IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

United States Courts
Southern District of Texas
FILED

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Michael N. Milby, Clerk

MARK NEWBY, et al., Plaintiffs, v. ENRON CORP., et al., Defendants.	§	No. H 01-CV-3624 (Consolidated Action)
PIRELLI ARMSTRONG TIRE CORPORATION RETIREE MEDICAL BENEFITS TRUST, Derivatively On Behalf of ENRON CORPORATION, et al., Plaintiffs, v. ENRON CORP., et al., Defendants.	§	No. H 01-CV-3645 (Consolidated Action)
TITTLE, et al., Plaintiffs, v. ENRON CORP., et al., Defendants.	§	No. H 01-CV-3913 (Consolidated Action)

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MEMORANDUM OF LAW IN SUPPORT OF THE MOTION OF THE *TITTLE, RINARD* AND *KEMPER* PLAINTIFFS FOR A PRELIMINARY ORDER FREEZING AND IMPOSING A CONSTRUCTIVE TRUST OVER INDIVIDUAL DEFENDANTS' ASSETS AND LIMITED EXPEDITED DISCOVERY INTO THOSE ASSETS

I. INTRODUCTION

As this Court is aware, certain plaintiffs in securities class actions filed before this Court under the caption of *Newby v. Enron Corp., et al.,* (Civil Action No. H-01-3624), have filed a motion seeking to freeze the ill-gotten assets of certain Enron officers who profited by selling their Enron stock while they were in possession of materially adverse nonpublic information concerning the true (and disastrous) state of Enron's finances.[1] On January 8, 2002, the Court ruled that (i) Plaintiffs were entitled to such preliminary relief upon a proper showing, consisting of "allegations and evidence showing that the defendants were concealing assets, were transferring them so as to place them out of the reach of post-judgment collection, or were dissipating assets;" but (ii) denied the motion on the record before it given the absence of such an evidentiary showing. *Newby v. Enron Corp.*, Memorandum and Order at 38, 42 (S.D. Texas Jan. 8, 2002) (hereinafter "Freeze Order"). Finally, the Court ordered the securities plaintiffs to file a motion for expedited discovery pursuant to the Private Securities Litigation Reform Act ("PSLRA"), 15 U.S.C. § 78u-4 (Supp. 2001). That motion is currently pending before this Court.

Now, Plaintiffs in the *Tittle, Rinard* and *Kemper* actions join in the security plaintiffs' freeze motion on behalf of the Enron Corp. Savings Plan ("Savings Plan"), the Employee Stock Ownership Plan ("ESOP"), and their participants and beneficiaries (hereinafter, "ERISA Plaintiffs"),[2] to be decided after discovery into the assets of the individual Enron officers at

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[1] That motion, *Plaintiffs' Ex Parte Application for (1) A Temporary Restraining Order and Order to Show Cause Why A Preliminary Injunction Should Not Be Entered Freezing And Imposing A Constructive Trust Over Insider Trading Proceeds, (2) Accounting of Insider Trading Proceeds, and (3) Limited Expedited Discovery,* (hereinafter "Freeze Motion") was filed by the plaintiffs in *Amalgamated Bank et al. v. Kenneth L. Lay, et al,* (Civ. Action No. H-01-4198 (S.D. Tex.). As a securities class action, that case has now been consolidated before this Court under the *Newby* caption.

[2] ERISA refers to the Employee Retirement Income Security Act of 1974, 29 U.S.C. 1001 *et seq.*

issue. Simply put, like the securities plaintiffs, the ERISA Plaintiffs have strong claims for equitable relief against specific individuals who wrongfully profited through the breach of duties owed to the Plans and their participants; hence, pursuant to the Freeze Order, this Court has the authority to freeze those assets pending the resolution of these claims. Likewise, as more and more information is revealed, as a parade of Enron insiders invoke the Fifth Amendment rather than answer questions about their involvement in the misconduct that destroyed Enron and decimated the retirement savings of its current and former employees, and as untold reams of documents have been shredded, it has become apparent that the available corporate assets and insurance policies can not even begin to make the Savings Plan and its participants whole. Given the estimated more than $1 billion in damages suffered by the Savings Plan and the ESOP, and the bankruptcy of Enron, the wrongfully obtained assets of the named individuals will form an essential portion of any meaningful recovery on behalf of the Savings Plan and the ESOP.

