United States Courts
Southern District of Texas
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Michael N. Milby, Clerk

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

In re ENRON CORPORATION SECURITIES LITIGATION	§	Civil Action No. H-01-3624 **(Consolidated)**
	§	CLASS ACTION
This Document Relates To:	§	
MARK NEWBY, et al., Individually and On Behalf of All Others Similarly Situated,	§	
Plaintiffs,	§	
vs.	§	
ENRON CORP., et al.,	§	
Defendants.	§	
THE REGENTS OF THE UNIVERSITY OF CALIFORNIA, et al., Individually and On Behalf of All Others Similarly Situated,	§	
Plaintiffs,	§	
vs.	§	
KENNETH L. LAY, et al.,	§	
Defendants.	§	

PLAINTIFFS' OPPOSITION TO ALLIANCE CAPITAL MANAGEMENT'S MOTION TO DISMISS

84

TABLE OF CONTENTS

Page

I. INTRODUCTION 1

II. ARGUMENT 2

A. Pleading Standard 2

B. Plaintiffs Have Properly Pleaded Their Underlying Section 11 Claim Against Savage 3

1. The Falsity of the Registration Statement 3

a. False and Misleading Statements About EBS and the EIN . . . 4

b. False Statements Regarding EES 6

c. False and Misleading Statements About Enron's Capitalization 7

d. False and Misleading Statements About Enron's Financial Risk Management 9

e. False and Misleading Statements About Enron's Price Risk Management Activities and Financial Instruments 10

2. Liability Under Section 11 11

C. Alliance's Control Person Liability 16

1. Plaintiffs Have Adequately Pleaded Control Person Liability 16

2. Alliance's Control over Savage Is a Fact Issue that Cannot Be Resolved on a Motion to Dismiss 20

3. Alliance's Public Policy Argument Is Erroneous 24

III. CONCLUSION 24

TABLE OF AUTHORITIES

CASES **Page**

Abbott v. Equity Group,
2 F.3d 613 (5th Cir. 1993) 11, 17, 18

Adair v. Bristol Tech. Sys.,
179 F.R.D. 126 (S.D.N.Y. 1998) 13

Blau v. Lehman,
368 U.S. 403 (1962) 23

Burkhart v. Allison Realty Trust,
363 F. Supp. 1286 (N.D. Ill. 1973) 19

Central Bank, N.A. v. First Interstate Bank, N.A.,
511 U.S. 164 (1994) 7, 16, 22

Christoffel v. E.F. Hutton & Co.,
588 F.2d 665 (9th Cir. 1978) 17

Dennis v. General Imaging, Inc.,
918 F.2d 496 (5th Cir. 1990) 11

Ellison v. Am. Image Motor Co.,
36 F. Supp. 2d 628 (S.D.N.Y. 1999) 17, 18

Feder v. Martin Marietta Corp.,
406 F.2d 260 (2d Cir. 1969) 23

First Interstate Bank v. Pring,
969 F.2d 891 (10th Cir. 1992),
rev'd on other grounds sub nom.,
Central Bank, N.A. v. First Interstate Bank, N.A.,
511 U.S. 164 (1994) 16

G.A. Thompson & Co. v. Partridge,
636 F.2d 945 (5th Cir. 1981) 11, 17

Gustafson v. Alloyd Co.,
513 U.S. 561 (1995) 12

Harriman v. EI Dupont De Nemours & Co,
372 F. Supp. 101 (D. Del. 1974) 19, 20

Harvey M. Jasper Retirement Trust v. Ivax, Corp.,
920 F. Supp. 1260 (S.D. Fla. 1995) 20

Hawkins v. Merrill, Lynch, Pierce Fenner & Beane,
85 F. Supp. 104 (W.D. Ark. 1949) 20

Herman & MacLean v. Huddleston,
459 U.S. 375 (1983) 3, 12

Page

Hertzberg v. Dignity Partners, Inc.,
191 F.3d 1076 (9th Cir. 1999) 13

Hollinger v. Titan Capital Corp.,
914 F.2d 1564 (9th Cir. 1990) 21, 22, 24

Holmes v. Bateson,
583 F.2d 542 (1st Cir. 1978) 21

In re Falstaff Brewing Corp. Antitrust Litig.,
441 F. Supp. 62 (E.D. Mo. 1978) 23

In re Landry's Seafood Restaurants, Inc. Sec. Litig.,
No. H-99-1948, 2000 U.S. Dist. LEXIS 7005
(S.D. Tex. Mar. 30, 2000) 24

In re Landry's Seafood Restaurants, Inc. Sec. Litig.,
No. H-99-1948 (S.D. Tex. Feb. 20, 2001) 17, 18, 20

In re Paracelsus Corp.,
6 F. Supp. 2d 626 (S.D. Tex. 1998) 2, 20

In re Sec. Litig. BMC Software, Inc.,
183 F. Supp. 2d 860 (S.D. Tex. 2001) 17, 18

Klapmeier v. Telecheck Int'l, Inc.,
315 F. Supp. 1360 (D. Minn. 1970) 20

Lone Star Ladies Inv. Club v. Schlotzsky's Inc.,
238 F.3d 363 (5th Cir. 2001) 2, 24

Murphy v. Hollywood Entm't Corp.,
No. 95-1926-MA, 1996 U.S. Dist. LEXIS 22207
(D. Ore. May 9, 1996) 3

