Case No. 06-1312

United States Court of Appeals

for the

Seventh Circuit

STEELWORKERS PENSION TRUST, *et al.*,

Plaintiffs-Appellants

-v.-

BAXTER INTERNATIONAL INC., *et al.*

Defendants-Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
Case No. 04 C 4909
The Honorable Judge William T. Hart

REPLY BRIEF FOR PLAINTIFFS-APPELLANTS

PATRICK V. DAHLSTROM, ESQ.
LEIGH H. SMOLLAR, ESQ.
POMERANTZ HAUDEK BLOCK
GROSSMAN & GROSS, LLP
One N. LaSalle Street, Suite 2225
Chicago, IL 60602-3908
(312) 377-1181
Liaison Counsel for
Plaintiffs-Appellants

SHERRIE R. SAVETT, ESQ.
ARTHUR STOCK, ESQ.
RUSSELL D. PAUL, ESQ.
DOUG M. RISEN, ESQ.
SHOSHANA T. SAVETT, ESQ.
BERGER & MONTAGUE, P.C.
1622 Locust Street
Philadelphia, PA 19103
(215) 875-3000

LIONEL Z. GLANCY, ESQ.
PETER A. BINKOW, ESQ.
GLANCY BINKOW & GOLDBERG LLP
1801 Avenue of the Stars, Suite 311
Los Angeles, CA 90067
(310) 201-9150
Co-Lead Counsel for Plaintiffs-Appellants

TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES

STATUTES

INTRODUCTION

This case involves fraud in Baxter's Brazilian subsidiary that: (1) Baxter admitted was a direct result of inadequate internal controls; (2) led to the termination of Brazil senior management; and (3) resulted in a restatement of financial results for over three years. Yet prior to revealing the fraud months after they knew about it and with full knowledge that Baxter's internal controls were defective, Defendants made false and misleading statements certifying the effectiveness of Baxter's internal controls and misrepresenting the accuracy of its financial statements. Defendants also failed to properly and timely correct those misstatements. Forestalling the revelation of the fraud allowed Anderson (who had never before sold Baxter shares in his six year tenure as CFO) and del Salto (who sold virtually all of his Baxter shares) to sell their Baxter shares at artificially inflated prices within days of each other.

ARGUMENT

I. THE DISTRICT COURT'S DISMISSAL OF THE SAC IS REVIEWED *DE NOVO*

Defendants argue that the District Court's December 22, 2005 Order should be reviewed by this Court under the "abuse of discretion" standard. (Appellees' Br. at 20-22) In making this argument, Defendants first attempt to cast the District Court's December 22, 2005 Order as merely a reversal of its September 23, 2005 Rule 59(e) Order. Defendants then argue the *non sequitur* that as a reversal of the Rule 59(e) Order, the December 22, 2005 Order must be construed as a denial of

Plaintiffs' Rule 59(e) motion, and that such a denial of a Rule 59(e) post-judgment motion to amend is reviewed under an "abuse of discretion" standard. (Appellees' Br. at 21) Defendants' argument, however, grossly mischaracterizes the procedural history, set forth below, and is wrong.

• The District Court first dismissed Plaintiffs' complaint on May 25, 2005. *(Higginbotham I)* Upon consideration of Plaintiffs' Rule 59(e) motion to reconsider that decision, the District Court granted Plaintiffs leave to file an amended complaint. *(Higginbotham II)*

• Plaintiffs promptly filed the Second Amended Complaint ("SAC") on September 28, 2005.

• Defendants then filed a motion to reconsider on October 11, 2005.

• In *Higginbotham III* , the District Court re-examined the sufficiency of the allegations in the SAC, but did not reverse its Rule 59(e) Order *(Higginbotham II)* granting Plaintiffs leave to file the SAC.

•To the contrary, the District Court specifically stated that it had properly allowed Plaintiffs to file the SAC. *See Higginbotham III* at *1 (A14) ("As we previously held. . . it was proper for this court to exercise its discretion to vacate the judgment and permit the filing of an amended complaint where it had been expressly stated when initially dismissing the case that such a procedure would be followed.")

• The District Court did, however, reconsider Plaintiffs' allegations in light of the same 12(b)(6) standards it applied in *Higginbotham I* and *Higginbotham II*,

again reassessing the sufficiency of Plaintiffs' allegations. *See Higginbotham III* at *1 (A1) ("This is the third review of a complaint in a securities fraud putative class action. . .")

• In *Higginbotham III,* the District Court specifically found Plaintiffs' claims "deficient," holding that "[t]he SAC will be dismissed in its entirety" and directed the Clerk of the Court "to enter judgment in favor of defendants and against plaintiffs dismissing plaintiffs' cause of action with prejudice." *Id.* at *3 (A16).

Thus, in *Higginbotham III* there was a final dismissal of Plaintiffs' action with prejudice for failure to state a claim. Such a final dismissal is properly reviewed under a *de novo* standard, where a complaint is construed in the light most favorable to plaintiff. *See McCready v. eBay, Inc.*, 453 F.3d 882, 888 (7th Cir. 2006) ("We review de novo a district court's granting of a motion to dismiss under Rule 12(b)(6). We construe the complaint in the light most favorable to the plaintiff, taking as true all well-pleaded factual allegations and making all possible inferences from those allegations in his or her favor. Dismissal is proper only if it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief.") (citations and quotations omitted)

