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

United States Courts
Southern District of Texas
FILED
MAY 0 8 2002
Michael N. Milby, Clerk

MARK NEWBY,	)	
	)	
Plaintiff,	)	
	)	
vs.	)	CIVIL ACTION NO. H-01-3624
	)	(Consolidated)
ENRON CORP., et al.,	)	
	)	
Defendants.	)	

DEFENDANT JOSEPH M. HIRKO'S MOTION TO
DISMISS THE CONSOLIDATED AMENDED COMPLAINT

Defendant Joseph M. Hirko hereby moves, pursuant to Section 21D(b)(3) of the Securities Exchange Act of 1934, 15 U.S.C. § 78u-4(b)(3), and Fed. R. Civ. P. 9(b) and 12(b)(6) for an Order dismissing the Consolidated Amended Class Action Complaint on the grounds that it fails to satisfy the pleading requirements of Sections 21(D)(b)(1) and (b)(2) of the Securities Exchange Act of 1934, 15 U.S.C. § 78u-4(b)(1) and (b)(2); fails to aver fraud with particularity, and otherwise fails to state a claim upon which relief can be granted. The grounds for the motion are further set forth in the accompanying memorandum of law, incorporated herein by reference.

Respectfully submitted,

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Dated: May 8, 2002

CERTIFICATE OF SERVICE

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

Paul D. Flack

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Plaintiff,	)	
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vs.	)	CIVIL ACTION NO. H-01-3624
	)	(Consolidated)
ENRON CORP., et al.,	)	
	)	
Defendants.	)	

ORDER GRANTING DEFENDANT JOSEPH M. HIRKO'S MOTION TO DISMISS
CONSOLIDATED AMENDED COMPLAINT

Upon consideration of the Motion of Defendant Joseph M. Hirko to Dismiss the Consolidated Amended Complaint, the submissions of the parties filed in connection therewith, and the arguments of counsel, it is, this _____ day of May, 2002,

ORDERED, that Defendant Joseph M. Hirko's Motion to Dismiss Consolidated Amended Complaint is GRANTED, and the Consolidated Amended Complaint is dismissed with prejudice in all respects as to Defendant Joseph M. Hirko.

_____
Melinda Harmon
United States District Judge

Houston, Texas
May ____, 2002

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Plaintiff,	)	
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	)	(Consolidated)
ENRON CORP., et al.,	)	
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Defendants.	)	

MEMORANDUM IN SUPPORT OF DEFENDANT JOSEPH M. HIRKO'S MOTION TO DISMISS THE CONSOLIDATED AMENDED COMPLAINT

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INTRODUCTION

Plaintiffs have exhaustively combed the public record for allegedly fraudulent statements made by Enron officials, their accountants and lawyers, and various investment banks. The result is a 499-page complaint ("Complaint"), containing 1030 paragraphs, plus subparts. Tellingly, Joe Hirko's name appears in only eight of the Complaint's 1030 paragraphs.[1] And remarkably, although plaintiffs purport to claim that Mr. Hirko committed securities fraud, they do not attribute a single misleading statement to him, nor do they allege that he was involved in preparing a single financial report or Registration Statement on Enron's behalf. Plaintiffs similarly fail to allege facts giving rise to *any* inference—let alone the "strong" inference required to survive a motion to dismiss—that Mr. Hirko acted with the requisite scienter to support a fraud claim. In short, the Complaint utterly fails to satisfy the stringent pleading standards required by Rule 9(b) of the Federal Rules of Civil Procedure and the Private Securities Litigation Reform Act ("PSLRA"), 15 U.S.C. § 78u-4 *et seq.* Consequently, the claims against Mr. Hirko must be dismissed.[2]

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1 Paragraphs 1 and 993 merely name Mr. Hirko as a defendant. Paragraph 88 alleges that he was part of the "Enron Executive Committee" from 1997 to 1999. Paragraphs 83, 84, 401, 402, and 415 allege the dates and amounts of Mr. Hirko's sales of Enron stock.

2 For the reasons set forth in the Certain Defendants' Joint Brief Relating to Enron's Disclosures ("Joint Brief"), plaintiffs have failed adequately to allege securities fraud with respect to any defendant. Mr. Hirko joins in and incorporates by reference the Joint Brief. As set forth in this memorandum, even if the Court were to conclude that the Complaint sufficiently states a claim as to one or more other defendants, the claims against Mr. Hirko should nevertheless be dismissed.

