

As to Mr. Rice, Plaintiffs' allegations of scienter are similarly lacking. Plaintiffs do not allege (1) what Mr. Rice specifically knew at any point in time, (2) what material undisclosed information Mr. Rice may have known, (3) when or how Mr. Rice became aware of any such undisclosed material information, or (4) any facts giving rise to an inference that Mr. Rice acted with the required state of mind. In fact, the only allegation of scienter relates to the Plaintiffs' "expert" witness who bases his conclusion on a "statistical" analysis of stock trading activity.

Plaintiffs' allegations of insider trading are also inadequate. Plaintiffs have failed to identify what material inside information Mr. Rice was aware of or anything suspicious or unusual about Mr. Rice's sales of Enron stock.

In short, as to Mr. Rice, Plaintiffs have not met the particularity requirement, the basis requirement, or the strong inference requirement of pleading an action under the PSLRA or Federal Rule of Civil Procedure 9(b) ("Rule 9(b)"). Plaintiffs' section 10(b) and Rule 10b-5 claims against Mr. Rice should be dismissed because, under the Rule 9(b) and PSLRA standards, (1) Plaintiffs have failed to allege that Mr. Rice made any material misrepresentation or omission, (2) Plaintiffs have failed to plead scienter or reliance, and (3) Plaintiffs have failed to state their claims with factual particularity.

I. THE APPLICABLE PLEADING REQUIREMENTS

The standards applicable to pleading this securities fraud case against Mr. Rice are set forth in the Joint Brief of Officer Defendants, which is incorporated herein by reference. Among the pertinent requirements, as stated by this Court, is "Plaintiffs must allege what actions each Defendant took in furtherance of the alleged scheme and specifically plead what he learned, when he learned it, and how Plaintiffs know what he learned." *In re Securities Litigation BMC Software, Inc.*, 183

F. Supp. 2d 860, 886 (S.D. Tex. 2001). As regards alleged misstatements, Plaintiffs must “specify the statements contended to be fraudulent, identify the speaker, state when and where the statements were made, and explain why the statements were fraudulent.” *Id.* at 865 n.14 (quoting *Williams v. WMX Techs., Inc.*, 112 F.3d 175, 177 (5th Cir.), *cert. denied*, 522 U.S. 966 (1997)). It is therefore necessary to examine the “specific” allegations that have been made against Mr. Rice.

II. THE ALLEGATIONS SPECIFICALLY REFERENCING RICE DO NOT MEET RULE 9(b) OR PSLRA PLEADING REQUIREMENTS.

“Specific” allegations in the Complaint about Mr. Rice fall into five categories: (1) allegations of his position within Enron; (2) allegations regarding bonuses received; (3) references to statements made (but not attributed specifically to Mr. Rice) during presentations to analysts; (4) vague allegations of knowledge, representations, and omissions; and (5) allegations of his stock sales.

A. Plaintiffs’ Allegations of Position are Insufficient to State a Claim.

Many of the Complaint’s references to Mr. Rice are allegations as to his position or office within Enron. For example:

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|-------------------|--|
| Paragraphs 1, 993 | Mr. Rice is listed as a top Enron executive. |
| Paragraph 83(p) | Mr. Rice was Chairman and Chief Executive Officer of EBS since 6/00. |
| Paragraph 88 | Mr. Rice is listed as part of Enron’s “Management Committee” for 1997, 1998 and 2000 and part of Enron’s “Executive Committee” for 1999. |

None of these references contains anything that would remotely state a claim against Mr.

Rice and such allegations are clearly insufficient to allege any scienter on the part of Mr. Rice.² Taken most favorably to the Plaintiffs, the allegations establish only that Mr. Rice was an officer of Enron and served on related committees during some portion of the class period.³

B. Plaintiffs' Allegations Regarding Bonuses are Insufficient to State a Claim.

Plaintiffs allege that Mr. Rice received bonus payments of \$6.4 million in addition to his salary, for 97, 98, 99 and 00 based on Enron's false financial reports and because Enron stock hit certain performance targets. Plaintiffs' allegations are insufficient to allege any scienter on the part of Mr. Rice.⁴

C. Plaintiffs' Allegations Regarding Statements Made During Presentations to Analysts Are Insufficient to State a Claim.

In paragraph 173, Plaintiffs allege that Mr. Rice appeared at the Bank of America Investment Conference on 9/29/99. Plaintiffs further allege that on 9/30/99, Bank America [sic] issued a report that stated "Mr. Rice detailed Enron's rapidly evolving strategy to capitalize on the exploding demand for high-bandwidth products and services" (Complaint ¶ 173.) This is insufficient to allege any fraudulent statement by Mr. Rice. Plaintiffs do not allege exactly what Mr. Rice said, much less how or why it was false or misleading, or how or why he was supposed to have known

² Allegations as to Mr. Rice's status as an officer of Enron are not sufficient to state a claim against him for securities fraud. *See* Joint Brief of Officer Defendants, Section II.A.