Complaints brought pursuant to the PSLRA are reviewed under the same standard. *See In re Stone & Webster, Inc., Sec. Litig.*, 414 F.3d 187, 200 (1st Cir. 2005) ("One difficulty we find with the district court's decision is that in several instances, in ruling on defendants' motion to dismiss under Federal Rule of Civil Procedure 12(b)(6), the court failed to read the Complaint in the light most

favorable to the plaintiff and failed to give the plaintiff the benefit of inferences that could reasonably be drawn. . . In assessing whether the pleading satisfies the strong-inference requirement [of the PSLRA], a court must draw all reasonable inferences in the plaintiff's favor, and then weigh whether they satisfy the statutorily mandated 'strong inference.'")[1]

II. PLAINTIFFS ADEQUATELY ALLEGED THE SCIENTER OF EACH INDIVIDUAL DEFENDANT[2]

A. The Allegations Must Be Considered Collectively

Defendants attack particular allegations in the SAC and argue that each individual allegation, by itself, is insufficient to establish that Defendants made misstatements with the requisite scienter. (Appellees' Br. at 25-45) Defendants not only disregarded much of the SAC's evidentiary detail, but also never addressed the cumulative weight of all the alleged facts applicable to each Defendant. Despite acknowledging that "the best approach for determining whether there is a strong inference of scienter is 'for courts to examine all of the allegations in the complaint and then to decide whether collectively they establish such an inference'" (*In re Hollinger, Inc. Sec. Litig.*, No. 04 C 0834, 2006 WL 1806382, *19 (N.D. Ill. June 28, 2006) (quoting *Makor Issues & Rights, Ltd. v. Tellabs, Inc.*, 437 F.3d 588, 601 (7th

[1] *See also Stavros v. Exelon Corp.*, 266 F. Supp. 2d 833, 841 (N.D. Ill. 2003) ("Defendants' motion to dismiss implicates Federal Rules of Civil Procedure 12(b)(6) and 9(b) as well as the PSLRA. When considering a motion to dismiss under Rule 12(b)(6), this Court views all facts alleged in the complaint, as well as any inferences reasonably drawn from those facts, in the light most favorable to the plaintiff."); *Tatz v. Nanophase Tech. Corp.*, No. 01 C 8440, 2002 WL 31269485, *3 (N.D. Ill. October 9, 2002) (same); *Schaps v. McCoy,* No. 00 C 5180, 2002 WL 126523, *2 (N.D. Ill. January 31, 2002) (same).

[2] The scienter of Greisch and del Salto is discussed in Section V herein.

Cir. 2006)), Defendants wholly ignore such collective consideration.[3] As demonstrated at length in Plaintiffs-Appellants' Opening Brief, the SAC clearly alleges facts giving rise to a strong inference that each Defendant knew of the fraud.

B. The Seventh Circuit's Reasonable Person Standard

A strong inference of scienter is "a conclusion logically based upon particular facts that would convince a reasonable person that the defendant knew a statement was false or misleading." *Tellabs*, 437 F.3d at 602 (quoting *Adams v. Kinder-Morgan, Inc.*, 340 F.3d 1083, 1105 (10th Cir. 2003)). Here, the SAC should survive because "it alleges facts from which, if true, a reasonable person could infer that the defendant acted with the required intent." *Id; see also In re Hollinger,* 2006 WL 1806382 at *19 (same).

In evaluating whether scienter has been pled properly, the "[i]nferences must be reasonable and strong – but not irrefutable. . .Plaintiff need not foreclose all other characterizations of fact, as the task of weighing contrary accounts is reserved for the fact finder." *Aldridge v. A.T. Cross Corp.*, 284 F.3d 72, 82 (1st Cir. 2002) (quoting *Helwig v. Vencor, Inc.*, 251 F.3d 540, 553 (6th Cir. 2001)).

[3] *See also Pirraglia v. Novell, Inc.,* 339 F.3d 1182, 1187 (10th Cir. 2003) ("[w]hether an inference is a strong one cannot be decided in a vacuum;" therefore, the court looks to the totality of the pleadings to determine whether the plaintiff's suggested inference is strong enough to adequately plead scienter under the PSLRA); *Nursing Home Pension Fund, Local 144 v. Oracle Corp.*, 380 F.3d 1226, 1234 (9th Cir. 2004) (reversing dismissal of Section 10(b) claim and stating: "We find that the totality of the allegations does create a strong inference that *Oracle* acted with scienter."); *In re Cabletron Sys., Inc.,* 311 F.3d 11, 40 (1st Cir. 2002) ("[e]ach individual fact about scienter may provide only a brushstroke, but the resulting portrait satisfies the requirement for a strong inference of scienter").

C. Statements of Confidential Witnesses Properly Support Plaintiffs' Allegations

Defendants attack the sufficiency of three of Plaintiffs' confidential witnesses (CW1, CW4 and CW5). (Appellees' Br. at 18, 33-36) However, these three confidential sources were "described in the complaint with sufficient particularity to support the probability that a person in the position occupied by the source would possess the information alleged." *Novak v. Kasaks,* 216 F.3d 300, 314 (2d Cir. 2000);[4] *see also In re National Golf Properties, Inc.*, No. CV 02 1383GHK, 2003 WL 23018761, *7 (C.D. Cal. March 19, 2003) ("Plaintiffs have alleged the position each witness held at the relevant time that allowed them to personally observe or know the facts that they assert. This sufficiently identifies such witnesses at the pleading stage. . .Requiring greater disclosure on a motion to dismiss 'serves no legitimate pleading purpose' but could have the effect of deterring informants from providing information.") (quoting *Novak*, 216 F.3d at 314).

