No. 06-1312

In the

United States Court of Appeals

for the Seventh Circuit

Dennis Higginbotham, *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
No. 04 C 4909
Hon. William T. Hart, Judge

BRIEF OF APPELLEES

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CIRCUIT RULE 26.1 DISCLOSURE STATEMENT

Appellate Court No: 061312

Short Caption: Higginbotham v. Baxter International Incorporated, et al.

To enable the judges to determine whether recusal is necessary or appropriate, an attorney for a non-governmental party or amicus curiae, or a private attorney representing a government party, must furnish a disclosure statement providing the following information in compliance with Circuit Rule 26.1 and Fed. R. App. P. 26.1.

The Court prefers that the disclosure statement be filed immediately following docketing; but, the disclosure statement must be filed within 21 days of docketing or upon the filing of a motion, response, petition, or answer in this court, whichever occurs first. Attorneys are required to file an amended statement to reflect any material changes in the required information. The text of the statement must also be included in front of the table of contents of the party's main brief. **Counsel is required to complete the entire statement and to use N/A for any information that is not applicable if this form is used.**

(1) The full name of every party that the attorney represents in the case (if the party is a corporation, you must provide the corporate disclosure information required by Fed. R. App. P 26.1 by completing item #3):

Baxter International Incorporated, Robert Parkinson, Jr., Brian P. Anderson, John J. Greisch, and Carlos Del Salto

(2) The names of all law firms whose partners or associates have appeared for the party in the case (including proceedings in the district court or before an administrative agency) or are expected to appear for the party in this court:

Skadden, Arps, Slate, Meagher & Flom LLP (formerly Skadden, Arps, Slate, Meagher & Flom (Illinois))

(3) If the party or amicus is a corporation:

i) Identify all its parent corporations, if any; and

Baxter International Incorporated is a publicly held corporation and has no parent company.

ii) list any publicly held company that owns 10% or more of the party's or amicus' stock:

No publicly held company owns ten percent or more of the stock of Baxter International Incorporated.

Attorney's Signature: _____ Date: August 30, 2006

Attorney's Printed Name: Matthew R. Kipp

Please indicate if you are *Counsel of Record* for the above listed parties pursuant to Circuit Rule 3(d). **Yes** _____ **No** _____

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Attorney's Signature: _____ Date: August 30, 2006

Attorney's Printed Name: Donna L. McDevitt

Please indicate if you are *Counsel of Record* for the above listed parties pursuant to Circuit Rule 3(d). **Yes** _____ **No** _____

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Attorney's Signature: _____ Date: August 30, 2006

Attorney's Printed Name: Dhananjai Shivakumar

Please indicate if you are *Counsel of Record* for the above listed parties pursuant to Circuit Rule 3(d). **Yes** _____ **No** _____

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JURISDICTIONAL STATEMENT

Appellant's jurisdictional statement is not complete or correct. Appellant Steelworkers Pension Trust ("Steelworkers") correctly states that the District Court had subject matter jurisdiction of appellant's claims pursuant to 28 U.S.C. §§ 1331 and 1337 and Section 27 of the Securities Exchange Act of 1934 (the "Exchange Act"). Section 27 of the Exchange Act is codified at 15 U.S.C. § 78aa, not at 15 U.S.C. § 78a, as indicated in appellant's jurisdictional statement.

Steelworkers incorrectly states that the District Court's December 27, 2005, judgment was entered with respect to a motion for reconsideration made by appellees pursuant to Fed. R. Civ. P. 60(b). The District Court's Memorandum Opinion and Order dated September 23, 2005, as to which appellees sought reconsideration, was an interlocutory order. Accordingly, neither Fed. R. Civ. P. 60(b) nor Fed. R. Civ. P. 59(e) applied to defendants' motion for reconsideration. *See, e.g.*, *Nieves-Luciano v. Hernandez-Torres*, 397 F.3d 1, 4 (1st Cir. 2005)("Rule 59(e) does not apply to motions for reconsideration of interlocutory orders from which no immediate appeal may be taken."); *Lowe v. McGraw-Hill Cos.*, 361 F.3d 335, 343 (7th Cir. 2004) ("Rule 60(b) is only applicable to 'final' judgments."). Instead, defendants' motion for reconsideration invoked the District Court's inherent authority to modify its interlocutory orders at any time before the entry of judgment. *See Cameo Convalescent Ctr., Inc. v. Percy*, 800 F.2d 108, 110 (7th

Cir. 1986) ("Pre-judgment orders . . . are interlocutory and may be reconsidered at any time.").

Steelworkers correctly states that this Court has jurisdiction of its appeal pursuant to 28 U.S.C. § 1291.[1]

ISSUE PRESENTED FOR REVIEW

Whether the District Court properly exercised its discretion in granting defendants' motion for reconsideration after correctly concluding that:

(1) the allegations in Steelworkers' proposed Second Amended Class Action Complaint (the "SAC") with respect to Messrs. Parkinson and Anderson—the only individual defendants alleged to have made any misstatements of material fact—failed to give rise to the necessary strong inference that they acted with scienter that is required by the Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (the "PSLRA");

(2) the SAC contained no allegations that the other two individual defendants, Messrs. Greisch and del Salto, made or participated in making the alleged misstatements;

(3) the individual defendants did not have a duty under the securities laws to make an immediate public disclosure upon receiving a report of possible

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[1] Although Steelworkers' brief bears the caption *Steelworkers Pension Trust, et al. v. Baxter International Inc., et al.*, Steelworkers' notice of appeal was captioned *Dennis Higginbotham, et al. v. Baxter International Inc., et al.* Defendants, therefore, have used the latter caption on this brief.

accounting errors at Baxter's Brazilian operations, but rather were entitled to a reasonable period to investigate the accuracy of the report and determine the magnitude of any accounting errors before making a disclosure;

(4) in the absence of sufficient allegations that any of the individual defendants or any other senior officer of Baxter committed securities fraud in violation of Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78j(b), and Securities and Exchange Commission ("SEC") Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5, the SAC failed to state a claim against Baxter for violation of Section 10(b) and SEC Rule 10b-5; and

(5) because the SAC failed to state any primary securities fraud claim against Baxter under Section 10(b) and SEC Rule 10b-5, the SAC also failed to state a claim against any individual defendant for controlling person liability under Section 20(a) of the Exchange Act, 15 U.S.C. § 78t(a).

STATEMENT OF THE CASE

A. The Nature of This Case

This putative securities fraud class action arises out of Baxter's July 22, 2004, announcement that it would restate its financial results for the years 2001 through 2003 and the first quarter of 2004 to correct certain accounting errors at its Brazilian operations. Baxter advised that the restatement was expected to result in aggregate adjustments to sales over the period of the restatement of not more than $70 million, representing less than one-half of one percent of sales in

any year. On the day of the announcement, the price of Baxter's common stock declined $1.48 per share, or 4.59 percent, to close at $30.79 per share.

B. The Allegations in the CAC

Five days after Baxter announced the planned restatement, plaintiff Dennis Higginbotham filed the first of the four substantially identical securities fraud complaints that were filed against defendants relating to the restatement. (R1.) On November 10, 2004, the District Court consolidated the cases under the caption *Dennis Higginbotham, et al. v. Baxter International Inc., et al.*, No. 04 C 4909, appointed as lead plaintiffs Steelworkers and the "Michigan Funds" (a group composed of various municipal retirement funds), and ordered plaintiffs to file a consolidated complaint. (R16.) Plaintiffs filed the Consolidated Amended Class Action Complaint (the "CAC") on January 10, 2005. (R22.)[2]

Plaintiffs sought to represent a class of all persons who purchased Baxter securities during the period from April 19, 2001, the date on which Baxter announced its financial results for the first quarter of 2001, to July 21, 2004, the day before the announcement of the restatement. (CAC ¶1; SA2.) Plaintiffs alleged that each of Baxter's financial reports filed with the SEC during the proposed three-and-a-quarter-year class period was false and misleading. (*Id.* ¶¶57,95; SA14,SA31.)

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[2] A copy of the SAC is included in Appellees' Supplemental Appendix (cited herein as "SA").

Plaintiffs named as defendants Baxter, Harry M. Jansen Kraemer, Jr., Baxter's Chief Executive Officer ("CEO") from 1999 through April 2004, Brian P. Anderson, Baxter's Chief Financial Officer ("CFO") from February 1998 through June 21, 2004, and John J. Greisch, who joined Baxter in 2002 and became CFO of Baxter on June 21, 2004. (*Id.* ¶¶19–22; SA5–SA6.)

Plaintiffs alleged that Baxter and Messrs. Kraemer, Anderson, and Greisch committed securities fraud in violation of Section 10(b) of the Exchange Act and SEC Rule 10b-5. (*Id.*, First Claim for Relief; SA47–50.) Plaintiffs also asserted a claim against Messrs. Kraemer, Anderson, and Greisch for controlling person liability under Section 20(a) of the Exchange Act. (*Id.*, Second Claim for Relief; SA50–51.)

C. The May 25 Order Dismissing the CAC with Prejudice

Defendants moved to dismiss the CAC on the ground that plaintiffs' allegations failed to give rise to the strong inference of scienter required by the PSLRA. (R26.) On May 25, 2005, the District Court issued a Memorandum Opinion and Order granting defendants' motion and dismissing the CAC with prejudice. (R38; A1–A9.)

The District Court found that "[t]here are no allegations in the CAC adequately supporting that the individual defendants acted with the necessary scienter. Therefore, the direct claims against the individual defendants must be dismissed." (A7.) The District Court also held that plaintiffs' failure to allege

adequately that the individual defendants or any other member of Baxter's senior management acted with scienter mandated the dismissal of plaintiffs' securities fraud claim against Baxter. (A7–A8.) In addition, the District Court dismissed plaintiffs' claims against the individual defendants for alleged controlling person liability. (A8.)

The District Court entered judgment in favor of defendants on May 27, 2005. (R39.)

D. The September 23 Order Granting Steelworkers' Rule 59(e) Motion

On June 13, 2005, Steelworkers filed a motion to alter the judgment under Fed. R. Civ. P. 59(e), by which it sought leave to file the SAC. (R40.) The Michigan Funds were not parties to that motion (*id.*), nor were they named as plaintiffs in the SAC. (JA1–JA53.)

