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Michael N. Milby, Clerk

UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF TEXAS  
HOUSTON DIVISION

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IN RE ENRON CORPORATION  
SECURITIES LITIGATION  
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Consolidated Civil Action  
No. H-01-3624

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This Document Relates To:  
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MARK NEWBY, et al., individually and  
on behalf of all others similarly situated,  
:  
Plaintiffs,  
:  
v.  
:  
ENRON CORPORATION, et al.,  
:  
Defendants.  
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-----X

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:  
THE REGENTS OF THE UNIVERSITY  
OF CALIFORNIA, et al., individually and  
on behalf of all others similarly situated,  
:  
Plaintiffs,  
:  
v.  
:  
KENNETH L. LAY, et al.,  
:  
Defendants.  
:  
-----X

**REPLY MEMORANDUM OF LAW OF MERRILL LYNCH & CO., INC.  
IN FURTHER SUPPORT OF ITS MOTION TO DISMISS**

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**REPLY MEMORANDUM OF LAW OF MERRILL LYNCH & CO., INC.  
IN FURTHER SUPPORT OF ITS MOTION TO DISMISS**

Defendant Merrill Lynch & Co., Inc. ("Merrill Lynch") respectfully submits this reply memorandum of law in further support of its motion, pursuant to Fed. R. Civ. P. 12(b)(6), to dismiss with prejudice plaintiffs' Consolidated Complaint (the "Complaint") as against Merrill Lynch for failure to state a claim and failure to plead fraud with the particularity required by Rule 9(b) and the Private Securities Litigation Reform Act.

## PRELIMINARY STATEMENT

To put it mildly, plaintiffs have digressed, with their 124-page opposition brief, from the principal issue on this motion to dismiss. As Merrill Lynch demonstrated in its opening brief, plaintiffs' complaint is utterly devoid of any facts, much less particularized facts, suggesting that Merrill Lynch knew, at the time it issued its analyst reports or participated as an underwriter in Enron's February 1999 common stock offering, that Enron's financial statements were false. Unable to state a claim based on any of Merrill Lynch's alleged statements, plaintiffs have embarked on a rambling discourse on alternative theories of liability in an attempt to hold Merrill Lynch liable for its alleged "conduct."

Plaintiffs cannot evade *Central Bank*, however, by simply re-labeling an aiding and abetting claim with phrases from Rule 10b-5. Merrill Lynch did not employ a "scheme to defraud" or a "manipulative device." Rather, Merrill Lynch is alleged to have provided underwriting services, issued analyst reports, and passively invested in an Enron-related partnership. That is not actionable. And plaintiffs' attempt to create the misimpression that Merrill Lynch somehow assisted Enron in carrying out its misrepresentations is nothing more than a transparent and improper attempt to assert an aiding and abetting claim.

Plaintiffs' disguised aiding and abetting claim is not only foreclosed by *Central Bank*, but concededly beside the point: "It is clear that for § 10(b) or Rule 10b-5 liability to attach under either theory, *scienter must be present*." Plaintiffs' Opposition Brief ("Ps' Br."), dated June 10, 2002, at 103 (bold and italics in original). The critical missing link in plaintiffs' complaint is any factual allegation that would support any inference, much less a *strong* inference, that Merrill Lynch knew Enron's financial statements were false.

In addition, plaintiffs also concede, or do not dispute, several key points. First, plaintiffs concede that their claim based on Enron's Registration Statement for the February 1999 common

stock offering and two Merrill Lynch analyst reports issued prior to April 1999 is barred by the three-year statute of repose. Second, plaintiffs make no attempt to address, much less distinguish, the authority cited by Merrill Lynch confirming that the vague, general statements of optimism excerpted by plaintiffs from Merrill Lynch's analyst reports are nonactionable. Third, plaintiffs do not dispute that they cannot assert a claim against Merrill Lynch for any alleged omissions in its analyst reports.

For these and all the other reasons set forth in its memoranda of law, Merrill Lynch respectfully requests that this Court dismiss, with prejudice, plaintiffs' Section 10(b) claim against Merrill Lynch.<sup>1</sup>

### ARGUMENT

**A. Plaintiffs Concede That Their Claim Against Merrill Lynch Based On Enron Offering Documents Is Time-Barred**

Plaintiffs concede, as they must, that their claim against Merrill Lynch for alleged misstatements prior to April 8, 1999 is barred by the three-year statute of repose for Section 10(b) claims. *See* Ps' Br. at 43 ("Merrill Lynch seems to argue that the three-year statute of repose for 34 Act claims bars plaintiffs from pursuing damages against them for any time period prior to 4/8/99. . . . We agree . . .").

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<sup>1</sup> Plaintiffs do not dispute that Merrill Lynch & Co., Inc., the only "Merrill Lynch" entity named as a defendant, is not alleged to have directly engaged in the activities attributed to "Merrill Lynch" in the complaint. *See* Ps' Br. at 3 n.5. Nonetheless, without citing any authority, plaintiffs declare that "naming the parent corporate entity – which, after all, is legally responsible for the operations and conduct of its subsidiaries – seems appropriate." *Id.* That is not the law. *See Abell Credit Corp. v. Bank of Am. Corp.*, No. 01 C 2227, 2002 WL 335320, at \*4 (N.D. Ill. Mar. 1, 2002) (dismissing Section 10(b) claim against bank defendant for alleged acts of its subsidiary because "a parent corporation is not liable for the acts or omissions of its subsidiary").

Accordingly, plaintiffs' claim relating to Enron's Registration Statement for its common stock offering in February 1999,<sup>2</sup> and to Merrill Lynch's January 20, 1999 and March 31, 1999 analyst reports, must be dismissed. *See Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 364 (1991); *Wafra Leasing Corp. v. Prime Capital Corp.*, 192 F. Supp. 2d 852, 863-65 (N.D. Ill. 2002).<sup>3</sup>

**B. Plaintiffs Concede That General Statements Of Optimism And Any Alleged Omissions In Merrill Lynch Analyst Reports Are Nonactionable**

Plaintiffs' claim based on Merrill Lynch's analyst reports and "statements to the media" after April 8, 1999 fares no better. Plaintiffs make no attempt to address, much less distinguish, the authority cited by Merrill Lynch confirming that the vague, general statements of optimism excerpted by plaintiffs from Merrill Lynch's analyst reports are nonactionable. *See, e.g., Kurtzman v. Compaq Computer Corp.*, Civ. A. No. H-99-779, slip op. at 52 (S.D. Tex. Mar. 30, 2002) (Harmon, J.) ("Vague optimistic statements are not actionable because reasonable investors do not rely on them in making investment decisions."); *Strassman v. Fresh Choice*,

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<sup>2</sup> The other Enron offerings for which Merrill Lynch is alleged to have been an underwriter all occurred prior to February 1999. *See* Ps' Br. at 20-21; Comp. ¶ 48. As Merrill Lynch demonstrated in its opening brief, plaintiffs' counsel erred in identifying Merrill Lynch as an underwriter for an offering of Enron "weather" bonds in October 1999. *See* ML Opening Br. at 7 n.3. Plaintiffs make the same error in their opposition brief, without even addressing Merrill Lynch's point. *See* Ps' Br. at 46. Plaintiffs' error is of no consequence, however, because they do not purport to assert a claim based on the offering and, indeed, make no attempt to identify any misrepresentations with respect to the offering.