[4] *See also In re Cabletron Sys.,Inc.*, 311 F.3d at 24 n.6, 28-31 (reference "to...anonymous sources as 'former employees with personal knowledge of the relevant facts' or some similar phrase" held sufficient); *ABC Arbitrage v. Tchuruk*, 291 F.3d 336, 353 (5th Cir. 2002) (sources only need to be "identified through general descriptions in the complaint with sufficient particularity to support the probability that a person in the position occupied by the source. . .would possess the information pleaded"); *In re Theragenics Corp. Secs. Litig.*,137 F. Supp. 2d 1339, 1346 (N.D. Ga. 2001) (sustaining complaint that identified as its "source," "numerous medical doctors in the field"; "[t]he additional information may be obtained through discovery, but is not required to be included in the Complaint"); *Fitzer v. Security Dynamics Techs., Inc.,* 119 F. Supp. 2d 12, 21-22 (D. Mass. 2000) (PSLRA's particularity requirements were met by relying upon unnamed "generally identified former employees" described as: "(1) a former employee who handled returns; (2) a former employee in the technical support department; (3) a former employee. . .who was responsible for strategic planning; (4) a former employee who was a sales representative for the company's western territory; and (5) a former employee who was a sales representative"; "persons in those positions are likely to have knowledge of the facts described, including product demand and sales practices").

Plaintiffs have more than sufficiently met the pleading requirements for their confidential witnesses by demonstrating that these witnesses likely had access to first-hand knowledge through their employment positions: CW1 was "a former Baxter executive employed in the Brazil office throughout the Class Period" (JA12; ¶38); CW4 was "retained by Baxter as a consultant on the issue of financial controls"(JA12-13; ¶40) who gave information "based upon observations and conversations with Baxter's internal audit personnel in Deerfield" (JA21; ¶63g); and CW5 was "a consultant hired to train Baxter's executives on issues related to financial reporting." (JA25; ¶73) Accordingly, it was probable that CW1, CW4 and CW5 possessed the knowledge attributed to them.

D. The Scienter of the Individual Defendants

1. The Scienter of Parkinson

Defendants attempt to deflect this Court away from considering the cumulative weight of all the allegations in the SAC regarding the scienter of Parkinson by attacking each allegation separately. (Appellees' Br. at 241-45) However, those allegations (set forth in Appellants' Brief at 25-31 and not repeated here), collectively establish a strong inference that Parkinson either knew of the fraud or acted recklessly when he signed the Sarbanes-Oxley Act ("SOA") certification in Baxter's first quarter 2004 10-Q.

a. The Kickback Scheme And The Brazilian Government's Accusation Of Fraudulent Bid-Rigging Were Red-Flags

Defendants argue that the illegal kickback scheme uncovered at the end of

the first quarter 2004 for which two Baxter employees were fired (JA 16-17; ¶¶ 55-59) and the Brazilian government's accusation of fraudulent bid rigging on April 29, 2004 – (3 days after Parkinson took office and 11 days before he signed his certification) – do not support an inference of Parkinson's scienter because Baxter's July 22, 2004 press release did not specifically identify those frauds as a basis for Baxter's restatement. (Appellees' Br. at 38). Defendants are wrong. First, the illegal kickback scheme and accusation of fraudulent bid-rigging certainly put Parkinson on notice that there was fraud in Brazil that likely, and as it was later revealed, was only the tip of the iceberg. Second, these frauds informed Parkinson that there necessarily were deficiencies in Baxter's disclosure controls and procedures.[5] Kickbacks from vendors reduced Baxter revenues and net income. Bid-rigging, which resulted in over-billing the Brazilian government, produced artificial and illegal revenues and earnings. Thus, the correct information required to be disclosed was not properly being "recorded, processed, summarized and reported." Third, it is not apparent, as Defendants contend, that the kickbacks and the bid-rigging had "nothing to do with the restatement." (Appellees' Br. at 38) Baxter's July 22, 2004

[5] The SEC defines "disclosure controls and procedures" in Rules 13a-15(e) and 15d-15(e) as "controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the Exchange Act is **recorded, processed, summarized and reported**, within the time periods specified in the Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by any issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer's management, including its principal executive officer or officers and principal financial officer or officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure." (emphasis added)

press release announcing Baxter's plans to restate, said that "[t]he restatement is primarily the result of incorrect revenue recognition," which certainly is language broad enough to include kickbacks and bid-rigging. (JA76) Baxter itself concluded, in its 2003 Form 10K/A filed August 6, 2004, that there was a "material weakness in the Company's internal controls over financial reporting," based on the Audit Committee's findings of "an ineffective control environment" in Brazil, "inadequate revenue recognition controls in Brazil," and "ineffective financial review" by management responsible for Brazil. (JA11-12; ¶¶ 34-37) This language is also broad enough to include kickbacks and bid-rigging, as well as the fictitious sales Baxter Brazil recorded. Furthermore, it is not necessary for these specific frauds to have led directly to Baxter's restatement. It is enough that they put Parkinson on sufficient notice of disclosure control deficiencies.[6]

Thus, Parkinson had sufficient red-flags – from the time he was appointed CEO – that there was fraud in Brazil that called into question the effectiveness of the internal controls he subsequently certified. Making that certification was reckless, and supports an inference of his scienter. *See PR Diamonds, Inc. v. Chandler*, 364 F.3d 671, 686 (6th Cir. 2004) ("Specific factual allegations that a

[6] Defendants argue that Parkinson was not reckless in signing the SOA certification in Baxter's first quarter 2004 10-Q because Baxter's Brazil operations were insignificant to Baxter as a whole and because the Brazil fraud resulted in a *de minimis* restatement of Baxter's sales and net income. (Appellees' Br. at 39) Defendants, however, counter an argument Plaintiffs did not make - that the magnitude of Baxter's restatement supports an inference of scienter. In fact, the importance of the restatement here is not that its magnitude is probative of Parkinson's scienter, but that it was made because of the weakness of Baxter's internal controls over financial reporting (which by itself supports Plaintiffs' allegations of Parkinson's scienter).

