

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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In re: :
LEHMAN BROTHERS SECURITIES : Civil Action 09 MD 2017
AND ERISA LITIGATION : (LAK)
This Document Applies to: :
In re Lehman Brothers Equity/Debt Securities :
Litigation, 08 Civ. 5523 (LAK) :
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**DEFENDANTS' JOINT REPLY MEMORANDUM OF LAW
IN SUPPORT OF THEIR MOTION TO DISMISS THE
THIRD AMENDED CLASS ACTION COMPLAINT**

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After amending their complaint a third time, abandoning many prior allegations and relying on the Examiner's Report for the TAC's new claims, Plaintiffs present the Court with an Opposition Brief ("Opposition" or "OB") that rewrites the complaint yet again.¹ They repeatedly rely on new claims and purported facts pleaded nowhere in the TAC but found in the Report (although when the Report contradicts their allegations, Plaintiffs ignore it), or invented for the occasion. They also cite characterizations by third parties of their conclusions of alleged facts as if to instruct the Court on how it should interpret the allegations. Each of these is improper and should be rejected. On this motion to dismiss, Plaintiffs must be limited to the allegations in the complaint they have filed. The TAC fails to state a claim against any Defendant and should be dismissed.

ARGUMENT

I. THE TAC FAILS TO STATE A SECURITIES ACT CLAIM

A. No Standing For 48 Structured Product Offerings

Plaintiffs lack standing to pursue Securities Act claims for offerings in which no named plaintiff purchased securities.² Indeed, Plaintiffs' counsel acknowledges that *Lehman MBS* required them to abandon claims unless they could find new plaintiffs with standing.³ Despite this concession, they insist – without authority – that the law applied in *Lehman MBS* and many other authorities is limited to cases involving mortgage-backed securities or mutual funds, or does not apply here because the misstatements Plaintiffs allege were (they claim) common across

¹ Terms not defined herein are defined in Defendants' Joint Memorandum of Law in Support of Their Motion to Dismiss the Third Amended Complaint ("DB"). References to "Ex." are to the exhibits attached to the Declaration of Michael J. Chepiga, dated June 4, 2010 (Dkt. No. 226).

² See *In re IndyMac Mortgage-Backed Sec. Litig.*, No. 09 Civ. 4583 (LAK), 2010 WL 2473243, at *3 (S.D.N.Y. June 21, 2010); *In re Lehman Bros. Sec. & ERISA Litig.*, 684 F. Supp. 2d 485, 490-91 (S.D.N.Y. 2010) ("*Lehman MBS*").

³ See OB 55 (new plaintiffs who purchased in offerings are necessary "to ensure that their claims, and those of other investors in the same offerings, would continue to be prosecuted"); see also TAC ¶ 24 n.2 (Plaintiffs will not seek to "assert claims for additional offerings" unless they find named plaintiffs "who purchased such additional securities").

all offerings. *See* OB 45.⁴ But nothing in the case law or the statutory language supports any standing distinction based on the type of security or the content of the alleged misstatements: dismissal in *Lehman MBS* was required because the plaintiffs could not allege that they “suffered any injury stemming from the offerings in which they did not purchase.” 684 F. Supp. 2d at 491. In fact, the plaintiffs in *Lehman MBS* made the same argument that Plaintiffs make here – *i.e.*, that “the misstatements and omissions in the Offering Documents for the Certificates that they purchased are common to those in the Offering Documents for the Certificates that they did not buy,” and that the offerings “were conducted pursuant to the same shelf registration statements.” *Id.* at 490-91. And this Court rejected it. *Id.* (no standing because “plaintiffs have not alleged any injury traceable to the Certificates issued in those offerings [in which they did not purchase securities]”).

Here, as well, Plaintiffs cannot trace any injury to the 48 unrepresented offerings in the TAC’s Appendix B, and therefore lack standing as to those offerings.

B. The Claims Of All New Plaintiffs And 37 Other Offerings Must Be Dismissed

Plaintiffs do not contest that, absent tolling, all Securities Act claims of the 25 new plaintiffs are barred by the one-year statute of limitations. They have the burden of proving that a toll applies, and they cannot do so. Plaintiffs rely almost entirely on cases where the original named plaintiffs had standing to pursue their claims on behalf of a class.⁵ But here the original Plaintiffs lacked standing, as this Court effectively held in *Lehman MBS*.⁶ In these circumstances, the majority of the courts in this Circuit that have addressed the issue have

⁴ In fact, Plaintiffs go out of their way to *avoid* basing their claims on the common documents by asserting that each of the pricing supplements for the 68 PPN offerings listed in Appendix B – each of which was unique to a single offering – was false and misleading. *See infra* Section I.D.

⁵ *See In re WorldCom Sec. Litig.*, 496 F.3d 245 (2d Cir. 2007); *In re Initial Pub. Offering Sec. Litig.*, 617 F. Supp. 2d 195 (S.D.N.Y. 2007).

⁶ Although *Lehman MBS* nominally addressed standing only in the related *MBS* case, the standing issues were argued jointly with this case. Hr’g. Tr. 3, Jan. 26, 2010 (Dkt. Nos. 227-28). Certainly, Plaintiffs here understood that the *Lehman MBS* decision was dispositive on the standing issues in this case. *See* OB 55 n.56 (“Plaintiffs had good cause to add new plaintiffs after the Court’s ruling in *Lehman MBS*”).

rejected *American Pipe* tolling, which reflects an appropriate balancing of the policies underlying tolling and the potential for abuse recognized by many courts.⁷

C. The Offering Materials Were Not Actionable

1. Repo 105 Transactions

a. No Misstatements Related To Lehman's Repo 105 Transactions

The TAC fails to allege material misstatements or omissions related to Repo 105 transactions because: (1) the Repo 105 transactions were properly reported as sales rather than financings under GAAP;⁸ (2) Lehman disclosed the effects of these transactions on its balance sheet; and (3) any purported misstatements about “net leverage” were immaterial as a matter of law. DB 4-10. In their Opposition, Plaintiffs mischaracterize⁹ or ignore key disclosures in Lehman's financial statements, and fail to show either that any additional disclosure of Repo 105 transactions was required or that an investor would have been misled about Lehman's leverage.

Lehman disclosed the effects of Repo 105 transactions. Lehman specifically disclosed that its balance sheet “will fluctuate from time to time” and could be and at times *was* larger than its balance sheet reported at quarter- or year-end and that its net assets, the numerator of the net leverage figure, reported at quarter-end was lower than the monthly average over the preceding

⁷ See DB 3-4 & nn.8, 10 (citing cases); see also *In re Crazy Eddie Sec. Litig.*, 747 F. Supp. 850, 856 (E.D.N.Y. 1990) (denying motion to amend to add new class plaintiffs after court had dismissed for lack of standing because original plaintiffs had not purchased securities at issue; “There appears to be no good reason to encourage bringing of a suit merely to extend the period in which to find a class representative.”).

⁸ Defendants expressly incorporate E&Y's arguments that it was – and remains – correct under the GAAP provisions applicable at the time to treat the Repo 105 transactions as “sales.” DB 4-5; E&Y Br. *passim*; see also E&Y's reply brief 4-7. Defendants also incorporate by reference, to the extent applicable to claims against the Defendants, any other arguments made in the E&Y briefs.

⁹ Plaintiffs' argument that Lehman “affirmatively” misrepresented that “*all* of its repurchase agreements” were treated as financings, OB 17 (emphasis added), is belied by Lehman's disclosure which made no such blanket claim. Rather, Lehman identified certain categories of transactions that were treated as “collateralized agreements for financial reporting purposes” and specifically included, for example, “other secured borrowings” that were “accounted for as financings *rather than sales* under SFAS 140,” which reinforced Lehman's disclosure that transfers that complied with FAS 140's criteria for sales accounting, including surrender of “effective control,” were treated as sales, as required by GAAP. See, e.g., 2007 10-K at 96-97 (emphasis added) (Ex. 7).

four and eight quarters. DB 6. These disclosures undercut any claim that investors were not already informed of Lehman's balance sheet management activities at the end of each reporting period. Plaintiffs cabin their comments to a footnote in which they make the incredible claim that these disclosures were "not even contained in any of the Offering Materials." OB 17 n.9. This representation flatly contradicts their prior pleading,¹⁰ and is wrong in any event.¹¹ Thus, there was no need for Lehman to make any further disclosures about its asset fluctuations and the reduction of net assets at the end of each reporting period,¹² and reasonable investors were informed that Lehman was taking steps that necessarily resulted in lower leverage ratios at the end of each reporting period. Plaintiffs' silence on this point speaks loudly.

Nor can Plaintiffs rely on Item 303 of SEC Regulation S-K (OB 20-21) to impose a duty to make further disclosure of these transactions. Defendants are unaware of any case – and Plaintiffs cite to none – in which a plaintiff has adequately alleged violations of Item 303 without showing that the issuer had "knowledge" of the omitted information. Indeed, all of the case law cited by Plaintiffs requires a showing of such knowledge, which Plaintiffs plainly have not pled with respect to their Securities Act claims. OB 21; DB 10. To fill this gap, Plaintiffs' selectively quote Item 303, omitting that an issuer has a duty to disclose *only* such other information that it

¹⁰ Plaintiffs affirmatively pleaded that the Offering Materials for each of the offerings in the Class Period incorporated the 2006 10-K and the 2007 1Q, which specifically contained these disclosures. *See* SAC App. A (alleging financial statements incorporated by reference into Offering Materials).

¹¹ Base Pro. at 42 (Ex. 22) (noting that documents filed with the SEC after prospectus date and until the completion of the offering would be incorporated by reference). *See* 15 U.S.C. § 77b(a)(8) (2006). Moreover, the 10-Qs for 2007 specifically stated that the disclosures "should be read together with" the disclosures in the 2006 10-K. *See, e.g.*, 2007 2Q at 45 (Ex. 5); 2007 3Q at 46 (Ex. 6).

