United States Court of Appeals
for the
Eighth Circuit

Case No. 05-1974

STONERIDGE INVESTMENT PARTNERS, LLC,

Plaintiff-Appellant,

– v. –

SCIENTIFIC-ATLANTA, INC. and MOTOROLA, INC.,

Defendants-Appellees,

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF MISSOURI
THE HONORABLE CHARLES A. SHAW (No. 02-01186)

OPENING BRIEF OF PLAINTIFF-APPELLANT

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SUMMARY OF THE CASE AND REQUEST FOR ORAL ARGUMENT

This class action on behalf purchasers of Charter Communications, Inc. ("Charter" or the "Company") common stock charges that Scientific-Atlanta, Inc. and Motorola, Inc. ("Appellees") committed securities fraud through sham transactions. Charter agreed to pay more for certain products that it had already contracted to buy from Appellees on condition that they kickback the excess payments under the guise of advertising fees. Appellees knew that the sole point of this bogus round tripping of Charter's own funds was to inflate the Company's financial results. The district court held that the charges only amounted to inactionable aiding and abetting. In so ruling, the district court misinterpreted *Central Bank, N.A. v. First Interstate Bank, N.A.*, 511 U.S. 164 (1994), to bar liability for partners in a fraudulent scheme, ignored the language of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5(a) and (c) (which prohibits deceptive *conduct*), and disregarded established precedents advocating a broad and flexible interpretation of the statutory scheme. Plaintiff requests 30 minutes for oral argument to address important issues of first impression in this Circuit.

CORPORATE DISCLOSURE STATEMENT

Pursuant to Fed. R. App. P. 26.1 and this Circuit's Rule 26.1A, the undersigned counsel for Plaintiff-Appellant StoneRidge Investment Partners LLC ("Plaintiff" or "StoneRidge") hereby certifies upon information and belief that Plaintiff is not a subsidiary of any other corporation, and that no publicly held corporation owns 10% or more of its stock.

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JURISDICTIONAL STATEMENT

This case arises under Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78(j)(b), and Rule 10b-5, 17 C.F.R. § 240.10b-5, promulgated thereunder by the Securities and Exchange Commission ("SEC"). The district court's jurisdiction was under Section 27 of the Exchange Act, 15 U.S.C. § 78aa, and 28 U.S.C. § 1331. This Court has jurisdiction to review Plaintiff's timely filed appeal pursuant to 28 U.S.C. § 1291 from the following orders of the district court: the October 12, 2004 Order dismissing Plaintiff's securities fraud claims against the Appellees, the December 20, 2004 Order denying Plaintiff's motion for reconsideration and leave to amend its complaint, and the February 15, 2005 entry of final judgment for Appellees.

STATEMENT OF THE ISSUES PRESENTED

1. Did the district court err in ruling, as a matter of law, that Plaintiff had not alleged a primary violation of Section 10(b) and Rule 10b-5(a) and (c) against the Appellees who entered into kickback arrangements, with no bona-fide business purpose, and with full appreciation that the sole point of their transactions was the inflation of Charter's reported results just because the Appellees did not make or draft a misstatement and lacked any "special relationship" with Charter? *SEC v. Zandford*, 535 U.S. 813 (2002); *Affiliated Ute Citizens v. United States*, 406 U.S.

128, 151 (1972); *In re Enron Corp. Sec.*, 310 F. Supp. 2d 819 (S.D. Tex. 2004); *In re Enron Corp. Sec. Derivative & ERISA Litig.*, 235 F. Supp. 2d 549 (S.D. Tex. 2002).

2. Did the district court err by denying leave to Plaintiff to file an amended complaint on futility grounds despite Plaintiff's identification of facts that further buttressed the allegation of a primary violation by the Appellees, including revelations that the Appellees fabricated documents to provide false cover to the wash transactions? *SEC v. Zandford*, 535 U.S. 813 (2002); *Freeman v. First Union Nat'l*, 329 F.3d 1231, 1234 (11th Cir. 2003)*; In re Global Crossing, Ltd. Sec. Litig*., 322 F. Supp. 2d 319, 335 (S.D.N.Y. 2004); *In re Enron Corp. Sec.*, 310 F. Supp. 2d 819 (S.D. Tex. 2004).

3. Did the district court err in refusing to reconsider its order dismissing Plaintiff's Amended Consolidated Class Action Complaint despite that court's clear error of law in its initial ruling that a primary violation of Section 10(b) and Rule10b-5(a) and (c) cannot be based on fraudulent conduct, no matter how deliberate or material, but must be premised on the making or drafting of a mis-statement in the absence of a special relationship? *SEC v. Zandford*, 535 U.S. 813 (2002); *Hagerman v. Yukon Energy Corp.*, 839 F.2d 407, 414 (8th Cir. 1988); *In re Enron Corp. Sec.*, 310 F. Supp. 2d 819 (S.D. Tex. 2004).

STATEMENT OF THE CASE

A. RELEVANT PROCEDURAL HISTORY

Beginning on July 31, 2002, numerous class actions were filed against Charter and certain of its officials (the "Charter Defendants"), as well as Scientific-Atlanta and Motorola (sometimes, referred as the "Vendors"), on behalf of purchasers of Charter common stock. After the Judicial Panel on Multidistrict Litigation Panel transferred the cases to the Eastern District of Missouri, the district court herein, by order dated January 27, 2003, consolidated these cases and appointed StoneRidge as Lead Plaintiff.

On August 5, 2003, Plaintiff filed the Amended Consolidated Class Action Complaint ("Complaint") against the Vendors, the Charter Defendants and Charter's outside auditors (Arthur Andersen LLP, "Andersen") alleging their deliberate participation in a scheme to defraud Charter investors during November 8, 1999 through July 17, 2002 (the "Class Period") in violation of the Exchange Act.[1]

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[1] Four former officials of Charter were indicted in July 2003 by a federal grand jury for misconduct related to the reporting of inflated financial results for the Company. The Indictment described the kickback arrangements at issue on this appeal, although the Vendors were not identified by name. All the former Charter officials have since entered guilty pleas and have been sentenced. Charter has also settled charges brought by the SEC.

In September and October 2003, all defendants moved to dismiss. After completion of briefing, negotiations ensued with the Charter Defendants, resulting in a settlement in principle for $144,000,000 in cash and securities reached on August 5, 2004. Settling defendants withdrew their dismissal motions.

