United States Courts
Southern District of Texas
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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

In re ENRON CORPORATION SECURITIES LITIGATION	§	Civil Action No. H-01-3624
	§	**(Consolidated)**
	§	
	§	CLASS ACTION
This Document Relates To:	§	
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' OPPOSITION TO ENRON'S MOTION FOR CONFIDENTIALITY ORDER

#1216

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I. INTRODUCTION

Last month, the Court granted Plaintiffs' Motion to Preclude the Filing or Production of Documents Subject to a Protective Order ("Public Proceedings Motion"). In so doing, the Court rejected Enron's attempt to litigate its catastrophic demise under a cloak of secrecy: "It is incumbent upon the defendants in the case, if they want parts of their discovery protected, to move in good faith for a particularized protective order pursuant to Rule 26(c)." Order on Plaintiffs' Motion to Preclude the Filing or Production of Documents Subject to a Protective Order ("December 19, 2002 Order") at 7. Enron's opportunity to impose a blanket protective order has passed. It should not be allowed to now accomplish the equivalent with its motion to secrete several broad categories of documents, which are so inclusive as to cover everything relevant in this action. Further, Enron's request for an additional 90 days to review documents its attorneys have possessed for over a year is unreasonable and an unnecessary delay. Enron's motion flies in the face of binding precedent and seeks to nullify the Court's well-reasoned December 19, 2002 Order. Enron fails to provide the Court with good cause to issue the protective orders it proposes.

"Rule 26(c)'s requirement of a showing of good cause to support the issuance of a protective order indicates that 'the burden is upon the movant to show the necessity of its issuance, ***which contemplates a particular and specific demonstration of fact*** as distinguished from stereotyped and conclusory statements.'" *In re Terra Int'l*, 134 F.3d 302, 306 (5th Cir. 1998).[1] The level of specificity demanded is substantial. In the December 19, 2002 Order, the Court cited approvingly *Citizens First Nat'l Bank v. Cincinnati Ins. Co.*, 178 F.3d 943 (7th Cir. 1999), where Judge Posner demonstrates the level of specificity demanded by a movant before an order secreting documents should issue:

> The order that the district judge issued in this case is not quite so broad as "seal whatever you want," but it is far too broad to demarcate a set of documents clearly entitled without further inquiry to confidential status. The order is not limited to trade secrets, or even to documents "believed to contain trade secrets," which anyway is too broad both because "believed" is a fudge and because a document that contains trade secrets may also contain material that is not a trade secret, in which case all that would be required to protect a party's interest in trade secrecy would be redaction of portions of the document. Also much too broad is "other confidential

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[1] All emphasis is added and citations are omitted unless otherwise noted.

> ... information," not further specified, and all "governmental information," a category absurdly overbroad.

Id. at 945. Enron has not met its burden. Rather, it proposes a protective order that would cover categories of documents similar to those Judge Posner described as "absurdly overbroad." Indeed, Enron moves to secrete categories of documents that include vast amounts of information detailing the Enron fraud. Such information is not protected trade secrets, research or commercial information. Enron's motion clearly does not meet the burden required of Enron to separate matter detailing the fraud from information purportedly entitled to protection.

Enron's motion also falters in its glaring silence on the proposed protective order's negative impact on the public's ability to follow and understand these proceedings. Plaintiffs' Public Proceedings Motion detailed the public interest in this case and the substantial weight of the public's interest in determining whether good cause exists.[2] Enron's silence speaks loudly: any purported benefit to the Company is not substantial enough to warrant hiding whole categories of documents from the public. Indeed, the majority of Enron's enterprise was fraudulent as demonstrated in part by Congressional investigations, and Enron has been in bankruptcy for over a year and likely will not emerge from that bankruptcy. Enron's motion should be denied in its entirety.

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[2] On this matter the courts are clear. *See, e.g.*, *Pansy v. Borough of Stroudsburg*, 23 F.3d 772, 788 (3d Cir. 1994) ("***A factor which a court should consider in conducting the good cause balancing test is ... whether the case involves issues important to the public.***"); *Phillips v. GMC*, 307 F.3d 1206, 1211 (9th Cir. 2002) ("If a court finds particularized harm will result from disclosure of information to the public, ***then it balances the public and private interests to decide whether a protective order is necessary.***"); *United States v. Gaynor*, No. 01 C 4753, 2002 U.S. Dist. LEXIS 4375, at *3-*4 (N.D. Ill. Mar. 14, 2002) (denying protective order and holding: "'As a general proposition, pretrial discovery must take place in ... public unless compelling reasons exist for denying the public access to the proceedings. That standard is embodied in Rule 26(c), which permits the Court to issue a protective order only "for good cause shown." To determine whether good cause exists, the Court must balance the public's interest in the proceeding against the "property and privacy interests of the litigants." Good cause exists "only if the latter interests predominate in [a] particular case."'").

II. ARGUMENT

A. No Protective Order Should Issue to Secrete Documents Regarding Enron's Position in Existing Conflicts with Third Parties

1. Enron Seeks to Conceal its Fraud by Marking as Confidential all Documents Concerning the Numerous Investigations and Legal Proceedings Concerning the Company

Enron proposes to secrete documents concerning its ongoing resolution of conflicts with third parties because it might be unfairly prejudiced should that information become public. This category of documents is so broad as to become the proverbial exception that swallows the rule. The Company does not reveal the scope of its ongoing conflicts or name the entities (other than Pacific Gas & Electric Company) with whom its purported conflicts exist. Rather, Enron only states that it is involved in "numerous" matters. Def's Mem. at 7. Plaintiffs do not dispute this. Indeed, a broad array of Enron's former businesses are being investigated, and a great deal of its former business partners and clients are attempting to enforce their rights against the Company.[3] Given that these conflicts concern nearly every aspect of Enron's business – and that plaintiffs' Complaint alleges a pervasive fraud – it is clear that this category of documents is extraordinarily broad and ostensibly covers all of the relevant documents Enron is to produce.

The proposed confidentiality order similarly suffers from overbreadth because it fails to define what "sensitive" information should be entitled to protection. Notably, while Enron hems and haws about giving third-party litigants access to its litigation strategies, neither the proposed confidentiality order nor Enron's briefing suggests that this category of documents is limited to attorney work product. Rather, Enron claims that ***everything*** is "sensitive." *See also infra*, §II.B.

Enron's proposed confidentiality order prohibits public dissemination of all documents pertaining to "discussions of factual and/or legal positions relative to active claims or disputes." Proposed Confidentiality Order, ¶4(a). If Enron seeks to protect purported attorney work product, it obviously may do so according to the proper procedure. But without further definition of this

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[3] The extent of Enron's proposed confidentiality order is, perhaps, best illustrated by the fact that it would prohibit public dissemination of documents pertaining to the illegal loans provided Enron by the bank defendants in this action. CIBC, Citigroup, J.P. Morgan Chase, Barclays, Credit Suisse First Boston, Bank of America, Merrill Lynch and Lehman all have claims against Enron in bankruptcy – but these claims are at the heart of this action.

category, Enron could restrict access to a whole spectrum of documents critical to these proceedings and of extreme interest to the public. For example, this clause could conceivably be used by Enron to protect intra-office e-mails dating from the Class Period where those messages discuss factual matters now the subject of criminal or Congressional investigations. In sum, the proposed language would enable Enron to mark as confidential smoking-gun memoranda. For example, the August 29, 2002 memorandum quoted in plaintiffs' Complaint[4] could be deemed confidential because it discusses business matters concerning Enron Energy Services' contracts with third parties, which Enron has breached and are enforceable by those third parties. Because this memo could qualify as a discussion of factual matters relative to active claims, Enron would have this smoking gun marked as confidential under its proposed confidentiality order.

Because this category of documents is broad, the proposed confidentiality order could conceivably secrete internal documents describing the factual bases of the Mahonia transactions – loans disguised as circular commodities trades that were designed by J.P. Morgan. After all, the insurance companies who backed J.P. Morgan's loans to Enron may sue the Company for reimbursement of their losses. *See, e.g.*, "Jurors Were Divided Over Morgan's Lawsuit," *N.Y. Times*, Jan. 4, 2003 (Ex. 1 hereto). Therefore, internal Enron documents showing that these disguised loans were designed to provide it with cash and to deceive its investors – documents at the heart of

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[4] On August 21, 2001, a management level employee at Enron's EES operation sent a letter to the Board that detailed the fraud.

> [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. The only product left is for the hotel and mall customers. Except that Starwood is also mad since EES has not invested the $45MM in equipment under the agreement. Enron was suppose[d] to invest $45MM over the first 3 years of the contract. The people who negotiated the contract FORGOT to put in, at Enron's discretion ... it turns out that it doesn't make financial sense for Enron to put in the Equipment, but Starwood wants it. Now you will loose [sic] at least $45MM on the deal. The Crisis was set in motion. You should also check on the Safeway contract, Albertson's, IBM and the California contracts that are being renegotiated.... 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....