The principal differences between the SAC and the CAC were that Steelworkers (1) alleged a four-month class period (as opposed to the three-and-a-quarter-year class period alleged in the CAC) (SAC ¶1; JA2); (2) dropped Mr. Kraemer as a defendant but added Robert L. Parkinson, who succeeded Mr. Kraemer as CEO of Baxter on April 26, 2004 (*id.* ¶17; JA7); and (3) named as an additional defendant Carlos del Salto, a Baxter executive whom plaintiffs had mentioned, but not named as a defendant, in the CAC. (*Id.* ¶18*;* JA7.)

On September 23, 2005, the District Court issued a Memorandum Opinion and Order granting Steelworkers' Rule 59(e) motion. (R52; A10–A13.) The District

Court observed that "[m]ost of defendants' opposition is focused on whether plaintiff has adequate grounds to move for amendment after a judgment has already been entered." (A10.) The District Court, however, did not address the Rule 59(e) standard or defendants' arguments that Steelworkers had not satisfied that standard. (*Id.*) Instead, the District Court stated that its usual practice in dismissing a complaint is to dismiss the complaint with prejudice and enter judgment, but then allow the filing of an amended complaint upon motion by the plaintiff as long as the defendant does not establish that amendment would be futile. (*Id.*) Stating that "[n]o sufficient basis has been presented for holding that the proposed [SAC] fails to state a claim," the District Court granted Steelworkers' motion to amend. (*Id.* at A12.)

E. The December 22 Order Granting Defendants' Motion for Reconsideration

On October 11, 2005, defendants filed a motion for reconsideration of the District Court's September 23 Order. (R55.) Recognizing that "a PSLRA case should not proceed if claims are not adequately alleged," the District Court allowed briefing on defendants' motion for reconsideration. (A14.) In a Memorandum Opinion and Order dated December 22, 2005, the District Court concluded that "the claims against all the individual defendants are deficient" and, therefore, "the claims against Baxter are also insufficient." (A16.) Finding no sufficient claim against Baxter, the District Court dismissed the controlling person claims against

Messrs. Parkinson, Anderson, Greisch, and del Salto. (*Id.*) The District Court entered judgment in favor of defendants on December 27, 2005.

F. Steelworkers' Appeal

In its notice of appeal, Steelworkers states that it is appealing both (1) the District Court's December 22, 2005, order and December 27, 2005, judgment granting defendants' motion for reconsideration and dismissing the SAC with prejudice, and (2) the District Court's May 25, 2005, order and May 27, 2005, judgment dismissing the CAC with prejudice. (A18–A19.) In its brief, however, Steelworkers does not argue that the District Court erred in dismissing the CAC. Rather, Steelworkers argues only that the District Court erred in granting defendants' motion for reconsideration and dismissing the claims asserted in the SAC. *See* Steelworkers' Br. (hereinafter "Br.") at 4 n.4 ("Plaintiffs-Appellants are pursuing the District Court's dismissal of all claims against all Defendants-Appellees *in the SAC*.") (emphasis added).

STATEMENT OF THE FACTS

A. The Parties

Defendant Baxter is a global medical products and services company that has its principal executive offices in Deerfield, Illinois. (SAC ¶16; JA6.) Baxter generates approximately 50 percent of its revenues outside the United States and sells its products and services in over 100 countries. (*Id.*) During the period at issue, Baxter's Brazilian operations generated approximately $100 million in

annual sales. (*Id.* ¶ 6; JA3.) For 2003, Baxter's aggregate sales were $8.9 billion. (SA69.)

Defendant Parkinson became Chairman of the Board, CEO, and President of Baxter on April 26, 2004, and held those positions at all times during the putative class period. (SAC ¶17; JA7.)

Defendant Anderson was Baxter's Senior Vice President and CFO from February 1998 until June 21, 2004. (*Id.* ¶19; JA7.)

Defendant Greisch became CFO of Baxter on June 21, 2004, and held that position throughout the remainder of the putative class period. (*Id.* ¶20; JA7.) From January to June 2004, Mr. Greisch served as Corporate Vice President of Baxter World Trade Corporation and Baxter Healthcare Corporation, Baxter's two principal operating subsidiaries, and as President of Baxter's BioScience division. (*Id.*)

Defendant del Salto was Senior Vice President of Baxter Healthcare Corporation from 2003 to August 2004 and "managed a diverse geographic region that encompassed Latin America as well as Asia and Japan." (*Id.* ¶18; JA7.)

Messrs. Parkinson, Anderson, Greisch, and del Salto are referred to herein as the "Individual Defendants."

Plaintiff Steelworkers allegedly purchased Baxter securities at various times during the putative class period. (*Id.* ¶15; JA6.) Steelworkers sought in the SAC

to represent a class of all persons who purchased Baxter securities between March 12 and July 21, 2004. (*Id.* ¶1; JA2.)

B. Baxter's 2003 Form 10-K and First Quarter 2004 Form 10-Q

On March 12, 2004, the first day of the alleged class period, Baxter filed its 2003 Form 10-K with the SEC. (*Id.* ¶60; JA17.) The Form 10-K was signed by Mr. Anderson, Baxter's then-CFO. (*Id.*)

The 2003 Form 10-K contained a "Report of Management," which was signed by Mr. Anderson and stated, among other points, that (1) "[t]he financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America," and (2) "[m]anagement maintains a system of internal controls (including disclosure controls) designed to provide reasonable assurance that . . . transactions are appropriately authorized and recorded to permit the preparation of consolidated financial statements in accordance with accounting principles generally accepted in the United States of America." (*Id.* ¶61; JA17–JA18.)

The 2003 Form 10-K also included a certification by Mr. Anderson pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (the "SOA"). (*Id.* ¶¶62,110.) Section 302(a) of the SOA, codified at 15 U.S.C. § 7241, requires a company's principal executive officer and principal financial officer to certify, in each quarterly or annual report filed with the SEC, that (1) the signing officer has reviewed the report; (2)the report does not contain any material

misstatements or omissions; (3) the financial information in the report fairly presents the condition of the issuer; and (4) the signing officer is responsible for establishing and maintaining a system of internal controls and has presented his or her conclusions regarding the effectiveness of these controls in the report. 15 U.S.C. § 7241(a)(1)–(4).[3]

On May 10, 2004, Baxter filed its first quarter 2004 Form 10-Q with the SEC. (SAC ¶83; JA29.) The Form 10-Q was signed by Mr. Anderson and contained SOA certifications signed by Mr. Anderson and Mr. Parkinson, who became CEO of Baxter on April 26, 2004. (*Id.* ¶¶17,83; JA7, JA29.)

Steelworkers did not allege that Mr. Greisch or Mr. del Salto prepared or signed the 2003 Form 10-K or first quarter 2004 Form 10-Q.

C. Mr. Anderson's and Mr. del Salto's Stock Sales

On March 9, 2004, Mr. Anderson filed a notice with the SEC on Form 144 of a planned sale of 44,902 shares of his Baxter stock. (*Id.* ¶33; JA11.) Mr. Anderson executed the planned stock sale on April 26, 2004, four days after Baxter reported its financial results for the first quarter of 2004. (SAC ¶¶75,78; JA26–JA27.) Mr. Anderson reported his stock sale by filing with the SEC a Form 4, "Statement of Changes in Beneficial Ownership," on April 27, 2004. (SA71–SA73.) The Form 4 showed that Mr. Anderson's stock sale consisted of the

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[3] Baxter's then-CEO, Harry M. Jansen Kraemer, Jr., also signed an SOA certification contained in Baxter's 2003 Form 10-K. (R22 (CAC) ¶91.) Steelworkers did not name Mr. Kraemer as a defendant in the SAC.

exercise of options with an expiration date of June 15, 2004, and the concurrent sale of the shares thus acquired. (SA71.)

Mr. del Salto sold 140,000 shares of his Baxter stock on April 29, 2004, a week after Baxter reported its first quarter 2004 results. (SAC ¶79; JA27.)

D. Baxter's July 22, 2004, Announcement that It Would Restate Its Previously Reported Financial Results

On July 22, 2004, Baxter announced that it would restate its previously reported financial results for the years 2001 through 2003 and the first quarter of 2004. (SAC ¶91; JA35.) In a July 22, 2004, press release, Baxter reported that

> [t]he restatement is primarily the result of incorrect revenue recognition and inadequate provisions for bad debts in Brazil during that period, which will result in a decrease in net income over the restatement period by an amount expected to be no more than $40 million, or $0.07 per diluted share. The restatement is expected to result in adjustments to sales over the period of an amount not more than $70 million, representing less than 0.5 percent of sales in any year.

(JA76.)

Mr. Greisch explained in the July 22 press release that, "[w]hile the adjustments to any of the individual years subject to restatement may not seem significant to Baxter's overall operations, the company concluded that a restatement is the most appropriate action." (*Id.*) The press release further disclosed 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. As a result of those investigations, two members of senior management in the company's Brazilian operations are being terminated. In addition, the company has looked for similar issues within its Latin America region and, aside from some minor issues in one other country, no similar issues have surfaced.

(*Id.*)

In a conference call with analysts on July 22, 2004, CEO Parkinson responded to a question about how the Brazilian accounting problems had come to light by stating: "We became aware of a call or an e-mail or letter—I can't recall which it was—from an employee in Brazilian operations some time in the May time frame." (SAC ¶81; JA28.) Mr. Parkinson added: "And it was, frankly, only in the recent week or two we began to get our arms around the magnitude of this issue." (JA63.)

On July 22, 2004, Baxter's common stock declined $1.48 per share, or 4.59 percent, to close at $30.79 per share. (SAC ¶93; JA35–JA36.) By January 10, 2005, the date the CAC was filed, Baxter's stock price had recovered fully and closed at $35.43 per share.[4]

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[4] Because Baxter's stock is listed on the New York Stock Exchange, the Court may take judicial notice of Baxter's stock price. *See, e.g., Ieradi v. Mylan Labs., Inc.*, 230 F.3d 594, 600 n.3 (3d Cir. 2000) (under Fed. R. Evid. 201, a court may take judicial notice of publicly reported stock prices because such prices are "capable of accurate and ready determination by resort to a source whose accuracy cannot be reasonably questioned").