On October 12, 2004, the district court granted the Vendors' motions to dismiss, while denying Andersen's. ("Op. I.") The court held that the claims against the Vendors amounted only to the aiding and abetting liability barred by *Central Bank, N.A. v. First Interstate Bank, N.A.*, 511 U.S. 164 (1994). Op. I p. 8, Addendum ("ADD") 8, Joint Appendix ("A") 417. The district court found dispositive that the Vendors did not make "a representation to Charter's investors nor participated in the drafting of statements Charter made to its investors." Op. I p. 14, ADD-14, A-423. Relying on *In re Homestore.com, Inc. Sec. Litig.*, 252 F. Supp. 2d 1018 (C.D. Cal. 2003), *appeal* docketed, No. 04-55665 (9th Cir. Apr. 16, 2004), the district court further ruled that in the absence of a special relationship, a business partner which did not "make" a public misstatement, could not be liable as a primary violator. Op. I pp. 10-11, ADD-10-11, A-419-20.[2] It also concluded

[2] The SEC has filed *amicus curiae* briefs in support of the *Homestore* plaintiff's appeal of the dismissal to the Ninth Circuit, which is *sub judice*. *See* Brief of the Securities and Exchange Commission, *Amicus Curiae*, in Support of Positions That Favor Appellant, *Simpson v. Homestore.com, Inc.*, No. 04-55665 (9th Cir. served Oct. 21, 2004 and filed Oct. 22, 2004), *also available at*

that investors relied on Charter's fraudulent statements, not the Vendors' deceptive scheme. Op. I pp. 9-11, ADD-9-11, A-418-20.[3]

In so ruling, the district court rejected Plaintiff's argument — based on cases such as *In re Enron Corp. Sec. Derivative & ERISA Litig.*, 235 F. Supp. 2d 549 (S.D. Tex. 2002) ("*Enron I*"), statutory language, and established Supreme Court precedents — that a primary violation of Section 10(b) and Rule 10b-5(a) and (c) can be predicated on a business partner's course of fraudulent conduct or scheme directed at deceiving investors.

Following the dismissal, Plaintiff timely sought leave to file the proposed Second Amended Consolidated Class Action Complaint ("SAC") to add allegations against the Vendors based on non-public facts uncovered during discovery which further buttressed the charge of a primary violation. Plaintiff also moved for reconsideration of the district court's dismissal of the claims based on precedents

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http://www.sec.gov/litigation/briefs/homestore_102104.pdf (last accessed June 10, 2005), and Reply Brief of the Securities and Exchange Commission, *Amicus Curiae*, in Support of Positions That Favor Appellant (served Feb. 4, 2005 and filed Feb 7, 2005), *also available at* http://www.sec.gov/litigation/briefs/homestore_020405.pdf (last accessed June 10, 2005).

[3] In its dismissal order, the court additionally rejected Plaintiff's argument that the Vendors' conduct rose to the level of a misstatement. Op. I p. 10, ADD-10, A-419. Plaintiff is not pressing this point on this appeal.

rendered after briefing on the motion to dismiss and the newly uncovered facts.[4]

By Order dated December 20, 2004 ("Op. II"), the district court denied the request to amend, concluding that "amending the complaint would be futile." Op. II p. 11, ADD-45, A-454. Its analysis was similar to that in its earlier order, except for the additional observation that the Vendors were not alleged to be the "'chief architect and executor'" of the deceptive scheme. Op. II pp. 10-11, ADD-44-45, A-453-54.

Also by its December Order, the district court denied reconsideration. Op. II p. 8, ADD-42, A-451. On February 15, 2005, final judgment was entered for the Vendors. ADD-47, A-456. On March 7, 2005, Plaintiff timely filed its notice of appeal from the October 12, 2004, December 20, 2004 and February 15, 2005 orders. A-458.

On May 23, 2005, the district court held a final hearing on the fairness of Plaintiff's $144,000,000 settlement with the Charter Defendants and the $2,250,000 settlement with Andersen (reached after the court's denial of the auditor's dismissal motion). No ruling has yet been issued. This is the second

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[4] Plaintiff further sought to amend the Complaint to extend the Class Period by one month to conform the period with the evidence adduced. This relief, granted by the Court's December 20, 2005 Order, is not part of this appeal. ADD-48, A-455.

largest settlement of a securities fraud class action ever reached in this Circuit.

B. STATEMENT OF THE FACTS[5]

1. Background

Charter is one of the country's largest cable television providers. Cplt. ¶ 22, A-46 ¶ 22. Its customers receive signals through digital cable converter boxes installed on the top of their television sets ("set-top boxes"). Cplt. ¶ 34, A-48 ¶ 34. These units were manufactured by Scientific-Atlanta and Motorola, Charter's two largest suppliers. Cplt. ¶¶ 34-35, 75, A-48 ¶¶ 34-35, A-67 ¶ 75.

Charter annually purchased millions of dollars worth of set-top boxes from these Vendors. Under Generally Accepted Accounting Principals ("GAAP"), such purchases were capitalized on Charter's books, *i.e.*, spread over the life of the units (rather than being expensed in the year of their purchase). Cplt. ¶ 43, A-50 ¶ 43. Such capitalization minimized the impact these purchases had on Charter's operating cash flow, a key measurement that securities analysts used to assess cable companies' financial performances during the Class Period. Cplt. ¶ 42, A-50 ¶ 42.[6]

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[5] This statement is based on the allegations of the Complaint (cited as "Cplt.") and SAC.

[6] In the late 1990's, cable companies spent heavily on capital investment and consolidation. Cplt. ¶ 40, A-49 ¶ 40. For stock market analysts, these companies' short term losses were not so important as long as the companies sustained a significant cash flow and were building solid customer bases. *Id.*

Throughout the Class Period, Charter consistently hit analysts' estimates, portraying itself as a booming company, with increased operating cash flow. Cplt. ¶¶ 3, 48, A-41 ¶ 3, A-52-53 ¶¶ 48. It also touted that its accounting policies conformed to GAAP. Cplt. ¶ 45, A-51 ¶ 45. This portrayal was materially false and resulted from a pervasively deceptive scheme entered into by Charter and others, including the Vendors, to dupe Charter investors.

2. <u>The Fraudulent Set-Top Box Scheme</u>

In August, 2000, Kent Kalwarf, then Executive Vice President and Chief Financial Officer of Charter, and David G. Barford, then Executive Vice President and Chief Operating Officer of Charter, realized that Charter would miss analysts' operating cash flow forecasts for the last quarter of 2000. Cplt. ¶ 76, A-67 ¶ 76. The Company turned to Scientific-Atlanta and Motorola to help cover the shortfall. *Id.*

Charter essentially agreed to "pay" Scientific-Atlanta and Motorola an extra $20 for each set-top box in exchange for the Vendors' agreement to repay the same amount to Charter in the form of "advertising" fees. Cplt. ¶ 77, A-67 ¶ 77. The

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During the relevant time herein, it was well known that operating cash flow was considered by the market to be a more reliable measure of a cable company's financial results because it reflected its core operating costs during a specific period, rather than capital investments whose benefits would be realized over a longer time frame. Cplt. ¶ 42, A-50 ¶ 42.

additional payments by Charter, and the advertising fees kicked back by the Vendors, were blatant "wash" transactions involving "round tripping" of Charter's funds, and should have had no impact on the Company's reported operating cash flow. However, since Charter capitalized its "purchases" (thereby spreading such costs over several years), but recorded the "advertising fees" as immediate revenues, the transactions materially inflated Charter's reported operating cash flow. Cplt. ¶¶ 78-79, 196, A-67-69 ¶¶ 78-79, A-105 ¶ 196.