BACKGROUND

Joe Hirko was the Chief Executive Officer of Enron Broadband Services ("EBS") in its early formative stages. Ken Rice took over as CEO in June 2000, after which time Mr. Hirko left Enron altogether. Compl. ¶ 83(k), (h).[3] In fact, Mr. Hirko's participation in Enron's management steadily diminished from June 1999, when Mr. Rice was named co-CEO of EBS, until Mr. Rice became the sole CEO in 2000. *See, e.g., id.* ¶ 88 (noting that 1999 was Mr. Hirko's last year of participation on Enron's management committees).[4]

Based on nothing more than his position at EBS and the fact that he sold some stock upon his departure, plaintiffs contend that Joe Hirko violated sections 10(b), 20(a), and 20A of the 1934 Act and Rule 10b-5 promulgated thereunder. *See* Compl. ¶¶ 992-1004. But in their voluminous and comprehensive Complaint, plaintiffs do not attribute a single statement to Mr. Hirko. Nor do they contend that Mr. Hirko was involved in establishing or maintaining—or that he was even aware of—the dozens of partnerships and other entities that are at the heart of the alleged fraudulent scheme. Plaintiffs similarly do not allege that Mr. Hirko took part in preparing Enron's financial statements or that he otherwise had input into any accounting decisions. In short, after parsing the 500-page Complaint, one is left to guess as to plaintiffs' basis for naming Joe Hirko as an "Enron Defendant."

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3 Mr. Hirko was at EBS only in its very early stages. For example, EBS completed over 320 bandwidth transactions in 2000, only 25 of which were completed by the end of the second quarter (June 2000). Compl. ¶ 282.

4 Mr. Hirko, a former Portland General Electric ("PGE") executive, became an Enron employee in 1997 when Enron acquired PGE. He remained in Oregon following the acquisition, and never lived in Houston, where the day-to-day management of Enron took place.

STANDARDS FOR PLEADING FRAUD WITH PARTICULARITY AS TO EACH INDIVIDUAL DEFENDANT

"A plaintiff [alleging securities fraud] may not rely on boilerplate or conclusory allegations to satisfy its pleading requirements." *Coates v. Heartland Wireless Comms., Inc.*, 55 F. Supp.2d 628, 634 (N.D. Tex. 1999) ("*Coates II*") (citing *Tuchman v. DSC Comms. Corp.*, 14 F3d 1061, 1067 (5th Cir. 1994)). Moreover, "[w]here multiple defendants must respond to allegations of fraud, the complaint should inform *each defendant* of the nature of his alleged participation in the fraud." *Thornton v. Micrografx, Inc.*, 878 F. Supp. 931, 938 (N.D. Tex. 1995) (emphasis supplied); *see also Eizenga v. Stewart Enters.*, 124 F. Supp.2d 967, 981 (E.D. La. 2000); *Coates v. Heartland Wireless Comms., Inc.*, 26 F. Supp.2d 910, 915 (N.D. Tex. 1998) ("*Coates I*") (plaintiffs must "enlighten each defendant as to his or her part in the alleged fraud" (quotation omitted)).

"In securities fraud actions, Rule 9(b) requires a plaintiff 'to 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.'" *In re Securities Litig. BMC Software, Inc.*, 183 F. Supp.2d 860, 865 n.14 (S.D. Tex. 2001) ("*BMC*") (quoting *Williams v. WMX Techs., Inc.*, 112 F.3d 175, 177 (5th Cir. 1997)). A plaintiff "must set forth specific facts that support an inference of fraud." *Tuchman*, 14 F.3d at 1068.

Pursuant to the PSLRA, a securities fraud complaint must, *inter alia*, "specify each statement alleged to have been misleading, [and] the reason or reasons why the statement is misleading." 15 U.S.C. § 78u-4(b)(1). Furthermore, to survive a motion to dismiss, a plaintiff alleging securities fraud must "state with particularity facts giving rise to a strong inference that

the defendant acted with the required state of mind," *id.* § 78u-4(b)(2), *i.e.*, that the defendant acted with knowledge or severe recklessness in making misrepresentations, *see Nathenson v. Zonagen Inc.*, 267 F.3d 400, 407 (5th Cir. 2001); *BMC*, 183 F. Supp.2d at 865 n.15. "[I]f a plaintiff does not meet this requirement, the district court 'shall,' on defendant's motion, 'dismiss the complaint.'" *Nathenson*, 267 F.3d at 407 (quoting 15 U.S.C. § 78u-4(b)(3); *see also Mortensen v. Americredit Corp.*, 123 F. Supp.2d 1018, 1023 (N.D. Tex. 2000).