Plaintiffs' Consolidated Complaint, ¶358.

plaintiffs' claims against J.P. Morgan – would be hidden from the public because they also concern facts pertaining to defendants' conflicts with third parties.

In seeking to protect this broad category of documents, Enron fails its burden to demonstrate legitimately confidential information, as previously ordered by the Court. The Court should not sign any protective order so vague that it would cover documents central to these proceedings and of great importance to the public's perception of the resolution of this conflict.

2. Precedent Supports the Dissemination of Discovery Materials Relevant to Third Party Disputes, Not the Suppression of Such Materials

Enron does not provide adequate legal support to exclude such a broad category of documents from disclosure. To the contrary:

> "As a general proposition, pretrial discovery must take place in the public unless compelling reasons exist for denying the public access to the proceedings. ***This presumption should operate with all the more force when litigants seek to use discovery in aid of collateral litigation on similar issues***, for in addition to the abstract virtues of sunlight as a disinfectant, access in such cases materially eases the tasks of courts and litigants and speeds up what may otherwise be a lengthy process ...."

Bell v. Chrysler Corp., No. 3:99-CV-0139-M, 2002 U.S. Dist. LEXIS 1651, at *5 (N.D. Tex. Feb. 1, 2002) (quoting *Wilk v. Am. Med. Ass'n*, 635 F.2d 1295, 1299 (7th Cir. 1980)). Numerous government entities are investing time and resources to investigate defendants' actions, and Lead Counsel, as well as the counsel for individual plaintiffs in numerous state-court proceedings, are doing the same. Enron's argument that documents that might aid collateral litigation cannot be publicly disclosed turns the law on its head, and to adopt it would add to the needless waste of time, money and resources resulting from Enron's collapse.

Furthermore, Enron provides no legal basis for its proposition that "[w]here ... public disclosure of a document will compromise a party's litigation position against third parties, good cause exists to protect the confidentiality of such documents." Def's Mem. at 7. Indeed, Enron cites only two cases as authoritative – but neither is analogous or otherwise applicable here.

Nothing in *Phillips* supports the proposition for which Enron cites this case. If *Phillips* is at all instructive, the Ninth Circuit merely held that the district court has the "authority to grant protective orders for confidential settlement agreements" if good cause is shown. 307 F.3d at 1212.

That a court may treat settlement agreements as confidential is not a matter of dispute – particularly in matters that are not of great public interest. This is a far cry from Enron's position. *Phillips* does ***not*** suggest that good cause is ***presumed*** where public dissemination of discovery materials – no matter how important to the public interest – might have an effect on collateral conflicts.[5] Instead, *Phillips* proves to be persuasive authority for plaintiffs: pre-trial discovery is "presumptively public," the burden is on the movant for a protective order, and, if "a court finds particularized harm will result from disclosure of information to the public, ***then it balances the public and private interests to decide whether a protective order is necessary***." *Id.* at 1211. As noted in the December 19, 2002 Order, the Ninth Circuit in *Phillips* "scolded" the lower court's failure to provide a detailed good-cause analysis considering the public's interests in judicial processes. Enron again has not provided the Court with sufficient grounds for finding good cause.

Enron also cites *Hasbrouck v. BankAmerica Housing Servs.*, 187 F.R.D. 453, 455 (N.D.N.Y.), *aff'd*, 190 F.R.D. 42 (N.D.N.Y. 1999), and provides this parenthetical: "issuing protective order preventing disclosure to opposing party of terms of settlement agreement." Def's Mem. at 8. But the Company fails to disclose that the *Hasbrouck* court's holding was based on considerations nonexistent here. ***First***, the key document was defined – a settlement agreement concerning a claim of "employment discrimination on the basis of sex," which was entered into by the plaintiff and the defendant's employer. *Hasbrouck*, 187 F.R.D. at 453. Here it is impossible to determine the documents Enron seeks to secrete. ***Second***, separate policy considerations existed in *Hasbrouck* that do not exist here: "protecting the confidentiality of the settlement agreement promotes the important public policy of encouraging settlements." *Id.* at 458. ***Third***, Enron is seeking to secrete these documents to protect itself and ***not*** the legitimate privacy interests of third parties, as was the case in *Hasbrouck*. *Id.* ("Trustco Bank's privacy interest in the information is given additional weight because it is not a party to this suit."). ***Fourth***, there was no strong public

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[5] Moreover, Enron falsely states the Ninth Circuit's final determination in *Phillips*. The circuit court did not reverse the district court's decision to lift the protective order as Enron asserts. *See* Def's Mem. at 8. Rather the court held: "The decision to lift the protective order is ***remanded*** and the lower court is instructed to conduct a 'good cause' analysis consistent with the principles laid out in this opinion." *Phillips*, 307 F.3d at 1212.

interest in the *Hasbrouck* proceedings: "Neither [party] posits a public interest argument in opposition to the motion for protective order," thus, "***there can be no claim of a general public interest***." *Id.* at 459. Therefore, because *Hasbrouck* is both legally unsupportive and factually distinguishable, and provides no support for Enron's motion, the protective order should be denied with respect to this category of documents.

B. No Protective Order Should Issue so that Enron May Conceal its Purportedly "Proprietary Materials" Concerning the Enron Fraud and Criminal Activities

1. Enron's Bald Assertion of Confidentiality Does Not Qualify its Purported "Proprietary Materials" for Protection as Trade Secrets

Enron seeks a protective order covering "competitively sensitive" information. Def's Mem. at 10. In effect, it argues for protection of its trade secrets without even attempting to meet the burden for such a showing.

> Where the proponent of the protective order contends that the materials at issue contain trade secrets, for example, the court must first determine whether such assertion is true. To present a prima facie case for trade secret protection, the proponent of the protective order must prove that it consistently treated the information as a secret and took steps to guard it, the information is of substantial value to the proponent, the information would be valuable to the proponent's competitors, and the information "derives its value by virtue of the effort of its creation and lack of dissemination." If the proponent fails to satisfy this first inquiry, then no "good cause" exists for the protective order. If satisfied, however, the court must then weigh the proponent's interest in confidentiality against the public's interest in access before ultimately deciding whether to issue the order.

Estate of Martin Luther King, Jr., Inc. v. CBS, Inc., 184 F. Supp. 2d 1353, 1366 (N.D. Ga. 2002).

Enron cannot simply call documents proprietary materials and have them magically transformed. "'[T]here is no absolute privilege for trade secrets and similar confidential information.'" *Fed. Open Mkt. Comm. v. Merrill*, 443 U.S. 340, 362 (1979). "[T]o rule that certain confidential business information may be categorically protected treads dangerously close to the Supreme Court's prohibition. Furthermore, to do so would essentially create an exception to the procedure outlined in Rule 26(c) where no such exception exists." *Andrew Corp. v. Rossi*, 180 F.R.D. 338, 342 (N.D. Ill. 1998). Even though the Company asserts that a protective order is necessary to protect confidential or sensitive business information, "***bald assertions of confidentiality, such as a statement by a movant that 'disclosure could ... harm [the movant's]***

competitive position' is insufficient." *Zahran v. Trans Union Corp.*, No. 01 C 1700, 2002 U.S. Dist. LEXIS 16791, at *5 (N.D. Ill. Sept. 5, 2002) (citing *Baxter Int'l, Inc. v. Abbott Labs.*, 297 F.3d 544, 547 (7th Cir. 2002)). Enron offers nothing more than conclusory or bald assertions here.

The Company claims that the public disclosure of its proprietary materials concerning its commodities trading business "would place Enron, and potentially its counterparties, at a competitive disadvantage." Def's Mem. at 10. Again, Enron provides only conclusory assertions: "For example, competitors or trading partners of Enron could use Enron's proprietary information to Enron's disadvantage." *Id.* And the Williams Affidavit does little better. Its only assertion is that Enron's contractual obligations to its trading partners and UBS AG (the entity which purchased much of its former trading operations) require the Company to keep this information secret. *See* Williams Aff., ¶¶14-17. Yet, Enron neither details what kind of documents it seeks to mark confidential, nor submits for review its purported contract with UBS AG, a contract upon which Enron's entire argument is founded, which may ***not*** cover the broad array of materials Enron seeks to hide from public scrutiny. Indeed, Enron has failed to demonstrate it "know[s] what a trade secret is and [is] acting in good faith in deciding which parts of the record are trade secrets." *Citizens First Nat'l Bank*, 178 F.3d at 946.

