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CONDITIONALLY FILED UNDER SEAL

SUPERIOR COURT OF THE STATE OF CALIFORNIA

COUNTY OF SAN FRANCISCO

OVERSTOCK.COM, INC., a Delaware corporation; KEITH CARPENTER, an individual; OLIVIER CHENG, an individual; FERN BAILEY and WENDY MATHER, as Co-Personal Representatives of the Estate of MARY HELBURN; ELIZABETH FOSTER, an individual; HUGH D. BARRON, an individual; DAVID TRENT, an individual; and MARK MONTAG, an individual,

Plaintiffs,

v.

MORGAN STANLEY & CO., et al.,

Defendants.

Case No. CGC-07-460147

PLAINTIFFS' CONSOLIDATED OPPOSITION TO DEFENDANTS' MOTIONS TO SEAL SUMMARY JUDGMENT PAPERS

Date: March 1, 2012
Time: 9:30 a.m.
Dept: 305
Judge: Hon. John Munter

Complaint Filed: February 2, 2007

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page

Cases

TABLE OF AUTHORITIES
(continued)

Page

Statutes & Rules

"[C]ommon sense tells us that the greater the motivation a corporation has to shield its operations, the greater the public's need to know." *Brown & Williamson Tobacco Corp. v. FTC*, 710 F.2d 1165, 1180 (6th Cir. 1983).

"[W]hat transpires in the court room is public property." *Craig v. Harney*, 331 U.S. 367, 374 (1947).

"[T]raditional Anglo-American jurisprudence distrusts secrecy in judicial proceedings and favors a policy of maximum public access to proceedings and records of judicial tribunals." *Estate of Hearst*, 67 Cal. App. 3d 777, 784 (1977).

I. INTRODUCTION

In prior discussions with the parties, the Court advised that it was not meting out private justice as a Star Chamber and that Defendants should be selective in determining what they seek to seal. Completely and utterly disregarding the Court's guidance, Defendants seek to seal virtually everything submitted with the summary judgment papers, including virtually every single evidentiary document and deposition excerpt submitted in opposition to summary judgment, as well as large portions of the summary judgment opposition, the seven supporting declarations from plaintiffs' expert witnesses that set forth Defendants' manipulation, and Defendants' reply papers. Just as Defendants abused the summary judgment objections process by objecting to virtually every document, Defendants have likewise again burdened both the Court and Plaintiffs with having to address their massive filing, much of which is completely frivolous. Plaintiffs are unaware of any California case where a party has tried to do anything even close to what Defendants are doing here – globally seal virtually every piece of evidence Plaintiffs submitted in opposition to summary judgment.

Defendants rely on two primary arguments for their global sealing request. First, Defendants contend that the Court need only make a sealing determination as to some undefined subset of summary judgment materials that the Court "considered or relied upon as a basis of adjudication" in denying summary judgment. Goldman Motion, at 7. However, even the legal authority cited by Defendants requires a sealing determination of all summary judgment materials, not some portion. Not only is Defendants' argument legally baseless, it is also

factually impossible because the essence of the Court's order is its finding—after reviewing all of the evidence—that the manipulative conduct occurred outside California. There is no way for the public to assess the fairness and validity of that conclusion without reviewing all of the evidence, nor is there any way for the Court to parse what evidence was or was not considered or relied upon in reaching its conclusion that the manipulative conduct occurred outside California. The public is entitled to see that evidence and make its own determination of whether the Court erred in dismissing the case based on what Defendants characterized as "jurisdictional limitations" of Section 25400. Even if those limitations were correctly applied by the Court, the public may wish to reconsider the scope of the statute. In either case, the public has a right to know how justice is rendered in its court system.

Second, despite moving to seal virtually the entire record, Defendants have failed to enumerate "specific facts" that justify what the California Court of Appeal refers to as the "extraordinary" measure of sealing any record—much less all of these years-old records. Instead, Defendants rely upon generic statements that all of these documents contain trade secrets, yet ignore the fact that much of the information they seek to seal is already in the public domain. The remainder is of no competitive value to anyone because the information is limited in scope and concerns obsolete procedures from six to seven years ago that were unlawful at the time and that are further blocked by the enactment of new federal regulations in 2008.

Defendants proffer generic conclusions about the supposed trade secret status of the materials at issue. That is a risible fiction. Such "trade secrets" represent nothing more than Defendants' efforts to hide evidence of how they intentionally failed trades and the nature of their relationship with two traders, Scott Arenstein and Steven Hazan (who have been suspended from the securities industry for a minimum of five years and sanctioned millions of dollars each). Indeed, Defendants seek to seal the materials reflecting the very policies that they claimed at oral argument were common knowledge: "[I]t was common knowledge in the marketplace that Merrill Pro and GSEC were not borrowing shares for market-maker trades because we were doing it for all of our market-maker customers. It wasn't just for Hazen [sic]." Jan. 5, 2012 Tr., at 23:21-24.[1]

[1] An additional copy of the summary judgment hearing transcript is attached to the Declaration of

Defendants' counsel further emphasized that "this case is about firmwide policies by Merrill Pro and GSEC to fail the short—the short sales of our market-maker clients." *Id.* at 167:7-10. Defendants now reverse course and claim that the emails and other evidence reflecting how they failed trades, why they failed trades, and who approved and disapproved of failing trades are all trade secrets. Defendants go so far as to request sealing of documents whose contents have already been substantially revealed, as set forth in the Factual Background below.

Whereas an order unsealing records requires no factual findings, a sealing order under California Rule of Court 2.550 requires, among other things, "express factual findings" for each record sealed establishing that Defendants have an interest that overrides the right of public access and that disclosure would prejudice Defendants. Before sealing any record, the Court must review the specific document to make the determinations of whether Defendants have established an overriding interest and would suffer prejudice and, if so, whether some portion of the document may still be disclosed in redacted form. Stale six and seven-year old emails should not be sealed merely because they reflect the Defendants' plan to fail trades and scheme with persons like Hazan and Arenstein in so doing. Embarrassment and a desire to hide wrongdoing do not qualify as an "overriding interest."

Defendants' refusal to identify any potentially confidential evidence within the overall evidence has forced Plaintiffs to spend massive amounts of time pointing out, document by document, how the mass of what Defendants seek to seal is already in the public record or otherwise does not meet the well-established standards for sealing records. Additionally, by requesting that the Court enter a global sealing order of the summary judgment papers and not submitting any redacted versions of any potentially sealable documents, Defendants have waived any claim that some lesser portion of a document or documents may be sealed. Where such a global sealing order is improperly requested, the law mandates unsealing of the entire record.

Ellen Cirangle in Support of Plaintiffs' Consolidated Opposition to Motions to Seal ("Cirangle Dec."), Ex. A.

II. FACTUAL BACKGROUND

A. Facts Already in the Publicly-Available Record in This Case

All of the following facts are taken from publicly-available filings and court records, with particular reliance on filings made by Defendants themselves.

Defendants' own witnesses have repeatedly stated that there is a T+3 delivery requirement for all short sales.[2] *See* Defendants' Responses and Objections to Additional Evidence Submitted by Plaintiffs in Opposition to Defendants' Motion for Summary Judgment, Or, Alternatively, Summary Adjudication ("Defendants' Responses")[3], Fact No. 255. Defendants are responsible for delivery of stock, even on market maker trades. *Id.*, Fact No. 134. Other clearing firms settled market maker short sales at T+3.[4] *Id.*, Fact No. 256. Morgan Stanley, Goldman's longtime competitor in securities lending (the two firms had the largest securities lending operations on Wall Street in 2006), made delivery for all stocks and promptly resolved any inadvertent failures-to-deliver, including for the very hard-to-borrow stocks, and that was industry practice. *Id.*, Fact No. 150. As experienced clearing firms, Defendants also know that intentionally failing market maker trades is inconsistent with industry custom and practice. *Id.*, Fact No. 176. Goldman executives acknowledged that prompt settlement was important, that negative rebate stocks should be settled just like any other stocks, and that letting market maker trades fail would not be consistent with Goldman policies. *Id.*, Fact No. 173.

Clearing firms' difficulty in borrowing Overstock placed a natural, market-based limit on short interest. Overstock was one of a small number of hard to borrow securities that were the focus of the day-to-day work in securities lending. Overstock was so hard to borrow that clearing brokers in 2006 charged borrow fees as high as 35% annualized. When a short seller would contact a clearing firm to inquire about short selling Overstock, the firm would sometimes

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[2] "T+3" is an industry term that refers to settlement three days after trade date.

[3] An additional copy of this pleading is attached as Exhibit B to the Cirangle Dec. for the Court's convenience.

[4] For example, O'Connor and Fortis, charged a borrow fee at settlement time for market maker shorts, and Morgan Stanley did not intentionally fail market maker trades after Reg SHO was implemented. *Id.*, Fact No. 256.

have to tell the short seller that no short sale could be executed because the firm had no inventory of the stock; if the broker could locate some stock, the broker typically had to pay a large fee to borrow the stock from a lender (such as custodial banks like State Street or Bank of New York) which the broker would in turn pass to the short seller with an added fee tacked on; and the short seller then had to decide whether it was willing to risk shorting a stock knowing that the stock had to, for example, drop 35% just for the short seller to break even. Defendants' Responses, Fact 135. All clearing firms, including Merrill and Goldman, faced, and would have been aware of, the same supply constraints for Overstock. Everyone "on the Street" constantly talked to other brokers looking for stock and therefore had a realistic, shared sense of how hard it was to locate stock and how expensive it was to borrow. All the brokers faced the same general supply-and-demand constraints when a stock, like Overstock, was hard to borrow. *Id.*, Fact 136.