ARGUMENT

I. PLAINTIFFS HAVE NOT ALLEGED FRAUD WITH THE REQUISITE PARTICULARITY TO SATISFY RULE 9(b) OR THE PSLRA.

"The failure to identify specific statements made by a defendant is fatal to the action because it deprives the defendants of notice." *Eizenga*, 124 F. Supp.2d at 981 (citing *Williams v. WMX Techs., Inc.*, 112 F.3d 175, 179 (5th Cir. 1997)). Plaintiffs allege the existence of a fraudulent scheme that "was accomplished over a multi-year period through numerous manipulative devices and contrivances and misrepresentations to investors in Enron releases and SEC filings." Compl. ¶ 70. Specifically, in 285 paragraphs extending over 149 pages of the Complaint, plaintiffs exhaustively recount scores of allegedly misleading statements made by numerous individuals in SEC filings, press releases, interviews, conference calls, and meetings. *Id.* ¶¶ 109-393. *Plaintiffs do not attribute a single one of those statements—not one—to Mr. Hirko.* Plaintiffs devote another 75 pages of the Complaint to Enron's allegedly "false financial statements." *Id.* ¶¶ 418-641. Once again, *Mr. Hirko is not alleged to have signed, prepared or participated in the preparation of a single Registration Statement or periodic report on behalf of Enron.*

The Complaint also alleges the existence of a tangled web of hundreds of partnerships and "SPEs" and contends that Enron improperly applied the complicated set of accounting rules that

governs the financial reporting requirements relating to those entities. *See, e.g.*, Compl. ¶¶ 429-505 (discussing GAAP rules and complicated factual underpinnings of Enron's alleged "failure to consolidate subsidiaries and special purpose entities"); *id.* ¶¶ 533-557 (discussing GAAP rules relating to "mark-to-market accounting"); *id.* at ¶¶ 558-574 (discussing Enron's alleged attempts to disguise loans "as hedging or derivative transactions"); *id.* ¶¶ 575-579 (discussing the impact of Enron's alleged use of "non-recourse debt to finance a wide array of its plant building projects"). The Complaint goes on at length to allege the involvement of Enron's auditors, as well as numerous investment banks and law firms, in structuring and maintaining the purported viability of the various entities and formulating the accounting treatment to apply to the related transactions. *Id.* ¶¶ 642-799 ("Involvement of the Banks"); *id.* ¶¶ 800-896 ("Involvement of the Law Firms"); *id.* ¶¶ 897-982 ("Involvement of Arthur Andersen"). The Complaint is deafeningly silent with respect to Mr. Hirko's involvement in any of the alleged "manipulative devices and contrivances" purportedly underlying the fraud. Indeed, plaintiffs do not allege that Mr. Hirko was even *aware* of the existence of the partnerships and SPEs.

Plaintiffs attempt to rectify their fatal pleading deficiencies by erroneously contending that "[i]t is appropriate to treat the Enron Defendants as a group for pleading purposes and to *presume* that the false, misleading and incomplete information conveyed in the Company's public filings, press releases and other publications, as alleged [in the Complaint], are the collective actions of the Enron Defendants." Compl. ¶ 89 (emphasis supplied). This Court, however, has twice before expressly recognized that the "group pleading doctrine" upon which plaintiffs rely "has not survived" the passage of the PSLRA. *See BMC*, 183 F. Supp.2d at 902 n.45; *In re Landry's Seafood Restaurants, Inc. Sec. Litig.*, H-99-1948, slip op, at 55 (S.D. Tex.

2001); *see also Schiller v. Physicians Resource Group, Inc.*, No. Civ.A. 3:97-CV-3158-L, 2002 WL 318441, at *5 (N.D. Tex. Feb. 26, 2002); *Coates I*, 26 F. Supp.2d at 916. Rather, "[p]laintiffs 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." *BMC*, 183 F. Supp.2d at 886 (emphasis supplied).

