

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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MARK NEWBY, *et al.*, Individually and
On Behalf Of All Others Similarly
Situating,

Plaintiffs,

v.

ENRON CORP., *et al.*,

Defendants.

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Michael N. Milby, Clerk

CIVIL ACTION NO. H-01-3624
(Consolidated)

DEFENDANT MICHAEL S. McCONNELL'S MOTION TO DISMISS

Plaintiffs failed to plead a securities fraud action against Michael S. McConnell.¹ The deficiencies in the few allegations against Mr. McConnell are obvious under the standards established by this Court and others under Rule 9(b) of the Federal Rules of Civil Procedure and the Private Securities Litigation Reform Act (the "PSLRA").

Introductory Statement

The Complaint does not specifically accuse Mr. McConnell of any false statements or any self-dealing of any kind. Nor does it allege that he participated in Enron's accounting or financial reporting. Except for boilerplate (such as the listing of defendants), Mr. McConnell is mentioned in only six paragraphs in the 500-page Complaint. Even if the allegations against Mr. McConnell were accepted as true, they would establish only that he worked in a management position at Enron

¹ Mr. McConnell joins in and incorporates by reference the arguments in both the Defendants' Joint Brief Relating to Enron's Disclosures and the Joint Brief of Officer Defendants.

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and sold a small fraction of his Enron stock in two March 2000 sales². They certainly do not state a claim against him for securities fraud.

As to Mr. McConnell, Plaintiffs' allegations of scienter are altogether lacking. Plaintiffs do not allege (1) what Mr. McConnell specifically knew at any point in time, (2) what material undisclosed information Mr. McConnell may have known, (3) when Mr. McConnell became aware of any such undisclosed material information, or (4) any facts giving rise to a strong inference that Mr. McConnell acted with the required state of mind.

Plaintiffs' allegations of insider trading are also inadequate. Plaintiffs allege only one sale that occurred before most of the conduct about which Plaintiffs complain. Even under Plaintiffs' allegations, Mr. McConnell *lost* millions of dollars on Enron stock that he did not sell. Plaintiffs have failed to identify what material inside information Mr. McConnell was aware of when he traded or anything suspicious or unusual about Mr. McConnell's sale of Enron stock.

Finally, Plaintiffs do not allege any particularized facts as to how Mr. McConnell participated in any scheme to defraud. In sum, Plaintiffs have not met the particularity requirement, the basis requirement, or the strong inference requirement under the PSLRA or Rule 9(b) for pleading an action as to Mr. McConnell.

I. THE APPLICABLE PLEADING REQUIREMENTS

The standards applicable to pleading this securities fraud case against Mr. McConnell 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

²Plaintiffs actually allege six transactions on two consecutive days (at two slightly different prices), but Plaintiffs' "expert" analysis treats them as a single sale. (Complaint ¶ 83(o) and Declaration of Scott C. Hakala Ex. C).

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. McConnell.

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

The Consolidated Complaint contains only the following few “substantive” allegations specific to Mr. McConnell:

1. Paragraph 83(o): Plaintiffs allege that Mr. McConnell was, “at all relevant times, Executive Vice President, Technology of Enron.”
2. Paragraph 83(o): Plaintiffs allege that “while in possession of adverse undisclosed information about the Company, McConnell sold 32,960 shares of his Enron stock for \$2,506,311 in illegal insider trading proceeds.”
3. Paragraph 84: Chart containing allegations as to number of Enron shares sold by Mr. McConnell and gross proceeds.
4. Paragraph 88: Mr. McConnell is alleged to have been part of the “Enron Executive Committee” for 1999 as the Chief Executive Officer, Global Technology, Enron Corp.
5. Paragraph 401: Duplication of chart set forth on page 87, paragraph 84.
6. Paragraph 402: Another chart or table of Defendants’ stock sales, including allegation that Mr. McConnell sold 34.32 percent of his stock and in the money options.
7. Paragraph 415: Chart with allegation that Plaintiffs’ “expert” (Dr. Hakala) has concluded that it was “more probable than not” that McConnell traded on inside

information.