E. The Restatement

Baxter implemented the restatement by filing with the SEC a Form 10-K/A, dated August 6, 2004. (SAC ¶5; JA3.) In Item 9A of the Form 10-K/A (referred to in ¶35 of the SAC; JA11), Baxter reported:

> This restatement was primarily the result of the inappropriate application of accounting principles for revenue recognition and inadequate provisions for bad debts in Brazil during this period. Senior management became aware of these issues in 2004 through the reporting procedures established under Baxter's Global Business Practice Standards.

(SA68.) In Item 9A Baxter identified the specific weaknesses in its internal controls that were uncovered as a result of its internal investigation (which Steelworkers recited in paragraph 35 of the SAC). (*Id.*) Baxter also disclosed the actions it already had taken and others it was implementing to address these internal control weaknesses. (*Id.*) Steelworkers did not mention these remedial measures in the SAC.

Item 9A of the Form 10-K/A also advised readers to consult Note 1A to the consolidated financial statements for further information regarding the restatement. (*Id.*) Note 1A contained a table (which was reproduced in paragraph 96 of the CAC but omitted from the SAC) summarizing the effect of the restatement on Baxter's previously issued financial results. (SA69–SA70.) As shown therein, sales for 2001 decreased $14 million from the $7.356 billion originally reported; sales for 2002 decreased $11 million from the $8.110 billion originally reported; and sales for 2003 decreased $12 million from the $8.916 billion originally reported.

Net income for 2001 decreased $11 million from the $612 million originally reported; net income for 2002 decreased $7 million from the $778 million originally reported; and net income for 2003 decreased $15 million from the $881 million originally reported. (*Id.*)

In the text of Note 1A, Baxter summarized the effect of the restatement:

> [A]s a result of the restatement, in aggregate, net sales decreased $37 million (0.2% of the originally reported amount) and net income decreased $33 million (1.5% of the originally reported amount) over the three-year period ended December 31, 2003. For the first quarter of 2004, net sales were unchanged as a result of the restatement and net income decreased $2 million (1.1% of the originally reported amount).

(SA69.)

SUMMARY OF ARGUMENT

The District Court properly exercised its discretion in granting defendants' motion for reconsideration because the District Court correctly concluded that Steelworkers' proposed SAC did not meet the PSLRA's heightened pleading standards.

The PSLRA requires, among other things, that a complaint in a private securities suit "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." 15 U.S.C. § 78u-4(b)(2). The required state of mind in a securities fraud suit is scienter, which "refers to a mental state embracing intent to deceive, manipulate, or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976). The PSLRA instructs courts to

dismiss securities fraud complaints that do not meet these pleading requirements. 15 U.S.C. § 78u-4(b)(3)(A).

"The enactment of the PSLRA in 1995 marked a bipartisan effort to curb abuse in private securities lawsuits, particularly the filing of strike suits." *Greebel v. FTP Software, Inc.*, 194 F.3d 185, 191 (1st Cir. 1999). Among the "abusive" practices that Congress sought to curtail was "the routine filing of lawsuits against issuers of securities and others whenever there is a significant change in an issuer's stock price, without regard to any underlying culpability of the issuer, and with only faint hope that the discovery process might lead eventually to some plausible cause of action." H.R. Conf. Rep. No.104-369 at 41 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730.

This is precisely the sort of frivolous securities "fraud" suit that the PSLRA was intended to curtail. Plaintiffs filed the initial complaints in this action within days of Baxter's July 22, 2004, announcement that it would restate its prior period financial statements because of accounting errors at its Brazilian operations. Although (1) Baxter's Brazilian operations accounted for only $100 million of Baxter's nearly $9 billion in 2003 annual revenues, (2) the magnitude of the restatement was minuscule, and (3) Baxter's stock price had fully recovered by the time plaintiffs filed the CAC on January 10, 2005, plaintiffs alleged in the CAC that Baxter and three of its senior executives knew of or recklessly

disregarded the Brazilian accounting errors during the entire three-and-one-quarter year period of the restatement.

After the District Court dismissed the CAC with prejudice for failure to meet the PSLRA's heightened pleading standards, Steelworkers filed a Rule 59(e) motion seeking leave to file the proposed SAC. Although the District Court initially granted Steelworkers' Rule 59(e) motion, upon reconsideration the District Court correctly concluded that the allegations in the SAC did not meet the PSLRA's heightened pleading standard.

The SAC's allegations failed to support a strong inference that Mr. Parkinson, who joined Baxter as its new CEO on April 26, 2004, committed securities fraud two weeks later when he signed the SOA certification in Baxter's first quarter Form 10-Q on May 10, 2004. The District Court acknowledged that, in granting Steelworkers' Rule 59(e) motion, it had misconstrued one of the SAC's central allegations.

The District Court initially concluded that the SAC adequately alleged that Mr. Parkinson knew of the Brazilian accounting errors *before* May 10 because Steelworkers alleged that Mr. Parkinson admitted that the Baxter Board discussed those errors at a May 4 meeting. In their motion for reconsideration, defendants demonstrated that this allegation was nothing more than a sleight of hand. By juxtaposing unrelated snippets from a transcript of Mr. Parkinson's comments during a conference call with analysts on July 22, 2004, Steelworkers

misleadingly implied that Mr. Parkinson had admitted that the Board knew of the Brazilian accounting errors by May 4. In fact, the transcript of the call refuted Steelworkers' insinuation. In granting defendants' motion for reconsideration, the District Court noted that the SAC's misleading allegations had been central to its earlier conclusion that Steelworkers adequately had alleged Mr. Parkinson's scienter.

The remaining allegations in the SAC failed to give rise to a strong inference that Mr. Parkinson acted with scienter because those allegations were based solely on (1) vague statements by confidential witnesses as to whom the SAC contained no details that would support a conclusion that the confidential witnesses had personal knowledge of the information attributed to them, and (2) the mere fact that Mr. Parkinson held a high-level executive position with Baxter.

The District Court also properly concluded that the SAC's allegations failed to support a strong inference that Mr. Anderson, Baxter's CFO through June 21, 2004, knew of or recklessly disregarded the Brazilian accounting errors when he signed Baxter's 2003 Form 10-K and the SOA certification contained therein on March 12, 2004, or when he signed Baxter's 2004 Form 10-Q and the SOA certification contained therein on May 10, 2004. As in the case of Mr. Parkinson, Steelworkers attempted to plead Mr. Anderson's scienter based on the insufficient allegations attributed to Steelworkers' confidential witnesses and the mere fact of Mr. Anderson's executive position. Steelworkers also alleged that Mr. Anderson

sold some of his Baxter stock on April 26, 2004. The District Court correctly concluded, however, that there was nothing suspicious about Mr. Anderson's stock sale.

As for Mr. Greisch and Mr. del Salto, the District Court concluded that the SAC did not allege that either of these defendants made or participated in making the alleged misstatements in Baxter's 2003 Form 10-K and first quarter 2004 Form 10-Q. The District Court correctly rejected Steelworkers' argument that Messrs. Greisch and del Salto could be held liable for the alleged misstatements in these SEC filings under the "group-pleading doctrine" because that doctrine is inconsistent with the PSLRA's pleading requirements.

The District Court also correctly rejected Steelworkers' omission theory of liability—*i.e.*, that the Individual Defendants violated the securities laws by failing to disclose the Brazilian accounting errors during the period from when they first received notification of the possible accounting errors until July 22, 2004, when Baxter announced the plan to restate. Contrary to Steelworkers' argument, the securities laws did not require the Individual Defendants to make an immediate public disclosure upon learning of possible accounting errors in Brazil, but rather allowed them a reasonable period to investigate the veracity of the information and assess the magnitude of any errors.

Because the allegations in the SAC failed to state a claim against any of the Individual Defendants for violation of Section 10(b) of the Exchange Act and SEC

Rule 10b-5, the District Court correctly concluded that the SAC also failed to state any claim against Baxter for violation of Section 10(b) and SEC Rule 10b-5.

Finally, the District Court correctly concluded that the SAC's failure to state any primary securities fraud claim against Baxter was fatal to Steelworkers' claim against the Individual Defendants for controlling person liability under Section 20(a) of the Exchange Act.

In sum, Steelworkers' proposed amendment would have been futile. The District Court, therefore, properly exercised its discretion in granting defendants' motion for reconsideration.

ARGUMENT

I. The District Court's Decision to Grant Defendants' Motion for Reconsideration Is Reviewed for Abuse of Discretion.

Whether to grant defendants' motion for reconsideration of the September 23 Order was within the sound discretion of the District Court. The September 23 Order was an interlocutory order and "every order short of a final decree is subject to reopening at the discretion of the district judge." *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 12 (1983).

Contrary to Steelworkers' argument (Br. at 49–53), the District Court's discretion was not subject to the restrictions of Fed. R. Civ. P. 60(b). *See* Fed. R. Civ. P. 60(b), advisory committee's note (1946 amendment) ("[I]nterlocutory judgments are not brought within the restrictions of the rule, but rather they are left subject to the complete power of the court rendering them to afford such relief

from them as justice requires."); *accord Acme Printing Ink Co. v. Menard, Inc.*, 891 F. Supp. 1289, 1295 (E.D. Wis. 1995) ("In contrast to a motion to reconsider a final judgment, which must meet the requirements of Federal Rules of Civil Procedure 59 or 60, a motion to reconsider an interlocutory order may be entertained and granted as justice requires.").

As Steelworkers itself recognizes, by granting defendants' motion for reconsideration, the District Court reversed its earlier decision granting Steelworkers' Rule 59(e) motion and thereby *denied* Steelworkers' Rule 59(e) motion. (*See* Br. at 6 (characterizing the District Court's December 22 Order as a "reversal" of its September 23 Order granting Steelworkers' Rule 59(e) motion).) It is well settled that the denial of a post-judgment motion to amend under Rule 59(e) is reviewed for abuse of discretion. *See, e.g.*, *Twohy v. First Nat'l Bank of Chicago*, 758 F.2d 1185, 1196 (7th Cir. 1985) ("[T]his Court has held specifically that review of a district court's decision not to permit an amendment after entry of judgment is reviewable only under the 'abuse of discretion' standard."); *accord Figgie Int'l, Inc. v. Miller*, 966 F.2d 1178, 1179 (7th Cir. 1992) ("We review the district court's denial of [the plaintiff's] Rule 59(e) motion under an abuse of discretion standard."); *Crestview Village Apts. v. U.S. Dep't of Housing & Urban Dev.*, 383 F.3d 552, 557 (7th Cir. 2004) (same).