<sup>3</sup> While plaintiffs contend that the pre-April 1999 documents should nonetheless be considered as "evidence" (Ps' Br. at 43), as demonstrated *infra* in Point D, plaintiffs fail to identify any facts whatsoever suggesting that Merrill Lynch had any reason to believe that Enron's financial statements were false at the time the pre-April 1999 documents were issued. Even if the pre-April 1999 documents could be considered, therefore, they would be "evidence" of nothing. Moreover, plaintiffs have not just tried to use the pre-April 1999 documents as "evidence," but repeatedly purport to assert a claim based on them. Ps' Br. at 29, 35, 37, 100.

*Inc.*, No. C-95-20017, 1995 WL 743728, at \*16 (N.D. Cal. Dec. 7, 1995) (dismissing securities fraud complaint against underwriter based on analyst reports which contained statements "too vague to be materially misleading as a matter of law").<sup>4</sup>

Moreover, plaintiffs do not dispute that they cannot assert a claim against Merrill Lynch for any alleged *omissions* in its analyst reports. See *In re Oak Tech. Sec. Litig.*, No. 96-20552, 1997 WL 448168, at \*13 (N.D. Cal. Aug. 1, 1997) ("H&Q cannot be liable to plaintiffs under Section 10(b) for any omissions in its analyst reports . . . [because] no named plaintiff was a client of H&Q."); *In re Valence Tech. Sec. Litig.*, No. C 95-20459, 1996 WL 37788, at \*9 (N.D. Cal. Jan 23, 1996) ("Plaintiffs contend that because Montgomery and Alex Brown chose to speak to the investment community through their analysts' reports, that they accepted a duty to disclose materially adverse facts. Plaintiffs do not cite any competent authority to support this contention. Accordingly, the Court hereby dismisses these allegations with prejudice.").

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<sup>4</sup> Despite their burden to "detail" the alleged misstatements in Merrill Lynch's analyst reports, plaintiffs simply recite portions of the reports. See Ps' Br. at 76-101. Other than generalized statements concerning Enron's projected and actual earnings per share, its cash flow and its stock price, plaintiffs point only to positive statements in the reports regarding aspects of Enron's business that they now say are fraudulent. Plaintiffs then follow their excerpts from the reports with laundry lists of the "true but concealed facts." These lists contains both highly generalized claims (such as "Enron's financial statements . . . were false") and discussions of alleged improprieties in Enron's wholesale, retail, broadband and international divisions (such as alleged abuse of mark-to-market accounting practices in the wholesale and retail business and overvaluation of international assets). But nowhere do plaintiffs detail how – at any period in time from 1999 to 2001 – Merrill Lynch would have known about any of these alleged improprieties by Enron. Instead, plaintiffs inexplicably declare that their complaint "is of the same style and format sustained by this Court in *In re Landry's*." Ps' Br. at 2. In fact, as this Court is aware, the Section 10(b) claim asserted against the underwriter defendants in *Landry's* was dismissed. See *In re Landry's Seafood Restaurant, Inc. Sec. Litig.*, Civ. A. No. H-99-1948, slip op. at 66 (S.D. Tex. Feb. 19, 2001).

**C. Plaintiffs' Transparent Attempt To Impose Aiding And Abetting Liability On Merrill Lynch Should Be Rejected**

Forced to effectively concede their inability to state a claim against Merrill Lynch for any of its own statements, plaintiffs contend that Merrill Lynch should nonetheless be liable for its alleged "conduct": "If the complaint fails to adequately allege the falsity of Merrill Lynch's own statements . . . the CC may still adequately allege that Merrill Lynch knowingly or recklessly employed deceptive acts or participated in [Enron's] fraudulent scheme." Ps' Br. at 103.

Plaintiffs' transparent attempt to assert an aiding and abetting claim should be rejected.

**1. Plaintiffs' Attempt To Recharacterize An Aiding And Abetting Claim As A "Scheme To Defraud " Or "Manipulative Device" Claim Should Be Rejected**

In *Central Bank of Denver, N.A. v. First Interstate Bank of Denver*, 511 U.S. 164 (1994), the Supreme Court held that there is no private right of action for aiding and abetting under Section 10(b). Plaintiffs do not dispute that *Central Bank* forecloses aiding and abetting liability, but instead contend that *Central Bank* is somehow inapplicable because they have tracked the language of Rule 10b-5(a) and (c) and dubbed their alternative theories of liability as "scheme to defraud" or "manipulative device" claims rather than as an "aiding and abetting" claim. See Ps' Br. at 58.

As courts have repeatedly made clear, plaintiffs may not evade *Central Bank* by re-labeling an aiding and abetting claim with phrases from Rule 10b-5. See, e.g., *Valence*, 1996 WL 37788, at \*11 (dismissing securities fraud complaint against underwriter because "the allegation that [the underwriter] participated in a 'scheme to defraud' is merely an attempt to state a cause of action for Section 10(b) 'aiding and abetting'"); *Stack v. Lobo*, No. Civ. 95-20049, 1995 WL 241448, at \*10 (N.D. Cal. Apr. 20, 1995) (dismissing securities fraud complaint

against underwriters because "plaintiffs' 'scheme' allegations are no more than a thinly disguised attempt to avoid the impact of the *Central Bank* decision").

Here, plaintiffs' purported "scheme to defraud" or "manipulative device" claim, no matter how it is labeled, is in fact a classic "aiding and abetting" claim. This case is about *Enron's misrepresentations*, not any undifferentiated "conduct" by Merrill Lynch. Indeed, the gravamen of plaintiffs' case is that Enron issued financial statements that were false and misleading because they afforded off-balance sheet treatment to certain transactions in violation of GAAP. Had Enron's financial statements properly reflected these transactions, plaintiffs undoubtedly would not purport to have any independent cause of action under Section 10(b) against Merrill Lynch for its "conduct." Plainly, therefore, plaintiffs' purported "scheme to defraud" or "manipulative device" claim is nothing more than an attempt to impute secondary liability to Merrill Lynch for *Enron's misrepresentations*. Merrill Lynch is not alleged, however, to have had any role whatsoever in the preparation of Enron's financial statements or the allegedly improper accounting decisions. Rather, the totality of plaintiffs' purported "scheme to defraud" or "manipulative device" claim is that Merrill Lynch (1) "had constant access to Enron's top executives," (2) "was selling securities of [Enron] to the public," (3) "was also constantly issuing analyst reports," and (4) "were secretly investors in a huge partnership (LJM2)." Ps' Br. at 114. That, in sum and substance, is an aiding and abetting claim (with the critical element of scienter wholly missing) and is foreclosed by *Central Bank*.

On this point, the court's decision in *Primavera Familienstiftung v. Askin*, No. 95 Civ. 8905, 1996 WL 494904 (S.D.N.Y. Aug. 30, 1996), is particularly instructive:

Primavera alleges that the Broker Defendants enabled the ACM Defendants to sell interests in the Funds. Primavera does not allege that the Broker Defendants directly sold interests in the Funds to the investors, but merely that the Broker Defendants' sales of CMOs to the Funds helped the Funds sell interests to the

investors. Deeming such action to constitute liability would nullify *Central Bank's* proscription against secondary liability under Section 10(b). . . .

The Broker Defendants, argues Primavera, violated the first and third of the [Rule 10b-5] proscriptions, thus constituting primary liability. It is true, of course, that *Central Bank* does not prevent a plaintiff from pursuing a primary liability claim against parties who violate Rule 10b-5(a) or (c). . . .

This, however, is not such a case. . . . The allegations that the Broker Defendants created, supplied, and financed the purchases of and then sold 'toxic waste' securities to ACM and Askin fail to constitute primary liability to Primavera. Similarly, allegations that the Broker Defendants unilaterally 'marked' the securities, that they violated their own internal credit requirements, and that they played a role in the selling frenzy following the collapse, do not state a claim for primary liability. *These allegations at their core, still constitute, at most, aiding and abetting of the alleged violations of the ACM Defendants.* . . .