³ While the Complaint alleges that "virtually all of Enron's top insiders have been kicked out of the Company," (Complaint ¶ 4), that statement does not apply to Mr. Rice. In September 2001, upon the initiative of Mr. Rice, he and the company agreed to terminate his employment inasmuch as there was little for him to do given EBS's demise.

⁴ Allegations as to Mr. Rice's receipt of bonuses in his capacity as an officer of Enron are not sufficient to state a claim against him for securities fraud. *See* Joint Brief of Officer Defendants, Section II.B.

of any alleged falsity. The allegation is also insufficient to allege any scienter on the part of Mr. Rice because: (1) the statement is written by a third party; (2) there is no allegation or evidence that Mr. Rice ever saw the statement, endorsed it, adopted it, or “entangled” himself in its making, *see In re Securities Litigation BMC Software, Inc*, 183 F. Supp. 2d 860, 871 (S.D. Tex. 2001); and (3) there is no allegation that Mr. Rice ever actually made the statement.

In paragraphs 309 and 317, Plaintiffs allege that Mr. Rice was one of a group of Enron executives who participated in presentations to and/or discussions with analysts and investors about Enron’s businesses and financial performance. As alleged, two of the three presentations included conference calls as well as “follow-up conversations” and the third presentation included “formal presentations and break-out sessions.” In each of these paragraphs, Plaintiffs allege that the Enron executives “stated” various matters set forth in bold, italicized bullet points. Such general allegations fail to allege any fraudulent statement by Mr. Rice, since it is impossible to ascertain exactly what was said, when, in what circumstances and to which analysts and/or investors (none of whom are identified by name). But even more problematic, nowhere in these two paragraphs do Plaintiffs attribute any specific statement(s) to Mr. Rice. Instead, in each instance, Mr. Rice is lumped in with four other Enron representatives. In the end, then, there are *no* allegations as to what statements *Mr. Rice* made, *if any*.

D. Plaintiffs’ Allegations Regarding Vague References to Mr. Rice’s Purported Knowledge, Representations, and Omissions Are Insufficient to State a Claim.

In the entire Complaint, only six specific allegations regarding knowledge, representations, and/or omissions are made in connection with Mr. Rice:

In paragraph 214(i) and repeated both in paragraphs 300(h) and 339(h), Plaintiffs allege that

EIN (Enron Intelligent Network) “did not work” and by “Spring 99, the development of the EIN had “deteriorated into chaos.” Plaintiffs further allege that by 10/99, EBS was “in crisis mode,” and “Rice, CEO of EBS, realized the EIN was a disastrous failure.” Initially, Plaintiffs’ anonymous quotations about EIN’s problems in 99 ignore the fact that EBS was not even launched until January, 2000, and Plaintiffs’ allegation that Mr. Rice realized that EIN was a disastrous failure by October, 1999, cannot be reconciled with their allegation that Mr. Rice “was Chairman and Chief Executive Officer of EBS *since 6/00.*” (Complaint ¶ 83(h) (emphasis added).) This allegation cannot support a securities fraud claim because there are no allegations as to what statements Mr. Rice made, *if any*; Plaintiffs simply purport to know what Mr. Rice “realized” about EBS at a point in time before EBS was even launched and before Mr. Rice was CEO of EBS. This allegation is also insufficient because it fails to allege any scienter on the part of Mr. Rice.

In paragraph 276, Plaintiffs allege that in a December 18, 2000, Enron press release announcing that Enron and Blockbuster had begun delivering movies via the Blockbuster Entertainment On-Demand service over Enron's broadband network in certain test markets, Mr. Rice stated:

"Much has been achieved as we launch this service – the successful development and execution of a solid technical and commercial foundation for delivering entertainment on-demand," said Ken Rice, chairman and CEO of Enron Broadband Services. "Customers have been extremely receptive to our offering, and the solution we have created will serve as the basis for delivering a wide range of valuable content globally."