An abuse of discretion standard applies even where, as here, the ground for denial of leave to amend is futility of amendment. *See J.D. Marshall Int'l, Inc. v.*

Redstart, Inc., 935 F.2d 815, 819 (7th Cir. 1991) (stating that "a motion for leave to file an amended pleading is a matter purely within the sound discretion of the district court"); *accord Arazie v. Mullane*, 2 F.3d 1456, 1464 (7th Cir. 1993) ("A district court does not abuse its discretion when it denies leave to amend where repleading would be futile.").

That said, in determining whether a district court properly exercised its discretion in denying leave to amend because of futility, this Court has stated that it will review the allegations of the proposed amended complaint in light of the legal standards that would apply to a motion to dismiss. *See, e.g., J.D. Marshall*, 935 F.2d at 819 ("Though we resist any invitation to consider the merits of Marshall's claims, we briefly review the allegations of the proposed second amended complaint to demonstrate the district court's exercise of its broad discretion."); *Arazie*, 2 F.3d at 1465 (stating, in a pre-PSLRA securities fraud case, that the Court would review the denial of leave to amend "bearing in mind the standards for dismissing complaints under [Rule] 9(b)"). A review of the SAC—even under the *de novo* standard urged by Steelworkers—leaves no doubt that the allegations in the SAC did not meet the PSLRA's heightened pleading requirements.

II. The PSLRA Imposes Heightened Pleading Standards for Securities Fraud Suits.

To state a claim for securities fraud under Section 10(b) of the Exchange Act and SEC Rule 10b-5, a plaintiff must allege that the defendant "(1) made a

misstatement or omission, (2) of material fact, (3) with scienter, (4) in connection with the purchase or sale of securities, (5) upon which the plaintiff relied, and (6) that reliance proximately caused plaintiff's injuries." *In re Healthcare Compare Corp. Sec. Litig.*, 75 F.3d 276, 280 (7th Cir. 1996); *accord Makor Issues & Rights, Ltd. v. Tellabs, Inc.*, 437 F.3d 588, 595 (7th Cir. 2006).

In 1995, Congress amended the Exchange Act by passing the PSLRA, which prescribes heightened pleading standards for private securities fraud suits. The Exchange Act, as amended by Section 21D of the PSLRA, provides, in pertinent part:

> (1) Misleading statements and omissions
>
> In any private action arising under this chapter in which the plaintiff alleges that the defendant—
>
> (A) made an untrue statement of material fact; or
>
> (B) omitted to state a material fact necessary in order to make the statements made, in the light of the circumstances in which they were made, not misleading;
>
> the complaint shall specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed.
>
> (2) Required state of mind
>
> In any private action arising under this chapter in which the plaintiff may recover money damages only on proof that the defendant acted with a particular state of mind, the complaint shall, with respect to each act or omission alleged to violate this chapter, *state with*

> *particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.*

15 U.S.C. §§ 78u-4(b)(1), (2) (emphasis added). The PSLRA further provides that "the court *shall*, on the motion of any defendant, dismiss the complaint if the requirements of paragraphs (1) and (2) are not met." 15 U.S.C. § 78u-4(b)(3)(A) (emphasis added).

As this Court observed in *Makor Issues*, "the PSLRA essentially returns the class of cases it covers to a very specific version of fact pleading—one that exceeds even the particularity requirement of Federal Rule of Civil Procedure 9(b)." 437 F.3d at 594 (citing *In re Rockefeller Ctr. Props., Inc. Sec. Litig.*, 311 F.3d 198, 217 (3d Cir. 2002)). Under the PSLRA's heightened pleading standards, "plaintiffs must not only plead a violation with particularity; they must also marshal sufficient facts to convince a court at the outset that the defendants likely intended 'to deceive, manipulate, or defraud.'" *Id.* at 594–95 (quoting *Ernst & Ernst*, 425 U.S. at 194 & n.12).

The PSLRA, however, did not change the substantive scienter standard; thus, recklessness remains a sufficient basis for the imposition of civil liability under Section 10(b) and SEC Rule 10b-5. *Makor Issues*, 437 F.3d at 600. Recklessness requires a showing of "'an extreme departure from the standards of ordinary care, [ ] which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been

aware of it.'" *Id.* (quoting *Sundstrand Corp. v. Sun Chem. Corp.,* 553 F.2d 1033, 1045 (7th Cir. 1997)).

"While § 78u-4(b)(2) did not impose a more stringent substantive scienter standard, it did unequivocally raise the bar for pleading scienter." *Makor Issues*, 437 F.3d at 601. Thus, a complaint will survive dismissal under this standard only if it "alleges facts from which, if true, a reasonable person could infer that the defendant acted with the required intent." *Id.* at 602. "If a reasonable person could not draw such an inference from the alleged facts, the defendants are entitled to dismissal; the complaint would fail as a matter of law to meet the requirements of § 78u-4(b)(2)." *Id.*

In determining whether the allegations in a complaint meet the PSLRA's strong inference requirement, "the best approach is for courts to examine all of the allegations in the complaint and then to decide collectively whether they establish such an inference." *Makor Issues*, 437 F.3d at 602.

III. The District Court Correctly Concluded that the SAC's Allegations Did Not Give Rise to a Strong Inference that Mr. Parkinson Acted with Scienter.

Mr. Parkinson became CEO of Baxter on April 26, 2004. (SAC ¶17; JA7.) Steelworkers did not allege that Mr. Parkinson was employed by Baxter or had any connection with Baxter prior to April 26, 2004. Nevertheless, Steelworkers alleged that on May 10, 2004, only two weeks after Mr. Parkinson became CEO of Baxter,

he committed securities fraud when he signed the SOA certification contained in Baxter's first quarter 2004 Form 10-Q. (*Id.* ¶83; JA29.)[5]

Steelworkers contends that Mr. Parkinson's representation that he had evaluated the effectiveness of Baxter's disclosure controls was false "because there had been no implementation of Sarbanes-Oxley procedures in Baxter-Brazil." (Br. at 25.) The SOA, however, does not require a company to implement any specific "Sarbanes-Oxley procedures" at each of the company's divisions. *See* 15 U.S.C. § 7241.

Furthermore, the mere fact that a breach of internal controls occurred does not render a signing officer's SOA certification false because no system of internal controls can totally eliminate the risk of intentional fraud. *See Staff Statement on Management's Report on Internal Control Over Financial Reporting,* Office of Chief Accountant, U.S. Securities and Exchange Commission (May 16, 2005), *available at* www.sec.gov/info/accountants/stafficreporting.htm ("[D]ue to their inherent limitations, internal controls cannot prevent or detect every instance of fraud. Controls are susceptible to manipulation, especially in instances of fraud caused by the collusion of two or more people including senior management.").

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[5] Steelworkers incorrectly asserts that Mr. Parkinson signed both the first quarter 2004 Form 10-Q and the SOA certification contained therein. (Br. at 25.) In fact, Mr. Parkinson signed only the SOA certification, as Steelworkers alleged in the SAC. (SAC ¶83; JA29.) Baxter's first quarter 2004 Form 10-Q is available at www.sec.gov.

Here, the accounting errors that led to the restatement were the result of "intentional overrides by senior management in Brazil of internal controls." (SAC ¶35; JA11.) Steelworkers did not allege that Mr. Parkinson (or any other member of Baxter's U.S. management) played any role in the improper accounting practices in Brazil. Rather, Steelworkers alleged that the accounting for Baxter's Brazilian operations was performed by "Baxter employees in Brazil" under the direction of Brazilian Finance Director Robert Vlasak (*id.* ¶38; JA12), and that the fictitious sales that were "the primary reason for the Restatement" were booked by Mr. Vlasak and other Brazilian employees. (*Id.* ¶43; JA13.)

The question, then, in evaluating whether the allegations in the SAC were sufficient to state a claim for securities fraud against Mr. Parkinson, is whether the SAC's allegations gave rise to a strong inference that Mr. Parkinson either knew of or recklessly disregarded the Brazilian accounting errors when he signed the SOA certification contained in Baxter's first quarter 2004 Form 10-Q on May 10, 2004. As the District Court correctly concluded, the SAC's allegations failed to give rise to the necessary strong inference of scienter on the part of Mr. Parkinson.

A. The Excerpts from Baxter's July 22, 2004, Conference Call Quoted in the SAC Did Not Support Any Inference that Mr. Parkinson Knew of the Brazilian Accounting Errors Before He Signed the SOA Certification.

Steelworkers asserts that Mr. Parkinson admitted in a July 22, 2004, conference call with analysts that he knew of the Brazilian accounting problems

by May 4, 2004, and discussed them at a meeting of the Board that day. (Br. at 25–26.) The allegations of fact in the SAC refute that assertion.

By juxtaposing two unrelated excerpts from the transcript of Baxter's July 22 conference call and emphasizing these excerpts with bold type and underlining, Steelworkers misleadingly *insinuated* that Mr. Parkinson knew of the Brazilian accounting problems when he signed the SOA certification on May 10, 2004. (SAC ¶81; JA28.) In the first excerpt, Mr. Parkinson, when asked how Baxter management had learned of the accounting problems in Brazil, responded: **"We became aware of a call or an e-mail or letter—I can't recall which it was—from an employee in Brazilian operations some time in the May time frame."** (SAC ¶ 81; JA28.) In the second excerpt, Mr. Parkinson, when asked about Baxter's dividend policy, responded: "[W]e meet once a year with the Board, Dave, to talk about this. **We talked about it as recently as this spring, in the May Board meeting.** The position of the Company at this point is no change in our dividend policy." (*Id.*) Baxter's May Board meeting took place on May 4, 2004. (*Id.* ¶80; JA27–JA28.)

In granting Steelworkers' Rule 59(e) motion, the District Court misconstrued the above allegations as stating that the Baxter Board had discussed the *Brazilian accounting problems* at the May 4 meeting. In its September 23 Order, the District Court wrote:

> During that [July 22] conference call, Parkinson revealed that "we" had become aware of the problem with Brazilian operations in "the

> May time frame" and had discussed it with the Board at the spring Board meeting, which was on May 4, 2004. Thus, Parkinson would have been aware of the problem prior to his May 10, 2004 certification of the 2004 first quarter Form 10-Q.

