No. 06-1341

IN THE

Supreme Court of the United States

THE REGENTS OF THE UNIVERSITY OF CALIFORNIA,
Petitioner,

v.

MERRILL LYNCH PIERCE FENNER & SMITH, INC., MERRILL LYNCH & COMPANY, INC.; CREDIT SUISSE FIRST BOSTON (USA), INC.; CREDIT SUISSE FIRST BOSTON LLC; PERSHING LLC; BARCLAYS PLC; BARCLAYS BANK PLC; BARCLAYS CAPITAL, INC.
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

SUPPLEMENTAL BRIEF IN SUPPORT

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Pursuant to Rule 15.8 of this Court, Petitioner The Regents of the University of California respectfully submits this Supplemental Brief In Support of its Petition for a Writ of Certiorari, and in opposition to the Supplemental Brief In Opposition filed by Respondents on January 16, 2008. As set forth below, this Court's *Stoneridge* opinion rejected the rationale of the Eighth Circuit that the Fifth Circuit followed in this case. Differences between *Stoneridge*, which involved liability of mere customers or suppliers, and this case, where financial professionals deliberately misled investors, make this case an appropriate one to grant certiorari and clarify the scope of §10(b) liability where it matters most—in relationship to deliberately misleading conduct of investment bankers, underwriters and securities analysts who had a duty to speak truthfully.

1. Respondents say there is no reasonable possibility that the Fifth Circuit might meaningfully reconsider in light of this Court's decision of *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, No. 06-43 (U.S. Jan. 15, 2008), as "the Fifth Circuit's decision in this case relied extensively on the Eighth Circuit decision now affirmed in *Stoneridge.*" Supplemental Brief In Opposition at 2. Yet the Eighth Circuit opinion says that only misstatements, omissions by one who has a duty to disclose, and manipulative trading practices (where "manipulative" is a word of art) may be deemed deceptive under §10(b). *See Stoneridge*, No. 06-43, slip op. at 7.

In *Stoneridge*, this Court noted: "If this conclusion were read to suggest there must be a specific oral or written statement before there could be liability under §10(b) or Rule 10b-5, it would be erroneous." *Id*. That, however, is precisely how the Fifth Circuit read the Eighth Circuit's opinion, expressly following its erroneous logic "that '"deceptive" conduct involves either a misstatement or a failure to disclose by one who has a duty to disclose.'" *See* Petition Appendix ("Pet. App.") at 21a [*Regents of the Univ. of Cal. v. Credit Suisse First Boston*, 482 F.3d 372, 388 (5th Cir. 2007)]. Indeed, the Fifth Circuit ruled that the district court erred because it applied §10(b) and Rule 10b-5 as written, and "by ascribing, natural, dictionary definitions to the words of the rule," rather than the contrived definition offered by the Eighth Circuit. Pet. App. at 20a [*Regents*, 482 F.3d at 387]. At a minimum, the Fifth Circuit should be allowed to reconsider its holding in light of *Stoneridge*.

2. Far from warranting a denial of certiorari, this Court's decision in *Stoneridge* demonstrates critical differences between *Enron* and *Stoneridge*—differences that warrant a *grant* of certiorari to determine §10(b)'s scope not in the context of ordinary business transactions addressed by *Stoneridge*, but in the context of fraud perpetrated by financial professionals engaged in fraudulent dealings in our securities markets. *Stoneridge* holds that the §10(b) right of action does not reach ordinary customer/supplier companies when their partners in ordinary business relations subsequently account improperly for the transactions entered between or among them. It does not rule out liability for fraud by financial professionals that is directed at securities transactions, *i.e.*, transactions structured and designed to make quarterly and year-end numbers. *Cf. Stoneridge*, No. 06-43, slip op. at 16 (contrasting investors' lack of reliance on suspicious transactions "in the market-

place for goods and services" with transactions taking place "in the investment sphere").

