United States Courts
Southern District of Texas
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Michael N. Milby, Clerk

UNITED STATES DISTRICT COURT
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.	§	

MEMORANDUM OF POINTS AND AUTHORITIES IN OPPOSITION TO MOTION TO DISMISS BY CIBC

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I. INTRODUCTION AND OVERVIEW[1]

In the face of a 500-page complaint alleging the largest and worst securities fraud in the history of the United States[2] in excruciating detail, every single defendant – Enron's insiders, Enron's outside directors, Enron's accountants, Enron's lawyers and Enron's bankers – has moved to dismiss. Some claim it is too long. Some claim it is not detailed enough. Everyone denies responsibility. Not one defendant has seen it fit to answer. Every defendant seeks to avoid accountability by raising technical pleading arguments based on the Private Securities Litigation Reform Act of 1995 ("95 Act") which was meant to deter the filing of ***frivolous*** suits – which everyone knows, except apparently the defendants, this case is not. While it does appear that the 95 Act was successful, at least in this case, in deterring plaintiffs' securities lawyers from filing cookie-cutter complaints, it

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[1] Because any changes to the pleading requirements were not intended to prevent aggrieved parties from obtaining redress for their valid claims, "courts still apply Rule 12(b)(6) principles to motions to dismiss securities class action cases." *In re Boeing Sec. Litig.*, 40 F. Supp. 2d 1160, 1166 (W.D. Wash. 1998) (collecting cases); *see also Bryant v. Avado Brands, Inc.*, 187 F.3d 1271, 1273 n.1 (11th Cir. 1999). Consequently, the Court must accept as true all well-pleaded allegations in the Complaint and construe them in the light most favorable to plaintiff. *Scheuer v. Rhodes*, 416 U.S. 232 (1974); *Calliott v. HFS, Inc.*, No. 3:97-CV-0924-I, 2000 U.S. Dist. LEXIS 4368, at *8 (N.D. Tex. Mar. 31, 2000); *Zuckerman v. Foxmeyer Health Corp.*, 4 F. Supp. 2d 618, 621 (N.D. Tex. 1998) (Maloney, R.) (stressing that "the complaint is to be liberally construed in favor of the plaintiff"); *Young v. Nationwide Life Ins. Co.*, 2 F. Supp. 2d 914, 919 (S.D. Tex. 1998); *Lawal v. British Airways, PLC*, 812 F. Supp. 713, 716 (S.D. Tex. 1992). "A motion to dismiss for failure to state a claim under Fed. R. Civ. P. 12(b)(6) 'is viewed with disfavor and is rarely granted.'" *Calliott*, 2000 U.S. Dist. LEXIS 4368, at *7. Dismissal is appropriate only if it appears that no relief could be granted under any set of facts that could be proven consistent with the allegations. *Rubinstein v. Collins*, 20 F.3d 160, 166 (5th Cir. 1994) (citing *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957)); *Tuchman v. DSC Communications Corp.*, 818 F. Supp. 971, 974 (N.D. Tex. 1993), *aff'd*, 14 F.3d 1061 (5th Cir. 1994); *Calliott*, 2000 U.S. Dist. LEXIS 4368, at *3. Unless otherwise noted, emphasis is added and citations are omitted throughout.

Plaintiffs apologize for the length and repetition involved in responding to motions to dismiss filed by each of the nine banks sued as defendants. However, since the banks insisted, as was their right, to move to dismiss separately and because they have chosen to either ignore or grossly mischaracterize the allegations against them in the 500-page Consolidated Complaint ("CC") – apparently in the hope that the Court will not be able to find and focus on those allegations – plaintiffs had no choice but to respond separately as to each of the banks and set forth in detail the ***actual*** allegations made against the banks in the CC. After all, plaintiffs are entitled to have the adequacy of their CC against the banks determined based on the ***actual allegations*** of the CC, not defendants' mischaracterization of them.

[2] *See* John C. Coffee, "Guarding the Gatekeepers," *New York Times*, 5/13/02 at A19, referring to Enron as a "Major debacle of historic dimensions ...."

does not appear to have the same salutary impact with respect to deterring defendants from filing meritless motions to dismiss.[3]

Canadian Imperial Bank of Commerce ("CIBC") denigrates the detailed CC as a "puzzle pleading" that violates Fed. R. Civ. P. 8. But, the CC is of the same style and format sustained by this Court in *In re Landry's Seafood Restaurants, Inc. Sec. Litig.*, No. H-99-1948 (S.D. Tex. Feb. 20, 2001) – a decision defendants basically ignore – and in many other reported and unreported decisions. The "puzzle pleading" charge has been repeatedly rejected by courts which respect good faith efforts to provide the kind of detail and individuality required by the 95 Act – especially in complex multi-party cases. As Judge Debevoise stated in sustaining a lengthy against a public company and its officers and directors:

> Defendants challenge the Complaint, claiming that rather than being a "short and plain statement of the claim" in conformity with Fed. R. Civ. P. 8, it is "puzzle pleading" that fails to meet the requirements of Rule 9(b) and the Private Securities Litigation Reform Act (the "Reform Act"). ***The Complaint certainly is not short, but if it is a puzzle, it is meant for a child and can be assembled readily***. The issues are whether plaintiffs plead actionable misrepresentations with sufficient particularity and whether plaintiffs adequately plead scienter on the part of Honeywell and each Individual Officer.

In re Honeywell Int'l Sec. Litig., 182 F. Supp. 2d 414, 416 (D.N.J. 2002). In truth, ¶¶1–74 of the CC provide a relatively succinct summary of the CC, while the balance of the CC provides the detail required by Rule 9(b) and the 95 Act, thus satisfying plaintiffs' dual pleading obligations.[4]

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[3] While the banks proclaim their innocence and insist that they acted properly, without conflict or corruption, and in accordance with normal commercial lending and investment banking activities, these denials ring hollow in light of the recent revelations of corruption on Wall Street. *See* Marcia Vickers and Mike France, "Wall St.: How Corrupt is it?," *Business Week*, 5/13/02, attached as Ex. 1 to plaintiffs' Appendix.

If it is "irrational" to engage in acts that violate the law, then it appears Wall Street is deranged. However, if it is irrational to violate the law because of the risk of financial loss and punishment that accompanies illegal conduct, then presumably no one would ever violate the law and acceptance of this after-the-fact rationale would provide all wrong doers from embezzlers to bank robbers to price fixers and sophisticated securities violators with a built-in defense.

[4] All references to "¶¶_-_" are to paragraphs of plaintiffs' CC filed 4/8/02.

CIBC[5] portrays itself as a victim of the Enron debacle – a financial institution that was merely rendering ordinary banking services to Enron when it became engulfed in the Enron conflagration. But this is not what is pleaded in the CC, and what is pleaded is what controls in the motion to dismiss context.[6] What the CC pleads and what now must be accepted as true is that CIBC is liable under the 1933[7] and 1934[8] Acts because it (i) sold Enron and Enron-related securities via false Registration Statements; (ii) issued false analysts' reports on Enron; (iii) employed acts, contrivances

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[5] CIBC is an integrated financial services institution that, through subsidiaries and divisions (such as CIBC Oppenheimer or CIBC World Markets), provides commercial and investment banking services and advisory services, including acting as underwriter in the sale of corporate securities and providing investment analysis and opinions on public companies. ¶103.

[6] CIBC suggests we sued the wrong party. We think not. Since the allegations of CIBC's involvement here involve both its investment banking operations and its commercial operations, the parent corporate entity which is responsible for all the corporation's operations seems the appropriate defendant. Plaintiffs clearly allege defendant CIBC "is a large integrated financial services institution that through its controlled subsidiaries and divisions (such as CIBC Oppenheimer or CIBC World Markets (collectively "CIBC")) ... engaged and participated in the scheme to defraud purchasers of Enron securities and Enron's course of business which operated as a fraud and deceit on purchasers of Enron's securities" by rendering various services to Enron. ¶103. Moreover, "[w]hether a subsidiary is a separate entity is a question of fact." *Burnside v. Sanders Assocs., Inc.*, 507 F. Supp. 165, 166 (N.D. Tex. 1980), *aff'd,* 643 F.2d 389 (5th Cir. 1981). The issue of whether the parent corporation is responsible for acts of its subsidiaries is "heavily fact-specific." *United States v. Jon-T Chems., Inc.*, 768 F.2d 686, 694 (5th Cir. 1985). CIBC's cases are not to the contrary. *United States v. Bestfoods*, 524 U.S. 51 (1998) actually holds in certain situations, where as here, "'the alleged wrong can seemingly be traced to the parent through the conduit of its own personnel and management' and 'the parent is directly a participant in the wrong complained of.' ... [T]he parent is directly liable for its own actions." *Id.* at 64-65. Similarly, in *Abbell Credit Corp. v. Bank of America Corp.*, No. 01 C 2227, 2002 WL 335320 (N.D. Ill. Mar. 1, 2002), plaintiffs named both Bank of America Corporation and Banc of America Securities as defendants seeking to hold both defendants liable for failing to disclose that Bank of America Corporation provided a credit facility to the company which issued the commercial paper plaintiffs claimed they were deceived into buying by Banc of America Securities. The court dismissed claims against Bank of America Corporation, noting that plaintiffs' complaint "does not allege, and plaintiffs do not argue, that corporate formalities should be disregarded in this case." *Id.* at *4. Also, plaintiff Abbell failed to allege direct involvement of the parent corporation in the wrongdoing. Here, by contrast, plaintiffs clearly allege CIBC the corporate parent was directly involved and should be held liable.

CIBC also relies on *Zishka v. Am. Pad & Paper Co.*, No. 3:98-CV-0660-M, 2000 U.S. Dist. LEXIS 13300 (N.D. Tex. Sept. 13, 2000). In that case the court found plaintiffs' allegations against a bank holding company were insufficient because, according to the court, plaintiffs failed to "show how [the bank] committed the wrongdoing alleged." *Id.* at *13-*14. The court found it was not enough to allege "conclusorily" that the bank controlled or conspired with subsidiaries. *Id.* at *14. Here, by contrast, plaintiffs have provided detailed information regarding CIBC's involvement in the fraudulent scheme. *See* ¶¶103, 715-734.

[7] 15 U.S.C. §77a, *et seq.*

[8] 15 U.S.C. §78a, *et seq.*

and manipulative or deceptive devices; and (iv) participated in a scheme to defraud or a course of business that operated as a fraud or deceit on, purchasers of Enron's securities between 10/18/98 and 11/27/01 (the "Class Period").

A. Year-End 97 Crisis

The fraudulent scheme and course of business involving Enron finds its origin in mid-97 when Enron suffered huge losses on British natural gas and MTBE transactions which called into question its trading and financial risk management statistics. Analysts downgraded Enron's stock and lowered their forecasts of Enron's future earnings growth. Enron's stock lost one-third of its value and Enron's executives' performance-based bonuses were slashed. Enron was determined to halt its stock's decline and push it back to higher levels. Enron knew this could only be accomplished by reporting stronger-than-expected financial results, thus enabling it to credibly forecast stronger future earnings growth. Unfortunately, Enron's actual business operations were not capable of generating such results. ¶8.

To make matters worse, in late 12/97, Enron learned that an entity it had established with an outside investor – Joint Energy Development Incorporated ("JEDI") – and had done transactions with to generate 40% of the profits Enron reported during 97 – had to be restructured, as the outside investor was going to withdraw from JEDI. This created a crisis. Because the outside investor in JEDI had been independent of Enron, JEDI had ***not*** been consolidated into Enron's financial statements, *i.e.*, Enron did deals with JEDI as an independent party, recognized profits and did not carry JEDI's debt on its books. Thus, unless JEDI could be quickly restructured with a new, independent investor, ***Enron would have to wipe out all of the profitable transactions it had done with JEDI in 97 – put JEDI's $700 million debt on Enron's balance sheet – and lose the ability to generate profits from similar such deals with JEDI's successor going forward.*** ¶9.

However, Enron ***could not find a legitimate buyer for the outside investor's interest*** in JEDI. So Enron quickly formed a new entity – Chewco – which Enron controlled, to buy the outside investor's interest in JEDI. Chewco ***did not have an outside equity investor which was an independent third party. So, Barclays Bank loaned $240 million to Chewco to fund this purchase, requiring a secret guarantee from Enron. Barclays also loaned the money to two straw parties***

to provide for their purported "equity" investment in Chewco. Because Barclays knew that the purported equity investors in Chewco were, in fact, Enron "strawmen," Barclays required Chewco to support the purported "equity loans" Barclays made to the two "strawmen" via a $6.6 million reserve paid to Barclays! Because there was no independent outside investor in Chewco, Chewco was required to have been consolidated with Enron and ***all of Enron's 97 profits from transactions with JEDI should have been eliminated***! ¶10.

The Chewco deal avoided a disaster for Enron by keeping the previously recorded JEDI profits in place, inflating Enron's 97 reported profits and keeping millions of dollars of debt off its books. Chewco was now also positioned to serve as a controlled entity which Enron could use to do non-arm's-length transactions with, creating at least $350 million in phony profits for Enron and allowing Enron to conceal millions of dollars of debt. ***Between 98 and 01, Enron and its bankers would create numerous other secretly controlled partnerships and entities and use them to generate hundreds of millions of dollars of phony profits while concealing billions of dollars of Enron debt***. ¶11.

B. The 97-00 Successes – Enron's Stock Soars

As Enron reported ***better-than-expected year-end 97 financial results***, its stock moved higher. During 98 through mid-01, Enron appeared to evolve into an enormously profitable high-growth enterprise, reaching annual revenues of $100 billion by 00, with annual profits of $1.2 billion, presenting a very strong balance sheet that entitled it to an investment ***grade credit rating***. By 01, Enron had become the 7th largest U.S. corporation and was consistently reporting ***higher-than-forecasted earnings each quarter*** and forecasting ***continued strong growth***. ¶¶12-13. Enron extolled the success and earning power of its Wholesale Energy trading business ("WEOS"), its retail Energy Services business ("EES") and its Broadband Content Delivery and Access Trading, *i.e.*, intermediation, business ("EBS"). ¶2.

Throughout 98 and 99, as Enron reported record profits and a strong financial position, Enron in releases, reports and conversations with investors and analysts and Enron's banks – ***including CIBC*** – in analyst reports, stated (¶14(a)):

- Enron's strong results were due to the success of all of its business lines.

- Enron had a leading position in each of its businesses. Enron had an extremely strong franchise position.

- Wessex Water would be accretive to Enron's business now and a $20 billion business in five years. Azurix Corp. was becoming a major global water company.

- International projects would drive major earnings growth for Enron. The Dabhol, India power project would contribute to earnings in 99 and beyond.

- WEOS's business remained strong.

- EES was exceeding expectations for contracts and profitability. EES was adding billions in new contracts and would be profitable by 4thQ 00.

- Enron was optimistic about its broadband business. EBS was firing on track.

- Enron's tremendous competitive advantages enabled it to achieve strong EPS growth.

- Enron was very well managed and knew how to manage and mitigate risk. Enron had effectively used off-balance sheet non-recourse financing. Enron had a strong balance sheet. Enron was a master of risk management.

- No other company offered such impressive sustainable growth.

- Enron was hitting on all eight cylinders. Enron's outlook was excellent. Enron was very optimistic.

- Enron was a global powerhouse, with EPS growth to exceed 17%. Enron would maintain strong earnings growth for years.

During 00, as Enron reported record annual profits and a very strong financial position, Enron and its banks – ***including CIBC*** – stated (¶14(b)):

- Enron's strong financial results were due to strong results in all operations.

- Enron had very strong momentum. Its new trends were sustainable and would accelerate.

- Enron's business was booming. All its operations were gaining momentum.

- Investors were about to see breakout performance of EES and rapid growth and development of EBS.

- EES's new contracts and profitability were accelerating. EES had the potential to double Enron's size in a few years.

- EBS broadband trading was accelerating. The market was larger than expected, and would reach $100 billion in a few years with 3%-4% margins.

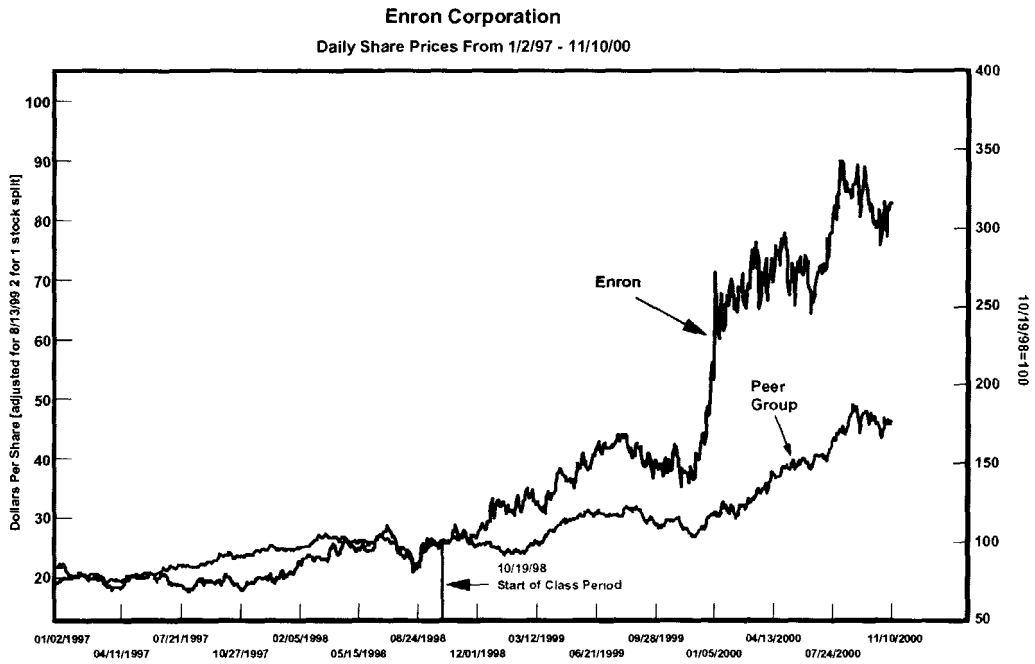
- Enron/Blockbuster video-on-demand ("VOD") deal a "killer app." Unparalleled quality of service. Contract worth over $1 billion. VOD to rollout nationally in 01. All components in place. VOD had solid technology and platform.

- Enron's WEOS merchant investments were protected through hedging.

- Enron had monumental earnings potential over the next five years. Enron was well managed and a pioneer in global energy. Enron was never in better shape. Enron was very optimistic about the continued strong outlook for the Company.

- Growth and strong earnings were why investors should buy Enron stock.

As a result of Enron's strong earnings, the positive statements about its business and the forecasts of continuing strong earnings growth, Enron's stock was a very strong performer. ¶15. Enron's apparent success and forecasts of strong profit growth gave Enron and its banks ready access to the capital markets by which they raised billions of dollars by selling newly issued Enron securities to public investors, using the proceeds to repay Enron's bank debt. ¶16. Enron's stock soared to its all-time high of $90-3/4 in 8/00 and then continued to trade at or near these levels for months, as shown below (¶15):



However, the apparent success of Enron was an illusion – a false picture created by contrivances and deceptive acts – a fraudulent scheme and course of business by defendants that operated as a fraud and deceit on the purchasers of Enron's publicly traded securities. The fraudulent scheme was accomplished by, *inter alia*, Enron and several banks, including CIBC, which pocketed millions of dollars a year from Enron – which by 97-98 had become the ***golden goose of Wall Street***. ¶17.

Inside Enron there was a fixation on Enron's stock and doing whatever was required to generate the financial results necessary to push the stock ever higher. Throughout Enron's corporate headquarters in Houston were TV monitors that displayed the price of Enron stock. Inside Enron there was a saying that managers were to be "***ABC***ing," meaning to "***a***lways ***b***e ***c***losing" deals to generate revenues and profits, even if the economics of the deal were suspect – a practice facilitated by a compensation system inside Enron for corporate managers and executives that directly rewarded them financially for ***closing*** transactions and placing a high (*i.e.*, inflated) value on them, regardless of the true economic substance of the deal, so long as the deal generated an apparent profit when "marked to market." ¶50.

Inside Enron, the pressures applied to corporate managers by the top executives to do anything necessary to enable Enron to make its numbers was widespread, as was the knowledge that Enron's revenues and earnings were being falsified. Former insiders have been quoted as saying "***[y]ou don't object to anything***" and "***[t]he whole culture at the vice-president level and above just became a yes-man culture***."

> But that culture had a negative side beyond the inbred arrogance. ***Greed was evident, even in the early days. "More than anywhere else, they talked about how much money we would make," says someone who worked for Skilling. Compensation plans often seemed oriented toward enriching executives rather than generating profits for shareholders. For instance, in Enron's*** energy services division, which managed the energy needs of large companies like Eli Lilly, executives were compensated based on a market valuation formula that relied ***on internal estimates. As a result, says one former executive, there was pressure to, in effect, inflate the value of the contracts – even though it had no impact on the actual cash that was generated.***

Fortune, 12/24/01 (¶51).

> ***"If your boss was [fudging], and you have never worked anywhere else, you just assume that everybody fudges earnings," says one young Enron control person. "Once you get there and you realized how it was, do you stand up and lose your job? It was scary. It was easy to get into 'Well, everybody else is doing it, so maybe it isn't so bad.'"***
>
> * * *
>
> ***The flaw only grew more pronounced as Enron struggled to meet the wildly optimistic expectations for growth it had set for itself. "You've got someone at the top saying the stock price is the most important thing, which is driven by earnings," says one insider. "Whoever could provide earnings quickly would be promoted."***

> ***The employee adds that anyone who questioned suspect deals quickly learned to accept assurances of outside lawyers and accountants. She says there was little scrutiny of whether the earnings were real or how they were booked. The more people pushed the envelope with aggressive accounting, she says, the harder they would have to push the next year. "It's like being a heroin junkie," she said. "How do you go cold turkey?"***

Business Week, 2/25/02 (¶51). In fact, in mid-8/01, an Enron executive (who was a former Andersen accountant) wrote Lay, telling him the Company was "***nothing but an elaborate accounting hoax***," and, in referring to the SPE transactions which Enron's banks – including CIBC – had structured and funded, that nothing "***will protect Enron if these transactions are ever disclosed in the bright light of day***" – warning that many employees believed "***[W]e're such a crooked company***." ¶51.

By 97-98, Enron was a hall of mirrors inside a house of cards – reporting hundreds of millions of dollars of phony profits, while concealing billions of dollars of debt that should have been on its balance sheet – inflating its shareholder equity by billions of dollars. Enron had turned into the largest Ponzi scheme in history – constantly raising fresh money by selling its securities or those of related entities, while appearing to achieve successful growth and profits. But, because Enron's reported profits were being generated by phony, non-arm's-length transactions and improper accounting tricks – including the abuse of "mark-to-market" accounting[9] to accelerate the recognition of hundreds of millions of dollars of profits to ***current periods*** from transactions in which Enron was only entitled to receive ***cash over many future years*** – Enron was cash starved. Yet to continue to

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[9] Enron engaged in several accounting tricks and manipulations to falsify its financial results during the Class Period. Chief among these was the abuse of "***mark-to-market accounting***" whereby Enron computed the purported profit it would ultimately obtain on a multi-year contract, discount that to present value and recognize the entire "mark-to-market" profit in the current period. Enron misused and abused mark-to-market accounting ***throughout its entire business to grossly inflate its reported revenues and profits***. In Enron's WEOS business this was done by assigning unrealistic values to wholesale energy transactions which inflated current period income. In Enron's EES business where Enron had no long-term track record to justify the use of mark-to-market accounting, Enron nevertheless consistently utilized mark-to-market accounting to record huge current period profits on long-term, highly speculative retail energy risk-management contracts which, in fact, Enron had no basis to project a profit on and in fact knew would likely result in losses. Finally, in Enron's EBS business – also a new business where Enron had absolutely no track record which would justify the use of mark-to-market accounting – Enron utilized mark-to-market accounting to generate hundreds of millions of dollars of phony current period profits in several transactions. Also, when reviewing those computations on a quarterly basis as it was required to do, Enron consistently ***increased*** the estimated value of the transaction even though subsequent data revealed ***a reduction of the estimated value of the transaction, a practice known within Enron as "moving the curve***." ¶36.

report ***growing*** profits, Enron was forced to not only continue to engage in such transactions and accounting abuses, ***but to accelerate the number and size of such transactions it engaged in***. This created a vicious cycle further exacerbating Enron's need to obtain cash from these transactions. To make matters worse, with the help of CIBC, Enron had capitalized certain controlled entities it was doing phony deals with (including entities CIBC was funding), with shares of Enron stock and ***had agreed to issue millions of additional shares of its stock to these entities if Enron's stock price declined below certain "trigger prices,"*** *i.e.*, $83, $81, $79, $68, $60, $57, $52, $48, $34 and $19 per share, ***and to become liable for the debt of those entities if Enron lost its investment grade credit rating***. Because of the "triggers" and the way Enron capitalized these entities, it was absolutely vital to Enron, CIBC and the other participants in the fraudulent scheme and course of business that Enron's stock continue to trade at high levels and that Enron maintain its "investment grade" credit rating, otherwise the scheme would unravel. ¶¶18, 20.[10]

Enron became completely dependent on maintaining its investment grade credit rating and a high stock price so that Enron could continue to have access to the capital markets to borrow billions in commercial paper and to enable it to periodically raise hundreds of millions of dollars of new longer term capital it needed to repay its commercial paper debt and the short-term loans it was receiving from its banks – including CIBC – to sustain its business operations and so the stock issuance "triggers" would not be hit which would force Enron into a death spiral. ¶20.