Accordingly, the ERISA Plaintiffs join in the freeze motion, and respectfully request that (1) this Court permit them to conduct discovery into the assets of the specific named individuals who are defendants in their cases; and (ii) after an evidentiary hearing, the Court grant the motion to freeze those assets pending the final resolution of their claims against the defendants.

II. THE COURT HAS ALREADY DELINEATED THE PROPER ANALYSIS FOR DETERMINING WHETHER IT HAS THE POWER TO ORDER A PREJUDGMENT FREEZE OF DEFENDANTS' ASSETS

As the Court has held, under *Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond Fund, Inc.*, 527 U.S. 308 (1999), the securities plaintiffs are authorized to seek a prejudgment asset freeze in aid of the equitable relief they seek against certain named defendants. Because the Freeze Order cogently sets out the proper analysis, and because this Court is quite familiar with the appropriate authorities, the ERISA Plaintiffs will not re-hash that analysis here.

Pursuant to the Court's analysis, the ERISA Plaintiffs have the same right to freeze the prejudgment assets of the named defendants in their actions as the securities plaintiffs do upon a proper showing in their action – and for the same reasons. Simply put, because (i) the ERISA

Plaintiffs seek various forms of equitable relief and (ii) there is a sufficient nexus between the equitable relief asserted by the ERISA Plaintiffs and the ill-gotten assets the ERISA Plaintiffs seek to freeze, this Court can (and should) freeze those assets upon a proper showing that the transient assets may disappear if they are not frozen. *See, e.g.,* Freeze Order at 14-15, *citing United States ex rel. Rahman v. Oncology Associates P.C.*, 198 F.3d 489, 493 (4th Cir. 1999).

III. THE EQUITABLE REMEDIES SOUGHT BY THE ERISA PLAINTIFFS AUTHORIZE THE PREJUDGMENT FREEZE OF DEFENDANTS' ASSETS

On February 12, 2002, the ERISA Plaintiffs filed a Derivative Complaint on behalf of the Savings Plan and the ESOP.[3] Based in part on the recently revealed information that has led the ERISA Plaintiffs to file the Motion of the *Tittle, Rinard* and *Kemper* Plaintiffs for Appointment of An Independent Fiduciary for the Enron 401(k) Plan, the Savings Plan and ESOP participants now seek the authority to bring derivative claims on behalf of their respective Plans given the demonstrated unfitness of the current fiduciaries. As the Derivative Complaint makes clear, the Savings Plan asserts claims for equitable relief such that the prejudgment freeze of certain named defendants' assets is proper. Given the circumstances of this case, such relief is not only proper but essential to preserve the ERISA Plaintiffs' ability to recover a meaningful portion of their losses at the hands of these defendants.

A. The ERISA Plaintiffs Seek The Imposition Of A Constructive Trust And An Equitable Accounting Pursuant To Their Claims Under The Federal Securities Laws

The Savings Plan has now brought securities fraud claims pursuant to Section 10(b) of the Securities Exchange Act (15 U.S.C. § 78j(b)), and Rule 10b-5 promulgated hereunder (17 C.F.R. § 240.10b-5). Derivative Complaint, Count VI. Based on recently revealed information, the defendants in this Count include Kenneth L. Lay ("Lay"), Jeffrey K. Skilling ("Skilling"), Andrew S. Fastow ("Fastow"), Michael Kopper ("Kopper"), Richard A. Causey ("Causey"), and

[3] First Amended Derivative Complaint For The Enron Corp. Savings Plan And Complaint For The Enron Corp. Stock Ownership Plan For Violations Of Federal Securities Law, The Employment Retirement Income Security Act of 1974 ("ERISA"), The Racketeer Influenced And Corrupt Organizations Act ("RICO"), and Texas Common Law (hereafter "Derivative Complaint").