(Emphasis in original.) This allegation cannot possibly support a fraud claim against Mr. Rice because Plaintiffs do not allege that any part of this statement is false or misleading. To the contrary, Plaintiffs’ own Complaint acknowledges that by the end of 2000, “there were . . . test systems in four cities.” (Complaint ¶ 524.)

In paragraphs 300(j)(iv) and 339(j)(iv), Plaintiffs complain that “[d]espite EBS’s failed operations, EBS CEO Rice publicly stated that broadband’s assets had an estimated value of \$36 billion.” Plaintiffs then quote an unnamed “high-ranking former EBS manager - one of the very first broadband employees” as responding, “I don’t know what metric he was looking at. We were well into the business by then and in the process of flopping.” (Complaint ¶¶ 300(j)(iv) and 339(j)(iv).) This allegation is insufficient to allege any fraudulent statement. Plaintiffs do not say that this estimate was fraudulent; they quote an anonymous source who apparently disagrees with Mr. Rice. Plaintiffs also fail to state when Mr. Rice is alleged to have revealed that estimate or what disclosure he gave of the methods and assumptions underlying any such estimate. Plaintiffs also fail to allege whether the estimate was before or after Blockbuster failed to deliver the content required for video on demand or before or after Enron’s potential counterparties for broadband intermediation became uncreditworthy and the market melted down. Such factors make the timing of the alleged estimate critical and the deficiency in Plaintiffs’ pleading fatal.

In paragraph 300(o) and repeated in paragraphs 339(o) and 523, Plaintiffs allege that EBS employees knew from the beginning that EBN could not deliver VOD as represented by Enron. Apparently in support of this proposition, Plaintiffs allege that in 6/00, Rice personally tried to recruit two EBS engineers, who had left Enron out of frustration over EBS Problems, by telling them that they were essential because “we [Enron] can’t deliver the Blockbuster deal.” This statement cannot support a securities fraud claim against Mr. Rice because Plaintiffs have not alleged this statement was false or misleading. Further, even if Mr. Rice had made such a statement, it was not made publicly and thus could not have been relied on by investors or the market, and even if it is intended to show knowledge by Mr. Rice, Plaintiffs do not allege what knowledge it shows Mr. Rice

had.

Plaintiffs' next two allegations about Mr. Rice simply reference alleged actions taken by him. In paragraph 475, Plaintiffs allege that Enron sold LJM certain telecommunications assets known as Backbone and recognized it as revenue. Plaintiffs allege that Andrew Fastow headed up the related negotiations, and at the end of the paragraph, Plaintiffs note that "Causey and Rice were also involved in the negotiations." In paragraph 604, Plaintiffs allege that Mr. Rice engaged in questionable accounting in connection with a pipeline in Puerto Rico that blew up. Plaintiffs' allege that the pipeline should have been written off or reported as an impaired asset, but instead, Rice purportedly structured a deal in which Enron put a fiber optic system where the pipeline was located in order to avoid the \$13 million write-off and to book earnings through certain "contractual terms." Even if these factual allegations made by Plaintiffs were true, neither of these alleged actions by Mr. Rice can form the basis of a securities fraud action against him. Plaintiffs altogether fail to allege that any false or misleading statements were made in connection with either action, and they further fail to attribute any statement to Mr. Rice.

Taken together or separately, these statements and alleged omissions do not raise a securities fraud claim against Mr. Rice. While throughout the Complaint Plaintiffs sprinkle conclusory allegations to the effect that "each of the statements issued between [certain dates] was false and misleading" (*see, e.g.*, paragraph 390), Plaintiffs make no effort to state why or how any of the statements by Mr. Rice are false or misleading. Indeed, as shown above, the statements are not misleading on their face. Each of the statements attributed to Mr. Rice in the Complaint is contained within longer documents that contain a variety of statements from a number of different people or sources. In that context, a conclusory statement that "each" statement is false and

misleading does not meet the PSLRA requirement to state specifically how any statement complained about was false or misleading or how the statement was material. Conclusory allegations or legal conclusions masquerading as factual conclusions will not suffice to prevent the granting of a motion to dismiss. *Southern Christian Leadership Conference v. Supreme Court of State of Louisiana*, 252 F.3d 781, 786 (5th Cir. 2001); *Campbell v. City of San Antonio*, 43 F.3d 973 (5th Cir. 1995); *Fernandez-Montes v. Allied Pilot's Ass'n*, 987 F.2d 278, 284 (5th Cir. 1993). Finally, none of the statements or omissions by Mr. Rice is material. Plaintiffs do not allege facts to show that any of the statements or omissions attributed to Mr. Rice had an impact on the market price of Enron stock.

