UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

In re ENRON CORPORATION SECURITIES LITIGATION	§	Civil Action No. H-01-3624 **(Consolidated)**
This Document Relates To:	§	CLASS ACTION
MARK NEWBY, et al., Individually and On Behalf of All Others Similarly Situated,	§	
Plaintiffs,	§	
vs.	§	
ENRON CORP., et al.,	§	
Defendants.	§	
THE REGENTS OF THE UNIVERSITY OF CALIFORNIA, et al., Individually and On Behalf of All Others Similarly Situated,	§	
Plaintiffs,	§	
vs.	§	
KENNETH L. LAY, et al.,	§	
Defendants.	§	

PLAINTIFFS' MEMORANDUM OF LAW IN OPPOSITION TO MOTIONS TO DISMISS FILED BY ENRON DEFENDANTS BUY, CAUSEY, DERRICK, FASTOW, FREVERT, HANNON, HARRISON, HIRKO, HORTON, KEAN, KOENIG, LAY, MARK-JUSBASCHE, MCMAHON, OLSON, PAI, RICE, SKILLING, SUTTON AND WHALLEY

TABLE OF CONTENTS

Page

Page

Page

Page

Page

Page

Page

TABLE OF AUTHORITIES

CASES **Page**

Page

Page

Page

Page

STATUTES, RULES AND REGULATIONS

SECONDARY AUTHORITIES

I. Introduction

In the face of a 500-page complaint alleging the largest and worst securities fraud in the history of the United States[1] in excruciating detail, every single defendant – Insiders, outside directors, Enron's accountants, its lawyers, and bankers have moved to dismiss. Some claim it is too detailed. Some claim it is not detailed enough. Everyone denies responsibility and not one defendant has seen fit to answer. Every defendant seeks to avoid accountability by raising technical pleading arguments based on the Private Securities Litigation Reform Act of 1995 ("95 Act") that was meant to deter the filing of ***frivolous*** suits – which everyone knows, except apparently the defendants, this case is not. While it does appear that the 95 Act was successful, at least in this case, in deterring plaintiffs' securities lawyers from filing cookie-cutter complaints, it does not appear to have had the same salutary impact with respect to deterring defendants from filing meritless motions to dismiss.

Each defendant denigrates the detailed CC as a "puzzle pleading" that violates Fed. R. Civ. P. 8.[2] But the CC is of the same style and format as that sustained by this Court in *In re Landry's Seafood Restaurants, Inc. Sec. Litig.*, No. H-99-1948 (S.D. Tex. Feb. 20, 2001) – a decision defendants basically ignore – and in many other reported and unreported decisions. *See* Plaintiffs' Opposition to Certain Defendants' Motion to Dismiss for Violations of Fed. R. Civ. P. 8 filed herewith. The "puzzle pleading" charge has been repeatedly rejected by courts which respect good-faith efforts by victims of securities fraud to provide the kind of detail and individuality required by the 95 Act – especially in complex multi-party cases. As Judge Debevoise stated in sustaining a lengthy complaint against a public company and its officers and directors:

> Defendants challenge the Complaint, claiming that rather than being a "short and plain statement of the claim" in conformity with Fed. R. Civ. P. 8 it is "puzzle pleading" that fails to meet the requirements of Rule 9(b) and the Private Securities Litigation Reform Act (the "Reform Act"). ***The Complaint certainly is not short, but if it is a puzzle, it is meant for a child and can be assembled readily***.

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1 *See* John C. Coffee, Jr., "Guarding the Gatekeepers," *New York Times*, 5/13/02, at A19 (referring to Enron as a "[m]ajor debacle[ ] of historic dimensions").

2 All references to "¶¶_-_" are to paragraphs of plaintiffs' CC filed 4/8/02.

In re Honeywell Int'l Secs. Litig., 182 F. Supp. 2d 414, 416 (D.N.J. 2002).[3] In truth, ¶¶1–74 of the CC provide a relatively succinct summary of the CC, while the balance of the CC provides the detail required by Rule 9(b) and the 95 Act, thus satisfying plaintiffs' dual pleading obligations.

The CC pleads that the Insiders are liable under the 1933 and 1934 Acts because they: (i) sold Enron securities to investors via false Registration Statements; (ii) issued false statements; (iii) employed manipulative and deceptive devices; and (iv) participated in a scheme to defraud and a course of business that operated as a fraud or deceit on purchasers of Enron securities between 10/18/98 and 11/27/01 (the "Class Period").

II. Factual Overview[4]

A. Year-End 97 Crisis

The fraudulent scheme and course of business involving Enron finds its origin in mid-97 when Enron suffered huge losses on British natural gas and MTBE transactions which called into question its trading and financial risk management statistics. Analysts downgraded Enron's stock and lowered their future earnings growth forecasts for Enron. Enron's stock lost one-third of its value and Enron's executives' performance-based bonuses were slashed. Enron was determined to halt its stock's decline and push it back to higher levels. Enron knew this could only be accomplished by reporting stronger-than-expected financial results, thus enabling it to credibly

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3 Emphasis is added and citations are omitted throughout unless otherwise noted.

4 Because any changes to the pleading requirements were not intended to prevent aggrieved parties from obtaining redress for their valid claims, "courts still apply Rule 12(b)(6) principles to motions to dismiss securities class action cases." *In re Boeing Sec. Litig*., 40 F. Supp. 2d 1160, 1166 (W.D. Wash. 1998) (collecting cases); *see also Bryant v. Avado Brands, Inc.*, 187 F.3d 1271, 1273 n.1 (11th Cir. 1999). Consequently, the court must accept as true all well-pleaded allegations in the complaint and construe them in the light most favorable to plaintiff. *Scheuer v. Rhodes*, 416 U.S. 232 (1974); *Calliott v. HFS, Inc.*, No. 3:97-CV-0924-J, 2000 U.S. Dist. LEXIS 4368, at *8 (N.D. Tex. Mar. 31, 2000); *Zuckerman v. Foxmeyer Health Corp*., 4 F. Supp. 2d 618, 621 (N.D. Tex. 1998) (Maloney, R.) (stressing that "the complaint is to be liberally construed in favor of the plaintiff"); *Young v. Nationwide Life Ins. Co.*, 2 F. Supp. 2d 914, 919 (S.D. Tex. 1998); *Lawal v. British Airways, PLC*, 812 F. Supp. 713, 716 (S.D. Tex. 1992). "A motion to dismiss for failure to state a claim under Fed. R. Civ. P. 12(b)(6) 'is viewed with disfavor and is rarely granted.'" *Calliott*, 2000 U.S. Dist. LEXIS 4368, at *7. (Unless otherwise noted, all emphasis is added, and footnotes and citations are omitted.) Dismissal is appropriate only if it appears that no relief could be granted under any set of facts that could be proven consistent with the allegations. *Rubinstein v. Collins*, 20 F.3d 160, 166 (5th Cir. 1994) (citing *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957)); *Tuchman v. DSC Communications Corp.*, 818 F. Supp. 971, 974 (N.D. Tex. 1993), *aff'd*, 14 F.3d 1061 (5th Cir. 1994); *Calliott*, 2000 U.S. Dist. LEXIS 4368, at *3.

forecast stronger future earnings growth. Unfortunately, Enron's actual business operations were incapable of generating such results. ¶8.

To make matters worse, in late 12/97, Enron learned that an entity it had established with an outside investor, Joint Energy Development Incorporated ("JEDI") – and had done transactions with to generate 40% of the profits Enron reported during 97 – had to be restructured, as the outside investor was going to withdraw from JEDI. This created a crisis. Because the outside investor in JEDI had been independent of Enron, JEDI had ***not*** been consolidated into Enron's financial statements, *i.e.*, Enron did deals with JEDI as an independent party, recognized profits and did not carry JEDI's debt on its books. Thus, unless JEDI could be quickly restructured with a new, independent investor, ***Enron would have to wipe out all of the profitable transactions it had done with JEDI in 97, put JEDI's $700 million debt on Enron's balance sheet, and lose the ability to generate profits from similar such deals with JEDI's successor going forward***. ¶9.

However, Enron ***could not find a legitimate buyer for the outside investor's interest*** in JEDI. So Enron quickly formed Chewco – which Enron and an Enron executive (Michael J. Kopper ("Kopper")) controlled – to buy the outside investor's interest in JEDI. Chewco ***did not have an outside equity investor which was an independent third party. So, Barclays Bank loaned $240 million to Chewco, requiring a secret guarantee from Enron. Barclays also loaned the money to two straw parties to provide for their purported "equity" investment in Chewco. Because Barclays knew that the purported equity investors in Chewco were, in fact, Enron "strawmen," Barclays required Chewco to support the purported "equity loans" Barclays made to the two "strawmen" via a $6.6 million reserve paid to Barclays***! Because there was no independent outside investor in Chewco, Chewco was required to have been consolidated with Enron and ***all of Enron's 97 profits from transactions with JEDI should have been eliminated***! ¶10.

By the non-arm's-length Chewco transaction at year-end 97, Enron avoided a disaster by keeping the previously recorded JEDI profits in place, inflating Enron's 97 reported profits and keeping millions of dollars of debt off its books. Chewco was now also positioned to serve as a controlled entity which Enron could use to do non-arm's-length transactions with, creating at least $350 million in phony profits for Enron and allowing Enron to conceal millions of dollars of debt.

Having now created its template to falsify Enron's financial results, between 98 and 01, Enron and its banks would create other secretly controlled partnerships and entities and use them to generate hundreds of millions of dollars of phony profits while concealing billions of dollars of Enron debt. ¶11.

B. The 97-00 Successes – Enron's Stock Soars

As Enron reported ***better-than-expected year-end 97 financial results***, its stock moved higher. During 98 through mid-01, Enron appeared to evolve into an enormously profitable high-growth enterprise, reaching annual revenues of $100 billion by 00, with annual profits of $1.2 billion, presenting a very strong balance sheet that entitled it to an investment ***grade credit rating***. By 01, Enron had become the seventh largest U.S. corporation and was consistently reporting ***higher-than-forecasted earnings each quarter*** and forecasting ***continued strong growth***. ¶12. Enron extolled the success and earning power of its Wholesale Energy trading business ("WEOS"), its Retail Energy Services business ("EES"), and its Broadband Content Delivery and Access Trading, *i.e.*, intermediation, business ("EBS"). ¶2.

Throughout 98 and 99, as Enron reported record profits and a strong financial position, Enron and the Insider Defendants stated (¶14(a)):

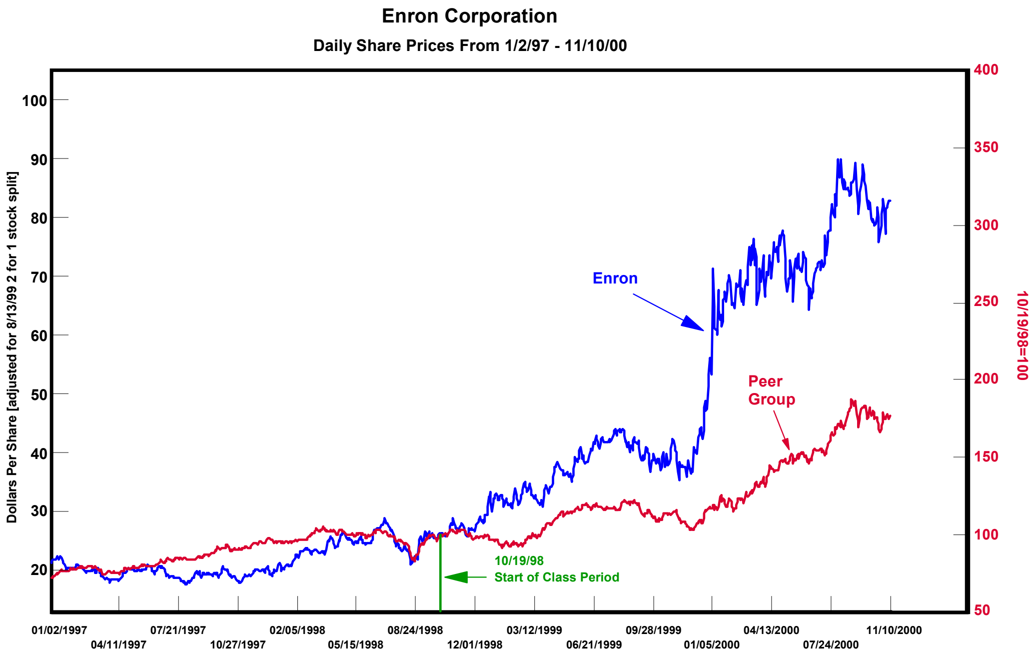
- Enron's strong results were due to the success of all of its business lines.
- Enron had a leading position in each of its businesses. Enron had an extremely strong franchise position.
- Wessex Water would be accretive to Enron's business now and a $20 billion business in five years. Azurix Corp. was becoming a major global water company.
- International projects would drive major earnings growth for Enron. The Dabhol, India power project would contribute to earnings in 99 and beyond.
- WEOS's business remained strong.
- EES was exceeding expectations for contracts and profitability. EES was adding billions in new contracts and would be profitable by 4thQ 00.
- Enron was optimistic about its broadband business. EBS was firing on track.
- Enron's tremendous competitive advantages enabled it to achieve strong EPS growth.
- Enron was very well managed and knew how to manage and mitigate risk. Enron had effectively used off-balance sheet non-recourse financing. Enron had a strong balance sheet. Enron was a master of risk management.

- No other company offered such impressive sustainable growth.
- Enron was hitting on all eight cylinders. Enron's outlook was excellent. Enron was very optimistic.
- Enron was a global powerhouse, with EPS growth to exceed 17%. Enron would maintain strong earnings growth for years.

During 00, as Enron reported record annual profits and a very strong financial position, Enron and the Insiders stated (¶14(b)):

- Enron's strong financial results were due to strong results in all operations.
- Enron had very strong momentum. Its trends were sustainable and would accelerate.
- Enron's business was booming. All its operations were gaining momentum.
- Investors were about to see breakout performance of EES and rapid growth and development of EBS.
- EES's new contracts and profitability were accelerating. EES had the potential to double Enron's size in a few years.
- EBS broadband trading was accelerating. The market was larger than expected, and would reach $100 billion in a few years with 3%-4% margins.
- Enron/Blockbuster video-on-demand ("VOD") deal a "killer app." Unparalleled quality of service. Contract worth over $1 billion. VOD to rollout nationally in 01. All components in place. VOD had solid technology and platform.
- Enron's WEOS merchant investments were protected through hedging.
- Enron had monumental earnings potential over the next five years. Enron was well managed and a pioneer in global energy. Enron was never in better shape. Enron was very optimistic about the continued strong outlook for the Company.
- Growth and strong earnings were why investors should buy Enron stock.

As a result of Enron's strong earnings, the positive statements about its business and the forecasts of continuing strong earnings growth, Enron's stock was a very strong performer and its debt securities also traded at high prices. ¶15. Enron's apparent success and forecasts of strong profit growth gave Enron and its bankers ready access to the capital markets by which they raised billions of dollars by selling newly issued Enron securities to public investors, using the proceeds to repay Enron's bank debt. ¶16. Enron's stock soared to its all-time high of $90-3/4 in 8/00 and then continued to trade at or near these levels for months, as shown below (¶15):



The apparent success of Enron was an illusion – a false picture created by contrivances and deceptive acts – a fraudulent scheme and course of business that operated as a fraud and deceit on the purchasers of Enron's publicly traded securities.

Inside Enron there was a fixation on Enron's stock and doing whatever was required to generate the financial results necessary to push the stock ever higher. Throughout Enron's corporate headquarters in Houston were TV monitors that displayed the price of Enron stock. Inside Enron there was a saying that managers were to be "***ABC***ing," meaning to "***a***lways ***b***e ***c***losing" deals to generate revenues and profits, even if the economics of the deal were suspect – a practice facilitated by a compensation system inside Enron for corporate managers and executives that directly rewarded them financially for ***closing*** transactions and placing a high (*i.e.*, inflated) value on them, regardless of the true economic substance of the deal, so long as the deal generated an apparent profit when "marked to market." ¶50.

The pressures applied to corporate managers by the top executives to do anything necessary to enable Enron to make its numbers was widespread, as was the knowledge that Enron's revenues and earnings were being falsified. Former insiders have been quoted as saying "***[y]ou don't object***

to anything" and "***[t]he whole culture at the vice-president level and above just became a yes-man culture***."

> But that culture had a negative side beyond the inbred arrogance. ***Greed was evident, even in the early days. "More than anywhere else, they talked about how much money we would make," says someone who worked for Skilling. Compensation plans often seemed oriented toward enriching executives rather than generating profits for shareholders. For instance, in Enron's*** energy services division, which managed the energy needs of large companies like Eli Lilly, executives were compensated based on a market valuation formula that relied ***on internal estimates. As a result, says one former executive, there was pressure to, in effect, inflate the value of the contracts – even though it had no impact on the actual cash that was generated.***

Fortune, 12/24/01 (¶51).

> ***"If your boss was [fudging], and you have never worked anywhere else, you just assume that everybody fudges earnings," says one young Enron control person. "Once you get there and you realized how it was, do you stand up and lose your job? It was scary. It was easy to get into 'Well, everybody else is doing it, so maybe it isn't so bad.'"***
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> ***The flaw only grew more pronounced as Enron struggled to meet the wildly optimistic expectations for growth it had set for itself. "You've got someone at the top saying the stock price is the most important thing, which is driven by earnings," says one insider. "Whoever could provide earnings quickly would be promoted***."
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> ***The employee adds that anyone who questioned suspect deals quickly learned to accept assurances of outside lawyers and accountants. She says there was little scrutiny of whether the earnings were real or how they were booked. The more people pushed the envelope with aggressive accounting, she says, the harder they would have to push the next year. "It's like being a heroin junkie," she said. "How do you go cold turkey?"***

Business Week, 2/25/02 (¶51). In fact, in mid-8/01, an Enron executive wrote Lay, telling him the Company was "***nothing but an elaborate accounting hoax***," and, in referring to the special purpose entity ("SPE") transactions that Enron and its banks – including J.P. Morgan – had structured and funded, that nothing "***will protect Enron if these transactions are ever disclosed in the bright light of day***" – warning that many employees believed "***we're such a crooked company***." ¶51.

By 97-98, Enron was a hall of mirrors inside a house of cards – reporting hundreds of millions of dollars of phony profits, while concealing billions of dollars of debt that should have been on its balance sheet, thus inflating its shareholder equity by billions of dollars. Enron had turned into the largest Ponzi scheme in history – constantly raising fresh money by selling its securities or those of related entities, while appearing to achieve successful growth and profits. But, because Enron's reported profits were being generated by phony, non-arm's-length transactions and improper accounting tricks – including the abuse of "mark-to-market" accounting[5] to accelerate the recognition of hundreds of millions of dollars of profits to ***current periods*** from transactions in which Enron was only entitled to receive ***cash over many future years*** – Enron was cash starved. Yet to continue to report ***growing*** profits, Enron was forced to not only continue to engage in such transactions and accounting abuses, ***but to accelerate the number and size of such transactions it engaged in***. This created a vicious cycle further exacerbating Enron's need to obtain cash from these transactions. To make matters worse, Enron had capitalized controlled entities with which it was doing phony deals with (deals approved by Enron's directors and officers, many of whom agreed to the waiver of Enron's conflicts of interest policy for defendant Fastow), with shares of Enron stock and ***had agreed to issue millions and millions of additional shares of its stock to these entities if Enron's stock price declined below certain "trigger prices***," *i.e.*, \$83, \$81, \$79, \$68, \$60, \$57, \$52, \$48, \$34 and \$19 per share, ***and to become liable for the debt of those entities if Enron lost its investment grade credit rating***. Because of the "triggers" and the way Enron capitalized these entities, it was absolutely vital to Enron and the other participants in the fraudulent scheme and

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5 Enron engaged in several accounting tricks and manipulations to falsify its financial results during the Class Period. Chief among these was the abuse of "***mark-to-market accounting***," whereby Enron computed the purported profit it would ultimately obtain on a multi-year contract, discount that to present value and recognize the entire "mark-to-market" profit in the current period. Enron misused and abused mark-to-market accounting ***throughout its entire business to grossly inflate its reported revenues and profits***. In Enron's WEOS business this was done by assigning unrealistic values to wholesale energy transactions which inflated current period income. In Enron's EES business where Enron had no long-term track record to justify the use of mark-to-market accounting, Enron nevertheless consistently utilized mark-to-market accounting to record huge current period profits on long-term, highly speculative retail energy risk-management contracts which, in fact, Enron had no basis to project a profit on and in fact knew would likely result in losses. Finally, in Enron's EBS business – also a new business where Enron had absolutely no track record which would form a basis for the use of mark-to-market accounting – Enron abused mark-to-market accounting to generate hundreds of millions of dollars of phony current period profits in several transactions. Also, when reviewing those computations on a quarterly basis as it was required to do, Enron consistently ***increased*** the estimated value of the transaction even though subsequent data revealed ***a reduction of the estimated value of the transaction, a practice known within Enron as "moving the curve***." ¶36.

course of business that Enron's stock continue to trade at high levels and that Enron maintain its "investment grade" credit rating, otherwise the scheme would unravel. ¶¶18, 20.[6]

Enron became completely dependent on maintaining its investment grade credit rating and a high stock price so that Enron could continue to have access to the capital markets to borrow billions in commercial paper and to enable it to periodically raise hundreds of millions of dollars of new longer term capital it needed to repay its commercial paper debt and the short-term loans it was receiving from its banks to sustain its business operations and so the stock issuance "triggers" would not be hit, which would force Enron into a death spiral. ¶20.

C. The Partnerships and SPEs

To falsify Enron's reported financial results, Enron and the other defendants engaged in a series of purported "partnership" and "related party" transactions with the entities known as SPEs. A public company that conducts business with an SPE may treat that SPE as if it were an independent entity ***only*** if it does not control the SPE. ***And***, at a bare minimum, two other conditions must be met: (i) an independent party must make an equity investment of ***at least 3% of the SPE's assets, which must remain at risk throughout the transaction***; and (ii) ***the independent party must exercise control of the SPE***. ¶21.

In 99, Enron created two ***LJM partnerships (LJM and LJM2) which Enron secretly controlled. Enron then engaged in numerous non-arm's-length transactions – contrivances and devices to deceive – with the LJM partnerships and associated SPEs, which inflated Enron's***

6 Enron's investment-grade credit rating was indispensable. As Enron's CFO stated in a 10/01 conference call: "***We understand that our credit rating is critical to both the capital markets as well as our counterparties***." Earlier, Fastow stated to *CFO Magazine*: "***My credit rating is strategically critical***." This investment grade credit rating gave Enron access to the commercial paper market – a market reserved for America's largest and most creditworthy corporations – so that it could borrow billions of dollars to maintain its liquidity and finance its capital-intensive business. Enron's access to the commercial paper market also meant that Enron's $3 billion commercial paper back-up credit line, arranged by the lead banks, J.P. Morgan and CitiGroup, ***would likely not be drawn down upon***, thus limiting those banks' financial exposure to Enron. It also meant that Enron and its banks could easily sell debt securities to investors to raise long-term capital, using the proceeds to reduce short-term commercial paper and other bank debt. Enron's investment grade credit rating was critical to the scheme, as only Enron's insiders and its banks knew, because under the terms of the partnership/SPE deals, ***if Enron's debt was downgraded to below investment grade, the debt of those entities would become recourse to Enron, which could cause the house of cards to topple***. ¶19.

reported profits by more than a billion dollars – at the same time enriching Enron's CFO (Fastow) and Enron's banks or bankers who had been secretly allowed to invest in the LJM2 partnership as a reward for their participation in the scheme, by hundreds of millions of dollars. The reason for establishing these partnerships was that they would permit Enron to accomplish transactions it could not otherwise accomplish with an independent entity, by providing Enron with a buyer of assets that Enron wanted to sell. ¶¶23, 29, 646-647.

One of the primary vehicles used to falsify Enron's financial results during 99-01 was LJM2, which Enron used to create numerous SPEs (including the infamous "Raptors"), which engaged in non-arm's-length fraudulent transactions to artificially inflate Enron's profits while concealing billions of dollars of its debt on terms so unfair to Enron that the deals provided huge returns to the LJM2 investors. ¶24. The LJM2 partnership offering memorandum by which Enron and Merrill Lynch brought investors into the partnership – ***which was not a public document*** – contained an invitation to benefit from the self-dealing transactions that LJM2 would engage in. It stressed the "***unusually attractive investment opportunity***" resulting from LJM2's connection to Enron. It emphasized Fastow's position as Enron's CFO and that LJM2's day-to-day activities would be managed by Fastow and other Enron insiders.[7] It explained that "***[t]he Partnership expects that Enron will be the Partnership's primary source of investment opportunities***" and that it "***expects to benefit from having the opportunity to invest some $150 million in Enron-generated investment opportunities that would not be available otherwise to outside investors.***" It specifically noted that Fastow's "***access to Enron's information pertaining to potential investments will contribute to superior returns." In addition, investors were told that investors in a similar Fastow controlled partnership (JEDI) that had done deals with Enron like the ones LJM2 would do had tripled their investment in just two years and that overall returns of 2,500% to LJM2 investors were actually anticipated***. ¶25.

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[7] In fact, Fastow's dual role by which he could self-deal on behalf of the LJM2 partnership with Enron's assets was so important ***that investors in LJM2 were assured that they did not have to make any additional capital contributions if Fastow's dual role ended***. ¶24.

Enron and the Insider Defendants knew that because LJM2 was going to engage in transactions ***with Enron where Enron insiders would be on both sides of the transactions, the LJM2 partnership would be extremely lucrative – a deal that was virtually guaranteed to provide huge returns to LJM2's investors as the Enron Ponzi scheme went forward***. ¶24. In short, the non-public LJM2 offering memorandum was an invitation to share in the benefits of non-arm's-length self-dealing transactions with Enron, *i.e.*, the looting of Enron. ***Enron's banks and the top executives of those banks were permitted to invest in LJM2 as a reward to them for their ongoing participation in the scheme – a sure thing for them***. ¶25.[8]

It was indispensable to the scheme that LJM2 be funded at year-end 99 to serve as a vehicle to consummate several deals with Enron before year-end 99 to create huge profits for Enron in the 4thQ 99 so that Enron could meet and exceed its forecasted 99 earnings. However, as had been the case with Chewco at year-end 97, there was tremendous time pressure and Enron and Merrill Lynch (which was raising the private equity capital for LJM2) could not complete the formation of LJM2 and raise sufficient money from the equity investors in LJM2 by year-end 99 with sufficient capital to enable it to do the desperately needed transactions with Enron. Creating LJM2 by year end was indispensable to Enron avoiding reporting a very bad 4thQ 99 – which would have caused its stock to plunge. These vital year-end 99 deals included:

(a) ***Collateralized Loan Obligations ("CLOs")***. ***On 12/22/99***, Enron pooled purchaser CLO rights and sold the lowest-rated tranche to Whitewing LLP (an Enron affiliate) and LJM2. Whitewing loaned LJM2 the money to purchase its interest in the CLOs. Enron secretly guaranteed Whitewing's investment and loan to LJM2. This transaction allowed Enron to record the sale of millions of dollars in the 4thQ 99 to an entity that should have been consolidated.

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8 While Enron's publicly filed reports disclosed the existence of the LJM partnerships, these disclosures did not reveal the essence of the transactions completely or clearly, and failed to convey the substance of what was going on between Enron and the partnerships. The disclosures also did not fully disclose the nature or extent of Fastow's financial interest in the LJM partnerships. This was the result of an effort to avoid disclosing Fastow's financial interest and to downplay the significance of the related-party transactions and to disguise their substance and import. The disclosures also represented that the related-party transactions were reasonable compared to transactions with third parties when, in fact, they were not. ¶67.

(b) ***Nowa Sarzyna (Poland Power Plant)***. ***On 12/21/99***, Enron sold LJM2 a 75% interest in the Nowa Sarzyna power plant. Enron had tried to sell this interest by year-end to an independent buyer but could not find an independent buyer in time, so it used LJM2, which paid $30 million. This transaction moved millions of dollars of debt off Enron's balance sheet. This was a sham transaction. The debt financing required Enron to maintain ownership of at least 47.5% of the equity until the project was completed. However, the lender ***granted a waiver*** of this until 3/31/00, at which time Enron and Whitewing reacquired LJM2's equity interest and repaid that loan.

(c) ***MEGS, LLC***. ***On 12/29/99***, Enron sold LJM2 a 90% equity interest in MEGS, a natural gas system in the Gulf of Mexico. This allowed Enron to avoid consolidating the asset at year-end 99, avoiding millions of dollars of debt on Enron's balance sheet. Enron repurchased LJM2's interest in MEGS in early 00.

(d) ***Yosemite***. ***On 12/29/99***, Enron purportedly sold certificates in Yosemite to LJM2, however, in fact, this transaction did not occur until 2/28/00. The transaction was made to appear to occur at year-end 99 to reduce Enron's interest in Yosemite from 50% to 10% so Enron would not have to disclose its ownership of these certificates in Enron's 99 financial statements and that, in effect, Enron owned some of its own debt. On 12/29/99, Condor (an affiliate of Whitewing), which was controlled by Enron, loaned the $35 million to LJM2 to buy the certificates. On 12/30/99, LJM2 transferred the certificates to Condor, satisfying the one-day loan. ¶28.

From 6/99 through 6/01, Enron entered into numerous other non-arm's-length fraudulent transactions with the LJM partnerships. Enron sold assets to LJM2 that it wanted to get off its books on terms that no independent third party would ever have agreed to. ***The transactions between the LJM partnerships and Enron or its affiliates occurred close to the end of financial reporting periods to artificially boost reported results to meet forecasts Enron and other participants in the scheme had been making***. For instance, near the end of the 3rdQ and 4thQ 99, Enron sold interests in seven assets to LJM and LJM2. The transactions permitted Enron to conceal its true debt levels by removing the assets from Enron's ***balance sheet and, at the same time, record large gains. However, (i) as it had agreed in advance it would do, Enron bought back five of the seven assets after the close of the financial reporting period; (ii) the LJM partnerships made large profits on***

every transaction, even when the asset they had purchased actually declined in market value; and (iii) those transactions generated "earnings" for Enron of $229 million in the second half of 99 out of total earnings for that period of $549 million. In three of these transactions where Enron ultimately bought back LJM's interest, Enron had agreed in advance to protect the LJM partnerships against any loss. Thus, the LJM partnerships functioned only as vehicles to accommodate defendants in the falsification and artificial inflation of Enron's reported financial results, while enriching the LJM investors who were benefitting from the looting of Enron. ¶32.[9]

LJM2 made extraordinary pay outs from the Raptor SPEs, which LJM2 controlled, over the next two years, securing hundreds of millions of dollars in distributions from the Raptors to LJM2 – cash generated by the illicit and improper transactions Enron was engaging in, *i.e.*, the manipulative and deceptive devices, with the Raptors to falsify Enron's financial results. ¶¶31.

One "hedging" transaction with LJM in 6/99 involved Rhythms NetConnections ("Rhythms") stock owned by Enron, ***to "hedge" Enron's huge gains in Rhythms stock and enable Enron to create a huge profit. Enron transferred its own stock to the SPE in exchange for a note. But if the SPE were required to pay Enron on the "hedge," the Enron stock would be the source of payment. Other "hedging" transactions occurred in 00 and 01 and involved SPEs known as the "Raptor" vehicles. These were also structures, funded principally with Enron's own stock, that were intended to "hedge" against declines in the value of certain of Enron's merchant investments. These transactions were not economic hedges. They actually were manipulative and deceptive devices devised to circumvent accounting rules. The economic reality was that Enron never escaped the risk of loss, because it had provided the bulk of the capital with which the SPEs would pay Enron***. Enron and Enron's banks used these contrivances and devices to deceive to inflate Enron's reported financial results. In 99, Enron recognized income of over $100 million from the Rhythms' "hedging" transaction. ***In the last two quarters of 00, Enron recognized pre-tax***

[9] The returns to the LJM2 investors were huge – up to 2,500% on one deal and 51% overall ***in the first year*** of the partnership. ***Skilling recently told investigators such gargantuan returns were possible only because LJM2, with Fastow at the wheel, was defrauding Enron in the billions of dollars of deals it was doing with Enron so Enron could create false profits and hide billions of dollars in debt***. Kurt Eichenwald, "Enron Ex-Chief Said to Voice Suspicion of Fraud," *New York Times*, 4/24/02.

earnings of $530 million on several transactions with the Raptor entities out of reported pre-tax earnings of $650 million. These ***"earnings" from the Raptors' deceptive contrivances accounted for more than 80% of the total***! ¶33.

Hedging Enron's investments with the value of Enron's stock created an enormous and unusual motive for the participants in the scheme to keep Enron stock trading at inflated levels. This was because if the value of Enron stock fell, the SPEs would be unable to meet their obligations and the "hedges" would fail. This happened in late 00 and early 01. In 12/00, Enron's gain (and the Raptors' corresponding net loss) on these transactions was over $500 million. Enron could recognize these gains – offsetting corresponding losses on the investments in its merchant portfolio – ***only if the Raptors had the capacity to make good on their debt to Enron***. If they did not, Enron would be required to record a "credit reserve," a loss that would defeat the very purpose of the Raptors, which was to shield Enron from reflecting the decline in value of its merchant investments. ¶34.

As year-end 00 approached, two of Enron's LJM2-financed Raptor SPEs were in danger of coming unwound as they lacked sufficient credit capacity to support their obligations. If something was not done to prevent the unwinding of these SPEs, Enron would have to take a multi-million dollar charge against earnings which would expose the prior falsification of Enron's financial results and result in Enron's stock plunging lower and piercing more and more of the stock issuance "triggers" in the LJM2 SPEs and a vicious fatal down-cycle would kick in. Therefore, with the participation of certain of its banks, Enron restructured and capitalized the LJM2-financed Raptor SPEs at year-end 00 by transferring to them rights ***to receive even more shares*** of Enron stock, creating ever-increasing pressure on Enron and the other participants in the scheme to support Enron's stock price. This artifice enabled Enron to avoid recording a huge credit reserve for the year ending 12/31/00. ¶35.

D. Enron Energy Services ("EES")

Enron and the other defendants, including the Insider Defendants, were telling investors that an area of tremendous growth for Enron was its retail energy services business – EES – where Enron purportedly undertook to manage the energy needs of corporate consumers for multi-year periods in return for fees to be paid over a number of years. Enron and its banks presented this business as achieving tremendous success by constantly signing new multi-million or even billion dollar contracts which allowed EES to exceed internal forecasts, and that this division had turned profitable in the 4thQ 99 and was achieving substantial gains in its profitability thereafter. ¶37.

The falsification of Enron's financial results was not limited to non-arm's-length fraudulent illicit partnership and SPE transactions. EES also was actually losing hundreds of millions of dollars. This was because in order to induce large enterprises to sign long-term energy management contracts and "jumpstart" this business so it could appear to obtain huge contract volumes, Enron was entering into EES management contracts which it knew would likely result in huge losses. However, through the ***abuse*** of mark-to-market accounting, Enron grossly overvalued these contracts and created greatly inflated current period profits from transactions which generated little, if any, current period cash, and which would likely actually result in long-term cash-out plans and losses. As a letter written in 8/01 to Enron's Board by an EES manager stated just after Skilling "resigned" (¶38):

> One can only surmise that the removal of Jeff Skilling was an action taken by the board to correct the wrongdoings of the various management teams at Enron ... (*i.e.*, ***EES's management's ... hiding losses/SEC violations***).
>
> * * *
>
> ... [I]t became obvious that EES had been doing deals for 2 years and was losing money on almost all the deals they had booked.
>
> * * *
>
> ... [I]t will add up to over $500MM that EES is losing and trying to hide in Wholesale. Rumor on the 7th floor is that it is closer to $1 Billion.... [T]hey decided ... to hide the $500MM in losses that EES was experiencing.... ***EES has knowingly misrepresented EES['s] earnings. This is common knowledge among all the EES employees, and is actually joked about. But it should be taken seriously***.

E. Enron Broadband ("EBS")

Another purported growth area of Enron's business was its broadband services business – EBS – which consisted of constructing an 18,000-mile fiber optic network which Enron was supposedly successfully building out while also engaging in trading access to fiber optic cable capability, *i.e.*, "Broadband Intermediation." Enron and the other defendants – including the Insider

Defendants – presented ***both parts*** of Enron's broadband business as poised to achieve and later as actually achieving huge success, reporting that its fiber optic network was being or had been successfully constructed, was state of the art and provided unparalleled quality of service, and that its broadband trading business was succeeding and achieving much higher trading volume and revenues than expected – *i.e.*, "***exponential growth***." ¶39.

A prime example of the purported success of Enron's broadband content business was its VOD joint venture with Blockbuster Entertainment, announced in 7/00. Enron presented this 20-year agreement as having a ***billion dollar value***, that it was a ***first-of-its-kind product*** whereby consumers would obtain VOD content from Blockbuster in their home as if they were watching the movie on their own VCR (start, stop, rewind), and that this incredible advance in technology was made possible due to the ***high quality of Enron's fiber optic network***. Abusing mark-to-market accounting and using an LJM2 SPE (funded by J.P. Morgan executives), Enron recognized an astonishing $110+ million bogus profit on this deal in the 4thQ 99 and 1stQ 00, even though the project was failing in its test markets because Enron did not have the technology to deliver the product as represented – and which could never have gone forward because Blockbuster did not have the legal right to deliver movies in digital format, the only format which could be utilized for VOD. ¶40. Even Chairman and CEO of EBS Ken Rice admitted, "[Enron] can't deliver the Blockbuster deal." ¶300. Just eight months after announcing this contract with great fanfare and just weeks after representing testing of the system in four cities had ***succeeded*** and the service was being launched nationwide, Enron was forced to abandon the venture. But Enron did ***not*** reverse the huge profits it had secretly recorded on this transaction, for to do so would have not only exposed its ongoing abuse and misuse of mark-to-market accounting, but also would have crushed Enron's stock at a time when Enron and the other participants in the scheme were desperately attempting to halt Enron's then falling stock price so that it would not fall below certain trigger prices. ¶41.

F. New Power

Another example of how Enron falsified Enron's reported results is the New Power IPO in 10/00, by which Enron improperly recognized a $370 million profit in the 4thQ 00.[10] Enron controlled New Power and owned millions of shares of New Power stock. If Enron and its banks could take New Power public and create a trading market in its stock, then Enron could recognize a profit on the gain in value on its New Power shares by "hedging" that gain through yet another non-arm's-length transaction via LJM2 – which the Insider Defendants approved of and participated in. In the 4thQ 00, Enron desperately needed to create profits to perpetuate the Ponzi scheme. Enron and CitiGroup did the New Power IPO – 27.6 million shares at $21 per share in 10/00. Then, in a deal secretly structured before the IPO, Enron created a phony profit using an LJM2 SPE called Hawaii 125-0. Certain of Enron's banks made a "loan" of $125 million to Hawaii 125-0, ***but secretly received a "total return swap" guarantee to protect them against any loss from Enron***. Enron transferred millions of New Power warrants to Hawaii 125-0 to "secure" the banks' loan and thus created a huge $370 million "profit" on the purported gain on the New Power warrants. Hawaii 125-0 supposedly "hedged" the warrants with another entity created by Enron called "Porcupine." To supposedly capitalize Porcupine, LJM2 put $30 million into Porcupine to facilitate the so-called hedge of the New Power warrants, but, one week later, Porcupine paid the $30 million back to LJM2 plus a $9.5 million profit – leaving Porcupine with no assets. New Power stock immediately fell sharply, as the chart below shows:

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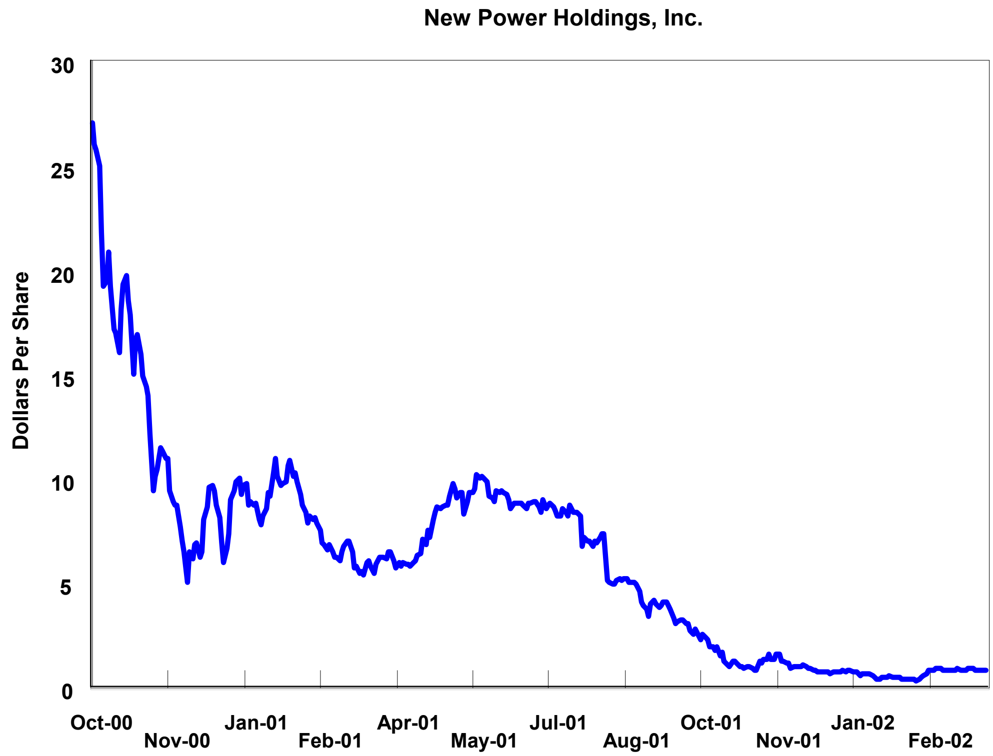
10 Concerning Enron's recognition of the New Power IPO stock price gain, Enron Board member Herbert Winokur testified to the House Energy and Commerce Committee:

> I cannot and will not defend this transaction. It seems obvious to me that one cannot hedge an investment in New Power with warrants on the same New Power stock. It is equally obvious to me that the terms of this transaction, which seem to me to fail to properly value the New Power stock being contributed, were grossly unfair to Enron.

2/7/02 Congressional Testimony.



This collapse converted Enron's gain on its New Power equity holdings into a huge loss early in 01 – a loss of about $250 million – which was concealed. ¶42.

G. Hidden/Disguised Loans

Another tactic utilized by Enron and its banks to falsify Enron's financial condition and hide debt involved manipulative and deceptive transactions with J.P. Morgan, CitiGroup and CS First Boston. J.P. Morgan used an entity it controlled known as "Mahonia," located in the Channel Islands off England. J.P. Morgan and Enron utilized a scheme which J.P. Morgan had utilized before with a commodities trader from Sumitomo, by which large bank loans were disguised as commodity trades. In fact, offsetting trades were arranged with the ultimate cost differential being in favor of the bank, representing the interest rate on the disguised loan. By utilizing this manipulative and deceptive device, J.P. Morgan and Enron falsified Enron's financial condition, concealing some $4 billion in debt. ¶44.[11]

CitiGroup and CS First Boston engaged in similar subterfuges to disguise large loans to Enron. CitiGroup lent Enron $2.4 billion via "pre-paid" swaps – the so-called "Delta" transactions – conducted through CitiGroup's Cayman Island subsidiary. These swap transactions perfectly replicated loans and were, in fact, loans – but Enron never reported them as such on its balance sheet. CS First Boston also engaged in making disguised loans to Enron. CS First Boston gave Enron $150 million to be repaid over two years, with Enron's payments to vary with the price of oil. The transaction was made to appear to be a "swap," but was, in fact, a loan – a reality admitted by the bank: "***It was like a floating-rate loan***," said Pen Pendleton, a CS First Boston spokesman. "***We booked the transaction as a loan***." However, Enron did not show the loans on its balance sheet. ¶45.

By so doing, J.P. Morgan, CitiGroup and CS First Boston were able to ***secretly*** prop up Enron's deteriorating finances without disclosing that in fact Enron ***had borrowed between $4-$6 billion from those banks***. Also astonishing about the Mahonia and Delta transactions is the way J.P. Morgan and CitiGroup were "***paid off***" to engage in this subterfuge. Based on Enron's purported investment grade credit rating, Enron could have borrowed money from banks at 3.75%-4.25%. However, in the phony Mahonia and Delta transactions, ***Enron paid J.P. Morgan and CitiGroup between 6.5%-7.0% for the disguised loans – a huge difference from the cost of a legitimate bank loan – which made these disguised loans hugely profitable for J.P. Morgan and CitiGroup*** – in effect paying them off for participating in these bogus transactions. ¶46.

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11 Knowing Enron's true financial condition was precarious, J.P. Morgan attempted to insure against default on those disguised loans by buying performance bonds from several insurance companies. However, the insurers have refused to pay, alleging that in fact the commodity trades were fraudulent and a subterfuge to conceal the real nature of the transactions, *i.e.*, done for the purpose of disguising loans. ***A federal district court judge has ruled that there is significant evidence to support the insurers' claims of fraud and deception and that these transactions were, in fact, disguised loans***. ¶44.