*Id.* at \*6-8 (emphasis added).

Here, as in *Primavera*, plaintiffs' attempt to re-label an aiding and abetting claim with phrases from Rule 10b-5 should be rejected. *See also Oak Tech.*, 1997 WL 448168, at \*15 ("Plaintiffs argue that [the underwriter] Defendants, in their efforts to substantially assist the huge insider sales of Oak stock, participated in a 'scheme' designed to defraud the investing public. . . . Pursuant to the Supreme Court's ruling in *Central Bank*, secondary liability claims . . . are not actionable under Section 10(b). Thus, plaintiffs' claims of H&Q's participation in a 'scheme' to defraud investors must be dismissed."); *Strassman*, 1995 WL 743728, at \*17 ("Plaintiffs attempt to hold the Underwriters liable for such statements through allegations that the Underwriters are part of a 'scheme to defraud' investors. However, plaintiffs' 'scheme to defraud' claims are barred by *Central Bank*.").

## 2. Merrill Lynch Did Not "Employ" A "Scheme To Defraud"

Nor can plaintiffs adequately link Merrill Lynch to Enron's alleged "scheme to defraud" investors through Enron's inaccurate financial statements. Merrill Lynch – a party that provided nothing more than routine market services – simply did not "employ any device, scheme, or

artifice to defraud." 17 C.F.R. § 240.10b-5(a) (emphasis added). *See Scone Investments, L.P. v. American Third Market Corp.*, No. 97 Civ. 3802, 1998 WL 205338, at \*7 (S.D.N.Y. Apr. 28, 1998) ("Standard Bank is not liable for Carajohn's misrepresentation simply because it is alleged to have been a participant with Carajohn and others in a conspiracy or scheme to defraud.").

As this Court perceived in *BMC Software*, to "employ" a scheme to defraud, a defendant must have exercised control over the alleged scheme. *See BMC Software*, 183 F. Supp. 2d at 871 n.21, 908-09 (dismissing Section 10(b) claim against issuer for alleged false statements in analyst reports because "this Court agrees with the majority view that there must be alleged facts showing some involvement in and control over the content of the analysts' reports by the defendants to hold them liable for misleading statements made in those reports"); *Scone*, 1998 WL 205338, at \*8 (dismissing Section 10(b) claim because bank defendant's conduct was "a far cry from the 'intimate' 'hands-on-involvement' and participation in 'key decisions' about the details of the [alleged fraudulent scheme] which would render it a primary violator").

For this reason, courts have recognized that Rule 10b-5(a) "scheme" liability is only applicable to primary actors on the market such as issuers, brokers and traders who, unlike secondary actors, are in a position to orchestrate an alleged scheme. *See Ellison v. American Image Motor Co., Inc.*, 36 F. Supp. 2d 628, 640-43 (S.D.N.Y. 1999) (sustaining Section 10(b) claim against broker-dealers who were also account executives at Liberian corporations and alleged to have "execute[d] manipulative buy and sell orders," but dismissing Section 10(b) claim against law firm defendants alleged to have set up Liberian corporations through which allegedly manipulative trades were executed because "there is no allegation in the complaint that the [law firm] defendants had the power to direct the Liberian Corporations" and "the [law firm] defendants cannot be held liable for conduct that amounts at most to aiding and abetting");

*Mishkin v. Ageloff*, No. 97 Civ. 2690, 1998 WL 651065, at \*17 n.12 (S.D.N.Y. Sept. 23, 1998) (recognizing "problem of importing a standard of liability for non-secondary actors into a secondary actor context").

Tellingly, all of the "scheme" liability cases cited by plaintiffs involve primary actors on the market. See *SEC v. Zandford*, 122 S. Ct. 1899 (2002) (discretionary broker trading on the market); *Superintendent of Ins. v. Bankers Life*, 404 U.S. 6 (1971) (parent corporation and broker acquiring securities); *SEC v. U.S. Envtl., Inc.*, 155 F.3d 107 (2d Cir. 1998) (trader); *Cooper v. Pickett*, 137 F.3d 616 (9th Cir. 1997) (issuer); *SEC v. First Jersey Sec. Litig.*, 101 F.3d 1450 (2d Cir. 1996) (broker-dealer trading on the market); *Finkel v. Docutel/Olivetti Corp.*, 817 F.2d 356 (5th Cir. 1987) (issuer); *In re Health Mgmt., Inc. Sec. Litig.*, 970 F. Supp. 192 (E.D.N.Y. 1997) (officers of issuer). In the few cases involving defendants who were nominally secondary actors, the defendants were in fact primary actors on the market. See *U.S. v. O'Hagan*, 521 U.S. 642 (1997) (attorney trading on insider information for his own account); *In re Livent, Inc. Noteholders Sec. Litig.*, 174 F. Supp. 2d 144, 152 (S.D.N.Y. 2001) (bank "became a primary actor" by soliciting and selling notes not traded on any public exchange directly to investors).

Plaintiffs' rambling discourse on "scheme" liability thus misses the mark. It is *Central Bank* and its progeny that controls over the question of Section 10(b) liability for *secondary* actors. As Merrill Lynch demonstrated in its opening brief, the weight of authority is clear that theories of secondary liability under Section 10(b) are no longer viable against secondary actors in the wake of *Central Bank*. See, e.g., *Ziamba v. Cascade Int'l, Inc.*, 256 F.3d 1194, 1205 (11th Cir. 2001); *Wright v. Ernst & Young LLP*, 152 F.3d 169 (2d Cir. 1998); *Shapiro v. Cantor*, 123

F.3d 717, 720 (2d Cir. 1997); *Anixter v. Home-Stake Prod. Co.*, 77 F.3d 1215, 1226 (10th Cir. 1996). *See also* ML Opening Br. at 33 n.18 (collecting district court cases).<sup>5</sup>

While plaintiffs purport to distinguish *Central Bank* and its progeny by relying on this Court's statement in *BMC Software* that "a defendant need not have made a false or misleading statement to be liable," plaintiffs omit the context in which that statement was made. *See BMC Software*, 183 F. Supp. 2d at 868 n.18. In *BMC Software*, the Court noted only that a defendant need not make a statement for Section 10(b) liability to attach *when the defendant has a fiduciary duty to the plaintiff and violates a duty to disclose*. *See id.* (collecting omission cases in which there was a fiduciary relationship giving rise to a duty to disclose). Plaintiffs do not and cannot allege that they were in a fiduciary relationship with Merrill Lynch. Plaintiffs' reliance on omission cases in which there was a fiduciary relationship giving rise to a duty to disclose is thus misplaced. *See, e.g., Zandford*, 122 S. Ct. at 1906 (broker violated fiduciary duty to clients who