Myzel v. Fields,
386 F.2d 718 (8th Cir. 1967) 16, 20

Paul F. Newton & Co. v. Texas Commerce Bank,
630 F.2d 1111 (5th Cir. 1980) 22

Pinter v. Dahl,
486 U.S. 622 (1988) 13

Rattner v. Lehman,
193 F.2d 564 (2d Cir. 1952) 23

Robertson v. Strassner,
32 F. Supp. 2d 443 (S.D. Tex. 1998) 21

Rubinstein v. Collins,
20 F.3d 160 (5th Cir. 1994) 20

Page

Ruiz v. Charles Schwab & Co.,
736 F. Supp. 461 (S.D.N.Y. 1990) 21

SEC v. First Jersey Sec.,
101 F.3d 1450 (2d Cir. 1996) 17

Schwartz v. Celestial Seasonings,
178 F.R.D. 545 (D. Colo. 1998) 13

Sennott v. Rodman & Renshaw,
474 F.2d 32 (7th Cir. 1973) 21

Sharp v. Coopers & Lybrand,
649 F.2d 175 (3d Cir. 1981) 20, 21

Stern v. Am. Bankshares Corp.,
429 F. Supp. 818 (E.D. Wis. 1977) 17, 19, 24

STATUTES, RULES AND REGULATIONS

15 U.S.C.
§77a 1
§77e 12
§77f 12
§77g 12
§77j 12
§77k . . . . . *passim*
§77k(a) 12
§77k(e) 12
§77k(g) 12
§77l 13
§77l(a)(2) 13
§77o . . . . . *passim*
§77p(b) 20
§78t(a) 11, 16, 17, 21

Federal Rules of Civil Procedure
Rule 8 . . . . . 2, 24, 25
Rule 9 2
Rule 12(b)(6) 1

17 C.F.R.
§230.174(d) 13
§230.405(f) 17

SECONDARY AUTHORITIES

Harry Schulman, *Civil Liability and the Securities Act* (1933)
43 Yale L.J. 227 14

Page

Larry D. Soderquist, *Understanding the Securities Laws* (PLI 2001)
§13:2.2 23

9 Loss & Seligman, *Fundamentals of Securities Regulation* (3d ed. 1995)
4267 13

Note, *Legislation* (1933)
33 Colum. L. Rev. 1220 14

William O. Douglas & George E. Bates, *The Federal Securities Act of 1933* (1933)
43 Yale L.J. 171 14

LEGISLATIVE HISTORY

H.R. Rep. No. 85, 73d Cong, 1st Sess (1933) 13

H.R. Rep. No. 1838, 73d Cong., 2d Sess (1934) 14

I. INTRODUCTION

In 8/01, CEO Jeff Skilling abandoned Enron for "personal reasons." Within two months, revelations of financial misconduct and scandal engulfed Enron – in short order destroying the Company. But just a few months earlier, Enron's Board of Directors, including Enron director Frank Savage, pulled off the gigantic sale of $1.9 billion in Zero Coupon Convertible Senior Notes due 2021 (the "0% Notes"). The Registration Statement for this offering incorporated Enron's ***admittedly*** false 98, 99 and 00 financial statements, as well as its grossly inflated and blatantly false interim 01 financials, *i.e.*, ***the quarter ending 3/31/01***. The falsity of this 7/01 Registration Statement simply cannot be disputed: it was filed only a ***few months*** before Enron collapsed, indeed imploded, in the largest and worst financial scandal in history and contained financial statements that have been restated by hundreds of millions – indeed billions of dollars.

There is no dispute Enron director Savage signed the 7/01 0% Notes Registration Statement – he had to under the law. Under §11 of the 1993 Act,[1] Savage is *prima facie* liable for any misstatements contained in that Registration Statement, unless he ***proves*** his "due diligence" defense. But that is not all. Savage was an employee of Alliance Capital Management ("Alliance") – and Alliance was Enron's ***single largest outside shareholder***. Savage sat on Enron's Board to represent and protect Alliance's interests. Alliance is liable as a controlling person of Savage for Savage's liability, unless Alliance ***proves*** its "good faith" defense. None of this can be determined at the Rule 12(b)(6) stage as these are ***affirmative defenses*** which necessarily raise factual issues.

Alliance's motion to dismiss fails miserably because the vast majority of its arguments require the resolution of disputed factual issues. For example, Alliance argues it is not responsible for Savage's misdeeds under the doctrine of *respondeat superior* (which would necessitate a factual analysis regarding Savage's scope of employment), and alternatively argues it is entitled to the good faith defense under §15 (a defense inapplicable under *respondeat superior*). Alliance's entire argument blurs legal theories – and the ***facts needed to prove them*** – in an attempt to mislead the Court concerning plaintiffs' minimal pleading burden. Because plaintiffs' §§11 and 15 claims are

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[1] 15 U.S.C. §77a, *et seq.*

non-fraud claims, plaintiffs need not meet the heightened pleading burden under Rule 9(b) or the PSLRA. Instead, all that is required is a "short and plain" statement of plaintiffs' allegations under Rule 8 – a test which, plaintiffs' respectfully submit, they have complied with.[2] Accordingly, Alliance's motion must be denied.