And without review, there is no way to know, because Enron's conclusory assertions are insufficient. "[T]o show good cause a party must 'demonstrate that disclosure of allegedly confidential information will work a ***clearly defined and very serious injury to his business***.'" *Turick v. Yamaha Motor Corp.*, 121 F.R.D. 32, 35-36 (S.D.N.Y. 1988) (denying defendants' protective order seeking to "limit the dissemination of Yamaha's purported trade secrets" because "conclusory allegations, in an attorney's affidavit" were not sufficient to show good cause); *see also Cook Inc. v. Boston Sci. Corp.*, 206 F.R.D. 244, 248 (S.D. Ind. 2001) (rejecting stipulated protective order because parties in a patent infringement case failed to "submit a proper definition of trade secrets ... so that the Court can be confident that the parties will make good faith and accurate designations of specific information"); *Andrew Corp.*, 180 F.R.D. at 341. Enron has shown no impending clearly defined or serious injury sufficient to satisfy its burden, and certainly has not demonstrated why these interests trump public disclosure.

2. Enron Points to No Persuasive Authority for Concealing its Purportedly "Proprietary" Information

Enron wants to protect purportedly competitively sensitive information, but it provides no principled legal guidance. Five of the six cases cited by Enron are from other district courts – none originates from the Fifth Circuit. And the decision of the Supreme Court in *Nixon v. Warner Communs.*, 435 U.S. 589, 598 (1978), deals with the issue in one sentence of dicta and is factually distinguishable. In *Nixon*, a third party attempted to gain access to judicial records. Here, plaintiffs seek to disseminate discovery materials in accordance with Fifth Circuit precedent: "A party may generally do what it wants with material obtained through the discovery process, as long as it wants to do something legal." *Harris v. Amoco Prod. Co.*, 768 F.2d 669, 683-84 (5th Cir. 1985); *see also* December 19, 2002 Order. Furthermore, simply because the *Nixon* Court held that some "courts have refused to permit their files to serve as ... sources of business information" (435 U.S. at 598), this does not mean that this Court should do so in this extraordinary case. Enron provides no persuasive authority suggesting otherwise, particularly in light of the public's interest.

3. Enron's Purported Proprietary Materials Concern Criminal Actions and Are of Particular Import to the Public

The focus of public interest in the Enron debacle shifts as the various ongoing investigations into defendants' misdeeds unearth new revelations. Lately, that public scrutiny has been focused on Enron's commodity-trading activities. Recent media and governmental reports confirm that the nation was affected not only by the economic forces unleashed by defendants' actions but also by their manipulations of commodities markets for energy. In September, federal prosecutors disclosed that they were investigating a link between fraud at Enron and the electricity crisis that plagued millions in several West-Coast states. *The Wall Street Journal* reported:

> Federal prosecutors are investigating alleged fraud by Enron Corp. in the manipulation of power prices in three Western states during the California electricity crisis two years ago.
>
> The Justice Department is presenting evidence to a new grand jury that was convened in San Francisco this summer ....
>
> ***Prosecutors are investigating whether Enron and other companies made fraudulent electricity trades between 1999 and 2001, and whether top Enron management knew what was going on at the hugely profitable trading unit ....***

John R. Wilke and Kathryn Kranhold, "Enron is Focus of U.S. Inquiry About Pricing," *Wall St. J.*, Sept. 16, 2002 (Ex. 2 hereto). Subsequently, the "former head of Enron Corp.'s Western energy-trading desk admitted he conspired to manipulate California's electricity market and extract illegal profits ***for his employer***." Rebecca Smith & John R. Wilke, "Enron Ex-Trader Admits to Fraud in California Crisis," *Wall St. J.*, Oct. 18, 2002 (Ex. 3 hereto).

By asking the Court to provide a protective order that would permit secreting purportedly proprietary materials concerning Enron's commodities trading business, Enron asks the Court to help it hide the truth concerning its role in manipulating the market for electricity and natural gas. This flies in the face of common sense and the law. It is evident that the documents Enron seeks to conceal are at the heart of a criminal enterprise. Courts of law are not meant to hide illegal activity, but unearth and punish it: "We can strike a fair balance between the privacy interests of a corporation and the health and safety of the public ***so long as we recognize that a publicly maintained legal system ought not protect those who engage in misconduct, conceal the cause of injury from the victims, or render potential victims vulnerable***. Secrecy in such instances defeats a function of the justice system – to reveal important legal factual issues to the public." Jack B. Weinstein, *Secrecy and the Civil Justice System Secrecy in Civil Trials: Some Tentative Views*, 9 J.L. & Pol'y 53, 61 (2000).

4. No Protective Order Should Issue That Conceals Documents Important to Plaintiffs' Claims, and, Therefore, of Great Public Interest

Plaintiffs' Public Proceedings Motion details the considerable public interest in these proceedings, which weighs heavily against the finding of good cause sufficient to justify issuing a protective order secreting documents central to these proceedings. Enron's purportedly proprietary trading information is central because it is the record of the Company's criminal involvement in the energy crisis, and this criminal enterprise is tied directly to several aspects of the fraud perpetrated against its shareholders.

There is considerable evidence to show that Enron padded its cash flow with disguised loans and defendants used illegal and unsustainable proceeds from energy trading activities to do the same. Indeed, Enron and the other defendants used this cash to support the very business units they claimed

were doing so well, but which plaintiffs have alleged were hemorrhaging money. Enron used its illegal proceeds from energy trading to fool investors into believing that its Energy Services unit was successful:

> Using trading strategies with ominous names like "Death Star" and "Get Shorty," Enron's energy traders raked in hundreds of millions – possibly billions – of dollars from California while perpetuating the state's misery.
>
> The resulting profits did more than just enrich Enron's notoriously aggressive traders. ***They were also used to paper over weaknesses in other divisions of the company that Mr. Skilling had touted to investors.***
>
> Nearly a year after Enron declared bankruptcy, the episode has become fodder for investigators, who extracted a guilty plea last month from Tim Belden, the former head of West Power, Enron's West Coast electricity trading arm.
>
> * * *
>
> The problem with these results – apart from their questionable legality – was that they were not highly valued by investors. Trading profits are notoriously lumpy, with big gains in one quarter that do not necessarily recur in another.
>
> Consequently, investors awarded trading companies' shares low price/earnings multiples.
>
> Mr. Skilling was forever in search of other, ground-breaking businesses that would not only contribute to overall growth, but also raise the quality of Enron's earnings in the eyes of investors.
>
> One result of this vision was EES. The entrepreneurial unit was created in late 1997 to supply companies with all their energy needs, from natural gas and electricity to power boilers, to the personnel to maintain them.
>
> Unlike trading, EES' commercial contracts would provide stable and predictable profits.
>
> * * *
>
> By combining the trading books, Enron hid huge EES losses in the profits Mr. Belden and others generated in California. Some claim management facilitated the process by dipping into abnormally large reserves that had been creamed off the trading profits.
>
> In any event, the net effect was the same: ***by sweeping all the EES losses under the carpet of the trading operation, Enron was able to maintain the illusion of profitability in the division that was underpinning its share price.***
>
> "They were publicly stating it was for efficiency reasons, while in reality, ***it was done simply to manipulate earnings,***" a former Enron finance official says.
>
> * * *

> Another question is whether Enron took appropriate reserves for the California gains or if it was merely salting away excessive profits that it could summon to cover the proverbial rainy day.
>
> * * *
>
> Chris Schreiber, an investigator for a special California panel examining market manipulation and the energy crisis, believes he has already found ample evidence that Enron did just that.
>
> "We know there are examples of trades where the reserve was padded," Mr. Schreiber says.

Joshua Chaffin, "Enron Tripped Over California Crisis," *Financial Times*, Nov. 22, 2002. And *The New York Times* has reported that independent analysts and rating agencies were deceived as to the nature of Enron's business and its involvement in the energy crisis:

> ***Even as Enron's top executives were insisting that the company did not engage in speculative trading, Enron was reaping the bulk of its profits during the California energy crisis by betting on the direction of gas and electricity prices, according to company records and interviews with former Enron traders and executives.***
>
> Enron made the hugely profitable bets – including one that resulted in a $485 million gain on a single day in December 2000 – at a time when federal and state investigators say the company was conspiring with other energy trading companies to manipulate power and natural gas prices in the West.
>
> Indeed, Enron's standing as the nation's biggest energy trader may have bolstered its ability to profit on bets on the direction of prices.... Enron trading officials said that to justify their risk-taking, ***they told the company's executives and directors that, like a casino, Enron had a "house advantage" in the energy markets.***
>
> A result of the speculation, the records show, was one of the most stunning runs ever for a corporate trading operation – some $7 billion in net trading profits for Enron during a power crisis that wreaked havoc on consumers in 2000 and 2001 ....
>
> * * *
>
> Wall Street analysts, who bullishly endorsed Enron's shares for much of the period, said that they might have shown more restraint had they known the extent of the company's speculative trading.
>
> * * *
>
> In a March 27, 2001, interview, Mr. Lay said: "We're basically making markets, buying and selling, arranging supplies, deliveries. We do not, in fact, speculate on where markets are headed." ***The company also denied, in meetings with Wall Street analysts, that California accounted for a large share of its profit in 2000, at the height of the state's energy crisis.***

> ***But the trading records show that about $1.3 billion, or over half of Enron's trading profit that year, was tied to soaring gas and power prices on the West Coast.***
>
> * * *
>
> In retrospect, officials at Moody's feel duped.
>
> "We did express concern about the level of trading activity that they showed us," said John Diaz, a managing director of Moody's energy group. "But what we have come to believe is that ***the information Enron provided to us was misleading, incomplete and designed to deceive. If we had known that they were really speculating in a big way, that probably would have led to a lower rating***."