Richard B. Buy ("Buy"). Pursuant to those claims, the Savings Plans seeks, *inter alia*, the following forms of equitable relief:

> That this Court impose a constructive trust on the profits made by Lay, Skilling, Fastow, Causey, and Buy from the sales of Enron stock made while in possession of materially adverse insider information, in breach of fiduciary duties owed to the Savings Plan and its participants as shareholders; [and]
>
> That this Court order an equitable accounting for all profits made by defendants Lay, Skilling, Fastow, Kopper, Buy and Causey from trading Enron stock while in possession of materially adverse insider information, in breach of fiduciary duties owed to the Savings Plan participants as shareholders.[4]

Hence, like the securities plaintiffs, the ERISA Plaintiffs bring cognizable claims for equitable relief – and "the fact that substantial 'money damages are claimed along with equitable relief does not defeat the district court's equitable powers.'" Freeze Order at 24 (quoting *Rahman*, 198 F.3d at 494-95. Indeed, "[t]he cases confirm that when a plaintiff asserts a cognizable claim in equity, even if in conjunction with a claim for money damages, a court has the power to issue a preliminary injunction freezing defendant's assets . . . ." Freeze Order at 24.

Moreover, the Court has also held that the remedies of constructive trust and equitable accounting are cognizable remedies for the very 10(b) claims asserted herein. *See id.* at 33-34 (noting that securities plaintiffs would be entitled to a constructive trust if they could "identify a specific asset or fund of money, held by each defendant, consisting of sales of Enron stock made while in the possession of materially adverse insider information, in breach of fiduciary duties owed to shareholders.") *Id.* at 34, *Citing* DOBBS ON REMEDIES § 4.3(2)); *see also id.* at 37 (securities plaintiffs had "asserted a cognizable claim to an equitable accounting for profits defendants earned by trading Enron securities during the Class Period.")

Hence, based on the very same claims as the securities plaintiffs, the ERISA Plaintiffs are entitled to a preliminary order freezing the assets of the named individual defendants Lay, Skilling, Fastow, Causey, Buy and Kopper.

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[4] Derivative Complaint, Prayer for Relief at E-F, pages 79-80.

B. Plaintiffs Also Seek Equitable Relief Under ERISA That Justifies The Prejudgment Freeze Of Assets Of The ERISA Fiduciaries

The ERISA Plaintiffs also seek equitable remedies pursuant to their ERISA claims for breach of fiduciary duty against the fiduciaries of the Savings Plan and the ESOP. Indeed, under ERISA§ 409(a), 29 U.S.C. § 1109(a), in addition to being personally liable for damages and disgorge of ill-gotten gains, a breaching fiduciary "shall be subject to such other equitable and remedial relief as the court may deem appropriate . . ." It is well-settled that ERISA authorizes preliminary as well as permanent injunctive relief to be awarded against breaching fiduciaries. *See, e.g., Schwartz v. Interfaith Medical Center,* 715 F. Supp. 1190 (E.D.N.Y. 1989); *see also Mertens v. Hewitt Assocs.*, 508 U.S. 248, 256 91993) ("It is true that, at common law, the courts of equity had exclusive jurisdiction over virtually all actions by beneficiaries for breach of trust.")

In their recently filed Memorandum Of Law In Support Of The Motion Of The *Tittle, Rinard* And *Kemper* Plaintiffs For Appointment Of An Independent Fiduciary For The Enron 401(K) Plan ("Appointment Motion"), the ERISA Plaintiffs describe in detail their ERISA claims, and demonstrate their likelihood of success on the merits of the claims such as to satisfy the prerequisites for preliminary relief pursuant to Fed. R. Civ. P. 65(a). *See, e.g., Busters, LLC v. Brennan,* 177 F.3d 258, 265 (5th Cir. 1999) (preliminary injunction or temporary restraining orders available on showing: (1) a substantial likelihood of success on the merits; (2) a substantial threat that the plaintiff will suffer irreparable injury if the injunction is denied; (3) that the threatened injury outweighs any damage that the injunction might cause defendants; and (4) that the injunction will not disserve the public interest.) Once again, rather than repeat that voluminous briefing, the ERISA Plaintiffs respectfully refer the Court to the Appointment Motion.

