JOSEPH W. COTCHETT (Admitted *pro hac vice*)
STEVEN N. WILLIAMS (Admitted *pro hac vice)*
COTCHETT, PITRE, SIMON & McCARTHY
840 Malcolm Road, Suite 200
Burlingame, CA 94010
650-697-600

United States District Court
Southern District of Texas
FILED

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Michael N. Milby, Clerk

STANLEY GROSSMAN (Admitted *pro hac vice)*
H. ADAM PRUSSIN (Admitted *pro hac vice)*
SHAHEEN RUSHD
POMERANTZ HAUDEK BLOCK GROSSMAN & GROSS LLP
100 Park Avenue
New York, NY 10017
212-661-1100

Attorneys for Plaintiffs

MDL DOCKET NO. 1446

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

(Transferred from the United States District Court for the Southern District of New York, Southern District Case No. 02cv413 (GEL), pursuant to order of the Judicial Panel on Multidistrict Litigation)

SILVERCREEK MANAGEMENT INC.; **SILVERCREEK LIMITED PARTNERSHIP;** **SILVERCREEK II LIMITED;** **OIP LIMITED, and PEBBLE LIMITED PARTNERSHIP,** **Plaintiffs,** **vs.** **SALOMON SMITH BARNEY, INC.;** **GOLDMAN SACHS & COMPANY;** **BANC OF AMERICA SECURITIES LLC;** **ARTHUR ANDERSEN LLP,** **Defendants.**	**Civil Case No. 01-CV-3624** **FIRST [AMENDED] COMPLAINT FOR:** **1. Violation of §11 of the Securities Act** **2. Negligent Misrepresentation** **3. Fraud and Deceit** **4. Violation of §§ 10(b) and 20(a) of the Exchange Act** **5. Violation of Article § 81-1 of the Texas Securities Act** **JURY TRIAL DEMANDED**

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Plaintiffs, as and for their amended complaint, allege as follows upon information and belief based, *inter alia*, upon investigation conducted by Plaintiffs and their counsel, except as to those allegations pertaining to Plaintiffs personally, which are alleged upon knowledge:

I.

NATURE OF THIS ACTION

1. In October 2001, Plaintiffs invested over $100 million in 7% Exchangeable Notes (the "Exchangeable Notes") and Zero Coupon Notes, both of which were issued by Enron Corporation ("Enron"). At the time of the Plaintiffs' investment, Enron was the world's largest energy trader, engaged in one out of every four electricity and natural gas sales. Enron was also engaged in myriad other businesses, including pipelines, telecommunications, and water. According to the 2001 Fortune 500 rankings, Enron was the seventh largest company in the world, ahead of IBM, reporting revenue for 2000 of over $100 billion and net income of approximately $1 billion.

2. Shortly after Plaintiffs purchased the Exchangeable Notes and Zero Coupon Notes, Enron was forced to restate its financial results for the previous four years, drastically reducing its reported income and increasing its reported debt. It soon became evident that this restatement was just the beginning and that additional restatements would become necessary, as a significant number of

previously undisclosed off-balance sheet transactions and entities surfaced.

3. Enron's demise followed swiftly. It filed for bankruptcy, and within a few months, its auditor, defendant Arthur Andersen LLP ("Andersen"), was found guilty of criminal violations and has been, for all intents and purposes, forced out of business. One of Enron's ex-officers has pleaded guilty to charges of money laundering and fraud. Andrew Fastow, its former Chief Financial Officer, has been indicted on numerous counts of securities fraud, wire and mail fraud, money laundering, and conspiracy. Indictments of other officers are imminent. Enron's underwriters and financial advisers have become the focal point of numerous governmental investigations concerning their role in Enron's collapse. The demise of Enron is one of the largest and most infamous financial debacles in U.S. business history.

4. In deciding to invest in Enron debt securities, Plaintiffs relied upon the information contained in the prospectuses for the Exchangeable Notes and Zero Coupon Notes, public disclosures and other representations made by management, the directors, and the other defendants. At no time prior to Plaintiffs' investment did Defendants, or anyone else, disclose Enron's overstatements of earnings, understatements of debt, or the existence and magnitude of the off-balance sheet transactions that were distorting Enron's reported financial results. It was primarily Plaintiffs' belief in the accuracy of the historical financial

information from 1994 to 2000 that resulted in their buying the Enron notes. Plaintiffs believed in the history and core strength of Enron.

5. In this action, Plaintiffs seek to hold accountable those individuals and entities responsible for their massive losses. These individuals and entities include the underwriters of the Exchangeable Notes and the Zero Coupon Note offerings and Andersen, which certified Enron's false financial statements.

II.

JURISDICTION AND VENUE

6. This action asserts claims under § 11 of the Securities Act, 15 U.S.C. §77k, under §10(b) and § 20 of the Securities Exchange Act, 15 U.S.C.§10(b) and Rule 10b-5, 17 C.F.R. § 240.10b-5, promulgated thereunder, 15 U.S.C. § 78t(a), and under the common law. Federal subject matter jurisdiction exists pursuant to § 22(a) of the Securities Act, 15 U.S.C. § 77v(a), § 27 of the Securities Exchange Act, 15 U.S.C. §78aa, and 28 U.S.C. § 1331 (federal question). Supplemental jurisdiction over the state law claims exists pursuant to 28 U.S.C. §1367(a).

7. Venue is appropriate in the Southern District of New York as the principal place of business of several Defendants is located therein, and several Defendants are incorporated in the State of New York. The majority of purchases and sales in the subject Enron debt securities offerings, which were purchased and sold by Plaintiffs, took place in the Southern District of New York. While this

action was transferred to the United States District Court for the Southern District of Texas, Houston Division, for coordination or consolidation pursuant to the order of the Judicial Panel on Multidistrict Litigation (Docket No. 1446), the trial of this action shall take place in the Southern District of New York pursuant to Lexecon Inc. v. Milberg Weiss Bershad Hynes & Lerach, 523 U.S. 26 (1998).

III.

THE PARTIES

A. Plaintiffs

8. Plaintiff Silvercreek Management, Inc. ("Silvercreek") is an investment manager with its principal place of business in Toronto, Province of Ontario, Canada. Silvercreek is incorporated under the Business Corporations Act of Ontario.

9. Plaintiff Silvercreek Limited Partnership is a limited partnership organized under the laws of the Province of Ontario, with its principal place of business in Toronto, Province of Ontario, Canada.

10. Plaintiff Silvercreek II Limited is a mutual fund incorporated as a limited liability company in the Cayman Islands, British West Indies.

11. Plaintiff OIP Limited ("OIP") is incorporated under the Business Corporations Act of Ontario, with its principal place of business in Toronto, Province of Ontario, Canada.

12. Plaintiff Pebble Limited Partnership is a limited partnership under the laws of the Province of Ontario, with its principal place of business in Toronto, Province of Ontario, Canada.

B. Defendants

1. The Underwriters

a. Citigroup/Salomon

13. Defendant Salomon Smith Barney Inc. ("Salomon") is a New York corporation with its principal place of business in New York, New York. Salomon is a subsidiary of Citigroup, Inc. ("Citigroup"). Salomon was one of the underwriters of the Exchangeable Notes offering and was a statutory underwriter and initial purchaser of the Zero Coupon Notes offering. Salomon led the Zero Coupon Notes offering.

