

Select '**Print**' in your browser menu to print this document.

©2007 National Law Journal Online

Page printed from: <http://www.nlj.com>

[Back to Article](#)

ENRON AND ITS BANKS

A bean ball for victims

Bill Lerach and Al Meyerhoff/Special to The National Law Journal

May 21, 2007

As a nation, we too quickly forget our victims. Maybe it's because we are already on to the next ones: those Rutgers University basketball players, the veterans at Walter Reed or, before that, the poor folks of New Orleans.

Remember Enron Corp.? "Kenny Boy" Lay and his happy band of scam artists took a small utility and turned it into the ultimate house of cards. Inside were greedy executives, dishonest dealmakers and ruthless energy traders. It was all a fraud, of course. The insiders bailed out along the way, cashing in their stock for a billion dollars. When the truth came out, thousands of investors lost everything: their pensions, their jobs, their homes and even their belief in the American dream.

Consider Mervyn "Buddy" Schwartz. An army vet, for nearly 39 years Buddy worked for the Hershey Co. as a mechanic on the assembly line. When he retired in late 1999, he turned to his son, a financial adviser at Merrill Lynch & Co., who told him Merrill was bullish on Enron. So Buddy heavily invested in the company — and lost it all. He and a group of other shareholders, large and small, sued. The defendants included Enron executives (some now imprisoned) and crooked accountants, but also several of the nation's premier banking institutions. Sometimes overlooked, it was the banks that helped concoct the bogus deals allowing Enron to falsify its finances. They then sold Enron's securities, pushed its stock — and wildly profited.

For example, in 1999, Merrill Lynch "bought" Enron's interest in a power plant floating on a barge off the coast of Lagos, Nigeria — solely in order to create earnings for Enron at year's end. According to deposition testimony from Enron's Andy Fastow, a high-ranking Merrill Lynch executive told him that, while not in the barge business, the bank would do this as a "favor." Enron would take the barge back in six months. Merrill Lynch and the other banks often solved such problems for Enron. When they needed to report increased cash flow and earnings while hiding increased debt, the banks simply created "structured finance transactions" — phony loans and asset sales. These deals were the critical cards holding up the entire house.

Eventually, some banks settled; others chose to fight, including Credit Suisse, Barclays — and Merrill Lynch. For them, for Buddy and for 1.6 million other shareholders, victims of the greatest fraud in U.S. history, the day of reckoning was about to arrive. On April 16, a jury trial of the Enron class action in Houston was set to begin. Justice was at hand. What happened next shocked all involved. On March 19, two judges of the 5th U.S. Circuit Court of Appeals intervened in *Regents of University of California v. Credit Suisse First Boston* and threw a bean ball at the victims. There would be no trial — no day of reckoning. The banks got off the hook.

No duty to shareholders?

Why? Because Enron investors were said not to be legally entitled to rely upon the banks acting honestly. In language worthy of Dickens' *Bleak House*, the court said that the "factual probability that the market relied on the banks' behavior . . . does not mean that plaintiffs are entitled to the *legal* presumption of reliance." Then, in one for the ages, they said that "the banks only aided and abetted [Enron's] fraud by engaging in transactions to make it more plausible; they owed no duty to Enron shareholders." Put differently, because the banks had made no false statements to shareholders, they were immune.

The two judges acknowledged that the banks "escape liability for alleged conduct that was hardly praiseworthy [W]e recognize . . . our ruling may not coincide . . . particularly in the minds of aggrieved former Enron investors

who have lost billions . . . with notions of justice and fair play." But to rule otherwise, they said, would open the litigation "floodgates." And as was once taught in law school: "It is far better that things be certain than that things be just."

Fortunately, such antiquated views of the rule of law in our society have evolved. Other courts take a different view of the Securities Exchange Act of 1934 — enacted during the New Deal to remedy stock-market fraud. The act by its plain words intends that victims of a scheme to defraud are protected against all perpetrators, including those hiding in the weeds.

So Buddy and his fellow plaintiffs have sought review by the U.S. Supreme Court. The high court just took another case presenting the same issue: whether investor victims can sue all who participate in an illegal scheme to defraud. These cases have enormous implications for those who invest in American markets, whether individual shareholders, 401(k) holders, retirees or pension funds. Investors are already being swamped by yet another corporate scandal: the clandestine diversion of billions of dollars to dishonest executives through the backdating of stock options.

On May 9, several Enron victims met with Securities and Exchange Commission Chairman Christopher Cox to urge that the SEC support their position before the Supreme Court. One trusts that the justices will remember that their decision will have consequences for the Enron victims. Let's hope they will remember Buddy.

Bill Lerach is a partner at San Diego-based Lerach Coughlin Stoia Geller Rudman & Robbins. Al Meyerhoff is of counsel to the firm's Los Angeles office. They are co-counsel for the class in the Enron shareholder fraud case.