
United States Court of Appeals
for the
Eighth Circuit

Case No. 05-1974

STONERIDGE INVESTMENT PARTNERS, LLC,

Plaintiff-Appellant,

– v. –

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

Defendants-Appellees.

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

REPLY BRIEF OF PLAINTIFF-APPELLANT

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INTRODUCTION

In re Parmalat Sec. Litig., 376 F. Supp. 2d 472 (S.D.N.Y. 2005), a recent decision that Appellees conveniently ignore, provides further compelling validation of the cause of action alleged by Plaintiff against Motorola and Scientific-Atlanta.¹ Based on a careful analysis of the text of Section 10(b), as well as Rule 10b-5, and established precedents, *Parmalat* demolishes Appellees' contention that a defendant must make a misstatement/omission, or engage in classic market manipulation, to be held primarily liable for securities fraud. *Parmalat* holds that deceptive conduct like that alleged here, which is intended to inflate a stock price, is sufficient. The holding is consistent with *In re Enron Corp. Sec., Derivative & ERISA Litig.*, 235 F. Supp. 2d 549 (S.D. Tex. 2002) ("*Enron I*"); *In re Enron Corp. Sec. Litig.*, 310 F. Supp. 2d 819 (S.D. Tex. 2004) ("*Enron II*"); *Quaak v. Dexia Bank Belgium*, 357 F. Supp. 2d 330 (D. Mass. 2005); *In re Global Crossing, Ltd. Sec. Litig.*, 322 F. Supp. 2d 319 (S.D.N.Y. 2004); and *In re Lernout & Hauspie Sec. Litig.*, 236 F. Supp. 2d 161 (D. Mass. 2003), all cited in the Opening Brief.

Significantly, *Parmalat* was rendered in a so-called "bright line" jurisdiction (Second Circuit), which provides that if a Section 10(b) violation is predicated on a

¹ Unless otherwise noted, all abbreviations herein are those defined in the Opening Brief of Plaintiff-Appellant ("*Opening Brief*").

defendant “making” a misstatement, the misstatement must be publicly attributable to the defendant. As explained in *Parmalat*, that rule is limited to a cause of action under Rule 10b-5(b). It has no application to a claim, as here, that is based on a defendant’s engagement in a deceptive act or fraudulent scheme, in violation of Rule 10b-5(a) and (c). The Supreme Court and other well reasoned authorities have reached the same conclusion.

Appellees incorrectly assert that *Central Bank, N.A. v. First Interstate Bank, N.A.*, 511 U.S. 164 (1994), limits the scope of primary liability to misstatements/omissions or market manipulation. *Central Bank* foreclosed the availability of aiding and abetting liability, but did not decide the full scope of misconduct that creates primary liability. See *Enron I*, 235 F. Supp. 2d at 583 (“[T]he Supreme Court left it to the lower courts to determine when the conduct of a secondary actor makes it a primary violator under the statute”); *Parmalat*, 376 F. Supp. 2d at 493. As discussed below, Appellees’ argument is premised on a misreading of *dictum* in *Central Bank*.

Indeed, *Parmalat* demonstrates that the actionability of Plaintiff’s claim against Appellees is entirely consistent with *Central Bank*. The defendant banks in *Parmalat* argued that they merely entered into lawful business deals with a customer, who in turn improperly accounted for the transactions in its public state-

ments. Thus, defendants purportedly only aided and abetted the customer's fraud. The court was unconvinced, ruling that the allegations supported a dramatically different view: the banks engaged in inherently deceptive transactions, "the very purpose" of which was to mislead investors about Parmalat's cash flow and other results. 376 F. Supp. 2d at 497, 504-05, 509. The court held that the banks' liability was based on their *own* deceptive acts, a far different situation from *Central Bank*, where the plaintiffs conceded that the defendant itself did not commit any deceptive or manipulative acts, but only assisted another's fraud by failing to insist on the updating of an appraisal that would have revealed the fraud.

Here, as in *Parmalat*, Motorola and Scientific-Atlanta entered into kickback arrangements, with no *bona fide* business purpose, whose *raison-d'etre* was to inflate Charter's cash flow and satisfy analysts' expectations. In connection with these sham transactions, Appellees fabricated documentation, thereby disguising their fraudulent nature. Appellees' own misconduct was inextricably connected to deception of Charter investors. Thus, Plaintiff has stated a primary violation.

In also arguing that the "reliance" element poses an insuperable bar to Plaintiff's claim, Appellees struggle to drive an artificial wedge between their deceptive acts, which were designed to inflate Charter's reported results, and Charter's state-

ments regarding those same inflated results. Appellees ignore that under settled securities law, reliance or “transaction causation” is satisfied so long as there is a causal connection between a defendant’s misconduct and the price plaintiff paid when purchasing the stock. The notion that a plaintiff has to directly rely upon a defendant’s wrongful acts was buried long ago by the “fraud on the market” doctrine, which holds that so long as such misconduct materially impacts the price of the stock in question, reliance/causation is satisfied. *See Basic Inc. v. Levinson*, 485 U.S. 224, 243, 247 (1988).