Facing the same supply constraints as all of the other brokers, Defendants decided to manipulate supply and demand for short sales by consciously opting not to settle certain short sales in hard to borrow stocks, including Overstock, at all. Defendants' Responses, Fact No. 137. Both Goldman Sachs and Merrill Lynch decided to create fails-to-deliver in their affiliates, GSEC and Merrill Pro, so that they could correspondingly create "supply" in Goldman Sachs and Merrill Lynch. Millions of shares of fails-to-deliver were concentrated in GSEC/Merrill Pro so that millions of shares of corresponding "supply" could be artificially created in Goldman Sachs/Merrill Lynch.[5] Defendants used the supply of Overstock stock freed up by their intentional fails to deliver in Merrill Pro and GSEC to cause additional short selling in Overstock at Merrill Lynch and GS&Co. *Id.*, Fact No. 139. Goldman Sachs expressed its "intentions to create supply and perpetuate selling in stocks with a large amount of short interest." *Id.* Goldman was known for its ability to supply hard to borrow stock to its hedge funds that its competitors could not supply and that gave Goldman a competitive advantage. Goldman's own hedge fund clients remarked on how they would ask "to short an impossible name (and expecting full well not to receive it) and [be] shocked to learn that [Goldman's representative] can get it for us." Defendants' Responses, Fact 161.

[5] GSEC's fails were concentrated in its 501 and 690 DTCC accounts. *Id.* Facts 106-07.

Artificial supply created by fails increased the number of shares that could be lent out to short sellers. Defendants' Responses, Fact 161. Hedge fund clients were particularly interested in a stock that was "truly hard to borrow" and would "really trade like a 'TASR, OSTK.'" *Id.*, Fact 162. As the price of a hard-to-borrow security declines, the volume of short selling in the security will typically increase because of piling in, resulting in greater profits to the clearing firm. *Id.*, Fact 155. "Piling in" refers to the practice by which short sellers want to short stocks that are already being heavily shorted, further increasing the short pressure on the price of those stocks, like Overstock. Short sellers typically pile in to the same securities, which increases short interest in a small number of stocks. Client shorts were typically concentrated in the red hot stocks more than any other stocks, and short sellers believed that concentrated short selling in a small number of small to mid-cap companies could be expected to have a downward price effect as short interest increased. *Id.*, Fact 158.

Goldman Sachs also induced additional short sales through its circulation of the artificially high short interest in Overstock to its hedge fund clients. *Id.*, Fact 160. Goldman Sachs marketed highly shorted stocks, including Overstock, to clients by distributing lists of the top shorted stocks, knowing that it had the ability to offer its artificial supply. *Id.*, Fact 227. Goldman Sachs knew that such lists would alert holders of Overstock shares to the potential short-selling activities described and that by placing Overstock on such a list, Goldman Sachs was signaling to these holders that Overstock shares may be subject to further price declines owing to short selling which would trigger further sales in the broader market of Overstock's shares and further fuel price declines. Goldman Sachs circulated lists of the top shorted stocks to clients which Goldman Sachs would have understood was signaling to these holders Overstock might be subject to further price declines; the data Goldman Sachs circulated included the false, inflated short interest data. *Id.*, Fact 228. Short sales Goldman effected were part of the unnatural level of short interest that Goldman was able to generate through its use of artificial supply created by causing fails-to-deliver. *Id.*, Fact 118.

Defendants failed millions of shares in their GSEC and Merrill Pro accounts. Defendants' Responses, Fact 139. The fails and corresponding naked short sales artificially

increase the tradable supply of shares of Overstock available for short sales by as much as 34%, thus artificially increasing short sales beyond their normal supply constraints. *Id.*, Fact 157. The fails created supply in excess of six times the average daily trading volume of Overstock. Jan. 5, 2012 Tr., at 152. Defendants' decisions to intentionally fail to deliver Overstock stock caused large-scale naked short selling of Overstock stock. Defendants' Responses, Fact 151.

Goldman Sachs failed the negative rebate GSEC trades, including Overstock, by intentionally withholding supply from GSEC to settle their trades. Defendants' Responses, Fact 144. Goldman Sachs was the exclusive supplier of stock to GSEC, and the Securities Lending Group within Goldman Sachs borrowed stock and made the decision as to whether to retain that stock with Goldman Sachs or send it to its affiliates, including GSEC, for its affiliates' needs. *Id.*, Facts 142-3. Because GSEC would simply fail trades, its clients were artificially induced to short without regard to the true economics of the short sale. *Id.*, Fact 121.

Merrill's decision to intentionally fail these trades was accomplished through what Merrill called the "do-not-flip" process. Normally, all trades at Merrill Pro are flipped to Merrill Pierce for settlement in the ordinary course. The "do-not-flip" process applied to negative rate securities, that is securities that cost Merrill money to settle. That process is a process by which Merrill Pro does not borrow stocks to settle those trades, but rather fails them. After Reg SHO, Merrill Pro put the do-not-flip system into place in August 2005. Thomas Tranfaglia, Linda Messinger and Peter Melz were the Merrill executives who decided to do this in August 2005. Jan. 5, 2102 Tr., 64:11-66:7 (argument by Merrill's counsel).

Merrill Pro agreed to fail trades for Hazan and other market-making customers and stopped borrowing shares for their short sales. Jan. 5, 2012 Tr., 23:21-28 (argument by Merrill's counsel). In August 2005, Merrill Pro told clients that they would now start failing their trades.[6] Jan. 5, 2012 Tr., 74:20-26. After Merrill Pro agreed to fail trades for clients in negative rebate securities these clients naked short sold Overstock in large quantities. Defendants' Responses,

[6] In a July 29, 2005 email, Cooper notes that Merrill Pro will begin failing Hazan's trades, and that Hazan understands Merrill Pro will fail his trades. Merrill Pro's stock record shows that the week after this, Hazan's short position in OSTK goes from 4500 shares to 515,000, and continued to be in the high six figures and go over a million shares on occasion for over a year after that point. Jan. 5, 2012 Tr., at 130.

Fact 191. The vast majority of Merrill Pro's fails to deliver in OSTK correspond to Steven Hazan and Scott Arenstein's trading in their Merrill Pro accounts. The trades are identified by looking at Merrill Pro stock records, which show the allocation of the short positions to these two traders – their accounts include "G05" and "AFR"; the stock record shows these traders were short millions of shares, which corresponds closely to the total fails in Merrill Pro's DTCC accounts of millions of shares. Jan. 5, 2012 Tr. at 139-40.

Millions of shares of reported short interest in Overstock were created by the naked short sales that Defendants decided in advance to fail to deliver, and therefore the short seller had no negative rebate cost to factor into its short selling decision. In other words, the naked short sales were not a genuine expression of negative sentiment. However, the market nonetheless perceived those millions of shares as short positions held by short sellers who were incurring that cost and thus had particularly strong negative sentiment. Defendants' Responses, Fact 159. Increasing short interest is considered an indicator to the market of negative sentiment regarding a stock, particularly with a hard-to-borrow stock, where a bona fide short seller has to factor in the steep cost of borrowing in deciding to bet against the stock. *Id.*, Fact 158.

Merrill Pro and GSEC clients were naked short selling Overstock in the form of reverse conversion trades. Defendants' Responses, Fact 182. Hazan and Arenstein's trading strategies were reversals, *i.e.*, reverse conversions. Other clients of Merrill Pro's San Francisco office later became involved in the same type of manipulative conversions. These clients have been identified by Plaintiffs' expert as Susquehanna, Group One and Labranche. Jan. 5, 2012 Tr. at 130-32.

Goldman purchased conversion trades, which were naked short sales, from Hazan and Arenstein, through their entities SBA Trading and Hazan Capital Management.[7] Fourth Amended Complaint, ¶¶ 50, 53. Goldman securities lending personnel purchased conversions. Jan. 5, 2012 Tr. 44:5-18, 48:16-22 (argument by Goldman's counsel). Goldman bought a number of conversion trades in Overstock from Hazan that were specifically identified by Plaintiffs'

[7] Conversions involved the purchase of stock from a counterparty who sold short, combined with options to hedge risk. Cirangle Dec., Ex. C.

expert. These exceeded 350,000 shares. Jan. 5, 2012 Tr. at 139-40. Goldman bought stock from Keystone, a GSEC client, knowing that GSEC would fail to deliver. Jan. 5, 2012 Tr. at 139; Defendants' Response, Fact No. 108. Goldman Sachs as a sophisticated clearing and trading firm must have recognized that the economics of the required short sale component of the conversion be a naked short sale because the pricing can only be explained by the anticipated use of naked short selling, with the knowledge of the seller, Merrill Pro or GSEC (the clearing firm), and Goldman Sachs. Defendants' Response, Fact 187.

The clearing firms, not the clients, determine whether a fail has been resolved and what the age of a fail is ("age" in this context refers to how long the fail has persisted). Defendants' Responses, Fact 177.

Merrill and Goldman also effected fraudulent trades to extend the duration of the fails-to-deliver. These trades allowed Defendants to avoid regulations designed to ensure that fails did not persist past thirteen days after settlement date, without any delivery of stock occurring. Defendants' Responses, Fact 243. Merrill instituted policies to accommodate manipulative trading styles such as "killing" required buy-ins, and providing clients, including Hazan, with information that would enable them to "sell into" buy-ins, resulting in matched trades between Merrill Pro and their clients, which were carried out by the Merrill Pro San Francisco office. Jan. 5, 2012 Tr., at 127. For example, Merrill Pro's Cooper called Hazan the day of buy-ins to tell him the volume to encourage him to sell into the buy in to maintain the fail. *Id.*, at 181.