¹² Plaintiffs' continued assertion that investors reading Lehman's financials would be unable to "discern that Repo 105 transactions" occurred, OB 17, confuses the issue. The point is not whether Lehman disclosed the particulars of its Repo 105 transactions in its financials, but whether Lehman properly disclosed the effects of those transactions on its balance sheet, which Lehman did. Moreover, Plaintiffs' quotation of a "high-ranking" Lehman employee as to what *he* may have thought about the level of "transparency" into the Repo 105 program, OB 17, is irrelevant to the Court's evaluation of whether Lehman made any false statements about its balance sheet. Finally, Plaintiffs' continued references to Exchange Act allegations, including this one, to support their Securities Act allegations are entirely inappropriate, *see, e.g.*, OB 14 (citing TAC ¶¶ 148, 212), 17 (citing TAC ¶ 148), as are their efforts to go beyond the four corners of the TAC to shore up their allegations, *see, e.g.*, OB 16 (citing ER at 878 n.3376).

“believes to be necessary to an understanding of its financial condition, changes in financial condition, and results of operations.” 17 C.F.R. § 229.303(a) (2010) (emphasis added). Given the requirement of knowledge *and* subjective belief, Plaintiffs’ pled theory of negligence is essentially inconsistent with any purported violation of Item 303.¹³

Any purported misstatements were immaterial. Plaintiffs fail even to address Defendants’ arguments that any purported misstatements were not material given Lehman’s disclosure of its total leverage near and above 30x during the Class Period. DB 7-8. Unlike its reported net leverage, which Lehman explained to investors “may not be comparable” to other firms’ net leverage ratios (since different firms use different methodologies), *see, e.g.*, 2007 10-K at 72 (Ex. 7), total leverage is a measure permitting comparison. And Lehman disclosed that its total leverage continuously *increased* through the first quarter until the second quarter of 2008, during which it decreased – making it clear to investors that it was highly leveraged, indeed one of the most leveraged among its industry peers. DB 8 & n.20. The TAC never challenges any of the reported total leverage metrics. Nor do Plaintiffs acknowledge their own reliance on just those metrics in the SAC to assert that Lehman had “very high leverage and strong reliance on short-term debt financing” and its leverage ratio was “more than double” the limit for commercial banks – facts that were publicly known to investors. SAC ¶¶ 5, 162. Given these disclosures about the objective measure of total leverage, and their own understanding of the disclosures’ clear import, Plaintiffs cannot now complain that Lehman’s reporting of Repo 105 transactions (amounting to 6% or less of total liabilities, OB 9) materially hid its “very high leverage.”

Yet even if “net leverage” were the sole metric, Plaintiffs fail to show that Lehman materially misstated that ratio or misled investors. First, as described by E&Y, Repo 105 transactions themselves had *no* effect on Lehman’s balance sheet or income, as Lehman simply

¹³ In any event, even under Item 303, Lehman had no duty to disclose the particulars of Repo 105 transactions because they were not a “capital expenditure” (OB 21) and, as described above, the balance sheet effects of such transactions were already disclosed to investors.

exchanged one asset (\$105 of securities) for two assets of similar value (\$100 cash and a derivative worth \$5 (less interest)); the only effect on net leverage ratio occurred when Lehman used cash to pay down liabilities. E&Y Br. 7-8, n.10 & 10. Second, Lehman publicly reported throughout 2008 the firm's substantial effort to reduce its exposure to less liquid assets, a primary driver in the decrease in net leverage. DB 6. Thus, investors were clearly not "deceive[d] . . . into believing that the Company's balance sheet was less risky than it was." OB 5. Investors had the objective data about Lehman's asset composition and total leverage to make their own determination of Lehman's financial condition. *Id.*¹⁴

b. Defenses Are Established On The Face Of The TAC

This is a case where the facts alleged in the TAC establish the statutory reliance defense for all Defendants and the due diligence defense for the Non-Officer Defendants. DB 10-13. Plaintiffs' only real response is to argue (repeatedly) that these defenses ordinarily raise issues inappropriate for disposition on a motion to dismiss. OB 48-49. But here, unlike any of the cases cited by Plaintiffs, (1) each of the alleged Repo 105 misstatements relates to an expert judgment about the application of GAAP; (2) the TAC establishes that the auditor knew of, and indeed continues to approve of, that accounting judgment; and (3) the TAC pleads no "red flags" that would have undermined the reliability of the financial statements. DB 11-12.¹⁵ The facts

¹⁴ In addition, Lehman's internal metric for determining "materiality" as to when to re-open and adjust Lehman's balance sheet simply does not govern materiality under the securities laws, DB 9, a point to which the Plaintiffs have no response.

Further, Plaintiffs' reliance on after-the-fact statements purportedly made by analysts to the Examiner, OB 20, about Repo 105 transactions is unavailing. Not only are the statements not alleged in the TAC, they are nothing more than ambiguous and speculative answers to hypothetical questions. Indeed, Plaintiffs' purported descriptions of these answers are highly misleading. For example, the Report makes clear that for the S&P analyst, whether a change in the net leverage ratio was relevant would "depend on other factors and committee deliberations" and specifically notes that the S&P analyst did *not* state the information about Repo 105 would be "material." See ER at 908 n.3476. Plaintiffs also fail to note that the Moody's analyst told the Examiner that Moody's considered net leverage ratio to have "limited usefulness." See *id.* at 909.

¹⁵ The cases cited by Plaintiffs either did not involve accounting judgments, see *Lehman MBS*, 684 F. Supp. 2d at 491-95, or involved allegations of specific red flags known to the defendants, see *In re Enron Corp. Sec., Deriv. & ERISA Litig.*, 258 F. Supp. 2d 576, 639-40 (S.D. Tex. 2003); *In re WorldCom, Inc. Sec. Litig.*, No. 02 Civ. 3288 (DLC), 2005 WL 638268, at *11 (S.D.N.Y. Mar. 21, 2005). *In re Morgan*

pled thus demonstrate that the Defendants cannot be liable because (1) they were entitled to rely on the expertised portions of the audited financial statements in the 2007 10-K, and (2) their due diligence was not required to uncover anything more than what Plaintiffs admit is an established fact – namely, that E&Y determined that Lehman’s accounting for the Repo 105 transactions complied with GAAP.¹⁶ Defendants challenged the Plaintiffs to identify what other diligence should have been done, DB 13; the Plaintiffs offered no response because there is none.

Plaintiffs’ argument that the Defendants are trying to impose a scienter requirement on the Securities Act is nonsense. OB 50. Where, as here, the complaint otherwise establishes the statutory reliance and due diligence defenses on its face, it must also make some showing of “red flags” that might undermine the reasonableness of Defendants’ reliance on E&Y’s accounting expertise. DB 12.¹⁷ Here, where Plaintiffs have not only failed to plead red flags but disclaim that there were any, the TAC must be dismissed.¹⁸

2. Risk Management

Defendants demonstrated there was nothing false about Lehman’s statements about risk management. See DB 14 n.34; 13-17. Lehman’s policies were accurately disclosed, including

Stanley Info. Fund Sec. Litig., 592 F.3d 347 (2d Cir. 2010), did not involve the due diligence defense at all, but merely stated, in footnoted dicta, that “*generally speaking*” defendants bear the burden of demonstrating the defenses under the Securities Act. *Id.* at 360 n.7 (emphasis added).

¹⁶ Indeed, the fact that E&Y continues to maintain that the accounting judgments were correct only demonstrates the implausibility of any claim that the Defendants are liable: even if the Defendants had pressed Lehman or E&Y about the accounting treatment for Repo 105 transactions, they would have been told that the accounting was correct.

¹⁷ See *In re Countrywide Fin. Corp. Sec. Litig.*, 588 F. Supp. 2d 1132, 1181-82 (C.D. Cal. 2008) (complaint did “not adequately allege that [defendants’] reliance on [auditor’s and issuer management’s] accounting-related statements during this period was unreasonable” where the alleged red flags would not have put them “on notice that the accounting-related statements were false or misleading”).

¹⁸ Plaintiffs’ argument that four of the Underwriter Defendants were also potential or actual counterparties in Repo 105 transactions, and therefore had “participation and knowledge of” Lehman’s Repo 105 program, OB 50 n.44, is unavailing. The claims are pleaded nowhere in the TAC, but appear for the first time in the Opposition. A plaintiff may not amend its allegations through its opposition brief. See *Pandozy v. Segan*, 518 F. Supp. 2d 550, 554 n.1 (S.D.N.Y. 2007). Even if alleged in the TAC, the claims would not satisfy Rule 8: Plaintiffs fail to state what these banks knew about Repo 105 transactions, or when they knew it, and there is nothing to connect the few offerings in which the handful of banks allegedly participated to the timing of their purported trades with Lehman.

that its risk limits and management policies were dynamic and that Lehman executives determined whether to grant exceptions to particular limits and policies. *Id.* at 14-15. In this regard, Lehman’s “approach to managing risk” was precisely to allow for exceptions and to extend limits; contrary to Plaintiffs’ contention, “monitor[ing] and enforc[ing] adherence to risk policies” included allowing for variation and revisions. *See* OB 25.