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<sup>5</sup> Not surprisingly, plaintiffs' authority either pre-dates *Central Bank* or originates from *In re Software Toolworks, Inc.*, 50 F.3d 615, 628 n.3 (9th Cir. 1994), in which the Ninth Circuit adopted a "significant role" standard without any explanation as to how a defendant's alleged "significant role" in the primary violation of another in any way differed from the "substantial assistance" element of an aiding and abetting claim. *See Shores v. Sklar*, 647 F.2d 462 (5th Cir. 1981) (pre-*Central Bank* case effectively applying "significant role" standard to attorney who "drafted the Offering Circular"); *In re Union Carbide Corp. Consumer Prods. Bus. Sec. Litig.*, 676 F. Supp. 458 (S.D.N.Y. 1987) (pre-*Central Bank*); *Adam v. Silicon Valley Bancshares*, 884 F. Supp. 1398 (N.D. Cal. 1995) (adopting *Software Toolworks*); *In re ZZZZ Best Sec. Litig.*, 864 F. Supp. 960 (C.D. Cal. 1994) (same); *McNamara v. Bre-X Minerals Ltd.*, 57 F. Supp. 2d 396, 429 (E.D. Tex. 1999) (same). The "significant role" standard has been roundly criticized by the Second, Tenth and Eleventh Circuits as indistinguishable from the "substantial assistance" element of an aiding and abetting claim rejected by the Supreme Court in *Central Bank*. *See Anixter*, 77 F.3d at 1226 n.10 (criticizing *Software Toolworks* and district court decisions adopting *Software Toolworks*); *Wright*, 152 F.3d at 175-76 (rejecting *Software Toolworks*); *Ziemba*, 256 F.3d at 1194 (same). Moreover, *Software Toolworks* is inapposite here because Merrill Lynch is not alleged to have played a "significant role" in preparing any of the statements by Enron alleged to be false.

had granted broker "discretion to manage their account"); *O'Hagan*, 521 U.S. at 652 (insider "misappropriate[d] confidential information for securities trading purposes, in breach of duty owed to the source of the information"); *Finkel*, 817 F.2d at 363 (issuer violated duty to disclose to shareholders).

In all events, there is no allegation here, nor could there be, that Merrill Lynch exercised any control over Enron's alleged fraud from which primary actor "scheme" liability could be imposed. To the contrary, plaintiffs attempt to sweep away any requirement that a defendant know anything about an alleged scheme: "It is axiomatic that with respect to scheme liability, a defendant may be liable for participating in a scheme even if it did not interact with all the other participants, was unaware of the identity of each of the other participants, did not know about the specific roles of the other participants in the scheme, did not know about or participate in all of the details of each aspect of the scheme, or joined the scheme at a different time than the other participants." Ps' Br. at 104.<sup>6</sup> As plaintiffs' own authority confirms, that is not the law. *See U.S. Env'tl.*, 155 F.3d at 112 (trader "effect[ed] the very buy and sell orders that artificially manipulated USE's stock upward"); *First Jersey*, 101 F.3d at 1459 (principal of broker-dealer "orchestrated every facet" of trading scheme). *See also Mishkin*, 1998 WL 651065, at \*18-19

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<sup>6</sup> In yet another backdoor attempt to revive aiding and abetting liability, plaintiffs purport to rely on pre-*Central Bank* RICO "scheme" cases. *See U.S. v. Elam*, 678 F.2d 1234 (5th Cir. 1982); *U.S. v. Read*, 658 F.2d 1225 (7th Cir. 1981); *U.S. v. Alvarez*, 625 F.2d 1196 (5th Cir. 1980); *U.S. v. Craig*, 573 F.2d 455 (7th Cir. 1977). As plaintiffs' own authority confirms, however, these pre-*Central Bank* RICO "scheme" cases are wholly inapplicable because, in the pre-*Central Bank* era, RICO "scheme" liability was "aiding and abetting" liability. *See Read*, 658 F.2d at 1240 ("As an aider and abettor, Spiegel need not agree to the scheme. He need only associate himself with the criminal venture.") (emphasis added). Of course, in the wake of *Central Bank*, aiding and abetting liability has been rejected in the RICO context as well. *See, e.g., In re Mastercard Int'l Inc. Internet Gambling Litig.*, 132 F. Supp. 2d, 494-95 (E.D. La. 2001) ("this Court finds that aiding and abetting liability under § 1962(c) was eliminated by the Court's holding in *Central Bank*").

(under *U.S. Envtl.* and *First Jersey*, a defendant alleged to have employed a scheme to defraud must have "orchestrated" the scheme).

In the absence of any specific allegation explaining how Merrill Lynch knew about Enron's alleged fraud, much less that it exercised any control over Enron's alleged fraud, plaintiffs' purported "scheme to defraud" claim must be rejected. *See Goldberger v. Bear, Stearns & Co., Inc.*, No. 98 Civ. 8677, 2000 WL 1886605, at \*5 (S.D.N.Y. Dec. 28, 2000) (dismissing Section 10(b) claim because "there are no allegations . . . that Bear Stearns asserted control over the Introducing Brokers' trading operations").

### 3. Merrill Lynch Did Not Engage In A "Manipulative Device"

Plaintiffs' purported "manipulative device" claim must likewise be rejected because Merrill Lynch did not "engage in any act, practice, or course of business which operate[d] . . . as a fraud or deceit." 17 C.F.R. § 240.10b-5(c). As both the Supreme Court and Judge Higginbotham have made clear, a "manipulative device" claim under Rule 10b-5(c) is limited to activities, such as wash sales and matched orders, *on the market*. *See Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 476 (1977) ("Manipulation' is 'virtually a term of art when used in connection with securities markets.' . . . The term refers generally to practices, such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity."); *Hundahl v. United Benefit Life Ins. Co.*, 465 F. Supp. 1349, 1360 (N.D. Tex. 1979) (manipulative devices are "practices in the marketplace which have the effect of either creating the false impression that certain market activity is occurring when in fact such activity is unrelated to actual supply and demand or tampering with the price itself").

Confronted with this authority and unable to point to any "activities in the marketplace" by Merrill Lynch, plaintiffs effectively concede that Merrill Lynch did not engage in conduct

that fits within the established definition of a "manipulative device": "It is of no moment that certain cases, purportedly building on *Santa Fe Industries*, 430 U.S. 462 (1977), appear to have expressly read into § 10(b)'s manipulation language a limited and restrictive congressional intent to simply prohibit [manipulative] practices *in the marketplace*." Ps' Br. at 73 (emphasis added).<sup>7</sup>

Nonetheless, without citing any authority, plaintiffs baldly declare that whether or not Merrill Lynch engaged in "technically market manipulation devices" is "academic" because "the SPE transactions have been pleaded as both contrivances and deceptive devices." *Id.* at 74. Yet, the only conduct of Merrill Lynch alleged in this regard is serving as placement agent for LJM2 and investing as a limited partner in LJM2. The capitalization of LJM2, in and of itself, was not fraudulent. Rather, according to plaintiffs, it was the subsequent transactions between Enron and Enron-related SPEs<sup>8</sup> that in turn had dealings with LJM2 – and, more precisely, *Enron's alleged failure to account for those transactions properly* – that caused a misstatement of Enron's financial statements and the alleged harm to plaintiffs. Thus, if a "manipulative device" existed at all, it was the use and reporting of SPE transactions by Enron, and not the mere existence or funding of LJM2. Accordingly, plaintiffs' purported "manipulative device" claim must be

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<sup>7</sup> Plaintiffs' reliance on cases in which the defendants engaged in direct activity on the market is thus misplaced. *See, e.g., Zandford*, 122 S. Ct. at 1904 (discretionary broker engaging in unauthorized trades); *U.S. Envtl.*, 155 F.3d at 112 (trader "effect[ed] the very buy and sell orders that manipulated USE's stock upward"); *First Jersey*, 101 F.3d at 1459 (broker-dealer selling securities on market with illegal markups).