H. Enron's Access to the Capital Markets

Enron required constant access to huge amounts of capital. For Enron to continue to appear to succeed it had to keep its investment grade credit rating and keep its stock price high. Enron's investment grade credit rating and high stock price could ***only*** be maintained by (i) limiting the amount of debt shown on Enron's balance sheet; (ii) reporting strong current period earnings; ***and*** (iii) forecasting strong future revenue and earnings growth. Yet Enron was able to achieve these ends only by pursuing an increasing number of phony transactions, many of which were accomplished by increasing the number and size of transaction entities which were supposedly independent of Enron but which, in fact, Enron controlled through a series of secret understandings and illicit financing arrangements, including the LJM2 partnerships. As a result of reporting strong earnings, the apparent success of its business and its future earnings growth forecasts, Enron had unlimited access to the capital markets, borrowing billions of dollars in the commercial paper markets and selling billions of dollars of Enron securities to the public. Enron raised at least $10 billion in new debt and equity capital from public investors through numerous securities offerings, thus raising the capital necessary to allow Enron to repay or pay down its short-term debt and continue to operate. ¶48.

I. Late 00/Early 01 Prop-Up

In late 00/early 01, Enron's financial results began to come under scrutiny from a few accounting sleuths and short-sellers, who began to question the quality of Enron's reported financial results. While Enron, the Insider Defendants and its bankers assured investors of the correctness of Enron's accounting and the high quality of Enron's reported earnings, the success and strength of its business and its solid prospects for continued strong profit growth, in part because of this increasing controversy, Enron's stock began to decline. As this price decline accelerated, it put pressure on Enron's top executives to do something – anything – to halt the decline in the price of the stock as they knew that if that price decline continued and the stock fell to lower levels, more and more of the Enron stock "triggers" contained in agreements for LJM2 SPE deals would be triggered, ***which would require Enron to issue over 100 million shares of its common stock to those partnerships, causing a huge reduction in Enron's shareholders' equity***. ¶52.

In late 3/01, inside Enron it appeared that Enron would be required to take a pre-tax charge against earnings of more than $500 million to reflect a shortfall in credit capacity of the LJM2-financed Raptor SPEs, which would have been catastrophic and exposed the scheme. Rather than take that loss and face these consequences, Enron "restructured" the LJM2-financed Raptor vehicles by transferring ***more than $800 million of contracts to receive Enron's own stock to them just before quarter-end, which permitted the participants in the scheme to conceal substantial losses in Enron's merchant investments, keep billions of dollars of debt off Enron's balance sheet and allow the Enron Ponzi scheme to continue***. ¶53.

During early 01, Enron continued to report record results and, along with the Insider Defendants, make very positive statements (¶54):

- Enron's strong results reflected breakout performance in all business units. Enron was a strong unified business. *See also* ¶¶281-283, 286, 293.
- WEOS had strong growth and a tremendous market franchise with significant sustainable competitive advantages. *See also* ¶¶282, 293, 332.
- EBS intermediation was great. Broadband glut and lowered prices ***would help Enron***. *See also* ¶¶281, 293-294, 317.
- VOD was successfully tested and launched. Proven technology created enormous opportunities. *See also* ¶¶281-282, 284, 316-317, 329.
- All of Enron's businesses were generating high levels of earnings. Fundamentals were improving. Enron was very optimistic. Enron was confident growth was sustainable for years to come. *See also* ¶¶282, 293, 317, 329, 332.

J. The Impending Collapse

By the Summer of 01, Enron realized that it would not be able to continue to sustain the illusion of strong profitable growth and that it would have to take large write-offs in the second half of 01 that, in turn, could result in a downgrade of Enron's critical investment grade credit rating – an event that they knew would mean that debt on the books of the SPEs Enron did business with (and partnerships controlled by them), which debt Enron had assured investors was "***non-recourse***" to Enron, would, in fact, become Enron's obligation. ¶55.

On 8/14/01, Enron announced that Skilling – who had become Enron's CEO just months earlier – was resigning, for "***personal reasons***." While this resignation fanned the controversy over the true nature of Enron's finances and the condition of Enron's business, Enron and the other defendants lied to investors, telling them that Skilling's resignation was only for personal reasons and did not raise "***any accounting or business issues of any kind***" and that Enron's financial condition "***had never been stronger***" and its "***future had never been brighter***." They said there was "***nothing to disclose***," Enron's "***numbers look good***," there were "***no problems***" or "***accounting issues***." According to them, the Enron "***machine was in top shape and continues to roll on – Enron's the best of the best***." ¶57.

K. The End

By 8/01, inside Enron management employees were complaining to Enron's Board that the fraud at Enron was so widespread it was out of control. In 8/01, two employees complained to the Board (¶59):

(a) One employee wrote:

> Skilling's abrupt departure will raise suspicions of accounting improprieties and valuation issues. Enron has been very aggressive in its accounting – most notably the Raptor transactions and the Condor vehicle. We do have valuation issues with our international assets and possibly some of our EES MTM positions.
>
> * * *
>
> We have recognized over $550 million of fair value gains on stock via our swaps with Raptor, much of that stock has declined significantly – Avici by 98%, from $178 mm to $5 mm. The New Power Co. by 70%, from $20/share to $6/share. The value in the swaps won't be there for Raptor, so once again Enron will issue stock to offset these losses. Raptor is an LJM entity. It sure looks to the layman on the street that we are hiding losses in a related company and will compensate that company with Enron stock in the future.
>
> ***I am incredibly nervous that we will implode in a wave of accounting scandals.... [T]he business world will consider the past successes as nothing but an elaborate accounting hoax***....
>
> ***[W]e booked the Condor and Raptor deals in 1999 and 2000, we enjoyed a wonderfully high stock price, many executives sold stock, we then try and reverse or fix the deals in 2001 and it's a bit like robbing the bank in one year and trying to pay it back 2 years later. Nice try, but investors were hurt, they bought at $70 and $80/share looking for $120/share and now they're at $38 or worse***. We are under too much scrutiny and there are probably one or two disgruntled "redeployed" employees who know enough about the "funny" accounting to get us in trouble.
>
> * * *
>
> I realize that we have had a lot of smart people looking at this .... ***None of that will protect Enron if these transactions are ever disclosed in the bright light of day***.
>
> * * *

I firmly believe that the probability of discovery significantly increased with Skilling's shocking departure. Too many people are looking for a smoking gun.

* * *

3. ***There is a veil of secrecy around LJM and Raptor. Employees question our accounting propriety consistently and constantly****....*

   a. Jeff McMahon was highly vexed over the inherent conflicts of LJM. ***He complained mightily to Jeff Skilling*** .... 3 days later, Skilling offered him the CEO spot at Enron Industrial Markets ....

   b. ***Cliff Baxter complained mightily to Skilling and all who would listen about the inappropriateness of our transactions with LJM***.

   c. I have heard one manager level employee ... say "***I know it would be devastating to all of us, but I wish we would get caught. We're such a crooked company." ... Many similar comments are made when you ask about these deals***.

(b) A second employee wrote:

One can only surmise that the removal of Jeff Skilling was an action taken by the board to correct the wrong doings of the various management teams at Enron. However ... I'm sure the board has only scratched the surface of the impending problems that plague Enron at the moment. (*i.e.*, EES's ... hiding losses/SEC violations ... lack of product, etc.).

* * *

[I]t became obvious that EES had been doing deals for 2 years and was losing money on almost all the deals they had booked. (JC Penney being a $60MM loss alone, then Safeway, Albertson's, GAP, etc.). Some customers threatened to sue if EES didn't close the deal with a loss (Simon Properties – $8MM loss day one).... Overnight the product offerings evaporated.... Starwood is also mad since EES has not invested the $45MM in equipment under the agreement.... Now you will loose [sic] at least $45MM on the deal.... You should also check on the Safeway contract, Albertson's, IBM and the California contracts that are being negotiated.... It will add up to over $500MM that EES is losing and trying to hide in Wholesale. Rumor on the 7th floor is that it is closer to $1 Billion....

This is when they decided to merge the EES risk group with Wholesale to hide the $500MM in losses that EES was experiencing. But somehow EES, to everyone's amazement, reported earnings for the 2nd quarter. According to FAS 131 – Statement of Financial Accounting Standards (SFAS) #131, "Disclosures about Segments of an Enterprise and related information," EES has knowingly misrepresented EES' earnings. This is common knowledge among all the EES employees, and is actually joked about....

There are numerous operational problems with all the accounts.

* * *

... Some would say the house of cards are falling....

> You are potentially facing Shareholder lawsuits, Employee lawsuits ... Heat from the Analysts and newspapers. The market has lost all confidence, and its obvious why.
>
> You, the board have a big task at hand. You have to decide the moral, or ethical things to do, to right the wrongs of your various management teams.
>
> * * *
>
> ... But all of the problems I have mentioned, they are very much common knowledge to hundreds of EES employees, past and present.

On 10/16/01, Enron shocked the markets with revelations of $1.0 billion in charges and a reduction of shareholders' equity by $1.2 billion. Within days, *The Wall Street Journal* began an exposé of the LJM SPEs, the SEC announced an investigation of Enron, and Fastow "resigned." In 11/01, Enron was ***forced to admit that Chewco had never satisfied the SPE accounting rules and – because JEDI's non-consolidation depended on Chewco's status – neither did JEDI, and Enron consolidated Chewco and JEDI retroactive to 97. This retroactive consolidation resulted in a massive reduction in Enron's reported net income and massive increase in its reported debt***. Enron then revealed that it was restating its 97, 98, 99 and 00 financial results to eliminate $600 million in previously reported profits and approximately $1.2 billion in shareholders' equity as detailed below (¶61):

ENRON ACCOUNTING RESTATEMENTS				
	1997	1998	1999	2000
Recurring Net Income Amount of Overstatement	$ 96,000,000	$113,000,000	$250,000,000	$ 132,000,000
Debt Amount of Understatement	$711,000,000	$561,000,000	$685,000,000	$ 628,000,000
Shareholders' Equity Amount of Overstatement	$313,000,000	$448,000,000	$833,000,000	$1,208,000,000

These partnerships – Chewco, LJM and LJM2 – ***were used by Enron and the other defendants to enter into transactions that Enron could not, or would not, do with unrelated commercial entities***. The significant transactions were designed ***to create phony profits or to improperly offset losses***. These transactions allowed Enron and its banks to conceal from the market

very large losses resulting from Enron's merchant investments by creating an appearance that those investments were hedged – that is, that a third party was obligated to pay Enron the amount of those losses, when in fact that third party was simply an entity in which only Enron had a substantial economic stake. The Raptors transactions with LJM2 alone resulted in Enron reporting earnings from the 3rdQ 00 through the 3rdQ 01 that were almost $1 billion higher than should have been reported! ¶62.[12]

Notwithstanding the write-offs and restatement revelations of 10/01-11/01, defendants believed that they could limit their legal exposure for participation in the scheme if they could sell Enron to another company. So, in 11/01, as the Enron scheme began to unravel, Enron tried desperately to arrange a salvation merger with Dynegy to avoid insolvency and the inevitable investigations and revelations that would follow. ¶64. However, Dynegy uncovered that the true financial condition of Enron was far worse than had been disclosed publicly and that Enron had been engaged in a wide-ranging falsification of its financial statements over the several prior years. Thus, Dynegy refused to acquire Enron. By 11/28/01, Enron's publicly traded debt had been downgraded to "junk" status. On 12/2/01, Enron filed for bankruptcy – ***the largest bankruptcy in history***. Enron stock and publicly traded debt securities have become virtually worthless, inflicting billions of dollars of damage on purchasers of those securities. ¶66.

As *Newsweek* has written (¶69):

> In the late 1990s, by my count, Enron lost about $2 billion on telecom capacity, $2 billion in water investments, $2 billion in a Brazilian utility and $1 billion on a controversial electricity plant in India. Enron's debt was soaring. If these harsh truths became obvious to outsiders, Enron's stock price would get clobbered – and a rising stock price was the company's be-all and end-all. Worse, what few people knew was that Enron had engaged in billions of dollars of off-balance-sheet deals that would come back to haunt the company if its stock price fell.

Newsweek, 1/21/02.

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[12] As huge as the 11/01 restatements of Enron's 97-00 financial statements were, they just scratched the surface of the true extent of the prior falsification of Enron's financial statements, failing to eliminate additional hundreds of millions of dollars of phony profits as Enron, the Insiders, Outside Directors, Andersen, Vinson & Elkins and Kirkland & Ellis and the banks were still trying to keep Enron afloat and trying to conceal how extensive the fraud had really been. ¶¶63, 422-423, 850-856.

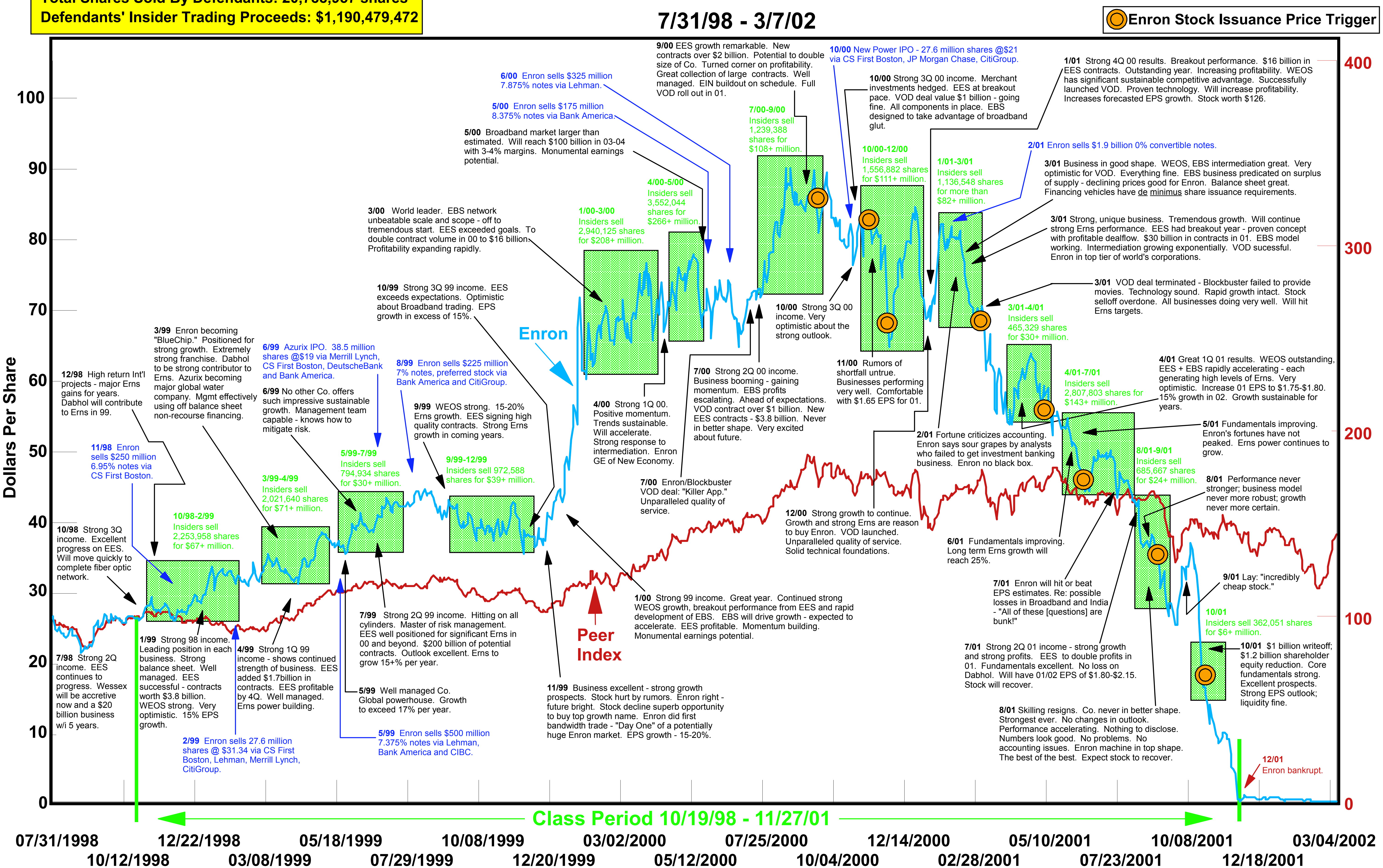
> ***The key to the Enron mess is that the company was allowed to give misleading financial information to the world for years***. Those fictional figures, showing nicely rising profits, enabled Enron to become the nation's seventh largest company, with $100 billion of annual revenues. Once accurate numbers started coming out in October, thanks to pressure from stockholders, lenders and the previously quiescent SEC, Enron was bankrupt in six weeks. The bottom line: we have to change the rules to make companies deathly afraid of producing dishonest numbers, and we have to make accountants mortally afraid of certifying them. Anything else is window dressing.

Newsweek, 1/28/02. The rise and demise of Enron is graphically displayed below:

Total Shares Sold By Defendants: 20,788,957 shares
Defendants' Insider Trading Proceeds: $1,190,479,472

Enron Timeline

7/31/98 - 3/7/02



L. The Enron Insiders Were Integral to the Fraudulent Scheme

This memorandum addresses the motions to dismiss filed by Enron Defendants Buy, Causey, Derrick, Fastow, Frevert, Hannon, Harrison, Hirko, Horton, Kean, Koenig, Lay, Mark-Jusbasche, McMahon, Olson, Pai, Rice, Skilling, Sutton, and Whalley – the "Insiders" – who were integral executives who created a company that vastly overstated its profits and hid enormous, crushing debts and contingent liabilities through accounting manipulations.[13] They extolled Enron's businesses and operations' success, which, in reality, they knew could not match in actual performance what Enron promised the market.

The CC details widespread, systemic deceit crossing international boundaries, permeating all of Enron's business lines and every aspect of its public financial reporting. Enron Insiders lied about revenues, borrowed money from banks and counted it as income and profits, traded assets with fictitious trading partners, and engaged in transactions with related companies that Enron controlled and counted them as profits, as they did from gains in Enron's own stock price, and claimed to have hedged against market risks where no real hedges existed.

Consequently, they knew that Enron was a hall of mirrors inside a house of cards. It reported hundreds of millions of phony profits each year, and concealed billions of dollars of debt that should have been on its balance sheet, thus falsely inflating its shareholder equity by billions of dollars. Because most of Enron's reported profits were being generated by phony, non-arm's-length transactions and improper accounting tricks – primarily abusing mark-to-market accounting techniques to accelerate recognition of hundreds of millions of profits to current periods from transactions that only entitled it to receive cash over many future years (if ever) – Enron was cash starved. To continue reporting growing profits, the Insiders forced the company ***to accelerate the number and size of the phony transactions and improper accounting tricks Enron engaged in***,

[13] Plaintiffs have moved to dismiss all claims against Michael McConnell without prejudice. The various Insiders filed or joined in a total of 21 motions to dismiss. Numerous arguments in these motions overlap, repeat or incorporate arguments made by the other Insiders. For convenience, this brief responds to the individual and joint Insiders' briefs, referred to individually, *e.g.*, as Buy Brf. or Causey Brf.; Joint Brief of Officer Defendants ("Jt. Officer Brf."); and Certain Defendants' Joint Brief Relating to Enron's Disclosures ("Jt. Def. Discl. Brf.").

creating a vicious cycle that only further exacerbated Enron's need to obtain cash financing from these transactions.

To make matters worse, Enron capitalized entities it controlled – and did phony deals with them – using shares of its stock. Enron ***had agreed to issue millions of shares of its stock to these entities if its stock price declined below certain so-called "trigger prices***." The stock-issuance triggers and Enron's capitalization of SPEs made crucial that Enron's stock price continue to trade at high levels and that Enron maintain its investment-grade credit rating to keep defendants' scheme from unraveling.

Meanwhile, Enron's top executives convinced investors that they were brilliant traders and risk managers, and creators of new markets, trading commodities, and derivative instruments for the Internet Age. They worked with Wall Street's investment banks, stock analysts, select law firms and their auditors to perpetuate this lie. Enron turned into the largest Ponzi scheme in history – constantly raising money through collusion with Wall Street analysts, brokers and banks from public offerings of Enron's and its related entities' securities to sustain itself, while deceptively portraying Enron as achieving successful growth and profits.

Before the Enron house of cards collapsed, Insiders sold millions of dollars of their own stock and took home millions more in cash bonuses and other compensation. Enron's directors and officers enriched themselves and left their public investors ruined. The reasons for Enron's rise are simple: smart and shrewd officials overstated profits and hid debt while they reaped enormous personal profits – the CC explains its fall, charting complex business structures, a web of partnerships and offshore corporations designed to transform real-world debt into the appearance of profits, accounting abuse, overpriced loans parading as derivative trades, and more.

In sum, the CC cogently sets forth the convoluted transactions that Insiders helped structure, approved of, participated in, and hid from public view, what they failed to say and what they said about Enron's current business condition, and the reasons why their statements were false when made.

III. ARGUMENT

A. Plaintiffs Meet the Applicable Pleading Standard

"In the securities context, Rule 12(b) (6) dismissals are difficult to obtain because the cause of action deals primarily with fact-specific inquiries." *Haack v. Max Internet Communications, Inc.*, No. 3:00-CV-1662-G, 2002 U.S. Dist. LEXIS 5652, at *11 (N.D. Tex. Apr. 2, 2002) (citing *Basic Inc. v. Levinson*, 485 U.S. 224, 240 (1988)). And in this Court the standard is clear: a motion to dismiss must be denied unless it appears beyond doubt that the plaintiff can prove no set of facts which would entitle him to relief. *Landry's*, slip op. at 4 n.8. In ruling on a motion to dismiss, the Court must accept as true all well-pleaded allegations and construe them in the light most favorable to the plaintiffs. *Nathenson v. Zonagen Inc.*, 267 F.3d 400, 406 (5th Cir. 2001); *Landry's*, slip op. at 4 n.8.

This should hold true even if the court doubts that a plaintiff can prove its well-pleaded allegations. *Scheuer*, 416 U.S. at 236. "What Rule 12(b)(6) does not countenance are dismissals based on a judge's disbelief of a complaint's factual allegations." *Neitzke v. Williams*, 490 U.S. 319, 327 (1989). Finally, the Court should consider the allegations in their entirety, because it is improper to isolate "the circumstances alleged in Plaintiffs' amended complaint rather than to consider them in their totality." *STI Classic Fund v. Bollinger Indus.*, No. 3-96-CV-823-R, 1996 U.S. Dist. LEXIS 21553, at *5 (N.D. Tex. Oct. 25, 1996).

The Fifth Circuit has ruled that, in reviewing the sufficiency of a complaint, judicial notice may be taken of SEC filings, documents referred to or partially quoted in the complaint, and documents of public record "with the restriction that these documents may be considered only for the purpose of determining what statements they contain and not for proving the truth of their contents." *In re Sec. Litig. BMC Software, Inc.*, 183 F. Supp. 2d 860, 882 (S.D. Tex. 2001) (citing *Lovelace v. Software Spectrum*, 78 F.3d 1015, 1017-18 (5th Cir. 1996)). This Court has ruled: "Courts may routinely consider not just documents named in Plaintiffs' complaint, but even documents that, if not named, are 'pertinent,' 'central,' or 'integral' to [Plaintiffs'] claim.... The Fifth Circuit recognizes the incorporation-by-reference doctrine." *Id.* at 883; *Collmer v. U.S. Liquids, Inc. ("U.S. Liquids")*, No. H-99-2785, 2001 U.S. Dist. LEXIS 23518, at *4 (S.D. Tex. Jan. 23, 2001).

Consequently, documents that have recently become part of the public record, including congressional testimony and Enron-related documents furnished to Congress, are pertinent, central, or integral to plaintiffs' claim, and are incorporated in plaintiffs' oppositions. Indeed, in their motions, defendants relied upon (and annexed) a variety of news reports, and referred to and relied upon congressional testimony. Jt. Def. Discl. Brf. at 235-244 (citing *BMC Software*); Skilling Brf. at 10 n.10 and 14 n.21 (citing congressional testimony of Arthur Andersen CEO Berardino).

B. The Complaint Satisfies the Particularity Requirements of Rule 9(b) and the 95 Act

While it is undisputed that in pleading fraud the circumstances shall be stated with particularity, neither Fed. R. Civ. P. 9(b) nor this Circuit, under the 95 Act, requires the pleading of evidence – let alone conclusive proof – of defendants' fraudulent conduct. *ABC Arbitrage v. Tchuruk*, No. 01-40645, 2002 U.S. App. LEXIS 9112, at *49 (5th Cir. May 13, 2002) ("'even with the heightened pleading standard under Rule 9(b) and the Securities Reform Act we do not require the pleading of detailed evidentiary matter in securities litigation'").

Plaintiffs are required only to put the Insiders on notice of the claims sufficient to allow them to frame responsive pleadings by specifying the who, what, when, where and why of their alleged securities fraud. *Rubinstein*, 20 F.3d at 163; *Berger v. Compaq Computer Corp.*, No. H-98-1148, slip op. at 16 (S.D. Tex. Dec. 22 1999). "Since Rule 9(b) is to be read in conjunction with Rule 8's general notice pleading requirement that pleadings contain a 'short and plain statement of the claim,' it can be satisfied as long as the complaint contains information concerning the 'time, place, and nature of fraudulent behavior and defendant's relationship thereto.'" *In re Compaq Sec. Litig.*, 848 F. Supp. 1307, 1310 (S.D. Tex. 1993).

Similar to Rule 9(b), the 95 Act provides that a §10(b) complaint must "specify each statement alleged to have been misleading" and "the reason or reasons why the statement is misleading." 15 U.S.C. §78u-4(b)(1)(B). The Fifth Circuit stated: "We have held that, pursuant to Rule 9(b), 'articulating the elements of fraud with particularity requires a plaintiff to specify the statements contended to be fraudulent, identify the speaker, state when and where the statements were made, and explain why the statements were fraudulent,' which is, as we have stated in dicta, 'the same standard' required by the PSLRA under 15 U.S.C. §78u-4(b)(1)." *ABC Arbitrage*, 2002 U.S. App. LEXIS 9112, at *29-*30 (footnote omitted). Moreover, the 95 Act "was ***not*** enacted to raise the pleading burdens under Rule 9(b) and section 78u-4(b)(1) to such a level that facially valid claims, which are not brought for nuisance value or as leverage to obtain a favorable or inflated settlement, must be routinely dismissed on Rule 9(b) and 12(b) (6) motions." *Id.* at *44. Indeed, "'the plaintiffs need not allege "all" facts that may be "related" to their claims,'" since "'such a requirement is impossible at the pleading stage because, in nearly every securities fraud case, only the defendants know "all" the facts.'" *Id.*

Plaintiffs can satisfy the requirement to explain why a disputed statement was untrue or misleading when made by pointing to inconsistent contemporaneous statements or information made by or available to the defendants. *In re Triton Energy Ltd. Sec. Litig.*, No. 5:98-CV-256, 2001 U.S. Dist. LEXIS 5920, at *28-*29 (E.D. Tex. Mar. 30, 2001); *McNamara v. Bre-X Minerals, Ltd.*, 57 F. Supp. 2d 396, 404 (E.D. Tex. 1999); *Fecht v. Price Co.*, 70 F.3d 1078, 1083 (9th Cir. 1995). Thus, even under the 95 Act, at the pleading stage, "'allegations of specific problems undermining a defendant's optimistic claims suffice to explain ***how*** the claims are false.'" *Cooper v. Pickett*, 137 F.3d 616, 626 (9th Cir. 1998) (emphasis in original) (quoting *Fecht*, 70 F.3d at 1083).

And Rule 9(b) does ***not*** require plaintiffs to name their confidential sources, as defendants claim. *See* Jt. Def. Discl. Brf. at 130. The Fifth Circuit recently confirmed its agreement with the Second Circuit that "'plaintiffs who rely on confidential sources are not always required to name those sources, even when they make allegations on information and belief concerning false or misleading statements.'" *ABC Arbitrage*, 2002 U.S. App. LEXIS 9112, at *36. Moreover, in rejecting the Ninth Circuit's analysis, the Fifth Circuit's "reading of the PSLRA rejects any notion that confidential sources must be named as a general matter." *Id.* at *37.

Plaintiffs have satisfied the requirements of particularized pleading. The CC ***identifies each*** of the statements alleged to be materially false and misleading, ***specifies who*** made the statements, ***when and where*** they were made, and ***why*** they were false. Plaintiffs also set forth facts and circumstances establishing the falsity of the challenged statements. In response, the Insiders offer little more than false, generalized accusations that the CC is insufficiently specific. *See, e.g.,* Fastow Brf. at 3 (colorful generalized denunciations of the entire CC, *e.g.,* as "scapegoating").

Fifteen CC paragraphs cite specific misstatements of small groups of named Insiders, including Causey, Fastow, Frevert, Kean, Koenig, Lay, McMahon, Rice, Skilling, and Whalley, made during specified conference calls and meetings with analysts and investors.

Compl ¶	**Date and Forum**	**Named Enron Insiders Making Misstatements**
¶119	10/13/98 analyst conference call	4 – Causey, Fastow, Koenig, Skilling
¶145	4/13/99 analysts' call	4 – Causey, Koenig, Lay, Skilling
¶157	7/13/99 analyst call and 7/14-16/99 2Q analyst meetings in New York, Boston and Houston	4 – Causey, Koenig, Sutton, Skilling
¶179	10/12/99 conference call and 10/13/99 quarterly analyst conference in Houston	4 – Causey, Fastow, Koenig, Skilling
¶197	1/18/00 conference call and 1/20/99 analyst conference in Houston	4 – Causey, Fastow, Koenig, Skilling
¶224	4/12/00 conference call and 4/13/00 analyst meeting in Houston	5 – Causey, Fastow, Koenig, Lay, Skilling
¶263	10/17/00 conference call	5 – Causey, Fastow, Frevert, Koenig, Skilling
¶282	1/21/01 conference call and 1/25/01 annual investors' conference in Houston	5 – Causey, Fastow, Kean, Koenig, Skilling
¶309	3/23/01 analysts and investors conference call	5 – Causey, Fastow, Koenig, Rice, Skilling
¶317	4/17/01 analyst conference call and 4/18/01 analyst conference in New York	5 – Causey, Fastow, Koenig, Rice, Skilling
¶329	7/12/01 analysts and investors conference call and 7/25-27/01 analyst conferences in New York and Boston	5 – Causey, Fastow, Kean, Koenig, Skilling
¶343	8/14/01 analysts and investors' conference call	5 – Causey, Fastow, Kean, Lay, Skilling
¶366	10/16/01 analysts and investors' conference call	7 – Causey, Fastow, Frevert, Kean, Koenig, Lay, Wha
¶377	10/23/01 analysts and investors' conference call	3 – Causey, Fastow, Lay
¶388	11/14/01 analysts conference call	4 – Causey, Lay, McMahon, Whalley

For example, during the 10/13/98 conference call, Skilling, Koenig, Causey, and Fastow made misstatements about Enron's 3rdQ 98 results. ¶119. Defendants insist that plaintiffs must also specify which Insider made each specific statement during the call. *See* Skilling Brf. at 41; Causey Brf. at 3-4. Even the restrictive decision *In re Silicon Graphics Sec. Litig.*, 970 F. Supp. 746 (N.D.

Cal. 1997), held that Rule 9(b) was satisfied when the complaint identified the speakers at an analyst telephone conference as "'a dozen officers, including [seven named officers]'" and provided information regarding the time, location and content of the statements because this description put defendants on "sufficient notice" and enabled them to "identify which executives participated in the conference, gave presentations, and what those presentations covered." *Id.* at 764. Simply stated, allegations that do not specify which defendants made the statements during analyst conference calls are "sufficient to put the alleged speakers on notice of the statements attributed to them.... In any case, a high ranking company official cannot sit quietly at a conference with analysts, knowing that another official is making false statements and hope to escape liability for those statements. If nothing else, the former official is at fault for a material omission in failing to correct such statements." *In re SmarTalk Teleservices, Inc. Sec. Litig.*, 124 F. Supp. 2d 527, 543 (S.D. Ohio 2000).

In rejecting the same specificity argument that the insiders raise here, one district court ruled that the pleading requirements were met where plaintiffs identified specific dates, types of communications, audience, and involvement of individual defendants: "With such information to narrow their search, Defendants can easily identify which executives made which statements ... [e]ven *Silicon Graphics*, which endorsed the 'most stringent of pleading standards under the [Reform Act],' and dismissed most statements made for lack of particularity, found sufficient notice to defendants where press releases or conference calls were made by the company's 'executives.'" *Schlagel v. Learning Tree Int'l*, No. CV 98-6384 ABC (Ex), 1998 U.S. Dist. LEXIS 20306, at *15-*16 (C.D. Cal. Dec. 23, 1998). With respect to every statement in the CC, plaintiffs plead the who, what, where and why required to meet the Circuit's requirements for pleading particularity.

1. The Complaint Does Not Substantially Rely on Group Pleading

The Enron Insiders assert plaintiffs "substantially rely" on "group pleading in lieu of particularized allegations." Jt. Officer Brf. at 5. To the contrary, plaintiffs plead participation in specific fraudulent transactions and businesses, the ignoring of red flags, and specific misstatements that the Insiders made, participated in, or signed.

First, Causey, Fastow, Harrison, Lay, Mark-Jusbasche, McMahon, and Skilling all ***signed*** Enron's public filings containing misstatements. *See, e.g.*, ¶¶141, 164, 221, 292, 336, 1006. Consequently, as signers of public disclosures, they "made" statements within the meaning of 10(b), even if they did not participate in drafting them. "'[T]he affixing of a signature is not a mere formality, but rather signifies that the signer has read the document and attests to its accuracy.'" *Howard v. Everex Sys.*, 228 F.3d 1057, 1061 (9th Cir. 2000); *see also AUSA Life Ins. Co. v. Dwyer*, 928 F. Supp. 1239, 1256 (S.D.N.Y. 1996) ("alleged misrepresentations that the audit committee defendants actually made include statements made in ... Forms 10-K, which were signed by the audit committee defendants"). ***Second***, Causey, Fastow, Frevert, Kean, Koenig, Lay, McMahon, Rice, Skilling, and Whalley made, or participated in pertinent misstatements during conference calls, which does ***not*** constitute group pleading, and which is ***not*** subject to the written-statement group-pleading doctrine. *See BMC Software*, 183 F. Supp. 2d 860; *Schlagel*, 1998 U.S. Dist. LEXIS 20306, at *15-*16; *see also* ¶¶119, 145, 157, 179, 197, 224, 263, 282, 309, 317, 329, 343, 366, 377, 388.

Third, Insiders were involved in preparation of false statements as part of Enron's fraudulent scheme. For example, Derrick was Enron's General Counsel and was involved in drafting Enron's press releases, SEC filings and shareholder reports; and he reported to the Board and attended Board meetings, including the 10/11/99 meeting at which the Board waived Enron's conflict-of-interest policy, enabling Enron to engage in fraudulent transactions with the Fastow-controlled LJM partnerships.

Fourth, the group-pleading cases the Insiders rely on – *BMC Software*, *Coates*, and *Allison* – only held inapplicable the "traditional 'group pleading presumption'" that company statements in annual reports, press releases, and the like "may be presumed to be the collective work of ***those individuals with direct involvement in the everyday business*** of the company." *BMC Software*, 183 F. Supp. 2d at 913 n.50; *see also Coates v. Heartland Wireless Communications, Inc.*, 26 F. Supp. 2d 910, 915-16 (N.D. Tex. 1998); *Allison v. Brooktree Corp.*, 999 F. Supp. 1342, 1350-51 (S.D. Cal. 1998). In *Allison*, because the group-published doctrine was "grounded in reasonableness," particular non-signing defendants were dismissed with leave to amend for "additional allegations demonstrating the reasonableness of applying the presumption to" them. 999 F. Supp. at 1351. Thus, the conclusion that the 95 Act eliminated the group-pleading presumption is of no help to Insiders who actually ***made, signed or significantly participated*** in misleading statements or transactions.

2. Claims Against Lay Are Pleaded with Particularity

Defendant Lay was director of Enron and Chairman of the Board of Directors and was Chief Executive Officer from 86 until 01 and again from 8/01 through the end of the Class Period. ¶83(a). Lay also served on the Board's Executive Committee from 95-02. ¶86. The CC alleges that the Executive Committee met on a frequent basis to oversee and review Enron's business and could exercise all the powers of the Board. ¶85(c). Lay also served on the Management Committee from 97-00, a collection of Enron's top officers who met regularly (weekly or bi-weekly) to oversee and review Enron's business. ¶88. The Management Committee conducted the day-to-day business of Enron and was aware of and approved all significant business transactions of Enron, including each of the partnership/SPE deals specified throughout the CC. Further evidence of Lay's involvement in the fraudulent scheme was that he approved the creation of the LJM2 partnerships and the waiver of Enron's conflict-of-interest policies for Fastow in connection with LJM2. Powers Report at 19. Lay also authorized the Rhythms transaction and three of the Raptor vehicles. Powers Report at 19. Lay was also personally notified of the fraud by Enron executive Sherron Watkins in 8/01. ¶340. Hence, the CC sufficiently demonstrates that Lay had direct involvement in Enron's core business and day-to-day operations.

Lay's principal defense is that plaintiffs' claims are "indecipherable." Lay Brf. at 43-47. Plaintiffs have pleaded with the requisite specificity that Lay made a series of materially false and misleading statements and omissions, setting out when and where the statements were made, what was said, and why the statements were false when made.

a. Lay's Statements About EES

The CC details Lay's numerous statements extolling the profitability and value of contracts entered into by Enron. ¶¶118, 128, 144-145, 177, 215, 223-224, 246, 281 and 293. For example, on 3/31/00, Lay stated in Enron's 99 Report to Shareholders:

> In 1999 we proved that Enron's retail business works. We exceeded our goal by signing energy outsourcing contracts representing $8.5 billion in total contract value, more than double the $3.8 billion achieved in 1998. Enron Energy Services achieved positive earnings in the fourth quarter, and its profitability is expanding rapidly.
>
> Our persistence in the retail energy market has given us an unassailable competitive advantage.

¶215. Likewise, on 4/13/99, Lay, Skilling, Koenig, and Causey, during a conference call for analysts and investors, stated:

> A good quarter for EES. EES added $1.7 billion of retail contracts to its growing contract portfolio, including several large multi-location energy outsourcing agreements, compared to $800 million in the 1stQ of last year reflecting the very significant growth being realized in this business. EES was on track for at least $8 billion of new contracts during 99.

¶145.

The CC sets forth why these statements about EES's contracts and expanded profitability were false and misleading when made, and why Lay knew there was no reasonable basis to make them. He knew the value of EES contracts was not nearly as high as was being reported and knew EES was likely to never recover start-up costs and make a profit. ¶¶121(g), 155(f)-(g), 214(f)-(g), 300(f)-(g), 339(f)-(g). Lay knew his statements were false because EES was, in fact, losing hundreds of millions of dollars on many of its retail contracts because: (a) Enron induced customers to enter into EES contracts by promising them unrealistic savings and by charging them low prices that Enron knew would likely result in a loss; and (b) Enron spent millions of dollars in the short term to purchase more energy-efficient equipment, a significant portion of which costs Enron knew it was likely never to recover and certainly never to make a profit on. *Id.* Further, EES contracts were grossly overstated by the misuse and abuse of mark-to-market accounting to create huge current-period values on what were, in fact, highly speculative long-term contracts on which Enron was certain to lose money. *Id.*

b. Lay's Statements About EBS

Allegations about Lay's numerous statements proclaiming the number of Enron broadband-service transactions and the build-out of its network satisfy Rule 9(b). ¶¶212, 223-224, 246, 281, 293-294, 366. For example, in 3/01, Enron's 00 Report to Shareholders included a letter from Lay and Skilling stating: "We have created a new market for bandwidth intermediation with Enron Broadband Services. In 2000 we completed 321 transactions with 45 counterparties." ¶293; Enron's 00 Annual Report signed by Lay stated: "Enron Broadband Services made excellent progress executing its business plan in 2000. The build-out of Enron's 18,000-mile global fiber network is near completion, bandwidth intermediation transaction volume is growing exponentially .... Clearly, the Enron business model is working in the broadband market." ¶294. On 10/16/01, Lay, Frevert, Whalley, Koenig, Causey, Fastow, and Kean, during a conference call held for analysts, stated: "Enron continued to actively participate in the intermediation market. Although the overall market had contracted recently, Enron entered into 405 intermediation transactions during this quarter." ¶366.

The CC alleges these statements about the number of EBS's transactions and the network build-out were false and misleading when made because Lay knew that there was no reasonable basis for them. Lay knew that the number of EBS transactions was not nearly as high, and the progress of its network build-out was not nearly as complete, as was reported, and that EBS did not have currently, and would not have at any reasonable time in the foreseeable future, a functioning broadband network.

The CC further explains why Lay knew the value and success of EBS was not as he portrayed, including;

- The success of EBS was grossly overstated because the Enron Intelligent Network ("EIN") was plagued by serious and persistent technical difficulties, which prevented it from providing the type of high-speed and high quality transmission that was indispensable to any hope of commercial success. ¶¶214(h), 300(h), 339(h). These technical difficulties included the failure of InterAgent, the software that was the core of EIN and was required to measure data that flowed to Enron's pooling points. ¶¶214(i), 300(h), 339(h). The failure of InterAgent meant the failure of EIN and, consequently, the failure of EBS. ¶¶214(i), 300(h), 339(h).

- Enron inflated EBS revenues by engaging in dark-fiber transactions and recognizing significant revenue on these transactions when, in fact, they were artificial contrivances known as "dark-fiber swaps," which involved no real economic substance, but were simply a swap of Enron's dark-fiber capacity with some counterparty for its dark-fiber capacity. ¶¶214(j), 300(i), 339(i), 390. Further, Enron accounted for the revenue it received ***as current-period revenue*** while, at the same time, Enron was ***capitalizing*** the amounts it paid as an asset. ¶¶214(k), 300(j), 339(j). Thus, Enron avoided recognizing the expense of that purchase in the current period, and instead, amortized it over many, many years – a deliberate accounting manipulation where revenue and expense were mis-matched to inflate current-period results. ¶¶214(k), 300(j), 339(j), 390.

- Enron grossly overstated the number of customers or counterparties it was doing bandwidth trading with by counting as ongoing customers or trading partners entities that had done only a test or an experimental trade, and had not engaged in any ongoing bandwidth intermediation. ¶¶300(m), 339(m). Enron grossly overstated the number of trades being conducted to create the illusion of ever-increasing levels of activity, which it accomplished by splitting up what was, in fact, a single unified trade into five or 10 or even more separate trades. ¶¶300(m), 339(m).

- Enron abused and misused mark-to-market accounting with respect to its broadband trading activity, abusing this accounting method – together with false assumptions of ultimate value – to create much higher current-period revenue and bottom-line results than were reasonable and attainable had proper accounting techniques been used. ¶¶300(n), 339(n).

c. Lay's Statements About Video-on-Demand

The CC alleges Lay's numerous statements that overstated the nature and favorable impact of the Blockbuster VOD joint venture, as well as its success. ¶¶240-241, 281 and 293. For example, in a 7/19/00 Enron press release, Lay stated:

> Entertainment on-demand is perhaps the most visible example of the power of Enron's broadband applications. With Blockbuster's extensive customer base and content, and Enron's network delivery application and the capabilities of the distribution providers, we have put together the "killer app" for the entertainment industry.
>
> Under the agreement, Blockbuster will provide content for the entertainment service .... Enron will encode and stream the entertainment over its global broadband network infrastructure ... and provide an unparalleled quality of service.

¶240. And in 3/01, Enron's 00 Report to Shareholders included a letter from Lay and Skilling stating: "Enron also has developed a compelling commercial model to deliver premium content-on-demand services via the Enron Intelligent Network.... Full-length movies-on-demand service has already been successfully tested in four U.S. metropolitan markets." ¶293.

These statements about the nature and favorable impact of the Blockbuster VOD joint venture, as well as its success, were false and misleading when made because Lay knew there was no reasonable basis for them. The CC alleges that Lay knew Blockbuster did not have the legal right to electronically distribute movie content in cable-quality digital format and, due to technical problems with its broadband network, Enron could not transmit movies or other content with sufficient quality or speed to permit the VOD system to ever succeed. ¶¶300(o), 339(o). The CC sets forth additional reasons why Lay knew the value and success of the Blockbuster VOD joint venture was not as he portrayed. *Id.* For instance, EBS employees (in a position to know) knew from the day the deal was announced that the fledgling EIN could not then – and probably never would be able to – deliver VOD as represented by Enron. Further, the reality was that Hollywood studios would not give DSL-quality content to Blockbuster. Thus, Enron did not have one movie to offer, let alone DSL quality. *Id.*

Despite these substantial defects, Enron recognized a wholly unrealistic projection of revenue over the entire 20-year life of the Blockbuster VOD venture into current periods, offset it by unrealistically low expense estimates, and failed to take any proper reserve for uncertainty of outcome or collectability. ¶¶300(o), 339(o). Consequently, Enron secretly recognized over $11 million of profits in the 4thQ 00 and the 1stQ 01 – two-thirds of the earnings claimed by EBS in those two periods. *Id.*.

d. Lay's Statements About Wholesale Energy Services

The allegations about Lay's statements concerning the profitability of Enron's Wholesale Energy Operations and Services ("WEOS") satisfy the Rule 9(b) requirements. *See* ¶¶118, 128, 144-145, 196, 223-224, 262, 281, 293, 364, 368. For instance, in the 10/17/00 press release, Lay stated:

> "Enron delivered very strong earnings growth again this quarter, further demonstrating the leading market positions in each of our major businesses .... Our wholesale and retail energy businesses have achieved record-setting levels of physical deliveries, contract originations and profitability. We operate in some of the largest and fastest growing markets in the world and we are very optimistic about the continued strong outlook for our company." ¶262.