Hazan, as a result of Merrill working to get Merrill Pro to intentionally fail to deliver his trades and Merrill informing him up front that Merrill would fail all trades, and knowing he could roll the fails longer than 13 days, proceeded to naked short sell millions of shares of OSTK for over a year.[8] Jan. 5, 2012 Tr., at 129. Merrill provided Hazan with regulatory advice regarding RegSHO and reset transactions, and an internal Merrill Pro email

[8] Hazan's account was based in Merrill Pro's San Francisco office, and the head of the San Francisco office, Alan Cooper, was Hazan's primary point person at Merrill Pro and communicated with Hazan five to six times a week. Cooper worked so closely with Hazan that he jokingly referred to him as his "boyfriend" in internal Merrill Pro emails. Jan. 5, 2012 Tr., at 125-26.

notes that Cooper's Merrill Pro traders "were knowingly putting on shorts and then basically rolling them every 13 days," Jan. 5, 2012 Tr., at 126, 128.

Likewise, Goldman encouraged and participated in sham close-outs of fails to deliver. GSEC would nominally "buy-in" clients, but GSEC would assist its clients (including Keystone and Wolverine Trading) in entering into sales that offset GSEC's purchases, again, a form of matched orders. Selling into buy-in negates the economic substance of the buy-in. Defendants' Responses, Fact 181, Jan. 5, 2012 Tr., 59:16-60:5, 61:24-28. These transactions would be understood in the securities industry to constitute "matched orders." These matched orders had the effect of maintaining GSEC's fails to deliver. In August 2006, GSEC had a huge fail-to-deliver position at CNS of approximately a million shares. Defendants' Responses, Fact 181.

Through their actions, Defendants artificially inflated short interest in Overstock in 2005 and 2006 to extraordinary levels. Defendants' fails-to-deliver in Overstock were so large and persistent that Overstock was on the "Threshold Securities List" for 667 consecutive trading days—nearly three straight years, every single trading day. Overstock was one of only two Nasdaq stocks to have fails that persistent. Defendants' Responses, Fact 147. A May 5, 2006 email from a GSEC employee to an employee in the Goldman Sachs Securities Lending Group stated that GSEC had "noticed fails going up rather dramatically over the last few months at GSEC" (email forwarded to James Dengler). *Id.*, Fact 225. A May 2006 internal Goldman email notes that "Two months ago 107% of the floating was short!", referring to the short interest in Overstock as a percentage of float. In May 2006, Goldman Sachs' research department report distributed to clients shows Overstock as the fourth-highest shorted stock for all stocks under $1 billion in market capitalization. *Id.*, Fact 163.

The naked short selling resulted in short positions on Defendants' books and records, even though Defendants had never borrowed stock and made delivery to settle the short position. Defendants' Responses, Fact 152. This artificially high short interest caused by the naked short selling was reported to the marketplace as bona fide short interest. *Id.*, Fact 153. Defendants' actions injected false information into the marketplace for Overstock securities in the

form of artificially high short interest figures for Overstock stock so that market participants would be induced to view the stock more negatively, creating downward price pressure on the stock. With high negative rebate stocks such as Overstock, the short interest is additionally signaling not only a negative sentiment, but one that is so strong the short seller is wiling to bet against the stock at a cost of whatever the negative rebate is. For example, where Overstock's negative rebate was 35%, a legitimate short seller was betting the stock will drop enough to cover his 35% cost and then make an additional profit after that. Here, millions of shares of reported short interest in Overstock was created by the naked short sales that Defendants decided in advance to fail to deliver, and therefore the short seller had no negative rebate cost to factor into its short selling decision. In other words, the naked short sales were not a genuine expression of negative sentiment. However, the market nonetheless perceived those millions of shares as short positions held by short sellers who were incurring that cost and thus had particularly strong negative sentiment. *Id.*, Fact 159.

Merrill made delivery of stock the first half of 2005 and recognized that it would violate federal law not to do so. Jan. 5, 2012 Tr., at 181.

Merrill Pro's Chief Compliance Officer was adamantly opposed to the scheme. Defendants' Responses, Fact 229. A Merrill email refers to "F* compliance" in response to Merrill's manually failing the first trade for Hazan from San Francisco. Jan. 5, 2012 Tr., at 181. Defendants lied to regulators about their fails to deliver. Defendants' Responses, Fact 174. Goldman Sachs also sought to conceal evidence of how fails occurred and might be linked to trades. *Id.*, Facts 238-39.

Defendants were members of an industry group that expressly referred to Overstock as an "enemy" and discussed "neutralizing" a potential Overstock expert witness in this case. An email from the Securities Industry and Financial Markets Association ("SIFMA") refers to efforts to prevent a potential expert from working with Overstock and goes on to state that the expert "should be someone we can work with, especially if he sees that cooperation results in resources, both data and funding; while resistance results in isolation." Defendants' Responses, Fact 244. When Overstock obtained passage of a law that would require disclosure of

clearing firms' fails-to-deliver (which is kept secret from the public), the Goldman Defendants gloated when their lobbying organization got the law overturned, with one person remarking that Goldman was seeing a return on its lobbying investment. *Id.*, Fact 245.

Much of this information was also contained in the Proposed Fifth Amended Complaint that the Court did not allow Plaintiffs to file. The proposed complaint refers to and quotes from discovery material, and the complaint also makes reference to a non-public SEC investigation. July 27, 2011 Tr., at 31.

B. Facts Made Public in the Nine Regulatory Orders For the Scheme Published to Date

This scheme so far has resulted in at least eight public sanctions orders against various traders, for both their role in selling the conversions to prime brokers, as well as their role in the fails, sham flex resets and selling into the buy-in when RegSHO buy-ins occurred—plus one recent new order instituting proceedings. *See* Cirangle Dec., Exs. C-J (sanctions orders against Scott Arenstein, Steven Hazan, Brian Arenstein, Group One Trading, Labranche, Keystone, Woverine) and Ex. K (Order Instituting Proceedings against Jeffrey and Robert Wolfson ("Wolfson Order")).

These nine orders all concern the precise trading that was part of the Defendants' scheme in this case. The demand for the naked short sales was driven by Goldman Defendants' desire to obtain supply of hard to borrow stock where no legitimate supply existed. The scheme required the clearing firms to set up their systems and procedures to intentionally fail the trades and to allow the fails to persist for the length of time the manipulated supply of stock was needed to support short sales. These nine orders reflect the actions of the traders in the scheme. These publicly available orders also provide significant additional detail regarding the scheme, including in-depth descriptions of the purposes of the scheme, the details of the trading, and the identification of various clearing firm policies and procedures that were part of the scheme.

For example, the January 31, 2012 Wolfson Order contains 22 pages of details of the trading scheme. Jeffrey Wolfson founded Pax Clearing Corporation which Merrill Lynch Professional Clearing Corp. purchased in April 2005. Cirangle Dec., Ex. K at p. 7, ¶ 21. The

Wolfson Order explains how Wolfson, his brother and others, proceeded to naked short sell 491 reverse conversions to prime brokers, details the precise trading methodology, gives examples of how the reversals worked, including pricing and the illicit profits made from the scheme, and how it worked on their clearing firms' books and records. *Id.*, p. 8-9, 13, ¶¶ 29, 30 42, 44.

The Wolfson Order explains that the conversions were purchased by prime brokers, who purchased the non-existent shares in order to acquire a long stock position that the prime broker could loan out, and receive significant fees from the borrowers. Cirangle Dec., Ex. K at pp. 3-4. In one example, the prime brokers would pay an implied borrow rate of 20% for the long stock it "purchased" from Wolfson, and then the prime broker would charge its hedge fund customers 30% to borrow the non-existent stock. *Id.* at p. 12, ¶40. In many cases, these conversions the prime brokers purchased were in stock that could not be borrowed at all. *Id.* at p. 4. When the traders sold the stock to the prime brokers, the stock was not borrowed and delivery never made on these sales. Thus, the traders did not have to factor in the cost to borrow stock when they quoted the conversions to the prime broker, which is why they could sell stock no one else had and below cost. *Id.* at pp. 12-13.

The Wolfson Order also details the sham flex reset transactions used to extend the fails, explaining the purpose was to reset the Reg SHO clock at the clearing firm without any stock ever being delivered. The Order details exactly how the trades worked, the effect on the clearing firm's books, and the profit formula of .03 cents per share that was common to these sham transactions. Cirangle Dec., Ex. K at pp. 4-5.

Likewise, the Hazan and Arenstein Orders detail the same exact scheme. These orders explain how "prime brokers created the demand for the reverse conversion to create inventory for stock loans on hard to borrow securities" and how Hazan, among others, fed this demand. Cirangle Dec., Ex. E ("Hazan SEC Order"). The Hazan SEC Order details the conversion trades and the flex reset "sham" transactions, including precise trading strategies, examples of trades, the illicit profits reaped from the trades, and how this trading resulted in large fails on the clearing firm books. The AMEX/ARCA Order against Hazan also discusses his purported "market making" on the Pacific Exchange/Arca in detail. Cirangle Dec., Ex. D. The

Arenstein AMEX Order, contains the same detail as the Hazan Orders. *Id.*, Ex. C. Collectively these orders fine Hazan and Arenstein $10 million and ban them from the industry for a minimum of five years.

