UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

LAWRENCE E. JAFFE PENSION PLAN, on behalf of itself and all others similarly situated, Plaintiff,	No. 02-C-5893 (Consolidated)
vs.	Judge Ronald A. Guzman
HOUSEHOLD INTERNATIONAL, INC., et al., Defendants.	Magistrate Judge Nan R. Nolan

DEFENDANTS GOLDMAN SACHS AND MERRILL LYNCH'S REPLY MEMORANDUM OF LAW IN SUPPORT OF THEIR MOTION TO DISMISS THE CORRECTED AMENDED CONSOLIDATED CLASS ACTION COMPLAINT

David F. Graham
Julie K. Zeglis
SIDLEY AUSTIN BROWN & WOOD LLP
Bank One Plaza
10 South Dearborn Street
Chicago, Illinois 60603
(312) 853-7000
(312) 853-7036 (fax)

Of Counsel:

Michael J. Chepiga
Allison R. Kimmel
David H. LaRocca
SIMPSON THACHER & BARTLETT LLP
425 Lexington Avenue
New York, New York 10017
(212) 455-2000
(212) 455-2502 (fax)

Attorneys for Defendants
Goldman, Sachs & Co. and Merrill Lynch, Pierce, Fenner & Smith, Inc.

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PRELIMINARY STATEMENT

Plaintiffs' Opposition Brief ("Opp.") demonstrates that their belated claims against Goldman Sachs and Merrill Lynch (the "Banks") are legally baseless, strain any good faith extension of existing law, and should never have been brought. Indeed, in the face of the overwhelming case law cited by the Banks in their Opening Brief ("Def. Br."), Plaintiffs are constrained simply to abandon outright their claims under §§ 12 and 15 of the 1933 Act. Opp. at 1 n.3. And while Plaintiffs attempt to defend their remaining § 11 claim, their Opposition merely underscores that it is both time-barred and lacks critical elements.

Plaintiffs do not even attempt to argue that their claim is timely under the one-year/three-year statute of limitations. Instead, Plaintiffs argue that in expanding the statute of limitations for securities *fraud* claims, Congress actually adopted a universal two-year/five-year limitations period applicable to *all* securities claims, whether or not they allege fraud. Opp. at 4; Opposition Brief to Household Defendants' Motion ("HH Opp.") at 45-50. But, the express language of the Sarbanes-Oxley Act, the cases that have applied it and its legislative history show that Congress meant precisely what it clearly said – that the expanded statute applies only to securities law claims (unlike Plaintiffs' § 11 claim) that involve "fraud, deceit, manipulation, or contrivance." Plaintiffs' effort to overcome the clear statutory language through a distortedly selective quotation of legislative history merely raises further questions as to their good faith.

Plaintiffs' response as to the merits of their § 11 claim demonstrates an equally disturbing effort to end run longstanding legal precedent limiting securities law claims based on opinions, as well as defining who may be liable under § 11.

First, Plaintiffs claim that the Fairness Opinions are actionable if they simply allege "facts contravening the investment advisor's conclusion that the merger was fair." Opp. at 9. This assertion contradicts the clear, binding authority set forth in the Opening Brief, which establishes that a statement of opinion is only actionable if the opinion was inaccurate *and* the defendant did not hold the stated opinion. *See* Def. Br. at 6-8. Both requirements are absent here. With respect to the latter, Plaintiffs misconstrue the law in an attempt to avoid a fatal flaw in their complaint – the failure to allege that the Banks did not believe that the Exchange Ratio was fair. With regard to the former, Plaintiffs do not even dispute that the Complaint fails to allege that the Exchange Ratio was not fair *under the express assumptions and limitations* set forth in the Opinions. Yet that is all that was opined, and Plaintiffs' attempts to recast what was actually said are utterly improper.

Second, Plaintiffs whitewash the technical concept of an "expert" under § 11 – a status which the Banks expressly disclaimed in their Opinions – and attempt to transform the Banks' general status as global investment banks into *de facto* § 11 status. But, these general qualifications do not give rise to "expert" liability under § 11(a)(4), since the Banks were not named as experts in the Registration Statement, did not consent to be experts, and indeed expressly notified Beneficial shareholders that they were *not* acting in that role, unlike the accounting and auditing firms that expressly assumed expert status. Def. Br. at 11-13. Plaintiffs further distort the Banks' specific, limited role here, Opp. at 14, directly contrary to the express disclosure that they were relying on the accuracy and completeness of the financial information they were provided, and that they were not investigating Household's financial information at all, much less making an "in-depth investigation." *Id.* To nonetheless impose disclaimed "expert" status now would fly in the face of § 11's precise delineation of liability standards, and would increase the cost of fairness opinions and/or increase banks' reluctance to issue such opinions – a scenario the SEC has expressly sought to avoid in an analogous situation.

Third, in the face of the clear showing that the Banks were not "experts," Plaintiffs conjure a new theory of liability – that the Banks were actually functioning as *underwriters*. But, they were not underwriters (indeed, no stock was *underwritten* at all in the Merger), nor did they "participate" in the distribution of any Household securities such that they could be considered "statutory underwriters." Tellingly, **Plaintiffs do not cite a single case** to support their novel theory that giving a fairness opinion is "participation" in a distribution of securities to transform the Banks into statutory underwriters. And for good reason – a fairness opinion does not involve the type of instrumental role in such distribution required to impose liability as underwriters.

Zealous advocacy has its bounds, and the Complaint far exceeds them. The Banks assumed a narrow role as financial advisors to *Beneficial* in *June 1998*, rendered fairness opinions containing express limitations, and disclaimed any role as "experts" under § 11 in connection with the *Household* Registration Statement. Plaintiffs' belated attempt almost five years later to transform them into general guarantors of Household's financial condition – through gross distortions of clear statutory language and settled caselaw – should not be countenanced.

ARGUMENT

I. THE SARBANES-OXLEY ACT'S STATUTE OF LIMITATIONS PERIOD CLEARLY DOES NOT APPLY TO PLAINTIFFS' § 11 CLAIM

Plaintiffs do not dispute that their § 11 claim against the Banks is time-barred under the one-year/three-year statute of limitations in § 13 of the 1933 Act. *See* 15 U.S.C. § 77m.[1] Recognizing this, Plaintiffs disingenuously claim that the Sarbanes-Oxley Act's two-year/five-year statute of limitations applies. This argument defies the clear language of the statute, its legislative history and the relevant case law.

First, Plaintiffs incredibly claim that, "[b]y its own terms, the Sarbanes-Oxley Act's statute of limitations explicitly applies to all private securities claims . . . ." HH Opp. at 47; *see also* Opp. at 4.[2] Plaintiffs essentially argue that because the extended limitations period applies to certain claims arising under the "securities laws," it somehow applies to all claims arising under those laws. *See* HH Opp. at 46-47. But, Plaintiffs ignore the clear and explicit terms of the statute, which expressly state that the limitations period applies only to "securities law" claims involving "***fraud, deceit, manipulation, or contrivance***." 28 U.S.C. § 1658(b) (*as amended by* Sarbanes-Oxley Act of 2002) (emphasis added).

The only decided cases on this issue go against Plaintiffs. *Friedman v. Rayovac Corp.*, Nos. 02-C-308-C, 02-C-325-C, 02-C-370-C, slip. op. (W.D. Wis. June 20, 2003) (decision on motion for reconsideration), unequivocally holds that the enlarged statute of limitations does not apply to § 11 claims. In reaching its conclusion, the court rejected this exact argument now advanced by Plaintiffs here:

> Although it is true that the 1933 Act is a "securities law" within the meaning of § 78c(a)(47), this does not resolve the issue. The longer statute of limitations does not apply to *all* securities laws; it applies to securities laws "that involv[e] a claim of fraud, deceit, manipulation, or contrivance." The title of the provision creating the longer limitations period is called "Statute of Limitations for Securities

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[1] Plaintiffs concede – as they must – that their claims were filed more than three years after the Beneficial Registration Statement was issued on June 1, 1998. HH Opp. Br. at 46; *see also* Def. Br. at 5.

[2] Section 804 of the Sarbanes-Oxley Act states that the extended statute of limitations period applies to any "private right of action that involves a claim of fraud, deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning the securities laws, as defined in section 3(a)(47) of the Securities Exchange Act of 1934." 28 U.S.C. § 1658(b). Section 3(a)(47) defines the term "securities laws" as the Securities Act of 1933, the Securities Exchange Act of 1934, the Sarbanes-Oxley Act of 2002, the Public Utility Holding Company Act of 1935, the Trust Indenture Act of 1939, the Investment Company Act of 1940, the Investment Advisers Act of 1940, and the Securities Investor Protection Act of 1970. 15 U.S.C. § 78c(a)(47).

> *Fraud*". . . §§ 11 and 12(a)(2) of the 1933 Act do not require the plaintiff to prove an intent to deceive or any other mental state. Thus, the statute is clear that [it] **applies only to claims of fraud and, therefore, it does not apply to plaintiff's claims under § 11 and § 12(a)(2) of the 1933 Act.**"

Friedman, at 2-4 (citations omitted; italics in original; emphasis added). The other decided cases are in accord. *See In re Merrill Lynch & Co., Inc. Research Reports*, --- F.3d ---, 2003 WL 21518833, at *19 (S.D.N.Y. July 2, 2003) (§ 11 claims must be brought within the one-year/three-year statute of limitations, while § 10(b) claims brought after the enactment of Sarbanes-Oxley are subject to extended two-year/five-year limitations period); *In re Mirant Corp. Sec. Litig.*, CA No. 1:02-CV-1467-BBM, slip. op., at 11-12, (N.D. Ga. July 14, 2003) (same).[3] Thus, Plaintiffs' attempt to manipulate the express language of the statute must be rejected.