II. ARGUMENT

A. Pleading Standard

Alliance's liability is based ***solely*** on the 1933 Act. Because claims arising under §§11 and 15 are ***not*** fraud claims, the heightened pleading standard under Rule 9(b) does not apply. Since plaintiffs' CC[3] "disavows and disclaims any allegation of fraud in its strict liability 1933 Securities Act claims, plaintiffs claims do not 'sound in fraud' and they cannot be dismissed for failure to satisfy Rule 9(b)." *In re Paracelsus Corp.*, 6 F. Supp. 2d 626, 633 n.13 (S.D. Tex. 1998) (citing *Lone Star Ladies Inv. Club v. Schlotzsky's Inc.*, 238 F.3d 363 (5th Cir. 2001)).

Here, plaintiffs have explicitly disclaimed any allegation that Savage or Alliance are sued for fraud. *See* ¶2 n.1.[4] Plaintiffs further circumscribe the relief sought by incorporating only those paragraphs containing allegations not sounding in fraud. ¶1005. As noted in the CC, plaintiffs expressly excluded and disclaimed any allegation that could be construed as alleging fraud or intentional or reckless misconduct since the §§11 and 15 claims are based "solely on claims of strict liability and/or negligence under the 1933 Act." *Id.* Thus, under the reasoning of *Lone Star Ladies*, 238 F.3d 363, and *In re Landry's Seafood Restaurants, Inc. Sec. Litig.*, No. H-99-1948, 2000 U.S. Dist. LEXIS 7005 (S.D. Tex. Mar. 30, 2000), these claims need only meet the minimal pleading burden of Rule 8 – plaintiffs need ***not*** allege their claims against Savage and Alliance with particularity. Defendants' arguments to the contrary should be rejected as the Court did so in

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[2] Ironically, several defendants have moved to dismiss plaintiffs' Consolidated Complaint on the ground that it is ***too long, too detailed***. *See* Certain Director Defendants' Brf.

[3] Citations to plaintiffs' Consolidated Complaint ("CC") are designated as "¶__."

[4] Savage's argument that plaintiffs, by expressly disavowing any allegations of fraud in their §11 claims (¶¶2, 1005), have "conclusively established" his affirmative defense is circular and nonsensical. Directors' Brf. at 57. Under this rationale, plaintiffs would have to plead fraud for their §11 claims – contrary to the law of this Circuit – in order to survive a 12(b)(6) motion. Clearly, this assertion has no merit.

Landry's. See also Herman & MacLean v. Huddleston, 459 U.S. 375 (1983) (holding plaintiff may sue under both 1933 Act §11 and 1934 Act §10(b) for same wrong but subjecting only 1934 Act claim to Rule 9(b)'s heightened pleading standard).

B. Plaintiffs Have Properly Pleaded Their Underlying Section 11 Claim Against Savage

Plaintiffs have properly pleaded all elements of a §11 claim against Savage, based on his signing of the allegedly false and misleading Registration Statement for the 0% Notes. The Registration Statement (and accompanying Prospectus) was false and misleading. It contained false statements and omitted to state facts necessary to make the statements made therein – and Enron's financial statements incorporated therein – not misleading, and misrepresented and failed to adequately disclose numerous other material facts as detailed herein. Specifically, the CC alleges the Registration Statement used to sell these securities incorporated by reference various of Enron's 10-K reports and other SEC filings (including 10-Q reports) and included Enron's then most recently released financial statements and reports, which, as detailed below, were false and misleading in many significant respects.

1. The Falsity of the Registration Statement

The 0% Notes Registration Statement was false and misleading due to the incorporation of Enron's 00 10-K and 3/31/01 10-Q that contained Enron's ***admittedly false financial statements for 98-00, and the 1stQ 01, which understated Enron's debt by billions of dollars and overstated its earnings by hundreds of millions of dollars***, as detailed in ¶¶418-611 of the CC. Enron's 98, 99 and 00 financial statements were all restated – and the restatement of previously issued financial statements is an admission that they were materially false when made. While the Registration Statement included audited annual financial statements, significantly, it also incorporated ***Enron's 3/31/01 10-Q which contained Enron's false and misleading unaudited first quarter financial results***. ¶¶336, 612-641.[5] ***Of course, since the interim financial statements were unaudited they***

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[5] While the signers of these Registration Statements may be able at trial to establish a defense to liability for these expertised, *i.e.*, certified financial statements, in light of the CC's allegations that they knew those annual certified financial statements were false they may not do so now at the 12(b)(6) stage. *Murphy v. Hollywood Entm't Corp.*, No. 95-1926-MA, 1996 U.S. Dist. LEXIS 22207 (D. Ore. May 9, 1996).

were not expertised and all signers of the Registration Statement, including Savage, and any entity that controlled a signer of it – Alliance – are legally responsible for the accuracy of those interim unaudited financial statements.

Under 1933 Act §11, each signer of the 0% Notes Registration Statement is *prima facie* liable to the purchasers of those securities subject to the ***defendant proving that they did not know, or with the exercise of due care or diligence,*** could not have known of the falsity of the Registration Statement containing these false financial results, and in the case of a controlling person that it had reasonable ground to know of the misstatement. Given the duration of falsity (over three years) and the size of the falsity (literally billions of dollars) of the 98-00 and 1stQ 01 financial statements in the Registration Statement, the signers of this Registration Statement (and those who controlled any signer) face quite a burden in this regard.