Other Merrill Pro customers Labranche, Group One, and Brian Arenstein have also been sanctioned for the same trading strategies, which are likewise described in the public sanctions orders. Cirangle Dec., Exs. F-H. Goldman customers Wolverine Trading, LLC and Keystone Trading Partners were publicly sanctioned for sham reset transactions. Cirangle Dec., Exs. I, J. The Keystone Order also describes 51 situations where, on the very same day they had been bought-in by their clearing firm, they sold into the buy-in. *Id.*, Ex. I.

C. Facts Defendants Improperly Seek to Seal

The documents, testimony and pleadings Defendants seek to seal in this case all concern the same scheme described above. Despite the fact that a) the vast majority of the information Defendants seek to seal is already in the public record, either through publicly available filings or transcripts in this case, or through the eight public sanctions orders against the various traders for the scheme, b) all of the policies and procedures that are discussed in the documents are outdated and could never be revived given the strengthening of federal law geared specifically to eliminating the ongoing fails that still persisted due to Defendants' policies that created fails, (*see, e.g.*, Cirangle Dec., Exs. L and M (Melz and Mastrianni testimony confirming Merrill's Reg SHO policies changed in 2008 when the rule changed)), c) the vast majority of the customer trading information Defendants seek to protect concerns the illegal trades that Defendants' customers have been publicly sanctioned for, and d) any other confidential customer information could easily be redacted to protect any legitimate remaining privacy concerns, ***Defendants still seek to seal the entirety of virtually every single evidentiary document*** submitted by the Plaintiffs in opposition to Defendants' motions for summary judgment.

For example, Defendants' counsel publicly stated:"[I]t was common knowledge in the marketplace that Merrill Pro and GSEC were not borrowing shares for market-maker trades because we were doing it for all of our market-maker customers. It wasn't just for Hazen [sic]." Jan. 5, 2012 Tr., at 23:21-24. Defendants' counsel further emphasized that "this case is about

firmwide policies by Merrill Pro and GSEC to fail the short—the short sales of our market-maker clients." *Id.* at 167:7-10. Yet Defendants seek to seal six to seven year-old emails discussing this very subject. Examples include a series of emails from 2005, where Merrill executives discuss the possibility of failing market maker negative rebate stocks:

- In a half-page email, a Merrill executive suggests "[w]e might want to consider allowing Sage customers to fail." Thomas Tranfaglia, Merrill Pro's then President responds "[y]es, we are going to look into that." Exhibit 6 to Cirangle MSJ Decl.[9]
- In a half-page email Merrill's CEO, John Brown, says "I understand that we have the same issue with 369 that we had with 551 market makers. How and when can we prevent the delivery?" and Tranfaglia responds "[s]top borrowing for the market-makers!" Exhibit 7 to Cirangle MSJ Decl.
- In a two-line email Brown writes his secretary: "I have a meeting at 2 with Tom T, tell him I want an update on how we're going to fix fails and I want to know what we nees [sic] to do to make 369 market makers fail." Exhibit 12 to Cirangle MSJ Decl.
- In June 2005 Tranfaglia emails "We are NOT borrowing negatives...I have made that clear from the beginning. Why would we have to borrow them? We want to fail on them", and in a June 2006 email, Tranfaglia states "We don't deliver mm negatives, has nothing to do with availability." Exhibits 41, 112 to Cirangle MSJ Decl.
- A one page 2005 compliance procedure notes that Merrill will not borrow securities for delivery on market maker deep negative rate securities. Exhibit 147 to Cirangle MSJ Decl.
- In an internal email exchange at the time Scott Arenstein was looking to change clearing firms and inquiring about Merrill's policies, Tranfaglia notes in reference to Arenstein "he wants to short and have us fail on the negatives, correct?" Another Merrill executive, Curt Richmond, responds "Yes...He is a market maker/floor trader on the AMEX." Exhibit 27 to Cirangle MSJ Decl.
- An email from Alan Cooper notes, in regard to Steven Hazan: "Steve understands that 671 will fail on negatives;" and in a follow up email Cooper notes "I think the transfer will affect his shorts. We borrowed all of these and will start failing at PAX." Exhibits 47, 49 to Cirangle MSJ Decl.

Given that it was "common knowledge" and a publicly disclosed "firmwide policy" of Merrill's " to fail short sales of market maker clients," these documents discussing and

[9] All of these references are to the original declarations filed in support of Plaintiffs' opposition to summary judgment. Additional courtesy copies of the cited documents, along with a few other similar examples, are provided in Exhibits Q (Merrill Defendants' documents) and R (Goldman Defendants' documents) to the Cirangle Declaration filed in opposition to the current motion.

reflecting that very policy are not trade secrets.[10]

Likewise, Goldman Defendants seek to seal emails reflecting their firm-wide policy to fail short sales of their market maker clients by withholding inventory for settlement:

- Ex. 7 to Sommer MSJ Decl.: This email informs GSEC's largest client, Wolverine Trading, that "we will let you fail," in response to an inquiry by Wolverine as to whether there was some effort "at cleaning up" fails.
- Ex. 43 to Sommer MSJ Decl.: This email refers to a senior GSEC executive, Peter Lawler, "really backing down from 'turning on neg[ative] rates on 1/26' and cleaning up fails."
- Ex. 47 to Sommer MSJ Decl.: This email refers to Arenstein having a "0% floor" for conversions, meaning that Arenstein will not pay to borrow the stock when selling a conversion to Goldman Sachs.
- Ex. 115 to Sommer MSJ Decl.: This email refers to "fails going up rather dramatically over the last few months at GSEC," followed by another email concluding that most of the fails are for stocks that are illiquid or "trading at negative rebate with non-paying customers."

Defendants seek to seal multiple emails and other documents concerning Hazan and Arenstein's Merrill Pro and GSEC accounts and their trading, despite the fact that this exact trading was both illegal and publicly detailed in the various sanctions orders. Examples include:

- A March 2005 internal Merrill email discusses Arenstein's "Reg-SHO fail with FLEX Options Strategy." Ex. 28 Cirangle MSJ Decl.
- An August 2007 email between a Merrill employee and a Goldman employee forwards the Arenstein sanctions order and the Merrill employee notes "I am sure you saw this. Our boy" and the Goldman employee responds "nice…You think there will be any fallout on clearing firms?" Ex. 144 Cirangle MSJ Decl.
- A January 2006 telephone transcript reflects a discussion between Merrill's compliance officer and another employee regarding the fact Arenstein is not making a market in OSTK, that he keeps "recycling" his short sales in ten to fifteen stocks and that this is "not okay." Ex. 94 Cirangle MSJ Decl.

[10] Defendants argue that although certain facts are in the public record, documents should still be sealed because they may reflect more detail about what is publicly available. *See* Merrill Defendants' Brief at p. 9, n. 6. Of course, Defendants make no effort to show that any of the documents they seek to seal actually have the kind of additional detail that reveals "internal strategic thinking" about otherwise publicly-known policies and procedures that qualifies for sealing. Most of these emails, such as the examples cited, simply reflect the fact that Defendants decided to stop borrowing and intentionally fail to deliver market maker negative rebate stocks, and/or that they did so through the methods already publicly discussed, such as the "do-not-flip" process at Merrill or by Goldman Sachs withholding inventory from GSEC to settle the trades. Defendants have made no showing as to what additional competitive disadvantage they would suffer from these discussions of procedures that they claim were common knowledge in the marketplace.

- Various spreadsheets and stock records reflect the naked short sales and sham flex reset trades in OSTK that Hazan and Arenstein were sanctioned for. See, e.g., Allaire Decl., Exs. C1-12, 19, Exs. 160, 161, 166, 167 Cirangle MSJ Decl.

- An August 2005 email reflects Cooper's statement that Hazan questioned "why Merrill did not tell him that we did not like his trading Reg Sho issues with flex's [sic]. He said he would have stopped if he knew Merrill was opposed to it." Ex. 119 Cirangle MSJ Decl.

Goldman Defendants seek to seal documents that reflect their strategy of purchasing conversions from market makers like Hazan and Arenstein in order to create inventory for stock lending at below market rates, despite the fact that this "strategy" is a matter of public knowledge. Moreover, such conversion trades with naked short sellers are presumably not a current practice at Goldman given the sanctions orders against Hazan and Arenstein, as well as regulatory changes that put in place new hurdles for trading strategies tied to abusive, persistent fails. Examples of documents Goldman seeks to seal include:

- Ex. 4 to Sommer MSJ Decl.: This internal GSEC email refers to Scott Arenstein and his entity, SBA Trading, "providing very aggressive liquidity to Goldman" in the form of conversion trades with Goldman Sachs' securities lending group. A senior GSEC executive observes that "that doesn't make sense" [because a naked short seller like Arenstein had no actual stock to sell to a securities lending desk];

- Exs. 8 and 53 to Sommer MSJ Decl.: Ex. 8 is an email from a senior GSEC executive refer to Arenstein carrying "large shorts in symbols that everyone on the street is failing"; Ex. 53 is an email that shows that SBA Trading's positions represent roughly $7.8 billion of $13.3 billion of market values of market maker positions in stocks that are negative rebate stocks, including hard-to-borrow stocks (meaning they do not pay a positive rebate like the vast majority of stocks);

- Exs. 17-20 to Sommer MSJ Decl.: These emails refer to a meeting between a team of Goldman Sachs executives and Arenstein in a bar named Ulysses on August 16, 2004. In Exhibit 17, William Conley, the second-in-command and later head of Goldman Sachs' securities lending group, inquires of a senior GSEC executive about Arenstein, who Conley characterizes as being "the other side of a lot of our activity." In Exhibit 18, the GSEC executive, Peter Lawler, informs Conley that he doubts Arenstein will trade once Reg SHO comes into effect "as he will not be able to fail anymore" and that he will be "out of this business come January." As shown in Exhibits 18 and 19, Conley nonetheless proceeds to meet with Arenstein, and, as shown in Exhibit 20, Conley and his team are exploring trades with Arenstein on August 19, 2004. The fact that Conley, Rosenbloom and Santina of Goldman Sachs met with someone at Ulysses on August 16, 2004 and exchanged emails regarding the meeting is already in public record. (Defs. Responses p. 80, Fact 216);

- Exs. 63 and 89 to Sommer MSJ Decl.: Ex. 63 is a list of compliance bullet points that refers to using conversions to "create inventory to allow customers to short."; Ex. 89 is an email that refers to Goldman Sachs "intentions to create supply and perpetuate selling in stocks with a large amount of short interest."