Second, Plaintiffs concede that their § 11 claim is not a fraud claim. *See* HH Opp. at 49.[4] However, in an attempt to circumvent the clear language of the statute, Plaintiffs incredibly suggest that the term "'contrivance' is not suggestive of fraud or intent" and, therefore, § 804 should apply to their non-fraud-based claims. *See* HH Opp. at 48-49. But the Supreme Court has expressly stated that the term "contrivance" shows an "unmistakable [] congressional intent to proscribe a type of conduct quite different from negligence." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 (1976). Moreover, "contrivance" is typically defined as "[a]ny device which has been arranged generally to deceive." *Black's Law Dictionary* 329 (6th Ed. 1990); *see also id.* (defining "contrive" as "[t]o devise; to plan; to plot; to scheme"); *Webster's Third New Int'l Dictionary Unabridged* 496 (1993) (defining contrivance as "skill at devising").[5] Beyond doubt,

3 Courts discussing the Sarbanes-Oxley Act's statute of limitations in other contexts have recognized that it does not apply to all securities law claims. *See Roberts v. Dean Witter Reynolds, Inc.*, No. 8:02-CV-2115-T-26EAJ, 2003 WL 1936116, at *1 (M.D. Fla. Mar. 31, 2003) ("For *particular* securities violations, the amendment extended the statute of limitations. . . .") (emphasis added); *Verizon Maryland Inc. v. RCN Telecom Servs., Inc.*, 232 F. Supp. 2d 539, 553 n.6 (D. Md. 2002) ("The amendment [] established a distinct federal statute of limitations for *certain* causes of action arising under the securities laws. . . .") (emphasis added).

4 Plaintiffs argue that fraud is never an element of a Section 11 claim and therefore the fact that they "merely invoke[d] a common pleading convention" by alleging that their claims do not sound in fraud is not material. *See* HH Opp. Br. at 48 & n.24. But, these are the exact reasons why the Sarbanes-Oxley Act statute of limitations does not apply – Plaintiffs' claim is not a fraud claim.

5 Even under Plaintiffs' definition of "contrivance" as "the vehicle through which the fraud is achieved," *see* HH Opp. Br. at 48, Plaintiffs fail to explain how their claims could possibly involve such a "a vehicle for fraud" where they specifically disclaim any allegations of fraud and allege that their claims are based solely on strict liability and/or negligence. *See* Comp. ¶ 354.

the term "contrivance," as well as the terms "fraud," "deceit," and "manipulation," connotes intentional, fraudulent conduct.

Third, undoubtedly recognizing that the statute's clear language refutes their argument, Plaintiffs resort to citing selective and misleading excerpts of the legislative history. *See* Opp. at 4; HH Opp. at 49-50. First, when the statutory language is unambiguous – as it is here – the Court need not look at its legislative history. *See Friedman*, at 4 ("When a statute is unambiguous, no further judicial inquiry into legislative intent is appropriate. It is therefore unnecessary to consider the [Sarbanes-Oxley Act's statute of limitations'] legislative history.") (citation omitted). Nevertheless, the legislative history confirms that Congress intended the enlarged statute of limitations to apply only to fraud claims, as the statutory language clearly provides:

- "This section would set the statute of limitations in private **securities fraud cases**...."
- "Section 804 protects victims by extending the statute of limitations in private **securities fraud cases**."
- "It would set the statute of limitations in private **securities fraud cases** to the earlier of five years after the date of the **fraud** or two years after the **fraud** was discovered."
- "The current statute of limitations for most such **fraud** cases is three years from the date of the **fraud** or one year after discovery, which can unfairly limit recovery for **defrauded** investors in some cases."
- "It applies to all private **securities fraud actions** . . ."
- "[T]he last two SEC Chairmen supported extending the statute of limitations in **securities fraud cases**."
- "In **fraud** cases the short limitations period under current law is an invitation to take sophisticated steps to conceal the **deceit**."
- "It is time that the law is changed to give victims the time they need to prove their **fraud** cases."

Legislative History of Title VIII of HR 2673: The Sarbanes-Oxley Act of 2002, 148 Cong. Rec. S. 7418, 7418-7420 (2002) (emphasis added), attached as Exhibit A.

Accordingly, the plain language of the statute and its legislative history make clear that the Sarbanes-Oxley Act's statute of limitations does not apply to Plaintiffs' § 11 claim against the Banks. Because Plaintiffs failed to assert this claim within three years of the issuance of the Fairness Opinions, it must be dismissed as time-barred under 15 U.S.C. § 77m.

II. THE FAIRNESS OPINIONS ARE NOT ACTIONABLE BECAUSE THEY DO NOT INCLUDE ANY UNTRUE STATEMENTS OF MATERIAL FACT

Because Plaintiffs' § 11 claim against the Banks is time-barred, the Court need not reach whether Plaintiffs have adequately alleged the elements of that claim. Nevertheless, Plaintiffs have not. Clear Supreme Court precedent (followed by other courts in similar circumstances as here) demonstrates that statements of opinion, like the Fairness Opinions, are only actionable where the speaker did not hold the opinion stated (subjective falsity) *and* the opinion was in fact incorrect (objective falsity). Plaintiffs fail both prongs.

A. Plaintiffs Do Not Dispute That The Banks Subjectively Believed The Exchange Ratio Was Fair

Plaintiffs argue that for a fairness opinion to be actionable, "a plaintiff need only allege facts contravening the investment advisor's conclusion that the merger was fair." Opp. at 9. Plaintiffs' myopic focus on objective falsity contradicts the clear and binding authority, *see* Def. Br. at 6-8, that a statement of opinion is only actionable if it both was objectively inaccurate *and* the speaker did not actually hold that opinion. The case law is clear. *See Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1096 (1991);[6] *see also In re Reliance Sec. Litig.*, 135 F. Supp. 2d 480, 515 (D. Del. 2001); *Freedman v. Value Health, Inc.*, 135 F. Supp. 2d 317, 337 (D. Conn. 2001), *aff'd*, 34 Fed. Appx. 408 (2d Cir. 2002); *In re McKesson HBOC, Inc. Sec. Litig.*, 126 F. Supp. 2d. 1248, 1265 (N.D. Cal. 2000); *Flake v. Hoskins*, 55 F. Supp. 2d 1196, 1227 (D. Kan. 1999); *Kahn v. Wien*, 842 F. Supp. 667, 677 (E.D.N.Y. 1994), *aff'd*, 41 F.3d 1501 (2d Cir. 1994).

Contrary to Plaintiffs' suggestion, Opp. at 11-12, the Banks do not attempt to import a scienter element into § 11. The requirement of alleging subjective falsity applies in the case of opinions whether or not scienter is an element of the asserted claim.[7] That is because when it comes to opinions, the very notion of falsity itself necessarily contains a subjective requirement. *See* Def. Br. at 6; *Virginia Bankshares,* 501 U.S. at 1090 (a statement of opinion "purports to

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[6] Contrary to Plaintiffs' assertion, *see* Opp. at 10, 12-13, *Virginia Bankshares* reviewed whether statements of opinion or belief are actionable *solely* where a defendant made such statements without "hold[ing] the beliefs or opinions expressed." 501 U.S. at 1090. The Supreme Court held that "disbelief or undisclosed motivation, *standing alone,* [is] insufficient." *Id.* at 1096 (emphasis added). Thus, it is necessary, but not sufficient, for a plaintiff to allege that the defendant did not believe the opinion was accurate.

[7] *See, e.g., Virginia Bankshares*, 501 U.S. at 1090 n.5 (reserving decision on whether scienter was element of the claim at issue); *Flake*, 55 F. Supp. 2d at 1227 (requiring allegations that defendants stated an opinion "even though they knew that th[e] statement was false" for Sections 11 and 12 claims).

express what is consciously on the speaker's mind" and therefore is false only if made "with knowledge that the [speaker] did not hold the [] opinions expressed"). Here, Plaintiffs do not contend – and the Complaint does not allege – that the Banks did not believe the Exchange Ratio was fair when they rendered the Opinions. Thus, they cannot establish – as the clear precedent cited above requires – that the Banks' Opinions knowingly did not state their actual beliefs.[8]

Plaintiffs feebly attempt to refute the cases cited in the Opening Brief by arguing that they are "no longer good law in light of the Second Circuit's decision in *Minzer* [*v. Keegan*, 218 F.3d 144 (2d Cir. 2000)]." Opp. at 12. But, a number of those decisions were issued **after** *Minzer*. *See In re Reliance Sec. Litig.*, 135 F. Supp. 2d 480 (decided 2001); *Freedman*, 135 F. Supp. 2d 317 (decided 2001; affirmed by Second Circuit 2002). That is not surprising because *Minzer* does not support Plaintiffs' claim that allegations of objective falsity alone suffice to state a claim under § 11. There, the court simply had no reason to analyze the defendants' subjective beliefs before rejecting the plaintiff's claim because the court *found that the plaintiff had not even alleged facts that the opinion was objectively false*. *See Minzer*, 218 F.3d at 151.[9]