The CC explains how these statements were false and misleading when made. Indeed, there was no reasonable basis for these statements. The results of WEOS were manipulated and falsified to boost its profitability. ¶¶121(e), 155(e), 214(e), 300(e), 339(e). And the CC explains why Lay knew the success and profitability of WEOS was not as he portrayed. *Id.* For example, the CC alleges that Enron used phony or illusory hedging transactions with entities that were not independent of Enron, abused mark-to-market accounting by adopting unreasonable contract valuations and economic assumptions, and arbitrarily adjusted those values upward at quarter's end to boost the wholesale operation's profits for that period – a practice known inside Enron as "moving the curve." ¶¶121(e), 155(e), 214(e), 300(e), 339(e).

e. Lay's Statements About Wessex Water Company

The allegations about Lay's statements on the newly purchased Wessex Water Company satisfy the Rule 9(b) requirements. ¶¶114-115. For example, in a 7/24/98 Enron press release, Lay stated:

> The new company is expected to be accretive to Enron's financial results in the first full year of operations, and we intend to pursue a strategy such that the new water company will be accretive in the future.
>
> * * *
>
> Wessex will be the flagship of the new water company .... As such, Wessex will be the center of excellence for the new international water business ....

¶114. And in a 7/24/98 interview with *Bloomberg News*, Lay stated that he expected the water business to be of comparable size to Enron's multibillion dollar electricity and gas business within five years or so. ¶115.

The CC sufficiently sets forth how these statements were false and misleading. Lay knew Enron had grossly overpaid for Wessex Water and that the business would hurt, not help, Enron's earnings. ¶¶121(h), 155(n). Moreover, he had no reasonable basis for making such statements because of the extraordinarily high risk of the venture – Enron had created its worldwide water business without any adequate feasibility study or the creation of any detailed business plan. *Id.* And despite Lay's assertions of financial success, he knew Wessex Water was not going to be accretive to Enron, but in fact would result in a later writedown of the overvalued asset. *Id.*

f. Enron's Financial Statements Signed by Lay

The CC's allegations about Enron's misleading financial statements signed by Lay satisfy the Rule 9(b) requirements. ¶¶109, 118, 128, 141, 144, 156, 177, 196, 219-223, 246, 262, 281, 292, 295-299, 316, 328, 364. The CC alleges Enron's financial statements and results were false and misleading as they inflated revenues, earnings, assets, and equity, and concealed billions of dollars of debt that should have been shown on its balance sheet. ¶¶121(a), 155(a), 214(a), 300(a), 339(a). To overstate Enron's assets, shareholders' equity, revenues, net income, and earnings per share and to understate and present materially misleading financial statements, the CC alleges Lay and the other Enron defendants caused the Company to violate GAAP and SEC rules in several ways. ¶418. The CC then details specific facts supporting how Enron's earnings, revenues, assets, and equity were inflated, as well as how billions of dollars of debt were concealed. ¶¶418-611. For example, the CC specifies Enron's failure to consolidate subsidiaries and special purpose entities into its financial statements violated GAAP. ¶¶429-505. For Enron's accounting scheme to work, the parties involved in the SPEs and subsidiaries had to be controlled by Enron and this control and affiliation had to be concealed, in violation of SFAS No. 57. The CC further alleges Lay knew proper disclosure of Enron's related-party transactions would reveal Enron's scheme. ¶¶506-516. Enron also overstated earnings and understated debt by allowing its banks to bypass their normal credit analysis and regulatory reporting requirements, while obtaining a higher return on their capital. ¶¶650-651. And, Enron International improperly recognized revenue in connection with many of its long-term construction projects, by recognizing ten percent of the construction services contract value as revenue upon signing, and during 97 and 98, Enron improperly capitalizing rather than expensing, costs associated with unsuccessful bids. ¶¶575-582.

g. Enron's Registration Statements Signed by Lay

The CC's allegations regarding Enron's false and misleading registration statements, which were used to sell Enron's securities that were purchased during the Class Period, satisfy Rule 9(b) requirements. ¶¶110, 126, 134, 164, 336. Enron's registration statements incorporated by reference Enron's 10-K reports for the Class Period, and these financial statements understated Enron's debt by billions of dollars and overstated its earnings by hundreds of millions of dollars. ¶¶418-611, 613. The CC further specifies how each registration statement was false and misleading and the reasons why. ¶¶613-641.

h. Lay's Illegal Insider Sales

Beyond his making false statements and Lay's participating in the fraudulent scheme, Lay also traded illegally while in possession of the above undisclosed information. During the Class Period, Lay sold 4,002,259 shares of his Enron stock for $184,494,426. ¶83(a). Lay also transferred 1,456,421 shares of his Enron stock, valued at $76,305,838 to the Company to pay the exercise price of options he was exercising, plus related tax withholding, such that the vast majority of his insider trading proceeds went directly into his pocket. ¶83(a). In addition, Lay received bonus payments of $18.1 million, in addition to his salary, for 97, 98, 99 and 00 based on Enron's false financial reports. ¶83(a).

3. Claims Against Buy Are Pleaded with Particularity

Richard Buy was Executive Vice President and Chief Risk Officer since 6/99, Senior Vice President and Chief Risk Officer from 3/99 to 7/99, and a management director and Chief Risk Officer of a division from 1/98 to 3/99. ¶83(i). In 98-99 he served on Enron's Management Committee, a collection of top officers who met regularly to oversee and review Enron's business, by which they approved all significant business transactions, including each of the Fastow-controlled partnership/SPE deals. ¶88. Buy was present at Board meetings when Enron's business condition and SPE transactions were reviewed and approved. The Board also charged Buy with a substantial role in the oversight of Enron's relationship with Fastow's LJM partnerships, which included regular updates from Fastow's global-finance group, plus the legal and accounting departments. Powers Report at 22. Consequently, he was intimately involved in Enron's core businesses and knew of and participated in the fraudulent scheme alleged by plaintiffs.

Buy's personal involvement in the scheme includes his review and approval of all Fastow-controlled LJM transactions. For example, he was advised by the head of Enron's Research Group, which handled sophisticated option pricing and modeling issues, that the Rhythms NetConnection put-option strategy was questionable: (1) it was an obvious conflict of interest due to Fastow's involvement in LJM1; (2) the payout was skewed against Enron because LJM1 would receive its benefit much earlier in the transaction; and (3) the structure was unstable from a credit- capacity standpoint because the SPE was capitalized largely with Enron's stock. Powers Report at 84-85.

Additional evidence of Buy's participation in the fraudulent scheme was Buy's approval of Raptor I, as evidenced by an "LJM2 Approval Sheet" that he signed and an Enron Deal Summary, both of which were executed ***long after*** the Raptor I deal had closed. Powers Report at 105. The Approval Sheet reported that Fastow-protege Michael Kopper – an Enron managing director – negotiated on behalf of LJM2. *Id.* Buy also attended the 8/7/00 Finance Committee meeting when the Raptor IV transaction was presented to and approved by the Board. Powers Report at 113 n. 54. He knew, but failed to inform the Board at the 2/01 review, that the Raptor vehicles then owed Enron approximately $175 million more than they had the capacity to pay. Powers Report at 160. He knew that this figure grew to approximately $500 million one month later and would have resulted in a charge against Enron's earnings in that quarter if not addressed. *Id.* In response, Buy and others restructured the Raptor vehicles on 3/26/01, and transferred approximately $800 million of Enron's stock contracts to avoid a charge to earnings. Powers Report at 160.

Beyond his participation in the fraudulent scheme, Buy also traded illegally on inside information. During the Class Period, Buy sold 140,234 shares of his Enron stock, pocketing $10,656,595 in illegal insider trading proceeds. ¶83(i). Buy also received bonus payments of over $1.6 million in addition to his salary for 97, 98, 99 and 00 based on Enron's false financial reports. Given his position and day-to-day operational duties, it is inconceivable that he was not aware of the sophisticated, complex, massive fraud being perpetrated by the Enron Defendants. Indeed, Enron executive Sherron Watkins believed him to know about the fraud. Her 8/01 letter – a smoking gun – specifically notes that Buy could corroborate her allegations: "Persons to quiz confidentially to determine if I'm all wet: a. Jeff McMahon, b. Mark Koenig, c. Rick Buy, d. Greg Whalley." Because the letter has proven accurate in all other material respects, it is reasonable to believe that she was accurate in her evaluation of Buy's knowledge.

4. Claims Against Causey Are Pleaded with Particularity

Richard Causey was Executive Vice President and Chief Accounting Officer and served on the Management Committee, from 97-00, where members approved all significant business transactions, including the Fastow-controlled partnership/SPE deals specified. ¶¶83(d), 88. Causey presided over and participated in a series of fraudulent accounting judgments that contributed to Enron's false and misleading financial statements. Powers Report at 21. He was also present at Board meetings when Enron's business and SPE transactions were discussed and approved. *See* Exs. 23, 24 and 25.[14]

14 Unless otherwise noted, all Exhibits are to plaintiffs' Appendix.

The Board charged Causey with a substantial role in the oversight of Enron's relationship with the LJM partnerships, which included regular updates from Fastow's global-finance group, plus the legal and accounting divisions. Powers Report at 10. Causey was also charged with annually reviewing all LJM partnership transactions with the Audit and Compliance Committees. Powers Report at 22. His involvement with Fastow's LJM partnerships included:

- Signing an agreement for the use of Enron employees by LJM1 and LJM2, who continued to be regular, full-time Enron employees for benefits purposes, but the LJM partnerships paid their bonuses and, in some cases, their base salary. Powers Report at 74-75.

- Causey was responsible for implementing the termination of the Rhythms hedge position. Powers Report at 87-88.

- He was responsible for determining whether Fastow's proposal that an LJM subsidiary receive $30 million from Enron in connection with a particular transaction was fair to Enron. Powers Report at 88. Causey executed a letter agreement on behalf of Enron with the subsidiary, setting out the terms of the transaction, which resulted in a huge windfall to the subsidiary and LJM1. Powers Report at 89.

- On behalf of Enron he settled an option with Talon, an LJM SPE, which was unusual because (1) it was a bet that Enron's stock price would decline substantially; and (2) Talon was not creditworthy. Powers Report at 103-04.

- Causey was involved in Enron's management's approval of Raptor I, as evidenced by the "LJM2 Approval Sheet" he signed and the Enron Deal Summary. He presented Raptor I to the Finance Committee on 5/1/00. Powers Report at 105-06.

- He signed all of the documentation for the derivative transactions between Enron and Talon, involving the document waiving the restriction placed on Talon concerning the selling of Enron stock for a three-year period by entering into a "costless collar" on the approximately 7.6-million Enron shares and stock contracts in Talon. Powers Report at 108, 110-11.

- Causey participated in the 8/7/00 presentation of Raptor IV to the Finance Committee, but he did not sign the LJM2 Approval Sheet for Raptor IV until six months later in 3/01. Powers Report at 112-13.

- He approved Enron's entering into "costless collars" on the Enron stock contracts in the Timberwolf and Bobcat SPE vehicles to provide credit-capacity support to the Raptors. These collars lifted the restrictions that were originally placed on Timberwolf and Bobcat in return for the discounted stock contracts. Powers Report at 113-14.

- Causey met with Lay and others in 9/01 to discuss problems with the Raptors. Powers Report at 127.

- He was advised that Fastow was intervening in the EBS team's attempt to get the best deal possible for Enron in connection with LJM2's purchase of unactivated "dark" fiber from Enron. As a result, Causey accommodated Fastow by sweetening EBS's original offer to LJM2. Powers Report at 144.

- Causey knew, but failed to inform the Board, that the Raptor vehicles owed Enron approximately $175 million more than they had the capacity to pay in 2/01. He also knew, but again failed to advise the Board, that this total grew to $500 million just one month later and would have resulted in a charge against Enron's earnings in that quarter if not addressed. As a result, Causey restructured the Raptor vehicles on 3/26/01, and transferred approximately $800 million of Enron stock contracts to avoid a charge to earnings. Powers Report at 160-61.
- He reported to the Board that the LJM Partnership transactions were arm's-length and that "the process was working effectively." Powers Report at 162. But he knew that was not the case.

Moreover, Causey signed or reviewed various Enron public filings, including (1) Enron's registration statement filed with the SEC on 1/12/99 for $1 billion in Enron securities, which incorporated its misleading 97 10-K; and (2) Enron's registration statement filed with the SEC on 2/3/99, which included a "Recent Developments" section and reported false and misleading financial results for 1998. ¶¶126, 134. He also signed Enron's 98 10-K, which was filed with the SEC in 3/99 and contained misleading 97 and 98 annual financial statements. ¶141. And Causey reviewed and approved Enron's 98 Annual Report, issued in 3/99, which contained false and misleading statements about, among other things, Enron Energy Services and Wessex Water. ¶¶136-140. Thus, the CC sufficiently alleges that Causey was intimately involved in Enron's core businesses and knew of the fraudulent scheme alleged by plaintiffs.

Beyond his participation in the fraudulent scheme, Causey also traded illegally on inside information – pocketing over $13 million. ¶83(d). Causey also received bonuses of over $1.5 million in addition to his compensation in 97, 98, 99 and 00, based on Enron's false financial reports. ¶83(d). Charged with the responsibility of overseeing all transactions between Enron and the LJM partnerships, and intimately involved with the day-to-day financial operations of Enron's various businesses, it is inconceivable that he was not aware of the massive, sophisticated fraud being perpetrated.

5. Claims Against Derrick Are Pleaded with Particularity

James Derrick was Executive Vice President and General Counsel of Enron since 7/99, and before that Senior Vice President and General Counsel. ¶83(e). He served on the Management Committee from 97 to 00 and on the Executive Committee in 99. The Management Committee approved all significant business transactions, including the Fastow-controlled partnership/SPE deals. ¶88. During the Class Period, while in possession of material, adverse, undisclosed information, Derrick sold 230,660 shares of his Enron stock for $12.5 million in illegal insider-trading proceeds, and received bonus payments of over $1.2 million, in addition to his salary based on Enron's false financial reports and because Enron's stock price hit certain performance targets. ¶83(e).

Derrick also served as an officer or director of New Power, an Enron-related company. Transactions involving New Power, including its IPO, by which Enron improperly recognized $370 million in profits in 4thQ 00, are detailed in the CC. ¶¶42, 83(hh), 488. As a top corporate insider in both Enron and New Power, Derrick was particularly aware of the fraudulent business transactions occurring between the two companies.

Derrick was also intimately involved in hiring Vinson & Elkins ("V&E"), his former law firm, to look into the allegations of Sherron Watkins. Derrick received a copy of the 8/01 letter and he and Lay agreed that Enron should retain a purportedly independent, outside law firm to conduct an investigation. Powers Report at 173. Incredibly, despite V&E's obvious conflict of interest, Derrick told the Powers Committee that V&E was the logical choice. In the end, V&E partners reported their findings to him personally in a letter dated 10/15/01. *Id*.

Derrick also helped V&E prepare Enron's deceptive related-party transactions disclosures and he gave substantial advice and reviewed disclosures made in Enron's financial statements. *Id*. at 183.

The decision not to disclose the substance of these transactions – although Derrick knew the truth – was a conscious decision of V&E, Fastow, in-house counsel Jordan Mintz, Derrick, and others at Enron, and was discussed in a memo written by Mintz. ¶848.

Board minutes also show Derrick was present at a number of critical meetings, including 10/11-12/99, when the board approved Chewco. *See* Exs. 21, 24, 25, 26. He also reported to the board on legal matters disclosed in Enron's financial statements. *See* Ex. 28.

Derrick also traded illegally while in possession of the above undisclosed information. During the Class Period, Derrick sold 230,660 shares of his Enron stock for $12,563,928. ¶83(e). Derrick also received bonus payments of over $1.2 million, in addition to his salary, for 97, 98, 99 and 00 based on Enron's false financial reports. ¶83(e). Intimately involved in the day-to-day operations of Enron, it is inconceivable that Derrick was not aware of the massive, sophisticated fraud being perpetrated.

6. Claims Against Fastow Are Pleaded with Particularity

Andrew Fastow, CFO until he was fired in 10/01, was intimately involved with the financial structures, SPE vehicles, and complex, sophisticated transactions that propped up Enron's bottom line and hid millions of debt. He was involved on both sides of related-party transactions. Powers Report at 18. ¶¶83(c), 88. Fastow created the SPEs to enter into transactions with Enron, which no independent entity would ever have entered into, to inflate Enron's financial results and enrich himself. ¶¶4, 7, 17, 23.

The CC particularizes Fastow's involvement in the fraudulent scheme:

- Fastow orchestrated the formation of Chewco in late-97, making it possible for Enron to continue to transact business with JEDI and artificially inflate its reported results. ¶10.

- He knew that Enron's credit rating was critical to the scheme because, if it was downgraded below investment grade, the debt of the SPEs and partnerships that Enron transacted with would become recourse to Enron. ¶19.

- Fastow controlled the LJM partnerships and engaged in a series of transactions between Enron and the partnerships, which resulted in Enron inflating its reported financial results by more than $1 billion, while at the same time enriching Fastow by tens of millions of dollars. ¶23.

- Fastow created LJM2, one of the primary devices used to falsify Enron's financial results during the Class Period, which was used after 10/99 to create numerous SPEs (including the Raptors) that Enron used to engage in transactions to artificially inflate its profits while concealing millions of dollars of debt that should have been included on Enron's balance sheet. ¶24.

- Fastow served as an officer, director or managing agent of Atlantic Water Trust and Egret, which were SPE vehicles utilized by the Enron Defendants to further facilitate the fraudulent scheme and course of business. ¶83(ii).

- On 10/16/01 Enron announced a $544-million after-tax charge against earnings related to transactions with Fastow's LJM2, and Enron was forced to restate its 97-01 financial statements because of accounting errors relating to transactions with different Fastow partnerships. Powers Report at 2.

- Fastow was enriched by $30 million as a result of his LJM partnerships. Powers Report at 3-4.

- He negotiated a termination of the Rhythms hedge in 00 that was extraordinarily generous to LJM1 and its investors, including Fastow. Powers Report at 16.

- Enron's disclosures of its transactions with the LJM partnerships were obtuse, did not communicate the essence of the transactions completely or clearly, and failed to convey the substance of what was going on between Enron and Fastow's partnerships. The process by which the relevant disclosures were crafted was influenced substantially by Fastow's Global Finance group. Powers Report at 17.

- Fastow violated and caused violations of Enron's Code of Conduct by purchasing and offering to select Enron employees extraordinarily lucrative interests in his Southampton Place partnership. Powers Report at 18-19.

- He was involved in negotiating the buy-out price for Chewco's interest in JEDI during 1stQ 00, which resulted in a $10.5-million return to Chewco's investors and a questionable cash payment to Chewco by Enron of $2.6 million. Powers Report at 61-62.

- Fastow signed an agreement on behalf of LJM for the use of Enron employees by LJM1 and LJM2; the employees continued to be regular, full-time Enron employees for benefits purposes, but the LJM partnerships paid their bonuses and, in some cases, their base salary. Powers Report at 74-75.

- Fastow, negotiating for his limited partners, was involved in the Rhythms unwind transaction and he proposed that Swap Sub, an LJM entity in the Rhythms transaction, receive $30 million from Enron. Powers Report at 88.

- Fastow was involved with the negotiations involving the Talon (a Raptor SPE) hedging transactions, which resulted in large benefits to LJM2 to the detriment of Enron. Fastow, on behalf of Talon and LJM2, and Causey, for Enron, settled an option with Enron in 8/00, which was unusual because: (1) the option was a bet that Enron's stock price would decline substantially; and (2) Talon was not creditworthy. Powers Report at 103-04.

- He was involved in Enron management's or the Board's approval of Raptor I, as evidenced by the Deal Summary Sheet attached to the "LJM2 Approval Sheet," signed by Fastow's Global Finance group. Powers Report at 105.

- Fastow's associate, Ben Glisan, presented Raptor I to the Finance Committee, with Lay, Skilling and Fastow in attendance. Powers Report at 105-06.

- All of the documentation for the derivative transactions between Enron and Talon was signed by Fastow for the LJM SPE and he proposed and presented additional Raptor vehicles to the Finance Committee on 8/7/00. Powers Report at 108, 111-13.

- Fastow was involved in LJM2's purchase of the Yosemite certificates in late-99. Powers Report at 142.

- He complained about and intervened with the EBS team's attempt to get the best deal for Enron in connection with LJM2's purchase of a portion of its unactivated "dark" fiber. Powers Report at 144.

In addition to Fastow's direct involvement in the fraudulent scheme, the CC sets forth statements made by him on 10/13/98, 10/12/99, 4/13/00, 7/24/00, 10/17/00, 1/21/01, 3/23/01, 4/18/01, 7/25-27/01 and 8/14/01 that were false and misleading because these statements misrepresented Enron's financial position and falsely emphasized the success of its business. ¶¶119, 179, 224, 247, 263, 282, 309, 317, 329, 343. Fastow also signed numerous documents filed with the SEC. *See* ¶¶109, 110, 126, 134, 141, 292, 336.

The allegations about Enron's misleading financial statements and registration statements, which were signed by CFO Fastow, satisfy the requirements of Rule 9(b). The financial statements and results were false and misleading because they inflated Enron's revenues, earnings, assets, and equity, and concealed billions of dollars of debt that should have been shown on its balance sheet. ¶¶121(a), 155(a), 214(a), 300(a) and 339(a). And to overstate Enron's assets, shareholders' equity, revenues, net income, and earnings per share, and to understate debt and present materially misleading financial statements during the Class Period, the CC alleges that Fastow, the head of Enron's global-finance group, and the other Enron Defendants, caused the Company to violate GAAP and SEC rules in specific and substantial ways. ¶418.

The CC details specific facts supporting how and why Enron's earnings, revenues, assets, and equity were inflated, as well as how billions of dollars of debt were concealed. ¶¶418-611. For example, the CC specifies that Enron's failure to consolidate subsidiaries and special-purpose entities into its financial statements violated GAAP. ¶¶429-505. For Enron's accounting scheme to work, Fastow and the parties involved in his SPEs and subsidiaries had to be controlled by Enron and this control and affiliation had to be concealed, in violation of FASB No. 57. ¶¶507, 510, 958. And Fastow knew that disclosure of the true nature of these transactions would reveal defendants' scheme to hide Enron's massive debt. ¶¶505-516.

Beyond making false statements and his participation in the fraudulent scheme, Fastow also traded illegally while in possession of the above undisclosed information. During the Class Period, Fastow sold 687,445 shares of his Enron stock for $33,675,004. ¶83(c). Fastow also received bonus payments of over $3 million, in addition to his salary, for 97, 98, 99 and 00 based on Enron's false financial reports. ¶83(c). Fastow also pocketed millions of dollars (over $30 million) of ill-gotten gains via the partnership and SPE transactions detailed throughout the CC. ¶83(c). Fastow was intimately involved in the day-to-day operations of Enron and it is inconceivable that he was not aware of the massive, sophisticated fraudulent scheme.

7. Claims Against Frevert Are Pleaded with Particularity

Mark Frevert was Chairman and CEO of Enron's Wholesale Services since 6/00, and Chairman and CEO of Enron Europe from 3/97 to 6/00. ¶83(f). From 97 to 00 he was a member of the Management Committee, which approved all significant business transactions, including the Fastow-controlled partnership/SPE deals. ¶88. The Management Committee conducted the day-to-day business of Enron and was aware of and approved all significant business transactions of Enron, including each of the partnership/SPE deals specified throughout the CC. ¶88. Frevert also made false and misleading statements regarding Enron's financial position and business success in conference calls held on 10/17/00 and 10/16/01. ¶¶263, 366.

Beyond his participation in the fraudulent scheme, Frevert also traded illegally while knowing of Enron's fraudulent scheme. During the Class Period, Frevert sold 986,898 shares of his Enron stock for $54,831,220. ¶83(f). Frevert also transferred 81,104 shares of his Enron stock valued at $5,570,831 to Enron to pay the exercise price of options he was exercising plus related tax withholding, such that much of his insider trading proceeds went directly into his pocket. ¶83(f). Frevert also received bonus payments of over $5.3 million, in addition to his salary, for 97, 98, 99 and 00 based on Enron's false financial reports. ¶83(f). Frevert was intimately involved in the day-to-day operations of Enron and it is inconceivable that he was not aware of the massive, sophisticated fraud being perpetrated.

8. Claims Against Hannon Are Pleaded with Particularity

Kevin Hannon was Operating Officer of EBS until his resignation in 8/01, and previously president of Enron's trading and commodities business. He served in 97-00 on the Management Committee, which approved all significant Enron business transactions, including the Fastow-controlled partnership/SPE deals specified. ¶¶83(t), 88. Beyond his participation in the fraudulent scheme, during the Class Period, while in possession of adverse, material, undisclosed information, Hannon sold his Enron stock for millions in illegal insider-trading proceeds, plus call options before 5/1/01 by which he would profit so long as Enron's stock price dropped below $70 per share by 1/19/02. ¶83(t).

The CC sufficiently set forth that Hannon knew of the false statements being issued about EBS. Hannon was intimately involved with EBS and knew of its inherent failure. For example, the CC alleges that a coup attempt by several executives who reported to Hannon took place in spring 01. ¶339(j)(iii). They wanted Hannon and EBS CEO Rice removed, because EBS was clearly failing under his supervision. They informed Skilling that EBS was in extremely dire straits – there was "no way to win," EBS "had no income," and the "cash-burn rate was too high" – and they showed Skilling ***actual*** EBS performance numbers. *Id.* Hannon knew the EBS Unit was a terrible failure, which was not disclosed to the public.

9. Claims Against Harrison Are Pleaded with Particularity

Ken Harrison was Chief Executive Officer of Portland General Electric, an Enron subsidiary until 3/31/00, he served on Enron's Management Committee from 97 to 99, and on the Board from 98 through 00. ¶83(l). Harrison made false and misleading statements to the market when he signed Enron's Form 10-Ks and registration statements filed with the SEC in 3/98, 4/98, 1/99, 2/99, 3/99, 7/99, and 3/01, ¶¶109-110, 126, 134, 141, 164, 292, which included false financial statements, ¶¶215-221, and materially false disclosures about Enron's related-party transactions which he knew to be false because he had personally approved waiving Enron's conflict-of-interest policy to allow CFO Fastow to control LJM2.

According to documents released by Congress, Harrison attended a crucial meeting in 10/99, at which the Board approved the creation of LJM2 and waived Enron's conflict-of-interest policies for Fastow in connection with LJM2. *See* Ex. 24. The Board passed a resolution authorizing the creation of a partnership (subsequently determined to be LJM2) to be managed by Fastow, which would serve as "a potential ready purchaser of the Company's businesses and assets or as a potential contract counterparty [that] could provide [Enron with] liquidity, risk management, and other financial benefits." *Id.* at 18. Harrison approved the resolution authorizing the partnership and waiving Enron's conflict-of-interest policy for Fastow. *Id.* Knowing Fastow controlled LJM2, Harrison still signed and endorsed Enron's false Form 10-Ks and registration statements.

Harrison was also present at the 5/1/00 Finance Committee meeting, when Fastow reported on LJM2 and McMahon presented a liquidity report and discussed Enron's guarantee portfolio –

which included its guarantees to the Raptors – and Enron's need for additional borrowing capacity. Ex. 26. Harrison had intimate knowledge of Enron's guarantees to the various SPEs referred to in the Complaint and the significance of those guarantees to Enron's financial condition. Thus, he had specific knowledge that its financial statements were false and misleading because they inflated Enron's revenues, earnings, assets, and equity, and concealed billions of dollars of debt that should have been shown on its balance sheet. ¶¶121(a), 155(a), 214(a), 300(a), 339(a), 418-611. For example, the CC specifies that Enron's failure to consolidate subsidiaries and special-purpose entities into its financial statements violated GAAP. ¶¶429-505. For Enron's accounting scheme to work, the SPEs and subsidiaries had to be controlled by Enron and this control and affiliation had to be concealed, in violation of SFAS No. 57. ¶¶507, 510, 958. Harrison knew that accurate disclosure of these related-party transactions would disclose their scheme to hide Enron's massive debt that it was keeping off its books. ¶¶505-516.

Beyond his participation in the fraudulent scheme, Harrison also traded illegally while in possession of the above undisclosed information. During the Class Period, Harrison sold 1,001,436 shares of his Enron stock for $75,416,636. ¶83(l). Harrison was intimately involved in the day-to-day operations of Enron and it is inconceivable that he was not aware of the massive, sophisticated fraud being perpetrated.

10. Claims Against Hirko Are Pleaded with Particularity

Joseph Hirko was Chief Executive Officer of EBS and in 97-00 he served on Enron's Management Committee, which was a collection of Enron's top officers who met regularly (weekly or bi-weekly) to oversee and review Enron's business. ¶88. The Management Committee conducted the day-to-day business of Enron and was aware of and approved all significant business transactions of the Company, including each of the partnership/SPE deals specified throughout the CC. ¶88. Beyond his participation in the fraudulent scheme, during the Class Period, while in possession of material, adverse, undisclosed information about the Company, he sold 473,837 shares of Enron stock for $35 million in illegal insider-trading proceeds. ¶83(k). Hirko was intimately involved in the day-to-day operations of EBS and it is inconceivable that he was not aware of the massive, sophisticated fraud being perpetrated.

11. Claims Against Horton Are Pleaded with Particularity

Stan Horton was Chairman and CEO of Enron Transportation Services. ¶83(g). From 97-00 he was a member of the Management Committee, a collection of top executives who approved all significant business transactions, including the Fastow-controlled partnership/SPE deals specified. ¶88. Beyond his participation in the fraudulent scheme, during the Class Period, while in possession of adverse, material, undisclosed information about the Company, Horton sold 830,444 shares of his Enron stock for $47.3 million in illegal insider-trading proceeds, and transferred 10,147 shares valued at $722,565 to the Company to pay the exercise price of options he was exercising plus related tax withholding, such that the vast majority of his insider-trading proceeds went directly into his pocket. ¶83(g). Horton also received bonus payments of over $3.1 million, in addition to his salary, based on Enron's false financial reports. Horton was intimately involved in the day-to-day operations of EBS and it is inconceivable that he was not aware of the massive, sophisticated fraud being perpetrated.

12. Claims Against Kean Are Pleaded with Particularity

Steve Kean was Executive Vice President and Skilling's Chief of Staff since 99. From 97 to 00, he was a member of the Management Committee, which approved all significant business transactions, including the Fastow-controlled partnership/SPE deals. ¶88. Board minutes show that Kean was present at and participated in approving many of the fraudulent transactions detailed in the CC, including Chewco. *See* Ex. 21.

Kean's involvement in the fraudulent scheme is further evidenced by the false statements he made on 1/21/01, 7/12/01, 8/01 and 10/16/01, which misrepresented Enron's financial position and falsely emphasized the success of its various businesses. ¶¶282, 329, 343, 366.

Beyond his participation in the fraudulent scheme, Kean also traded illegally while in possession of undisclosed adverse information about Enron. During the Class Period, Kean sold 64,932 shares of his Enron stock for $5,166,414. ¶83(m). Kean was intimately involved in the day-to-day operations of Enron and it is inconceivable that he was not aware of the massive, sophisticated fraud being perpetrated.

13. Claims Against Koenig Are Pleaded with Particularity

Mark Koenig was Executive Vice President, Investor Relations. ¶83(s). From 97 to 99 he served on the Management Committee, which approved all significant business transactions, including the Fastow-controlled partnership/SPE deals. ¶88. Board minutes show that Koenig was present for and participated in approving many of the fraudulent transactions detailed in the CC, particularly Chewco and LJM2. *See* Exs. 21, 24, 26 and 27.

Koenig's involvement in the fraudulent scheme is further evidenced by his statements issued on 10/13/98, 4/13/99, 7/13/99, 10/12/99, 4/13/00, 7/24/00, 10/17/00, 1/21/01, 3/23/01, 4/18/01, 7/25-27/01 and 10/16/01, which were false and misleading in that they misrepresented Enron's financial position and falsely emphasized the success of its various business. ¶¶119, 145, 157, 179, 224, 247, 263, 282, 309, 317, 329, 366.

Beyond his participation in the fraudulent scheme, Koenig also traded illegally while in possession of undisclosed, adverse information about Enron. During the Class Period, Koenig sold 129,153 shares of his Enron stock for $9,110,466. ¶83(s). Koenig was intimately involved in the day-to-day operations of Enron and it is inconceivable that he was not aware of the massive, sophisticated fraud being perpetrated.

14. Claims Against Mark-Jusbasche Are Pleaded with Particularity

Rebecca Mark-Jusbasche served as CEO of Enron International from 93 until 10/98, after which she served as CEO of an Enron affiliate, Azurix Corp., and she served on Enron's Board from 7/99 to 8/00. ¶83(n); Mark-Jusbasche Mot. at 1. She made false statements to the market when she signed Enron's Form 99 10-K, filed on 3/31/00, which included false financial statements, ¶¶215-221, and materially false disclosures about Enron's related-party transactions, that she knew to be false because she had personally approved waiving Enron's conflict-of-interest policy to allow CFO Fastow to control LJM2.

While Mark-Jusbasche implies that her tenure as a director was short, therefore she did not learn any inside information, this is not borne out by the facts. According to documents released by Congress, she attended a crucial meeting in 10/99, at which the board approved the creation of

LJM2 and waived Enron's conflict-of-interest policies for Fastow in connection with LJM2. *See* Ex. 24. Those minutes stated that the board passed a resolution authorizing the creation of a partnership (subsequently determined to be LJM2) to be managed by Fastow, which would serve as "a potential ***ready purchaser of the Company's businesses and assets*** or as a potential contract counterparty [that] could provide [Enron with] liquidity, risk management, and other financial benefits." *Id.* at 18. Mark-Jusbasche approved the resolution authorizing the partnership, and waiving Enron's conflict-of-interest policy for Fastow. *Id.* Knowing Fastow controlled LJM2, Mark-Jusbasche still signed and endorsed Enron's false Form 10-K.

Mark-Jusbasche also learned material, adverse, inside information while serving as CEO of Enron International, even though it occurred mainly before the Class Period. The same underlying problems persisted within Enron International throughout the Class Period, thus making certain positive statements – Enron's financial statements – false. ¶155(h), (i), (j). And these facts were never disclosed to the market before Mark-Jusbasche's stock sales or her approval of Enron's 99 10-K. Thus, she traded illegally under §10(b) and lied to the market. She contends that the 11/17/98 Form 10-Q disclosed that Enron would be taking an after-tax charge of $100 million in compliance with newly adopted AICPA Statement of Position 98-5. Mark-Jusbasche Mot. at 10, n.11. This is certainly not dispositive. Rather, this disclosure failed because it never disclosed that the charge was associated with many projects that were no longer viable, and had not been for some time. Because the disclosure was so sparse on details, it did nothing to dispel the notion that the $100-million charge was associated with normal start-up costs in projects, which, going forward, would provide Enron International with a positive revenue stream. In reality, Enron International "snowballed" start-up costs on projects "even when it was clear that the project would never go forward." ¶121(f).

Mark-Jusbasche also learned of and traded on non-public, material, adverse information in her role as CEO of Azurix. ¶¶590-593. For example, she knew that Atlantic Water Trust was formed in 98 by Enron to purchase part of Azurix, that Atlantic Water Trust was capitalized in part by Marlin Water Trust, which was capitalized by $915 million in debt and $125 million in equity, and the debt was supported in part by Enron stock. ¶593. She knew that if the stock price dropped below $34.13 per share, Enron would be in default and obligated to make up the difference, an obligation that was not adequately disclosed. But she traded her stock while in possession of this material, non-public information anyway. ¶83(n).

Beyond her participation in the fraudulent scheme, during the Class Period, while in possession of adverse, material, undisclosed information about the Company, she sold 895,631 shares of her Enron stock for $82,536,737 in illegal insider-trading proceeds. ¶83(n).

15. Claims Against McMahon Are Pleaded with Particularity

Jeffrey McMahon ("McMahon") was Executive Vice President, Finance and Treasurer of Enron since 7/99. ¶83(p). Prior to that he was Senior Vice President, Finance and Treasurer from 7/98-7/99, and from 94-7/98 was Chief Financial Officer of Enron Europe. *Id*. McMahon served on Enron's Management Committee from 98-99 which approved all significant business transactions including the Fastow-controlled partnerships/SPE deals. ¶83(p).

Aside from McMahon's direct involvement in Enron's core businesses, the CC sufficiently alleges McMahon made false and misleading statements to the market when he participated in a conference call for analysts on 11/14/01. ¶388.

The CC sufficiently sets forth that McMahon knew the statements being issued by the Enron Defendants, as well as Enron's financial statements, were false and misleading at the time his single insider sale netted him $2,739,226. ¶83(p). McMahon personally approached Skilling in 3/00 – ***the same month in which his insider sale was made*** – with serious concerns about Enron's dealings with the LJM partnerships. Powers Report at 21. Accordingly to McMahon's own account, he notified Skilling that Fastow was pressuring Enron employees who were negotiating with LJM. Powers Report at 21. Additionally, McMahon had concerns regarding Enron's buy out of Chewco because he felt a $10 million return to Chewco investors was inappropriate and if that was the agreement, it would be better for Enron to continue with the current JEDI structure and not buy out Chewco's interest. Powers Report at 61-62. Additionally, two months after McMahon sold 39,630 shares of his Enron shares, McMahon presented a liquidity report to the Finance Committee of the Board, wherein he discussed Enron's guarantee portfolio – which included Enron's guarantees to the Raptors – and Enron's need for additional borrowing capacity. *See* Ex. 26. McMahon had intimate knowledge of Enron's guarantees to the various SPEs referred to in the CC and the significance of those guarantees to Enron's financial condition at the time he engaged in insider trading.

16. Claims Against Olson Are Pleaded with Particularity

Cindy Olson was Executive Vice President, Human Resources, in charge of administration of Enron's employees' pension plan. ¶83(q). Beyond her participation in the fraudulent scheme, she was privy to inside, material, adverse information not publicly disclosed and, while in possession of that information, sold 85% of her Enron stock for $6.5 million in illegal insider-trading proceeds. And her sales were suspicious – particularly 2/00 – because she took actions that were contrary to her public statements to Enron's employees, which has been the topic of a congressional inquiry:

> Ms. Olson [told] employees in December of '99 to put all of their 401(k) monies into Enron.... I want to point out that Ms. Olson, ... who led the cheering rally there for Enron stock – ***two months after she told people to put their money in started to sell off her stock ....***

Hearing of the Senate Commerce, Science and Transportation Committee, 2/26/02. Other senators took note of her actions:

> [Senator] Waxman said in his letter to [Senator] Lieberman that the videotape provides evidence "that seems to conflict with Ms. Olson's testimony that she would have advised Enron employees to diversify if the law permitted such advice."
>
> "It also appears to cast Ms. Olson's personal financial transactions in a new light," he wrote.
>
> Olson testified that, on the advice of her own financial adviser, she sold $6.5 million of her Enron stock in an effort to diversify her portfolio. Most of the stock was sold in late 2000 and early 2001, Olson said.
>
> ***But Waxman pointed out that Olson sold more than $ 1 million of Enron stock on Feb. 16, 2000 - less than three months after the employee meeting.***

"The Fall of Enron; Enron Exec's Testimony Disputed; Waxman Says Tape Shows Olson Touted Firm's Stock," *Houston Chronicle*, 2/22/02. Furthermore, she was capable of understanding the fraud as alleged by plaintiffs. Not that one needed an accounting degree to understand that the Enron Defendants were engaged in a fraudulent scheme, but before taking over Enron's human-resources department, she worked for fifteen years as an accountant and was, therefore, quite capable of understanding the intricacies of the fraud. *See* "Did HR Fuel the Demise of Enron? Jane

Lewis Examines the Risk-Taking, Entrepreneurial Work Culture of the Energy Giant and Shows How HR Played a Leading Role," *Personnel Today*, 3/19/02.

Beyond her participation in the fraudulent scheme, during the Class Period, while in possession of adverse, material, undisclosed information about the Company, she sold 83,183 shares of her Enron stock for $6,505,870 in illegal insider-trading proceeds. ¶83(q).

17. Claims Against Pai Are Pleaded with Particularity

Lou Pai was Chairman and Chief Executive Officer of Enron Accelerator from the end of 00 and before then was President and a director of EES. ¶83(j). The fraudulent practices in Enron's EES business are well documented in the CC. ¶¶121(g), 155(f)-(g), 214(f)-(g), 300(f)-(g), 339(f)-(g). Pai was no bit player in the Enron fraud, as he would have the Court conclude. Pai Mot. at 8. Rather, he made false statements to the market, sold stock on inside information, participated in and authorized the signing of contracts that EES knew would lose hundreds of millions of dollars for Enron, but which were accounted for as profitable endeavors to inflate Enron's stock price.

EES was not and would not be profitable. EES personnel induced customers to sign large contracts for the provision of demand-side-management services, issued glowing press releases about their number and size, and then manipulated the accounting for those contracts to make EES look profitable. Enron Defendants repeatedly portrayed EES in a highly positive light. For example, on 10/13/98, Enron executives told analysts that EES was very strong and would be profitable in 4thQ 99. ¶119. This was false. ¶121(g), (j). Enron's 98 Annual Report also stated:

> [EES] significantly exceeded its contracting objectives and signed contracts representing $3.8 billion of customers' future energy expenditures. Based on both the current backlog of prospects and contracting activity, Enron expects to double the level of new contracts to be added in 1999.... [R]esults for this business ... are expected to reflect positive earnings in late 1999.

¶138. This glowing review was reiterated to analysts on 4/13. ¶145. But there was no prospect of positive earnings. ¶155(e), (f), (g), (o). The parade of positive pronouncements about the size of EES contracts, including statements about specific contracts and their value, the division's strength, and EES's impending profitability, continued throughout Pai's tenure as EES President and director throughout the Class Period. ¶¶179, 197, 218, 247, 263, 329. But they were false and misleading. ¶¶214(f), (g), 300(f), (g), 339(f), (g).

Pai made false and misleading statements to the market that substantially echoed and endorsed those made by other Enron Defendants. Late in 4thQ 99, Pai told a CS First Boston analyst that Enron's EES business was expected to be profitable in 99, which CS First Boston reported to the market on 11/30/99, and stated that upon

> ***a very recent visit*** with Enron Energy Services "Retail Energy Services/EDSing of Energy" President ***Lou Pai*** suggested ***that momentum in the retail business continues to accelerate***. Backlogs ... continue to grow, the impressive roster of Enron clients continues to expand, and ***Enron expects a positive fourth quarter of 1999***. We expect to see earnings for full year 2000 exceeding the $50 million target that Enron has set.

These statements were false and Pai knew it. ¶214(f), (g).

EES would never be profitable because its transactions were known to be unprofitable, and first contracts were signed merely to further the appearance of profitability. For example, when Pai was at EES, Enron announced a huge contract with Eli Lilly, on which it improperly recognized approximately $44 million. ¶¶540-543. As *The Washington Post* reported on 2/18/02, it was well known in EES that Enron would actually lose money on the transaction:

> Eli Lilly and Co., the Indianapolis pharmaceutical manufacturer, signed a $1.3 billion contract in February 2001 turning all its energy requirements over to Enron for 15 years. But Enron paid Eli Lilly $50 million upfront to win the deal, according to a former senior executive of Enron.
>
> Eli Lilly spokesman Ed West confirmed that Enron had made an advance payment but would not disclose the amount for business confidentiality reasons. "We looked at it as Enron backing up their words with cash," he said.
>
> Such upfront payments were not unusual, said Glenn Dickson, a former EES director of asset operations. "It was fairly common ***on the really big deals to pay the customer, to lose money***, in effect, on the contract, whether you were paying the customer or losing money you were charging less than it really cost."
>
> What made it all work, Dickson said, was a form of accounting in which the company ***counted future projected earnings as current income***. "It was huge amounts of money that covered up those cash outlays," he said.

¶542. EES regularly signed huge contracts that it knew would lose large sums of money. Simply stated, EES was not remotely profitable.