defendant ignored red flags, or warning signs that would have revealed the accounting errors prior to their inclusion in public statements, may support a strong inference of scienter"); *Miller v. Material Sciences Corp.*, 9 F. Supp. 2d 925, 928 (N.D. Ill. 1998) ("Deliberately ignoring 'red flags'...can constitute the sort of recklessness necessary to support § 10(b) liability.")[7]

b. The SOA Certification Itself Supports A Strong Inference Of Scienter

Parkinson's SOA certification by itself provides an inference that he was, at the very least, deliberately reckless. In that certification, Parkinson attested to the SEC that: (i) he had reviewed Baxter's first quarter 2004 Form 10-Q and that, based on his knowledge, none of the information presented in that report was false or misleading; (ii) he was responsible for establishing and maintaining Baxter's disclosure controls and procedures; (iii) he had designed controls and procedures to ensure that material information is "made known to us by others" within Baxter during the period covered by the report; (iv) he had personally evaluated the effectiveness of those controls within the last 90 days; (v) any deficiencies in those controls and procedures had been disclosed in the 10-Q, as well as to Baxter's outside auditors and internal audit committee; and (vi) any fraud, whether or not material, involving management or other employees who have a significant role in Baxter's internal control over financial reporting had also been disclosed. (JA29-33, 41-42; ¶¶ 83, 110)

[7] In addition, Plaintiffs contend that it was in and of itself reckless for Parkinson, as the new CEO, to certify Baxter's internal controls after only two weeks with the Company.

Despite Parkinson's certification, Baxter acknowledged that its August 6, 2004 restatement was necessitated by "material weakness in the Company's internal controls over financial reporting" (JA11-12; ¶¶ 34-37) that existed at the time Parkinson signed the SOA certification.[8] Thus, Parkinson either knew about the Brazil fraud because of the internal controls he certified (which would have uncovered the fraud)[9] or he did not properly evaluate the internal controls as he certified he did.[10] Either of these inescapable conclusions supports a strong inference that Parkinson knew his statements regarding Baxter's internal controls were false or was reckless in making those statements. *See Lattice*, 2006 WL 538756 at *18 ("I conclude that the Sarbanes-Oxley certifications give rise to an inference of *scienter* because they provide evidence either that defendants knew about the improper journal entries and unreported sales credits that led to the over-

[8] Defendants' argument that Baxter Brazil management may have overridden the internal controls only further supports the conclusion that those controls were inadequate. *See In re Lattice Semiconductor Corp. Sec. Litig.*, No. CV04-1255, 2006 WL 538756, *17 (D. Or. Jan. 3, 2006) ("Lattice now admits that its chief financial officer overrode the internal controls to make incorrect and misleading journal entries; this further underscores the contradiction between the facts and the Sarbanes-Oxley certifications.")

[9] Defendants argue that "no system of internal controls can totally eliminate the risk of intentional fraud." (Appellee's Br. at 26) First, whether or not Baxter's internal controls should have detected the kickback scheme and bid-rigging is a question of fact incapable of being determined at this stage of the proceedings. Second, regardless of whether Baxter's internal controls should have uncovered the Brazil fraud, Plaintiffs have alleged that Parkinson had independent knowledge of the fraud.

[10] According to a confidential witness, Baxter did not implement any internal control procedures in Brazil in response to the SOA until September 2004, when it retained Deloitte & Touche to oversee the process. (JA3, 21; ¶¶8, 63(g)) While Defendants maintain that the SOA "does not require a company to implement any specific 'Sarbanes-Oxley procedures' at each of the company's divisions" (Appellees' Br. at 26), the later September 2004 internal controls overhaul is further evidence that Baxter's internal controls were ineffective at the time of Parkinson's (and Anderson's) certifications.

reporting of revenues because of the internal controls they said existed or alternatively, knew that the controls they attested to were inadequate" because they were overridden).

c. The May 4, 2004 Board Meeting

Defendants argue that it is not reasonable to infer that Parkinson specifically discussed the Brazilian fraud with Baxter's Board of Directors at the May 4, 2004 Board meeting. (Appellees' Br. at 27-29) The facts are as follows and do support such a reasonable inference: (i) six members of Baxter Brazil's management, two of whom were terminated, masterminded a kickback scheme involving Baxter vendors (JA16; ¶¶55-58) that, according to a confidential witness, was uncovered at the end of the first quarter 2004; (ii) the Brazilian government accused Baxter of fraudulent bid rigging on April 29, 2004 (JA14; ¶48); (iii) the Board met just prior to the annual stockholders meeting, on May 4, 2004 (JA27-28; ¶¶80-81); (iv) the Board discussed Baxter's dividend policy at that May 4, 2004 meeting (id.); (v) Parkinson admitted that "we" were made aware in "the May time frame" of fictitious sales in Baxter Brazil (JA28; ¶81); and (vi) the bid-rigging and the fictitious sales, which both artificially inflated revenue without a corresponding influx of cash, would necessarily have adversely effected cash flow and, thus, Baxter's ability to pay a dividend.[11] Thus, it is a reasonable inference that the Board discussed at the May 4

[11] Plaintiffs emphatically dispute and take umbrage at Defendants statement that Plaintiffs "misleadingly insinuated" (Appellees' Br. at 28) Parkinson's scienter through excerpting, juxtaposing and highlighting Parkinson's statements in the July 22, 2004 conference call. Plaintiffs did no such thing. As Defendants readily admit, it "was apparent on the face of the SAC" that Plaintiffs alleged that Baxter's dividend policy was discussed at

meeting the bid-rigging (which was exposed in the prior month) and the fictitious sales (exposed in "the May time frame"[12]) when assessing Baxter's ability to pay a dividend out of cash.