Here, the Complaint fails to allege any action Mr. Hirko "took in furtherance of the alleged scheme," *Coates I*, 26 F. Supp.2d at 916, beyond simply being a member of Enron management. This Court has dismissed with prejudice similar claims where plaintiffs have failed to allege how "individual nonspeaking Defendants have participated in the alleged scheme to defraud or how they could have controlled misstatements by other named Defendants." *BMC*, 183 F. Supp.2d. at 915, 917; *see also In re Vantive Corp. Secs. Litig.*, 283 F.3d 1079, 1094 (9th Cir. 2002) (affirming dismissal with prejudice of claims against defendant who was "not alleged to have uttered a word, or have participated in preparing statements, during the entire class period"); *Schiller*, 2002 WL 318441, at *6, *16; *In re NetSolve, Inc. Secs. Litig.*, 185 F. Supp.2d 684, 699 (W.D. Tex. 2001) (dismissing with prejudice claims against defendant who was "not listed as participating in any conference calls or press releases," but was sued solely because of his corporate position and his sales of stock during class period); *Eizenga*, 124 F. Suppp.2d at 981; *Coates I*, 26 F. Supp.2d at 916, 923. Plaintiffs' claims here should fare no better.

II. THE COMPLAINT FAILS TO ALLEGE WITH PARTICULARITY FACTS GIVING RISE TO ANY INFERENCE OF SCIENTER.

Plaintiffs contend that, by virtue of his "position[] with the Company," Compl. ¶ 399, Mr. Hirko, among others, "controlled and/or possessed the power and authority to control" the

content of Enron's SEC filings, reports, and press releases, *id.* ¶¶ 397, 399. Based on nothing more than Mr. Hirko's title and the sale of less than 20% of his Enron stock, *id.* ¶¶ 396-399, 401, plaintiffs make an unsupported leap to conclude that Mr. Hirko "knew" that Enron's public documents and statements were "materially false and misleading . . . and knowingly and substantially participated or acquiesced in the issuance or dissemination of such statements or documents," *id.* ¶ 400. But the Complaint utterly fails to "state with particularity" *any* facts to support any such inference, let alone the "strong inference" that is required to survive a motion to dismiss. *See* 15 U.S.C. § 78u-4(b)(2); *see also Coates v. Heartland Wireless Comms., Inc.*, 100 F. Supp.2d 417, 422 (N.D. Tex. 2000) ("*Coates III*") ("[I]nferences of scienter survive a motion to dismiss only if they are both reasonable and '*strong*' inferences" (emphasis in original, quotation omitted)).

A. Plaintiffs' Generalized Allegations of Mr. Hirko's Position and His Alleged Access to Information Fail to Raise a Strong Inference of Scienter.

Plaintiffs first contend that, "by virtue of [his] high-level position[] with the Company," Mr. Hirko must have acted fraudulently. Compl. ¶¶ 89-90, 397, 399-400. However, even before the PSLRA, the law required plaintiffs to allege much more. *See, e.g., Melder v. Morris*, 27 F.3d 1097, 1102 (5th Cir. 1994) (conclusory allegations that defendants, because of the positions with the defendant company, knew or had access to adverse nonpublic information were insufficient to adequately plead scienter). The Plaintiffs in *BMC* similarly based their scienter allegations on the defendants' "executive positions, their involvement in day-to-day management of BMC's business, their access to internal corporate documents, conversations with corporate officers and employees, and their attendance at management and Board meetings." *BMC*, 183 F. Supp.2d at

885. This Court held that "such vague pleading is insufficient to give rise to a strong inference of scienter under the PSLRA." *Id.* at 916; *see also Vantive*, 283 F.3d at 1087; *In re Advanta Corp. Secs. Litig.*, 180 F.3d 525, 539 (3d Cir. 1999) ("Generalized imputations of knowledge do not suffice, regardless of the defendants' positions within the company"); *In re Baker Hughes Secs. Litig.*, 136 F. Supp.2d 630, 648 (S.D. Tex. 2001) (dismissing claims based on "generalized allegations that the Defendants were intimately familiar with [the company's] daily operations and were otherwise knowledgeable of [the company's] actual financial situation"); *Eizenga*, 124 F. Supp.2d at 982-84 (allegations that executives "closely monitored" the company's performance and had "intimate involvement in the day-to-day management of its business" held insufficient); *Coates I*, 26 F. Supp.2d at 916 (plaintiffs "cannot merely rely on the individuals' positions or committee memberships with the . . . organization"). Just as it did in *BMC*, the Court should, with respect to Mr. Hirko, dismiss the present Complaint with prejudice.