The same reliance/causation defense raised by Appellees was rejected in *Parmalat*. There the court recognized that although defendants made no misrepresentations, “they knew that the very purpose of certain of their sham transactions was to allow Parmalat to make such misrepresentations,” and that defendants’ transactions “foreseeably caused losses in the securities market.” 376 F. Supp. 2d at 509. Appellees’ misconduct here was no different in its foreseeable impact on the price of Charter common stock.

Moreover, Appellees misstate the holdings of *Enron I* and *Enron II*. While the courts in those cases mentioned, *in passing*, that defendants issued statements to the market (*e.g.*, analyst reports issued by affiliated brokerage firms), the decisions clearly held that liability was *not* based on such statements, but rather on

defendants' engagement in deceptive transactions with Enron, which were inseparable from that company's release of fraudulent financial statements.

In sum, this is far from the garden variety aiding and abetting claim, *e.g.*, where an attorney reviews an issuer's false registration statement, an accountant reviews a company's false financials, or as in *Central Bank*, where an indenture trustee of bonds fails to require a developer to update an appraisal. In those scenarios, the claims are based on *a defendant's failure to expose another's fraud*, not its *own* use of any "deceptive device or contrivance" in connection with that fraud. Here, the claims are based on Appellees' direct engagement in kickbacks and fabrication of documents that were inextricable elements of the scheme to defraud Charter investors. Such claims are actionable under Section 10(b) and Rule 10b-5(a) and (c).

Thus, it is clear that the district court's dismissal of the Complaint, denial of the motion to amend, and denial of reconsideration of its initial dismissal order were erroneous and should be reversed by this Court.²

² Since filing of the Opening Brief, the court below has approved the settlement of claims against the other defendants in this litigation for \$146,250,000.

ARGUMENT

A. Standard of Review

Appellees' iteration of the appropriate standard is incomplete, especially as to this Court's review of the denial of Plaintiff's motion to amend. *De novo* review, rather than scrutiny limited to abuse of discretion, is required because the district court's sole reason for denial was on futility grounds. *See United States ex rel. Gaudineer & Comito, L.L.P. v. Iowa HHS*, 269 F.3d 932, 935 (8th Cir. 2001): "The denial of leave to amend based on futility means that the court found that the amended complaint failed to state a claim, and our review is therefore *de novo*."³ (Citations omitted.) Accordingly, this Court examines a proposed amended complaint "using the same standard applied for motions to dismiss under Rule 12(b)(6)." *United States ex rel. McCauley v. Best Care Home Health, Inc.*, Nos. 98-1261, 99-1207, 2002 U.S. Dist. LEXIS 19506, at *9-*10, WL 31248025 at *3 (D. Minn. Oct. 7, 2002). *See also* Opening Brief at 19-20.

Scientific-Atlanta also asserts that the allegations of the SAC are not before this Court. This position (not seconded by Motorola) is made *without any citation*,

³ *See also Freeman v. First Union Nat'l*, 329 F.3d 1231, 1234 (11th Cir. 2003); *Petters Co. v. Stayhealty, Inc.*, No. 03-3210, 2004 U.S. Dist. LEXIS 11872, 2004 WL 1465830 (D. Minn. June 1, 2004); *Lumsden v. Ramsey County Cmty. Corr. Dep't*, Civ. No. 00-2223, 2002 U.S. Dist. LEXIS 25398, at *3 n.2, 2002 WL 31886630 at *1 n.2 (D. Minn. Dec. 23, 2002).

and is otherwise outrageous. How is this Court to decide whether the allegations could state a cause of action without examining the SAC's contents? Obviously, it is in Scientific-Atlanta's interest to keep this Court from reviewing damning facts further evidencing the sham nature of Appellees' transactions and the inseparable connection of their misconduct with the deception of Charter investors. There is, however, no legal justification for asking this Court to turn a blind eye to such allegations.

B. A Primary Violation of Section 10(b) Can Be Predicated on a Defendant's Deceptive Act Alone; A Misstatement/Omission or Market Manipulation by a Defendant Is Not Necessary

Appellees' attempt to limit a primary violation of Section 10(b) only to instances where a defendant makes a misstatement/omission, or engages in market manipulation, is not supported by the text of Section 10(b). The statute expressly provides that liability may be predicated on "any manipulative or *deceptive device or contrivance.*" 15 U.S.C. § 78j(b) (emphasis added). Significantly, the statutory text says nothing about misstatement or omissions, which are expressly proscribed only in Rule 10b-5(b). Appellees' kickback transactions designed to inflate Charter's results and their related fabrication of documents constitute the "deceptive device[s] or contrivance[s]" prohibited by Section 10(b).

The text of Rule 10b-5(a) (prohibiting the use by "any person" of "any

device, scheme or artifice to defraud”) and (c) (prohibiting “any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person”) likewise contradicts Appellees’ position, while supporting the actionability of Plaintiff’s claim. Recognizing this, Appellees argue that the text of Section 10(b) takes precedence over the text of the Rule, and that the statute is narrower. Appellees, however, cite no authority for the proposition that in adopting Rule 10b-5(a) or (c), the SEC exceeded its authority under the statute. In any event, the text of Section 10(b) does not make misstatements and market manipulation the exclusive means of establishing liability, but also includes misconduct of the type alleged here.