It is inconceivable that Pai did not know that EES was a fraudulent scheme to inflate Enron's stock price, and management-level employees have admitted it. An EES employee stressed that the information she conveyed to the Board was known to everyone in EES:

> One can only surmise that the removal of Jeff Skilling was an action taken by the board to correct the wrong doings of the various management teams at Enron. However ... I'm sure the board has only scratched the surface of the impending problems that plague Enron at the moment. (*i.e.*, ***EES's ... hiding losses/SEC violations ... lack of product, etc.***).
>
> * * *
>
> ***[I]t became obvious*** that EES had been doing ***deals for 2 years*** and was losing money on almost all the deals they had booked. (JC Penney being a $60MM loss alone, then Safeway, Albertson's, GAP, etc.). Some customers threatened to sue if EES didn't close the deal with a loss (Simon Properties – $8MM loss day one).... You should also check on the Safeway contract, Albertson's, IBM and the California contracts that are being negotiated.... ***It will add up to over $500MM that EES is losing and trying to hide in Wholesale. Rumor on the 7th floor is that it is closer to $1 Billion***....
>
> This is when they decided to merge the EES risk group with Wholesale to hide the $500MM in losses that EES was experiencing. But somehow EES, to everyone's amazement, reported earnings for the 2nd quarter. According to FAS 131 – Statement of Financial Accounting Standards (SFAS) #131, "Disclosures about Segments of an Enterprise and related information," ***EES has knowingly misrepresented EES' earnings***. ***This is common knowledge among <u>all</u> the EES employees, and is actually joked about....***
>
> * * *
>
> ... Some would say the house of cards are falling....
>
> You are potentially facing Shareholder lawsuits, Employee lawsuits ... Heat from the Analysts and newspapers. The market has lost all confidence, and its obvious why.
>
> You, the board have a big task at hand. You have to decide the moral, or ethical things to do, to right the wrongs of your various management teams.
>
> * * *
>
> ... ***But all of the problems I have mentioned, they are very much common knowledge to hundreds of EES employees, past and present.***

¶59(b). If "hundreds of EES employees" knew about this fraud, surely there is a strong inference that Pai, a former president and director at EES, knew too, that EES had been losing money on almost all of its deals for ***two years***.

Beyond his participation in the fraudulent scheme, during the Class Period, while in possession of adverse, material, undisclosed information about the Company, he sold 3,912,205 shares of his Enron stock for $270,276,065 in illegal insider-trading proceeds, ¶83(j), and transferred 57,756 shares of his Enron stock valued at $3,961,973 to the Company to pay the exercise price of options he was exercising plus related tax withholdings, such that the vast majority of his insider-trading proceeds went directly into his pocket. ¶83(j).

18. Claims Against Rice Are Pleaded with Particularity

Ken Rice was Chairman and CEO of EBS since 6/00, after serving as Chairman and CEO of Enron Capital & Trade ("ECT") - North America from 3/97 until 6/99. ¶83(h). In 97-00 he served on Enron's Management Committee, top officers who met regularly to oversee Enron's business and approve all significant business transactions, including the Fastow-controlled partnership/SPE deals specified herein. ¶88.

Rice made false and misleading statements to the market and traded on inside information. In late 9/99, he made statements at a Bank of America investment conference, including representations about "management's conviction in Enron Energy Service's ability to turn profitable in 4Q99," and the prospects for the EBS business, which were attributed to Rice in a report on Enron issued by Bank America the next day. ¶173. But Enron's management could not possibly have believed that Enron's EBS business was viable, let alone would be profitable in that quarter. ¶214(f), (g), (h), (i), (j), (k), (l).

Rice also was quoted in Enron's 12/18/00 press release announcing the Blockbuster VOD deal, which purportedly was going to "deliver the entertainment on-demand service to consumers' televisions by the end of this year." ¶276. Enron supposedly had "the infrastructure in place" and Rice noted Enron's "[c]ustomers have been extremely receptive" to the service. *Id.* These statements were not true. ¶300(h), (o). Just six months before the near-year-end announcement Rice had admitted that Enron "can't deliver the Blockbuster deal." ¶300(o). Indeed, Enron never could transmit movies in a commercially viable manner – an EBS director of engineering stated: "Flat out, we didn't have the technology to do it, and we didn't have the expertise" – as characterized by another EBS employee: "[T]he Blockbuster deal was a fraud, and Enron's top management knew it." *Id.*

Enron held a 3/23/01 conference call to discuss its business, during which – and in follow-up conversations with analysts – Rice noted his EBS unit was coming along just fine. ¶309. On 4/17/01, he again participated in an analyst conference where his EBS unit was lauded and it was noted that Enron was pleased about its development. ¶317. But EBS was not doing just fine. ¶339(h), (i), (j), (k), (l), (m), (n), (o). By Spring 99 the development of a key component had "deteriorated into chaos," by 10/99 EBS was "***in crisis mode***," and Rice realized the broadband network was a failure. ¶¶300(h)-(o), 339(h)-(o).

Rice was involved in the manipulation of Enron's financial statements and he knew of the self-dealing inherent in the SPEs and partnerships controlled by CFO Fastow. For example, he negotiated the sale of certain telecommunications assets known as Backbone to Fastow's LJM, which enabled Enron to improperly recognize $54 million in revenue. ¶475. EBS then sold the unactivated – "dark" – fiber to LJM2 because no one else would buy it, and during those negotiations LJM was represented by Fastow. *Id*. Rice clearly knew that the transaction was not an arm's-length negotiation on par with what would have happened between two independent parties. Thus, he knew, at a minimum, that Enron's third-party disclosures and financial statements in its SEC filings were false and misleading.

Beyond his participation in the fraudulent scheme, during the Class Period, while in possession of adverse, material, undisclosed information about the Company, he sold 1,234,009 shares of his Enron stock for $76,825,145 in illegal insider-trading proceeds, ¶83(h), and transferred 27,847 shares of his Enron stock valued at $2,222,691 to the Company to pay the exercise price of options he was exercising plus related tax withholdings, such that the vast majority of his insider-trading proceeds went directly into his pocket. ¶83(h).

19. Claims Against Skilling Are Pleaded with Particularity

Jeff Skilling was a director and served as the Company's President and Chief Operating Officer until 2/01, when he became Chief Executive Officer. He served on the Executive Committee from 97 to 01 and the Management Committee from 97 to 00. ¶¶86-87. He was present at Board meetings when Enron's business and transactions with Fastow-controlled SPEs were reviewed and approved. The Board charged him with a substantial role in the oversight of Enron's relationship with the LJM partnerships, which included regular updates from the global-finance group, plus the legal and accounting committees. Consequently, Skilling was intimately involved with or knowledgeable about the day-to-day financing and operations of Enron's various businesses and was present when reports were made or he reported to the Board about central facets of the fraudulent scheme alleged in the CC, including:

- The formation of Fastow-controlled Chewco in 11/97, making it possible for Enron to continue to transact business with JEDI and artificially inflate its reported results. ¶10. He approved of Fastow's participation in Chewco. Powers Report at 43.

- Skilling knew that the $2.8-billion purchase of Wessex Water and the establishment of Enron's global water business were not the result of careful risk analysis. ¶¶121(h), 155(n).

- He was a senior member of management responsible for the LJM relationship, and he approved of and participated in the presentation of LJM1 to the Board on 6/28/99. Powers Report at 20, 69.

- Skilling supported the Board's decision to permit Fastow to proceed with LJM, notwithstanding the CFO's conflict of interest. Powers Report at 20-21.

- Skilling, who was proud of the risk-management controls he installed at Enron, bears substantial responsibility for the failure of the system of internal controls to mitigate the risk inherent in the relationship between Enron and the Fastow-controlled LJM partnerships. Powers Report at 20-21.

- Skilling was advised by Treasurer McMahon in 3/00 that Fastow was pressuring Enron employees who were negotiating with LJM. Powers Report at 21.

- Skilling approved a transaction that was designed to conceal substantial losses in Enron's merchant investments by approving the Raptor restructuring transaction. Powers Report at 21.

- Skilling was aware of and approved Fastow-protege Michael Kopper's participation in Chewco, knowing it violated Enron's Code of Conduct. Powers Report at 46.

- He approved the additional $2.6 million Enron paid Chewco in connection with the Chewco buyout. Powers Report at 65-66.

- Skilling attended the 10/11/99 Finance Committee meeting when the Board approved Fastow's participation in LJM2. Powers Report at 71.

- Skilling approved of Fastow's presenting his proposal to hedge the Rhythms investments to the Board on 6/28/99. Powers Report at 79.

- Skilling and Lay were appointed as a committee of the Board to determine if the consideration received by Enron in connection with the Rhythms hedge was sufficient, in the event of a change in the terms of the transaction from those presented to the Board. Powers Report at 82.

- Skilling decided to liquidate Enron's Rhythms position in 1stQ 00, which necessitated an unwind transaction that resulted in huge windfalls to LJM1 and its SPE subsidiaries to the detriment of Enron. Powers Report at 89-90.

- In late-99, at Skilling's urging, a group of Enron commercial and accounting professionals devised a mechanism to allow Enron to hedge a portion of its merchant-investment portfolio, which created the Raptors. Powers Report at 99-100.

- Skilling was present when Enron-controlled Raptor I was presented to the Finance Committee on 5/1/00. Powers Report at 105.

- Skilling was present when Enron-controlled Raptor IV was presented to the Finance Committee of the Board on 8/7/00. And he advised the Board that the Executive Committee had approved Raptor II at its June meeting and that Raptor IV would "provide additional mechanisms to hedge the profit and loss volatility of the Company's investments." Powers Report at 112.

- Skilling signed the LJM2 approval sheet for Raptor IV ***six months after*** the deal had closed and the Board had approved the transaction. Powers Report at 113 n.54.

- Skilling was aware that the credit capacity of the Raptors was declining and in 1stQ 01 he believed that this problem was one of the Company's highest priorities. Powers Report at 121.

- Skilling consistently reviewed all disclosures of related-party transactions. Powers Report at 182.

Beyond his direct involvement in the fraudulent scheme, the CC sets forth numerous false and misleading statements issued by Skilling during the Class Period. For example, he participated on various conference calls and attended various conferences with analysts during which he misrepresented Enron's financial position and falsely emphasized the success of its businesses. ¶¶119, 145, 157, 179, 197, 224, 247, 263, 282, 309, 317, 329, 343. The CC also specifies numerous false and misleading statements in personal interviews, press releases or in statements quoted by analysts. ¶¶129, 160, 167, 175, 178, 184, 191-192, 202, 213, 228, 232, 257, 264, 272, 274-275, 283, 286, 289, 311, 316, 318, 328, 330-332, 337.

Moreover, Skilling signed various financial statements and registration statements. ¶¶109, 110, 126, 134, 141, 164, 215, 221, 292, 293, 336. The CC sufficiently sets forth why the registration statements were false and misleading, due to the incorporation of 10-Ks and 10-Qs that contained Enron's admittedly false financial statements for 97-00, which understated its debt by billions of dollars and overstated its earnings by hundreds of millions of dollars. ¶¶418-611. Enron's 97, 98, 99 and 00 financial statements were all restated, which is an admission that they were materially false when made. Skilling, as a signer of these registration statements, may be able to establish at trial a defense to liability for these expertised – certified – financial statements. But, in light of the CC's allegations he knew these annual certified financial statements were false, he may not do so at this stage. *Murphy v. Hollywood Entm't Corp.*, No. 95-1926-MA, 1996 U.S. Dist. LEXIS 22207, at *23 (D. Or. May 9, 1996). While the registration statements included audited annual financial statements, they also incorporated all documents filed pursuant to §13(a) of the 1934 Act prior to the respective offerings, including Enron's 10-Qs, which contained unaudited quarterly financial results. ¶615. Thus, since the interim financial statements were unaudited – not expertised – all signers of those registration statements are legally responsible for their accuracy.

The falsity of the registration statements was not confined to false financial statements – they were materially false in many other aspects. For instance, each of them contained a statement to the effect that any transactions Enron had entered into with "unconsolidated affiliates" were on terms representative of or reasonable when compared to those that could have been obtained from independent third parties. Obviously, given the Fastow-controlled LJM entities, those statements were false, as were the statements about Enron's EBS business, ¶¶631, 633-635, 639, statements about EES, ¶¶418-611, 641, statements about Enron's capitalization, ¶¶618-623, statements about financial-risk management, ¶¶624-627, and statements about Enron's price-risk-management activities and financial instruments. ¶¶628-630.

Skilling also traded on inside information – undisclosed, adverse, material information about Enron's financial records and various businesses – selling 1,307,678 Enron shares for $70.6 million in illegal insider-trading proceeds. ¶83(b). Taking the allegations in their entirety, and that Skilling was charged with the responsibility of overseeing all transactions between Enron and the LJM partnerships, it is inconceivable that he was not aware of the massive fraud being perpetrated.

20. Claims Against Sutton Are Pleaded with Particularity

Joseph Sutton was Vice-Chairman of Enron until early-01 and served as President and COO of Enron International in 1997-98, immediately before the Class Period. ¶¶83(r), 88. In 97 to 99 he served on Enron's Management Committee, which approved all significant business transactions, including the Fastow-controlled partnership/SPE deals specified. ¶88.

Vice-Chairman Sutton made false statements to the market to inflate the prices of Enron's securities. He appeared at Enron's second-quarter analyst meetings in New York, Boston and Houston on 7/14-16/99, during which he made numerous representations that were false. ¶157. He also supervised various aspects of the fraudulent scheme. For example, during his time as President and COO, Enron International repeatedly deferred start-up costs, including developer, financing and promotional fees, that were incurred on failed project proposals – a practice known inside Enron as "snowballing" – and very few write-offs were taken. ¶121(f). Costs for South African projects involving oil and gas reserves, pipelines, and a plant designed to convert ore into another form of energy, and projects in China, among others, were snowballing quickly – the cash burn rate was as much as ***one million dollars a month*** – but were not being expensed. ¶121(f). By 97, Enron had deferred a $100-million "snowball" on some 75 projects, including those in Central and South America and the Dabhol power plant in India, while the cash-burn rate – virtually all deferred – dwarfed the revenue return. ¶121(f). It is inconceivable that the President and COO was not aware of how these large expenses were being accounted for. The fraud in Enron International continued throughout Sutton's tenure, including misrepresentations about the fact that the Dabhol plant was a financial disaster, ¶155(h), about other projects in the Philippines and the Dominican Republic, ¶155(i), and the continued snowballing of start-up costs. ¶155(j). At the very least, the sheer size and scope of these projects, and the magnitude of the costs being hidden by improper deferrals, qualify them as core businesses that Sutton was aware of. And beyond his participation in the fraudulent scheme, during the Class Period, while in possession of material, adverse, undisclosed information about the Company, he sold 688,996 shares of Enron stock for $42,231,283 million in illegal insider-trading proceeds. ¶83(r).

21. Claims Against Whalley Are Pleaded with Particularity

Greg Whalley was President and Chief Operating Officer of Enron in 8/01, and before that President and Chief Operating Officer of Enron Capital Wholesale Services and Enron's Chief Executive Officer of Risk Management. ¶83(u). *See also* Ex. 24. Whalley's involvement in the fraudulent scheme included making false and misleading statements to analysts on 10/16/01 and 11/14/01. ¶¶364, 388. In fact, in the 11/14/01 conference call he told analysts and rating agencies that there were no additional partnerships that had undisclosed debt. ¶¶83(u), 388. He knew this and other statements he made to be false. The Sherron Watkins 8/01 letter notes that Whalley could corroborate her allegations: "Personnel to quiz confidentially to determine if I'm all wet: a. Jeff McMahon, b. Mark Koenig, c. Rick Buy, d. Greg Whalley." ¶850. Because Ms. Watkins's letter has proven to be accurate in all material respects, there is no reason to believe she was not accurate in her evaluation of Whalley's knowledge. Furthermore, her letter predates his statements to the market and belies his later positive statements. Given their falsity and importance to the market, Whalley was at least severely reckless in making these representations.

Whalley is also liable for trading illegally on inside information. Although plaintiffs do not presently know the dates or amounts of his sales, as they were not reported, plaintiffs plead on information and belief that he sold Enron stock during the Class Period. As detailed in the Watkins letter and the CC, it is inconceivable that he was not aware of the sophisticated, massive fraud perpetrated by Enron's Capital Wholesale Services, of which he was COO. Under Whalley the results of Enron's wholesale (WEOS) business – its largest business unit – were manipulated and falsified to boost its reported profitability in various ways. ***First***, by phony or illusory hedging transactions with entities that were not independent of Enron. ***Second***, by the abuse of mark-to-market accounting by adopting unreasonable contract valuations and economic assumptions when contracts were initially entered into. And ***third***, by arbitrarily adjusting those values upward at quarter's end to boost the wholesale operation's profits for that period – a practice known inside Enron as "moving the curve." ¶121(e). And Enron had not effectively hedged its WEOS merchant-investment portfolio as most of the purported hedges were with non-independent parties in transactions structured such that the hedge depended on Enron's stock price and thus Enron was still at risk. *Id.* These activities continued throughout the Class Period. ¶¶121(j), 155(e), 155(o), 214(e), 300(e), 339(e).

The sheer size of the fraud permeating WEOS supports a strong inference that the man in charge of that division knew of its existence, for it could not have been perpetrated without his approval and participation. Further, in his capacity as Chief Executive Officer of Risk Management, a position with "supervisory authority over all trading operations, in all commodities" throughout the Company, Whalley was charged with "primary responsibilities [that] included reviewing major commodity risks taken by the business units." *See* Ex. 24. Whalley was charged with direct oversight of Enron's trading activities and he reviewed the hedging transactions that were established (purportedly) to limit Enron's risks. These activities, on which Whalley reported to the Board, were central facets of the alleged fraudulent scheme.

C. Plaintiffs Have Stated a Claim for the Insiders' Violation of §10(b)

1. Insiders Are Liable for Primary Violations of §10(b) as Participants in a Fraudulent Scheme

Plaintiffs sufficiently allege primary violations of §10(b). They neither impermissibly rely on the group-pleading doctrine nor do they make improper aiding-and-abetting allegations, in contravention of *Central Bank, N.A. v. First Interstate Bank, N.A.*, 511 U.S. 164, 191 (1994), as argued by the Enron Insiders. Jt. Officer Brf. at 5.

Plaintiffs here have pleaded and are pursuing theories of recovery against the Insiders that are well-grounded in the express language of §10(b) of the 1934 Act, which states:

> §78j Manipulative and deceptive devices
>
> It shall be unlawful for any person, directly or indirectly ...
>
> * * *
>
> (b) [t]o use or employ, in connection with the purchase or sale of any security registered on a national securities exchange ... ***any manipulative or deceptive device or contrivance*** in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.[15]

15 U.S.C. §78j(b).

Rule 10b-5 promulgated by the SEC flows directly from the language of §10(b) itself and provides:

> §240.10b-5 Employment of manipulative and deceptive devices.
>
> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

[15] Note that §10(b) itself does not expressly prohibit untrue statements of material facts or material omissions. This prohibition, like the prohibition against fraudulent schemes and fraudulent courses of business, is in Rule 10-5.

> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. §240.10b-5.

Not only does Rule 10b-5 forbid the making of "any untrue statement of a material fact," it also provides for scheme liability, which is authorized by the text of §10(b). According to the Supreme Court, §10(b)'s prohibition of "any ***manipulative or deceptive device or contrivance***" necessarily encompasses any "***scheme to defraud***." In *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), the Court referred to dictionary definitions to find that a "device" is "'[t]hat which is devised, or formed by design; a contrivance; an invention; project; ***scheme; often, a scheme to deceive***; a stratagem; an artifice.'" *Id*. at 199 n.20 (quoting *Webster's International Dictionary* (2d ed. 1934)). The Court found that a "contrivance" means "'***a scheme, plan, or artifice***.'" *Id*. (quoting *Webster's International Dictionary*); *see also Aaron v. SEC*, 446 U.S. 680, 696 n.13 (1980). Clearly, "scheme" is encompassed in the broad language of §10(b). Thus Rule 10b-5 – adopted by the SEC to implement §10(b) – makes it unlawful for any person "***directly or indirectly***" to employ "***any*** device, ***scheme***, or artifice ***to defraud***," "***to make any untrue statement[s]***," or to "***engage in any act, practice, or course of business which operates ... as a fraud or deceit upon any person***." 17 C.F.R. §240.10b-5. *See also U.S. Quest, Ltd. v. Kimmons*, 228 F.3d 399, 407 (5th Cir. 2000).

Prior to the Supreme Court's endorsement of the presumption of reliance based on the fraud-on-the-market theory for both misrepresentations and omissions in *Basic*, the Fifth Circuit had held the theory applied ***only*** to omission cases and not misrepresentation cases. In some instances, securities plaintiffs sought recovery under subsection (1) and (3) of Rule 10b-5 alleging ***fraudulent scheme and course of business liability***, and the Fifth Circuit expressly recognized the validity of these theories of recovery.

For instance, in *Finkel v. Docutel/Olivetti Corp.*, 817 F.2d 356 (5th Cir. 1987), plaintiffs sued under §10(b) and Rule 10b-5, claiming Docutel's stock was inflated due to false financial reports. According to plaintiff, Olivetti, which owned 46% of Docutel and controlled it, forced Docutel to buy Olivetti's excess inventories at inflated prices so Olivetti could hide losses it was suffering. Docutel concealed this financial manipulation for some time but, when its auditors discovered the financial manipulation and forced a large inventory writedown, huge losses were disclosed and Docutel's stock price fell. The district court dismissed the complaint against Olivetti and Docutel because plaintiff failed to allege reliance on any of the false statements in Docutel's SEC filings.

> But the fact that the complaint lists a number of documents filed with the SEC does not limit plaintiff's claim to subsection (2) only. For, as in *Shores*, plaintiff's lack of reliance on these documents does not resolve the claims made under 10b-5(1) and (3). ***We find that plaintiff's complaint properly alleges a scheme to defraud or course of business operating as a fraud for purposes of the first and third subsections; plaintiff's complaint, taken as a whole, alleges that Olivetti forced Docutel to take its worthless inventories, that this scheme or course of business was not disclosed, and that the effect was to defraud certain purchasers of Docutel****....*
>
> The most significant event which allegedly led to the loss by plaintiff is the claim that Olivetti forced Docutel to take worthless inventories without disclosing that fact in the market place; ***if proved, that conduct could equate with a scheme to defraud or course of business operating as a fraud in violation of 10b-5(1) and (3)***. Thus, we conclude that the district court erred in its dismissal of the complaint as to plaintiff's claims under 10b-5(1) and (3).

Id. at 363-64; *accord Heller v. Am. Indus. Props. Reit*, No. SA-97-CA-1315-EP, 1998 U.S. Dist. LEXIS 23286, at *14 (W.D. Tex. Sept. 28, 1998) ("The first and third subsections, on the other hand, ***create a duty not to engage in a fraudulent scheme or course of conduct*** ....").

The fraudulent scheme and course of business involving Enron ***was worldwide in scope, years in duration, and unprecedented in scale***, and required the skills and active participation of the Enron Insiders to help design, implement, conceal, and falsely account for the deceptive acts and devices, manipulative contrivances, and artifices being used to falsify its reported profits and financial condition and to continue its fraudulent course of business.

Defendants are liable under Fifth Circuit precedent even if they do not directly make a false statement which is attributed to them. *Shores v. Sklar*, 647 F.2d 462 (5th Cir. 1981). In *Shores*, plaintiff Bishop purchased industrial municipal bonds in a new issuance accomplished via a false Offering Circular. When the underlying industrial project failed the bonds declined in value, and plaintiff sued several parties, including a lawyer involved in the offering – one Sklar. After Bishop admitted he never read or relied on the Offering Circular the district court threw his case out. The Fifth Circuit reversed. The Fifth Circuit characterized Bishop's claim as one that the bonds had been "fraudulently marketed" via a "***fraudulent scheme***," and stated:

> We reheard this case en banc to determine whether a plaintiff must rely specifically on material misrepresentations or omissions in a single disclosure document when, in addition to charges based on its untrue statements or misleading omissions, other allegations would admit proof that the existence of the security in the marketplace resulted from the successful perpetration of a fraud on the investment community and that he purchased in reliance on the market. We hold the securities laws and regulations have a purpose broader than merely criticizing ever-lengthening, complex prospectuses. ***They cover deliberate, manipulative schemes to defraud which can annul not only the purpose of disclosure but also the market's honest function. Since plaintiff's pleadings would permit such proof, his suit should not have been dismissed at this initial stage***.

Id. at 464.

The Fifth Circuit ruled that the District Court erred in construing the complaint narrowly and requiring reliance on the Offering Circular because "***Rather than containing the entire fraud, the Offering Circular was assertedly only one step in the course of an elaborate scheme***" (*id.* at 468), concluding:

> ***Bishop has alleged the necessary elements of an action under 10b-5(1) or (3). In the literal words of rule 10b-5, he must be able to show a "scheme to defraud or (an) act, practice or course of business which operates as a fraud or deceit upon (him) in connection with the sale of (the Bonds)***."

Id. at 469.

The Fifth Circuit then engaged in a discussion about the lawyer, Sklar, who was involved ***in the documentation of*** the underlying industrial transaction and ***participated in drafting*** the Offering Circular, which contained false statements about the underlying project and ***audited*** financial statements that were false because of the deficiencies in the underlying project. Thus, the lawyer allegedly knew or recklessly disregarded the deficiencies in underlying industrial transactions and the falsity of the audited financial statements in the Offering Circular. In addressing the lawyer's liability the Fifth Circuit held:

> First, the purposes of the securities acts and rule 10b-5 are far broader than merely providing full disclosure or fostering informed investment decisions. The Supreme Court has held that the acts were designed "to protect investors against fraud and to promote ethical standards of honesty and fair dealing. See H.R. Rep. No. 85, 73d Cong., 1st Sess., 1-5 (1933)." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 195, 96 S. Ct. 1375, 1382, 47 L. Ed. 2d 668, 667 (1976). ***This court has held that "(t)he basic intent of section 10(b) and rule 10b-5 and indeed, of the Exchange Act, is to protect investors and instill confidence in the securities markets by penalizing unfair dealings***." ... and the promotion of free and honest securities markets .... ***The acts reach complex fraudulent schemes as well as lesser misrepresentations or omissions.***

* * *

> ***Ute expressly recognized that rule 10b-5 was not limited to dealing with misrepresentation or omission cases under 10b-5(2), but reached "a "course of business' or a "device, scheme or artifice' that operated as a fraud***" 406 U.S. at 153, 92 S. Ct. at 1472.... The most significant common thread in all these precedents is that rule 10b-5 is not limited to a narrow right to recover for knowing fraudulent misrepresentations or omissions in disclosure documents which mislead a securities buyer. ***The rule is recognized also to provide the basis for a federal cause of action for more elaborate, intentional schemes which deceive or defraud purchasers of securities***.

Id. at 470-72. *See also SEC v. U.S. Envtl., Inc.*, 155 F.3d 107, 112 (2d Cir. 1998) (while there is no aiding and abetting, complaint properly alleged defendant to be primary violator because he "'***participated in the fraudulent scheme***'").

The notion that *Central Bank* issued a broad edict that persons who don't make statements are immune from liability for their participation in complex securities frauds, as asserted by the Insiders is nonsense. *Central Bank* expressly recognized: "The absence of § 10(b) aiding and abetting liability ***does not mean that secondary actors in the securities markets are always free from liability under the securities Acts. Any person or entity, including a lawyer ... or bank, who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser ... relies may be liable as a primary violator under 10b-5 .... In any complex securities fraud, moreover, there are likely to be multiple violators***." 511 U.S. at 191. A scheme to defraud often will involve a variety of actors, and investors are entitled to allege "***that a group of defendants acted together to violate the securities laws, as long as each defendant committed a manipulative or deceptive act in furtherance of the scheme***." *Cooper*, 137 F.3d at 624; *accord SEC v. First Jersey Sec. Litig.*, 101 F.3d 1450, 1471 (2d Cir. 1996); *In re Health Mgmt. Sec. Litig.*, 970 F. Supp. 192, 209 (E.D.N.Y. 1997); *Adam v. Silicon Valley Bancshares*, 884 F. Supp. 1398, 1401 (N.D. Cal. 1995); *In re ZZZZ Best Sec. Litig.*, 864 F. Supp. 960, 969-70 (C.D. Cal. 1994).

Central Bank cannot mean that defendants cannot be liable under §10(b) unless they made misleading statements because the Court rejected that argument in *United States v. O'Hagan*, 521 U.S. 642 (1997). After the Eighth Circuit held, under *Central Bank*, that "§ 10(b) covers ***only*** deceptive statements or omissions on which purchasers and sellers, and perhaps other market participants, rely," the Court reversed, holding that §10(b) does ***not*** require a defendant to speak.

Id. at 664. Because the §10(b) prohibition reaches "'any manipulative or deceptive device or contrivance'" in contravention of SEC rules, this reaches "any deceptive device," whether or not defendants spoke. *Id.* at 650. And in *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6 (1971), consistent with *O'Hagan*, a ***unanimous*** court upheld a §10b/Rule10b-5 complaint involving a "fraudulent scheme" for the sale of securities where ***no*** false statement was alleged: "***There certainly was an 'act' or 'practice' within the meaning of Rule 10b-5 which operated as 'a fraud or deceit' on Manhattan, the seller of the Government bonds***." *Id*. at 9 (footnote omitted).

Citing *O'Hagan*, the Court has stated a "***defendant need not have made a false or misleading statement to be liable***." *Landry's*, slip op. at 9 n.12; *In re Waste Mgmt., Inc. Sec. Litig.*, No. H-99-2183, slip op. at 75 (S.D. Tex. Aug. 16, 2001);[16] *BMC Software*, 183 F. Supp. 2d at 869. That this reading of §10(b)/Rule 10b-5 liability is clearly correct is shown by a new ***unanimous*** Supreme Court decision *SEC v. Zandford*, __ U.S. __, No. 01-147, 2002 U.S. LEXIS 4023 (June 3, 2002), in which the Supreme Court repeatedly cited with approval its seminal "***fraudulent-scheme***" case, *Superintendent of Ins.*, reversed dismissal of a §10(b)/Rule 10b-5 complaint, and made the following key points:

- "***The scope of Rule 10b-5 is coextensive with the coverage of § 10(b)***." *Id*. at *7 n.1.
- "***[N]either the SEC nor this Court has ever held that there must be a misrepresentation about the value of a particular security [to violate §10(b)***]." *Id*. at *13.
- Allegations that defendants "***engaged in a fraudulent scheme***" or "'***course of business' that operated as a fraud or deceit***" stated a §10(b) claim. *Id*. at *13, *14-*17.

Thus, *Central Bank* ***merely*** stands for the proposition no aiding- and-abetting liability exists under the 1934 Act. The decision is ***quite narrow***. By contrast, *Zandford* unanimously reaffirms the language of §10(b) and Rule 10b-5 is ***very broad***, defendants need not make a misrepresentation to be liable and scheme liability is viable under §10(b). As required by this Court, plaintiffs allege Insiders' actions in furtherance of the scheme. *BMC Software*, 183 F. Supp. 2d at 885-86.

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[16] Due to the length of these opinions, and the fact that this Court has access to them, they are not being attached to this brief.

2. Insiders' Misrepresentations and Omissions of Material Fact Are Actionable

a. Plaintiffs Have Adequately Pleaded Claims Under §10(b) of the Exchange Act and Satisfied the 95 Act's Standards for Pleading Falsity

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b), imposes liability when a public statement contains an untrue statement of material fact or fails to disclose material information required to be stated therein or necessary to make the statements contained therein not misleading. To state a §10(b) claim for misrepresentation, plaintiffs must allege: (1) that the defendant made a misrepresentation or omission of material fact; (2) in connection with the purchase or sale of a security; (3) with scienter; (4) that the plaintiff relied upon;[17] (5) causing plaintiff to suffer damages. *Basic*, 485 U.S. at 230-32; *Berger*, slip op. at 18; *Robertson*, 32 F. Supp. 2d at 621. The CC, read in the light most favorable to plaintiffs, adequately pleads each of these elements and therefore states a §10(b) claim.

The Insiders' misstatements concern the condition of Enron's assets and its finances, which are classic allegations actionable under the securities laws. *See Triton Energy*, 2001 U.S. Dist. LEXIS 5920, at *28-*29. Years ago the Fifth Circuit sustained plaintiffs' allegations that a company and its officers made statements inconsistent with the condition of its assets, and adopted worth analyses that were not in accord with its financial affairs. *Rubinstein*, 20 F.3d at 167-68. What the CC alleges as to the Insiders follows the *Rubinstein* and *Triton* analyses.

The Insiders' challenge to the actionability of their statements falls short: Plaintiffs' allegations are worlds apart from the nonactionable statements – a "vague and optimistic" press release containing no concrete factual or material misrepresentation – defendants point to in *Lain v. Evans*, 123 F. Supp. 2d 344 (N.D. Tex. 2000). The Insiders' effort to cast the specific factual claims as "conclusory" is unavailing and their cases are inapposite. The allegations against the Insiders are detailed and specific and show their assertions were known to be false when made, far

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[17] Allegations of individual reliance are not necessary where, as here, a fraud-on-the-market is alleged. *See Basic*, 485 U.S. at 241-47; *Robertson v. Strassner*, 32 F. Supp. 2d 443, 448 (S.D. Tex. 1998); *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972).

beyond general assertions. *Tuchman*, 14 F.3d at 1067. There is nothing conclusory about the CC's detailed description of Insiders' statements.

Courts have routinely sustained the actionability of statements far more generalized than those challenged here:

- proxy solicitation statement that merger was "fair" was actionable under Rule 14a-9 because "such conclusory terms in a commercial context are reasonably understood to rest on a factual basis that justifies them as accurate, the absence of which renders them misleading," *see, e.g., Virginia Bankshares v. Sandberg*, 501 U.S. 1083, 1093 (1991);

- statements that the company was "optimistic" and "believe[s] that 1991 will be another good year" were actionable, *Compaq*, 848 F. Supp. at 1318;

- claims arising from statement that company is a "thriving business," and statements of present reality no less "soft" than "this is a thriving business" were sustained, *Freedman v. Value Health, Inc.*, 958 F. Supp. 745, 760 (D. Conn. 1997);

- §10(b) statements "that the inventory situation was 'in good shape' or 'under control'" were actionable, defendants may be liable for misrepresentations of existing facts, and "complaint allege[d] that the defendants did more than just offer rosy predictions," *Novak v. Kasaks*, 216 F.3d 300, 315 (2d Cir. 2000);

- alleged misrepresentations that loan portfolio was of "'high' quality" and that loan-loss reserves were "'adequate,'" "adequately maintained,'" "'strong,'" and "'solid'" were actionable, *Shapiro v. UJB Fin. Corp.*, 964 F.2d 272, 283 (3d Cir. 1992);

- Rule 9(b) motion denied where complaint alleged that defendant mischaracterized its lending policy as "'conservative'" and its loan-loss reserves as "'adequate,'" *Siebert v. Nives*, 871 F. Supp. 110, 117-18 (D. Conn. 1994); and

- Allegation about falsity of characterization of investment as "'sound and viable'" stated a §10(b) claim, *Seeman v. Arthur Andersen & Co.*, 896 F. Supp. 250, 258 (D. Conn. 1995).

At a minimum, the Insiders' statements, taken together and in context, created a misleading impression. *Isquith ex rel. Isquith v. Middle S. Utils.*, 847 F.2d 186, 203 (5th Cir. 1998) ("emphasis and gloss can ... create liability under ... Rule 10b-5"). "The central issue ... is not whether the particular statements, taken separately, were literally true, but whether defendants' representations, taken together and in context, would have misled a reasonable investor." *McMahan & Co. v. Wherehouse Entm't*, 900 F.2d 576, 579 (2d Cir. 1990).

b. Insiders Are Liable Under §10(b) for Failing to Make Full and Accurate Disclosure of All Material Facts

The CC particularizes defendants' dishonest business practices that were shrouded in secrecy. The fundamental philosophy underlying the federal securities laws is one of complete and accurate disclosure: In enacting the securities laws, "Congress sought 'to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry.'" *Zandford*, 2002 U.S. LEXIS 4023, at *11. "'There cannot be honest markets without honest publicity. Manipulation and dishonest practices of the market place thrive upon mystery and secrecy.'" *Basic*, 485 U.S. at 230. Building upon this foundation, courts have recognized that a duty to disclose material facts arises when ***any*** one of the following three tests is satisfied: (1) when a corporate insider trades securities; (2) when a statute or regulation requires such disclosure; or (3) when a corporation has made "inaccurate, incomplete or misleading" statements prior or contemporaneous disclosures. *See Berger*, slip op. at 18.

Plaintiffs have alleged particular facts that went to the core of Enron's business condition and prospects that should have triggered the Insiders' duty to disclose under each of these three tests. ***First***, because they chose to sell their stock – millions worth for each of them – the Insiders were obligated to inform the public about all material matters, including insurmountable problems with EBS, the failure to deliver VOD, the effects of "snowballing" on international projects, and the abuse of mark-to-market accounting, especially on EES demand-side-management contracts.

Second, securities regulations promulgated by the SEC mandated that the Insiders disclose all known material facts that would tend to contradict or qualify Enron's reported financial results. "Investors have legitimate expectations that public companies are making, and will continue to make, prompt disclosure of significant corporate developments." SEC Release No. 18271, 1981 SEC LEXIS 292, at *13 (Nov. 19, 1981). While Enron was not required to make predictions about its future performance in its public records, pursuant to Item 303 of Regulation S-K, the SEC explicitly ***distinguishes predictions from presently known data that will impact upon future operating results***, which the SEC ***does require to be disclosed*** if material. *See, e.g., In re Caterpillar, Inc.*, SEC Release No. 30532, 1992 SEC LEXIS 786, at *15 (Mar. 31, 1992) (a company must provide sufficient information to permit investors to see the company "'through the eyes of management'").

Third, numerous times during the Class Period the Insiders made public statements regarding the financial condition of Enron, many of which they signed. These public statements were positive affirmations of Enron's current operational and financial condition. Once the Insiders chose voluntarily to speak, they had a duty to tell the whole truth: "As we have long held under Rule 10b-5, 'a duty to speak the full truth arises when a defendant undertakes a duty to say anything.' Although such a defendant is under no duty to disclose every fact or assumption underlying a prediction, he must disclose material, firm-specific adverse facts that affect the validity or plausibility of that prediction." *Rubinstein*, 20 F.3d at 170 (footnotes omitted).

And whether the "full truth" has been disclosed is a jury question. *First Virginia Bankshares v. Benson*, 559 F.2d 1307, 1317 (5th Cir. 1977). As the Fifth Circuit explained: "Generally, like materiality, determining whether information has been adequately disclosed is a mixed question of fact and law and, therefore, is a ***question for a jury***.... Consequently, we will only remove the question from the jury if the disclosure is so obvious that reasonable minds cannot differ." *Isquith*, 847 F.2d at 208.

Insiders made positive statements during the Class Period relating specifically to the various failing business conditions and known problems Insiders knew about or were severely reckless in not knowing about. Thus, unbeknownst to investors, Enron had enormous material problems that wreaked havoc with its financial conditions and prospects. Any reasonable investor would have wanted to know the truth about EBS and Azurix, and how Insiders used mark-to-market accounting for EES contracts that were known when signed to be losing propositions. *See TSC Indus. v. Northway, Inc.*, 426 U.S. 438, 449-50 (1976) ("[a]n omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important;" such a determination necessarily involves "assessments [that] are peculiarly ones for the trier of fact").

(1) Insiders Are Primary Violators Because They Played a "Significant Role" in the Preparation of False or Misleading Statements

In *Central Bank* the Supreme Court emphasized that secondary actors in the securities markets are not always free from liability. 511 U.S. at 191. Primary liability attaches under §10(b) if a defendant played a "significant role" in preparing a false or misleading statement actually uttered by another. *McNamara v. Bre-X Minerals, Ltd.*, No. 5:97-CV-159, 2001 U.S. Dist. LEXIS 4571, at *131 (E.D. Tex. Mar. 30, 2001). *See In re Software Toolworks Sec. Litig.*, 50 F.3d 615, 628-29 (9th Cir. 1994) (accountant primarily liable under §10(b) for role in drafting letter that client sent to SEC); *In re NetSolve, Inc.*, 185 F. Supp. 2d 684 (W.D. Tex. 2001); *Cashman v. Coopers & Lybrand*, 877 F. Supp. 425, 432-34 (N.D. Ill. 1995); *Whirlpool Fin. Corp. v GN Holdings, Inc.*, 873 F. Supp. 111, 119 (N.D. Ill.), *aff'd*, 67 F.3d 605 (7th Cir. 1995); *ZZZZ Best*, 864 F. Supp. 960.

In *NetSolve*, 185 F. Supp. 2d 684, Judge Nowlin expressly upheld a substantial-participation standard for pleading primary liability, implicitly rejecting defendants' bright-line rule. He ruled that adopting the substantial-participation test was perfectly consistent with rejecting the group-pleading doctrine.

> [T]o state a claim against an individual defendant, a plaintiff must allege the defendant contributed in some manner to a misleading statement. Thus, ***if a plaintiff explains how the defendant was involved*** in a misleading press release or analyst conference call, that is sufficient. Or, ***if a plaintiff explains how the defendant ratified or helped prepare another defendant's misleading public statement***, this may suffice.

Id. at 698-99. Thus, in alleging the Insiders' liability, plaintiffs do not attempt to circumscribe the Court's previous rulings that the group-pleading doctrine runs contrary to the 95 Act's pleading requirements.

In *Bre-X Minerals*, plaintiffs alleged violations of §10(b) and Rule 10b-5 arising from a massive securities fraud scheme involving officers, directors, investment bankers and engineers concerning Bre-X's mineral rights to a mining area called "Busang." The defendants falsely represented to the public that Busang contained one of the richest gold deposits ever discovered. 2001 U.S. Dist. LEXIS 4571 at *5-*6. In truth, Bre-X was a fraud. *Id.* at *22, *33-*45. Judge Folsom of the Eastern District of Texas held that defendants who "played a 'significant role' in preparing a false statement actually uttered by another" could be held primarily liable. *Id.* at *132. Thus, where plaintiffs alleged engineering defendants significantly participated in the preparation of studies that were used to attract investors, the allegations were "sufficient to plead [defendant] played a significant role" and, thus, could be held liable under the federal securities laws. *Id.* at *135. Defendants argued that plaintiffs failed to meet their Rule 9(b) burden because they did not plead with particularity each defendant's "precise role" in preparing the misleading reports. *Id.* at *134. The *Bre-X Minerals* court disagreed with their overly demanding standard. Plaintiffs need not plead with particularity the "precise role" of each defendant, especially where such information is "within the exclusive control" of the defendants. *Id.* As Judge Folsom emphasized, the overzealous application of Rule 9(b) "'prior to discovery "may permit sophisticated defrauders to successfully conceal the details of their fraud."'" *Id.*

Similarly, Judge Kent held defendants are primarily liable for securities fraud when they play a substantial role in making misrepresentations uttered by another. *Young v. Nationwide Life Ins. Co.*, 2 F. Supp. 2d 914 (S.D. Tex. 1998). In *Young*, American Century, an advisor, claimed that statements or omissions made by Nationwide could not be attributed to it because aider-and-abettor liability was eliminated by *Central Bank*. *Id.* at 921. But the court held American Century could be liable because it was "not factually clear that American Century did not have a more ***substantial role*** in the alleged misrepresentations." *Id.* And this Court has stated that "'[p]rimary liability may be imposed "'not only on persons who made fraudulent misrepresentations but also on those who had knowledge of the fraud and assisted in its perpetration."'"[18] *BMC Software*, 183 F. Supp. 2d at 905.

The Ninth Circuit reached a similar result in *Software Toolworks*. The Ninth Circuit held a defendant may be found primarily liable under §10(b) for his "significant role" in preparing misrepresentations or omissions. *Software Toolworks*, 50 F.3d at 628 n.3. Plaintiffs had alleged an accounting firm violated §10(b) through its participation in drafting two false and misleading letters the corporation sent to the SEC. *Id.* at 628. The accountant's participation included "'extensive review and discussions'" with the corporation and a "significant role in drafting and editing" the letters. *Id.* at 628 n.3. The district court, interpreting plaintiff's allegations as aiding-and- abetting claims, dismissed pursuant to *Central Bank*. *Id.* The Ninth Circuit reversed, holding "plaintiffs' complaint clearly alleges that [defendant] is primarily liable under section 10(b) for the SEC letters"

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18 Additionally, the Court recognized this principle in the insider-trading context. *See Landry's*, slip op. at 9 n.12 (defendants "need not have made a false or misleading statement to be liable" under §10(b)) (citing *O'Hagan*, 521 U.S. at 652).

and evidence that defendant played a "significant role" "is sufficient to sustain a primary cause of action under section 10(b)." *Id.* And the Ninth Circuit has reaffirmed its position: "substantial participation or intricate involvement in the preparation of fraudulent statements is grounds for primary liability even though that participation might not lead to the actor's actual making of the statements." *Howard*, 228 F.3d at 1061 n.5. And in *ZZZZ Best*, the court held primary liability under §10(b) would lie where accounting firm reviewed, edited or approved financial reports and was "intricately involved" in misrepresentations or nondisclosures made by others. 864 F. Supp. at 970.

Applying a similar rationale, *Murphy* held "any person or entity who directly participates in an alleged violation of § 10(b), even if that person falls within the category of professionals usually deemed 'collateral' participants, may still be liable as a 'primary violator.'" 1996 U.S. Dist. LEXIS 22207, at *17. In *Murphy*, plaintiffs alleged a defendant underwriter's role in the securities fraud arose from a "'close association'" with the defendant company and from continuous access to the individual defendants. *Id.* at *22. Plaintiffs also alleged the underwriter defendants were direct participants in the wrongdoing by their role in "coordinating the offering, drafting disputed offering documents and conducting a due diligence investigation." *Id.* The *Murphy* court held plaintiffs' allegations concerning direct participation by the underwriter were "sufficient to bring the complaint within the scope of allegations similar to those sustained by the Ninth Circuit in Software Toolworks." *Id*. at *23.

