United States Courts
Southern District of Texas
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Michael N. Milby, Clerk of Court

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

MARK NEWBY, Plaintiff, v. ENRON CORPORATION, ANDREW S. FASTOW, KENNETH L. LAY and JEFFREY K. SKILLING, Defendants.	C.A. No. H-01-3624

PULSIFER & ASSOCIATES' FURTHER MEMORANDUM IN SUPPORT OF ITS MOTION TO BE APPOINTED LEAD PLAINTIFF FOR PURCHASERS OF ENRON 7% EXCHANGEABLE NOTES AND IN OPPOSITION TO COMPETING MOTIONS

Plaintiff Pulsifer & Associates ("Pulsifer"), the plaintiff in the related action *Pulsifer & Associates v. Kenneth L. Lay*, et al., C.A. No. H-01-4356, respectfully submits this memorandum in further support of its motion to be appointed a lead plaintiff for a class consisting of purchasers of Enron Corporation ("Enron" or the "Company") 7% Exchangeable Notes due July 31, 2002 ("7% Notes" or "Notes")). Pulsifer is an investment advisory firm located in Ipswich, Massachusetts, which had losses of $882,142 on Notes purchased on behalf of its clients.

A number of motions seeking appointment as lead plaintiff have been filed in this action.[1] None of the other movants purchased 7% Notes.[2]

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[1] Pulsifer believes there have been nine other class members, or groups of class members, who have filed motions.

[2] Some of the other movants did purchase other types of Enron debt securities. As discussed in this memorandum, purchasers of 7% Notes have unique claims not shared by purchasers of other debt securities.

As more fully explained below, Pulsifer respectfully submits that it should be designated a lead plaintiff to represent purchasers of the 7% Notes for the following reasons.

1. Pulsifer is an institutional investor with a financial interest of $882,142 in losses that meets all the requirements of the PSLRA for appointment as lead plaintiff.

2. Pulsifer is the only movant that purchased 7% Notes, and only purchasers of the Notes have standing to bring claims against the underwriters of the Notes.[3]

3. Any competing movant with substantial investments in the underwriters of the Notes has a conflict of interest with respect to claims against the underwriters. None of the competing movants purchased 7% Notes and therefore they would not share in any recovery from the underwriters. On the other hand, any recovery of damages from the underwriters would be prejudicial to their investment in the underwriters.[4]

4. Pulsifer's counsel are experienced in securities litigation of this nature and qualified to serve as lead counsel.

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[3] The 7% Notes are registered securities that were sold to the public in an initial public offering on or about August 10, 1999 pursuant to a registration statement filed with the SEC. There were three underwriters for the offering who have statutory liability to purchasers of the 7% Notes for false or misleading statements or omissions in the registration statement or prospectus, under Sections 11 and 12 of the Securities Act of 1933.

[4] According to public records, at least the movants State Board of Administration of Florida ("Florida"), Amalgamated Bank, Deutsche Asset Management (US) and Private Asset Management owned shares in one or more of the three underwriters.

DESCRIPTION OF THE 7% NOTES

The 7% Notes were issued by Enron pursuant to a Registration Statement and Prospectus dated August 17, 1999 (the "Offering"). The Offering was for ten million Notes at an issue price of $22.25 per share, and it raised gross proceeds of $225 million The Notes were, from the time of the Offering, listed and publicly traded on the New York Stock Exchange. The average trading volume of the Notes during 2001 was approximately 230,000 Notes a day. On January 15, 2002, the Notes were delisted by the New York Stock Exchange, but continue to trade over-the-counter. The 7% Notes were the only debt security of Enron that traded on a listed securities exchange.

The Notes are unusual in that the principal amount of the Notes is payable in shares of Enron Oil & Gas Co., Inc. ("Enron Oil & Gas"), a former subsidiary of Enron, on the date of maturity (July 31, 2002) at a conversion ratio (subject to adjustment based on the market price of Enron Oil & Gas common stock) of .8475 shares of Enron Oil & Gas common stock per Note. Although the Notes are to be paid at maturity in shares of Enron Oil & Gas rather than in cash, current holders of the Notes have no security interest in those shares and are unsecured creditors in Enron's bankruptcy.