Even more to the point, *Enron* simply is not a case in which Petitioner seeks to apply §10(b) "beyond the securities markets—the realm of financing business—to purchase and supply contracts—the realm of ordinary business operations." *Stoneridge*, No. 06-43, slip op. at 10. *Enron* is, at its core, a case about financial fraud, executed by financial professionals targeting investors; it is not about "ordinary business operations." *Id*. Although §10(b) "does not reach all commercial transactions that are fraudulent and affect the price of a security in some attenuated way," *Stoneridge*, No. 06-43, slip op. at 11, it certainly does reach fraud by financial professionals, in securities transactions—including registered offerings—and other statements addressed to the financial markets. *Stoneridge* emphasizes:

> All secondary actors, furthermore, are not necessarily immune from private suit. The securities statutes provide an express private right of action against accountants and underwriters in certain circumstances, see 15 U. S. C. §77k, and the implied right of action in §10(b) continues to cover secondary actors who commit primary violations.

Id. at 15.

This coverage, of course, includes an underwriter who knowingly underwrites a fraudulent offering and deliberately disseminates fraudulent offering documents, selling securities to the public. "'By participating in an offering, an underwriter makes an implied recommendation about the securities [that it] . . . has a reasonable basis for belief in the truthfulness and *completeness* of the key representations made in any disclosure documents used in the offerings." *Dolphin & Bradbury, Inc. v. SEC*, No. 06-1319, 2008 U.S. App. LEXIS 492, at *13 (D.C. Cir. Jan. 11, 2008) (emphasis in original). In *Enron*, the banks who were underwriters made several knowingly false representations to the market.

Respondents were Enron's underwriters for numerous securities offerings, selling securities with offering circulars, prospectuses and registration statements containing false financial information.[1] They drafted and disseminated offering materials hiding debt and reporting phony revenues that they themselves had contrived for Enron to report. Investors were entitled to rely on the truthfulness of the offering documents that Respondents framed and disseminated into the market for the specific purpose of inducing investors to purchase Enron securities. And the Respondents as underwriters were fiduciaries, with a duty to make full disclosures—

[1] Merrill Lynch underwrote sales of Enron stock and notes in 1999. First Amended Consolidated Complaint ("FACC") ¶738. Barclays acted as a placement agent and/or reseller with respect to the public offering in February 2001 of Enron's $1.9 billion zero coupon notes. FACC ¶752. In addition, Barclays sold Enron-related securities: Yosemite Securities Co. Ltd. L200,000,000 8.75% Series 2000-A Linked Enron Obligations. FACC ¶753. During the Class Period, CSFB was an underwriter for one Enron stock offering and two debt offerings. In addition, CSFB sold Enron-related debt, Osprey and Marlin. FACC ¶¶696-699. The summary judgment briefing, the letter prefixed documents, the five-digit exhibit numbers, deposition transcripts, analyst reports, complaints and sworn statements cited herein are part of the record Petitioner submitted in the Fifth Circuit Court of Appeals case, *Regents v. Credit Suisse First Boston*, No. 06-20856 (5th Cir.).

completely unlike the independent customers and suppliers in *Stoneridge.*

This Court's *Stoneridge* opinion emphasizes: "First, if there is an omission of a material fact by one with a duty to disclose, the investor to whom the duty was owed need not provide specific proof of reliance." *Stoneridge*, No. 06-43, slip op. at 8. "Second, under the fraud-on-the-market doctrine, reliance is presumed when the statements at issue become public," as did the offering documents for Enron's public offerings of securities. *Id*. Thus, though Respondents deny it, facts supporting both of the presumptions on which reliance may be based are present in this case.

3. In addition to being underwriters, these banks spoke to the market by structuring and supporting off-the-books special-purpose entities and related-party transactions like Osprey, LJM1 and LJM2 that hid debt and provided false positive cash flow from operations.[2] As this Court emphasized in *Stoneridge,* in that case "nothing respondents did made it necessary or inevitable for Charter to record the transactions as it did." *Id*. at 10. In this case, by contrast, Enron's bankers designed and then executed transactions so that they *would have to be* accounted for in a way that both hid Enron's debt and falsified its revenues.[3] For example, Merrill Lynch

[2] As investors have noted: "'My whole emphasis was, if Merrill Lynch is selling it, it has to be good because they're the biggest brokerage firm in the world,'" said Joe Marsh, a Merrill Lynch client. Paula Dwyer, Laura Cohn, Emily Thornton & Wendy Zellner, *Merrill Lynch: See No Evil*, Business Week, Sept. 16, 2002, at 3-4.

