IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

In re ENRON CORPORATION SECURITIES LITIGATION	§	Civil Action No. H-01-3624 **(Consolidated)**
	§	CLASS ACTION
This Document Relates To:	§	
MARK NEWBY, et al., Individually and On Behalf of All Others Similarly Situated, Plaintiffs,	§	
vs.	§	
ENRON CORP., et al., Defendants.	§	
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.	§	

LEAD PLAINTIFF'S OPPOSITION TO MERRILL LYNCH'S NOTICE OF SUPPLEMENTAL AUTHORITY IN OPPOSITION TO LEAD PLAINTIFF'S AMENDED MOTION FOR CLASS CERTIFICATION [DOCKET # 2286]

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I. Introduction

In its latest attempt to evade responsibility for its primary role in defrauding Enron investors, Merrill Lynch offers a fact-bound summary judgment decision as a new ground for asserting class certification should be denied. As discussed in this brief, none of the recent decisions (in circuit or out) presented in Merrill Lynch's Notice of Supplemental Authority in Opposition to Lead Plaintiff's Amended Motion for Class Certification ("Notice") demonstrate the claims pleaded against Merrill Lynch are ill-suited to class certification. As Lead Plaintiff demonstrated in its reply memorandum in support of its motion for class certification [docket #1854], all the prerequisites for class certification are met, and plaintiffs may avail themselves of the fraud-on-the-market presumption. Nothing in the decisions offered by Merrill Lynch suggests a contrary result.

Before discussing Merrill Lynch's new but irrelevant authorities, however, some context is required. This Court has previously ruled that the "fraud-on-the-market theory is particularly relevant where a §10(b) and Rule 10b-5 case alleges market manipulation." *In re Enron Corp. Sec. Litig.*, 235 F. Supp. 2d 549, 574 (S.D. Tex. 2002). Such manipulative "'schemes which are intended to distort the price of a security, if successful, necessarily defraud investors who purchase the security in reliance on the market's integrity.'" *Id.* (quoting *Scone Invs., L.P. v. Am. Third Mkt. Corp.*, No. 97 Civ. 3802 (SAS), 1998 U.S. Dist. LEXIS 5903, at *16 (S.D.N.Y. April 27, 1998)). The Court has also previously recognized the fraud-on-the-market presumption applies in an action "under prongs (a) and (c)." *Enron*, 235 F. Supp. 2d at 693.

Merrill Lynch's latest submission ignores three critical points. First, Merrill Lynch's liability rests principally on its role as a primary violator in a scheme to defraud, not on misrepresentations. Second, Merrill Lynch's representations in furtherance of the scheme were not confirmatory. There were expansive embellishments by Merrill Lynch. Third, a "court's rejection of the fraud-on-the-market theory as a basis for class action treatment ... [is] an inappropriate inquiry into the merits of plaintiffs' claims." *Kirkpatrick v. J.C. Bradford & Co.*, 827 F.2d 718, 722 (11th Cir. 1987). Issues of reliance and whether defendants can rebut the presumption of reliance are matters for ***trial***. *Kalodner v. Michaels Stores*, 172 F.R.D. 200, 206 n.6 (N.D. Tex. 1997). Moreover, even if the fraud-on-the-market presumption does not apply, "[i]ndividual questions of reliance are ... not an impediment" to class certification. *Blackie v. Barrack*, 524 F.2d 891, 905 (9th Cir. 1975); *Kirkpatrick*, 827 F.2d at 724-25 ("the mere presence of the factual issue of individual reliance could not render claims unsuitable for class treatment" where "the complaint[] alleges 'a single ... fraudulent scheme'"); *In re Ramtek Sec. Litig.*, No. C 88 20195 RPA, 1990 U.S. Dist. LEXIS 14947, at *11 (N.D. Cal. Sept. 7, 1990) (issues of individual reliance "'are not grounds for refusing to permit an action to proceed as a class action.'") (citation omitted).