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[10] Enron's investment grade credit rating was indispensable. As Enron's CFO stated in a 10/01 conference call, "***We understand that our credit rating is critical to both the capital markets as well as our counterparties***." Earlier, Fastow stated to *CFO Magazine*, "***My credit rating is strategically critical***." This investment grade credit rating gave Enron access to the commercial paper market – a market reserved for America's largest and most creditworthy corporations – so that it could borrow billions of dollars to maintain its liquidity and finance its capital-intensive business. Enron's access to the commercial paper market also meant that Enron's $3 billion commercial paper back-up credit line, arranged by the lead banks (JP Morgan and CitiGroup) with CIBC as a participating bank, ***would likely not be drawn down upon***, thus limiting those banks' financial exposure to Enron. It also meant that Enron and its banks could easily sell debt securities to investors to raise long-term capital, using the proceeds to reduce short-term commercial paper and other bank debt. Enron's investment grade credit rating was critical to the scheme, as only Enron's insiders and its banks knew, because under the terms of the partnership/SPE deals, ***if Enron's debt was downgraded to below investment grade, the debt of those entities would become recourse to Enron, which could cause the house of cards to topple***. ¶19.

C. The Partnerships and SPEs

To falsify Enron's reported financial results, Enron and its banks engaged in a series of purported "partnership" and "related party" transactions with the entities known as SPEs. A public company that conducts business with an SPE may treat that SPE as if it were an independent entity ***only if it does not control the SPE. And***, at a bare minimum, two other conditions must be met: (i) an owner independent party must make an equity investment of ***at least 3% of the SPE's assets, which must remain at risk throughout the transaction***; and (ii) ***the independent party must exercise control of the SPE***. ¶21.

In 99, Enron and several of Enron's banks created two ***LJM partnerships (LJM and LJM2), which Enron secretly controlled. Enron then engaged in numerous non-arm's-length transactions – manipulative or deceptive contrivances – with the LJM partnerships and associated SPEs, which inflated Enron's reported profits by more than a billion dollars – at the same time enriching Enron's CFO (Fastow) and his friends and all of Enron's banks or bankers named as defendants – including CIBC or its top executives – who had been secretly allowed to invest in the LJM2 partnership as a reward for their participation in the scheme – by hundreds of millions of dollars. The reason for establishing these partnerships was that they would permit Enron to accomplish transactions it could not otherwise accomplish with an independent entity, by providing Enron with a buyer of assets that Enron wanted to sell***. ¶¶23, 29, 646-647.

Thus, LJM2 was one of the primary vehicles used to falsify Enron's financial results during 99-01, which was secretly controlled by Enron and used to create numerous SPEs (including the infamous "Raptors") which engaged in numerous non-arm's-length fraudulent transactions with CIBC to artificially inflate Enron's profits while concealing billions of dollars of its debt on terms so unfair to Enron that the deals would provide huge returns to the LJM2 investors. ¶24. Because the LJM2 partnership was going to be so lucrative to investors in that entity ***and provide exceptional returns as the Enron Ponzi scheme continued***, Enron decided that in funding LJM2, it would ***allow certain favored bank officers or the banks themselves get in on LJM2***. The LJM2 partnership offering memorandum by which Enron brought investors into the partnership – ***which was not a public document*** – contained an invitation to benefit from the self-dealing transactions that LJM2

would engage in. It emphasized Fastow's position as Enron's CFO, and that LJM2's day-to-day activities would be managed by Fastow and other Enron insiders. It explained that "***[t]he Partnership expects that Enron will be the Partnership's primary source of investment opportunities***" and that it "***expects to benefit from having the opportunity to invest [some $150 million] in Enron-generated investment opportunities that would not be available otherwise to outside investors***." It specifically noted that Fastow's "***access to Enron's information pertaining to potential investments will contribute to superior returns." In addition, investors were told that investors in a similar Fastow controlled partnership (JEDI) that had done deals with Enron like the ones LJM2 would do had tripled their investment in just two years and that overall returns of 2,500% to LJM2 investors were actually anticipated***. ¶25. Enron and CIBC knew that because LJM2 was going to engage in transactions ***with Enron where Enron insiders (especially Enron's CFO Fastow) would be on both sides of the transactions, the LJM2 partnership would be extremely lucrative – a deal that was virtually guaranteed to provide huge returns to LJM2's investors as the Enron Ponzi scheme went forward***. ¶24.[11] In short, the non-public offering memorandum was an invitation to join in the benefits of non-arm's-length self-dealing transactions with Enron – to loot Enron and share in the fruits of that looting. ***Enron's bankers and the top executives of those banks – including CIBC – were permitted to invest in LJM2, as a reward to them for their ongoing participation in the scheme – a sure thing for them***. ¶25.[12]

It was indispensable to the scheme that LJM2 be funded at year-end 99 to serve as a vehicle to consummate several deals with Enron before year-end 99 to create huge profits for Enron in the 4thQ 99 so that Enron could meet and exceed its forecasted 99 earnings. However, as had been the

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[11] In fact, Fastow's dual role by which he could self-deal on behalf of the LJM2 partnership with Enron's assets was so important ***that investors in LJM2 were assured that they did not have to make any additional capital contributions if Fastow's dual role ended***. ¶24.

[12] While Enron's publicly filed reports disclosed the existence of the LJM partnerships, these disclosures did not reveal the essence of the transactions completely or clearly, and failed to convey the substance of what was going on between Enron and the partnerships. The disclosures also did not fully disclose the nature or extent of Fastow's financial interest in the LJM partnerships. This was the result of an effort to avoid disclosing Fastow's financial interest and to downplay the significance of the related-party transactions and to disguise their substance and import. The disclosures also represented that the related-party transactions were reasonable compared to transactions with third parties when, in fact, they were not. ¶67.

case with Chewco at year-end 97, there was tremendous time pressure and Enron (and Merrill Lynch, which was raising the LJM2 equity money) could not complete the formation of LJM2 and raise money from the equity investors in LJM2 by year-end 99 with sufficient capital to enable it to do the desperately needed year-end transactions with Enron. So, in an extraordinary step, on 12/22/99, CIBC (or top executives of CIBC) via CIBC Capital Corporation, even though LJM2 had not yet been fully formed or funded or received the minimum ***required*** capital contribution commitments from investors, but knowing that LJM2 was going to be an extraordinarily lucrative investment anyway, advanced $2,250,000 to "pre-fund" LJM2, *i.e.*, many times more than their allocated shares in LJM2. ¶26. The reason the banks – including CIBC – put up the money to pre-fund LJM2 in 12/99 was that they knew enabling Enron to do the 99 year-end deals with LJM2 and its SPEs was indispensable to Enron avoiding reporting a very bad 4thQ 99 – which would have caused its stock to plunge. These vital year-end 99 deals included:

(a) ***Collateralized Loan Obligations ("CLOs"). On 12/22/99***, Enron pooled purchaser CLO rights and sold the lowest-rated tranche to Whitewing LLP (an Enron affiliate) and LJM2. Whitewing loaned LJM2 the money to purchase its interest in the CLOs. Enron secretly guaranteed Whitewing's investment and loan to LJM2. This transaction allowed Enron to record the sale of millions of dollars in the 4thQ 99 to an entity that should have been consolidated.

(b) ***Nowa Sarzyna (Poland Power Plant). On 12/21/99***, Enron sold LJM2 a 75% interest in the Nowa Sarzyna power plant. Enron had tried to sell this interest by year-end to an independent buyer but could not find an independent buyer in time, so it used LJM2, which paid $30 million. This transaction moved millions of dollars of debt off Enron's balance sheet. This was a sham transaction. The debt financing required Enron to maintain ownership of at least 47.5% of the equity until the project was completed. However, the lender ***granted a waiver*** of this until 3/31/00, at which time Enron and Whitewing reacquired LJM2's equity interest and repaid that loan.

(c) ***MEGS, LLC. On 12/29/99***, Enron sold LJM2 a 90% equity interest in MEGS, a natural gas system in the Gulf of Mexico. This allowed Enron to avoid consolidating the asset at year-end 99, avoiding millions of dollars of debt on Enron's balance sheet. Enron repurchased LJM2's interest in MEGS in early 00.

(d) ***Yosemite. On 12/29/99***, Enron purportedly sold certificates in Yosemite to LJM2, however, in fact, this transaction did not occur until 2/28/00. The transaction was made to appear to occur at year-end 99 to reduce Enron's interest in Yosemite from 50% to 10% so Enron would not have to disclose its ownership of these certificates in Enron's 99 financial statements and that, in effect, Enron owned some of its own debt. On 12/29/99, Condor (an affiliate of Whitewing), which was controlled by Enron, loaned the $35 million to LJM2 to buy the certificates. On 12/30/99, LJM2 transferred the certificates to Condor, satisfying the one-day loan. ¶28.

From 6/99 through 6/01, Enron entered into numerous non-arm's-length fraudulent transactions with the LJM partnerships. Enron sold assets to LJM that it wanted to get off its books on terms that no independent third party would ever have agreed to. ***The transactions between the LJM partnerships and Enron or its affiliates occurred close to the end of financial reporting periods to artificially boost reported results to meet forecasts Enron and other participants in the scheme had been making***. For instance, near the end of the 3rd and 4thQ 99, Enron sold interests in seven assets to LJM1 and LJM2. The transactions permitted Enron to conceal its true debt levels by removing the assets from Enron's ***balance sheet and, at the same time, record large gains. However, (i) as it had agreed in advance it would do, Enron bought back five of the seven assets after the close of the financial reporting period; (ii) the LJM partnerships made large profits on every transaction, even when the asset they had purchased actually declined in market value; and (iii) those transactions generated "earnings" for Enron of $229 million in the second half of 99 out of total earnings for that period of $549 million. In three of these transactions where Enron ultimately bought back LJM's interest, Enron had agreed in advance to protect the LJM partnerships against any loss. Thus, the LJM partnerships functioned only as vehicles to accommodate defendants in the manipulation, falsification and artificial inflation of Enron's reported financial results, while enriching the LJM investors***, including CIBC or its top executives via the looting of Enron. ¶32.[13]

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[13] The returns to the LJM2 investors were huge – up to 2,500% on one deal and 51% overall ***in the first year*** of the partnership. ***Skilling has recently told investigators such gargantuan returns were possible only because LJM2, with Fastow at the wheel, was defrauding Enron in the billions of dollars of deals it was doing with Enron so Enron could create false profits and hide***

One "hedging" transaction with LJM in 6/99 involved Rhythms NetConnections ("Rhythms") stock owned by Enron, ***to "hedge" Enron's huge gains in Rhythms stock and enable Enron to create a huge profit. Enron transferred its own stock to the SPE in exchange for a note. But if the SPE were required to pay Enron on the "hedge," the Enron stock would be the source of payment. Other "hedging" transactions occurred in 00 and 01 and involved SPEs known as the "Raptor" vehicles. These were also structures, funded principally with Enron's own stock, that were intended to "hedge" against declines in the value of certain of Enron's merchant investments. These transactions were not economic hedges. They actually were manipulative or deceptive devices devised to circumvent accounting rules. The economic reality was that Enron never escaped the risk of loss, because it had provided the bulk of the capital with which the SPEs would pay Enron***. Enron and Enron's banks used these contrivances and manipulative or deceptive devices to inflate Enron's reported financial results. In 99, Enron recognized income of over $100 million from the Rhythms "hedging" transaction. ***In the last two quarters of 00, Enron recognized pre-tax earnings of $530 million on several transactions with the Raptor entities*** out of reported pre-tax earnings of $650 million. These ***"earnings" from the Raptors' manipulative contrivances accounted for more than 80% of the total***! ¶33.

Hedging Enron's investments with the value of Enron's stock created an enormous and unusual motive for the participants in the scheme to keep Enron stock trading at inflated levels. This was because if the value of Enron stock fell, the SPEs would be unable to meet their obligations and the "hedges" would fail. This happened in late 00 and early 01. In 12/00, Enron's gain (and the Raptors' corresponding net loss) on these transactions was over $500 million. Enron could recognize these gains – offsetting corresponding losses on the investments in its merchant portfolio – ***only if the Raptors had the capacity to make good on their debt to Enron***. If they did not, Enron would be required to record a "credit reserve," a loss that would defeat the very purpose of the Raptors, which was to shield Enron from the decline in value of its merchant investments. ¶34.

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billions of dollars in debt. Kurt Eichenwald, "Enron Ex-Chief Said to Voice Suspicion of Fraud," *New York Times*, 4/24/02.

As year-end 00 approached, two of Enron's Raptor SPEs were in danger of coming unwound as they lacked sufficient credit capacity to support their obligations. If something were not done to prevent the unwinding of these SPEs, Enron would have to take a multi-million dollar charge against earnings which would expose the prior falsification of Enron's financial results and result in Enron's stock plunging, more and more of the stock issuance "triggers" would be hit, and a vicious fatal down-cycle would kick in. Therefore, Enron restructured and capitalized the LJM2-financed Raptor SPEs at year-end 00 by transferring to them rights ***to receive even more shares*** of Enron stock, creating ever-increasing pressure on Enron and the other participants in the scheme to support Enron's stock price. This artifice enabled Enron to avoid recording a huge credit reserve for the year ending 12/31/00. ¶35.

Thus, these favored investors in LJM2 – like CIBC or its top executives – actually ***witnessed*** a series of extraordinary pay outs from the Raptor SPEs which LJM2 controlled over the next two years – securing hundreds of millions of dollars in distributions from the Raptors to LJM2 and ***then to themselves*** – cash generated by the illicit and improper transactions Enron was engaging in – *i.e.*, the manipulative or deceptive devices – with the Raptors to falsify Enron's financial results. Thus, the banks and bankers – like CIBC or its top executives – who were partners in LJM2 ***were not only knowing participants in the Enron scheme to defraud, they were economic beneficiaries of it – and of the looting of Enron. Had the Enron Ponzi scheme continued to operate for the full life of the LJM2 partnership, Enron's banks would have achieved the stupendous returns they were promised – measured in thousands of percent. And these actual and potential payments from LJM2 were on top of the huge advisory fees, underwriter fees, interest and loan commitment fees these banks were already getting from Enron and would continue to get if the Enron scheme continued***. ¶31.

D. Enron Energy Services ("EES")

The falsification of Enron's financial statements was not limited to non-arm's-length fraudulent partnership and SPE transactions. While Enron's Wholesale Energy business was the largest single contributor to its profits, Enron and its banks – including CIBC – were also telling investors that an area of tremendous growth for Enron was its retail Energy Services business – EES

– whereby Enron purportedly undertook to manage the energy needs of corporate consumers for multi-year periods in return for fees to be paid over a number of years. Enron and its banks presented this business as achieving tremendous success by constantly signing new multi-million or even billion dollar contracts which allowed EES to exceed internal forecasts and that this division had turned profitable in the 4thQ 99 and was achieving substantial gains in its profitability thereafter. ¶37.

However, EES was actually losing hundreds of millions of dollars. This was because in order to induce large enterprises to sign long-term energy management contracts and "jumpstart" this business so it could appear to obtain huge contract volumes, Enron was entering into EES management contracts which it knew would likely result in huge losses. However, by the abuse of mark-to-market accounting, Enron grossly overvalued the ultimate value of these contracts and created greatly inflated current period profits from transactions which generated little, if any, current period cash, and which would likely actually result in long-term cash out plans and losses. As a letter written in 8/01 to Enron's Board by an EES manager stated just after Skilling "resigned"(¶38):

> One can only surmise that the removal of Jeff Skilling was an action taken by the board to correct the wrongdoings of the various management teams at Enron .... (*i.e.*, ***EES's management's ... hiding losses/SEC violations***).
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> * * *
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> ... [I]t became obvious that EES had been doing deals for 2 years and was losing money on almost all the deals they had booked.
>
> * * *
>
> ... [I]t will add up to over $500MM that EES is losing and trying to hide in Wholesale. Rumor on the 7th floor is that it is closer to $1 Billion.... [T]hey decided ... to hide the $500MM in losses that EES was experiencing.... ***EES has knowingly misrepresented EES['s] earnings. This is common knowledge among all the EES employees, and is actually joked about. But it should be taken seriously.***

E. Enron Broadband ("EBS")

Another purported growth area of Enron's business was its broadband services business – EBS – which consisted of constructing an 18,000-mile fiber optic network which Enron was supposedly successfully building out and engaging in trading access to Enron's and others' fiber optic cable capability, *i.e.*, "Broadband Intermediation." Enron and its banks presented ***both parts*** of

Enron's broadband business as poised to achieve, and later as actually achieving, huge success, reporting that its fiber optic network was being or had been successfully constructed, was state of the art and provided unparalleled quality of service, and that its broadband trading business was succeeding and achieving much higher trading volume and revenues than expected – *i.e.*, "***exponential growth***." ¶39.

A prime example of the purported success of Enron's broadband content business was its VOD joint venture with Blockbuster Entertainment, announced in 7/00. Enron presented this 20-year agreement as having a ***billion dollar value***, that it was a ***first-of-its-kind product*** whereby consumers would obtain VOD content from Blockbuster in their home as if they were watching the movie on their own VCR (start, stop, rewind) and that this incredible advance in technology was made possible due to the ***high quality of Enron's fiber optic network***. Abusing mark-to-market accounting, with the help of CIBC, ***which purportedly invested in the deal but secretly got a no-loss guarantee from Enron***, Enron recognized an astonishing $110+ million profit on this deal in the 4thQ 99 and 1stQ 00, even though the project was failing in its test markets because Enron did not have the technology to deliver the product as represented – and which could never have gone forward because Blockbuster did not have the legal right to deliver movies in a digital format, the only format which could be utilized for VOD. ¶40.[14]

F. New Power

Another example of how Enron and CIBC falsified Enron's reported results is the New Power IPO in 10/00, by which Enron improperly created a $370 million profit in the 4thQ 00. Enron controlled New Power and owned millions of shares of New Power stock. If Enron and its banks could take New Power public and create a trading market in its stock, Enron could recognize a profit

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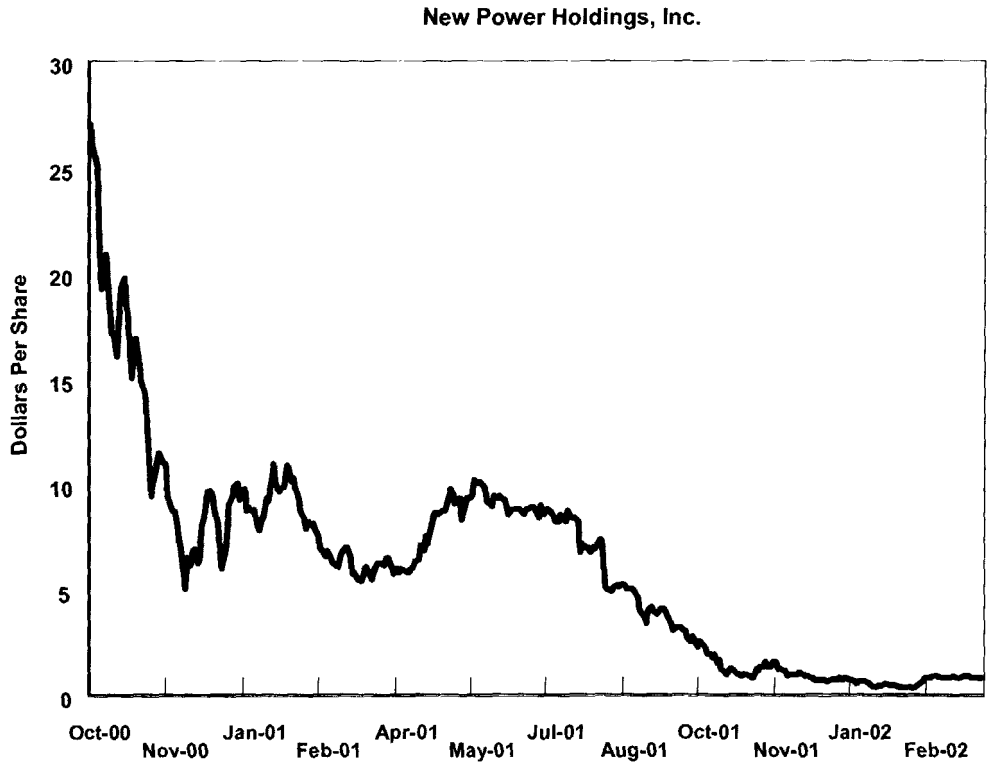
[14] Just eight months after announcing this contract with great fanfare and just weeks after representing that testing of the system in four cities had ***succeeded*** and that the service was being launched nationwide, Enron was forced to abandon the venture. But Enron did not reverse the huge profits it had secretly recorded on this transaction, for to do so would have not only exposed its ongoing abuse and misuse of mark-to-market accounting, but also would have crushed Enron's stock at a time when Enron and the other participants in the scheme were desperately attempting to halt Enron's then falling stock price so that it would not fall below certain trigger prices. CIBC did not force Enron to honor its secret guarantee against losses, as it knew to do so would undermine Enron's fragile financial condition, but rather, carried it as part of its overall exposure to Enron. ¶41.

on the gain in value on its shares by "hedging" that gain via yet another non-arm's-length transaction via LJM2. In the 4thQ 00, Enron desperately needed to create profits to perpetuate the Ponzi scheme. Enron and CIBC did the New Power IPO – 27.6 million shares at $21 per share in 10/00. Then, in a deal secretly structured with CIBC before the IPO, Enron created a phony profit using an LJM2 SPE called Hawaii 125-0. CIBC (and several other of Enron's banks) made a "loan" of $125 million to Hawaii 125-0, ***but secretly received a "total return swap" guarantee to protect CIBC and the other banks against any loss from Enron***. Enron transferred millions of New Power warrants to Hawaii 125-0 to "secure" the banks' loan and thus created a huge $370 million "profit" on the purported gain on the New Power warrants. Hawaii 125-0 simultaneously supposedly "hedged" the warrants with another entity created and controlled by Enron called "Porcupine." To supposedly capitalize Porcupine, LJM2 put $30 million into Porcupine to facilitate the so-called hedge of the New Power warrants, but, one week later, Porcupine paid the $30 million back to LJM2 plus a $9.5 million profit – leaving Porcupine with no assets. New Power stock immediately fell sharply, as the chart below shows:



This collapse converted Enron's huge gain on its New Power equity holdings into a huge loss early in 01 – a loss of about $250 million – which was concealed. ¶42.[15]

G. Enron's Access to the Capital Markets

Enron required constant access to huge amounts of capital. For Enron to continue to appear to succeed it had to keep its investment grade credit rating and keep its stock price high. Enron's investment grade credit rating and high stock price could ***only*** be maintained by (i) limiting the amount of debt shown on Enron's balance sheet; (ii) reporting strong current period earnings; ***and*** (iii) forecasting strong future revenue and earnings growth. Yet Enron was able to achieve these ends only by pursuing an increasing number of phony transactions, many of which were accomplished by increasing the number and size of transaction entities which were supposedly independent of Enron but which, in fact, Enron controlled through a series of secret understandings and illicit financing arrangements, including LJM2. As a result of reporting strong earnings, the apparent success of its business and its future earnings growth forecasts, Enron had unlimited access to the capital markets, borrowing billions of dollars in the commercial paper markets and by selling billions of dollars of Enron securities to the public. Enron and its bankers raised over $6 billion in new debt and equity capital for Enron or associated entities through numerous securities offerings,

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[15] After LJM2 was formed, CIBC and/or its top executives had secretly been permitted to invest in LJM2 and was engaging in other illicit transactions with Enron to boost its profits and hide its debts, like Braveheart and Hawaii 125-0, CIBC continued to issue very positive analyst reports on Enron. Each of these reports contained "boilerplate" disclosures like:

> We may from time to time have long or short positions in any buy and sell securities referred to herein. The firm may from time to time perform investment banking or other services for, or solicit investment banking or other business from, any company mentioned in this report.

