

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

MAR 01 2002 JS

MICHAEL N. MILBY, CLERK OF COURT

MARK NEWBY, et al., Individually and On §
Behalf of All Others Similarly Situated, §

Plaintiffs, §

v. §

ENRON CORP., et al., §

Defendants. §

C.A. No. H-01-3624
(Consolidated)

CLASS ACTION

**THE OUTSIDE DIRECTORS' SURREPLY REGARDING LEAD PLAINTIFF'S
REQUEST FOR DISCOVERY IN AID OF REQUEST FOR ASSET FREEZE**

Robin C. Gibbs
State Bar No. 07853000
S.D. Tex. I.D. No. 4790
1100 Louisiana Street, Suite 5300
Houston, Texas 77002
Telephone: (713) 650-8805
Facsimile: (713) 750-0903

ATTORNEY-IN-CHARGE FOR DEFENDANTS

Robert A. Belfer, Norman P. Blake, Ronnie C. Chan,
John H. Duncan, Wendy L. Gramm, Robert K.
Jaedicke, Charles A. LeMaistre, and Joe H. Foy.

OF COUNSEL:
GIBBS & BRUNS, L.L.P.
Kathy D. Patrick
State Bar No. 15581400
Jean C. Frizzell
State Bar No. 07484650
Robert J. Madden
State Bar No. 00784511
Jeremy L. Doyle
State Bar No. 24012553
1100 Louisiana Street, Suite 5300
Houston, Texas 77002
Telephone: (713) 650-8805
Facsimile: (713) 750-0903

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TO THE HONORABLE JUDGE OF THE UNITED STATES DISTRICT COURT:

The Outside Directors have already pointed out to the Court that Lead Plaintiff has completely failed to offer any particularized allegation that any Outside Director is now or is likely in the future to transfer or dissipate assets, such as would be necessary to permit discovery into their personal and private financial records.¹ In its reply, Lead Plaintiff essentially ignores this fundamental defect, devoting less than two pages of its briefing to offer in reply one case, that directly contradicts its position, and a red herring argument that seeks to substitute the hypothetical possibility of undue harm in the place of the requirement that it plead allegations that can support the discovery it seeks. In order to bring to the Court's attention Lead Plaintiff's complete failure to contradict, justify, or excuse its inability to cross over the "pleading threshold"² necessary to permit asset discovery, the Outside Directors file this brief surreply.

Despite its defects, Lead Plaintiff's reply is at least admirable for its candor in admitting that "Plaintiff Lacks Information to Demonstrate Dissipation in Support of a Freeze Motion . . ." See Lead Plaintiff's Reply at 5. However, Lead Plaintiff then attempts to transform the vice of having absolutely no information indicating asset dissipation into a virtue by mis-citing *In re Websecure*,

¹The Outside Directors' response in opposition sets forth a number of defects in Lead Plaintiff's request for discovery and the Outside Directors continue to urge the Court to reject Lead Plaintiff's request based upon each or any of those defects. In this surreply, the Outside Directors focus only on the failure of Lead Plaintiff to offer particularized allegations of the type necessary to support its request for discovery.

²"[T]he price of entry, even to discovery, is for the plaintiff to allege a factual predicate concrete enough to warrant further proceedings, which may be costly and burdensome. Conclusory allegations in a complaint, if they stand alone, are a danger sign that the plaintiff is engaged in a fishing expedition . . . the factual allegations must be specific enough to justify dragging a defendant past the pleading threshold . . ." *DM Research, Inc. v. College of Am. Pathologists*, 170 F.3d 53, 55 (1st Cir. 1999) (emphasis added).

Inc., 1997 WL 770414 (D. Mass. Nov. 26, 1997) for the proposition that mere suspicion that a defendant may be dissipating assets, and nothing more, is sufficient to permit prejudgment asset discovery in order to prevent the hypothetical “undue prejudice” that could result if such imagined asset dissipation is actually happening and is not stopped. Contrary to Lead Plaintiff’s assertion, the *Websecure* case, stands for no such rule and, indeed, directly contradicts this contention.