David Barboza, "Despite Denial, Enron Papers Show Big Profit on Price Bets," *N.Y. Times*, Dec. 12, 2002 (Ex. 5 hereto).

Enron and the other defendants were capable of deceiving so many investors in Enron's public securities by engaging in multiple fraudulent activities. Enron's energy-trading unit contributed significant cash flow to its financial statements – cash flow used to convince investors that the Company was a thriving business. It was not. Defendants knew that Enron's trading activities were not sustainable and that the Company would be punished by investors if the truth concerning this unit was revealed. Enron seeks to keep from public purview this very same information, and it asks the Court's blessing in doing so. But it has not provided the required good cause to justify its request. Rather, without once addressing the magnitude of the public's interest in these trading records, Enron concludes that "the resulting harm from public disclosure of this category of documents easily outweighs any public interest in the information." Def's Mem. at 8. This is wrong. The public's interest in this information is overwhelming.

C. No Protective Order Should Issue to, as Enron Requests, Secrete Documents "Pertaining to [Enron's] Assets Being Marketed"

1. The Proposed Protective Order Fails to Properly Demonstrate Any Legitimately Confidential Information

Enron is in bankruptcy, and whether it will emerge as a going concern is debatable. In August 2002, Enron advised the Bankruptcy Court that it was marketing all of its significant assets. In December 2002, Enron informed the Bankruptcy Court that it has received its first round of bids for the assets, would review the bids in conjunction with the official Creditors Committee and decide whether to sell the assets or try and reorganize as "Newco." Despite the fact that its entire remaining

business is for sale, Enron seeks to secrete all "[d]ocuments pertaining to [Enron's] assets being marketed." Def's Mem. at 8. The use of the incredibly broad language "documents pertaining to" – coupled with the fact that nearly every Enron business is being actively marketed – suggests that the Company seeks to conceal every document in the depository.

The wording in the proposed confidentiality order – versus that in Enron's papers – fares no better. The Company describes the category of documents as: "Information pertaining to certain asset sales and bids that could impact Enron's reorganization plan." Proposed Confidentiality Order, ¶4(b). This categorized description is impermissibly vague and fails to demonstrate a category of legitimately confidential information.

Enron has not met its burden to describe in good faith a "'properly demarcated category of legitimately confidential information,'" as contemplated by the December 19, 2002 Order.

2. Public Policy Will Not Tolerate Judicial Protection of Criminal Behavior, Nor Does it Condone Actions Which May Enable Ongoing Fraud

The only specific asset Enron mentions with respect to its divestiture of assets is Portland General Electric. Def's Mem. at 8. But that asset was involved in fraudulent activities concerning the price for electricity in California: "a report issued by the Federal Energy Regulatory Commission said that Enron conspired with Portland General Electric, an Oregon utility it owns, to manipulate the price of power in the spring of 2000." *See* Ex. 5. Enron claims that disclosure of its market analyses and similar documents will undermine its negotiating position and the value it receives for Portland General, but it is hardly unjust to Enron to disclose documents exposing Portland General's true valuation – one not artificially inflated by fraud. Given Portland General's involvement in the California energy crisis – a fraud of overwhelming proportion and public interest – the slight harm that Enron may suffer from the public dissemination of discovery documents is insufficient to warrant granting defendant's proposed confidentiality order.

3. Enron's Citation of Bankruptcy Cases and Statutes Is Baseless

Enron cites extensively from federal bankruptcy law and case law, including *In re Orion Pictures Corp.*, 21 F.3d 24, 27 (2d Cir. 1994), for the proposition that "bankruptcy law (11 U.S.C. 107(b)) essentially presumes the existence of good cause with respect to a debtor's commercial

information and ***requires*** a bankruptcy court to issue a protective order." Def's Mem. at 9 (emphasis in original).[6] But this is ***not*** a bankruptcy case. ***First***, the Court, unlike bankruptcy courts, is bound by the Federal Rules of Civil Procedure when determining whether to grant a protective order. ***Second***, ***bankruptcy law*** does not require the Court to do anything and 11 U.S.C. §107(b) has no bearing on these proceedings. ***Third***, despite Enron's protestations, bankruptcy law – 11 U.S.C. §107(b) – does not presume good cause or suggest that good cause is met merely because a company has filed for bankruptcy. Indeed, this bankruptcy statute merely omits good cause from a ***bankruptcy court's*** analysis.

> When congress addressed the secrecy problem in § 107(b) of the Bankruptcy Code it imposed no requirement to show "good cause" as a condition to sealing confidential commercial information. This omission is particularly significant because FRCP 26(c), from which the language of § 107(b) appears to have been drawn, expressly required "good cause" to be established before a discovery protective order could be granted – even when the material sought to be protected was "a trade secret or other confidential research, development, or commercial information."

Orion Pictures, 21 F.3d at 28. Enron cites no case for the proposition that Fed. R. Civ. P. 26(c) is modified by bankruptcy law and no case where a district court ever considered 11 U.S.C. §107(b) in determining whether good cause existed for the issuance of a protective order. Because bankruptcy law has no bearing on these proceedings, Enron's motion should be denied.

D. Enron's Motion for a Protective Order Concerning Confidential Personnel Information Is Substantially Moot

Plaintiffs have made it clear that nothing shall be construed to relieve the parties from compliance with General Order No. 2002-9, which applies to all civil cases within the Southern District of Texas, and specifically calls for the redaction of documents for the purposes of "protecting personal privacy and other legitimate interests." Furthermore, plaintiffs' proposed order would protect certain private documents: "Documents containing personal information of individuals, including, but not limited to, Social Security number, date of birth, driver's license number, telephone number, address, account number and/or type of account, individual portfolio statements,

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[6] Indeed, the only non-bankruptcy authority cited by Enron in this section of its motion is *FDIC v. Schoenberger*, 1990 WL 52863, at *1 (E.D. La. Apr. 24, 1990). *See* Def's Mem. at 8-10. This decision involved "the issuance of a joint protective order" ***opposed by no one***.

individual account statements ("Personal Information"), shall be deemed confidential and shall not be disclosed by any person given access to documents in the document depository." This language is specific and tailored, such that it will not lead to abuse by defendants.

E. Enron Has Been Afforded More Than Sufficient Time to Review its Own Documents and Should Not Be Granted Ninety Days to Mark Documents Confidential

Enron's request for additional time to review its own documents for confidentiality should be denied. This matter has been pending since November 2001 – 13 months for Enron to review documents. It would be absurd to assume that any portion of that time should be discounted because Enron relied on the discovery stay mandated by the Private Securities Litigation Reform Act because, given the facts of this case, any reasonable legal counsel would have begun making preparations for document production prior to the lifting of the discovery stay. Also during the past year, Enron has provided documents to the Creditors Committee and the Bankruptcy Examiners. Furthermore, Enron was ordered last August to produce the great bulk of the 13 million documents now in the depository. Not only has Enron had those five months to review its own production, but the Court's August 16, 2002 Order held that, because the documents were already produced in the Enron bankruptcy proceeding: "Enron has already found, reviewed, and organized the documents." Consequently, there is no need for Enron to receive 90 days more to review documents.[7]

III. CONCLUSION

In what the Court described as a "mountain of briefing," the parties have litigated the very issues Enron raises now. The Court rejected arguments of those seeking broad confidentiality. Rather than heed the Court's demand that defendants move in "good faith" for a "particularized order," Enron has returned with the same arguments and proposes a confidentiality order so broad as to potentially cover every important document in its production. Enron has not met its burden of

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[7] Enron's request for an additional 90 days to review its document production is not premised on its change of counsel, nor should such a consideration be given much credence. Enron's new counsel in the securities litigation, Weil, Gotshal & Manges LLP, has also been Enron's legal counsel in its bankruptcy proceedings. As such, Weil, Gotshal has had access to substantially all (if not all) of Enron's documents now submitted to the document depository for many months.

showing good cause and Enron has failed to demonstrate legitimately confidential information in its proposed confidentiality order. Consequently, Enron's motion should be denied.

DATED: January 10, 2003

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DECLARATION OF SERVICE BY WEBSITE AND UPS

I, the undersigned, declare:

1. That declarant is and was, at all times herein mentioned, a citizen of the United States and a resident of the County of San Diego, over the age of 18 years, and not a party to or interest in the within action; that declarant's business address is 401 B Street, Suite 1700, San Diego, California 92101.