14. Citigroup is a financial services company which provides banking and investment services, including through its subsidiary Salomon. Citigroup's headquarters are in New York, New York. Citigroup, through Salomon, was an underwriter of both the Exchangeable Notes and the Zero Coupon Notes. Citigroup also provided banking services, advising services and other financial services to Enron.

15. Citigroup and its subsidiary Salomon are referred to herein as Citigroup/Salomon.

b. Goldman

16. Defendant Goldman Sachs & Company ("Goldman") is a New York limited partnership with its principal place of business in New York, New York. Goldman was the lead underwriter of the Exchangeable Notes offering and was a statutory underwriter of the Zero Coupon Notes offering.

c. Banc of America

17. Defendant Banc of America Securities LLC ("Banc of America") is a Delaware limited liability company with its principal places of business in New York, New York., and San Francisco, California. Banc of America was one of the underwriters of the Exchangeable Notes offering and was a statutory underwriter and initial purchaser of the Zero Coupon Notes offering. Banc of America is a subsidiary of Bank of America. Bank of America and its subsidiary Banc of America are referred to herein collectively as Bank of America.

2. Arthur Andersen LLP

18. Defendant Andersen is an Illinois limited liability partnership with its principal place of business in Chicago, Illinois. Andersen was the outside auditor for Enron, and also provided non-auditor professional services to Enron and its subsidiaries and affiliates. Its opinions certifying Enron's financial statements were included in the registration statements for both note offerings. During the relevant period, it maintained offices in New York, New York.

IV.

ENRON'S FINANCIAL STATEMENTS, 1997-2001

A. Enron's Annual And Quarterly Financial Statements For 1997

19. On May 14, 1997, Enron filed with the Securities and Exchange Commission ("SEC") its financial statements for the first quarter of 1997 on Form 10Q for the period ended March 31, 1997.

20. On August 14, 1997, Enron filed with the SEC its financial statements for the second quarter of 1997 on Form 10Q for the period ended June 30, 1997.

21. On November 14, 1997, Enron filed with the SEC its financial statements for the third quarter of 1997 on Form 10Q for the period ended September 30, 1997.

22. On March 31, 1998, Enron filed with the SEC its Form 10K for 1997, which included its audited annual financial statements for the period ended December 31, 1997. The financial statements were prefaced by an unqualified audit opinion from Andersen stating that those financial statements:

> "present fairly, in all material respects, the financial position of Enron Corp. and subsidiaries as of December 31, 1997 and 1996, and the results of their operations, cash flows and changes in shareholders' equity for each of the three years in the period ended December 31, 1997, in conformity with generally accepted accounting principles."

Neither the financial statements nor the 10K disclosed the significant off-balance sheet transactions and hidden liabilities described herein.

23. Andersen also certified that it had conducted its audit in accordance with Generally Accepted Auditing Standards ("GAAS"). GAAS requires an auditor to plan and perform an audit to obtain assurance that the financial statements are free of material misstatement. To comply with GAAS, an auditor must examine evidence and assess the accounting principles used and the significant estimates made by management, and must perform an overall evaluation of the financial statement presentation. As discussed below, Andersen did not conduct its audit in accordance with GAAS.

B. <u>Enron's Annual And Quarterly Financial Statements For 1998</u>

24. On May 15, 1998, Enron filed with the SEC its financial statements for the first quarter of 1998 on Form 10Q for the period ended March 31, 1998.

25. On August 14, 1998, Enron filed with the SEC its financial statements for the second quarter of 1998 on Form 10Q for the period ended June 30, 1998.

26. On November 16, 1998, Enron filed with the SEC its financial statements for the third quarter of 1998 on Form 10Q for the period ended September 30, 1998.

27. On March 31, 1999, Enron filed with the SEC its Form 10K for 1998, which included its audited annual financial statements for the period ended December 31, 1998. Once again, those financial statements were prefaced by an unqualified audit opinion letter from Andersen, certifying that the financial statements:

> "present fairly, in all material respects, the financial position of Enron Corp. and subsidiaries as of December 31, 1998 and 1997, and the results of their operations, cash flows and changes in shareholders' equity for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles."

28. Andersen also certified, once again, that it had conducted its audit in accordance with GAAS.

29. This 1998 10-K was later incorporated by reference into the registration statement for the Exchangeable Notes, as was Andersen's certification of those financial statements. The underwriters for the Exchangeable Notes were Goldman, Bank of America, and Salomon. Neither the financial statements, the 10K, nor the prospectus for the Exchangeable Notes disclosed the significant off-balance sheet transactions and hidden liabilities described herein.

C. Enron's Annual And Quarterly Financial Statements For 1999

30. On May 14, 1999, Enron filed with the SEC its financial statements for the first quarter of 1999 on Form 10Q for the period ended March 31, 1999. This financial statement was later incorporated by reference into the registration

statement for the Exchangeable Notes. The underwriters for the Exchangeable Notes were Goldman, Bank of America, and Salomon.

31. On August 16, 1999, Enron filed with the SEC its financial statements for the second quarter of 1999 on Form 10Q for the period ended June 30, 1999.

32. On November 15, 1999, Enron filed with the SEC its financial statements for the third quarter of 1999 on Form 10Q for the period ended September 30, 1999.

33. On March 30, 2000, Enron filed with the SEC its Form 10K for 1999, including its audited annual financial statements for the period ended December 31, 1999. Those financial statements were prefaced, once again, by an unqualified audit opinion from Andersen stating that the financial statements:

> "present fairly, in all material respects, the financial position of Enron Corp. and subsidiaries as of December 31, 1999 and 1998, and the results of their operations, cash flows and changes in shareholders' equity for each of the three years in the period ended December 31, 1999, in conformity with generally accepted accounting principles."

Neither the financial statements, the 10K, the offering memorandum, nor the prospectus for the Zero Coupon Notes disclosed the significant off-balance sheet transactions and hidden liabilities described herein.

34. Andersen also certified, once again, that it had conducted its audit in accordance with GAAS.

D. Enron's Annual And Quarterly Financial Statements For 2000

35. On May 15, 2000, Enron filed with the SEC its financial statements for the first quarter of 2000 on Form 10Q for the period ended March 31, 2000.

36. On August 14, 2000, Enron filed with the SEC its financial statements for the second quarter of 2000 on Form 10Q for the period ended June 30, 2000.

37. On November 14, 2000, Enron filed with the SEC its financial statements for the third quarter of 2000 on Form 10Q for the period ended September 30, 2000.

38. On April 2, 2001, Enron filed with the SEC its Form 10K for 2000, which included its audited annual financial statements for the period ended December 31, 2000. Once again, those statements were prefaced by an unqualified audit opinion from Andersen, certifying that the financial statements:

> "present fairly, in all material respects, the financial position of Enron Corp. and subsidiaries as of December 31, 2000 and 1999, and the results of their operations, cash flows and changes in shareholders' equity for each of the three years in the period ended December 31, 2000, in conformity with generally accepted accounting principles."

39. Andersen also certified, once again, that it had conducted its audit in accordance with GAAS.

40. This 10-K was later incorporated by reference into the registration statement for the Zero Coupon Notes, as was Andersen's certification of the 2000

financial statements. Led by Salomon, the initial purchasers of the Zero Coupon Notes were Salomon, Deutsche Banc, Alex. Brown, JP Morgan, Bank of America, and Barclay's Capital. Neither the financial statements, the 10K, the offering memorandum, nor the prospectus for the Zero Coupon Notes disclosed the significant off-balance sheet transactions and hidden obligations described herein.