Based on the alleged breaches of fiduciary duties by Enron, the Savings Plan Administrative Committee (the "Committee") and its members, the ERISA Plaintiffs seek equitable remedies, including, among others, (1) the rescission of each purchase of Enron stock

made by the Savings Plan during the relevant period when the stock was artificially inflated; and (2) the disgorgement by the Plan fiduciaries of any profits they made through sales of Enron stock they made while in possession of adverse material information that they did not disclose to the Savings Plan or its participants in violation of their duties of prudence, loyalty and care. In this regard, it has recently been revealed that Cindy K. Olson ("Olson"), an Enron Human Resources Executive Vice President and a member of the 401(k) Plan Committee who became a Savings Plan trustee in January of 2001, has since sold over $2 million dollars of Enron stock. *See* Ex. 3 to Appointment Motion (*Wall Street Journal*, Feb. 6, 2002). For his part, James S. Prentice ("Prentice"), an Enron executive and the Chairman of the Savings Plan Administrative Committee, sold some $900,000 worth of Enron stock in June, 2001, alone. *Id.* ***Because the ill-gotten proceeds of the Enron stock sales of Committee members are available to help satisfy the claims of the Savings Plan, the ESOP and their members, this Court can (and should) freeze those assets pending the resolution of this case.***

Accordingly, the ERISA Plaintiffs also seek to freeze all the proceeds from the sale of Enron stock during the relevant period for all of the ERISA fiduciaries who are known at this time, namely, Olson, Prentice, fellow Savings Plan fiduciaries Mikie Rath ("Rath"), Sheila Knudsen ("Knudsen") Rod Hayslett ("Hayslett"), Tod Lindholm ("Lindholm"), Paula Rieker ("Rieker"), and Mary K. Joyce ("Joyce"), and ESOP Trustee William D. Gathman ("Gathman"). *See* Derivative Complaint at 30-38 (naming and identifying defendants).

IV. THE ERISA PLAINTIFFS SHOULD BE PERMITTED DISCOVERY TO ESTABLISH THE INSIDER TRADING OF THE DEFENDANTS, AND TO DETERMINE THE LOCATION OF THE PROCEEDS OF THOSE TRADES

A. Pursuant To The Court's Freeze Order, The ERISA Plaintiffs Need Discovery Concerning The Defendants' Assets

As the Court has held, in order to obtain the equitable relief sought herein, Plaintiffs must demonstrate (i) that the individual defendants engaged in insider trading during the relevant period, and (ii) that the proceeds of those transactions are at risk of being removed from the Court's reach. Since the Freeze Order was entered, evidence connected with Lay has already

demonstrated that risk with respect to him; indeed, Lay's wife has publicly announced a plan to sell various properties in order to achieve "liquidity." This same "liquidity" would, of course, allow the assets to be easily transferred so as to place them out of the reach of post-judgment collection.[5]

In order to make the requisite showing, the ERISA Plaintiffs seek leave to take limited discovery of the following defendants: Olson, Rath, Knudsen, Hayslett, Lindholm, Rieker, Prentice, Joyce, Gathman, Lay, Skilling, Fasotw, Kopper, Causey and Buy.

Significantly, unlike the securities class action plaintiffs who originally brought the freeze motion, ***the ERISA Plaintiffs are not subject to the PSLRA's stay of discovery***. *See* 15 U.S.C. § 77z-1 (imposing stay on discovery pending motions to dismiss in securities class action cases). Hence, the only obstacle to Plaintiffs' seeking of discovery is the Court's Stay Order, entered on January 8, 2002. Accordingly, Plaintiffs respectfully request that the Court lift that stay and allow them to serve discovery on the named defendants.

B. The Discovery Sought By The ERISA Plaintiffs

Much like the securities plaintiffs, the ERISA Plaintiffs seek the following limited discovery from each of the named individual defendants in advance of an evidentiary hearing to determine whether the grant of a preliminary freeze Order is proper:

1. Document Requests

> (1) For each purchase, sale, pledge, encumbrance or ownership of any Enron security during the Relevant Period (from January 1, 1998 through November 28, 2001) (including stock options), documents which identify the brokerage house through whom or which the stock was transacted;
>
> (2) All documents identifying the location of proceeds of insider sales evidenced in (1) above or any assets derived from such proceeds (including institution, account number and account name, or, if the proceeds or assets are in the possession, custody or control of a person, the identification and location of any such person);

[5] *See* Third Supplemental Brief In Support Of Amalgamated Bank's *Ex Parte* Application For Particularized Expedited Discovery From Defendant Arthur Andersen LLP and Enron Executives, Including Defendant Ken Lay To Preserve Evidence.