II. The Court Has Already Rejected Merrill Lynch's Assertions in the Motion to Dismiss

Merrill Lynch raised many of the contentions advanced in its supplemental submission when it moved to dismiss plaintiffs' claims, but did so under the guise of loss causation. Merrill Lynch contended that

> because the Nigerian barge transaction and the power swaps were not known to the public until April and August 2002, respectively, five and nine months after the Class Period ended on November 27, 2001, and long after the price of Enron securities had collapsed, Lead Plaintiff cannot plead or prove that the plaintiffs' losses were caused by these two transactions, nor that any conduct by Merrill Lynch caused plaintiffs any pecuniary loss.

Memorandum and Order re Merrill Lynch and Deutsche Bank Entities, filed March 29, 2004 [docket #2036] ("March 29 Order") at 8-9 (footnote omitted). They repeat the same claim in their supplemental submission (Notice at 7-8). They are wrong for the reasons the Court previously explained:

> Not only does the complaint allege that the fraud artificially inflated the value of Enron securities, indeed of the corporation itself, but there is no showing that the plaintiffs' loss was the result of external market forces such as recession, a volatile market, a fall in prices in energy trading generally or any "intervening" factor.

> Instead the plaintiffs have adequately pleaded that their loss was directly and foreseeably caused by Defendants' alleged fraudulent practices at Enron, including Merrill Lynch's Nigerian barge transaction and bogus power trades involving Enron North America .... While information about Merrill Lynch's individual role in the Nigerian barge transaction and the sham power swaps may not have been made public until long after the Enron bankruptcy, ***that fact does not relieve Merrill Lynch of responsibility for Enron's collapse; Merrill Lynch's alleged substantial participation in the deceptive business practices contributed to the artificial inflation of the price of the securities*** and thereby was a direct and major cause of plaintiffs' financial loss, according to the amended complaint.

March 29 Order at 16-17.

The same analysis is apt in the context of reliance. Merrill Lynch engages in misdirection when it contends that plaintiffs have not shown "the revelation of the 'truth' about Merrill Lynch's conduct resulted in a material decrease in the stock price." Notice at 7. Merrill Lynch's latest attempts to link Enron's post-bankruptcy stock price to the revelation regarding Merrill Lynch's role in the power swap transactions focuses on the wrong "revelation." It is not ***revelation*** of Merrill Lynch's role in the fraud that is an element of the claim, it is the initial revelation of the fraud and its effect on Enron's stock price at the time of that initial revelation that supports both the fraud-on-the-market presumption and loss causation. The Court has considered and rejected Merrill Lynch's theory regarding the date the public became aware of Merrill Lynch's role in the fraud. Enron's stock price began to decline in early 2001 when questions regarding its financial condition were raised in the media. When Enron announced a huge third quarter loss, followed quickly by a restatement, investors bolted. The market understandably reacts to such revelations regarding a company's financial condition. It does not wait until all the perpetrators of the fraud are revealed.

Merrill Lynch's contention that Enron's stock declined after it announced its fourth quarter earnings in January 2000 and thus Merrill Lynch's transactions with Enron at the end of the fourth quarter of 1999 "did not result in an increase to Enron's stock price" completely misses the mark. Notice at 7. The market had no clue as to Merrill Lynch's role in the massive Enron fraud. Indeed, at that time ***no one*** knew Enron was engaged in numerous transactions with Merrill Lynch and others that painted a false picture of a successful company while concealing the fact that the company was an immense Ponzi scheme. Had the market known of the deception, the stock price would have reflected that, just as it did when revelations concerning the Enron fraud became known. *See*, *e.g.*, First Amended Consolidated Complaint ("Complaint") at ¶61; ¶74 (Timeline). Under Merrill Lynch's view, those who cleverly conceal their fraud are rewarded. But Merrill Lynch's view is clearly contrary to the policy of the securities laws. "The acts reach complex fraudulent schemes as well as lesser misrepresentation or omission." *Shores v. Sklar*, 647 F.2d 462, 470 (5th Cir. 1981).