E. Additional Representations

41. Footnote 1 to the 2000 audited annual financial statements of Enron, as set forth on Form 10K, documented by management, and approved by Andersen, represented that the financial statements were in conformity with Generally Accepted Accounting Principles ("GAAP") as to consolidation of financial statements:

> "Consolidation Policy and Use of Estimates. The accounting and financial reporting policies of Enron Corp. and its subsidiaries conform to generally accepted accounting principles and prevailing industry practices. The consolidated financial statements include the accounts of all subsidiaries controlled by Enron Corp. after elimination of significant intercompany accounts and transactions."

42. On its 2000 Form 10K, Enron represented that its "senior unsecured long-term debt is currently rated BBB+ by Standard & Poor's Corporation and Fitch IBCA and Baa1 by Moody's Investor Services. Enron's continued investment grade status is critical to the success of its wholesale businesses as well as its ability to maintain adequate liquidity. Enron's management believes it will be able to maintain its credit rating."

F. Enron's First Quarter 2001 Financial Statements

43. On May 15, 2001, Enron filed with the SEC its financial statements for the first quarter of 2001 on Form 10Q for the period ended March 31, 2001. These first quarter financial statements were prepared by management and reviewed and approved by Andersen prior to filing with the SEC. These financial statements were later incorporated by reference into the registration statement for the Zero Coupon Notes. Defendants Salomon, Bank of America and Goldman were statutory underwriters of the Zero Coupon Notes. The registration statement for the Zero Coupon Notes did not disclose the magnitude of the off balance sheet activities and liabilities of Enron.

G. Enron's Second Quarter 2001 Financial Statements

44. On August 14, 2001, Enron filed with the SEC its financial statements for the second quarter of 2001 on Form 10Q for the period ended June 30, 2001. These second quarter financial statements were prepared by management and reviewed and approved by Andersen prior to filing with the SEC.

H. Public Statements About Enron in 2001

45. Set forth below are some of the representations that were being made by both management and other defendants with respect to the financial condition and future prospects of Enron during the months leading up to its financial collapse.

46. In August 2001, Skilling resigned as President and CEO of Enron, citing personal reasons. Skilling admitted that part of the reason for his resignation was the pressure associated with the decline in the market price of Enron common stock during his six-month tenure as CEO. Upon Skilling's resignation, Lay reassumed his position as CEO.

47. Also in August 2001, Chairman and CEO Lay sent email messages to Enron employees, encouraging them to invest in Enron stock. An email from Lay dated August 14, 2001 stated: "Our performance has never been stronger; our business model has never been more robust. . . . We have the finest organization in American business today."

48. An email from Lay dated August 27, 2001 discussed the Enron Employee Stock Ownership Plan, with Lay stating that he anticipated "a significantly higher price" for Enron stock in the future.

49. On October 9, 2001, Goldman disseminated a market analyst report calling Enron "the best of the best" and "strongly reiterating [its] Recommended List" rating.

50. On October 16, 2001, Enron issued a press release reporting its financial results for the quarter ending September 30, 2001. Enron announced that it had recorded a $1 billion after-tax charge to its third quarter 2001 earnings to recognize asset impairments, restructuring costs, and losses associated with certain

investments. Enron put a positive spin on this one-time charge and stated that its core businesses were strong. Enron's press release stated:

> "Enron Corp. announced today recurring earnings per diluted share of $0.43 for the third quarter of 2001, compared to $0.34 a year ago. Total recurring net income increased to $393 million, versus $292 million a year ago.
>
> "'Our 26 percent increase in recurring earnings per diluted share shows the very strong results of our core wholesale and retail energy businesses and our natural gas pipelines,' said Kenneth L. Lay, Enron Chairman and CEO. 'The continued excellent prospects in these businesses and Enron's leading market position make us very confident in our strong earnings outlook.'
>
> "Non-recurring charges totaling $1.01 billion after-tax, or $(1.11) loss per diluted share, were recognized for the third quarter of 2001. The total net loss for the quarter, including non-recurring items, was $(618) million, or $(0.84) per diluted share.
>
> "'After a thorough review of our businesses, we have decided to take these charges to clear away issues that have clouded the performance and earnings potential of our core energy businesses,' said Lay."

51. Enron and its banks, including the underwriter defendants, downplayed the impact of the write-offs and represented to the public that Enron had resolved the improper balance sheets, taken all appropriate losses, and was going to achieve strong profitable growth due to the strength of its core businesses.

52. Chairman Lay and Enron management told the public that Enron was in strong financial condition, and that performance in the third quarter of 2001

included a 35% increase in recurring net income and a 26% increase in diluted recurring earnings per share. Lay told the public that Enron's core energy business fundamentals were excellent, and that the company would meet its fourth-quarter and year-end earnings targets.

53. Of particular importance to debt investors, Lay said that Enron's liquidity was excellent, with a debt to total capital ratio of about 50%, and that Enron did not foresee any credit downgrades.

54. When questioned, Chairman Lay denied that Enron would be taking further write-offs.

55. On October 16, 2001, Citigroup/Salomon issued an analyst report on Enron rating Enron stock a "Buy" and declaring that the write-offs would "clear the balance sheet of under-performing non-core assets which have been an overhang on the stock. View write-offs positively in the long run."

56. Also on that day, Bank of America released a report on Enron that continued to rate the company a "strong buy" and included its optimistic forecast for Enron earnings in 2001 and 2002. An energy analyst for the Bank of America represented that "we like the energy marketing and trading industry, and we like Enron, being the biggest energy trader. It's an industry that is benefitting from deregulation in the United States and Europe. Volatility we think will be a positive. Enron does risk management and we see that as a good, long term

investment". Goldman continued to keep Enron on its Recommended List, its top rating.

57. Another Bank of America analyst statement on October 16, 2001, said "we believe the company has cleared the woods and therefore its investment outlook is positive. We reiterate our Strong Buy recommendation and $45 price target."

58. On October 17, Goldman Sachs issued a statement that "we remain confident that Enron's core businesses have high and sustained growth prospects, that Enron can grow at an over 20% rate long term and that charges to dispose of non-core operations will undershoot fears." Enron remained on Goldman's Recommended List.

59. Two days later, on October 19, 2001, Citigroup/Salomon issued a report rating Enron a "Buy" and maintaining its forecast for healthy earnings in 2001 and 2002; it "reiterated [its] buy rating on Enron after untangling part of a complicated story involving their balance sheet, cash flow and business practices."

60. On October 22, 2001, Enron issued a press release disclosing that the SEC had commenced an informal inquiry into its accounting for certain related party transactions. In this press release, Enron stated that these transactions had been approved by the Enron Board of Directors, legal counsel, and Andersen.

61. On October 23, 2001, on a conference call with investors, Enron management expressed disappointment with its stock price and dismissed emerging criticisms of LJM[1] – which it termed a "private equity partnership." Management stated that LJM transactions had been reviewed by inside and outside auditors and lawyers, and approved by the Board of Directors of Enron. Management reaffirmed its "faith and confidence" in Mr. Fastow and praised his work as CFO. Management denied that there was any impropriety in its transactions with LJM and other special purpose entities, and claimed that the earnings from its transactions with SPEs would have been the same even if the transactions had been with unrelated third parties. Management told the public that a Chinese Wall and other prophylactic structures were in place to ensure that the paramount interests in any transactions with LJM were the company and its well-being.