As a result, Charter's reported operating cash flow was inflated by at least $17 million for the fourth quarter of 2000. Cplt. ¶ 79, A-69 ¶ 79. Without these fraudulent transactions, Charter's reported operating cash flow would have missed analysts' forecasts, and its stock price would have fallen. *Id.* The Company was ultimately compelled to restate its results for 2000 due to, among other things, these fraudulent transactions. Cplt. ¶ 154, A-94 ¶ 154.

The kickback arrangements with the Vendors, and Charter's inflation of its 2000 operating cash flow, were inextricably connected and constituted one continuous scheme to defraud investors. The kickback transactions had no legitimate business purpose and were deliberately designed only to inflate Charter's reported operating cash flow, as the Vendors were well aware. Cplt. ¶ 196, A-105 ¶ 196.

The SAC buttresses the allegations of Appellees' active engagement in this

scheme, and awareness of its fraudulent purpose. As detailed therein, upon realizing the likelihood of year-end shortfall, in August 2000, Charter initially requested that the Vendors simply purchase advertising with their own funds. This overture was rebuffed. SAC ¶ 92, A-290 ¶ 92. The Vendors then agreed to the kickback transactions whereby they would be provided cash by Charter to purchase advertising. SAC ¶ 93, A-290 ¶ 93.

Unquestionably, the Vendors knew the scheme was fraudulent from the outset, and that its sole purpose was to inflate Charter's reported operating cash flow. Charter already had pre-existing contracts with the Vendors to purchase a certain number of set-top boxes over a specific period at designated prices. SAC ¶¶ 94-96, A-290-91 ¶¶ 94-96. A contract with Scientific-Atlanta entered in December 1999, and modified only a month before the August 2000 wash transactions, required Charter to purchase over 450,000 set-top boxes by the end of 2000, plus an additional 1,000,000 boxes in 2001-2002, all at predetermined prices. SAC ¶¶ 95-96, A-291 ¶¶ 95-96. The Motorola agreement, dated December 7, 1999, required Charter to purchase 1,000,000 set-top boxes over the two year period 2000-01, again at agreed upon prices. SAC ¶ 94, A-290 ¶ 94. Thus, there was no need for Charter to purchase any additional boxes, nor pay additional amounts for them.

Nonetheless, to give the appearance of legitimacy to the transactions, on August 28, 2000, Charter's John Pietri (Senior Vice President, Engineering) wrote to Tom Nilson (Scientific-Atlanta's Managing Director for North American Sales, SAC ¶ 98, A-292 ¶ 98), instructing him to fabricate a letter informing Charter that Scientific-Atlanta was raising set-top box prices. SAC ¶ 100, A-292-93 ¶ 100. Pietri told Scientific-Atlanta just what the "pricing increase notification letter" should say:

> 1. The reason for the price increase and the date (09/01/00) of the increase.
> 2. A description of the quantities of set-tops this letter would cover (the anticipated number of set-tops (351,180) that SA expects to ship and Charter expects to take delivery of between 09/01/00 and 12/31/00).
> 3. A penalty provision in case Charter doesn't accept the anticipated number of set-tops in the specified time frame.
>
> In addition, I will be sending the advertising contract for review prior to the final particulars being worked out.

Id.

No such price hike was contemplated by Scientific-Atlanta at the time. To the contrary — Charter had just signed an amended contract with Scientific-Atlanta the month before which covered these very same purchases (*i.e.* the balance of the 450,000 set-top boxes still to be shipped by the end of the year). SAC ¶ 102, A-293-94 ¶ 102. Indeed, Scientific Atlanta had provided Charter a

"most favored customer" clause which prohibited the Vendor from increasing Charter's prices without doing so for every one of its customers. *Id.*

Immediately after sending these instructions to fabricate documentation of a price increase, Pietri emailed Wes Hart, Charter's Vice-President of Advertising Sales, and instructed him to prepare an advertising contract for Scientific-Atlanta worth nearly $6.8 million, the exact amount charged for the alleged price increase. SAC ¶ 101, A-293 ¶ 101.

Wholeheartedly following Pietri's instructions, Steve Kaufman (Scientific-Atlanta's National Business Manager, SAC ¶ 95, A-291 ¶ 95) notified Charter, on August 31, 2000, that Scientific-Atlanta was increasing the price for all set-top boxes scheduled to be purchased by Charter for the balance of 2000. SAC ¶ 102, A-293-94 ¶ 102. Kaufman attributed the price change to "increased manufacturing costs." *Id.* He knew that this was false, and that the existing contract prevented any such cost increase being passed along to Charter. *Id.*

Thereafter, in September 2000, Scientific-Atlanta and Charter executed "marketing support" agreements entitled: "Spot Telecasting and Digital Marketing Support Fee Agreements." SAC ¶¶ 106-07, A-295 ¶¶ 106-07. These agreements adopted rates in the exact amount necessary to funnel back to Charter the millions that Charter had agreed to pay for the sham price increase. *Id.* Charter agreed to

pay $6.73 million for the boxes it had previously agreed to buy, and Scientific-Atlanta agreed to pay exactly the same amount for advertising. SAC ¶¶ 101-02, A-293-94 ¶¶ 101-02. Tellingly, before September, Charter had no agreements for spot telecasting with any cable equipment vendors. SAC ¶ 91, A-289-90 ¶ 91. Moreover, the rates for the advertising were 4-5 time the amounts ordinarily charged for such time spots, further indicative of the lack of any genuine business purpose to the transactions. SAC ¶ 106, A-295 ¶ 106.