<sup>8</sup> SPEs also are not, in and of themselves, fraudulent. Indeed, SPEs are commonly used in a wide variety of forms by corporations and banks, including for securitization of debts or assets. *See, e.g.,* Exclusion from the Definition of Investment Company for Certain Structured Financings, SEC Rel. No. IC-18736, 57 Fed. Reg. 23980 (June 5, 1992) (discussing developing uses of SPEs for secured financings and similar financing structures); Commission Statement About Management's Discussion and Analysis of Financial Condition and Results of Operations, SEC Rel. Nos. 33-8056, 34-45321, 67 Fed. Reg. 3746 (Jan. 22, 2002) (discussing SPEs in connection with issuer's disclosure obligations).

dismissed as against Merrill Lynch. *See Hundahl*, 465 F. Supp. at 1359 ("The issue which this court must resolve is whether the Supreme Court's definition of manipulation in *Santa Fe* encompasses acts occurring outside the marketplace . . . We find that it does not."); *Ellison*, 36 F. Supp. 2d at 639-40 (dismissing Rule 10b-5(c) claim because defendants' alleged acts, "standing alone or in combination, do not come close to satisfying the rigorous standard for pleading scienter").

#### 4. **Plaintiffs Did Not Rely On Any Act By Merrill Lynch**

As the Supreme Court made clear in *Central Bank*, reliance is a requisite element of private civil liability under Section 10(b): "Respondents' argument would impose 10b-5 aiding and abetting liability when at least one element critical for recovery under 10b-5 is absent: reliance. . . . 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." *Central Bank*, 511 U.S. at 180.

Plaintiffs' own authority underscores this very point:

These allegations indicate that, by effectively becoming an accomplice of Livent's misconduct by means of the CIBC Wood Gundy Agreement, CIBC had knowledge of at least some portions of Livent's alleged fraud. The secret side letters exchanged in that arrangement could reasonably be construed as an element of Livent's improper accounting of income and false or misleading public statements regarding its financial condition. However, such assistance and participation in a securities law violation, without more, would not suffice to establish primary liability under § 10(b). *See Central Bank . . . Absent a clear indication that their purchase was actually made from CIBC, [plaintiffs] could not satisfy the element of their reliance on CIBC . . .*

*Livent*, 174 F. Supp. 2d at 149-50 (sustaining claim against CIBC, which sold debt security not traded on any public exchange directly to investors, only after plaintiffs established that "CIBC 'personally' solicited the class representatives"). *See also Primavera*, 1996 WL 494904. at \*6

(dismissing Section 10(b) claim because "Primavera does not allege that the Broker Defendants directly sold interests in the Funds to the investors").

Plaintiffs do not and cannot allege that they relied on Merrill Lynch's alleged "deceptive conduct" as placement agent for, and limited partner in, LJM2.<sup>9</sup> The capitalization of LJM2 is not alleged to have had any impact whatsoever on Enron or the market for Enron securities. Nor is there any allegation that plaintiffs, in purchasing their Enron shares, relied upon any statement in the LJM2 private placement memorandum, or on the fact that Merrill Lynch or certain of its officers invested as limited partners in LJM2. Instead, it was the alleged use of LJM2 by Fastow and Kopper to engage in transactions and Enron's alleged improper accounting of those transactions that allegedly caused Enron's financial statements to be misstated and plaintiffs to be harmed. As such, plaintiffs' claim is bottomed upon alleged *misrepresentations by Enron*, and not upon any alleged statement or action of Merrill Lynch. At most, plaintiffs allege that Merrill Lynch's involvement with LJM2 ultimately was of assistance to Enron in carrying out its

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<sup>9</sup> Moreover, a presumption of reliance for purported Rule 10b-5(a) and (c) claims arises only in (1) omission cases where there is a fiduciary or special relationship between parties giving rise to a duty to disclose, or (2) in "fraud-created-the-market" cases involving newly issued securities that would have been completely worthless and not entitled to be marketed but for the fraud. See *Smith v. Ayres*, 845 F.2d 1360, 1363-64 (5th Cir. 1988) (presumption of reliance for purported Rule 10b-5(a) and (c) claims arises "where the gravamen of the fraud is a *failure to disclose*") (emphasis in original); *Abell v. Potomac Ins. Co.*, 858 F.2d 1104, 1121-22 (5th Cir. 1988) (denying application of *Shores* "fraud-created-the-market" presumption of reliance because "plaintiffs' theory is only that they bought inferior bonds" and "the Westside bonds *always* had [some] legitimate value in the bond market") (emphasis in original); *Heller v. American Indust. Props. v. USAA Real Estate Income Inv.*, No. Civ. A. SA-97-CA-1315-EP, 1998 WL 1782550, at \*3-4 (W.D. Tex. Sept. 28, 1998) (Ps' Br. at 56) (dismissing Section 10(b) claim because presumptions of reliance for Rule 10b-5(a) and (c) claims were unavailable). Plaintiffs do not and cannot allege that Merrill Lynch served as their fiduciary or that Enron's securities had no legitimate value at all.

misrepresentations.<sup>10</sup> This, however, is a classic "aiding and abetting" claim, which is now precluded by *Central Bank*.

**D. Plaintiffs' Conclusory Allegations Do Not Support A Strong Inference Of Scierter Against Merrill Lynch**

Under any theory of liability, a critical missing link in plaintiffs' complaint is any particularized facts giving rise to a *strong* inference of scierter on the part of Merrill Lynch.

**1. Plaintiffs Do Not And Cannot Demonstrate That Merrill Lynch Had Any Motive To Defraud**

As Merrill Lynch demonstrated in its opening brief, plaintiffs cannot even satisfy the lesser, and now rejected, pleading standard of "motive and opportunity." Plaintiffs make no attempt to distinguish the myriad authority confirming the patent insufficiency of their conclusory motive allegations. *See, e.g., Melder v. Morris*, 27 F.3d 1097, 1104 (5th Cir. 1994) (rejecting plaintiffs' allegation that "the underwriters agreed to participate in the wrongdoing alleged herein in order to obtain substantial fees"); *Chan v. Orthologic Corp.*, No. Civ. 96-1514, 1998 WL 1018624, at \*23 (D. Ariz. Feb. 5, 1998) ("it is clear that under *any* test underwriting commissions do not establish scierter") (emphasis in original).

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<sup>10</sup> In fact, Merrill Lynch's involvement is at least several steps removed from the alleged misrepresentations by Enron. LJM2 itself is not named as a defendant or alleged to have participated in the alleged misrepresentations, and Merrill Lynch was a passive limited partner in LJM2. For this reason, plaintiffs' purported Rule 10b-5(a) and (c) claims also must be rejected because Merrill Lynch's alleged "deceptive conduct" as a limited partner in LJM2 was not "in connection with the purchase or sale of a security." Alleged "deceptive" acts that are one step removed from the purchase or sale of a security do not meet the "in connection with" requirement. *Kaplan v. Utilicorp United, Inc.*, 9 F.3d 405, 407 (5th Cir. 1993) (dismissing Section 10(b) claim where plaintiff failed to demonstrate "a nexus between the defendant's actions and plaintiff's purchase or sale"). Rather, as plaintiffs' own authority confirms, the alleged "deceptive" act must "coincide" with the purchase or sale of a security. *See Zandford*, 122 S. Ct. at 1904 ("respondent's fraud coincided with the sales themselves"); *O'Hagan*, 521 U.S. at 656 ("the securities transaction and the breach of duty thus coincide").

Instead, without citing any authority, plaintiffs declare that "while the investment banking fees to be gained in an isolated securities offering by an investment bank which does not have an ongoing relationship with the issuer may not, in and of itself, create sufficient weight to show a motive to defraud – surely the size and the continuity of the investment banking fees here, especially when combined with the fees being obtained from the bank's commercial activities in the context of the bank's secret involvement in the LJM2 partnership must be given great weight vis-à-vis motive." Ps' Br. at 119-20.