Moreover, it is not crucial to Plaintiffs' allegations of Parkinson's scienter for the Board to have discussed the fraud on May 4, 2004. As shown above, Parkinson was made aware of the frauds prior to his SOA certification via the uncovering of kickback scheme and accusations of bid-rigging, both prior to the May 10, 2004 filing of Baxter's first quarter 2004 10-Q.

2. The Scienter of Anderson

As with Parkinson, Defendants parse out and individually attack each of the allegations in the Complaint regarding the scienter of Anderson, without ever addressing the cumulative weight of those allegations. (Appellees' Br. at 241-45) In fact, those allegations (set forth in Appellants' Brief at 31-38 and not repeated here), collectively establish a strong inference that Anderson knew of the fraud when he signed Baxter's 2003 10-K and first quarter 2004 10-Q, both of which contained SOA certifications. Furthermore, in the Company's 2003 10-K and first quarter 2004 Form 10-Q Anderson signed the same SOA certification as Parkinson did, specifically certifying that he had evaluated Baxter's internal controls and had disclosed "all significant deficiencies and material weaknesses" in their design and

---

the May 4th Board meeting, and not the Brazil fraud per se. (Appellees' Br. at 29) Thus, as Defendants have agreed, Plaintiffs certainly quoted a sufficient amount of the transcript in the SAC for this to be evident.

[12] What exactly Parkinson meant by "the May time frame" is a question of fact for the jury properly answered after development of a full record through discovery.

operation and "any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting."[13] Thus, like Parkinson, Anderson either knew of the fraud because of the internal controls he evaluated and certified as effective, or was reckless in certifying those controls as effective when he did not properly evaluate them. Both scenarios support a strong inference of scienter. *See Lattice*, 2006 WL 538756 at *18.

Two confidential witnesses stated that Baxter's Internal Audit Department and Baxter Management became aware of the fraud at or around "the end of the first quarter of 2004." (JA17; 25; ¶¶59, 73). Therefore, even if this language is construed strictly to mean by March 31, 2004, at a minimum Anderson, as a member of both Baxter's Internal Audit Department and Baxter Management, is properly charged with scienter as of April 22, 2004 (the date of Baxter's conference call alleged to contain misstatements) (JA26; ¶¶75-77), as of April 26, 2004 (the date he sold 44,902 Baxter shares in a highly unusual sale for approximately $1.5 million) (JA27; ¶¶78), and as of May 10, 2004 (the filing date of Baxter's first quarter 2004 10-Q alleged to contain misstatements).[14] Furthermore, it is

[13] Because such management includes the Finance Director Robert Vlasik, who, by the nature of his position, had a significant role in Baxter's internal control over financial reporting (JA13; ¶¶42-43), this latter statement in Anderson's certification regarding disclosure of "any fraud" was false as well.

[14] Defendants argue that the statement of CW1 that fictitious contracts in Brazil were brought to the attention of Anderson "no later than May 2004" (JA13; ¶46) "would not support a strong inference that Mr. Anderson knew of the Brazilian accounting errors by either March 12, 2004 or May 10, 2004." (Appellees' Br. at 42). However, the "no later than" language does not exclude March 12, 2004 or May 10, 2004, and this statement, when

reasonable to infer that confidential witnesses who, because they could not recall exact dates, used the terms "at" or "around" the end of the first quarter of 2004, were including March 9, a day that is only 22 days from the end of the quarter, as the date Baxter management, including Anderson, was informed of the fraud. This reasonable inference further supports Anderson's scienter prior to his March 9, 2004 Rule 144 filing and the March 12, 2004 filing of Baxter's 2003 10-K.[15]

Furthermore, Anderson was CFO of Baxter for over six years. (JA7; ¶19) Plaintiffs have alleged that on April 26, 2004, he sold 44,902 shares of Baxter stock, and that he had never before, throughout his entire tenure as the most senior-ranking financial officer at the Company, sold any Baxter stock, making his sale unusual in amount.[16] Indeed, Defendants do not contend otherwise. This alone supports a strong inference of scienter, without the sale also being suspicious in

---

considered along with all Plaintiffs' allegations, only supports an inference of scienter.

[15] Defendants argue that Plaintiffs acknowledged Anderson may not have learned of the fraud until after he signed the 2003 10-K and first quarter 2004 10-Q because Plaintiffs alleged that Anderson and the Baxter Board "knew of the Brazilian fraud either before the Company's 2004 first quarter Form 10-Q had been filed with the SEC *or at some point in time within three weeks of the filing date*." (JA33; ¶85) However, court's "recognize that in assessing a motion to dismiss for insufficient pleading, we must read the Complaint in the manner most favorable to the plaintiff, drawing reasonable inferences in the plaintiff's favor, *see Aldridge,* 284 F.3d at 79, and that inconsistent pleading does not deprive the pleader of the right to have the complaint read, as between the inconsistencies, in the manner that supports the adequacy of the pleading. The PSLRA's strong-inference requirement does not change this rule." *In re Stone & Webster,* 414 F.3d at 200.

