.* at 29-31. Again, plaintiffs here make no such detailed allegations regarding the purported control of LBI by LBHI. Finally, plaintiffs misread *Ellison v. American Image Motor Co.*, 36 F. Supp. 2d 628 (S.D.N.Y. 1999). There, the court stated that "[a] plaintiff may not allege 'controlling person' status merely by reciting a corporate officer's title without alleging *actual* control and the nature of the controlling persons 'culpable participation' in the fraud." *Id.* at 642 (emphasis added).

dismissed control person claims when the complaint fails to make legally sufficient allegations. *See, e.g.*, *Johnson*, 262 F. Supp. 2d at 958-59 (dismissing control person because plaintiffs, among other things, failed to allege sufficiently that the defendants controlled the primary violator); *In re Digital Island Sec. Litig.*, 223 F. Supp. 2d 546, 563 (D. Del. 2002) (the "complaint 'does nothing more than restate the legal standard for control person liability; it does not provide adequate facts to support these allegations'"); *Zishka v. Am. Pad & Paper Co.*, No. 3:98-CV-0660-M, 2001 WL 1748741, at *1 (N.D. Tex. Sept. 28, 2001) (dismissing control person allegations as insufficient because "[s]tatus alone as to persons not involved in day-to-day management is legally insufficient..."); *Dartley v. Ergobilt Inc.*, No. 398CV1442M, 2001 WL 313964, at *1-2 (N.D. Tex. Mar. 29, 2001) (dismissing control person claims because mere fact of major stock ownership and participation in voting agreement were insufficient to show power to control the purported primary violator); *Ellison*, 36 F. Supp. 2d at 642 ("Aside from the naked assertion that the [] Defendants were 'officers' of the Liberian Corporations, the complaint is devoid of any allegation as to how these lawyers 'controlled' these companies."). In fact, this Court dismissed certain individual Andersen defendants on that very basis at the pleading stage. *See In re Enron Corp.*, 2003 WL 230688, at *20.[31] The control person claims against LBHI should meet a similar fate.

[31] This Court did not rule on whether plaintiffs adequately alleged control person liability against LBHI in the Consolidated Complaint under either Section 15 or Section 20(a). *See In re Enron Corp*, 235 F. Supp. 2d at 691 ("The Court defers ruling on the issue [of controlling person liability] under the federal and Texas statutes until it has thoroughly reviewed all the individual defendants' motions."). In any event, the controlling person allegations against LBHI in the Consolidated Complaint are significantly different from those in the Amended Complaint. The Consolidated Complaint alleged that LBHI controlled every alleged violator of Section 11, including Enron and all of the other defendants. The Amended Complaint alleges only that LBHI controlled LBI.

V. The Washington Board's Claim Under The Texas Securities Act Fails.

In their opening brief, the Lehman Defendants demonstrated that the Washington Board did not adequately plead privity with the Lehman Defendants. (Lehman Mem. at 23-24.) The Washington Board defends its Texas Securities Act ("TSA") claim by referencing its conclusory allegation in the Amended Complaint that it and subclass members "are in privity with ... Lehman Brothers." (Pltfs.' Opp. at 68-69.) That assertion, unsupported by any facts, is plainly insufficient to satisfy the Washington Board's pleading burden. Indeed, the Washington Board appears to recognize this fact, and thus it attaches trade confirmations to its opposition that it argues demonstrates its privity with LBI.

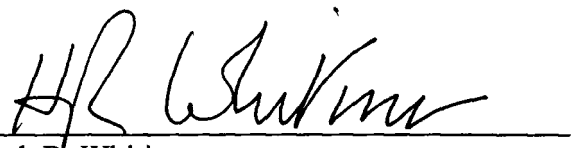
"It is axiomatic that the complaint cannot be amended by briefs in opposition to a motion to dismiss." *Car Carriers, Inc. v. Ford Motor Co.*, 745 F.2d 1101, 1107 (7th Cir. 1984); *see also Moskvowitz*, 2000 U.S. Dist. LEXIS 22424, at *29 (holding that plaintiffs' attachment of sales confirmations to their response to motion to dismiss does not cure defects in the complaint); *accord Martin v. Morgan Drive Away, Inc.*, 665 F.2d 598, 602 n.1 (5th Cir. 1982). The Washington Board had every opportunity to include any facts necessary to maintain its TSA claim against LBI in the Amended Complaint (and in fact, was ordered to do so by this Court). Its failure to adhere to the Court's admonition warrants the dismissal of its TSA claim.

CONCLUSION

For all of the foregoing reasons, and for the reasons stated in the Lehman Defendants' opening brief, plaintiffs' claims against the Lehman Defendants should be dismissed with prejudice.

Dated: July 31, 2003
Houston, Texas

Respectfully submitted,



Hugh R. Whiting
Attorney-in-Charge
Texas Bar No. 21373500
S.D. Admission No. 30188
JONES DAY
600 Travis Street, Suite 6500
Houston, Texas 77002
Tel: (832) 239-3939
Fax: (832) 239-3600

Attorneys for Lehman Brothers Holdings Inc. and Lehman Brothers Inc.

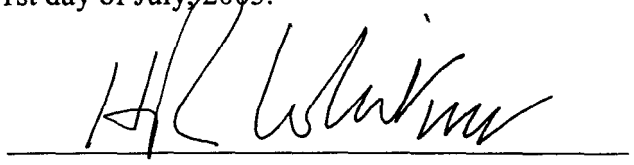
OF COUNSEL:

David E. Miller
Texas Bar No. 14067150
S.D. Admission No. 27647
JONES DAY
600 Travis Street, Suite 6500
Houston, Texas 77002
Tel: (832) 239-3939
Fax: (832) 239-3600

David L. Carden
Robert C. Micheletto (not admitted in NY)
JONES DAY
222 E. 41st Street
New York, New York 10017-6702
Tel: (212) 326-3939
Fax: (212) 755-7306

CERTIFICATE OF SERVICE

The undersigned certifies that a copy of the foregoing instrument was served on the attorneys of record for all parties to the above cause through esl3624.com in accordance with the Court's order regarding website service on the 31st day of July, 2003.



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