Plaintiffs are wrong on both the law and the facts. On the law, the court's decision in *Vogel v. Sands Bros. & Co., Ltd.*, 126 F. Supp. 2d 730 (S.D.N.Y. 2001), is particularly instructive. In *Vogel*, plaintiffs alleged that a small investment banking firm was motivated to participate in the fraud of its "most valued and long-standing client" because of the large amount of fees and commissions that had been generated from the client over the course of a relationship "spanning over fourteen years." *Id.* at 733-34. The court dismissed plaintiffs' claim, with prejudice, holding that the bank's "alleged desire to realize greater transaction fees and its close relationship with Consec [the client] are insufficient to show an improper motive." *Id.* at 739. *See also Odyssey Re (London) Ltd. v. Stirling Cooke Brown Holdings Ltd.*, 85 F. Supp. 2d 282, 298-99 (S.D.N.Y. 2000) ("Taken together, these facts can only lead to the inference that Web and its principals successfully did business with their long-time business contacts. Plaintiff must allege more than that defendants had worked together previously to create an inference of the fraudulent intent . . . [and] Odyssey must plead more than that a corporate defendant sought to profit . . . in order to give rise to an inference of fraudulent motive.").

On the facts, plaintiffs have unfortunately resorted to misrepresenting the allegations in their own complaint. Plaintiffs now claim, for example, that "Merrill Lynch sold some \$3.5 billion in new Enron/Enron-related securities to the public." Ps' Br. at 29, 31, 46, 75, 102, 114. As plaintiffs' own complaint demonstrates, however, Merrill Lynch merely participated in *syndicates* of underwriters – which included dozens of other banks, six of which are also named as defendants in this action – that sold Enron securities. *See* Compl. ¶ 48. Thus, there is absolutely no support – in the complaint or in fact – for plaintiffs' gross exaggeration in their brief that Merrill Lynch somehow earned "*billions* of dollars of fees, commissions, interest and other charges." Ps' Br. at 36 (emphasis added).

Plaintiffs also now assert that Merrill Lynch provided commercial banking services to Enron (Ps' Br. at 29, 101, 114), but there are no allegations in the complaint that Merrill Lynch made any commercial loans to Enron.<sup>11</sup> Instead, Merrill Lynch is alleged to have loaned money to LJM2, and the allegations concerning Merrill Lynch's loan to LJM2 are themselves a serious – and deliberate – distortion of the facts by plaintiffs. Merrill Lynch did not, as plaintiffs state over a dozen times, fund LJM2 with a "\$120 million loan." *See* Ps' Br. at 15 n.11, 30, 31, 38, 38 n.22, 47, 51, 53 n.33, 75, 100, 102, 108, 112. To the contrary, as evidenced by plaintiffs' own complaint, Merrill Lynch was merely one of a number of banks, each with only a fraction of the line of credit. *See* Compl. ¶ 27 ("JP Morgan initially provided a \$65 million line of credit to

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<sup>11</sup> Indeed, plaintiffs' assertion that "Enron secretly paid Merrill Lynch grossly excessive interest rates on billions of dollars of concealed/disguised loans" is certainly meant for some other defendant. Ps' Br. at 29. Plaintiffs' complaint pleads no such thing and it is simply false.

LJM2 – later, increased to \$120 million with CS First Boston doing the lending."); Compl. ¶ 712 ("CS First Boston also was a major lender to LJM2 via a \$120 million credit line").<sup>12</sup>

Providing underwriting services over a two and a half year period and extending a portion of one line of credit does not create a motive to defraud. *See In re SmarTalk Teleservs., Inc. Sec. Litig.*, 124 F. Supp. 2d 505, 518 (S.D. Ohio 2000) ("a desire to maintain the fees flowing from a client relationship is not a sufficient basis on which to infer scienter"); *Sloane Overseas Fund, Ltd. v. Sapiens Int'l Corp., N.V.*, 941 F. Supp. 1369, 1377 (S.D.N.Y. 1996) (rejecting plaintiffs' allegation that "since SB was a founder, a substantial creditor, and a shareholder of Sapiens, and since SB was also the lead manager and underwriter [for Sapiens], SB had ample motive to inflate Sapiens' financial soundness").

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<sup>12</sup> These are not the only blatant and deliberate falsehoods in plaintiffs' brief. Plaintiffs also repeatedly claim that there was somehow a "\$500 million payoff" by Enron to Merrill Lynch (Ps' Br. at 75, 102, 108, 112, 114), in connection with a purported sale of certain Nigerian barges "which allowed Enron to book a phony \$12 million earnings gain." *Id.* at 52. This spurious claim is then contradicted by plaintiffs elsewhere in their own brief. *See id.* at 38. Tellingly, neither any Nigerian barge transaction nor any payoff of any amount is mentioned anywhere in plaintiffs' complaint. *See Halter v. Allmerica Fin. Life Ins. & Annuity Co.*, No. Civ. A. 98-0718, 1998 WL 516109, at \*4 (E.D. La. Aug. 19, 1998) ("the Court should not consider claims raised for the first time in plaintiffs' responsive memorandum"). Plaintiffs' attempt to raise implausible, contradictory and unpled allegations in their opposition brief should be rejected. *See Henson v. Bassett Furniture Indus., Inc.*, No. Civ. A. 99-3462, 2000 WL 1477496, at \*2 (E.D. La. Oct. 4, 2000) ("a court is not bound to accept conclusory allegations concerning the legal effect of the events plaintiff has set out if these allegations do not reasonably follow from his description of what happened, or if these allegations are contradicted by the description itself"). Moreover, even by plaintiffs' own unreliable figures, the purported "\$12 million earnings gain" would have amounted to barely 1% of Enron's net income for 1999. *See* Compl. ¶ 424; *In re Anchor Gaming Sec. Litig.*, 33 F. Supp. 2d 889, 894-95 (D. Nev. 1999) (dismissing Section 10(b) claim because "courts have found that allegedly fraudulent transactions which are under one or two percent of net operating revenues are immaterial" and "the amount involved in the vendor dispute is not material, as a matter of law").

Plaintiffs also make no serious effort to salvage their "credit default put" theory of motive. And with good reason. In a misguided attempt to concoct a motive, plaintiffs inadvertently undermined their own claim. Plaintiffs' illogical theory was that although Merrill Lynch supposedly knew that Enron's financial condition was precarious "by the beginning of the Class Period [October 1998]" (Compl. ¶ 748), Merrill Lynch nonetheless decided in 2000 and 2001 to expose itself to the risk of "potentially large losses" by writing "hundreds of millions of dollars of credit default puts" predicated on the strength of Enron's financial condition. *Id.* ¶ 743.

As courts have made clear, "where plaintiff's view of the facts defies economic reason, it does not yield [even] a reasonable inference of fraudulent intent." *Kalnit v. Eichler*, 264 F.3d 131, 140-41 (2d Cir. 2001) (dismissing securities fraud complaint with prejudice). Here, Merrill Lynch's alleged writing of "credit default puts" in 2000 and 2001 *negates* any plausible inference that Merrill Lynch believed Enron's financial condition to be precarious because, as plaintiffs themselves allege, the "credit default puts" were predicated on the *strength* of Enron's financial condition. *See In re Sun Healthcare Group, Inc. Sec. Litig.*, 181 F. Supp. 2d 1283, 1297 (D.N.M. 2002) ("It is difficult to discern how Defendants could be acting in their self-interest by holding or purchasing artificially inflated Sun stock, as well as acquiring a company that they allegedly knew was doomed for failure under PPS. Motive, therefore, is entirely absent from Plaintiffs' Complaint.").