B. Mr. Hirko's Alleged Sale of Less than 20% of His Enron Holdings—the Smallest Percentage of any of the Individual Defendants—is Insufficient to Raise any Inference of Scienter.

Plaintiffs allege that Mr. Hirko's "scienter . . . is further evidenced" by the fact that he sold 19.87% of his Enron stock—the smallest percentage of any of the 30 individual "Enron Defendants." Compl. ¶ 402. As an initial matter, Mr. Hirko's stock sales are not probative of anything in light of the fact that plaintiffs have not attributed to him a single fraudulent statement. *See BMC*, 183 F. Supp.2d at 902 (citing cases for proposition that sales of stock by non-speaking defendants are insufficient to give rise to inference of fraud); *cf. Vantive*, 283 F.3d at 1095-96 (sale of 48% and 49% of executives' shares were not suspicious in light of complaint's failure to allege that those executives made any misleading statements).

In addition, "'[i]nsider' trading must be 'unusual' to have meaningful probative value." *Nathenson*, 267 F.3d at 420-21; *see also Coates I*, 26 F. Supp.2d at 920. "In determining whether the sale was unusual or suspicious, [the Court] should examine the proportion of shares actually sold by the insider to the volume of shares he could have sold." *BMC*, 183 F. Supp.2d at 898 (citation omitted). As is clear from numerous cases decided by courts in this circuit—including this Court—Mr. Hirko's sale of less than 20% of his Enron stock is insufficient to give rise to a strong inference of scienter. *See, e.g., Nathenson*, 267 F.3d at 420-21 (individual's sales of 18.5% of his total holdings did not give rise to strong inference of scienter); *BMC*, 183 F. Supp.2d at 880, (sales of 31%, 13%, 81%, 71%, 70%, 68%, 53%, 40%, 28%, and 27% held not suspicious); *Coates II*, 55 F. Supp.2d at 645 (sale of 87% not sufficient); *Wenger v. Lumisys, Inc.*, 2 F. Supp.2d 1231, 1238, 1251 n.6 (N.D. Cal. 1998) (sales of 26%, 38%, 25%, and 32% held not suspicious).

Indeed, Mr. Hirko's retention of more than 80% of his Enron holdings actually *negates* an inference that he was dumping his Enron stock in anticipation that fraud had inflated the price and would soon be discovered. *See, e.g., Vantive*, 283 F.3d at 1094 (executive's sale of 13% of his shares, "rather than supporting an inference of fraud, . . . tend[ed] to negate such an inference"); *Advanta*, 180 F.3d at 541 ("Far from supporting a 'strong inference' that defendants had a motive to capitalize on artificially inflated stock price, [fact that defendants retained significant percentage of their holdings] suggest[ed] they had every incentive to keep [the company] profitable"). Plaintiffs' allegation of scienter is further undercut by the fact that the vast majority of Mr. Hirko's Class Period sales occurred in the spring of 2000, as he was leaving the company—a natural time for him to liquidate his shares, and hardly the "suspicious" timing

that might otherwise cause the Court to pause. *See* Ex. C to the "Exhibit Appendix" filed in support of the Complaint (detailing alleged stock sales).[5]

In short, plaintiffs have not alleged facts with particularity that "constitute persuasive, effective, and cogent evidence from which it can logically be deduced that [Mr. Hirko] acted with intent to deceive, manipulate or defraud." *See Coates III*, 100 F. Supp.2d at 422. Like the plaintiffs in *Coates*, plaintiffs' "assertion is framed in conclusory terms and is therefore inadequate to support a strong inference of fraud." *Id.* at 425; *see also Schiller*, 2002 WL 318441, at *6; *Mortensen*, 123 F. Supp.2d at 1023. The Court should thus dismiss plaintiffs' claims with prejudice. *See Coates III*, 100 F. Supp.2d at 432; *Mortensen*, 123 F. Supp.2d at 1027-28 (dismissing with prejudice claims relying on a "captain of the ship metaphor," which failed adequately to plead "the scienter of each individual defendant").