E. Plaintiffs Do Not Allege Actionable “Insider Trading” by Rice.

In Paragraphs 83(p), 84 and 401, Plaintiffs cite trading history of Mr. Rice in an effort to assert an insider trading claim against him. As they do with all “Enron defendants,” Plaintiffs attempt to support its “insider trading” claim with the conclusion of its “expert” that it was statistically *likely* that Mr. Rice’s stock trades were made with “the possession and use of material adverse non-public information.” (Complaint ¶ 415.) This “expert analysis” is clearly statistically lacking and does not take into account other material information such as portfolio concentration, vesting dates, and other material individualized trading information. The Hakala Declaration should not even be considered by this Court. *See* Joint Brief of Officer Defendants, Section II.C.2. Plaintiffs’ effort to allege insider trading against Mr. Rice fails, and the insider trading claims against Mr. Rice should be dismissed.

Plaintiffs have failed to plead anything “unusual” or “suspicious” about Mr. Rice’s stock sales, or otherwise meet the requirements of Rule 9(b) and the PSLRA for pleading illegal insider trading,

as reviewed in Section II.C.1 of the Joint Brief of Officer Defendants. None of the insider trading paragraphs identifies any specific material, non-public information known to Mr. Rice when he made the stock sales about which Plaintiffs complain. Plaintiffs only generally allege that Mr. Rice was in possession of some unspecified “adverse undisclosed information.” (Complaint ¶ 83(h).) They do not plead that Mr. Rice was aware of any specific non-disclosure; nor do they allege that Mr. Rice was aware of any public misstatement. Paragraph 83(h) is further flawed by the absence of any allegation that the undisclosed information (itself unidentified) was material. The Complaint is devoid of (1) any specific allegations concerning nonpublic information (2) of which Mr. Rice was aware or (3) how Mr. Rice knew the undisclosed information was material or nonpublic. *See In re Securities Litigation BMC Software*, 183 F. Supp. 2d at 916.

Plaintiffs also make no specific allegations regarding how Mr. Rice’s sales were improper, unusual, or suspicious. The closest Plaintiffs come is to allege that “[t]hese defendants’ illegal insider selling escalated massively as Enron’s stock moved to more inflated levels during the Class Period and also when internally they knew the scheme was unraveling.” (Complaint ¶ 403.) This is yet another instance of group pleading, prohibited by the PSLRA.

Beyond that defect, Plaintiffs’ asserted insider trading claim against Mr. Rice fails — and must be dismissed — for the following reasons. First, Plaintiffs do not — and cannot — allege a “pattern” of trading by Mr. Rice. He had sales transactions in 16 separate months, from October 1998 to August 2001. He sold from \$26 a share to \$82 a share. According to the Complaint, over half of the shares he sold (and for which he received close to 50 percent of his proceeds) were sold during the seven months just prior to his entering into a voluntary termination agreement with Enron; one third of the total shares he sold (and for which he received 25 percent of his proceeds) were sold

within *two months* of his entering into that agreement. Finally, Plaintiffs point to no sales history outside the class period against which the relevant sales could be measured. *See In re Securities Litigation BMC Software, Inc.*, 183 F. Supp.2d at 901-02 (citing *In re Silicon Graphics, Inc. Sec. Litig.*, 183 F.3d 970, 987 (9th Cir.), *reh'g and reh'g en banc denied*, 195 F.3d 521 (9th Cir. 1999), for proposition that “stock sales cannot be viewed as ‘unusual’ where defendant “ha[s] no significant trading history for purposes of comparison.”)

Second, Mr. Rice’s insider trades or “pattern” are inconsistent with Plaintiffs’ allegations concerning the “pattern” of other Defendants who, according to the Complaint, were also “aware” of some undisclosed information. Indeed, according to the Complaint, one or more (but not all) of the Defendants collectively sold in almost every month of the Class Period. Plaintiffs then claim that each Defendant’s sales “pattern” – although different from the others – somehow supports the same statistically certain inference. If, however, there truly is a specific “pattern” that demonstrates the use of inside information and other Defendants’ sales match or establish that pattern, then Mr. Rice’s sales cannot possibly match that purported pattern. For example, it is nonsense for Plaintiffs to allege that Mr. Rice’s “pattern” matches the pattern of Mr. McMahon’s trades (a single trade) or the “pattern” of Mr. Lay’s trades (which number in the hundreds) and that all are recognized patterns of trading on inside information. *Any* trading “matches” this “pattern.” Indeed, according to Plaintiffs, every sale by every insider was suspect. Like all “one size fits all” garments, Plaintiffs’ droops here and pinches there.