These substantive allegations fall into two categories: (a) Mr. McConnell's position within Enron; and (b) his March 2000 sale of Enron stock. Significantly, Mr. McConnell is not accused of making any misrepresentations and there are no allegations of any specific material, undisclosed information known to Mr. McConnell. The entirety of Plaintiffs' case against Mr. McConnell is that he must have committed securities fraud because he sold 32,960 shares of his Enron stock on March 27 and March 28, 2000, twenty months before the class period ended. As discussed below, these scant allegations against Mr. McConnell do not raise even a suggestion of insider trading, much less meet the strict pleading standard under the PSLRA to plead fraud, including scienter, with particularity.

A. Plaintiffs' Allegations of Position Are Insufficient to State a Claim.

As noted above, Plaintiffs assert that Mr. McConnell was either Executive Vice President, Technology or Chief Executive Officer, Global Technology, and they allege he was on the Enron Executive Committee for 1999. Regardless of his precise title and position, the allegations concerning his status as an executive officer of Enron do not state a claim against him for securities fraud. *See* Section II.A, Joint Brief of Officer Defendants.

B. Plaintiffs Do Not Allege Actionable "Insider Trading" by McConnell.

In Paragraphs 83(o), 84 and 401, Plaintiffs cite incomplete trading history of Mr. McConnell in an effort to assert an insider trading claim against him. Plaintiffs attempt to support their "insider trading" claim with the conclusion of their "expert" that it was "more probable than not" that Mr. McConnell "traded in a manner that was independent of 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. Further, as alleged in paragraph 415, the “certainty” of Plaintiffs’ allegations, based on Dr. Hakala’s inadmissible analysis, that Mr. McConnell engaged in illegal insider trading, as at best “more probable than not”; this contrasts markedly with what Plaintiffs assert to be the “scientific acceptance standard (95%).” Plaintiffs’ effort to allege insider trading against Mr. McConnell fails and the insider trading claims against him should be dismissed.

Plaintiffs have altogether failed to plead anything “unusual” or “suspicious” about Mr. McConnell’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, Joint Brief of Officer Defendants. None of the insider trading paragraphs identifies any specific material, publicly undisclosed information known to Mr. McConnell when he sold the stock about which Plaintiffs complain. Instead, Plaintiffs allege only generally that Mr. McConnell was in possession of some unspecified “adverse undisclosed information.” (Complaint ¶ 83(o).) They do not plead that Mr. McConnell was aware of any specific non-disclosure; nor do they allege that he was aware of any public misstatement. It is well settled that simply being a member of management — *i.e.*, in a position to know inside information — does not equate to scienter or knowledge of false statements. *Nathenson v. Zonagen, Inc.*, 267 F.3d 400, 424-5 (5th Cir. 2001); *In re Securities Litigation BMC Software, Inc.*, 183 F. Supp. at 887 (citing *Coates v. Heartland Wireless Communications, Inc.*, 26 F. Supp.2d 910, 921 (N.D. Tex. 1998)). This is the kind of generalized, non-specific allegations the PSLRA outlawed.

Paragraph 83(o) is further flawed by the absence of any allegation that the undisclosed

information (itself unidentified) was material. The Complaint is utterly devoid of (1) any specific allegations concerning nonpublic information (2) of which Mr. McConnell was aware or (3) how he knew the undisclosed information was material or nonpublic. See *In re Securities Litigation BMC Software*, 183 F. Supp. 2d at 916. Plaintiffs' allegations of insider trading are insufficient to state a claim and must be dismissed.

Plaintiffs also make no specific allegations regarding how Mr. McConnell's sales are 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." This is yet another instance of group pleading, now prohibited by the PSLRA, and clearly does not apply to Mr. McConnell.

Beyond that defect, Plaintiffs' asserted insider trading claim against Mr. McConnell fails — and must be dismissed — for the following reasons. First, Plaintiffs do not — and cannot — allege a "pattern" of trading by Mr. McConnell. Plaintiffs allege only one sale by Mr. McConnell. One point does not a pattern make.

Second, Mr. McConnell was only a section 16(b) officer during 1999. Accordingly, the published Form 3 and Form 4 trading history for Mr. McConnell only covers 1999 and the first quarter of 2000. Based on the published information, there is insufficient trading data on McConnell to establish a pattern. *In re Securities Litigation BMC Software, Inc.*, 183 F. Supp. 2d at 901-02; *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).

