No. _____

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

IN RE ENRON CORPORATION SECURITIES, DERIVATIVE & "ERISA" LITIGATION	)	On Petition for Leave to Appeal from the Southern District of Texas MDL No. 1446 Civil Action No. H-01-3624 Hon. Melinda Harmon *Judge Presiding*

BRIEF OF THE BOND MARKET ASSOCIATION, THE CLEARING HOUSE ASSOCIATION L.L.C., AND THE SECURITIES INDUSTRY ASSOCIATION AS *AMICI CURIAE* IN SUPPORT OF THE PETITIONS OF CERTAIN DEFENDANTS PURSUANT TO FED. R. CIV. P. 23(F) FOR LEAVE TO APPEAL FROM THE DISTRICT COURT'S CLASS CERTIFICATION ORDER

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July 26, 2006

CERTIFICATE OF INTERESTED PERSONS

The undersigned counsel of record certifies that the following listed persons and entities as described in the fourth sentence of Fifth Circuit Rule 28.2.1 have an interest in the outcome of this case. These representations are made in order that the judges of this court may evaluate possible disqualification or recusal.

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

Cases

Statutes

Pursuant to Federal Rules of Appellate Procedure 5 and 29, The Bond Market Association (the "BMA"), The Clearing House Association L.L.C. ("The Clearing House") and the Securities Industry Association ("SIA") (collectively, "*Amici*") respectfully submit this brief as *amici curiae* in support of Defendants-Petitioners (collectively, "Petitioners")[1], to urge this Court to grant the Petition for Leave to Appeal so that the Court can provide much-needed guidance to district courts, litigants, and businesses in this Circuit by addressing the proper scope of primary liability under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder.

INTEREST OF THE *AMICI CURIAE*

The BMA represents approximately 200 securities firms and banks that underwrite, trade and sell fixed-income securities in the United States and in international markets. The Clearing House was founded over 150 years ago and is an association of leading commercial banks in the United States that provides payment, clearing and settlement services to its member banks and to other financial institutions. SIA brings together the shared

[1] Merrill Lynch & Co., Inc., Credit Suisse First Boston (USA), Inc. (n/k/a Credit Suisse (USA), Inc., Credit Suisse First Boston LLC (n/k/a Credit Suisse Securities (USA) LLC), and Pershing LLC (f/k/a Donaldson, Lufkin & Jenrette Securities Corporation).

interests of nearly 600 securities firms to accomplish common goals. *Amici* regularly file *amicus curiae* briefs in cases raising issues of importance to the securities markets and commercial banking industry.

The litigation in the District Court involves a complex set of facts. The primary legal issue sought to be resolved in this Court, however, is straightforward: Does an implied cause of action exist under Section 10(b) and Rule 10b-5 against a "secondary actor," such as a bank, which has made no misrepresentations and has no duty of public disclosure, on the purported ground that such secondary actors engaged in transactions with an issuer of securities, which the issuer later misreported. The District Court's affirmative answer to this question in its class certification order is at odds with the Supreme Court's decision in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994), which held that aiding and abetting is not civilly actionable under Section 10(b). It also conflicts with the holdings of other courts within this Circuit and beyond, which find no liability under such circumstances. *Compare In re Charter Communications, Inc.*, 443 F.3d 987, 991-92 (8th Cir. 2006) (rejecting analysis adopted by District Court here); *In re Dynegy*, 339 F. Supp. 2d 804, 916 (S.D. Tex. 2004) (same). Indeed, in a very recent order, issued after the

filing of the Petitions before this Court, the District Court itself recognized the significant disarray in the law and commented on the difficulties presented by the absence of clear guidance in this area. (July 20 Order at 42); *see also In re Enron Corp. Sec., Derivative & "ERISA" Litig.*, 2003 WL 22025050, at *3 (S.D. Tex. Jan. 27, 2003) ("division among the courts is so substantial [as to the proper standard under C*entral Bank*] that either a ruling by the Supreme Court or action by Congress appears necessary to resolve the differences.").