(3) Computer printouts summarizing the individual defendants' options holdings, options exercised, options vested and not vested, option grant dates, option vesting schedules, and option prices during the Relevant Period;

(4) Computer printouts, summaries or other documents (*e.g.*, account statements) concerning the individual defendants' transactions involving margin trading or derivative securities in Enron's stock (including, without limitation, zero-cost dollars, cot-plus dollars or equity swaps) during the Relevant Period;

(5) In connection with the limited partnerships Enron transacted with: formation documents, documents identifying all limited and general partners of the partnerships including ownership percentage, documents identifying all Enron personnel who received compensation or profit from those ownerships, documents summarizing all transactions between Enron and those partnerships or between those partnerships and any Enron employee, and documents reflecting any compensation or profit resulting from the association of any Enron employee with the limited partnerships;

(6) Notes, memoranda and work papers concerning the review of accounting practices being conducted by Enron's inside and outside auditors, or concerning the restatements of Enron's previously reported results from operations;

(7) All Enron Board of Director reports and minutes generated during the Relevant Period;

(8) All documents produced to the United States Securities and Exchange Commission, including document indices; and

(9) The document and computer data destruction or retention policy the defendants caused Enron to adopt and implement.

2. Depositions

For each category of document listed above, the ERISA Plaintiffs seek an order providing for depositions of the individual defendants concerning the above-referenced topics, limited to two hours, upon three calendar days' notice.

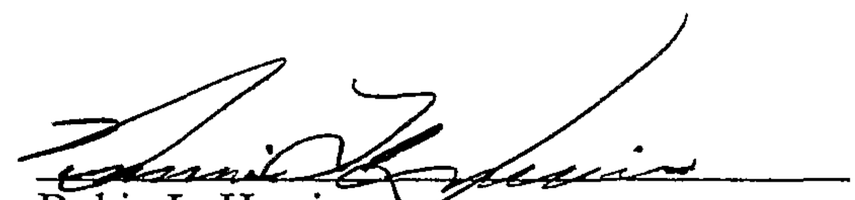
V. CONCLUSION

For the reasons stated above, as well for those stated in the Freeze Order and in the briefs submitted by the securities plaintiffs, the ERISA Plaintiffs request that (1) this Court permit them to conduct discovery into the assets of the specific named individuals who are defendants subject

to equitable claims in their cases (namely, Olson, Rath, Knudsen, Hayslett, Lindholm, Rieker, Joyce, Prentice, Gathman, Lay, Skilling, Fasotw, Kopper, Causey and Buy); and (ii) after an evidentiary hearing, the Court grant the motion to freeze those assets and place them in a constructive trust pending the final resolution of the claims against these defendants.

DATED this 14th day of February, 2002.

Respectfully submitted,



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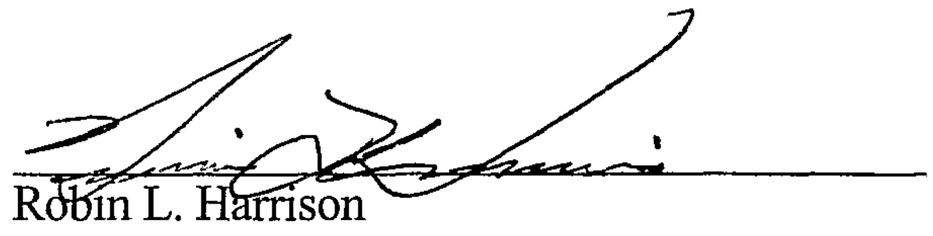
CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of this Memorandum of Law was served on all known counsel of record by first class mail or telecopy this 14th day of February, 2002.



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