The Opposition does not show otherwise. Instead, Plaintiffs repeatedly refer without citation to the purported “hard” limits, OB 7 (quoting that word as if it had been contained in some public disclosure), but Lehman never stated that any risk limit was “hard” or not subject to discretionary extension. DB 14-15. Further, Plaintiffs’ reference in the TAC for the purported “hardest” of all Lehman risk limits” is merely to internal “risk management policies,” not any representation made to investors. TAC ¶ 75.¹⁹ The only place Plaintiffs come close to acknowledging Defendants’ principal argument is in a footnote, OB 26 n.19, where they distort the issue from the undisputed content of Lehman’s actual risk management disclosures into the red herring of what investors might have understood. *Id.* Plaintiffs do not deny that Lehman told investors about its risk management systems or show how the discussion was confusing, and a motion to dismiss based upon clear disclosure cannot be turned into a “fact” question by contending that individual investors may not have understood the disclosure.

There is also nothing actionable about the specific management judgments that were the product of Lehman’s disclosed procedures. DB 15-16. Risk management is a matter of business judgment, and Lehman expressly told investors that its risk mitigation and monitoring techniques were “subject to judgments” and that under certain circumstances Lehman may not be able to “offset the increase in measured risk.” *Id.* at 15.²⁰ Plaintiffs’ challenge to the business judgment

¹⁹ Plaintiffs also assert that Lehman “failed to enforce its *publicly stated* ‘single transaction limits,’” OB 7 (emphasis added), but the paragraph of the TAC to which they cite does not even generally *allege* that “single transaction limits” were publicly disclosed, let alone identify any specific Lehman disclosure making such limits public, *id.* (citing TAC ¶ 77).

²⁰ The business of financial institutions like Lehman is to “evaluate the trade-off between risk and return.” *In re Citigroup Inc. S’holder Derivative Litig.*, 964 A.2d 106, 126 (Del. Ch. 2009).

of Lehman executives in managing risk thus amounts, at most, to a claim of mismanagement, not a securities claim. *Id.* Recognizing this, Plaintiffs attempt to rewrite the TAC, contending that its focus is on misstatements related to Lehman's alleged mismanagement, and not simply claims of mismanagement. OB 24-25. These allegations are not in the TAC. Rather, the TAC attempts – improperly – to build a securities law claim by contending that Lehman altered *internal* risk management practices that were never disclosed in public filings. TAC ¶¶ 74, 81-82. But Plaintiffs must allege that Lehman failed to follow practices and policies that were disclosed to investors, and the TAC does not do so.

Finally, Plaintiffs are wrong that Lehman's statement that it “monitor[s] daily trading net revenues compared to reported historical simulation VaR” was false and misleading due to Lehman's “fail[ure] to disclose that [it] . . . repeatedly breached VaR limits on an almost daily basis.” OB 27-28; DB 17. Lehman's VaR limits and its historical simulation VaR are not the same measure; breaches of the VaR limits are irrelevant to disclosures about monitoring trading revenues compared to historical simulation VaR. Specifically, as Lehman disclosed, *historical simulation VaR* is a measure of “the potential loss in the fair value” of Lehman's portfolio under adverse market conditions that reflects “the offsetting risk characteristics” of Lehman's different portfolio positions. 2007 10-K at 70 (Ex. 7). In contrast, Lehman's *VaR limits* “represented the maximum amount that Lehman was willing to lose under normal market conditions” ER App. 8 at 8-9. The limits reflected Lehman's tolerance for loss in the value of its portfolio.

Plaintiffs improperly conflate these different VaR measures as if they were one and the same. *See* OB 28. They are not, and Plaintiffs plead no facts showing that publicly disclosed facts about one measure necessarily affected the other.

3. Liquidity

Plaintiffs' arguments that Lehman's liquidity risk disclosures were false due to the effect of the Repo 105 transactions also fail. First, the TAC establishes that the Repo 105 assets were “highly liquid,” TAC ¶ 190, and thus were essentially as good as cash. They could not have had a material impact on Lehman's liquidity. DB 18.

Second, apart from disavowing the TAC's allegations²¹ and attempting to rely on entirely new "facts" not found in the TAC, Plaintiffs do not dispute that the TAC fails to allege *facts* showing how the Repo 105 transactions would have had any material impact on Lehman's liquidity pool. *See id.* at 18 n.44. Having failed to plead any plausible facts, Plaintiffs wrongly criticize Defendants for "speculat[ing]" about whether the effect of Repo 105 transactions on Lehman's liquidity was material. OB 29-30. There is nothing speculative, however, in relying on Plaintiffs' allegation that the Repo 105 assets were "highly liquid," TAC ¶ 190, to establish the TAC's failure to state a claim.²²

Finally, there is no merit to Plaintiffs' contention that Lehman misled investors by stating that it had a "very strong liquidity position." OB 28-29. Plaintiffs argue that this statement was false because Lehman had "a large concentration of *illiquid* assets with deteriorating values," *id.* at 28 (emphasis added), but there is no allegation in the TAC or argument in the Opposition showing why a purported loss in value to these assets would affect Lehman's liquidity pool. *See* DB 18 n.45. Plaintiffs again resort to their fallback position that this is somehow a factual issue, OB 29 n.22, but Plaintiffs first must show they have a plausible claim. Similarly, Plaintiffs' late-hour contention that Lehman had determined by July 2007 that its liquidity pool was short \$400 million must be rejected. DB 18 n.45. The TAC fails to identify critical information on the timing and source of the allegations, among other things, *id.*, and the Opposition does not cure these critical pleading deficiencies. Indeed, Plaintiffs themselves insist that "matters extraneous to the Complaint should not be considered for their truth." OB 51.

²¹ In response to their own pleading, Plaintiffs backtrack and now attempt to rewrite the TAC by making the remarkable contention that it is not "appropriate on a motion to dismiss" to conclude that the Repo 105 assets were "highly liquid." OB 30. They similarly attempt to incorporate entirely new assertions that contradict the TAC – arguing that only the "vast majority" of the assets were "investment grade," some were therefore non-investment grade, and "a substantial portion of the assets collateralizing the Repo 105 transactions were not Level 1 assets." *Id.* This further attempt to amend the TAC through their Opposition must be rejected.

²² Lehman also warned investors about the potential liquidity risks. DB 18. Plaintiffs' only response is to again improperly presume what is not alleged, and in fact contradicted by the allegations – that Lehman's "Repo 105 transactions were certain to impact Lehman's liquidity pool." OB 31.

4. Valuation Of Commercial Real Estate Assets

No actionable misstatements. Conceding their failure to allege facts showing that Lehman did not truly hold its disclosed valuation opinions, Plaintiffs now argue that two of Lehman's commercial real estate valuations are actionable because the Company misrepresented its "methodology" for valuing these assets. OB 31-32. This argument also fails.

To state a claim that Lehman's disclosures about its valuation "methodology" were false, Plaintiffs must allege that Lehman: (1) disclosed it would use specific inputs or calculations in reaching its valuations; and (2) did not do so.²³ Plaintiffs allege neither. Instead, they point to Lehman's statement that it would mark CRE assets to "fair value," and assert this representation was false because Lehman did not include certain information considered by the Examiner. *Id.* at 31. But by merely using the phrase "fair value," Lehman did not promise it would use any particular assumptions.²⁴ And Plaintiffs do not identify any requirement (statutory, regulatory, or otherwise) that Lehman use any specific assumptions (much less those considered by the Examiner in his hindsight valuation judgment) in reaching its fair value judgment.

Lehman's statement that it would mark illiquid commercial real estate assets to "fair value" thus constituted only a representation that its valuation was based upon "management's estimates" and judgment as to the value of the underlying assets, which is permitted under FAS 157. *See, e.g.*, 2006 10-K at 62, 65-66 (Ex. 3). Its disclosure could thus only be materially false if there were allegations that "would give rise to a strong inference that management did not give its honest opinion."²⁵ Again, Plaintiffs allege no such facts. DB 20.²⁶

²³ *See Fraternity Fund Ltd. v. Beacon Hill Asset Mgmt.*, 479 F. Supp. 2d 349, 363 (S.D.N.Y. 2007).

²⁴ Tellingly, Plaintiffs' argument relies almost exclusively on their mischaracterization of a case decided three decades ago – well before the adoption of SFAS 157. OB 32-33 (citing *Automatic Catering, Inc. v. First Multifund for Daily Income, Inc.*, No. 80 Civ. 4117, 1981 WL 1664 (S.D.N.Y. Aug. 3, 1981)). There, Judge Sweet found an issue of fact about whether assets were marked to "fair value" because the SEC had previously stated the methodology used "cannot . . . represent a 'good faith' effort to determine [] 'fair value'" under the applicable SEC rule. *Automatic Catering*, 1981 WL 1664, at *8. Here, however, Plaintiffs do not point to any pre-existing (or current) rule or regulation that prohibited Lehman's disclosed methodology.

²⁵ *Fraternity Fund*, 479 F. Supp. 2d at 362-63. Moreover, because they must establish Lehman itself did not truly hold this opinion, Plaintiffs' continuing references to after-the-fact statements made by third

Alleged overvaluations were immaterial. Plaintiffs also do not defend the TAC’s attempt to conjure materiality by highlighting Lehman’s disclosures at the asset level. Instead, Plaintiffs now focus exclusively on Lehman’s “pre-tax income” as a measure of materiality. OB 33-34.²⁷ While Plaintiffs seek to exploit the raw size of the numbers, the figures must be viewed in context. DB 21 & n.50. For example, while Plaintiffs allege Archstone was overvalued by up to \$450 million at the end of 2008 1Q, Lehman’s total assets at that time were \$786 billion. *Id.* at 20. Such a *de minimis* “overstatement” clearly had no material impact on Lehman’s reported assets. Ignoring authority that requires materiality to be assessed in the overall context of a company’s business, Plaintiffs cite a handful of cases that focus on income. But in those cases, unlike here, defendants misstated income figures and plaintiffs highlighted other materiality considerations.²⁸ None of that is alleged in the TAC.²⁹

parties are irrelevant. DB 22; *see also* *Fait v. Regions Fin. Corp.*, No. 09 Civ. 3161 (LAK), 2010 WL 1883487, at *5 (S.D.N.Y. May 10, 2010).