Parmalat is squarely on point. There, the defendant banks were not charged with any misstatements or omissions, or “classic market manipulation.” 376 F. Supp. 2d at 492. Instead, defendants’ liability was based on their use of fraudulent transactions, *i.e.*, their securitization and factoring of worthless Parmalat invoices which were misreported in Parmalat’s statements. *Id.* at 504. In holding that plaintiff had alleged a primary violation of Section 10(b), the court explained:

The Supreme Court has given instruction on the meaning of the relevant terms in Section 10(b). The key phrase for present purposes is “directly or indirectly . . . [t]o use or employ . . . any . . . deceptive device or contrivance.” “Device,” according to the Supreme Court, should be understood to mean “that which is devised, or formed by

design; a contrivance; an invention; project; scheme; often, a scheme to deceive; a stratagem; an artifice.” Contrivance, the Court noted, means “a thing contrived or used in contriving; a scheme, plan, or artifice.” [FN151] The same dictionary used by the Supreme Court defines “deceptive” as “[t]ending to deceive; having power to mislead.” [FN152]

FN151. *Ernst & Ernst [v. Hochfelder]*, 425 U.S. [185] at 199 n. 20, 96 S.Ct. 1375 (quoting Webster’s New International Dictionary 580, 713 (2d ed.1934)).

FN152. Webster’s New International Dictionary 679 (2d ed.1934).

Id. at 502 (alterations and omissions in the original), 502 n.151, 502 n.152. In rejecting defendants’ restrictive reading of the text of Section 10(b) similar to that posed by Appellees, *Parmalat* noted that the court in *Lernout & Hauspie*, held:

“[T]he better reading of § 10(b) and Rule 10b-5 is that they impose primary liability on any person who substantially participates in a manipulative or deceptive scheme by directly or indirectly employing a manipulative or deceptive device (*like the creation or financing of a sham entity*) intended to mislead investors, even if a material misstatement by another person creates the nexus between the scheme and the securities market.”

Id. at 502 (quoting *Lernout & Hauspie*, 236 F. Supp. 2d at 173 (emphasis added)).

The court in *Parmalat* adopted this formulation, except for the reference to “substantial participation,” explaining that “[t]he text asks only whether a defendant directly or indirectly used or employed a manipulative or deceptive

device or contrivance.” *Id.* at 503 (footnote omitted).

This is the same conclusion drawn in *Enron I*, *Enron II*, *Quaak*, and *Global Crossing*, discussed in the Opening Brief at 24-31. For example, the court in *Enron I* concluded:

Securities fraud actions under § 10(b) and Rule 10b-5 are not merely limited to the making of an untrue statement of material fact or omission to state a material fact. Section 10(b) prohibits “any manipulative or deceptive contrivance,” which, as indicated above, the Supreme Court, relying on Webster’s International Dictionary, includes “a scheme to deceive” or “scheme, plan or artifice.” *Ernst & Ernst*, 425 U.S. at 199 n.20. While subsection (b) of Rule 10b-5 provides a cause of action based on the “making of an untrue statement of a material fact and the omission to state a material fact,” subsections (a) and (c) “are not so restricted” and allow suit against defendants who, with scienter, participated in “a ‘course of business’ or a ‘device, scheme or artifice’ that operated as a fraud” on sellers or purchasers of stock *even if these defendants did not make a materially false or misleading statement or omission.* *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 152-53, 31 L. Ed. 2d 741, 92 S. Ct. 1456 (1972).

235 F. Supp. 2d at 577 (emphasis added).⁴

⁴ See also *Enron I*, 235 F. Supp. 2d at 589 (“Thus the Attorneys General concur with this Court, contrary to the arguments of some Defendants, that liability is not limited to the making of a material misstatement or omission, nor to a few very technical forms of manipulation.”); *id.* at 692 (“As indicated for violations of § 10(b), Lead Plaintiff may assert and has asserted claims under all three prongs of Rule 10b-5, and is not limited to the second prong’s material misrepresentation or omission category.”); *id.* at 693.

Appellees nevertheless insist, as did the district court below, that *Enron I* and *Enron II* were predicated on affirmative misstatements. Plainly, liability in those cases was based on defendants' engagement in sham transactions, and did not hinge on any misstatements. *Enron II* made this abundantly clear:

[A]s explained in [*Enron I*], a misrepresentation need not have been made because the statute also applies to conduct, here the alleged substantial, active role in major fraudulent transactions with no legitimate business purpose, but designed to deceive investors in and central to a scheme and course of business operating to present a falsely inflated image of Enron's financial strength.

310 F. Supp. 2d at 829 (footnote omitted, emphasis added).

Appellees similarly mischaracterize *Global Crossing*. There, plaintiff sought to hold the outside auditor liable for a scheme to defraud "even in the years for which it did not issue audits." 322 F. Supp. 2d at 335. The court concluded: "in attempting to reduce plaintiffs' arguments to a mere theory of 'fraudulent statement by another name,' [the auditor] itself conflates the distinct elements of a claim for false statements under subsection (b) of Rule 10b-5 with those of a claim for engaging in fraudulent scheme under subsections (a) or (c)." *Id.*; see also Opening Brief at 30.

