UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

United States Courts
Southern District of Texas
FILED

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Michael N. Milby, Clerk

MARK NEWBY, Plaintiff, v. ENRON CORP., et al., Defendants.	Civil Action No. H-01-3624 (Securities Suits)

MOTION OF THE FLORIDA STATE BOARD OF ADMINISTRATION AND NEW YORK CITY PENSION FUNDS FOR A TEMPORARY RESTRAINING ORDER PROHIBITING ARTHUR ANDERSEN LLP FROM DESTROYING EVIDENCE AND A LIMITED LIFTING OF THE DISCOVERY STAY AND MEMORANDUM OF LAW IN SUPPORT THEREOF

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The Florida State Board of Administration ("FSBA") and the New York City Pension Funds ("New York City Funds"), by their counsel, hereby respectfully move this Court: (i) for a temporary restraining order prohibiting Arthur Andersen LLP ("Arthur Andersen") from destroying evidence; and (ii) a limited lifting of the discovery stay. As grounds, the FSBA and the New York City Funds shows as follows:

I. INTRODUCTION

The FSBA and the New York City Funds (collectively "Plaintiffs"), who jointly seek appointment as lead plaintiffs, seek a temporary restraining order and leave to take certain limited discovery against defendant Arthur Andersen to prevent the further destruction of evidence and information pertaining to Enron and Arthur Andersen's role as auditor and consultant of Enron.

On January 10, 2002, Arthur Andersen publicly admitted that there has been "substantial" destruction of evidence concerning Arthur Andersen's audits of Enron by individuals within the firm. Arthur Andersen stated that certain un-named individuals who were "involved with the Enron engagement" have destroyed "a significant but undetermined number of electronic and paper documents relating to the Enron engagement." Press Release of Arthur Andersen dated January 10, 2002 (Copy attached hereto as Exhibit "A").

Arthur Andersen issued a second press release on January 10, 2002 stating that it has "been unable to determine whether the destruction" occurred after Arthur Andersen officials issued an instruction to employees to preserve documents after being subpoenaed by the United States Securities and Exchange Commission ("SEC"). (Copy attached hereto as Exhibit "B").

We respectfully submit that there is a substantial likelihood that additional documents and evidence in the possession of Arthur Andersen may be destroyed, causing the FSBA, the New York City Funds, and the Class to suffer irreparable injury to their ability to prosecute this case.

The FSBA and the New York City Funds request the following relief on an immediate basis:

1. An Order immediately requiring Arthur Andersen to preserve all documents and evidence with respect to its audits and engagements concerning Enron from 1997 through the present;
2. An Order requiring Arthur Andersen to identify to this Court, and whomever is appointed as Lead Plaintiff and Lead Counsel, to the best of Arthur Andersen's ability, the documents and evidence that were destroyed and the individuals responsible for the destruction;
3. An Order allowing the FSBA and the New York City Funds the right to conduct one or more depositions, pursuant to Fed. R. Civ. P. 30(b)(6), to determine when and what documents were destroyed, where and how existing documents are stored and what procedures have been and will be implemented to prevent further destruction of documents or other evidence in accordance with the preservation order requested by this motion; and
4. An Order requiring Arthur Andersen to inform this Court, and whomever is appointed as Lead Plaintiff and Lead Counsel, what efforts have been and are being undertaken to recover, retrieve, and re-create the evidence that has already been destroyed.

Under Section 21D(b)(3)(B) of the Private Securities Litigation Reform Act ("PSLRA"), 15 U.S.C. § 78u-4(b)(3)(B), discovery is stayed during the pendency of any motion to dismiss, unless "particularized discovery is necessary to preserve evidence or to prevent undue prejudice" to the party seeking such discovery. Here, there is a strong need to preserve evidence and prevent irreparable injury as a result of the admitted document destruction by Arthur Andersen.

