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UNITED STATES COURT OF APPEALS  
FOR THE SEVENTH CIRCUIT

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DAVID E. ROGERS, on behalf of himself	)	
and a class of persons similarly situated,	)	
and on behalf of the Baxter International, Inc.	)	
and Subsidiaries Incentive Investment Plan and	)	
the Baxter Healthcare Corporation of Puerto	)	Interlocutory Appeal from the
Rico Savings and Investment Plan,	)	United States District Court for
	)	the Northern District of Illinois,
<i>Plaintiff-Respondent,</i>	)	Eastern Division
	)	
v.	)	Case No. 04 C 6476
	)	
BAXTER INTERNATIONAL, INC., the	)	Judge Joan B. Gottschall
Administrative Committee, the Investment	)	
Committee, Brian P. Anderson, John J.	)	
Greisch, Harry M. Jansen Kraemer, Jr., Robert	)	
Parkinson, Jr. and John Does 1-30,	)	
	)	
<i>Defendants-Petitioners.</i>	)	

**PLAINTIFF’S SUPPLEMENTAL MEMORANDUM IN  
RESPONSE TO COURT’S ORDER DATED JULY 27, 2007**

Plaintiff-Respondent and class representative David E. Rogers (“Rogers”) files the following memorandum to discuss the bearing of *Higginbotham v. Baxter Int’l, Inc.*, No. 06-1312 (7th Cir. July 27, 2007); *Harzewski v. Guidant Corp.*, 489 F.3d 799 (7th Cir. 2007); and *LaRue v. DeWolff, Boberg & Associates, Inc.*, 450 F.3d 570 (4th Cir. 2006), on this appeal.<sup>1</sup>

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<sup>1</sup>The plaintiff class has also moved in the district court to supplement the record, updating developments since this appeal was docketed a year ago. As discussed below (in Section II), the class has discovered new facts and documents that support its claims. This record bears on the applicability of *Higginbotham*, which (in contrast to the present case) was decided on a motion to dismiss without the benefit of discovery. The motion to supplement is noticed for September 13, 2007, when Judge Gottschall will next hear motions. We request that the Court defer action on this case until the supplemental record becomes available. Once it is transmitted to this Court, the class will seek leave to file a supplemental appendix for ease of reference.

As set forth more fully below, the three cases affect the current appeal as follows:

- With the Supreme Court's recent grant of review in *LaRue*, the Supreme Court's disposition will likely redirect the analysis in this case. The class respectfully recommends that the Court defer decision until *LaRue* is decided. In any event, the analysis in the Fourth Circuit's supplemental rehearing order in *LaRue* (458 F.3d 359 (4th Cir. 2006)) supports the district court's order below.
- *Higginbotham*, though addressing Baxter's July 2004 restatement, is an entirely separate action from this one. *First*, as a securities fraud case — with a heightened pleading standard and requiring proof of scienter — *Higginbotham* concerned a different body of law from this case. Indeed, the ERISA issue certified for this interlocutory appeal (whether Rogers can seek relief for the plan under ERISA § 502(a)(2)) is totally alien to securities law. *Second*, while *Higginbotham* terminated at the pleading stage, this case has advanced into discovery and involves a range of allegations stretching back before the events in *Higginbotham*. The Court in *Higginbotham* inferred, on the basis of the securities fraud complaint filed in that case, that the earliest Baxter that senior managers could have known about the fraud at the Brazilian subsidiary was March 12, 2004 (*Higginbotham*, slip op. at 6). The class has discovered facts, presented to the district court, that Baxter's board was alerted to the problems in the Brazilian operations long before March 2004 and was also long aware of problems in Baxter's internal audit operations.
- *Harzewski* clarifies that ERISA claims for breach of fiduciary duty are not to be measured by the same substantive standards as securities fraud litigation, and that *Summers v. State Street Bank*, 453 F.3d 404 (7th Cir. 2006), ought not be read to immunize culpable fiduciaries for continuing imprudently to offer company stock as a Section 401(k) investment option.

The cases thus collectively support the district court's order, which should be affirmed.