2. That on January 10, 2003, declarant served the following documents:

PLAINTIFFS' OPPOSITION TO ENRON'S MOTION FOR CONFIDENTIALITY ORDER

by posting to the website or UPS overnight to the parties as indicated on the attached Service List, pursuant to the Court's August 7, 2002 Order Regarding Service of Papers and Notice of Hearings.

I declare under penalty of perjury that the foregoing is true and correct. Executed this 10th day of January, 2003, at San Diego, California.

Mo Maloney

MO MALONEY

SERVICE LIST
January 10, 2003

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Jurors Were Divided Over Morgan's Lawsuit

By Bloomberg News
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Jurors who were about to weigh J. P. Morgan Chase's $965 million claim against 11 insurers over Enron oil and gas trades said yesterday that they had been split before the opponents in the lawsuit reached a settlement.

The insurers agreed on Thursday to a settlement that allowed them to pay $503 million to $579 million on six surety bonds, ending a monthlong trial in federal court in Manhattan just as jury deliberations were to begin. Four of the six jurors said in a group interview that they had been divided on whether the insurers should pay and had expected to spend days deciding the outcome.

The trial showed that the insurers and J. P. Morgan Chase, whose shares rose 6 percent after the settlement, failed to do enough research about the risks of the oil and gas transactions, the jurors said. The dispute was part of the fallout from the accounting scandal that led to Enron's collapse and bankruptcy more than a year ago.

"These are big boys and they both should have settled it instead of wasting everybody's time," Gary Tannenbaum, a juror who works in real estate management, said of the J. P. Morgan Chase suit. "It's sort of embarrassing to me that big business is conducting business the way that they did."

Under the settlement, the insurers could pay the bank as much as $579 million in cash, or they could pay $503 million and assign their Enron bankruptcy claims to the bank. Ten of 11 insurers opted for the lower payments. A spokesman for the Fireman's Fund Insurance Company, a unit of Allianz, could not immediately provide details of the company's plans.

The bank's shares rose 50 cents, to $25.94.

J. P. Morgan Chase sued to force the insurers to pay the bonds. The insurers claimed they were tricked into backing disguised loans between the bank and Enron that looked like commodity trades. The trades involved Mahonia Ltd., a bank-sponsored "special purpose vehicle" in the Channel Islands.

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THE WALL STREET JOURNAL

Leading the News: Enron Is Focus Of U.S. Inquiry About Pricing --- New Grand Jury Hears Evidence on Alleged Fraud During California Crisis

By John R. Wilke and Kathryn Kranhold
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(Copyright (c) 2002, Dow Jones & Company, Inc.)

WASHINGTON -- **Federal prosecutors are investigating** alleged fraud by **Enron** Corp. in the manipulation of power prices in three Western states during the California electricity crisis two years ago.

The Justice Department is presenting evidence to a new grand jury that was convened in San Francisco this summer, lawyers close to the case said. It is the second grand jury in the **Enron** case; a special grand jury in Houston already had been investigating last year's collapse of the energy-trading firm.

Prosecutors are investigating whether **Enron** and other companies made fraudulent electricity trades between 1999 and 2001, and whether top **Enron** management knew what was going on at the hugely profitable trading unit, the lawyers close to the case said. They said that as part of this effort, the prosecutors are examining whether Jeffrey Skilling, **Enron**'s former chief executive, and Greg Whalley, its former president and head of trading, were aware of the practices or sought to conceal them.

Enron traders made false trades to overload California's power-transmission system, then sought state payments for relieving the congestion they had caused, even as they drove up the price of power sold to the state, according to state and federal investigators and lawyers close to the case.

The state and federal investigators believe the alleged schemes by **Enron** and a handful of other power traders helped fuel the California electricity crisis two years ago, leading to rolling blackouts, political and economic chaos and higher rates for millions of customers in California, Oregon and Washington.

The electricity-trading investigation and the empaneling of a second grand jury takes the **Enron** investigation in a significant new direction, and could result in criminal charges against several other senior former executives and traders who oversaw **Enron**'s Western states power-trading operations. At least two traders already have invoked their Fifth Amendment rights and declined to testify in other lawsuits arising from the power crisis, and some have said they are cooperating with federal investigators.

Mr. Whalley has retained a new criminal lawyer, Zachary Carter, a former U.S. attorney, to represent him in the power-trading investigation; Mr. Carter declined to comment. An attorney for Mr. Skilling didn't return calls; in congressional testimony earlier this year, Mr. Skilling denied wrongdoing at **Enron** and defended his stewardship of the energy company. Asked specifically about **Enron**'s electricity-trading practices, he told lawmakers that "the rules weren't quite clear" in California's newly deregulated electricity market and that overbooking power lines in some instances "is absolutely standard industry practice."

The new grand jury has been hearing evidence from agents of the Federal Bureau of Investigation and prosecutors with the U.S. Attorney's office in San Francisco, who are working with the Justice Department's **Enron** task force. The grand jury has called members of the California Independent System Operator, the body that runs the state's electricity transmission system, and others involved in the meltdown of California's power market two years ago, one lawyer close to the case said.

Some of the power-trading practices were outlined by the Federal Energy Regulatory Commission this summer and are the subject of a thicket of public and private litigation, as well as investigations by California Attorney

General Bill Lockyer and a special committee of the state Senate.

The U.S. Commodity Futures Trading Commission and the U.S. Attorney in Houston are investigating "round trip" trading and the alleged manipulation of energy prices on Internet-trading sites. Round-trip, or "wash," trading occurs when two firms exchange matched gas or power contracts that cancel each other out while inflating reported revenue and trading volume. A half-dozen energy-trading firms that did business online already have disclosed receiving subpoenas in the Houston inquiry.

Some of the questionable **Enron** power-trading practices were first outlined in memos that **Enron**'s new management gave to FERC in May. **Enron** traders gave the complex practices colorful names such as "Death Star," "Get Shorty" and "Ricochet." Many of the alleged schemes involved scheduling power transmissions that never were actually delivered, or deliberately overbooking transmission lines at choke-points such as the California-Oregon border. **Enron** then would seek multimillion-dollar payouts for relieving congestion, as well as getting higher prices for power.

In an August study of the California energy crisis, FERC said **Enron** and two trading partners, Avista Corp., of Spokane, Wash., and El Paso Electric Co., of El Paso, Texas, may have manipulated prices during the crisis that began in the summer of 2000 and ended a year later when price caps were imposed. The commission has said that some of the trading strategies were legal and were a form of arbitrage, while questioning others.

Enron's internal memos laying out the trading practices were produced in the fall of 2000 after the firm was subpoenaed by California's electricity regulators. Stephen Hall, then an outside lawyer for **Enron**, told Congress that he was asked to draft a memo reviewing the company's practices in light of the subpoena. Mr. Hall said he and a partner warned senior **Enron** executives in December 2000 that these "deceptive trading practices" might violate criminal law.

Christopher Yoder, a former **Enron** lawyer who was listed as a co-author of the memos, told congress he immediately got the memo to his supervisors and to a lawyer at **Enron** North America. Mr. Yoder, now a lawyer with the energy-trading unit that UBS Warburg acquired from **Enron**, said he wanted to "make sure the seriousness of the memo was reflected to upper management."

Additionally, Richard Sanders, a top **Enron** lawyer, told Senate lawmakers that he had several meetings with **Enron** traders after the firm's internal investigation started, on Oct. 3, 2000. Mr. Sanders said he also met with top **Enron** executives, including the general counsel, in the fall of 2000 to discuss the trading practices; it is unclear whether the former chief executive, Mr. Skilling, or **Enron**'s former chairman, Kenneth Lay, knew of the practices in 2000. Mr. Sanders has said that he briefed Mr. Skilling on the practices in June 2001 after they were ended.

Christopher Tayback, a Los Angeles defense attorney, said his clients, Messrs. Yoder and Sanders, are cooperating with all investigations, including the Justice Department's. Mr. Hall, who like Mr. Yoder now works for UBS Warburg Energy, couldn't be reached.

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THE WALL STREET JOURNAL

Leading the News: Enron Ex-Trader Admits to Fraud In California Crisis

By Rebecca Smith and John R. Wilke
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The former head of **Enron** Corp.'s Western energy-trading **desk admitted he conspired to manipulate** California's electricity market and extract illegal profits for his employer, giving federal prosecutors a valuable witness who will help them develop cases against executives at **Enron** and other big energy-trading companies.

Timothy Norris Belden, 35 years old, pleaded guilty to a single count of wire fraud. He told U.S. District Judge Martin Jenkins in San Francisco that he helped devise "schemes" to manipulate the California wholesale-electricity market from when it was first deregulated in 1998 until **Enron**'s collapse in December 2001, "because I was trying to maximize profit for **Enron**." In doing so, he said he deliberately submitted false data to the state's electric-grid operator and to the organization that ran the daily power auction. The meltdown of California's power market in 2000 and 2001 and its cleanup could end up costing the state's consumers $80 billion or more.