These boilerplate disclosures did not change after CIBC and/or its top executives became huge investors in LJM2 or engaged in, financed or facilitated other illicit transactions with Enron, its controlled partnerships or their SPEs to boost Enron's reported profits and/or hide billions of dollars of debt. The failure to disclose the LJM2 investments of these banks and/or their top executives or the banks' other transactions with Enron to boost its profits or enable it to hide debt and made their "boilerplate" disclosures false and misleading and ***concealed from the market the very significant and serious conflict of interests between Enron and the banks which they knew would have cast serious doubts on the objectivity and honesty of those banks' analyst reports and disclosed that the banks or their executives had compromising ties to and serious conflicts of interest regarding Enron.*** ¶29.

thus raising the capital necessary to allow Enron to repay or pay down its short-term debt and continue to operate. The Enron offerings involving CIBC are shown below (¶48):

ENRON SECURITIES UNDERWRITINGS		
Banks Named As Defendants	**Date of Offering**	**Security Sold**
CS First Boston Lehman Brothers Merrill Lynch ***CIBC*** JP Morgan Bank America	05/98	35 million shares of common stock at $25 per share raising $850 million for Enron
JP Morgan CS First Boston Lehman Brothers Merrill Lynch ***CIBC*** CitiGroup	02/99	27.6 million shares of common stock at $31.34 raising $870 million for Enron
Lehman Brothers Bank America ***CIBC***	05/19/99	$500,000,000 7.375% Notes due 5/15/2019

Some of the offerings of the associated entities involving CIBC are shown below (¶49):

ENRON-RELATED SECURITIES UNDERWRITINGS		
Banks Named As Defendants	**Date of Offering**	**Security Sold**
CS First Boston CitiGroup ***CIBC***	10/00	27.6 million shares New Power at $21 per share enabling Enron to book a $370 million phony profit
CS First Boston Deutsche Bank Bank America ***CIBC*** JP Morgan	7/01	$1 billion 6.31% and 6.19% Marlin Water Trust II and Marlin Water Capital Corp. II Notes

H. Late 00/Early 01 Prop-Up

In late 00/early 01, Enron's financial results began to come under scrutiny from a few accounting sleuths and short-sellers, who began to question the quality of Enron's reported financial results. While Enron, its top insiders and its bankers – including CIBC – assured investors of the correctness of Enron's accounting and the high quality of Enron's reported earnings, the success and strength of its business and its solid prospects for continued strong profit growth, in part because of

this increasing controversy, Enron's stock began to decline. As this price decline accelerated, it put pressure on Enron's top executives to do something – anything – to halt the decline in the price of the stock as they knew that if that price decline continued and the stock fell to lower levels, more and more of the Enron stock "triggers" contained in agreements for deals with entities controlled by LJM2 would be triggered, ***which would require Enron to issue over 100 million shares of its common stock to those partnerships, causing a huge reduction in Enron's shareholders' equity.*** ¶52.

In late 3/01, inside Enron it appeared that Enron would be required to take a pre-tax charge against earnings of more than $500 million to reflect a shortfall in credit capacity of the LJM2-financed Raptor SPEs, which would have been catastrophic and exposed the scheme. Rather than take that loss and face these consequences, Enron and certain of Enron's banks "restructured" the LJM2-financed Raptor vehicles by transferring ***more than $800 million of contracts to receive Enron's own stock to them just before quarter-end, which permitted the participants in the scheme to conceal substantial losses in Enron's merchant investments, keep billions of dollars of debt off Enron's balance sheet and allowed the Enron Ponzi scheme to continue.*** ¶53.

During early 01, Enron continued to report record results and it and its bankers – ***including CIBC*** – continued to make very positive statements (¶54):

- Enron's strong results reflected breakout performance in all business units. Enron was a strong unified business.
- WEOS had strong growth and a tremendous market franchise with significant sustainable competitive advantages.
- EBS intermediation was great. Broadband glut and lowered prices ***would help Enron***.
- VOD was successfully tested and launched. Proven technology created enormous opportunities.
- All of Enron's businesses were generating high levels of earnings. Fundamentals were improving. Enron was very optimistic. Enron was confident growth was sustainable for years to come.

I. The Impending Collapse

By the Summer of 01, Enron realized that it would not be able to continue to sustain the illusion of strong profitable growth and that it would have to take large write-offs in the second half

of 01 that, in turn, could result in a downgrade of Enron's critical investment grade credit rating – an event that they knew would mean that debt on the books of the SPEs Enron did business with (and partnerships controlled by them), which debt Enron had assured investors was "***non-recourse***" to Enron would, in fact, become Enron's obligation. ¶55.

On 8/14/01, Enron announced that Skilling – who had become Enron's CEO just months earlier – was resigning, for "***personal reasons***." While this resignation fanned the controversy over the true nature of Enron's finances and the condition of Enron's business, Enron and its banks – including CIBC – lied to investors, telling them that Skilling's resignation was only for personal reasons and did not raise "***any accounting or business issues of any kind***" and that Enron's financial condition "***had never been stronger***" and its "***future had never been brighter***." They said there was "***nothing to disclose***," Enron's "***numbers look good***," there were "***no problems***" or "***accounting issues***." According to them, the Enron "***machine was in top shape and continues to roll on – Enron's the best of the best***." ¶57.

J. The End

By 8/01, inside Enron management employees were complaining to Enron's Board that the fraud at Enron was so widespread it was out of control. In 8/01, two employees complained to the Board (¶59):

A. One employee wrote:

> Skilling's abrupt departure will raise suspicions of accounting improprieties and valuation issues. Enron has been very aggressive in its accounting – most notably the Raptor transactions and the Condor vehicle. We do have valuation issues with our international assets and possibly some of our EES MTM positions.
>
> * * *
>
> We have recognized over $550 million of fair value gains on stock via our swaps with Raptor, much of that stock has declined significantly – Avici by 98%, from $178 mm to $5 mm. The New Power Co. by 70%, from $20/share to $6/share. The value in the swaps won't be there for Raptor, so once again Enron will issue stock to offset these losses. Raptor is an LJM entity. It sure looks to the layman on the street that we are hiding losses in a related company and will compensate that company with Enron stock in the future.
>
> ***I am incredibly nervous that we will implode in a wave of accounting scandals.... [T]he business world will consider the past successes as nothing but an elaborate accounting hoax....***

[W]e booked the Condor and Raptor deals in 1999 and 2000, we enjoyed a wonderfully high stock price, many executives sold stock, we then try and reverse or fix the deals in 2001 and it's a bit like robbing the bank in one year and trying to pay it back 2 years later. Nice try, but investors were hurt, they bought at $70 and $80/share looking for $120/share and now they're at $38 or worse. We are under too much scrutiny and there are probably one or two disgruntled "redeployed" employees who know enough about the "funny" accounting to get us in trouble.

* * *

I realize that we have had a lot of smart people looking at this .... ***None of that will protect Enron if these transactions are ever disclosed in the bright light of day....***

* * *

I firmly believe that the probability of discovery significantly increased with Skilling's shocking departure. Too many people are looking for a smoking gun.

* * *

3. ***There is a veil of secrecy around LJM and Raptor. Employees question our accounting propriety consistently and constantly....***

   a. Jeff McMahon was highly vexed over the inherent conflicts of LJM. ***He complained mightily to Jeff Skilling*** .... 3 days later, Skilling offered him the CEO spot at Enron Industrial Markets ....

   b. ***Cliff Baxter complained mightily to Skilling and all who would listen about the inappropriateness of our transactions with LJM.***

   c. I have heard one manager level employee ... say "***I know it would be devastating to all of us, but I wish we would get caught. We're such a crooked company."... Many similar comments are made when you ask about these deals....***

   B. A second employee wrote:

One can only surmise that the removal of Jeff Skilling was an action taken by the board to correct the wrong doings of the various management teams at Enron. However ... I'm sure the board has only scratched the surface of the impending problems that plague Enron at the moment. (*i.e.*, EES's ... hiding losses/SEC violations ... lack of product, etc.).

* * *

[I]t became obvious that EES had been doing deals for 2 years and was losing money on almost all the deals they had booked. (JC Penney being a $60MM loss alone, then Safeway, Albertson's, GAP, etc.). Some customers threatened to sue if EES didn't close the deal with a loss (Simon Properties – $8MM loss day one).... Overnight the product offerings evaporated.... Starwood is also mad since EES has not invested the $45MM in equipment under the agreement.... Now you will loose [sic] at least $45MM on the deal.... You should also check on the Safeway contract, Albertson's, IBM and the California contracts that are being negotiated.... It will add up to over $500MM that EES is losing and trying to hide in Wholesale. Rumor on the 7th floor is that it is closer to $1 Billion....

> This is when they decided to merge the EES risk group with Wholesale to hide the $500MM in losses that EES was experiencing. But somehow EES, to everyone's amazement, reported earnings for the 2nd quarter. According to FAS 131 – Statement of Financial Accounting Standards (SFAS) #131, "Disclosures about Segments of an Enterprise and related information," EES has knowingly misrepresented EES' earnings. This is common knowledge among all the EES employees, and is actually joked about....
>
> There are numerous operational problems with all the accounts.
>
> * * *
>
> ... Some would say the house of cards are falling....
>
> You are potentially facing Shareholder lawsuits, Employee lawsuits ... Heat from the Analysts and newspapers. The market has lost all confidence, and its obvious why.
>
> You, the board have a big task at hand. You have to decide the moral, or ethical things to do, to right the wrongs of your various management teams.
>
> * * *
>
> ... But all of the problems I have mentioned, they are very much common knowledge to hundreds of EES employees, past and present.

On 10/16/01, Enron shocked the markets with revelations of $1.0 billion in charges and a reduction of shareholders' equity by $1.2 billion. Within days, *The Wall Street Journal* began an exposé of the LJM participants or its SPEs, the SEC announced an investigation of Enron and Fastow "resigned." In 11/01 Enron was ***forced to admit that Chewco had never satisfied the SPE accounting rules and – because JEDI's non-consolidation depended on Chewco's status – neither did JEDI, and Enron consolidated Chewco and JEDI retroactive to 97. This retroactive consolidation resulted in a massive reduction in Enron's reported net income and massive increase in its reported debt.*** Enron then revealed that it was restating its 97, 98, 99 and 00 financial results to eliminate $600 million in previously reported profits and approximately $1.2 billion in shareholders' equity as detailed below (¶61):

ENRON ACCOUNTING RESTATEMENTS				
	1997	1998	1999	2000
Recurring Net Income Amount of Overstatement	$ 96,000,000	$113,000,000	$250,000,000	$ 132,000,000
Debt Amount of Understatement	$711,000,000	$561,000,000	$685,000,000	$ 628,000,000
Shareholders' Equity Amount of Overstatement	$313,000,000	$448,000,000	$833,000,000	$1,208,000,000

These partnerships – Chewco, LJM1 and LJM2 – ***were used by Enron and its banks to enter into transactions that Enron could not, or would not, do with unrelated commercial entities***. The significant transactions were designed ***to create phony profits or to improperly offset losses***. These transactions allowed Enron to conceal from the market ***very large losses resulting from Enron's merchant investments by creating an appearance that those investments were hedged – that is, that a third party was obligated to pay Enron the amount of those losses, when in fact that third party was simply an entity in which only Enron had a substantial economic stake. The Raptors transactions alone resulted in Enron reporting earnings from the 3rdQ 00 through the 3rdQ 01 that were almost $1 billion higher than should have been reported***! ¶62.

As *Newsweek* has written (¶69):

> In the late 1990s, by my count, Enron lost about $2 billion on telecom capacity, $2 billion in water investments, $2 billion in a Brazilian utility and $1 billion on a controversial electricity plant in India. Enron's debt was soaring. If these harsh truths became obvious to outsiders, Enron's stock price would get clobbered – and a rising stock price was the company's be-all and end-all. Worse, what few people knew was that Enron had engaged in billions of dollars of off-balance-sheet deals that would come back to haunt the company if its stock price fell.

Newsweek, 1/21/02.

The key to the Enron mess is that the company was allowed to give misleading financial information to the world for years. Those fictional figures, showing nicely rising profits, enable Enron to become the nation's seventh largest company, with $100 billion of annual revenues. Once accurate numbers started coming out in October, thanks to pressure from stockholders, lenders and the previously quiescent SEC, Enron was bankrupt in six weeks. The bottom line: we have to change the rules to make companies deathly afraid of producing dishonest numbers, and we have to make accountants mortally afraid of certifying them. Anything else is window dressing.

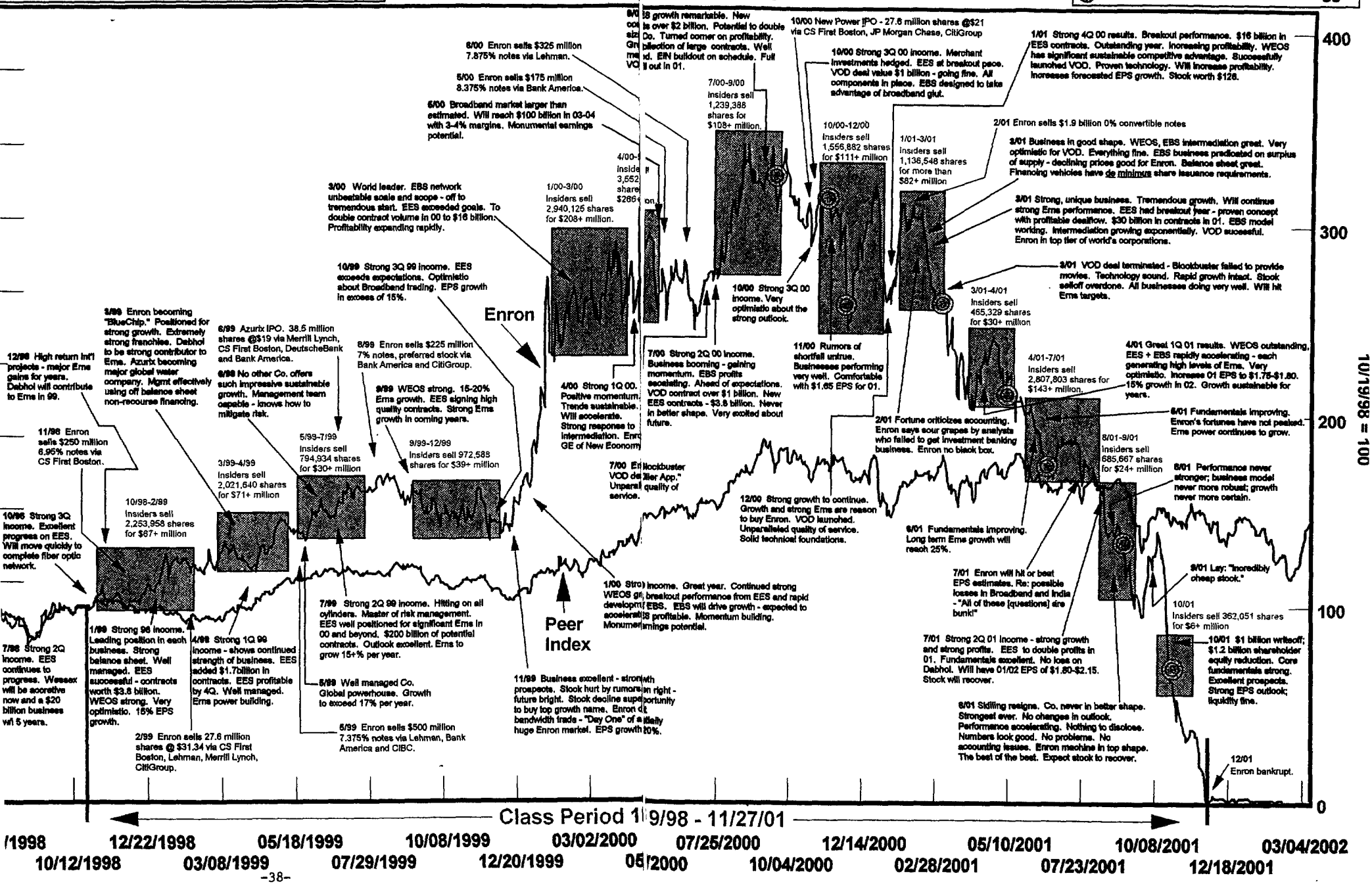
Newsweek, 1/28/02. The rise and demise of Enron is graphically presented below:

otal Shares Sold By Defendants: 20,788,957 shares
efendants' Insider Trading Proceeds: $1,190,479,472

Enron Timeline

7/1/98 - 3/7/02

Enron Stock Issuance Price Trigger



II. SUMMARY OF CIBC'S FACTUAL INVOLVEMENT AND LEGAL LIABILITY

CIBC had an extensive and extremely close relationship with Enron. CIBC provided ***both*** commercial banking and investment banking services to Enron, helped structure and fund several of Enron's secretly controlled partnerships and illicit transactions with its SPEs and helped Enron falsify its financial statements and misrepresent its financial condition by hiding billions in debt that should have been on Enron's balance sheet. Also, CIBC or top executives of CIBC were permitted to personally invest at least $15 million in Enron's lucrative LJM2 partnership as a reward to them for orchestrating CIBC's participation in this fraud, while Enron secretly paid CIBC grossly excessive interest rates on billions of dollars of concealed/disguised loans. CIBC also sold over $2.3 billion in Enron and Enron-related securities to the public and extended $4.2 billion in loans or lending commitments to Enron. At the same time, CIBC's ***securities analysts were issuing extremely positive – but false and misleading – reports on Enron, extolling Enron's business success, the strength of its financial condition and its prospects for strong earnings and revenue growth***. In return for CIBC's participation in the scheme, it received huge underwriting and consulting fees, interest payments, commitment fees and other payments from Enron and related entities, while CIBC or its top executives pocketed the lush returns flowing to them as LJM2 investors from the looting of Enron. ¶¶715-716, 722.

CIBC acted as an underwriter in selling $500 million of Enron 7.375% notes due 5/15/2019 pursuant to a false and misleading 5/99 Registration Statement. ¶¶723, 1006. This exposes CIBC to §11 liability under the 1933 Act – ***non-fraud liability*** – under which it is *prima facie* liable and can avoid liability only by bearing ***its burden of proof*** that it had, "after reasonable investigation, reasonable ground to believe and did believe ... that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading," *i.e.*, the underwriter's so-called "due diligence" defense. 15 U.S.C. §77k(a)(5), (b)(3).

CIBC also made false and misleading statements in the 2/99 Registration Statement for the sale of 27.6 million shares of Enron stock at $31.34, in the 5/99 Registration Statement for the sale

of $500 million of Enron 7.375% notes, in the 10/00 New Power Registration Statement for the sale of 27.6 million shares of New Power stock ***and*** in 15 analysts' reports on Enron it issued during the Class Period, which helped to artificially inflate the trading prices of Enron's securities. ¶¶132, 148, 161, 176, 183, 194, 199, 207, 230, 251, 269, 323, 334, 349, 372, 718, 721, 724. Such false statements are expressly made illegal by the text of Rule 10b-5, issued pursuant to §10(b) of the 1934 Act, which prohibits "***any untrue statement of a material fact***" by "***any person***" in connection with securities transactions.

CIBC's false statements in the Registration Statements used for the sale of $500 million of Enron 7.375% notes, the 27.6 million shares of Enron stock and for the New Power IPO and in its 15 analysts' reports were also part of a wider pattern of misconduct by CIBC in which CIBC employed acts, manipulative or deceptive devices, and contrivances and participated in a fraudulent scheme and course of business – disguising and thus concealing billions of dollars of loans to Enron, providing millions to finance Enron's secretly controlled partnerships and illicit transactions with associated SPEs to falsify Enron's reported financial condition and profits, all of which operated to artificially inflate the prices of Enron's publicly traded securities. This conduct is also expressly prohibited by the language of §10(b) and Rule 10b-5.[16] CIBC's sale of Enron and Enron-related securities, its commercial loans to Enron and its analysts' reports on Enron are shown on the following graphic chart:

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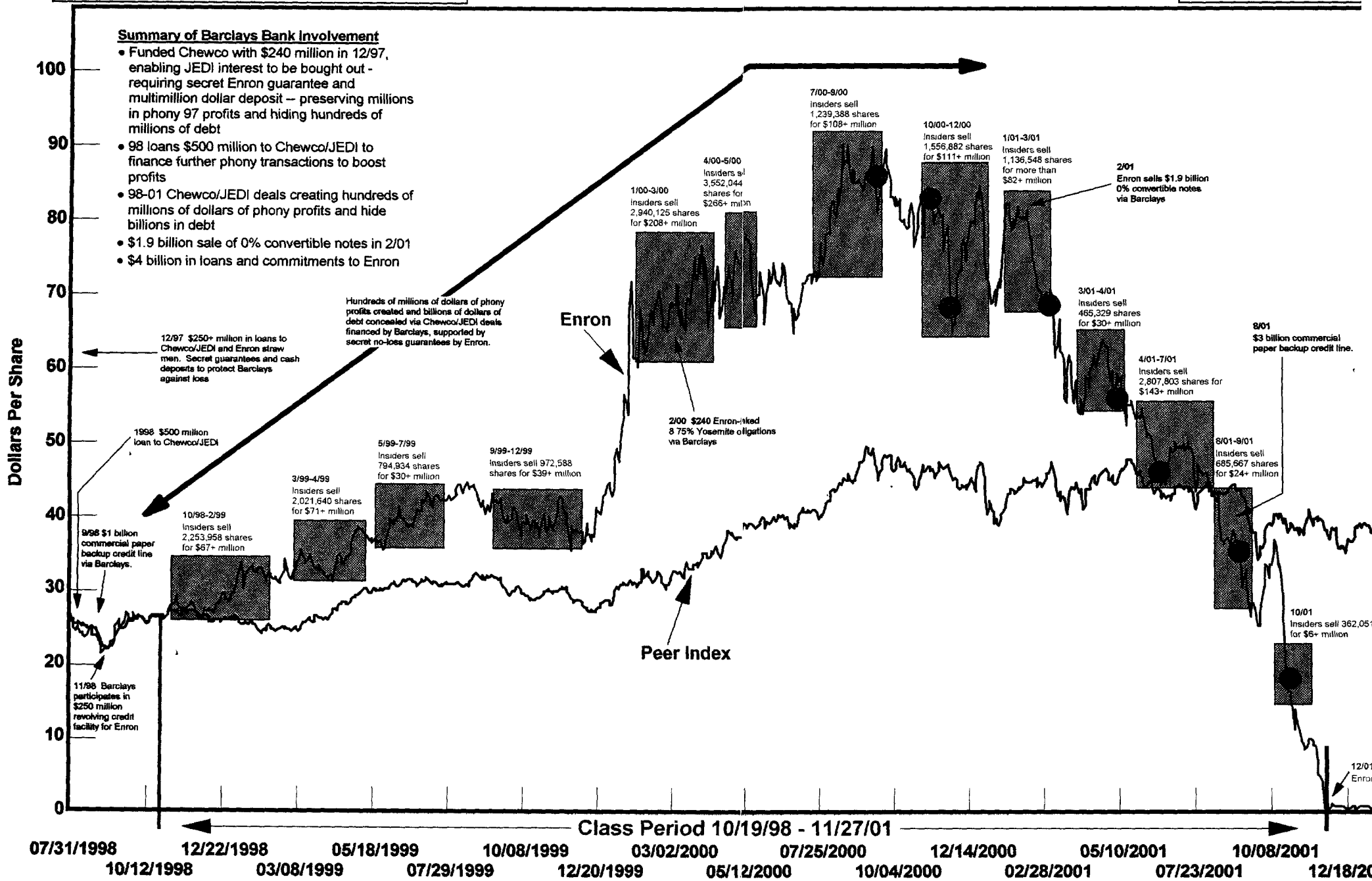
[16] False statements in a Registration Statement can create liability under both 1933 Act §11 and 1934 Act §10(b), and Rule 10b-5. *Herman & MacLean v. Huddleston*, 459 U.S. 375 (1983). The remedies provided investors under the 1933 and 1934 Acts are cumulative. *Id.*

Total Shares Sold By Defendants: 20,788,957 shares
Defendants' Insider Trading Proceeds: $1,190,479,472

Enron Timeline -- Barcays Underwritings/Loans/Analyst Reports

7/31/98 - 3/7/02

Bank America Analys
Enron Stock Issuanc



According to the Supreme Court, §10(b)'s prohibition of "any ***manipulative or deceptive device or contrivance***" necessarily encompasses any "***scheme to defraud***." In *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), the Court referred to the ***dictionary definitions*** of §10(b)'s words, to find that a "device" is "'[t]hat which is devised, or formed by design; a contrivance; an invention; project; ***scheme; often, a scheme to deceive***; a stratagem; an artifice.'" *Id.* at 199 n.20 (quoting *Webster's International Dictionary* (2d ed. 1934)). The Court found that a "contrivance" means "'***a scheme, plan, or artifice***.'" *Id.* (quoting *Webster's International Dictionary*); *see also Aaron v. SEC*, 446 U.S. 680, 696 n.13 (1980). Thus, scheme liability ***is authorized by the text of §10(b)***. Rule 10b-5 – adopted by the SEC to implement §10(b) – accordingly, in addition to prohibiting false statements, makes it unlawful for any person "***directly or indirectly***" to employ "***any*** device, ***scheme***, or artifice ***to defraud***" or to "***engage in any act, practice, or course of business which operates ... as a fraud or deceit upon any person***." 17 C.F.R. §240.10b-5. *See also U.S. Quest, Ltd. v. Kimmons*, 228 F.3d 399, 407 (5th Cir. 2000).