[16] Any impending expiration date of these options does not alter the conclusion that Anderson's stock sale was suspicious in timing. Plaintiffs do not contend that the exercise of these options supports an inference of scienter, but that the sale of Baxter stock received upon exercise of these options supports such an inference. Anderson could certainly have exercised his options prior to their expiration date and retained the shares he received upon exercise.

timing. *See Selbst v. McDonald's Corp.*, Civ. No. 04 C 2422, 2005 WL 2319936, *19 (N.D. Ill. Sept. 21, 2005) (defendants' pleading burden for scienter met by alleging, *inter alia*, that defendants sold the company's stock "at a suspicious time **or** in an unusual amount") (emphasis added) (citation omitted); *Asher v. Baxter Int'l, Inc.*, No. 2C5608, 2005 WL 331572, *5 (N.D. Ill. February 3, 2005) (same).

Anderson's stock sale was suspicious in timing as well, despite Defendants argument to the contrary. (Appellees' Br. at 43-45) A reasonable person could certainly infer that a senior officer who had never before sold company shares during his six year tenure, who files a Form 144 for the sale of shares at the same time that officer is alleged to have received notice of a fraud, acted with scienter in thereafter making public misstatements that served to keep the company stock price artificially inflated until after he could sell those shares. *See Tellabs,* 437 F.3d at 602 (stating "reasonable person" standard). [17]

III. PLAINTIFFS HAVE ADEQUATELY PLED A SECURITIES FRAUD CLAIM AGAINST BAXTER

The SAC details many facts that clearly indicate corporate awareness of the fraud. First and foremost, as has been shown, Plaintiffs have adequately alleged that the Individual Defendants had knowledge of the Brazil fraud. As corporate officers, their knowledge is imputed to the corporation.

[17] Although Defendants argue that Anderson's sale is not made suspicious in timing because it came four days after Baxter announced on April 22, 2004 its first quarter 2004 results (Appellees' Br. at 44), it is a reasonable inference that Anderson timed his stock sale perfectly to take advantage of the stock price inflated by public statements made false and misleading by the fraud, and, thus, maximize his profits on the sale.

Second, Plaintiffs have also alleged the scienter of other, unnamed Baxter employees in addition to the Individual Defendants, whose scienter is also attributable to the corporation. (JA25; ¶73) Those Brazilian employees brought the Brazilian fraud "to the attention of Baxter management" no later than March 31, 2004. (JA25; ¶73)

In addition, the knowledge of the Finance Director, President and Sales Manager of Baxter Brazil, who generated the fictitious sales, is imputed to Baxter. These employees were acting not only to benefit themselves by increasing their bonuses (JA13; ¶44), but also to benefit Baxter by pumping up Baxter revenues and consistently meeting Baxter sales targets. *Cf. United States v. Barrett*, 51 F.3d 89-90 (7th Cir. 1995) (knowledge of illegal actions of corporate employee that were in no way beneficial to the company not imputed to the corporation) Their knowledge, therefore, also supports the inference of Baxter's scienter.

Third, the Brazilian government accused Baxter of fraud on April 29, 2004. (JA14; ¶48) Specifically, Baxter was accused of colluding with other companies to fix the bidding process for the purchase of blood products. The Brazilian government then initiated an administrative proceeding against Baxter. (JA14; ¶48) Thus, the Baxter corporate entity itself knew of this fraud, a fraud that by its very nature indicated revenues were being manipulated and that additional fraud was likely afoot.

Fourth, as demonstrated in Appellants' Opening Brief (at 47-48), scienter may be found against a corporation even when it is not shown against any one

individual.[18] Among other things, the corporation's scienter may be established where "management had recklessly failed to set up a procedure that insured the dissemination of correct information to the marketplace." *In re Warner Communications Sec. Litig.*, 618 F. Supp. 735, 752 (S.D.N.Y. 1985), aff'd, 798 F 2d 35 (2d Cir. 1986)

IV. DEFENDANTS' FAILURE TO CORRECT FALSE INFORMATION IS ACTIONABLE

Plaintiffs have properly alleged in the SAC that Defendants knew of the Brazil fraud, and, thus, material weaknesses in the Company's internal controls over financial reporting and overstatement of Brazilian revenue and earnings, in March 2004. (JA3, 11, 25, 34, 38; ¶¶8, 33, 73, 89, 101) Defendants made no disclosures whatsoever regarding this fraud until over four months later, when they announced a restatement on July 22, 2004, (JA76). Defendants argue they corrected their prior misstatements in a reasonable amount of time. (Appellees' Br. at 50-53) In fact, they did not. Correcting prior misstatements within days or weeks, not the months it took Baxter, is a reasonable amount of time. *See, e.g., In re WorldCom,*

[18] *See In re NUI Sec. Litig.*, 314 F. Supp. 2d 388, 411-414 (D.N.J. 2004) (where the court held plaintiffs' allegations satisfied the scienter pleading requirements with respect to the corporation even though scienter pleading was not satisfied as to the individual defendants) Furthermore, Defendants misread *Nordstrom, Inc. v. Chubb & Son, Inc.,* 54 F.3d 1424, 1435 (9th Cir. 1995) which, although it did not find collective scienter, stated that collective scienter could be a basis for liability ("Theoretically, collective scienter could be a basis for liability. 'In litigation involving Section 10(b) of the Securities Exchange Act and SEC Rule 10b-5, even though a corporation is incapable of acting except through individual directors and officers, the cumulative knowledge of its directors and officers is imputed to it. . . .[A] corporation's knowledge need not be possessed by a single officer or agent; the cumulative knowledge need not be possessed by a single officer or agent; the cumulative knowledge of all its agents will be imputed to the corporation.'") (citation omitted)

Inc. Sec. Litig., 02cv03288, 2006 WL 1047130, *4 (S.D.N.Y. April 21, 2006) (Audit Committee announced restatement of WorldCom's financial statements just days after learning of the fraud).