Third, Mr. McConnell's insider trades or "pattern" (such as it is) are altogether inconsistent

with Plaintiffs' allegations concerning the trading "pattern" of other Defendants who, according to the Complaint, were also "aware" of some undisclosed information. Indeed, according to the Complaint, one or more of (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. McConnell's *single* sale cannot possibly match that purported pattern. For example, it is patent nonsense for Plaintiffs to allege that the "pattern" of Mr. Lay's trades (which number in the hundreds) matches a recognized pattern of trading on inside information as does Mr. McConnell's *single* trade.

Fourth, Mr. McConnell's sale occurred in March 2000, before most of the alleged wrongdoing, well before the market peak, and twenty months before the end of the Class Period. Contrary to Plaintiffs' general group allegation that all of the insider defendants' sales "escalated massively as Enron's stock moved to more inflated levels during the class period," Mr. McConnell had no further sales as the stock price increased.

Fifth, the timing of Mr. McConnell's single sale is neither suspicious nor unusual. Every share of the stock Mr. McConnell sold on March 27, 2000, and March 28, 2000, was acquired by him or vested to him on or around that same date. To establish "suspicious timing," Plaintiffs would have to show that Mr. McConnell's trade was "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*, 267 F.3d at 420-21 (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 423, 435 (9th Cir. 2001). Mr. McConnell's challenged sale, at more than \$13 below market peak and months before that date, does not meet this test.

Sixth, according to Plaintiffs' own allegations, the shares sold by Mr. McConnell amounted to only 34.32 percent of his total shares, which indicates that Mr. McConnell retained the great majority of his Enron stock. Contrary to suggesting the intent to cash out based on inside information of Enron's impending doom, Mr. McConnell's trading history suggests either that he had no inside information or that he did not use any such information to his own benefit. *See, In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1426 (3d Cir. 1997); *In re Securities Litigation BMC Software*, 183 F. Supp. 2d at 902 (citing *In re FVC.COM Sec. Litig.*, 136 F. Supp. 2d 1031, 1038-39 (N.D. Cal. 2000) (sales of twenty-nine percent by one defendant and thirty percent by another are "insufficient to support an inference of scienter"); *Wenger v. Lumisys, Inc.*, 2 F. Supp. 2d at 1238 n.6, 1251 (sales of twenty-six percent, thirty-eight percent, twenty-five percent, and thirty-two percent held not suspicious) As this Court has noted: "Retention of the vast majority of their stock negates any inference of scienter." *In re Waste Management, Inc. Securities Litigation*, C.A. No. H-99-2183 (S.D. Tex. Aug. 16, 2001) at *131 (citing *In re Vantive Corp. Sec. Litig.*, 110 F. Supp. 2d 1209, 1219 (N.D. Cal. 2000) (no scienter because sales of 38 percent of stock "necessarily

means they retained 62”)). Plaintiffs’ allegation regarding sales by Mr. McConnell during the three-year Class Period establishes nothing where, as here, he is not charged with any alleged misstatements. *See In re Scholastic Corp. Sec. Litig.*, 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.”) .

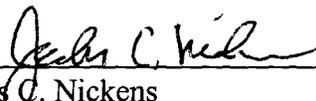
Further, analysis of the alleged percentages of stock sales by Mr. McConnell must be placed in the context of the extraordinarily long class period selected by Plaintiffs – 37 months. See Joint Brief of Officer Defendants, Section II.C.1.a. It is obvious that more sales would occur in a three-year class 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. McConnell’s sales. *See, e.g., In re Silicon Graphics*, 183 F.3d at 985-86, 987 (sales by some individuals ranging up to 75 percent insufficient to infer scienter even in a fifteen week class period); *Ronconi*, 253 F.3d at 435 (sale of 17 percent of holdings in a seven-month period clearly “not suspicious in amount.”); *In re Waste Management*, at *16 & *131 (no basis for strong inference of scienter when individuals sold as much as 39.6 percent in a five-month class period).

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

III. PLAINTIFFS' SECTION 20(a) AND 20A CLAIMS AGAINST MR. McCONNELL 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. McConnell under either Sections 20(a) or 20A of the Exchange Act.

Respectfully submitted,



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CERTIFICATE OF SERVICE

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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