Prosecutors say that Mr. Belden, who has agreed to cooperate, can potentially provide them with a road map on how big energy firms sought to extract illicit profits from the California market, as well as to clarify the role allegedly played by top **Enron** executives in executing the strategy. Among them: former head of **Enron** trading Greg Whalley, who briefly served as **Enron**'s president before the firm sought bankruptcy protection in late 2001, and **Enron**'s former chief executive, Jeffrey Skilling, who denied before Congress that **Enron** had sought to manipulate California's energy market.

In Washington, Deputy Attorney General Larry Thompson called Mr. Belden "a central actor" in the trading operations that produced most of **Enron**'s profits after 1998, and stressed that the government's probe into that area "is active and ongoing." Until now, the government's criminal investigation has largely been focused on **Enron**'s use of off-balance-sheet partnerships to illegally bolster profit and hide debt. That investigation has resulted so far in a plea arrangement by former **Enron** Managing Director Michael Kopper and a criminal complaint alleging fraud against **Enron**'s former chief financial officer, Andrew Fastow.

Still, **Enron**'s role in California's market meltdown has been under scrutiny for some time, with the Federal Energy Regulatory Commission and the Commodities Futures Trading Commission both conducting probes. Action on this front ratcheted up several weeks ago when a federal grand jury was empaneled in San Francisco. The case against Mr. Belden marks the first time since state electricity markets were deregulated in 1998 that the federal government has brought criminal charges against a trader for breaking rules of new markets. It also indicates that federal prosecutors may now be willing to intervene in situations where market authorities complain they have been hamstrung by the lack of punitive powers, such as in California.

If Mr. Belden's cooperation proves valuable to prosecutors, they have said they will seek a lighter sentence for him than the five-year imprisonment and $250,000 fine permitted under the law. As part of the plea agreement signed yesterday by Mr. Belden, he will forfeit $2.1 million, "which is a percentage of the compensation traceable to the compensation he received from implementing the trading schemes," said Assistant U.S. Attorney Matthew Jacobs, who helped bring the case.

The case against Mr. Belden was initiated four months ago, shortly after **Enron** released a series of memos that showed the firm had devised trading strategies with names like "Get Shorty" and "Death Star" that showed the company had sought to profit dishonestly from California's fledgling deregulation scheme. One strategy, for

example, called for **Enron** to submit energy-supply schedules that would have created bottlenecks on the state's high-voltage transmission system, if carried out. In order to prevent actual "congestion," the ISO was forced to change supply schedules in a way that generated extra fee income for **Enron** and extra expense for others.

Mr. Belden, a former researcher at a federal energy lab, went to work for **Enron** after it bought Portland General Electric Co., a regional utility located in Portland, Ore., in 1997. According to former colleagues, Mr. Belden worked hard at uncovering regulatory loopholes and was the brains behind many of the trading strategies for exploiting them. Under his leadership, **Enron**'s revenue from energy trading in the Western states rose from $50 million in 1999 to $800 million by 2001. Although it is unclear how much money **Enron** made from these trading strategies, the firm's overall electricity-trading profit soared to $1.8 billion during 2000 and 2001. According to **Enron** records subpoenaed by a California Senate committee investigating the state's electricity crisis, Mr. Belden met or dined with Mr. Whalley and Mr. Skilling on several occasions while he headed the Western trading unit.

Mr. Skilling's attorney, Bruce Hiler, said that Mr. Belden's plea doesn't involve Mr. Skilling. "There's already been testimony before Congress by **Enron** attorneys that demonstrates that my client wasn't involved in any of this," Mr. Hiler said. Mr. Whalley didn't return calls to comment last night. Zachary Carter, Mr. Whalley's attorney, said that his client has "cooperated with every government agency that has had an interest in this matter from Congress to the Securities and Exchange Commission, CFTC, FERC and law-enforcement officials."

It is possible Mr. Belden's testimony could also implicate executives at other energy companies that were **Enron**'s main trading partners in the California market. Several of the nation's big energy companies own power plants in California, including Duke Energy Corp., Dynegy Inc., Reliant Resources Inc., AES Corp., Calpine Corp. and Mirant Corp., and were **Enron** trading partners. All of these firms have denied manipulating power prices in California.

The guilty plea doesn't have any direct impact on **Enron**, though it probably will be used by plaintiffs attorneys who are pursuing shareholder claims against the company. It may also bolster California's demand that any windfall profits be returned to it via a federal order. The state stepped in to assume energy-buying duties, on behalf of the state's insolvent utilities, in early 2001, and racked up billions of dollars of debts that it will be repaying for 20 years.

Mr. Belden moved from **Enron**'s employment to UBS AG's UBS Warburg, when the banking company bought **Enron**'s trading operations early this year, but he left UBS in September. Mr. Whalley, Mr. Belden's former boss, remains head of those operations.

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COMPANIES & FINANCE THE AMERICAS - Enron tripped over Californian crisis.

By JOSHUA CHAFFIN.
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COMPANIES & FINANCE THE AMERICAS - **Enron tripped over Californian crisis** - US authorities are determining whether the accounting irregularities which gave rise to Enron's partnerships were also present in its core trading business. Joshua Chaffin reports.

In the summer of 2001, at a conference in Las Vegas,Jeff Skilling, the then chief executive of Enron, showed little sympathy for Californians suffering from a bitter energy crisis that had dimmed the state's lights and cost its taxpayers billions of dollars.

"I probably shouldn't say this," Mr Skilling began, according to those in attendance. Then he grinned.

"What's the difference between California and the Titanic? At least the lights were on when the Titanic went down."

Mr Skilling's attempt at humour belied just how deeply Enron was involved in the California crisis.

Using trading strategies with omimous names like "Death Star" and "Get Shorty", Enron's energy traders raked in hundreds of millions - possibly billions - of dollars from California while perpetuating the state's misery.

The resulting profits did more than just enrich Enron's notoriously aggressive traders. They were also used to paper over weaknesses in other divisions of the company that Mr Skilling had touted to investors.

Nearly a year after Enron declared bankruptcy, the episode has become fodder for investigators, who extracted a guilty plea last month from Tim Belden, the former head of West Power, Enron's West Coast electricity trading arm.

Mr Belden pleaded guilty to conspiracy to commit wire fraud, charges stemming from the probe into market manipulation in California.

He has agreed to co-operate with authorities as they try to determine whether the accounting irregularities which gave rise to Enron's partnerships were also prevalent in its core trading business.

The Californian adventure is a reminder of Enron's obsession with meeting Wall Street's profit targets.

The pressure was so great that executives strained not only to deliver outsize profits, but also reliable ones from the types of activities that investors favoured. In many cases, as the financial scandals of the last year have demonstrated, Enron and others pushed too far.

A year before Mr Skilling made his Titanic remark, Californians were literally feeling the heat of the electricity crisis. Suffering a heatwave, Californians were forced to pay exorbitant rates to power their air conditioners. Some consumers could not even get electricity because of rolling black-outs.

The state deregulated its electric utility industry in 1996. Under the plan, utilities were forced to dismantle their generation and transmission monopolies and instead buy power on the open market.

The results of the experiment were worse than anyone could have imagined: left to the market, already high wholesale energy prices went through the roof.

Enron itself was struggling to deal with the very uneven effects of the California crisis.

One one side, there was Enron North America, the company's wholesale trading unit, which employed Mr Belden and generated the lion's share of the profits. On the other was Enron Energy Services, the floundering retail power group Enron started in the late 1990s and billed as its next great success.

ENA and its energy traders thrived in California. In his plea, Mr Belden explained some of the deceptive means they used to exploit the state's newly-deregulated energy market.

One strategy to avoid price caps, for example, was called a "ricochet" trade. Enron traders would buy electricity generated in California, where prices were legally capped, sell it to an out-of-state affiliate, and then send it back into the state at a huge mark-up.

West Power generated about $50m in revenue in 1999, according to Mr Belden's plea. In 2000, when the crisis began, that number jumped to $500m, and then, in 2001, to $800m.

The problem with these results - apart from their questionable legality - was that they were not highly valued by investors. Trading profits are notoriously lumpy, with big gains in one quarter that do not necessarily recur in another.

Consequently, investors awarded trading companies' shares low price/earnings multiples.

Mr Skilling was forever in search of other, ground-breaking businesses that would not only contribute to overall growth, but also raise the quality of Enron's earnings in the eyes of investors.

One result of this vision was EES. The entrepreneurial unit was created in late 1997 to supply companies with all their energy needs, from natural gas and electricity to power boilers, to the personnel to maintain them.

Unlike trading, EES' commercial contracts would provide stable and predictable profits.