(A12.)

In their motion for reconsideration, defendants pointed out that the "it" that Mr. Parkinson stated was discussed at the May 4 Board meeting was Baxter's *dividend policy*—not the accounting problems in Brazil. Although this was apparent on the face of the SAC, defendants attached the full transcript of the conference call to their memorandum in support of their motion for reconsideration to show that at no point during the call did Mr. Parkinson state that the Board knew of the Brazilian accounting errors by the time of the May 4 Board meeting or discussed those errors at the May 4 meeting. (JA54–JA74.) The transcript of the July 22 call made clear that Mr. Parkinson was not alluding to Brazil when he referred to the Board's discussion of Baxter's dividend policy. (JA65.)

Defendants also pointed out that Mr. Parkinson's statement that Baxter learned of the problems in Brazil "some time in the May time frame" did not support the conclusion that the Board learned of the errors *prior to May 10*, since the "May time frame" also encompassed May 11 through May 31 (and perhaps beyond). Indeed, Steelworkers itself alleged elsewhere in the SAC that Mr. Parkinson 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 [on May 10,

2004] *or at some point in time within three weeks of the filing date*." (SAC ¶85 (emphasis added); JA33.)

Upon reconsideration, the District Court held:

> The [SAC] . . . contains an allegation that Parkinson made a statement supporting that he was aware of the Brazilian operations improprieties in early May, before the Form 10-Q was issued. The alleged statement, however, was part of a public interview which defendants have provided and of which this court may properly take judicial notice. The transcript of the public interview does not support the allegation of the [SAC] . . . . The inference to be drawn from this statement was central to the prior holding that the [SAC] adequately alleged Parkinson's scienter. The Count I claim against Parkinson will be dismissed in its entirety.

(A15.)

The District Court acted well within its discretion in granting defendants' motion for reconsideration and dismissing the securities fraud claim against Mr. Parkinson. "A motion for reconsideration performs a valuable function where 'the Court has patently misunderstood a party, or has made a decision outside the adversarial issues presented to the Court by the parties, *or has made an error not of reasoning but of apprehension.*'" *Bank of Waunakee v. Rochester Cheese Sales, Inc.*, 906 F.2d 1185, 1191 (7th Cir. 1990) (emphasis added, citation omitted).

On appeal, Steelworkers argues that the District Court erred by failing to accept as true its allegation of "fact" that the Baxter Board discussed the Brazilian accounting problems at its May 4 meeting. (Br. at 26.) Steelworkers, however, did *not* allege affirmatively in the SAC that the Baxter Board discussed the Brazilian accounting problems at this meeting. Rather, Steelworkers asked the District

Court to draw this *inference* based on Steelworkers' selective quotations from the transcript of the July 22 conference call. Steelworkers contends that such an inference is reasonable because the Baxter Board discussed Baxter's cash flow during the May 4 Board meeting and the Brazilian accounting problems "necessarily affected corporate cash flow." (*Id.* at 26.) Steelworkers' contention is a *non sequitur*. Steelworkers does not explain how improper recognition of revenues and the failure to reserve adequately for bad debts in Brazil would have had any effect on cash flow. And even if the Brazilian accounting errors did affect cash flow, this would not support a conclusion that Mr. Parkinson and the other members of the Baxter Board knew of those errors by May 4 and discussed them at the May 4 Board meeting.

Furthermore, the District Court was not required to draw "all possible inferences" in Steelworkers' favor. (*Id.* at 20 (quoting *Lee v. City of Chi.*, 330 F.3d 456, 459 (7th Cir. 2003)).) *Lee* was a civil rights case that did not involve application of the PSLRA's heightened pleading standards. In *Makor Issues*, this Court made clear that the PSLRA's pleading standard is *not* the same as the pleading standard that applies to "a run-of-the-mill complaint, which will survive a motion to dismiss for failure to state a claim so long as it is 'possible to hypothesize a set of facts, consistent with the complaint, that would entitle the plaintiff to relief.'" 437 F.3d at 594 (citation omitted).

Under the PSLRA, a plaintiff may not rely upon "vague or unspecific allegations—inferences that may arguably have been justified under a traditional Rule 12(b)(6) analysis." *Rockefeller Ctr. Props.*, 311 F.3d at 224; *see also, e.g.*, *Greebel*, 194 F.3d at 195–96 ("[I]nferences of scienter do not survive if they are merely reasonable, as is true when pleadings for other causes of action are tested by motion to dismiss under Rule 12(b)(6)."). Rather, to survive a motion to dismiss under the PSLRA, a plaintiff must plead facts that support inferences that "are both reasonable and 'strong.'" *Id.* at 196.

In re Cabletron Systems, Inc., 311 F.3d 11 (1st Cir. 2002), and *Pirraglia v. Novell, Inc.*, 339 F.3d 1182 (10th Cir. 2003), which Steelworkers cites in support of its argument that the PSLRA did *not* change standard for dismissal under Fed. R. Civ. P. 12(b)(6) (Br. at 20), in fact expressly acknowledge that the PSLRA *did* change the Rule 12(b)(6) standard for securities fraud cases. *See Cabletron*, 311 F.3d at 28 (the PSLRA "alters the usual contours of a Rule 12(b)(6) ruling because, while a court continues to give all reasonable inferences to plaintiffs, those inferences supporting scienter must be strong ones"); *Pirraglia*, 339 F.3d at 1187 ("[T]he 12(b)(6) standard has been modified by that statute [the PSLRA].").

Because no reasonable person could conclude, based on Mr. Parkinson's comments during the July 22, 2004, conference call, that Mr. Parkinson knew of the Brazilian accounting errors by May 4, the SAC did not support a strong

inference that Mr. Parkinson acted with scienter when he signed the SOA certification on May 10, 2004.

B. The "Additional Factual Allegations" in the SAC Also Failed to Support Any Inference that Mr. Parkinson Knew of or Recklessly Disregarded the Brazilian Accounting Errors When He Signed the SOA Certification.

Steelworkers further contends that the District Court ignored five "additional factual allegations" in the SAC that supported a strong inference that Mr. Parkinson acted with scienter. (Br. at 27–31.) These "additional factual allegations" fall into two broad categories: (1) allegations attributed to confidential witnesses and (2) allegations that Mr. Parkinson "must have known" about the problems in Brazil because of his high-level position with Baxter. (*Id.* at 24–25, 27–31.)

Allegations Attributed to Confidential Witnesses. With respect to Mr. Parkinson's purported scienter, Steelworkers relies on the following allegations attributed to Confidential Witness 1 ("CW1"), Confidential Witness 4 ("CW4"), and Confidential Witness 5 ("CW5") (*id.* at 27–29):

1. According to CW1, whom Steelworkers identified only as "a former Baxter executive employed throughout the Class Period and knowledgeable regarding the Brazilian situation which prompted Baxter to restate" (SAC ¶38; JA12), the financial results for Baxter's Brazilian operations were entered into Brazil's "stand-alone local ledger system," in Brazilian currency, and "then

forwarded to Baxter management in Deerfield, on a monthly basis." (*Id.* ¶39; JA12.)

2. According to CW4, "who was retained by Baxter as a consultant on the issue of financial controls . . . , all Brazilian transactions were entered into the J.D. Edwards software system, which enabled senior management in Deerfield to see the transactions on a 'real-time' basis." (*Id.* ¶40; JA12–JA13.)

3. Also, according to CW4, "the problems with Baxter's Brazilian operations were discovered around the end of the first quarter of 2004." (*Id.* ¶59; JA17.)

4. And, according to CW5, "who had been responsible for training Baxter's financial executives, 'some of the Brazilian Baxter employees had discovered the problem **at the end of the first quarter of 2004, and brought it to the attention of Baxter Management.'"** (*Id.* ¶73 (emphasis in original); JA25.)

The allegations attributed to CW1, CW4, and CW5 are insufficient to support any inference of scienter on the part of Mr. Parkinson. In *Makor Issues*, this Court held that while plaintiffs need not name their confidential witnesses in a complaint, "[t]hey must, however, describe their sources with sufficient particularity 'to support the probability that a person in the position occupied by the source would possess the information alleged' or in the alternative provide other evidence to support their allegations." 437 F.3d at 596 (quoting *Novak v. Kasaks*, 216 F.3d 300, 314 (2d Cir. 2000)).

The SAC was devoid of any details about how or when CW1, CW4, and CW5 acquired the information attributed to them. In the absence of such details, the reader of the SAC was "left to speculate whether the anonymous sources obtained the information they purport to possess by firsthand knowledge or rumor." *Cal. Pub. Employees' Ret. Sys. v. Chubb Corp.*, 394 F.3d 126, 148 (3d Cir. 2004); *see also, e.g.*, *City of Austin Police Ret. Sys. v. ITT Educ. Servs., Inc.*, 388 F. Supp. 2d 932, 943 (S.D. Ind. 2005) ("The lack of allegations regarding how or why such employees would have access to the information they purport to possess is problematic because there is no way to tell if they are relaying information received first, second, or even third hand.") (finding allegations insufficient where confidential witnesses were identified only "by their job titles in the sparest terms"); *accord Davis v. SPSS, Inc.*, 431 F. Supp. 2d 823, 828 (N.D. Ill. 2006).

Steelworkers' assertion that its confidential witnesses "corroborate each other" (Br. at 24) does nothing to rectify Steelworkers' insufficient pleading. "[V]ague assertions by one confidential witness corroborated by vague assertions by another are still insufficient to establish scienter." *Davis*, 431 F. Supp. 2d at 831.

Furthermore, the unremarkable fact that Brazilian sales were entered into the local general ledger in Brazil and then forwarded to senior management at Baxter headquarters in Deerfield in no way supports a conclusion that Mr. Parkinson (or any other member of Baxter's senior management) knew or had any

reason to suspect that some of the reported sales were *fictitious*. And if CW5 in fact knew that Brazilian accounting problems were reported to "Baxter Management" at the end of the first quarter of 2004, he presumably would know to whom they were reported. Yet Steelworkers did not allege that the Brazilian accounting problems were reported to Mr. Parkinson (or to any other specific member of "Baxter Management") at the end of the first quarter of 2004. *See In re Alpharma Inc. Sec. Litig.*, 372 F.3d 137, 150–51 (3d Cir. 2004) (allegation that unidentified employees at company headquarters were alerted to accounting irregularities at Brazil division insufficient to give rise to a strong inference of scienter on the part of the individual defendants).