62. On October 24, 2001, Goldman reiterated its Recommended List rating (its top rating) and stated "we believe these concerns are very much exaggerated."

---

[1] LJM, discussed below at ¶¶ 142 through 168, was one of the special purpose entities which were used to hide debt and inflate earnings.

V.

PLAINTIFFS' INVESTMENTS IN ENRON DEBT SECURITIES

63. Plaintiffs relied upon publicly available information in investing in Enron debt securities. They reviewed and considered Enron's financial statements in order to assess the current and recent financial condition of the company, including Enron's profitability, cash flow, outstanding debt, and capital structure. Plaintiffs reviewed historical data concerning Enron in order to confirm that Enron had demonstrated the ability to generate positive cash flow sufficient to service its debt.

64. Particularly important to Plaintiffs was their review of the offering documents for the Exchangeable Notes and Zero Coupon Notes. The offering documents are required to include a number of disclosures that are important to investors including, but not limited to, the relative seniority of the offering, terms of the debt, the tax implications of the offering, and an assessment of the key risk factors that investors should consider in advance of investing in the offering. The prospectus/registration statements were key to Plaintiffs' review process, and they relied upon those documents in making their investment decision. Plaintiffs believed in the competency of the underwriter defendants, and relied on their ability to complete due diligence on the company and their obligation to insure that the disclosures were complete and accurate.

65. Plaintiffs also relied upon the trustworthiness of other publicly available information concerning Enron, including the reports of so-called independent research analysts, including Defendants.

66. Because Plaintiffs were investing in debt securities, a key consideration in investing was their determination that Enron would be capable of returning Plaintiffs' capital in full, and of servicing the outstanding debt with timely coupon payments.

67. Plaintiffs relied upon the information disclosed by Enron, documented by management and confirmed by Andersen and the underwriters as a basis for their investment decision. This information was both filed directly with the SEC and was also incorporated by reference in the registration statements for the Exchangeable Notes and Zero Coupon Notes in which the Plaintiffs invested. The Plaintiffs relied on the representations made by the Defendants and believed the representations to be complete, accurate, and timely. This reliance on the historic public information resulted directly in the massive losses suffered by the Plaintiffs.

68. The publicly disclosed information failed to consolidate off-balance sheet entities in accordance with GAAP and failed to disclose the off-balance-sheet entities and transactions and their associated hidden obligations as a possible risk factor.

VI.

ENRON'S REVELATIONS AND FINANCIAL COLLAPSE

69. On October 31, 2001, the SEC's inquiry became a formal investigation.

70. On November 1, 2001, Enron issued a press release stating:

> "ENRON SECURES COMMITMENTS FOR ADDITIONAL $1 BILLION IN FINANCING
>
> "Enron Corp. announced today that J.P. Morgan (the investment banking arm of JP Morgan & Co.) and Salomon Smith Barney Inc. (the investment banking arm of Citigroup Inc.) as co-arrangers have executed commitment letters to provide $1 billion of secured credit lines . . .. The proceeds will be used to supplement short-term liquidity and to refinance maturing obligations. . . .
>
> "'With more than $1 billion in cash currently on our balance sheet, this additional credit capacity will further solidify Enron's standing as the leading market maker in wholesale energy markets,' said Kenneth L. Lay, Enron chairman and CEO. 'We very much appreciate the support of two of our longstanding banking partners, JP Morgan and Citigroup.'
>
> 'This is yet another step in our efforts to enhance market and investor confidence,' said Jeffrey McMahon, Enron's newly appointed chief financial officer. 'We are moving aggressively to strengthen our balance sheet and maintain our investment grade credit rating.'"

71. On November 8, 2001, Enron announced that it would be restating its audited annual financial statements for 1997, 1998, 1999, and 2000, and its quarterly financial statements for all of 1997, 1998, 1999, 2000 and for the first two quarters of 2001.

72. Also on November 8, 2001, Enron filed a Form 8K with the SEC, signed by Richard Causey as Enron's Executive Vice President and Chief Accounting Officer, which included its restated financials for 1997 through 2001, and disclosed information concerning its off-book, related party transactions. In this filing, Enron stated that:

a. It had been forced to restate its annual and quarterly financial statements for the years ended December 31, 1997 through December 31, 2000 and its quarterly financial statements for the periods ended March 31, 2001 and June 30, 2001;

b. None of the quarterly and annual financial statements from 1997 through 2001 "should not be relied upon";

c. The restatement of prior period financial statements would reflect and include: (1) a $1.2 billion reduction to shareholders' equity to be booked in the third quarter of 2001, which was previously reported as an increase in assets and shareholders' equity, and (2) the consolidation of financial statements of three entities which engaged in related party transactions and/or in which Enron had an ownership interest, as required under GAAP;

d. That a Special Committee had been created, headed by a newly appointed director, to review the related party, off-book transactions;

e. That Enron's Chief Financial Officer Andrew Fastow ran related party limited partnerships, with which Enron engaged in off-book transactions, and for which Fastow received management fees of at least $30 million;

f. The financial statements and financial activities of Chewco and JEDI should have been consolidated with the financial statements of Enron beginning in November 1997; and

g. The financial statements and financial activities of LJM and its subsidiary should have been consolidated with the financial statements of Enron beginning in 1999.

73. Enron's annual financials were restated as follows:

RESTATEMENTS				
	1997	1998	1999	2000
Overstatements of Recurring Net Income	$96,000,000	$113,000,000	$250,000,000	$132,000,000
Understatement of Debt	$711,000,000	$561,000,000	$685,000,000	$628,000,000
Overstatement of Shareholders' Equity	$313,000,000	$448,000,000	$834,000,000	$1,164,000,000

74. These restatements constitute an admission that the representations made in the original financial statements and other financial information contained in the registration statements and prospectuses concerning the compliance of those financial statements with GAAP were materially false and misleading when made. Under GAAP, financial statements are to be restated *only* when the facts that necessitate the restatement were material and known or knowable at the time the financial statements were originally issued. Similarly, restatements may only be made and are required where material accounting errors or irregularities existed at the time the financial statements were prepared.

75. As large as the 1997 to 2000 financial restatements were, they just scratched the surface of the true extent of the prior falsification of Enron's financial statements because Enron, its advisors, and the banks were still trying to keep Enron afloat and trying to conceal how extensive the abuse had been. At this point in time Enron had disclosed debt on its balance sheet of approximately $13 billion. Post-bankruptcy estimates of its true obligations are in the order of $60 billion. Preliminary claims against the company are $260 billion.

76. At the time the restatements were issued, the Defendants were still recommending that investors purchase Enron securities.

A. FAILURE TO CONSOLIDATE SPECIAL PURPOSE ENTITIES – VIOLATION OF GAAP

77. Enron's financial statements from 1997 through 2001 were materially false and misleading, and therefore had to be restated, primarily because of the improper use of so-called special purpose entities to engage in off-book or off balance sheet transactions with Enron. A special purpose entity (sometimes referred to as an "SPE") is an entity created by a sponsor to carry out a specified purpose or activity, such as to consummate a specific transaction or series of transactions with a narrowly defined purpose. SPEs are generally used as financing vehicles in which assets are sold to a trust or similar entity in exchange for cash or other assets funded by debt issued by the trust. SPEs are often used in a structured transaction or series of transactions to achieve off-balance-sheet treatment for accounting purposes. Special purpose entities were used by Enron to hide debt, hide underperforming assets, and manipulate its earnings. Enron would sell assets to special purpose entities at prices that Enron never could have received in a true arms-length sale, creating the appearance that Enron was generating cash from operations, rather than from financing through non-arms-length deals.