II. FACTS

This is a securities class action lawsuit brought on behalf of all persons or entities who purchased the securities of Enron Corporation ("Enron" or the "Company") from October 18, 1998 through November 27, 2001 (the "Class Period"), and alleging violations of §§ 10(b) and 20(a) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. §§ 78j(b) and 78t, and Rule 10b-5, 17 C.F.R. § 240.10b-5 promulgated thereunder.

During the Class Period, Enron -- which filed for Chapter 11 protection under the U.S. bankruptcy laws on December 2, 2001 - and the Defendants, Kenneth L. Lay, Jeffrey K. Skilling, Andrew S. Fastow, Richard A. Causey, Jeffrey McMahon, Robert K. Jaedicke, Ronnie C. Chan, John Mendelsohn, Paulo C. Ferraz Pereira, John Wakeham, Wendy L. Gramm, Joe H. Foy, and Arthur Andersen (collectively, the "Defendants"), issued materially false and misleading financial statements concerning Enron's earnings, assets, debt, and shareholders' equity. Specifically, over a four-year period, the Company reported almost $600 million in false earnings and understated debt by as much as $711 million through the use of various partnership schemes designed to improperly exclude the material results of such partnership operations from its books in violation of generally

accepted accounting principles ("GAAP"). The Defendants also overstated stockholders' equity by a staggering $1.2 billion. During the Class Period, Enron common stock traded as high as $90.75 per share, but after a series of public revelations from October 16, 2001 to November 23, 2001, its stock plummeted from $33.84 to $4.74, an 86% decline, and is currently trading below $1 per share on the New York Stock Exchange.

Arthur Andersen served as Enron's auditor and paid consultant throughout the Class Period, and as a result has substantial documentation and information regarding Enron's finances and reporting during the class period. On January 10, 2002, Arthur Andersen issued a press release stating that "individuals in the firm involved with the Enron engagement disposed of a significant but undetermined number of electronic and paper documents and correspondence related to the Enron Engagement."

III. ARGUMENT

A. A Temporary Restraining Order is Necessary to Protect Against the Destruction of Further Evidence and Documents

A temporary restraining order is warranted if there is: "(1) a substantial likelihood of success on the merits; (2) a substantial threat that the movant will suffer irreparable injury if the injunctive relief is denied; (3) the threatened injury to the movant outweighs the harm the injunction may cause the opponent; and (4) the injunctive relief will not disserve the public interest." EEOC v. Cosmair, Inc., 821 F.2d 1085, 1088 (5th Cir. 1987); Gerhart Industries v. Smith International, Inc., 741 F.2d 707, 710 (5th Cir. 1984); Faulder v. Johnson, 99 F. Supp. 2d 774, 776 (S.D. Tex. 1999). Whether to issue a temporary restraining order is soundly within the discretion of the district court judge. House the Homeless, Inc v. Widnall, 94 F.3d 176, 180 (5th Cir. 1996); Sebastian v. Texas Dep't of Corrections, 541 F. Supp. 970, 974 (S.D. Tex. 1982).

First, there is a substantial likelihood that the FSBA, the New York City Funds, and the Class will be successful in stating a valid claim for relief for violations of the federal securities laws against defendants and will ultimately be entitled to full discovery in this action from Arthur Andersen. The evidence of fraud is overwhelming. Enron has already admitted that it overstated its net income and earnings per share during the Class Period by failing to properly include the financial results of three related entities into Enron's consolidated financial statements from 1997 through 2000. Enron improperly accounted for several of these entities as Special Purpose Entities ("SPE") and omitted such entities' related debt and losses from Enron's consolidated financial statements. Enron has now admitted that those entities did not meet the accounting criteria to qualify as SPEs and, as a result, Enron has restated its financial results to consolidate the debt and losses from these entities into the Company's financial statements. Enron has further admitted that it improperly accounted for a note the Company received from a related party in exchange for Enron common stock. Enron accounted for the note as an asset – an increase in shareholder equity – when, instead, under the most basic of accounting principles, the note should have been recorded as a deduction to shareholders' equity. Finally, Enron has also admitted that it failed to make proposed audit adjustments and reclassifications in prior years that would have substantially reduced the Company's net income during the Class Period. Even Arthur Andersen has testified before Congress that the Company engaged in "possible illegal acts." It is clear that an action against certain officers and directors of the Company will survive a motion to dismiss. In that context, and even if Andersen is not a defendant in the surviving action, the FSBA, the New York

City Funds, and the Class will be able to obtain complete discovery from Arthur Andersen - even as a third-party witness.

