UNITED STATES COURTS
SOUTHERN DISTRICT OF TEXAS
FILED

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

MARK NEWBY, Plaintiff, v. ENRON CORPORATION, ANDREW S. FASTOW, KENNETH L. LAY, and JEFFREY K. SKILLING, Defendants.	C.A. No. H-01-3624 JURY TRIAL DEMANDED
HENRY H. STEINER, Individually and on Behalf of All Others Similarly Situated, Plaintiff, v. ENRON CORP., KENNETH L. LAY, JEFFREY K. SKILLING, ANDREW S. FASTOW, and ARTHUR ANDERSEN LLP, Defendants.	C.A. No. H-01-3717 JURY TRIAL DEMANDED

MEMORANDUM OF LAW IN SUPPORT OF MOTION FOR APPOINTMENT OF SEPARATE LEAD PLAINTIFFS FOR ENRON PREFERRED SHAREHOLDERS AND APPROVAL OF THE PROPOSED LEAD PLAINTIFFS' SELECTION OF COUNSEL

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Plaintiffs Henry H. Steiner, Christine L. Benoit, Daniel Kaminer, and Michael and Jennifer Cerone (hereinafter, the "Proposed Preferred Purchaser Lead Plaintiffs"), who in the aggregate lost $189,264 on their purchases of Enron preferred stock and on behalf of other purchasers of Enron preferred stock who lost a total of $814,803, respectfully submit this memorandum of law in support of their motion, pursuant to Section 21D(a) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78u-4(a), as amended by the Private Securities Litigation Reform Act of 1995, (the "PSLRA"), for: (1) their appointment as separate Lead Plaintiffs for a class of purchasers of the preferred shares of Enron Corporation; and (2) approval of their selection of lead counsel.

On December 22, 1995, Congress amended the Exchange Act to include a new Section 21D, 15 U.S.C. § 78u-4, which, among other things, sets forth a procedure for providing notice to members of the proposed class regarding commencement of a proposed class action and for the selection of a lead plaintiff or plaintiffs to oversee actions brought under the federal securities laws. Specifically, Section 21D(a)(3)(A)(i) provides that:

> Not later than 20 days after the date on which the complaint is filed, the plaintiff or plaintiffs shall cause to be published, in a widely circulated national business-oriented publication or wire service, a notice advising members of the purported plaintiff class -- (I) of the pendency of the action, the claims asserted therein, and the proposed class period; and (II) that, not later than 60 days after the date on which the notice is published, any member of the purported class may move the court to serve as lead plaintiff of the purported class.

Under Section 21D(a)(3)(B), the Court is directed to consider any motions by purported class members to serve as lead plaintiffs in response to a notice by: (i) no later than 90 days after the date of publication of the notice; or (ii) if more than one action asserting substantially the same claims has been filed and any party has sought to consolidate those actions for pretrial purposes or trial, as soon as practicable after the Court decides the motion to consolidate.

In addition, Section 21D(a)(3)(B)(iii)(I) establishes a rebuttable presumption that the "most adequate plaintiff" to serve as lead plaintiff "is the person or group of persons" that:

> (aa) has either filed the complaint or made a motion in response to [the aforementioned] notice;
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> (bb) in the determination of the court, has the largest financial interest in the relief sought by the class; and

(cc) otherwise satisfies the requirements of Rule 23 of the Federal Rules of Civil Procedure.

The Proposed Preferred Purchaser Lead Plaintiffs hereby move to be appointed as lead plaintiffs for a class of Enron preferred shareholders pursuant to Section 21D of the PSLRA. As discussed below, the Proposed Preferred Purchaser Lead Plaintiffs do not seek to represent Enron common shareholders who have brought similar claims. Each has submitted a plaintiff's certification indicating a willingness to serve as lead plaintiff. The Proposed Preferred Purchaser Lead Plaintiffs include the named plaintiff in the action styled Henry H. Steiner v. Enron Corp., et al., CA No. H-01-3717.

INTRODUCTION

More than 30 federal securities actions are presently pending in this district against Enron Corporation ("Enron" or the "Company") and certain of its officers and directors (the "Individual Defendants"), alleging violations of sections 10(b) and 20(a) of the Exchange Act, and Rule 10b-5 promulgated thereunder, as well as a state law claim for negligent misrepresentation on behalf of purchasers of Enron preferred shares. All but one of those cases are brought, *inter alia,* on behalf of Enron's common stockholders. The action brought by Proposed Lead Plaintiff Henry H. Steiner, on the other hand, is the only case brought exclusively on behalf of Enron's preferred shares. The Proposed Preferred Purchaser Lead Plaintiffs believe that unless separate lead plaintiffs are appointed for purchasers of the preferred shares, their rights will be prejudiced.

The Court is faced with two distinct claimant groups. The first claimant group, consisting of preferred shareholders of Enron (the "Preferred Shareholder Claimants"), is represented exclusively only in Mr. Steiner's preferred shareholder action (the "Steiner Action" or the "Preferred Shareholder Action"). The Steiner Action is brought on behalf of the following two classes: (1) a Federal Claim Class including all those who purchased the preferred stock of Enron between November 28, 1998 and November 28, 2001, inclusive; and (2) a Negligent Misrepresentation Claim Class including all those who purchased the preferred stock of Enron between January 21, 1997 and November 27, 1998, inclusive. The Steiner Action alleges violations of section 10(b) of the Securities Exchange Act of 1934 ("1934 Act"), 15 U.S.C. §78j(b), and Rule 10b-5 against Enron,

certain officers and directors, and Arthur Andersen LLP, Enron's independent accountant and auditor. It also alleges violations of section 20(a) of the 1934 Act, 15 U.S.C. § 78t(a) against individual defendants Kenneth Lay, Jeffrey Skilling and Andrew Fastow, as well as a negligent misrepresentation claim against all defendants. The other pending federal securities cases bring claims on behalf of, among others, purchasers of Enron's common stock (the "Common Stockholder Claimants") and allege violations of sections 10(b) and 20(a) against Enron and its officers and directors.