Appellees ultimately peg their entire analysis about the scope of actionable misconduct to a passing reference in *Central Bank* that Section 10(b) "prohibits

only the making of a material misstatement (or omission) or the commission of a manipulative act.” 511 U.S. at 177. This is pure *dictum*. In *Central Bank*, the Court ruled that aiding and abetting liability was unavailable, in a context where plaintiff admitted that defendant itself did not commit any deceptive acts. See Section E *infra*. The Court did not itemize the full range of acts sufficient to establish primary liability under Section 10(b) or Rule 10b-5, since it was addressing conduct self-described as aiding and abetting. Instead, “the Supreme Court left it to the lower courts to determine when the conduct of a secondary actor makes it a primary violator under the statute.” *Enron I*, 235 F. Supp. 2d at 583. See also *Parmalat*, 376 F. Supp. 2d at 493 (*Central Bank* “did not change the scope of Rule 10b-5 or what constitutes a primary violation of it.”). In *In re Dynegy, Inc.*, 339 F. Supp. 2d 804, 915 (S.D. Tex. 2004), invoked by Appellees, the court came to the same conclusion: “In *Central Bank* the Court was not called upon to determine what constituted a manipulative act for purposes of § 10(b) and Rule 10b-5 because the plaintiffs alleged only that *Central Bank* was ‘secondarily liable under § 10(b) for its conduct in aiding and abetting the fraud.’” (Quoting *Central Bank*, 511 U.S. at 191.)

It is hardly likely that *Central Bank* would have resolved the important issue about the full scope of primary liability by the cryptic language cited by Appellees.

The Court's *dictum* cannot be construed as a full scale analysis of Section 10(b)'s prohibition against "manipulative or deceptive device or contrivance." The Court had no reason to address, far less decide, whether the deception prong of Section 10(b) only prohibits misstatements or omissions, but not other fraudulent misconduct that is expressly prohibited by Rule 10b-5(a) and (c). *See Parmalat*, 376 F. Supp. 2d at 493, 499.⁵

Finally, since the misconduct here falls within the parameters of "deceptive device[s] or contrivance[s]" barred by Section 10(b), this Court need not address whether it is also covered by the proscription against "manipulative" devices. Thus, Appellees' lengthy arguments that "manipulation" covers only highly technical market manipulation are irrelevant.

⁵ Indeed, just after the *dictum* quoted by Appellees, *Central Bank* cited to *Santa Fe Industries v. Green*, 430 U.S. 462, 473 (1977) and *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 214 (1976), cases that undercut Appellees' restrictive interpretation. *Central Bank*, 511 U.S. at 177. After reviewing precedents concerning the scope of deceptive conduct, the Court in *Santa Fe* stated: "[T]he cases do not support the proposition . . . that a breach of fiduciary duty by majority stockholders, without any *deception*, misrepresentation, or non-disclosure, violates the statute and the Rule." 430 U.S. at 476 (emphasis added). The Court obviously did not treat deception as limited to a misleading statement or omission. Similarly, in *Ernst & Ernst*, the Court noted that subsections (b) and (c) of Rule 10b-5 can be read as "proscribing . . . any type of material misstatements or omission, *and any course of conduct*, that has the effect of defrauding investors." 425 U.S. at 212 (emphasis added). Thus, a fraudulent "course of conduct" is prohibited in addition to misleading statements.

C. *Wright* and the Other Related Post-Central Bank Cases Do Not Immunize Appellees Merely Because They Did Not “Make” Any Misstatements

According to Appellees, *Wright v. Ernst & Young LLP*, 152 F.3d 169 (2d Cir. 1998), and other post-*Central Bank* decisions by the Sixth, Tenth, and Eleventh Circuits provide that unless a defendant issues the false statement, it cannot be held liable for a primary violation.⁶ Those cases are inapposite because they did not address the scope of liability based on *deceptive acts or schemes*, as here, but instead only considered under what circumstances a defendant can be deemed to have *made a misstatement*. The courts reached different conclusions, with the strictest requiring that a misstatement be publicly attributable to a defendant, *Wright*, and the Ninth Circuit adopting the more relaxed “substantial participation” standard, *In re Software Toolworks Sec. Litig.*, 50 F.3d 615 (9th Cir. 1994).⁷ In *In re Rural Cellular Corp. Sec. Litig.*, No. Civ. 02-4893, 2004 U.S. Dist. LEXIS 393, 2004 WL 67651 (D. Minn. Jan. 9, 2004), an unreported decision cited by Scientific-Atlanta, the district court adopted the *Wright* standard.

⁶ See *Fidel v. Farley*, 392 F.3d 220 (6th Cir. 2004); *Ziemba v. Cascade Int’l, Inc.*, 256 F.3d 1194 (11th Cir. 2001); *Anixter v. Home-Stake Prod. Co.*, 77 F.3d 1215 (10th Cir. 1996).

⁷ Even as to the making of misstatements, the Second Circuit has since adopted a more relaxed standard. See *In re Scholastic Corp. Sec. Litig.*, 252 F.3d 63, 75-76 (2d Cir. 2001).