Allegations Regarding Mr. Parkinson's Executive Position. Steelworkers cites the Second Circuit's decision in *Stevelman v. Alias Research, Inc.*, 174 F.3d 79, 84–85 (2d Cir. 1999), for the proposition that "courts have repeatedly held that CEO's and CFO's positions and continuous, intimate knowledge of corporate information during the period of the restatements support a strong inference of scienter." (Br. at 25.) *Stevelman* does not support that proposition.

In *Stevelman*, the Second Circuit *rejected* the argument that the mere fact that a company restates its earnings is probative of scienter. 174 F.3d at 84. The Second Circuit then cited with a "*but cf.*" signal its earlier, pre-PSLRA decision in *Sirota v. Solitron Devices, Inc.*, 673 F.2d 566, 573 (2d Cir. 1982), in which it held that "[t]he jury could properly infer intent from subsequent admissions of

misrepresentations, coupled with the defendants' continuous intimate knowledge of company affairs." *Stevelman*, 174 F.3d at 84–85.

Even before the enactment of the PSLRA, it was well settled that allegations that a defendant "must have had" knowledge simply because of his high-level corporate position did not suffice to plead scienter. *See, e.g., In re Advanta Corp. Sec. Litig.,* 180 F.3d 525, 539 (3d Cir. 1999) (citing pre-PSLRA cases from various circuits and affirming dismissal of post-PSLRA case in which plaintiffs made "blanket statements that defendants must have been aware of the impending losses by virtue of their positions within the company"); *accord PR Diamonds*, *Inc. v. Chandler*, 364 F.3d 671, 688 (6th Cir. 2004) ("Contrary to Plaintiffs' assertions, fraudulent intent cannot be inferred merely from the Individual Defendants' positions in the Company and alleged access to information."); *Chu v. Sabratek Corp.*, 100 F. Supp. 2d 827, 837 (N.D. Ill. 2000) ("Under the plain language of the [PSLRA], pleading scienter based exclusively on a defendant's corporate position is insufficient to survive a motion to dismiss.").

Citing paragraph 103 of the SAC, Steelworkers asserts that "[t]he SAC alleges that Parkinson had access to data regarding Baxter-Brazil, . . . data that would have shown a pattern of disproportionately increasing sales and fictitious customers raising red flags." (Br. at 28.) In fact, paragraph 103 of the SAC contains no such allegation. It states in its entirety:

> During the Class Period, each of the Individual Defendants, as senior executive officers of Baxter, were privy to non-public information concerning its inadequate internal controls, its failure to implement Sarbanes-Oxley compliance procedures in Latin America, its business, finances, products, markets and present and future business prospects via access to internal corporate documents specifically including the Brazilian segment's "real time" and monthly financial reporting, conversations and connections with other corporate officers and employees, attendance at management and Board of Directors meetings and committees thereof and via reports and other information provided to them in connection therewith. Because of their possession of such information, the Individual Defendants knew or recklessly disregarded the fact that adverse facts specified herein had not been disclosed to, and were being concealed from, the investing public.

(SAC ¶103; JA38–JA39.)

Steelworkers also points to its allegation in paragraph 48 of the SAC that, on April 29, 2004, the Brazilian Ministry of Justice accused Baxter of being part of a cartel that rigged the bidding for blood products administered by the Brazilian Department of Health. (Br. at 29.) Steelworkers contends that, because this accusation was made after Mr. Parkinson became CEO of Baxter, Mr. Parkinson "knew or recklessly disregarded that Baxter-Brazil's sales and revenues were inflated." (*Id.*) Steelworkers' assertion is yet another *non sequitur*. As is apparent from the allegations in the SAC, the alleged bid rigging (as well as the alleged improper payment of vendor rebates (SAC ¶55–57; JA16)) had nothing to do with the restatement. Contrary to Steelworkers' assertion (Br. at 8–9), Baxter's July 22, 2004, press release did not even mention the alleged bid rigging or improper rebates, let alone attribute the need to restate to these practices. (JA75–JA77.)

Thus, the SAC did *not* allege any "red flags" that should have alerted Mr. Parkinson or the other Individual Defendants to the Brazilian accounting errors.

Baxter's Brazilian operations, moreover, accounted for only a *minute fraction* of Baxter's annual sales—$100 million of Baxter's total sales for 2003 of $8.9 billion (approximately 1.1 percent of Baxter's total sales). (SAC ¶6; JA3 & SA69.) The magnitude of the restatement was equally small, representing only a 0.2 percent decrease in Baxter's reported sales for 2001 through 2003, a 1.5 percent decrease in reported net income for that period, a zero percent effect on reported sales for the first quarter of 2004, and a 1.1 percent decrease in reported net income for that quarter. (*Id.*) Given the absence of any "red flags," the relative insignificance of the Brazilian operations to Baxter as a whole, and the *de minimis* effect of the Brazilian accounting errors on Baxter's overall results, there simply is no basis to conclude that Mr. Parkinson's action in signing the SOA certification contained in Baxter's first quarter 2004 Form 10-Q represented an extreme departure from the standards of ordinary care.

Numerous courts have found that averments analogous to those in the SAC failed to support a strong inference of scienter. *See, e.g., Alpharma*, 372 F.3d at 151 (3d Cir. 2004) (noting that Brazil division's revenues accounted for only slightly more than one-half of one percent of company's total revenues and affirming dismissal because "the Complaint is devoid of any allegations which would establish that AHD's Brazil division was so central to Alpharma's business

that its increased revenue figures should have received particular attention from company executives"); *In re Comshare Inc. Sec. Litig.*, 183 F.3d 542, 554 (6th Cir. 1999) (affirming dismissal where plaintiffs "failed to plead facts that show that the revenue recognition errors at Comshare's UK subsidiary should have been obvious to Comshare or that Comshare consciously disregarded 'red flags' that would have revealed the errors prior to their inclusion in public statements"); *PR Diamonds*, 364 F.3d at 684–86 ($1.3 million restatement for a company with over $280 million in revenues did not support a strong inference of scienter: "It simply cannot be said that Intrenet's accounting improprieties, by virtue of their type and size, 'should have been obvious' to the Individual Defendants. These are not 'in your face facts' that 'cry out' scienter." (citation omitted)); *Stavros v. Exelon Corp.*, 266 F. Supp. 2d 833, 851 (N.D. Ill. 2003) ("relatively insignificant error" that caused net income to be inflated by less than 3 percent "does not raise a strong inference of scienter"); *contrast Makor Issues*, 437 F.3d at 603 (allegation that CEO's misstatements concerned company's best-selling product supported inference of scienter).

Thus, contrary to Steelworkers' contention, the "additional factual allegations" in the SAC also failed to offer any basis on which a reasonable person could conclude that Mr. Parkinson acted with scienter.

IV. The District Court Correctly Concluded that the SAC's Allegations Did Not Give Rise to a Strong Inference that Mr. Anderson Acted with Scienter.

Steelworkers alleged that Mr. Anderson committed securities fraud by signing Baxter's 2003 Form 10-K and the SOA certification contained therein on March 12, 2004, and by signing Baxter's first quarter 2004 10-Q and the SOA certification contained therein on May 10, 2004. (SAC ¶¶60, 62, 83; JA17–20, JA29–33.) Steelworkers also alleged that Mr. Anderson's statement on April 22, 2004, that Baxter's first quarter results were in line with expectations and previous guidance from Baxter, was false and misleading because Baxter's first quarter financial results subsequently were restated. (SAC ¶¶75–77; JA26.)

As in the case of Mr. Parkinson, Steelworkers argues that it adequately alleged Mr. Anderson's scienter based on (1) the allegations attributed to CW1 and CW4 that the Brazilian sales were entered into the local general ledger in Brazil and then forwarded to senior management at Baxter headquarters; (2) the allegation attributed to CW5 that the Brazilian accounting problems were brought to the attention of "Baxter Management" at the end of the first quarter of 2004; (3) the fact that the Brazilian Ministry of Justice accused Baxter of being part of a bid-rigging cartel on April 29, 2004; and (4) Mr. Anderson's high-level position with Baxter. (Br. at 31–33.) Appellees discussed the insufficiency of these allegations in Section III above with respect to Mr. Parkinson. The same analysis applies here.

Additionally, Steelworkers relies on the allegation in paragraph 46 of the SAC that the fictitious contracts in Brazil "were brought to the attention of defendant Greisch on a regular basis, and to defendant Anderson no later than May 2004, according to CW1." (Br. at 33.) Even if Steelworkers had alleged any facts about how CW1 supposedly learned this information, this allegation would not support a strong inference that Mr. Anderson knew of the Brazilian accounting errors by either March 12, 2004, or May 10, 2004. Indeed, Steelworkers alleged in paragraph 85 of the SAC that Mr. 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*." (SAC ¶85 (emphasis added); JA33.) Thus, Steelworkers' own allegations acknowledged that Mr. Anderson might not have learned of the Brazilian accounting errors until *after* he had signed the 2003 Form 10-K and first quarter 2004 Form 10-Q.

The only *fact* alleged by Steelworkers in support of its contention that Mr. Anderson acted with scienter was that Mr. Anderson sold 44,902 shares of his Baxter common stock on April 26, 2004, for proceeds of $1,458,865.98. (*Id.* ¶78; JA27.) However, as the Third Circuit observed in *In re Burlington Coat Factory Securities Litigation*, 114 F.3d 1410, 1424 (3d Cir. 1997), "[a] large number of today's corporate executives are compensated in terms of stock and stock options. It follows then that these individuals will trade those securities in the normal

course of events." Courts, therefore, "will not infer fraudulent intent from the mere fact that some officers sold stock." *Id.* (citation omitted); *accord Shaw v. Digital Equip. Corp.*, 82 F.3d 1194, 1224 (1st Cir. 1996) ("[T]he mere fact that insider stock sales occurred does not suffice to establish scienter.").