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5 Plaintiffs attempt to salvage their scienter allegations by relying on the Declaration of Dr. Scott D. Hakala, a purported "expert in security market econometrics and insider trading." Compl. ¶ 406. Plaintiffs contend that "[e]xpert analysis of the timing of an insider's exercise of stock options can provide strong evidence that the transactions were based on non-public information." *Id.* Specifically, plaintiffs posit, where option exercises "can only rationally be explained by considering inside information, there exists strong evidence that inside information was utilized to conduct the transaction." *Id.* ¶ 407. Dr. Hakala thus set out to determine whether each individual defendant's trading was "rational," *id.* ¶¶ 411-13, and concluded that there was a greater than 90% probability that Mr. Hirko "traded on inside information," *id.* ¶ 415. Specifically, Dr. Hakala determined that Mr. Hirko's May 2000 option exercise was "premature." Hakala Decl. at 10, ¶ 9(e). Critically, however, the vast majority of Mr. Hirko's sales—including the May 2000 option exercise—occurred just as he was leaving Enron, a natural time for him to sell a portion of his holdings. Nothing in Dr. Hakala's Declaration suggests that, in determining whether Mr. Hirko's sales were "rational" or "premature," Dr. Hakala was even aware that Mr. Hirko's sales coincided with his departure from Enron. Consequently, to the extent that it is appropriate for a complaint to include and rely on expert testimony at all, Dr. Hakala's "conclusions" with respect to Mr. Hirko are baseless and inherently unreliable.

III. PLAINTIFFS IMPROPERLY ATTEMPT TO ALLEGE "FRAUD BY HINDSIGHT."

Even if plaintiffs otherwise satisfied their obligations to plead with particularity the circumstances of Mr. Hirko's involvement in the alleged scheme and his related scienter—and they have not—the claims against Mr. Hirko would still be fatally defective. "It is . . . impermissible to allege fraud by hindsight, that is, to seize upon disclosures in later reports and allege that they should have been made in earlier ones." *Coates II*, 55 F. Supp.2d at 635; *see also Schiller*, 2002 WL 318441, at *10 ("Plaintiffs may not rely on fraud by hindsight to establish a claim for securities fraud"); *Eizenga*, 124 F. Supp.2d at 985. Nevertheless, that is precisely what plaintiffs have done here. The Complaint cites a number of cautiously optimistic public statements uttered by company officials or contained in analysts' reports or Enron filings in 1999 and early 2000. Based on subsequent negative developments in late 2000 and 2001—after Mr. Hirko's departure—plaintiffs contend that the earlier statements were fraudulent. That is precisely the type of "fraud by hindsight" allegation that courts have consistently rejected.

In fact, at the time of Mr. Hirko's departure, the mix of information in the market indicated that, while promising, the future of Enron's broadband business was dependent on a number of future contingencies.[6] For example, the vast majority of the 1999 statements to which plaintiffs cite refer only to the "potential" of Enron's broadband business. *See, e.g.,* Compl. ¶ 136 (citing Enron 1998 Annual Report referring to "tremendous potential" of the company's

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6 Each of the documents cited in this Memorandum was also cited in the Complaint. In support of his motion to dismiss, Mr. Hirko is entitled to rely on the contents of documents referred to in the Complaint. *See, e.g., Collins v. Morgan Stanley Dean Witter*, 224 F.3d 496, 498-99 (5th Cir. 2000); *Franks v. Prudential Health Care Plan, Inc.*, 164 F. Supp.2d 865 , 872 (W.D. Tex. 2001); *Meghani v. Shell Oil Co.*, 115 F. Supp.2d 747, 753 n.18 (S.D. Tex. 2000).