Given the nature of defendants' alleged fraud and the differences between Enron's common and preferred stock as investment vehicles, the fraud claims of the Preferred Shareholder Claimants are clearly distinct from those of the Common Shareholder Claimants. Those differences create conflicts between the two claimant groups with regard to presentation of proof, and calculation of damages and settlement, and necessitate the appointment of separate lead plaintiffs for the two claimant groups. Additionally, there are potential Texas state law claims for negligent misrepresentation relating to prospectus liability for two Enron preferred stock IPOs, a claim not available to the common share purchasers.

The differences between the two claimant groups were emphatically reinforced when the Company filed a voluntary petition for relief under Chapter 11 of Title 11 of the United States Code (the "Bankruptcy Code") in the United States Bankruptcy Court for the Southern District of New York on December 2, 2001. When the federal securities claims of the two claimant groups are pressed in Bankruptcy Court, the Bankruptcy Code will provide for priority of payment for the claims of the preferred shareholders including the securities fraud claims.[1] Such disparate treatment under the Bankruptcy Code of the two Claimant groups creates a true conflict between them and disables Enron's common shareholders from properly representing the interests of the preferred shareholders. Further, the two Claimant groups have substantially different factual claims against non-bankrupt defendants, such as Arthur Andersen, because the investors in Enron common stock, wholly an equity instrument, and investors in Enron Preferred Stock, which partakes of debt

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[1]See 11 U.S.C.A. §§ 510(b) and 1129(b)(2)(B).

characteristics, relied on different financial disclosures to assess the wisdom of their investments.

Here, where there are substantial differences between the claimant groups in terms of the impact of the defendants' fraud upon them, the calculation of damages, and recovery potential under the federal bankruptcy laws, separate lead plaintiffs should be appointed to represent the interests of each group.

Plaintiff Henry H. Steiner, who has brought a class action on behalf of purchasers of the preferred stock of Enron Corporation ("Enron" or the "Company"), is concurrently filing an objection to the consolidation ordered by this Court on December 12, 2001 to the extent it consolidated the claims of purchasers of Enron's various preferred shares with the federal securities fraud claims of purchasers of Enron's common stock (the "Consolidation Order"). Mr. Steiner incorporates that memorandum by reference. Mr. Steiner does not oppose, and indeed, urges the coordination of all of the federal securities actions before one judge for discovery and pretrial purposes. Mr. Steiner believes, however, that consolidation of the preferred shareholders' claims with those of the common shareholders would prejudice the preferred shareholders' rights.

PROCEDURAL BACKGROUND

On October 22, 2001, a complaint styled Mark Newby v. Enron Corp., et al., Civil Action No. 01-CV-3624, was filed in this Court on behalf of a class consisting of those who purchased the common stock of Enron during the Class Period and were damaged thereby. More than 30 federal securities actions against Enron were subsequently filed in this district. By order dated December 12, 2001, this Court consolidated the above - captioned securities fraud claims into the Newby action (the "Consolidation Order"). Mr. Steiner is concurrently filing a memorandum in support of his objection to the Consolidation Order, which he incorporates herein by reference.

On october 29, 2001, Henry H. Steiner filed an action exclusively on behalf of purchasers of the preferred shares of Enron. On October 22, 2001, pursuant to Section 21D(a)(3)(A)(i) of the Exchange Act, the plaintiff in the action styled Patricia Parsons et al. v. Enron Corp., et al., C.A. No. H-01-3903 caused a notice of pendency of their class action on behalf of all purchasers of all Enron securities including presumably the preferred shares (the "Notice") to be disseminated over the PR

Newswire, a widely circulated national business-oriented wire service, advising members of the proposed class of, inter alia, their right to move the Court to serve as lead plaintiff no later than 60 days from the publication of the Notice.[2] The Notice is annexed as Exhibit A to the accompanying December 21, 2001 Declaration of Jack E. McGhee (the "McGhee Decl.").

Since a proper notice has been published and since the present motion is being made within 60 days of the issuance of the Notice, the Proposed Preferred Purchaser Lead Plaintiffs have satisfied the procedural prerequisites set forth in the PSLRA.

STATEMENT OF FACTS

On or about June 1, 1991, Enron entered into the first of its "structured finance arrangements" with two limited partnerships that were managed by Enron's Chief Financial Officer, defendant Andrew S. Fastow.[3] Thereafter, Mr. Fastow's two limited partnerships engaged in billions of dollars of complex hedging transactions with Enron involving company assets and millions of shares of Enron stock. (¶ 84) These hedge transactions, which were in the energy and communications markets, including the broadband communications market, committed Enron to forward contracts to purchase its own shares at the market price on a given day (¶ 49), and exposed the Company to materially increased risk and uncertainty in the form of given the weakening market for bandwidth. (¶ 38). The hedge transactions also materially increased Enron's leverage and investment exposure (¶ 39), and the failure to disclose those transactions and their impact on Enron's earning reports (of concern to common purchasers) and their impact on the balance sheet (of concern to preferred purchasers) was the proximate cause of the damages suffered by investors during the Class Period. (¶ 46)

On October 16, 2001, Enron announced that the Company was taking a non-recurring charge of $1.01 billion after-tax for the third quarter of 2001. (¶ 71). On October 18, 2001, Enron chairman

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[2] The PR Newswire is recognized as a suitable vehicle for meeting the statutory requirement that notice be published "in a widely circulated national business-oriented publication or wire service." Greebel v. FTP Software, Inc., 939 F.Supp. 57, 62-64 (D. Mass. 1996); Lax v. First Merchants Acceptance Corp., 1997 U.S. Dist. LEXIS 11866 at *2 (N.D. Ill. 1997) (Ex. A hereto).