These cases are entirely irrelevant, as illustrated by *Parmalat*, decided in the “bright line” *Wright* jurisdiction. As noted in *Parmalat*: “This [misstatement] attribution rule defines the contours of liability for violations of Rule 10b-5(b),” but not the reach of subsections (a) and (c). 376 F. Supp. 2d at 499. The Supreme Court, too, recognized in *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972), that while Rule 10b-5(b) liability is premised on the “making of an untrue statement of a material fact and the omission of a material fact,” subsections (a) and (c) “are not so restricted.” *Id.* at 152-53. See also *Global Crossing*, 322 F. Supp. 2d at 335-36; *Enron I*, 235 F. Supp. 2d at 577; Opening Brief at 22-23, 30-31.⁸

Contrary to Appellees’ suggestion, recognizing this distinction among the subsections of Rule 10b-5 will not revive aiding and abetting liability. As emphasized in *Parmalat*:

This analysis is not a back door into liability for those who help others make a false statement or omission in violation

⁸ *In re Bristol-Myers Squibb Sec. Litig.*, 312 F. Supp. 2d 549 (S.D.N.Y. 2004), is distinguishable for the same reason. It applied *Wright*, where plaintiff was trying to hold defendant responsible for a third party’s statements; no deceptive conduct by defendant under Rule 10b-5(a) or (c) was implicated. Similarly, *In re Livent, Inc. Noteholders Sec. Litig.*, 174 F. Supp. 2d 144 (S.D.N.Y. 2001), did not address the scope of subsections (a) or (c); instead the court analyzed under what circumstances a defendant can be said to have made an implicit misrepresentation about the value of securities it was selling.

of subsection (b) of Rule 10b-5. The Second Circuit has made clear that to “make” a statement for purposes of Rule 10b-5(b) requires that the statement be attributed to its maker at the time it is made. *That is a different matter from whether a defendant’s challenged conduct in relation to a fraudulent scheme constitutes the use of a deceptive device or contrivance.*

376 F. Supp. 2d at 503 (emphasis added) (footnote omitted).

D. Courts Have Upheld Allegations of Primary Violations Based on Deceptive Conduct Similar to That Alleged by Plaintiff

Appellees insist they did not engage in any deceptive acts but entered into legitimate transactions (Scientific-Atlanta labels them “marketing contracts”) that were improperly accounted for by Charter. Plaintiff’s factual allegations, however, support the opposite inference: Appellees engaged in bogus transactions. These allegations are detailed in the Opening Brief at 7-16 and will only be summarized here. Appellees used kickback arrangements to create an appearance of cash flow growth for Charter where none existed. After rebuffing Charter’s request that they buy advertising so that Charter could meet analysts’ estimates of cash flow for the fourth quarter of 2000, Appellees deliberately engaged in sham transactions to create the illusion of cash flow growth in the exact amount of the shortfall. The Appellees and Charter first agreed that Charter would pay \$20 above the contract price for set top boxes that it was already contractually obligated to purchase, and that the Appellees would kickback the same amount to Charter as advertising fees.

They then falsified documentation to lend the appearance of legitimacy. For example, on August 31, 2000, Scientific-Atlanta notified Charter it was raising the price of each set top box by \$20, even though there was no such increase (and a “most favored customer” clause prevented passing along any purported increased costs in any event). Scientific-Atlanta’s notification was a pure fabrication, written at Charter’s behest (Charter sent it an email requesting the increase) and intended to disguise the sham nature of the transaction.

Motorola also entered into a sham arrangement requiring Charter to pay \$20 penalty for each set top box that Charter *did not* order in the fourth quarter of 2000, even though, under a previous contract, Charter did not have to order those same products until the end of the following year.⁹

The kickbacks were completed by Appellees’ signing spot telecast agreements with Charter for advertising they did not need, thereby returning all the excess moneys Charter had agreed to pay. As part of the sham, Appellees knowingly agreed to fees that were *four to five times the market rate*.

Given these allegations, where their legal sufficiency is the only issue on the plate, this Court cannot accept Appellees’ benign view of the transactions. Indeed,

⁹ Had Charter actually purchased all the products in the fourth quarter, its entire cash flow would have been wiped out.

courts have rejected similar attempts by other defendants to label their fraudulent acts as merely lawful business deals, including, most recently, *Parmalat*:

The complaint alleges that Citigroup securitized, and BNL factored, invoices that, for various reasons, were worthless. Each thought itself secure from the obvious credit “risk,” Citigroup because it sold the receivables or assigned back to Parmalat the right to collect payment . . . and BNL because it relied on Parmalat’s guarantee. Parmalat’s security holders, however, allegedly were not so fortunate. They were victimized by Parmalat’s misleading financial statements.

The Court concludes that the arrangements involving the regular factoring and securitization of worthless invoices were deceptive devices or contrivances for purposes of Section 10(b). *These were inventions, projects, or schemes with the tendency to deceive because they created the appearance of a conventional factoring or securitization operation when, in fact, the reality was quite different.* BNL knew when it paid Parmalat for the invoices that they were worth nothing and were in fact a trick to disguise its loan to Parmalat. The same is true of Citigroup’s purchase of certain invoices. If the allegations of the complaint are accepted, the banks used these devices. In the language of Rule 10b-5(c), the banks engaged in acts, practices, or courses of business that would operate as a fraud or deceit upon others. In these circumstances, it cannot be said that the banks’ conduct fell outside of Rule 10b-5 or Section 10(b).