### **MERITS CONTINUE TO BE LITIGATED BELOW**

This Court docketed defendants' interlocutory appeal on August 18, 2006. Meanwhile, the action has progressed in the district court pursuant to 28 U.S.C. § 1292(b) ("application for an appeal hereunder shall not stay proceedings in the district court unless the district judge or the Court of Appeals or a judge thereof shall so order"). The U.S. Magistrate Judge supervising

discovery has set a fact discovery cut-off of October 28, 2007, dates have been set for ten depositions noticed by plaintiffs, and some 350,000 pages of documents have been produced.

On May 14, 2007, defendants filed a motion for partial judgment on the pleadings. Both sides submitted extensive exhibits. This motion is now fully briefed and awaiting decision. The parties addressed *Guidant* and *Higginbotham* in the memoranda filed in the district court.

**I. *LARUE v. DEWOLFF, BOBERG & ASSOCIATES, INC.***

The class previously addressed *LaRue* in its brief (at 22), noting that the Fourth Circuit there held — as the class urges here — that class actions on behalf of injured participants to restore losses may proceed under ERISA § 502(a)(2). *See, e.g., LaRue v. DeWolff, Boberg & Associates, Inc.*, 450 F.3d 570, 573 (4th Cir.) (claim allowed when “an individual plaintiff sues on behalf of the plan itself or on behalf of a class of similarly situated participants”), *supplemental order*, 458 F.3d 359 (4th Cir. 2006), *cert. granted*, 127 S. Ct. 2971 (2007).

But now that the U.S. Supreme Court has granted certiorari in *LaRue*, this Court has cause to hold this appeal until *LaRue* is decided. The Supreme Court granted certiorari on the question of whether ERISA § 502(a)(2) “permit[s] a participant to bring an action to recover losses attributable to his account in a ‘defined contribution plan’ that were caused by fiduciary breach.” Although not specifically the issue presented here — Rogers’ case involves a certified class action to restore plan losses, rather than an individual action for personal recovery — it is close enough that any decision by the Supreme Court is liable to shed new meaning on ERISA § 502(a)(2). A premature decision by this Court would likely lead to a certiorari petition to the Supreme Court by the losing side, followed by a grant of the writ, vacatur and remand in light of *LaRue*. This sequence occurred in another ERISA case, *Matz v. Household Int’l Tax Reduction*

*Inv. Plan*, 265 F.3d 572, 573 (7th Cir. 2001) (following decision on interlocutory appeal, the “Plan petitioned for writ of certiorari, which the Supreme Court granted, thereby vacating and remanding the case to us for further consideration in light of *United States v. Mead Corp.* . . .”).

To avoid successive appeals, the class respectfully requests that the Court defer action pending the outcome in *LaRue*, just as it did in *Higginbotham*. *Higginbotham*, slip op. at 3 (“after argument, however, the Supreme Court granted certiorari in *Tellabs*, and we deferred action pending the Court’s decision”). The Court might even consider dismissing the interlocutory appeal to allow the case below to play out. *See, e.g., Johnson v. Burken*, 930 F.2d 1202, 1205 (7th Cir. 1991) (merits panel has discretion, in consideration of subsequent developments, to “dismiss [section 1292(b)] appeal as having been improvidently granted”).

The Fourth Circuit’s decision in *LaRue* nevertheless supports the class’s claim, especially in light of the supplemental order denying rehearing. *LaRue* concerned an individual’s claim of breach of fiduciary duty, seeking personal monetary relief, rather than (as here) a class action to restore losses to the plan itself. In its supplemental order, the Fourth Circuit clarified that class cases filed on behalf of a *subset* of participants may proceed under ERISA § 502(a)(2) to recover losses to a plan. In response to arguments in the U.S. Department of Labor’s amicus brief, the panel contrasted cases involving “a subset of plan beneficiaries or participants that alleged plan losses” (as here) with a case involving “an individual plaintiff.” *LaRue*, 458 F.3d at 362-63. The Fourth Circuit panel underscored that “[t]he cases cited by the Secretary thus stand only for the limited proposition that liability under § 502(a)(2) is not limited to losses that accrue to *all* plan participants — it is, however, limited to plan losses.” *Id.* at 363 (emphasis in original).