"Instead, plaintiffs must allege that the trades were made at times and in quantities that were suspicious enough to support the necessary strong inference of scienter." *Burlington Coat Factory*, 114 F.3d at 1424; *see also, e.g.*, *In re Vantive Corp. Sec. Litig.*, 283 F.3d 1079, 1092 (9th Cir. 2002) ("Insider stock sales are not inherently suspicious; they become so only when the level of trading is 'dramatically out of line with prior trading practices at times calculated to maximize the personal benefit from undisclosed public information.'" (quoting *Ronconi v. Larkin*, 253 F.3d 423, 435 (9th Cir. 2001))).

Mr. Anderson's stock sale was not suspicious in timing or amount. Although Steelworkers represents in its brief that Mr. Anderson decided to sell his stock "around the same time Plaintiffs have alleged he learned of the Brazil fraud" (Br. at 34), the allegations in the SAC contradict that assertion. On March 9, 2004, Mr. Anderson filed with the SEC a Form 144, publicly disclosing his intention to sell 44,902 shares of his Baxter stock. (SAC ¶33; JA11.) Obviously, March 9 was well before "the end of the first quarter of 2004," which was when, according to CW5, an unidentified member or members of "Baxter Management" became aware of the Brazilian accounting problems. (SAC ¶73; JA25.) Steelworkers' assertion in

paragraph 73 of the SAC that, "[i]n this regard, March 9, 2004 may be considered as 'the end of the first quarter of 2004,'" is nonsensical. Steelworkers, moreover, expressly acknowledged in paragraph 85 of the SAC that Mr. Anderson might not have learned of the Brazilian accounting errors until late May—*after* his stock sale on April 26, 2004. (SAC ¶85; JA33.) The allegations in the SAC, therefore, failed to support a strong inference that Mr. Anderson knew or had any reason to know of the Brazilian accounting errors when he sold some of his Baxter stock on April 26, 2004. *See Makor Issues*, 437 F.3d at 604 (no strong inference of scienter where company's chairman and former CEO sold 80,000 shares of stock in the first week of February 2001 but declining sales of company's major product did not become obvious until March 2001).

Furthermore, Mr. Anderson sold his stock four days after Baxter announced its first quarter results, which were in line with expectations. (*Id.* ¶¶ 75, 78; JA26, JA27.) The Form 4, "Statement of Changes in Beneficial Ownership," that Mr. Anderson filed with the SEC to report the sale disclosed that Mr. Anderson exercised options that were set to expire on June 15, 2004, and then sold the acquired shares. (SA71–SA73.) Rather than giving rise to any inference that Mr. Anderson acted with scienter, the fact that Mr. Anderson waited until after the first-quarter earnings release to exercise options that were set to expire before Baxter's next earnings release suggests compliance with, rather than a violation of, the securities laws.

The District Court, therefore, correctly concluded that Mr. Anderson's stock sale "does not turn otherwise weak inferences of scienter into the strong inference of scienter required under the PSLRA." (A16.)

V. The District Court Correctly Concluded that the SAC Failed to Allege that Mr. Greisch or Mr. del Salto Made, or Participated in Making, Any of the Alleged Misstatements of Material Fact.

Steelworkers did not allege that Mr. Greisch or Mr. del Salto signed, prepared, or had any role in the preparation of Baxter's 2003 Form 10-K or first quarter 2004 Form 10-Q. Nor did Steelworkers allege that Messrs. Greisch or del Salto made any other affirmative misstatements of material fact during the putative class period. In dismissing the securities fraud claims alleged against Mr. Greisch in the CAC (Mr. del Salto was not named as a defendant in the CAC), the District Court cited the Fifth Circuit's decision in *Southland Securities Corp. v. INSpire Insurance Solutions, Inc.*, 365 F.3d 353 (5th Cir. 2004), as support for its conclusion that "[t]he claims against Greisch cannot be sustained unless it is specifically alleged that he was responsible for the misrepresentations that have been specifically alleged." (A5.)

In *Southland Securities*, the Fifth Circuit held that the so-called group pleading doctrine "cannot withstand the PSLRA's specific requirement that the untrue statements or omissions be set forth with particularity as to 'the defendant' and that scienter be pleaded with regard to 'each act or omission' sufficient to give 'rise to a strong inference that the defendant acted with the required state of

mind.'" 365 F.3d at 364 (quoting 15 U.S.C. § 78u-4(b)). The Fifth Circuit reasoned that "[t]hese PSLRA references to 'the defendant' may only reasonably be understood to mean 'each defendant' in multiple defendant cases, as it is inconceivable that Congress intended liability of any defendants to depend on whether they were all sued in a single action or were each sued alone in several separate actions." *Id.* at 364–65; *accord Phillips v. Scientific-Atlanta, Inc.*, 374 F.3d 1015, 1018 (11th Cir. 2004). Finding the reasoning of *Southland Securities* and *Phillips* persuasive, this Court stated in *Makor Issues* that, "[w]hile we will aggregate the allegations in the complaint to determine whether it creates a strong inference of scienter, plaintiffs must create this inference with respect to *each individual defendant* in multiple defendant cases." 437 F.3d at 603 (emphasis added).

Steelworkers acknowledges that *Makor Issues* requires it to plead scienter with respect to each of the Individual Defendants. (Br. at 42 n.14.) Steelworkers argues, however, that it still may avail itself of the group pleading doctrine's presumption that statements in company documents are the collective work of the company's officers and directors. (*Id.* at 41–43.) Steelworkers' argument ignores the plain language of the PSLRA.

The PSLRA requires, in any private action in which "the plaintiff alleges that *the defendant* misstated or omitted to state material facts," that the complaint "specify each statement alleged to have been misleading." 15 U.S.C. § 78u-4(b)(1)

(emphasis added). In light of the PSLRA's language, the Fifth Circuit in *Southland Securities* concluded that "corporate officers may not be held responsible for unattributed corporate statements solely on the basis of their titles, even if their general level of day-to-day involvement in the corporation's affairs is pleaded." 365 F.3d at 365. The Fifth Circuit, therefore, held that the allegation that each of the individual defendants in *Southland Securities* "controlled the contents of and participated in writing INSpire's SEC filings, reports and releases" was insufficient to meet the PSLRA's pleading requirements. *Id.*

Steelworkers did not allege any facts tying Mr. Greisch or Mr. del Salto to the alleged misstatements in Baxter's 2003 Form 10-K and first quarter 2004 Form 10-Q. Accordingly, with respect to Messrs. Greisch and del Salto, Steelworkers failed to allege the first element of a securities fraud claim, *i.e.*, that these defendants misstated material facts or omitted to state material facts necessary to make any statements made not misleading. *See Healthcare Compare*, 75 F.3d at 280.

In a tacit recognition of this pleading deficiency, Steelworkers argues that Mr. Greisch and Mr. del Salto can be held liable under subsections (a) and (c) of SEC Rule 10b-5. Section 10(b) of the Exchange Act makes it unlawful "to use or employ, in connection with the purchase or sale of any security . . . *any manipulative or deceptive device or contrivance*." 15 U.S.C. § 78j(b) (emphasis

added). SEC Rule 10b-5 implements Section 10(b) by making it unlawful for any person, in connection with the purchase or sale of a security:

> (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.

In *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 476 (1977), the United States Supreme Court explained that "'[m]anipulation' is 'virtually a term of art when used in connection with securities markets.' The term refers generally to practices, such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity." (quoting *Ernst & Ernst*, 425 U.S. at 199). Steelworkers did not allege that Messrs. Greisch or del Salto engaged in any such activities.

Indeed, Steelworkers argues only that it alleged that Messrs. Greisch and del Salto "participated" in the purported fraud by "making false and misleading statements and by failing to correct false statements made by Defendants." (Br. at 45.) Steelworkers, however, did *not* allege any false statements by Messrs. Greisch or del Salto. And, to the extent that Steelworkers is suggesting that

Messrs. Greisch and del Salto can be held liable under an aiding and abetting theory, that suggestion conflicts with the Supreme Court's holding in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 191 (1994), that "a private plaintiff may not maintain an aiding and abetting suit under § 10(b)."

Finally, even if Steelworkers had alleged that Mr. Greisch or Mr. del Salto misstated material facts or engaged in manipulative acts, it did not allege any facts that would support a strong inference that either individual acted with scienter. Other than alleging Mr. Greisch's corporate position, Steelworkers averred only that Mr. Greisch "had oversight responsibilities for Brazil" (SAC ¶100; JA38) and that, according to CW1, the fictitious Brazilian contracts "were brought to the attention of defendant Greisch on a regular basis." (*Id.* ¶46; JA13.) These vague allegations are insufficient to plead scienter, as the District Court correctly concluded in addressing the identical allegations in the CAC. (A5.)

As for Mr. del Salto, other than pleading his corporate position, Steelworkers alleged only that he sold 140,000 shares of Baxter stock on April 29, 2004, and received proceeds of $4,444,890. (SAC ¶79; JA27.) As in the case of Mr. Anderson, there was nothing suspicious about Mr. del Salto's stock sale, which occurred a week after Baxter announced its first-quarter earnings and almost three months before the announcement of the restatement.

VI. The Securities Laws Did Not Require the Individual Defendants to Make an Immediate Public Disclosure upon Receiving a Report of Possible Accounting Problems at Baxter's Brazilian Operations.

Steelworkers argues that the District Court erred in dismissing its claim that the Individual Defendants committed securities fraud by failing to disclose the Brazilian accounting problems during the period from the date on which they first learned of those problems through July 22, 2004, the date on which Baxter announced that it would restate. (Br. at 38–40.) Steelworkers' argument is baseless.

Steelworkers' assertion that the Individual Defendants knew of the Brazilian accounting problems prior to the filing of March 12, 2004, is wholly unsupported by any allegations of fact in the SAC, as appellees demonstrated above. The only well-pleaded fact in the SAC about when Baxter management learned of the Brazilian accounting problems is Mr. Parkinson's disclosure during the July 22, 2004, conference call that management had received a communication from a Brazilian employee about accounting problems "some time in the May time frame." (SAC ¶ 81; JA28.)