78. The effect of those transactions was to artificially inflate Enron's earnings and improperly exclude billions of dollars of debt from Enron's balance sheet.

B. THE COLLAPSE OF THE MERGER WITH DYNEGY

79. On November 9, 2001, Enron announced the signing of a definitive merger agreement with its competitor Dynegy. Under the deal, Dynegy would acquire Enron for approximately $9 billion in Dynegy stock and the assumption of $13 billion in debt. With this merger agreement it appeared to the public that Enron had value and would survive.

80. On November 12, 2001, Goldman issued a report describing the Enron/Dynegy merger as a "Strong Combination" with "strong accretion to Dynegy." Enron was maintained on Goldman's Recommended List with a price target of $11 to $12.

81. On November 14, 2001, Enron held a conference call with investors, including Plaintiffs, to assure them of Enron's commitment to the Dynegy deal and to calm fears of liquidity issues until the deal closed.

82. On November 19, 2001, Enron filed its Form 10Q with the SEC for the third quarter ending September 30, 2001, which incorporated the negative disclosures of the restatements as set forth in the prior Form 8K. In its third quarter 2001 Form 10Q, Enron also disclosed that a note payable in the amount of

$690 million related to a limited partnership had been accelerated due to a downgrade in Enron's debt rating. It also disclosed that other additional debt amounts would be accelerated if the debt rating fell below investment grade. It was further disclosed that Andersen had not completed, and was unable to complete, its review of the third quarter financial statements prior to filing with the SEC due to an on-going investigation by the Enron Board's Special Committee. Based on these further revelations, the market became concerned that the Dynegy deal might not be consummated, resulting in a severe decline in Enron bond prices, including the debt securities held by Plaintiffs.

83. Investment banks were continuing to recommend purchase of Enron securities throughout this period. As of November 19, 2001, the stock remained on Goldman's Recommended List, its top rating.

84. On November 27, 2001, it was reported that the Dynegy deal was being renegotiated and that new terms would be announced.

85. On November 28, 2001, Dynegy announced the termination of the merger agreement with Enron, and Enron's debt securities were downgraded to "junk bond" status (*i.e.*, below investment grade). After these announcements, the value of Enron's securities, both debt and equity, collapsed. After a market price high of $90.75 in 2000 and a price of approximately $85 per share at the

beginning of 2001, Enron common stock plummeted to a mere 26 cents by the end of November 2001.

C. ENRON'S CHAPTER 11 FILING

86. On December 2, 2001, Enron filed Chapter 11 bankruptcy, constituting what was then the largest bankruptcy in U.S. history.

87. The disclosures and revelations of October and November 2001 were just the beginning. After it filed for bankruptcy, Enron's equity and debt securities were worthless. The Exchangeable Notes are trading at approximately 7 cents on the dollar. Assuming Enron has approximately $60 billion in obligations, based on its market capitalization of approximately $22 billion as of October 1, 2001, Enron investors suffered over $75 billion of losses over a two month period from October 1 to December 1, 2001.

88. The November restatement, although material, did not scratch the surface of the extent of the Enron scandal. This was confirmed in April 2002 in a court filing by Stephen Cooper, the chief Restructuring Officer for Enron. This document stated:

> "[C]urrent management of the Company has not undertaken, and does not intend to undertake, a comprehensive review of accounting adjustments, including asset impairments and write-downs, relating to previously reported financial information, and has not prepared a consolidated balance sheet of the Company as of December 31, 2001 prepared in accordance with generally accepted accounting principles. However, current management believes that, if such a review were conducted and balance sheet prepared, a

> significant write-down of assets on such balance sheet would be required, which current management estimates would be approximately $14 billion. . . .
>
> "a material portion of such estimated amount would relate to valuations of several assets the historical carrying value of which current management believes may have been overstated due to possible accounting errors or irregularities.
>
> "In addition to the aforesaid write-down of assets, current management has identified potential downward adjustments on certain price risk management assets and collateral subject to set-off. . . . [C]urrent management believes that these adjustments could fall in the range of $8 billion - $10 billion."

89. The magnitude of the fraud is also confirmed in the evidence presented by the Permanent Subcommittee on Investigations – The Role of the Financial Institutions in Enron's Collapse (See Exhibit A).

VII.

THE ENRON NOTE OFFERINGS

A. THE EXCHANGEABLE NOTES OFFERING

1. Offering Summary

90. In July of 1999, Enron made a public offering of 7% Exchangeable Notes, exchangeable into common stock of EOG Resources, Inc. (formerly named Enron Oil & Gas Company ("EOG Resources")). EOG Resources had formerly been a subsidiary of Enron, but is now an independent public company. Upon maturity of the Exchangeable Notes, Enron was contractually required to deliver

its remaining EOG shares to the holders of the Exchangeable Notes in satisfaction of the principal. After the Exchangeable Notes offering, Enron owned enough shares of EOG Resources to satisfy that obligation. In essence, Enron pre-sold its remaining 11.5 million EOG shares, through the Exchangeable Notes, with delivery expected at maturation of the notes, July 31, 2002.

91. Enron filed the preliminary prospectus and prospectus with the SEC on Form S3 filed July 23, 1999, Form S3/A as the Amendment No. 1 filed August 2, 1999, and Form S3/A as the Amendment No. 2 filed August 10, 1999 (collectively, the "registration statement"). Those signing the registration statement included Lay, Skilling, Causey, and Fastow, along with several directors. The underwriters were Goldman, Salomon, and Bank of America.

92. The registration statement for the Exchangeable Notes incorporated by reference Enron's annual financial statements for the year 1998 and for the first quarter of 1999:

> "The SEC allows us to 'incorporate by reference' the information we file with them, which means that we can disclose important information to you by referring you to those documents. The information incorporated by reference is an important part of this prospectus, and information that we file later with the SEC will automatically update and supersede this information. We incorporate by reference the documents listed below and any future filings made with the SEC under Sections 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act until we sell all of the securities:
>
> "– Our Annual Report on Form 10-K for the year ended December 31, 1998;

"– Our Quarterly Report on Form 10-Q for the quarter ended March 31, 1999; and

"– Our Current Reports on Form 8-K, filed January 26, 1999 and March 18, 1999.

The amendments to the registration statements incorporated

"– [Enron's] Annual Report on Form 10-K for the fiscal year ended December 31, 1998, as amended by Amendment No. 1 on Form 10-K/A; and

– [Enron's] Quarterly Report on Form 10-Q for the quarter ended March 31, 1999.

* * *

"The consolidated financial statements included in our Current Report on Form 8-K dated March 18, 1999 and the consolidated financial statements and schedules included in our Annual Report on Form 10-K for the year ended December 31, 1998, incorporated by reference in this prospectus and elsewhere in the registration statement, have been audited by Arthur Andersen LLP, independent public accountants, as indicated in their reports with respect thereto, and are incorporated by reference herein in reliance upon the authority of said firm as experts in giving said reports."