Indeed, the Southern District of New York's recent holding in *Bond Opportunity Fund v. Unilab Corp.*, No. 99 Civ. 11074 (JSM), 2003 WL 21058251 (S.D.N.Y. May 9, 2003), flatly contradicts the argument that *Minzer* somehow overturned this settled law and affirms that a fairness opinion is only actionable if it was incorrect *and* the speaker did not hold that opinion:

> Plaintiffs who charge that a statement of opinion, including a fairness opinion, is materially misleading must allege . . . that the statement of opinion is both objectively and subjectively false. Thus, the **plaintiff must show both that the [defendants] did not actually hold the belief or opinion stated, *and* that the opinion stated was in fact incorrect.**

Id. at *5 (citing *Virginia Bankshares*) (italics in original; emphasis added).[10] This recent holding

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[8] While the issuance of an opinion that is not truly held suggests an actual knowledge standard, some lower courts, *see* Def. Br. at 7 n.4, have suggested that the subjective prong may be met if the speaker acted in reckless disregard as to the opinion's accuracy. Regardless, as pointed out in Def. Br. p.7, n.4, and as Plaintiffs do not dispute, they have expressly disclaimed allegations of both intentional and reckless conduct. Comp. ¶ 354

[9] *Zemel Family Trust v. Philips Int'l Realty Corp.*, 00 Civ. 7438 (MGC), 2000 U.S. Dist. LEXIS 17320 (S.D.N.Y. Nov. 30, 2000), cited by Plaintiffs, Opp. at 11, is also inapposite for this exact reason.

[10] *See also In re Merrill Lynch & Co.*, No. 02 MDL 1484 MP, 02 CV 3210 MP, 02 CV 3321 MP, 2003 WL 21500293, at *15 (S.D.N.Y. June 30, 2003) (citing *Bond Opportunity Fund*); *In re Real Estate Assocs. Ltd. P'ship Litig.*, 223 F. Supp. 2d 1142, 1148 (C.D. Cal. 2002) (plaintiff must plead speaker *knew* opinion was false); *Hayes v. Crown Cent. Petroleum Corp.*, 249 F. Supp. 2d 725, 735 (E.D. Va. 2002) (fairness opinion only actionable if *knowingly* false when made).

– rendered almost simultaneously with the filing of the Motion – underscores the continued vitality of *Virginia Bankshares* and its progeny as analyzed in the Opening Brief.[11]

Finally, the trio of § 10(b) cases from within the Seventh Circuit cited by Plaintiffs, Opp. at 10-11, to support their tortured reading of *Virginia Bankshares* do not do so. *Eckstein v. Balcor Film Investors*, 8 F.3d 1121 (7th Cir. 1993), merely held that a *future prediction* is not false "[i]f [it] had a reasonable basis when made;" it does not stand for the proposition that a fairness opinion is actionable *solely* if it proves to be objectively incorrect. *Id.* at 1132. And, in both *Ziemack* and *Beedie*, the defendants did not actually hold their stated opinion. *See Ziemack v. Centel Corp.*, 856 F. Supp. 430, 435-36 (N.D. Ill. 1994) (opinion actionable because defendants misrepresented the degree of interest of bidders in an acquisition *knowing* that the bidders in fact had shown only "weak interest"); *Beedie v. Battelle Mem'l Inst.*, Case No. 01 C 6740, 2002 U.S. Dist. LEXIS 171, at *12-13 (N.D. Ill. Jan. 4, 2002) (company's false statements that it had validated the effectiveness of its product were actionable where company *knew*, and did not disclose to investors, that it had no data supporting these assertions).[12]

The overwhelming case law, including the Supreme Court's *Virginia Bankshares*, thus refutes Plaintiffs' argument that they need not allege that the Fairness Opinions were subjectively false, despite Plaintiffs' attempt to manufacture authority through tortured readings. Plaintiffs' failure to allege that the Banks did not actually hold the opinion that the Exchange Ratio was fair is fatal to their claim. For this reason alone, the § 11 claim must be dismissed.

B. Plaintiffs Do Not Allege That The Exchange Ratio Was Unfair Based On The Information Expressly Relied On By The Banks

Plaintiffs do not contest the correctness of the only opinion actually expressed by the Banks – that the Exchange Ratio was fair based on the information expressly relied on by them.

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11 Plaintiffs' conclusory assertion that *Perlman* and *Kahn* offer "no pertinent analysis," Opp. at 12, rings hollow. Both cases clearly held that a statement of opinion is actionable only if the opinions were *knowingly* false when made. *Perlman v. Zell*, 938 F. Supp. 1327, 1340 (N.D. Ill. 1996) (citing *Virginia Bankshares*), *aff'd in part and vacated in part on other grounds*, 185 F.3d 850 (7th Cir. 1999); *Kahn*, 842 F. Supp. at 677 (same). *See also United States v. Morris*, 80 F.3d 1151, 1163-65 (7th Cir. 1996) (opinion false if speaker "did not truly believe" its opinion *and* statement was not supported by available facts) (citing *Virginia Bankshares*).

12 *See also Kaplan v. Rose*, 49 F.3d 1363 (9th Cir. 1994) (company knew information contradicting its statement before it was made) (Opp. at 11). The remaining cases cites by Plaintiffs, *id.*, are also unpersuasive. *Herskowitz v. Nutri/System, Inc.*, 857 F.2d 179 (3d Cir. 1988), predates *Virginia Bankshares* and, accordingly, is no longer good law. And, not only does *In re Westinghouse Sec. Litig.*, CA No. 91-354, 1998 U.S. Dist. LEXIS 3033 (W.D. Pa. Mar. 12, 1998), rely on *Herskowitz*, but the challenged statement in that case was not one of opinion or belief.

Instead, Plaintiffs improperly attempt to characterize the Fairness Opinions as opinions regarding the accuracy of Household's financial statements, *see* Opp. at 10, something they clearly and expressly were not. Although Plaintiffs seem to believe that the Banks could have or should have rendered different Opinions, *see* Opp. at 10; Comp. ¶¶ 373, 378, the truthfulness of the Fairness Opinions can only be viewed in the context in which they were *actually* rendered. *See Nielson v. Greenwood*, 849 F. Supp. 1233, 1242 (N.D. Ill. 1993) (central inquiry in determining objective falsity is "whether, taken together and *in context*," the statements were false and misleading) (internal quotations and citations omitted) (emphasis added).[13]

Where a fairness opinion discloses the assumptions and limitations on which it is based, they are part of the opinion and necessarily supply the context for evaluating its truthfulness. *See* Def. Br. at 8; *Ince & Co. v. Silgan Corp.*, Civ. A. No. 10941, 1991 WL 17171, at *6 (Del. Ch. Feb. 7, 1991) (fairness opinion was not materially false and misleading in light of express disclaimers as to its limited scope). As *Kitchens v. U.S. Shelter*, Civil Action No. 82-1951-1, 1988 U.S. Dist. LEXIS 18546 (D.S.C. June 30, 1988), held, "[a] fairness opinion has an accepted meaning and focus within the securities industry. **Its scope is defined by the contract that the author has with the entity who pays for the work. A fairness opinion should be judged on the basis of that scope.**" *Id.* at *68 (emphasis added) (cited by Plaintiffs, Opp. at 7).

Plaintiffs do not dispute that the Banks expressly disclosed that their limited Opinions were *based solely on the information provided to them and assumed to be accurate and complete,* and that the Opinions were, in fact, accurate within these explicitly assumed parameters. *See* Def. Br. at 8; Comp. ¶ 372; *see also* Opp., Ex. D (Registration Statement specifically states that each Fairness Opinion "should be read in its entirety with respect to assumptions made, matters considered and limitations on the review undertaken by" the Banks). Accordingly, Plaintiffs do not and cannot argue that, in light of these express limitations, the Opinions were false or misleading.

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13 The only contrary case that Plaintiffs cite, *Picard Chem. Inc. Profit Sharing Plan v. Perrigo Co.*, 940 F. Supp. 1101 (W.D. Mich. 1996), Opp. at 13, held that a defendant can be liable under Section 10(b) for forward-looking statements where the defendant did not just use misleading information supplied to it, but rather "control[led] the content" of the misleading information by expressly adopting and elaborating on it in a broader analysis. *Id.* at 1120. Here, the Banks did not adopt any of the information provided to it, but rather expressly disclosed that they were merely assuming the accuracy and completeness of that information in rendering their Opinions.

III. THE BANKS WERE NOT "EXPERTS" FOR § 11 PURPOSES

Plaintiffs' claim must also be dismissed for the independent reason that the Banks cannot be liable as "experts" under § 11(a)(4). Plaintiffs do not dispute that the Banks (i) were not named as "experts" in the Registration Statement; (ii) did not consent to be named as "experts" in the Registration Statement; and (iii) expressly notified Beneficial shareholders that they were not acting as "experts" within the meaning of § 11(a)(4). *See* Def. Br. at 11-13. Nonetheless, Plaintiffs argue that the Banks are "experts" whose profession gives authority to their statements (the Fairness Opinions) because they are "global" investment banking firms that often provide a "wide range of financial services," including "underwriting" and "valuations for estate, corporate, and other purposes." Opp. at 7-8.[14]

But while Plaintiffs correctly note that the Banks *sometimes* agree to undertake a more extensive analysis of a company or a proposed transaction (and are compensated accordingly), *id.*, they conflate the roles in which the Banks *sometimes* act and the role in which they *did* act here. *Compare id. with* Comp. ¶ 372. Their general qualifications as investment banks do not give "authority" to their statements here, because the Banks made clear that they were not acting in such an "expert" role. When, as in this instance, an entity expressly disclaims "expert" status, and thereby notifies others that no such "authority" is meant to attach to its statements, they have not "expertised" their statements. *See generally Herman & MacLean v. Huddleston*, 459 U.S. 375, 381 n. 11 (1983) (a person whose profession gives authority to the statement made by him may only be liable for statements he "expertise[d]"); Comp. ¶ 372.