Thus, the Fourth Circuit's decision in *LaRue* case supports the district court's decision in this case. Indeed, the *LaRue* supplemental rehearing decision (458 F.3d at 363) cited this Court's decision in *Steinman v. Hicks*, 352 F.3d 1101, 1102 (7th Cir. 2003), holding that "[t]here was some confusion in the district court over whether the suit was under section 502(a)(3) or 502(a)(2), but it is clearly the latter, because the plaintiffs are asking that the trustees be ordered to make good the losses to the plan caused by their having breached fiduciary obligations."

## **II. *HIGGINBOTHAM v. BAXTER INT'L, INC.***

This Court's recent decision in *Higginbotham v. Baxter Int'l, Inc.*, No. 06-1312 (7th Cir. July 27, 2007), is entirely separate from this case. *First*, in contrast to *Higginbotham*, the class case here arises under ERISA, and so the issues of scienter and the heightened securities-fraud pleading standards are not presented. The issue certified for appeal here — whether Rogers may under ERISA § 502(a)(2) pursue return of losses to the plan, if fewer than all participants were affected — would never crop up in a securities fraud case such as *Higginbotham*. *Second*, unlike *Higginbotham*, the class in this case has obtained documents that directly support its contentions that defendants knew about (or recklessly disregarded) deficiencies in Baxter's internal accounting and fraud in its Brazilian subsidiary long before the July 2004 restatement. And the July 2004 restatement is only one element in the longer time-line covered by this case.

The *Higginbotham* case was based on an alleged fraud carried out by Baxter executives and employees at its subsidiary in Brazil, which eventually led the company to announce on July 22, 2004 that it would restate its earnings for a several-year period. The claims were brought under the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and the SEC's Rule 10b-5, 17 C.F.R. § 240.10b-5. As the Court noted, such cases are governed by a special pleading standard

under the Private Securities Litigation Reform Act of 1995 (“PSLRA”), 15 U.S.C. § 78u-4(b)(2). *Higginbotham*, slip. op. at 3. This Court affirmed the dismissal of *Higginbotham* on the ground that the complaint — evaluated under the unique PSLRA’s pleading standard as clarified in *Tellabs Inc. v. Makor Issues & Rights, Ltd.*, 127 S. Ct. 2499 (2007) — failed to manifest a cogent and compelling inference of scienter and thus failed to state a claim under that Act.

The present case alleges breach of fiduciary duty in violation of ERISA § 409(a), 29 U.S.C. § 1109. It is premised on a series of failures by defendant fiduciaries to disclose materially adverse facts as well as their decisions, omissions, acts, and inaction in continuing to offer Baxter stock as an investment option in the company’s 401(k) Plan between January 1, 2001 through at least the July 2004 restatement. Sounding in trust rather than securities law, ERISA neither requires proof of scienter, nor does it demand the heavier standard of proof required of securities fraud claims. *Harzewski v. Guidant Corp.*, 489 F.3d 799, 805-06 (7th Cir. 2007). Ordinary notice-pleading (Fed. R. Civ. P. 8(a)(2)) applies to ERISA cases. *See McDonald v. Household Intern., Inc.*, 425 F.3d 424, 427-28 (7th Cir. 2005); *Bartholet v. Reishauer A.G. (Zürich)*, 953 F.2d 1073, 1078-79 (7th Cir. 1992). *See also EEOC v. Concentra Health Serv., Inc.*, No. 06-3436, slip op. at 9 (7th Cir. Aug. 3, 2007) (“[t]he intent of the liberal notice pleading system is to ensure that claims are determined on their merits rather than through missteps in pleading’ . . . [A] plaintiff might sometimes have a right to relief without knowing every factual detail supporting its right; requiring the plaintiff to plead those unknown details before discovery would improperly deny the plaintiff the opportunity to prove its claim”), *quoting* 2 James W. Moore, et al., *Moore’s Federal Practice* § 8.04 (3d ed. 2006).