[3] *See* ¶ 46 of the Amended Class Action Complaint (the "Complaint") filed in the Steiner Action. References to the Complaint will hereinafter be designated ¶ ___.

and defendant Kenneth Lay was quoted as stating that approximately $35 million of those charges was related to transactions with Mr. Fastow's limited partnerships. (¶ 85). Mr. Lay explained that approximately 55 million Enron shares had been repurchased by Enron as it "unwound" its participation in those transactions. Those 55 million shares had been contributed to a "structured finance vehicle" more than two years earlier in which Enron and LJM2, one of Mr. Fastow's limited partnerships, were the only investors. The transaction had aimed to provide hedges against fluctuating values of some of Enron's Broadband telecommunication and other technology investments, and in exchange for Enron stock, LJM2 had provided Enron with a note. The Company further disclosed that its repurchase of the 55 million shares reduced Enron's shareholders' equity by $1.2 billion. This reduction damaged the Company's debt to equity ratio and endangered the Company's standing with debt rating agencies. (¶ 85).[4]

Defendants' false and misleading statements regarding the "structured finance arrangements" with Mr. Fastow's limited partnerships affected the two claimant groups differently because of the differences in their respective investment vehicles. The value of preferred stock is derived from stockholder equity, is based in part on the credit rating of the company, and generally trades much more like a corporate bond than does common stock.[5] Common stock, on the other hand, most often trades on the basis of a combination of present and expected future earnings and growth. Purchasers of preferred stock rely on the seniority of its claim on corporate assets to assure the value of their

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[4]Although disastrous to Enron, the company's arrangement with Mr. Fastow's limited partnerships proved to be very lucrative to Mr. Fastow. In addition to the $7 million in management fees for 2000, and approximately $4 million in capital increases on an investment of only $3 million, Mr. Fastow was also able to earn money for the limited partnerships by betraying his fiduciary duties to Enron and its shareholders. (¶ 86) Thus, in September 2000, Mr. Fastow's partnership invested $30 million in "Raptor III" which involved writing put options committing LJM2 to buy Enron's stock at a set price for six months. Four months into the deal, LJM2 reportedly approached Enron to settle the investment early causing LJM2 to receive its $30 million capital invested plus $10.5 million in profit. The renegotiation was commenced and completed before a precipitous decline in Enron's stock price which could have forced LJM2 to buy Enron's stock at a loss of as much as $8 dollars per share. (¶ 87).

[5] See the accompanying Declaration of Steven R. Wolfe in Support of Proposed Preferred Purchaser Lead Plaintiffs' Motion to Appoint Separate Lead Plaintiffs and Lead Counsel For Purchasers of Enron Preferred Shares, and in Support of Objection to the Order of Consolidation (the "Wolfe Decl."), at ¶ 12.

investment. (Wolfe Decl. at ¶ 12.)

Preferred Stock purchasers pay a premium for what is, in effect, a guaranteed return: they have set dividend payments and priority if the company is sold or liquidated. (Wolfe Decl. at ¶ 13.) On the other hand, preferred shareholders do not share directly in the earnings growth of the enterprise and consequently are less concerned with earnings per share or future earnings growth. Id. Their principal concern is that the dividend payment is secure and that there be sufficient assets to pay off the preferred shares on liquidation of the company. (Wolfe Decl. at ¶ 13.)

From a business and financial point of view, preferred stock resembles a debt instrument, such as a bond, and mainly trades based on interest rate fluctuations. (Wolfe Decl. at ¶ 15.) Accordingly, unlike common stock, preferred shares do not share the full upside potential of the company nor do they reflect short term earnings fluctuations. Id.

Accordingly, the undisclosed material information regarding Mr. Fastow's limited partnerships had materially different effects on the risk profiles and values of these different classes of stock. Wolfe Decl. at ¶ 17. For example, the Preferred Shareholder Claimants were more significantly injured by the defendants' failure to disclose that Enron's investment and hedging deals with Mr. Fastow's limited partnerships involved forward commitments to deliver Enron stock. Those forward commitments ensured that Enron would not have to report earnings' losses on those deals, but instead could reduce shareholder equity and the liquidation value of the Company without affecting its income and earnings statements. (¶ 110(a); Wolfe Decl. at ¶¶ 18-20.)

By keeping billions of dollars of debt and trading losses off Enron's balance sheet through its complicated financing strategies with Mr. Fastow's limited partnerships, defendants left Enron liable to pay in cash or in stock if and when Enron's portfolio was marked down. (¶ 110(b)). The Preferred Shareholder Claimants suffered greater harm than did the Common Shareholder Claimants from defendant's failure to disclose the potential enormous write-downs in shareholder equity that Enron faced as a result of its structured finance arrangements with Mr. Fastow's limited partnerships. (¶ 110(d)). By putting the Company in the undisclosed position of having to repurchase 55 million shares in order to unwind a hedging transaction with Mr. Fastow's limited partnership, defendants

materially increased the risk of impairing Enron's equity on its balance sheet. (¶ 110(j)). That increased risk more significantly affected the Preferred Shareholder Claimants than the Common Shareholder Stock Claimants due to the enormous reduction of shareholders' equity. (Wolfe Decl. at ¶¶ 18-20).

Defendants further jeopardized the value of Enron's preferred shares by failing to disclose that the Company might be forced to borrow billions of dollars on its bank lines of credit, which would create debt with rights senior to that of the preferred shares. (¶ 110(e)). Defendants' undisclosed investment and hedging activities incurred a material risk of substantial deterioration of the Company's financial condition, making the preferred stock dividends less secure. (¶ 110(f) Wolfe Decl. ¶ 23). As Enron's preferred stock dividends were to be paid in full before any dividends were paid on its common stock, this affected the preferred shareholders more immediately. (Id.) Subsequent to the filing of the Steiner Action, Enron established another $1 billion - plus bank line of credit, which in the usual course would be debt senior to the preferred shares. Id.

The trading in Enron's common and preferred stock as the market learned of Enron's fraud illustrates the manner in which those different stocks were affected differently by it. (See Trading Chart attached as Exhibit A to the Wolfe Decl.) As discussed below, those trading differences impact each claimant group's proof of liability and damages (Wolfe Decl. at ¶ 25).