Indeed, the SEC has expressly recognized, in an analogous situation, that when a person who might otherwise be viewed as an "expert" discloses the limitations depriving his statements of authority, §11(a)(4) liability may not attach to those statements. Under 17 C.F.R. § 230.436, an independent accountant is not one whose "profession gives authority" to its statements under § 11(a)(4) if it issues "a report on unaudited interim financial information," as long as the accountant identifies the information it reviewed, describes the procedures that it used in its analysis, and acknowledges the limited scope of its report. 17 C.F.R. §§ 230.436(c), (d). The SEC's impetus for imposing this rule:

[14] Plaintiffs do not contend, Opp. at 13, that the Banks may be liable under § 11(a)(4) for statements in the Registration Statement (including the alleged false financial information) other than the Fairness Opinions. *See also* Def. Br. at 12.

> was concern that… there may be reluctance on the part of accountants to issue reports on the basis of [] limited review procedures… because of their potential liability under Section 11(a) of the Securities Act; and that, alternatively, if accountants perform significantly expanded procedures, much closer to a complete audit, in order to meet potential liability concerns under Section 11(a), substantial increased costs to issuers could result.

McFarland v. Memorex Corp., 493 F. Supp. 631, 643 n. 16 (N.D. Cal. 1980) (*quoting* SEC Release No. 33-6173, at 8); *see id.* at 643 (accountants "can bear no Section 11 liability" where they did not audit the financial information).

The impact of 17 C.F.R. § 230.436 on this action is clear. Accountants are the archetypical experts under § 11(a)(4). If their "profession" does not give expert "authority" to their statements when their reports are expressly based on limited, "unaudited" information, surely the Banks' "profession" does not give such "authority" when, as here, they too identify the information they reviewed, describe the procedures they used in their analysis, and acknowledge the limited scope of the Fairness Opinions, particularly where they disclaim being "experts" altogether. *See* Comp. ¶ 372; Def. Br., Exs. B & C.

Indeed, the very concerns the SEC expressed in limiting § 11(a)(4) liability for accountants apply equally here. A holding that the Banks are liable under § 11 will significantly alter the compensation that investment banks will demand before issuing a fairness opinion, if they agree to issue one at all. This reluctance, combined with the increased cost of such opinions, ultimately will negatively impact shareholders – the very result § 11 aims to prevent.

Finally, Plaintiffs' assertion that the Banks are experts under § 11(a)(4) because they somehow delivered a "message" that they would uncover certain "red flags" as to Household's "true" financial situation, Opp. at 14, directly contradicts the express limitations in the Fairness Opinions. The Banks were not asked, and did not undertake, to investigate the accuracy or completeness of the information provided to them. *See* Comp. ¶ 372; Def. Br., Ex. C at 38-42 (identifying the specific tasks performed by the Banks). It could not have been clearer that the Banks were not vouching for the accuracy of Household's financial information, which was "expertised" by auditor Arthur Anderson LLP. *See* Def. Br., Ex. A (Registration Statement, "Experts" section). Plaintiffs imply that the Banks were overpaid for rendering the Fairness Opinions and "should have" done more. *See* Opp. at 14. Yet, Plaintiffs' opinion as to what the scope of the Banks' engagement *should have* been (and the compensation they *should have* received) does not alter what their engagement actually *was*, and that it did not include auditing Household's financial information, or otherwise "expertising" any statements.

In short, merely stating that the Banks are generic "experts" and acted as such *with respect to the Beneficial Registration Statement* for purposes of § 11 does not make it so. There simply is no basis for extending § 11 liability to the Banks here merely for issuing limited opinions that expressly warned that they were not to be treated as authoritative "expert" statements.[15]

IV. THE COMPLAINT DOES NOT – AND COULD NOT – ALLEGE THAT THE BANKS ACTED AS UNDERWRITERS

Because it is clear that the Banks cannot be liable as "experts" – the only alleged basis in the Complaint for asserting liability – Plaintiffs now attempt to argue that they should be liable as "underwriters" under § 11(a)(5).[16] But, Plaintiffs have alleged no facts to support this new contention. Nor did the Banks play the type of instrumental role in the distribution of securities that courts require to impose liability on "participants" as "statutory underwriters." The issuance of the Fairness Opinions is wholly insufficient to render the Banks statutory underwriters.

Plaintiffs simply do not allege (or even argue) that the Banks acted as traditional underwriters with respect to the Household merger, nor could they. *See, e.g., Sanders v. Nuveen*, 619 F.2d 1222, 1224 (7th Cir. 1980) ("As the underwriter, it bought the notes … and resold them to customers at a profit."); 69 Am. Jur. 2d *Securities Regulation – Federal* § 69 n.82 (2002) (an underwriter sells securities to the public either as an agent for the issuer or as principal by purchasing the securities and then selling them to the public).[17] In fact, the Merger involved no

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15 Plaintiffs cite only one case, *Kitchens*, 1988 U.S. Dist. LEXIS 18546, for the unique proposition that an investment bank may be an "expert" for rendering a fairness opinion that is used in a registration statement. *See* Opp. Br. at 7. However, the *Kitchens* court did not analyze whether the defendant in that case expressly limited its role as the Banks did here. *Kitchens*, 1988 U.S. Dist. LEXIS 18546, at *68. Indeed, the *Kitchens* court found that the fairness opinion at issue was not false and misleading (and consequently that the defendant was not liable), and therefore its statement that the defendant was an "expert" is merely dicta. *See id.* at *71.

16 Plaintiffs feign surprise that the Banks did not realize that Plaintiffs supposedly asserted a claim against them as underwriters, *see* Opp. at 5 n.4, but, the Complaint in no way put them on notice that they were asserting such a claim – the term "underwriter" does not appear anywhere with respect to the Banks.

17 Section 2(11) of the 1933 Securities Act defines an "underwriter" as "any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking…." 15 U.S.C. § 77b(11). Plaintiffs do not allege that the Banks either purchased Household securities from Household with the goal of redistributing them, offered or sold Household securities on behalf of Household, or participated in the underwriting of such securities.

underwriters *at all*, much less the Banks. *See* Def. Br. at 3 n.1 (Registration Statement) (no underwriters identified).

Plaintiffs contend that the Banks should be liable as statutory underwriters "for every material false and misleading statement contained in the Registration Statement" because they supposedly "participated" in the distribution of Household securities. Opp. at 5-6. Plaintiffs' sole basis for now asserting that they have alleged underwriter liability is their generic allegations (which do not even specifically mention the Banks) that all defendants "issued," Comp. ¶ 379, and "participated in drafting, revising or approving the Beneficial Registration Statement." Comp. ¶ 376. Such conclusory allegations of participation are insufficient. *See, e.g., McFarland*, 493 F. Supp. at 643 (mere allegations of "participation" and "assistance" in the preparation of the registration statement insufficient to impose liability for the entire registration statement).[18]

The only facts Plaintiffs allege with respect to the Banks are that, as financial advisors to Beneficial, they issued the Fairness Opinions to Beneficial, and the Opinions were included in the Registration Statement. Not surprisingly, **Plaintiffs do not cite one case that holds that the issuance of a fairness opinion constitutes "participation" in a distribution of securities to impose statutory underwriter liability.**

Harden v. Raffensperger, Hughes & Co., 65 F.3d 1392 (7th Cir. 1995), the case on which Plaintiffs primarily rely, *see* Opp. at 5-6, is totally irrelevant. In *Harden*, the Seventh Circuit held that a person who acts as a "qualified independent underwriter" "participates in the underwriting" (a theory of liability not asserted by Plaintiffs here) by virtue of the explicit duties it performs pursuant to NASD rules. *Harden*, 65 F. 3d at 1401.[19] The NASD rules require a qualified independent underwriter to perform due diligence, participate in the preparation of the registration statement, and, significantly, agree "'to undertake the legal responsibilities and liabilities of an underwriter under the Securities Act of 1933, specifically including those inherent in Section 11.'" *Id.* at 1398. Unlike a qualified independent underwriter, the Banks did not agree to undertake any of the legal responsibilities or liabilities of an underwriter under § 11.

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18 When Plaintiffs acknowledged that the Complaint does not support a Section 12(a)(2) claim against the Banks, they effectively conceded that the conclusory allegations of participation on which they now rely (Comp. ¶¶ 376, 379) are insufficient to meet what Plaintiffs claim, Opp. at 5, is *Pinter's* "broad" definition of "participation" for Section 12 purposes. *See* Def. Br. at 9-10 (citing cases).

19 An issuer cannot use an affiliated company as its underwriter unless it also retains an independent company (a "qualified independent underwriter") to insulate the transaction. *Harden*, 65 F.3d at 1404.