Its prospects were huge as states across the country were poised to follow California's lead and deregulate their energy markets.

Mr Skilling boasted to investors that EES and Broadband, another Enron venture, were poised to be its businesses of the future.

According to a calculation frequently cited within Enron, EES was so prized by the market that it accounted for $30-$35 of Enron's share price in 1999 - more than one third of the total - even though it had yet to turn a profit.

"It was highly touted and it was going to be extremely profitable," recalled John Olson, an analyst at Sanders Morris Harris and a noted sceptic of EES.

Like other Enron ventures, the EES myth far outstripped the reality. As the FT has previously reported, its sales staff used aggressive mark-to-market accounting in order to book profits on long-term deals that were unlikely to materialise.

It underestimated all sorts of costs to pad its profits. But one of its biggest problems was California.

Ironically, the power shortages and market-rigging that drove up energy prices in 2000 and provided a windfall for Mr Belden and his traders were a disaster for the retail business.

The unit suffered heavy losses because it was forced to buy electricity and natural gas at exorbitant prices on the open market to deliver to its California customers at pre-negotiated prices.

At times, the tension between the units was laid bare. Some of the commodities price estimates that EES used when it negotiated customer contracts had to be approved by the same ENA traders who were making them skyrocket in the secondary markets.

"They thought very highly of themselves," a former EES executive says of the traders. "They were a nightmare. I know what they did to people internally. God knows what they did to people externally."

The crisis could not have come at a worse time. EES had just delivered its first profitable year, narrowly beating the $100m profit it had promised Wall Street analysts.

Enron tried to wriggle out of unprofitable California contracts. But a state court dismissed its arguments.

In early 2001, Mr Skilling dispatched Dave Delainey, a former trading executive, to take over EES from Lou Pai..

On April 17, when Enron announced its first-quarter results, EES employees were astonished to hear the news: the division had made a $40m profit - its largest ever.

"Everyone was shaking their heads. We were losing tens of millions of dollars a month," a former EES executive recalled. "It came out of nowhere."

The figure may have been small compared to the $755m racked up by the wholesale division that quarter. But its contribution was disproportionately large because EES was being billed as a profit engine at a time when Broadband and ventures in India and South America were haemhorraging money.

By way of explanation, Enron said EES had recently inked long-term contracts with companies like Owens-Corning and Quaker Oats.

Enron's tendency to play with its forward power curves probably also played a role. The company was known to fiddle with long-term price forecasts for natural gas and other commodities to improve the value of some of its EES con tracts.

But the biggest factor appears to have been buried in the fine print. At the bottom of the earnings release, the management mentioned in a terse, convoluted sentence that it had merged the EES trading book with that of Enron North America. The new entity was known as Enron Wholesale Services.

The company said the move was undertaken to improve efficiency. But many former Enron employees have a different view: they claim the change was part of an elaborate accounting scheme to flatter earnings.

By combining the trading books, Enron hid huge EES losses in the profits Mr Belden and others generated in California. Some claim management facilitated the process by dipping into abnormally large reserves that had been creamed off the trading profits.

In any event, the net effect was the same: by sweeping all the EES losses under the carpet of the trading operation, Enron was able to maintain the illusion of profitability in the division that was underpinning its share price.

"They were publicly stating it was for efficiency reasons, while in reality, it was done simply to manipulate earnings," a former Enron finance official says.

There are two central issues raised by the transaction. One is whether Enron omitted material information about the health of EES when it merged the trading books.

At the time, the move raised suspicions both inside and outside the company. A former EES employee, Margaret Ceconi, later claimed in a whistleblowing e-mail to Ken Lay, Enron's former chairman, that the hidden EES losses

were believed to have amounted to at least $500m. Some market rumours at the time put them closer to $1bn.

Mr Olson and other analysts claim that during a conference call in April 2001, in which Mr Skilling participated - and many times thereafter - they pressed management to reveal the extent of the damage. But they were stonewalled, they say.

"I don't think there was too much doubt among sceptical analysts that that was their intention," says Carol Coale of Prudential Securities. "But we had no way of proving it."

Another question is whether Enron took appropriate reserves for the California gains or if it was merely salting away excessive profits that it could summon to cover the proverbial rainy day.

There are legitimate reasons for companies to set aside a portion of the profits they earn on each trade and hold them in reserve.

Traders establish credit reserves to guard against the risk that one of their counterparties might default on a payment. They also put money into prudence reserves to account for market risks such as changes in liquidity or price information that could undermine long-term commodities contracts.

"If there is an economic reason for taking the reserve, then that is one thing," says Jacob Frenkel, a securities lawyer in Washington.

"But if the (reserves are overstated or the) purpose of taking them is purely to serve as a cookie jar, then that is problematic."

Chris Schreiber, an investigator for a special California panel examining market manipulation and the energy crisis, believes he has already found ample evidence that Enron did just that.

"We know there are examples of trades where the reserve was padded," Mr Schreiber says.

One of the most intriguing signs is the fact that West Power recorded $250m in North American electricity trading profits on December 31 2001, according to daily position reports obtained by investigators.

At that rate, Mr Belden's group would have generated more than $1bn in trading profits a week.

The gigantic one-day gain is all the more unusual because it materialised after California's crisis had abated and energy prices had normalised. Further, Enron had declared bankruptcy by that point and was struggling just to find counterparties who were willing to trade with it.

Mr Schreiber suspects that the profits were in fact left-over reserves that Enron decided to recognise on the last day of the year as the company was disintegrating.

He suspects that the company was using the reserves not only to cover up losses at EES but also to make uneven trading revenues appear more consistent over time.

The daily position reports reveal that trading profits tailed off dramatically - at least on day-to-day basis - after California imposed price caps in June 2001 to curb the crisis. The December 31 profit, for example, accounted for West Power's entire reported earnings for the month, and most of the $310m it booked for the quarter.

"This is where the circles overlap in the investigations. In many ways, I think the energy trading concerns drove the accounting irregularities," Mr Schreiber explains.

Federal investigators have already questioned several former Enron employees about Enron's trading reserves. The inquiry is significant, lawyers say, because it may represent the best avenue to bring charges against senior Enron executives.

While Enron's California energy trades were certainly aggressive, it may be difficult to prove to a jury that they

were illegal.

Unfortunately for investigators, the only way to determine for certain whether Enron abused its reserves would be to roll up their sleeves and sift through old trades one at a time. It will be painstaking work.

Many of the long-term commodities contracts Enron traded were in relatively new, illiquid markets, where price information was often erratic or even subjective.

Investigators, for instance, will have a hard time discerning what constituted a fair assumption for the price of natural gas in California in 2020.

Mr Belden, from his perch at West Power, should have had an intimate knowledge of Enron's trading books and how they were managed amid the California crisis.

"Belden was in the belly of the beast on the trading side," a former Enron finance employee says. "He would know what was done and by whom."

Mr Belden's lawyer declined to comment. The two trading executives to whom he reported, Greg Whalley, Enron's former president, and John Lavorato, former head of ENA, also declined to comment on the matter.

Both work for UBS Warburg, which acquired Enron's energy trading operations in February after the company collapsed. The bank has now announced plans to shed most of its traders and move the operation to Connecticut.

While at Enron, Mr Whalley and Mr Lavorato reported to Mr Skilling.

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Despite Denial, Enron Papers Show Big Profit on Price Bets

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A front-page article yesterday about speculative trading by the Enron Corporation referred incorrectly to the performance of the company's trading operation during the California energy crisis. Enron recorded $7 billion not in net profit but in gross margins (a figure that does not include overhead costs).

In addition, a chart with the article mislabeled the operation's performance. The figures showed daily trading profits and losses, a measure not calculated on a net basis.

CORRECTED BY THE NEW YORK TIMES FRIDAY DECEMBER 13, 2002

Even as Enron's top executives were insisting that the company did not engage in speculative trading, Enron was reaping the bulk of its profits during the California energy crisis by betting on the direction of gas and electricity prices, according to company records and interviews with former Enron traders and executives.

Enron made the hugely profitable bets -- including one that resulted in a $485 million gain on a single day in December 2000 -- at a time when federal and state investigators say the company was conspiring with other energy trading companies to manipulate power and natural gas prices in the West.

Indeed, Enron's standing as the nation's biggest energy trader may have bolstered its ability to profit on bets on the direction of prices. While it is unclear whether Enron could singlehandedly move markets with its trades, several Enron trading officials said that to justify their risk-taking, they told the company's executives and directors that, like a casino, Enron had a "house advantage" in the energy markets.

A result of the speculation, the records show, was one of the most stunning runs ever for a corporate trading operation -- some $7 billion in net trading profits for Enron during a power crisis that wreaked havoc on consumers in 2000 and 2001 and forced rolling blackouts in some parts of California. That tally included days with immense trading losses, including a $550 million reversal just a week after the $485 million gain. Former Enron executives said the company hid its speculative activities to shield it from criticism that it was profiting from California's energy woes.