The Insiders played a significant role in preparing Enron's false and misleading SEC filings, registration statements, and prospectuses. They controlled the content of various SEC filings, press releases and other public statements pertaining to the Company during the Class Period. ¶90. The financial fraud and fraudulent course of business at Enron permeated virtually all aspects of its operations. The fraud was widespread, involving frequent manipulations of Enron's public disclosures and financial reports via ***huge*** transactions – many of which were entered into at or near the end of reporting periods. ¶395. Further, these transactions were also highly structured and complex, requiring the ***personal attention*** of several top executives of Enron, especially those sitting on the Enron Management Committee. ¶88.

These allegations satisfy the "significant role" for primary liability. The Insiders' actions and conduct were the foundation for the massive Enron fraud. These transactions and accounting manipulations were directly incorporated into, and indeed comprised the very heart of, the numerous press releases, public filings, and other public statements particularly by the Insiders who were on the Management Committee. They had daily contact with each other while running Enron as "hands-on" managers, dealing with the important issues facing its business – WEOS, EES, EBS, the JEDI and LJM partnerships, and the related Fastow-controlled SPEs, and Enron's future revenues and profits. They controlled or possessed the power and authority to control the contents of Enron's registration statements, its Form 10-K SEC filings, its quarterly and annual reports, and press releases, and were provided with copies of the filings, reports and releases alleged to be misleading before or shortly after their issuance and they had the ability and opportunity to prevent their issuance or cause them to be corrected. ¶¶397, 398.

(2) Primary Liability Attaches Even When a Statement is Not Attributable to The Defendant At the Time of Its Dissemination

The severe restrictions on primary liability urged by the Insiders runs counter to the public interest and recent Supreme Court precedent. To find defendants liable only when a misstatement is attributable to them at the time of its issuance would encourage behind-the-scenes involvement in the fraud:

> There is little sense, however, in limiting fraud liability to those whose involvement is public and direct. The vast bulk of securities law makes clear that behind the scenes involvement in fraudulent ***disclosure*** (or actionable nondisclosure), as opposed to mere participation in the fraud, by no means absolves the participant from culpability. The very nature of securities fraud often involves obscuring the source and interests of its authors. People can have a significant influence on how fraudulent disclosure is packaged, and hence how effective it is, without being identifiable to the victim.

Donald C. Langevoort, *Words from on High About Rule 10b-5: Chiarella's History, Central Bank's Future*, 20 Del. J. Corp. L. 865, 889 (1995) (emphasis in original).

Despite these well reasoned viewpoints, defendants insist the Court should follow the Second and Eleventh Circuit opinions of *Wright v. Ernst & Young LLP*, 152 F.3d 169, 171 (2d Cir. 1998), and *Ziemba v. Cascade Int'l, Inc.*, 256 F.3d 1194, 1202-07 (11th Cir. 2001). *See, e.g.,* Causey Brf.

at 2. But these cases misconstrue the holding of *Central Bank*, as is clear from the Supreme Court's newest holding in *Zandford*: "Neither the SEC nor this Court has ever held that there must be a misrepresentation about the value of a particular security in order to run afoul of the Act." 2002 U.S. LEXIS 4023, at *13. Further, the basis for the Second and Eleventh Circuits' holdings, which both reasoned that §10(b) requires that the defendant have either performed a manipulative act or made a false misrepresentation (*see Wright*, 152 F.3d at 174; *Ziemba*, 256 F.3d at 1204), was rejected by the Court: "In reaching this conclusion, we did not ask, as the Fourth Circuit did in this case, whether the directors were misled about the value of a security or whether the fraud involved 'manipulation of a particular security.'" *Zandford*, 2002 U.S. LEXIS 4023, at *15. Rather, the Court "refused to read the statute so narrowly." *Id.* at *16.

The proposition a defendant need not utter a false statement directly to the public in order to incur primary liability under §10(b) is also supported by cases holding that a defendant can be liable for the public misstatements of third parties (such as securities analysts) who act as conduits for the defendant's misrepresentations. *See, e.g.*, *Suna v. Bailey Corp.*, 107 F.3d 64 (1st Cir. 1997); *Elkind v. Liggett & Myers, Inc.*, 635 F.2d 156, 163 (2d Cir. 1980); *Harvey M. Jasper Retirement Trust v. Ivax Corp.*, 920 F. Supp. 1260, 1267 (S.D. Fla. 1995).

c. Insiders' Statements and Omissions Are Not Protected by the 95 Act's Safe-Harbor Provisions or the Bespeaks-Caution Doctrine

(1) The Conference Calls Are Not Protected by the Safe Harbor Provisions

A review of any of the 15 conference calls alleged in the CC shows that the Insiders did not identify their statements as forward looking. Most of these calls, which took place throughout the Class Period, contained no cautionary statements at all. At the very end of the Class Period two calls began with ***boilerplate*** cautions: an 11/12/01 Enron/Dynegy joint conference call about the proposed merger (the boilerplate caution was given by ***Dynegy's*** spokesperson), and an 11/14/01 investor update call. Thus, statements made in these conference calls cannot qualify for safe harbor protection. The 95 Act requires:

(c) Safe harbor.

(1) In general. Except as provided in subsection (b), in any private action arising under this title [15 USCS §§ 78a et seq.] that is based on an untrue statement of a material fact or omission of a material fact necessary to make the statement not misleading, a person referred to in subsection (a) shall not be liable with respect to any forward-looking statement, whether written or oral, if and to the extent that –

(A) the forward-looking statement is –

(i) identified as a forward-looking statement, and is accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement; or

(ii) immaterial; or

(B) the plaintiff fails to prove that the forward-looking statement –

(i) if made by a natural person, was made with actual knowledge by that person that the statement was false or misleading; or

(ii) if made by a business entity; [,] was –

(I) made by or with the approval of an executive officer of that entity; and

(II) made or approved by such officer with actual knowledge by that officer that the statement was false or misleading.

(2) Oral forward-looking statements. In the case of an oral forward-looking statement made by an issuer that is subject to the reporting requirements of section 13(a) or section 15(d) [15 USCS § 78m(a) or 78o(d)],or by a person acting on behalf of such issuer, the requirement set forth in paragraph (1)(A) shall be deemed to be satisfied –

(A) if the oral forward-looking statement is accompanied by a cautionary statement –

(i) that the particular oral statement is a forward-looking statement; and

(ii) that the actual results might differ materially from those projected in the forward-looking statement; and

(B) if –

(i) the oral forward-looking statement is accompanied by an oral statement that additional information concerning factors that could cause actual results to materially differ from those in the forward-looking statement is contained in a readily available written document, or portion thereof;

(ii) the accompanying oral statement referred to in clause (i) identifies the document, or portion thereof, that contains the additional information about those factors relating to the forward-looking statement; and

(iii) the information contained in that written document is a cautionary statement that satisfies the standard established in paragraph (1)(A).

15 U.S.C. §78u-5.

Insiders argue the safe-harbor provision immunizes their misstatements made during analyst conference calls because, for example, an Insider stated that "[e]arlier today we reported our first-quarter 2000 results. We hope you have seen the release." Skilling Brf. at 47. This ignores the fact that listeners were ***not*** directed to cautionary statements in the release and the statement did not identify the conference call as containing any forward-looking statements as required by law.

Further, neither the 95 Act safe-harbor provisions nor the bespeaks-caution doctrine is applicable here because the Insiders had no reasonable basis for their statements, the challenged statements were not in fact forward-looking, and the cautionary language the Insiders point to was inadequate. Indeed, the Insiders knew about the undisclosed facts, which the CC details, that would undermine the accuracy of their statements. *Rubinstein*, 20 F.3d at 171. And "a forward-looking statement that was known to be false when made is actionable." *Seibu Corp. v. KPMG LLP*, No. 3-00-CV-1639-X, 2001 U.S. Dist. LEXIS 15623, at *11 n.4 (N.D. Tex. Oct. 2, 2001). In the Fifth Circuit, "the inclusion of general cautionary language regarding a prediction would not excuse the alleged ***failure to reveal known material, adverse facts***." *Rubinstein*, 20 F.3d at 171.

(2) The Insiders' Statements Were Not Forward-Looking

The 95 Act's safe-harbor provisions and the bespeaks-caution doctrine apply ***only*** to forward-looking statements, and cannot be used to neutralize misrepresentations and omissions of current facts. As Judge Atlas determined, statements not identified as and that are not, in fact, "forward-looking" "do not qualify for 'safe-harbor' protection." *Robertson*, 32 F. Supp. 2d at 450. To claim refuge in the 95 Act's safe-harbor provisions and the bespeaks-caution doctrine, Insiders attempt to transfer their statements of historical or present-tense fact into forward-looking future-tense by truncating them and taking them out of context. Their statements, read as a whole, make misrepresentations and omissions about ***then-existing facts***.

Because several of the allegedly misleading statements referred to then-present factual conditions, or implied background factual assumptions a reasonable investor would regard the speaker as believing to be true, the bespeaks-caution doctrine is no defense. *Id.* at 449. Even if a contested statement contains both a forward-looking and non-forward-looking component, the 95 Act's safe-harbor provision does ***not*** apply. Where a statement with a forward-looking aspect also "encompasses a representation of present fact" that was false or misleading when made, then "surrounding cautionary language could ***not*** have rendered the statement immaterial as a matter of law," and "the bespeaks caution doctrine cannot render misrepresentations of 'hard' fact nonactionable." *Shaw v. Digital Equip. Corp.*, 82 F.3d 1194, 1213 (1st Cir. 1996); *Harris v. Ivax*

Corp., 182 F.3d 799, 806 (11th Cir. 1999) (cited by defendants) ("if any of the individual sentences describing known facts ... were allegedly false, we could easily conclude that [ ] smaller, non-forward-looking statement falls outside the safe harbor").

(a) Skilling's Statements Were Not Forward- Looking

Skilling argues that many of his statements were forward-looking. This is not true. For example, he challenges these two statements concerning Enron's EES unit: "EES would be profitable by the 4th Q99," ¶119, and "EES was on track for at least $8 billion of new contracts during 99," ¶145. These were not forward-looking statements because Enron was not then "on track" nor could it then expect EES to ever be profitable. Skilling Brf. at 46. These statements were made in bad faith and were not reasonably supported by available evidence. *See* ¶¶121(g); 155(e)(f)(g)(o). EES was not, and would not be, profitable in 4thQ 99 since it lost money on each contract it signed. *Id.*

(b) Lay's Statements Were Not Forward-Looking

Lay claims that reams of statements he made to the market should be protected by the 95 Act's safe harbor and the bespeaks-caution doctrine. Lay Brf. at 54-61. But many of his statements are not afforded protection because they occurred during Enron's conference calls with analysts, which did not contain the required forward-looking-statement identification as detailed above. *See, e.g.*, Lay Brf. at 55 (challenging statement in ¶343). Further, Lay would have the Court dismiss numerous statements of material, present fact that he made about Enron by introducing "Trojan Horse" examples – hand-picked and selectively quoted – from the CC. Simply because some of these examples appear to be forward-looking does not mean the Court should throw out the statement. For example, Lay chooses to challenge his statement in ¶343 by quoting the phrase: "'We expect [EES] to continue to grow very, very strong ....'" Lay Brf. at 55. This statement only appears to be forward-looking. Lay's quotation disguises the fact that, immediately preceding this sentence, he stated: "***Enron Energy Services, of course, in recent, fairly new business, only started about five years ago ... but in that business, over the last two or three years, we have been doubling revenue and doubling income quarter-on-quarter, year-on-year for now about the last three years***." ¶343. This was a statement of a then-existing fact, which was materially false and misleading and does not deserve the safe-harbor protection, or the benefit of the bespeaks-caution doctrine. Other examples abound. In the following text, lifted from the CC, Lay challenges only the ***non***-highlighted language, while plaintiffs challenge the whole excerpt:

> ***Enron Broadband Services is off to a tremendous start: we own and operate a superior intelligent fiber optic network that is focused on delivering bandwidth-intensive content, such as TV-quality video, over the Internet.... We are establishing benchmark bandwidth contracts and making a market in bandwidth. We initiated the first bandwidth trade in December 1999.*** The market for bandwidth intermediation will grow from $30 billion in 2000 to $95 billion in 2004. With our head start, we expect to become the leader in this field.

Compare Lay Brf. at 57 *with* ¶215. It is clear that present-tense language such as "we own and operate a superior intelligent fiber optic network" is not forward-looking but, rather, a false representation about then-existing facts. The Court should not reject whole statements because Lay has selectively quoted language out of context.

(3) Any Forward-Looking Statements Were Not Protected by the Safe-Harbor Provisions or the Bespeaks-Caution Doctrine

(a) Plaintiffs Have Adequately Alleged Actual Knowledge of the Falsity of the Statements When Made

The Court has made clear "[t]he safe harbor provision does not apply where the defendants knew at the time that they were issuing statements that the statements contained false and misleading information and thus lacked any reasonable basis for making them." *BMC Software,* 183 F. Supp. 2d at 881 n.28; *Landry's*, slip op. at 58 (same). Even if the Court were to find certain Insiders' statements to be forward-looking, they are still actionable if the defendant did not have a basis for the representation. Plaintiffs have demonstrated that the Insiders did not believe their projections and other forward-looking statements to be true.

For example, Skilling challenges the financial projections found in ¶¶197, 224, 247, 263, 271-272, 282, 317, claiming they are protected by the safe harbor. Skilling Brf. at 46. But he made each of these statements in bad faith and with no reasonable basis. Enron had repeatedly manipulated its financial statements before and throughout the Class Period. Skilling knew that, at any point if Enron properly accounted for its business activities it would not be able to meet the stated projections. Only by continuing to perpetrate their fraudulent scheme would the Insiders be able to meet their estimates. Skilling was aware that Enron had been falsifying its financial statements by hiding substantial debt and overvaluing contracts and other assets. Consequently, he knew that the only way Enron could meet the public projections was by continuing the scheme that artificially drove up the stock price.

In this Circuit, "the inclusion of general cautionary language regarding a prediction [does] not excuse the alleged failure to reveal known material, adverse facts." *Rubinstein*, 20 F.3d at 171.[19] "'Only if a disclosure was "so obvious that reasonable minds could not differ" can the issue of whether shareholders have been adequately cautioned about the risks be settled as a matter of law. Moreover, inclusion of some cautionary language in a company's disclosures is "not enough to support a determination as a matter of law that defendant's statements were not misleading."'" *Robertson*, 32 F. Supp. 2d at 450. Furthermore, whether purportedly cautionary language is sufficient to immunize defendants' forward looking statement is properly reserved for the trier of fact since it requires "'delicate assessments of the inferences a "reasonable shareholder" would draw.'" *Fecht*, 70 F.3d at 1080. ***In sum***, this issue should not be determined on a motion to dismiss. *In re Wells Fargo Sec. Litig.*, 12 F.3d 922, 930 (9th Cir. 1993).

(b) Insiders' Cautionary Language Was Not Meaningful

Insiders contend the bespeaks-caution doctrine and 95 Act safe harbor applies because their "detailed and informative warning[s were] just the type of cautionary statement that the 95 Act had in mind." Skilling Brf. at 47. But their supposed warnings were boilerplate and fell far short of the specific disclosures necessary to invoke the protections of the bespeaks-caution doctrine. A decade ago the Supreme Court foreshadowed the complexities – and the ironies – of the Enron fraud: "[N]ot

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19 Insiders' reliance upon *In re Donald J. Trump Casino Sec. Litig.*, 7 F.3d 357, 371 (3d Cir. 1993); *In re Royal Appliance Sec. Litig.*, No. 94-3284, 1995 WL 490131, at *3 (6th Cir. Aug. 15, 1995); *Mercury Air Group, Inc. v. Jet USA Airlines, Inc.*, No. 97 CIV 3473, 1998 WL 542291, at *4 (S.D.N.Y. Aug. 26, 1998), *aff'd*, 189 F.3d 461 (2d Cir. 1999); *Stavroff v. Meyo*, No. 95-4118, 1997 WL 720475, at *5 (6th Cir. Nov. 12, 1997); *Grossman v. Novell, Inc.*, 120 F.3d 1112, 1122 (10th Cir. 1997); *P. Schoenfeld Asset Mgmt. L.L.C. v. Cendant Corp.*, 47 F. Supp. 2d 546, 556 (D.N.J. 1999), *vacated on other grounds sub nom.*, *Semerenko v. Cendent Corp.*, 216 F.3d 315 (3d Cir. 2000); and *Rhodes v. Omega Research, Inc.*, 38 F. Supp. 2d 1353, 1363 (S.D. Fla. 1999), for the proposition that forward-looking statements accompanied by tailored and specific cautionary warnings are protected from liability is misplaced. Their purported warnings were inadequate to entitle their statements to protection under the bespeaks-caution doctrine because they were neither sufficiently tailored nor specific.

every mixture with the true will neutralize the deceptive. If it would take a financial analyst to spot the tension between the one and the other, whatever is misleading will remain materially so, and liability should follow." *Virginia Bankshares,* 501 U.S. at 1097.

Insiders' supposed cautionary statements were routine listings of the very types of broad, ordinary, competitive and political factors that, as *Berger* held, fail to bespeak caution. Slip op. at 25-26. Their ostensible warnings, such as the ability to penetrate the broadband service market, were either vague cautionary language to which the bespeaks-caution doctrine does not apply or were themselves misleading statements. *Rubinstein*, 20 F.3d at 171.

What Insiders refuse to acknowledge is that plaintiffs had no way of knowing Enron's true financial condition at the time they purchased their shares. It is impossible for plaintiffs to know what insiders purposefully omitted from their public statements and failed to disclose to the market in their public filings and conferences. The Fifth Circuit's admonition two decades ago is squarely on point: "'To warn that the untoward may occur when the event is contingent is prudent; to caution that it is only possible for the unfavorable events to happen when they have already occurred is deceit.'" *Id.* And their arguments that ***other documents*** bespoke caution are of no avail because purported cautionary statements can only bespeak caution as to other forward-looking statements in ***the same*** document. *Fecht*, 70 F.3d at 1082. For example, EBS executive Hirko argues that ***analysts*** reported to the market the risk of bandwidth capacity. Hirko Brf. at 12. This third-party caution cannot bespeak-caution as to ***Enron's*** repeated reports of the "tremendous potential" of its broadband business. ¶136.

(c) Insiders' Purported Disclosures Were Not Only Non-Existent, Misleading and Inadequate, but Also Were Buried and Incomprehensible

Insiders' remarkable assertion that "Enron's disclosures were adequate, complete and disclosed the facts Plaintiffs contend were concealed or misrepresented," Jt. Def. Discl. Brf. at 2, are belied by the Enron Board of Investors' Special Investigative Committee's conclusions that:

> [T]he footnote disclosures ***failed to achieve a fundamental objective: they did not communicate the essence of the transactions in a sufficiently clear fashion*** to enable a reader of the financial statements to understand what was going on. Even after months of investigation, and with access to Enron's information, ***we remain uncertain as to what transactions some of the disclosures refer***. ***The footnotes also***

> ***glossed over issues concerning the potential risks and returns of the transactions, their business purpose, accounting policies they implicated, and contingencies involved. In short, the volume of details that Enron provided in the financial statement footnotes did not compensate for the obtuseness of the overall disclosure***.

Powers Report at 197. *See also* Pl. Mot. to Strike Jt. Discl. Brf. at 12 (and the entire brief) which rebuts defendants claimed "disclosures."

Insiders argue that, through text and notes in their 00 Annual Report and similar statements in financial statements, Enron disclosed sufficient information to calculate total on and off-balance-sheet exposure of over $66 billion. Jt. Def. Discl. Brf. at 12-13. In fact, the amount Enron considered as debt was only $10.229 billion in 00, according to the Form 8-K filed on 11/8/01, ***not*** $66 billion. *See* SEC App. Tab 76 at 4; Plt. Mot. to Strike Jt. Discl. Brf. at 14-17. Moreover, such tucked-in-a-back corner, piecemeal disclosures cannot cure their misrepresentations about Enron's "successes"[20] and "strength"[21] and absence of accounting issues,[22] which omitted Enron's enormous off-the-books debt. For example, in one case the court was "unpersuaded that defendants' appendix of the marketing agreement to the Form 10-K constituted a disclosure of adverse information ***sufficient to neutralize***" defendants' misleading statements. *See Marksman Partners, L.P. v. Chantal Pharm. Corp.*, 927 F. Supp. 1297, 1307 (C.D. Cal. 1996). In another, the court found the proxy statement to be materially misleading for prominently disclosing an investment adviser's favorable opinion, but ***burying in an appendix*** that the adviser had failed to evaluate the firm's assets. *Kohn v. Am. Metal Climax*, 322 F. Supp. 1331, 1362-63 (E.D. Pa. 1970).

This is especially true here. Insiders essentially admit that Enron's disclosures were buried among notes to securities filings, which required investors to piece together information from various notes to start calculating Enron's real debt and risk exposure. Jt. Def. Discl. Brf. at 12. To the contrary, "courts interpreting the securities laws have long recognized that reviewing the context in which a disclosure appears is an essential part of determining the disclosure's adequacy." *Isquith*,

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20 *See, e.g.*, statement by Skilling on 8/14/01 analysts' conference call, participated in by Causey, Fastow, Kean, and Lay that Enron was "succeeding very, very well." ¶343.

21 *See, e.g*., statements by Lay on same (8/14/01) conference call, including "[t]he company is very strong," there were "no accounting issues." ¶¶343, 344.

22 *See* statements by Lay on same conference call that there were "no accounting issues." ¶344.

847 F.2d at 201. Plaintiffs urge the Court to study the purported Enron disclosure as to debt or transaction risk – the depth of its complexity is marked by its indecipherable prose. For an in-depth analysis of defendants' disclosures, *see* plaintiffs' Motion to Strike Certain Defendants' Joint Disclosure Brief.

d. The Complaint Pleads Actionable Misstatements and Omissions, Not Vague Expressions of Optimism

The CC's detailed allegations of fraud are not rendered inactionable by Insiders' claims of "puffing," especially where, as here, they can only point to selective statements as possible support of their defense. A district court in this Circuit rejected this defense in April: "[T]he complaint sets forth a series of detailed allegations, which rebut the claim that the company was making merely optimistic statements about its products.... Alternatively, even if the court were to find that these select 'puffing' allegations (in total only a few sentences from five different paragraphs of a 52-page complaint) were not actionable, the defendants fail to address [plaintiff]'s other detailed allegations of fraud." *Haack*, 2002 U.S. Dist. LEXIS 5652, at *15-*16 (footnote omitted). Nonetheless, some Insiders ask the Court to focus on a few out-of-context statements they attack as non-actionable "puffing" and to ignore the forest of fraud displayed in the CC. Plaintiffs specify Insider's knowledge of and participation in complex, undisclosed transactions to overvalue assets and hide Enron's current debts and contingent liabilities, while substantially participating in making positive statements about its current business condition and prospects, which they knew or were severely reckless in not knowing were contradicted by internal, undisclosed information.

The characterization of a statement as "puffing" is a conclusion that, as a matter of law, is "immaterial, either because it is so exaggerated ... or so vague ... that a reasonable investor would not rely on it considering the 'total mix' of [available] information." *Hoxworth v. Blinder, Robinson & Co.,* 903 F.2d 186, 200-01 (3d Cir. 1990). *See Basic*, 485 U.S. at 231. In the §10(b) context, an omitted fact is material if there is a substantial likelihood that its disclosure would have been viewed by a reasonable investor as having significantly altered the "'total mix'" of available information. *TSC Indus.*, 426 U.S. at 449. Consequently, courts examine so-called puffery in context. For example: a statement that the company believes an acquisition will enhance its competitive position was not a general, non-specific statement – inactionable puffery – as it linked future success and the acquisition. *In re MobileMedia Sec. Litig.*, 28 F. Supp. 2d 901 (D.N.J. 1998). And a statement that a company was confident of achieving at least 7% real earnings growth was ***not*** the type of vague expression of optimism that has been found immaterial. *Weiner v. Quaker Oats Co.*, 129 F.3d 310, 320 (3d Cir. 1997). An examination of the statements in this case, reviewed in context, compels the conclusion that the Insiders' statements were sufficiently specific and material.

Insiders' characterization of their statements as merely statements of optimism disregards settled precedent that statements of opinion are actionable. *See Cooper*, 137 F.3d 616; *Shaw*, 82 F.3d at 1218. Further, it ignores that the CC also pleads non-disclosures –material omissions: what they knew but didn't say – and not simply overly optimistic statements. ***Specific*** statements were materially misleading because they failed to disclose adverse facts directly contradicting those statements. *MobileMedia*, 28 F. Supp. 2d at 930. The Insiders cannot escape the well-settled rule in this circuit that statements about a company's business that are ***made without reasonable basis*** can be material and actionable. *Rubinstein*, 20 F.3d at 166; *Robertson*, 32 F. Supp. 2d at 449.

Insiders ignore relevant, controlling authority. The Fifth Circuit has sustained allegations about defendants' statements that "'[w]e're very pleased with the consistency of our financial progress,'" "'[o]ur outlook continues to call for a strong second half,'" "'[w]e're confident that Compaq's new business model will accelerate market share gains and improve profitability,'" "'[o]ur outlook continues to call for a strong fourth quarter performance, with a healthy outlook for 1998,'" and that Compaq had not "'had any major problems adopting the new strategy to its dealer network.'" *Berger*, slip op. at 4-7.[23]

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[23] *See also In re Computer Assocs. Class Action Sec. Litig.*, 75 F. Supp. 2d 68 (E.D.N.Y. 1999) (statements actionable that "'business is stronger than ever,'" that there was "'strong worldwide demand'" for the defendant company's software, that the company's "'business fundamentals are strong,'" and that the company was "'solidly positioned for growth'"); *Fecht*, 70 F.3d at 1081 (company "'anticipates a continuation of its accelerated expansion schedule,'" representing that it "'feels a little more optimistic about our near-term future than [it] did at the end of the last quarter,'" predicting "'overall improvement in the sales trend'"); *Kaplan v. Rose*, 49 F.3d 1363, 1375-76 (9th Cir. 1994) (company's competitive position was "'strong,'" "'[p]rogress is excellent,'" "'our outlook is bright,'" and "'we see increased sales activity'" as [t]he market is responding favorably'" to a new product).

Moreover, allegations very similar to those in the CC have been sustained: company "continues to strengthen its leadership position within the emerging Internet device marketplace," "the recent quarter was extremely positive," and "the recent progress of Spyglass has strengthened our leadership position within the market and put us in an excellent position to capitalize on the tremendous growth opportunities " in the Internet marketplace. *In re Spyglass, Inc.*, No. 99 C 512, 1999 U.S. Dist. LEXIS 11382, at *7 (N.D. Ill. July 20, 1999). With direct implications for the bloated Enron EES contracts, which were accounted for through the misuse of mark-to-market accounting, the *Spyglass* court upheld these allegations, noting that plaintiffs "***contend the positive news was misleading because defendants omitted informing the public that certain contracts were not likely to close as had previously been expected***." *Id.*

In the Fifth Circuit, when executives make optimistic public statements about their company's business and products, their failure to correct those statements, in light of subsequent developments and other adverse business conditions, can state a claim: "[O]ptimistic projections became materially misleading when subsequent testing and production undermined the basis of those projections.... [D]efendants have a duty under Rule 10b-5 to correct statements if those statements have become materially misleading in light of subsequent events." *See, e.g., Rubinstein*, 20 F.3d at 170 n.41. Here, Insiders' Class-Period statements about Enron's current business condition and financial prospects were actionable because they were made either without a reasonable basis or, at the very least, they required correction at some point during the Class Period.

In this regard, Insiders' reliance on *Wielgos v. Commonwealth Edison Co.*, 892 F.2d 509 (7th Cir. 1989), is misplaced because the court held that defendant "needn't disclose the hazards of its business, hazards apparent to all serious observers and most casual ones." *Id.* at 515. That is not the case here. Insiders' statements omitted any explanation, for example, of the secret SPEs, hedges, and dark-fiber swaps without economic substance, which made possible the complex fraud to hide Enron's huge debt that went undisclosed until its house collapsed. Moreover, they mistakenly rely on cases, such as *In re Verifone Sec. Litig.*, 784 F. Supp. 1471 (N.D. Cal. 1992), *aff'd*, 11 F.3d 865 (9th Cir. 1993), where the complaint alleged "a failure to disclose a forecast of ***future*** sales and revenue," 11 F.3d at 869, as well as others involving only vague ***predictions*** of growth.

The CC, by contrast, alleges that defendants deliberately mischaracterized ***current*** facts. "Present, known information that strongly implies an important future outcome is not immune from mandatory disclosure merely because it does not foreordain any particular outcome." *Shaw*, 82 F.3d at 1210. Shareholders pay close attention to opinions of corporate insiders because they "usually have knowledge and expertness far exceeding the normal investor's resources." *Virginia Bankshares*, 501 U.S. at 1091. Thus, even conclusory expressions of insiders "are reasonably understood to rest on a factual basis that justifies them as accurate, the absence of which renders them misleading." *Id.* at 1093. And the *Compaq* court was "not persuaded that management's statements about general economic matters could never be material." 848 F. Supp. at 1315.

Insiders' suggestion that plaintiffs allege only "misjudgments" with respect to their failure to disclose known, material information is wrong. The CC's allegations are unlike the cases cited by defendants, in which plaintiffs alleged ***only*** that defendants had failed to exercise good business judgment, and had not made misrepresentations and omissions of material facts. *Melder v. Morris*, 27 F.3d 1097, 1101 n.8 (5th Cir. 1994) (plaintiffs pointed to no misleading statements, thus had failed to allege scienter); *Isquith v. Caremark Int'l*, 136 F.3d 531, 534 (7th Cir. 1998) (no purchase or sale of securities).

In sum, plaintiffs have alleged specific facts establishing that when the Insiders' statements were made they were false and lacked a reasonable basis, and that their knowledge of undisclosed, material facts undermined their positive statements about Enron's current conditions and prospects. When taken together, or even viewed separately, the allegations support an inference that the Insiders did not have a reasonable basis for their statements, which, drawing all reasonable inferences in plaintiffs' favor, were material and are therefore actionable.

The responses below to the specific purported puffing examples, pointed to by Lay, Skilling, and Sutton, are representative as to why the statements of all Insiders are not mere puffery.

(1) Lay's Statements Were not Mere Puffery

Plaintiffs' claims against Lay are hardly non-actionable "cheerleading statements" as Lay argues. Lay Brf. at 2. Examples of Lay's statements that he deems to be nothing more than "inactionable puffery," Lay Brf. at 48-49, and why the statements are indeed actionable misrepresentations, are set forth below:

Lay's Statements	Reason Statement is not Puffery
"Entertainment on-demand is perhaps the most visible example of the power of Enron's broadband applications. With Blockbuster's extensive customer base and content, and Enron's network delivery application and the capabilities of the distribution providers, we have put together the 'killer app' for the entertainment industry." ¶240; Lay Br. at 48. "[I]t means we're going to change the whole entertainment experience for the average American over the next few years .... [T]he main thing about the agreement is it's a 20-year exclusive agreement between Blockbuster and Enron, to provide entertainment on demand .... ***[W]e bring in our technology and our broadband system, worldwide***." ¶241; Lay Br. at 49.	Enron's broadband network was plagued by persistent technical difficulties and intractable problems, including the lack of a viable InterAgent program. As a result, Enron did not currently have, and would not in the foreseeable future, have a functioning broadband network. ¶300(h).
"***Our strong results reflect breakout performance in all or our operations," ... "Our wholesale services, retail energy and broadband business further expanded their leading market positions, as reflected in record levels of ... profitability...."*** Retail Energy Services: ...Enron Energy Services reported $103 million of recurring IBIT during 2000 compared to a loss of $68 million in 1999. Revenues increased 155 percent to $4.6 billion in 2000. Enron Energy Services executed $16.1 billion of new contracts during 2000, representing customers' future expenditures for natural gas, power and energy services, which is almost double the $8.5 billion contracting level in 1999.... ***Major long-term energy management agreements announced during 2000 include new contracts with Chase, IBM Quebecor, Starwood Hotels and Sonoco and expanded contracts with Compaq and Simon Properties.*** ¶281.	EES was in fact losing hundreds of millions of dollars on many of its retail-energy contracts. To claim growth, Enron had "purchased" its customers' participation by charging low prices Enron knew would result in losses, and agreeing to spend millions to purchase energy-efficient equipment to upgrade customers' facilities, which guaranteed losses on most contracts. In addition, anticipated revenues from each contract were pulled into a single quarter by misusing mark-to-market accounting. ¶300(g).
"***There were no changes in Enron's earnings outlook.... [T]he company is on solid footing and was looking forward to continued strong growth***. [Enron] had a very, very strong first half, second quarter ... second quarter net income is up 40% , earnings per share up about 32%. In the last five years, [Enron] had 20% per year compound annual growth and earnings	Lay's statement (¶343) completely misrepresented Enron's condition at the time (8/14/01). Enron was on the verge of complete collapse due to the accumulated weight of the falsification of its results. ¶360. The specific statements about EES were actionable misrepresentations for the reasons listed above. ¶300(g).

Lay's Statements	Reason Statement is not Puffery
per share. ***If anything, there seems to be even a little acceleration in the company's both financial performance and operational performance.... I see absolutely no change in our business direction or our business strategy"*** ... "You can go back over a ten-year period, the income before interest and taxes has, in fact, been increasing at about 30% per year, compounded and that growth has been stronger in the last couple of years as you also know.... Retail or Enron Energy Services, of course, in recent, fairly new business, only started about five years ago ... but in that business, over the last two or three years, we have been doubling revenue and doubling income quarter-to-quarter, year-on-year for now about the last three years. ***We expect that to continue to grow very, very strong****....* [T]he company believe[s] that the Enron Energy Services component could become as large or larger than Enron's wholesale business within a five or six year period or so." ¶343; referred to at Lay Br. at 48.	

(2) Skilling's Statements Were not Mere Puffery

Plaintiffs' claims against Skilling are actionable and not, as he argues, puffing. Skilling Brf. at 52-53. He made enumerable misrepresentations about Enron's financial condition and specific businesses. *See, e.g.*, ¶¶145, 224, 263, 282. None of them were puffing. The statements Skilling singles out to criticize (Skilling Brf. at 55) are material, actionable misrepresentations. For example, his misrepresentations that Enron had a "very strong growth rate" and "strong earnings," on 12/13/00, were material in light of, among other things, Enron's inflation of its earnings, and concealment of billions of dollars of debt. ¶¶300, 418-611.

(3) Sutton's Statements Were not Mere Puffery

Likewise, the claims against Sutton are not puffing. Sutton Brf. at 12-13. He points solely to the following 07/99 conference-call and follow-up analyst meetings in which he participated as puffing:

> EPS in the 2ndQ increased 29% to $.27 per share compared to $.21 in the 2ndQ of last year. Net income in the 2ndQ increased 53% to $222 million up from $145 million last year.

> Enron had a great quarter. Enron was hitting on all eight cylinders. Enron was very pleased with the results for the quarter and very optimistic about the outlook for the future. Enron was very optimistic about how the business was playing out.
>
> Overall, Enron's businesses had been performing well. Enron was well positioned for significant continued growth.

¶157; Sutton Br. at 12. These were not statements of corporate optimism. Rather, these statement set forth specific fraudulent data about Enron's net income, as well as its prospects. *See* ¶214 (results were false and misleading because they inflated Enron's revenue and earnings, concealed billions of dollars of debt that should have been shown on Enron's financials, as described in ¶¶418-611).

(4) Insiders' Statements Via the Conduit of Analysts Are Actionable

Insiders argue that challenged statements made by third-party securities analysts cannot be actionable. But allegations that they communicated false statements directly to analysts to ***use them as conduits*** to the securities market can provide the basis for imposing liability under §10(b): "'Corporate defendants may be directly liable under 10b-5 for providing false or misleading information to third-party securities analysts [defendants] cannot escape liability simply because [they] carried out [the] alleged fraud through the public statements of third parties.'" *Robertson*, 32 F. Supp. 2d at 450.

3. The Complaint Alleges Facts Giving Rise to a Strong Inference of Scienter

a. The 95 Act's Scienter Standard

As amended by the 95 Act, 15 U.S.C. §78u-4(b)(2), the 1934 Act requires that a complaint asserting claims under §10(b) "state with particularity facts giving rise to a strong inference that the defendant[s] acted with the required state of mind." The Fifth Circuit has joined with the First, Third, Sixth and Eleventh Circuits in ruling that "recklessness" or "conscious misconduct" still constitutes scienter for §10(b) and Rule 10b-5 claims: "The PSLRA neither mandated nor prohibited ***any*** particular method of establishing a strong inference of scienter," and further ruled that "circumstantial evidence can support a strong inference of scienter." *Nathenson*, 267 F.3d at 410-11 (emphasis in original). And as a method of proving scienter, "motive and opportunity could be 'relevant' to pleading scienter and 'may, on occasion, rise to the level of creating a strong inference of reckless or knowing conduct.'" *Id*.

Plaintiffs have complied with the Fifth Circuit's rule that plaintiffs "must plead specific facts constituting strong circumstantial evidence of conscious misbehavior or recklessness and motive and opportunity may be considered as a factor in determining whether a strong inference has been raised." *Abrams v. Baker Hughes, Inc.*, No. 01-20514, 2002 U.S. App. LEXIS 9565, at *7 (5th Cir. May 21, 2002). The Court is instructed to "consider whether all facts and circumstances 'taken together' are sufficient to support the necessary strong inference of scienter on the part of the plaintiffs." *Id*. at *12. Here, despite the Insiders' attempt to parse the allegations in the CC into discreet bits, if the Court examines the CC as a whole, the evidence of the Insiders' scienter is simply overwhelming.

b. The Complaint Alleges Facts Indicating Conscious Misbehavior or Recklessness

(1) The Alleged Misstatements and Omissions about Enron Businesses – Problems that Would Be Obvious to Insiders – Support a Strong Inference of Scienter

Scienter may be alleged by specifying problems that, if true, would have been obvious to the Insiders. That is, where top executives obviously would have known of the alleged problem, "plaintiffs are not alleging scienter based solely on the individual defendants' positions as officers." *NetSolve*, 185 F. Supp. 2d at 697 (scienter found through allegations that company was experiencing significant customer losses due to service problems that would have been obvious to company's top officers).

Insiders' misstatements about core Enron businesses demonstrate a strong inference of scienter under any applicable pleading standard. Scienter was adequately pleaded in *Nathenson* for statements about patent protection for a product that was "obviously important," involved substantial company efforts, and about which the CEO had "ample opportunity to become familiar." 267 F.3d at 425. Facts critical to a business's core operations or an important customer generally are so well known to senior executives that knowledge may be attributed to them for pleading purposes. *Kurtzman v. Compaq Computer Corp.*, No. H-99-779, slip op. at 38 (S.D. Tex. Apr. 1, 2002)

("Courts have continuously held that knowledge of core business matters can be inferred to the officers and directors of a company."); *see also Cosmas v. Hassett*, 886 F.2d 8, 10, 13 (2d Cir. 1989) (finding scienter by attributing to directors knowledge of recent import restrictions that eliminated company's self-described "important" new revenue source); *In re Ancor Communications*, 22 F. Supp. 2d. 999, 1004 (D. Minn. 1998) (knowledge of potential incompatibility of the company's technology with a key customer may be imputed to officers and directors and supports strong inference of scienter under the strictest interpretation of 95 Act) (referred to by the Fifth Circuit in *Nathenson*, 267 F.3d at 425). "[T]he fact that a particular matter constitutes a significant source of income to a company can establish a strong inference that the company and its relevant officers knew of easily discoverable additional facts that directly affected that source of income." *Epstein v. Itron, Inc.*, 993 F. Supp. 1314, 1325-26 (E.D. Wash. 1998).

Pleading the Insiders' positions, only one component establishing scienter, dovetails with detailed facts about their involvement with Enron's core businesses, risk-management, complex SPEs, fraudulent financial structures, and off-balance-sheet transactions to hide Enron's debt and liabilities. This is then contrasted with what the Insiders told the public about the true state of affairs at the Company. "One of the classic fact patterns giving rise to a strong inference of scienter is that defendants published statements when they knew facts or had access to information suggesting that their public statements were materially inaccurate." *See Fla. State Bd. of Admin. v. Green Tree Fin. Corp.*, 270 F.3d 645, 665 (8th Cir. 2001). Simply stated, "[c]ommon sense dictates that, unless there is some type of catastrophic intervening event ... problems of this type and magnitude likely develop over time, and do not become apparent to management all at once." *In re Grand Casinos Sec. Litig.*, 988 F. Supp. 1273, 1283 (D. Minn. 1997). Moreover, alleged knowledge of undisclosed factors that may impact on important contracts – like the known EES contract deficiencies – supports a strong inference of scienter. As one court found, alleged undisclosed knowledge of potential systems incompatibility that could adversely impact on a highly significant contract, "may be imputed to Defendants and supports a strong inference of scienter." *Ancor Communications*, 22 F. Supp. 2d at 1005.

Some of the undisclosed factors affecting Enron's contracts and core businesses – and their valuation – that support a strong inference of scienter include:

- Undisclosed information about Enron's Dabhol, India power-plant disaster, including huge cost overruns, the uncollectability of the rates Enron would need to charge to recoup its investment, and that Indian government officials would oppose paying power rates that Enron was charging. ¶155(h).

- The failure to disclose Enron International's expensive failed projects, including the failure to expense costs on failed projects, the failure to expense escalating costs of bidding on large projects that were lost, and the multi-year deferral – "snowballing" – of accumulated expenses, with a cash-burn rate of as much as $1 million per month; the "snowball" grew so large that an international accounting officer repeatedly told CFO Causey a writedown had to be taken because so many proposals were no longer even arguably viable. ¶155(k).

- The undisclosed but foregone conclusion that Azurix would not become a major global water company or be accretive to Enron's earnings, including gross overpayment for Wessex Water of hundreds of millions of dollars more than the company was worth, which Insiders knew would result in a write-down of this overvalued asset; and the extraordinary high risk and unlikelihood of even adequate returns due to Enron's creation of a purported worldwide business without adequate feasibility studies or creation of a detailed business plan. ¶155(n).

- Undisclosed factors making EES's contracts to provide businesses demand-side management of bundled energy-related products and services, money losers, including individualization of the contracts precluding economies of scale, lack of sufficient billing infrastructure; and the huge current capital expenditures to upgrade customer facilities, which guaranteed losses on most contracts. Enron also specifically failed to disclose specific significant money-losing contracts, including:

    - the J.C. Penney contract losses of $60 million;

    - significant losses on the IBM contract from the outset;

    - millions in losses on the Citigroup contract from its inception; and

    - Eli Lilly contract's requirement that Enron had to invest $168 million ***up front*** (including $50 million in cash paid to Lilly just to sign the deal), making the contract one on which Enron would suffer a loss, contrary to its announcement that the contract was a $1.3 billion deal. ¶339.

- The failure to disclose that Enron's VOD/Blockbuster venture and related delivery technology and expertise, and necessary fiber-optic communications network were a complete sham from inception; and that the publicly touted successful test of the system in 12/00 in fact failed. ¶¶40, 41, 282, 300(o), 521. The deal was such a disaster that Enron suddenly announced termination in 3/01. ¶301.

- Undisclosed realities of Enron's transactions with SPEs, which were a massive and widespread part of Enron's "business." ¶¶21-28, 646-647. For instance, Enron treated asset transfers to SPEs, including energy-related projects and dark-fiber swaps, as sales when they should have been treated as loans. These transactions permitted Enron to not only report sales revenues, but also to conceal massive debt. ¶¶496-505.

- Undislosed financial fraud and fraudulent course of business permeating virtually all aspects of Enron's operations, including all three core business operations: WEOS, EES and EBS. ¶395.

The results of Enron's WEOS business – its ***largest*** business unit – were manipulated and falsified to boost its reported profitability by:

- phony or illusory hedging transactions with entities not independent of Enron;
- the abuse of mark-to-market accounting; and
- "moving the curve" – arbitrarily adjusting values upward at quarter's end to boost the wholesale operations profit for the period.

These transactions were large, frequent, widespread, often at quarter's end, and were highly structured and complex, requiring the personal attention of top Insiders. *See* ¶¶155(e), 214(e), 300(e), 395.

- The failure to disclose that Enron's broadband services (EBS) – supposedly a big and growing business – was a complete fiction. EBS never developed an intelligent network, never developed beyond the conceptual stage, and that at 12/31/00 most of the network was still dark and not functioning. ¶595.
- Undisclosed realities of Enron's massive so-called "commodities trades" and "swaps" entities owned by J.P. Morgan and CitiGroup, and with CS First Boston. These transactions were actually disguised loans. ¶¶44-46.
- Failure to disclose that Enron's key business strategies of "risk management" and "hedges" to allegedly limit risk were not real economic hedges because the economic reality was that Enron ***never*** escaped the risk of loss. ¶33.