The first major announcement by the Company, on October 16, 2001, of a $1.01 billion after-tax charge to earnings and a $1.2 billion hit to shareholder equity (digested by the financial media by October 18, 2001) caused Enron common stock to decline nearly 50% over the next five trading days, while Enron's 8 1/8 R Series Preferred Shares (the "Preferred R Shares") declined only about 8% during that period. (Wolfe Decl. at ¶ 29). This difference reflects the respective concerns of the two classes of shareholders: the common shareholders anticipated reduced earnings from the after-tax charge while the preferred shareholders did not believe the after-tax charge was large enough to affect their expected dividend payments. (Wolfe Decl. at ¶ 30).

On November 9th, Enron announced that it had agreed to be acquired by its rival, Dynegy Inc. (Compl. ¶ 103). The Dynegy acquisition was perceived by the market as being much more beneficial

to the preferred shareholders than the common, as it promised to "better" Enron's credit and increase stockholder equity to support the dividend payments and claims of the preferred shareholders. (Wolfe Decl. at ¶ 31). The Dynegy acquisition promised to do less for future earnings and growth, the determinants of the common stock price. Id. Accordingly, Preferred R Shares increased in value by about 25% after the announcement while the common stock increased only 15%. (Wolfe Decl. ¶ 31).

Enron's preferred stock was more significantly affected than its common stock, however, when Standard and Poor's lowered Enron's credit rating to triple-B- minus on November 12, 2001. (¶ 105) Whereas the Preferred R Shares lost 8.5% of their value over the two days following that announcement, Enron's common stock closed up 8% over the same time period. (Wolfe Decl. ¶ 33).

The most dramatic, and dispositive difference in the trading between the common and preferred shares concerns when each essentially lost its value (Wolfe Decl. ¶ 26). While as of November 21, 2001, Enron common stock had lost at least approximately 90% of its value since October 16th, the price of the Preferred R Shares at that date was only approximately 44% lower than its year high on October 17th. (Wolfe Decl., Ex. A).

When, on November 28th Dynegy announced it was calling off the acquisition (¶ 106), the Preferred R Shares were devastated, declining in value that day by about 90%. The likelihood that Enron would be able to pay its dividend had become extremely dubious. Enron common stock declined only $3.00 that day, the prospects for future earnings and growth already having become remote. (Wolfe Decl. ¶ 32) .

Subsequent to the filing of the Steiner Action, Enron, on December 2, 2001, filed a voluntary petition for relief under Chapter 11 of Title 11 of the United States Code (the "Bankruptcy Code") in the United States Bankruptcy Court for the Southern District of New York. (Wolfe Decl. ¶ 11).

Apparently, the Company was stealing from the preferred shareholders to bolster the price of the common stock. In the markets for forwards and derivatives, where Enron was a major player, credit-worthiness is essential. Enron's trading portfolios consisted largely of over-the-counter,

private party deals. The willingness of the counter-parties to Enron's trades to accept Enron's credit was essential to Enron's viability (Wolfe Decl. ¶ 37).

As Enron's portfolios became ever larger and more leveraged and its misstated mark-to-markets, therefore, more onerous, the necessity to maintain the fiction that future earnings and growth were robust became more desperate. In order to support a larger and larger house of cards, Enron buried losing trades and portfolios in related, off-book entities, like LJM2, and made concealed agreements to repurchase its treasury stock with those entities. The effect of these portfolio and stock manipulations was to surreptitiously take value from shareholder equity and assets in order to support earnings, i.e., to favor common over preferred. The preferred stock, thus, was differently inflated than the common stock throughout the class period, until the last few days (when all stock became essentially worthless). The claims should be pursued separately, not together, in recognition of how the Enron scheme affected the two classes of securities. (Wolfe Decl. ¶38).

Negligent Misrepresentation Claim

A further distinction between the two claimant groups is the preferred shareholders state law claim for negligent misrepresentation based on Enron's November 8, 2001, announcement that it was restating its earnings back to January 1, 1997. (Compl. ¶ 101). The Steiner Action alleges a negligent misrepresentation claim, under Texas state law, with respect to the IPO trading in two classes of Enron preferred stock, based upon possible material misstatements or omissions concerning 1997 in the respective prospectuses. (Compl. ¶¶ 156-163). As there was no common stock IPO during this period, this claim is not available to the Common Shareholder Stock Claimants. (Wolfe Decl. ¶ 10).

ARGUMENT

A. THE COURT HAS THE AUTHORITY AND RESPONSIBILITY TO APPOINT A SEPARATE LEAD PLAINTIFF AND COUNSEL FOR THE PREFERRED SHAREHOLDER CLASS AT THIS STAGE OF LITIGATION

"[T]he plain language of the PSLRA expressly contemplates the appointment of more than one lead plaintiff," see In re Oxford Health Plans, Inc. Sec. Litig., 182 F.R.D. 42, 47 (S.D.N.Y.

1998), and lead plaintiffs may be appointed for particular securities, claims, or parts of the Class Period. Numerous courts evaluating lead plaintiff motions under the PSLRA have appointed separate lead plaintiffs in cases where multiple classes have asserted diverse claims arising out of a related set of events. See, e.g., In re Cendant Corp. Litig., 182 F.R.D. 144, 149 (D.N.J. 1998); Chill v. Greentree Fin. Corp., 181 F.R.D. 398, 402 (D. Minn. 1998); Mark v. Fleming Cos., Inc., et al., Case No. CIV 96 506 M, Order (W.D. Okla. Mar. 26, 1997) ("Mark"); Harbour Court LPI v. Nanophase Tech. Corp., et al., 98 C 7447, Memorandum Opinion and Order (N.D. Ill. Sept. 27, 1999)("Harbour Court");[6] Oxford Health Plans, 182 F.R.D. at 49. Thus, there is no question that this Court has the authority to appoint a separate lead plaintiff and counsel for the Preferred Shareholder Claimants.