The July 2004 restatement — the foundation of *Higginbotham* — is alleged in Rogers' complaint, but as only one entry in the multi-year time-line of defendants' breach of fiduciary duty. Since 2001, the plan fiduciaries withheld materially adverse facts while continuing to offer the Baxter Common Stock Fund as an investment alternative. The time frame include significant stock drops in July 2002 (26% in one day) and March 2003 (27.9% in one day) after the market learned of the omissions. And unlike the *Higginbotham* plaintiffs, the class has moved far beyond the pleading stage in this case. Depositions of Baxter's executives are currently underway, and defendants have produced some 350,000 pages of documents and data so far.

In the midst of this pretrial preparation, on May 14, 2007, defendants filed a motion styled as a "Motion for Partial Judgment on the Pleadings," supported by some 500 pages of documents which defendants contended were cognizable under Fed. R. Civ. P. 12(c) as documents cited in the complaint. The defendants' motion characterized allegations about the July 2004 restatement as a separate "claim" and asked the district court to dismiss it with prejudice. In response, the class requested that defendants' motion be treated as one for summary judgment — because defendants' motion was supported by documents not in the record — and that (under Fed. R. Civ. P. 56(f)) decision on the motion be deferred until discovery was completed; the requisite affidavit detailing the additional discovery needed was appended.

The class further argued that the July 2004 allegations were not a "claim," subject to dismissal, but cited as evidence of an ongoing and longer-term practice stretching over multiple years. Yet even if the July 2004 restatement constituted a stand-alone claim, then unlike the plaintiffs in *Higginbotham*, the class had obtained discovery corroborating the allegations that defendants knew about problems in Baxter's internal audit function generally and in its Brazil

operations specifically. (As noted above, in n.1, the class has moved to supplement the record with these motion papers and exhibits. As the underlying documents were designated by Baxter as “confidential,” pursuant to the parties’ confidentiality agreement they were filed under seal.)

In sum, because (1) the substantive securities law in *Higginbotham* is inapplicable to this ERISA action, with the only issue presented on this appeal being one of ERISA law (ERISA § 502(a)(2)); and (2) the class can document the allegations that defendants had actual knowledge (or reckless disregard) of the problems in Brazil and with their internal audits long before July 2004, the decision in *Higginbotham* will not affect the outcome of this interlocutory appeal.

### **III. HARZEWSKI v. GUIDANT CORP.**

This appeal concerns itself with whether the relief sought by the class — restoration of losses to a defined contribution plan — is a proper remedy under ERISA § 502(a)(2), where not all plan participants had invested in the Baxter Common Stock Fund. This Court’s decision in *Harzewski v. Guidant Corp.*, 489 F.3d 799 (7th Cir. 2007), has no bearing on this question. It does, however, resolve three subsidiary arguments that defendants have pressed in its briefing.

First, defendants argue in their opening brief (at 40-2) that there is no need to allow a remedy for breach of fiduciary duty under ERISA § 502(a)(2), because participants supposedly may recover the same losses by way of a securities fraud claim. *Harzewski* puts this argument to rest, holding that ERISA provides broader protection to plan participants and thus constitutes a remedial scheme independent from and in addition to the securities laws. *Id.* at 805-06.

Second, *Harzewski* rejects a reading of *Summers v. State Street Bank & Trust Co.*, 453 F.2d 404 (7th Cir. 2006), urged by defendants below, that fiduciaries are virtually immunized from liability for failing to compel disposal of company stock held by 401(k) participants.

Instead, *Harzewski* clarifies that *Summers* permits the trustee to “be faulted for failing to recognize” the risk in maintaining the 401(k) plan’s position in the company stock. *Harzewski*, 489 F.3d at 807. This supports the theory of relief that the class pursues here, and belies any suggestion that a loss in value of an imprudent investment cannot be recovered on behalf of the plan by way of ERISA § 502(a)(2). (*See* Pl. Br. at 31-38, for further response to this argument.)