The Offering of the Notes was underwritten by Goldman, Sachs & Co., Banc of America Securities LLC, and Salomon Smith Barney (a wholly-owned subsidiary of Citigroup, Inc.) (collectively the "Underwriters"). Enron's audited financial statements for fiscal years ended December 31, 1997 and December 31, 1998, and the audit opinion letter signed by Arthur Andersen LLP ("Andersen") for those two fiscal years representing that those financial statements were compiled in compliance with generally accepted accounting principles, were incorporated by reference in the Registration Statement.

The fiscal 1997 and 1998 financial statements contained in the Registration Statement were materially false, as has now been acknowledged by Enron and Andersen. Those financial statements were restated by Enron on November 8, 2001 to reduce net income for fiscal 1997 from $105 million to $9 million, and net income for fiscal 1998 from $703 million to $590 million.

Because all of the Notes were initially sold pursuant to the Offering and all Notes purchased since then are traceable to the Offering, purchasers of the Notes have statutory claims under Sections 11, 12(a)(2) and 15 of the Securities Act of 1933 (the "1933 Act"), 15 U.S.C. §§ 77k, 77o, and 77l(a)(2) against the underwriters of the Offering, against Andersen on account of its expert audit opinion included in the Registration Statement, and against Enron's officers and directors who signed the Registration Statement. Pulsifer's complaint (Civil Action No. H-01-4356) names as defendants the three underwriters for the Offering, Andersen, and four individual Enron officers who signed the Registration Statement for the Offering.[5] Only purchasers of the 7% Notes have these statutory claims against these defendants. While purchasers of other Enron securities have <u>different</u> claims against officers and directors of Enron, <u>only Pulsifer and other purchasers of the Notes have claims against the three underwriters of the Notes</u>.

Moreover, because the Notes were to be paid at maturity with shares of Enron Oil & Gas, which is now an independent company, the Notes are an unusual type of security and there will be substantial issues of materiality, causation and damages that are unique to the 7% Notes and not shared by purchasers of any other Enron equity or debt security.

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[5] It is anticipated that an amended complaint will name all of the then directors of Enron who signed the registration statement for the 7% Notes.

ARGUMENT

I. PULSIFER MEETS THE QUALIFICATIONS TO BE A LEAD PLAINTIFF

Pulsifer is an investment advisory firm which has been in business in Ipswich, Massachusetts for 30 years. It is an institutional investor that meets the qualifications for appointment as a lead plaintiff under the PSLRA, as demonstrated in the Memorandum of Law in Support of Pulsifer & Associates' Motion to be Appointed Lead Plaintiff and for Approval of its Selection of Lead Counsel, filed on December 21, 2001 (hereafter "Pulsifer Original Memorandum"). Pulsifer has a substantial financial interest in this litigation, with losses of $882,142 on investments in 7% Notes it made for its clients.[6]

II. PULSIFER IS THE ONLY PROPOSED LEAD PLAINTIFF WITH STANDING TO SUE THE UNDERWRITERS OF THE 7% NOTES

The United States Supreme Court has recognized that "to have standing to sue as a class representative it is essential that a plaintiff must be a part of that class..." Schlesinger v. Reservist Comm. to Stop the War, 418 U.S. 208, 216 (1974); *see DiJulio v. Digicon, Inc.*, 339 F.Supp. 1284, 1292-1293 (D. Md. 1972) ("...a party who lacks standing to sue on his own behalf may not assert claims on behalf of an alleged class of which he is not a member."); *Dolgow v. Anderson*, 43 F.R.D. 472, 492 (E.D.N.Y. 1968); *Herbst v. Able*, 278 F.Supp. 664, 668 n.6 (S.D.N.Y. 1967). In the present situation, a plaintiff like Pulsifer who has standing to assert the 7% Note purchasers' 1933 Act claims must be a plaintiff in this action

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[6] See Affidavit of Nathaniel Pulsifer (filed herewith), Exhibit 1, which lists transactions in 7% Notes.