376 F. Supp. 2d at 504 (emphasis added) (footnotes omitted). *See also* Opening Brief at 26-29.

Appellees’ assertion that Charter could have properly accounted for the

transactions is irrelevant. Nothing in the record suggests there was any intention to properly account for these deals — the only intent of Appellees and Charter was to deceive investors. These transactions had no valid business purpose. Indeed, Appellees fabricated documents to disguise the bogus nature of the transactions.

Similar “accounting treatment” related arguments were raised and rejected in *Enron II*. There, in December 1999, Enron sold Merrill Lynch its interest in the Nigerian barges “in time to record a multi-million dollar profit in the final quarter of the year and meet Wall Street projections,” *Enron I*, 235 F. Supp. 2d at 651 n. 87. At the same time, Merrill Lynch entered a secret side agreement under which Enron was obligated to repurchase the barges within six months. *Id.*; *Enron II*, 310 F. Supp. 2d at 829. Had Enron reported the transaction as a loan, rather than recognizing revenues from it, plaintiffs would have not been harmed. But, as the court in *Enron II* concluded:

Sham business transactions with no legitimate business purpose that are actually guaranteed “loans” employed to inflate Enron financial image are not above-board business practices. This Court disagrees with Merrill Lynch’s contention that the alleged “‘deception’ did not occur until Enron allegedly misreported” the transactions.

310 F. Supp 2d at 830; *see also Enron I*, 235 F. Supp. 2d at 651 n.87.

Scientific-Atlanta seeks to distinguish the *Enron* rulings on the ground that several of Enron’s business partners had “non-public information about Enron’s

finances.” This argument is entirely inconsistent with Scientific-Atlanta’s assertion that whether a defendant engaged in actionable deceptive conduct must be decided by focusing on the nature of the acts, rather than defendant’s scienter. In any event, the Complaint and SAC adequately plead the sham nature of Appellees’ transactions, their connection to the scheme to defraud Charter investors, as well as Appellees’ scienter. *Accord Parmalat*, 376 F. Supp. 2d at 504 n.160 (rejecting argument that invoices that bank securitized were not worthless and the fraud arose only from Parmalat’s failure to make certain disclosures because, on a motion to dismiss, plaintiffs were entitled to the favorable inference that the invoices were worthless).

E. Central Bank Is Inapplicable

In *Central Bank*, plaintiffs claimed that the indenture trustee of bonds failed to request that the appraisal of the security for the bonds be updated, although it suspected that the appraisal was no longer accurate. 511 U.S. at 167-68. In stark contrast to this case, plaintiffs in *Central Bank* admitted that defendant had only aided and abetted a fraud on investors, and did not allege any deceptive acts that could be a basis for primary liability:

Respondents concede that Central Bank did not commit a manipulative or deceptive act within the meaning of § 10(b). Instead, in the words of the complaint, Central Bank was “secondarily liable under § 10(b) for its conduct

in aiding and abetting the fraud.”

Id. at 191-92 (citations omitted). Thus, *Central Bank* was based on the trustee’s failure to take actions to *prevent another’s misconduct*. Unlike this case, there was no allegation that defendants employed “deceptive devices,” *i.e.*, engaged in kickback transactions and fabricated supporting documents as part of a scheme which caused investor losses. Thus, Appellees’ insistence aside, *Central Bank* cannot be viewed as describing the totality of misconduct constituting primary violations.

This critical distinction was addressed in *Parmalat*:

[T]he decision did not affect the contours of a primary violation of Section 10(b). The plaintiffs in *Central Bank* conceded that the indenture trustee “did not commit a manipulative or deceptive act within the meaning of § 10(b),” but there is nothing in the decision to suggest that Central Bank would have escaped liability if it had been found to have committed such an act.

376 F. Supp. 2d at 499 (footnote omitted). As further explained in *Parmalat*:

The defendants’ argument that they were at most aiders and abettors of a program pursuant to which Parmalat made misrepresentations on its financial statements misses the mark. The transactions in which the defendants engaged *were by nature deceptive*. They depended on a *fiction*, namely that the invoices had value. *It is impossible to separate the deceptive nature of the transactions from the deception actually practiced upon Parmalat’s investors*. Neither the statute nor the rule requires such a distinction.

Id. at 504 (emphasis added); *see also* Opening Brief at 32-33.

Here too, the transactions depended on several “fictions” — a non-existent price increase; a penalty imposed for not ordering products earlier than previously required; and payments for unwanted advertising at 4-5 times the market rate.

F. Reliance/Causation Poses No Obstacle to the Allegations of a Primary Violation

The thrust of the reliance element is that there must be a causal nexus between the fraudulent conduct alleged and the price of securities purchased by investors. *See Parmalat*, 376 F. Supp. 2d at 509 (“Transaction causation has been described as ‘akin to reliance.’” (Quoting *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 172 (2d Cir. 2005))). Such reliance/causation is readily apparent here. All parties are in agreement that Charter’s stock price was driven by its reported operating cash flow. Here, Appellees directly engaged in a scheme to inflate operating cash flow so analysts’ estimates could be met. Appellees’ deceptive acts, and Charter’s misrepresentations about operating cash flow arising therefrom, were part and parcel of the fraudulent scheme to deceive investors. The impact of such misconduct on the market price of Charter securities was both foreseeable and intended. The *entire scheme* was designed to, and affected, the market price. *See* Opening Brief at 34-35.