Moreover, they did not perform the duties of an underwriter, such as due diligence or verifying Household's financial statements and other information in the Registration Statement. *See id.* at 1395.

The definition of "underwriter" for § 11 purposes simply does not include, as Plaintiffs suggest, every person who had some connection to a merger. *See, e.g.*, Opp. at 5 n.4, 6 (arguing that banks qualify as underwriters because they "participat[ed] in effectuating the merger" by acting as financial advisors to Beneficial). Under such a limitless definition, every lawyer, accountant, investment bank, consultant, or other advisor to either party to a merger could be deemed an "underwriter" with the attendant § 11 liability. If that were the case, there would have been no need for Congress to specifically delineate the specific and narrow categories of proper § 11 defendants.

Rather, the participation that is envisioned by § 2(11) requires the performance of some actions that play an instrumental role in the distribution of securities from the issuer to the investor, not merely that "but for" defendants' actions, the distribution would not have taken place. *Compare SEC v. Int'l Chem. Dev. Corp.*, 469 F.2d 20, 33 (10th Cir. 1972) (defendant who "served as a conduit for the distribution of the[] shares" was a statutory underwriter because his participation "was a vital aspect in the steps necessary to the distribution") *with In re Activision Sec. Litig.*, 621 F. Supp. 415, 423-24 (N.D. Cal. 1985) (investors who sold shares to underwriters who then sold those shares to the public did not "participate" in distribution); *McFarland*, 493 F. Supp. at 644-646 (warrantholders who sold warrants to underwriters, who then sold resulting shares in an offering, did not "participate" in distribution of securities).

Neither Goldman Sachs nor Merrill Lynch had any affiliation with Household in connection with the Beneficial Registration Statement, nor assisted in any distribution of Household securities. *See Ingenito v. Bermec Corp.*, 441 F. Supp. 525, 535-36 (S.D.N.Y. 1977) (no underwriter claim where defendant did not purchase securities with an eye to public redistribution, sell the issuer's security, or "act[] on behalf of [issuer] by paving the way for a public sale"). Plaintiffs have not alleged that they promoted the sale of securities on behalf of Household, aided the actual transfer of Household securities from Household to the public, acted as intermediaries between Household and the public, or in any way participated in any sale or distribution of Household shares. **Indeed, they did not even work for Household: they were retained by Beneficial.** Moreover, the Banks did not solicit shareholder approval of the Merger.

See Comp. ¶ 372 (specific disclaimer that Opinions were not recommendations to Beneficial's shareholders as to whether to approve the merger).

Even if the Fairness Opinions helped the Beneficial Board determine whether to approve the Merger, *see* Opp. at 6, *citing* Ex. E (disclosing seven specific factors, of many considered, on which Beneficial's Board relied in determining to approve the merger),[20] this is not the same as a necessary step in the *distribution* of Household Securities. *Cf. SEC v. Dolnick*, 501 F.2d 1279, 1282-83 (7th Cir. 1974) (defendant who organized a meeting at which he expected a stock transfer to occur participated in distribution of securities); *Int'l Chem. Dev. Corp.*, 469 F.2d at 33 (a person participates in distribution of securities when they acquire and distribute stock or arrange for the purchase of shares). Thus, the issuance of a fairness opinion is not the type of "participation" in a distribution of securities from the issuer (in this case, Household) to the public required to impose underwriter liability.

Plaintiffs' belated attempt to apply the term statutory underwriter to the Banks here is unsupported by the case law and would stretch the definition beyond all recognition.

CONCLUSION

For all of the foregoing reasons, the Banks respectfully request their motion to dismiss be granted in its entirety.

Dated: July 21, 2003

Respectfully submitted,

By: ______________________

David F. Graham
Julie K. Zeglis
SIDLEY AUSTIN BROWN & WOOD LLP
Bank One Plaza
10 South Dearborn Street
Chicago, Illinois 60603
(312) 853-7000 (tel.); (312) 853-7036 (fax)

Attorneys for Defendants
Goldman, Sachs & Co. and Merrill Lynch, Pierce, Fenner & Smith, Inc.

Of Counsel:

Michael J. Chepiga
Allison R. Kimmel
David H. LaRocca
SIMPSON THACHER & BARTLETT LLP
425 Lexington Avenue
New York, New York 10017
(212) 455-2000 (tel.); (212) 455-2502 (fax)

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[20] Contrary to Plaintiffs' assertion, Opp. at 6, "fairness opinions . . . are not required as a matter of law" in merger transactions. *Smith v. Van. Gorkom*, 488 A.2d 858, 866 (Del. 1985).

CERTIFICATE OF SERVICE

Julie K. Zeglis, an attorney, hereby certifies that on Monday, July 21, 2003, she caused a copy of the foregoing DEFENDANTS GOLDMAN SACHS AND MERRIL LYNCH'S REPLY MEMORANDUM OF LAW IN SUPPORT OF THEIR MOTION TO DISMISS THE CORRECTED AMENDED CONSOLIDATED CLASS ACTION COMPLAINT to be served on the persons listed below:

BY HAND DELIVERY

Marvin A. Miller
Jennifer Winter Sprengel
Lori A. Fanning
MILLER FAUCHER and CAFFERTY LLP
30 North LaSalle Street, Suite 3200
Chicago, Illinois 60602
(312) 782-4880
(312) 782-4485 (fax)

BY FACSIMILE AND U.S. MAIL

Patrick J. Coughlin
Azra Z. Mehdi
Luke O. Brooks
MILBERG WEISS BERSHAD HYNES & LERACH LLP
100 Pine Street, Suite 2600
San Francisco, CA 94111
(415) 288-4545
(415) 288-4534 (fax)

William S. Lerach
MILBERG WEISS BERSHAD HYNES & LERACH LLP
401 B Street, Suite 1700
San Diego, CA 92101
(619) 231-1058
(619) 231-7423 (fax)

Nathan P. Eimer
Adam B. Deutsch
EIMER STAHL KLEVORN & SOLBERG
224 South Michigan Avenue, Suite 110
Chicago, Illinois 60064-2516
(312) 660-7600
(312) 692-1718 (fax)

Paul Vizcarrondo, Jr.
Warren R. Stern
WACHTELL, LIPTON, ROSEN & KATZ
51 West 52nd Street
New York, New York 10019
(212) 403-1000
(212) 403-2000 (fax)

Robert Y. Sperling
WINSTON & STRAWN
35 West Wacker Drive
Chicago, Illinois 60601
(312) 558-5600
(312) 558-5700 (fax)

Stanley Parzen
Lucia Nale
MAYER, BROWN, ROWE & MAW LLP
190 South LaSalle Street
Chicago, Illinois 60603-3441
(312) 782-0600
(312) 701-7711 (fax)

Julie K. Zeglis

LEGISLATIVE HISTORY OF TITLE VIII OF HR 2673: THE SARBANES-OXLEY ACT OF 2002

Mr. LEAHY. Mr. President, yesterday during my floor remarks on the final passage of H.R. 2673, the Sarbanes-Oxley Act, I requested unanimous consent that a section by section analysis and discussion of Title VIII, the Corporate and Criminal Fraud Accountability Act, which I authored, be included in the CONGRESSIONAL RECORD as part of the official legislative history of those provisions of H.R. 2673. That unanimous consent request was granted, but due to a clerical error, this essential legislative history was not printed in yesterday's CONGRESSIONAL RECORD.

It is my understanding that this document will appear in yesterday's CONGRESSIONAL RECORD when the historical volume is compiled. However, in order to provide guidance in the legal interpretation of these provisions of Title VIII of H.R. 2673 before that volume is issued, I ask unanimous consent that the same document be printed in today's CONGRESSIONAL RECORD and be treated as legislative history for Title VIII, offered by the sponsor of these provisions, as if it had been printed yesterday.

There being no objection, the material was ordered to be printed in the RECORD, as follows:

SECTION-BY-SECTION ANALYSIS AND DISCUSSION OF THE CORPORATE AND CRIMINAL FRAUD ACCOUNTABILITY ACT (TITLE VIII OF H.R. 2673)

Title VIII has three major components that will enhance corporate accountability. Its terms track almost exactly the provisions of S. 2010, introduced by Senator Leahy and reported unanimously from the Committee on the Judiciary. Following is a brief section by section and a legal analysis regarding its provisions.

SECTION-BY-SECTION ANALYSIS

Section 801.—Title. "Corporate and Criminal Fraud Accountability Act."

Section 802. Criminal penalties for altering documents

This section provides two new criminal statutes which would clarify and plug holes in the current criminal laws relating to the destruction or fabrication of evidence and the preservation of financial and audit records.

First, this section would create a new 20-year felony which could be effectively used in a wide array of cases where a person destroys or creates evidence with the intent to obstruct an investigation or matter that is, as a factual matter, within the jurisdiction of any federal agency or any bankruptcy. It also covers acts either in contemplation of or in relation to such matters.