- Ex. 86 to Sommer MSJ Decl.: This worksheet analyzed conversions purchased by the Goldman Sachs securities lending group for October 2005 and finds that Arenstein sold 63% of the shares to Goldman Sachs.

- Ex. 155 to Sommer MSJ Decl.: In this email, a GSEC executive refers to Keystone as being "Scott Arenstein all over again";

- Ex. 228 to Sommer MSJ Decl.: This June 6, 2005 letter terminated Arenstein as a GSEC client, but, as shown above, Goldman Sachs continued its special trading relationship with Arenstein post-termination.

Defendants also seek to seal a series of documents that indisputably do not contain any trade secrets or otherwise confidential information, but are simply embarrassing to Defendants because they reflect business decisions to put profits and corporate ambition over compliance. Examples include:

- In a May 2005 email string, Messinger expresses concern that Cooper has intentionally failed a short sale for Hazan. In response, Melz, Merrill Pro's President, emails: "Fuck the compliance area – procedures, schmecedures." Ex. 39 Cirangle MSJ Decl. Melz previously swore to this Court that his quoted statement was "a joke", but now swears it is a trade secret. Cirangle Decl, Ex. N.

- In various internal Merrill emails, Messinger expresses repeated concern that the fails to deliver are improper. See, e.g. Ex. 112 to Cirangle MSJ Decl., "As far as I'm concerned, this is totally unacceptable – we are failing when we have over a million shares of stock available…Is there a blanket agreement that we allow every market maker client to continue failing even if there is enough availability? In my opinion, there needs to be some assessment done here, and fails cleaned up regardless of who is causing them."

- In other internal Merrill emails, other Merrill employees recognize that it would be illegal to fail the trades: *See, e.g.*, Ex. 33 to Cirangle MSJ Decl., where, in a discussion about whether they should fail the market maker trades, Brown notes that "[t]he intent of SHO is to clean up Threshold securities which should include an economic incentive to clean it up…I think we can not give them a choice."; *Id.* at Ex. 19, an email authored by Melz where he states "RegSHO…mandates delivery of certain 'threshold' securities if available."; *Id.* at Ex. 15, an email where Richmond states "Scott Arenstein…also wants to trade hard-to-borrow securities and not be charged a negative…I will tell Arenstein that he can't trade these" and "If Merrill Lynch has to borrow according to Reg-SHO then clients have to pay the negatives. We must be within the rules and we must pass these negs to the clients."

- A September 2006 telephone transcript between Merrill executive Collin Carrico and a client contains a discussion by Carrico about how a trader could do non-market making trades within a market making account, which is illegal,

but would never get caught, and discusses strategies to carry out this illegal activity. Ex. 121 Cirangle MSJ Decl. Carrico also discusses in a July 2007 email how Merrill's balances have been seriously impacted after Wolfson and his buddies "minimized their Reg SHO trading activity given the heightened regulatory risk environment." *Id.* Ex. 140.

- Exhibit 110 to Cirangle MSJ Decl. is a presentation Merrill gave to regulators regarding its Reg SHO tracking system. The key point in this document is that Merrill says in multiple places its system requires "delivery" of stock. Messinger testified that this was false – their system did not require delivery. Cirangle Dec., Ex. 0. Obviously a false statement about internal systems cannot reflect any trade secret.

- Ex. 96 to Sommer MSJ Decl. is an email from John Masterson that sends nonpublic data concerning customer short positions in Overstock and four other hard-to-borrow stocks to Maverick Capital, a large hedge fund that sells stocks short.

- Ex. 123 to Sommer MSJ Decl.: This email from a GSEC executive exclaims that short sales amount to 107% of the float of Overstock.

- Ex. 167: In this email, a Goldman Sachs executive states: "[P]er Les Nelson, we have to be careful not to link locates to fails [because] we have told the regulators we can't."

- Ex. 177 to Sommer MSJ Decl.: In this email chain, a SIFMA lobbyist emails a Goldman Sachs executive and explains how to engage an expert that would otherwise work for "our more powerful enemies," meaning Overstock: "[H]e should be someone we can work with, especially if he sees that cooperation results in resources, both data and funding; while resistance results in isolation."

- Ex. 193 to Sommer MSJ Decl.: In this email, as disclosed in Defendants' Responses, Fact 161, a Goldman Sachs hedge fund client remarked on how they would ask "to short an impossible name and expecting full well not to receive it) and [be] shocked to learn that [Goldman's representative] can get it for us." The contents of the email are in Defendants Responses, but Goldman Sachs does not want the document to be public so that there will be an actual document that can be viewed, not just a legal brief.

Defendants also seek to seal graphs and testimony regarding the volume of their fails to deliver in Overstock stock from 2004 to 2007, despite the fact that the general volume of these fails is publicly known, and the data is years old. See, e.g., Ex. 159 Cirangle MSJ Decl.

These documents are just a handful of the hundreds of documents Defendants seek to seal, and there are countless additional examples of how these documents do not contain

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information that qualifies for the "extraordinary" measure of sealing. None of the documents involve any legitimate, current confidentiality interest of Defendants or their clients. There is no way Plaintiffs can, in the limited time and space allowed for this brief, point out all of the problems with each document, nor is it Plaintiffs' burden to do so.

D. Facts Where No Confidentiality Designation Was Made

1. Cohodes Testimony

Goldman improperly seeks to seal the testimony of Marc Cohodes, the managing partner of one of its largest short-selling clients, Copper River Partners. However, no person, including Goldman, Mr. Cohodes, or their counsel, designated the Cohodes transcript as confidential. Under Section 4 of the Stipulated Protective Order, a deposition transcript is designated as confidential "either during the deposition or by written notice to the court reporter and all counsel of record… ." The transcript was not designated by any person as confidential during the deposition nor was it designated by written notice to the court reporter. *See* Declaration of Jonathan Sommer in Support of Plaintiffs' Consolidated Opposition to Defendants' Motion to Seal Summary Judgment Papers, ¶ 2.

In spite of the lack of confidentiality designation, Goldman wants to keep the Cohodes transcript nonpublic because of potential embarrassment, including testimony such as the following:

> Q. Well, do you know how -- do you have any view as to whether the securities lending market is actually efficient or inefficient?
>
> A. I think the securities lending market is just like the mob. I think it's completely rigged. It's a completely manipulated black hole, non-transparent market.
>
> Q. Now, when you say you think they're just like the mob, are you referring to Goldman Sachs?
>
> A. Yes. I think Goldman Sachs is like the mob.
>
> Q. And are you referring to them in particular or them and the rest of the market altogether?

> A. I think Goldman Sachs is a racketeering entity that does whatever they can to make a dime without conscience, thought, foresight or care about ramifications. I think they are cold-blooded and could care less about the law. That's my opinion. I think I can back it up.

Ex. A to Sommer Decl., at 144. Its failure to designate the transcript ends the issue.

2. Power Point Presentations at Summary Judgment Hearing

In asserting confidentiality claims, Defendants also ignore the fact that at the hearing on summary judgment, Plaintiffs presented Power Point presentations that were projected on a large screen while members of the public, including the press, were present. These presentations further detailed facts of the scheme the Defendants now claim must be sealed in order to protect trade secrets or confidential information, including exact quotes from many of the same documents Defendants now seek to seal. Defendants did not object at the time and did not move to seal the courtroom or otherwise disallow anyone to view these details. The Power Point presentations further show that disclosure of these facts is not prejudicial to Defendants, as they have identified no prejudice arising from the disclosures at the hearing.[11]

III. ARGUMENT

A. The Sealing Rules Apply to All of the Documents Submitted as Part of the Summary Judgment Motion.

"Rules 2.550-2.551 apply to records sealed or proposed to be sealed by court order." Cal. R. Ct. 2.550(a)(1). Here, Defendants seek to seal the summary judgment records; therefore, Rules 2.550-2.551 apply. The Stipulated Protective Order expressly subjects the sealing of records to the analysis required by California Rules of Court 2.550-2.551, and the parties knew that any sealing of records for dispositive motions was subject to the standards therein. In other words, Defendants understood, and the rules required, that any designation of a document as "confidential" was only for discovery purposes and that, upon the filing of a non-

[11] An extra copy of these presentations is attached as Ex. P to the Cirangle Declaration in support of this opposition. Plaintiffs have filed these presentations under seal not because they believe that there is any basis to seal them, but rather as a courtesy to allow the Court to first confirm that, given the public presentation, the additional copies of these documents cannot be sealed.