²⁶ Plaintiffs contend that Lehman’s valuation opinions are actionable because “there was no reasonable basis for holding the opinion” with respect to the PTG Assets at the end of 2008 2Q. OB 33 (citing TAC ¶ 98). But as the Examiner recognized, “almost all PTG assets were classified as Level 3, whose values are the most subjective because they depend on unobservable inputs.” ER at 319. Lehman was thus required under FAS 157 to make “its own assumptions about the assumptions that market participants would use in pricing the asset or liability.” FAS 157 at 10 ¶ 21-22. That Lehman’s assumptions turned out to be erroneous in hindsight does not make Lehman’s methodology “unreasonable” at the time it was employed. It is also irrelevant to the claims against the Underwriter Defendants, who did not participate in any Lehman offerings at that time. DB 21 n.51.

²⁷ Although Plaintiffs repeatedly assert – without explanation – that the appropriate metric is “pre-tax income,” OB 33-34, the only figure they cite (\$489 million) is Lehman’s post-tax “net income.” *See* 2008 1Q at 4 (Ex. 8). Plaintiffs’ calculations are therefore vastly overstated – further underscoring the absurdity of their approach to materiality.

²⁸ *See Ganino v. Citizens Utils. Co.*, 228 F.3d 154, 166 (2d Cir. 2000) (intentional manipulation of income “to meet analysts’ expectations” could be material); *SEC v. Penthouse Int’l, Inc.*, 390 F. Supp. 2d 344, 354 (S.D.N.Y. 2005) (intentional overstatement of income to “convert[.]” a loss into a profit could be material); *In re Kidder Peabody Sec. Litig.*, 10 F. Supp. 2d 398, 411 (S.D.N.Y. 1998) (“false profits” that were “minor” to corporate parent but “quite significant” to “touted” subsidiary could be material).

²⁹ Plaintiffs’ belated argument that “how Lehman was valuing its commercial real estate assets [was] even more material than [it] otherwise may have been because investors were specifically ‘focused’ on the quality of Lehman’s valuations given the dislocation of the markets,” OB 34, fails. This factual allegation also appears nowhere in the TAC.

5. Concentration Of Risk

Significant disclosures. Acknowledging that Lehman made disclosures about its real estate assets and loan commitments, OB 10, 36, 38-39, Plaintiffs fail to show that any of these disclosures were false. As Defendants demonstrated, DB 22,³⁰ these disclosures provided investors with key details about Lehman's real estate assets and loan commitments, and Plaintiffs do not identify anything inaccurate about them.

Timing. The TAC fails to present, as it must, any facts plausibly showing undisclosed significant concentrations of risk "at the time [the offerings] were made."³¹ Indeed, timing is especially important here, as Lehman's holdings and the market generally experienced substantial fluctuations during the Class Period. But none of the TAC documents or data in this regard is actually from the Class Period.³² Plaintiffs' only response to this deficiency is to assert, without any basis, that Lehman amassed concentrations before and during the Class Period and to incorporate allegations pleaded *only* in the Exchange Act counts. OB 37, 39. Plaintiffs cannot now pick and choose Exchange Act allegations to sustain their Securities Act claims when they have specifically disclaimed such reliance. *See* TAC ¶¶ 23, 120.

Improper categories of concentrations. Despite their insistence that "all significant concentrations of credit risk" must be disclosed, OB 35, Plaintiffs fail to address that nothing in FAS 107 or any other GAAP provision required Lehman to use Plaintiffs' preferred characterizations of its assets – as opposed to the ones Lehman did use.³³ Nor could they.

³⁰ *See also* SAC MTD 37-38, 41-42, 50-51, 58-59; SAC MTD Reply 26, 38-40.

³¹ *In re JP Morgan Chase Sec. Litig.*, 363 F. Supp. 2d 595, 624 (S.D.N.Y. 2005).

³² Plaintiffs' allegations about Alt-A assets refer to documents predating the Class Period, TAC ¶¶ 106, 173, or data that Plaintiffs admit was disclosed in Lehman's offerings, *id.* ¶¶ 106, 186. The allegations regarding Lehman's CRE and leveraged loan commitments also rely on data from the pre-Class Period growth of these assets. *Id.* ¶¶ 107-08; OB 38-39.

³³ Plaintiffs get no support from the cases on which they rely regarding Lehman's combined disclosure of Alt-A and prime assets; unlike here, each case involved allegations of fraud. *See Ong ex rel. Ong IRA v. Sears, Roebuck & Co.*, 388 F. Supp. 2d 871, 894 (N.D. Ill. 2004) (finding that defendants had intentionally sought to hide financial data about one asset class by off-setting it with positive data of another); *Caiola v. Citibank, N.A.*, 295 F.3d 312 (2d Cir. 2002) (finding that despite the lack of duty for

Courts and the SEC have made clear that the particular break-out of assets demanded by Plaintiffs is not required by GAAP.³⁴ Indeed, certain of Plaintiffs' proposed categories are particularly improper because they would require disclosure of Lehman's assets in derogatory terms, and the use of descriptive terms rather than categories.³⁵

No "significant" concentrations. The Opposition also does not address the TAC's failure to show that a "significant" concentration of risk existed during the Class Period. DB 25-26. GAAP requires disclosure of those concentrations *judged by issuer's management* to be significant at the time. *Id.* at 25. There is no numerical threshold that defines a "significant" concentration of risk; rather, significance is defined by the likelihood, in the issuer's judgment, that these concentrations will give rise to severe near-term impacts. *Id.*³⁶ Plaintiffs do not dispute that the TAC fails to meet this standard.³⁷ Instead, Plaintiffs again attempt to rely on allegations imported from their Exchange Act pleadings. *See, e.g.*, OB 36-37 (citing TAC ¶¶ 173, 186, 246). Such maneuvering should be rejected.³⁸

defendant to disclose its hedging strategy, it misrepresented its strategy by claiming it engaged in delta hedging when it had not).

³⁴ *See Nolte v. Capital One Fin. Corp.*, 390 F.3d 311, 316-17 (4th Cir. 2004) (finding that AICPA SOP 94-6 did not require issuer to break out subprime from other assets because this was a descriptive, not categorical, division); SEC Div. of Corp. Finance Letter, at 1-2 (Ex. 12). Plaintiffs argue that the SEC's letter should not be considered, but the Court may properly consider SEC materials as persuasive authority on a motion to dismiss – a principle Plaintiffs themselves embrace. *See, e.g.*, OB 19 n.11 (citing SAB 99, which was not cited in the TAC).

³⁵ *See* DB 24; *In re N.Y. Cmty. Bancorp, Inc. Sec. Litig.*, 448 F. Supp. 2d 466, 479-80 (E.D.N.Y. 2006) (no requirement for bank to describe mortgage-backed securities in "pejorative terms"). Again without any basis, Plaintiffs further assert that Lehman should have disclosed information in two new sub-categories not alleged in the TAC – "risky bridge equity" and "PTG investments." OB 38.

³⁶ Plaintiffs' retort that management's judgment should not be considered because "there was no reasonable basis upon which to characterize Lehman's Alt-A assets as prime," OB 38, states a false predicate. The relevant judgment was that Lehman's Alt-A, CRE and leveraged loan assets were not significant concentrations *for GAAP purposes*.

³⁷ In contrast, in *SEC v. Spiegel, Inc.*, No. Civ. A 03 C 1685, 2003 WL 22176223 (N.D. Ill. Sept. 15, 2003), cited by Plaintiffs, the SEC adequately alleged that a significant concentration was not disclosed by showing that the company's management and auditors recognized at the time of the company's incomplete disclosures that the success of certain securitization activities was crucial to the company's debt obligations and its continuance as a going concern. *Id.* at **2-3, 71-73.

³⁸ Further, other cited materials contradict Plaintiffs' position. For example, Plaintiffs emphasize the November 2007 GREG presentation, *see* OB 38; TAC ¶ 107, but it concludes that GREG's portfolio was

D. The Principal Protection Note Offering Materials Are Not Actionable

Plaintiffs concede that the PPN Offering Materials expressly advised investors – at least “a handful” of times (OB 42) – that the PPNs *were unsecured debt obligations of Lehman*.³⁹ Plaintiffs laud the “informative and candid” statements from other banks’ principal protected note offerings (*see* OB 42), but ignore that each of these statements is also made, almost verbatim, in the Lehman PPN Offering Materials.⁴⁰

Plaintiffs’ only response is the naked assertion that Lehman’s disclosures can be ignored because they are contained in “documents other than the pricing supplements” – what Plaintiffs’ disparagingly characterize as the “SEC reading room.” OB 42.⁴¹ Not surprisingly, Plaintiffs fail to cite a case that supports the rule they advocate – *i.e.*, that unequivocal disclosures in SEC filings that are part of the same registration statement, that are expressly linked to other parts of the registration statement, and that investors are advised (in the pricing supplements themselves) to “review carefully,”⁴² can be ignored in assessing whether the registration statement taken “as a whole” is materially misleading. Merely to state such a proposition is to refute it.⁴³

“well-diversified by region, property and risk type,” the opposite of an undue concentration of risk. Lehman Global Real Estate Update, dated Nov. 6, 2007, at 7 (Ex. 18).

³⁹ *See* DB 27-28; Base Pro. at 2, 8 (Ex. 22); Pro. Supp. at S-7 (“The notes will be solely our obligations.”), S-13 (Ex. 23); Prod. Supp. 550-I (Nov. 27, 2007) at 1 (Ex. 24); Prod. Supp. 220-I (March 6, 2007) at 1 (Ex. 25); Prod. Supp. 1050-I (March 14, 2008) at 1 (Ex. 26).