In *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972), the Court observed that "the second subparagraph of [Rule 10b-5] specifies the making of an untrue statement of a material fact and the omission to state a material fact," *id.* at 152-53, but held that "[t]he first and third subparagraphs ***are not so restricted***." *Id.* at 153. It held that the defendants violated Rule 10b-5 when they participated in "***a 'course of business' or a 'device, scheme or artifice' that operated as a fraud" – even though these defendants had never themselves said anything that was false or misleading***. *Id.*; *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 11 n.7 (1971) ("'[We do not] think it sound to dismiss a complaint merely because the ***alleged scheme does not involve the type of fraud that is 'usually associated with the sale or purchase of securities.' We believe that §10 (b) and Rule 10b-5 prohibit all fraudulent schemes in connection with the purchase or sale of securities, whether the artifices employed involve a garden type variety of fraud, or present a unique form of deception. Novel or atypical methods should not provide immunity from the securities laws***.'") (quoting *A. T. Brod & Co. v. Perlow*, 375 F.2d 393, 397 (2d Cir. 1967)). As stated by the Second Circuit: "***Not every violation of the anti-fraud provisions of the federal securities law can be, or should be, forced into a category headed 'misrepresentations' or 'nondisclosures***.'"

Competitive Assocs., Inc. v. Laventhol, Krekstein, Horwath & Horwath, 516 F.2d 811, 814 (2d Cir. 1975).

Thus, the Fifth Circuit sitting *en banc* held that a defendant who did not himself make the statements in a misleading Offering Circular could be held primarily liable ***as a participant in a larger scheme to defraud of which that Offering Circular was only a part: "Rather than containing the entire fraud, the Offering Circular was assertedly only one step in the course of an elaborate scheme."*** *Shores v. Sklar*, 647 F.2d 462, 468 (5th Cir. 1981). *See Finkel v. Docutel/Olivetti Corp.*, 817 F.2d 356, 363 (5th Cir. 1987) (complaint alleging manipulations of reported financial results by two public companies properly alleged a scheme to defraud or course of business operating as a fraud as the effect was to defraud certain purchasers of Docutel securities in violation of Rule 10b-5(a) and (c)).

The fraudulent scheme and course of business involving Enron ***was worldwide in scope, years in duration and unprecedented in scale***. Wrongdoing of this scope and on this scale could not have been accomplished solely by the efforts of Enron's executives, no matter how dishonest or determined they may have been. Wrongdoing of this scope and on this scale required the skills and active participation of lawyers, bankers and accountants. It could not have happened otherwise.

The notion that *Central Bank, N.A. v. First Interstate Bank, N.A.*, 511 U.S. 164 (1994), issued a broad edict that lawyers, banks and accountants are immune from liability for their participation in complex securities frauds is nonsense. *Central Bank* expressly recognized: "The absence of §10(b) aiding and abetting liability ***does not mean that secondary actors in the securities markets are always free from liability under the securities Acts. Any person or entity, including a lawyer ... or bank who employs a manipulative device[17] or makes a material misstatement (or omission) on which a purchaser ... relies[18] may be liable as a primary violator under 10b-5.... In any***

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[17] As pointed out earlier, the Court has previously held that §10(b)'s language "any manipulative or deceptive device or contrivance" includes a "scheme to deceive" or "scheme, plan or artifice." *Ernst & Ernst*, 425 U.S. at 199 n.20.

[18] Because this action's 1934 Act claims are "fraud-on-the-market" claims, reliance is established, *i.e.*, presumed, based on the materiality of false representations to the market, subject to defendants' right to rebut that presumption. *Basic Inc. v. Levinson*, 485 U.S. 224, 247 (1988); *Summit Props. v. Hoechst Celanese Corp.*, 214 F.3d 556, 561 (5th Cir. 2000), *cert. denied*, 531 U.S.

complex securities fraud, moreover, there are likely to be multiple violators." 511 U.S. at 191. A scheme to defraud often will involve a variety of actors, and investors are entitled to allege "***that a group of defendants acted together to violate the securities laws, as long as each defendant committed a manipulative or deceptive act in furtherance of the scheme***." *Cooper v. Pickett*, 137 F.3d 616, 624 (9th Cir. 1998); *accord SEC v. First Jersey Sec.*, 101 F.3d 1450, 1471 (2d Cir. 1996).

Central Bank denied recovery to victims of an alleged securities fraud who pleaded ***only one theory of recovery*** against a bank defendant – "secondary" liability they dubbed "aiding and abetting." 511 U.S. at 191. However, neither the words aiding and abetting nor any other language encompassing aiding and abetting appear in §10(b) or Rule 10b-5. The Court said "***the text of the 1934 Act does not itself reach those who aid and abet a §10(b) violation [and] that conclusion resolves the case***." *Id.* at 177. The *Central Bank* plaintiffs did not, as the plaintiffs here do, plead or pursue recovery under the theory that the bank defendant – here CIBC – (i) made false and misleading statements in Registration Statements where the bank acted as underwriter in selling securities or other documents the bank issued to the public, *e.g.*, analysts' reports, ***or*** (ii) employed acts, manipulative or deceptive devices and contrivances, ***or*** (iii) engaged in a fraudulent scheme or course of business that operated as a fraud or deceit on purchasers of the securities in issue. In the words of the Court, the plaintiffs "***concede that Central Bank did not commit a manipulative or deceptive act within the meaning of §10(b)***." *Id.* at 191. Plaintiffs here make no such concession. Thus, because the *Central Bank* plaintiffs made fatal concessions and pursued a theory of recovery which found ***no support in the text of either the statute or the rule, they lost***.

Central Bank cannot mean that a defendant cannot be liable under §10(b) unless the defendant made misleading statements because the Court later rejected that argument in *United States v. O'Hagan*, 521 U.S. 642 (1997). The Eighth Circuit had held that, under *Central Bank*, "§10(b) covers ***only deceptive statements or omissions on which purchasers and sellers ... rely***." *Id.* at 664. The Court reversed, holding that §10(b) does not require a defendant to speak because §10(b) prohibits "***any manipulative or deceptive device or contrivance***" in contravention of SEC

1132 (2001); *Fine v. Am. Solar King Corp.*, 919 F.2d 290, 298 (5th Cir. 1990).

rules and thus reaches "any deceptive device," whether or not the defendant spoke. *Id.* at 653. *Superintendent of Ins.*, 404 U.S. 6, is consistent with *O'Hagan*. In *Superintendent of Ins.*, a ***unanimous*** Court upheld a §10(b)/Rule10b-5 complaint involving a "***fraudulent scheme***" involving the sale of securities where ***no*** false statement was alleged because:

> ***There certainly was an "act" or "practice" within the meaning of Rule 10b-5 which operated as "a fraud or deceit" on Manhattan, the seller of the Government bonds.***

Id. at 9 (footnote omitted).

This Court has repeatedly stated:

> ***A defendant need not have made a false or misleading statement to be liable.***

Landry's, slip op. at 9 n.12; *In re Waste Mgmt. Inc. Sec. Litig.*, No. H-99-2183, slip op. at 75 (S.D. Tex. Aug. 16, 2001);[19] *In re Sec. Litig. BMC Software, Inc.*, 183 F. Supp. 2d 860, 869 (S.D. Tex. 2001). So while false statements are not indispensable to §10(b)/Rule 10b-5 liability, here, CIBC allegedly made numerous false or misleading statements in three Registration Statements and in 15 analysts' reports. Thus, CIBC is wrong in asserting that there is a bright line test for §10(b)/Rule 10b-5 liability – *i.e.*, you must make a statement. But even if such a rule existed, the CC would still state valid claims against CIBC because its own false statements are alleged.

That this reading of §10(b)/Rule 10b-5 is clearly correct is shown by a new ***unanimous*** Supreme Court decision – *SEC v. Zandford*, __ U.S. __, No. 01-147, 2002 U.S. LEXIS 4023 (June 3, 2002). In *Zandford*, the Court repeatedly cited with approval its seminal "***fraudulent scheme***" case *Superintendent of Ins.*, and reversed dismissal of a §10(b)/Rule 10b-5 complaint making the following key points:

- "***The scope of Rule 10b-5 is coextensive with the coverage of §10(b)*** ...." *Id.* at *7 n.1.

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[19] Due to the length of the opinions in *Landry's* and *Waste Management*, and the fact that the Court has access to them, they have not been attached to this brief.

- ***"[N]either the SEC nor this Court has ever held that there must be a misrepre sentation about the value of a particular security" to violate §10(b).*** *Id.* at *13.[20]

- Allegations that defendant "'***engaged in a fraudulent scheme***'" or "'***course of business that operated as a fraud or deceit***'" stated a §10(b) claim. *Id.* at *13, *14-*17.

Central Bank clearly – ***but merely*** – stands for the proposition that no aiding and abetting liability exists under the 1934 Act because neither §10(b) nor Rule 10b-5 contain language encompassing "aiding and abetting." The decision in *Central Bank* is actually ***quite narrow***. By contrast, the language of §10(b) and Rule 10b-5 is ***very broad*** and the purposes of §10(b) and Rule 10b-5 are remedial, intended to provide access to federal court to persons victimized in fraudulent securities transactions:

> [T]he 1934 Act and its companion legislative enactments [including the 1933 Act] embrace a "fundamental purpose ... to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry...." Congress intended securities legislation enacted for the purpose of avoiding frauds to be construed "not technically and restrictively, but flexibly to effectuate its remedial purposes."

Affiliated Ute Citizens, 406 U.S. at 151. As noted by the Fifth Circuit:

> [T]he Court has concluded that the Exchange Act and the Securities Act should be ***construed broadly to effectuate the statutory policy affording extensive protection to the investing public***. *See Tcherepnin*, 389 U.S. at 336, 88 S. Ct. at 533. *See also* S. Rep. No. 47, 73d Cong. 1st Sess. 1 (1933) (***indicating legislative intent of the Securities Act to protect the public from the sale of fraudulent and speculative schemes***).

Meason v. Bank of Miami, 652 F.2d 542, 549 (5th Cir. 1981). "***The federal securities statutes are remedial legislation and must be construed broadly, not technically and restrictively***." *Paul F. Newton & Co. v. Texas Commerce Bank*, 630 F.2d 1111, 1118 (5th Cir. 1980).

Here, CIBC did it all. CIBC made false statements in Registration Statements where CIBC sold Enron and Enron-related securities and in CIBC's analysts' reports on Enron. And CIBC employed specified acts, manipulative or deceptive devices and contrivances to help falsify Enron's finances and which were essential to the ongoing fraudulent scheme and course of business. In short, in order to pocket billions of dollars of fees, commissions, interest and other charges – profits from

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[20] To the extent *Ziemba v. Cascade Int'l, Inc.*, 256 F.3d 1194, 1205 (11th Cir. 2001), seems to require a statement be made about a company which is "publicly attributable to the defendant at the time the plaintiff's investment decision was made," it is inconsistent with *Zandford*.

its investment in the fraudulent scheme and course of business – CIBC facilitated, furthered and participated in the fraud. All of these activities directly contravened prohibitions of the 1933 and 1934 Acts. CIBC was not an unwitting victim of the fraud involving Enron – ***it was an active perpetrator of and participant in that fraud. Thus, CIBC's alleged liability is "primary"*** and not "***secondary***."

Not only does the CC assert viable legal theories of recovery against CIBC under the 1933 and 1934 Acts, it also pleads ***in detail*** why the statements made by CIBC were false when made and why CIBC ***knew or recklessly disregarded that those statements were false***, thus satisfying the two-pronged pleading standard, *i.e.*, "falsity" and "scienter" of the 95 Act as applicable to the 1934 Act. 15 U.S.C. §78u-4.

The Registration Statements CIBC used to sell 27.6 million shares of Enron stock at $31.34 in 2/99 and $500 million in 7.375% notes in 5/99 and 27.6 million shares of New Power stock in the 10/00 New Power IPO contained Enron's false annual 97, 98 and 99, interim 99 financial results and false statements concerning the structures of and Enron's relationship to SPEs and related parties, Enron's financial risk management statistics, as well as the condition of Enron's business operations and the value of its assets. *See infra* at 95-96. The 15 CIBC analysts' reports on Enron issued between 10/98-10/01 also contained false statements about Enron's financial results and financial condition and the success of Enron's EES business, Enron's Broadband network and EBS business. *See infra* at 77-94. Thus, the allegedly false statements made by CIBC are ***quoted, specified by date, and the reasons the statements were false when made are pleaded***, satisfying the 95 Act's "falsity" pleading requirement. *See id.*

CIBC's scienter, *i.e.*, its "required state of mind" is also well-pleaded.[21] The CC explains how, due to the close involvement of CIBC top executives and commercial and investment bankers with Enron, in lending, deal-making and other activities, CIBC knew of the falsity of the statements it was making in Registration Statements and analysts' reports concerning Enron. *See infra* at 77-94. The CC also details numerous specific fraudulent Enron transactions involving CIBC (as participant

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[21] Scienter is only required for the 1934 Act claims. CIBC's 1933 Act liability requires no showing of fraud, intent or knowledge. 15 U.S.C. §77k; *Landry's*, slip op. at 11 n.13, 65.

or financier) which were intentionally deceptive acts or manipulative or deceptive contrivances – falsifying Enron's reported financial results and financial condition and making Enron's business appear to be successful when it was not. These include:

- Helping to "pre-fund" Enron's LJM2 partnership in the last days of 12/99 with $2.25 million advanced by CIBC (via CIBC Capital Corp.) which enabled LJM2 to fund four critical non-arm's-length fraudulent year-end 99 deals with Enron to inflate Enron's 99 results – generating false profits while hiding hundreds of millions of dollars of debt. ¶¶26-29, 881-882.

- During 00-01, CIBC ultimately invested $15 million in LJM2 to help fund LJM2, which enabled LJM2 to do numerous non-arm's-length fraudulent transactions with Enron to artificially boost Enron's profits during 99-01, while hiding billions of dollars of debt that should have been reported on Enron's balance sheet while CIBC pocketed the fruits of those non-arm's-length fraudulent transactions with Enron, *i.e.*, the looting of Enron.

- CIBC's bogus Braveheart deal with Enron to create a controlled SPE to implement the Blockbuster/Enron VOD joint venture, which enabled Enron to create and report $110 million in bogus profits in the 4thQ 00 and 1stQ 01.

- CIBC's bogus Hawaii 125-0 deal with Enron in connection with the New Power IPO, whereby a CIBC-financed Enron/SPE deal created a non-arm's-length hedging deal to generate a fictitious $370 million profit for Enron in the 4thQ 00.

Finally, in addition to CIBC's knowledge of the fraud and intentional involvement in many of Enron's deceptive and fraudulent transactions, the CC details CIBC's motive and opportunity[22] to engage and participate in the fraudulent scheme and course of business. CIBC was reaping huge amounts of money from the scheme. Also, CIBC was being ***rewarded by being allowed to invest $15 million in LJM2 and thus reaping huge returns as secret investors in the LJM2 partnership, unusually profitable returns generated by that entity's illicit deals with Enron SPEs – transactions CIBC knew would collapse if Enron's stock fell through the equity issuance trigger prices embedded in those LJM2/SPE deals***. ¶732.[23]

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[22] By selling Enron and Enron-related securities via SEC filed Registration Statements and issuing analysts' reports on Enron and helping structure and finance Enron's illicit partnerships and their related SPE transactions, CIBC had plenty of opportunity to mislead investors and advance the fraud as well.

[23] The returns to the LJM2 investors were huge – up to 2,500% on one deal and 51% overall ***in the first year*** of the partnership. ***Skilling has recently told investigators such gargantuan returns were possible only because LJM2, with Fastow at the wheel, was defrauding Enron in the billions of dollars of deals it was doing with Enron so Enron could create false profits and hide billions of dollars in debt***. Kurt Eichenwald,"Enron Ex-Chief Said to Voice Suspicion of Fraud," *New York Times*, 4/24/02.

CIBC had ***powerful incentives to take steps to not only keep Enron solvent, but to maintain its coveted investment grade credit rating*** which provided Enron access to the commercial paper market. CIBC had made and was making hundreds of millions of dollars from the fraudulent scheme involving Enron and Enron's fraudulent course of business and stood to continue to make hundreds of millions more ***if it could be sustained – and to lose a bundle if the scheme was discovered, unraveled or came to an end***. CIBC had plenty of motive to defraud Enron's investors.

Thus, as to CIBC, the CC pleads 1933 Act §11 non-fraud liability and 1934 Act ***"primary liability" based on legal theories*** of recovery rooted in the express language of §10(b) and Rule 10b-5 and pleads the facts in ***sufficient detail*** to satisfy the "falsity" and "scienter" prongs of the 95 Act's pleading standard applicable to the 1934 Act.

And, in fact, many courts have upheld complaints against banks in §10(b)/Rule 10b-5 cases where, as here, false statements, manipulative or deceptive devices, contrivances and acts, and participation in a scheme to defraud have been alleged with sufficient particularity. *Cooper*, 137 F.3d at 628 (Scheme liability survived *Central Bank*. Allegations that the investment bank defendants had issued analysts' reports knowing them to be false due to their "***access to inside information***" stated a valid §10(b)/Rule 10b-5 claim.); *In re Livent, Inc. Noteholders Sec. Litig.*, 174 F. Supp. 2d 144. 150-52 (S.D.N.Y. 2001) (complaint alleging investment bank made disguised loan to Livent enabling Livent to falsify financial condition, while selling securities to public states valid §10(b)/Rule 10b-5 claims); *Murphy v. Hollywood Entm't Corp.*, No. 95-1926-MA, 1996 U.S. Dist. LEXIS 22207 (D. Or. May 9, 1996) and *Flecker v. Hollywood Entm't Corp.*, No. 95-1926-MA, 1997 U.S. Dist. LEXIS 5329, at *25 (D. Or. Feb. 12, 1997) (Refused to dismiss a complaint or grant summary judgment to banks, stating that their "***roles as analysts, investment bankers and business advisors with extensive contacts with [issuer] defendants, superior access to non-public information and participation in both drafting and decision-making is sufficient to establish a***

As huge as the 11/01 restatements of Enron's 97-00 financial statements were, they just scratched the surface of the true extent of the prior falsification of Enron's financial statements, failing to eliminate additional hundreds of millions of dollars of phony profits as Enron, Andersen, Vinson & Elkins and the banks were still trying to keep Enron afloat and trying to conceal how extensive the fraud had really been. ¶¶63, 850-856.

triable primary liability claim under §10(b)."); *In re Cascade Int'l Sec. Litig.*, 840 F. Supp. 1558, 1568 (S.D. Fla. 1993) (allegations that a securities broker issued false reports on company which made exaggerated predictions while ignoring "red flags" adequately pleaded recklessness); *McNamara v. Bre-X-Minerals Ltd.*, No. 5:97-CV-159, 2001 U.S. Dist. LEXIS 4571, at *166 (E.D. Tex. Mar. 30, 2001) (Denied motion to dismiss by J.P. Morgan based on allegations it participated in a scheme to violate §10(b)/Rule 10b-5 by helping to structure fraudulent business transactions, acting as financial advisor, and issuing false analysts' reports, while ignoring "red flags."). *See also SEC v. U.S. Envtl., Inc.*, 155 F.3d 107, 112 (2d Cir. 1998) (while there is no aiding and abetting, where complaint properly alleged defendant to be primary violator because he "'***participated in the fraudulent scheme,***'" noting "***lawyers, accountants, and banks who engage in fraudulent or deceptive*** practices at their client's direction [are] a primary violator"); *Scholnick v. Continental Bank*, 752 F. Supp. 1317, 1323 & n.9 (E.D. Mich. 1990) ("bank ... may still be held liable under Rule 10b-5(a) and 10b-5(c) as a participant in the allegedly fraudulent scheme" and "allegations that Continental was directly involved in perpetrating a fraudulent scheme distinguish" case from situation where bank was only engaging in a "'routine commercial financing transaction'"). The CC in this action pleads more wrongful conduct by CIBC vis-à-vis the fraudulent scheme involving Enron and with greater specificity than was pleaded in any of the above cases where complaints naming banks as defendants in §10(b)/Rule 10b-5 actions were upheld.

Of course, as with most fraudulent schemes, the scheme to falsify Enron's finances and inflate the prices of its securities – and sustain its fraudulent course of business – ultimately collapsed from the accumulated weight of years of deceit and deception. But the fact that the scheme ultimately collapsed in late 01 is of little legal moment. It had succeeded for years, enriching the perpetrators to the tune of billions of dollars. Securities violators frequently find themselves involved in complicated schemes by which financial reports are manipulated, securities prices are inflated, new securities are sold to the public and yet, despite all their efforts to perpetuate the wrongdoing, the scheme ultimately collapses and their participation is disclosed. But participants in fraudulent schemes – especially Ponzi securities schemes like Enron – expect them to succeed and take action to help them ***continue to succeed, as they gain more profits from the scheme as it continues***. The

fact that such complex schemes may ultimately fail – and the perpetrators may ***then*** suffer some loss – in no way shields them from liability for the damage inflicted on the victims of their unlawful conduct while the scheme was succeeding. In the end it is the public investors in a situation like Enron – the people and pension funds who invested ***billions of dollars to purchase Enron securities at inflated prices that are left holding the bag. They are the ones who are truly damaged***. And the federal securities laws are supposed to protect them.

The important remedial purposes of investor suits under the anti-fraud provisions of the 1934 Act were ***ratified by Congress when it enacted the 95 Act***:

> The overriding purpose of our Nation's securities laws is to protect investors and to maintain confidence in the securities markets, so that our national savings, capital formation and investment may grow for the benefit of all Americans.
>
> ... Private securities litigation is an indispensable tool with which defrauded investors can recover their losses without having to rely upon government action. Such private lawsuits promote public and global confidence in our capital markets and help to deter wrongdoing and to guarantee that ***corporate officers, auditors, directors, lawyers and others properly perform their jobs***.

H.R. Conf. Rep. No. 104-369, at 31 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 730. The 95 Act's pleading requirements must be applied and interpreted with these important principles in mind.

It is an unfortunate reality that the worst securities frauds create the most difficult situations for the victims.[24] The issuer (here Enron) goes bankrupt – and is ***shielded from liability***. Whatever directors' and officers' liability insurance policies exist (here some $350 million) ***are impaired*** – as the carriers can claim that they were defrauded into issuing the policies by the issuer's false financial statements. Here, the situation is further exacerbated by the fact that Andersen, which played a significant role in the fraud, is financially impecunious and able to pay only a fraction of the damages suffered by the victims.