Moreover, recent decisions of the United States Supreme Court require the Court to address intra-class conflicts by assuring that independent classes have separate representation. Ortiz v. Fibreboard Corp., 527 U.S. 815, 855 (1999); Amchem Prods. v. Windsor, 521 U.S. 591, 626-27 (1997). In Ortiz, the Supreme Court stated that although the class members shared common interests in securing contested insurance funds for payment of claims, such common interests did not obviate the need to provide structural protections and required that the subgroups be independently represented. Ortiz, 527 U.S. at 815.

Furthermore, the creation of separate classes at this stage of the litigation is appropriate under Rule 23 of the Federal Rules of Civil Procedure. See Ortiz, 527 U.S. at 855 (Rule 23 requires protections under subdivisions (a) and (b) against inequity and potential inequity at the pre-certification stage); see also Phillips Petroleum Co. v. Shutts, 472 U.S. 797, 812 (1985) (due process requires that the named plaintiff at all times adequately represent the interests of absent class members).

1. Intraclass Conflicts Between Classes Require Separate Representation For The Preferred Shareholder Class

Serious conflicts exist between the Preferred Stock Class and the Common Stock Class

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[6] The Mark and Harbour Court opinions are attached hereto as Exhibits ("Ex.") A and B.

which require separate representation for the Preferred Stock Class. These conflicts are not hypothetical and therefore require separate representation at this stage of the litigation.

a. Rule 23(a)(4) Demands Separate Representation For Classes With Conflicting Or Potentially Conflicting Claims

In two recent cases, the United States Supreme Court ruled that potential intra-class conflicts must be addressed by assuring that independent subclasses have separate representation. Amchem Prods. V. Windsor, 521 U.S. 591 and Ortiz v. Fibreboard Corp., 527 U.S. at 847. For example, the Supreme Court held in Amchem, 521 U.S. at 625-28, that adversity among sub-groups requires independent representation even though class representatives thought settlement served the aggregate interest of the entire class. The Supreme Court's admonishment that separate representation is appropriate when classes have potentially conflicting claims is applicable here, where the difference between the Common Stock Class claims and claims of the Preferred Shareholders may lead to conflicts of interest -- as well as conflicts of strategic emphasis -- if a single lead counsel is appointed to represent both groups.

Rule 23(a)(4) requires that "the representative parties ... fairly and adequately protect the interest of the class." The standards of Rule 23(a)(4) are met if: (i) the named plaintiffs' interests are coincident with, and not antagonistic to, those of other members of the class, and (ii) the named plaintiffs, through their attorneys, are prepared to prosecute the action vigorously. See In re Pilgrim Sec. Litig., No. CV 94-8491-KN, 1996 W.L. 742448, at *4 (C.D. Cal. January 23, 1996).

b. Intraclass Conflicts Between Classes Require Separate Representation For The Preferred Shareholder Class

Unless separate lead plaintiffs are appointed for the Preferred Shareholder Claimants, their rights will be prejudiced. Here the Preferred Shareholder Claimants suffered a distinct and greater injury than did the Common Shareholder Claimants by the defendants' fraud to the extent that fraud threatened to, or actually increased, Enron's debt to equity ratio, created the risk of debt with senior rights, and jeopardized payment of dividends. The difference between the claims of the two shareholder groups is underscored by the disparate trading histories of the two classes of stock as the Company's fraud began to be understood by the market.

The different recovery prospects in bankruptcy court for the two groups of claimants also necessitate appointment of separate lead plaintiffs for the Preferred Shareholder Claimants. Together, sections 510(b) and 1129(b)(2)(B) of the Bankruptcy Code mandate that the preferred shareholders' fraud claims be fully paid before the common shareholders receive any payment for their fraud claims. Under section 510(b) "damages arising from the purchase or sale of [the security of the debtor] . . . shall be subordinated to all claims or interests that are senior to or equal the claim or interest represented by such security." The prospectus for each tranche of preferred stock offered by Enron, as well as Enron's Charter, provided that the purchasers of those preferred shares had interests senior to Enron's common shareholders in terms of both dividends and liquidation.[7] Accordingly, the Preferred Shareholder Claimants will recover for their fraud claims before the Common Shareholder Claimants. And, pursuant to section 1129(b)(2)(B)[8] the Preferred Shareholder Claimants must be fully compensated before the Common Shareholder Claimants recover anything on their fraud claims.

c. Practical Litigation Conflicts Dictate Separate Lead Plaintiffs And Counsel

Appointment of a common shareholder lead plaintiff as a global representative for the two claimant classes would virtually leave the claims of the Preferred Shareholder Claimants

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[7] See Enron Capital Trust I 8:30% Trust Originated Preferred Securities Prospectus, dated 11/18/96, at p. 4; Enron Capital Trust II Prospectus, dated 1/13/97 at p. 4; Enron Capital LLC 8% Cumulative Guaranteed Monthly Inc. Pref. Shares Prospectus, dated 11/8/93 at p. 8 (no dividends to lower ranking securities until preferred shares get dividends); and p. 9 (Liquidation Distribution); Portland General Electric Company 7.75% Series Cumulative Preferred Stock Prospectus Suppl, dated 6/3/92 at p. 6 - Under Dividend Rights, and p. 7 (Liquidation Rights); Enron Capital Resources LP Prospectus, dated 7/28/94.

[8] 11 U.S.C.A. § 1129(b)(2)(B) states:

(B) With respect to a class of unsecured claims --

(i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property.

unprosecuted, as that global plaintiff would seek to prove different facts than the Preferred Shareholder Claimants in order to establish liability and would use different facts to establish damages as well. For example, while the Preferred Shareholder Claimants will need to focus on Enron's assets, the Common Shareholder Claimants will have no interest in proving that Enron's asset base was eroding. The two claimants groups will also have materially different interests with respect to proving defendant Arthur Andersen's involvement in knowing fraud or recklessness, as each group will focus on the misstatements material to the information it relied on in making its respective investments. (Wolfe Decl. ¶ 40.)