⁴⁰ *Compare* Ex. 29 (RBS notes “are solely the unsecured obligations of Royal Bank”) *with* Prod. Supp. 550-I (Nov. 27, 2007) at 1 (Ex. 24) (PPNs “are the senior unsecured obligations of Lehman Brothers Holdings Inc.”); Ex. 32 (Barclays notes “are not deposit liabilities of Barclays Bank PLC”) *with* PS No. 1 (52522L566) at 1 (Ex. 19) (PPNs “are not deposit liabilities of Lehman Brothers Holdings Inc.”); Ex. 30 (Merrill Lynch notes “will rank equally with all of our other unsecured and unsubordinated debt”) *with* Pro. Supp. at S-13 (Ex. 23) (PPNs “will rank on an equal basis with all of our other unsecured debt”).

⁴¹ Plaintiffs also suggest that Lehman’s disclosures would only be relevant if they were “adjacent” to the description of “principal protection” or in the “Key Risk” section of the pricing supplements. OB 41. There is no support for any of these contentions – and Plaintiffs’ varying and inconsistent articulations of the supposed legal requirement is strong evidence that Plaintiffs are making up the standard as they go.

⁴² *See, e.g.*, PS No. 1 (52522L566) at 2 (Ex. 19); PS No. 1 (52522L202) at 2 (Ex. 20); PS No. 1 (52522L525) at 2 (Ex. 21).

⁴³ The suggestion that disclosures are irrelevant if they appear in documents other than the pricing supplements is also completely inconsistent with Plaintiffs’ claims based on alleged misstatements in Lehman’s quarterly and annual reports. Those alleged misstatements *also* do not appear in the pricing supplements themselves, but – like the Base Prospectus, the MTN Prospectus Supplement, and the

This is not a case with obscure disclosures about complex subjects, or the need to “piece together” disparate pieces of information in order to understand the full picture of transactions or relationships.⁴⁴ Plaintiffs contend, simply, that reasonable investors were (mis)led to believe that the PPNs were secured investments and that there was a source of repayment other than “Lehman alone.” OB 41. The Offering Documents, however, expressly and clearly, and in multiple places, state otherwise – that the PPNs were Lehman’s “unsecured obligations” and that the notes were “solely our [Lehman’s] obligations.” *See supra* notes 39-40. As a result, Plaintiffs fail to state a claim under Section 11 or 12 relating to the PPNs.⁴⁵

II. THE EXCHANGE ACT CLAIMS SHOULD BE DISMISSED

The TAC’s primary claim is that Lehman created the “illusion” that Lehman was deleveraging by selling illiquid assets when it was “only able to achieve the appearance of deleveraging through undisclosed Repo 105 transactions.” TAC ¶ 156; *see also id.* ¶¶ 195, 201. As a result, the TAC alleges, these transactions masked undisclosed risks that later materialized and caused Lehman to fail. Yet, in their Opposition, Plaintiffs concede that *deleveraging in 2008 was due to sales and write-downs of “sticky” assets, and not due to Repo 105 transactions.* *See* OB 91-92. This concession is fatal to the TAC’s centerpiece allegation. Indeed, the undisputed record clearly demonstrates that the Company dramatically reduced its exposure to residential mortgages (by 47%), commercial mortgages (by 38%), other asset-backed securities (by 25%),

relevant product supplements and underlying supplements – were a part of the same registration statement or prospectus, as provided by SEC rules.

⁴⁴ In *In re Alstom SA Sec. Litig.*, 406 F. Supp. 2d 433, 453 n.11 (S.D.N.Y. 2005), on which Plaintiffs rely for the “piece together” proposition, the court noted that the two footnotes at issue were “not cross referenced or linked in any other manner.” Here, by contrast, the pricing supplements expressly referenced the underlying SEC filings for a full statement of the terms of the PPNs, provided internet links, and specifically directed investors to the “Risk Factors” sections of those documents. *See I. Meyer Pincus & Assocs. P.C. v. Oppenheimer & Co.*, 936 F.2d 759, 763 (2d Cir. 1991).

⁴⁵ While Plaintiffs claim they have alleged control person liability against Lowitt, OB 54, Plaintiffs do not dispute that Lowitt was not Lehman’s CFO during the time period covered by the filings that Plaintiffs allege were misleading. Indeed, Lowitt became the CFO on June 12, 2008, TAC ¶ 12, after the second quarter concluded and signed only one Form 10-Q, which was for the period ended May 31, 2008 (during which he was not the CFO). Thus, no Securities Act claims can be stated against Lowitt as he was not involved in nor did he certify any documents contained in any of the Offering Materials.

real estate held for sale (by 33%) and leveraged loans (by 70%) from Q4 2007 to Q3 2008. Appendix B. The Opposition attempts to deal with this reality by espousing a new theory not found in the TAC, namely that Lehman sold and wrote down troubled assets due to constraints on its ability to engage in Repo 105 transactions. OB 91-92. But there is no support for this novel theory. Rather, as the TAC alleges, Lehman's decreased usage of Repo 105 transactions as 2008 progressed was due to a deliberate decision to reduce the volume of such transactions, TAC ¶ 212, not an inability to conduct them.

The inescapable fact is that Lehman did not increase its Repo 105 usage during the mounting financial crisis of 2008, yet nevertheless brought down its gross leverage and net leverage numbers over the course of the year. It did this by selling assets and taking write-downs. Given the disconnect between Lehman's declining use of Repo 105 and its successful efforts to deleverage, Plaintiffs have failed to plead any *material* misstatement or omission, any inference of scienter, or any coherent theory of loss causation.

A. The TAC Fails To Plead Any Material Misstatement Or Omission Under The Exchange Act Claims⁴⁶

No Repo 105 misstatement. Plaintiffs allege that Callan made misleading statements during the Q1 and Q2 2008 conference calls that Lehman had reduced its net leverage by selling less liquid asset categories.⁴⁷ OB 82-83. Tellingly, Plaintiffs do not contest the truth of these statements and embrace them in their arguments concerning loss causation. Lehman had no duty to disclose the particulars of the Repo 105 transactions, and no affirmative statement by Callan created an impression that was materially different from the truth.⁴⁸

No liquidity misstatement. Plaintiffs' efforts to show misstatements concerning the

⁴⁶ The Officer Defendants refer to the discussion above and the DB for their discussions of alleged misstatements underlying both the Section 11 and Section 10(b) claims.

⁴⁷ With respect to Q1 2008, Callan's actual statement was only that "[w]e did, very deliberately, take leverage down for the quarter." TAC ¶ 184.

⁴⁸ See *SEC v. Texas Gulf Sulphur*, 401 F.2d 833, 862 (2d Cir. 1968); *Hoffman v. UBS-AG*, 591 F. Supp. 2d 522, 535 (S.D.N.Y. 2008) (statements not misleading where they "did not affirmatively create an impression that was materially different from the truth").

estimated value of the firm's liquidity pool in 2008 are unavailing. *First*, Plaintiffs' argument about "improperly" including encumbered funds in Lehman's liquidity pool calculation presupposes a standard that determines the types of assets that may be included in liquidity calculations. OB 84. Because no statute, regulation, SEC guidance, or industry definition existed, *see* ER at 1480 (notably, Plaintiffs cite none), there is no objective standard to support the allegation that Lehman's disclosure of the size of its liquidity pool was false. *Second*, statements by certain Officer Defendants describing the Company's liquidity position as "robust" or "strong," TAC ¶¶ 185, 202, are as a matter of law too indefinite to support § 10(b) liability.⁴⁹

B. The TAC Fails To Plead Scienter

Repo 105. The TAC fails to plead that any Officer Defendant benefited in a concrete and personal way from any purported fraud, or any other facts showing motive and opportunity. As a result, the strength of the allegations supporting an inference of conscious misbehavior or recklessness must be "correspondingly greater." DB 36-37.⁵⁰ The Opposition does not dispute this.

Instead, the Opposition spends considerable time discussing the Officer Defendants' supposed knowledge of Repo 105 transactions. OB 61-64.⁵¹ But alleging knowledge of Repo

⁴⁹ *See In re IBM Corp. Sec. Litig.*, 163 F.3d 102, 108 (2d Cir. 1998) (statement that company was not concerned about covering dividend "is plainly an expression of optimism that is too indefinite to be actionable under the securities laws"); *SRM Global Fund Ltd. P'ship v. Countrywide Fin. Corp.*, No. 09 Civ. 5064 (RMB), 2010 WL 2473595, at *11 (S.D.N.Y. June 17, 2010) (holding non-actionable CEO's statement "liquidity plan was impressive").

⁵⁰ *Kalnit v. Eichler*, 264 F.3d 131, 142 (2d Cir. 2001).

⁵¹ As to Fuld, all Plaintiffs are able to muster is a reference to a single alleged conversation in June 2008 from which McDade purportedly "understood" that Fuld "was familiar with the term Repo 105." OB 63 & n.70. But mere knowledge does not translate into fraudulent intent. Nothing in the one-page "agenda" for the March 2008 Executive Committee meeting (which Plaintiffs concede Fuld did not attend), TAC ¶ 211, or in the alleged June 2008 discussion about the reduction in balance sheet items generally with McDade, *id.*, even remotely suggested that Lehman's Repo 105 transactions were incorrectly accounted for or inadequately disclosed, or anything that would have reasonably triggered an obligation to inquire further.