Second, the section creates a new 10-year felony which applies specifically to the willful failure to preserve audit papers of companies that issue securities. Section (a) of the statute has two sections which apply to accountants who conduct audits under the provisions of the Securities and Exchange Act of 1934. Subsection (a)(1) is an independent criminal prohibition on the destruction of audit or review work papers for five years, as that term is widely understood by regulators and in the accounting industry. Subsection (a)(2) requires the SEC to promulgate reasonable and necessary regulations within 180 days, after the opportunity for public comment, regarding the retention of categories of electronic and non-electronic audit records which contain opinions, conclusions, analysis or financial data, in addition to the actual work papers. Willful violation of such regulations would be a crime. Neither the statute nor any regulations promulgated under it would relieve any person of any independent legal obligation under state or federal law to maintain or refrain from destroying such records. In Conference language was added that further clarified that the rulemaking called for under the (b) provision was mandatory, and gave the SEC authority to amend and supplement such rules in the future, after proper notice and comment.

Section 803.—Debts nondischargeable if incurred in violation of securities fraud laws

This provision would amend the federal bankruptcy code to make judgments and settlements arising from state and federal securities law violations brought by state or federal regulators and private individuals nondischargeable. Current bankruptcy law may permit wrongdoers to discharge their obligations under court judgments or settlements based on securities fraud and securities law violations. The section, by its terms, applies to both regulatory and more traditional fraud matters, so long as they arise under the securities laws, whether federal, state, or local.

This provision is meant to prevent wrongdoers from using the bankruptcy laws as a shield and to allow defrauded investors to recover as much as possible. To the maximum extent possible, this provision should be applied to existing bankruptcies. The provision applies to all judgments and settlements arising from state and federal securities laws violations entered in the future regardless of when the case was filed.

Section 804.—Statute of limitations

This section would set the statute of limitations in private securities fraud cases to the earlier of two years after the discovery of the facts constituting the violation or five years after such violation. The current statute of limitations for most private securities fraud cases is the earlier of three years from the date of the fraud or one year from the date of discovery. This provision states that it is not meant to create any new private cause of action, but only to govern all the already existing private causes of action under the various federal securities laws that have been held to support private causes of action. This provision is intended to lengthen any statute of limitations under federal securities law, and to shorten none. The section, by its plain terms, applies to any and all cases filed after the effective date of the Act, regardless of when the underlying conduct occurred.

Section 805.—Review and enhancement of criminal sentences in cases of fraud and evidence destruction

This section would require the United States Sentencing Commission ("Commission") to review and consider enhancing, as appropriate, criminal penalties in cases involving obstruction of justice and in serious fraud cases. The Commission is also directed to generally review the U.S.S.G. Chapter 8 guidelines relating to sentencing organizations for criminal misconduct, to ensure that such guidelines are sufficient to punish and deter criminal misconduct by corporations. The Commission is asked to perform such reviews and make such enhancements as soon as practicable, but within 180 days at the most.

Subsection 1 requires that the Commission generally review all the base offense level and sentencing enhancements under U.S.S.G. §2J1.2. Subsection 2 specifically directs the Commission to consider including enhancements or specific offense characteristics for cases based on various factors including the destruction, alteration, or fabrication of physical evidence, the amount of evidence destroyed, the number of participants, or otherwise extensive nature of the destruction, the selection of evidence that is particularly probative or essential to the investigation, and whether the offense involved more than minimal planning or the abuse of a special skill or position of trust. Subsection 3 requires the Commission to establish appropriate punishments for the new obstruction of justice offenses created in this Act.

Subsections 4 and former subsection 5 of the Senate passed bill, which was moved to Title 11 in Conference, require the Commission to review guideline offense levels and enhancements under U.S.S.G. §2B1.1, relating to fraud. Specifically, the Commission is requested to review the fraud guidelines and consider enhancements for cases involving significantly greater than 50 victims and cases in which the solvency or financial security of a substantial number of victims is endangered. New Subsection 5 requires a comprehensive review of Chapter 8 guidelines relating to sentencing organizations. It is specifically intended that the Commission's review of Section 8 be comprehensive, and cover areas in addition to monetary penalties, additional punishments such as supervision, compliance programs, probation and administrative action, which are often extremely important in deterring corporate misconduct.

Section 806.—Whistleblower protection for employees of publicly traded companies

This section would provide whistleblower protection to employees of publicly traded companies. It specifically protects them when they take lawful acts to disclose information or otherwise assist criminal investigators, federal regulators, Congress, supervisors (or other proper people within a corporation), or parties in a judicial proceeding in detecting and stopping fraud. If the employer does take illegal action in retaliation for lawful and protected conduct, subsection (b) allows the employee to file a complaint with the Department of Labor, to be governed by the same procedures and burdens of proof now applicable in the whistleblower law in the aviation industry. The employee can bring the matter to federal court only if the Department of Labor does not resolve the matter in 180 days (and there is no showing that such delay is due to the bad faith of the claimant) as a normal case in law or equity, with no amount in controversy requirement. Subsection (c) governs remedies and provides for the reinstatement of the whistleblower, backpay, and compensatory damages to make a victim whole, including reasonable attorney fees and costs, as remedies if the claimant prevails. A 90 day statute of limitations for the bringing of the initial administrative action before the Department of Labor is also included.

Section 807.—Criminal penalties for securities fraud

This provision would create a new 10-year felony for defrauding shareholders of publicly traded companies. The provision would supplement the patchwork of existing technical securities law violations with a more general and less technical provision, with elements and intent requirements comparable to current bank fraud and health care fraud statutes. It is meant to cover any scheme or artifice to defraud any person in connection with a publicly traded company. The acts terms are not intended to encompass technical definition in the securities laws, but rather are intended to provide a flexible tool to allow prosecutors to address the wide array of potential fraud and misconduct which can occur in companies that are publicly traded. Attempted frauds are also specifically included.

DISCUSSION

Following is a discussion and analysis of the Act's Title 8 provisions.

Section 802 creates two new felonies to clarify and close loopholes in the existing criminal laws relating to the destruction or fabrication of evidence and the preservation of financial and audit records. First, it creates a new general anti shredding provision, 18 U.S.C. §1519, with a 10-year maximum prison sentence. Currently, provisions governing the destruction or fabrication of evidence are a patchwork that have been interpreted, often very narrowly, by federal courts. For instance, certain current provisions make it a crime to persuade another person to destroy documents, but not a crime to actually destroy the same documents yourself. Other provisions, such as 18 U.S.C. §1503, have been narrowly interpreted by courts, including the Supreme Court in United States v. Aguillar, 115 S. Ct. 593 (1995), to apply only to situations where the obstruction of justice can be closely tied to a pending judicial proceeding. Still other statutes have been interpreted to draw distinctions between what type of government function is obstructed. Still other provisions, such as sections 152(8), 1517 and 1518 apply to obstruction in certain limited types of cases, such as bankruptcy fraud, examinations of financial institutions, and healthcare fraud. In short, the current laws regarding destruction of evidence are full of ambiguities and technical limitations that should be corrected. This provision is meant to accomplish those ends.

Section 1519 is meant to apply broadly to any acts to destroy or fabricate physical evidence so long as they are done with the intent to obstruct, impede or influence the investigation or proper administration of any matter, and such matter is within the jurisdiction of an agency of the United States, or such acts done either in relation to or in contemplation of such a matter or investigation. The fact that a matter is within the jurisdiction of a federal agency is intended to be a jurisdictional matter, and not in any way linked to the intent of the defendant. Rather, the intent required is the intent to obstruct, not some level of knowledge about the agency processes of the precise nature of the agency of court's jurisdiction. This statute is specifically meant not to include any technical requirement, which some courts have read into other obstruction of justice statutes, to tie the obstructive conduct to a pending or imminent proceeding or matter by intent or otherwise. It is also sufficient that the act is done "in contemplation" of or in relation to a matter or investigation. It is also meant to do away with the distinctions, which some courts have read into obstruction statutes, between court proceedings, investigations, regulatory or administrative proceedings (whether formal or not), and less formal government inquiries, regardless of their title. Destroying or falsifying documents to obstruct any of these types of matters or investigations, which in fact are proved to be within the jurisdiction of any federal agency are covered by this statute. Questions of criminal intent are, as in all cases, appropriately decided by a jury on a case-by-cases basis. It also extends to acts done in contemplation of such federal matters, so that the timing of the act in relation to the beginning of the matter or investigation is also not a bar to prosecution. The intent of the provision is simple; people should not be destroying, altering, or falsifying documents to obstruct any government function. Finally, this section could also be used to prosecute a person who actually destroys the records himself in addition to one who persuades another to do so, ending yet another technical distinction which burdens successful prosecution of wrongdoers.1 6

Second, Section 802 also creates a 10 year felony, 18 U.S.C. §1520, to punish the willful failure to preserve financial audit papers of companies that issue securities as defined in the Securities Exchange Act of 1934. The new statute, in subsection (a)(1), would independently require that accountants preserve audit work papers for five years from the conclusion of the audit. Subsection (b) would make it a felony to knowingly and willfully violate the five-year audit retention period in (1)(a) or any of the rules that the SEC must issue under (1)(b). The materials covered in subsection (1)(b), which contains a mandatory requirement for the SEC to issues reasonable rules and regulations, are intended to include additional records which contain conclusions, opinions, analysis, and financial data relevant to an audit or review. Specifically included in such materials are electronic communications such as emails and other electronic records. The Conference added the ability of the SEC to update its rules to specifically allow it to capture additional types of records that could become important in the future as technologies and practices of the accounting industry change. The regulations are intended to cover the retention of all such substantive material, whether or not the conclusions, opinions, analyses or data in such records support the final conclusions reached by the auditor or expressed in the final audit or review so that state and federal law enforcement officials and regulators and victims can conduct more effective inquiries into the decisions and determinations made by accountants in auditing public corporations. Non-substantive materials, however, such as administrative records, which are not relevant to the conclusions or opinions expressed (or not expressed), need not be included in such retention regulations. The language of the provision is clear. The SEC "shall" and "is required" to promulgate regulations relating to the retention of the categories of items which are specifically enumerated in the statutory provision. "Reviews," as well as audits are also recovered by both (a) and (b). When a publicly traded company is involved, the precise name which the auditor chooses to give to an engagement is not important. Documents pertinent to the substance of such financial audits or review should be preserved. Willful violation of these regulations will also be a crime under this section.