discovery motion, a party would have to meet the standard for the sealing of the records, as applied by the Court. Rules 2.550-2.551 forbid sealing documents upon the parties' stipulation. *H.B. Fuller Co. v. Doe*, 151 Cal. App. 4th 879, 891 (2007).[12]

The sealing rules were adopted to comply with the California Supreme Court's decision in *NBC Subsidiary*. *In re Providian Credit Card Cases*, 96 Cal. App. 4th 292, 298 (2002). In *NBC Subsidiary*, the California Supreme Court held that the First Amendment right of access applies to civil proceedings. *NBC Subsidiary, Inc. v. Superior Ct.*, 20 Cal. 4th 1178, 1209 (1999). In reaching that holding, the Court reviewed case law concerning access to judicial records in addition to case law concerning access to trials:

> Numerous reviewing courts likewise have found a **First Amendment right of access to civil litigation documents filed in court as a basis for adjudication.** (See *Brown & Williamson Tobacco Corp. v. F.T.C.* (6th Cir.1983) 710 F.2d 1165, 1179 (*Brown & Williamson*) [documents **filed** in civil litigation; "[i]n either the civil or criminal courtroom, secrecy insulates the participants, masking impropriety, obscuring incompetence, and concealing corruption"]; *Rushford v. New Yorker Magazine, Inc.* (4th Cir.1988) 846 F.2d 249 (*Rushford*) [**summary judgment pleadings**]; *Matter of Contintental Illinois Securities Litigation* (7th Cir.1984) 732 F.2d 1302 (*Continental Illinois Securities*) [**records related to "hybrid summary judgment motion"**]; cf. *Grove Fresh Distributors, Inc. v. Everfresh Juice Co.* (7th Cir. 1994) 24 F.3d 893 [assuming both a First Amendment and a common law right of access to civil litigation documents].)
>
> ****
>
> By contrast, decisions have held that the First Amendment does not compel public access to discovery materials that are neither used at trial nor **submitted** as a basis for adjudication. [citations omitted]

NBC Subsidiary, 20 Cal. 4th at 1208-09 n. 25 (emphasis added).

In an opinion published shortly after *NBC Subsidiary*, the Ninth Circuit likewise

[12] It is irrelevant that documents were previously designated as confidential and lodged under seal. *See, e.g., Foltz v. State Farm Auto Ins. Co.*, 331 F.3d 1122, 1136 (9th Cir. 2003). The procedures for allowing a party to designate a document as confidential are inapplicable to the sealing determination because only the Court can determine whether a record may be sealed, not the parties by private agreement. Moreover, while paragraph 18 allowed Plaintiffs to file motions seriatim to challenge confidentiality designations, that procedure extended to all discovery—not just the limited discovery submitted in connection with the motion for summary judgment. Nothing in paragraph 18 required Plaintiffs to challenge a designation through the procedures set forth in that paragraph, and filing such motions would have consumed the Court's and Plaintiffs' resources unnecessarily because there were hundreds of thousands of documents to wade through. It is far more efficient to await the identification of the much more limited material in the summary judgment motion before spending time and money examining whether those important records were properly designated.

found that the public's right of access "extends to materials submitted in connection with motions for summary judgment in civil cases... ." *San Jose Mercury News, Inc. v. District Ct.*, 187 F. 3d 1096, 1102 (9th Cir. 1999) (emphasis added).

Summary judgment "serves as a substitute for trial," "stands on a wholly different footing" than mere discovery and is subject to the heightened First Amendment standard for sealing. *Rushford v. New Yorker Magazine*, 846 F. 2d 249, 252-53 (4th Cir. 1988) (cited in *NBC Subsidiary*, see block quotation above). The Sixth Circuit summarized policy considerations from the United States Supreme Court precedent that underlie the public right of access in civil cases: First, "[t]he crucial prophylactic aspects of the administration of justice cannot function in the dark; no community catharsis can occur if justice is 'done in a corner [or] in any covert manner.'" Second, "public access provides a check on courts. Judges know that they will continue to be held responsible by the public for their rulings. Without access to the proceedings, the public cannot analyze and critique the reasoning of the court." Third, open courts promote "true and accurate fact finding" because the dissemination of information to the public through the media may cause additional witnesses to come forward and will cause existing witnesses to testify more truthfully. *Brown & Williamson Tobacco Corp. v. F.T.C.*, 710 F.2d 1165, 1178 (6th Cir. 1983) (cited in *NBC Subsidiary*, see block quotation above); *see also H.B. Fuller Co. v. Doe*, 151 Cal. App. 4th 879, 894 (2007) ("The deeper the public's understanding of judicial treatment of these issues, the better equipped the public will be to, for instance, seek legislative modification of the governing rules and procedures"). Applying this reasoning here, it is imperative for the Court not to seal Defendants' records where summary judgment is entered in favor of the Defendants and there will be no future exposure of Defendants' conduct at trial.

Defendants ignore the controlling authority above and instead try to misapply *Mercury Interactive*—which had nothing to do with summary judgment or dispositive motions—to create the following purported standard: "[M]aterials obtained through discovery must be considered or relied upon by the Court as a basis of adjudication before the presumption of public

access can even be invoked by a party seeking to make such documents public."[13] Goldman Motion, at 7. Nothing in Rules 2.550-2.551 requires an "invocation" by the non-sealing party, and Defendants offer no definition of what it means to "consider or rely upon" a document as a basis of adjudication. Nothing in Rules 2.550-2.551 refers to the Court having to "consider" or "rely" upon a document, nor does the case law. As shown above, the sealing records apply to all documents "submitted as a basis for adjudication," and *NBC Subsidiary* relied on cases that review all documents "filed," *i.e.*, submitted, in connection with a summary judgment motion. *See NBC Subsidiary*, 20 Cal. 4th at 1208-1209 n. 25; *see also Republic of the Philippines v. Westinghouse Elec. Corp.*, 949 F.2d 653, 660 (3d Cir. 1991) (holding that party moving for summary judgment could not avoid the public right of access simply because the motion was denied (and thus the court did not rely on any documents filed by the moving party)). In sum, no California law requires a Court to parse out exactly which documents were purportedly "considered" or "relied upon" as a basis for its adjudication.

Nor would it be practical for the Court to try to determine what it "considered" or "relied upon" as a basis for adjudication. In essence, the Court's holding is that insufficient wrongful conduct occurred in California. In reaching that determination, the Court should have considered all of the evidence submitted as part of the summary judgment papers. It would be erroneous for the Court to disregard any evidence of wrongful conduct. Thus, there is no practical means for the Court to parse out evidence as being evidence of wrongful conduct not considered in connection with summary judgment. And, if the Court failed to consider such evidence, its failure to consider evidence should be specified in the order granting summary judgment so that the Court of Appeal will know what summary judgment evidence was not considered by the Court.

Finally, Defendants cannot complain that Plaintiffs purportedly submitted too much evidence as a basis for adjudication and, on that basis, ask the Court to withhold the evidence from the public. In their summary judgment motions, Defendants raised 38 purportedly

[13] Of course, Defendants are "seeking" to withhold documents from the public and bear the burden of proof, and Defendants cannot escape that burden by using linguistic tricks such as referring to Plaintiffs as "seeking" to make documents public.

dispositive issues which made a wide range of arguments concerning whether Defendants engaged in market manipulation, whether Defendants acted with fraudulent intent, whether the manipulative conduct occurred in California, etc. In response to the 38 summary judgment issues, Plaintiffs submitted evidence in the form of two declarations from counsel that attached deposition exhibits and testimony, as well as seven expert declarations. The combined number of exhibits totaled less than 500 in response, or less than 0.0009 percent of the documents produced by Defendants. Cirangle Dec., ¶23. Those exhibits were also referred to in the summary judgment pleadings.[14]

Based on the Court's ruling that there was insufficient evidence of actionable conduct in California, Plaintiffs were, if anything, prejudiced by not putting in enough evidence in response to summary judgment issues directed to that point. Of course, Plaintiffs had no way of knowing which of the 38 issues would ultimately become the focus of the Court's interest and had to put in evidence on all of the issues.[15] Much of that evidence is overlapping and indistinguishable, *e.g.*, evidence of manipulative conduct would be relevant both to the issue of whether manipulative conduct occurred and whether that manipulative conduct occurred in California. Indeed, all evidence of wrongful conduct, which is essentially all of the evidence submitted by Plaintiffs in the declarations from experts and counsel, is relevant to determining

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[14] Defendants claim that some of the exhibits to the Cirangle and Sommer Declarations filed in support of their opposition to the Motion for Summary Judgment were not cited in Plaintiffs' Separate Statement. That is false. Plaintiffs cited all these exhibits in Plaintiffs' Separate Statements, either in response to individual specific facts or in response to Defendants' facts that encompassed Section 25400 or the UCL. See, e.g., Plaintiffs' Separate Statement of Disputed and Undisputed Facts in Opposition to Merrill Lynch Professional Clearing Corp.'s Motion for Summary Judgment, at p. 60, Fact 48 (Section 25400 Claim), p. 75, Fact 91 (UCL Claim); Plaintiffs' Separate Statement of Disputed and Undisputed Facts in Opposition to Merrill Lynch Pierce Fenner & Smith's Motion for Summary Judgment at p. 38, Fact 39 (Section 25400 Claim); p. 48, Fact 65 (UCL Claim); Plaintiffs' Separate Statement of Disputed and Undisputed Facts in Opposition to Goldman Sachs Execution & Clearing, L.P.'s Motion for Summary Judgment at pp. 14-15, Fact 30 (Section 25400 Claim), and pp. 58-59, Fact 92 (UCL Claim); Plaintiffs' Separate Statement of Disputed and Undisputed Facts in Opposition to Goldman Sachs & Co's Motion for Summary Judgment at p. 36, Fact 25 (Section 25400), at 100, Fact 89 (UCL Claim).