The Southern District of Texas has held that plaintiffs who did not "acquire" any of the securities offered in a public notes offering had no standing to bring 1933 Act claims on behalf of a class of purchasers who did purchase securities in that offering:

> Plaintiffs therefore have failed to plead the express statutory standing requirements for an action under Section 11 and 12 of the Securities Act, and they have failed to state a cause of action upon which relief can be granted with respect to the Notes Offering.

In re Paracelsus Corp., Sec. Litig., 6 F. Supp.2d 626, 631 (S.D. Tex. 1998); *See also In re Taxable Mun. Bond Sec. Litig.*, 51 F.3d. 518, 522 (5th Cir. 1995) (dismissing RICO claims brought on behalf of a class for lack of standing when the class representative was not eligible to receive a loan under a federal farm loan program which was the source of the alleged conspiracy); *Smolen v. Deloitte, Haskins & Sells*, 921 F.2d 959, 965 (9th Cir. 1990) (dismissing claims under Section 12(2) of the 1933 Act when plaintiffs were not purchasers or offerees in the offering at issue); *In re Storage Technology Corp. Sec. Litig.*, 630 F.Supp. 1072, 1078 (D. Colo. 1986) (dismissing 1933Act claims when none of the parties to the class action had purchased the securities offered pursuant to the allegedly false offering documents). The only way that the 1933 Act claims of purchasers of 7% Notes can be prosecuted is if Pulsifer, the only Movant who purchased Notes, is appointed the lead plaintiff for those claims.

This Court's opinion in *In re Waste Management Securities Litigation*, 128 F.Supp. 2d 401 (S.D.Tex. 2000) is distinguishable. In *Waste Management*, this Court denied a movant's application to be appointed a lead plaintiff for an options subclass. *Id.* at 432. However, in *Waste Management*, there were no issues (i) with regard to standing to sue

the defendants on the options claim[7], or (ii) with regard to different issues of liability, causation and damages such as there are with the 7% Notes because of their unusual characteristic of being payable in shares of Enron Oil & Gas. In *Waste Management*, the issues of liability, causation and measurement of damages were the same for both the common stock and the option claims. The lead plaintiff in *Waste Management*, by litigating the common stock claim will have necessarily litigated the options claim. Here, the Notes are a significantly different security. The other movants will have no motivation or standing to litigate those claims, and in fact (as shown in the following section of this memorandum) have a disabling conflict because of their significant stock ownership in the underwriter defendants.

The appointment of lead plaintiffs who represent purchasers of different types of securities or who have distinct claims has been made by various courts when necessitated by the circumstances. *See, e.g., In re Alcatel Alsthom Securities Litigation*, Memoranda Opinion and Order, MDL 1263 (E.D. Tex. June 7, 1999 and June 14, 1999) (appointing separate leadership structure for open market class and class of persons who exchanged securities) (Finkel Aff., Exhs. A and B); *In re Bank of America Securities Litigation*, Order Appointing Lead Plaintiffs and Lead Counsel Pursuant to 15 U.S.C. §78u-4, MDL 1264 (E.D. Mo. April 20, 1999) (appointing a separate leadership structure for open market class and class of persons who exchanged securities) (Finkel Aff., Exh. C); *Norma J. Thurber v. Mattel, Inc.*, Order Appointing The Mattel Plaintiffs' Group As Lead Plaintiff Pursuant To §21D(a)(3)(B) Of The Securities Exchange Act of 1934 And Approving Lead Plaintiff's

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[7] The defendants on the common stock claims were the same as the defendants on the options claims, whereas in the case at bar only the 7% Notes purchasers have claims against the underwriters of the Notes.