(2) Internal Complaints Made to Insiders, Contrasted with Inconsistent Optimistic Statements, Strongly Establishes Conscious Misbehavior or Recklessness

Conscious misbehavior or recklessness may be pleaded by alleging factual circumstances supporting a strong inference that defendants had actual knowledge, or recklessly disregarded, that their allegedly fraudulent statements were untrue when made or were made without reasonable basis. *Lovelace*, 78 F.3d at 1018-19; *Zuckerman*, 4 F. Supp. 2d at 623. Here, internal complaints made to Insiders – about accounting practices – for one, failing EES contracts, for another, and snowballing costs, for a third, easily satisfy the standard. The CC's detailed allegations establish Insiders' actual knowledge concerning the falsity of their statements, including allegations that Enron employees complained directly to them about improper EES contract practices and, as another example, improper recognition of Enron's own stock-price appreciation. And they acted with scienter when they ignored these complaints. "'[A] conscious purpose to avoid learning the truthfulness of a statement is an extreme departure from the standards of ordinary care.'" *Fine v. Am. Solar King Corp.*, 919 F.2d 290, 297 (5th Cir. 1990); *see also Scheiner v. i2 Techs., Inc.*, No. 3:01-CV-418-H, bench op. at 5 (N.D. Tex. Apr. 11, 2002) (allegations about complaints made to defendants about the company's product sufficiently pleaded scienter).

The CC thus provides detailed factual allegations about the Insiders' actual knowledge, and cannot be likened to the inadequate "general averments" in *Mortensen v. AmeriCredit Corp.*, 123 F. Supp. 2d 1018 (N.D. Tex. 2000), which Insiders compare to this case. Skilling Brf. at 15. In *Mortensen*, plaintiffs merely "appear[ed] to rely generally on the[] defendants' signatures on financial reports and their positions with [the defendant company]." *Mortensen*, 123 F. Supp. 2d at 1027. By contrast, plaintiffs here allege that Insiders were the direct recipients of serious complaints about their financial misrepresentations. ¶850 (Watkins letter to Lay noting that employees questions "accounting propriety consistently and constantly," officers complained about LJM, and a managerial-level employee noted Enron was "such a crooked company"); ¶38 (EES Manager's letter to Enron's Board noting, "EES' management's ... hiding losses/SEC violations").

Plaintiffs' allegations, which must be accepted as true for purposes of this motion, would permit a jury to find that defendants acted with the requisite scienter when they disseminated false and misleading statements and failed to properly disclose the truth when under a duty to do so. *Fine*, 919 F.2d at 301 (evidence that accountant told company that company's provision for uncollectible accounts was inadequate created a triable issue of fact as to whether company knew its provision for uncollectible accounts was inadequate).

(3) The Temporal Proximity of Enron's Demise to Highly Inconsistent Statements Evidences Scienter

On 8/14/01, specific Insiders went to great lengths to portray Enron as "succeeding very, very well"[24] and free and clear of accounting or other problematic issues[25] – just weeks before Enron's mammoth, if still grossly insufficient $1-billion write-off on 10/16. Enron's restatement, which eliminated $600 million of previously reported profits and approximately $1.2 billion in shareholders' equity on 11/8, was followed by Enron's filing of the largest bankruptcy in history on 11/28, and new managements' subsequent admission that the prior financial statements were unreliable and that a write-down of at least another $14 billion would be required. ¶¶364, 384, 391. Thus, the proximity in time between defendants' false assurances and the revelation of the truth evidences Insiders' scienter at the time of their misstatements.

(4) Enron's Alleged GAAP Violations and the Magnitude of the Restatement Support a Strong Inference of Scienter

"[A] violation of Generally Accepted Accounting Principles ("GAAP") may be used to show that a company overstated its income, which may be used to show the scienter for a violation of Section 10(b) and Rule 10b-5." *Marksman Partners*, 927 F. Supp. at 1313 (when combined with other circumstances suggesting fraudulent intent, allegations of improper accounting may support a strong inference of scienter). And, as a general proposition, a restatement of earnings does not ***automatically*** support a strong inference of intent to defraud, but "the overstatement of significant revenues can support the claim that the defendants acted in a severely reckless manner." *Haack*, 2002 U.S. Dist. LEXIS 5652, at *24. Although GAAP violations ***standing alone*** are insufficient to establish scienter, "this does not mean that a misapplication of accounting principles or a restatement of financials can never take on significant inferential weight in the scienter calculus," taking into account the size and context. *Triton Energy*, 2001 U.S. Dist. LEXIS 5920, at *33. Moreover, "whether an accounting principle was violated is a fact-sensitive inquiry not well-suited for resolution in the context of a motion to dismiss." *Id.* at *24. Insiders' contentions that the size

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[24] ¶343 (Statement by Skilling on 8/14/01 analysts conference call participated in by Causey, Fastow, Kean, Skilling and Lay).

[25] ¶344 (Statement by Lay on 8/14/01 conference call: "There are no accounting issues, no trading issues, no reserve issues, no previously unknown problem issues.").

of a restatement suggests the lack of intentional or reckless conduct "will not [be] entertain[ed] [on a motion to dismiss] ... because it concerns a factual dispute about motive." *Haack*, 2002 U.S. Dist. LEXIS 5652, at *25.

Nonetheless, Insiders – defying all reason – attempt to minimize the mammoth Enron write-downs, GAAP violations, and restatement. For instance, Skilling casts a jaw-dropping $1.2-billion reduction in shareholders' equity recorded in the 3rdQ 01 financial statements as an innocent accounting error in classification. Skilling Brf. at 15. The contention is laughable: the $1.2-billion reduction – not to mention the ***additional*** $14 billion writedown that new management believes needs to be recorded (a material portion of which relates to the historical carrying value which new management believes may have been overstated due to errors or irregularities) – is far beyond any of the "monumental" or "breathtaking" restatement amounts on which scienter was based in other cases. For example, alleged GAAP violations and restatements amounted to a "night-and-day difference" with regard to the company's representations of profitability – reported aggregate "record" net income of $18.9 million, when net loss of more than $36 million was incurred, and overstated revenues by $66 million, over a three-year period – was of "breathtaking" magnitude and compelled "an inference that fraud or recklessness was afoot." *In re MicroStrategy Inc. Sec. Litig.*, 115 F. Supp. 2d 620, 636-37 (E.D. Va. 2000). A $73.8-million write-off, taken together with allegations of poor sales, sufficiently alleged facts supporting a strong inference of recklessness. *Rothman v. Gregor*, 220 F.3d 81, 92 (2d. Cir. 2000). And a restatement that corrected an $18-million revenue overstatement and an $11-million income overstatement supported a strong inference of scienter. *Gelfer v. Pegasystems, Inc.*, 96 F. Supp. 2d 10, 16 (D. Mass. 2000). At Enron, during the Insiders' watch, the restatement was in the ***billions***.

Perhaps the Northern District of Illinois, addressing a "massive" year-end increase of $5 million in credit-loss reserves and slashing of reported yearly earnings from $3.5 million to $325,000, summed it up best: "The more serious the error, the less believable are defendants [sic] protests that they were completely unaware of [the company's] true financial status and the stronger is the inference that defendants must have known about the discrepancy." *Rehm v. Eagle Fin. Corp.*, 954 F. Supp. 1246, 1256 (N.D. Ill. 1997). ***Simply calculated***, the Enron restatement – its size, timing, context – dwarfs the "massive" and "monumental" amounts that courts used before to find scienter.

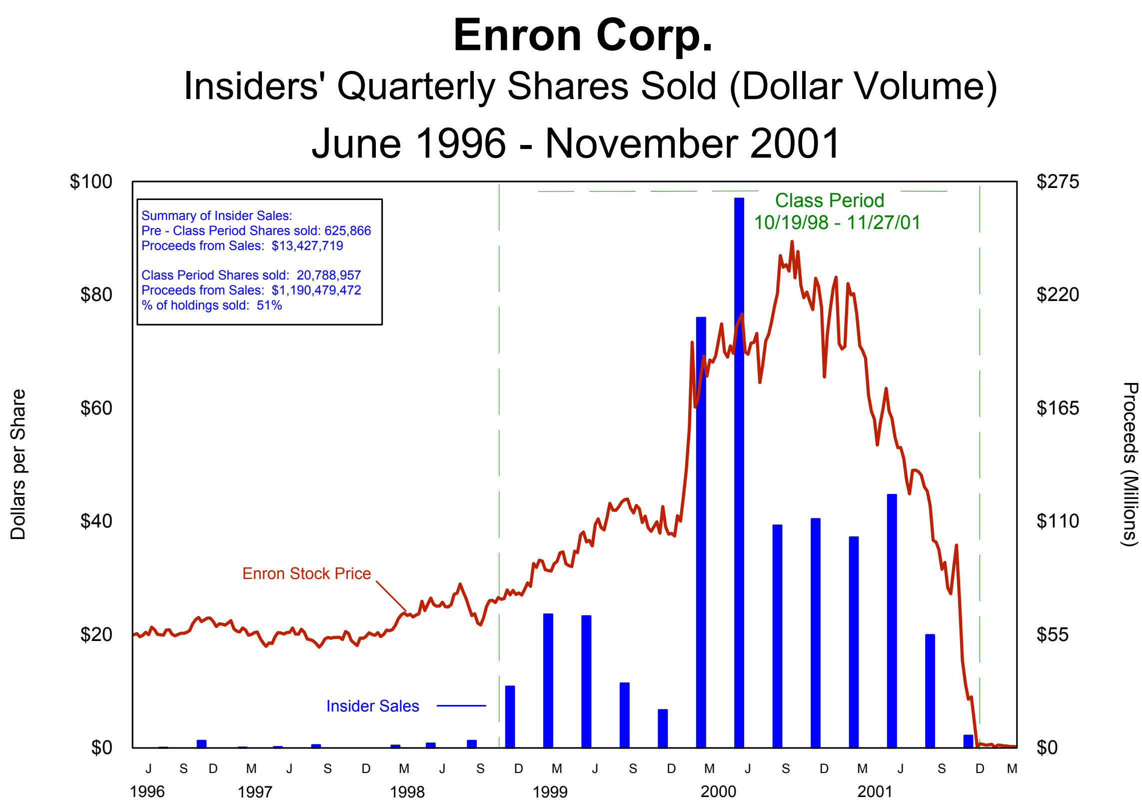
(5) The Enron Insiders' Monumental Stock Sales Support a Strong Inference of Scienter

The fact that, collectively, the Enron Defendants sold 20 million shares of their Enron stock for proceeds of $1.2 billion during the Class Period (¶84), although not required, further supports a finding of scienter. "What must be alleged is not motive and opportunity as such but particularized facts giving rise to a strong inference of scienter. Appropriate allegations of motive and opportunity may meaningfully enhance the strength of the inference of scienter...." *Nathenson*, 267 F.3d at 412. Stock transactions can provide a strong inference of scienter where they are "unusual." *Id.* at 421. In the Fifth Circuit, at the pleading stage, "[i]nsider trading in suspicious amounts or at suspicious times is, of course, presumptively probative of bad faith and scienter." *Rubinstein*, 20 F.3d. at 169. Plaintiffs have alleged in detail that the Insiders' sales and option exercises were both in suspicious amounts and at suspicious times. ¶¶403-417.

When evaluating scienter, courts are required to consider the sales of all defendants and not view an individual's sales in isolation. *Nathenson*, 267 F.3d at 421. This follows from the Fifth Circuit's general principle that "allegations should not be read in isolation, but taken together as a whole to see if they raise the necessary strong inference of scienter." *Abrams*, 2002 U.S. App. LEXIS 9565, at *12. The appropriate analysis, under *Nathenson*, is to consider whether all facts and circumstances taken together are sufficient to support the necessary strong inference of scienter.

The Insiders who do not contest their opportunity to commit fraud, sold large percentages (as well as large dollar amounts) of their shares. Even those whose percentage of shares sold was purportedly low (according to them) received inflated prices – and astronomical total amounts – for their shares. The sheer magnitude of their sales at inflated prices suffices for motive, even though they ignore the tremendous dollar ***amount*** of sales involved, arguing that some of them sold relatively modest ***percentages*** of the number of shares they owned. Insiders' computations of their percentage sold are frequently misleading, including, for instance, shares not then capable of being sold in the calculation of the percentages-sold figure. In actuality, both the percentages and amounts were high, an extremely strong indicia of scienter. *In re SmarTalk Teleservices, Inc. Sec. Litig.*, 124 F. Supp. 2d 527, 542 (S.D. Ohio 2000). In a case where motive was established even though defendants collectively sold only 12% of their total holdings, it was "both the ***amount and the timing of the sale*** which, with the other evidence discussed, provide strong circumstantial evidence of conscious misbehavior." *Friedberg v. Discreet Logic*, 959 F. Supp. 42, 51-52 (D. Mass. 1997).

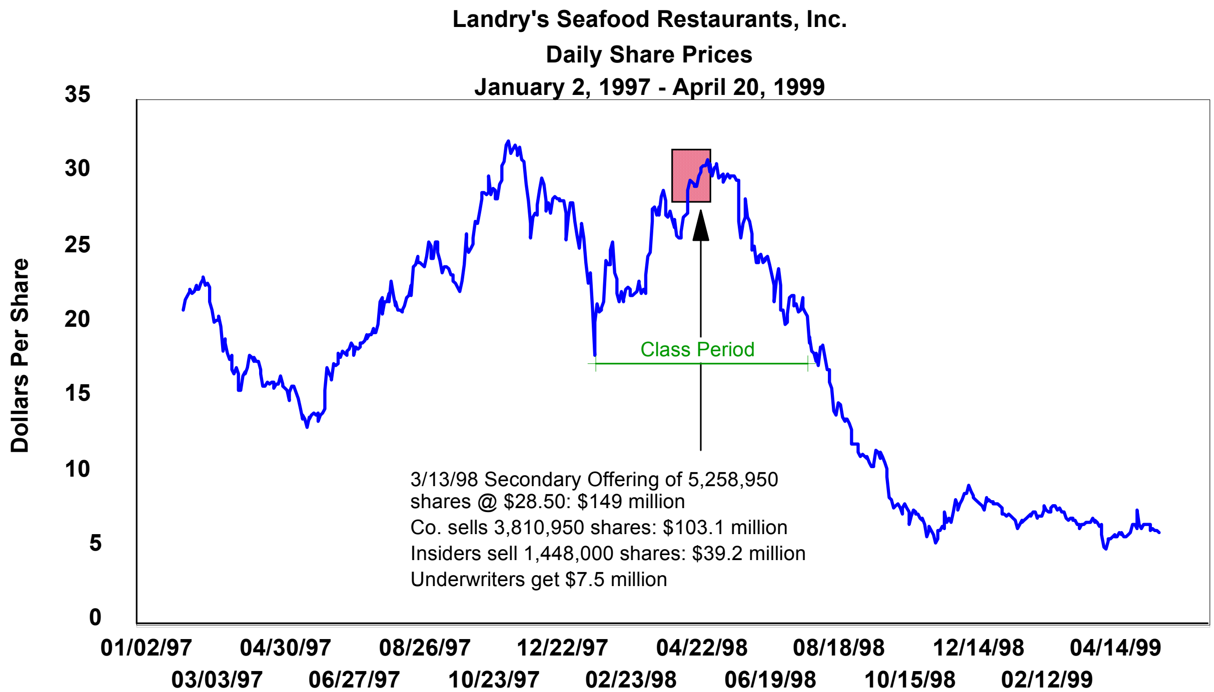
Although plaintiffs have provided the Court with expert analysis of the Enron defendants' insider sales, even without such analysis, the magnitude and time of these Class-Period sales of $1.2 billion demonstrate that such trades set out at ¶¶84, 403, were unusual and suspicious:



This chart graphically suggests the Insiders (and the Enron Defendants), knew Enron's stock was inflated by the accounting improprieties for which Enron and its accountants are now under congressional and criminal investigation. Indeed, it is difficult to imagine how Class-Period sales of nearly $1.2 billion worth of stock compared to pre-Class Period sales of a mere $13 million would not meet the suspicious-amount or at suspicious-times standard.[26]

26 Charts breaking down these sales for each Insider are listed in ¶83(a)-(ee).

The Court found that insider sales amounting to far less than the Enron Defendants' percentage was probative of scienter. In *Landry's*, the Court acknowledged the amount of trading by insiders, as illustrated on the chart below. Comparing the *Landry's* defendants' sales to the Enron Defendants' sales graphically demonstrates their sales were unusual and suspicious.



In addition, plaintiffs included with their CC an expert study scientifically demonstrating that the defendants' selling could not have occurred by mere chance. *See* Declaration of Scott Hakala, dated 4/5/02 ("Hakala Decl."), ¶¶24-27 (CC Ex. B). Using sophisticated and well-accepted methods of event studies, Dr. Hakala's study confirms that the chance that the insider trading could have occurred for some other reason than based on material, non-public information was fewer than one in one thousand. Given that plaintiffs' burden at trial is to prove facts beyond the more-probable-than-not standard, this study is clearly adequate to plead scienter. Dr. Hakala took the additional step of analyzing the Enron Defendants' option exercises, utilizing the latest techniques of option valuation, coupled with empirical research on executive option-exercise behavior. By combining these techniques, Dr. Hakala was able to compare the Enron executives' behavior not only with what modern economics would expect, but also with how honest executives actually behave, and, indeed, with how these same Enron executives acted before the Class Period. His finding of some 120 option exercises during the Class Period, which no honest executive would ever have undertaken absent foreknowledge that Enron's stock was about to plummet, also establishes scienter. *See* Hakala Decl., ¶¶7-8.

The circumstantial evidence of the Insiders' scienter is overwhelming. Nevertheless, they either fail to cite judicial authority or merely rely on non-binding decisions from within the Ninth Circuit to argue that their Enron stock sales cannot aid the court in finding a strong inference of scienter.[27] Interestingly, the Insiders all but ignore the Court's *Landry's*, decision, which clearly demonstrates that their insider trading was unusual and suspicious. *See Landry's*, slip op. at 25 (insider selling by defendants netting over $39.2 million in illegal insider-trading proceeds was unusual in timing and amount). Plaintiffs also made numerous specific allegations that the Insiders sold large amounts of stock, constituting large portions of their holdings, in close temporal proximity to false positive statements, as well as immediately before the disclosure of Enron's financial writedown. ¶¶222, 235, 261, 271, 280, 299. *See In re Secure Computing Corp.,* 184 F. Supp. 2d 980, 990 (N.D. Cal. 2001) (finding circumstantial support for the inference of deliberate recklessness in the temporal proximity between defendants' last positive statements regarding the company's financial status and the disclosure of negative information); s*ee also Stevelman v. Alias Research Inc.,* 174 F.3d 79, 85-86 (2d Cir. 1999) (sale of officers' stock in proximity to allegedly false optimistic statements was significant to issue of whether sales were unusual and suspicious).

Despite their claims, allegations as to the suspicious amount and timing of the Insiders' trading cannot be disregarded ***as a matter of law***. Whether their sales were unusual is an issue of fact that is not appropriate for resolution at the pleading stage. *See Rubinstein,* 20 F.3d at 170 n.38 (defendants' explanations as to why stock was sold was inappropriate at motion stage because it is

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[27] They fail to cite support for the majority of their arguments. When insider-trading case law is cited, they rely, almost exclusively, on authorities from outside the Fifth Circuit. For example, their individual briefs and the Joint Brief for Officer Defendants consistently rely on: *Ronconi v. Larkin*, 253 F.3d 423 (9th Cir. 2001); *In re Silicon Graphics Sec. Litig.*, 183 F.3d 970, 987 (9th Cir. 1999); *In re Vantive Corp. Sec. Litig.*, 283 F.3d 1079 (9th Cir. 2002); *Demarco v. Depotech Corp.*, 149 F. Supp. 2d 1212 (S.D. Cal. 2001); *In re Splash Tech. Holdings, Inc. Sec. Litig.*, No. C 99-00109 SBA, 2000 WL 1727377, at *20 (N.D. Cal. Sept. 29, 2000).

"impossible" for the court to consider defendants' evidence then); *see also In re Hi/fn, Inc. Sec. Litig.*, No. C 99-4531 SI, 2000 U.S. Dist. LEXIS 11631, at *31-*32 (N.D. Cal. Aug. 9, 2000) ("although defendants assert that adequate explanations exist for the timing of their stock sales, the Court concludes that plaintiffs' allegations present questions of fact as to those explanations, which are not best resolved on a motion to dismiss"). On a motion to dismiss, the Court must accept all allegations of the complaint as true. "The issue is not whether a plaintiff will ultimately prevail but whether the claimant is entitled to offer evidence to support its claims." *BMC Software*, 183 F. Supp. 2d at 866 n.13. Nevertheless, assuming that the Insiders' arguments about their sales could be considered at the pleading stage, their arguments fail.

(a) The Hakala Declaration Provides Relevant, Significant Circumstantial Evidence of Scienter and Should Not be Stricken

Enron Insiders' recognition of the tremendous effect that Dr. Hakala's analysis has on demonstrating illegal insider trading no doubt lies behind their request to strike his declaration from the CC.[28] For purposes of judicial economy, plaintiffs refer the Court to their opposition to Lay's motion to strike the Hakala Declaration for a full response and merely summarize pertinent arguments here.

First, motions to strike are viewed with disfavor and "'are generally not granted unless it is clear that the matter to be stricken could have no possible bearing on the subject matter of litigation.'" *Lazar v. Trans Union LLC*, 195 F.R.D. 665, 669 (C.D. Cal. 2000) (quoting *LeDuc v. Kentucky Cent. Life Ins. Co.*, 814 F. Supp. 820, 830 (N.D. Cal. 1992)); *see also In re Gaming Lottery Sec. Litig.*, No. 96 Civ. 5567 (RPP), 1998 U.S. Dist. LEXIS 7926, at *26 (S.D.N.Y. May 29, 1998) (same).[29] Plaintiffs submitted Dr. Hakala's declaration as ***one*** part of their strong circumstantial evidence of defendants' scienter – a key issue of this litigation. Statistical

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28 Jt. Officer Brf. at 19, Buy Brf. at 5, Causey Brf. at 5, Fastow Brf. at 4.

29 *See also Lentz v. Woolley*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶94,498 (C.D. Cal. 1989); *Magnavox Co. v. APF Elecs., Inc.*, 496 F. Supp. 29 (N.D. Ill. 1980) (allegations regarding actions are relevant and should not be stricken). *See also* 5A Charles Alan Wright & Arthur R. Miller, *Federal Practice & Procedure* §1382, at 681-716 (1990). In a motion to strike, the court must view the facts most favorably to the non-moving party. *Am. Agric., Inc. v. Shropshire*, No. 99-366-AS, 1999 U.S. Dist. LEXIS 13972 (D. Or. Aug. 11, 1999).

demonstrations of intent are well established in the law. *See, e.g., Mayor of Philadelphia v. Educational Equal. League*, 415 U.S. 605, 620 (1974) (discrimination); *McDonnell Douglas Corp. v. Green*, 411 U.S. 792, 805 (1973) (same); *Turner v. Fouche*, 396 U.S. 346, 360-61 (1970) (discrimination in jury selection); *United States v. Ironworkers Local 86*, 443 F.2d 544, 551 (9th Cir. 1971). Hence, Insiders cannot possibly assert that the declaration "'could have no possible bearing on the subject matter of litigation.'" *Lazar*, 195 F.R.D. at 669.

Second, in deciding a motion to dismiss, courts in the Fifth Circuit inquire into "facts stated in the complaint and the documents either attached to or incorporated in the complaint." *Lovelace*, 78 F.3d at 1017. And this Court takes judicial notice of all documents that are pertinent, central, and integral to the claims. *BMC Software*, 183 F. Supp. 2d at 883. The Hakala declaration was attached to the CC, incorporated by reference into the CC, ***and*** reiterated and summarized in its text. Expert declarations annexed to complaints are appropriately considered in evaluating a motion to dismiss in a federal securities case. *See Mortensen*, 123 F. Supp. 2d at 1026 (considering expert's declaration, but finding that plaintiffs failed to plead scienter).

Third, Enron Insiders rely on *Demarco*, 149 F. Supp. 2d 1212, which is apparently the only case in federal-court history that struck an expert declaration attached to a complaint. But that case explicitly stated that the contents of the expert's declaration could be pleaded in the complaint: "A better approach might be to include the expert's nonconclusory assertions within specific paragraphs in the complaint. This would reduce needless redundancy and simplify pleadings ...." *Id.* at 1222. Here, plaintiffs "include the expert's explicitly nonconclusory assertions" in the CC. ¶¶406-416.

And ***fourth***, Insiders should be barred from seeking to have it both ways – contesting the particularity of plaintiffs' scienter allegations as conclusory while moving to strike very particularized allegations of scienter in Dr. Hakala's declaration. And they argue that plaintiffs' expert's evidence should not be considered until summary judgment. Jt. Officer Brf. at 19. But this underscores the hypocrisy of their request to dismiss for failure to plead scienter by ignoring evidence that, if considered, would be sufficient to prove it.

Enron Insiders' attacks on Dr. Hakala's objectivity and methodology (Jt. Officer Brf. at 17-18) is an improper last ditch effort to avoid important evidence about their scienter. They suggest that Dr. Hakala ignores reality by failing to account for personal reasons (such as children's education) for their one billion dollars worth of stock sales. Jt. Officer Brf. at 17-19. Dr. Hakala specifically acknowledges the tendency of insiders to prematurely exercise options and sell shares for personal reasons. Hakala Decl., ¶12. But he finds that premature option exercises are irrational for executives when they are inconsistent with prior-observed behavior for that same executive or when the premature option exercises sacrifice value well in excess of the sacrifices commonly observed. Certain premature exercises of stock options by some Insiders were specifically related to the allegations in the CC and were inconsistent with those individual's prior economic behavior. Hakala Decl., ¶¶9c, 9d, 9e, 20, 25, 30, 34, 37, 41, 44. The concept of using the Insiders' prior economic behavior is a foundational principle in economics and articles utilizing this methodology are cited to by both Dr. Hakala as well as Lay in his motion to strike. *See* ¶406; Hakala Decl.; Lay Motion to Strike at 5-15.[30]

(b) Event-Study Methodology Is Proper and Accepted

Event studies have a long and rich history in academia and the law.[31] The sole purpose of an event study is to prove or disprove causality. In the securities context, plaintiffs and defendants typically provide the fact-finder with event studies that prove or disprove loss causation. *See, e.g.*,

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30 The Insiders also raise a parade of terribles by suggesting that consideration of the Hakala Declaration should not be taken into account now. However, there will not be any evidentiary complication in considering Dr. Hakala's declaration because the facts contained in Dr. Hakala's declaration are specifically incorporated into the CC. Defendants have not moved to strike the allegations of plaintiffs' CC, which incorporate the allegations of Dr. Hakala's declaration nor have they motioned to strike plaintiffs' summary of his findings. As such, facts alleged in the declaration must be accepted as true – like all other allegations in the CC. *See In re Stratosphere Corp., Sec. Litig.*, 1 F. Supp. 2d 1096, 1110 (D. Nev. 1998) ("Therefore, when Plaintiffs cite certain documents, this Court must accept Plaintiffs' interpretation as true .... "). Like every other allegation in the CC, there are no complicated procedural issues that would arise by considering Dr. Hakala's declaration.

31 *See, e.g.*, 11 John Binder, *Review of Quantitative Finance and Accounting: The Event Study Methodology Since 1969*, at 111-37 (1998) (noting that event study that was introduced by Fama, Fisher, Jensen and Roll "started a methodological revolution in accounting and economics as well as finance"). *See also In re Seagate Tech. II Sec. Litig.*, 843 F. Supp. 1341, 1368 (N.D. Cal. 1994); *In re Oracle Sec. Litig.*, 829 F. Supp. 1176, 1181 (N.D. Cal. 1993) (use of event study necessary in securities case to evaluate impact of false statements); Jon Koslow, Note, *Estimating Aggregate Damages in Class-Action Litigation Under Rule 10b-5 for Purposes of Settlement*, 59 Fordham L. Rev. 811 (1991); Bradford Cornell & R. Gregory Morgan, *Using Finance Theory to Measure Damages in Fraud on the Market Cases*, 37 UCLA L. Rev. 883 (1990); Amy Zipkin, "Stock Options Take Prominent Role in Divorce Courts," *New York Times*, 8/9/00.

In re Gaming Lottery Sec. Litig., No. 96 Civ. 5567 (RPP), 2001 U.S. Dist LEXIS 2034, at *55 (S.D.N.Y. Mar. 1, 2001) (summary judgment granted to plaintiffs where plaintiffs' damages expert's event study proved that a particular event "caused" the company's stock price to decline and therefore "[n]o reasonable juror could find that a genuine issue of material fact exists regarding loss causation"). Hence, Dr. Hakala's event study does not confuse correlation with causation. Using event studies to demonstrate loss causation is standard practice, found in numerous cases, including the largest securities case in United States history. *In re Cendant Corp. Sec. Litig.*, 109 F. Supp. 2d 225, 229 (D.N.J. 2000) (event studies are methodologically sound and are designed to prove causation). Indeed, in *Oracle*, 829 F. Supp. at 1181, Judge Walker held that event studies were ***required*** to determine whether fraud-related influences caused plaintiffs' damages.

It is almost certain that Insiders will rely upon event-study methodology to ***defend*** their claims at trial, to support their view of the effect their statements had upon investors' valuation of Enron – whether their false statements caused plaintiffs' damages. Dr. Hakala cites dozens of academic articles confirming his methodological approach and provides his exact method and data sources. Hakala Decl., ¶¶10-14; n.32. This literature and the case law confirm that statistical analysis is an appropriate method of demonstrating that defendants' sales of shares were not merely by chance or for the alternative purposes proposed by Insiders.

(c) The Length of the Class Period Does Not Preclude the Strong Inference of Scienter Evidenced by Insiders' Massive Class Period Trading

Contrary to their assertions, the strong inference of scienter evidenced by the Insiders' massive insider trading during the Class Period is not precluded by the length of the Class Period.[32] They rely on a case that merely held that the class period length weighed against a finding of scienter because ***in that particular case*** the court found that plaintiffs failed to support an inference of fraud throughout the entire class period, and adopted a long class period for the sole purpose of "sweep[ing] as many stock sales into their totals as possible." *Vantive Corp.,* 283 F.3d at 1092.

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32 *See* Jt. Officer Brf. at ¶¶8-10, Buy Brf. at 5-8, Causey Brf. at 5-9, Fastow Brf. at 4-5.

Unlike Vantive, plaintiffs did not allege long-term fraud to create a long class period to sweep in stock sales. In fact, most of the Insiders' sales occurred late in the Class Period, between 3/00 and 9/01. ¶84. Further, plaintiffs have pleaded that Enron Insiders' Class- Period sales dramatically exceeded their prior sales. ¶403. The Class Period sales amounted to between 19% and 100% of their holdings, netting over $1 billion in illegal insider sales. ¶402. This supports a stronger inference of scienter. *See Landry's*, slip op. at 25 (defendant's individual sales between 30%-87% of their holdings netting over $39.2 million suspicious). Viewed in the totality of the circumstances, the Class Period length does not weigh against finding the Insiders' sales probative of scienter.

Furthermore, Dr. Hakala's declaration showed that the three-year long Class Period did not confound his insider-trading analysis. Hakala Decl., ¶¶11, 14, 17-20. He describes peer-reviewed academic research that suggests increased insider sales over extended periods of time before a negative disclosure can, and often do, signal or imply insider knowledge that the share price was inflated. Hakala Decl., ¶11. Dr. Hakala provides additional studies to show that insiders (1) often begin selling shares at an increased rate well in advance of negative earnings disclosures; (2) tend to increase their rate of sales in the year before the negative event and (3) may tend to increase sales over time as the negative-earnings event becomes more certain and proximate. Indeed, Insiders' monumental sales during the period of their fraudulent activity follow the very patterns described in the research and studies Dr. Hakala points to.

(d) Plaintiffs Did Not Fail to Consider Pre-Class Period Sales

Insider trading is probative of scienter if it is unusual. *Nathenson*, 267 F.3d at 420-21. One method of demonstrating that insider trading is unusual is to plead that insider trading is out of line with prior trading practices. *See Landry's*, slip op. at 50 ("'trading must be in a context where defendants have incentives to withhold material, nonpublic information, and it must be unusual, well beyond the normal'"). As clearly demonstrated by plaintiffs' chart contained in ¶403 of the CC, plaintiffs have met this standard. Indeed, as described in the CC, Enron Defendants' trades during the Class Period were approximately 33 times the amount of trading in prior periods; 20,788,957 shares sold during the Class Period compared to 625,866 shares sold prior to the Class Period. ¶403. Plaintiffs posit that this case provides a clear case for establishing that Enron Insiders' trades were out of line with their prior trading practices. *See Landry's*, slip op. at 25 (class period sales were suspicious because defendants sold 1,448,000 shares during the class period, but none before); and no sales prior to the class period); *see also Secure Computing*, 184 F. Supp. 2d at 989 (class-period sales were suspicious because defendants had no stock sales prior to the class period and sold 200,000 shares of stock during the class period). Plaintiffs alleged pre-Class-Period sales by seven Enron Insiders – Lay, Skilling, Fastow, Horton, Harrison, Mark-Jusbasche and Sutton and three Outside Directors – Belfer, Gramm and Foy ¶¶83(a), (b), (c), (g), (l), (n), (r), (v), (z), (cc), 84, and demonstrated that all of their pre-Class-Period sales were dwarfed by their Class-Period sales, thus highly unusual and suspicious in timing and amount. For the remaining Enron Defendants, pre-Class Period sales data was either unavailable or absent. Enron Insiders acknowledge that plaintiffs do not have access to information regarding Enron Insiders who were not required to file Forms 3, 4 and 5. Jt. Officer Brf. at 14.

The Insiders argue that the Court should disregard plaintiffs' allegation that the vast majority of them did ***not*** sell stock before the Class Period. Jt. Officer Brf. at 14. They fail to contradict the CC with evidence that any Insider, ***other than Causey***, made sales before the Class Period. The CC clearly sets forth the amount of trades each made both before and during the Class Period. ¶83(a)-(ee). A comparison of those periods illustrates a substantial increase in insider trading during the Class Period. *See Marksman Partners*, 927 F. Supp. at 1313 (insider sales highly unusual where defendant had not sold any of her stock in the three years prior to the class period).

The Insiders' assertions that Causey and Horton had additional pre-Class-Period sales not included in the CC is a factual argument and is not appropriate here. Nevertheless, assuming that their arguments could be considered now, the additional pre-Class-Period sales asserted by Causey and Horton do not change the before-and-during comparison. For instance, Causey's claimed pre-Class-Period sales of 28,135 shares, *see* Jt. Officer Brf. at 14 and Causey Brf. at 6-9, is dwarfed by his Class Period sales of 208,940 shares. ¶83(d). Defendant Horton's claimed pre-Class Period sales of an additional 31,660 shares (total pre-Class-Period sales of 28,135 shares), Jt. Officer Brf. at 14, Horton Brf. at 4-9, is also dwarfed by his Class Period sales of 830,444 shares. ¶83(g). Thus, any comparison demonstrates that Causey's and Horton's sales during the Class Period were unusual or suspicious in timing and amounts.[33]

(d) Insiders' Trades *Were* Tied to False Positive Statements

Insiders argue that an "archetypical suspicious insider trade" would be one "transacted just prior to a significant announcement" and that "Plaintiffs made no effort to tie an individual trade to any announcement or omission." Jt. Officer Brf. at 15. They neither supply case authority for their proposition that the failure to tie trades to significant events or announcements is fatal – nor do they explain why immediate tie-ins would be necessary when the Enron Defendants inflated the stock price over three years by manipulating accounting practices. And over that period Enron's false financials were effective and relied upon every single day by the market and analysts in valuing its stock.

In any event, plaintiffs ***do*** also demonstrate that the Insiders' sales during the Class Period were tied to their positive statements. The CC contains an enlarged color-coded chart illustrating all insider trades made by the Enron Defendants during the Class Period, the stock price when the trades were made, as well as the false and misleading statements issued ***immediately before those trades***. ¶74. The chart illustrates that on numerous occasions throughout the Class Period Enron Insiders sold shares shortly after false or misleading statements caused the price of Enron stock to rise. Some examples of these statements and accompanying sales.

> ***9/99 - Positive statement issued***: WEOS strong. 15-20% Earnings growth. EES signing high quality contracts. Strong earnings growth in coming years. ¶74.
>
> ***9/99-12/99 - Insiders sold 972,588 shares for $39+ million***. ¶74.
>
> ***4/00 - Strong 1stQ 00 results issued***: Positive momentum. Trends sustainable. Will accelerate. Strong response to intermediation. Enron GE of New Economy. ¶74.
>
> ***4/00-5/00 - Insiders sold 3,552,044 shares for $266+ million***. ¶74.

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33 Furthermore, Dr. Hakala analyzed the Insiders' trading practices dating back to 6/96. *See* Hakala Decl. at Ex. E, F-1, F-2, F-3, G and H.

7/00 - Strong 2ndQ 00 income results issued: Business booming - gaining momentum. EBS profits escalating. Ahead of expectations. VOD contract over $1 billion. New EES contracts – $3.8 billion. Never in better shape. Very excited about future. ¶74.

7/00-9/00 - Insiders sold 1,239,388 shares for $108+ million. ¶74.

10/00 - Strong 3rdQ 00 income results issued: Merchant Investment hedged. EES at breakout pace. VOD deal value $1 billion - going fine. All components in place. EBS designed to take advantage of broadband glut. ¶74.

10/00-12/00 - Insiders sold 1,556,882 shares for $111+ million. ¶74.

1/01 - Strong 4thQ 00 results issued: Breakout performance. $16 billion in EES contracts. Outstanding year. Increasing profitability. WEOS has significant sustainable competitive advantage. Successfully launched VOD. Proven technology. Will increase profitability. Increases forecasted EPS growth. Stock worth $126. ¶74.

1/01-3/01 - Insiders sold 1,136,584 shares for more than $82+ million. ¶74.

3/01 - Statement issued: Business in very good shape. WEO, EBS intermediation great. Very optimistic for VOD. Everything fine. EBS business predicated on surplus of supply – declining prices good for Enron. Balance sheet great. Financing vehicles have *de minimus* share issuance requirements. ¶74.

3/01-4/01 - Insiders sold 465,329 shares for $30+ million. ¶74.

8/01 - Statement issued: Performance never stronger; business model never more robust; growth never more certain. ¶74.

8/01-9/01 - Insiders sold 685,667 shares for $24+ million. ¶74.

10/01 - Statement issued: $1 billion writeoff; $1.2 billion shareholder equity reduction. Core fundamentals strong. Excellent prospects. Strong EPS outlook; liquidity fine. ¶74.

10/01- Insiders sold 362,051 shares for $6+ million - 2 months before Enron filed for bankruptcy. ¶74.

The CC further specifies that after Enron reported better-than-expected 4thQ and year-end 00 results, and held its most bullish investor analyst conference ever in late 1/00 in Houston, the stock price soared, reaching $73 per share in late 1/00 and $78 at the end of 3/00. ¶222. As the price climbed higher, Insiders dramatically stepped up their trading. *Id*. They took advantage of this artificial stock-price inflation by selling 2.9 million shares at as high as $76.44 per share, pocketing $208 million in illegal insider trading proceeds between 1/20/00 and 3/28/00. *Id*.[34]

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[34] In fact, the CC sets forth numerous instances where Enron Insiders sold off large portions of their insider shares following the issuance of positive false statements about Enron, thus evidencing scienter. ¶¶235, 261, 271, 280 and 299. *See In re Xerox Corp. Sec. Litig.*, 165 F. Supp. 2d 208, 222 (D. Conn. 2001) (holding insider sales to be unusual and suspicious in timing where "the sales took place shortly after false or misleading statements that had caused the price of Xerox

In sum, the Insiders' sales during the Class Period were unusual and suspicious in timing and amount, providing strong evidence of scienter, and even if the Insiders could create a tie-in ***requirement***, plaintiffs have more than amply complied with it. Moreover, Enron Insiders sold 362,051 shares of stock for over $6 million in 10/01 – immediately following positive statements accompanying the announcement of Enron's $1-billion writeoff – and two months before Enron filed for bankruptcy. ¶74. Insider sales made in close proximity to the disclosure of negative information are suspicious and are probative of scienter. [35]

(e) Defendants' Failure to Sell All of Their Shares or to Maximize the Timing of Their Stock Sales Does Not Undercut the Strong Inference of Scienter

Similarly, plaintiffs have adequately demonstrated that the mere fact that some Insiders did not sell their shares at the highest price or the fact that they retained portions of their shares when Enron filed for bankruptcy does not undercut the strong inference of scienter.[36] The Eight Circuit last year addressed and rejected these claims in holding that a CEO's failure to sell all of his stock did not undercut a finding of scienter. *See Green Tree*, 270 F.3d at 662; *see also San Leandro Emergency Med. Group Profit Sharing Plan v. Philip Morris Cos., Inc.*, 75 F.3d 801, 814-15 (2d Cir. 1996) (defendant's retention of a large portion of company stock did not vitiate insider trading liability). "While 'allegations of unusual insider trading by defendants immediately preceding the disclosure of negative news' may be ... characteristic of a 'typical securities fraud class action,' they are not required." *Wells Fargo*, 12 F.3d at 931. Thus, the fact that some of the Insiders did not sell all of their stock does nothing to negate the inference of scienter.

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stock to rise").

[35] *See Provenz v. Miller,* 102 F.3d 1478, 1491 (9th Cir. 1996) (scienter shown as to defendants who sold stock shortly after positive conference call, but just before negative disclosures); *see also In re Oxford Health Plans, Inc. Sec. Litig.*, 187 F.R.D. 133, 139-40 (S.D.N.Y. 1999) (insider trades made two months prior to the issuance of devastating news about the company are suspiciously timed); *see also Secure Computing,* 184 F. Supp. 2d at 990 (finding circumstantial support for the inference of deliberate recklessness in the temporal proximity between defendants' last positive statements regarding the company's financial status and the disclosure of negative information).

[36] *See* Buy Brf. at 5-9, Causey Brf. at 5-9, Frevert Brf. at 5-10, Hirko Brf. at 8-10, Horton Brf. at 4-9, Kean Brf. at 4-9, Koenig Brf. at 5-9, Lay Brf. at 15-30, McMahon Brf. at 11-16, Olson Brf. at 4-9, Rice Brf. at 9-13, Sutton Brf. at 19-22 and Whalley Brf. at 5-9.

The CC alleges that the Enron Insiders sold 20,788,957 shares during the Class Period, which dwarfs the total shares they claim they retained at the time Enron filed for bankruptcy.[37] The Enron Defendants profited in the amount of $1 billion from their illegal insider sales. *Id*. That Insiders were unable to completely divest themselves of all shares before its demise does vitiate their intent to profit from insider trading. As phrased by the Eight Circuit, "***[t]he ultimate profitability*** of a course of conduct is ***not*** conclusive of intent. Just as we cannot countenance pleading fraud by hindsight neither can we infer innocence by hindsight because the alleged misdeeds did not pay off." *Green Tree*, 270 F.3d at 662.

(f) Insiders' Group-Pleading Assertion is Improper

In arguing that plaintiffs' insider-trading allegations are improper group pleading, Lay, Fastow, Causey, and Buy play fast and loose with the facts.[38] ***First***, defendants use the loaded (and inaccurate) term group-pleading doctrine but it has nothing to with insider-trading analysis. The Court defined the doctrine as follows: "Under the traditional 'group pleading presumption,' a company's statements 'in prospectuses, registration statements, annual reports, press releases, or other group-published information' may be presumed to be the collective work of those individuals with direct involvement in the everyday business of the company." *BMC Software*, 183 F. Supp. 2d at 913 n.50. Thus, the group-pleading doctrine concerns adequately pleading a defendants' involvement in making a statement, not whether the defendant sold stock on inside information. ***Second***, plaintiffs establish the unusual and suspicious nature of each Insider's trading, including Lay, Fastow, Causey, and Buy. *See* ¶83(a),(c), (d) and (i). Each chart in ¶83 shows the timing and amount of their trades in relation to Enron's stock price and compares the individual's pre-Class-Period and Class-Period trades. Each analysis is separate and apart from all the others. There is nothing group-pleaded about them. Indeed, if a picture is worth a thousand words, these graphic

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[37] The CC alleges that during the Class Period Buy sold 140,234 shares; Causey sold 208,940 shares; Frevert sold 986,898 shares; Hirko sold 473,837 shares, Horton sold 830,444 shares; Kean sold 64,932 shares; Koenig sold 129,153 shares; Lay sold 4,002,259 shares; McMahon sold 39,630 shares; Olson sold 83,183 shares; Sutton sold 688,996 shares; and Whalley sold not reported shares. ¶83(a), (d), (f), (g), (i), (k), (m), (p), (q), (r), (s), (u).

[38] *See* Lay Brf. at 28, Fastow Brf. at 3, Causey Brf. at 6, and Buy Brf. at 5.

representations speak volumes about why Lay's, Fastow's, Causey's and Buy's trades during the Class Period were unusual and suspicious.