Motorola's participation in the deceptive scheme was even more outrageous. On August 31, 2000, the same day of the alleged price increase by Scientific-Atlanta, Motorola's Jeffrey Pierce (Director of National Accounts for a major division of Motorola, SAC ¶ 94, A-290-91 ¶ 94) and Charter's Pietri signed a "contract" obligating Charter to buy 540,000 set-top boxes over the next four months, *i.e.*, through the end of 2000. SAC ¶ 103, A-294 ¶ 103. This represented all the set-top boxes that Charter was obliged to purchase under its existing contract with Motorola for the entire 12 months of 2001. SAC ¶ 104, A-294 ¶ 104. Amazingly, Charter further agreed to pay Motorola $20 liquidated damages for each unit that it *failed to* purchase during the fourth quarter. SAC ¶ 103, A-294 ¶ 103. Both parties to this "contract" clearly understood that Charter had no intention of ever purchasing the additional units. Indeed, it would have cost Charter $140 million to

complete these purchases, which, as Motorola could have easily ascertained from Charter's publicly disclosed financials, Charter did not have. SAC ¶ 104, A-294 ¶ 104. It was self evident, that the only purpose of this contract was to create an artifice whereby Charter's *failure* to order set-top boxes would result in Charter funneling $10,800,000 in penalties to Motorola, which Motorola agreed to return disguised as advertising payments. SAC ¶ 105, A-295 ¶ 105. The round tripping of these funds was completed by Motorola's agreement dated September 29, 2000 to pay Charter $10,800,000 for advertising Motorola did not need, and at rates that were highly inflated. SAC ¶ 107, A-295 ¶ 107.

The amounts "paid" by the Vendors in advertising fees corresponded exactly to the amount of Charter's anticipated $17 million shortfall for the fourth quarter of 2000. SAC ¶ 108, A-296 ¶ 108.

Given their engagement in this blatant round tripping of revenue with no legitimate business purpose and their fabrication of documents, the Vendors clearly knew that the transactions were structured solely to inflate Charter's reported cash flow. It was common knowledge during the Class Period that media companies, such as Charter, recognized advertising revenue as soon as an advertisement was broadcast. It was equally well known that set-top box purchases were capitalized over the life of the equipment. SAC ¶¶ 10-11, A-262-63 ¶¶ 10-11. Indeed, these

same Vendors engaged in the same sham transactions intended to boost the reported operating cash flow of another major customer, Adelphia Communications, Inc. ("Adelphia"), shortly after the Charter transactions in 2000. SAC ¶ 111, A-296 ¶ 111; *see also* Cplt. ¶ 82, A-69 ¶ 82. Testimony during the criminal trial of Adelphia principals concerning that company's inflation of financial results characterized the deals between Adelphia and the Vendors as "Charter like." SAC ¶ 111, A-296 ¶ 111.[7]

The fraudulent nature of these transactions is further evidenced by the SEC's July 27, 2004 Cease and Desist Order against Charter. As the SEC characterized the scam:

> In reality, no real revenue was generated from these transactions because Charter provided the suppliers with the money they used to purchase the advertising services from Charter. Charter *overpaid* approximately $17 million to the two set-top box suppliers and received the same amount back from the two suppliers as advertising revenue in the fourth quarter of 2000. . . .

SAC ¶113, A-297 ¶113 (emphasis added).

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[7] As with Charter, in or about October 2000, Scientific-Atlanta sent Adelphia the same fraudulent letter regarding a purported price increase, though this time the amount was $31.00 instead of $20.00 per box. The increased payments for the boxes were then kicked back to Adelphia in the form of advertising. Motorola entered into similar arrangements with Adelphia. The sham transactions with Adelphia inflated its reported cash flow by over $100 million. SAC ¶ 112, A-296-97 ¶ 112.

> [T]hese transactions were not undertaken at fair value of the time slots purchased because these set-top box suppliers paid four to five times more for their advertisement time slots than other parties had paid Charter for advertisement time slots during 2000.

SAC ¶ 114, A-297 ¶ 114.[8]

ARGUMENT

A. THE COMPLAINT AND SAC STATE A CLAIM FOR A PRIMARY VIOLATION OF THE SECURITIES LAWS AGAINST THE VENDORS

1. Summary of the Argument

In the Complaint and the SAC, Plaintiff alleged primary violations against the Vendors based on their engagement in kickback arrangements, whose sole intent and effect was the inflation of Charter's reported results. The claims are

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[8] Significantly, the Vendors engaged in the sham arrangements within months after the SEC publicized the illegality of recognizing revenues from less egregious barter transactions. In November 1999 and January 2000, the Emerging Issues Task Force ("EITF") of the Financial Accounting Standards Board, issued EITF 99-17, in response to internet companies' increasing dependence on barter transactions (frequently involving the swapping of advertising for advertising) to generate revenues. The concern was that where one party buys something from another, but the consideration is returned either in kind, or in exchange for something else, no real revenues are generated. The new accounting standard prohibited a company from reporting gross revenue from a barter transaction and required the recognition of expenses related to the transaction.

In this case, the arrangements were even more suspect because they did not just involve the recognition of revenues where services of potentially equal value were exchanged but involved the Vendors' return of Charter's own funds under the rubric of advertising fees.

predicated on Rule 10b-5(a) and (c), which expressly impose liability for employment of any "scheme or artifice to defraud" or a fraudulent "act" or "course of business." In contrast, Rule 10b-5(b) limits liability to misleading "statements." This critical distinction was lost upon the district court. *See In re Global Crossing, Ltd. Sec. Litig*., 322 F. Supp. 2d 319, 335 (S.D.N.Y. 2004) (criticizing defendant for "conflat[ing] the distinct elements of a claim for false statements under subsection (b) of Rule 10b-5 with those of a claim for engaging in a fraudulent scheme under subsections (a) or (c)") (citation omitted). Indeed, the Supreme Court has long recognized that Section 10(b) and Rule10b-5 covers misconduct beyond false statements, and has repeatedly advocated a broad and flexible interpretation of the statutory scheme such that wrongdoers are not provided immunity merely because they engage in novel, unique, or atypical fraudulent schemes.

Contrary to the district court's ruling, *Central Bank* is not dispositive of Plaintiff's claim. Plaintiff alleged primary liability, not the aiding and abetting barred by *Central Bank*. The Vendors knowingly engaged in wash transactions, which had no legitimate purpose and were directed solely to create fictitious revenues and inflate Charter's operating cash flow. The Vendors were central, direct and indispensable players in the scheme to defraud investors. They engaged in acts which were themselves fraudulent, including fabricating documentation of

expense increases. They were Charter's partners, not merely assistants. This case is very different from *Central Bank*, where the plaintiff conceded that the defendant itself had not directly engaged in any deceptive act, but only assisted another party's fraud.

This is not the time to narrow the reach of the securities laws. As this Court well knows, in recent years corporations and their business associates have been highly inventive in creating new mechanisms for defrauding investors. One need look no further than the Enron debacle, where scheming business partners actively engaged in round trip transactions with Enron to create the illusion of a company in sound financial health. The court dealing with that fraudulent scheme has refused to shield such partners in crime from Section 10(b) and Rule 10b-5 primary liability, rejecting the very arguments mistakenly accepted by the lower court in this case — *i.e*, that a defendant's liability must arise from its own misstatement unless it has a special relationship with a company issuing a misstatement.