In addition, the Company revealed in its July 22, 2004 press release that "[u]pon becoming aware of the issue in Brazil, senior management, with the assistance of the company's internal audit team, conducted a preliminary investigation, which was followed by a more comprehensive investigation by the Audit Committee of Baxter's Board of Directors with the assistance of external legal counsel and accountants." (JA76) However, Defendants did not timely disclose either the existence of the preliminary investigation or its findings, or the existence of the more comprehensive investigation, instead waiting until months later to finally reveal the truth. These omissions are actionable, since such information was material. *See Tellabs*, 437 F.3d at 596 (information is material where a reasonable investor "(1) would consider the fact important in deciding whether to buy or sell the security or (2) would have viewed the total mix of information made available to be significantly altered by disclosure of the fact.")

V. GREISCH AND DEL SALTO ARE LIABLE UNDER § 10(b)

Although Greisch and del Salto did not sign the SEC filings or attached certifications at issue here, they are liable for misstatements and omissions in those documents under both the group pleading doctrine and for participating in a scheme to defraud. (JA39; ¶105)

Although the Seventh Circuit has not yet specifically upheld the group

pleading doctrine, a majority of district courts in the Seventh Circuit have. *See Selbst*, 2005 WL 2319936, *5 ("Until the Seventh Circuit rules otherwise, this Court will follow the majority of its sister courts in this district. The Court is thus unwilling to hold that the PSLRA abolished the group pleading doctrine.") (citation omitted); *See also In re Spiegel, Inc. Sec. Litig.*, 382 F. Supp. 2d 989, 1018 (N.D. Ill. 2004) (collecting cases).[19]

In *Spiegel* , the court found that the misrepresentations and omissions at issue could be attributed to defendants who did not directly make the statements under the group pleading doctrine, stating "Plaintiffs have done much more than simply identify the German Defendants' titles; Plaintiffs have alleged that the German Defendants were intimately involved with, and had significant control over, Spiegel's operations and specific disclosures (or nondisclosures)." *Id.* at 1019. Here, Plaintiffs have made similar allegations regarding Gresich and del Salto. Greisch was specifically alleged to have been Corporate Vice President of Baxter World Trade Corporation, with oversight of Baxter's Brazilian operations (JA7, 37; ¶¶ 20, 99), access to and control over Brazil's financial reporting (JA12, 38, 39, 40; ¶¶ 39, 103, 104, 106, 108), with participation in the drafting of the SEC-filed periodic reports containing the misstatements complained of. (JA40, 41; ¶¶ 108,

[19] Indeed, use of the group pleading doctrine has been upheld in this Circuit against Baxter executives in a separate 2002 securities fraud class action. *Asher*, 2005 WL 331572, at *9 ("Here, until the Seventh Circuit holds otherwise, this Court will continue to apply the group pleading doctrine, and until evidence is presented to the contrary, attribute the Public Statements to all of the Individual Defendants, particularly given that Plaintiffs allege that they are high-level managers who were involved in the day-to-day operations of Baxter during the Class Period.")

109) Del Salto was specifically alleged to have been a member of Baxter's executive management team and the manager of geographic region that included Brazil. (JA7; ¶18). He, too, was alleged to have oversight of Brazil (JA38; ¶100), access to and control over Brazil's financial reporting (JA38, 39, 40; ¶¶103, 104, 106, 108), with participation in the drafting of Baxter's 2003 10-K and first quarter 2004 10-Q. (JA40, 41; ¶¶ 108, 109)[20]

Greisch and del Salto are also liable for the misstatements and omissions at issue because they engaged in a scheme to defraud.[21] Here, Defendants had, as Plaintiffs have alleged, a duty to disclose allegations of the Brazil fraud, that Baxter financial statements contained misstatements and that Baxter internal controls were ineffective. Because of their failure to disclose this information, they are liable under Rules 10b-5(a) and (c) for engaging in a scheme to defraud. *See In re Matter of Lake States Commodities,* 936 F. Supp. 1461, 1472 (N.D. Ill. 1996) (fraudulent scheme under 10b-5(a) and (c) properly alleged where 10b-5 claim alleges either "(1)

[20] As one district court in the Seventh Circuit has stated in holding that the PSLRA did not abolish the group pleading doctrine, "'[a]lthough pleading securities fraud after the PSLRA can no longer be described as merely 'notice pleading,' courts must be careful not to set the hurdles so high that even meritorious actions cannot survive a motion to dismiss. Such a regime would defeat the remedial goals of the federal securities laws.'" *Sutton v. Bernard*, No. 00 C 6676, 2001 WL 897593, *5 (N.D. Ill. August 9, 2001) quoting *In re PETsMART, Inc. Secs. Litig.*, 61 F. Supp. 2d 982, 988 (D. Ariz. 1999).

[21] Plaintiffs contend that all of the defendants are liable under Rule 10b-5(a) and (c) as participants in a scheme to defraud. (JA42, 44, 45; ¶¶111, 112, 118-120)

material misstatements or (2) material omissions by a person having a **duty to disclose**") (emphasis added).[22]

Defendants also argue that Plaintiffs have not specifically alleged facts that support a strong inference that Greisch and del Salto each acted with scienter. (Appellees' Br. at 49) This argument directly contradicts the District Court's holding. *See Higginbotham II* at *3 (A12) ("In the proposed Second Amended CAC, plaintiff has adequately alleged that Anderson, del Salto, and Greisch had knowledge of the Brazilian operations improprieties prior to the March 12, 2004 filing of the 2003 Form 10-K."); *Higginbotham III* at *1 (A14) (confirming that *Higginbotham II* held that Plaintiffs had adequately alleged the scienter of Greisch and del Salto, and not revisiting that issue).