Choice Of Counsel, No. CV-99-10368-MRP (CWx) (C.D. Cal. January 11, 2000) (appointing lead plaintiffs in the Consolidated Action for Violations of Sections 10(b), 20(a) and 14(a) of the Exchange Act and specifically designating counsel to be primarily responsible for prosecution of claims under Section 14(a))(Finkel Aff. Exh. D).

III. PURCHASERS OF THE 7% NOTES REQUIRE SEPARATE REPRESENTATION BECAUSE THE OTHER PROSPECTIVE LEAD PLAINTIFFS HAVE A CONFLICT OF INTEREST

As noted above, Pulsifer is the only proposed lead plaintiff who purchased 7% Notes. Purchasers of the Notes have statutory claims against the underwriters of the Notes, pursuant to Sections 11 and 12(2) of the Securities Act of 1933 ("1933 Act").[8] Only purchasers of the 7% Notes have standing to bring those claims.[9]

Pulsifer has a reasonable basis for believing that the other prospective lead plaintiffs either have, or likely have, a significant financial interest in the underwriters, which would give rise to a conflict of interest.[10]

As documented in the affidavit of Elizabeth Hutton, filed herewith, publicly available records indicate that certain of the movants have substantial holdings in the underwriters as follows:

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[8] Purchasers of the Notes also have these statutory claims against Andersen and Enron's officers and directors who signed the Registration Statement.

[9] These claims are clearly substantial. $225 million of the Notes were sold in an initial public offering and they traded around the $5 range (compared to the offering price of $22.50) before they were delisted.

[10] By pointing out that there is a conflict of interest, Pulsifer does not intend any criticism of the other movants or question their qualifications to serve as lead plaintiffs for investors in Enron securities other than the 7% Notes. As explained herein, their investments in the underwriters create an unavoidable conflict of interest with respect to claims against the underwriters.

Movant	Citigroup	Bank of America	Goldman, Sachs
Florida	$ 470	$196	$80
Amalgamated Bank	84	33	0
Deutsch Asset Mgmt	2,545	888	46
Private Asset Mgmt	21	1.7	2.9

Note: All numbers represent stock holdings in $ millions.

Pulsifer has not been able to determine from publicly available records the holdings in the underwriters of other proposed lead plaintiffs with substantial losses, such as the pensions funds of New York City, Georgia, Ohio, Washington, Alabama, Local 710, University of California and Central States. However, in light of the substantial sizes of these funds, and the prominence of the underwriters,[11] there is a reasonable basis to believe that these prospective lead plaintiffs also have material holdings in the stock of one or more of the underwriters.

In one of the largest securities fraud class actions to date, the New Jersey federal court held that a significant financial interest in a defendant creates a conflict of interest that is sufficient to defeat the statutory presumption of adequacy under the PSLRA. The court ordered separate counsel for investors in a particular security because the designated lead plaintiff owned substantial amounts in the underwriter of that security and therefore was not an adequate representative for those investors in pursuing a claim against that underwriter. *In re Cendant Corp. Securities Litigation*, 182 F.R.D. 144, 149-150 (D.N.J. 1998). *See also Aronson v. McKesson HBOC, Inc.*, 79 F.Supp.2d 1146, 1150-

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[11] Citigroup, for example, has the fifth largest market capitalization of any public company in the United States, with a market value of approximately $250 billion. The market value of Bank of America and Goldman, Sachs is approximately $95 billion and $43 billion, respectively. Counsel for Pulsifer has written counsel for each of these proposed lead plaintiffs requesting disclosure of their clients' investments or other business relationships with the underwriters. If this information is not provided, Pulsifer will seek leave of court to obtain this limited discovery pursuant to the provisions of Section 27(a)(3)(B)(iv) of the1933 Act, as amended by Section 101 of the PSLRA.