If Enron investors are to achieve any significant recovery here, in what is acknowledged to be the largest and worst financial fraud in U.S. history, it will only be because our nation's securities laws permit these victims to hold accountable ***securities professionals like banks and lawyers, who are supposed to safeguard the public in securities transactions, for their misconduct in employing***

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[24] For instance, *Equity Funding*, *U.S. Financial*, *Lincoln Savings*, *Washington Public Power Supply Systems* and *Global Crossing*.

acts and contrivances to deceive and participating in a scheme to defraud and a course of business that operated as a fraud or deceit on those purchasers of Enron's securities. One man's "deep pocket" is another man's legitimate defendant. If our Nation's securities laws do not provide an opportunity for the thousands of investors in Enron – what appeared to be a hugely successful public company earning a billion dollars of profit a year – to pursue Enron's bankers and lawyers who allegedly engaged and participated in the fraudulent scheme and course of business, that will make a mockery of the investor protection purposes of our securities laws. To put it bluntly, if the 95 Act's enhanced pleading standard combined with the Court's decision in *Central Bank* operate to shield the banks named as defendants here from even having to answer the CC and defend the allegations on the merits, then Congress will have to act by ameliorating that harsh pleading standard and restoring aiding and abetting liability.

III. DETAILED FACTUAL ALLEGATIONS REGARDING CIBC

> In reviewing the sufficiency of a complaint in response to a motion to dismiss for failure to state a claim under Fed. R. Civ. P. 12(b)(6), before any evidence has been submitted, the district court's task is limited. *Scheuer v. Rhodes*, 416 U.S. 232, 236 (1974). The issue is not whether a plaintiff will ultimately prevail but whether the claimant is entitled to offer evidence to support its claims. *Id.* The district court should consider all allegations in favor of the plaintiff and accept as true all well-pleaded facts in the complaint. *Lawal v. British Airways, PLC*, 812 F. Supp. 713, 716 (S.D. Tex. 1992). Dismissal is not appropriate "unless it appears beyond a doubt that the plaintiff can prove no set of facts in support of [his] claim which would entitle him to relief." *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957).

Landry's, slip op. at 4 n.8. The Fifth Circuit recently stated, "we will accept the facts alleged in the complaint as true and construe the allegations in the light most favorable to the plaintiffs." *Nathenson v. Zonagen Inc.*, 267 F.3d 400, 406 (5th Cir. 2001). This Court must consider the allegations in their entirety. As Judge Buchmeyer stated in *STI Classic Fund v. Bollinger Indus.*, No. 3-96-CV-823-R, 1996 U.S. Dist. LEXIS 21553, at *5 (N.D. Tex. Oct. 25, 1996), it is improper to isolate "the circumstances alleged in Plaintiffs' amended complaint rather than to consider them in their totality."[25]

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[25] CIBC makes the point that the 500-page CC uses the word "help" or "helped" to describe its conduct vis-à-vis Enron on some occasions. Seizing on the word help/helped, CIBC claims that its use conclusively shows that the true core allegation against it here is one of aiding and abetting, which is barred by *Central Bank*. This argument is wrong. First of all, persons who participate in a scheme to defraud or a course of business that operates as a fraud or deceit on purchasers of a

CIBC seems to argue that the three-year statute of response for 1934 Act claims bars plaintiffs from pursuing damages against them for any time period prior to 4/8/99 ***and*** any consideration of its alleged misconduct prior to 4/8/99 for pleading or other purposes. We agree as to the former point, but not as to the latter. In other words, while the three-year statute of repose bars damage recovery from CIBC on behalf of purchasers who purchased before 4/8/99, it does not affect plaintiffs' ability to plead conduct or present evidence of its misconduct prior to that date. *United States v. Ashdown*, 509 F.2d 793 (5th Cir. 1975), affirmed defendants' mail fraud convictions, holding there was no merit in the argument that it was error to admit evidence of acts committed beyond the statute of limitations period where the evidence helped to establish the scheme – "the statute of limitations is a defense to prosecution, not a rule of evidence. Therefore, once prosecution is timely instituted, the statute of limitations has no bearing on the admissibility of evidence." *Id.* at 798.[26] Instead, the court found that the evidence defendants questioned "***helps establish the scheme and the guilty intent***." *Id.*; *accord United States v. Blosser*, 440 F.2d 697, 699 (10th Cir. 1971) (Evidence of mail fraud occurring before the statute of limitations "***bore on the existence of the scheme to defraud, the falsity of representations made, and intent***.").[27]

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public company's securities or employ acts or manipulative or deceptive devices are actually "helping" to defraud investors. In any event, this is not medieval England where meritorious actions are dismissed because pleaders used an ambiguous word or mischaracterized a claim for relief. Fortunately, in the United States today, complaints are to be construed ***in favor of the pleader with all ambiguities resolved and inferences drawn in the pleader's favor***. And the CC clearly does repeatedly allege that CIBC participated in a fraudulent scheme or course of business while employing acts and manipulative devices and/or contrivances to deceive. That conduct is actionable under the text of §10(b) and Rule 10b-5 as well as the wealth of decisions cited in this brief.

[26] There is no dispute that as to CIBC, claims were timely filed for the three-year period, beginning 4/8/99.

[27] An early case upholding this principle is *Little v. United States*, 73 F.2d 861 (10th Cir. 1934). There, the court held that "if the mails were used in execution of a fraudulent scheme, it is no defense that the scheme was formed and partially carried out back of the statute of limitations. Proof running back of the statute is admissible provided it is connected up with the scheme existing when the letters were mailed." *Id.* at 867; *accord United States v. Marconi*, 899 F. Supp. 458, 463 (C.D. Cal. 1995) (Defendant misunderstood the nature of the statute of limitations as "acts of fraud prior to that date are still evidence of his continuing fraudulent scheme to defraud." Trier of fact can consider defendant's pre-statute of limitations action to determine whether defendant had the requisite intent to defraud.); *United States v. Whitt*, 718 F.2d 1494, 1501 (10th Cir. 1983) (Certain testimony regarding events that were not within the statute of limitations was used "to establish a scheme or plan rather than as direct evidence."); *United States v. Haskins*, 737 F.2d 844, 848 (10th Cir. 1984) (Affirmed mail fraud and extortion convictions noting that arguments relating to evidence of

A similar result has been obtained in Title VII cases. *Fitzgerald v. Henderson*, 251 F.3d 345 (2d Cir. 2001), *petition for cert. filed*, (Aug. 29, 2001), held that evidence of defendant's sexual advances and the fact that the plaintiff rebuffed those advances at an earlier time were relevant to show defendant's motivation for the harassment that occurred during the time plaintiff's claim was ripe. "***A statute of limitations does not operate to bar the introduction of evidence that predates the commencement of the limitations period but that is relevant to events during the period***." *Id.* at 365.[28]

CIBC had an extensive and extremely close relationship with Enron, providing ***both*** commercial banking and investment banking services while helping to structure and fund several of Enron's secretly controlled partnerships and illicit transactions with its SPEs and helped Enron falsify its financial statements and misrepresent its financial condition. At the same time, CIBC's ***securities analysts were issuing extremely positive – but false and misleading – reports on Enron, extolling Enron's business success, the strength of its financial condition and its prospects for strong earnings and revenue growth***.[29] CIBC received huge underwriting and consulting fees, interest

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transactions not charged in the indictment but used to help support scheme allegations could be properly admitted: "The fact that a number of the overt acts performed in furtherance of the conspiracy were committed beyond the statute of limitations does not preclude the admission in evidence of such acts to show the nature of the scheme and [the commissioner's] intent where the later use of the mails occurred."). Although these cases relate to evidentiary issues, the same reasoning should apply in this case at the motion to dismiss stage. If evidence can be admissible at trial regarding defendants' earlier acts in furtherance of their scheme then so too should allegations regarding actions taken beyond the statute of limitations be considered at the pleading stage.

[28] In *Black Law Enforcement Officers Ass'n v. City of Akron*, 824 F.2d 475 (6th Cir. 1987), the Sixth Circuit found the lower court erred when it granted a motion by the city seeking to limit evidence presented in the case to events that occurred within the one year statute of limitations period. *Id.* at 479. "It is clear that the district court erred in using the statute of limitations to bar the admission of evidence. The function of the statute of limitations is to bar stale claims." *Id.* at 482-83. "'The statute of limitations is a defense ..., not a rule of evidence. Therefore, ... [it] has no bearing on the admissibility of evidence.'" *Id.* at 483. The Sixth Circuit found that plaintiffs were correct in offering evidence of events extending beyond the statute of limitations ***as admissible to show motive, intent or continuing scheme***. *Id.* (citing *United States v. Garvin*, 565 F.2d 519, 523 (8th Cir. 1977)).

[29] As the CC explains, the banks named as defendants all evolved into their present form after the repeal of the Glass-Steagall Act in 99. That law prohibited banks from acting in such dual capacities, and was enacted to remedy abuses that occurred in the 20s when banks sold securities of, and made loans to, their corporate customers. With the repeal of Glass-Steagall, the banks sued here, including CIBC, quickly morphed back into financial services institutions offering commercial ***and*** investment banking services to corporate customers. The abuses of the 20s quickly returned as well.

payments, commitment fees and other payments from Enron and related entities. Also, CIBC or top

¶¶643-644. According to *Business Week*:

> After the stock market crashed in 1929, Congress hauled in Wall Street bosses to explain how bankers helped companies inflate earnings for a decade through complex structures. Congress scrutinized bank practices for years, then passed the Glass-Steagall Act, splitting commercial banks from brokerages. That checked the Street's temptation to monkey with clients' finances while flogging their stock.
>
> Now Congress needs answers from Wall Street's chiefs again. Congress repealed Glass-Steagall in 1999, under pressure from bankers ***who swore they would manage such conflicts of interests. They would erect so-called Chinese Walls that forbade sharing information between those selling a company's stock and those arranging its financing***.
>
> ***But the Chinese walls are porous. Bankers ignore them when it's convenient: They take analysts on road shows of investment-banking clients – their way of making it clear they don't want downgrades of those companies***. The walls also provide cover for bankers, who let analysts push a client's stock even when they know the company is in trouble. That's why analysts recommended Enron to the end, though the bankers behind its complex financing knew it was on the skids.

Business Week, 3/25/02 (¶643).

According to the *Miami Herald* on 3/19/02 (¶644):

> ***Banks Tangled in Fall of Enron***
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> * * *
>
> They are the titans of Wall Street, possessing pedigrees that date to the founding of America and wealth greater than many nations.
>
> * * *
>
> Empowered by the massive deregulation of financial services they zealously sought, New York's investment banks created their masterpiece in Enron, providing every conceivable product and service.
>
> ***They lent it money, often without collateral. They sold its securities to an unsuspecting public. They wrote rosy, inaccurate analyst reports***.
>
> ***They were pivotal players in the mysterious offshore partnerships that ultimately brought Enron down***.
>
> Wearing so many hats was unthinkable a generation ago, when laws kept the banking, brokerage and insurance industries separate. Deregulation changed all that, particularly in 1999 when the Depression-era Glass-Stegall Act was repealed....
>
> * * *
>
> Enron was such a lucrative customer that virtually every Wall Street firm had a relationship with it.

executives of CIBC were permitted to personally invest (though CIBC Capital Corp.) at least $15 million in Enron's lucrative LJM2 partnership as a reward to them for orchestrating CIBC's participation in this fraud. ¶¶715, 732.

CIBC engaged and participated in the fraudulent scheme and course of business in several ways. It participated in commercial loans and lending commitments of over $4.2 billion to Enron during the Class Period. CIBC also helped raise over $2.3 billion from the investing public for Enron via the sale of Enron and Enron-related securities during the Class Period, sales accomplished via false Registration Statements. CIBC also helped structure and finance certain of the partnerships Enron controlled and their illicit transactions with SPEs, knowing they were vehicles being utilized by Enron to falsify its reported financial results. ¶716.

CIBC acted as an underwriter of billions of dollars of Enron securities before and during the Class Period, including (¶718):

DATE	SECURITY
11/93	8 million shares of 8% Enron capital preferred shares at $25 per share
7/94	3 million shares of 9% Enron capital preferred shares at $25 per share
1/97	6 million shares of 8-1/8% Enron capital preferred shares at $25 per share
5/98	35 million shares Enron common stock at $25
2/99	27.6 million shares of Enron common stock at $31.34
5/99	$500 million 7.375% Enron notes

CIBC was also the lead underwriter in the New Power IPO, which enabled Enron to improperly recognize and report $370 million in profits in the 4thQ 00. In 00, Enron owned millions of shares of New Power stock – then a private company – and controlled New Power. If Enron could take New Power public and create a trading market in its stock, then Enron could recognize a profit on the gain in value on its shares by "hedging" that gain via yet another non-arm's-length transaction with the LJM2 entity. In the 4thQ 00, Enron desperately needed to create profits to perpetuate the Ponzi scheme. Enron and CIBC did the huge New Power IPO – 27.6 million shares at $21 per share in 10/00. After the IPO, Enron continued to hold 13.6 million shares of New Power common stock and warrants to purchase 42 million more shares. In a deal secretly structured before the IPO, Enron

created a huge phony profit using LJM2 and an SPE called Hawaii 125-0. CIBC (and several other of Enron's banks) made a "loan" of $125 million to Hawaii 125-0, but received a "total return swap" guarantee that was supposed to protect CIBC against ***any loss*** from Enron. Enron transferred millions of its New Power warrants to Hawaii 125-0 to "secure" the banks' loan and thus created a huge $370 million "profit" on the purported gain on the New Power warrants made possible by the New Power IPO. Hawaii 125-0 simultaneously supposedly "hedged" the warrants with another entity created and controlled by Enron called "Porcupine." To supposedly capitalize Porcupine, LJM2 put $30 million into Porcupine to facilitate the so-called hedge of the New Power warrants, but, one week later, Porcupine paid the $30 million back to LJM2 plus a $9.5 million profit – leaving Porcupine with no assets. During 01, New Power stock collapsed, converting Enron's huge gain on its New Power equity holdings into a huge loss early in 01 – which Enron concealed. ¶42.[30]

During the Class Period, CIBC was also a major commercial lender to Enron.[31] For instance (¶719):

DATE	TRANSACTION
11/97	$250 million credit facility for Enron
7/98	$250 million loan to an Enron subsidiary guaranteed by Enron
9/98	$1 billion committed credit facility for Enron to back up commercial paper

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30 In 7/01, CIBC also acted as an underwriter of certain Enron-related securities, *i.e.*, $1 billion 6.31% and 6.19% Marlin Water Trust II and Marlin Water Capital Corp. II notes. ¶720.

31 In analyzing potential borrowers on commercial loans or credit facilities, CIBC was required to perform extensive credit analysis of the borrower after obtaining detailed financial information from it. Included in this credit analysis is a detailed review of the borrower's actual and contingent liabilities, its liquidity position, any equity issuance obligations it may have which could adversely affect its shareholders' equity, any debt on which the borrower may be potentially liable, even if not on the borrower's books directly, the quality of the borrower's profits on earnings and the borrower's actual ***liquidity***, including sources of funding to support repayment of any loans. In addition, when CIBC made large loans to or committed itself to credit facilities for a corporation, it was required to closely monitor the company by frequently reviewing its financial condition and ongoing operations for any material changes and insist that top financial officers of the borrower keep it informed of the current status of the borrower's business and financial condition. As a result, CIBC obtained and retained extremely detailed information concerning the actual financial condition of Enron throughout the Class Period and was aware that the actual condition of Enron's business, its finances and its financial condition was far worse than was being publicly disclosed by Enron, or as described or disclosed in each of CIBC's analyst reports on Enron. ¶650.

8/01	$3 billion committed credit facility for Enron to back up commercial paper

CIBC's commercial paper back-up credit facilities for Enron were ***extremely significant***. They enabled Enron to stay liquid by helping Enron maintain its access to the commercial paper market where it could borrow billions to finance day-to-day operations, while CIBC pocketed huge commitment fees on the back-up credit line. ¶¶719, 722-728.

CIBC was willing to engage and participate in the fraudulent scheme and course of business because its participation created enormous profits for CIBC (and its top executives) ***as long as the Enron scheme continued in operation*** – something that CIBC was in a unique position to cause. While CIBC was lending hundreds of millions to Enron, it was limiting its own risk in this regard, as it knew that so long as Enron maintained its investment grade credit rating and continued to report strong current period financial results and credibly forecast strong ongoing revenue and profit growth, ***Enron's access to the capital markets would continue to enable Enron to raise hundreds of millions, if not billions, of dollars of fresh capital from public investors which would be used to repay or reduce Enron's commercial paper debt and the loans from CIBC to Enron so that the scheme could continue***. ¶722.

In fact, the proceeds of Enron's securities offerings during the Class Period underwritten by CIBC or other investment banks were utilized to repay Enron's existing commercial paper and bank indebtedness, including indebtedness to CIBC. Thus, throughout the Class Period, CIBC was pocketing millions of dollars a year in interest payments, syndication fees and investment banking fees by participating in the Enron scheme to defraud and stood to ***continue*** to collect these huge amounts on an annual basis going forward so long as it helped perpetuate the Enron Ponzi scheme, ***while CIBC's top executives pocketed huge returns on their secret investment in LJM2*** – returns created by the very manipulative or deceptive acts and contrived transactions between Enron and LJM2 entities which CIBC was financing – and which were hiding billions of Enron's debt and artificially inflating its profits by hundreds of millions of dollars while looting Enron. ¶722.

In addition, CIBC also engaged and participated in the scheme to defraud by ***making false statements to the market regarding Enron***. First of all, the Registration Statements for the Enron

stock sale – Enron's 2/99 27.6 million share common stock offering, Enron's 5/99 $500 million 7.375% Enron notes and the New Power IPO each contained false and misleading statements – ***which are statements made by CIBC as an underwriter*** – including false interim and annual financial statements, and false statements concerning the structures of and Enron's relationship to SPEs and related parties, Enron's financial risk management statistics, as well as the condition of Enron's business operations and the value of its assets. ¶723. *See infra* at 95-96.

In addition, throughout the Class Period, CIBC ***issued*** 15 analysts' reports on Enron which contained false and misleading statements concerning Enron's business, finances and financial condition and prospects, including those dated 1/25/99, 4/14/99, 7/14/99, 10/7/99, 10/13/99, 1/6/00, 1/18/00, 1/21/00, 4/12/00, 7/24/00, 10/19/00, 4/19/01, 7/13/01, 8/15/01 and 10/17/01. ¶132, 148, 161, 176, 183, 194, 199, 207, 230, 251, 269, 323, 334, 349, 372 and 724. *See infra* at 77-94.

These were all statements by CIBC to the securities markets which helped artificially inflate the trading prices of Enron's publicly traded securities. ***Keeping Enron's stock price inflated was also important to CIBC as it knew that if the stock price fell below various "trigger" prices embedded in the LJM2 SPEs CIBC was funding, Enron would be required to issue millions of additional Enron shares, which would reduce Enron's shareholders' equity by hundreds of millions, if not billions, of dollars, endanger its investment grade credit rating, likely cut off its access to the capital markets, and thus endanger the ongoing scheme from which CIBC and its top officials were profiting***. ¶724.

In addition to its own direct liability for making false and misleading statements, CIBC also engaged and participated in and furthered the fraudulent scheme by helping to finance or otherwise participate in illicit transactions with Enron which it knew would contribute materially to Enron's ability to continue to falsify its financial condition and thus continue the operation of the Enron Ponzi scheme.

One of the primary vehicles utilized to falsify Enron's financial results during the Class Period was LJM2, which was secretly controlled by Enron and was used to help create numerous SPEs (including the infamous Raptors) with which Enron engaged in contrived transactions to artificially inflate Enron's profits while concealing billions of dollars in debt that should have been

on Enron's balance sheet. LJM2 was a privately held entity created by Enron with the help of CIBC at year-end 99. ¶¶24, 646-647, 732.

It was indispensable that LJM2 be formed before year-end 99 because of the need to fund new SPEs to deal with Enron to create huge 4thQ 99 profits for Enron so it could meet its forecasted 99 earnings and move hundreds of millions of dollars of debt off Enron's balance sheet. However, there was tremendous time pressure and Merrill Lynch could not raise sufficient money from outside investors in LJM2 in time to fund LJM2 by year-end 99 with sufficient capital to enable it to do the desperately needed transactions with Enron. CIBC knew, because LJM2 was going to be principally utilized to engage in transactions with Enron where Enron insiders (Fastow, Kopper and Glisan) would be on both sides of the transactions, that the LJM2 partnership would be extremely lucrative – virtually guaranteed to provide huge returns to LJM2's investors like itself – basically from looting Enron. ¶¶646-647. So, in an extraordinary step, CIBC, knowing that LJM2 was going to be an extraordinarily lucrative investment, put up $2.25 million early – many times more than their allocated shares – on or about 12/22/99 – to pre-fund LJM2. This early money from Enron's banks – including CIBC – on 12/22/99, provided critical funding to enable Enron to engage in the Whitewing, CLO, Nowa Sarzyna Power Plant, MEGS natural gas and Yosemite certificates deals between 12/22-29/99. These were SPE deals funded by LJM2 – transactions that generated millions in phony profits for Enron, just before year-end 99, and moved hundreds of millions of dollars of debt off Enron's balance sheet. ¶647. These deals were then "undone" in the 1stQ 00 with huge returns to the banks and bankers like CIBC that had pre-funded LJM2. ¶¶466-475. During 00-01, ***the LJM2 partnership, with the*** financing CIBC helped to provide, was able to form and finance several SPEs – ***including the Raptors*** – with which Enron engaged in manipulative or deceptive devices and transactions to inflate its reported profits, while improperly moving billions in debt off Enron's balance sheet and into the SPEs. ¶¶461-464, 476-488, 731-732.

To the extent that Enron's bankers – including CIBC – were permitted to invest in LJM2, ***this was a reward to them for their ongoing participation in the scheme.*** ¶¶25, 646.[32] ***In this regard, as a reward for CIBC's participation in the scheme, CIBC was permitted to ultimately invest $15 million in LJM2 which facilitated the financing of that critical vehicle.***

According to *The New York Times*:

Enron Ex-Chief Said to Voice Suspicion of Fraud

> ***Jeffrey K. Skilling, the former chief executive of Enron, has told investigators that the top flight financial returns that investors made from a partnership that did business with the company could have been achieved only if the corporation was defrauded***, according to documents and people involved in the case.... He indicated to the S.E.C. and to investigators for a special committee of the Enron board that such returns – which were as high as 2,500 percent in one transaction – ***could not have been achieved through arm's-length transactions, according to these people and investigative notes***.... Mr. Skilling was said to have grown agitated as he described his opinion of the information.... In the LJM2 presentation, investors were told that the partnership had generated rates of return on its investments in the Raptor ranging from just more than 150 percent to 2,500 percent.

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32 After LJM2 was fully funded in early 00 as other investors' money flowed into LJM2, the banks' "over-funding" in 12/99 was adjusted for in the subsequent capital contributions to LJM2. ¶647. This is shown below:

LJM2 PARTNERSHIP FUNDING

Partnership Investor	Bank	Total LJM-2 Funding Commitment	% of Fund	Pre-Funding 12/22/99	2d/3d Close Draw	4th Close Draw	Net Investment @ 6/30/00
Chemical Investments, Inc , J P Morgan Partnership Investments Corp ; Sixty Wall Street Fund, LP	JP Morgan	$ 25,000,000	6 3928%	3,750,000	$ (1,688,475)	$ (894,485)	$ 1,167,040
CIBC Capital Corporation	CIBC	$ 15,000,000	3 83568%	2,250,000	$ (1,013,085)	$ (536,679)	$ 700,236
Citicorp, Travelers, Primerica	CitiGroup	$ 15,000,000	3 83568%	1,500,000	$ (675,390)	$ (106,470)	$ 718,140
BT Investment Partnership, Inc	Deutsche Bank	$ 10,000,000	2 55712%	1,500,000	$ (675,390)	$ (357,786)	$ 466,824
DLJ Fund Investment Partners III, L P	CS First Boston	$ 5,000,000	1 27856%	750,000	$ (337,695)	$ (178,893)	$ 233,412
LBJ Group Inc	Lehman	$ 10,000,000	2 55712%	1,500,000	$ (675,390)	$ (357,786)	$ 466,824
MLJDX Positions, Inc ; Louis Chiovacci, ML/LJM2 Co-Investment, LP	Merrill Lynch	$ 22,645,000	5 79059%	750,000	$ (337,695)	$ 707,820	$ 1,120,125
Papyrus I Funding Trust	Bank America	$ 45,000,000	11 50703%			$ 2,261,844	$ 2,261,844

Kurt Eichenwald,"Enron Ex-Chief Said to Voice Suspicions of Fraud," *New York Times*, 4/24/02.