III. The *Greenberg* Decision Has No Application Here Because Merrill Lynch's Liability Is Based on a Scheme and Its Misrepresentations in Furtherance of the Scheme Were Not Confirmatory

Merrill Lynch claims the *Greenberg v. Crossroads Sys.*, 364 F.3d 657 (5th Cir. 2004), decision precludes class treatment of the claims pleaded against it. But *Greenberg* was not a class certification case, it was a summary judgment case, where "after completing discovery" the company filed a motion for partial summary judgment contending that its evidence rebutted the presumption and showed that plaintiffs were not entitled to rely on the fraud-on-the-market theory to establish reliance. *Id.* at 661. The district court granted summary judgment, but a panel of the Fifth Circuit reversed in part and affirmed as to certain statements. The Fifth Circuit held: (1) drop of 63% in stock price following company's revelation of news that contradicted earlier alleged misrepresentations constituted statistically significant decrease, supporting fraud-on-the-market presumption of reliance; (2) negative news contradicting earlier alleged misrepresentations did not raise presumption of reliance where it was accompanied by much more severe negative news unrelated to misrepresentations; and (3) news that quarterly financial results would be up to 66% below estimates, contradicting earlier alleged misrepresentations, raised the presumption of reliance.

Id. at 657. In addition, *Greenberg* held that certain confirmatory misrepresentations that do not cause a change in stock price "cannot be the basis for a fraud-on-the-market claim." *Id.* at 666. A confirmatory statement is said to be one that simply repeats information that "has already been digested by the market and will cause a change in stock price." *Id.*

A. The Case Against Merrill Lynch Is Not "Classically Confirmatory"

Merrill Lynch tries to redefine the case pleaded against it into *Greenberg's* "confirmatory" statements' analysis. Merrill Lynch contends the case pleaded against it is "classically 'confirmatory' under the plaintiffs' own characterization." Notice at 4. Plaintiffs' case against Merrill Lynch is a "scheme case" rather than simply a misrepresentation case like *Greenberg*. Plaintiffs here allege that Merrill Lynch worked with Enron to inflate Enron's publicly issued financial results by engaging in a variety of schemes, including power swaps, LJM and the Nigerian barge transactions. Merrill Lynch claims that because these fraudulent transactions were undertaken to help Enron meet its financial targets and because Enron (through fraud) met its targets in the fourth quarter of 1999, this means under *Greenberg*, reliance cannot be presumed. Merrill's reading of *Greenberg* is at odds with common sense and the case pleaded against it. Nothing in the wide-ranging scheme pleaded against Merrill Lynch was "confirmatory." As the Court previously stated in upholding claims against Merrill Lynch:

> The allegations of nondisclosure of vital information materially affecting the market price of Enron's securities support application of the rebuttable fraud-on-the-market theory of reliance. Leaving aside the allegations of misrepresentations about Enron made by Merrill Lynch analysts, the Court observes that this doctrine, which is recognized in the Fifth Circuit, suffices to establish reliance.

March 29 Order at 9 n.10. Thus, regardless of the movement in Enron's securities prices (either up or down) following publication of Merrill Lynch's reports, its role in the fraudulent scheme, a part of which consisted of false and misleading analyst reports, resulted in artificially maintaining Enron's inflated securities price as plaintiffs' experts will testify at trial.

B. Allegations Concerning Analyst Reports Do Not Fall Under the Rule Announced in *Greenberg*

As to the analyst statements that Merrill Lynch has argued are "confirmatory" of Enron's prior announcements, the Court held:

> Furthermore, to help artificially inflate the trading prices of Enron's publicly traded securities, because Merrill Lynch knew that Enron would have to issue substantial additional shares of stock if the price dropped below the various trigger points in its capitalization of a number of Enron-controlled entities and that Enron's investment grade credit rating would be in danger, Merrill Lynch's securities analysts issued reports containing false and misleading statements to the securities markets about Enron's business, finances, financial condition, and future prospects ....

Enron, 235 F. Supp. 2d at 651. Such false assurances were not "confirmatory," they were part of a scheme to lull the investing public into a false sense of security and conceal the underlying fraud.