The likelihood of success in stating a claim against Arthur Andersen is also strong. Arthur Andersen served as Enron's auditor and consultant during the class period and had unrestricted access to Enron's accounting department, serving not only as the Company's outside auditor, but also as its internal auditor. Indeed, Arthur Andersen physically occupies an entire floor at Enron's downtown Houston headquarters and served as Enron's internal auditors, so there is a substantial likelihood, due to the extent of the fraud alleged in this case and Arthur Andersen's intimate relationship with Enron that Arthur Andersen participated in, or at least acquiesced to the fraud at Enron.

Plaintiffs will suffer irreparable injury to their ability to prove their case against Arthur Andersen and other defendants if additional documents are destroyed. Indeed, the FSBA, the New York City Funds, and the Class have already suffered irreparable injury. As Arthur Andersen has already admitted, "individuals within the firm involved with the Enron engagement disposed of a significant but undetermined number of electronic and paper documents and correspondence relating to the Enron engagement." If this Court does not issue a temporary restraining order against Arthur Andersen prohibiting further evidence destruction there is the risk that additional documents will be destroyed, forever impairing the plaintiffs' ability to prove their case and uncover the true extent of the fraud that occurred at Enron.[1]

The risk of the destruction of further documents significantly outweighs any potential harm to Arthur Anderson. Indeed, Arthur Andersen faces no significant injury

[1] In fact, the stringent standards for granting a temporary restraining order may not apply for applications to preserve evidence.

at all. The temporary restraining order simply requires Arthur Andersen to do what it is already obligated to do under the PSLRA – preserve documents. 15 U.S.C. § 78u-4(b)(3)(C)(i). On the other hand, if even one more document is destroyed, the effect on Plaintiffs' ability to prove their case could be disastrous.

The additional relief sought – an investigation into and an accounting for what was destroyed, by whom, and a determination of where documents are and how they will be preserved going forward – is more than appropriate. The Lead Plaintiffs and Lead Counsel should be afforded every opportunity to determine what evidence has been destroyed. Requiring Arthur Andersen to report what was destroyed, when it was destroyed, and by whom and allowing a Rule 30(b)(6) deposition, will at least permit the Plaintiffs some opportunity to recover, re-create or at least understand what evidence has been destroyed and help assure no further destruction of evidence will occur.

Finally, the relief requested, rather than doing any disservice to the public interest, advances the public interest. This is an unprecedented case of stock fraud, at a company that was one of the most widely held stocks and which just last year was ranked number 7 on the Fortune 500 list of the largest corporations worldwide. The public interest is patent: numerous Congressional investigations, a task force announced by the President of the United States to investigate what occurred at Enron, and a full scale criminal investigation by the Justice Department demonstrates the strong public interest in this case. It is clearly in the public interest to preserve all documents regarding this massive fraud, which resulted in Enron filing for Chapter 11 and which resulted in Enron overstating its publicly reported earnings by almost $600 million.

B. The Court Should Order Arthur Andersen To Account for the Destroyed Evidence and Allow a 30(b)(6) Deposition

The FSBA and the New York City Funds request that this Court further order Arthur Andersen to: (1) provide a report concerning what evidence has already been destroyed; (2) provide a report on the steps being taken to retrieve, reproduce and/or re-create the destroyed evidence; and (3) allow a 30(b)(6) deposition of an Arthur Andersen designee concerning the destruction of evidence, location of remaining evidence, and procedures to preserve same. We believe that this is vital to insure the preservation of this evidence and prevent the further destruction of documents.