[3] As CSFB noted in 2000: "As you probably know, Osprey is a vehicle enabling Enron to raise disguised debt which appears as

and Andrew Fastow ("Fastow") structured and launched LJM2 for the express purpose of engaging with Enron in earnings and balance-sheet management transactions—*i.e.*, transactions designed to deceive investors. LJM2 was designed and operated as a "conduit" through which Merrill Lynch and others indirectly engaged in these deceptive transactions.[4] Having conceptualized, designed and structured LJM2 for the deceptive purpose, according to Fastow, of "managing [Enron's] earnings," Merrill Lynch is liable as a primary violator. At a minimum, this case should be remanded to explore whether these transactions meet this Court's causation standards as set forth in *Stoneridge*.

4. Finally, Respondents note somewhat defensively that this case also involves false statements

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equity on Enron's balance sheet. . . . Osprey serves the added purpose for Enron of being an off-balance sheet parking lot for certain assets." Ex. 10264. As Merrill Lynch noted in 1999 ("Nigerian Barge"): "Jeff McMahon, EVP and Treasurer of Enron Corp. has asked ML to purchase $7MM of equity in a special purpose vehicle that will allow Enron Corp. to book $12MM of earnings. Enron must close this transaction by 12/31/99. Enron is viewing this transaction as a bridge to permanent equity and they have assured us that we will be taken out of our investment within six months. The investment would have a maximum 22.5% return." MLBE0111776.

[4] 10/24/06 Deposition Transcript of Andrew Fastow ("10/24/06 Fastow Depo. Tr.") at 417:6-11. This testimony is corroborated by numerous other facts, including the contemporaneous documents showing that Merrill Lynch "approved" the year-end 1999 transactions—before it became a limited partner—and that it was given detailed information as to each transaction before it was asked to fund it. Moreover, Merrill Lynch understood the deceptive purpose of the transactions and—without any legitimate business purpose of its own—went forward anyway.

issued by securities analysts in their employ—including "buy" recommendations on Enron stock. They say that the district court "*dismissed* the §10(b) claims that were premised on statements of research analysts on the entirely independent ground that petitioner had not alleged that the specific employees associated with the analyst reports had acted with scienter," (Supplemental Brief In Opposition at 4) (emphasis in original), but that Petitioner did not cross-appeal the dismissals—as if Petitioner *could* cross-appeal from an interlocutory dismissal order when the only basis for appellate review was under Federal Rule of Civil Procedure 23(f). The district court directed the parties, in any event, to raise the issue again on summary judgment if they so chose: "If there is a question, it should be raised by motion for summary judgment." *In re Enron Corp. Sec. Litig.*, No. H-01-3624, 2006 U.S. Dist. LEXIS 43146, at *391 (S.D. Tex. June 5, 2006). Petitioner accordingly cited Merrill Lynch's analyst reports in its opposition to Merrill Lynch's currently pending summary judgment motion and cited Credit Suisse First Boston's ("CSFB") analyst reports in its opposition to CSFB's pending summary judgment motion. *See* Opposition to Merrill Lynch Motion for Summary Judgment at 132 n.519; Opposition to CSFB's Motion for Summary Judgment at 214-232. The Petition for Certiorari, moreover, notes that Merrill Lynch issued 15 analyst reports and CSFB issued 19. Petition at 29 n.30.

The analysts' venality shows Respondents' duplicity in deliberately using the sham transactions they created to mislead investors and defraud the market. For example, CSFB publicly represented Enron stock as a "Strong Buy," based on its phonied financials, maintaining a target price of over $100 per share until July 2001, when it eventually lowered the target to $84.[5] Its private belief, however, was that Enron was an absolute "don't buy."[6]

In an October 2001 email from CSFB analyst Brian Gibbons ("Gibbons") to analyst Andy DeVries ("DeVries"), Gibbons derided the illicit Enron partnerships as "basic money laundering operations in essence." Ex. 15637. Immediately thereafter, with Enron shares trading at $35, Curt Launer and DeVries issued an October 2001 analyst report rating Enron a "Strong Buy" and issued a target price of $54.[7] DeVries acknowledges that while he told his friends not to pay even $35 a share for Enron, he told CSFB's clients it was a great buy. *See* n.6.