This issue is critically important to *Amici.* The members of *Amici* collectively engage in a vast array of transactions each year with publicly traded companies. Under the District Court's class certification ruling, such secondary actors face dramatically expanded potential civil liability, unchecked by the discretion of government enforcement officials.[2]

This area of law demands clarity at an early stage in the proceedings. *Id.* at 188-89; *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 755 (1975). Because the law in this area is anything but clear, and because the

[2] The SEC has authority to bring actions for aiding and abetting liability, even after *Central Bank. See SEC v. Fehn*, 97 F.3d 1276, 1283-84 (9th Cir. 1996).

District Court's class certification ruling in this case was in error, *Amici* request that the Court grant these Petitions.

ARGUMENT

A. The District Court's Class Certification Order Conflicts With The Language Of Section 10(b), The Supreme Court's Decision In *Central Bank* And Decisions Of Other Federal Courts

The starting point for an analysis of the issue here is the language of the statute. Section 10(b) of the Securities and Exchange Act of 1934 provides:

> It shall be unlawful for any person, directly or indirectly, . . . (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j(b). To implement Section 10(b), the Securities and Exchange Commission (SEC) long ago promulgated Rule 10b-5. 17 C.F.R. § 240.10b-5.

The elements of a claim under Section 10(b) and Rule 10b-5 are: Defendant must itself (1) use or employ any manipulative or deceptive device; (2) with *scienter*, (*i.e.*, a wrongful state of mind); (3) in connection

with the purchase or sale of a security. Plaintiffs must then have (4) relied on this conduct; (5) causing economic loss to plaintiffs with a connection between Defendant's conduct and the loss. *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336, 341-42 (2005).

A private right of action will not lie against "secondary actors" in securities markets, unless "*all* of the requirements for primary liability under Rule 10b-5 are met." *Central Bank*, 511 U.S. at 473 (emphasis original). Accordingly, there is no private right of action under Rule 10b-5 for aiding and abetting. *Id.* at 473.

This brief focuses on the first and third elements of a Section 10(b) claim, *i.e.* what constitutes the use or employment of a manipulative or deceptive device in connection with the purchase or sale of a security. *Dura*, 544 U.S. at 341. In their petitions here, Petitioners also focus on the reliance element and the impropriety of joint and several liability. *Amici* fully endorse Petitioners' reasoning and arguments on these points but do not address them separately.

The District Court held that Petitioners themselves made no actionable statements and had no duty to disclose anything. (June 5 Order at 49.) It nevertheless found that plaintiffs sufficiently alleged that Petitioners

"use[d] or employ[ed] a "manipulative or deceptive device" in "connection with the purchase or sale of any security" based on allegations that Petitioners' transactions had the "*principal purpose and effect*" of creating a false appearance of revenues. (June 5 Order at 79 (emphasis added).) The District Court thus found liability for secondary actors that were not accused of making any material misstatements or making materials omissions in the face of a duty of disclosure.[3]

Other cases, however, have rejected this view. *See, e.g., In re Dynegy*, 339 F. Supp. 2d 804, 916 (S.D. Tex. 2004) (rejecting Judge Harmon's analysis). As the Eighth Circuit persuasively explained in its recent opinion, *In re Charter Communications, Inc.*, the text of Section 10(b), the Supreme Court's precedent and the weight of authority from the federal courts mandate adoption of an entirely different principle: "any defendant who does not make or affirmatively cause to be made a fraudulent misstatement or omission, or who does not *directly engage* in manipulative securities trading practices, is at most guilty of aiding and abetting and

[3] As noted by Petitioners, other courts taking an unduly broad view of Section 10(b) (and consequently an unduly narrow view of *Central Bank*) include *Simpson v. AOL Time Warner Inc.*, _ F.3d _, 2006 U.S. App. LEXIS 16556, *27 (9th Cir. 2006) and *In re Parmalat*, 376 F. Supp. 2d 472, 492-503 (S.D.N.Y. 2005).

cannot be held liable under § 10(b) or any subpart of Rule 10b-5." 443 F.3d at 992 (emphasis added) (collecting authorities).