**2. The Complaint Is Barren Of Any Facts Suggesting Conscious Misbehavior Or Severe Recklessness By Merrill Lynch**

Plaintiffs do not dispute that, in the absence of motive, a far more stringent pleading standard applies. *See Schiller v. Physicians Resource Group, Inc.*, No. Civ. A. 3:97-CV-3158-L, 2002 WL 318441, at \*10 (N.D. Tex. Feb. 26, 2002). Under these circumstances, plaintiffs must identify conduct that "approximates an actual intent to aid in the fraud being perpetrated by the

company." *In re WRT Energy Sec. Litig.*, No. 96 Civ. 3610, 1999 WL 178749, at \*9 (S.D.N.Y. Mar. 31, 1999) (dismissing securities fraud complaint against underwriter with prejudice).

Plaintiffs do not come close to meeting this stringent standard.

a) **Merrill Lynch As Underwriter And Analyst**

Plaintiffs do not even attempt to identify any documents or other information that came to Merrill Lynch's attention in its capacity as an underwriter or analyst that would have led it to believe that Enron's financial statements were false. *See Abrams v. Baker Hughes Inc.*, \_\_\_ F.3d \_\_\_, 2002 WL 1018944, at \*6 (5th Cir. May 21, 2002) ("An unsupported general claim about the existence of confidential corporate reports that reveal information contrary to reported accounts is insufficient to survive a motion to dismiss. Such allegations must have corroborating details regarding the contents of allegedly contrary reports, their authors and recipients."); *Elliot Assocs., L.P. v. Covance, Inc.*, No. 00 Civ. 4115, 2000 WL 1752848, at \*7 (S.D.N.Y. Nov. 28, 2000) ("to withstand a motion to dismiss, plaintiffs must detail specific contemporaneous data or information known to the defendant that was inconsistent with the representation in question").<sup>13</sup>

Instead, without more, plaintiffs speculate that Merrill Lynch must have known about Enron's fraud because "Merrill Lynch had constant access to Enron's top executives and Enron's financial records, finances, plans, etc. in connection with a series of large ongoing major commercial loans and/or lending commitments, as well as several securities offerings between 98 and 01!" Ps' Br. at 114 (exclamation in original). *See also* Compl. ¶ 748 ("Merrill Lynch

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<sup>13</sup> Plaintiffs' reliance on *Cooper v. Pickett*, 137 F.3d 616 (9th Cir. 1997), is misplaced. As this Court recognized in *BMC Software*, *Cooper* was a pre-PSLRA case in which the Ninth Circuit did not require scienter to be pled with specificity. *See BMC Software*, 183 F. Supp. 2d at 909 n.48 (rejecting *Cooper* as "a pre-PSLRA case"); *Cooper*, 137 F.3d at 628 ("This amounts to an argument that scienter, not falsity, must be pled with specificity. *Glenfed I* [a pre-PSLRA decision] is to the contrary.").

knew that Enron was falsifying its publicly reported financial results . . . due to its access to Enron's internal business and financial information as one of Enron's main underwriters and financial advisors, as well as its intimate interaction with Enron's top officials which occurred virtually on a daily basis.").

Plaintiffs' rank speculation is patently insufficient. *See Landry's*, slip op. at 66 (dismissing securities fraud claim based on conclusory allegation that underwriters "had access to confidential corporate information and communicated frequently with [the company's officers] about the business"); *BMC Software*, 183 F. Supp. 2d at 887 (even as to an issuer, "conclusory allegations that [the company's officers] had the requisite scienter based on their executive positions . . . their involvement in day-to-day management of its business, their access to internal corporate documents, their conversations with corporate officers and employees, and their attendance at Board meetings are insufficient").<sup>14</sup>

In the absence of any facts, much less particularized facts, demonstrating that anyone<sup>15</sup> at Merrill Lynch knew that any part of its analyst reports or the Enron offering documents was

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<sup>14</sup> Ignoring this Court's decisions in *Landry's* and *BMC Software*, plaintiffs instead rely on two decisions from the same case in which the district court judge did not apply the heightened pleading standards of the PSLRA because the suit had been commenced prior to the effective date of the PSLRA. *See Flecker v. Hollywood Entm't Corp.*, No. 95-1926-MA, 1997 WL 269488 (D. Or. Feb. 12, 1997); *Murphy v. Hollywood Entm't Corp.*, No. 95-1926-MA, 1996 WL 393662 (D. Or. May 9, 1996).

<sup>15</sup> Plaintiffs miss the point when they argue that "to determine the *mens rea* of a corporation, courts not only consider the actual knowledge of each individual employee, but also aggregate each employee's knowledge." Ps' Br. at 115. Plaintiffs have failed to identify *anyone* at Merrill Lynch who knew that any part of Enron's financial statements was false. *See In re Splash Tech. Holdings Inc. Sec. Litig.*, 160 F. Supp. 2d 1059, 1080 (N.D. Cal. 2001) (dismissing securities fraud claim because plaintiffs failed to plead the "identity of any specific person alleged to have received or conveyed the [adverse] information"). Quite simply, there was no knowledge to "aggregate."

false, plaintiffs' Section 10(b) claim relating to those documents should be dismissed. *See Chan*, 1998 WL 1018624, at \*23 (dismissing securities fraud complaint because "plaintiffs have failed to point to any facts establishing that the underwriters had any knowledge that the statements were misleading"); *Wenger v. Lumisys, Inc.*, 2 F. Supp. 2d 1231, 1251 (N.D. Cal. 1998) (dismissing securities fraud complaint because "plaintiff fails to demonstrate anywhere in the complaint that . . . the underwriters w[ere] aware of any allegedly 'adverse' information at the time the Prospectus was issued").

**b) Merrill Lynch's Role With Respect To LJM2**

Plaintiffs also do not attempt to identify anyone at Merrill Lynch who had documents or other information indicating that LJM2 "was to be used and was used to engage in non-arm's-length transactions to boost Enron's reported profits." Compl. ¶ 742. *See Splash*, 160 F. Supp. 2d at 1070 (dismissing securities fraud claim with prejudice because plaintiffs' "allegations concerning defendants' access to, and awareness of, adverse information through internal reports and oral communications within Splash are not supported by any specific facts concerning the people who made or received the reports, the content of the reports, the dates of transmissions, [or] the manner in which they were transmitted").<sup>16</sup>

Instead, plaintiffs simply point to Merrill Lynch's role as placement agent for, and a limited partner in, LJM2 and presume that Merrill Lynch must have known the details of LJM2's allegedly improper internal business operations. *See Ps' Br.* at 11-12. Yet, as plaintiffs concede, Merrill Lynch was not involved in LJM2's day-to-day operations. *See Ps' Br.* at 11 ("LJM2's

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<sup>16</sup> Plaintiffs' allegations relating to LJM2 have no bearing on the offerings in which Merrill Lynch participated, all of which occurred long before LJM2 was formed in December 1999, or to the seven analyst reports and "statements to the media" allegedly made by Merrill Lynch prior to December 1999.

day-to-day activities would be managed by Fastow, and other Enron insiders"). Merrill Lynch's role as placement agent ended with the sale of the partnership interests and did not encompass any management role. Likewise, as a limited partner, Merrill Lynch was "a passive investor similar to a corporate shareholder." *Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*, 714 A.2d 96, 99 (Del. Ch. 1998). *See also* Private Placement Memorandum, at 30 ("Limited Partners will be relying entirely on the General Partner and Manager to conduct and manage the affairs of the Partnership. The Agreement will not permit the Limited Partners to engage in the active management and affairs of the corporation.").