Thus, these favored investors in LJM2 like CIBC or the top executives at CIBC actually ***witnessed*** and ***benefitted from*** a series of extraordinary payouts from the Raptor SPEs which LJM2 controlled over the next two years – securing hundreds of millions of dollars in distributions from the Raptors to LJM2 and ***then to themselves*** – cash generated by the illicit and contrived transactions Enron was engaging in with the Raptors to falsify its financial results. Thus, the banks and bankers who were partners in LJM2 ***were not only knowing participants in the Enron scheme to defraud, they were direct economic beneficiaries of it – from the looting of Enron***. ¶649.[33]

CIBC and Enron also engaged in fraudulent transactions utilizing an entity which CIBC and Enron controlled, known as Project Braveheart, a partnership which related to Enron's VOD joint venture with Blockbuster and enabled Enron to improperly report over $110 million in phony profits in the 4thQ 00 and the 1stQ 01. ¶725.

When Enron announced its VOD joint venture with Blockbuster in 7/00, and as it and CIBC described that venture in following months, they were extraordinarily positive about it, assuring investors the Blockbuster VOD venture was a first-of-its-kind, that it validated Enron's Broadband content delivery technology and was worth more than $1 billion to Enron. They also extolled the high quality of the EIN, *i.e.*, Enron's fiber optic system. ¶726.

However, CIBC knew that the VOD project was very risky and was plagued by technical and legal problems that made it likely that it would never advance past a pilot project stage – at least not for a long time. Nevertheless, CIBC worked with Enron to misuse mark-to-market accounting to improperly accelerate and record over $100 million of profit from the Blockbuster joint venture in current periods, *i.e.*, year-end 00 and the 1stQ of 01, when Enron desperately needed to create profits to cover the true adverse condition of its business. Thus, on 12/28/00, CIBC and Enron formed a partnership – EBS Content Systems LLC – known as Project Braveheart. Enron and CIBC assigned an arbitrary and unrealistic value of $124 million to the partnership and CIBC agreed to ***invest*** (not loan) $115 million in the partnership in return for a large up-front fee and the right to receive 93%

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[33] ***These payments from LJM2 were on top of the huge advisory fees***, underwriter fees, interest and loan commitment fees CIBC was already getting from Enron. ¶649.

of Enron's profits from the VOD joint venture over the next 20 years. This enabled Enron to recognize $110 million in profits from this transaction in the 4thQ of 00 and 1stQ of 01. ¶727.

However, this profit recognition was fraudulent as the VOD joint venture was nothing more than a failing project. The CIBC/Enron partnership was a phony contrivance, as ***Enron had secretly guaranteed CIBC's investment in Braveheart so that CIBC was not a true investor and was not at risk***. CIBC demanded and got its guarantee because it knew that the VOD venture was very troubled and unlikely to succeed and entered into the transaction as an accommodation to Enron to allow Enron to create and report phony profits to falsify its financial condition. To attempt to create the 3% outside equity investor participation necessary to create a "legitimate" SPE, Enron and CIBC got a company called nCUBE (a contractor for Enron on the VOD project) to put $2 million into Braveheart at year-end 00. However, Enron and CIBC secretly promised to return that $2 million right after year-end 00. Creating these phony profits was indispensable to allowing Enron to publicly stress the success of Enron's new Broadband content delivery business. However, in reality the VOD partnership was an illusion. Enron's technology did not work – it could not deliver the content over its fiber optic network and the test of the system in late 00 was a catastrophic failure. Blockbuster also did not have and could not obtain the legal right to provide the VOD venture content (movies) in digital form because it had not acquired and could not acquire those rights from the movie studios. The VOD venture was abandoned in 3/01, less than eight months after it started – but Enron ***did not at that time reverse*** the over $110 million in phony profits it had recorded. And because CIBC knew Enron's financial condition was such that it could not honor its secret guarantee to repay CIBC its $115 million investment in Braveheart, CIBC agreed to carry that amount for Enron until later so as to permit the Enron Ponzi scheme to continue. ¶728.

The Wall Street Journal has reported on this bogus transaction as set forth below (¶729):[34]

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[34] To the extent CIBC argues this Braveheart transaction was not as alleged, this is a factual denial which is not permitted at the 12b-6 stage.

A Blockbuster Deal
Shows How Enron
Overplayed Its Hand

Company Booked Big Profit
From Pilot Video Project
That Soon Fizzled Out

"I Just Couldn't Believe It"

When Enron Corp-. and Blockbuster Inc. joined forces in mid-2000, it looked like they were onto something big. The companies announced they would soon be allowing consumers across America to choose from among thousands of movies, including hot new features, sent via ***telephone lines to watch on their TVs at home***.

Announcing the partnership in July 2000, Enron Chairman Kenneth Lay called it the "***killer app for the entertainment industry***."...

It looked like another brilliant move by Enron, already a hero on Wall Street. The Houston company had aligned itself with the nation's leading video retailer. the 20-year deal would ***bring traffic to Enron's fledgling fiber-optic telecommunications network***. And the venture reaffirmed the notion that Enron, already America's preeminent energy trader, would soon be a lucrative middleman for a vast range of other products, as well.

* * *

Enron ... set up an affiliated partnership, code-named Project Braveheart .... Enron obtained a $115.2 million investment in the partnership from ***CIBC World Markets***, the investment-banking arm of Canadian International Bank of Commerce in Toronto. In return, CIBC received a promise of almost all earnings from Enron's share of the venture ....

The partnership had no separate staff and no assets other than Enron's stake in the venture with Blockbuster, which was barely getting off the ground in late 2000. Still, in an audacious accounting move, ***Enron claimed $110.9*** million in profits from Braveheart in the fourth quarter of 2000 and the first quarter of 2001. That amount sharply limited the overall losses suffered by Enron's ***young broadband-services division in the two periods***.

* * *

"It was nothing but a pilot project," says Blockbuster's Ms. Raskopf. "I don't know how anyone could have been booking revenues." Blockbuster ... never accounted for any financial gain or loss from the short-lived venture, she says.

Project Braveheart was one of dozens of outside partnerships that Enron officials created to burnish the company's financial results at a time when it felt under pressure to show high profit that would justify its soaring stock price, according to current and former company executives....

Enron's current chief financial officer, Jeffrey McMahon, says he had nothing to do with Braveheart or related partnerships. "***I'm not going to defend them***," he says.

* * *

In exchange for its $115.2 million investment, CIBC was supposed to receive 93% of Braveheart's cash flow for 10 years. ***But Enron made the investment in the embryonic partnership more attractive by promising to repay CIBC the full value of its investment if the partnership failed to be a money maker.***

Three former Enron employees familiar with the partnership deals say that this kind of guarantee was designed specifically to attract investors who otherwise might worry about the viability of the deals. "The banks didn't care about the assets they invested in and that's how it got out of control," says one former Enron employee who helped create some of the partnerships.

* * *

Enron began using Braveheart for accounting purposes in the fourth quarter of 2000. For that period, Enron claimed its ownership of Braveheart resulted in a $53 million profit, even though the Blockbuster venture was only two weeks into its pilot program and not generating any profit at all.

One of the former Enron employees familiar with Braveheart recalls wondering at the time," '***How can they monetize this asset when we're still putting it together?' It didn't make any sense to me.***"

In the following quarter, the first of 2001, Enron claimed an additional $57.9 million gain from Braveheart. "***I was just floored," says the former employee. "I mean, I couldn't believe it.***"

Another example of how CIBC participated in the falsification of Enron's reported results is the New Power IPO, by which Enron created and improperly recognized $370 million in profits in the 4thQ 00. In 00, Enron controlled and owned millions of shares of New Power stock – then a private company. If Enron could take New Power public, create a trading market in its stock, then Enron could recognize a profit on the gain on its shares by "hedging" that gain via yet another non-arm's-length transaction with the CIBC financed-LJM2 entity. In the 4thQ 00, when Enron desperately needed to create profits to perpetuate the Enron Ponzi scheme, CIBC did the huge New Power IPO – 27.6 million shares at $21 per share. Then CIBC and Enron quickly moved to create a huge phony profit using the CIBC-financed LJM2. Immediately after the New Power IPO, Enron and CIBC created Hawaii 125-0. CIBC (and several other of Enron's banks) made a "loan" of $125 million to Hawaii 125-0, but received a secret "total return swap" guarantee that protected CIBC and the other banks against ***any loss*** from Enron. Enron transferred millions of its New Power warrants

to Hawaii 125-0 to "secure" the banks' loan and created a huge $370 million "profit" on the purported gain on the New Power warrants made possible by the New Power IPO. Hawaii 125-0 supposedly "hedged" the warrants with another entity created and controlled by Enron called "Porcupine." To supposedly capitalize, LJM2 put $30 million into Porcupine to facilitate the so-called hedge of the New Power warrants, but, one week later, Porcupine paid the $30 million back to LJM2 plus a $9.5 million profit – leaving Porcupine with no assets. During 01, New Power stock fell sharply. This collapse in New Power's stock turned Enron's huge gain on its New Power stock/warrants into a huge loss early in 01 – a loss of about $250 million – which Enron concealed until 10/01. ¶731.[35]

After LJM2 was formed and CIBC had secretly been permitted to invest in LJM2 (ultimately to the tune of over $15 million), which funded bogus deals with Enron to artificially inflate its profits while hiding debt, and after CIBC's secret participation in the bogus Project Braveheart and Hawaii 125-0 deals which created additional phony profits for Enron while also hiding large amounts of debt, CIBC continued to issue very positive analyst reports on Enron. Each of these reports contained "boilerplate" disclosures like:

> We may from time to time have long or short positions in any buy and sell securities referred to herein. The firm may from time to time perform investment banking or other services for, or solicit investment banking or other business from, any company mentioned in this report.

These boilerplate disclosures were the same as they were before 12/99 – i.e., they did not change after CIBC secretly invested in LJM2 or secretly financed the Hawaii 125-0 or Braveheart deals, which, in fact, were non-arm's-length fraudulent deals to artificially inflate Enron's earnings and enable top Enron insiders and CIBC or CIBC executives to loot Enron. The failure to disclose the LJM2 involvement of CIBC or its role in the Braveheart and Hawaii 125-0 transactions made its "boilerplate" disclosure false and misleading and concealed from the market the very significant and serious conflict of interests which Enron and CIBC knew would have cast serious doubts on the objectivity and honesty of CIBC's analyst reports on Enron and disclosed that CIBC or its executives had compromising ties to and serious conflicts of interest regarding Enron.

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[35] As with the Braveheart SPE deals, CIBC's factual denials of the allegations or attempt to have inferences drawn its way on the Hawaii 125-0 deal is improper at the 12b stage.

IV. CIBC IS LIABLE UNDER 1933 ACT TO PURCHASERS OF ENRON'S 7.375% NOTES IN 5/99 FOR SELLING THOSE SECURITIES PURSUANT TO A FALSE AND MISLEADING REGISTRATION STATEMENT

Wall Street underwriters play an extremely important – indeed indispensable role – in protecting investors in public companies and ensuring that public companies and those associated with public companies comply with their obligations of full, fair and complete disclosure when selling securities to the public.

> By associating himself with a proposed offering, an underwriter impliedly represents that he has made such an investigation in accordance with professional standards. Investors properly rely on this ***added protection which has a direct bearing on their appraisal of the reliability of the representations in the prospectus***. The underwriter who does not make a reasonable investigation is derelict in his responsibilities to deal fairly with the investing public.

In re Richmond Corp., 41 S.E.C. 398, 406 (1963). In *Chris-Craft Indus. v. Piper Aircraft Corp.*, 480 F.2d 341, 370 (2d Cir. 1973), the Second Circuit stated:

> Self-regulation is the mainspring of the federal securities laws. ***No greater reliance in our self-regulatory system is placed on any single participant in the issuance of securities than upon the underwriter***. He is most heavily relied upon to verify published materials because of his expertise in appraising the securities issue and the issuer, and because of his incentive to do so. He is familiar with the process of investigating the business condition of a company and possesses extensive resources for doing so. Since he often has a financial stake in the issue, he has a special motive thoroughly to investigate the issuer's strengths and weaknesses. ***Prospective investors look to the underwriter – a fact well known to all concerned and especially to the underwriter – to pass on the soundness of the security and the correctness of the registration statement and prospectus***.

In *Escott v. Barchris Constr. Corp.*, 283 F. Supp. 643, 697 (S.D.N.Y. 1968), the court emphasized the importance of independent verification by underwriters:

> The purpose of Section 11 is to protect investors. To that end the underwriters are made responsible for the truth of the prospectus. If they may escape that responsibility by taking at face value representations made to them by the company's management, then the inclusion of underwriters among those liable under Section 11 affords the investors no additional protection. To effectuate the statute's purpose, the phrase "reasonable investigation" must be construed to require more effort on the part of the underwriters than the mere accurate reporting in the prospectus of "data presented" to them by the company. It should make no difference that this data is elicited by questions addressed to the company officers by the underwriters, or that the underwriters at the time believe that the company's officers are truthful and reliable. ***In order to make the underwriters' participation in this enterprise of any value to the investors, the underwriters must make some reasonable attempt to verify the data submitted to them. They may not rely solely on the company's officers or on the company's counsel. A prudent man in the management of his own property would not rely on them***.

Finally, in *Feit v. Leasco Data Processing Equip. Corp.*, 332 F. Supp. 544, 582 (E.D.N.Y. 1971), the court stated that underwriters

> are expected to exercise ***a high degree of care in investigation and independent verification of the company's representations***. Tacit reliance on management assertions is unacceptable; the underwriters must play devil's advocate.

CIBC grossly violated these duties in its dealings with Enron. This Court has noted §11 is a non-fraud remedy:

> A plaintiff is not required to demonstrate scienter under §11, and a defendant will be liable for innocent or negligent material misrepresentations. *Id.* Nevertheless, where §11 and §12(a)(2) claims sound in fraud, the plaintiff is required to plead the circumstances constituting the alleged fraud with particularity under Rule 9(b). *Melder v. Morris*, 27 F.3d 1097, 1100 n.6 (5th Cir. 1994); *In re Stac Electronics Sec. Litig.*, 89 F.3d 1399, 1405 & n.3 (9th Cir. 1996), *cert. denied sub nom. Anderson v. Clow*, 520 U.S. 1103 (1997). The Fifth Circuit recently issued an opinion that limits the holding of *Melder* and makes clear that where a complaint does not allege that the defendants are liable for fraudulent or intentional conduct, especially where it disavows and disclaims any allegations of fraud in its strict liability 1993 Securities Act claims, its claims do not "sound in fraud" and they cannot be dismissed for failure to satisfy Rule 9(b). *Lone Star Ladies Inv. Club v. Schlotzsky's Inc.*, ___ F.3d ___, No. 99-50958, 2001 WL 21259, *2-3 (5th Cir. Jan. 9, 2001).

Landry's, slip op. at 11 n.13.[36]

CIBC acted as an underwriter in selling $500 million of Enron 7.375% notes in 5/99 – pursuant to a false Registration Statement. This Registration Statement was false and misleading due to the incorporation of Enron's 97-98 10-Ks and its 98 10-Qs that contained Enron's ***admittedly false financial statements for 97-98, which understated Enron's debt by billions of dollars and overstated its earnings by hundreds of millions of dollars***, as detailed in ¶¶418-611 of the CC. The restatement of previously issued financial statements is an admission that they were materially false when issued – and Enron has restated these results by huge amounts. While the Registration Statement included audited annual financial statements, significantly, it also incorporated or included all documents filed pursuant to §13(a) of the 1934 Act prior to the respective offerings, ***including Enron's 98 10-Qs which contained Enron's admittedly unaudited financial false and misleading***

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[36] The CC contains the required disclaimer. ¶1005.

unaudited quarter financial results. ¶615.[37] Since the interim 98 financial statements were unaudited, they were not expertised, and CIBC is responsible for them.

Thus, under 1933 Act §11, CIBC, as an underwriter in this offering is *prima facie* liable to the purchasers of these securities subject to the defendant proving that in the exercise of due care or diligence, they did not know and could not have known of the falsify of the Registration Statements forecasting these false financial results. Given the duration and the size of the falsity of the financial statements, CIBC, which foisted these worthless securities on the public, faces quite a burden in this regard.

This exposes CIBC to §11 liability under the 1933 Act – ***non-fraud liability*** – under which it is *prima facie* liable and can avoid liability only by bearing ***its burden of proof*** that it had, "after reasonable investigation, reasonable ground to believe and did believe ... that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading," *i.e.*, the underwriter's so-called "due diligence" defense. 15 U.S.C. §77k(a)(5), (b)(3).

In *Landry's*, this Court upheld a §11 claim against the defendant investment banks, stating:

> The Court also finds that Plaintiffs have also adequately pled their claims against the Landry Defendants under §11 of the Securities Act. They have identified specific purportedly untrue statements in Landry's Prospectus and alleged that Defendants, who were directors of the issuer and some of whom signed the document, negligently breached their duty to make a reasonable investigation or possess reasonable grounds for believing that the representations were true and not materially misleading. The complaint expressly disavows reliance on or incorporation of the allegations elsewhere in the complaint alleging fraud, thus falling within the holding of *Melder*, 27 F.3d at 1100 n.6. *Lone Star Ladies Inv. Club v. Schlotzsky's Inc.*, ___ F.3d ___, No. 99-50958, 2001 WL 21259, *2-3 (5th Cir. Jan. 9, 2001).
>
> * * *
>
> As for the Underwriter Defendants' motion to dismiss, Section 11 imposes essentially absolute liability for false statements or omissions in a prospectus. No scienter need be alleged Nor do the requirements of Rule 9(b) need to be met. *Lone Star Ladies Inv. Club v. Schlotzsky's Inc.*, ___ F.3d ___, No. 99-50958, 2001 WL 21259, *2-3 (5th Cir. Jan. 9, 2001). Plaintiffs have met their pleading burden.

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[37] While the CIBC may be able at trial to establish a defense to liability for these expertised, *i.e.*, certified financial statements, in light of the CC's allegations that CIBC knew those annual certified financial statements were false, CIBC may not do so now at the 12b-6 stage. *Murphy*, 1996 U.S. Dist. LEXIS 22207, at *23.

Landry's, slip op. at 64-65. The same is true here as to CIBC. Thus, regardless of the enhanced pleading requirements of the 95 Act or Rule 9(b) or the reach of 1934 Act §10(b)/Rule 10b-5 liability, CIBC is in this case due to its 1933 Act §11 liability.

V. CIBC CAN BE LIABLE UNDER 1934 ACT §10(b) AND RULE 10b-5 (i) FOR MAKING FALSE STATEMENTS, OR (ii) FOR PARTICIPATING IN A FRAUDULENT SCHEME OR COURSE OF BUSINESS THAT OPERATED AS A FRAUD OR DECEIT ON PURCHASERS OF ENRON'S SECURITIES, OR (iii) FOR EMPLOYING ACTS OR MANIPULATIVE DEVICES TO DECEIVE

Plaintiffs here have also pleaded and are pursuing theories of recovery against CIBC that are well-grounded in the express language of the 1934 Act. Section 10(b) of the 1934 Act states:

> Manipulative and deceptive devices
>
> It shall be unlawful for any person, directly or indirectly ...
>
> * * *
>
> (b) [t]o use or employ, in connection with the purchase or sale of any security ... ***any manipulative or deceptive device or contrivance*** in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.[38]

15 U.S.C. §78j(b).

Rule 10b-5 promulgated by the SEC flows directly from the language of §10(b) itself and provides:

> §240.10b-5 Employment of manipulative and deceptive devices
>
> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
>
> (a) to employ any device, scheme or artifice to defraud,
>
> (b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

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[38] Note that §10(b) itself does not expressly prohibit untrue statements of material facts or material omissions. This prohibition, like the prohibition against fraudulent schemes and fraudulent courses of business, are expressed in Rule 10b-5.

in connection with the purchase or sale of any security.

17 C.F.R. §240.10b-5.

Not only does Rule 10b-5 forbid the making of "any untrue statement of a material fact," it also provides for scheme liability. Scheme liability is authorized by the text of §10(b). According to the Supreme Court, §10(b)'s prohibition of "any ***manipulative or deceptive device or contrivance***" necessarily encompasses any "***scheme to defraud***." In *Ernst & Ernst*, the Court referred to the dictionary definitions of §10(b)'s words, to find that a "device" is "'[t]hat which is devised, or formed by design; a contrivance; an invention; project; ***scheme; often, a scheme to deceive***; a stratagem; an artifice.'" 425 U.S. at 199 n.20 (quoting *Webster's International Dictionary* (2d ed. 1934)). The Court found that a "contrivance" means "'***a scheme, plan, or artifice***.'" *Id.* (quoting *Webster's International Dictionary*); *see also Aaron*, 446 U.S. at 696 n.13. Clearly, "scheme" is encompassed in the broad language of §10(b).

Thus, Rule 10b-5 – adopted by the SEC to implement §10(b) – makes it unlawful for any person "***directly or indirectly***" to employ "***any*** device, ***scheme***, or artifice ***to defraud***," "***to make any untrue statement[s]***," or to "***engage in any act, practice, or course of business which operates ... as a fraud or deceit upon any person***." 17 C.F.R. §240.10b-5. *See also U.S. Quest*, 228 F.3d at 407.

Prior to the Supreme Court's endorsement of the presumption of reliance based on the fraud-on-the-market theory for both misrepresentations and omissions in *Basic*, 485 U.S. 224, the Fifth Circuit had held that the theory applied ***only*** to omission cases and not misrepresentation cases. Thus, in some instances, securities plaintiffs sought recovery under subsection (a) and (c) of Rule 10b-5 alleging ***fraudulent scheme and course of business liability***. The Fifth Circuit expressly recognized the validity of these theories of recovery.

For instance, in *Finkel*, 817 F.2d 356, plaintiffs sued under §10(b) and Rule 10b-5, claiming that the stock of Docutel was inflated due to false financial reports. According to plaintiff, Olivetti (which owned 46% of Docutel and controlled it) forced Docutel to buy Olivetti's excess inventories at inflated prices so Olivetti could hide losses it was suffering. Docutel concealed this financial manipulation for some time but, when its auditors discovered the financial manipulation and forced

a large inventory writedown, huge losses were disclosed and Docutel stock fell. The district court dismissed the complaint against Olivetti and Docutel because plaintiff failed to allege reliance on any of the false statements in Docutel's SEC filings, etc. that were alleged in the Complaint.

> But the fact that the complaint lists a number of documents filed with the SEC does not limit plaintiff's claim to subsection (2) only. For, as in *Shores*, plaintiff's lack of reliance on these documents does not resolve the claims made under 10b-5(1) and (3). ***We find that plaintiff's complaint properly alleges a scheme to defraud or course of business operating as a fraud for purposes of the first and third subsections; plaintiff's complaint, taken as a whole, alleges that Olivetti forced Docutel to take its worthless inventories, that this scheme or course of business was not disclosed, and that the effect was to defraud certain purchasers of Docutel.***
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> The most significant event which allegedly led to the loss by plaintiff is the claim that Olivetti forced Docutel to take worthless inventories without disclosing that fact in the marketplace; ***if proved, that conduct could equate with a scheme to defraud or course of business operating as a fraud in violation of 10b-5(1) and (3).*** Thus, we conclude that the district court erred in its dismissal of the complaint as to plaintiff's claims under 10b-5(1) and (3).

Id. at 363-64; *accord Heller v. Am. Indus. Props. Reit*, No. SA-97-CA-1315-EP, 1998 U.S. Dist. LEXIS 23286, at *14 (W.D. Tex. Sept. 28, 1998) ("The first and third subsections, on the other hand, ***create a duty not to engage in a fraudulent scheme or course of conduct*** ....").