The falsity of the 0% Notes Registration Statement was not confined to false financial statements. This Registration Statement was materially false in many other aspects. For instance, it incorporated a statement to the effect that any transactions Enron had entered into with its "unconsolidated equity affiliates" were on terms "***reasonable***" when compared to those that could have been obtained from third parties. Obviously that statement is false, given the looting of Enron that occurred via the LJM2 partnership's SPE transactions with Enron. Enron's directors – including Savage – who repeatedly waived Enron's conflict of interest policies to enable Fastow and his friends to self deal via LJM2, will have a very difficult time proving that they did not know (or in the exercise of due care could not have known) of the falsity of these related party transaction misrepresentations.

a. False and Misleading Statements About EBS and the EIN

The 0% Notes Registration Statement incorporated Enron's 00 10-K which contained false statements about Enron's EBS business, including the EIN. Enron's 00 10-K extolled the progress of the EIN's development (¶636):

> During 2000 Enron Broadband Services ***substantially completed the Enron Intelligence Network ("EIN")***, a high capacity, global fiber optic network which through pooling points can switch capacity from one independent network to another and create scalability.

* * *

At December 31, 2000, the EIN included ***25 pooling points of which 18 were in the U.S.*** and one each in Tokyo, London, Brussels, Amsterdam, Paris, Dusseldorf, and Frankfurt, allowing the EIN to ***connect to most major U.S. cities*** and a large number in Europe.

* * *

Enron's Broadband Operating System ***provides the intelligence to the EIN and connects to both physical and software network elements***. Enron's broadband operating system enables the EIN to: (i) provision bandwidth in real time; (ii) control quality and access to the network for internet service providers; and (iii) control and monitor applications ***as they stream over the network*** to ensure quality and avoid congested routes. ***Enron's broadband operating system automates the transaction process*** from the order's inception to electronic billing and funds transfer. As a result, ***the EIN allows Enron to provide high quality content delivery services for content providers*** and to contract for firm bandwidth delivery commitments to support Enron's bandwidth intermediation business.

* * *

Enron ***provides premium broadband delivery services*** for media and entertainment, financial services, general enterprise and technology companies. The ***transportation of media-rich content, including live and on-demand streaming video, over the EIN*** significantly enhances the quality and speed to end-users from that provided by the public internet.

* * *

In implementing Enron's network strategy, Broadband Services is constructing the Enron Intelligent Network, a nationwide fiber optic network that consists of both fiber deployed by Enron and acquired capacity on non-Enron networks and is ***managed by Enron's Broadband Operating System software***.... Enron's bandwidth-on-demand platform ***allows delivery of high-bandwidth media-rich content such as video streaming, high capacity data transport and video conferencing***.

These statements were false because the EIN and the underlying BOS never worked. An internal EBS document showing data as of 12/00 reflected that only 3 U.S. cities – Las Vegas, Los Angeles and New York – and London had pooling points that were running/operating by the end of the year, and pooling-point equipment installed in other cities was ***not yet operational because the equipment in each of those cities had not yet been connected to a network-operations center***, which was required before the pooling-point equipment could transmit bandwidth beyond that location. Most of Enron's fiber-optic network was "dark," *i.e.*, not operating. In truth, Enron could

not even make a broadband connection between Portland and Seattle, and was using ISPs to carry content that it represented to be transmitted by EIN's video-streaming.[6]

b. False Statements Regarding EES

Enron's 00 10-K and 01 10-Q filings contain false statements about EES. Enron's 1stQ 01 10-Q stated that EES, which included commodity and energy-asset management and services contracts, had 1stQ 01 revenues of $693 million and income of $40 million, which was a dramatic improvement over 1stQ 00 revenue of $314 million and income of $6 million. The 10-Q stated the increase in EES revenues was "primarily ... a result of long-term energy contracts originated in 2001 and the growth of energy services' European operations." These numbers were materially false and misleading because the revenue and income for both 1stQ 00 and 1stQ 01 were falsified and overstated due to overvaluation of the EES contracts and Enron's abuse of mark-to-market accounting as detailed at ¶¶418-611. ¶640. Likewise, in Enron's 00 10-K, Enron reported income for EES of $165 million, which was a huge increase over the reported $68 million loss in 99, and attributed 00 revenue and gross-margin increases – $2.8 billion and $331 million, respectively, compared to 99 – primarily to long-term contracts originated in 00 and the increase in value of the EES contract portfolio. Enron's 99 10-K stated that EES was a "nationwide provider of energy outsourcing products and services to business customers," including energy management services directly to commercial and industrial customers to reduce total energy costs, and reported EES total revenue of $1.8 billion. These numbers were false due to the accounting falsification and manipulations, as described in ¶¶418-611. ¶641.

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[6] The 12/00 internal Enron document also reflects that the 3 U.S. locations were deemed operational only because of Enron's 5/00 acquisition of WarpSpeed, a California software company that had MetaRouter, a software application capable of regulating bandwidth capacity and supply-on-demand at pooling points. Enron used WarpSpeed's MetaRouter software in conjunction with third-party operating systems on the few hundred Sun Microsystems and Windows Media Player servers it had purchased, which Enron had to do because the BOS never worked. ¶638.

c. False and Misleading Statements About Enron's Capitalization

Enron's 00 10-K contained false and misleading statements about Enron's capitalization. The 0% Notes Registration Statement incorporated the following disclosure with either the same prices indicated or lower prices from Enron's 00 10-K (¶618):

> Enron is a party to certain financial contracts which contain provisions for early settlement in the event of a significant market price decline in which Enron's common stock falls below certain levels (prices ranging from $28.20 to $55.00 per share) or if the credit ratings for Enron's unsecured, senior long-term debt obligations fall below investment grade. The impact of this early settlement ***could*** include the issuance of additional shares of Enron common stock.