The allegations regarding Merrill Lynch's misleading analyst reports similarly do not fall under the rule announced in *Greenberg*. Merrill Lynch claims the analyst reports were based on information previously announced by Enron and, therefore were confirmatory and thus non-actionable. Notice at 5. On the contrary, plaintiffs' claims regarding the analyst reports issued by Merrill Lynch are based on Merrill Lynch's own conduct and knowledge – not on Merrill Lynch's simply reconfirming Enron's information. *See, e.g.*, *Cooper v. Pickett*, 137 F.3d 616, 629 (9th Cir. 1998). "The complaint alleges that the analysts were aware of undisclosed facts that showed there was no reasonable basis for their forecasts, which they did not genuinely believe." *Id.*

Plaintiffs allege that Merrill Lynch, as a participant in the scheme, made false statements to the public regarding Enron's financials despite Merrill Lynch's actual knowledge, based on the deals it did with Enron, that those financials were false. This is not a situation like *Greenberg* where a company made a statement and later confirmed the statement. Indeed, as the Court's prior Order makes clear, Merrill Lynch was not merely "confirming" statements made by Enron but issued its own false and misleading reports "to help artificially inflate the trading prices of Enron's publicly traded securities." *Enron*, 235 F. Supp. 2d at 651.

Merrill Lynch broadly claims the Merrill Lynch analyst reports cited in the Complaint were based on information previously announced by Enron. A footnote in Merrill Lynch's brief then purports to describe the content of those analyst reports. Merrill Lynch's characterization, however, completely ignores the fact that these reports went well beyond merely reporting previously announced information and indeed primarily contained Merrill Lynch's fraudulent embellishment of Enron's business prospects, future success and operations.

First, the reports contained false and misleading recommendations to buy Enron's securities. Second, far from simply "summarizing 'information presented by [an Enron] conference,'" the March 31, 1999 report quoted at ¶142 of the Complaint touts management's "commit[ment] to maintaining or improving its current credit ratings" discussed how the company "effectively utilized off-balance sheet, non-recourse financings to fund expansion efforts" and praised the Company's fiber optic network as being "fully capable of delivering" "high quality, high bandwidth applications to businesses." The other reports cited in a cursory fashion by Merrill Lynch in footnote 6 of its supplemental submission similarly go well beyond "confirmatory" statements. For example, the April 18, 2001 Merrill Lynch report quoted at ¶321 of the Complaint also presents more than a rehash of Enron's earnings announcement. The report contained a recommendation to buy Enron securities and touts Enron's supposed ability to "successfully execute its Broadband strategy." *Greenberg* does not hold inactionable an analyst statement that is one part confirmatory and 99 parts fraud.

IV. Two Out-of-Circuit Decisions Do Not Suggest Class Treatment Is Inappropriate

Merrill Lynch also relies on two out-of-circuit decisions which it wrongly suggests demonstrate a class cannot be certified. Neither *Hevesi v. Citigroup Inc.*, 366 F.3d 70 (2nd Cir. 2004), nor *DeMarco v. Lehman Bros.*, 03 Civ. 3470 (JSR), 2004 U.S. Dist. LEXIS 12438 (S.D.N.Y. July 6, 2004) remotely come close to the situation presented in the Enron case where along with analyst statements, the complaint alleges the banks controlling the analysts engaged in a massive number of fraudulent transactions that falsely inflated a company's financials for years. The defendants here acted in concert – their scheme impacted Enron's performance and its securities price causing massive injury. The analyst statements are not stand-alones. They are part of a larger scheme.

DeMarco did not involve a massive scheme like that presented in this case. In *DeMarco*, plaintiffs alleged a research analyst at Lehman Brothers issued reports strongly recommending the purchase of a company's stock while privately recommending to preferred customers that they sell or "short" the stock. 2004 U.S. Dist. LEXIS 12438, at *2. The court denied class certification holding plaintiffs in that case failed to make a showing that the analyst's statements materially impacted the market price in a reasonably quantifiable respect. *Id.* at *10.

Merrill Lynch's reliance on *Hevesi* is also misplaced. In that case the court granted an interlocutory appeal finding "novel" the issue whether a court may certify a suit against a research analyst and his employer, based on the fraud-on-the-market doctrine, without a finding that the analyst's opinion affected a company's stock.

The case against Merrill Lynch, by contrast, presents a far different scenario, for here the false and misleading analyst statements are an integral part of the overall scheme charged against Merrill Lynch. "If an enterprise is so laden with fraud that its entire public image is distorted, it is sensible to presume that reasonable investors relied on many material misrepresentations which, in aggregate, created a false image." *In re Am. Cont'l Corp./Lincoln Sav. & Loan Sec. Litig.*, 140 F.R.D. 425, 432 (D. Ariz. 1992).

V. Conclusion

For the foregoing reasons and those stated in previous briefs, the Court should grant plaintiffs' motion for class certification.