2. Standard of Review

This Court undertakes a de novo review of a district court's Rule 12(b)(6) dismissal of a complaint for failure to state a claim. *Frey v. City of Herculaneum*, 44 F.3d 667, 671 (8th Cir. 1995). It applies the same standards as were applicable below. A complaint's allegations "must be assumed to be true, and further, must

be construed in [plaintiff's] favor." *United States v. Aceto Agric. Chems. Corp.*, 872 F.2d 1373, 1376 (8th Cir. 1989) (citations omitted). Dismissal "should be granted only if it is clear that no relief could be granted under any set of facts." *County of St. Charles v. Missouri Family Health Council*, 107 F.3d 682, 684 (8th Cir. 1997) (citations omitted); *see also, Frey*, 44 F.3d at 671 (Dismissal is appropriate "'only in the unusual case in which a plaintiff includes allegations that show on the face of the complaint that there is some insuperable bar to relief.'"). (Citations omitted.)

This Court also engages in a de novo review of a district court's denial of a motion to amend a complaint on futility grounds. As held in *United States ex rel. Gaudineer & Comito, L.L.P. v. Iowa HHS*, 269 F.3d 932, 935 (8th Cir. 2001): "The denial of leave to amend based on futility means that the court found that the amended complaint failed to state a claim, and our review is therefore de novo." (Citations omitted.) *See also Freeman v. First Union Nat'l*, 329 F.3d 1231, 1234 (11th Cir. 2003); *Petters Co. v. Stayhealty, Inc.*, No. 03-3210, 2004 U.S. Dist. LEXIS 11872, 2004 WL 1465830 (D. Minn. June 1, 2004). Accordingly, this Court examines a proposed amended complaint "using the same standard applied for motions to dismiss under Rule 12(b)(6)." *United States ex rel. McCauley v. Best Care Home Health, Inc.*, Nos. 98-1261, 99-1207, 2002 U.S. Dist. LEXIS

19506, at *9-*10, WL 31248025 at *3 (D. Minn. Oct. 7, 2002).

Significantly, while a plaintiff cannot amend as of right after a motion to dismiss has been granted, the law in this Circuit is that leave to amend should be granted "liberally." *Quartana v. Utterback*, 789 F.2d 1297, 1300 n.3 (8th Cir. 1986).

Under these standards, the Complaint states a claim against the Vendors for a primary violation of the securities laws. The district court erred in ruling that the allegations constituted merely aiding and abetting. Although the SAC provided additional compelling factual support for the primary violation, the district court again erred in denying leave to amend on futility grounds. Op. II at 11, ADD-45, A-454.[9]

3. **The Plain Language of Section 10(b) and Rule 10b-5 Supports the Allegation of a Primary Violation**

Plaintiff's allegation of a primary violation against the Vendors is supported by the plain language of Section 10(b) and Rule 10b-5(a) and (c). *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 197 (1976) ("[W]e turn first to the language of

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[9] The only reason that the court below gave for denial, was the futility of the proposed amendments; it did not invoke any discretionary grounds, such as delay or any unfairness to the Vendors. As such, the abuse of discretion standard of review, *Dorn v. State Bank of Stella*, 767 F.2d 442, 443 (8th Cir. 1985), is inapplicable.

§ 10(b), for '[t]he starting point in every case involving construction of a statute is the language itself.'" (Citation omitted.)

Under Section 10(b), "*any person*, *directly* or *indirectly*" is prohibited from using "*any manipulative or deceptive device or contrivance* in contravention of such rules and regulations as the [SEC] may prescribe . . ." 15 U.S.C. § 78j(b) (emphasis added). The statutory language is not by any stretch limited to conduct implicating misstatements or the other limitations imposed by the district court.

Rule 10b-5, promulgated by the SEC, which tracks the language of Section 10(b), *see Central Bank*, 511 U. S. at 172, is also directed against "any person" who engages in broadly described misconduct:

> It shall be unlawful for any person, directly or indirectly . . . ,
>
> (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*, ...

17 C.F.R. § 240.10b-5 (emphasis added).

Thus, under Rule 10b-5(a) and (c) deception can be caused by *conduct*. Only under Rule 10b-5(b) are "*words*," *i.e.*, misleading statements or omissions, necessary. Any other interpretation would render Sections (a) and (c) entirely superfluous.

4. Supreme Court Precedents Support the Imposition of Primary Liability Based on Fraudulent Acts

The Supreme Court has long recognized that the reach of Section 10(b) extends beyond misleading statements and omissions. In *Hochfelder*, the Court acknowledged that Section 10(b) prohibits "any manipulative or deceptive contrivance," including a "scheme to deceive" or "scheme, plan, or artifice." 425 U.S. at 199 n.20. In *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 151 (1972), the Court made plain that while Rule 10b-5(b) liability is premised on the "making of an untrue statement of a material fact and the omission of a material fact," subsections (a) and (c) "are not so restricted." *Id.* at 152-53. *See also Herman & MacLean v. Huddleston*, 459 U.S. 375, 386 (1983) ("§10(b) makes it unlawful to use 'any manipulative or deceptive device or contrivance'"); *Santa Fe Industries v. Green,* 430 U.S. 462 (1977) (deceptive "practices," *id.* at 475-76, and "conduct," *id*. at 475 n.15, covered); *accord United States v. O'Hagan*, 521 U.S. 642, 650, 653 (1997) (reversing a ruling by Eighth Circuit that "§ 10(b) covers *only* deceptive statements or omissions," and holding that misappropriation of nonpublic informa-

tion for trading purposes qualifies as a "deceptive device or contrivance" (emphasis added)).

Central Bank did not render obsolete the above analysis. In *SEC v. Zandford*, 535 U.S. 813 (2002), decided eight years after *Central Bank*, the Court addressed claims under Rule 10b-5(a) and (c) involving a stock broker's sale of customers' securities and use of such proceeds for his own benefit without the customers' knowledge. The Court was not troubled by defendant's lack of any misstatement. *Id*. at 822. It ruled: "Indeed, each time respondent 'exercised his power of disposition [of his customers' securities] for his own benefit,' *that conduct*, '*without more*,' was a fraud." *Id.* at 821 (emphasis added) (citation omitted). The Court further stressed that "neither the SEC nor this Court has ever held that there must be a misrepresentation about the value of a particular security in order to run afoul of the Act." *Id.* at 820.

Here, Plaintiff has pled a fraudulent course of conduct or scheme by Vendors whose intent and effect was the duping of investors. Their misconduct represents a "threat to investor confidence in the securities industry," just as much as a misstatement does. *See Zandford*, 535 U.S. at 822.