Merrill Lynch did the same. According to Fastow, he "drew a short straw" among Enron's senior management in that he was asked to deliver the message to Merrill Lynch as to its then-current analyst John Olson ("Olson"), "that it would be difficult, if not impossible, for Enron to give Merrill the business of leading an equity offering for Enron because their equity analyst was saying not to buy the stock."[8] After Merrill Lynch fired Olson, it appointed another equity analyst, Donato Eassey

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[5] *Compare* CSFBLLC006888291, CSFBLLC006888293 *with* CSFBLLC006888606, CSFBLLC006888608.

[6] 5/25/05 Deposition Transcript of Andy DeVries at 311:23-312:19; *accord* Exs. 15643 (DeVries email stating "I wouldn't touch" Enron shares); Ex. 15647 (email communications evidencing DeVries' personal "sell" recommendation to friends saved them money).

[7] CSFBLLC006844639, CSFBLLC006844641.

[8] 10/24/06 Fastow Depo. Tr. at 519:4-19

("Eassey"), to cover Enron.[9] In Eassey's first report on Enron, he upgraded Merrill Lynch's rating on Enron stock from neutral to accumulate.[10] Merrill Lynch's reports contributed to statistically significant stock price increases on January 19, 1999, April 13, 1999, November 9, 1999, January 20, 2000, January 21, 2000, January 24, 2000, April 12-13, 2000, July 27, 2000, January 22-23, 2001, April 18, 2001, May 18, 2001, June 27, 2001, and October 10, 2001. All the while, Merrill Lynch was creating false revenues for Enron to report through LJM2.

Having spoken through analyst reports, and indeed, having touted Enron's false results, which their transactions created while recommending purchase of Enron stock (clearly satisfying the "in connection with" requirement) unlike the defendants in *Stoneridge,* the banks in this case had a duty to disclose what each knew about those false results. This alone raises a presumption of reliance based on "an omis-

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[9] 5/21/03 Sworn Statement of Donato J. Eassey, former Vice President in Securities and Research at Merrill Lynch, to Robb Hellwid, A & B) at 14-15.

[10] ELIB00000631-00001-04 (1/20/99 Donato J. Eassey, Merrill Lynch Comment: "Enron Corp.—Solid Results in a difficult Environment"); 5/21/03 Sworn Statement of Donato J. Eassey at 27-28. *See also* Neal Batson Third Interim Report, Appendix I at 22; 1/19/99 Merrill Lynch Analyst Report at 1 ("Intermediate Term: Accumulate") ("Enron Corp.—Solid Results In a Difficult Environment"); 10/12/99 Merrill Lynch Analyst Report at 1 ("Intermediate Term: Accumulate"); 1/20/00 Merrill Lynch Analyst Report at 1 ("Intermediate Term: Accumulate"); 1/22/01 Merrill Lynch Analyst Report at 1 ("Intermediate Term: Buy") ("Enron Corp.—Strength In Numbers and Then Some"); 4/18/01 Merrill Lynch Analyst Report at 1 ("Raising the Bar—Again") ("We reiterate our Buy opinions.").

sion of material fact by one with a duty to disclose." *Stoneridge,* No. 06-43, slip op. at 8.[11]

CONCLUSION

The fact is that Respondents are financial professionals who structured financial transactions that deceived the market and were reported as structured. In addition, Respondents did speak to the markets in underwritings and analyst reports and as a result had a duty to speak the full truth. This Court should remove any doubt about what *Stoneridge* means by granting certiorari to clarify when financial professionals may be liable for deliberately misleading investors. At a minimum, the case should be remanded for a fuller examination of the facts.

Respectfully submitted,

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January 17, 2008

[11] "Silence, or omission to state a fact, is proscribed only in certain situations: first, where the defendant has a duty to speak, secondly, where the defendant has revealed some relevant, material information even though he had no duty (*i.e.*, a defendant may not deal in half-truths)." *First Virginia Bankshares v. Benson*, 559 F.2d 1307, 1314 (5th Cir. 1977).