*Harzewski* presented a case, such as this one, where the participants alleged that the administrator imprudently retained company stock in a defined contribution plan, while management concealed material information, leading to a plunge in the price of the stock when the fraud was finally exposed. *Id.* at 800-01. The Court reversed dismissal of the complaint, holding that the loss in value of benefits cause by imprudent management of a defined contribution plan may be recovered under ERISA:

Suppose Guidant had stolen half the money in a plan participant’s retirement account and a suit by the participant resulted in a judgment for that amount; the suit would have established the retiree’s eligibility for the larger benefit. There is no difference if instead of stealing the money from the account, Guidant by imprudent management caused the account to be half as valuable as it would have been under prudent management. The benefit in a defined-contribution pension plan is, to repeat, just whatever is in the retirement account when the employee retires or *whatever would have been there had the plan honored the employee’s entitlement*, which includes an entitlement to prudent management. [Emphasis in original.]

*Id.* at 804-05.

Third, *Harzewski* obviates the need to determine whether individual plan participants must maintain this action on their own behalf only under ERISA § 502(a)(3), as distinguished from ERISA § 502(a)(2) on behalf of the plan. This is another issue that defendants have interjected into the present appeal (*see* defendants’ opening brief at 39-40). *Harzewski* held that plan participants can sue on their own behalf for losses in their 401(k) accounts directly as a loss

of benefits under ERISA § 502(a), and so the reach of ERISA § 502(a)(3) need not be decided. *Harzewski* holds that ERISA § 502(a), which expressly gives plan participants the right to sue “to recover benefits due to him under the terms of his plan, to enforce his rights under the terms of the plan, or to clarify his rights to future benefits under the terms of the plan” (ERISA § 502(a)(1)(B)), confers standing on individual participants to seek monetary relief from plan fiduciaries for losses to their 401(k) accounts caused by fiduciary breach. *Id.* at 805-06. A participant may sue under ERISA § 502(a)(2) to “recover whatever would have been” in his account had the Plan trustees been prudent managers. *Id.* at 805. As the Court explained,

Benefits are benefits; in a defined-contribution plan they are the value of the retirement account when the employee retires, and a breach of fiduciary duty that diminishes that value gives rise to a claim for benefits measured by the difference between what the retirement account was worth when the employee retired and cashed it out and what it would have been worth then had it not been for the breach of fiduciary duty.

*Id.* at 807. The Third Circuit in *Graden v. Conexant Systems Inc.*, No. 06-2337 (3d Cir. July 31, 2007), and the Sixth Circuit in *Bridges v. American Electric Power Co.*, No. 06-4100 (6th Cir. Aug. 15, 2007), have recently adopted the Seventh Circuit’s specific reasoning on this point.

The class anticipates that Baxter may, in its supplemental memorandum, cite language found at the conclusion of *Harzewski* (489 F.3d at 807), that “[i]t seems exceedingly speculative to suppose that Guidant in its capacity as plan fiduciary should and would have found a substitute investment that would have turned out as well,” thus calling into question the class’s theory of the loss. But with discovery proceeding below, it is premature to reach this issue (*id.*):

The claim in this case is that Guidant knew that the price of its stock was overvalued but took no measures to protect the participants in the pension plan, as it could have done by selling the Guidant stock held by the plan before the overvaluation was discovered by the market and its price plummeted. *The plaintiffs have not yet had an opportunity to try to prove that there was such a*

*window of opportunity. Remember that the suit was dismissed for failure to state a claim; there has been no discovery.*

(Emphasis added). *See also id.* at 808 (Ripple, J.) (“it would be far better, as a prudential matter, to refrain from commentary on the merits at this time”). This interlocutory appeal arises from a denial of a motion to dismiss, discovery is in full swing, and ruling on this point is premature.

The class respectfully requests that the Court stay this appeal pending the outcome in *LaRue*, or alternatively affirm the decision below denying the motion to dismiss.

Dated: August 17, 2007

Respectfully submitted,

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**CERTIFICATE OF SERVICE**

Undersigned Counsel caused the attached **PLAINTIFF'S SUPPLEMENTAL MEMORANDUM IN RESPONSE TO COURT'S ORDER DATED JULY 27, 2007** to be served via hand-delivery this 17th of August, 2007 on:

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