This purported disclosure was false and misleading because it misrepresented or concealed the nature, substance and effect of the "provisions for early settlement." ***First***, if Enron's stock price declined below the stated price levels, then Enron ***had*** to issue more shares – as it did in the Raptors – ***and the risk of this event was imminent***. ***Second***, the so-called disclosure concealed that in Enron's bogus hedge transactions Enron bore the ultimate risk of the so-called hedges – Enron was actually hedging with itself, not really hedging – and thus was ***multiplying, not reducing its risk***. None of these matters were disclosed. ***And it was well known that the Enron Board members knew – or certainly should have known – that if Enron's stock price hit those triggers it would decimate Enron because of the quantity of shares that Enron would have to issue to bear the risk of the bogus hedges. Third,*** the Registration Statement failed to disclose that "early settlement" could grossly dilute Enron's common stock as it did in the case of the bogus hedging transactions – "early settlement" was an imminent and highly negative risk. ***Fourth,*** the Registration Statement did not disclose that the triggers concerning LJM2/Raptors transactions were, in fact, massive credit support for Enron's bogus hedging transactions. ***Fifth***, the Registration Statement concealed the magnitude of the credit support, which in the case of the LJM2/Raptors transactions alone amounted to over $2 billion. And ***sixth***, the range of the triggers was materially misrepresented as well: the LJM2/Raptors transactions ranged from $57.50 to as high as $83 per share, which would have signaled much higher risk if the true price range and nature, substance and effect of the triggers were disclosed. Moreover, the cost to Enron to just maintain the credit support represented by the undisclosed triggers was approximately $500 million as of 4/02/01. ¶¶619-620.

The true effect of "early settlement" and the undisclosed triggers was that Enron was betting over 100 million shares of its own stock against market volatility and was ***multiplying, not reducing, the Company's risk***. To disclose this about the LJM2/Raptors' triggers (among others) would mean revelation of the fact that Enron's hedging activities were not only bogus – the risk had not been truly hedged – but also that the purported hedging transactions had actually increased the risks to Enron, not reduced them. Enron's banks had structured and prepared the documents for the bogus hedging transactions. Simply stated, ***the stock price issuance triggers were toxic for Enron***.

For example, in a 6/01 meeting between Enron managers and two CS First Boston managing directors – just as the first Registration Statement to permit the resale of the $1.9 billion 0% Notes, (which had been privately placed in 2/01) – CS First Boston discussed with Enron employees the public statements Enron was making in light of the undisclosed dire circumstances presented by the triggers in Enron's bogus hedging transactions. At that time, CS First Boston's managing directors stated, "How can you guys keep doing this?" – referring to Enron's repeated statements to the market that its stock was undervalued. CS First Boston's managing directors continued that even at $40 per share, Enron's stock was still overvalued in their view: "***Do employees actually believe it's worth what management is saying***?" (At that time, Enron's stock was trading at approximately $48.50.) The CS First Boston managing directors added, "***You guys are at a critical price point right now***," referring to the bogus Raptors hedges, and stated that if Enron's stock continued to fall, that would cause Raptor to unwind and the massive credit support provided by Enron to come due. CS First Boston's managing directors asked the Enron managers, "Do you know how much off-balance sheet debt you [Enron] have?" When the Enron executive replied that he thought it was around one to two billion dollars, CS First Boston's managing directors stated, "***Try eight to 12 billion ... if Enron's stock hits $20 a share ... you guys are gonna be fucked***." ¶622.

It is obvious these misstatements misled market sophisticates for when, in 3/01, Skilling indicated to analysts in response to Enron's equity issuance plans that Enron had some financing vehicles "**with *de minimus***" share issuance requirements, no analyst, money manager, or investor challenged this statement as incorrect or inconsistent with Enron's prior disclosures in that regard. ¶623.

d. False and Misleading Statements About Enron's Financial Risk Management

Enron's Registration Statement for the 0% Notes also contained false statements about Enron's purported Financial Risk Management actions, skills and capabilities, incorporated from Enron's 00 10-K. These statements gave the false and misleading impression that Enron had greatly reduced the risk of its business through a series of sophisticated risk-management techniques and risk analyses, and falsely quantified the components of market risk to which Enron was subject. The Registration Statement stated that Enron managed the components of its market risk (*e.g.*, commodity-price risk, interest-rate risk, foreign-currency exchange-rate risk, and equity risk) and its credit risk. Enron had materially compromised, if not altogether destroyed, its Financial Risk Management through its bogus hedging transactions, which Enron's Board members knew, or should have known, made Enron's market risk materially greater than stated. For example, Enron's 00 10-K contained the following:

> FINANCIAL RISK MANAGEMENT
>
> * * *
>
> ***Enron has performed an entity-wide value at risk analysis of virtually all of Enron's financial instruments, including price risk management activities and merchant investments.*** Value at risk incorporates numerous variables that could impact the fair value of Enron's investments, including commodity prices, interest rates, foreign exchange rates, equity prices and associate volatilities, as well as correlation within and across these variables.
>
> The value at risk for equity exposure discussed above is based on J.P. Morgan's RiskMetrics (TM) approach.

¶625.