5. **Well Reasoned Post-*Central Bank* Decisions Support the Sufficiency of Plaintiff's Allegations**

In the wake of *Central Bank*, courts in other jurisdictions have formulated different standards for determining when scheming business partners can be liable for securities fraud. Plaintiff submits that this Court should adopt the well-reasoned approach of courts that have predicated such wrongdoers' primary liability on their fraudulent acts, where, as here, they engaged in sham transactions directed solely to the reporting of inflated financial results.

For example, in *Enron I*, 235 F. Supp. 2d 549, plaintiffs alleged that Credit Suisse First Boston made "disguised loans to Enron to hide Enron's actual credit situation, liquidity, and debt levels." *Id*. at 646. Plaintiffs also charged that JP Morgan engaged "in fraudulent transactions . . . , structured to appear to be natural gas futures contracts, or commodity trades," when in fact "the transactions were disguised loans from JP Morgan to Enron to appear to boost [Enron's] liquidity since Enron booked them as revenue while concealing over $ 3.9 billion in debt that should have been recorded on Enron's balance sheet." *Id.* at 641.

The court denied defendants' motion to dismiss, holding that Rule 10b-5(a) and (c) are "not limited to the making of a material misstatement, nor to a few very technical forms of manipulations." *Id*. at 589 (citations omitted); *see also id.* at 577. *Enron I* noted that *Zandford* "made crystal clear that a misrepresentation need

not be involved." *Id.* at 585. It relied on the Supreme Court's recognition 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 [emphasis in original].'" *Id.* at 589, quoting *Superintendent of Ins. v. Bankers Life and Casualty Co.*, 404 U.S. 6, 11 n.70 (1971) (citation omitted in original). It also followed the Supreme Court's repeated guidance that Section 10(b) should be "construed 'not technically and restrictively, but flexibly to effectuate its remedial purposes.'" *Id.* at 569, quoting *Affiliated Ute*, 406 U.S. at 151, quoting *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963).[10] The *Enron I* Court then concluded:

> "*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. at 591, quoting *Cooper v. Pickett*, 137 F.3d 616, 624 (9th Cir. 1997).

Applying these principles, the *Enron I* Court refused to provide immunity to

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[10] Congress' main purpose in enacting the Exchange Act was to "insure honest securities markets and thereby promote investor confidence." *O'Hagan*, 521 U. S. at 658 (citation omitted). Congress intended to offer greater protection than provided under the common law. "[A]n important purpose of the federal securities laws was to rectify perceived deficiencies in the available common-law protections by establishing higher standards of conduct in the securities industry." *Huddleston*, 459 U.S. at 389 (citation omitted).

the banks that engaged in transactions, which, similar to those implicated here, had:

> [*N*]*o economic purpose* other than as contrivances or deceptive devices to misrepresent Enron's financial condition and defraud investors into continuing to pour money into Enron securities to keep the Ponzi scheme afloat and thereby enrich themselves in a variety of ways.

235 F. Supp. 2d at 693 (emphasis added). The court held that the banks' deceptive scheme "operated to present a falsely positive picture of Enron's financial condition . . . thereby artificially inflating the value of [Enron's] publicly traded securities . . . ." *Id.*[11]

Similarly, in *In re Enron Corp. Sec.*, 310 F. Supp. 2d 819 (S.D. Tex. 2004) ("*Enron II*"), the court ruled that Merrill Lynch could be a primary violator based on "swap" transactions involving electric power, and another transaction whereby it bought barges from Enron at inflated prices, with the side agreement that Enron would either itself, or arrange that another party, repurchase the barges from

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[11] As stated in Restatement (2d) of Torts, § 8A (ALI 1965):

> If the actor knows that the consequences are certain, or substantially certain, to result from his act, and still goes ahead, he is treated by the law as if he had in fact desired to produce the result.

Comment: b.

Merrill Lynch in a few months. Merrill Lynch had raised almost identical arguments as those invoked by the court below in this case in claiming that only aiding and abetting had been alleged:

> [M]errill Lynch contends that it had no special business relationship with Enron . . . , did not create, structure or direct any purported misstatements, and that any injury suffered by plaintiffs was caused by Enron's alleged misstatements about its financial status. In the same vein Merrill Lynch insists that it never directed or contrived the Nigerian barge investment nor the power swaps in 1999, which it maintains were merely normal business deals . . . , and that it never participated in recording these challenged transactions in Enron's books or reviewing the correctness of Enron's accounting.

310 F. Supp. 2d at 827-28.

The *Enron II* Court was unpersuaded, ruling:

> [A] misrepresentation need not have been made because the statute also applies to conduct, here the alleged substantial, active role in major fraudulent transactions with no legitimate business purpose, but designed to deceive investors in and central to a scheme and course of business operating to present a falsely inflated image of Enron's financial strength.
>
> . . . .
>
> All these facts constituted conduct purportedly designed to mislead potential investors and the market generally about Enron's financial integrity. Although Merrill Lynch argues its actions were not unlawful and that they were merely business transactions later misrepresented by Enron in its financial statements, the factual allegations

> suggest knowingly deceptive conduct, concealed for unlawful purpose(s), which included misleading Enron investors . . . . *Sham business transactions with no legitimate business purpose that are actually guaranteed "loans" employed to inflate Enron financial image are not above-board business practices.*

Id. at 829-30 (footnote omitted, emphasis added).

Although the district court below tried to distinguish *Enron I* and *II* as involving situations where the business partners also issued some misleading statements, Op. p. 14, ADD-14, A-423; Op. II pp. 10-11, ADD-44-45, A-453-54, the *Enron* rulings under Rule 10b-5(a) and (c) were clearly not predicated on such statements.

Another instructive precedent is *Quaak v. Dexia, S.A.*, 357 F. Supp. 2d 330 (D. Mass. 2005), where the court upheld the charge of a primary violation against a bank that loaned non-operating shell entities funds to purchase licenses from a company that then falsely reported these fees as revenues. The bank required the company's officers to guarantee the loans by credit default swaps, but designed the guarantees so that the company could fraudulently conceal them from the investing public. The court concluded that Section 10(b) and Rule 10b-5:

> [I]mpose primary liability on any person who substantially participates in a manipulative or deceptive scheme by directly or indirectly employing manipulative or deceptive device (like the creation or financing of a sham entity) intended to mislead investors, even if a material misstate-

> ment by another person creates the nexus between the scheme and the securities market.

Id. at 337, quoting *In re Lernout & Hauspie Sec. Litig.*, 236 F. Supp. 2d 161, 173 (D. Mass. 2003).

Indeed, the Ninth Circuit recognizes a primary violation when there is "substantial participation or intricate involvement" by a defendant in the preparation of fraudulent statements "even though that participation might not lead to the actor's actual making of the statements." *See Howard v. Everex Sys.*, 228 F.3d 1057, 1061 n.5 (9th Cir. 2000) (citation omitted); *see also In re Software Toolworks Sec. Litig.*, 50 F.3d 615, 628 n.3 (9th Cir. 1995). Primary liability should also arise when the "intricate involvement" is in a fraudulent scheme, or course of conduct, as here.