In light of the apparent massive document destruction by Andersen, and the company's apparently misleading document retention policy, even in light of its prior SEC violations, it is intended that the SEC promulgate rules and regulations that require the retention of such substantive material, including material which casts doubt on the views expressed in the audit of review, for such a period as is reasonable and necessary for effective enforcement of the securities laws and the criminal laws, most of which have a five-year statute of limitations. It should also be noted that criminal tax violations, which many of these documents relate to, have a six-year statute of limitations and the regulatory portion of the Act requires a 7 year retention period. By granting the SEC the power to issue such regulations, it is not intended that the SEC be prohibited from consulting with other government agencies, such as the Department of Justice, which has primary authority regarding enforcement of federal criminal law or pertinent state regulatory agencies. Nor is it the intention of this provision that the general public, private or institutional investors, or other investor or consumer protection groups be excluded from the SEC rulemaking process. These views of these groups, who often represent the victims of fraud, should be considered at least on an equal footing with "industry experts" and others who participate in the rulemaking process at the SEC.

This section not only penalizes the willful failure to maintain specified audit records, but also will result in clear and reasonable rules that will require accountants to put strong safeguards in place to ensure that such corporate audit records are retained. Had such clear requirements and policies been established at the time Andersen was considering what to do with its audit documents, countless documents might have been saved from the shredder. The idea behind the statute is not only to provide for prosecution of those who obstruct justice, but to ensure that important financial evidence is retained so that law enforcement officials, regulators, and victims can assess whether the law was broken to begin with and, if so, whether or not such was done intentionally, or with or without the knowledge or assistance of an auditor.

Section 803 amends the Bankruptcy Code to make judgments and settlements based upon securities law violations non-dischargeable, protecting victims' ability to recover their losses. Current bankruptcy law may permit such wrongdoers to discharge their obligations under court judgments or settlements based on securities fraud and other securities violations. This loophole in the law should be closed to help defrauded investors recoup their losses and to hold accountable those who violate securities laws after a government unit or private suit results in a judgment or settlement against the wrongdoer. This provision is meant to prevent wrongdoers from using the bankruptcy laws as a shield and to allow defrauded investors to recover as much as possible. To the maximum extent possible, this provision should be applied to existing bankruptcies. The provision applies to all judgments and settlements arising from state and federal securities laws violations entered in the future regardless of when the case was filed.

State securities regulators have indicated their strong support for this change in the bankruptcy law. Under current laws, state regulators are often forced to "reprove" their fraud cases in bankruptcy court to prevent discharge because remedial statutes often have different technical elements than the analogous common law causes of action. Moreover, settlements may not have the same collateral estoppel effect as judgments obtained through fully litigated legal proceedings. In short, with their resources already stretched to the breaking point, state regulators must plow the same ground twice in securities fraud cases. By ensuring securities law judgments and settlements in state cases are non-dischargeable, precious state enforcement resources will be preserved and directed at preventing fraud in the first place.

Section 804 protects victims by extending the statute of limitations in private securities fraud cases. It would set the statute of limitations in private securities fraud cases to the earlier of five years after the date of the fraud or two years after the fraud was discovered. The current statute of limitations for most such fraud cases is three years from the date of the fraud or one year after discovery, which can unfairly limit recovery for defrauded investors in some cases. It applies to all private securities fraud actions for which private causes of actions are permitted and applies to any case filed after the date of enactment, no matter when the conduct occurred. As Attorney General Gregoire testified at the Committee hearing, in the Enron state pension fund litigation the current short statute of limitations has forced some states to forgo claims against Enron based on alleged securities fraud in 1997 and 1998. In Washington state alone, the short statute of limitations may cost hard-working state employees, firefighters and police officers nearly $50 million in lost Enron investments which they can never recover.

Especially in complex securities fraud cases, the current short statute of limitations may insulate the worst offenders from accountability. As Justices O'Connor and Kennedy said in their dissent in Lampf, Pleva. Lipkind, Prupis, & Petigrow v. Gilbertson, 111 S. Ct. 2773 (1991), the 5-4 decision upholding this short statute of limitations in most securities fraud cases, the current "one and three" limitations period makes securities fraud actions "all but a dead letter for injured investors who by no conceivable standard of fairness or practicality can be expected to file suit within three years after the violation occurred." The Consumers Union and Consumer Federation of America, along with the AFL-CIO and other institutional investors, strongly support the bill, and views this section in particular as a needed measure to protect investors.

The experts agree with that view. In fact, the last two SEC Chairmen supported extending the statute of limitations in securities fraud cases. Former Chairman Arthur Levitt testified before a Senate Subcommittee in 1995 that "extending the statute of limitations is warranted because many securities frauds are inherently complex, and the law should not reward the perpetrator of a fraud, who successfully conceals its existence for more than three years." Before Chairman Levitt, in the last Bush administration, then SEC Chairman Richard Breeden also testified before Congress in favor of extending the statute of limitations in securities fraud cases. Reacting to the Lampf opinion, Breeden stated in 1991 that "[e]vents only come to light years after the original distribution of securities, and the Lampf cases could well mean that by the time investors discover they have a case, they are already barred from the courthouse." Both the FDIC and the State securities regulators joined the SEC in calling for a legislative reversal of the Lampf decisions at that time.

In fraud cases the short limitations period under current law is an invitation to take sophisticated steps to conceal the deceit. The experts have long agreed on that point, but unfortunately they have been proven right again. As recent experience shows, it only takes a few seconds to warm up the shredder, but unfortunately it will take years for victims to put this complex case back together again. It is time that the law is changed to give victims the time they need to prove their fraud cases.

Section 805 of the Act ensures that those who destroy evidence or perpetrate fraud are appropriately punished. It would require the Commission to consider enhancing criminal penalties in cases involving obstruction of justice and serious fraud cases where a large number of victims are injured or when the victims face financial ruin.

The Act is not intended as criticism of the current guidelines, which were based on the hard work of the Commission to conform with the goals of prior existing law. Rather, it is intended to join the provisions of the Act which substantially raise current statutory maximums in the law as a policy expression that the former penalties were insufficient to deter financial misconduct and to request the Commission to review and enhance its penalties as appropriate in that light.

Currently, the U.S.S.G. recognize that a wide variety of conduct falls under the offense of "obstruction of justice." For obstruction cases involving the murder of a witness or another crime, the U.S.S.G. allow, by cross reference, significant enhancements based on the underlying crimes, such as murder or attempted murder. For cases when obstruction is the only offense, however, they provide little guidance on differentiating between different types of obstruction. This provision requests that the Commission consider raising the penalties for obstruction where no cross reference is available and defining meaningful specific enhancements and adjustments for cases where evidence and records are actually destroyed or fabricated (and for more serious cases even within that category of case) so as to thwart investigators, a serious form of obstruction.

This provision and Title 11, also require that the Commission consider enhancing the penalties in fraud cases which are particularly extensive or serious, even in addition to the recent amendments to the Chapter 2 guidelines for fraud cases. The current fraud guidelines require that the sentencing judge take the number of victims into account, but only to a very limited degree in small and medium-sized cases. Specifically, once there are more than 50 victims, the guidelines do not require any further enhancement of the sentence. A case with 51 victims, therefore, may be treated the same as a case with 5,000 victims. As the Enron matter demonstrates, serious frauds, especially in cases where publicly traded securities are involved, can affect thousands of victims.

In addition, current guidelines allow only very limited consideration of the extent of devastation that a fraud offense causes its victims. Judges may only consider whether a fraud endangers the "solvency or financial security" of a victim to impose an upward departure from the recommended sentencing range. This is not a factor in establishing the range itself unless the victim is a financial institution. Subsection (5) requires the Commission to consider requiring judges to consider the extent of such devastation in setting the actual recommended sentencing range in cases such as the Enron matter, when many private victims, including individual investors, have lost their life savings. Finally this provision requires a complete review of the Chapter 8 corporate misconduct guidelines, which should include not only monetary penalties but other actions designed to deter organizational crime, such as probation and compliance enforcement schemes.

Section 806 of the Act would provide whistleblower protection to employees of publicly traded companies who report acts of fraud to federal officials with the authority to remedy the wrongdoing or to supervisors or appropriate individuals within their company. Although current law protects many government employees who act in the public interest by reporting wrongdoing, there is no similar protection for employees of publicly traded companies who blow the whistle on fraud and protect investors. With an unprecedented portion of the American public investing in these companies and depending upon their honesty, this distinction does not serve the public good.