broadband business, which "*could be* significant contributor[] to the value of our stock *in the next couple of years*");[7] *id.* ¶ 142 (citing 3/31/99 Merrill Lynch report: "The company currently *estimates* the unit . . . will turn cash flow positive *by the year 2001*"); *id.* ¶ 179 (citing 10/13/99 analyst conference in which executives were allegedly "very optimistic about bandwidth trading" which "[i]nvestors would *start* seeing . . . showing up in the first and second quarters of [2000]"); *id.* ¶ 184 (citing 10/13/99 Deutsche Bank report characterizing Enron's broadband business as "fledgling"); *id.* ¶ 191 (citing 11/30/99 CS First Boston report: "Mr. Skilling also added that he believes Enron's telecommunications business has substantial upside *potential*"). Such "optimistic generalizations . . . cannot support the plaintiffs' claims." *Nathenson*, 267 F.3d at 419; *see also Azurix Corp. Secs. Litig.*, No. H-00-4034, 2002 WL 562819, at *14 (S.D. Tex. March 21, 2002). Furthermore, the market realized in 1999 that "[b]andwidth trading [was] in its infancy," that "[a] huge amount of bandwidth [would] come on line in the next few years," and that "a sharp slowdown in demand for bandwidth . . . would result in overcapacity." *See* JP Morgan 6/9/99 Report (cited at ¶ 153 of the Complaint (*see* Master App., Vol. 1, Tab 20)).

The 2000 statements made prior to Mr. Hirko's departure similarly portrayed the broadband business as promising, but not without significant risk. For example, plaintiffs cite a January 20, 2000 meeting at which Enron Executives allegedly stated that "Enron *laid the foundation* for its new broadband services business" and expected "rapid development" of EBS in 2000. *Id.* ¶ 197. Following that meeting, analysts concluded that Enron's broadband strategy was "the real deal, *if you believe in the Internet*." Merrill Lynch 1/21/00 Report (cited at

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[7] Unless otherwise indicated, the emphasis in each of the passages cited herein does not appear in the source document.

Complaint ¶ 208 (*see* Master App., Vol. 2, Tab 43)). Analysts conveyed to the market that the broadband market was "subject to high volatility," CIBC 1/21/00 Report (cited at Complaint ¶ 207) (*see* Master App., Vol. 2, Tab 45)), and that the broadband portion of Enron's business was "the most difficult to quantify," JP Morgan 2/9/00 Report (cited at Complaint ¶ 211 (*see* Master App., Vol. 1, Tab 27)). In early 2000, Enron executives continued to express optimism regarding the future *potential* of Enron's broadband business. *See, e.g.*, Compl. ¶ 209 (citing 1/24/00 Merrill Lynch Report: "Management sees EBIT *potential* for Broadband of $2.3 B *by 2004*"); *id.* ¶ 211 (citing 2/9/00 JP Morgan Report: EBS "offers an opportunity that *may ultimately create* more value than Enron's entire energy business portfolio"). In April 2000, Merrill Lynch reported that EBS was "breakeven" in the first quarter of 2000, and that "management expects full-year 2000 *losses* in the range of $60 to $65 million." Merrill Lynch 4/12/00 Report (cited at Complaint ¶ 226). The enthusiasm expressed in Enron's contemporaneous SEC filings was similarly muted. For example, in its Form 10-K filed on March 30, 2000 (SEC App., Vol. 1, Tab 10), the company stated that it "*anticipated* that broadband . . . applications will be an area of growth in the internet industry, as well as a platform for growth in e-commerce." *Id.* at 17. The company cautioned, however, that "[d]evelopment of bandwidth as a commodity will be dependent, among other things, on the ability of the industry to develop and measure quality of service benchmarks and connectivity of networks of market participants to facilitate processing of contracted services," and warned that "*[t]here can be no assurance that such a market will develop.*" *Id* at 18.[8] In its May 15, 2000

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[8] In the 10-K, Enron also made clear that its statements relating to "demand in the market for broadband services and high bandwidth applications" were "forward-looking

Form 10-Q, Enron hardly gave a glowing report regarding the financial success of EBS up to that point: "First quarter 2000 results included earnings from sales of excess fiber capacity as well as software licenses and increased market value of Broadband Services' merchant investments, offset by expenses related to the business." SEC App., Vol. 2, Tab 12, at 21.

In sum, at the time Mr. Rice replaced Mr. Hirko as sole CEO of EBS in June 2000, although the company was optimistic regarding EBS's future, it had publicly announced its expectation that the business unit would lose $60 to $65 million in 2000. Furthermore, the market was on notice that Enron's broadband business was "highly volatile," "difficult to quantify," and dependent on the success of the Internet. Analysts also recognized the potential for "overcapacity" (*i.e.*, a bandwidth "glut") and the negative ramifications to Enron that might result from such overcapacity.