Plaintiffs' sole reference to Repo 105 as to Gregory is that he allegedly received materials at the March 28 meeting, and that McDade recalled that (i) the purpose of the meeting was to "obtain Gregory's blessing in freezing Repo 105 usage" and (ii) Repo 105 was discussed at the meeting. OB 64. Yet, as in the TAC, the Opposition provides no information regarding what those "materials" stated or what was

105 transactions is not the same as pleading knowledge that the transactions were (allegedly) “artificial” or fraudulent.⁵² An intent to deceive is incompatible with the facts: (1) Lehman started using Repo 105 transactions only after FASB issued FAS 140, which describes these types of repo transactions and dictates the accounting treatment for them, (2) Lehman consulted outside counsel and its auditor, (3) Lehman developed an internal written accounting policy covering the transactions, and (4) the transactions were openly discussed among the relevant business people. *See* DB 37-39.⁵³ These factors wholly undercut Plaintiffs’ argument that there was any “concealment” of Repo 105 transactions.⁵⁴ The far more compelling inference is that the Officer Defendants, to the extent they were even aware of Repo 105 transactions, had an

actually discussed at that meeting regarding Repo 105 (including with respect to McDade’s alleged desire to freeze Repo 105 usage). The TAC provides no inference that Gregory had any basis to know of any improper activity regarding Repo 105.

For Callan, Plaintiffs simply allege a conversation with Kelly, OB 61-62, in which he expressed his belief that Lehman’s Repo 105 program presented a “reputational” or “headline risk” that might “reflect poorly on the firm.” *See* ER at 886. Although Plaintiffs note that Kelly (an accountant) discussed the “technical basis” for Repo 105 transactions with Callan (not an accountant), TAC ¶ 212, they have not alleged that Kelly told Callan that treatment of the Repo 105 transactions as sales was improper or that any further disclosures were required. The more compelling inference is that Callan would only have had a reason to believe that Kelly had business concerns about Lehman’s reputation. *See* ER at 921.

⁵² *See In re PXRE Group, Ltd., Sec. Litig.*, 600 F. Supp. 2d 510, 536 (S.D.N.Y. 2009) (to plead the recklessness prong of scienter, a plaintiff must “specifically [allege] defendant’s knowledge of facts or access to information contradicting their public statements” as well as allege “that (1) *specific* contradictory information was available to the defendants (2) *at the same time* they made their misleading statements”) (emphasis in original), *aff’d sub nom. Condra v. PXRE Group Ltd.*, 357 F. App’x 393, 394 (2d Cir. 2009); *see also Chill v. Gen. Elec. Co.*, 101 F.3d 263, 270 (2d Cir. 1996).

⁵³ The Opposition attempts to refute the fact that Lehman vetted the transactions with E&Y. OB 67. This is at odds with the TAC’s allegations that E&Y “knew about Lehman’s use of Repo 105 transactions to manage its balance sheet at the end of each quarter,” TAC ¶ 226, and never communicated any concern about either accounting for Repo 105 transactions as sales or the footnote and other disclosures relating to these transactions. TAC ¶¶ 233, 236-38.

⁵⁴ *See Kalnit*, 264 F.3d at 142 (to establish scienter based upon an omission, plaintiff must establish a clear duty to disclose). Plaintiffs assume that a corporation’s failure to publicly disclose a fact evidences an intent to “conceal” that fact. This is obviously a flawed assumption. Moreover, none of the cases cited by Plaintiffs in OB 65 n.72 involved allegedly improper activities widely and openly discussed within a corporation. For example, in *SEC v. Guenther*, 212 F.R.D. 531, 533-34 (D. Neb. 2003), the SEC alleged that defendants lied to the board about their actions in booking fake receivables and falsely stated that the company’s auditors had approved the transactions. Here, Plaintiffs have alleged no remotely similar facts.

honest belief that these transactions were legitimate means for business units to obtain funding and stay within their balance sheet targets, and were accounted for in accordance with GAAP.⁵⁵

The theory of scienter advanced in the Opposition relies on unsupported and false assumptions. *First*, the theory assumes that balance sheet management is fraudulent, when in fact it is a legitimate, widely practiced and well-known business management tool. As the Examiner commented, “There is nothing necessarily improper about balance sheet management; it is normal business practice used by many institutions.” ER at 822-23 n.3166. Indeed, the TAC pleads that setting balance sheet limits was a prudent business practice: “balance sheet limits [] were designed to contain [Lehman’s] overall risk and maintain net leverage ratio within the range required by rating agencies.” TAC ¶ 78; *see also* ER App. 8 at 39 (“Lehman’s balance sheet limit was another risk-related control that Lehman employed to allocate its resources efficiently, ensure that the business was adequately capitalized, and guarantee adequate returns on assets.”).

Second, Plaintiffs argue that Repo 105 transactions could not be legitimate because they were more expensive than other types of repos. OB 67. But critically, Plaintiffs do not allege that any Officer Defendant was aware of this alleged cost differential. Nor do Plaintiffs dispute that Repo 105 transactions were more lucrative than and preferable to outright sales. OB 67 n.76. Lehman could have achieved the same balance sheet impact through outright sales accompanied by derivatives to preserve the hedging benefits of the sold assets, but pursued the less expensive and preferable alternative of Repo 105 transactions instead. This is highly relevant because it provides a plausible, wholly innocuous explanation for such transactions.⁵⁶

⁵⁵ Even if, despite the considered opinions of outside counsel and its auditor, Lehman’s accounting and disclosure turned out to be incorrect (and they were not), this would not establish scienter. *See, e.g., In re Take-Two Sec. Litig.*, 551 F. Supp. 2d 247, 272 (S.D.N.Y. 2008) (“Given the evident ambiguity in the [rating agency’s] rules, Lead Plaintiffs’ mere allegation that [the company] had violated the [rating agency’s] rules does not give rise to a strong inference that [defendants] knew that [the company] had violated those rules.”).

⁵⁶ Plaintiffs point to Lehman’s “continuous use” internal guideline for Repo 105 transactions. OB 66. However, this guideline simply provided assurance that there would be a reliable market for Repo 105

Third, without providing any support for their speculation, Plaintiffs suggest that Lehman shopped around the world until it found a law firm that would look at the terms of the contracts and reach the factual conclusion that Lehman surrendered control of the assets used in Repo 105 transactions. OB 68. Plaintiffs ignore the fact that the answer to the “control” question depends on the law applicable to the transaction. English law is clear that, in the event of a counterparty’s bankruptcy, Lehman would not have been able to enforce its right to regain collateral worth 105% of its repurchase price. U.S. law is not clear on that point. *See, e.g.,* Marke Raines & Gabrielle Wong, *Aspects of Securitization of Future Cash Flows Under English and New York Law*, 12 DUKE J. COMP. & INT’L L. 453 (2002). Thus, when Lehman sold assets for less than their value, it lost “control” of those assets under UK law, thereby rendering the transaction a true sale under FAS 140. *See* ER App. 17 at 31 (opinion of Linklaters stating that “Seller will have disposed of its entire proprietary interest in the Purchased Securities by way of sale.”). Lehman’s use of an internationally renowned law firm’s legal opinion in the jurisdiction where the transactions occurred does not plead scienter.

Fourth, Lehman made concerted efforts in 2008 to decrease its holdings in less liquid or “sticky” assets, which resulted in real reductions in the firm’s exposure to problematic asset classes. *See* DB’s Appendix B. According to Plaintiffs’ theory, as the real estate and credit markets were reaching new lows in 2008, Lehman would have had the greatest incentive to ramp up Repo 105 usage to lower its net leverage. *In fact, the opposite occurred.* Over the course of 2008, initially Lehman essentially froze and then *cut in half* its Repo 105 usage. OB 63 & n.70, 91-92. The Company lowered its gross leverage and net leverage through concerted and successful efforts to reduce its positions in less liquid or “sticky” assets. Shorn of its prejudicial descriptors, the TAC does not plead a strong inference of scienter with respect to the TAC’s Repo 105 claim.⁵⁷

transactions (e.g., available counterparties) and encouraged balance sheet discipline throughout the quarter.

⁵⁷ Plaintiffs concede that the TAC does not attribute any statements to Gregory, and fall back on the “group pleading” doctrine. However, since the passage of the Reform Act, every Court of Appeals that

Risk. The collapse of a financial firm may be evidence that it was unable to manage all of the risks it faced. It is not *per se* evidence of intent to deceive with disclosures regarding the firm's risk management program. No risk management program is infallible, as Lehman warned its investors.⁵⁸ And no financial firm can survive a "run on the bank" in which counterparties and clearing banks refuse to do business with it, as Lehman also cautioned investors.⁵⁹ Plaintiffs ask this Court to infer that because Lehman could not survive the tumultuous events of 2008, the Officer Defendants must have acted with scienter. More is needed to state a claim.⁶⁰

In addition, limits such as Lehman's risk appetite limit were *internal* management

has addressed the issue has held that the Act eliminated the group pleading doctrine. In any case, the doctrine has no applicability to the Reform Act's scienter requirement. *In re Bisys Sec. Litig.*, 397 F. Supp. 2d 430, 440 (S.D.N.Y. 2005). Plaintiffs have not met their burden to establish through individualized pleadings that Gregory acted with scienter.

Plaintiffs' sole allegation against Lowitt is that he was "familiar" with the fact that Lehman used Repo 105 transactions to reduce its balance sheet. The only 10-Q Lowitt signed was for a quarter in which the volume of Repo 105 transactions was nearly flat from the prior quarter, and contained detailed disclosure of "sticky" asset holdings as well as asset sales contributing to the lower net leverage. Thus there was no misstatement. Moreover, Plaintiffs do not, and cannot, allege that Lowitt believed or was aware that Repo 105 transactions were improper or required additional disclosure. *See also In re Centerline Holding Co. Sec. Litig.*, No. 09-3744-cv, 2010 WL 2303312 (2d Cir. June 9, 2010) (complaint fails to sufficiently plead scienter without allegations that defendant was clearly aware of duty to disclose). Indeed, the opposite inference is warranted here, where Lowitt signed the certification for 2Q 2008 Form 10-Q only after E&Y issued a clean review of Lehman's Q2 2008 10-Q (which came after Matthew Lee's allegation that Lehman had moved billions in assets off the balance sheet). Likewise, the only filings O'Meara signed during the Class Period were for Q2 and Q3 2007, when Lehman's net leverage was increasing, as expected given the Company's disclosed growth strategy, and its Repo 105 usage was relatively low. The Court should dismiss the § 10(b) claims against Lowitt and O'Meara for these reasons as well.