Even in the Second Circuit, which requires that a misstatement must be attributable to a defendant, *Wright v. Ernst & Young LLP*, 152 F.3d 169, 175 (2d. Cir. 1998), courts have shown flexibility on this issue. Claims for primary violations have been upheld where corporate officers have actively participated in or orchestrated a fraudulent scheme without actually making a false statement,[12] and,

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[12] *See e.g.*, *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1471-72 (2d Cir. 1996) (upholding liability of CEO of brokerage firm who "orchestrated" scheme at branch offices to charge customers excessive markups); *In re Salomon Analysts AT&T Litig.*, 350 F. Supp. 2d 455, 474 (S.D.N.Y. 2004) ("[I]t perverts the meaning of *Central Bank* to apply its holding to an allegation that a CEO effectively directly ordered [a stock analyst] to issue false and misleading statements on behalf of the

more importantly, where outsiders have engaged in deceptive conduct.[13]

For example, in *Global Crossing*, 322 F. Supp. 2d 319, the court ruled that an outside auditor's primary liability was not just limited to the company's false audited reports, but extended to Global Crossing's unaudited false statements because the auditor had "essentially created the accounting schemes used to inflate the Companies' financials at the outset." *Id*. at 335-36. As the court noted:

> It is apparent from Rule 10b-5's language and the case law interpreting it that a cause of action exists under subsections (a) and (c) for behavior *that constitutes participation in a fraudulent scheme*, even absent a fraudulent statement by the defendant. . . . Claims for engaging in a fraudulent scheme and for making a fraudulent statement or omission are thus distinct claims, with distinct elements.

Id. (emphasis added).[14]

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firm."). *Accord In re Scholastic Corp. Sec. Litig*., 252 F.3d 63, 75-76 (2d Cir. 2001) (vice president for finance and investor relations cannot escape liability for his company's misleading statements, where he was alleged to have been involved in the drafting and dissemination of such statements).

[13] The Tenth Circuit requires that defendants "must themselves make a false or misleading statement (or omission) that they know or should know will reach potential investors" but does not require a challenged statement to be publicly attributable to a defendant. *See Anixter v. Home-Stake Prod. Co.*, 77 F.3d 1215, 1226 (10th Cir. 1996) (footnote omitted). The Eleventh Circuit seems to demand a publicly attributable statement. *See*, *Ziemba v. Cascade Int'l, Inc.*, 256 F.3d 1194, 1205 (11th Cir. 2001).

[14] *Accord*, *In re Livent, Inc. Noteholders Sec. Litig.*, 174 F. Supp. 2d 144, 152 (S.D.N.Y. 2001) (broker was potentially liable "in structuring and keeping

The district court here limited *Global Crossing* to its facts — an auditor who was the "chief architect and executor" of the alleged misconduct. Op. II p. 10, ADD-44, A-453. The *Global Crossing* Court's reasoning about the reach of subsections (a) and (c) cannot be so restricted.

The district court's error is also illustrated by *SEC v. U.S. Envt'l, Inc.*, 155 F.3d 107 (2d Cir. 1998). There, acknowledging that "*Central Bank* never intended to restrict § 10(b) liability to supervisors or directors of securities fraud," the Second Circuit upheld the primary liability of a broker who executed manipulative trades at a stock promoter's request. 155 F.3d at 112. It explained that "[l]ike lawyers, accountants and banks who engage in fraudulent or deceptive practices, at their clients' direction, [the trader] is a primary violator despite the fact that someone else directed the market manipulation scheme." *Id.*

6. The District Court Adopted *Homestore's* Misinterpretation of *Central Bank*

The district court improperly relied on *Homestore*, 252 F. Supp. 2d 1018, 1039, which misinterpreted *Central Bank* as requiring a misstatement by an "'outsider,'" unless it had a "'special relationship'" with a corporation issuing a

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secret the misrepresented" relationship between the underwriter and the issuer, where the broker also served as the underwriter); *In re AOL Time Warner Sec. & "ERISA" Litig.*, MDL Docket No. 1500, No. 02 Civ. 5575, 2004 U.S. Dist. LEXIS 7917, at *53-*55, 2004 WL 992991 at *14-*15 (S.D.N.Y. May 5, 2004).

misstatement, no matter how egregious its engagement "in transactions that led to that statement or omission." *See* Op. I p. 11, ADD-11, A-420. In *Enron II*, *Homestore*'s "narrow construction of the statute and of primary violations" was rejected for the sound reasons already discussed. 310 F. Supp. 2d at 829.

Central Bank does not support the *Homestore* analysis. In *Central Bank*, the plaintiffs conceded that the defendant "did not commit a manipulative or deceptive act." 511 U.S. at 191-92. Thus, the only issue the Court faced was "the existence and scope of the § 10(b) aiding and abetting action." *Id*. at 170. The Court limited its aiding and abetting analysis to acts that "are not themselves manipulative or deceptive." *Id*. at 178. It did not address whether a primary violation can arise from a defendant's engagement in a deceptive scheme or course of conduct under Rule 10b-5(a) and (c).

Significantly, *Central Bank* acknowledged that "[i]n any complex securities fraud, . . . there are likely to be multiple [primary] violators," and strongly cautioned that "[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." *Id*. at 191. It stressed that "[a]ny 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 relies may be liable as a primary violator

under 10b-5 . . . ." *Id.* (Emphasis added.)

In this case, the Vendors partnered in kickback arrangements and fabricated supporting documentation, with the clear understanding that their conduct was directed to the inflation of Charter's results. *The Vendors' acts had no legitimate business purpose and were themselves blatantly fraudulent*. Thus, this is not a case where allowing the Plaintiff to proceed with its claims against the Vendors, will blur the distinction between primary actors and aiders and abettors. This Court will not be opening the floodgate of litigations against business partners who enter into *legitimate* business transactions with a company, which the company then abuses by reporting false results. Exposure will be limited to only those business partners that engage in sham transactions knowing that they will be used to improperly inflate reported results.

Nor is there any basis in *Central Bank* for the "special relationship" demanded by *Homestore* and the district court below. The reference in *Central Bank*, quoted above, to "lawyer, accountant, or bank" was clearly meant to provide illustrative, not exhaustive, examples. Why else would the Court preface the examples with "[a]ny person" and the term "including"? It makes no sense to immunize a vendor from liability for the same conduct, committed with the same scienter, and with the same negative impact on investors that can provide a basis

for primary liability for an auditor, banker or lawyer.