Based on *later* developments—including, for example, the failed Blockbuster deal, which was not even *announced* until a month after Mr. Rice replaced Mr. Hirko, *see* Compl. ¶ 240 (alleging that deal was announced on July 19, 2000)—plaintiffs conclude that Enron must have acted fraudulently when it expressed optimism early on in its development of EBS. But plaintiffs have pled no facts, as they must to survive a motion to dismiss, demonstrating that Mr. Hirko (or anyone else) had "actual knowledge" that Enron's pre-July 2000 statements regarding EBS were false when made. *See* 15 U.S.C. § 78u-4(b)(1), 78u-5(c)(1)(B). "Plaintiffs' conclusory allegations that defendants *fraudulently* 'touted' their probabilities for success, simply because [EBS's] business prospects ultimately declined, are not sufficient to state a claim

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statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934." *Id.* at 58.

for securities fraud." *Azurix*, 2002 WL 562819, at *14 (emphasis in original); *see also BMC*, 183 F. Supp.2d at 888 ("Vague, loose, optimistic allegations that amount to little more than corporate cheerleading are 'puffery,' projections of future performance not worded as guarantees, and are not actionable under federal securities laws"). This additional pleading deficiency provides yet another reason to dismiss plaintiffs' claims against Mr. Hirko.

IV. THE SECTION 20(a) and 20A CLAIMS AGAINST MR. HIRKO MUST ALSO BE DISMISSED.

Plaintiffs also fail to plead a cause of action for "control person" liability against Mr. Hirko under § 20(a) of the Exchange Act, 15 U.S.C. § 78t(a). *See* Compl. at 488-90 ("First Claim for Relief"). Like the § 10(b) claims, the control person claim fails to satisfy plaintiffs' stringent pleading requirements. For example, plaintiffs fail to allege *any* facts to support the notion that Mr. Hirko either "had actual power or influence over the controlled person" or that he "induced or participated in the alleged violation." *Dennis v. General Imaging, Inc.*, 918 F.2d 496 (5th Cir. 1990); *see also In re Browning-Ferris Indus. Inc. Secs. Litig.*, 876 F. Supp. 870, 910-11 (S.D. Tex. 1995). Furthermore, as this Court has previously recognized, allegations that are "insufficient to state a claim for securities fraud under § 10(b) and Rule 10b-5" are insufficient "as a matter of law" to state a claim under § 20(a). *BMC*, 183 F. Supp.2d at 916; *see also Greebel v. FTC Software*, 194 F.3d 185 (1st Cir. 1999); *Lovelace v. Software Spectrum Inc.*, 78 F.3d 1015, 1021 n.8 (5th Cir. 1996). Because plaintiffs have failed adequately to allege any predicate § 10(b) or Rule 10b-5 violation, they cannot maintain a § 20(a) claim either. For each of these reasons, the Court should dismiss the § 20(a) claim.

Similarly, "claims under section 20A are derivative, requiring proof of a separate underlying violation of the Exchange Act." *Advanta*, 180 F.3d at 541; *Jackson Nat'l Life Ins. Co. v. Merrill Lynch & Co.*, 32 F.3d 697, 703 (2d Cir. 1994); *In re VeriFone Sec. Litig.*, 11 F.3d 865, 872 (9th Cir. 1993).[9] Because plaintiffs have failed adequately to plead a predicate violation of Section 10(b) or Rule 10b-5, the section 20A "insider trading" claim against Mr. Hirko (the Complaint's "Second Claim for Relief") must also be dismissed. *See, e.g., Advanta*, 180 F.3d at 541.

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[9] Section 20A provides as follows:

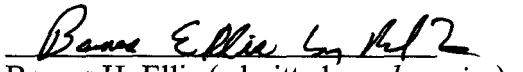
> Any person who violates any provision of this chapter or the rules or regulations thereunder by purchasing or selling a security while in possession of material, nonpublic information shall be liable in an action in any court of competent jurisdiction to any person who, contemporaneously with the purchase or sale of securities that is the subject of such violation, has purchased (where such violation is based on a sale of securities) or sold (where such violation is based on a purchase of securities) securities of the same class.

15 U.S.C. § 78t-1.

CONCLUSION

For the reasons set forth herein, the Court should dismiss with prejudice all claims against Joseph M. Hirko.

Respectfully submitted,



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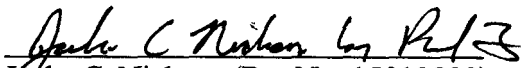

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