The federal securities laws did not impose any duty on the Individual Defendants to disclose the possible accounting errors in Brazil *immediately* upon receiving a report of such errors from an employee in Brazil. In *Stransky v. Cummins Engine Co.*, 51 F.3d 1329, 1331–32 (7th Cir. 1995), this Court explained that a "duty to correct" arises "when a company makes a historical statement that,

at the time made, the company believed to be true, but as revealed by subsequently discovered information was not." In that circumstance, "[t]he company then must correct the prior statement *within a reasonable time*." *Id.* (emphasis added); *accord Burlington Coat Factory*, 114 F.3d at 1430–31 (quoting *Stransky*).

The securities laws afford a company a reasonable time to correct prior statements because "[c]orporate officers . . . have the obligation to be certain the recently discovered adverse facts are accurate before making a corrective disclosure." *In re MobileMedia Sec. Litig.*, 28 F. Supp. 2d 901, 937 (D.N.J. 1998); *see also, e.g.*, *Fin. Indus. Fund, Inc. v. McDonnell Douglas Corp.*, 474 F.2d 514, 519 (10th Cir. 1973) (before a duty to disclose arises, information must be "available and ripe for publication": "To be ripe under this requirement, the contents must be verified sufficiently to permit the officers and directors to have full confidence in their accuracy."); *In re Glenayre Techs., Inc. Sec. Litig.*, 982 F. Supp. 294, 297 (S.D.N.Y. 1997) ("[D]efendants had a right to ensure that any announcement regarding the possible impact of the [adverse event] be accurate and the timing of such an announcement is a matter of business judgment."), *aff'd*, 201 F.3d 431 (2d Cir. 1999); *cf. Healthcare Compare*, 75 F.3d at 282 (duty to correct prior projections did not accrue upon February 24 receipt of internal memorandum with revised projections unless information in memorandum was "certain and reliable, not merely a tentative estimate"); *Panter v. Marshall Field & Co.*, 646 F.2d

271, 292 (7th Cir. 1981) ("[P]rojections, estimates, and other information must be reasonably certain before management may release them to the public.").

Steelworkers did not allege any facts showing that two months was an unreasonable period for Baxter's management and Audit Committee to investigate the information provided by the Brazilian employee, ascertain whether the accounting improprieties in fact had occurred in Brazil or elsewhere in Latin America, and determine the magnitude of any accounting errors and their effect on Baxter's prior-period financial statements.

In its July 22 press release announcing the restatement, Baxter described in detail the steps it took, with the assistance of external legal counsel and accountants, to investigate the information it received in May from the Brazilian employee about possible accounting improprieties. (JA76.) Steelworkers did not allege that any of the statements in Baxter's press release was false. Nor did Steelworkers allege as false Mr. Parkinson's statement during the July 22 conference call that "it was, frankly, only in the recent week or two we began to get our arms around the magnitude of this issue." (JA63.)

Furthermore, had Baxter rushed to inform the market of the possible accounting problems in Brazil and then later determined that the information from the Brazilian employee was inaccurate, Baxter likely would have been sued by investors who sold on the revelation of the inaccurate and premature "bad news." The securities laws imposed no duty on Baxter to disclose such indefinite

information. *See Fin. Indus. Fund, Inc.*, 474 F.2d at 519 ("As to the verification of data aspect, the hazards which arise from an erroneous statement are apparent.")

Notably, Steelworkers did not allege any motive for the Individual Defendants to delay informing the market about the Brazilian accounting errors once they ascertained the existence and magnitude of the errors. Steelworkers did not allege that any of the Individual Defendants or any other Baxter insiders sold any Baxter stock during the period from notification of the possible problems in May to the announcement of the restatement on July 22, 2004.

Thus, Steelworkers failed to allege that the Individual Defendants had a duty to disclose the Brazilian accounting problems prior to July 22, 2004, or that they acted with scienter in not making disclosure prior to that date.

VII. The District Court Correctly Concluded that the Allegations in the SAC Failed to State Any Claim for Securities Fraud Against Baxter.

Steelworkers argues that Baxter can be held liable for securities fraud based on the collective scienter of all of its employees. (Br. at 46–48.) Under Steelworkers' theory, a corporation could be held liable for securities fraud based on unauthorized accounting manipulations by any employee, even if the employee was not an officer or director and had no responsibility for the issuance of the corporation's financial statements or other disclosures to the investing public, and whether or not any member of the corporation's senior management knew of, or recklessly disregarded, the accounting manipulations. Not surprisingly, the case

law does not support this expansive theory of corporate liability under the federal securities laws.

In *Southland Securities*, the Fifth Circuit addressed the scope of corporate liability under Section 10(b) and SEC Rule 10b-5. After surveying the case law and other authorities, the Fifth Circuit concluded:

> For purposes of determining whether a statement made by the corporation was made by it with the requisite Rule 10(b) scienter we believe it appropriate to look to the state of mind of the *individual corporate official or officials who make or issue the statement* (or order or approve it or its making or issuance, or who furnish information or language for inclusion therein, or the like) rather than generally to the collective knowledge of all the corporation's officers and employees acquired in the course of their employment.

365 F.3d at 366 (citing cases and other authorities).[6]

As demonstrated above, the allegations in the SAC were insufficient to give rise to a strong inference that any of the four Individual Defendants acted with scienter. And Steelworkers did not identify any other senior officers whom it claimed misrepresented or omitted to state any material facts with scienter.

Steelworkers argues that "[o]ther Baxter directors and officers with knowledge can only be identified through discovery." (Br. at 48 n.17.) This

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[6] *See also, e.g., Adams v. Kinder-Morgan, Inc.*, 340 F.3d 1083, 1106 (10th Cir. 2003) ("The scienter of the *senior controlling officers* of a corporation may be attributed to the corporation itself to establish liability as a primary violator of § 10(b) and Rule 10b-5 when those senior officials were acting within the scope of their apparent authority." (emphasis added)); *Nordstrom, Inc. v. Chubb & Son, Inc.*, 54 F.3d 1424, 1435 (9th Cir. 1995) (rejecting concept of "collective scienter" for attributing scienter to corporation with respect to alleged violation of Section 10(b)).

argument runs afoul of the PSLRA. The PSLRA imposes a mandatory stay of discovery during the pendency of a motion to dismiss. 15 U.S.C. § 78u-4(b)(3)(B). The purpose of the PSLRA's discovery stay is to prevent a plaintiff from doing exactly what Steelworkers seeks to do—evade the PSLRA's heightened pleading requirements by filing a cursory complaint and then trying to fill in the gaps through discovery. *See, e.g., Newby v. Enron Corp.*, 338 F.3d 467, 471 (5th Cir. 2003) ("The rationale underlying the stay was to prevent costly 'extensive discovery and disruption of normal business activities' until a court could determine whether a filed suit had merit, by ruling on the defendant's motion to dismiss.")

Steelworkers also argues that it sufficiently alleged the scienter of the Brazilian employees who engaged in the improper accounting. (Br. at 48.) But the scienter of the Brazilian employees who engaged in the improper accounting practices cannot be attributed to Baxter because the allegations in the SAC make clear that these employees were acting to benefit themselves, not Baxter. (*See* SAC ¶¶43, 44 (alleging that the Brazilian employees booked the fictitious sales "to meet the sales quotas they had previously set and represented to senior management . . . so as to achieve certain targets which entitled them to larger bonuses"); JA13.) In *United States v. 7326 Highway 45 N.*, 965 F.2d 311 (7th Cir. 1992), this Court explained:

> Corporate criminal and civil cases reflect application of agency principles. Only knowledge obtained by corporate employees acting within the scope of their employment is imputed to the corporation. Acting within the scope of employment entails more than being on the

> corporate employer's premises. This circuit had indicated that acting within the scope of employment means "with intent to benefit the employer." Therefore, the agent is outside the scope of his employment when he is not acting at least in part for the benefit of the corporation, and any knowledge the agent obtains is not imputed to the corporation.

Id. at 316 (citations omitted).

Accordingly, because the allegations in the SAC did not give rise to a strong inference that any of the Individual Defendants, or any other Baxter senior officer who was acting within the scope of his or her authority, acted with scienter in misstating any material facts, the District Court correctly concluded that the SAC's allegations failed to state any claim against Baxter for violation of Section 10(b) and SEC Rule 10b-5.

VIII. The District Court Correctly Concluded that the Allegations in the SAC Failed to State a Claim Against the Individual Defendants for Controlling Person Liability.

An essential predicate to a claim for controlling person liability is that the plaintiff first state a securities claim against the alleged controlled person. *See, e.g., Southland Securities*, 365 F.3d at 383 ("Control person liability is secondary only and cannot exist in the absence of a primary violation."); *Greebel*, 194 F.3d at 207 ("Because plaintiffs' complaint does not adequately allege an underlying violation of the securities laws, the district court was correct to dismiss the Section 20(a) claim."). The District Court, therefore, correctly concluded that Steelworkers' failure to allege any primary violation of Section 10(b) of the Exchange Act and SEC Rule 10b-5 by Baxter, the alleged "controlled person," was

fatal to their claim against the Individual Defendants for alleged "controlling person" liability under Section 20(a) of the Exchange Act.

CONCLUSION

For the reasons set forth herein, the District Court properly exercised its discretion in granting defendants' motion for reconsideration because amendment would have been futile. Accordingly, this Court should affirm the District Court's judgment of December 27, 2005, granting defendants' motion for reconsideration and dismissing with prejudice the claims asserted in the SAC.

Dated: August 30, 2006
Chicago, Illinois

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CERTIFICATE OF COMPLIANCE WITH CIRCUIT RULE 31(e)

The undersigned, an attorney, certifies that appellees' brief, disclosure statements, table of contents, table of authorities, and certificates of compliance have been provided in electronic format pursuant to Circuit Rule 31(e). The undersigned further certifies that the contents of the supplemental appendix are not available in an electronic format.

_____

Matthew R. Kipp

CERTIFICATE OF COMPLIANCE WITH CIRCUIT RULE 32(a)(7)

The undersigned, an attorney, certifies that appellees' brief complies with the type-volume limitations of Fed. R. App. P. 32(a)(7). The brief was prepared using Corel WordPerfect, version 9.0, and contains 13,940 words.

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CERTIFICATE OF SERVICE

The undersigned, an attorney, hereby certifies that on August 30, 2006, he caused two copies of the foregoing Brief of Appellees and Appellees' Supplemental Appendix and a digital version of the Brief of Appellees to be served by messenger on Chicago counsel and by FedEx on out-of-state counsel at the addresses listed below:

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