Furthermore, the district court's conclusion, again based on *Homestore*, that Plaintiff could not satisfy the reliance prerequisite is flawed. Reliance or transaction causation requires that Plaintiff link its purchases of Charter's securities to the Vendors' deceptive scheme. *See Harris v. Union Elec. Co.*, 787 F.2d 355, 366 (8th Cir. 1986). In *Basic Inc. v. Levinson*, 485 U.S. 224, 245 (1988), the Court reasoned, "[t]here is . . . more than one way to demonstrate the causal connection." *Id.* at 243. The Court acknowledged that where stock is traded in an efficient and impersonal market, the market sets the stock price based on the publicly available information and misleading statements will defraud investors even if they did not directly rely on them. The Court went on to hold that there is a presumption of reliance by the investors on the integrity of the market price. *Id.* at 247.

Here, Plaintiff alleges that Charter's stock price was driven by its operating cash flow and that Vendors engaged in a fraudulent scheme and course of conduct deliberately intended to inflate those very results. *See Enron II*, 310 F. Supp. 2d at 829-30 (The alleged misconduct was "designed to deceive investors in and central to a scheme and course of business operating to present a falsely inflated image of Enron's financial strength."). In this situation, reliance is not destroyed as a matter of law "even if a material misstatement by another person created the [ultimate]

nexus between the scheme and the securities market." *In re Lernout Hauspie Sec. Litig.*, 236 F. Supp. 2d at 173.[15]

Any misgiving expressed in *Central Bank* about the erosion of the reliance element was in the context where it was conceded that the defendant had not engaged in any deceptive conduct. That is not the situation here.

In sum, Plaintiff's allegation of a primary violation against the Vendors is fully supported by the text of the statute, and by precedents discussed above. The Vendors were knowing partners in a "scheme," "artifice" or "course of business" designed to dupe investors and thereby engaged in actionable misconduct. The district court's orders dismissing the Complaint and denying leave to amend should therefore be reversed.

B. THE DISTRICT COURT ERRED IN DENYING PLAINTIFF'S <u>MOTION FOR RECONSIDERATION OF ITS DISMISSAL ORDER</u>

Under Fed. R. Civ. P. 60(b), reconsideration of a prior order is warranted to correct "'manifest errors of law or fact or to present newly discovered evidence.'"

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[15] As the SEC stated in *Homestore*: "The test is met where the plaintiff relies on a material deception that flows from a deceptive act committed by the defendant, even though the conduct of others is a subsequent link in the chain of causation that injects the material deception into the securities markets." SEC's Reply Brief in *Homestore* at 12. *See Zandford*, 535 U.S. at 819-20 (SEC's interpretation of Section 10(b) and Rule 10b-5 "is entitled to deference if it is reasonable") (citations omitted). Here, the Vendors' fraudulent conduct was meant to and did flow into the market through Charter's false statements.

Hagerman v. Yukon Energy Corp., 839 F.2d 407, 414 (8th Cir. 1988) (citation omitted). As the court below acknowledged, an additional basis for reconsideration is "a controlling or significant change in the law or facts since the submission of the issues to the Court." Op. II p. 8 ADD-42, A-451, citing *Above the Belt, Inc. v. Mel Bohannon Roofing, Inc.*, 99 F.R.D. 99, 101 (E.D. Va. 1983). Plaintiff met these criteria in seeking reconsideration of the district court's October 12, 2004 dismissal order.

The district court's denial of reconsideration is reviewed for abuse of discretion, *Broadway v. Norris*, 193 F.3d 987, 989 (8th Cir. 1999), which "occurs if the district court rests its conclusion on clearly erroneous factual findings or if its decision relies on erroneous legal conclusions,'" *Hosna v. Grosse*, 80 F.3d 298, 303 (8th Cir, 1996) (citation omitted). The court below committed both these errors.

The district court misinterpreted cases decided after briefing on the motion to dismiss which provided well-reasoned analysis supporting Plaintiff's allegation of a primary violation against the Vendors. For example, in *Enron II,* in unmistakably plain language, the court predicated Merrill Lynch's primary liability under Rule 10b-5(a) and (c) on its engagement in sham transactions rather than the false analysts reports it had issued. The district court misread this case as requiring

a misstatement, just as it had misread the law in its dismissal order as imposing the same requirement. Similarly, it incorrectly limited *Global Crossing* to situations where a defendant is the chief designer of a deceptive scheme. Op. II pp. 10-11, ADD-44-45, A-453-54.

The district court's misreading of the law also infected its analysis of the newly discovered facts that Plaintiff presented. These facts left no doubt, and the district court did not find otherwise,[16] that the Vendors engaged in wash transactions with full understanding that their sole purpose was the inflation of Charter's reported results. What else could possibly explain Scientific-Atlanta responding to a customer's direction to send it a letter stating that costs had risen and that prices would therefore be increased, although none of this was true? Why else would Motorola enter into a sham agreement to charge Charter penalties for failing to order in 2000 products the Company had previously ordered for 2001? Why else would both Vendors agree to pay 4-5 times the going rates for advertising they did not need? Yet, because the district court remained wedded to its initial wrong legal

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[16] In its dismissal order, the district court did not reach the Vendors' contention that the Complaint did not satisfy the pleading requirements of the Private Securities Litigation Reform Act. Op. I p. 14, ADD-14, A-423. In opposing reconsideration, "Motorola contend[ed] the new facts allegedly relate to Motorola's scienter, even though this Court did not reach that question." Op. II p. 7, ADD-41, A-450.

analysis, it found these facts irrelevant.

CONCLUSION

For the foregoing reasons, Plaintiff requests that this Court: (1) reverse the October 12, 2004 order of dismissal; (2) or, in the alternative, reverse the December 20, 2004 order denying Plaintiff leave to amend or for reconsideration; (3) vacate the February 15, 2005 entry of final judgment for Appellees; and (4) remand for further proceedings.

Dated: June 13, 2005

Respectfully submitted,

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By:_____________________________

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CERTIFICATE OF COMPLIANCE WITH RULE 32(a)

1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because it contains 8,829 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. This brief complies with the typeface requirements of Fed R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because it has been prepared in a proportionally spaced typeface using WordPerfect Version 11.0.0.321 in 14 point Times New Roman font.

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Dated: June 13, 2005

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Stoneridge Investment Partners, LLC.,

vs.

Scientific-Atlanta, Inc. and Motorola, Inc.

---X

STATE OF NEW YORK)

COUNTY OF NEW YORK)

I, , being duly sworn according to law and being over the age of 18, upon my oath depose and say that:

On **June 14, 2005**

I served the within **Opening Brief for Plaintiff-Appellant** in the above captioned matter upon:

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via **USPS Express Mail** by depositing **2** copies of same, enclosed in a postpaid properly addressed wrapper, under the exclusive custody and care of the United States Postal Service, within the State of New York.

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Sworn to before me on June 14, 2005

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