1151 (N.D.Cal. 1999)(noting absence of "an actual conflict of interest" as in *Cendant, supra*, in rejecting separate representation); *In Re Tyco International Ltd.*, Nos. 00-MD-1335-B, 2000 WL 1513772 at *6 n.14 (D.N.H. Aug. 17, 2000)(noting that litigating an action "with only a single lead plaintiff would be problematic where the lead plaintiff was subject to a conflict of interest that prevented it from adequately representing the interests of a subclass."); *In re Microstrategy Inc. Securities Litigation*, 110 F.Supp.2d 427, 439 (E.D.Va. 2000)(in designation of lead plaintiff, court noted that there were "no apparent conflicts between [lead plaintiff] and the class."); *see also* 15 U.S.C. §§ 77z-1(a)(3)(B)(iii)(II)(aa) (adequacy presumption rebutted when that plaintiff will not fairly and adequately protect the interests of the class).

In *Cendant*, the court had determined that various public pension funds were the presumptively most adequate group of plaintiffs to serve as lead plaintiffs. The group had significant investments in Merrill Lynch, which had served as the underwriter for a security offered by the defendant called "Prides" securities. Investors in Prides sought separate representation, arguing that the lead plaintiff group's investments in Merrill Lynch prevented it from adequately protecting their interests in pursuing a claim against Merrill Lynch. The lead plaintiff group responded by "publicly (and theatrically) pledg[ing] to the Court and gallery to pursue any and all viable claims against Merrill Lynch . . .". *In re Cendant*, 182 F.R.D. at 149. Despite the lead plaintiff group's assurances, the court noted that "logic and mathematics speak louder" and found the lead plaintiff group could not "overcome this substantial conflict of interest and fully protect the interests of the Prides-holders." *Id.*

The same situation exists here. Movants who did not invest in the 7% Notes, but who have significant holdings of stock in the underwriters, have a disabling conflict of

interest. On the one hand, they will not share in any recovery from the underwriters because they have no claims against the underwriters of the 7% Notes. On the other hand, damages paid by the underwriters will adversely affect their investments in the underwriters. Accordingly, not only would they have no financial motive to seek the maximum recovery from the underwriters, it would be against their financial interest to recover damages from the underwriters.[12]

Indeed, the premise of the lead plaintiff provisions of the PSLRA is that the class member with the "largest financial interest in the relief sought in the action" will have the greatest motivation to vigorously prosecute the action. See 15 U.S.C. § 78u-4(a)(3)(B)(iii)(I);15 U.S.C. § 77z-1(a)(3)(B)(iii)(I). This Court should not stand the PSLRA on its head and appoint a lead plaintiff for the 7% Note purchasers that not only has no financial interest in the relief sought for this class, but whose financial interests in its investments in the stock of the underwriters gives them a conflict of interest.

The existence of the unique claims of the 7% Notes purchasers against the underwriters is particularly significant in the circumstances of this case. As has been widely reported, damages from Enron's financial collapse are in the tens of billions of dollars. Damages of this magnitude means that only a fraction of investor losses can realistically be expected to be recovered from Enron's insurance policies, the personal

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[12] Pulsifer currently has 13,098 shares of Bank of America worth approximately $85,000; 512 shares of Citigroup worth approximately $25,000; and approximately 10,000 Citigroup Capital VI DEF INT Trust PFD stock, 6.875%, due March 15, 2009, worth approximately $250,000. Pulsifer has no conflict of interest because it will share in any damages recovered from the underwriters. Not only are Pulsifer's losses in the 7% Notes substantially greater than its investments in the underwriters, its benefit from any recovery from the underwriters will vastly outweigh any adverse affect to its investments in the underwriters. Pulsifer's small investments in the underwriters represent an infinitesimal percentage of their market capitalizations. Moreover, the value of the Citigroup preferred stock should not be affected by any damage award against Citigroup. In sum, Pulsifer's position is no different from any lead plaintiff who also continues to have an investment in a defendant. Being a current shareholder of a defendant company does not disqualify a class member from being an adequate lead plaintiff. *See, e.g., In re Frontier Ins. Group, Inc. Securities Litigation*, 172 F.R.D. 31, 44 (E.D.N.Y. 1997).

assets of its responsible directors and officers and Andersen, or from other sources of recovery who may yet be named as defendants. The Notes purchasers' claims against the three underwriters of the Notes, which only the Notes purchasers have, offer the only practical prospect for recovering all or a substantial part of their damages. Thus, it is especially important that the 7% Notes purchasers have their own representative to pursue these claims on their behalf.