This was false and misleading. Enron had not done an "entity-wide value at risk analysis" and it had not analyzed its equity exposure because the results of the value-at-risk analysis, or "VaR," did not reflect the Company's leveraging of its equity in 99-01. For example, in Enron's Registration Statements in 01, at a minimum, the results of the VaR did not reflect the massive amount of derivative securities trades that the banks had engaged in with Enron in negotiating and structuring the LJM/Raptors transactions and in participating as LJM2 investors. The derivatives trades Enron executed through LJM2 and the Raptors, in its bogus hedging transactions, with over $2 billion

notional principal, destroyed Enron's Financial Risk Management because those trades leveraged Enron's own equity to extreme multiples. As a matter of market risk, these transactions were so dangerous to Enron that, internally, the banks referred to the trades or the risk they presented as "***toxic waste" or "toxic***." ¶626.

Enron's 00 10-K also states "Non-Trading Market Risk" in the Financial Risk Management discussion which did not disclose or account for the actual impact of the leveraging of Enron's own stock in the LJM2/Raptors bogus hedging transactions. This resulted in a material understatement of Enron's Non-Trading Market Risk. In particular, the Equity category of Enron's Non-Trading Market Risk indicated $7 million for 00, meaning that in 00 there was a 5% chance that on any day Enron would lose $7 million in the event of a severe negative change in Enron's equity exposure. ***This indicated minimal risk***. This statement was false and misleading. ***Enron's leveraging of its own stock in the LJM2/Raptors bogus hedging transactions in 00 alone increased Enron's equity risk materially higher than what was represented – approximately $100 million instead of $7 million – resulting from a severe negative change in Enron's equity exposure***. ¶627.

e. False and Misleading Statements About Enron's Price Risk Management Activities and Financial Instruments

The Registration Statement for Enron's 0% Notes also made numerous misrepresentations concerning Enron's credit risk, incorporated by reference from Enron's 00 10-K. Enron's true credit risk was misstated and the false impression was given that Enron had minimized its credit risk. In truth, Enron had leveraged billions of dollars of its own stock as credit support for the purported third parties that it was dealing with in Enron's bogus hedging transactions through the LJM partnerships and the Raptors.

The Registration Statement for Enron's 0% Notes sale incorporated the following statement from Enron's 00 10-K (¶629):

> Credit risk relates to the risk of loss that Enron would incur as a result of the nonperformance by counterparties pursuant to the terms of their contractual obligations. Enron maintains credit policies with regard to its counterparties that management believes significantly minimize overall credit risk. These policies include an evaluation of potential counterparties' financial condition (including credit rating), collateral requirements under certain circumstances and the use of standardized agreements which allow for the netting of positive and negative exposures associated with a single counterparty.

* * *

> Enron does not anticipate any material impact to its financial position or results of operations as a result of nonperformance of third parties on financial instruments related to non-trading activities.

The 00 10-K further represented that Enron's total reserves for credit exposure were only $452 million as of year-end 00. These statements above were false and misleading. Enron's credit exposure in 00 due to the LJM2/Raptors transactions ***alone*** – over $250 million – was not reflected in the reserves. In 01 Enron's credit exposure due to the LJM2/Raptors transactions, alone, was over $500 million as of 4/01 and $1 billion as of 7/01. And, contrary to what was represented, Enron did anticipate a material impact to Enron's financial position due to Enron's credit exposure. Indeed, from the fall of 00 and during 01, Enron's stock price was spiraling downward, piercing equity issues, and triggering massive credit exposure to Enron. The house of cards was crumbling before the eyes of those who engaged and participated in constructing it. ¶630.

As the foregoing indicates, plaintiffs have more than met their falsity pleading burden with respect to the 0% Notes Registration Statement.

2. Liability Under Section 11

There is no dispute Savage was a member of Enron's Board, or that he signed the 0% Notes Registration Statement. Thus, Savage is *prima facie* liable for any false statements contained in or omissions from the Registration Statement, subject to ***his*** burden of proof of due diligence – a matter not appropriate for resolution on a 12(b)(6) motion. "Lack of participation and good faith constitute an affirmative defense ... since the burden of proof with respect to the latter is on the defendant ... while the burden of establishing control is on the plaintiff."[7] *Thompson*, 636 F.2d at 958. Savage

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[7] Defendants' citation to *Dennis v. General Imaging, Inc.*, 918 F.2d 496 (5th Cir. 1990), is misplaced. Alliance Brf. at 6 n.5. *Dennis* incorrectly states that *G.A. Thompson & Co. v. Partridge*, 636 F.2d 945 (5th Cir. 1981), requires defendants' participation to establish a §20(a) violation. The Fifth Circuit rectified this error in *Abbott v. Equity Group*, 2 F.3d 613, 620 n.18 (5th Cir. 1993) ("*Dennis* does not accurately reflect our rejection in *Thompson* of a 'culpable participation' requirement."). Despite this clarification, defendants have cited a number of district court cases in the Fifth Circuit which mistakenly follow *Dennis*, instead of *Thompson* and *Abbott*. Because the Fifth Circuit has mandated a different approach than other jurisdictions, defendants' authorities from outside this circuit are inapplicable. There is no culpable participation doctrine in this Circuit.

asserts, "[t]he existence of a registration statement is the *sine qua non* of a §11 claim." Directors' Brf. at 58. We agree.