In *Websecure*, as in the present case, the plaintiffs sought a prejudgment freeze of assets. *Id.* at 1. However, unlike Lead Plaintiff in this case, the *Websecure* plaintiffs specifically alleged that the defendant was actively dissipating assets and pointed the court to three specific “indications of dissipation of assets” in the defendant’s publicly filed financial reports. *Id.* at 3. Although the *Websecure* court found these allegations insufficient to support the granting of a preliminary injunction, it did find that one of the indications of dissipation of assets alleged by the plaintiff “raises a serious question of dissipation” and therefore allowed the plaintiff limited discovery to inquire further into the matter. *Id.*

Thus, contrary to Plaintiff’s description of the case, the *Websecure* court did not allow the plaintiffs discovery because they, like Lead Plaintiff here, had no information regarding asset dissipation. Rather, the *Websecure* court allowed such discovery precisely because the plaintiffs had such information and had presented the court with particularized allegations and information that the court found “raises a serious question of dissipation,” justifying further inquiry into these matters. *Id.*

Lead Plaintiff’s tortured reading of *Websecure*, and the argument that it advances here based on that reading, turns the pleading requirements of the Federal Rules of Civil Procedure and the automatic stay of the PSLRA on their heads. As Lead Plaintiff would have it, a plaintiff is entitled

to prejudgment asset discovery, not because it has information that raises serious questions of asset dissipation (as was the case in *Websecure*), but because it has no such information but can nonetheless postulate some hypothetical “undue prejudice” that could befall it if, and only if, the imagined activity is in fact happening and is not stopped.

This argument effectively transforms the “undue prejudice” exception to the PSLRA automatic stay from a hurdle to discovery that a securities plaintiff must surmount even if its factual allegations would otherwise merit immediate discovery, into a wide open doorway to expedited discovery into areas that a plaintiff would otherwise never be permitted to inquire into because it could make no factual allegation to support such discovery. Indeed, as Lead Plaintiff views the law, a plaintiff need only postulate some “undue prejudice” that could befall it if some theoretical activity, that it has no information is actually occurring, is not stopped in order to be entitled to immediate discovery into these areas to test its surmise, suspicions, and speculations.

Lead Plaintiff’s argument notwithstanding, it should be an unremarkable observation to note that a plaintiff’s ability to imagine the possibility of some injury that could befall it, if some supposed activity it has no information is actually occurring is not stopped, is not and has never been a permissible basis for discovery in any civil proceeding, much less one governed by the PSLRA. *See e.g. Migdal v. Rowe Price-Fleming Int’l, Inc.*, 248 F.3d 321, 328 (5th Cir. 2001) (“plaintiffs cannot simply promise the court that once they have completed discovery, something will turn up. Rather before they are permitted to proceed to discovery, plaintiffs must have some factual basis for believing that a legal violation has actually occurred.”); *In re Transcript Int’l Sec. Lit.*, 57 F. Supp.2d 836, 841 (D. Neb. 1999) (*citing* H.R. Conf. Rep. No. 104-369, 104th Cong. 1st Sess. at 31-32 (1995) (noting that one purpose of the PSLRA is the “protection of the corporate defendants from

plaintiffs' counsel 'discovering' their way into facts which could allow them to amend an initially frivolous complaint so as to state a claim.").

Thus, for all the forgoing reasons, and for all the reasons set forth in their response, the Outside Directors respectfully request that the Court deny Plaintiff's request for expedited discovery as to them.

Respectfully submitted,

GIBBS& BRUNS, L.L.P.

By: Robin C. Gibbs/gjm.
Robin C. Gibbs
State Bar No. 07853000
S.D. Tex. I.D. No. 4790
1100 Louisiana Street, Suite 5300
Houston, Texas 77002
Telephone: (713) 650-8805
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Houston, Texas 77002

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Facsimile: (713) 750-0903

CERTIFICATE OF SERVICE

I certify that a true and correct copy of the forgoing was served on all counsel on March 1, 2002 via facsimile, U.S. Mail, Federal Express or hand delivery.



Robert J. Madden