More than a year after Enron's collapse, the company's full role in the energy crisis is only now coming to light. The disclosure of its speculative trading practices, which are being reviewed by federal and state investigators, comes as California officials await a decision by a Federal Energy Regulatory Commission judge on the state's demand for billions in refunds from power merchants. That ruling is expected soon.

At the time, Kenneth L. Lay, Enron's chairman and longtime chief executive, and other Enron officials said that the company was simply a middleman in the fast-growing market for buying and selling natural gas and electricity. Most of the company's profits, they said, were made on the markup taken as Enron's traders bought and then resold soaring volumes of electricity and natural gas, as well as on selling to other companies hedges against big moves in energy prices.

But in recent interviews, several former traders said that a huge share of Enron's profit came from big bets on whether natural gas and power prices would rise or fall.

"Yes, we were speculating," said John Arnold, who was Enron's most successful trader last year, alone making a $750 million profit for the company by trading natural gas in 2001. "There was a big move in 2001. I identified it early and played it with lots of leverage."

In dozens of pages of profit-and- loss tables obtained by The New York Times, Enron's records show a winning streak that several trading experts called astounding.

For instance, at a time when Wall Street executives say a $100 million daily trading profit was considered sizable for a major trading operation, Enron recorded a $485 million profit on Dec. 4, 2000. For the full month -- a period when, California regulators, say the company was trading with its own affiliates in an effort to raise energy prices -- the records show that Enron's net trading profit was $440 million.

Federal regulators have also accused Enron of trying to raise prices by engaging in sham trades with an unnamed company on Jan. 31, 2001. On that day, according to Enron's internal records, the company recorded a $114 million trading profit.

Over the course of 2000 and 2001, the records show single-day trading profit of $100 million or more on at least 17 days.

Wall Street analysts, who bullishly endorsed Enron's shares for much of the period, said that they might have shown more restraint had they known the extent of the company's speculative trading. Enron disclosed some risk measures about its trading activities, and careful analysts could have noted how those numbers rose in 2000 and 2001. But analysts paid more heed to guidance from the company's executives.

"They specifically told us they were not speculating," said an analyst at one of the nation's biggest brokerage houses, who insisted on anonymity. "At the time, Enron was valued at close to 40 times earnings. And Enron naysayers were saying, 'How is this different from Goldman Sachs, which on a good day is valued at 12 times earnings?' "

In a March 27, 2001, interview, Mr. Lay said: "We're basically making markets, buying and selling, arranging supplies, deliveries. We do not, in fact, speculate on where markets are headed." The company also denied, in meetings with Wall Street analysts, that California accounted for a large share of its profit in 2000, at the height of the state's energy crisis.

But the trading records show that about $1.3 billion, or over half of Enron's trading profit that year, was tied to soaring gas and power prices on the West Coast.

"We had meetings every morning," one former trader said. "And there was a lot of pressure to use more and more leverage and to put on bigger and bigger trades."

A spokesman for Enron, which is struggling to emerge from Chapter 11 bankruptcy protection, said the company was cooperating with investigators.

Mr. Lay's spokeswoman declined to comment. Jeffrey K. Skilling, who built Enron's trading operation and served as the company's chief executive for half of last year, was unavailable for comment.

Three weeks ago, a report issued by the Federal Energy Regulatory Commission said that Enron conspired with Portland General Electric, an Oregon utility it owns, to manipulate the price of power in the spring of 2000. In October, Timothy N. Belden, a former Enron senior trader, pleaded guilty in federal court to helping manipulate power prices in the West during the California energy crisis. Mr. Belden is cooperating with the government in continuing investigations.

According to the records, Enron's trading profit soared during the most volatile trading periods in 2000 and 2001, when consumers and politicians in the West started complaining about unusually high gas and power prices.

In November and December 2000, for instance, Enron made nearly $1 billion in trading profit just in North America, according to a presentation the company made to Moody's Investors Service, the credit rating agency. Those results are evidence that the company was engaged in speculative trading, financial experts said.

"Given their profit-and-loss swings, they were taking on huge positions," said Robert Litzenberger, the former head of risk management at Goldman Sachs. "You might have swings, but not like that in a hedged market. That's quite extreme."

Occasionally, Enron got on the wrong side of the market, as it did in mid-December 2000, when the trading operation lost nearly $1 billion over three days.

The worst day was Dec. 12, when gas prices unexpectedly plummeted. Enron's traders lost $550 million -- a figure that sent shock waves through the company. The loss equaled what Long Term Capital Management, the hedge fund, lost on one of its worst trading days in 1998, when its near-collapse shook global markets.

The $550 million reversal exceeded the company's risk control levels, meaning that they had to be reported to the board. A week earlier, after the traders recorded their $485 million gain, they had persuaded the board to loosen Enron's risk limits. Trading executives argued that Enron had superb risk management controls and that the traders could reap even bigger profits in a volatile market, executives and trading officials said.

During the last three months of 2000, according to internal company records, Enron's so-called value-at-risk limits -- what Enron was willing to lose on a single day -- were raised three times, from $80 million in October to $140 million on Dec. 7.

J. C. Nickens, a lawyer for Richard B. Buy, who at the time was Enron's chief risk officer, said that it was obvious that Enron was speculating.

"Of course they were speculating; they were traders," Mr. Nickens said this week. "But they thought they were better traders and less risky. They thought they had the system beat."

Another limit set by Enron's board -- the "risk appetite," or the overall amount of the company's capital that the company was willing to risk losing in the course of a year -- was set at $2 billion in early 2001, records show.

"That figure is huge, shocking," said Mark Williams, a former energy trading executive who now teaches at Boston University. "This gets back to, was Enron really a hedge fund disguised as an energy company?"

Early in 2001, Herbert S. Winokur Jr., who was then the chairman of the finance committee of Enron's board, began asking the company's risk managers to re-evaluate the trading policies and tighten risk controls, according to W. Neil Eggleston, a lawyer for Mr. Winokur.

After learning about the Dec. 12 loss, Moody's also grew concerned about Enron's risk profile. Mr. Buy traveled to New York in late 2000 or early 2001 to soothe Moody's concerns, according to several former Enron executives. Moody's said it decided not to take any action against the company after Enron assured it that there were good controls in place and that this was an opportunity to make even bigger profits.

In retrospect, officials at Moody's feel duped.

"We did express concern about the level of trading activity that they showed us," said John Diaz, a managing director of Moody's energy group. "But what we have come to believe is that the information Enron provided to us was misleading, incomplete and designed to deceive. If we had known that they were really speculating in a big way, that probably would have led to a lower rating."

Instead, the trading profits during the California energy crisis only heightened Enron's hunger for more, according to a former executive in the company's risk-management unit.

"Enron's appetite for risk was huge," he said. "We could set some limits, but we couldn't stop the train."

Photo: Kenneth L. Lay and other Enron officials said that the company was simply a middleman in the market

for buying and selling energy. (Frontline/WGBH)(pg. C6) Chart: "Californias Pain, Enron's Gain" During the California energy crisis, when federal and state investigators say Enron was helping manipulate the prices of gas and electricity, the company's trading operation was strikingly profitable. The bulk of that profit came from speculating on whether prices would rise or fall, according to company records and interviews with former executives and traders. FOURTH QUARTER '00 -- Enron helped drive up energy prices by engaging in sham trades with affiliated companies, the California Public Utilities Commission concludes in a report issued in April 2002 DEC. 4, '00 -- As gas and electricity prices soar on the West Coast, Enron's trading operation records a $485 million profit. DEC. 7, '00 -- With the approval of Enron's board, the trading group increases its risk tolerance to $140 million a day. DECEMBER '00 -- California declares Stage 3 power alerts. Enron records $440 million in trading profit for the month. DEC. 12, '00 -- Enrons trading operation loses $550 million as power and natural gas prices fall both sharply and unexpectedly. DEC. 29, '00 -- Enron earned $3.1 billion in trading profit for 2000, according to internal records. JAN. 17, '01 -- First rolling blackouts in Northern California; Enron records $300 million in trading profit over the next three days. JAN. 31, '01 -- A Federal Energy Regulatory Commission study suggests that Enron used its online trading platform on this day to engage in sham trades to drive up the price of natural gas in the West. Enron records a $114 million trading profit. MARCH 19-20, '01 -- California's first statewide blackouts; Enron records $110 million in profit on the two days. MARCH 27, '01 -- In an interview, Kenneth L. Lay, Enron's chairman, denies that the company bets on prices. "We're basically making markets, buying and selling, arranging supplies, deliveries," he says "We do not, in fact, speculate on where markets are headed." Graph tracks Enron's daily net trading porfits and losses from October 2000 to June 2001. (Source: Company records [profits and losses])(pg. C6)

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