The 1933 Act generally requires securities to be registered before they may be offered or sold to the public, *see* 15 U.S.C. §§77e-77f, and "[s]ections 7 and 10 of the Act set forth the information required in the registration statement and prospectus." *Gustafson v. Alloyd Co.*, 513 U.S. 561, 570 (1995); *see* 15 U.S.C. §§77g, 77j. Section 11 of the 1933 Act gives relief to "any person acquiring" a security ***issued*** pursuant to a materially incomplete or misleading registration statement. 15 U.S.C. §77k(a). If a security's registration statement "contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, ***any person acquiring such security ... may, either at law or in equity, ... sue***" the issuer, its directors, and every person who signed the defective registration statement as well as the underwriters of such security. *Id.*[8] Thus, "[i]f a plaintiff purchased a security ***issued pursuant to a registration statement***, he need only show a material misstatement or omission to establish his *prima facie* case." *Herman & MacLean*, 459 U.S. at 382. Contrary to defendants' "secondary market purchases" argument (*see* Directors' Brf. at 58-59), even those who buy the security after the issuer releases financial statements for more than a year following a registration statement's effective date may recover. 15 U.S.C. §77k(a). ***While those who acquire*** the subject securities ***after*** the issuer releases financial statements for a full year following the date a registration statement is deemed effective must plead and prove actual reliance, this provision is not implicated here as the plaintiffs bought in 01. *See* 15 U.S.C. §§77k(e), (g). Nothing in the statute suggests investors must purchase "in" the offering in order to recover. Section 11's reliance and damages provisions would be nonsensical – as are Alliance's arguments to the contrary (*see* Alliance Brf. at 3 n.4) – if that were the law.[9]

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[8] Unless otherwise noted, all emphasis has been added and citations are omitted.

[9] Defendants do not argue that Staro Asset Management's purchases of the 0% Notes were greater than one year from the offering (since in fact they were not) – requiring plaintiffs to plead reliance – and thus, it will not be addressed in this brief. However, this erroneous assertion is made with respect to several of Enron's other offerings and is rebutted in other of plaintiffs' briefs, including the Outside Directors' brief and the Andersen brief.

Consistent with §11's text, courts "have uniformly allowed for recovery by purchasers in the aftermarket." *Hertzberg v. Dignity Partners, Inc.*, 191 F.3d 1076, 1081 (9th Cir. 1999). In doing so, courts recognized §11 affords relief to purchasers of registered shares, whether they acquired the registered shares ***in*** a public offering or not, if they can "trace" their securities to the offending registration statement. *See, e.g., Schwartz v. Celestial Seasonings*, 178 F.R.D. 545, 554-57 (D. Colo. 1998); *Adair v. Bristol Tech. Sys.*, 179 F.R.D. 126, 131-33 (S.D.N.Y. 1998).[10]

Again, in direct contravention with defendants' arguments (*see* Alliance Brf. at 3 n.4; Directors' Brf. at 58-59), §11 contains "no language which can be read to limit claims only to those investors who purchase their shares directly in a public offering." *Celestial Seasonings*, 178 F.R.D. at 555-56. Rather, "the statute contemplates relief for those who purchase shares after the public offering," *id.* at 556, and "permits the ultimate investor to sue both the issuer and the underwriter notwithstanding a chain of title from issuer to underwriter to dealer to investor, and ***gives the same right of action even to a buyer in the open market***." 9 Loss & Seligman, *Fundamentals of Securities Regulation*, 4267 (3d ed. 1995). Indeed, the 1993 Act's House Report confirms this analysis: because the value of a security may be affected by the information given in the registration statement, ***§11(a)'s remedies "against those responsible for a false or misleading statement filed with the [SEC] are given to all purchasers ... regardless of whether they bought their securities at the time of the original offer or at some later date***." H.R. Rep. No. 85, 73d Cong, 1st Sess, at 22 (1933). The Report emphasizes that Congress desired "to accord a remedy to all purchasers who may reasonably be affected by any statements in the registration statement." *Id.*

Even at the time of its enactment, it was uniformly understood that §11 protected post-offering purchasers of registered securities. William O. Douglas observed that §11 protects an investor who "buys in the open market" because he "may be as much affected by the concealed

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[10] In this respect, §11 is different from §12, which by its terms makes one who uses a misleading prospectus to sell a security liable only "to the person purchasing such security from him." 15 U.S.C. §77l(a)(2). This language in §12 "contemplates a buyer-seller relationship not unlike traditional contractual privity." *Pinter v. Dahl*, 486 U.S. 622, 642 (1988). As a practical matter, this may tend to limit §12(a)(2) claimants to persons who purchase from defendants "in" the offering – or at least in the 25 day post-offering period when, pursuant to SEC Rule 174(d), the prospectus must be used by dealers who sell the securities.

untruths or the omissions as if he had read and understood the registration statement." William O. Douglas & George E. Bates, *The Federal Securities Act of 1933*, 43 Yale L.J. 171, 176 (1933). Yale professor Harry Schulman similarly observed that under §11 an investor "may sue the persons named ***even though he purchased in the market after the securities had gone through several hands***." Harry Schulman, *Civil Liability and the Securities Act*, 43 Yale L.J. 227, 248 (1933). Other law review analyses of the then new legislation reflected the same view, that "a remedy is given to all persons 'acquiring' the security, even though it was not obtained directly from" the defendants, in an offering or otherwise. Note, *Legislation*, 33 Colum. L. Rev. 1220, 1229 (1933) (footnote omitted); *see id.*, at 1228-29 & n.77 (contrasting §11 with §12). When Congress amended §11 the following year, to require proof of reliance from some subsequent investors,[11] the amending bill's Conference Report emphasized that §11's new "reliance" requirement would apply ***only*** to post-offering purchasers.[12]