Appellees’ effort to break the scheme down into separate acts and thereby

shield themselves from liability should be rejected. There is no requirement that Appellees' misconduct be the "sole and exclusive cause" of the inflation; it need only be a "substantial, *i.e.*, a significant contributing cause." *Parmalat*, 376 F. Supp. 2d at 509 (quoting *Wilson v. Comtech Telecommuns. Corp.*, 648 F.2d 88, 92 (2d Cir.1981) (internal quotation marks and citation omitted in original)). So long as the misconduct impacted the market price of Charter stock, Plaintiff and other class members who relied on the integrity of the market can satisfy the reliance element on defendants' misconduct under the fraud-on-the-market theory, which provides "that, in an open and developed market, the price of the security is determined by all available information." *Parmalat*, 376 F. Supp. 2d at 508 (footnote omitted). Appellees' misconduct was enmeshed in the information about inflated cash flow reported by Charter. *See* Opening Brief at 34.

This is exactly what *Enron I* held:

Reliance under prongs (a) and (c) can also be established by the fraud-on-the-market doctrine: Lead Plaintiff has alleged that the identified contrivances . . . operated to present a falsely positive picture of Enron's financial condition and maintain its high credit ratings, thereby artificially inflating the value of Enron's public traded securities and continuing to attract funds from the investing public

235 F. Supp. 2d at 693. *Accord Quaak*, 357 F. Supp. 2d at 337 (a person using a deceptive device as part of a fraudulent scheme commits a primary violation

“even if a material misstatement by another person creates the nexus between the scheme and the securities market”) (citation omitted).

As *Parmalat* confirmed, the absence of misrepresentations by Appellees does not break the causal link between their misconduct and Plaintiff’s reliance:

In this case, the complaint alleges that the banks’ actions in connection with the relevant transactions actually and foreseeably caused losses in the securities markets [by inflating the stock price]. *The banks made no relevant misrepresentations to those markets, but they knew that the very purpose of certain of their transactions was to allow Parmalat to make such misrepresentations.* In these circumstances, both the banks and Parmalat are alleged causes of the losses [inflation of the price] in question. So long as both committed acts in violation of statute and rule, both may be liable.

376 F. Supp. 2d at 509 (emphasis added).

Parmalat also convincingly rebuts Appellees’ contention that recognition of a primary violation in the circumstances here is inconsistent with *Central Bank’s* reliance/causation concerns:

This analysis is not an end run around *Central Bank*. If a defendant has committed no act within the scope of Section 10(b) and Rule 10b-5 -- as in fact was the case in *Central Bank* -- then liability will not arise on the theory that defendant assisted another in violating the statute and rule. But where, as alleged here, a financial institution enters into deceptive transactions as part of a scheme in violation of Rule 10b-5(a) and (c) *that causes foreseeable losses in the securities markets*, that institution is subject to private liability under Section 10(b) and rule 10b-5.

Id. at 509-10 (emphasis added).¹⁰ Here, the sole purpose of Appellees’ sham transactions and fabrication of documents was the creation of the appearance of cash flow growth so that an important client could satisfy analysts’ estimates. Thus, the loss caused to purchasers of Charter securities was not merely foreseeable; it was intended by Appellees.

G. Scientific-Atlanta’s Argument That Its Misconduct Was Not “In Connection With” the Purchase/Sale of a Security Is Improperly Raised and Substantively Defective

This Circuit does not consider issues that are raised for the first time on appeal, absent extraordinary circumstances. *See Green v. United States*, 323 F.3d 1100, 1103 (8th Cir. 2003); *Fritz v. United States*, 995 F.2d 136, 137 (8th Cir. 1993); *United States v. Oldham*, 787 F.2d 454, 457 (8th Cir. 1986). Ignoring this settled principle, Scientific-Atlanta raises an argument that it failed to make to the court below — that the Rule 10b-5 requirement that a fraud be connected to the purchase or sale of a security cannot be met. This argument is not properly before

¹⁰ It was in the context of the plaintiff’s concession in *Central Bank* that defendant *did not* engage in any manipulative or deceptive act that the Court stated: “[w]ere we to allow the aiding and abetting action proposed *in this case*, the defendant could be liable without any showing that the plaintiff relied upon the aider and abettor’s statements or actions.” 511 U.S. at 180 (emphasis added). As detailed here, Appellees’ “actions” were intended to and did cause losses in the market for Charter securities.

this Court. Even if it were, it is substantively defective.