In particular, the class certification ruling focuses not on whether Petitioners actually used or employed a manipulative or deceptive device in connection with a securities transaction, but on whether they acted with a *purpose* of creating a false appearance of revenue and whether their transactions had the *effect* of harming purchasers of Enron securities.

This focus finds no support in the text of Section 10(b). Analysis of the "purpose" of a transaction addresses whether the element of *scienter* is met, but it ignores the defendant's actual *conduct* (*i.e.*, whether it actually "used or employed" a deceptive device in connection with a securities transaction, as the statute requires). 78 U.S.C. § 78j(b). The Supreme Court in *Central Bank*, however, clearly held that a Plaintiff must allege that the secondary actor itself engaged in every element of Section 10(b). *Central Bank*, 511 U.S. at 473.

The "effect" of a transaction also does not reveal whether a specific defendant actually used or employed a device in connection with such a transaction. The "effect" of a transaction is relevant to whether a purportedly manipulative or deceptive device ultimately results in injury

relating to a securities transaction, but it does not answer the question of which party used "use[d] or employe[d]" a device in connection with such a transaction.

To the extent that Plaintiffs in this case suffered injury, they were harmed by *Enron's* misreporting of the effect of certain transactions. But since Petitioners neither made any relevant statements to the investing public nor had a duty to do so, they never used any deceptive device in connection with a securities transaction. Their conduct with respect to Enron's misreporting can be at most that of aiders and abettors and therefore cannot give rise to liability under *Central Bank.*

Given the District Court's own frank acknowledgement of the disarray of the law in this area, this Court's guidance is necessary both to the efficient administration of further proceedings in this case, *and* to the business needs of the members of *Amici*, which require clarity on the legal standards that govern their conduct.

B. This Court Should Resolve The Issues Raised By The Petitions Now And Provide Needed Clarity To The Law In This Circuit

As the Supreme Court has stated, "litigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that

which accompanies litigation in general." *Central Bank*, 511 U.S. at 189. *Amici* urge this Court to resolve the issue raised by the Petitions now. Uncertainty and possible further misapplications of the law by other district courts in this Circuit may cause extraordinary costs to legitimate businesses such as members of *Amici*.

The District Court's holding that secondary actors are liable in damages for the misreporting of securities issuers will impose an immense burden on secondary actors in securities markets, such as members of *Amici*, because they could be forced to scrutinize and audit public financial statements of every issuer with which they do business in order to assure that they are not misleading the public. If such a requirement is to be imposed on financial institutions that are not themselves securities issuers (or even auditors), the decision to do so should be made by Congress after a public debate where all affected can be heard, and where a careful study of the costs and benefits of such a regime can be made. Clearly, such requirements should not be imposed *ad hoc* by the judicial branch.

Uncertainty and possible further misapplications of the law by other district courts in this Circuit could have other costly effects. If the decision below is permitted to stand uncorrected, members of *Amici* may very well be

unwilling to provide certain services to new, unestablished businesses who do not have a proven reputation for honesty in their dealings with the public. Thus, rather than reviving the securities markets in the wake of the loss of public confidence in them after the Enron scandal, this case may have the ironic effect of further depressing those markets. But this all can be avoided by this Court granting the Petitions for leave to appeal and clarifying that the district court's decision was inconsistent with *Central Bank*.

CONCLUSION

Amici pray that the Court grant these Petitions, reverse the District Court and settle the law in this Circuit on the important issues raised herein. If this is not an appropriate case for the exercise of discretion under Federal Rule of Civil Procedure 23(f), it is hard to imagine what would be.

Dated: July 26, 2006

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