The facts supporting the District Court's finding that Greisch and del Salto acted with scienter include the following. Greisch had oversight responsibilities for Brazil (JA37; ¶99), received the financial results for Baxter's Brazilian operations on a monthly basis (JA12; ¶39), was informed of fictitious contracts in Brazil on a

[22] *See also United States S.E.C. v. Santos*, 355 F. Supp. 2d 917, 918 (N.D. Ill. 2003) (in scheme whereby City Treasurer allegedly directly and indirectly demanded illegal cash payments and campaign donations from two investment professionals in order to secure their receipt of the City's investment business, the court found participation in the scheme sufficient to impose liability under 10b-5(a) and (c),even without any corresponding duty to disclose participation in the scheme); *In re Initial Pub. Offering Sec. Litig.,* 241 F. Supp. 2d 281, 385-90 (S.D.N.Y. 2003) (claims under Section 10(b) based on improper market manipulation are independent of and just as valid as claims based on material misrepresentations and may be pled with less specificity than claims alleging material misstatements); *In re AOL Time Warner, Inc. Secs. and "Erisa" Litig.*, 381 F. Supp. 2d 192, 227 (S.D.N.Y. 2004) (individual who participated in fraudulent underlying transaction that affected financial statements, but made no public statements, may be liable under Rule 10b-5(a) and (c)).

regular basis (JA13; ¶42) and was elected CFO of Baxter on June 21, 2004 (JA34; ¶87). Del Salto had oversight responsibilities for Brazil (JA38; ¶100), was likely informed of the Brazil fraud by Brazilian employees before the end of the first quarter of 2004 (JA25; ¶73), disposed of virtually all of his holdings of Baxter common stock on April 29, 2004 for approximately $4.5 million (JA27; ¶79) and within days of Anderson's highly unusual Baxter stock disposition on April 26, 2004. (JA27; ¶78)

In addition, as disclosed in Baxter's Form 10-K/A for the year ended December 31, 2003, the Baxter fraud was the result of, *inter alia*, "ineffective financial review by management responsible for the Intercontinental region, which includes Latin America." (JA11; ¶35) Thus, Greisch and del Salto's admitted lack of monitoring supports a strong inference of their scienter. *See Novak,* 216 F.3d at 311 (strong inference of scienter "may arise where the complaint sufficiently alleges that the defendants. . . failed to check information they had a duty to monitor") Accordingly, Plaintiffs have amply alleged the scienter of Greisch and del Salto.

VI. PLAINTIFFS ADEQUATELY ALLEGED SECTION 20(a) CONTROL PERSON CLAIMS

Plaintiffs and Defendants apparently agree that the viability of Plaintiffs' control person claims depends on whether the Court upholds predicate violations. (Appellees' Br. at 56). Plaintiffs have adequately alleged such violations.

CONCLUSION

For all the reasons stated herein and in Plaintiffs/Appellants' Opening Brief, the District Court's dismissal of the SAC should be reversed.

Dated: September 22, 2006 Respectfully submitted,

By_____

Patrick V. Dahlstrom
Leigh H. Smollar
POMERANTZ HAUDECK BLOCK
GROSSMAN & GROSS, LLP
One North LaSalle Street, Suite 2225
Chicago, IL 60602-3908
(312) 377-1181

PLAINTIFFS-APPELLANTS'
LIAISON COUNSEL

Sherrie R. Savett
Arthur Stock
Russell D. Paul
Doug M. Risen
Shoshana T. Savett
BERGER & MONTAGUE, P.C.
1622 Locust Street
Philadelphia, PA 19103
(215) 875-3000

Lionel Z. Glancy
Peter A. Binkow
GLANCY BINKOW & GOLDBERG LLP
1801 Avenue of the Stars, Suite 311
Los Angeles, CA 90067
(310) 201-9150

PLAINTIFFS-APPELLANTS' CO-LEAD
COUNSEL

CERTIFICATE OF COMPLIANCE WITH TYPE-VOLUME LIMITATION, TYPEFACE REQUIREMENTS, AND TYPE STYLE REQUIREMENTS

This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains 6985 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

This brief complies with the typeface requirements of Fed. R. App. R. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Corel Wordperfect 12.00.499 in 12-Point Century.

Dated: September 22, 2006

_____

Attorney for Plaintiffs-Appellants

CERTIFICATE OF COMPLIANCE WITH
CIRCUIT RULE 31(e)

Pursuant to Rule 31(e) of the Circuit Rules of the United States Court of Appeals for the Seventh Circuit, the undersigned, an attorney associated with the firm of Berger & Montague, hereby certifies that the Table of Contents, Table of Authorities, Brief, and Certificates of Compliance have been provided in electronic format.

Dated: September 22, 2006

_____

Attorney for Plaintiffs-Appellants

CERTIFICATE OF SERVICE

The undersigned, counsel for the Plaintiff-Appellant Steelworkers Pension Trust, hereby certifies that on September 22, 2006, two copies of the Brief, as well as a digital version of this document, were delivered by overnight mail to the below-listed counsel for the Defendants-Appellees Baxter International, Inc., Brian P. Anderson, John J. Greisch, Carlos del Salto and Robert L. Parkinson.

Matthew R. Kipp, Esquire
Donna L. McDevitt, Esquire
Dhananjai Shivakumar, Esquire
Lanelle K. Meidan, Esquire
Skadden, Arps, Slate, Meagher & Flom LLP
333 West Wacker Drive, Suite 2100
Chicago, IL 60606-1285

BERGER & MONTAGUE, P.C.

Dated: September 22, 2006

By_____
Russell D. Paul
Attorney for Plaintiffs-Appellants