There will also be conflicts in terms of the two claimants groups' proof of damages due to the fact that the common and preferred stock reacted differently to the different disclosures. For example, by November 21, 2001, Enron's common stock had lost approximately 90% of its value since October 16th, while Enron's Preferred R Shares had lost only 48% of their value from that date. (See Wolfe Decl., Ex. A.) Here, since the price of the Preferred R Shares did not collapse until after the November 28th announcement that the Dynegy deal had fallen through, the Preferred Shareholder Claimants will require damages to be calculated as of a later date than the Common Shareholder Claimants in order to fairly and accurately reflect their damages. (Wolfe Decl. Ex. A)

Finally, a global representative, if allowed to stand, will wrongly provide for equal allocation between the two claimant groups of any settlement fund. Since the common and preferred shares are now each worth essentially zero, treating the common and preferred purchasers the same will not take into account their reasonable, different expectations. The Preferred Shareholder Claimants had an expectation of lower risk than that knowingly assumed by the Common Shareholder Claimants, and it is inequitable to require the Preferred Shareholder Claimants to retroactively assume a greater risk than that for which they bargained.

Defendants may also want to settle separately with one or the other of the classes in this case. For example, in In re Cendant Corp. Litig., 182 F.R.D. 144, 149 (D.N.J. 1998), the court appointed separate lead plaintiffs and lead counsel for one particular class of security holders in the litigation. One of the separate classes then settled its claim with the defendant for a very significant sum of

money. If the defendants here are interested in a separate settlement with the Preferred Shareholders Class, it will be virtually impossible to achieve such a settlement with a global representative, who has loyalties to the other class members.

d. Courts Frequently Appoint Separate Lead Plaintiff And Counsel Under These Circumstances

In fact, in another suit with factual circumstances very similar to this one, a U.S. District Court required the establishment of independently represented subclasses. In Mark v. Fleming Cos., Inc., Case No. CIV-96-506-M, Order (W.D. Okla, March 26,1997), the court refused to consolidate a note case with a stockholder case and appointed a separate lead plaintiff and lead counsel for the Note class. Mark v. Fleming Cos., Inc., Case No. CIV-96-506-M, Order (W.D. Okla, March 26,1997) (Ex. A). Similarly, in Harbour Court LPI v. Nanophase Tech. Corp., et al., Case No. 98 C-7447 (N.D. Ill. September 27, 1999), slip. op. at 4 (Ex. B), the court appointed separate lead plaintiffs and lead counsel for §10(b) claims and for claims under §§11, 12(2) and 15 of the Securities Act because of the requirement that scienter be approved for §10(b) claims.

In a recent decision, Miller v. Ventro Corp. et al., No. C 01-01287 SBA, slip op. at 18 (N.D. Cal. November 28, 2001) (Exhibit C hereto), the court appointed different lead plaintiffs for bondholders and stockholders to serve as a group of co-lead plaintiffs. The group was to make decisions by consensus except in those instances where the interests of the bondholders and shareholders were separate and independent. In those instances, the representative for each group will have the final decision-making authority for those issues.

2. The Policy Goals Of The PSLRA Are Best Served By Separate Representation Of The Preferred Stock And Common Stock Classes

The goal of the PSLRA -- to provide more effective representation on behalf of a class of persons injured by violations of the securities laws -- is best served by appointing separate lead plaintiffs and lead counsel for separate groups of plaintiffs with diverse interests. In determining the most adequate plaintiff, the PSLRA requires that the proposed lead plaintiff satisfy the requirements of Rule 23. 15 U.S.C. §78u-4(a)(3)(B)(iii)(I)(cc). Accordingly, numerous courts evaluating lead plaintiff motions under the PSLRA have appointed separate lead plaintiffs in situations like this

where multiple classes assert diverse claims arising out of a related set of events. See e.g., Cendant, 182 F.R.D. at 149 (separate lead plaintiff and counsel appointed due to underwriter being a necessary defendant in action by holder class); Chill v. Greentree Fin. Corp., 181 F.R.D. at 402 (separate lead plaintiffs and counsel appointed for class of options purchasers and securities purchasers). Appointing separate lead plaintiffs and lead counsel for the Preferred and Common Shareholder Claimants assures that the interests of all class members will be adequately represented in the prosecution of the action. In re Oxford Health Plans, Inc. Sec. Litig., 182 F.R.D. at 49.

> Allowing for diverse representation...ensures that the interests of all class members will be adequately represented in the prosecution of the action and in negotiations and approval of a fair settlement, and that the settlement process will not be distorted by the differing aims of differently situated claimants.

Id.

B. THE PROPOSED PREFERRED PURCHASER LEAD PLAINTIFFS ARE THE MOST ADEQUATE PLAINTIFFS FOR THE PREFERRED SHAREHOLDER CLASS

1. The Proposed Preferred Purchaser Lead Plaintiffs Filed A Complaint

As noted above, under Section 21D(a)(3)(B)(iii)(I) the most adequate plaintiff is, among other things, presumed to be "the person or group of persons that...(a) has either filed a complaint or made a motion in response to a notice..." Here, Henry H. Steiner, one of the Proposed Preferred Purchaser Lead Plaintiffs has filed a complaint. In addition, the Proposed Preferred Purchaser Lead Plaintiffs have submitted plaintiff's certifications in accordance with Section 21D(a)(2). See McGehee Decl. Ex. B. Therefore, the Proposed Preferred Purchaser Lead Plaintiffs have satisfied the requirements of Section 21D(a)(3)(iii)(I)(aa).