Although the Court recently held in its Order dated January 8, 2002, that there exists no basis for lifting the PSLRA discovery stay with respect to Arthur Andersen, circumstances have now drastically changed. We now know that substantial documents at Arthur Andersen pertaining to Enron have been destroyed. This is an extraordinary circumstance, which warrants the relief requested and to prevent any further injustice.

1. Extraordinary circumstances warrant the discovery sought by Plaintiff

In Vacold LLC v. Cerami, 2001 U.S. Dist. LEXIS 1589 at *22 (S.D.N.Y. Feb. 16, 2001), the court recognized that in "exceptional circumstances," a court may allow discovery in securities actions prior to a determination by the court that the complaint is legally sufficient. Such exceptional circumstances are clearly present in this case. Arthur Andersen has already disclosed that "substantial" evidence has been destroyed, warranting discovery now, before any additional evidence is destroyed. See In re Grand Casinos, Inc. Sec. Litig., 988 F. Supp. 1270, 1272 (D. Minn. 1997) ("If ... Congress had

intended an absolute stay on discovery, then Congress would not have authorized a judicial reprieve from such a stay, when a reprieve is needed.").

2. The Relief Sought By Plaintiffs Is Necessary To Prevent Undue Prejudice And Preserve Evidence

Courts have defined "undue prejudice" as "improper or unfair detriment," which is a lower standard than irreparable harm. Medical Imaging Centers of America, Inc. v. Lichtenstein, 917 F. Supp. 717, 720 (S.D. Cal. 1996). As the court observed, "[u]sing an 'undue prejudice' standard in applying the exception to the discovery stay appropriately attempts to balance the competing concerns of maintaining truth and integrity in the marketplace while curbing meritless litigation." Id. at 721. Additionally, the "undue prejudice" exception "contemplates an analysis of the facts and circumstances surrounding a request" for an exception to the PSLRA's stay provisions. Id.

Under the facts and circumstances of this case, an exception is clearly warranted. Courts have noted that undue prejudice can arise where a failure to lift the stay would prevent plaintiffs from ever proving their case. For example, in Global Intellicom, Inc. v. Thomson Kernaghan & Co., 1999 U.S. Dist. LEXIS 5439 (S.D.N.Y. Apr. 16, 1999), the court lifted the automatic stay and allowed limited discovery, because defendants were trying to take over the plaintiff company and prevent the plaintiff from proceeding with the action. The court found that the delay imposed by the automatic stay might prevent the plaintiff from recovering on its claim. The same possibility exists here where the potential destruction or loss of evidence by Arthur Andersen might make it impossible for plaintiffs to prosecute their action. Accordingly, the discovery stay should be lifted because discovery is necessary both to preserve evidence and to prevent undue prejudice to Plaintiffs.

3. None Of The Abuses Identified By Congress In Enacting The Discovery Stay Provision Is Present In This Case

One of Congress' primary concerns in enacting the automatic discovery stay was its desire to ensure that discovery would not be used by class action securities plaintiffs as a vehicle to muster evidence to support an otherwise frivolous lawsuit. See, e.g., In re Transcrypt Int'l Sec. Litig., 57 F. Supp. 2d 836, 841 (D. Neb. 1999) (citing H.R. Conf. Rep. No. 104-369, 104th Cong. 1st Sess. at 32 (1995), reprinted in 1995 U.S.C.C.A.N. 730, 748 ("Conference Report")). As the court observed in Medical Imaging Centers of America, Inc. v. Lichtenstein, 917 F. Supp. at 720, the legislation was also prompted by evidence of abuse in the discovery process resulting in "costs so burdensome that it is often economical for the victimized party to settle." Clearly this is not such a case, as evidenced by the magnitude of the restatements by Enron; the extent of insider trading; the duration of the fraud -- four-and-a-half years; the testimony by Arthur Andersen that the Company engaged in "possible illegal acts"; and the fact that this is a corporate collapse of historic proportions -- the largest in U.S. history. This is not a case involving "only [a] faint hope that the discovery process might eventually lead to some plausible cause of action." 141 CONG. REC. H13699 (daily ed. Nov. 28, 1995) (statement of House managers). Consequently, the concerns that motivated Congress to enact the automatic discovery stay provision simply are not present in this case, as there can be no doubt that this case will not be dismissed on the ground that plaintiffs' securities fraud allegations are "frivolous."