Scientific-Atlanta cannot be serious in suggesting that the fact that it did not sell any Charter securities during the Class Period is dispositive. Outside auditors and directors are routinely held liable in situations where they do not sell stock because their misconduct is sufficiently connected to investors' purchase of securities at inflated prices. Appellees' deceptive scheme and Plaintiff's purchase of Charter's stock at inflated prices are inextricably interconnected, interdependent and co-incident, as already described. As held in *Parmalat*:

A plaintiff makes out a sufficient nexus with the purchase or sale of securities when the defendants' deceptive conduct affects a market for securities. The alleged factoring and securitization schemes would have created the appearance of revenue or assets where there was none and thus distorted the prices of Parmalat's securities.

376 F. Supp. 2d at 505-06 (footnotes omitted). The same conclusion is warranted here.

SEC v. Zandford, 535 U.S. 813 (2002), hardly supports Scientific-Atlanta's position. There, the Court acknowledged that the "in connection with" prerequisite "should be 'construed "not technically and restrictively, but flexibly to effectuate [the statute's] remedial purposes.'"" *Id.* at 819 (quoting *Affiliated Ute*, 406 U.S. at 151 (internal citation omitted)). It held that the requirement was satisfied where a broker had misappropriated proceeds from his sales of clients' securities, although

the sales were in themselves not unlawful, because the misappropriation was interdependent or coincident with the sales. The court in *Enron I*, 235 F. Supp. 2d at 578, 693, cited to *Zandford* as supporting its ruling that the business partners' sham transactions were so interdependent with the sale of security that the "in connection with" prerequisite was met despite the absence of any misstatements by such actors.

In sum, Scientific-Atlanta's narrow construction is contrary to the Supreme Court's repeated admonition:

"§ 10(b) and Rule 10b-5 prohibit all fraudulent schemes in connection with the purchase or sale of securities, whether the artifices employed involve a garden variety type of fraud, or present a unique form of deception. Novel or atypical methods should not provide immunity from the securities laws."

Superintendent of Ins. Bankers Life & Casualty Co., 404 U.S. 6, 11 n.7 (1971)

(quoting *A.T. Brod & Co. v. Perlow*, 375 F.2d 393, 397 (2d Cir. 1967)).

H. *Homestore* and Other Authorities Cited by Appellees Are Unpersuasive or Distinguishable

In re Homestore.com, Inc. Sec. Litig., 252 F. Supp. 2d 1018 (C.D. Cal.

2003), *appeal docketed*, No. 04-55665 (9th Cir. Apr. 16, 2004), misapplied *Central Bank*, by limiting primary liability to a defendant's participation in the drafting or making of a misstatement or concealment of material information. *See* Opening

Brief at 31-35. As the court in *Parmalat* pointed out, the *Homestore* analysis is not based on the text of Section 10(b). See 376 F. Supp. 2d at 502 n.153. *Enron II* also rejected *Homestore*'s "narrow construction of the statute and of primary violations." 310 F. Supp. 2d at 829. For similar reasons, *Dynegy, Inc.*, 339 F. Supp. 2d 804, and *In re Lake State Commodities*, 936 F. Supp. 1461 (N.D. Ill. 1996), should be disregarded.

Appellees' invocation of *Wenneman v. Brown*, 49 F. Supp. 2d 1283 (D. Utah 1999), is incomprehensible. There, the court actually denied the motion to dismiss. While acknowledging the obvious proposition that aiding and abetting liability is no longer available under any subsection of Rule 10b-5, it concluded that *Central Bank* "did not preclude a plaintiff from bringing a claim against members of a conspiracy to defraud so long as the plaintiff sufficiently alleges facts which would support a finding that a particular participant could be primarily liable as a co-conspirator under Rule 10b-5." 49 F. Supp. 2d at 1288. Plaintiff's authorities are actually more conservative. For example, in *Enron I*, the court rejected the availability of a conspiracy theory, while premising defendants' liability on their *own* deceptive acts. 235 F. Supp. 2d at 589-91.

Here, as in *Enron I & II* and *Parmalat* line of cases, Appellees are being called to task for their own deceptive acts, not their conspiracy to aid another's

fraud. Indeed, in *Dinsmore v. Squadron, Ellenoff, Plesent, Sheinfeld & Sorkin*, 135 F.3d 837 (2d Cir. 1998), invoked by Appellees, while rejecting liability under a conspiracy theory, the Second Circuit cautioned: “secondary actors who conspire to commit such violations will still be subject to liability so long as they independently satisfy the requirements for primary liability.” *Id.* at 842. (*Enron I*, 235 F. Supp 2d at 589-91, expressly followed *Dinsmore*). Plaintiff has alleged just such a primary violation by Appellees.

CONCLUSION

For the foregoing reasons, and those cited in the Opening Brief, Plaintiff respectfully requests this Court to reverse the lower court's orders dismissing the Complaint, denying leave to amend and denying reconsideration.

Dated: August 26, 2005

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE WITH RULE 32(a)

1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because it contains 6930 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

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

CERTIFICATE OF COMPLIANCE WITH LOCAL RULE 28A(d)(2)

In compliance with L.R. 28A(d)(2), a virus-free digital version of this brief have been copied onto virus-free media.

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Dated: August 26, 2005

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Stoneridge Investment Partners, LLC.,

vs.

Scientific-Atlanta, Inc. and Motorola, Inc.

-----X

STATE OF NEW YORK)

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

On August 26, 2005

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Sworn to before me on August 26, 2005

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