Third, Plaintiffs’ allegation that Mr. Rice sold 55 percent of his holdings during the three-year Class Period establishes nothing where, as here, he cannot be charged with any alleged misstatements. *See In re Scholastic Corp. Securities Litigation*, 2000 WL 91939, *13 (S.D.N.Y. Jan. 27, 2000) (stock

sales of eighty percent of holdings by executive that did not make any alleged misstatements did not establish scienter); *Head v. NetManage, Inc.*, 1998 WL 917794, *5 (N.D. Cal. Dec. 30, 1998) (executives' sales of 76 percent and 94 percent held "insufficient to create the requisite strong inference of scienter in light of the lack of any specific allegations as to their fraudulent conduct, including the lack of any allegation that they personally made any of the fraudulent statements.").

Further, analysis of the alleged percentages of stock sales by Mr. Rice must be placed in the context of the extraordinarily long class period selected by Plaintiffs – 37 months. *See* Joint Brief of Officer Defendants, Section II.C.1.a. It is obvious that more sales would occur in a three-year class period than in a shorter, more reasonable timeframe. A number of courts have found nothing suspicious or alarming in sales of stock by insiders in percentages that, if adjusted to reflect a three-year "window," would dwarf Mr. Rice's sales. *See, e.g., Silicon Graphics*, 183 F.3d at 985-87 (sales by some individuals ranging up to 75 percent insufficient to infer scienter even in a fifteen week class period); *Ronconi v. Larkin*, 253 F.3d 423, 435 (9th Cir. 2001) (sale of 17 percent of holdings in a seven-month period clearly "not suspicious in amount."); *In re Waste Management, Inc. Securities Litigation*, H-99-2183 (S.D. Tex. 2001), slip. op. at *116, *131 (no basis for strong inference of scienter when individuals sold as much as 39.6 percent in a five-month class period).

Finally, the timing of Mr. Rice's sales are neither suspicious nor unusual. His sales of stock, at various dates after the options vested, are the type of activity that one would expect from a rational investor seeking to diversify his portfolio.⁵ To establish "suspicious timing," Plaintiffs must show

⁵Under Plaintiffs' model, however, an Officer Defendant who sold everything as it vested (a not irrational diversification strategy), or simply sold enough to cover taxes on the exercise of options, would automatically be assumed to have traded on illegal inside information, *even if he had no inside information*.

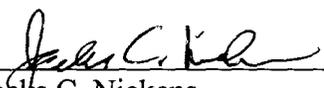
that Mr. Rice's trades were "at times calculated to maximize personal benefit" to him. *In re Apple Computer Litigation*, 886 F.2d 1109, 1117 (9th Cir. 1989). A recognized example would be the sale of a significant percentage of his shares "immediately before a negative earnings announcement." *See, e.g., Wenger v. Lumisys*, 2 F. Supp. 2d 1231, 1251 (N.D. Cal. 1998). Conversely, sales made before the market peak, after its fall, or at other times not maximizing seller's proceeds, give rise to no inference of scienter. *See Nathenson v. Zonagen, Inc.*, 267 F.3d at 400, 420-21 (5th Cir. 2001) (sales made when stock well below "class period high" were "so inauspiciously timed" they "d[id] not meet this test."); *Greebel v. FTP Software*, 194 F.3d 185, 206 (1st Cir. 1999) ("timing does not appear very suspicious" where stock not "sold at the high points of the stock price"). "When insiders miss the boat [by selling well off the market peak], their sales do not support an inference" of scienter. *Ronconi v. Larkin*, 253 F. 3d at 435. Mr. Rice's transactions were below the market peak.

In sum, Plaintiffs have not pleaded adequate specific facts to support a claim for insider trading against Mr. Rice.

III. PLAINTIFFS' SECTION 20(a) AND 20A CLAIMS AGAINST MR. RICE SHOULD BE DISMISSED.

For the reasons set forth in section III of the Joint Brief of Officer Defendants, Plaintiffs have failed to plead an actionable claim against Mr. Rice under either sections 20(a) or 20A of the Exchange Act.

Respectfully submitted,



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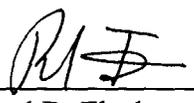
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I certify that a true and correct copy of the foregoing document was forwarded to all counsel listed on the attached Exhibit A Service List by e-mail or facsimile on this 8th day of May, 2002.



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