(g) Plaintiffs' Calculations are Reliable

The Insiders suggest without any basis, that plaintiffs' calculation of percentages of shares owned by them during the Class Period is "suspect."[39] Once again they raise issues that are inappropriate at this stage. *Rubinstein,* 20 F.3d at 170 n.38. Plaintiffs relied on proxy filings and shares reported sold by Enron Insiders on Forms 3, 4, 144 and 5. If there are any discrepancies, it was because they failed to correct or amend their securities filings with the SEC, which is a criminal violation, pursuant to 18 U.S.C. §1001 and 15 U.S.C. §78ff(a). Notably, the Insiders neither claim that the percentages in the CC are actually incorrect nor point to any specific errors. It can be assumed that if the CC were in error they would have provided the Court with the correct percentages and supporting SEC documents (as plaintiffs have).

(h) Insiders' Various Trading Patterns Do Not Weaken the Strong Inference of Scienter

Certain Insiders assert that their Class-Period trades did not fall within a "standard pattern" of illegal insider trading, as if real-world conduct must be measured by paradigms.[40] In other words, some of them believe that they are entitled to be absolved because they did not break the law as often as the other egregious inside traders, such as Lay, did. But all the Insiders' trading patterns are well within the parameters of unusual illegal trading. *See* ¶415.

While the Insiders cite no law to support their artificial "pattern" requirement, scienter may be demonstrated by showing that their sales were "'unusual,'" *Nathenson*, 267 F.3d at 420-21, which plaintiffs have done. The suspicious nature and timing of their unusually large trades is depicted by the stock sales chart in ¶403 of the CC, which strongly suggests that the Insiders knew that Enron's stock price was inflated while they engaged in massive illegal insider selling. ¶403. Their assertion that Class-Period sales of $1.2 billion is not unusual –when compared to their pre-Class-Period sales of $13 million – is, at best, perplexing.

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[39] *See* Jt. Officer Brf. at 16, *see, e.g.,* Buy Brf. at 5, Causey Brf. at 5-8, Frevert Brf. at 5.

[40] *See, e.g.,* Buy Brf. at 6-7, Causey Brf. at 7, Rice Brf. at 10, Frevert Brf. at 7, Horton Brf. at 6.

4. Insiders' Various Excuses Do Not Negate the Strong Inference of Scienter Flowing from Their Insider Sales

a. Derrick's Assertions Fail To Negate The Strong Inference of Scienter Flowing From His Illegal Insider Sales

Derrick's assertion that he exercised only 12.9% of his holdings, Derrick Brf. at 7, conflicts with the 73.8% alleged in ¶402, and at best raises a factual issue not appropriate for a motion to dismiss. Derrick provides the Court with an extremely difficult-to-follow "Exhibit A," which purportedly suggests that he had 1.6 million shares of vested options at the end of the Class Period. Notably, he cannot point to a specific SEC filing supporting his position, but instead refers to every Form 3, 4, and 5 apparently filed with the SEC summarized on a spreadsheet. But the actual forms directly refute Derrick's assertions. For example, the last SEC form supplied by Derrick, Table 1 of Form 4 filed on 7/3/01, stamped by the SEC as document 3145894, explicitly states that his entire share holdings (after huge sales in June) consisted solely of 14,727 shares in his ESOP plan. Moreover, in stark contrast to Derrick's representation that he held onto 1.6 million options, Derrick Brf. at 8 n.13, on Table 2 of 7/3/01 Form 4, he responded that "0.00" was the number of derivative securities, which includes executive options, owned at the end of the month. Derrick signed this Form 4 under criminal penalty for intentional misstatements or omissions of fact. Hence, accepting his assertion that he only sold 12.9% of his shares would require the Court to not only find a fact in his favor on a motion to dismiss, but also to disregard a direct admission to the contrary, and, in doing so, to find that Derrick lied to the SEC in criminal violation of 8 U.S.C. §1001 and 15 U.S.C. §78ff(a).

Derrick's argument that he only exercised his options when they were about to expire does not insulate his ***sales*** during the Class Period. Derrick Brf. at 7-8. There is nothing that prevents an insider from exercising his options before expiration, and then holding all or a part of the shares thus obtained for sale at a later date. In fact, the more typical course for executives is to hold a portion of the shares obtained via such option exercises for later sale. The Table IIs on Form 4s annexed to Derricks' Motion list the title of his derivative securities as "Employee Non-Qualified Stock Option (Right To Buy)." The title of these securities evidences that Derrick's options only involved a "right to buy" – not a requirement that he simultaneously sell. The alleged prompt sale of these shares is highly suspicious and indicative of inside knowledge of Enron's fraudulent activity.

b. Fastow's and Causey's Objections to Dr. Hakala's Analysis Are Unpersuasive

Although Dr. Hakala's analysis "merely" demonstrated that it was "more probable than not" that Fastow's and Causey's trades were based upon insider information – and Dr. Hakala's extremely high scientific acceptance standard of 95% was met with respect to the findings – this hardly serves as grounds for dismissal. Fastow Brf. at 5, Causey Brf. at 5. Plaintiffs' standard of proof at trial is exactly the standard that Fastow and Causey complain of: to prove that it is "more probable than not" that Fastow and Causey were trading on inside information. Hakala's results are relevant evidence to support plaintiffs' other scienter allegations against these Insiders. Further, Fastow and Causey ignore Dr. Hakala's separate finding that they engaged in numerous suspicious option exercises, which can only be explained by their possession and use of inside information. Hakala Decl., ¶9(e).

c. Hannon's Co-Defendants' Insider Sales During The Class Period Should Be Considered

Hannon argues that Dr. Hakala's declaration does not mention him. This is so because Hannon did not report his trades to the SEC. In any event, his sales should be considered in the Court's evaluation of scienter.

d. Harrison's Assertions Fail to Negate the Strong Inference of Scienter Flowing From His Illegal Insider Sales

(1) Hakala's Analysis Is Not Legal Speculation

Dr. Hakala utilizes mathematical analysis and well-accepted methodologies in the academic literature to determine whether trades can be explained absent the use of non-public information. Hakala Decl., ¶4. This is not illegal speculation. Harrison Brf. at 16-17. Dr. Hakala takes no position as to whether these Insiders' use of non-public information is illegal or justified by some legal defense, he merely statistically analyzes the probable explanations for particularized stock patterns. He expertly applies well-established event-study methodology – the same methodology defendants will no doubt present to the jury when they argue at trial that their false statements to the public did not cause inflation of Enron's stock price.

As to Harrison's argument that Hakala's study does not meet the 95% confidence interval as to Harrison, Dr. Hakala found that the probability was 90%, which sufficiently meets the civil more-probable-than-not standard. Regardless, his analysis supports the CC's allegations about Harrison's scienter.

(2) Plaintiffs Have Considered Harrison's Trading History

Harrison's claim that he had no trading history ignores the fact that until the Class Period he ***never*** sold his stock, despite the fact that he owned shares and options during this pre-Class-Period time frame. ¶83(l). That ***is*** Harrison's trading history – he held his shares. By contrast, during the Class Period Harrison unloaded the majority of his available holdings. ¶83(l). This stark contrast between no pre-Class-Period and overwhelming Class-Period sales is exactly the type of allegation that substantially infers scienter. *See, e.g., Secure Computing*, 184 F. Supp. 2d at 989-90 (absence of pre-class period sales followed by sudden substantial sales during the class period, regardless of percentage sold, made sales "suspicious" and constituted substantial evidence of scienter). Moreover, contrary to Harrison's assertion, Dr. Hakala's analysis considered the vesting of Harrison's options. In addition, Harrison's argument that his trading was not timed to Enron's negative disclosure in late 01 is a complete red herring. Insider trading occurs when an insider trades on the basis of non-public information. It is insider trading whether that information leaks out in 1 month, 6 months, a year, or even if the public never finds out. Indeed, had Harrison sold later in the Class Period, he would be arguing that scienter should not be found because he missed the Enron boat.

(3) Harrison's Insider Sales Were Unrelated to Retirement

Harrison's purported retirement excuse is likewise without merit. Harrison Brf. at 22. On 4/1/01, one day after his retirement from CEO and Chairman of PGE, more than 1.1 million of his unvested options immediately vested. Harrison Brf. at 19. Rather than take advantage of his newly vested options by exercising and selling stock immediately, Harrison chose to wait, a riskier behavior for one wishing to retire, and then he sold his stock at close to its peak price. ¶83(l).

Furthermore, Harrison's timing was suspect because he was under no obligation to exercise the majority of his stock options until the year 2008.

e. Lay's Assertions Fail to Negate the Strong Inference of Scienter Flowing from his Illegal Insider Sales

The Complaint sufficiently alleges that defendant Lay's sales of Enron stock during the Class Period were both unusual and suspicious. During the Class Period, while in possession of adverse undisclosed information about the Company, Lay sold 4,002,259 shares of his Enron stock for a monumental $184,494,426 in illegal insider trading proceeds. ¶83(a). Lay also transferred 1,456,421 shares of his Enron stock valued at $76,305,838 to the Company to pay the exercise price of options he was exercising, plus related tax withholding, such that the vast majority of his insider trading proceeds went directly into his pocket. ¶83(a). Furthermore, these numbers substantially understate Lay's sales during the Class Period because the proceeds from an additional $80+ million in sales back to Enron which have not been included in this total as they were only recently reported. The excessively large volume of Lay's trades during the Class Period is probative of scienter. *See San Leandro*, 75 F.3d at 814 (defendant's sales amounting to $2 million gave rise to an inference of scienter); *see also Oxford*, 187 F.R.D. at 140 (finding large volumes of insider trades may be suspicious where the total insider sales amounted to $78 million and each individual defendants profited between $621,000 and $237 million).

Dr. Hakala's declaration addresses Lay's assertions with regard to exercising options to sell stock versus exercising options to "hold" stock. Lay Brf. at 10. His claims that he exercised 25,000 options on 8/20/01, and 68,620 on August 21, 2001, not to sell these 93,620 shares but to "hold" Enron stock strains credibility. Lay Brf. at 10-11. He did not simply "hold Enron stock" as he claimed. Rather, Lay immediately sold these shares and many more. As detailed in his SEC Form 5, Lay sold 110,706 shares on 8/21/01; sold 108,254 shares on 8/23/01; sold 110,041 shares on 8/24/01; sold 112,706 shares on 8/30/01; and sold 114,346 shares on 9/4/01. All told, he received a total of $12,013,068 from the sale of shares in the very same week he claims to have purchased and "held" shares. Hakala Decl., Ex. E. Lay's assertion that he exercised options to "hold" the stock is nonsense.

(1) Lay's Option Exercises Were Also Unusual

Dr. Hakala's analysis indicates that Lay's stock-option exercises during the Class Period ***were*** unusual, contrary to Lay's assertions. Lay Brf. at 15-32. Dr. Hakala explained that:

> Premature exercises of stock options by Lay in May, June and July 2001 under a 10b5-1 plan were at relatively low ratios (under 3.0) of Enron's stock price to the option exercise prices in comparison with Lay's prior pattern of behavior in 2000. On August 20, 2001, Lay prematurely exercised 25,000 options at $20.78 per share at a time when the share price of Enron was $36.25. These options would not expire until December 31, 2004. The premature exercise of these options was economically inconsistent with Lay's prior economic behavior and inconsistent with rational economic behavior absent a belief that Enron's shares would decline in absolute or relative value.... Given the August 20, 2001, exercise of stock options, the implied non-systematic or excess risk premium using the market implied volatility for Enron call options of 50% was 13.5% per annum. This is well beyond the implied non-systematic risk premium previously implied by Lay's option exercise behavior prior to 2001 (at or under 3.1% for premature option exercises in early 2000).

Hakala, ¶34, Ex. B (footnote omitted).

Lay does not dispute any of the ***facts*** presented by Dr. Hakala. Rather, he presents a misleading chart without factual basis. Lay Brf. at 12. For instance, Lay's option exercise on 8/20/01, at $20.78, when the shares were trading at $36.25, Hakala Decl., ¶34, directly refutes the information in this chart. Dividing the market price by the strike price ($36.25/$20.78) provides the ratio for this exercise of 1.74. But Lay's chart suggests a ratio of 2.5-3.0. Lay Brf. at 12. Lay's chart is simply a highly inaccurate attempt to assert facts conflicting with the allegations of the CC and cannot be considered on a motion to dismiss.

(2) Lay's and Skilling's 10b-5-1 Sales Are Not Insulated

Both Lay and Skilling assert that portions of their sales were sold pursuant to 10b-5-1 selling programs, and therefore cannot raise a suspicion of scienter. Lay Brf. at 18; Skilling Brf. at 6-7. But the CC alleges that they are not entitled to the protection afforded under such plans. ¶204. Plaintiffs sufficiently alleged that both Lay's and Skilling's "selling programs" were not protected because at the time the programs were adopted Lay, Skilling, and the other Insiders were already in the midst of pursuing a fraudulent scheme and course of business that operated as a fraud or deceit on the purchasers of Enron securities. ¶405. Lay was present at the Board meeting held in 10/99 when LJM2 was approved. Exs. 23, 24. Throughout 99, Lay and Skilling were aware that Enron's financial condition was deteriorating and that it would not be able to meet its earnings projections without engaging in the sham non-arm's-length transactions that LJM2 was set up for. Lay and Skilling and others devised these trading plans to insulate themselves from liability. Thus, because at the time the selling program was adopted, Lay and Skilling were aware that Enron's stock was artificially inflated, and they are not entitled to the protection of 10b-5-1(c)(1)(i)(A).

Additionally, as described above, the length of the Class Period does not render Lay's insider sales any less unusual or suspicious. Lay is incorrect that *In re VISX, Inc. Sec. Litig.,* No. C 00-0649 CRB, 2001 WL 210481 (N.D. Cal. Feb. 27, 2001), "held that a CEO's sale of 730,000 shares generating proceeds of $51.8 million over a 50-week class period was not sufficiently suspicious to raise and inference of scienter." Lay Brf. at 21. The Court in *VISX* never mentions class-period length as a reason for not finding scienter. Moreover, *VISX* acknowledges that the sheer dollar amount of the individual defendants' stock trades raise some suspicion where sales ranged from $51.8 million to $13.7 million to $4.1 million. 2001 WL 210481, at *9. But, when considered in connection with the allegations of the complaint as a whole, the *VISX* stock sales did not give rise to a strong inference of scienter. *Id*. at *8.

(3) Lay's Enormous Form 5 Sales Were Hidden From Investors

Lay's sale of 5.6-million shares of Enron stock included secret sales of 1 million shares to Enron between 5/01 and 10/01. *See* Ex. 20. These sales were hidden from the public until February 14, ***2002***, when Lay was finally forced to report them on SEC Form 5. Lay conducted these sales via the following suspicious, oft-repeated mechanism: ***First***, he borrowed $4 million from Enron. ***Second***, he quickly (within a day or two) "repaid" the $4-million loan by selling some of his shares to Enron. ***Third***, Lay then "borrowed" another $4 million. Congressional investigations determined that Lay "repaid" Enron for the $4-million loans with stock sales ***22 times*** between 11/00 and 10/01. ***In sum***, Lay camouflaged huge stock sales as loan transactions. Moreover, he used this loan-transaction facade as a pretext for not reporting on Form 4 (as sales) his wholesale unloading of shares during the middle and later part of 01, so as not to tip off the market as to the state of affairs at Enron.

(4) Lay's Chart Should be Ignored

Lay relies on a chart, which purportedly graphs his shares sold as a percentage of his total holdings, to argue that his sales were not unusual. Lay Brf. at 15. But his assertion of contested facts in the form of a chart should be ignored. *Rubinstein*, 20 F.3d at 170 n.38. Moreover, Lay's chart is misleading because it calculates his percentage of holdings sold by using Lay's available shares and options throughout ***the entire Class Period*** (including periods when these shares had either not vested or had already been sold), rather than recalibrating the denominator for each month's calculation. To compare apples with apples, the percentage of ***contemporaneous*** shares held and sold in each month during the Class Period should have been set forth.

Further, many of Lay's options were not exercisable during most of the Class Period and certain granted options were also out-of-the money and, therefore, not economically valuable in 01. Hakala Decl. at 27-28. Thus, Lay's chart substantially understates the percentage of his holdings he sold each month by substantially overstating the shares available to be sold in each month and throughout the Class Period. For example, by 12/31/01, Lay had beneficial holdings and options of 1.6 million shares but held only approximately 1.1 million shares that had intrinsic value. Applying the same reasoning, the percentage of Lay's remaining holdings sold in 8/01 and 10/01 was substantially greater than 10% in exch respective month, as compared with the 4% or less suggested on the chart. From 8/21/01 to 10/26/01, lay reported selling 918,104 shares. Hakala Decl., Ex. E. Thus, while Lay's chart suggests that Lay sold only 10% of his holdings between 8/01 and 10/01, ***Lay actually sold close to 60% of his remaining holdings*** of shares in just those three months. These sales were even more significant given the obvious restrictions on trading during portions of those three months. More accurately stated, Lay's chart merely reflects his wishful thinking concerning the facts of this case.

(5) Lay's Insider Sales Were Not Related to Retirement

Lay's attempt to explain his inside trading by his impending retirement also fails. Lay Brf. at 28. No retirement plans were announced by Lay during the Class Period. Rather, he didn't leave Enron until he was forced out in 02, when his participation in the massive fraud at Enron came to light. Notably, Lay's greatest selling spree occurred ***after*** he agreed to retake the helm at Enron as CEO. ¶83(a). Clearly, there was no relationship between Lay's insider selling and any retirement plan.

f. Mark-Jusbasche's Assertions Fail to Negate the Strong Inference of Scienter Flowing From Her Illegal Insider Sales

(1) Dr. Hakala's Analysis of Mark-Jusbasche's Option Exercises Provides Additional Circumstantial Evidence of Scienter

Mark-Jusbasche exercised options during the Class Period, including a huge number in 99 constituting more than $14 million worth of stock sales that cannot be explained as the result of normal economic behavior of executives, established by the empirical literature, absent her foreknowledge of the potential risks of Enron's financial practices. ¶83(n); Hakala Decl., ¶25. The premature exercise of these options was inconsistent with her general prior trading history, and the implied risk premiums far exceeded 10%. Hakala Decl., ¶25. This is similar to taking an 18% mortgage when the going rate is 8% – an unusual step for a sophisticated professional who was integral to running one of the largest companies in the world. Empirical literature demonstrates that such behavior is simply not a part of sophisticated executives' behavior. Hakala Decl., ¶¶23-24. A reasonable inference can be made that her options exercises are suspicious, providing additional evidence of Mark-Jusbasche's scienter.

(2) Mark-Jusbasche's Sales Strongly Evidence Her Scienter

Dr. Hakala's statistical event study of Mark-Jusbasche's sales found that the possibility that she conducted her trades absent the possession of inside information was less than 10%. Hakala Decl., ¶¶21, 24-25. This finding provides additional evidence of her scienter. Dr. Hakala's event study was based upon the long-accepted methodology required by many courts in securities cases. *See, e.g.*, Hakala Decl., ¶¶10-20. In addition, he considered defendants' trading activities by reviewing SEC Forms 3, 4, 5, 144 and Company proxy statements, including prior trading history, notwithstanding her argument that this was ignored. Hakala Decl., ¶5, Mark-Jusbasche Brf. at 25-27. And he analyzed these trades using the sophisticated risk premium analysis, described extensively in his declaration. Hakala Decl., ¶¶10-14. Moreover, contrary to Mark-Jusbasche's argument that diversification needs were ignored, Mark-Jusbasche Brf. at 37, Dr. Hakala specifically factored diversification needs into his analysis and only isolated extreme option exercises, which exceeded all known empirical results known for honest executive diversification behavior. Hakala Decl., ¶¶10-14, 25.

As to Mark-Jusbasche's disingenuous argument that the declaration lacks specificity, it should be noted that the there are 37 pages of detailed findings and methodologies, and over 100 pages of supporting data. Finally, her argument about causality is a red herring. While statistical tests cannot prove causation with absolute certainty, they can establish causation with a certain degree of confidence sufficient in both academic and litigation purposes. Statistical event studies are widely used to establish causation with a reasonable degree of confidence. Hakala Decl., ¶¶6, 7.

g. McMahon's Assertions Fail to Negate the Strong Inference of Scienter Flowing from His Illegal Trades

McMahon sold 39,630 Enron shares during the Class Period netting nearly $3 million, but he sold none before the Class Period. ¶83(p). Clearly, these sales were unusual and suspicious and out of line with his prior trading history. *Landry's*, slip op. at 25 (class-period sales were suspicious because defendants sold 1,448,000 shares ***during***, but no sales before the class period); *Secure Computing*, 184 F. Supp. 2d at 989 (sales were suspicious because defendants had none before, but sold 200,000 shares during class period).

h. Olson's Assertions do not Negate the Strong Inference of Scienter

Olson offers unsubstantiated factual assertions that she sold her options because she was "considering" leaving the company and because an unidentified financial advisor told her to diversify. That Olson asserted these same defenses in her congressional testimony, in response to suspicions about her sales, does not alter the fact that they are simply self-serving unsubstantiated factual assertions. *See* Olson Brf. at 8. Dr. Hakala has determined that Olson's option exercises of 12/00 were extremely suspicious both in comparison to her prior trading pattern and in comparison to normal executive trading behavior. Hakala Decl., ¶9(e). And his statistical analysis shows that her trading could be attributed to the use of inside information, and not some other disclosed or undisclosed reason, with a 90% degree of confidence level – far in excess of plaintiffs' standard of proof at trial. *United States v. Fatico*, 458 F. Supp. 388, 403 (E.D. N.Y. 1978), *aff'd*, 603 F.2d 1053 (2d Cir. 1979). Moreover, Dr. Hakala specifically considered executive diversification in conducting his analysis and rejected this as an explanation for Olson's sales. Hakala Decl., ¶12.

i. Pai's Assertions Fail to Negate the Strong Inference of Scienter Flowing From His Illegal Insider Sales

(1) Dr. Hakala Sufficiently Demonstrates that Pai's Option Exercises Were Irrational

Dr. Hakala's analysis clearly provides additional evidence of Pai's scienter. His study demonstrates that the options exercised by Pai in 5/01 and 6/01 were extremely inconsistent with his prior trading behavior, and cannot be explained by the behavior of a rational executive absent Pai's possession and use of inside information. Hakala Decl., ¶41. Indeed, Pai's excess-risk premium related to his options exercises at this time ran as high as 32.4%. Hakala Decl., ¶41. This is similar to agreeing to a home mortgage of 40.4% when mortgage rates are running at 8% – or agreeing to sell a house for 68 cents on the dollar. No rational person would do this unless, as here, he was trading on inside information that Enron was overvalued or, in the case of the house sale, the foundation was about to collapse.

Furthermore, Dr. Hakala's statistical analysis of Pai's sales found a strong association – 99% level of confidence – between the timing of his sales and the relative price of Enron's shares. Hakala Decl., ¶42. Pai's economic behavior was inconsistent with the sales of shares for mere wealth-diversification purposes and liquidity and strongly consistent with the sale of shares with foreknowledge that the shares were inflated in value in 00 and 01. Hakala Decl., ¶42. This level of confidence far exceeds the level required to prove scienter at trial.

(2) Pai's Insider Sales Were Unrelated to His Divorce

Pai provides no evidence for his argument that his sales of shares during the first half of 00 "was driven by his divorce and the related financial issues." Pai Brf. at 44. This is clearly a strawman argument: There is no requirement that stock be sold before a divorce; the shares can simply be divvied up between the parties. To the contrary, Pai's divorce should have had the opposite effect. Pai's divorce occurred in Texas, a community-property state, where one party can be liable for dissolution of assets during the period before a division of assets by divorce. *Pitman v. Pitman*, 721 N.E.2d 260, 265 (Ind. Ct. App. 1999) (selling shares of stock before divorce decree held to be dissipation of marital assets); *Echols v. Echols*, No. E1999-00619-COA-R3-CV, 2000 WL 688589, at *5 (Tenn. Ct. App. May 30, 2000) (same); *In re Marriage of Huston*, 967 P.2d 181, 185 (Colo. Ct. App. 1998) (same). Pai and his wife were not divorced until 8/00 – several months after Pai had stopped exercising his options and selling his stock. Pai Brf. at 43.

Moreover, since Pai's option exercises and subsequent stock sales implied non-systematic excess-risk premiums, as high as 32.4% on an annualized basis, Hakala Decl., ¶¶33-34, unless he had inside information that Enron's stock would soon be declining, Pai placed himself at great risk of a dissolution-of-assets claim by his then wife by exercising options well before his divorce was final. Interestingly, in 4/00, Pai transferred 200,000 options to his then wife as indicated in his SEC Form 4 for 4/00. Mrs. Pai apparently did not share his belief that the divorce required her immediate disposal of these options, as she did not sell these shares until well after the divorce. A similar "divorce defense" was raised, without success, in *Secure Computing*, 184 F. Supp. 2d at 989, where there were insider sales while the defendant was separated from his wife many months before divorce was finalized, for which he did not have a reasonable explanation. And community property is normally divided at the time of the divorce, not at the time of separation. The scenario in *Secure Computing* mirrors the defenses raised by Pai, who allegedly sold his shares in "preparation" of the divorce without any approval of his then wife, not as part of a final decree, and where the divorce was not finalized until many months after his sales.

(3) Pai's Insider Sales Were Unrelated to Retirement

Pai's departure from Enron in 7/01 does not explain his suspicious trading. While some of his stock-sale transactions occurred in the months before he left Enron in 7/01, the vast majority of them occurred one year earlier. ¶86(j). Thus, Pai's sales six months in advance of this date have little in connection with his departure.

j. Rice's Assertions Fail to Negate the Strong Inference of Scienter Flowing From His Illegal Insider Sales

Dr. Hakala's study does not merely show that Rice's trading was likely – more probable than not – based upon inside information, rather, the statistical analysis demonstrates a 99% confidence interval for Rice's sales. That is, that there is less than one chance in 100 that he could have undertaken his trades for reasons other than based upon inside information. Hakala Decl., ¶ 43. This level of certainty exceeds plaintiff's pleading and proof burden in both civil and criminal cases, and far exceeds the standards for scientific acceptance. *See Fatico*, 458 F. Supp. at 403. Contrary to criticisms, Rice Brf. at 9, Dr. Hakala also analyzed Rice's share holdings over time and specifically considered the vesting of Rice's options, Hakala Decl., ¶¶9d, 25,43 and 44 and Ex. F-3. Further, Dr. Hakala examined (and rejected) alternative explanations for Rice's option exercises, and found that the odds that Rice's unusual option exercises could be explained by other factors were less than 1%. Hakala Decl., ¶43.

(1) Plaintiffs Have Established that Rice's Sales Were Unusual and Suspicious

Contrary to Rice's suggestion, plaintiffs have adequately pleaded that Rice's sales were unusual or suspicious. Rice Brf. at 9-13. Dr. Hakala found that Rice sold very little of his holdings before October 1999, increased his rate of selling in 2000, and then sold the remainder of his holdings in 2001. Hakala Decl., ¶43. Plaintiffs allege an unusual pattern of trading by demonstrating that Rice's sales increased during the Class Period (Hakala Decl., ¶43) and that his option exercises in 2001 were completely inconsistent with his prior economic behavior. In fact, they implied an unreasonably high degree of risk aversion so as to not be explainable absent knowledge that Enron's share price was inflated. Hakala Decl., ¶44. Rice makes no attempt to explain his obviously premature stock-option exercises in January and February 2001 or why his option exercises in 2001 were so vastly inconsistent with his prior economic behavior. Hakala Decl., ¶44. And Rice's argument that he had no stock-sales history, Rice Brf. at 9-13, is contradicted by plaintiffs' allegations that he had a significant trading history before and during the Class Period, demonstrating Rice's high degree of risk aversion and likelihood of selling shares. Hakala Decl.,

¶¶43-44. At best, his argument constitutes a factual dispute inappropriate for resolution at this stage of the proceedings.

Rice's insider sales were clearly unusual and suspicious. He did not merely sell 55% of his holdings during the Class Period. He sold ***all or nearly all of his valuable holdings,*** according to Rice's own Form 4 filings. Hakala Decl., ¶43. Those options not exercised by Rice were vested in some cases on 2/14/01, or were out-of-the money and, therefore, worthless. Hakala Decl., ¶44. Dr. Hakala discusses the fact that, even for those options that had so little intrinsic value that it would not make any economic sense to exercise them, Rice still exercised to obtain what minimal value was available; *e.g.,* options with an exercise price of $67.81 in 1/01, 2/01 and 3/01. Rice cannot rationally explain why an executive, even one supposedly expecting termination, would exercise a stock option with a strike price of $67.81 per share when the price of Enron stock was $70.00 on 1/17/01. Hakala Decl., ¶44. "The exercises of the $67.81 per share options in January and February 2001 implied an extreme sacrifice of future expected value unless the individual had foreknowledge or reasonable expectations of future declines in the stock price of Enron." Hakala Decl., ¶44, n.34. Rice ultimately ***extracted more than 80% of the total dollars*** that were available to him. *Id*. Further, Rice's sales were not evenly spaced over a three-year period, but were grouped and increased in a manner reflecting growing knowledge of the extent of the inflation in Enron's share price in 00 and 01. Hakala Decl., ¶43, Ex. F-3. His pattern of stock sales and premature option exercises was suspicious in amount and in timing. Hakala Decl., ¶¶43-44, Ex. F-3.

k. Skillings' Assertions Fail to Negate the Strong Inference of Scienter Flowing From His Insider Sales

(1) Skilling's Dividend and Tax Incentive Argument Is Without Merit

Skilling suggests that plaintiffs ignore "the fact" that Enron's stock paid dividends and the substantial tax incentives that affect an individual's decisions regarding the exercise of compensatory stock options. Skilling Brf. at 67. Whether or not this argument has merit is beside the point. Skilling's entire theory hinges on an assumption that is inapplicable to him. Skilling assumes that the individual exercising the options is able to take advantage of the long-term capital gains tax that kicks in at one year; Skilling was not such an individual. Therefore Skilling did not exercise his options to take advantage of this hypothetical tax advantage.

(2) Skilling's Sales Were Clearly Unusual And Suspicious

Skilling sold 1.3 million shares during the Class Period for proceeds of over $70 million. ¶83(b). Compare this with Skilling's pre-Class Period sales of 14,246 shares for mere proceeds of $286,298. Nothing Skilling argues can suggest that his Class Period sales were normal for him. Indeed, Skilling sold 42% of his holdings during the Class Period and hadn't sold ***any*** stock for the two years prior. *Id*. Contrary to Skilling's suggestion that he stopped trading before July 2001 because he considered Enron stock's valuation to be low, it merely suggests he was smart enough to know that the end was near.

l. Sutton's Assertions Fail to Negate the Strong Inference of Scienter Flowing from His Illegal Insider Sales

Sutton's arguments attempting to overcome the compelling evidence contained in Dr. Hakala's declaration are easily disposed of. ***First***, his argument that the declaration should be considered at a later stage is incompatible with Sutton's application to dismiss the CC with prejudice. Dr. Hakala's analysis may be appropriately considered at this juncture to avoid a dismissal.

Second, Sutton's challenge that Dr. Hakala's graduate-school studies, on his way to obtaining his doctorate in economics, were typical of many graduate curriculums, and therefore "unremarkable" is inapposite. Sutton Brf. at 23-24. An expert's curriculum need not be remarkable. What is relevant is that Dr. Hakala's methodology is in widespread use and widely accepted. *See* Hakala Decl., ¶¶10-14, n. 33.

Third, Sutton's argument regarding the reliability of the Enron peer group, which is a minor data-analysis component of Dr. Hakala's study, is a red herring. Sutton Brf. at 24. Dr. Hakala used the peer group ***chosen by Enron*** in Enron's proxy filings. Hakala Decl., ¶5 n.1. Presumptively, Enron's choice of its peer group is appropriate.

Fourth, Sutton's argument that there was not an efficient market for Enron's stock, Sutton Brf. at 25, ignores the legal presumption that there is an efficient market for publicly traded stock. *See Basic*, 485 U.S. at 253. During the Class Period, Enron became the seventh-largest U.S.

corporation and trading in its stock averaged many million shares a day. Clearly, Enron stock traded in an efficient market.

5. Insiders' Performance Bonuses Support a Strong Inference of Scienter

The CC alleges another motive to commit fraud – namely, the Insiders' unusual, millions-plus compensation and bonuses. ¶83. *See Green Tree*, 270 F.3d at 661 (***magnitude*** of officer's compensation package, together with coincident overstatement of earnings, "provides an unusual, heightened showing of motive to commit fraud"). Insiders were in a position to pocket huge cash bonuses if, but only if, Enron achieved certain preset earnings targets and its stock price advanced to certain targeted trading levels. ¶396. The bonuses awarded to the Insiders were indeed huge, ¶83, and provided additional motive for them to misrepresent and conceal Enron's true condition. Moreover, huge bonuses suffice for scienter even when insiders abstain from insider trading. *Green Tree*, 270 F.3d at 663.[41]

6. Plaintiffs' Allegations About Enron's House of Cards, Including Stock-Price Triggers, Reveal the Insiders' Motive and Further Support a Strong Inference of Scienter

Enron's undisclosed financial deals, which concealed its massive debt, involved stock-issue and price triggers, which provided an additional, heightened motive for Insiders to continue to misrepresent and conceal the Company's true financial condition. If Enron's stock price fell below certain trigger prices, the Enron stock "triggers" contained in deals with entities controlled by Chewco, LJM1 and LJM2, would require Enron to issue over 100-million shares to those partnerships, causing a huge reduction in its shareholders' equity and a death spiral for the Company. Simply stated, when the stock price fell below one of the last trigger points, Enron's massive Ponzi scheme would be exposed. ¶52. The fraud was so massive and concealed that CFO Fastow claimed Enron's financial information was a secret:

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41 ¶83 alleges that Insiders received the following enormous bonus payments: Lay – $18.1 million; Skilling – $13.2 million; Fastow – $3 million; Causey – $1.5 million; Derrick – $1.2 million; Frevert – $5.3 million; Horton – $3.1 million; Rice – $6.4 million; Buy – $1.6 million; Mark-Jusbasche – $1.9 million; McMahon – $3.3 million; Sutton – $2.3 million. ¶83(a)-(i), (n), (p), (r).

> As for the details about how it makes money, Enron says that's proprietary information, sort of like Coca-Cola's secret formula. Fastow, who points out that Enron has 1,217 trading "books" for different commodities, says, "***We don't want anyone to know what's on those books***. We don't want to tell anyone where we're making money.

¶289. *See also* ¶¶18, 20, 35, 41, 46, 271, 305, 313, 342, 361, 396, 497-498, 617-622, 630, 651(d), 663, 682, 686, 704, 708-09, 724, 769, 782, 796, 820, 822, 892, 926.

7. Scienter Is Further Demonstrated by Post-Class Period Discrepancies and Statements

Enormous additional discrepancies, which appeared in its post-bankruptcy SEC filings for the first time, are further evidence of scienter and strongly support plaintiffs' allegation that the truth about the Company's undisclosed debt was concealed during the Class Period. "The temporal proximity between an alleged misstatement and the later disclosure of inconsistent information can provide some circumstantial factual support of the defendants' scienter." *Friedberg*, 959 F. Supp. at 51 (citing *Shaw*, 82 F.3d at 1225). Another district court denied a motion to dismiss where the new CFO "almost immediately discovered the discrepancies in the financial statements." *In re First Merchants Acceptance Corp. Sec. Litig.*, No. 97 C 2715, 1998 U.S. Dist. LEXIS 17760, at *32 (N.D. Ill. Nov. 2, 1998). Enron's new management's disclosure of the inaccurate condition of Enron's prior-reported businesses continued in Enron's 4/22/02 8-K, which explained that

> the Company's prior reported financial information for the fiscal years ended December 31, 1997 through 2000 and the first and second quarter of 2001 should not be relied upon.... [I]f ... a review were conducted and balance sheet prepared, ***a significant write-down of assets on [Enron]'s balance sheet would be required,*** which current management estimates would be approximately ***$14 billion*** ... a material portion of such estimated amount, would relate to valuations of several assets the ***historical carrying value*** of which current management believes ***may have been overstated due to possible accounting errors or irregularities***.

D. Plaintiffs Adequately Allege That Insiders Violated §20A

Insiders argue that the §20A claim, ¶¶998-1004, should be dismissed because plaintiffs failed to allege a predicate violation of the 1934 Act. Defs' Brf. at 20. But plaintiffs have adequately alleged that Insiders are liable under §§10(b) and 20A, as well as under Rule 10b-5. Dismissal of the §20A claims is simply unwarranted as plaintiffs have adequately pleaded predicate violations of the 1934 Act and clearly demonstrated that named plaintiffs traded contemporaneously with the

Enron Insiders. *See* Ex. A to the CC. Notably, only a handful of Enron Insiders make more than the most cursory arguments regarding this claim.[42]

Insiders engaged in enormous insider trading while in possession of material, nonpublic information, selling millions of their Enron shares – large percentages of their holdings – at artificially inflated prices.[43] ¶¶83-84, 395-404. For sales between 10/27/98 and 9/21/01, plaintiffs identify the date of each sale, the number of shares sold, and the plaintiff who made a contemporaneous trade. As Ex. A to the CC shows, plaintiffs' trades occurred either on the very same day as the Insiders' sales or within twenty-four hours of them. This Court has held:

> To state a claim for securities fraud based on insider trading in a private cause of action under §10(b) Rule 10b-5 and §20A of the Exchange Act, a plaintiff must show that a defendant (1) used material, nonpublic information, (2) knew or recklessly disregarded that the information was material and nonpublic, and (3) traded contemporaneously with the defendant.

BMC Software, 183 F. Supp. 2d at 916. In sharp contrast to this case, where the details surrounding plaintiff and defendants' trades are set out in painstaking detail, in *BMC Software* the Court found that "[t]here are no specific allegations of contemporaneous trading of Plaintiffs/investors and Defendants here, with alleged facts to support such a contention." *Id.* Section 20A of the 1934 Act provides a private right of action:

> Any person who violates any provision of this title ... or the rules or regulations thereunder by purchasing or selling a security while in possession of material, nonpublic information shall be liable in any action ... to any person who, contemporaneously with the purchase or sale of securities that is the subject of such violation, has purchased (where such violation is based a on sale of securities) or sold (where such violation is based on a purchase of securities) securities of the same class.

15 U.S.C. §78t-1(a). And the contemporaneous requirement is flexible. So long as plaintiffs' trades occur within a reasonable period of an insider's transaction, plaintiffs satisfy the requirement.

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[42] Plaintiffs do not allege a violation of §20A against Hannon. Rather the CC adequately alleges his liability under §10(b) and Rule 10b-5 based on his participation in the fraudulent scheme, as well as his illegal insider trading.

[43] A summary of the Insiders' trades is in Ex. C of the Appendix to the CC.

Neubronner v. Milken, 6 F.3d 666, 669-70 (9th Cir. 1993).[44] At least one court has held the standard to encompass defendants' entire scheme. In *In re Am. Bus. Computers Corp. Sec. Litig.*, [1995 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶98,839, at 93,055 (S.D.N.Y. 1994), defendants traded over a period of several weeks and a pattern and conspiracy of insider trading had been established. The court held that, "a class action may be maintained on behalf of all persons who purchased stock on an exchange during the period that defendants were selling that stock on the basis of insider information." *Id.* Under this rubric Insiders are liable for their trades occurring at any point during the Class Period, even with respect to trades not listed in the appendix to the CC.

As detailed fully in this memoranda, plaintiffs allege that the Insiders violated §§10(b) and 20A as well as Rule 10b-5. Plaintiffs have adequately pled claims under §10(b) and Rule 10b-5 based on their failure to make full and accurate disclosure of material facts affecting Enron and their failure to disclose material, nonpublic information or refrain from trading. The material, nonpublic information possessed by the Insiders is well documented in the CC, as are their stock sales. Finally, Ex. A to the CC spells out in detail the date of each sale, the number of shares sold, and the plaintiff who made a contemporaneous trade. Nothing more is required. *BMC Software*, 183 F. Supp. 2d at 916.

Lay, Mark-Jusbasche and Skilling attempt to extricate themselves by rehashing arguments related to particularity and scienter. As demonstrated in §III.B of this brief, plaintiffs satisfy the particularly requirements of the 95 Act, and allege specific facts raising a strong inference that all Insiders acted with scienter. Lay provides no authority for his claim that plaintiffs are required to allege different facts raising a strong inference of scienter for a claim under §20A. Lay Brf. at 37. Rather, the scienter allegations provide the requisite basis upon which to hold him liable. And

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44 *See In re Cypress Semiconductor Sec. Litig.*, 836 F. Supp. 711, 714 (N.D. Cal. 1993) (purchase within five days fulfills requirement); *Oxford*, 187 F.R.D. at 138 (reasonable period); *In re Eng'g Animation Sec. Litig.*, 110 F. Supp. 2d 1183, 1196 (S.D. Iowa 2000) (three days); *Froid v. Berner*, 649 F. Supp. 1418, 1421 n.2 (D.N.J. 1986) (holding nine days between trades "is unquestionably contemporaneous"); *Gerstein v. Micron Tech.*, No. 89-1262, 1993 U.S. Dist. LEXIS 21214, at *20 (D. Idaho Jan. 4, 1993) (a "few days"); *In re Nord Res. Corp. Sec. Litig.*, No. C-3-90-380, 1992 U.S. Dist. LEXIS 22739, at *21 (S.D. Ohio Dec. 16, 1992) ("liability extends forward a few days from the date of an insider trade"); *Silicon Graphics*, 970 F. Supp. at 761 (adopting six-day period).

Mark-Jusbache's claim that plaintiffs failed to provide the degree of particularity required by the 95 Act is similarly misplaced. The CC is replete with examples of her role in the Enron debacle. *See, e.g.,* ¶¶83(n), 121(h), 590-591, 739. Thus, her protestations about the level of detail in the CC are unavailing. And even if she is correct that one of the plaintiffs may lack standing to bring a §20A claim related to one incident of trading, Mark Brf. at 22 n. 25, Mark-Jusbache is still liable for six other contemporaneous trades pleaded in the CC. Ex. A at 2-3. There is no support for the notion that a single noncontemporaneous trade can destroy plaintiffs' §20A claims as to trades that were undisputedly contemporaneous.

Skilling similarly misapprehends the law. Despite the extensive factual information alleged, he claims plaintiffs have "failed to plead any facts sufficient to demonstrate that Mr. Skilling traded on the basis of material non-public information." Skilling Brf. at 82. The CC is replete with information detailing Skilling's knowledge of the Enron fraud, as well as his suspicious insider-stock sales. *See, e.g.,* ¶¶7, 10, 57, 59, 83(b), (gg), 121(f), (h), 126, 164, 271, 300(j), 343, 359, 413, 457, 500, 581.

E. Insiders Are Liable Under §11 of the 1933 Act

Enron's Insiders/Directors who signed the false and misleading Registration Statements used to issue securities during the Class Period are liable under §11 of the 1933 Act.[45] These individuals not only signed the Registration Statements, but also participated in the preparation and dissemination of the Registration Statements/prospectuses.

Enron Insiders who signed registration statements were responsible for the contents and dissemination of the registration statements and thereby issued, caused to be issued and participated in the issuance of the materially false and misleading written statements to the investing public which were contained in the registration statements. In response, they defend themselves with specious and technical arguments. They (1) improperly claim Rule 9(b) applies to §11 claims; (2)

[45] Causey, Fastow, Harrison, Lay, and Skilling signed Enron's 2000 10-K, as well as the Form S-3, 7/18/01 Registration Statement, which incorporated Enron's 2000 10-K and prior pertinent Registration Statements and filings incorporated therein. ¶¶292, 336. Insider Mark-Jusbasche either signed or was liable as a director with respect to the pertinent Registration Statements and public filings incorporated therein.

hide behind "experts," Skilling Brf. at 82-87; (3) claim plaintiffs do not have standing to sue because they cannot trace their purchases to the issuance of the Registration Statement,[46] Lay Brf. at 73, Causey Brf. at 12; and (4) claim that plaintiffs do not adequately allege any material misstatements or omissions, Lay Brf. at 73.

Section 11 of the 1933 Act imposes liability upon directors or signers of Registration Statements, among other persons, when a registration statement contains an untrue statement of material fact or fails to disclose material information required to be stated therein or necessary to make the statements contained therein not misleading. *See Herman & McLean v. Huddleston*, 459 U.S. 375, 382 (1983). Section 11 "impos[es] a stringent standard of liability on the parties who play a direct role in a registered offering." *Id*. at 381-82 (footnote omitted). A plaintiff who "purchased a security ***issued pursuant to a registration statement ... need only show a material misstatement or omission to establish his prima facie case***." *Id.* at 382. Section 11 does not require a plaintiff to plead or prove scienter. *Id*. at 381-82; *Ernst & Ernst*, 425 U.S. at 200 (congressional policy underlying §11 was to create liability regardless of fault). The rule is simple, if there is a material misstatement or omission in the registration statement, the buyer may sue the issuer underwriter or signer of the Registration Statement.

1. False and Misleading Statements Were Contained in Enron's Registration Statements

Contrary to the arguments proffered by defendants Causey and Lay (*see* Causey Brf. at 13, Lay Brf. at 73), plaintiffs have adequately pleaded that the Registration Statements used to issue securities during the Class Period contain material misrepresentations and omissions. Enron's Registration Statements, used to sell securities during the Class Period, incorporated by reference various Enron 10-K reports and other SEC filings (including 10-Q reports). The Class Period offerings of Enron's securities included (¶¶48, 612):

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[46] This is not a defense which can be relied upon at the motion to dismiss stage.