93. Also incorporated as part of the registration statement for the Exchangeable Notes offering, with Andersen's written consent, was its audit opinion for Enron's 1998 annual financial statements:

"CONSENT OF INDEPENDENT PUBLIC ACCOUNTANTS

"As independent public accountants, we hereby consent to the incorporation by reference in this registration statement of our report on the consolidated financial statements of Enron Corp. and subsidiaries dated March 5, 1999, included in Enron Corp.'s Form 10-K, for the year

ended December 31, 1998, and to all references to our Firm included in this registration statement.

s/ ARTHUR ANDERSEN LLP

Houston, Texas
July 23, 1999"

94. The prospectus for the Exchangeable Notes contained financial information for Enron for the period 1994 through March 31, 1999. This financial history painted a picture of a company that was strong and profitable. The assessment of historical financial information is particularly important for debt investors because they are looking for evidence that they will get their money back. The assessment of historic performance and trends is critical for debt investors because, unlike equity investors, they are not participating in the future growth of the company.

2. <u>Misstatements and Omissions</u>

95. In addition to the acknowledged material errors in the financial statements that resulted in the November restatements of Enron's financial statements for the 1997 to 2000 period, there was virtually no disclosure included in the prospectus as to the full existence and magnitude of the company's off-balance sheet activities and obligations. This information was not disclosed or even mentioned as a risk.

96. As described in the first report by the Court-Appointed Examiner, the disclosure of Enron's obligations related to the SPE transactions was not in accordance with GAAP.

97. The off-balance sheet transactions were very sophisticated and reliant on a particular legal interpretation and accounting treatment to ensure that they were properly excluded from Enron's financial statements. Given the evolution of both legal interpretations and accounting methodology with respect to financing vehicles, and the fact that any small change in legal interpretation or accounting practice could have resulted in the consolidation of the off-balance sheet structures, the risk that these transactions might be required to be included in Enron's financial statements should have been disclosed to investors. If these structures had been identified as a possible risk, potential investors would have been able to take the necessary steps to assess the impact these transactions would have on the value and viability of this investment.

98. For example, Plaintiffs believed they were investing in a company with $7.4 billion in debt obligations as of December 1998. Instead, the true obligations, as revealed after Enron's restatements, totaled $29.5 billion. This was a material misrepresentation. Enron's assets and liabilities were consistently and grossly understated from 1994 through 1999:

All Figures in Millions	Dec. '99	Dec. '98	Dec. '97	Dec. '96	Dec. '95	Dec. '94
Assets on Balance Sheet	33,381	29,350	22,552	16,137	13,239	11,966
Total Assets	60,364	51,475	36,103	27,690	23,798	21,132
Understatement	26,983	22,125	13,551	11,553	10,559	9166
Long Term Debt on Balance Sheet	7,151	7,357	6,254	3,349	3,065	2,805
Actual Obligations	34,134	29,482	19,805	14,902	13,624	11,971
Understatement	26,983	22,125	13,551	11,553	10,559	9,166

99. The financial picture and risk factors that were disclosed in the prospectus were materially incomplete and incorrect, resulting in the Plaintiffs' inability to fairly evaluate Enron's financial condition. Plaintiffs relied on the accuracy of the historical financial information contained in the prospectus for the Exchangeable Notes in making their investment decisions.

B. THE ZERO COUPON NOTE OFFERING

1. Offering Summary

100. In a private placement on February 7, 2001, Enron sold $1.9 billion in Zero Coupon Notes, convertible into common stock of Enron, to a group of financial institutions (the "Initial Purchasers"). These Initial Purchasers then sold the notes to institutional purchasers, and then to the public, once the registration statement for these notes had become effective. Citigroup/Salomon was the lead underwriter on the transaction.

101. The public offering of these notes began in June of 2001. Enron filed the preliminary prospectus and prospectus with the SEC on Form S3 dated June 1, 2001, Form S3/A as the Amendment No. 1 dated July 13, 2001, a Form 424(b)(3) prospectus dated July 25, 2001, and supplements 1-4 to the Form 424(b)(3) prospectus dated August 3, 2001, August 17, 2001, September 26, 2001, and October 12, 2001, respectively (collectively, the "registration statement"). Those signing the registration statement for these notes included Lay, Skilling, Fastow, and Causey.

102. Citigroup/Salomon, Deutsche Bank, JP Morgan, Bank of America, and Barclay's were the initial purchasers/underwriters of the Zero Coupon Notes. Subsequent buyers in the private placement (including Goldman) purchased with the intent to re-sell the Notes they had purchased. Goldman purchased some of the private placement and is a statutory underwriter.

103. The registration statement for these Notes stated that the private placement purchasers would be required to be named as a selling security-holder in the related prospectus, would be required to deliver a copy of the form S-3 to purchasers, would be "subject to certain of the civil liability provisions under the Securities Act in connection with such sales," and "may be deemed to be underwriters within the meaning of the Securities Act." Defendants purchased the

Zero Coupon Notes with a view to the distribution of those securities and were statutory underwriters of this offering.

104. The registration statement for the Zero Coupon Notes stated:

> "We incorporate by reference in this prospectus the following documents filed by us with the SEC:
>
> "– Our Annual Report on Form 10-K for the year ended December 31, 2000;
>
> "– Our Quarterly Report on Form 10-Q for the quarter ended March 31, 2001;
>
> "– Our Current Reports on Form 8-K filed with the SEC on January 31, 2001 and February 28, 2001; and
>
> "– The description of our capital stock set forth in our Registration Statement on Form 8-B filed on July 2, 1997.
>
> * * *
>
> "The consolidated financial statements and schedule included in our Annual Report on Form 10-K for the year ended December 31, 2000, incorporated by reference in this prospectus and elsewhere in the registration statement, have been audited by Arthur Andersen LLP, independent public accountants, as indicated in their reports with respect thereto, and are incorporated by reference herein in reliance upon the authority of said firm as experts in giving said reports."

105. Andersen had given its written consent to incorporation of its audit opinion for Enron's 2000 annual financial statements as part of the Prospectus and Form S3s on the Zero Coupon Notes:

"CONSENT OF INDEPENDENT PUBLIC ACCOUNTANTS

"As independent public accountants, we hereby consent to the incorporation by reference in this Registration Statement of our reports dated February 23, 2001, included in Enron Corp.'s Form 10-K, for the year ended December 31, 2000, and to all references to our Firm included in this Registration Statement.

s/ ARTHUR ANDERSEN LLP

Houston, Texas
May 31, 2001"

2. Misstatements and Omissions

106. In addition to the materially misstated earnings, cash flow from operations and debt (acknowledged in the November restatement and further confirmed in the April 2002 report by the Chief Restructuring Officer, the Powers Report, and the First Interim Report of the Court Examiner), the prospectus for the Zero Coupon Notes did not disclose the full existence and magnitude of Enron's off balance sheet activities and true financial obligations. They were not even mentioned as a risk factor. As discussed earlier, Enron disclosed debt of approximately $13 billion on its balance sheet. Current estimates of its true obligations are in the order of $60 billion and preliminary registered claims are $260 billion. In addition to the materially incorrect financial statements, all the financial ratios in the prospectus were wrong and misleading. Historic financial ratios are of particular importance to an investor in debt securities.

