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

United States Courts
Southern District of Texas
FILED
MAR 14 2002
Michael N. Milby, Clerk

MARK NEWBY, et al., Individually and On Behalf of All Others Similarly Situated,	§	
	§	
Plaintiffs,	§	C.A. No. H-01-3624
	§	**(Consolidated)**
v.	§	
	§	CLASS ACTION
ENRON CORP., et al.,	§	
	§	
Defendants.	§	

THE OUTSIDE DIRECTORS' REPLY IN SUPPORT OF THEIR MOTION FOR LIMITED RECONSIDERATION OF THE COURT'S ORDER OF JANUARY 8, 2002 REGARDING THE COURT'S AUTHORITY TO ORDER A PREJUDGMENT RESTRAINT OF DEFENDANTS' ASSETS

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TO THE HONORABLE JUDGE OF THE UNITED STATES DISTRICT COURT:

Lead Plaintiff does not dispute that the essential premise of Judge Rosenthal's Order of January 8, 2002 is a showing that each of the Outside Directors owed a common law fiduciary duty to the purchaser class that Lead Plaintiff purports to represent. Likewise, Lead Plaintiff makes no attempt to rebut or distinguish the case law cited in the Outside Directors' motion establishing that the existence of a fiduciary duty in the corporate context is a question of law determined according to the law of the state of incorporation. Nor does Lead Plaintiff dispute that under Oregon law -- the place of Enron's incorporation -- corporate directors owe no fiduciary duties to share purchasers such as the plaintiff class.

Instead, Lead Plaintiff seeks to establish the existence of the requisite common law fiduciary duty sufficient to support an "historically available" equitable claim[1] by relying exclusively on an inapposite line of cases that purports to define, not the existence of common law fiduciary duties, but rather the scope of liability of corporate directors for insider trading in the context of the federal securities laws. Because the line of authority relied upon by Lead Plaintiff was never intended to be used, and has never been used, as the basis for establishing fiduciary liability in any context out side of the statutory federal securities context in which it was developed, Lead Plaintiff's argument fails.

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[1]Judge Rosenthal explained that "[d]eciding whether a plaintiff has properly stated a claim for equitable relief requires an examination, in accordance with *Grupo Mexicano*, of the equitable claims historically available." *See* Order at 26. In *Grupo Mexicano*, the Supreme Court explained that "the equity jurisdiction of the federal courts is the jurisdiction in equity exercised by the high Court of Chancery in England at the time of the adoption of the Constitution and enactment of the Judiciary Act of 1789. . . . [T]he equitable powers conferred by the Judiciary Act of 1789 did not include the power to create remedies previously unknown to equity jurisprudence." *Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond Fund, Inc.*, 527 U.S. 308, 332 (1999).

As Lead Plaintiff acknowledges, the line of authority on which it rests its argument has its genesis in a widely cited decision on 10b liability for insider trading, *In the Matter of Cady, Roberts & Co.*, SEC Release No. 34-66681961, 1961 WL 60638 (November 8, 1961).[2] In *Cady, Roberts*, the SEC took note of the fact that, under the common law, officers and directors who sell shares of a corporation owe no fiduciary duty to the purchasers of such shares, but held that this rule would not be carried forward into interpreting the scope of liability under the anti-fraud provisions of section10b:

> Whatever distinction may have existed at common law based on the view that an officer or director may stand in a fiduciary relationship to existing stockholders from whom he purchases but not to members of the public to whom he sells, it is clearly not appropriate to introduce these into the broader anti-fraud concepts embodied in the securities acts.

Cady, Roberts, 1961 WL 60638 at * 5.

Thus, in *Cady, Roberts* the SEC expressly adopted a standard for the duties of insider sellers of shares under section 10b that was acknowledged to be separate and apart from, and more expansive than, traditional common law fiduciary duties. Although courts following and citing to *Cady, Roberts*, including those cited in Lead Plaintiff's brief, have referred to the heightened statutory duty of corporate inside sellers under the securities law as a "fiduciary duty" (despite the clear expansion of this duty beyond the scope of common law fiduciary duties), it is clear that the duty recognized in *Cady, Roberts* and relied on here by Lead Plaintiff is not a common law fiduciary duty of the kind that can support a common law breach of fiduciary claim, the existence of which forms the basis of Judge Rosenthal's reasoning in the January 8, 2002 Order. This fact was expressly

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[2]Lead Plaintiff's brief describes *Cady, Roberts* as "the seminal case" in the line of authority on which it relies. *See* Lead Plaintiff's Response at 9.

acknowledged in *Cady, Roberts* itself, and has been recognized by other courts as well.

For instance, in *O'Connor & Assoc. v. Dean Witter Reynolds, Inc.*, 529 F.Supp. 1179 (S.D.N.Y. 1981) it was explained that "[u]nlike the fiduciary duty, which is owed only to the corporation and its shareholders, this additional [*Cady, Roberts*] duty is owed to the investing public, to those investors trading contemporaneously with the insider." *Id.* at 1187 (citations and quotations omitted, emphasis added). Likewise, in *Leung v. Schuler*, 2000 WL 264328 (Del. Ch. 2000), the court dismissed a common law claim for breach of fiduciary duty against corporate directors on the grounds that the plaintiff class of prospective shareholders (like the putative purchaser class here) was owed no fiduciary duty, and went on to state that:

> This does not mean that the plaintiff class has no available remedy. Although the Court finds that the complaint does not allege actionable disclosure claims under state law, the plaintiff's family has made the same conduct the subject of a federal disclosure claims that are currently being pursued in the separate companion Federal action in the United States District Court of Delaware. The existence (or nonexistence) of disclosure liability under the Federal Securities laws is not dependant upon the existence of a fiduciary relationship."

Id. at * 6 n. 21 (emphasis added).

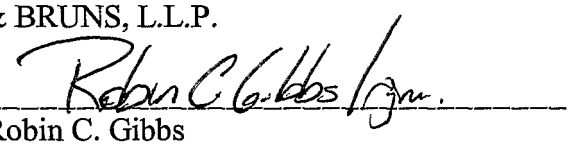
In sum, Lead Plaintiff now seeks to uproot the *Cady, Roberts* "fiduciary duty" from the only context in which it was ever intended to, and has ever been held to, apply -- defining the scope of liability for insider trading under the federal securities laws -- and plant it instead into a context where it has never been held to apply -- defining the scope of common law fiduciary duties that can support an "historically available" claim for equitable relief. Based on this reasoning, Lead Plaintiff would have the Court hold that the purchaser class it purports to represent is entitled to equitable relief on account of the existence of a fiduciary relationship that was allegedly breached, despite the

fact that here, just as in *Leung*, the purchaser class has not and cannot, as a matter of law, assert or maintain a common law cause of action for breach of a fiduciary duty under the authorities cited by Lead Plaintiff or under controlling Oregon law. This approach is contrary to logic, it is without support or precedent in the case law, and accordingly, it should be rejected here.

Thus, for all the forgoing reasons, and all the reasons set forth in their motion for reconsideration, the Outside Directors respectfully request that the Court reconsider the Order of January 8, 2002 and enter in its place a new order providing that the Court has no authority under its general equitable powers to grant the restraint of the Outside Director's assets that Plaintiff seeks here.

Respectfully submitted,

GIBBS& BRUNS, L.L.P.

By: 

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CERTIFICATE OF SERVICE

I certify that a true and correct copy of the forgoing was served on counsel on all counsel on March 14, 2002 via U.S. Mail, Federal Express, hand delivery or facsimile transmission.

Robert J. Madden