[15] Indeed, the Court repeatedly told the parties that Plaintiffs had raised material issues of fact as to whether Defendants' conduct constituted manipulation and as to whether Defendants had the requisite intent to manipulate the market. The fact that the Court did not grant the motion for summary judgment on any of these alternative grounds is in and of itself a determination by the Court on summary judgment.

whether wrongful conduct occurred in California.

Accordingly, the sealing rules set forth in Rules 2.550 and 2.551 apply to each document Defendants seek to seal in their current motion.

B. <u>For each document, Defendants have not met the five-part test set forth in Rule 2.550(d).</u>

Defendants have the burden—on a document-by-document basis—of enumerating specific facts satisfying the test for sealing records (whether pleadings or exhibits). For each record Defendants seek to shield from the public, Defendants must introduce evidence sufficient for the Court to make "express factual findings" establishing: (1) there exists an overriding interest that overcomes the right of public access to the record; (2) the overriding interest supports sealing the record; (3) a substantial probability exists that the overriding interest will be prejudiced if the record is not sealed; (4) the proposed sealing is narrowly tailored; and (5) no less restrictive means exist to achieve the overriding interest. Cal. R. Ct. 2.550(d)(1)-(5). As set forth in the rule itself, these five express factual findings must be made for each record to be sealed.

1. For each document, Defendants have failed to establish an interest that overrides the strong presumption of public access and that supports sealing the record.

Whereas an order unsealing records does not require any specific factual findings, an order sealing records requires specific factual findings for each record that justifies the sealing of the record in question. *Providian*, 96 Cal. App. 4th at 302. In light of the First Amendment issues involved, that distinction in the California Rules of Court is "not at all surprising." *Id.*

In order to seal the exhibits and summary judgment pleadings that reference those exhibits, it is Defendants' burden to prove the existence of trade secrets to establish the interest that overrides the right of public access. *Providian*, 96 Cal. App. 4th at 301.[16] If a trial court finds

[16] Defendants also argue that even if their documents do not contain trade secrets, they can be sealed if they contain "confidential internal business information." See, e.g., Merrill Defs. Br., pp. 10-11, citing a string of federal cases. However, even where phrased as "confidential" business information, such information is only sealed when a showing is made by Defendants that that information is actually confidential, and its release would be harmful. None of the cases Defendants cite involve the sealing of documents that contain superseded, outdated policies and procedures, or discussions of policies, procedures or strategies that are publicly known. *See, e.g., Prochaska & Assoc. v. Merrill Lynch Pierce Fenner & Smith*, 155 F.R.D. 189, 191 (D.Neb. 1993) (finding <u>current</u> compliance policies of Defendant confidential where Defendant submitted three

a declaration to be conclusory or unpersuasive, it can find that Defendants failed to demonstrate any overriding interest that overcomes the right of public access and unseal the record. *Id.* California courts could not be more emphatic about the moving party's burden to establish specific facts demonstrating an overriding interest justifying sealing for each record: "[W]ithout a clear enumeration of *specific facts* alleged to be worthy of the extraordinary measure of maintaining our records under seal, there is simply no basis to conclude that unsealing the records will actually infringe any interest of [moving party] or inflict any harm on it." *H.B. Fuller Co. v. Doe*, 151 Cal. App. 4th 879, 898 (2007) (emphasis in original) (brackets added).

Here, Defendants merely submit declarations that parrot Section 3426.1 of the Civil Code (defining trade secrets), and conclude that outdated, superseded policies, six to seven year old emails, and information regarding Hazan and Arenstein rise to the level of trade secrets or information subject to constitutional privacy protection. Defendants' trade secrets claims are conclusory, vague and not tied to specific information in a specific document.[17] A trade secret is defined as information that (1) derives independent economic value, actual or potential, from not being generally known to the public or to other persons who can obtain economic value from its disclosure or use; and (2) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy. Civ. Code § 3426.1(d). Defendants do not specify, for each document they seek to seal, the information that purportedly possesses economic value and what that economic

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affidavits with specific allegations of potential damage to business if the information in the documents were revealed); *Bank of New York v. Meridien Biao Bank Tanzania, Ltd.*, 171 F.R.D. 135, 144 (S.D.N.Y. 1997) (finding that bank's current Credit Policy Manual, Authorized Signature Book, Audit Review Manual, Internal Auditing Manual and Operations Manual would be sealed because the Bank made showing that the manuals were only selectively provided to internal employees, that the Bank had spent significant time and money in developing the manuals and ensuring their secrecy, and that knowledge of these policies and procedures would diminish the bank's competitive edge and confer on its competitors an unwarranted advantage in the industry.); *Gohler v. Wood*, 162 F.R.D. 691 (D.Utah 1995) (finding accounting firm's current audit practice manuals would be sealed as Defendant had made showing that they had made substantial investments of time and money in creating the manuals, which contained distinctive accounting and auditing procedures, that they had went to great lengths to guard the confidentiality of the manuals as used internally, and that disclosing the complete audit manuals would be detrimental to its business because competitors could copy their methods.). Defendants have made no such showing here as to any of the materials they seek to seal.

[17] Mr. Melz only specifically references four documents out of the hundreds Merrill seeks to seal as containing confidential business information. Melz Dec., ¶¶ 13, 14. Dunphy fails to specifically reference a single document Goldman Defendants seek to seal.

value is.

General business know-how, knowledge and skill is not a trade a secret. *Providian*, 96 Cal. App. 4th at 308-09. The trade secret must provide a non-trivial advantage over others beyond just being generally helpful or useful. *Yield Dynamics, Inc. v. Tea Systems Corp.*, 154 Cal. App. 4th 547, 564-65 (2007). Virtually none of the material in question was marked confidential prior to this litigation, which is evidence that Defendants did not consider the material to be trade secrets. *See Gemisys Corp. v. Phoenix American, Inc.*, 186 F.R.D. 551, 560 (N.D. Cal. 1999) ("Regardless of whether [party claiming trade secrets] was required by the agreement to mark the program or materials as confidential, its failure to mark any of the materials it provided to [opposing party], including the PMIS software, indicates that [party claiming trade secrets] did not regard those materials as confidential, much less trade secret."). Most of the documents are just ordinary emails sent in the course of an employee's work day. *See, e.g.*, Ex. 18 to Sommer Decl.

The vast majority of the information at issue in this motion is from the 2005-2006 time period, *i.e.*, it is around six to seven years old. Some of the information is even older, dating back to 2004. By way of comparison, the *Providian* court, in affirming the unsealing of the record, observed that "much of this information is up to four years old and much of it does not amount to trade secrets at all." *Providian*, 96 Cal. App. 4th at 306 n.13; *see also Taylor v. Babbitt*, 760 F. Supp. 2d 80, 88 (D.D.C. 2011) ("[O]bsolete information that provides no competitive advantage is not commercially valuable and cannot constitute a trade secret."). This case does not involve a carefully-guarded trade secret such as the formula to Coke, which can preserve its trade secret status indefinitely. The information here is, by its very nature, of value only for a limited period of time, often days, hours or minutes.

As explained in the Declaration of Michael Manzino in Support of Plaintiffs' Consolidated Opposition to Defendants' Motions to Seal, securities lending involves the use of up-to-the-minute information concerning stock lending rates, the availability of securities to borrow and lend, and the interest of clients in potentially borrowing, all of which quickly becomes stale. *See* Manzino Decl., ¶¶ 5-6, 13-14. Securities lending personnel are on the

telephone all day receiving updates from lending sources, clients and other securities lending personnel about such issues. Yet Defendants are so absurdly overreaching that they contend that testimony about Overstock being a "hot"[18] stock in 2006 is "competitively-sensitive information"! *See* Ex. A to Floren Decl., at 99 (discussing Ex. 212 to Sommer Declaration).

When Defendants' conclusory statements are examined, there is no substance to back up their assertions that such ancient material has competitive value. Declarations that generally track Section 3426.1 of the Civil Code do not establish trade secret status; rather, they merely show that the party's lawyers know how to draft declarations that track the statute. *See Providian*, 96 Cal. App. 4th at 305 (rejecting declarations that tracked Section 3426.1 as "conclusionary and lacking in helpful specifics" as to the specific documents in question).

It is important to observe that Defendants put the most emphasis on sealing documents reflecting the very policies that they claimed at oral argument were common knowledge: "[I]t was common knowledge in the marketplace that Merrill Pro and GSEC were not borrowing shares for market-maker trades because we were doing it for all of our market-maker customers. It wasn't just for Hazen [sic]." Jan. 5, 2012 Tr., at 23:21-24. Documents containing material that has been disclosed to the public cannot contain trade secrets and may not be sealed on that basis. *Providian*, 96 Cal. App. 4th at 304. Thus, Defendants have waived any possible claim of trade secrets concerning their intentionally failing trades, including but not limited to conversion trades. In truth, Defendants do not seek to preserve a trade secret; rather, they seek to avoid disclosure of documents that are evidence of what they did. *See* Manzino Decl., ¶¶ 18-19 (purchase of conversions by securities lending personnel was not a secret, and improper and unlawful strategies involving such conversions have become public via sanctions orders). Defendants cannot argue at the summary judgment hearing that those policies were common knowledge and then try to withhold incriminating emails exposing the policies on the ground that the emails contain valuable trade secrets unknown to competitors. The hypocrisy is staggering.