In approving a class action settlement in *In re Lease Antitrust Litigation*, 186 F.R.D. 403 (S.D. Tex. 1999), Judge Jack of this district wrote that:

> each group of attorneys was motivated to seek the maximum recovery for their de facto subclass during the negotiation of the allocation....and any conflict of interest between the two subclasses was "resolved through the normal pull and tug of the factions within the class itself." That is, as in In re Paine Webber, the fact that separate attorneys negotiated on behalf of subclasses with distinct legal claims reasonably and adequately protected the interest of the class.

Id at 425, quoting *In Re Paine Webber*, 171 F.R.D. 104, 123-124 (S.D.N.Y. 1997). Equally in the case at bar, the 7% Notes purchasers deserve their own representation and "separate attorneys" to seek to maximize their recovery and to adequately protect the interest of the 7% Notes class.

IV. RESPONSE TO THE MOTION OF THE ARCHDIOCESE OF MILWAUKEE SUPPORTING FUND MOTION

The Archdiocese of Milwaukee Supporting Fund ("Milwaukee") has filed a motion seeking appointment as lead plaintiff for purchasers of publicly traded debt securities of Enron. According to its certification, Milwaukee has losses of $70,000. Pulsifer has much greater losses of approximately $880,000. It is therefore presumptively the more adequate lead plaintiff. As an institutional investor with a larger financial interest, and which satisfies the requirements of Rule 23, Pulsifer should be appointed lead plaintiff for purchases of

debt securities over Milwaukee. *In re Waste Management, Inc. Securities Litigation*, 128 F. Supp. 2nd 401, 432 (S.D. Texas 2000).

V. THE COURT SHOULD APPROVE PULSIFER'S CHOICE OF COUNSEL

Pulsifer's Original Memorandum and the Declaration of Thomas G. Shapiro filed therewith demonstrate that Pulsifer's counsel are experienced and qualified to represent Pulsifer as Lead Counsel for the class of purchasers of 7% Notes. The Court should approve Pulsifer's selection of counsel.

CONCLUSION

For the reasons set forth herein and in Pulsifer's Original Memorandum filed December 21, 2001, Pulsifer should be appointed lead plaintiff for a class of purchasers of Enron's 7% Exchangeable Notes due 7/31/02 and Pulsifer's selection of counsel should be approved

Dated: January 22, 2002.

By its attorneys,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the **PULSIFER & ASSOCIATES MEMORANDUM IN SUPPORT OF ITS MOTION TO BE APPOINTED LEAD PLAINTIFF FOR PURCHASERS OF ENRON 7% EXCHANGEABLE NOTES AND IN OPPOSITION TO COMPETING MOTIONS** has been forwarded via United States Regular mail on this 22nd day of January 2002 to all known counsel of record listed below:

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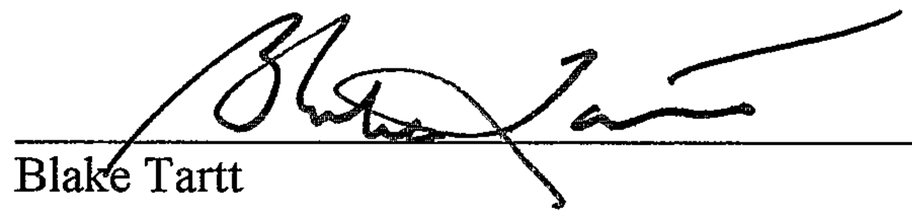

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