2. The Proposed Preferred Purchaser Lead Plaintiffs Have the Largest Financial Interest In The Relief Sought By The Class

As noted above, Section 21D(a)(3)(B)(iii)(I) further provides that the most adequate plaintiff is presumed to be the person or group of persons that "(bb) in the determination of the court, has the largest financial interest in the relief sought by the class..." Here, the Proposed Preferred Purchaser Lead Plaintiffs sustained aggregate losses in excess of $189,264.35 as a result of their Class Period

transactions in Enron preferred shares. Christine L. Benioit lost $54,592.31 on Class Period purchases of preferred shares of Enron Capital LLC. Daniel Kaminer lost approximately $70,719.40 on Class Period purchases of the preferred shares of Enron Capital Trust I. Henry H. Steiner lost $6,849.51 on Class Period purchases of preferred shares of Enron Capital Trust II. And Michael and Jennifer Cerone lost $57,103.13 on Class Period purchases of preferred shares of Enron Capital Resources LP. In addition, the Proposed Preferred Purchaser Lead Plaintiffs have received certifications from other purchasers of Enron Preferred Shares, whose aggregated damages total $814,803.31, and who are also available to serve as Preferred Purchaser Lead Plaintiffs.

To the Proposed Preferred Purchaser Lead Plaintiffs' knowledge, no other class member has filed a motion seeking lead plaintiff status for purchasers of Enron's preferred shares. Therefore, the Proposed Preferred Purchaser Lead Plaintiffs prima facie satisfy the second prong of the "most adequate plaintiff" test with the largest financial interest in the relief sought on behalf of the Class.

3. The Proposed Preferred Purchaser Lead Plaintiffs Otherwise Satisfy The Requirements of Rule 23 of The Federal Rules of Civil Procedure

As noted above, Section 21D(a)(3)(B)(iii)(I) further provides that the most adequate plaintiff(s) is presumed to be the person or group of persons that "(cc) otherwise satisf[y] the requirements of Rule 23 of the Federal Rules of Civil Procedure." Rule 23(a) provides that a party may serve as a class representative if the following four requirements are satisfied:

> (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.

Of the four prerequisites to class certification, only two -- typicality and adequacy -- directly address the personal characteristics of the class representative. Consequently, in deciding a lead plaintiff motion, the Court should limit its inquiry to the typicality and adequacy prongs of Rule 23(a) and defer examination of the remaining requirements until the lead plaintiffs move for class certification. This interpretation is supported by Section 21D(a)(3)(B)(iii)(II), which provides that the presumption in favor of the most adequate plaintiff may be rebutted only upon proof that this individual or group "(aa) will not fairly and adequately protect the interests of the class; or (bb) is

subject to unique defenses that render such plaintiff incapable of adequately representing the class." See Lax, 1997 U.S. Dist. LEXIS 11866 at *20; Fischler v. Amsouth Bancorporation, 1997 U.S. Dist. LEXIS 2875 at *7-8 (M.D. Fla. Feb. 6, 1997). As discussed below, the Proposed Preferred Purchaser Lead Plaintiffs satisfy both the typicality and adequacy requirements of Rule 23.[9]

a. The Proposed Preferred Purchaser Lead Plaintiffs Fulfill The Typicality Requirements

Courts have consistently held that in a motion for appointment of lead plaintiffs, plaintiffs need only make a preliminary showing of typicality and adequacy under Rule 23(a). See In re Oxford Health Plans, Inc., Sec. Litig., 182 F.R.D. 42, 49 (S.D.N.Y. 1998); Greebel, 939 F.Supp. at 64. Under Rule 23(a), typicality is satisfied when "the claims or defenses of the representative parties are typical of the claims or defenses of the class," and adequacy is met when "the representative parties will fairly and adequately protect the interests of the class." See Fed. R. Civ. P. 23(a)(3), (4). The Fifth Circuit has held that "the test for typicality is not demanding. It focuses on the similarity between the named plaintiffs' legal and remedial theories and the theories of those whom they purport to represent." Mullen v. Treasure Chest Casino, LLC, 186 F.3d 620, 625 (5th Cir. 1999) (internal quotation marks and citation omitted).

Here, the Proposed Preferred Purchaser Lead Plaintiffs, like all other preferred shareholder class members: (1) purchased or acquired the preferred shares of Enron during the Class Period; (2) at prices allegedly artificially inflated by defendants' materially false and misleading statements or omissions; and (3) suffered damages thereby. Thus, the ' claims are typical of those of other preferred shareholder class members since the claims of each arise out of the same event or course of conduct and are based on the same legal theory.

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[9] The plain language of the PSLRA dictates that only members of the plaintiff class may offer evidence to rebut the presumption in favor of the most adequate plaintiff. See Section 21D(a)(3)(B)(iii)(II); Fischler, 1997 U.S. Dist. LEXIS 2875 at *6 (M.D. Fla. Feb. 6, 1997). Defendants therefore are without standing to take any position and the Court should disregard any filings by defendants on this motion. Id. The determination of lead plaintiffs and lead counsel at this stage does not preclude revisiting these issues upon consideration of a motion for class certification. Id., citing Greebel, 939 F. Supp. at 61.

b. The Proposed Preferred Purchaser Lead Plaintiffs Fulfill The Adequacy Requirement

In determining the adequacy of representation requirement, courts consider the plaintiffs' ability to vigorously prosecute the class claims and whether there exist any conflicts or antagonism between the interests of those seeking to represent the class and the interests of the class. See Kalodner v. Michael Stores, Inc., 172 F.R.D. 200, 204-05 (N.D. Tex. 1997). Indeed, Section 21D of the PSLRA directs the court to limit its inquiry on a lead plaintiff determination to the existence of any conflicts between the interests of the and the members of the class, and then allows the lead plaintiffs to retain lead counsel to represent the class "subject to the approval of the court." See Section 21D(a)(3)(B)(v).

Here, the are adequate representatives of the preferred shareholder class. The interests of the are clearly aligned with the members of the class, and there is no evidence of any conflict or antagonism between their interests and the interests of the class. As detailed above, the share common core questions of law and fact with the members of the preferred shareholder class and their claims are typical of the claims of other preferred shareholder class members. Further, the already have taken significant steps demonstrating that they have and will protect the interests of the class: they have initiated suit and executed certifications expressing their interest in participating as lead plaintiffs in this action; and they have retained competent and experienced counsel who, as shown below, will be able to conduct this complex litigation in a professional manner. See generally Lax, 1997 U.S. Dist. LEXIS 11866 at *21-25.