In addition, corporate employees who report fraud are subject to the patchwork and vagaries of current state laws, even though most publicly traded companies do business nationwide. Thus, a whistleblowing employee in one state (e.g., Texas, see supra) may be far more vulnerable to retaliation than a fellow employee in another state who takes the same actions. Unfortunately, companies with a corporate culture that punishes whistleblowers for being "disloyal" and "litigation risks" often transcend state lines, and most corporate employers, with help from their lawyers, know exactly what they can do to a whistleblowing employee under the law. U.S. laws need to encourage and protect those who report fraudulent activity that can damage innocent investors in publicly traded companies. The Act is supported by groups such as the National Whistleblower Center, the Government Accountability Project, and Taxpayers Against Fraud, all of whom have written a letter placed in the Committee record calling this bill "the single most effective measure possible to prevent recurrences of the Enron debacle and similar threats to the nation's financial markets."

This provision would create a new provision protecting employees when they take lawful acts to disclose information or otherwise assist criminal investigators, federal regulators, Congress, their supervisors (or other proper people within a corporation), or parties in a judicial proceeding in detecting and stopping actions which they reasonably believe to be fraudulent. Since the only acts protected are "lawful" ones, the provision would not protect illegal actions, such as the improper public disclosure of trade secret information. In addition, a reasonableness test is also provided under the subsection (a)(1), which is intended to impose the normal reasonable person standard used and interpreted in a wide variety of legal contexts (See generally Passaic Valley Sewerage Commissioners v. Department of Labor, 992 F. 2d 474, 478). Certainly, although not exclusively, any type of corporate or agency action taken based on the information, or the information constituting admissible evidence at any later proceeding would be strong indicia that it could support such a reasonable belief. The threshold is intended to include all good faith and reasonable reporting of fraud, and there should be no presumption that reporting is otherwise, absent specific evidence.

Under new protections provided by the Act, if the employer does take illegal action in retaliation for such lawful and protected conduct, subsection (b) allows the employee to elect to file an administrative complaint at the Department of Labor, as is the case for employees who provide assistance in aviation safety. Only if there is not final agency decision within 180 days of the complaint (and such delay is not shown to be due to the bad faith of the claimant) may he or she may bring a de novo case in federal court with a jury trial available (See United States Constitution, Amendment VII; Title 42 United States Code, Section 1983). Should such a case be brought in federal court, it is intended that the same burdens of proof which would have governed in the Department of Labor will continue to govern the action. Subsection (c) of this section requires both reinstatement of the whistleblower, backpay, and all compensatory damages needed to make a victim whole should the claimant prevail. The Act does not supplant or replace state law, but sets a national floor for employee protections in the context of publicly traded companies.

Section 807 creates a new 25 year felony under Title 18 for defrauding shareholders of publicly traded companies. Currently, unlike bank fraud or health care fraud, there is no generally accessible statute that deals with the specific problem of securities fraud. In these cases, federal investigators and prosecutors are forced either to resort to a patchwork of technical Title 15 offenses and regulations, which may criminalize particular violations of securities law, or to treat the cases as generic mail or wire fraud cases and to meet the technical elements of those statutes, with their five year maximum penalties.

This bill, then, would create a new 25 year felony for securities fraud—a more general and less technical provision comparable to the bank fraud and health care fraud statutes in Title 18. It adds a provision to Chapter 63 of Title 18 at section 1348 which would criminalize the execution or attempted execution of any scheme or artifice to defraud persons in connection with securities of publicly traded companies or obtain their money or property. The provision should not be read to require proof of technical elements from the securities laws, and is intended to provide needed enforcement flexibility in the context of publicly traded companies to protect shareholders and prospective shareholders against all the types schemes and frauds which inventive criminals may devise in the future. The intent requirements are to be applied consistently with those found in 18 U.S.C. §§1341, 1343, 1344, 1347.

By covering all "schemes and artifices to defraud" (see 18 U.S.C. §§1344, 1341, 1343, 1347), new §1348 will be more accessible to investigators and prosecutors and will provide needed enforcement flexibility and, in the context of publicly traded companies, protection against all the types schemes and frauds which inventive criminals may devise in the future.

VOTE EXPLANATION

Mr. BIDEN: Mr. President, I arrived in Washington this morning after the vote to invoke cloture on the nomination of Julia Smith Gibbons, to be United States Circuit Judge for the Sixth Circuit.

It was my intention to be here in time to vote in favor of this cloture motion.

Unfortunately, the catenary wire providing power for Amtrak was knocked down in Elkton, MD. This delayed the train on which I was traveling and regrettably prevented me from being present to vote.

THE FEDERALIST SOCIETY: SETTING THE RECORD STRAIGHT

Mr. HATCH. Mr. President, I also take this opportunity today to right a wrong. Over the past 2 years, members of The Federalist Society have been much maligned by some of my Democrat colleagues, no doubt because they see political advantage in doing so. The Federalist Society has even been presented as an 'evil cabal' of conservative lawyers. Its members have been subjected to questions which remind one of the McCarthy hearings of the early 1950's. Detractors have painted a picture which is surreal, twisted and untrue.

The truth is that liberal orthodoxies reign rampant and often unchecked in a majority of this countries law schools and in the legal profession, and that the left is shocked that an association of constitutionalist lawyers would exist, much less include the notable legal minds it does.

During the mid-1990's, Professor James Lindgren of Northwestern University Law School conducted a survey of law school professors and came to the fallowing conclusion. At the faculties of the top 100 law schools 80 percent of law professors were Democrats, or leaned left, and only 13 percent were Republicans, or leaned right. These liberal professors promulgate their ideology in and outside the classroom.

Anyone associated with America's campuses or law schools knows that nonliberal views are regularly stifled and those espousing those views are often publicly shunned and ridiculed. It was this environment of hostility to freedom of expression and the exchange of ideas in universities that set the stage for the formation of the Federalist Society. And given my Democrat colleagues' reaction to the Society, it appears to be fighting against liberal narrow-mindedness still.

In 1982, the Federalist Society was organized, not to foster any political agenda, but to encourage debate and public discourse on social and legal issues. Over the past 20 years the Federalist Society has accomplished just that. It has served to open the channels of discourse and debate in many of America's law schools.

The Federalist Society espouses no official dogma. Its members share acceptance of three universal ideas: 1. that government's essential purpose is the preservation of freedom; 2. that our Constitution embraces and requires separation of governmental powers; and 3. that judges should interpret the law, not write it.

For the vast majority of Americans, these are not controversial issues. Rather, they are basic Constitutional assertions that are essential to the survival of our republic. They are truths that have united Americans for more than two centuries. Recently we have seen the emergence of some groups that seek to undermine the third of these ideas—that judges should not write laws. These groups have attempted to use the judiciary to circumvent the democratic process and impose their minority views on the American people.

This judicial activism is a nefarious practice that seeks to undermine the principle of democratic rule. It results in an unelected oligarchy, government by a small elite. Judicial activism imposes the will of a small group of politicized lawyers upon the American people and undermines the work of the people's representatives.

Indeed, if the radical left is successful, if we continue to appoint judges that are committed to writing law and not interpreting it, than all of us can just go home. We can resign ourselves to live under the oligarchical rule of lawyers. I happen to know a few lawyers, and please trust me when I say, this is not a good idea.

Beyond acceptance to its three key ideas, freedom, separation of powers, and that judges should not write laws, it is challenging, if not impossible, to find consensus among Federalist Society members. Its members hold a wide array of differing views. They are so diverse that it is impossible to describe a Federalist Society philosophy.

The assertion that members are ideological carbon copies of each other is ludicrous. The Society revels in open, thoughtful, and rigorous debate on all issues. It rests on the premise that public policy and social issues should not be accepted as part of a party-line but rather warrant much thought and dialogue. Any organization that sponsors debate on issues of public importance, as opposed to self-serving indoctrination, is healthy for us all.

Now, how does the Federalist Society accomplish its goal? Not by lobbying Congress, writing amicus briefs, or issuing press releases. The Federalist Society seeks only to sponsor fair, serious, and open debate about the need to enhance individual freedom and the role of the courts in saying what the law is rather than what it should be. The Society believes that debate is the best way to ensure that legal principles that have not been the subject of sufficient attention for the past several decades receive a fair hearing.

The Federalist Society's commitment to fair and open debate can be seen by a small sampling of some participants in its meetings and symposiums. They have included scores of liberals like Justices Ruth Bader Ginsburg and Stephen Bryer, Michael Dukakis, Barney Frank, Abner Mikva, Alan Dershowitz, Laurence Tribe, Steve Shapiro, Christopher Hitchins and Ralph Nader, just to name a few.

I would like to include for the RECORD a list of 60 participants in Federalist Society events that demonstrates the remarkable diversity of thought of Federalist Society events. One of them is Nadine Strossen, President of the ACLU, who has participated in Federalist Society functions regularly and constantly since its founding. She has praised its fundamental principle of individual liberty, its high-profile on law school campuses, and its intellectual diversity, noting that there is frequently strenuous disagreement among members about the role of the courts. Strossen has even said that she cannot draw any firm conclusion about a potential judicial nominee's views based on the fact that he is a Federalist Society member.

It seems to me that an organization that includes such a wide array of opinion serves this nation well and does not deserve the vilification it gets from the usual suspects.

There are many notable conservatives that also affiliate with the Federalist Society. But as the members of the Senate demonstrate, even amongst those that are often labeled "conservatives" there is a much disagreement on most social and political issues. Some often portray the Federalist Society as a tightly-knit, well-organized coalition of conservative lawyers who are united by their right-wing ideology. This is far from true. Allow me to illustrate further.