In the absence of any involvement by Merrill Lynch in the day-to-day operations of LJM2, there is no basis from which to infer that Merrill Lynch had any knowledge of the alleged misuse of LJM2 by LJM2 Capital Partners, the general partner of LJM2 controlled by Fastow and Kopper. *See Boley v. Pineloch Assocs., Ltd.*, No. 87 Civ. 5124, 1990 WL 113201, at \*8-9 (S.D.N.Y. Aug. 2, 1990) (dismissing securities fraud claim against placement agent because, unlike the general partner of a limited partnership, the placement agent was "not involved in day-to-day operations" of the limited partnership).

While plaintiffs attempt to characterize LJM2 as "an invitation to share in the benefits of non-arm's-length self-dealing transactions with Enron" (Ps' Br. at 12), plaintiffs omit to mention the significant steps that LJM2 represented would be taken to avoid a conflict of interest:

Several steps have been taken to assure that the conflict-of-interest issue is fully vetted and appropriate procedures are put in place to allow for operation of the Partnership in situations where conflicts arise. The Partnership will establish an Advisory Committee (as defined below) to provide for an independent review of decisions made by the General Partner . . . In addition, Richard Causey, Executive Vice President and Chief Accounting Officer of Enron, will, in behalf of Enron, monitor and mediate conflict-of-interest issues between Enron and the Partnership.

Private Placement Memorandum, at 12.

Thus, contrary to plaintiffs' self-serving characterization, the formation and capitalization of LJM2 was not inherently fraudulent. Nor was there anything inherently fraudulent about Enron's alleged desire to sell assets to LJM2 by year-end. *See Rieger v. Price Waterhouse Coopers LLP*, 117 F. Supp. 2d 1003, 1008-09 (S.D. Cal. 2000) (rejecting inference of fraudulent intent based upon allegation that "Altris recorded both transactions on the last day of the year" because "the timing and structuring of these transactions does not inherently suggest fraud, and could suggest a desire to obtain more favorable tax or regulatory treatment"). Similarly, despite plaintiffs' sinister innuendo regarding the initial closing of LJM2's limited partnership interests as a "pre-funding," there was nothing inherently fraudulent about the alleged desire to complete the formation of the LJM2 limited partnership by year-end. *See Hallwood*, 714 A.2d at 99 n.6 ("the limited partnership attracts promoters and investors because it combines passive investment . . . with the favorable tax treatment of a partnership").<sup>17</sup> Indeed, partnerships that seek capital investment from the participation of limited partners frequently hold more than one closing – a fact that plaintiffs for all their aspersions do not and cannot dispute.

While plaintiffs conclusorily assert that Merrill Lynch must have known that LJM2 would be an instrumentality of an Enron fraud because "the Partnership's objective [wa]s to generate an annualized internal rate of return in excess of 30% to investors in the Partnership" (Private Placement Memorandum, at 1), plaintiffs do not and cannot allege that the targeted returns were somehow unusually high for a private equity fund, which typically offers high

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<sup>17</sup> Moreover, plaintiffs' assertion that "Enron's banks and bankers, including Merrill Lynch put up . . . on 12/22/99 many times more than their allocated share of LJM2's capital at that time" (Ps' Br. at 50), is demonstrably false. Indeed, as set forth in plaintiffs' own chart, each bank's contribution to complete the formation of LJM2 was but a fraction of their respective allocated shares. *Id.* at 50 n.30. Merrill Lynch's contribution of \$750,000, for example, represented just 3% of the \$22 million share for Merrill Lynch and its employees. *Id.*

returns in exchange for high risks, or that Merrill Lynch knew LJM2's conflict of interest procedures would be violated.

Plaintiffs' attempt to mischaracterize LJM2, and the opportunity to invest in LJM2, as a "reward" for willing participants in Enron's fraud should therefore be rejected. As discussed above, what was allegedly fraudulent was not LJM2 itself, but the alleged misuse of LJM2 by Fastow and Kopper and Enron's reporting of transactions with SPEs that in turn had dealings with LJM2. There is no allegation, nor could there be, that Merrill Lynch, or any of the other limited partner investors in LJM2, were in any way involved in the alleged misconduct.<sup>18</sup>

In the absence of any specific allegation demonstrating that Merrill Lynch knew LJM2 would be misused, plaintiffs cannot adequately plead that Merrill Lynch believed Enron's financial condition to be "precarious" at the time it issued its analyst reports (or at any other time). See *Branca v. Paymentech, Inc.*, No. Civ. A. 3:97-CV-2507-L, 2000 WL 145083, at \*10 (N.D. Tex. Feb. 8, 2000) ("Plaintiffs have pleaded no facts indicating that at the time the

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<sup>18</sup> Plaintiffs' improper attempt to rely on the statement of Enron President and CEO Jeffrey Skilling, *after* Enron's fraud was exposed and *after* plaintiffs' complaint was filed, that he would have suspected fraud if he had known of LJM2's returns on its transactions with Enron (Ps' Br. at 52), actually undermines plaintiffs' claim. See *In re First Union Corp. Sec. Litig.*, 128 F. Supp. 2d 871, 888 (W.D.N.C. 2001) ("Plaintiffs' repeatedly cite statements made by Mr. Crutchfield after the Class Period. . . . This practice of alleging fraud by hindsight – claiming that defendants knew of facts at an earlier time based on subsequent disclosures – has been categorically rejected by numerous courts."). If Skilling, the President and CEO of Enron, did not know about the allegedly improper transactions between Enron and LJM2, there is no reason to presume that Merrill Lynch, a passive investor in LJM2, would have known about them. Indeed, plaintiffs' hindsight speculation that Merrill Lynch must have suspected fraud because LJM2's actual returns were meeting its targeted returns is tantamount to imposing a duty on passive investors to probe behind a company's internal controls (here, LJM2's conflict of interest procedures) any time their investments are successful. Plaintiffs do not and cannot identify any such duty.

allegedly false statements were made, defendants had actual knowledge of contradictory facts, and thus their complaint does not state a claim for securities fraud.").

In sum, plaintiffs' conclusory allegations do not satisfy the heightened pleading requirements of the PSLRA or Rule 9(b). Accordingly, plaintiffs' Section 10(b) claim against Merrill Lynch should be dismissed for failure to plead facts supporting a strong inference of fraudulent intent and failure to plead fraud with particularity. *See Vogel*, 126 F. Supp. 2d at 743 (dismissing securities fraud complaint against underwriter alleged to have issued false analyst reports because "while plaintiffs contend that defendant had access to facts that contradict these generally optimistic reports, plaintiffs fail to specifically identify the reports or statements containing this information").

### CONCLUSION

For all of these reasons, this Court should dismiss plaintiffs' Consolidated Complaint against Merrill Lynch with prejudice and grant such other and further relief as it deems appropriate.

Dated: June 24, 2002

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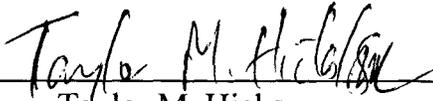
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**CERTIFICATE OF SERVICE**

I hereby certify that a true and correct copy of the foregoing instrument was served upon all known counsel of record by e-mail, facsimile or certified mail, return receipt requested, pursuant to the Court's Order dated April 10, 2002 (Docket No. 449), on this the **24th** day of **June, 2002**.

*Please See Attached Service List*

  
Taylor M. Hicks

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