Thus, the Fifth Circuit sitting *en banc* held that a defendant who did not himself make the statements in a misleading Offering Circular could be held primarily liable ***as a participant in a larger scheme to defraud of which that Offering Circular was only a part: "Rather than containing the entire fraud, the Offering Circular was assertedly only one step in the course of an elaborate scheme."*** *Shores*, 647 F.2d at 468.

The fraudulent scheme and course of business involving Enron ***was worldwide in scope, years in duration and unprecedented in scale*** and required the skills and active participation of lawyers, bankers and accountants to help design, implement, conceal and falsely account for the deceptive acts and devices, manipulative or deceptive contrivances and artifices they and Enron were using to falsify Enron's reported profits and financial condition and to continue its fraudulent course of business.

The notion that *Central Bank*, 511 U.S. 164, issued a broad edict that lawyers, bankers and accountants are immune from liability for their participation in complex securities frauds is

nonsense. *Central Bank* expressly recognized: "The absence of §10(b) aiding and abetting liability ***does not mean that secondary actors in the securities markets are always free from liability under the securities Acts. Any person or entity, including a lawyer ... or bank who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser ... relies may be liable as a primary violator under 10b-5.... In any complex securities fraud, moreover, there are likely to be multiple violators.***" *Id.* at 191. A scheme to defraud often will involve a variety of actors, and investors are entitled to allege "***that a group of defendants acted together to violate the securities laws, as long as each defendant committed a manipulative or deceptive act in furtherance of the scheme.***" *Cooper*, 137 F.3d at 624; *accord First Jersey*, 101 F.3d at 1471; *In re Health Mgmt. Inc. Sec. Litig.*, 970 F. Supp. 192, 209 (E.D.N.Y. 1997); *Adam v. Silicon Valley Bancshares*, 884 F. Supp. 1398, 1401 (N.D. Cal. 1995); *In re ZZZZ Best Sec. Litig.*, 864 F. Supp. 960, 969-70 (C.D. Cal. 1994).

In *Central Bank*, 511 U.S. 164, a public building authority issued bonds to finance public improvements. Central Bank served as indenture trustee. The bonds were secured by liens covering property. The bond covenants required that the liened land be worth at least 160% of the principal amount of the bonds. Central Bank got a letter expressing fear that property values were declining and that perhaps the 160% value test was no longer met. The bank did nothing. Soon afterwards, the public building authority defaulted on the bonds. The bonds were not publicly traded. Central Bank, which had no commercial lending relationship with the municipal entity involved and which was not an investment bank, issued no analysts' reports about the issuer of the municipal bonds and thus made no statement and took no affirmative act that could have affected the trading price of the municipal bonds in issue. Clearly, this is a significantly different fact pattern from the Enron situation.

The *Central Bank* majority noted that their reasoning was "confirmed" by the fact that if they accepted the plaintiffs' aiding and abetting argument it would impose §10(b) liability when "at least one element critical for recovery" was absent, *i.e.*, reliance. *Id.* at 180 (citing *Basic*, 485 U.S. at 243 (the Supreme Court's "***fraud-on-the-market***" decision) for the proposition that a plaintiff must show reliance to recover under 10b-5). "Were we to allow the aiding and abetting action proposed in this

case, the defendant could be liable without any showing that the plaintiff relied upon the aider and abettor's statements ***or actions***." *Id.* The Court found that allowing plaintiffs to "circumvent the reliance requirement would disregard the careful limits on 10b-5 recovery mandated by our earlier cases." *Id.* However, in this case, the alleged scheme and fraudulent course of business ***inflated*** the prices of Enron's ***publicly traded*** securities. ¶¶74, 418-424, 715-734. Thus, the reliance element is not "***absent***" and the Supreme Court's prior decision in *Basic* is not circumvented – it is satisfied.

Central Bank thus denied recovery to victims of an alleged securities fraud who pleaded only one theory of recovery against the defendant bank – secondary liability dubbed "aiding and abetting." 511 U.S. at 191. However, the words aiding and abetting do not appear in §10(b) or Rule 10b-5. The Court said "***[T]he text of the 1934 Act does not itself reach those who aid and abet a §10(b) violation ... that conclusion resolves the case***." *Id.* at 177. The *Central Bank* plaintiffs did not, as the plaintiffs do here, plead or pursue recovery under the theory that the bank defendant made false and misleading statements in Registration Statements or other documents issued to the public, *e.g.*, analysts' reports ***or*** employed acts and manipulative or deceptive devices, or engaged in a fraudulent scheme or course of business that operated as a fraud or deceit on purchasers of the securities in issue. In the words of the Court, the plaintiffs "concede that Central Bank did not commit a manipulative or deceptive ***act*** within the meaning of §10(b)." *Id.* at 191. Thus, because the *Central Bank* plaintiffs pursued a theory of recovery which found ***no support in the text of either the statute or the rule, they lost***.

Central Bank cannot mean that a defendant cannot be liable under §10(b) unless it made misleading statements because the Court rejected that argument in *O'Hagan*, 521 U.S. 642. The Eighth Circuit had held that, under *Central Bank*, "§10(b) covers only deceptive statements or omissions on which purchasers and sellers, and perhaps other market participants, rely." *Id.* at 664. The Court reversed, holding that §10(b) does not require a defendant to speak. *Id.* Because §10(b) prohibits "'any manipulative or deceptive device or contrivance'" in contravention of SEC rules, this reaches "any deceptive device," whether or not the defendant spoke. *Id.* at 653. *Superintendent of Ins.*, 404 U.S. 6, is consistent with *O'Hagan*. In *Superintendent of Ins.*, a ***unanimous*** court upheld

a §10(b)/Rule10b-5 complaint alleging a "fraudulent scheme" involving the sale of securities where ***no*** false statement was alleged because:

> ***There certainly was an "act" or "practice" within the meaning of Rule 10b-5 which operated as "a fraud or deceit" on Manhattan, the seller of the Government bonds.***

Id. at 9 (footnote omitted).

This Court has stated, citing *O'Hagan*, that:

> ***A defendant need not have made a false or misleading statement to be liable.***

Landry's, slip op. at 9 n.12; *Waste Mgmt.*, slip op. at 75; *BMC Software*, 183 F. Supp. 2d at 869. But here, of course, CIBC did allegedly make false statements in Registration Statements and analysts' reports.

That this reading of §10(b)/Rule 10b-5 is clearly correct is shown by a new ***unanimous*** Supreme Court decision – *Zandford*, 2002 U.S. LEXIS 4023. In *Zandford*, the Court repeatedly cited with approval its seminal "***fraudulent scheme***" case *Superintendent of Ins.*, and reversed dismissal of a §10(b)/Rule 10b-5 complaint making the following key points:

- "***The scope of Rule 10b-5 is coextensive with the coverage of §10(b)*** ...." *Id.* at *7 n.1.
- "***[N]either the SEC nor this Court has ever held that there must be a misrepresentation about the value of a particular security" to violate §10(b)***. *Id.* at *13.[39]
- Allegations that defendant "'***engaged in a fraudulent scheme***'" or "'***course of business that operated as a fraud or deceit***'" stated a §10(b) claim. *Id.* at *13, *14-*17.

Central Bank clearly – ***but merely*** – stands for the proposition that no aiding and abetting liability exists under the 1934 Act because neither §10(b) nor Rule 10b-5 contain "aiding and abetting" language. The decision in *Central Bank* is ***quite narrow***. By contrast, the language of §10(b) and Rule 10b-5 is ***very broad***. Also, the purposes of §10(b) and Rule 10b-5 are remedial, intended to provide access to federal court to persons victimized in securities transactions:

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[39] To the extent *Ziemba*, 256 F.3d at 1205, seems to require a statement be made about a company which is "publicly attributable to the defendant at the time the plaintiff's investment decision was made," it is inconsistent with *Zandford*.

> [T]he 1934 Act and its companion legislative enactments [including the 1933 Act] embrace a "fundamental purpose ... to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry ...." Congress intended securities legislation enacted for the purpose of avoiding frauds to be construed "not technically and restrictively, but flexibly to effectuate its remedial purposes."

Affiliated Ute Citizens, 406 U.S. at 151. As noted by the Fifth Circuit:

> [T]he Court has concluded that the Exchange Act and the Securities Act should be construed broadly to effectuate the statutory policy affording extensive protection to the investing public. *See Tcherepnin*, 389 U.S. at 336, 88 S. Ct. at 553. *See also* S. Rep. No. 47, 73d Cong. 1st Sess. 1 (1933) (indicating legislative intent of the Securities Act to protect the public from the sale of fraudulent ***and speculative schemes***).

Meason, 652 F.2d at 549. "The federal securities statutes are remedial legislation and must be construed broadly, not technically and restrictively." *Paul F. Newton & Co.*, 630 F.2d at 1118.[40]

CIBC's claim that *Central Bank* eliminated scheme liability is flawed. Notwithstanding *Central Bank*, primary liability may be based on participation in a scheme to defraud or a course of business that operated as a fraud or deceit on securities purchasers pursuant to subsections (a) or (c) of Rule 10b-5. Fraudulent scheme or course of business liability is viable because:

- It is encompassed by the ***express language*** of the statute, which prohibits the "direct or indirect" "use or employment" of "any manipulative or deceptive device or contrivance;"
- It is encompassed by the ***express language*** of Rule 10b-5;
- It comports with the ***broad antifraud purposes*** of the statute;

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[40] The broad purposes of §10(b)'s prohibition of securities fraud and the Supreme Court's longstanding recognition of such broad purposes also support conspiracy and scheme liability. *See, e.g., Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 477 (1977) ("No doubt Congress meant to prohibit the full range of ingenious devices that might be used to manipulate securities prices."); *Affiliated Ute Citizens*, 406 U.S. at 152-53 (Proscriptions of §10(b) and Rule 10b-5 "are broad and, by repeated use of the word 'any,' are obviously meant to be inclusive. The Court has said that the 1934 Act and its companion legislative enactments embrace a 'fundamental purpose ... to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry.'") (footnote omitted) (quoting *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963)); *Capital Gains Research*, 375 U.S. at 186 (1963) (§10(b) should be construed "not technically and restrictively, but flexibly to effectuate its remedial purposes"); *Superintendent of Ins.*, 404 U.S. at 11 n.7 ("'[We do not] think it sound to dismiss a complaint merely because the alleged scheme does not involve the type of fraud that is "usually associated with the sale or purchase of securities." We believe that §10 (b) and Rule 10b-5 prohibit ***all*** fraudulent schemes in connection with the purchase or sale of securities, whether the artifices employed involve a garden type variety of fraud, or present a unique form of deception. Novel or atypical methods should not provide immunity from the securities laws.'") (emphasis in original) (quoting *A. T. Brod & Co.*, 375 F.2d at 397).

- It has ***long been upheld*** by the courts; and
- It imposes liability based on a ***primary*** violation of the federal securities laws committed directly by the defendant that goes beyond merely assisting another in committing a violation.

In Central Bank, the plaintiffs did not allege primary liability against the bank, did not allege a scheme to defraud, did not allege a fraudulent practice or course of business and did not invoke subsections (a) or (c) of Rule 10b-5.[41] The plaintiffs alleged only that the bank was "'***secondarily*** liable under § 10(b) for its conduct in ***aiding and abetting the fraud***.'" *Central Bank*, 511 U.S. at 168. The Court, therefore, did not address other liability theories. Yet defendants offer up numerous rationales as to why *Central Bank* eliminated Rule 10b-5(a) and (c) liability. They are:

1. ***The "Textualist" Rationale***. The Court took a strict textualist approach in concluding that there is no private aiding and abetting liability under §10(b). Just as the statute does not explicitly mention "aiding and abetting," it also does not mention "scheme," "act," "practice," or "course of business."

2 ***The "Manipulation and Misrepresentation Is It" Rationale***. The Court stated that "the statute prohibits only the making of a material misstatement (or omission) or the commission of a manipulative act," *Central Bank*, 511 U.S. at 177, which must be interpreted to mean that liability can only be premised upon conduct falling within subsection (b) of Rule 10b-5.

3. ***The "No More Secondary Liability" Rationale***. The Court's opinion holds that only primary violators may be held liable. Because scheme liability is a secondary liability theory similar to aiding and abetting, it is precluded.

None of these rationales for precluding fraudulent scheme and/or course of business liability under Rule 10b-5(a) and (c) are supportable because scheme and course of business liability is a ***textually-based, primary liability theory*** and there is no hard and fast rule that a defendant must make a false statement to face §10(b) liability – ***while in this case CIBC did, in fact, allegedly make several false and misleading statements***.

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[41] The *Central Bank* decision did not distinguish among the different subsections of Rule 10b-5.

- **The Flaws of the "Textualist" Rationale**

A major flaw of the textualist rationale is that scheme liability is ***firmly based*** on the language of both the statute and the rule. The statute itself contains only the general "***manipulative or deceptive device[s] or contrivance[s]***" language, leaving it to the SEC to more specifically proscribe fraudulent conduct. The SEC's rule-making authority would be superfluous if the rules it adopted had to use precisely the same words as in the statute. To be sure, "the private plaintiff may not bring a 10b-5 suit against a defendant for acts not prohibited by the text of § 10(b)," *Central Bank*, 511 U.S. at 173, and "'the 1934 Act cannot be read more broadly than its language and the statutory scheme reasonably permit.'" *Id.* at 174 (quoting *Chiarella v. United States*, 445 U.S. 222, 234 (1980)). But it is patently reasonable for the SEC to have determined that the "employment" of a "scheme to defraud" and the "engagement" in a fraudulent "act, practice, or course of business" constitute the "use or employ[ment]" of a "manipulative or deceptive device or contrivance."[42]

In *Ernst & Ernst*, the Court implicitly found that a "scheme to defraud" falls within the meaning of the "manipulative or deceptive device or contrivance" language of §10(b). 425 U.S. at 199 n.20. The Court relied in part on the 1934 dictionary definitions of "device" and "contrivance." *See id.*; *see also Aaron*, 446 U.S. at 696 n.13 (relying on same definitions to find scienter requirement under §17(a)(1) of 1933 Act). Both of those definitions included a "scheme." *See Ernst & Ernst*, 425 U.S. at 199 n.20.[43]

The Court itself showed that *Central Bank* should not be interpreted as ushering in a new era of strict textualist construction of the federal securities laws. In upholding the misappropriation theory of insider trading in *O'Hagan*, 521 U.S. 642, the Court upheld a non-textual form of securities

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[42] No subsection of Rule 10b-5 has ever been successfully challenged in any court as being outside the scope of §10(b) in the 60-year existence of the Rule.

[43] The statutory prohibition against "directly or indirectly" violating §10(b) must cover a scheme to commit manipulative or deceptive acts. It is unlikely that Congress would have prohibited the direct commitment of a fraudulent act and yet approved the commission of the same fraudulent act through joint activity – *i.e.*, a scheme. The "directly or indirectly" language in §10(b) was not enough for the Supreme Court to save aiding and abetting liability in *Central Bank*. But that was because aiding and abetting liability covered a broader range of conduct than the direct commission of a manipulative or deceptive act. Scheme conduct, however, involves joint action to commit a manipulative or deceptive act that should itself be considered, directly or indirectly, a manipulative or deceptive act by each of the schemers.

fraud and, in doing so, again exposed the long familiar broad expressions of the remedial purposes of the statute.[44]

- **The Flaws of the "Manipulation and Misrepresentation Is It" Rationale**

The Court in *Central Bank* said that §10(b) "prohibits only the making of a material misstatement (or omission) ***or the commission of a manipulative act***." 511 U.S. at 177. It also indicated §10(b) liability existed where there was reliance on a defendant's "statement or actions." *Id.* at 180; *see also id.* at 191 ("Any person or entity, including a lawyer, accountant, or bank, who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser or seller of securities relies may be liable as a primary violator under 10b-5, assuming ***all*** of the requirements for primary liability under Rule 10b-5 are met.") (emphasis in original).

There is absolutely nothing in the language of the statute, the legislative history, or the Rule that warrants restricting liability solely to misrepresentations or omissions or certain technical forms of manipulation. The express language of §10(b) clearly allows for liability by a person who does not actually make a statement or omit to say something he is under a duty to disclose. The statutory language "directly or indirectly, ... [t]o employ" in §10(b) is much broader than simply "directly to make." Similarly, the statutory language "any manipulative or deceptive device or contrivance" is much broader than simply "a misrepresentation or omission." Therefore, if the starting point in interpreting a statute is the language itself, *see Central Bank*, 511 U.S. at 173, there is no reason why liability under §10(b) must be limited to directly making misstatements or omissions or manipulating securities prices through certain specific technical or mechanical means.[45]

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[44] The Court also noted that the misappropriation theory is designed to protect the integrity of the securities markets against abuses and that the 1934 Act was enacted in part to insure the maintenance of fair and honest markets and thereby promote investor confidence. *O'Hagan*, 521 U.S. at 652, 657-59. For example, the Court stated that "[t]he theory is also well-tuned to an animating purpose of the Exchange Act: to insure honest securities markets and thereby promote investor confidence." *Id.* at 658. The Court detailed how investors would be hesitant to invest in an unfair market. *See id.*

[45] As the Supreme Court has stated, "***[no] doubt Congress meant to prohibit the full range of ingenious devices that might be used to manipulate securities prices***." *Santa Fe*, 430 U.S. at 477.

In addition, the SEC, in adopting subsections (a) and (c) of Rule 10b-5, implicitly recognized this. ***Unless this Court would strike down a rule that has been upheld for 60 years, the language "employ any device, scheme, or artifice to defraud" and "engage in any act, practice, or course of business which operates or would operate as a fraud or deceit" in subsections (a) and (c) of Rule 10b-5 is much broader than simply "make a misrepresentation or omission."***[46]

If the Court in *Central Bank* meant to strike down subsections (a) and (c) of Rule 10b-5, the Court certainly would have explicitly said so. To the contrary, the courts have long recognized that the scope of liability under subsections (a) and (c) of Rule 10b-5 is broader than that under subsection (b) and that those who engage in a fraudulent scheme may be liable in the absence of misrepresentations or omissions. *See, e.g., Affiliated Ute Citizens*, 406 U.S. at 152-53 (subsections (a) and (c) are broader than subsection (b) of Rule 10b-5); *First Jersey*, 101 F.3d at 1471-72; *SEC v. Seaboard Corp.*, 677 F.2d 1301, 1312 (9th Cir. 1982); *Shores*, 647 F.2d at 468 (*en banc*); *Competitive Assocs.*, 516 F.2d at 814-15 ("Not every violation of the anti-fraud provisions of the federal securities law can be, or should be, forced into a category headed 'misrepresentations' or 'nondisclosures.' ***Fraudulent devices, practices, schemes, artifices and courses of business are also interdicted by the securities laws.***"); *Blackie v. Barrack*, 524 F.2d 891, 903 n.19 (9th Cir. 1975) ("Rule 10b-5 liability is not restricted solely to isolated misrepresentations or omissions; ***it may also be predicated on a 'practice, or course of business which operates ... as a fraud ....'***"); *Richardson v. MacArthur*, 451 F.2d 35, 40 (10th Cir. 1971) ("Rule 10b-5 is a remedial measure of far greater breadth than merely prohibiting misrepresentations and nondisclosures concerning stock prices. No attempt is made in 10b-5 to specify what forms of deception are prohibited; rather, ***all fraudulent schemes in connection with the purchase and sale of securities are prohibited.***") (emphasis added and in original).

- **The Flaws of the "No More Secondary Liability" Rationale**

The principal flaws of this rationale are that *Central Bank* did not strike down every form of "secondary" liability and that, in any event, violations through fraudulent schemes, acts, practices,

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[46] Even from a common sense standpoint, schemes, acts, practices and courses of conduct can readily be manipulative or deceptive, irrespective of any statements or omissions.

or courses of business constitute primary violations of §10(b). In *Central Bank*, the Court did not make fine distinctions between conduct that constitutes a "primary" as opposed to that which constitutes a "secondary" violation of the statute. Nor did it hold that only "primary" violations are cognizable. It held that aiding and abetting could not constitute a violation because, as interpreted by the courts, aiders and abettors did not commit violations ***but only assisted them***, and the statute holds liable only those who commit violations.

Fraudulent acts, practices and scheme liability and course of business are ***primary*** liability theories in the sense that the defendant is directly liable for committing a violation of the statute. ***The fraudulent scheme, act, practice, or course of business is a direct violation of §10(b) and Rule 10b-5***. With respect to fraudulent acts, practices and a participation in the scheme to defraud or fraudulent course of business is itself the manipulative or deceptive act, even without the making of misrepresentations or omission. There is nothing derivative, vicarious or secondary about it. ***And CIBC here allegedly made false and misleading statements as well.***

All three subsections of Rule 10b-5 proscribe conduct for which a defendant may be ***primarily*** liable. Therefore, liability for a scheme to defraud or fraudulent act, practice, or course of business does not run afoul of *Central Bank*'s elimination of aiding and abetting liability. Cases both before and after *Central Bank* have recognized that scheme liability is a form of primary liability. *Hill v. Hanover Energy, Inc.*, No. 91-1964 (JHG), 1991 U.S. Dist. LEXIS 18566 (D.D.C. Dec. 16, 1991), is an example of such a pre-*Central Bank* case. In *Hill*, the defendant argued that the §10(b) claim should be dismissed for failure of the plaintiffs to allege any misrepresentations or omissions of material facts. *Id.* at *10-*11. The court rejected that argument, specifically finding that *Santa Fe* does not restrict §10(b) liability to misrepresentations or omissions. *See id.* at *11-*12. Rather, the court found that the alleged conduct of the defendant Hanover Energy, which included fraudulently inducing the plaintiff to give up his rights to acquire certain stock and to post a letter of credit, could fairly be viewed as manipulative or deceptive within the meaning of §10(b)

and an unlawful scheme to defraud within the meaning of subsection (a) or (c) of Rule 10b-5. *See id.*[47]

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[47] District court decisions after *Central Bank* have continued to recognize scheme liability as a form of primary liability. For example, in *BMC Software*, 183 F. Supp. 2d at 885-86, this Court seemed to recognize scheme liability, although it found that the plaintiffs had failed to satisfy the pleading requirements. In *BMC Software*, when discussing the pleading requirements in securities fraud cases and what must be pled to support scheme allegations, this Court stated:

> As its first ground for dismissal, Defendants emphasize that the amended complaint fails to allege with any particularity that nine of the eleven individual Defendants made any representations or participated in any way in the alleged scheme to defraud .... ***Plaintiffs must allege what actions each Defendant took in furtherance of the alleged scheme and specifically pled what he learned, when he learned it, and how Plaintiffs know what he learned.***
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> "***Primary liability may be imposed 'not only on persons who made fraudulent misrepresentations but also on those who had knowledge of the fraud and assisted in its perpetration.'***"

Id. at 885-86, 904-05.

District court decisions before *Central Bank* also recognized scheme liability. In *ZZZZ Best*, the district court directly addressed Ernst & Young's liability under subsections (a) and (c) of Rule 10b-5, explicitly recognizing that liability under §10(b) and Rule 10b-5 is not restricted to material misstatements and omissions. 864 F. Supp. at 971-72 ("It appears that the scope of deceptive devices or schemes prohibited by subsections (a) and (c) [of Rule 10b-5] is quite extensive."). The plaintiffs alleged that Ernst & Young, hired to review the company's financial statements, was primarily liable because it participated in the creation of publicly released statements, issued a review report, and failed to disclose additional material facts related to the review report. Ernst & Young moved for dismissal on the grounds that it was really being charged with aiding and abetting liability precluded by *Central Bank*. The court denied the motion, concluding that the facts taken as a whole as to Ernst & Young's participation and knowledge could render it liable under a scheme to defraud. *Id.* at 969-72.

In *Adam*, the plaintiffs alleged that Deloitte & Touche was primarily liable under §10(b) for misrepresentations and "participation in a scheme to defraud" through its involvement with the issuer's press releases and financial statements. 884 F. Supp. at 1401. The plaintiffs also alleged that Deloitte knew of the inadequate controls and deviated from conducting its audits in accordance with generally accepted auditing standards. *Id.* at 1399. The court denied the accounting firm's motion to dismiss because it found that its participation in the preparation of the issuer's statements was part of a scheme to defraud, making the firm primarily liable under Rule 10b-5. *Id.* at 1399-1401. In so holding, the court recognized that Rule 10b-5(b) "essentially outlaws the making of a material misrepresentation or omission," but that subsections (a) and (c) of the Rule "also" outlaw fraudulent schemes and courses of conduct. *Id.* at 1400.