Registration Statements for Enron Offerings During the Class Period[47]

Date of Offering	Date of Registration Statement	Description of Security	Under-writer(s)	Annual Financial Statements/10 Ks Incorporated by Reference	Quarterly Financial Statements Included or Incorporated by Reference
11/24/98	12/31/97	$250 million of 6.95% notes	CS First Boston	Registration Statement incorporated the 96 and 97 10-Ks	10-Qs for 3/31/97; 6/30/97; 9/30/97
2/11/99	2/05/99	27.6 million shares of common stock @ $31.34	CS First Boston, Lehman Brothers, Merrill Lynch, JP Morgan, CitiGroup, CIBC, Bank America, Deutsche Bank	Registration Statement incorporated the 97 10-K	10-Qs for 3/31/98; 6/30/98; 9/30/98
5/19/99	2/05/99	$500 million 7.375% notes	Lehman Brothers, Bank America, CIBC	Registration Statement incorporated the 97 and 98 10-Ks	10-Qs for 3/31/98; 6/30/98; 9/30/98
5/00 & 6/00	2/05/99	$325 million in 7.875% notes	Lehman Brothers	Registration Statement incorporated the 97, 98 and 99 10-Ks	10-Q for 3/31/00
7/18/01	6/01/01 & 7/13/01	Resale of Zero Coupon Convertible Notes	None	Registration Statement incorporated the 00 10-K	10-Q for 3/31/01

47 Plaintiffs are no longer pursuing their claim with respect to the 7% Exchangeable Notes Offering. Thus, their §11 claims against Mark-Jusbasche with respect to this offering are moot. However, although not pled in the CC, it should be noted that Mark-Jusbasche signed the post-effective Registration Statement for the 7.375% and 7.875% Notes on 3/01/00 and thus has §11 liability for those offerings.

Each of these Registration Statements were false and misleading due to the incorporation of Enron 10-Ks and 10-Qs that contained Enron's ***admittedly false financial statements for 97-00, which understated its debt by billions of dollars and overstated its earnings by hundreds of millions***. ¶¶418-611. Enron's 97, 98, 99, and 00 financial statements were all restated, which is an admission that they were materially false when made. The incorporated ***Enron 10-Qs contained Enron's admittedly unaudited false and misleading quarterly financial results***. ¶615.[48] Since the interim financial statements were unaudited, ***they were not expertised***. Thus, all signers of those Registration Statements are legally responsible for their accuracy.

Under 1933 Act §11, each signer of these Registration Statements is *prima facie* liable to the purchasers of those securities, subject to the defendant proving that they did not know, or in the exercise of due care or diligence, could not have known, of the falsity of the Registration Statements containing the false financial results. Given the duration of falsity – over three years – and the size of the falsity – literally billions of dollars – the signers of these Registration Statements who foisted these worthless securities on the public face quite a burden.

a. False and Misleading Financial Results and Related Party Transaction Representations

The Registration Statements were materially false in many aspects, in addition to the false financials. For instance, each one contained a representation that any transactions Enron entered into with "unconsolidated affiliates" were on terms representative of or reasonable when compared to terms that could have been obtained from third parties. That statement was false. Given the looting of Enron that occurred via the LJM2 partnership's transactions with Enron, its executives and directors who repeatedly waived Enron's conflict-of-interest policies, which enabled Fastow and his friends to self deal in Enron's assets via transactions with LJM2, will have a very difficult time proving that they did not know, and in the exercise of due care could not have known, of the falsity of these related party transaction misrepresentations.

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[48] While the signers of these Registration Statements may at trial be able to establish a defense to liability for these expertised, *i.e.*, certified, financial statements, in light of the CC's allegations that they knew the annual certified financial statements were false, they may not do so at this stage. *Murphy*, 1996 U.S. Dist. LEXIS 22207, at *23.

Each of the Registration Statements also contained false and misleading statements about Enron's financial-risk management, and credit-risk activities and capabilities, which concealed the substance, nature, and effect of the non-arm's-length transactions Enron was entering into with related parties. The Registration Statements indicated that Enron had hedged risk in its earnings and equity and thus its finances were secure and its credit standing and rating were sound, when in fact its financial structure was extremely precarious. ¶¶70, 110, 126, 134, 164, 336, 393, 425, 612, 615.

b. False and Misleading Statements About EBS and the EIN

Each of the Registration Statements, which incorporated Enron's 99 and 00 10-Ks, contained false statements about Enron's EBS business. Enron's 99 10-K stated that "the Enron Intelligence Network (EIN) ... ***currently connects to most major U.S. cities*** ...," and "***the EIN allows Enron to provide high quality delivery services for content providers***." ¶631. ***This was false because EBS had no "intelligent" network then – and never did***. The EIN – which Enron defined as its network of fiber-optic lines connected by pooling points, at which bandwidth could be metered and directed, and the internally developed Broadband Operating System ("BOS") – was ***never*** completed. Although Enron had access to miles and miles of fiber-optic cable, only a tiny fraction of the lines were lit and connected at pooling points in the U.S. ¶632. By spring 99, EIN development had "deteriorated into chaos," as stated by a co-author of Enron's broadband business plan, and by 10/99 EBS was "in crisis mode." Simply stated, Enron's representation that EIN "***currently connects to most major U.S. cities***" was a lie. ¶635.

Similarly, the statements in Enron's 00 10-K extolling the progress of the EIN's development (¶636), incorporated by reference into a Registration Statement, *e.g.,* "During 2000 Enron Broadband Services ***substantially completed the Enron Intelligence Network ("EIN")***, a high capacity, global fiber optic network which through pooling points can switch capacity from one independent network to another and create scalability," were false because the EIN and the underlying BOS never worked. *See* ¶¶633, 635, 637 (internal EBS document showing that as of 12/00, pooling points that were running/operating by the end of the year, and pooling-point equipment installed in other than three U.S. cities, was ***not yet operational because the equipment***

in each of those cities had not yet been connected to a network-operations center). Most of Enron's fiber-optic network was dark and not operating. In truth, Enron could not even make a broadband connection between Portland and Seattle, and was using internet-service providers to carry content that it represented to be transmitted by EIN's video-streaming. ¶639.

c. False Statements Regarding EES

The Registration Statements that incorporated Enron's 99-00 10-Ks and 01 10-Q filings contained false statements about EES. Enron's 1stQ 01 10-Q stated that EES, which included commodity and energy-asset management and services contracts, had 1stQ 01 revenues of $693 million and income of $40 million, which was a dramatic improvement over 1stQ 00 revenue of $314 million and income of $6 million. The 10-Q stated that the increase in EES revenues was "primarily ... a result of long-term energy contracts originated in 2001 and the growth of energy services' European operations." These numbers were materially false and misleading because the revenue and income for both 1stQ 00 and 1stQ 01 were falsified and overstated due to overvaluation of the EES contracts and Enron's abuse of mark-to-market accounting. ¶¶418-611, 640. Likewise, in Enron's 00 10-K, Enron reported income for EES of $165 million, which was a huge increase over the reported $68 million loss in 99, and attributed 00 revenue and gross-margin increases – $2.8 billion and $331 million, respectively, compared to 99 – primarily to long-term contracts originated in 00 and the increase in value of the EES contract portfolio. Enron's 99 10-K stated that EES was a "nationwide provider of energy outsourcing products and services to business customers," including energy-management services directly to commercial and industrial customers to reduce total energy costs, and reported EES total revenue of $1.8 billion. These numbers were false due to the accounting falsification and manipulations. ¶¶418-611, 641.

d. False and Misleading Statements About Enron's Financial Risk Management

Enron's Registration Statements for securities sales in 00-01 also contained false statements about Enron's purported financial-risk-management actions, skills and capabilities, incorporated from Enron's 99-00 10-Ks. These statements gave the false and misleading impression that Enron had greatly reduced the risk of its business through a series of sophisticated risk-management techniques and risk analyses, and falsely quantified the components of market risk to which Enron was subject. The Registration Statements stated that Enron managed the components of its market risk (*e.g.,* commodity-price, interest-rate, foreign-currency exchange-rate, and equity risk) and its credit risk. Enron had materially compromised, if not altogether destroyed, its financial-risk management through its bogus hedging transactions, as the banks knew because they had structured and prepared the documents for the bogus hedging transactions. Indeed, the banks, using the same risk analyses as Enron, concluded its market risk was materially greater than that stated. ¶624.

For example, the 00-01 Registration Statements for Enron's securities sales, incorporated from Enron's 99 and 00 10-Ks, state the following:

> FINANCIAL RISK MANAGEMENT
>
> * * *
>
> ***Enron has performed an entity-wide value at risk analysis of virtually all of Enron's financial instruments, including price risk management activities and merchant investments.*** Value at risk incorporates numerous variables that could impact the fair value of Enron's investments, including commodity prices, interest rates, foreign exchange rates, equity prices and associate volatilities, as well as correlation within and across these variables.
>
> The value at risk for equity exposure discussed above is based on J.P. Morgan's RiskMetrics (TM) approach.

¶625.

This was false and misleading. Enron had not done an "entity-wide value at risk analysis" and it had not analyzed its equity exposure because, as the banks knew, the results of the value-at-risk analysis, or "VaR," did not reflect the Company's leveraging of its equity in 99-01. For example, the banks' VaR, stress-testing and scenario analyses for risk management/risk measurement produced results materially different than the results presented in the discussion of Enron's Financial Risk Management in Enron's Registration Statements for the securities offerings in 00-01. In Enron's 01 Registration Statements, at a minimum, the results of the VaR did not reflect the massive amount of derivative-securities trades that the banks had engaged in with Enron in negotiating and structuring the LJM/Raptors transactions and in participating as LJM2 investors. The derivatives trades Enron executed through LJM2 and the Raptors, in its bogus hedging transactions, with over $2 billion notional principal, destroyed Enron's financial-risk management because those trades leveraged Enron's own equity to extreme multiples. As a matter of market risk, these transactions were so dangerous to Enron that, internally, the banks referred to the trades or the risk they presented as ***"toxic waste" or "toxic."*** ¶626.

Enron's Registration Statements for its 01 securities sales also incorporated "Non-Trading Market Risk" in the financial-risk management discussion for its 00 10-K, which did not disclose or account for the actual impact of the leveraging of Enron's own stock in the LJM2/Raptors bogus hedging transactions. This resulted in a material understatement of Enron's non-trading market risk. In particular, the equity category of Enron's non-trading market risk indicated $7 million for 00, meaning that in 00 there was a 5% chance that on any day Enron would lose $7 million in the event of a severe negative change in Enron's equity exposure. ***This indicated minimal risk***. This statement was false and misleading. ***Enron's leveraging of its own stock in the LJM2/Raptors bogus hedging transactions in 00 alone increased Enron's equity risk materially higher than what was represented – approximately $100 million instead of $7 million – resulting from a severe negative change in Enron's equity exposure***. ¶627.

e. False and Misleading Statements About Enron's Price Risk Management Activities and Financial Instruments

The Registration Statements for Enron's securities sales in 00-01 also made numerous misrepresentations concerning Enron's credit risk, incorporated by reference from Enron's 99-00 10-Ks. Enron's true credit risk was misstated and the false impression was given that Enron had minimized its credit risk. In truth, Enron had leveraged billions of dollars of its own stock as credit support for the purported third parties that it was dealing with in Enron's bogus hedging transactions through the LJM partnerships and the Raptors. ¶628.

The Registration Statements for Enron's 00-01 securities sales incorporated the following statement from Enron's 10-Ks (¶629):

> Credit risk relates to the risk of loss that Enron would incur as a result of the nonperformance by counterparties pursuant to the terms of their contractual obligations. Enron maintains credit policies with regard to its counterparties that management believes significantly minimize overall credit risk. These policies include an evaluation of potential counterparties' financial condition (including credit rating), collateral requirements under certain circumstances and the use of standardized agreements which allow for the netting of positive and negative exposures associated with a single counterparty.

*   *   *

> Enron does not anticipate any material impact to its financial position or results of operations as a result of nonperformance of third parties on financial instruments related to non-trading activities.

The 00 10-K, incorporated in Enron's 01 Registration Statements, further represented that Enron's total reserves for credit exposure were only $452 million as of year-end 00. These statements were false and misleading. Enron's credit exposure in 00 due to the LJM2/Raptors transactions ***alone*** – over $250 million – was not reflected in the reserves. In 01 Enron's credit exposure due to the LJM2/Raptors transactions ***alone*** was over $500 million as of 4/01 and $1 billion as of 7/01. And, contrary to what was represented, Enron anticipated a material impact to its financial position due to credit exposure. Indeed, from the fall of 00 and during 01, Enron's stock price was spiraling downward, piercing equity-issues price triggers and bringing massive credit exposure to Enron. The house of cards was crumbling before the eyes of those who engaged and participated in constructing it. ¶630.

2. Plaintiffs Must Only Meet the Liberal Rule 8 Pleading Standard with Respect to Their Section 11 Claims

The Fifth Circuit does not apply 9(b) to §11 claims not "sounding in fraud." As this Court held, where plaintiffs §11 allegations "expressly disavow[] and disclaim[] any allegations of fraud ... its claims do not 'sound in fraud' and the claims cannot be dismissed for failure to satisfy Rule 9(b)". *Landry's*, slip op. at 60 (citing *Lone Star Ladies Inv. Club v. Schlotsky's Inc.*, 238 F.3d 363, 368 (5th Cir. 2001)); *see also U.S. Liquids*, 2001 U.S. Dist. LEXIS 23518, at *108 ("given the express disavowal of those elements in the complaint that relate to fraud to the fraud claims in the Securities Act claims, the Court finds that Plaintiffs have stated claims under the 1933 Act"). As the Fifth Circuit explained:

> ***The lower threshold of liability under section 11 and 12 of the 1933 Act as compared to the 1934 Act here matters a great deal***. This threshold and its relevance to a Rule 12(b)(6) motion is illustrated by two hornbook principles of securities law. The liability of an issuer to a plaintiff who purchases a security issued pursuant to a registration statement for a material misstatement or omission is "virtually absolute...." "Defendants other than the issuer can avoid liability by demonstrating due diligence...." And this is an affirmative defense that must be pleaded and proved.

Lone Star, 238 F.3d at 369.

In light of the clear legislative intent to eliminate onerous pleading requirements and legalistic impediments to investor recovery and to provide a deterrent to dishonesty in the issuance of new securities, and since neither fraud nor mistake is an element of a §11 claim, courts find it inappropriate to apply the harsh pleading requirements of Rule 9(b) to the strict-liability and negligence provisions of the 1933 Act. Furthermore, courts appropriately apply the liberal notice pleading standard of Rule 8(a)(2) when plaintiffs' counsel, in the interest of conserving judicial resources, pleads both §§11 and 10(b) claims in one complaint.[49]

Although defendants Mark-Jusbasche, Causey and Lay have declined to give these controlling authorities any prominence in their briefs (*see* Mark-Jusbasche Brf. at 41-46; Causey Brf. at 12-13; Lay Brf. at 73), their willful blindness cannot hide the fact that their argument is contrary to current Fifth Circuit precedent and the prior holdings of this Court. ***Lone Star, Landry's, and U.S. Liquids each unequivocally held that Rule 9(b) does not apply to plaintiff's §11 claims where, like here, plaintiffs disavowed all allegations of fraud***. The CC here states unequivocally that "plaintiffs expressly exclude and disclaim any allegation that could be construed as alleging fraud or intentional or reckless misconduct." ¶1005.[50]

3. This Court Has Found That Purchasers In the Aftermarket May Bring Section 11 Claims; The Statutory Framework and Ample Precedent Support That Holding

This Court has already rejected defendants' assertion that purchasers in the aftermarket do not have standing to bring a claim under §11. In *In re U.S. Liquids Sec. Litig.*, No. H-99-2785 (S.D. Tex. Apr. 30, 2002), the Court held: "Although there is a division of opinion among lower courts, all federal courts of appeals that have addressed the question have concluded that a secondary market purchaser who can trace his securities to a registered offering has standing to sue under §11."

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49 *See Steiner v. Southmark Corp.*, 734 F. Supp. 269, 278 (N.D. Tex. 1990) (holding that §11 violation need not be pleaded with specificity required by Rule 9(b), even when §10(b) claims are also pled); *In re BankAmerica Corp. Sec. Litig.*, 78 F. Supp. 2d 976, 987 (E.D. Mo. 1999) (Rule 9(b) does not apply to claims under section 11 because such a claim does not require proof of fraud).

50 Although this Court has held, "boilerplate disclaimers of fraud" do not permit the Court to disregard fraud based claims, the Court recognized "'where the complaint alleged incorrect financials based on the use of incorrect accounting rules, ***the allegations did not sound in fraud ... and thus were not subject to the requirements of Rule 9(b)***.'" *Kurtzman*, slip op. at 75 & n.27 (citing *Lone Star*, 238 F.3d 363). Plaintiffs' claims here are based on admittedly "incorrect financials."

Id. at 14 (citing *Barnes v. Osofsky*, 373 F.2d 269, 271-73 (2d Cir. 1967) (Friendly, J.); *Hertzberg v. Dignity Partners, Inc.*, 191 F.3d 1076, 1080 (9th Cir. 1999); *Joseph v. Wiles*, 223 F.3d 1155, 1158-59 (10th Cir. 2000); *Versyss, Inc. v. Coopers & Lybrand*, 982 F.2d 653, 654 (1st Cir. 1992)).

Section 11 of the 1933 Act gives relief to "any person acquiring" a security ***issued*** pursuant to a materially incomplete or misleading registration statement. 15 U.S.C. §77k(a). If a security's registration statement "contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, ***any person acquiring such security ... may, either at law or in equity, ... sue***" the issuer, its ***directors, and every person who signed the defective registration statement*** as well as the underwriters of such security. 15 U.S.C. §77k(a). Thus, "***[i]f a plaintiff purchased a security issued pursuant to a registration statement, he need only show a material misstatement or omission to establish his prima facie case***." *Herman & MacLean*, 459 U.S. at 382. Even those who buy the security after the issuer releases financial statements for more than a year following a registration statement's effective date may recover pursuant to 15 U.S.C. §77k(a).

Consistent with §11's text, courts "have uniformly allowed for recovery by purchasers in the aftermarket." *Hertzberg*, 191 F.3d at 1081.[51] Section 11 affords relief to purchasers of registered shares, if they acquired the registered shares ***in*** a public offering or, if they can "trace" their securities to the offending registration statement. *See*, *e.g.*, *Paracelsus*, 6 F. Supp. 2d at 631 (plaintiff has standing under §11 if he alleges he purchased a security ***pursuant to*** an offering statement); *Schwartz v. Celestial Seasonings*, 178 F.R.D. 545, 554-57 (D. Colo. 1998); *Adair v. Bristol Tech. Sys.*, 179 F.R.D. 126, 131-33 (S.D.N.Y. 1998). The 1933 Act's House Report confirms

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[51] The Insider defendants cite *Azurix Corp.*, 2002 WL 562819, at *25-*26, for the misguided proposition that plaintiffs' §11 claims fail because plaintiffs purchased in the aftermarket. *See* Causey Brf. at 12; Lay Brf. at 73. To the extent *Azurix* supports defendants, it runs contrary to the great weight of authority allowing tracing for aftermarket purchasers to establish a §11 claim. *See*, *e.g.*, *U.S. Liquids*, slip op. at 14 (this Court holding "all federal courts of appeals" to address the issue allow tracing); *see also Danis v. USN Communications, Inc.*, 73 F. Supp. 2d 923, 931 (N.D. Ill. 1999) (holding that "a plaintiff who purchases stock on the open market after the initial offering has standing to sue under §11"); *In re Paracelsus Corp*, 6 F. Supp. 2d 626, 631 (S.D. Tex. 1998); *Gibb v. Delta Drilling Co.*, 104 F.R.D. 59, 70 (N.D. Tex. 1984). Indeed, few of the handful of cases making up the minority position advocated by defendants are still good law in light of the unanimous circuit court approval of plaintiffs' position.

that because the value of a security may be affected by the information given in the registration statement, ***§11(a)'s remedies "against those responsible for a false or misleading statement filed with the [SEC] are given to all purchasers ... regardless of whether they bought their securities at the time of the original offer or at some later date***." H.R. Rep. No. 85, 73d Cong, 1st Sess, at 22 (1933). The Report emphasizes that Congress desired "to accord a remedy to all purchasers who may reasonably be affected by any statements in the registration statement." *Id*.

Indeed, at the time of its enactment, it was uniformly understood that §11 protected post-offering purchasers of registered securities. William O. Douglas observed that §11 protects an investor who "buys in the open market" because he "may be as much affected by the concealed untruths or the omissions as if he had read and understood the registration statement." William O. Douglas & George E. Bates, *The Federal Securities Act of 1933*, 43 Yale L.J. 171, 176 (1933). Yale professor Harry Shulman similarly observed that under §11 an investor "may sue the persons named ***even though he purchased in the market after the securities had gone through several hands***." Harry Shulman, *Civil Liability and the Securities Act*, 43 Yale L.J. 227, 248 (1933). Other law-review analyses of the new legislation reflected the same view, that "a remedy is given to all persons 'acquiring' the security, even though it was not obtained directly from" the defendants, in an offering or otherwise. Note, *Legislation*, 33 Colum. L. Rev. 1220, 1229 (1933) (footnote omitted); *see id*., at 1228-29 & n.77 (contrasting §11 with §12). When Congress amended §11 the following year, to require proof of reliance from some subsequent investors,[52] the amending bill's Conference Report emphasized that §11's new "reliance" requirement would apply ***only*** to post-offering purchasers.[53]

4. Plaintiffs Adequately Allege That the Registration Statements Contained Material Misrepresentations and Omissions

Plaintiffs have properly pleaded all elements of their §11 claims against defendants, based on their signing of the false and misleading Registration Statements as set forth in the CC. ¶1006.

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52 *See* Pub. L. No. 34-291, §206(a), 48 Stat. 881 (1934), codified at 15 U.S.C. §77k(a).

53 Reliance would be required for purchases "after a period of 12 months subsequent to the effective registration date and then ***only*** when the issuer shall have published an earning statement to its security holders covering a period of at least 12 months after the effective registration date." H.R. Rep. No. 1838, 73d Cong., 2d Sess, at 41 (1934).

The Registration Statements were false and misleading in that they contained false statements and omitted to state facts necessary to make the statement made therein – and Enron's financial statements incorporated therein – not misleading, and misrepresented and failed to adequately disclose numerous other material facts as detailed herein above.

Contrary to Enron Insiders' unsupported arguments, plaintiffs have more than met the Fifth Circuit's standard for alleging material misrepresentations and omissions: "Generally, like materiality, determining whether information has been adequately disclosed is a mixed question of fact and law and, therefore, is a question for a jury .... Consequently, we will only remove the question from the jury if the disclosure is so obvious that reasonable minds cannot differ." *Isquith*, 847 F.2d at 208. "The appropriate inquiry is whether, under all the circumstances, the omitted fact or the prediction without a reasonable basis 'is one [that] a reasonable investor would consider significant in [making] the decision to invest, such that it alters the total mix of information available about the proposed investment.'" *BMC Software,* 183 F. Supp. 2d at 869 n.18. A determination of materiality, like the determination of whether defendants' disclosures are adequate, cannot be resolved at the 12(b)(6) stage. *Lone Star*, 238 F.3d at 369.

Here, plaintiffs have more than adequately pled that the Registration Statements, which were executed by Enron Insiders, and which incorporated by reference Enron's 10-K's (the "Offering Documents") contained material misrepresentations and omissions. For example, plaintiffs allege misrepresentations concerning Enron's reported ratio of earnings to fixed charges for the 7/7/98 offering of $500 million in notes. ¶613. Moreover, the offering documents also incorporated by reference all documents filed pursuant to §13(a) of the 1934 Act prior to the respective offerings, including Enron's subsequently filed 10-K's which misrepresented Enron's financial results, including earnings, ***the debt-to-equity ratio, total debt, and shareholder equity***, by failing to consolidate non-qualifying SPEs as required by GAAP and numerous other accounting misstatements. ¶615. Finally, the offering documents for Enron's securities offerings during 00-01 misrepresented its capitalization, specifically, the nature, substance and effect of Enron's "provisions for early settlement." Plaintiffs explicitly note why such misrepresentations were material in their discussion of the 7/18/01 7.875% Notes:

- If Enron's stock price dropped, Enron would have to issue more shares;
- The disclosures concealed that Enron bore the ultimate risk of so-called hedges, which were not true hedges;
- Early settlement could grossly dilute Enron's common stock;
- The triggers concerning LJM2/Raptors transactions were really massive credit support for Enron's bogus hedging transactions;
- The Offerings Documents concealed the magnitude of the credit support, which alone amounted to over $2 billion; and
- The range of the triggers was materially misrepresented, which hid the risk from investors.

¶¶618-627. Plaintiffs further allege that Enron knew of these misrepresentations and describe a 6/01 meeting between Enron managers and two CS First Boston managing directors at which the misrepresentations were discussed. ¶622. Plaintiffs also painstakingly detailed the misrepresentations in the Offering Documents concerning Enron's credit risk. ¶¶628-630.

5. Insiders Cannot Avoid Liability Under §11 Due to Reliance on Experts

Whether Insiders Mark-Jusbasche and Skilling can meet ***their burden of proof for demonstrating reliance*** on the opinions of experts in signing the false Registration statements cannot be resolved at the pleading stage. *Murphy*, 1996 U.S. Dist. LEXIS 22207, at *22-*23.[54] Insiders, ***not plaintiffs***, have the burden of proof here. They need to assert the due-diligence defense as an affirmative defense, and not give this explanation as a reason for plaintiffs failing to assert a claim. Moreover, *Escott v. Barchris Constr. Corp.,* 283 F. Supp. 643, 688 (S.D.N.Y. 1968), succinctly holds (regarding an outside director who relied upon representations of insiders):

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[54] Section 11(b) provides that:

> ***[N]o person, other than the issuer, shall be liable*** ... ***who shall sustain the burden of proof*** – ... (3) that (A) as regards any part of the registration statement not purporting to be made on the authority of an expert ..., he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading.

15 U.S.C. §77k(b)(1)(3).

> Section 11 imposes liability in the first instance upon a director, no matter how new he is. He is presumed to know his responsibility when he becomes a director. He can escape liability only by using that reasonable care to investigate the facts which a prudent man would employ in the management of his own property.

Id.

Here the so-called expertised sections referred to by Insiders were Registration Statements that were false and misleading due to the incorporation of Enron 10-Ks and 10-Qs, which contained Enron's admittedly false financial statements for 97-00 and that understated Enron's debt by billions of dollars and overstated its earnings by hundreds of millions of dollars. ¶¶418-611. While the Registration Statements included audited annual financial statements, significantly, they also incorporated all documents filed pursuant to §13(a) of the 1934 Act prior to the respective offerings, ***including Enron's 10-Qs which contained Enron's admittedly unaudited false and misleading quarter financial results***. ¶¶494, 615. Since the interim financial statements were unaudited ***they were not expertised*** and all signers of those Registration Statements are legally responsible for the accuracy of those interim unaudited financial statements. Insiders cannot hide behind so-called expertised financial statements in ***unaudited financial statements that they have approved***. *See Escott*, 283 F. Supp. at 684 (accountants who certified certain financial statements were not responsible for interim figures that they did not certify).

Moreover, Enron board committees had actual notice from the experts that its accounting in core business areas was highly risky and subject to scrutiny or reversal. *See* Exs. 22, 25, 28. Therefore, Mark-Jusbasche and other Enron Insiders who signed the Registration Statements had no reasonable ground to believe the statements were true and they failed to do any reasonable investigation when they were given explicit knowledge of the falsehood. Finally, the Insiders who signed or are otherwise liable under §11 with respect to Enron's Registration Statements extensively participated in fraudulent transactions misrepresented in and omitted from the Registration Statements, and thus cannot prove that they relied on experts when signing. Finally, as noted above, defendants' ability to rely on this affirmative defense – particularly when some of the financials were not expertised – cannot be resolved at the pleading stage. *Murphy*, 1996 U.S. Dist. LEXIS 22207, at *23.

F. Plaintiffs' Control-Person Claims Should Be Sustained

Under §15 of the 1933 Act and §20(a) of the 1934 Act, liability attaches to one who "controls" a person who violates any provision of the securities laws. To state a valid control-person claim in this Court, plaintiffs need only allege a violation of the securities laws, and that the defendant was a controlling person with respect to the violation within the meaning of §15 and §20.[55] *See Landry's*, slip op. at 11 n.14. In the Fifth Circuit, "[t]he term 'control' ... means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise." *G.A. Thompson & Co. v. Partridge*, 636 F.2d 945, 957 (5th Cir. 1981); *Landry's*, slip op. at 12 n.14; *First Jersey*, 101 F.3d at 1473.

To successfully plead control-person liability, plaintiffs need ***not*** allege that the controlling person actually participated in the securities violation, "The Fifth Circuit has stated that a plaintiff need only show that the alleged control persons possessed '***the power to control*** [the primary violator], not the exercise of the power to control.'" *BMC Software*, 183 F. Supp. 2d at 869 n.17.

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55 Although worded differently, the control-person liability provisions of §15 of the 1933 Act and §20(a) of the 1934 Act are interpreted in the same way. *See First Interstate Bank, N.A. v. Pring*, 969 F.2d 891, 897 (10th Cir. 1992), *rev'd on other grounds*, 511 U.S. 164 (1994). Section 15 of the 1933 Act, 15 U.S.C. §77(o), provides:

> Every person who, by or through stock ownership, agency, or otherwise, or who, pursuant to or in connection with an agreement or understanding with one or more other persons by or through stock ownership, agency, or otherwise, controls any person liable under section 11 or 12 [15 USCS §77k or 77l], shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist.

Id. Section 20(a) of the 1934 Act, 15 U.S.C. §78t(a), contains an analogous control-person provision:

> Every person who, directly or indirectly, controls any person liable under any provision of this title or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

Similarly, in *Landry's*, the Court noted that the Fifth Circuit has held plaintiffs need ***only*** show the power to control, ***not*** the exercise of that power and control may be established by

> ... demonstrating that the defendant possessed the power to direct or cause the direction of the management and policies of a person through ... ***business relationships, interlocking directors***, ... and ***the power to influence and control the activities of another***.

Landry's, slip op. at 12 n.14. Courts will generally find control-person liability if plaintiffs make a *prima facie* showing that defendants "had the power (whether exercised or not) to control the transactions in question and to control the operations ... in general. In other words, it is ***enough*** if the Defendant simply had the ***abstract power*** to control. ***Actual exercise*** of that power is ***not*** required." *McNamara v. Bre-X Minerals, Ltd.*, 46 F. Supp. 2d 628, 638 (E.D. Tex. 1999).[56]

Consequently, plaintiffs have properly pleaded that the Insiders are liable as control persons because they had the power – and exercised it – to control and influence the activities of another. Protestations to the contrary by certain defendants such as Lay and Skilling border on the comical.

G. Plaintiffs' Texas Securities Act Claims Should Be Sustained

1. The Individual Defendants Are Liable for Offering and Selling Enron Securities[57]

Contrary to their assertions, the directors and officers are liable under art. 581-33A of the Texas Securities Act. Indeed, Insiders err in arguing that the term "seller" is to be narrowly or technically construed; further, the issue is irrelevant to the degree that each is liable as a control person or aider and abettor.

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56 Insiders' reliance on *Dennis v. Gen. Imaging, Inc.*, 918 F.2d 496 (5th Cir. 1990), is misplaced, because that case incorrectly states that the Fifth Circuit's 1981 *Thompson* decision requires their participation to establish a §20(a) control-person violation. The Fifth Circuit rectified this error in *Abbott v. Equity Group*, 2 F.3d 613, 620 n.18 (5th Cir. 1993) ("*Dennis* does not accurately reflect our rejection in *Thompson* of a 'culpable participation' requirement."). Despite this clarification, Insiders have cited a number of district-court cases in the Fifth Circuit that mistakenly follow *Dennis*, instead of *G.A. Thompson* and *Abbott.* Because the Fifth Circuit has mandated a different approach than other jurisdictions, Insiders' authorities from outside this Circuit are inapplicable, because simply stated, ***there is no culpable-participation doctrine in this Circuit***.

57 Texas law is applicable, contrary to the assertion of Insider Harrison (Harrison Brf. at 27), as is demonstrated in plaintiffs' Opposition to J.P. Morgan's Motion to Dismiss, which plaintiffs incorporate herein.

The term "seller" is not narrowly construed. Indeed all of the officer and director defendants fit this definition. The court in *Rio Grande Oil Co. v. State*, 539 S.W.2d 917 (Tex. Civ. App. – Houston [1st Dist.] 1976, writ ref'd n.r.e.), addressed who is a "seller" for purposes of the Texas Securities Act, stating:

> Article 581-12 provides that "no person, firm, corporation or dealer shall directly ***or through agents or salesmen***, offer for sale, sell or make a sale of any securities in this state ...." The provisions of the Security Act are broad. The terms "sale", "offer to sell", and "sell" are defined in Article 581-4E as including every disposition, or attempt to dispose of a security for value. In the words of the Act, ***the seller may be any link in the chain of the selling process***. He is the one who performs "***any act by which a sale is made***." *Brown v. Cole*, 155 Tex. 624, 291 S.W.2d 704 (1956).

Id. at 922; *see also Texas Capital Sec., Inc. v. Sandefer*, 58 S.W.3d 760, 776 (Tex. App. – Houston [1st Dist.] 2001, pet. denied) ("The Act applies if the seller is any link in the chain of the selling process."). Here, the individual director and officer defendants were a link in the selling process – they either prepared or signed the offering documents or otherwise were involved in the selling process. *See*, *e.g.*, ¶¶1020-1027; 83-88.

Analogizing to federal case law, certain Insiders make the related argument that they themselves did not sell the securities directly to plaintiffs because the sales were pursuant to a "firm commitment offering." *See, e.g.,* Harrison Brf. at 27-28; Lay Brf. at 71. Insiders' position would render not only the language of the Texas Securities Act meaningless, but limit the reach of the statute in direct contradiction of the Texas' legislature's intent. "The term 'sell' means 'any act by which a sale is made, and the term 'sale' or 'offer for sale' shall include ... an offer to sell, ***directly or by an agent or salesman*** ...." *Anheuser-Busch Cos. v. Summit Coffee Co.*, 934 S.W.2d 705, 707-08 (Tex. App. – Dallas 1996, writ dism'd) (citing Tex. Rev. Civ. Stat. Ann. art. 581-4(E) (Vernon Supp. 1996)). As the vast majority of public offerings are firm commitment offerings, whereby the issuer does not sell directly to the purchasers, the legislature's definition of "sale" clearly was drafted to encompass this process.[58]

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[58] Defendants cite cases holding issuers in firm commitment underwritings not liable under §12(a)(2) of the 1933 Act. *See* Outside Directors' Mot. at 79. These are clearly off-base. The two statutes are not interpreted to have the same meaning. According to *Shaw*, 82 F.3d 1194, cited by defendants, it reasoned that: "'It seems quite clear that §12 contemplates only an action by a buyer against his or her immediate seller.'" *Id*. at 1216. As interpreted by the courts and shown above, the same cannot be said for plaintiffs' claim under the Texas Securities Act. Indeed, the "language used

Notwithstanding the 1977 revisions to the Texas Securities Act, directors and officers remain liable under art. 581-33 as control persons for actions taken in connection with public offerings "if they ***directly or indirectly control a seller***, buyer ***or issuer*** of a security." *Frank v. Bear*, 11 S.W.3d 380, 383 (Tex. App. – Houston [14th Dist.] 2000, pet. denied) (citing 581–33F §1). The *Frank* court further stated:

> ... "the rationale for control person liability is that a control person is in a position to prevent the violation and may be able to compensate the injured investor when the primary violator (*e.g.*, ***a corporate issuer*** which has gone bankrupt) is not." The comment also notes that "a control person might include an employer, an ***officer or director***, a large shareholder, a parent company, and a management company." *Id*. Control is defined in the same terms as under federal securities law; under that law "control means the possession, direct or indirect, of the power to direct or cause the direction of the management or policies of a person, whether through the ownership of voting securities, by contract, or otherwise." *Id*.

Id. at 383-84. Therefore, Enron's directors and officers, persons in control of Enron – the corporate issuer – cannot escape liability by claiming that the only sellers plaintiffs identify are J.P. Morgan and Lehman Brothers.

2. Defendants' Misstatements Induced Plaintiffs' Purchase Of The Securities

Certain Insiders contest plaintiffs' claims under the Texas Securities Act because the allegations of the CC only relate to offerings and events that occurred after 10/98, and that is after plaintiffs purchased the notes. *See, e.g.,* Urquhart Brf. at 22 (allegations "relate to offerings and events that occurred ***after*** October of 1998") (emphasis in original); Skilling Brf. at 96. This is gross misrepresentation of the CC.

For example, plaintiffs' introduction includes: "Year-End 97 Crisis." *See* ¶¶9-11; *see also* ¶¶613-617. This section details how Enron's year-end 97 financial statements, which were incorporated into the documents used to sell the Notes, were falsified by the (now infamous) fraudulent creation and use of the JEDI/Chewco SPEs. *Id.* This enabled Enron to improperly recognize $45 million of revenue and hide $700 million worth of debt. ¶11. These events took place ***before*** 98, despite defendants' suggestion that the CC only relates to fraudulent actions

in the Texas Securities Act is broader than that used in its federal counterpart." *Texas Capital*, 58 S.W.3d at 776.

occurring after 10/98. Another example of fraud occurring in 97, detailed in the CC, is Enron International's improper repeated deferral of start-up and proposal costs. These deferrals included developer, financing and promotional fees, that were incurred on ***failed*** project proposals. ¶¶121(f), 614. These deferred expenses were accumulated for more than five years – between 93 and 97 – a practice known inside Enron as "***snowballing***." *Id*. Both the JEDI/Chewco transactions and the "snowballing" made Enron's 97 financial statements false. The accounting manipulations committed by defendants, including those detailed above, were included in Enron's 97 Form 10-K, rendering the Form 10-K false and misleading. Enron's 97 Form 10-K, which was filed in ***3/98***, was incorporated by reference into the Registration Statement which was used to sell the Notes. ¶613. The Washington Board bought the Notes in 7/98. Also, the 7/7/98 Prospectus incorporated Enron's 3rdQ 97 10-Q which improperly accounted for contracts in Enron's EES department. ¶¶613, 615. Thus, it is quite clear that plaintiffs plead improper conduct which induced their purchases.

3. Plaintiffs Adequately Plead Aider and Abettor Liability Under The Texas Securities Act

a. Plaintiffs Have Adequately Alleged Defendants' Violations of the Texas Securities Act

Texas law imposes joint and several liability for anyone who "'directly or indirectly with intent to deceive or defraud or with reckless disregard for the truth or the law materially aids … [an] issuer of a security'" in violation of the Texas Securities Act. *Frank*, 11 S.W.3d at 384. "In order to establish [aiding and abetting] liability ... plaintiff[s] must demonstrate 1) that a primary violation of the securities laws occurred; 2) that the alleged aider had 'general awareness' of its role in this violation; 3) that the actor rendered 'substantial assistance' in this violation; and 4) that the alleged aider either a) intended to deceive plaintiff or 2) acted with reckless disregard for the truth of the representations made by the primary violator." *Id.*; *Crescendo Invs. v. Brice*, 61 S.W.3d 465, 472 (Tex. App. – San Antonio 2001, pet. denied). The Complaint satisfies each of these requirements.

b. Enron Committed a Primary Violation of the Texas Securities Act

An issuer of securities is strictly liable for untrue statements of material fact contained in a prospectus accompanying a public offering. Tex. Rev. Civ. Stat. Ann. art. 581-33C(2) (Vernon

2001). Enron's offering documents incorporated Enron's financial statements, including the representations concerning Enron's levels of debt and earnings – which were manipulated by, among other things, the defendants' use of SPEs and partnerships to engage in the transactions detailed in the CC, the abuse of mark-to-market accounting, the creation of hidden loans, etc. By restating these financial statements, Enron and the Enron defendants have now admitted that these offering documents were untrue statements of material fact. *See* APB Opinion 20 at ¶13; *In re Telxon Corp. Sec. Litig.*, 133 F. Supp. 2d 1010, 1026 (N.D. Ohio 2000) ("Telxon, itself, admitted its prior disclosures were materially misstated when it issued the restatements which gave rise to this litigation."). Enron thus violated the Texas Securities Act. Tex. Rev. Civ. Stat. art. 581-33C(2).

c. Each Insider Had a General Awareness of His/Her Role in Enron's Violations and Rendered Substantial Assistance to Enron

Each Insider had a general awareness of his/her role in Enron violating the Texas Securities Act. *See* §III.B. Each Insider has performed actions in furtherance of the fraudulent scheme, as demonstrated herein. *See* III.B. These allegations are sufficient to show each defendant "was generally aware of its role in a securities violation by a primary party." *Fine*, 919 F.2d at 300.

Plaintiffs need not allege that each Insider was aware of his/her role in the underwriters' violations of the Texas Securities Act. This is not necessary because each Insider materially aided Enron's – the issuer's – violations of the Texas Securities Act. "A person who directly or indirectly with intent to deceive or defraud or with reckless disregard for the truth of the law materially aids ... [an] issuer of a security is liable under Section ... 33C jointly and severally with the ... issuer, and to the same extent as if he were the ... issuer." Tex. Rev. Stat. Art. 581-33F(2).

4. Defendant Buy Was In Fact a Control Person of Enron

Defendant Buy claims that he is not liable as a controlling person under art. 581-33 because he was "***not*** an officer of Enron" prior to the 7/7/98 effectiveness of the Registration Statement and Prospectus used to induce the Washington Board's purchase of the Notes. *See* Buy Brf. at 11 (emphasis in original). Buy's argument, however, is not dispositive of whether or not he may be classified as a controlling person under the statute. Whether or not Buy was given the official title of "officer" (as he claims in contradiction of the CC) is irrelevant; the law will look to Buy's actual capacity, not his title. Indeed, art. 581-33(F) is devoid of any limitation of control person liability to "titled" corporate positions, and the commentary accompanying it broadly states that "'a control person is [a person] in a position to prevent the violation'" of the law. *See also Summers v. Welltech, Inc.*, 935 S.W.2d 228, 231 (Tex. App. – Houston [1st Dist.] 1996, no writ). Buy was such a person. Throughout 98, prior to the issuance of the Notes in July, defendant Buy served on Enron's Management Committee as Senior Vice President, Risk Assessment and Control, Enron Corp. ¶88. Enron's Management Committee was a "collection of top officers who met regularly (weekly or bi-weekly) to oversee and review Enron's business. The Management Committee was aware of and approved all significant business transactions of Enron, including each of the partnership/SPE deals specified" in the CC. *Id.* As a person on Enron's Management Committee in 98, Buy could have prevented Enron's violation of the law had he desired to do so. He did not. Buy is liable as a control person.

5. Defendants' Violations of the Texas Securities Act Are Actionable Even Though They Predate the Federal Class Period

The Insiders argue that plaintiffs' claims under the Texas Securities Act fail as a matter of law because none of the allegations or purchases on which Washington Board's claim is based occurred during the class period. *See, e.g.,* Causey Brf. at 14; Lay Brf. at 68. The Insiders are wrong. The class period Insiders refer to is only the "Federal Class Period" – as explicitly stated in paragraph 121 of the CC. Only the Federal Class Period began on 10/19/98. The beginning date of the Federal Class Period is by operation of law 10/19/98, because §10(b) claims are governed by a three year statute of repose, and plaintiffs' claims were filed on 10/19/01. *See Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 359 (1991). The Texas Securities Act, however, does not impose a three year statute of repose. Rather, the Texas Securities Act has a three year statute of limitations ***and a five year statute of repose***. Tex. Rev. Civ. Stat. art. 581-33(H)(2).[59] Because plaintiffs' state law claims are not subject to the three year statute of repose, which limits

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[59] Indeed, plaintiffs allege that, at the time the CC was filed, less than three years had passed since the Washington Board discovered, or could have discovered via the exercise of reasonable diligence, the fraud alleged in the CC. ¶1030. Further, plaintiffs alleged that less than five years had elapsed from the time the securities at issue were offered. *Id.*

the Federal Class Period as defined, it is clear that the pertinent period for Plaintiffs' Fourth Claim for Relief includes misrepresentations made during a period of time prior to the federal statute of repose.[60] The misrepresentations made by defendants during the Federal Class Period do not impact or limit plaintiffs' claims under the Texas Securities Act.

IV. Conclusion

Just last week the Supreme Court eviscerated the Insiders' core defense and affirmed a fundamental tenet of plaintiffs' claims "neither the SEC nor this Court has ever held that there must be a ***misrepresentation*** about the value of a particular security" to violate §10(b). *Zandford*, 2002 U.S. LEXIS 4023, at *13. The massive fraud involving Enron's businesses, the Insiders' active participation, and their outrageous profiteering more than state a claim for securities fraud. The motion to dismiss must be denied.

DATED: June 10, 2002

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60 If the Court so desires, plaintiffs will amend their CC to expressly so state.

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