Defendants' concern here is not protecting any trade secrets. Rather, Defendants

[18] A "hot" stock refers to a stock that clients were interested in shorting and, consequently, borrowing from a clearing firm's securities lending department. *See* Manzino Decl., ¶ 5.

want to conceal from the public the nature and extent of their relationships with Hazan, Arenstein and others because it may (should) embarrass them and put them in a bad light, not because these facts will reveal any trade secret. The SEC banned Hazan from trading for a minimum of five years and fined him millions of dollars, so there is no competitive advantage that could be impaired by not sealing his communications with Defendants. Cirangle Dec., Ex. C; Manzino Decl., ¶ 15. Arenstein was banned from trading for five years by the NASD and also fined millions of dollars. Cirangle Dec., Ex. C. Again, there is no competitive advantage at issue. Manzino Decl., ¶ 15. Indeed, neither Hazan nor Arenstein has been a client of the Merrill or Goldman Defendants since 2007. Likewise, Keystone was also sanctioned and is no longer a client of the Merrill or Goldman Defendants. Cirangle Dec., Ex. I. [19]

Defendants' primary concern is to shield information that may expose wrongdoing on their part and/or embarrass them, but such concerns do not establish an interest that overrides the strong presumption of public access. *See Huffy Corp. v. Superior Ct.*, 112 Cal. App. 4th 97, 108 (2003) (no overriding interest warrants "secreting from the public documents filed in its courts" showing that there may have been violations of federal and state pollution laws); *Foltz v. State Farm Mut. Auto. Ins. Co.*, 331 F.3d 1122, 1136 (9th Cir. 2003) (a litigant is not entitled to

[19] Defendants also claim they have a duty to protect client confidential information and argue that as a secondary basis for sealing some subset of the documents. Melz specifically references five documents that fall into this category (Melz Dec., ¶16); Ms. Dunphy fails to specifically reference any. This argument also fails for many reasons. First, most of the documents are emails with clients, not financial records such as those the court discussed in Defendants' case, *Valley Bank of Nevada v. Sup. Ct.*, 15 Cal. 3d 652 (1975), which concerns whether documents should be produced in the first instance, not a sealing motion. Second, to the extent the records contain any client confidential information, the majority of them concern Hazan and Arenstein's accounts. Given their public sanctioning for the same trading in these same accounts, Hazan and Arenstein have no continuing privacy interest in trading account information. The same is also true of the trading by the other Merrill and Goldman customers that formed the basis of their sanctions. Third, to the extent any remaining customer information exists in the documents Defendants seek to seal, any privacy concerns could easily be addressed through simple redaction of any such information. For example, Defendants' "blue sheets" for the trading in OSTK could be unsealed as to the manipulative trading at issue in the case, and the rest kept private. This could easily be accomplished by unsealing the exhibits to Marc Allaire's declaration, which contain the manipulative trades he culled from the blue sheets, while keeping the rest of the blue sheets under seal. Another example would be, if an email string discussed Hazan and Arenstein's trades but makes mention of unrelated client confidential information, that portion of the email could be redacted. There are simple solutions to any potentially legitimate issues of client confidentiality, but Defendants have chosen to utterly ignore them. Because Defendants have not met their burden to establish that any sealing order is narrowly tailored, the records must be unsealed.

the court's protection merely because it may be "embarrassed, incriminated or exposed to litigation through dissemination of materials"). Nor is a non-party entitled to protection because it may be exposed to litigation. *See Huffy*, 112 Cal. App. 4th at 109 (rejecting defendant's argument that "the identities of other parties which have been identified by a government agency of violating federal and state and environmental laws must be sealed" because there was no overriding interest).

Defendants should be embarrassed and want to hide details of setting up their systems to intentionally fail to deliver stocks, given that their central role in the integrity of the United States stock market is to ensure delivery of stock. Goldman Defendants should be embarrassed and want to hide details of their knowing purchases of non-existent stock from traders they knew were abusing their options market maker exemptions to meet their stock lending demands and perpetuate short selling in vulnerable stocks, thereby destroying companies in order to earn Goldman more profits. These facts are shameful. However, the fact that Defendants' actions are embarrassing and not the type of information they want known to the public does not qualify them for the narrow, limited sealing of public records available under California law.

2. For each document, Defendants have not shown that a substantial probability exists that an overriding interest will be prejudiced if the record is not sealed.

Even where an overriding interest is found that supports sealing a specific document, such an express factual finding of an overriding interest does not end the inquiry. Even where an overriding interest exists for a specific record, there can be no sealing unless the moving party also shows a substantial probability that it will be prejudiced if the particular record is not sealed. For example, in *Huffy Corp. v. Superior Ct.*, 112 Cal. App. 4th 97 (2003), the Court of Appeal found that a defendant had established an overriding interest where the record in question was a settlement agreement that the defendant was contractually bound not to disclose. *Id.* at 107. However, the Court of Appeal found that "[n]o prejudice to defendant's legitimate business and proprietary interests will occur if the settlement agreement is ordered unsealed." *Id.*; *see also H.B. Fuller Co. v. Doe*, 151 Cal. App. 4th 879, 896 (2007) ("At no time does [moving

party] squarely address the central question, which is what harm the unsealing of these documents, or any part of them, will inflict upon its interests.").

Again, there is no evidence of any prejudice that Defendants will suffer if the information is unsealed. Indeed, Defendants' counsel argued that the Section 17200 claim should be dismissed because Defendants' business practices that led to fails-to-deliver had ceased because of regulatory enactments in 2008: "The drop [in fails-to-deliver] is a direct result of the fact that the governing federal regulations changed substantially in late 2008, and those changes made fails-to-deliver both much less common and, when they occurred, much smaller in size and much shorter in duration." Jan. 5, 2012 Tr. at 83:20-24 (argument by Goldman's counsel); *see also* Manzino Decl., ¶ 16; *accord* Cirangle Decl., Exs. L and M (Melz and Mastrianni testimony confirming Merrill's Reg SHO policies changed in 2008).

Again, prejudice must be shown on a document-by-document basis, and Defendants' charts that purport to list the overriding interests that justify sealing do not even attempt to list the purported prejudice that Defendants would suffer if a particular document were unsealed. Instead, Defendants rely exclusively on global, generic statements about vague injury they might suffer if all of the documents were unsealed. For example, the declarations of Peter Melz for the Merrill Defendants and Beverly Dunphy for the Goldman Defendants vaguely refer to potential competitive disadvantages, but fail to identify any actual, specific competitive disadvantage that would likely result from disclosure of a particular document or part of a document. Defendants provide pages and pages of filler for the Court, but the "oblique, vague, attributive, conditional, incomplete or otherwise circumlocutory manner" of the assertions renders them meaningless. *See H.B. Fuller*, 151 Cal. App. 4th at 897.

3. For each document, Defendants have not shown that the proposed sealing order is narrowly tailored and that no less restrictive means exist to protect any overriding interest.

The Merrill Defendants' proposed order fails to set forth express factual findings that establish that the order is narrowly tailored and that no less restrictive means exist to protect any overriding interest, as required by Rule 2.550(d)(4)-(5). By their failure to submit any proposed order, the Goldman Defendants have also failed to meet these two requirements.

Merrill Defendants argue that their request is "narrowly tailored" because they "went through extraordinary lengths to review the voluminous material submitted by plaintiffs and identify the specific sections of those materials [sic] should be protected....As shown by Exhibit A, Merrill Lynch's request is narrowly tailored and focuses only on the sections of the materials that should be sealed." Merrill Defendants' Motion, at 17-18. Likewise, Goldman Defendants claim their sealing request is "narrowly tailored." Goldman Defendants' Motion, at 19. These assertions are nonsense. A review of the list of materials Defendants seek to seal shows that the Defendants move to seal 95% of all discovery exhibits, in their entirety, that Plaintiffs submitted in support of their opposition to the motion for summary judgment. Defendants move to seal the entirety of the pleadings as well, except as to those portions that were previously disclosed by Plaintiffs when Plaintiffs submitted the pleadings in redacted form. In sum, Defendants made no effort to narrow their sealing request in regard to these documents.

Where a defendant overreaches in seeking sealing on an all-or-nothing basis, *Providian* instructs that the trial court should unseal the entire record. The Court in *Providian* observed that defendants claimed trade secret status for "virtually every section" of the documents at issue, while failing to propose measures such as "editing or redacting" the documents that might have reached a "reasonable accommodation" between their interests and "the strong presumption of public access."[20] *Providian*, 96 Cal. App. 4th at 309. The Court of Appeal found that the defendants were, in effect, "framing and submitting the issue on an all-or-nothing basis." *Id.* Because the defendants spurned a "line by line approach," the trial court acted properly in unsealing the entirety of all of the documents. *Id.*

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[20] In spite of what the Court of Appeal found to be an improper effort to globally seal documents, the defendants in *Providian* were actually far more reasonable than Defendants here. Unlike Defendants here who seek to seal virtually every summary judgment exhibit, the defendants in Providian conceded that a substantial percentage of the documents—28 out of 67—were not confidential. *Id.* at 296-97.

IV. CONCLUSION

For the reasons set forth above, Plaintiffs respectfully request the Court deny Defendants' Motions to Seal and enter Plaintiffs' proposed order unsealing the records.

Dated: February 9, 2012

STEIN & LUBIN LLP

By: _____

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