In *In re Union Carbide Corp. Consumer Prods. Bus. Sec. Litig.*, 676 F. Supp. 458, 467-70 (S.D.N.Y. 1987), Morgan Stanley's liability did not depend on whether it "certified or made other public representations about a corporation's allegedly misleading statements;" rather, its "alleged role in knowingly or recklessly preparing the projections could constitute the employment of a 'device, scheme, or artifice to defraud' in violation of 10b-5(1) or an 'act, practice, or course of business which operates or would operate as a fraud or deceit upon any person' in violation of 10b-5(3)."

A scheme is "'[a] plan or program of something to be done.'"[48] A "scheme to defraud" encompasses any "plan designed or concocted for perpetrating a fraud." *Ballentine's Law Dictionary* 1142 (3d ed. 1969) ("scheme to defraud"). It has long included any scheme to defraud investors by causing securities to trade at fraudulently inflated prices.[49] When §10(b) was enacted, such conduct already was an unlawful "scheme to defraud" under the mail fraud statute, and today it is called a "fraud-on-the-market" that is actionable under §10(b). *See Basic*, 485 U.S. at 241-47; *Lipton v. Documation, Inc.*, 734 F.2d 740, 744-47 (11th Cir. 1984). Every person who engages in a "scheme" to defraud is thus a ***primary violator*** of Rule 10b-5 and §10(b).

In *Affiliated Ute Citizens*, the Court observed that "the second subparagraph of the rule specifies the making of an untrue statement of a material fact and the omission to state a material fact," 406 U.S. at 152-53, but held that "[t]he first and third subparagraphs are not so restricted." *Id.* at 153. It held that the defendants violated Rule 10b-5 when they participated in "***a 'course of business' or a 'device, scheme, or artifice' that operated as a fraud*" – *even though these defendants had never themselves said anything that was false or misleading***. *Id.* "***Not every violation of the anti-fraud provisions of the federal securities law can be, or should be, forced into a category headed 'misrepresentations' or 'nondisclosures*.'" *Competitive Assocs.*, 516 F.2d at 814. "Fraudulent devices, practices, schemes, artifices and courses of business are also interdicted by the securities laws." *Id.*

Subsections (a) and (c) of Rule 10b-5 thus are aimed at "broader schemes of securities fraud" than are necessarily embodied in a single misleading statement or document, and the "'classic' fraud

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48 *Aaron*, 446 U.S. at 696 n.13 ("Webster's International Dictionary (2d ed. 1934) defines ... 'scheme' as '[a] plan or program of something to be done; an enterprise; a project; as, a business ***scheme*** [,or a] crafty, unethical project ....") (emphasis in original). To "scheme" is "[t]o form plans or designs; to devise intrigue." *Webster's International Dictionary* 2234 (2d ed. 1934). *The Oxford English Dictionary* 616 (2d ed. 1989) defines "scheme": "A plan, design; a programme of action .... [H]ence, [a] plan of action devised in order to attain some end; a purpose together with a system of measures contrived for its accomplishment; a project, enterprise." *Black's Law Dictionary* 1344 (6th ed. 1990) defines "scheme": "A design or plan formed to accomplish some purpose; a system."

49 In *Harris v. United States*, 48 F.2d 771 (9th Cir. 1931), for example, "[t]he fraudulent scheme charged ... was one for the sale of [a mining company's] corporate stock ... by the manipulation of the price of the stock on the [stock exchanges] and the circulation of false reports concerning the mine through the mails." *Id.* at 774. "In fact, the whole scheme centered around the establishment of an alleged stock exchange value which is in fact wholly fictitious." *Id.* at 775.

on the market case [which] ***arises out of transactions on an open and developed market" easily fits within the expansive language of Rule 10b-5(a) and (c)***. *Lipton*, 734 F.2d at 744-45, 747. Thus, the Fifth Circuit sitting *en banc* held that a defendant who did not himself make the statements in a misleading Offering Circular could be held primarily liable ***as a participant in a larger scheme to defraud of which that Offering Circular was only a part: "Rather than containing the entire fraud, the Offering Circular was assertedly only one step in the course of an elaborate scheme***." *Shores*, 647 F.2d at 468.

In *Cooper*, 137 F.3d 616, plaintiffs sued Merisel, its officers and directors, its accountants, Deloitte & Touche ***and Lehman Brothers and Robinson-Humphrey, investment banks which served as underwriters of Merisel's public offerings and issued analysts' reports on Merisel***. The complaint alleged that "'defendants falsely presented the Company's current and future business prospects and prolonged the illusion of revenue and earnings growth by making it appear that the Company's revenue and earnings growth was strong and would continue.'" *Id.* at 620.

Defendants argued that "plaintiffs cannot allege a 'scheme' to defraud, because ***those are conspiracy allegations foreclosed by Central Bank***." *Id.* at 624. However, the Ninth Circuit rejected this argument, stating that the complaint "alleges a 'scheme' in which Merisel and the other defendants directly participated, tracking the language of ***Rule 10b-5(a), which makes it unlawful for any person 'to employ any device, scheme, or artifice to defraud***.'" *Id.* Moreover, "Central Bank does not preclude liability based on allegations that a group of defendants acted together to violate the securities laws, as long as each defendant ***committed a manipulative or deceptive act in furtherance of the scheme***." *Id.* Furthermore,

> "[t]he absence of § 10(b) aiding and abetting liability does not mean that secondary actors in the securities markets are always free from liability under the securities Acts. ***Any person or entity, including a lawyer, accountant, or bank, who employs a manipulative device or makes a material misstatement (or omission) ... may be liable as a primary violator under 10b-5*** .... In any complex securities fraud, moreover, there are likely to be multiple violators ...."

Id. at 624-25.

In *First Jersey*, 101 F.3d 1450, a top First Jersey corporate official who had not made any false statement claimed he should not be held liable under §10(b) of the 1934 Act for an extensive violation of §10(b) and Rule 10b-5 by First Jersey. The Second Circuit stated:

> Brennan contends that even if First Jersey committed fraud, he should not have been held personally liable for any violation ... as a primary violator of the securities laws....
>
> 1. Primary Liability
>
> "Any person or entity ... who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser or seller of securities relies may be liable as a primary violator under [federal securities law], assuming all of the requirements for primary liability ... are met." *Central Bank v. First Interstate Bank*, 511 U.S. 164, 191, 128 L. Ed. 2d 119, 114 S. Ct. 1439 (1994) (emphasis omitted). ***Primary liability may be imposed "not only on persons who made fraudulent misrepresentations but also on those who had knowledge of the fraud and assisted in its perpetration."*** *Azrielli v. Cohen Law Offices*, 21 F. 3d 512, 517 (2d Cir. 1994).
>
> ***The evidence presented at trial sufficed to establish that Brennan had knowledge of First Jersey's frauds and participated in the fraudulent scheme.***
>
> * * *
>
> In light of the evidence presented at trial with regard to Brennan's hands-on involvement in the pertinent decisions, we conclude that the trial court did not err in finding that Brennan ***knowingly participated in First Jersey's illegal activity and that he should be held primarily liable for its violations of the securities laws.***

Id. at 1471-72.

And, in fact, many courts have upheld complaints against banks in §10(b)/Rule 10b-5 cases where, as here, false statements, manipulative or deceptive devices, contrivances and acts, and participation in a scheme to defraud have been alleged with sufficient particularity.

In *Cooper*, 137 F.3d at 628, the court held scheme liability had survived *Central Bank* and specifically noted that allegations that the investment banks named as defendants there had knowingly issued false analysts' reports and had "***access to inside information***" set them apart from other analysts who had issued favorable reports on the issuer during the Class Period and stated a valid §10(b)/Rule 10b-5 claim.

> Lehman Brothers also made specific forecasts.... Although the complaint quotes other analysts who made similar positive statements about [the company's] current status and future prospects, this does not mean that the Lehman Brothers and Robinson-Humphrey analysts' statements are somehow automatically reasonable. All the analysts wrote optimistic reports based in part on information from [the

company]; ***only Robinson-Humphrey and Lehman Brothers are alleged to have known better through their access to inside information***.

> Even the analysts' optimistic statements can be actionable if not genuinely and reasonably believed, or if the speaker is aware of undisclosed facts that tend seriously to undermine the statement's accuracy.... 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. at 629. These false analysts' reports were misleading and deceptive acts and part of the fraudulent scheme. When the banks in *Cooper* claimed the so-called "Chinese Wall" shielded them from liability, the Ninth Circuit rejected this assertion:

> [Defendant investment banks] Robinson-Humphrey and Lehman Brothers assert that they followed SEC rules which prevent the sharing of inside information within their companies. 15 U.S.C. §78o(f) requires registered brokers or dealers to create and enforce "written policies and procedures reasonably designed ... to prevent the misuse ... of material, nonpublic information by such broker or dealer or any person associated with such broker or dealer," and authorizes the SEC to create rules for such policies. ***If Robinson-Humphrey and Lehman Brothers have established such policies and followed them in this case, they may raise that as a defense. The existence of such policies does not, however, preclude plaintiffs from asserting in their complaint that inside information was misused***.

Id. at 628-29. The court said that the Chinese Wall might later be used as a defense, but, the court said, such an assertion (a factual issue) was ***not*** a defense at the motion to dismiss stage.

In *Murphy v. Hollywood Entm't Corp.*, 1996 U.S. Dist. LEXIS 22207, and *Flecker v. Hollywood Entm't Corp.*, 1997 U.S. Dist. LEXIS 5329, the court refused to dismiss a complaint against investment bankers and then later refused to grant summary judgment to those banks, stating that their "***roles as analysts, investment bankers and business advisors with extensive contacts with [issuer] defendants, superior access to non-public information and participation in both drafting and decision-making is sufficient to establish a triable primary liability claim under §10(b)***." *Id.* at *25. In initially denying the bank's motion to dismiss, the court recognized that "***any person or entity who directly participates in an alleged violation of § 10(b), even if that person falls within the category of professionals usually deemed 'collateral' participants, may still be liable as a 'primary violator' under § 10(b)***." *Id.* at *20-*21. The court concluded:

> As for the Underwriters' role in the alleged fraud, plaintiffs do not allege the existence of any contemporaneous "smoking gun" type of documents which would demonstrate that the Underwriter defendants knew they were selling a landfill when they sold Hollywood securities. However, plaintiffs do allege that the underwriter defendants had a "***close association" with Hollywood which gave them "constant***

> ***access" to the individual Hollywood defendants and all relevant, non-public information about the company. Plaintiffs further allege that the underwriter defendants were "direct participants" in the alleged wrongdoing by their role in coordinating the offering, drafting disputed offering documents and conducting a due diligence investigation. This is sufficient to bring the complaint within the scope of allegations similar to those sustained by the Ninth Circuit in Software Toolworks....*** Plaintiffs' claims are not limited to accounting fraud and thus, the underwriters' claimed reliance upon certified accounting statements does not bar the maintenance of plaintiffs' claims under 10(b). ***Further, whether the underwriters' reliance upon expertised portions of the financial statements was reasonable as a matter of law is an issue best addressed on summary judgment.***

Murphy, 1996 U.S. Dist. LEXIS 22207, at *21-*23 (footnote omitted).

In later denying summary judgment, the court noted that the defendants' motive included a "***desire to keep the stock price above $ 25.50 to avoid having to redeem***" certain shares previously issued in a corporate transaction and that the investment banks "***stood to accrue significant fees***." *Flecker*, 1997 U.S. Dist. LEXIS 5329, at *14. The court stated that "primary liability extends to all who make assertions 'in a manner reasonably calculated to influence the investing public'" (*id.* at *23) and then denied summary judgment because:

> [T]he underwriters ... had long standing close connections to Hollywood such that they either knew or should have known that historical revenues were misstated due to changes in the same store sales base, and that revenue projections were ill-founded given the company's earnings track record as influenced by accounting changes which had the effect of adding revenue to Hollywood's balance sheets and prior earnings per share dividends.
>
> * * *
>
> Based on the foregoing, I find that defendants' roles as analysts, investment bankers and business advisors with extensive contacts with Hollywood defendants, superior access to non-public information and participation in both drafting and decision-making is sufficient to establish a triable primary liability claim under § 10(b).

Id. at *20, *25.

Livent, 174 F. Supp. 2d 144, shows that a valid §10(b)/Rule 10b-5 claim has been alleged here. In *Livent*, purchasers of Livent securities sued Livent's investment bank (CIBC) for violations of 1933 Act §11 and 1934 Act §10(b)/Rule 10b-5. The court held plaintiffs' §11 claims sufficient under a Rule 8 non-fraud pleading standard. The court also sustained the adequacy of the §10(b)/Rule 10b-5 claims – finding scienter adequately alleged. The key to plaintiff's scienter allegations against CIBC was that CIBC allegedly made a $4.6 million payment to Livent in return

for play royalties, which in reality was a secret "bridge" loan, as CIBC had a side agreement from Livent to repurchase the $4.6 million advance in six months for $4.6 million, plus interest – the "CIBC Wood Gundy Agreement." This was a fraudulent contrivance because Livent recorded income on the transaction, but did not record the loan. The district court held:

> It does not require an unreasonable inferential leap to conclude, as the Noteholders suggest, that in entering into the bridge loan transaction and secret side agreements with Livent, CIBC, as Livent's investment bankers since 1993, had acquired substantial knowledge of Livent's real financial condition and was aware of Livent's reasons to account for the $ 4.6 million "non-refundable fee" as a revenue-generating investment rather than a repayable loan....
>
> Significantly, according to the complaint, the proceeds from the alleged fraudulent arrangement were reported by Livent as current revenue in its accounts and public registration statements in order [to][sic] create a false financial basis to reinforce and ensure the success of Livent securities issues intended in part to repay Livent's substantial debt to CIBC.
>
> From these allegations, ***it is fair to infer that in entering into the CIBC Wood Gundy Agreement, CIBC was aware not only that Livent contemplated marketing securities on the basis of public representations of its financial condition that Livent knew to be false, but that CIBC itself subsequently undertook to solicit and sell the very securities whose value incorporated and was affected by the falsehood CIBC itself had conceived with Livent. In this manner, CIBC's participation in Livent's fraudulent scheme went beyond a passive capacity as Livent's investment banker and financial adviser.***
>
> * * *
>
> ***The Noteholders have pled facts suggesting that CIBC became part and parcel of Livent's misleading statements by entering into a loan transaction whose true character and financial implications it agreed not to disclose.*** This financial interest and complicity not only assisted Livent in concealing critical information, it also committed CIBC to similarly withhold the truth from investors with whom it dealt in Livent securities, a commitment that effectively conflicted with any applicable duty CIBC had to disclose material facts in connection with subsequent public sales of such securities affected by the transaction.
>
> ***Rather than generally reflecting the profit motive of any securities dealer, the concrete benefit derived by CIBC from Livent's fraud alleged here was uniquely personal to CIBC in several ways. Only CIBC, as Livent's investment bankers since 1993, is alleged to have had a longstanding, intimate relationship with Livent executives that offered it uncommon opportunity to know of, and play an active role in Livent's, financial affairs. And only CIBC is accused, in furtherance of its own motives, of assisting Livent in structuring and keeping secret the misrepresented CIBC Wood Gundy Agreement. Later, in publicly marketing Livent securities whose value partly depended on the true nature of that agreement, CIBC stood to realize gains particular to it. Beyond the standard fees and commissions associated with any investment bank's sales of securities. CIBC had a higher stake in Livent's public financings. It uniquely benefitted from the application of the proceeds of the Notes sales to Livent's considerable debt to CIBC.***

* * *

> The Noteholders' pleadings ... allege misconduct that involved CIBC in more than merely aiding and abetting Livent's fraudulent transactions. Rather, read in their totality, and drawing all reasonable in the Noteholders' favor, the Noteholders' claims assert that CIBC played what amounts to a primary rather than a secondary role in the alleged misrepresentations. The Noteholders effectively state that CIBC was involved as an insider which not only aided in structuring the fraudulent arrangement embodied in the CIBC Wood Gundy Agreement but actually solicited and itself sold to public investors Notes whose financial worth depended in part on the truth concerning that transaction. The Noteholders contend that CIBC's false or misleading statements to investors were reflected not just in its omitting to disclose material facts in connection with its sales of Notes, but in more affirmative, if implicit misrepresentations.

Id. at 151-54.

Similarly, in *Cascade*, 840 F. Supp. 1558, the court found that allegations that a securities broker ignored red flags presented a sufficient showing of recklessness to constitute scienter. According to the complaint, the broker, Raymond James, continued to recommend Cascade's stock, ignoring red flags that had been raised, while its

> "reports and statements with respect to [the company], while purporting to be disinterested and objective professional investment analyses, based on in-depth current research, were in reality substantially false and misleading sales brochures which made exaggerated predictions based on unverified and unsupported information for which Raymond James knew, or should have known, it had no reasonable basis."

Id. at 1578. Based on the broker's alleged disregard of red flags, the court held the complaint sufficiently pleaded scienter. "These allegations, if true, may evince severe recklessness or proof of knowing misconduct." *Id.*

Finally, in *Bre-X-Minerals*, 2001 U.S. Dist. LEXIS 4571, the court denied the motion to dismiss by J.P. Morgan based on allegations it participated in a scheme to violate §10(b) and Rule 10b-5 in connection with the securities fraud involving Bre-X, Ltd. In *Bre-X Minerals*, plaintiffs alleged involvement of J.P. Morgan in assisting Bre-X in structuring fraudulent business transactions, acting as Bre-X's financial advisor, and issuing false analysts' reports – ignoring "red

flags" that Bre-X's claimed assets were falsified. Thus, J.P. Morgan's motion to dismiss was denied.[50]

The CC in this action pleads more wrongful conduct by CIBC vis-à-vis the fraudulent scheme involving Enron and with more specificity than was pleaded in any of the above cases where complaints naming banks as defendants in §10(b)/Rule 10b-5 actions were upheld.

In finding the complaint in *Landry's* did not adequately plead a §10(b) claim against the defendant investment banks there, this Court stated:

> Plaintiffs have generally alleged without any particularity that the Underwriters also conducted a comprehensive due diligence investigation into Landry's operations and future prospects in connection with the secondary offering, for which they helped prepare the Registration Statement and Prospectus. They purportedly had access to confidential corporate information and communicated frequently with Fertitta and West about the business, but Plaintiffs fail to provide any details or identify specifically ***what kind of information, when it was conveyed, by whom and to whom***. Plaintiffs have failed to identify any specific information communicated by document or conversations to the Underwriter Defendants or uncovered by them in their due diligence investigation. Instead they have made general statements that might give rise to speculation, but not particularized facts giving rise to a strong inference that the Underwriters acted with severe recklessness or knowingly to support allegations of fraud under the Exchange Act.

Landry's, slip op. at 66. Obviously, the allegations against CIBC in this case are much more detailed than those found wanting in *Landry's*. The specifics regarding (i) CIBC's (or its executives) pre-funding of the LJM2 partnership in 2/99, (ii) funding of LJM2 to enable it to engage in the year-end 99 non-arm's-length fraudulent transactions, (iii) their ongoing funding of LJM2 in 00-01 to enable it to engage in several more such transactions in 00-01 to artificially boost Enron's reported profits by hundreds of millions of dollars, while hiding billions of dollars of debt while CIBC or its top executives as LJM2 investors pocketed the fruits of those fraudulent deals – the looting of Enron – its participation in and funding of the bogus Braveheart and Hawaii 125-0 transactions which enabled Enron to report hundreds of millions of dollars of phony profits, (iv) CIBC's involvement

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[50] *See also U.S. Envtl.*, 155 F.3d at 112 (while there is no aiding and abetting, where complaint properly alleged defendant to be primary violator because he "'***participated in the fraudulent scheme***,'" noting "***lawyers, accountants, and banks who engage in fraudulent or deceptive*** practices at their client's direction [are] a primary violator"); *Scholnick*, 752 F. Supp. at 1323 & n.9 ("bank ... may still be held liable under Rule 10b-5(a) and 10b-5(c) as a participant in the allegedly fraudulent scheme" and "allegations that Continental was directly involved in perpetrating a fraudulent scheme distinguish" case from situation where bank was only engaging in a "'routine commercial financing transaction'").

in the New Power IPO and the secret Hawaii 125-0 side deal to create a phony $370 million profit for Enron, (v) its involvement in the bogus Braveheart SPE deal which created a phony $110 million profit for Enron, ***and*** (vi) its extensive investment banking and ***commercial*** lending relationships with Enron, as well as its extensive and continuing investment banking and commercial banking relationship with Enron, distinguish the pleading here from the one found wanting in *Landry's*. Here, CIBC took affirmative steps to further the fraud. It participated in – funded and facilitated – non-arm's-length fraudulent deals with Enron that enabled CIBC to profit from looting Enron ***and*** enabled Enron to falsify its profits and hide debt. Nothing remotely approaching this was alleged in *Landry's*.

VI. CIBC MADE FALSE AND MISLEADING STATEMENTS IN REGISTRATION STATEMENTS AND ANALYSTS REPORTS

CIBC admits that its analysts issued at least 13 analysts' reports on Enron during the Class Period. Mot. at 6, 22. None of the cases cited by CIBC hold that investment banks cannot (or even should not) be liable for statements of their analysts. Indeed, CIBC would have to disavow it issued analyst reports (among other things) to give any meaning to the cases CIBC cites at pages 20-21of its Motion. CIBC does ***not*** do that. Nor do any of the cases CIBC cites support the incredible suggestion that CIBC cannot be liable for concealing its $115.2 million investment in Project Braveheart, Enron's subsequent accounting of that transaction, or CIBC's knowledge that the VOD venture was troubled.

CIBC asserts that the CC does not identify with specificity any false statement by it. To the contrary, the CC specifies that CIBC made false and misleading statements in the Registration Statements for the sale of $500 million of 7.375% Enron notes in 5/99 issued during the Class Period, which exposes it to 1933 Act §11 liability. *See infra* at 95-96.

The CC also specifies CIBC made numerous false and misleading statements in the analyst reports it issued on Enron between 10/14/98 and 10/17/01. These are detailed below. Enron's stock was a weak performer, basically tracking the stock of companies in its "peer index." In order to push Enron's stock higher, CIBC issued positive reports on Enron.

On 10/14/98, CIBC issued a report on Enron. The report stated:

Enron reported third quarter net income of $[0.235] per share ... better than our estimate of $[0.22]. [G]rowth has been spearheaded by sharp gains in Wholesale Energy Operations and Services ....

* * *

Enron Energy Services provides comprehensive energy solutions to U.S. commercial and light industrial end-users. ***Future retail contracts growing; future undiscounted revenues should exceed $3 billion by year-end. Management continues to build its retail business under Enron Energy Services.... The division is expected to turn profitable during the second half of 1999. During the third quarter the company signed contracts representing $850 million of total future energy expenditures, taking the total under contract to $2.3 billion. EES's backlog of retail contracts the division is now pursuing approximates $12 billion with average contract life of 5 years. Contracts under negotiation ... outsourcing income which should carry higher margins***.

¶120.

On 1/25/99, CIBC issued a report on Enron, stating:

[W]e believe longer term earnings power should build at attractive rates .... ***Following operating setbacks 1995-1997, Enron has re-emerged as a sector favorite***....

At last week's analyst conference ... management provided significant details on its long-range plans to build market share and earnings power along several higher growth fronts.

* * *

... ***Future retail contracts are growing; future undiscounted revenues should exceed $3 billion by year-end***.... ***The division is expected to turn profitable during the second half of 1999. During the fourth quarter, the company signed contracts representing $1.8 billion of total future energy expenditures, taking the total under contract to $3.8 billion***....

¶132.

On 4/14/99, CIBC issued a report on Enron, rating forecasting 00 and 01 EPS of $1.325 and $1.475 for Enron, and stating:

Enron reported 1999 Q-1 income of $253 MM or $[0.34] per share ... above our ... estimate .... ***Improved performance was driven by continued momentum at Enron Wholesale Services.... Accordingly, we believe longer term earning power should build at attractive rates*** ....

* * *

In recent months the relative strength in ENE shares can be attributed to three factors. 1) continued momentum at Enron Wholesale Services 2) rising expectations and valuations for Enron Energy Services (EES), Enron's retail marketing arm, following management's increased expectations for the potential size of the higher margin energy management/outsourcing business, and 3) clarification of the company's