C. PLAINTIFFS' NOTE PURCHASES

1. Summary of Purchases

107. The Plaintiffs purchased Enron debt securities in October of 2001, and were damaged thereby. Prior to making any debt purchases, Plaintiffs, through their agent Silvercreek Management, Inc., read the prospectus for the Exchangeable Notes and the offering memorandum and prospectus for the Zero Coupon Notes and relied on the accuracy and completeness of the information contained therein. At the time that Plaintiffs were making their investments, Enron was one of the most highly recommended companies by the analysts on Wall Street – including by the Defendants. It was a BBB+ investment grade credit, with a multi-billion dollar equity market capitalization and a long history of stable financial performance. Because Plaintiffs were investing in senior bonds, Enron would have had to lose at least $20 billion of equity value before Plaintiffs' investment would potentially start to be impaired. Plaintiffs were not buying distressed securities. They were buying senior bonds of a BBB+ rated highly regarded company. Plaintiffs' investments were – or should have been – relatively low-risk yield-oriented trades. Unlike a common equity investment (or a distressed security investment), there was not a large potential upside. To be successful, all that was required was that the company stay solvent – which, at the time that investments were made, seemed certain. However, the financial

information in the prospectuses did not reflect the company's true financial condition.

108. Plaintiffs purchased the Enron securities as follows:

a. Plaintiff Silvercreek II Limited initially purchased Exchangeable Notes in October 2000. This position was completely sold prior to October 24, 2001. Plaintiff Silvercreek II Limited re-purchased Exchangeable Notes on October 24 and 25, 2001, and purchased Zero Coupon Notes on October 18 through October 26, 2001;

b. Plaintiff OIP Limited initially purchased Exchangeable Notes in October 2000. This position was completely sold prior to October 24, 2001. Plaintiff OIP Limited re-purchased Exchangeable Notes on October 24, 25, and 26, 2001, and purchased Zero Coupon Notes on October 19 through October 24, 2001;

c. Plaintiff Pebble Limited Partnership initially purchased Exchangeable Notes in October 2000. This position was completely sold prior to October 24, 2001. Plaintiff Pebble Limited Partnership re-purchased Exchangeable Notes on October 24 and 26, 2001, and purchased Zero Coupon Notes on October 19 through 24, 2001; and

d. Plaintiff Silvercreek Limited Partnership initially purchased Exchangeable Notes in October 2000. This position was completely

sold prior to October 24, 2001. Plaintiff Silvercreek Limited Partnership re-purchased Exchangeable Notes on October 24 and 25, 2001, and purchased Zero Coupon Notes on October 19 through 31, 2001.

2. Reliance on Prospectuses and Historic Financial Information

109. Prior to Plaintiffs' purchases of the Zero Coupon Notes, Enron had not made generally available to security holders an earnings statement covering a period of at least 12 months beginning after the effective date of the registration statement for those Notes. The prospectus was dated July 25, 2001, with supplements dated as late as October 12, 2001.

110. In purchasing the Zero Coupon Notes, Plaintiffs relied on the offering memorandum, the registration statement, and the financial statements incorporated by reference therein.

111. Prior to Plaintiffs initial purchases of the Exchangeable Notes, Enron had not made generally available to security holders an earnings statement covering a period of at least 12 months beginning after the effective date of the registration statement for these Notes. Prior to Plaintiffs repurchase of the Exchangeable Notes, Enron had not made generally available to security holders an earnings statement covering the year 2001.

112. In purchasing the Exchangeable Notes, Plaintiffs relied on the registration statement, the financial information contained therein, and the financial statements incorporated by reference therein, as well as other information disseminated by Enron and the Defendants.

3. Reliance on Publicly Available Information

113. In making the purchases of these Enron debt securities, Plaintiffs, and each of them, either directly or through their agent Silvercreek, read, reviewed, and relied upon the following:

a. The registration statement for the Zero Coupon Notes, and all information and documents incorporated therein by reference;

b. The offering memorandum prepared by the underwriters for the Zero Coupon Notes;

c. The registration statement for the Exchangeable Notes, and all information and documents incorporated therein by reference;

d. Enron's Annual Reports, including but not limited to the 1999 and 2000 Annual Reports, and the 1999 and 2000 Form 10Ks filed with the SEC, including the financial statements and auditor's opinions contained therein;

e. Enron's quarterly financial statements as filed with the SEC on Form 10Q, including but not limited to financial statements for the fiscal

years 1999 and 2000, and the first two quarters of 2001;

f. Enron's press releases and earnings announcements, including but not limited to public announcements as to the financial results for Enron for the year ends 1999 and 2000, and the first two quarters of 2001;

g. Information contained in the Enron Website;

h. Public credit ratings for the Enron notes purchased by Plaintiffs, including ratings, press releases, and information from S&P, Moody's and Fitch;

i. Investment research regarding Enron provided by securities brokerages, including but not limited to Defendants named in this complaint;

j. Representations made by Defendants' research analysts including but not limited to the Defendants named in this complaint, who all commented favorably on the October 2001 announced financial results of Enron and reiterated their "buy" ratings on the company; and

k. Representations made by Enron officers and representatives in conference calls with investors on October 16 and October 23, 2001.

4. Economic Losses Suffered as a Direct Result of Reliance on Information

114. Plaintiffs have sustained economic losses as follows:

a. Plaintiff Silvercreek II Limited has sustained economic losses in excess of **$40 million** in Enron Exchangeable Note trades and **$10 million** in Enron Zero Coupon Notes;

b. Plaintiff OIP Limited has sustained economic losses in excess of **$30 million** in Enron Exchangeable Note trades and almost **$3 million** in Enron Zero Coupon Notes;

c. Plaintiff Pebble Limited Partnership has sustained economic losses in excess **$10 million** in Enron Exchangeable Note trades and in excess of **$2 million** in Enron Zero Coupon Notes;

d. Plaintiff Silvercreek Limited Partnership has sustained economic losses in excess of **$20 million** in Enron Exchangeable Note trades and in excess of **$4 million** in Enron Zero Coupon Notes; and

e. Due to the reversal of accrued fees as a result of the Enron losses, Plaintiff Silvercreek Management Inc.'s direct share of the total losses is almost **$20 million** as to the Enron Exchangeable Note trades and in excess of **$4 million** as to the Enron Zero Coupon Bonds. In addition, Plaintiff Silvercreek Management, Inc. has

suffered additional losses of at least $190 million due to damages to its business as a result of the Enron losses.

VIII.

DEFENDANTS' NEGLIGENCE

115. As alleged above, Enron issued registration statements in connection with the Zero Coupon Notes and Exchangeable Notes offerings. The registration statement for the Zero Coupon Notes offering incorporated by reference Enron's financial statements for 2000 and the first quarter of 2001; and the registration statement for the Exchangeable Notes offering incorporated by reference Enron's financial statements for 1998 and the first quarter of 1999. The registration statement for the Zero Coupon Notes offering also included, with its permission, Andersen's opinion certifying the 2000 financials; and the registration statement for the Exchangeable Notes offering also included, with its permission, Andersen's opinion certifying the 1998 financials.

116. As noted above, the registration statements for both the Exchangeable Notes and Zero Coupon Notes misrepresented Enron's earnings, assets and liabilities, and failed to disclose key information that impacted the company's credit condition, in particular the off-balance sheet obligations and other hidden obligations. Material information and risk factors were withheld.

117. Prior to these offerings, the underwriters and statutory underwriters

for each offering were required to exercise due diligence in conducting an investigation into the business, operations, business strategy, prospects, financial condition, and accounting and management control systems of Enron, known as a "due diligence investigation." Had they conducted that investigation with due care, they would have discovered that the Enron financial statements that were incorporated into the offering materials, and other statements included therein concerning Enron's financial condition and operations, were materially false and misleading.