⁵⁸ *See, e.g.*, 2007 10-K at 22 (Ex. 7) ("risk management techniques may not be fully effective in mitigating [the Company's] risk exposure in all market environments or against all types of risk, including risks that are unidentified or unanticipated").

⁵⁹ *See, e.g.*, 2007 10-K at 17, 37 (Ex. 7) (warning that Lehman relied upon "external borrowings for the vast majority" of its funding, that "failures in our industry are typically the result of insufficient liquidity," and its "liquidity could be impaired by an inability to access secured and/or unsecured debt markets" or by an "inability to sell assets or unforeseen outflows of cash or collateral").

⁶⁰ *See In re Citigroup Auction Rate Sec. Litig.*, No. 08 Civ. 3095 (LTS), 2009 WL 2914370, at *6 (S.D.N.Y. Sept. 11, 2009) (finding subprime crisis "give[s] rise to an opposing and compelling inference that Defendants only engaged in bad (in hindsight) business judgments in connection with ARS," not "conduct with an intent to deceive").

tools.⁶¹ The TAC's allegations simply demonstrate that decisions made by Lehman senior managers to increase and/or exceed these limits were undertaken following internal debate and in accordance with procedures established by internal guidelines. *See* TAC ¶¶ 216-17; *see also* DB 43-44. Such business practices do not demonstrate scienter.⁶²

Moreover, Plaintiffs have no response to other key facts demonstrating that it is not plausible that the Officer Defendants had an intent to deceive, including:

- Lehman made the SEC aware of every decision made by the Company on its risk management policies and procedures. DB 42.
- The Examiner acknowledged that “[w]ithin the industry, Lehman’s risk management function was widely regarded as among the best.” ER App. 8 at 2 (citing to Federal Reserve Bank of New York’s assessment and comparison of risk management practices at the four largest investment banks); *see also* DB 44.
- The Examiner recognized that “Lehman’s management seriously considered the risks involved in the Archstone [leveraged loan] transaction, tried to manage it, and ultimately decided that the rewards would outweigh the risks.” ER at 174-75; *see also* DB 44.

The TAC’s allegations present a plausible, non-culpable explanation for the Officer Defendants’ conduct: they “were entitled to set and decide to exceed risk limits, which were merely tools to assist them in their investment decisions, not legal restraints on their authority. They made considered business decisions to do so because of profit-making opportunities.” ER at 168-69.

Liquidity. The TAC fails to establish that the Officer Defendants knowingly or recklessly made misleading statements regarding Lehman’s liquidity position. Plaintiffs improperly look to material from outside the TAC, teasing out selective statements from the Report, *see* OB 79-80, although they conveniently ignore the Examiner’s conclusion that there was insufficient

⁶¹ The TAC does not allege that Lowitt oversaw Lehman’s risk limits and management policies before he became CFO on June 12, 2008, or that he became a member of the Executive Committee until then. Nor is there any allegation of any false statements concerning Lehman’s risk management during Q3 2008. Plaintiffs cannot establish scienter against Lowitt arising from Lehman’s alleged risk management.

⁶² *See Sharenow v. IMPAC Mortgage Holdings, Inc.*, No. 09-55533, 2010 WL 2640195, at *1 (9th Cir. June 29, 2010) (finding allegations do not describe underwriting guideline violations or tie those violations to the class period with the “great detail” required to give rise to a strong inference of scienter and affirming dismissal of 10(b) claim with prejudice).

evidence to support a determination that any Lehman officer acted “with actual or constructive knowledge to cause Lehman to make misleading statements about liquidity.” ER at 1479. Plaintiffs have not alleged that Lehman’s senior officers subjectively believed the reported liquidity figures were incorrect.

In addition, the TAC pleads no facts that any Officer Defendant knowingly or recklessly misstated the “liquidity risk” facing the firm. OB 80. Plaintiffs, for example, allege that Lowitt, O’Meara and others set up ALCO “as a result of their liquidity concerns” and that ALCO members exchanged an analysis on June 20, 2007, which showed that Lehman was projecting large deficits of cash capital. TAC ¶ 218. However, when confronted with this analysis, Lehman took actions, such as refraining from committing to future high yield or commercial real estate transactions. *Id.* ¶ 176. Such actions demonstrate that Lehman proactively managed its liquidity by reviewing and addressing potential shortfalls, not scienter.⁶³ OB 80-81; TAC ¶ 218; DB 48 n.92. Moreover, Lehman’s disclosures warned in precise terms about the very run-on-the-bank scenario that thrust the firm into bankruptcy.⁶⁴ Plaintiffs have no response to the fact that regardless of Lehman’s liquidity pool numbers as of the September 10, 2008 conference call, as former SEC Chair Cox testified, “no amount of liquidity” would be enough in the event of a run on the bank. Ex. 48 at 42; *see also* DB 58.

C. The TAC Fails To Plead Loss Causation

Market-wide collapse. Plaintiffs fail to plead loss causation. They do not dispute that there was no corrective disclosure of any alleged misstatement. OB 86-87. They do not dispute that there was a “slow, steady decline” of Lehman’s share price throughout the Class Period, as opposed to the share price plummeting after a sudden materialization of a previously unknown

⁶³ Plaintiffs also allege that Callan received emails from Eric Felder expressing concerns about liquidity shortly before Bear Stearns failed. OB 81. However, nothing in Felder’s emails was inconsistent with Lehman’s public statements about liquidity or its liquidity pool.

⁶⁴ *See, e.g.*, 2007 10-K at 17 (Ex. 7) (“Even within the one-year time frame contemplated by our liquidity pool, we depend on continuous access to secured financing in the repurchase and securities lending markets . . .”).

risk. *In re Rhodia S.A. Sec. Litig.*, 531 F. Supp. 2d 527, 546 (S.D.N.Y. 2007). Plaintiffs do not seriously dispute that this steady decline corresponded with a global collapse of the financial markets and the end of the investment banking business model.⁶⁵ DB 50-51.

Plaintiffs' attempt to dismiss the Officer Defendants' reference to market events as a "time worn" tactic. OB 96. But the market phenomena that caused Lehman's share price to decline by 57% between the start of the Class Period and the first alleged "partial disclosure" were of historic proportions. The issue here is not what might be proven at a trial, but whether the TAC pleads loss causation. That is clearly a plaintiff's burden: a claim fails when the plaintiff "has not adequately ple[]d facts which, if proven, would show that its loss was caused by the alleged misstatements as opposed to intervening events." *Lentell v. Merrill Lynch & Co. Inc.*, 396 F.3d 161, 174 (2d Cir. 2005) (citing *First Nationwide Bank v. Gelt Funding Corp.*, 27 F.3d 763, 772 (2d Cir. 1994)).⁶⁶ With their loss causation theory built on Lehman's real estate losses, Plaintiffs cannot ignore that at the time the real estate and credit markets were in *extremis*.

Repo 105. Loss causation requires "that the loss was foreseeable and caused by the materialization of the concealed risk." *In re Omnicom Group, Inc. Sec. Litig.*, 597 F.3d 501, 513 (2d Cir. 2010). A misrepresentation is a foreseeable cause of the loss only if "the significance of the truth is such as to cause a reasonable investor to consider seriously a zone of risk that would be perceived as *remote or highly unlikely by one believing the fraud*, and the loss ultimately suffered is within that zone" *Lentell*, 396 F.3d at 173 (citing *Castellano v. Young & Rubicam Inc.*, 257 F.3d 171, 188 (2d Cir. 2001)) (emphasis added). That is simply not true here.

⁶⁵ Plaintiffs half-heartedly argue that while Lehman's competitors' share price similarly declined during the Class Period, only Lehman's share price declined all the way to zero. OB 98. This distinction loses whatever luster it might have in light of the undisputed fact that Lehman alone was denied the government assistance that permitted its competitors to survive. *See* DB 51.

⁶⁶ Plaintiffs attempt to distinguish *First Nationwide* as inapplicable to securities fraud. OB 96 n.109. They ignore that *First Nationwide's* conclusion was adopted by *Lentell* in the securities fraud context, and was used by *Lentell* to distinguish *Emergent Capital*, on which Plaintiffs rely. *See* OB 96, n.109, 110; *Lentell*, 396 F.3d at 174 (citing *Emergent Capital* for the proposition that whether losses were caused by an intervening event is normally a matter of proof at trial, but distinguishing circumstances in which the loss coincided with a market-wide phenomenon, citing *First Nationwide*).

Nor can it be, given what was happening in the world, and Lehman's disclosures of risk factors.