DATED: August 9, 2004

Respectfully submitted,

LERACH COUGHLIN STOIA GELLER
RUDMAN & ROBBINS LLP
WILLIAM S. LERACH
DARREN J. ROBBINS
HELEN J. HODGES
BYRON S. GEORGIOU
JAMES I. JACONETTE
MICHELLE M. CICCARELLI
JAMES R. HAIL
ANNE L. BOX
JOHN A. LOWTHER
TRIG R. SMITH
ALEXANDRA S. BERNAY
MATTHEW P. SIBEN
ROBERT R. HENSSLER, JR.

Helen J. Hodges w/ permission

HELEN J. HODGES

401 B Street, Suite 1700
San Diego, CA 92101
Telephone: 619/231-1058

LERACH COUGHLIN STOIA GELLER
RUDMAN & ROBBINS LLP
REGINA M. AMES
355 South Grand Avenue, Suite 4170
Los Angeles, CA 90071
Telephone: 213/617-9007
213/617-9185 (fax)

LERACH COUGHLIN STOIA GELLER
RUDMAN & ROBBINS LLP
G. PAUL HOWES
JERRILYN HARDAWAY
Texas Bar No. 00788770
Federal I.D. No. 30964
1111 Bagby, Suite 4850
Houston, TX 77002
Telephone: 713/571-0911

Lead Counsel for Plaintiffs

SCHWARTZ, JUNELL, GREENBERG
& OATHOUT, LLP
ROGER B. GREENBERG
State Bar No. 08390000
Federal I.D. No. 3932

Roger B. Greenberg

ROGER B. GREENBERG

Two Houston Center
909 Fannin, Suite 2000
Houston, TX 77010
Telephone: 713/752-0017

HOEFFNER & BILEK, LLP
THOMAS E. BILEK
Federal Bar No. 9338
State Bar No. 02313525
440 Louisiana, Suite 720
Houston, TX 77002
Telephone: 713/227-7720

Attorneys in Charge

BERGER & MONTAGUE, P.C.
SHERRIE R. SAVETT
1622 Locust Street
Philadelphia, PA 19103
Telephone: 215/875-3000

Attorneys for Staro Asset Management

WOLF POPPER LLP
ROBERT C. FINKEL
845 Third Avenue
New York, NY 10022
Telephone: 212/759-4600

Attorneys for Nathaniel Pulsifer

SCOTT + SCOTT, LLC
DAVID R. SCOTT
NEIL ROTHSTEIN
S. EDWARD SARSKAS
108 Norwich Avenue
Colchester, CT 06415
Telephone: 860/537-3818

Attorneys for the Archdiocese of Milwaukee Supporting Fund, Inc.

LAW OFFICES OF JONATHAN D. McCUE
JONATHAN D. McCUE
4299 Avati Drive
San Diego, CA 92117
Telephone: 858/272-0454

Attorneys for Imperial County Board of Retirement

CUNEO WALDMAN & GILBERT, LLP
JONATHAN W. CUNEO
MICHAEL G. LENETT
317 Massachusetts Avenue, N.E.
Suite 300
Washington, D.C. 20002
Telephone: 202/789-3960

Washington Counsel

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing LEAD PLAINTIFF'S OPPOSITION TO MERRILL LYNCH'S NOTICE OF SUPPLEMENTAL AUTHORITY IN OPPOSITION TO LEAD PLAINTIFF'S AMENDED MOTION FOR CLASS CERTIFICATION [DOCKET # 2286] document has been served by sending a copy via electronic mail to serve@ESL3624.com on this August 9, 2004.

I further certify that a copy of the foregoing LEAD PLAINTIFF'S OPPOSITION TO MERRILL LYNCH'S NOTICE OF SUPPLEMENTAL AUTHORITY IN OPPOSITION TO LEAD PLAINTIFF'S AMENDED MOTION FOR CLASS CERTIFICATION [DOCKET # 2286]document has been served via overnight mail on the following parties, who do not accept service by electronic mail on this August 9, 2004.

Carolyn S. Schwartz
United States Trustee, Region 2
33 Whitehall Street, 21st Floor
New York, NY 10004

Mo Maloney

Mo Maloney