118. Although it consented to the inclusion of its unqualified opinion letters in the registration statements, Andersen also did not, in fact, exercise due diligence in certifying the 1998 and 2000 financial statements. Had it done so, it would have discovered that the Enron financial statements that were incorporated into the offering materials, and other statements included therein concerning Enron's financial condition and operations, were materially false and misleading.

IX.

DEFENDANTS' PARTICIPATION IN THE WRONGFUL SCHEME

A. The Off-Book Financial Transactions

1. The Purposes and Effects of Enron's Use of Special Purpose Entities

119. Enron's use of special purpose entities to manipulate its reported

financial statements was a primary reason why the financial statements were materially false and misleading.

120. The purpose and effect of the SPE transactions was to artificially inflate Enron's earnings and cash flow from operations and improperly exclude billions of dollars of recourse debt from Enron's balance sheet. The recourse debt was not disclosed and the proceeds from these obligations were actually reported as revenue and cash flow. The investment bank defendants directly participated in many of these transactions, and invested in many of the special purpose entities, knowing that they were being used to mislead the public, to generate false profits for Enron, and to hide debt and liabilities.

121. Ordinarily, majority owned subsidiaries of a company must be consolidated with the parent for financial reporting purposes, unless the parent does not actually exercise control over that subsidiary, or such control is temporary. If owned by a special purpose entity, the financial statements need not be consolidated if the parent does not maintain control over the assets transferred to that entity. As discussed below, Enron, with the active participation of the Defendants, created a series of SPEs that appeared to own assets; in reality, Enron actually controlled and continued to own the assets.

122. Enron took the position that an entity did not have to be consolidated if there was as little as 3% independent ownership of the entity. Although that

position had no clear foundation, many of the SPEs never even had 3% independent equity ownership, despite the efforts of several of the Defendants, described below, to make it appear that 3% independent ownership did exist. It was improper under GAAP to exclude these SPEs from Enron's reported financial results.

123. Enron's extensive use of SPEs resulted in a massive understatement of its obligations and overstatement of its earnings and cash flow. According to the Powers Report, which was commissioned by Enron, SPEs resulted in Enron reporting earnings for the third quarter of 2000 through the third quarter of 2001 that were almost $1 billion higher than should have been reported. At a private meeting with its bankers on November 19, 2001, Enron disclosed that in addition to the $13 billion in debt on its balance sheet it also had an additional $25.1 billion in debt that was not disclosed as debt on its financial statements. Of this additional $25.1 billion, $13 billion was attributed to transactions with SPEs. Ultimately, this deceptive practice defrauded investors, including Plaintiffs, of billions of dollars and resulted in the collapse of the company.

124. The SPE transactions were of two general types: asset "sales" (in reality disguised loans) and purported "hedging" transactions (such as the Rhythms transaction and Raptors transactions discussed below). Each transaction type was fraudulent and neither disclosed nor accounted for properly.

125. In an asset "sale" transaction, an Enron entity purported to sell an asset to an SPE (typically an underperforming asset at an inflated price) in exchange for cash and other consideration. That cash was obtained through a loan to the SPE from a financial institution. However, unlike most transactions in which a person sells an asset, in these SPE transactions, Enron:

(i) agreed to repay the debt incurred by the SPE to finance the purchase price (typically through an undisclosed total return swap with the financial institution);

(ii) continued to control the "sold" asset;

(iii) retained the full economic risk of the asset (both upside and downside); and in some cases,

(iv) treated the transaction as a loan for tax purposes.

126. In reality, the asset was not sold and the funds received from the financial institution were a disguised loan to Enron and should have been disclosed as such. Instead, Enron:

(i) recorded a gain from the "sale" of the asset (i.e. manufactured earnings);

(ii) categorized the loan proceeds from the financial institution as "cash from operations" (should have been cash from financing); and

(iii) did not consolidate the asset, thereby moving any debt associated with asset off-balance sheet, including the additional debt associated with the funding of the "sale" (i.e. substantial debt was hidden).

127. As stated by the court-appointed examiner in his first interim report "the only common characteristics in most of the Selected Transactions that support a sale characterization are the express terms of the documents that, among other things, state that the relevant transfers are sales and that Enron accounted for most of these transactions as sales" (i.e. they were "papered" as sales but in reality were loans).

128. It is clear that the lenders in these transactions (including. Citigroup/Salomon) viewed the arrangements as Enron debt (not a financing dependent upon the financial performance of the underlying assets). Lenders did not take a back-up security interest nor did they require delivery to them of legal opinions on true sale and non-substantive consolidation - the Lenders were really loaning money to Enron. In addition, the loan pricing was based on Enron's credit. However, they worked with Enron to create documentation that had the appearance of a sale, thereby misleading investors, including Plaintiffs.

129. In return for acting as the front man on these transactions, the SPEs (which had many financial institutions as investors including Citigroup/Salomon, and Bank of America) received a very attractive "specified return on their equity,"

and Enron guaranteed their debt. The SPEs did not take on any economic risk but were paid for a "service" (i.e. to perpetuate a fraud on investors).

130. In the "hedging" transactions, the SPEs were used to manufacture earnings and hide substantial losses on underperforming assets. These were highly fraudulent transactions as Enron was, in effect, "hedging" with itself. The company retained the risk associated with the assets and the sole benefit was the ability to deceptively manipulate its financial statements. These had a material impact on Enron's financial statements. Two examples are the Rhythms transaction and the Raptors transactions, described below. Again, the investors (including Citigroup/Salomon and Bank of America) in the SPEs used to front these transactions earned usurious returns.

131. For example, the rates of return on the four Raptor transactions were 193%, 278%, 2500% and a projected 125% respectively. According to the Powers Report "LJM2 was largely assured of a windfall from the inception of the transaction."

132. Hence, there was an economic cost to these transactions as the SPE, such as LJM2, was paid to act as a "front man" for the fraudulent scheme.

133. According to the Court Examiner, "Enron's obligations . . . entered into in connection with the SPE transactions were not properly disclosed in Enron's financial statements as required by GAAP."

2. Specific Examples of Improper Use of Special Purpose Entities

134. There are a number of examples of SPEs that Enron and its bankers used to deceive investors. The following sections summarize a few structures that are representative of the financial manipulation perpetrated by Enron and its investment bankers and advisors.

a. JEDI and Chewco

135. Joint Energy Development Investments Limited Partnership, which Enron called "JEDI", is a Delaware limited partnership. From June 1993 through November 1997, Enron Capital Management LP of Houston served as JEDI's general partner, and the California Public Employees' Retirement System ("CalPERS") was the limited partner. Because CalPERS was a genuinely independent entity, there was originally a legitimate basis for excluding JEDI's financial results from Enron's.

136. In November 1997 CalPERS bowed out as limited partner of JEDI, and no substitute independent investor could be found to take its place. The departure of CalPERS created a significant issue for Enron. As long as there was a truly independent limited partner, Enron was not required to consolidate JEDI in its financial statements and it was able to record a number of profitable transactions it had executed with JEDI. Unless the ownership structure of JEDI could be restructured and a new, independent investor added, Enron would be

The Exhibit(s) May

Be Viewed in the

Office of the Clerk