Plaintiffs fail to connect the dots between the alleged omissions about Repo 105 transactions entered into during "fiscal 2007 and early 2008" and losses resulting from the "massive write-downs that Lehman took in June and September 2008." OB 89. The TAC's theory of loss causation is directly contradicted by the fact that Lehman's actual usage of Repo 105 transactions did not increase in 2008, but decreased. So Plaintiffs have added another improbable link to their already Rube Goldberg-like chain of events. They now argue that Repo 105 transactions, through their impact on net leverage, made Lehman "appear financially stronger than it was," OB 89, and that its lack of strength was a risk that materialized when Lehman took write-downs, which raised "question[s]" about the firm's liquidity, which caused counterparties to demand more collateral, which led to a genuine loss of liquidity, which necessitated Lehman filing for bankruptcy. OB 95. This simplistic "you said you were strong, but you weren't" argument is insufficient, as a matter of law. Loss causation requires proximate cause between a misstatement and a specific risk that came to pass that had been concealed by that misstatement.⁶⁷ Otherwise, virtually any positive statement about a company, no matter how general, could be said to have concealed whatever set-back the company ultimately experienced, and loss causation would effectively be written out of § 10(b) liability.⁶⁸

The Opposition argues that Lehman's June and September write-downs of illiquid assets were the materialization of a risk that, up until that point, had been concealed by Repo 105 transactions. OB 89. This is nonsensical. *First*, there was no concealment that Lehman held illiquid assets, how much it held each quarter, and in what categories. And Lehman made blunt and full disclosures of the risks associated with its mortgage, real-estate and leveraged loan assets in its public filings.⁶⁹ The accounting treatment and alleged lack of sufficient disclosure

⁶⁷ See *Omnicom*, 597 F.3d at 514; *In re AOL Time Warner Sec. Litig.*, 503 F. Supp. 2d 666, 678 (S.D.N.Y. 2007).

⁶⁸ See *In re Initial Pub. Offering Sec. Litig.*, 399 F. Supp. 2d 261, 266-67 (S.D.N.Y. 2005).

⁶⁹ Plaintiffs' assertion that Lehman's growth strategy was "undisclosed," OB 3, is flatly wrong. See, e.g., 2007 10-K at 16 (Ex. 7) (disclosing Lehman had increased its proprietary trading and "principal

regarding Repo 105 transactions did not cause investors to perceive the risks of losses on these asset holdings as “remote or highly unlikely.” *See Lentell*, 396 F.3d at 173.

Second, the disclosed (and obvious) risk that Lehman might have to write down its illiquid assets was unrelated to Repo 105 transactions.⁷⁰ Indeed, the TAC alleges Lehman was obligated to mark down its assets when they declined in value, TAC ¶ 93, regardless of whether or not it used Repo 105 transactions. Plaintiffs assert that Repo 105 transactions’ impact on net leverage concealed the risk that write-downs might be necessary or losses might be incurred, which was first allegedly partially disclosed with Lehman’s Q2 2008 earnings report released in June. But they cannot deny that at the time of this first partial disclosure there had been no significant increase in Repo 105 usage.⁷¹ Lehman deleveraged between Q1 and Q2 2008 *despite* Repo 105 usage remaining virtually constant, and deleveraged further between Q2 and Q3 2008 *despite* Repo 105 transactions being reduced by nearly half. Significantly – and in contradiction to what they alleged in the TAC – Plaintiffs now concede that this deleveraging was due to sales of troubled assets and write-downs of assets, not Repo 105 transactions. *Compare* OB 91-92 *with* TAC ¶¶ 195, 201.

To salvage their loss causation theory in light of this concession, Plaintiffs now say – for the first time – that Lehman was unable to increase its Repo 105 usage in Q2 2008 because of the “limited availability of relatively ‘liquid’ assets to collateralize” and a lack of “willing[] counterparties to participate in such transactions.” OB 90-91. Plaintiffs then posit that apart from Repo 105 transactions, “the only other way Lehman could reduce net leverage at the end of 2Q08 was to sell assets and record writedowns” and that Lehman was “forced to sell billions of

investments (such as in real estate and real estate-related products and private equity),” and “expect[s] to continue to do so, which increases our exposure to market risk.”); *id.* at 15-16 (stating “[c]oncentration of risk will increase as we expand our proprietary trading and principal investing activities”).

⁷⁰ Indeed, in briefing the loss causation issue in connection with the SAC, Plaintiffs attempted to attribute these losses to alleged misstatements wholly unrelated to Repo 105 transactions.

⁷¹ The Opposition states that Repo 105 usage went up from Q1 to Q2 2008, OB 5, but Plaintiffs are forced to admit usage went only from \$49.1 to \$50.3 billion, *id.* at 63 & n.70, 91.

dollars in ‘sticky’ assets and write down the values of other assets to make its balance sheet targets.” OB 91. Similarly, for Q3 2008, the Opposition argues (ironically) that there was an “undisclosed reduction” of Repo 105 usage by half, and states that as a result Lehman “was forced to book massive write-downs in 3Q08 on its ‘sticky’ assets” to offset the increase in net leverage that would have resulted from the reduction of Repo 105 usage. OB 92.

This new argument is unavailing. The TAC does not allege that there was a lack of counterparties willing to enter into Repo 105 transactions or a shortage of liquid collateral to use them. Nor does it allege that some inability to engage in such transactions is what led Lehman to sell troubled assets and write-down assets that had declined in value. Moreover, the Opposition offers no basis for its speculation. The Report certainly does not allege that Lehman was forced to sell assets because Repo 105 transactions were somehow not available.

Lehman’s Q2 and Q3 2008 earnings announcements and disclosures of asset sales and write-downs – the first and fourth of the four “partial disclosures” alleged – temporally coincided with Lehman capping and then decreasing its Repo 105 transaction usage. At best, Plaintiffs are pointing to an incidental relationship between Repo 105 transactions and the decision to sell illiquid assets in 2008. But “[t]o ‘touch upon’ a loss is not to cause a loss, and it is the latter that the law requires.” *See Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 343, 125 S. Ct. 1627 (2005).

The second and third of the alleged partial disclosures – Lehman’s announcement that it was releasing earnings early and market reports that KDB had been in discussions with Lehman that had failed – had nothing to do with Repo 105 transactions or net leverage. Those disclosures also did not constitute the materialization of the allegedly concealed risks.

Risk and concentration limits. The Opposition does not attempt to explain how concentration limit violations were concealed by prior misstatements or caused Plaintiffs’ alleged losses. Moreover, while the Opposition discusses risk management, Plaintiffs conclude that Lehman’s bankruptcy was the materialization of the risk of “significant liquidity problems,” not risk management failures. OB 95. Plaintiffs also argue that a factor in Moodys’ decision to downgrade Lehman in June 2008 was the “ineffectiveness of hedges to mitigate these [real

estate] exposures” OB 94. What that statement demonstrates, however, is that Lehman tried to manage its risk through hedges. The fact that hedges that had proven effective in the past stopped working in 2008 does not demonstrate a disregard of risk. *See* DB 45.

The Opposition also ignores that Lehman’s statements about its approach to risk management, especially when coupled with its disclosures about the inherent limitations of its risk management processes, did not conceal from a reasonable investor the obvious fact that assets could decline in value in a troubled market and necessitate write-downs. Lehman’s disclosures of course did not include the proprietary information of what its risk limits were, and Lehman never represented that its risk limits would not be raised or exceeded after review and authorization as circumstances warranted. Lehman did disclose, however, that no risk management program is infallible or can withstand the risk of a run on the bank. *See supra* notes 58, 59 & 64.

The Company’s disclosures about risk management would not have caused a reasonable investor to perceive the risk of losses on investments as “remote or highly unlikely.” *See Lentell*, 396 F.3d at 173. Nor have Plaintiffs alleged a basis for believing that Lehman did not adhere to its risk management program as described and that this caused the Company’s failure. Loss causation from risk management and concentration violations has not been adequately pleaded.

Liquidity. The TAC does not allege that the liquidity problems that Plaintiffs claim were the immediate cause of Lehman’s demise were caused by the obligation to repurchase *liquid* Repo 105 collateral, or in any other way related to Repo 105 transactions. The Opposition’s loss causation theory is unrelated to those transactions. Instead, it supports that Lehman’s failure was triggered, not by any actual lack of liquidity, but by the *perception* of a lack of liquidity following the Company’s announcement of losses from real estate asset write-downs. OB 95-96.

Plaintiffs allege that the losses announced in June and September 2008 “plainly caused investors to question the sufficiency of Lehman’s liquidity” and “led Lehman’s counterparties to require more collateral, triggering the liquidity crisis.” OB 95. According to the TAC, Lehman’s “actual” liquidity pool of \$25 billion on September 10 was reduced to \$2 billion by

September 12, TAC ¶¶ 202-04 – a quintessential run on the bank. The risk that *following the announcement of multi-billion dollar losses* doubts might arise as to the sufficiency of Lehman’s liquidity and counterparties might refuse to do business with Lehman without additional collateral, was not concealed by alleged misstatements regarding liquidity. In any event, Lehman fully disclosed the risk to liquidity and a run on the bank. *See supra* notes 58, 59 & 64.

Plaintiffs have not adequately pleaded that any corrective disclosure or realization of a previously concealed risk caused the liquidity crisis necessitating Lehman’s bankruptcy. Instead, the TAC and Opposition support the inference that the collapse of confidence in Lehman that occurred during an unprecedented real estate and credit market meltdown caused the run on the bank that the Company’s liquidity pool could not withstand. *See* OB 95.

D. Plaintiffs’ §§ 20(a) and 20A Claims Should Be Dismissed

Plaintiffs’ failure to state a claim under § 10(b) defeats their § 20(a) claims against all Officer Defendants and § 20A claim against Fuld. DB 59-60. In addition, Plaintiffs’ § 20A argument that Fuld was “in possession of material nonpublic information concerning the adherence to Lehman’s risk management at the time he sold his Lehman stock,” OB 99, falls short because Plaintiffs have not pleaded any breach of Lehman’s risk appetite limits in June 2007, when Plaintiffs allege Fuld sold his Lehman stock. *See* TAC ¶¶ 75, 268.

CONCLUSION

For the foregoing reasons, and those set forth previously, the Securities Act and Exchange Act claims alleged in the TAC should be dismissed pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure without leave to replead.

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Respectfully submitted,

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