Here, as in Tobias Holdings, Inc. v. Bank United Corp., 2001 U.S. Dist. LEXIS 11811 at *7-*8 (S.D.N.Y. Aug. 14, 2001), "[n]one of the perceived abuses addressed by Congress are present in this case." The FSBA and New York City Funds "are not

attempting to use discovery as a 'fishing expedition' to find a sustainable claim not alleged in its Complaint which has already been amended [and] this is not a frivolous lawsuit designed to extort money from defendants who would rather settle than pay exorbitant discovery costs." Id.

4. The Discovery Sought Is Limited And Particularized

The FSBA and New York City Funds have identified the requested relief from the discovery stay with sufficient particularity. The request does not request a complete lifting of any stay, does not seek to conduct substantive discovery of third parties such as depositions or interrogatories, and does not seek depositions of any Arthur Andersen executive or any of the Defendants.

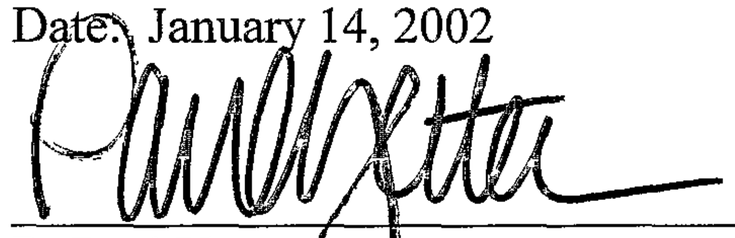
Rather, movants' request is narrowly tailored to determine what evidence has already been destroyed, by whom, and the efforts being undertaken to re-create and/or recover the destroyed evidence.

IV. CONCLUSION

For all of the foregoing reasons, the FSBA and the New York City Funds respectfully request that the Court grant its motion for a temporary restraining order prohibiting Arthur Andersen from destroying evidence and a limited lifting of the discovery stay.

Date: January 14, 2002

Respectfully submitted,



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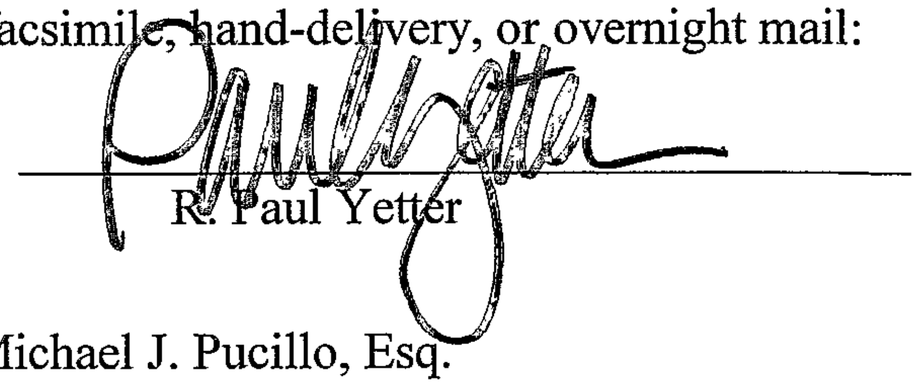
Certificate of Service

I hereby certify that on this 14th day of January, 2001, a copy of the foregoing was served on the following counsel for defendants by facsimile, hand-delivery, or overnight mail:



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