C. THE COURT SHOULD APPROVE THE PROPOSED PREFERRED PURCHASER LEAD PLAINTIFFS' CHOICE OF COUNSEL

Section 21D(a)(3)(b)(v) vests authority in the lead plaintiff or plaintiffs to select and retain counsel to represent the class, subject to the approval by the Court. See 15 U.S.C. § 78u-4(a)(3)(B)(v); see also, e.g., Lax, 1997 U.S. Dist. LEXIS 11866 at *25. Thus, a court should not disturb the Proposed Lead Plaintiff's choice of counsel unless "necessary to protect the interests of the [plaintiff] class." 15 U.S.C. § 78u-4(a)(3)(B)(iii)(II)(aa).

The have selected and retained the law firm of Wolf Haldenstein Adler Freeman & Herz LLP to serve as Plaintiffs' Lead Counsel, and the firm of McGehee & Pianelli to serve as Plaintiffs' Local Liaison Counsel. These firms have extensive experience in handling complex securities class action litigation and has successfully prosecuted numerous securities fraud class actions on behalf of injured investors. See firm resumes attached to the McGehee Decl. as Exhibits C and D. Thus, the Court may be assured that, in the event the motion is granted, the members of the class will receive the highest caliber of legal representation available.

CONCLUSION

For all of the foregoing reasons, the respectfully request that this Court: (1) appoint them as Lead Plaintiffs on behalf of those who purchased Enron's preferred shares during the class period pursuant to Section 21D(a)(3)(B) of the Exchange Act; and (2) approve their selection of Wolf Haldenstein Adler Freeman & Herz LLP as Plaintiffs' Lead Counsel, and McGehee and Pianelli as Local Counsel, pursuant to Section 21D(a)(3)(B)(v) of the Exchange Act.

Dated: December 21, 2001

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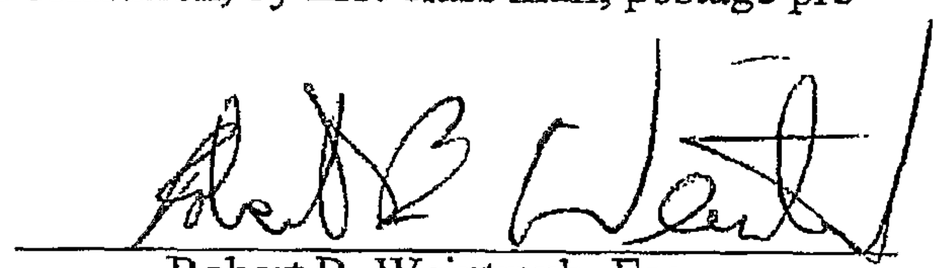
Certificate of Service

I, Robert B. Weintraub, hereby certify under the penalty of perjury that I caused to be served: (1) the Proposed Preferred Purchaser Lead Plaintiffs' motion to appoint preferred purchaser lead plaintiffs and lead and local counsel, with a Memorandum of Law, the Declaration of Jack E. McGehee with exhibits, the Declaration of Steven R. Wolfe with exhibit, and Proposed Order; and also (2) Plaintiff Henry Steiner's Objection and Memorandum of Law Opposing Consolidation with the Steven R. Wolfe Declaration, by first class mail, postage pre-paid upon the following law firms listed below.



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

MARK NEWBY, Plaintiff, v. ENRON CORPORATION, ANDREW S. FASTOW, KENNETH L. LAY, and JEFFREY K. SKILLING, Defendants.	C.A. No. H-01-3624 JURY TRIAL DEMANDED
HENRY H. STEINER, Individually and on Behalf of All Others Similarly Situated, Plaintiff, v. ENRON CORP., KENNETH L. LAY, JEFFREY K. SKILLING, ANDREW S. FASTOW, and ARTHUR ANDERSEN LLP, Defendants.	C.A. No. H-01-3717 JURY TRIAL DEMANDED

DECLARATION OF JACK E. McGEHEE IN SUPPORT OF THE PROPOSED PREFERRED PURCHASER LEAD PLAINTIFFS' MOTION FOR APPOINTMENT AS LEAD PLAINTIFFS AND APPROVAL OF THEIR SELECTION OF LEAD AND COUNSEL

JACK E. McGEHEE declares under the penalty of perjury pursuant to 28 U.S.C. Section 1746:

1. I am a partner in the law firm of McGehee & Pianelli, LLP, plaintiffs' local counsel in the action entitled Henry H. Steiner v. Enron Corp. et al., C.A. No. H-01-3717. I submit this Affidavit in support of the motion for appointment of the Proposed Preferred Purchaser Lead Plaintiffs as Lead Plaintiffs, approval of their selection of Wolf Haldenstein Adler Freeman & Herz

LLP ("Wolf Haldenstein") as Plaintiffs' Lead Counsel; and approval of my firm as Local Counsel.

2. Attached hereto as Exhibit A is a true and correct copy of the notice published by plaintiff in the first noticed related action, the Patricia Parsons et al. v. Enron Corp., et al., C.A. No. H-01-3903 Action, over the PR Newswire, a national, business-oriented newswire service, on October 22, 2001.

3. Attached hereto as Exhibit B is a true and correct copy of the individual certifications of the Proposed Preferred Purchaser Lead Plaintiffs, which demonstrate their standing and requisite financial interest in the outcome of the litigation.

4. Attached hereto as Exhibit C is a true and correct copy of a description of the Wolf Haldenstein firm's litigation department.

5. Attached hereto as Exhibit D is a true and correct copy of the McGehee firm's resume.

JACK E. McGEHEE
TBN 13623700, Fed No. 8163

The Exhibit(s) May

Be Viewed in the

Office of the Clerk