In the face of this clear, easily understood liability theory and a Registration Statement which reeks of falsity, defendants try to avoid liability by transmogrifying both the CC's allegations and the provisions of the 1933 Act. Their wholly false argument regarding plaintiffs' §11 claim is that the 0% Notes offering was initially a private placement, for which no §11 liability exists, and that the subsequent resale to the public, since it was not the "initial placement," is likewise not actionable under §11. Directors' Brf. at 56-60; Alliance Brf. at 3 n.4. Specifically, Savage argues that the 0% Notes "placement was made 'only to qualified institutional buyers' ... 'deemed not to have been offered to the public,'" and thus, since a "private placement is ***not*** made pursuant to a registration statement, [] no §11 claim may be brought in connection with it." Directors' Brf. at 58 (emphasis in original). ***Conveniently, what is missing from this "analysis" is the underlying fact of the Registration Statement, filed by Enron for the resale of these very 0% Notes to the public effective 7/18/01***! *See* Ex. 29, at 3. While these bonds may indeed have been initially privately placed, the

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[11] *See* Pub. L. No. 34-291, §206(a), 48 Stat. 881 (1934), codified at 15 U.S.C. §77k(a).

[12] Reliance would be required for purchases "after a period of 12 months subsequent to the effective registration date and then ***only*** when the issuer shall have published an earning statement to its security holders covering a period of at least 12 months after the registration date." H.R. Rep. No. 1838, 73d Cong., 2d Sess, at 41 (1934).

0% Notes Registration Statement ***specifically states that it covers the resale of the bonds to the public***. *See* Ex. 29, at 3. This argument is disingenuous in the extreme, and should be dismissed as such.

Taken as a whole, defendants' §11 arguments are nothing more than a collection of erroneous facts (*e.g.*, there is no Registration Statement) combined with mis-cited authority (*e.g.*, plaintiffs are "secondary market purchasers" not entitled to bring a §11 claim) in an attempt to cloud what is otherwise a clear-cut §11 claim. There is – or at least there can be – no dispute that the 0% Notes were a new and unique security. Thus, every purchaser of the 0% Notes during the Class Period unquestionably purchased a security ***issued pursuant to the 7/18/01 Registration Statement***. Not only do defendants' arguments utterly disregard the allegations of the CC in contravention of 12(b)(6), but they are also completely inconsistent with the underlying fact that these 0% Notes were sold to public investors via a Registration Statement which plaintiffs have alleged contained numerous false statements, as set forth in detail above.

There is no question that plaintiffs have plead a valid §11 claim against Savage and therefore Alliance, his employer. Specifically, the CC alleges that plaintiffs bought the 0% Notes pursuant to the Registration Statement, ¶81(e), and that the Registration Statement was false. ¶¶83(ee), 612-613, 615, 618-641. In light of Alliance's argument (*see* Alliance Brf. at 3 n.4), however, plaintiffs will set forth the sequence of events relative to the public sale of the 0% Notes:

- As alleged in the CC, on 6/1/01, Enron filed a preliminary prospectus and registration statement with respect to the following securities:

TITLE	AMOUNT TO BE REGISTERED
Zero Coupon Convertible Senior Notes due 2021	$1,907,698,000

See 6/1/01 Registration Statement, Ex. 29, at 2.

- The preliminary prospectus registration statement stated that ***the registration statement "relate[d] to the offering for resale of Enron Corp.'s Zero Coupon Convertible Senior Notes due 2021***." *Id.* at 3. It also specifically addressed the "private placement issue" discussed in Savage's brief *ad nauseum*. "***This prospectus will be used by selling securityholders to resell their notes*** ...." *Id. See* Directors' Brf. at 56-60.

- The 6/1/01 Registration Statement incorporated by reference the following false financial statements of Enron: Enron's 12/31/98, 99 and 00 financial statements; Enron's 3/31/01 financial statements. *Id.* at 6.

- The Registration Statement was signed by Savage. *Id.* at 59.

- The 6/1/01 Registration Statement was supplemented on 7/13/01, which is identified as "Amendment No. 1" to the 6/1/01 Registration Statement. *See* 7/13/01 Registration Statement attached hereto as Ex. 30, at 1.

- This amendment to the initial registration statement is also signed by Savage. *Id.* at 62.

- On 7/25/01, Enron filed its prospectus with respect to the 0% Notes which by its express terms, related to "the offering ***for resale*** of Enron Corp.'s Zero Coupon Convertible Senior Notes due 2021." *See* 7/25/01 prospectus, attached hereto as Ex. 31, at 1. The prospectus identifies the entities who initially received the notes in the private placement and who will be selling them subject to the Registration Statement. *Id.* at 49-51.

- The prospectus was amended on 8/3/01, 8/17/01, 9/26/01 and 10/12/01, each time identifying additional selling parties and amounts subject to the Registration Statements.

As the foregoing indicates, defendants' "private placement," missing Registration Statement, and "secondary market purchases" arguments contradict not only plaintiffs' allegations, but also the undisputed facts regarding the 0% Notes offering. Thus, this Court should reject those factual and inaccurate claims.

C. Alliance's Control Person Liability

1. Plaintiffs Have Adequately Pleaded Control Person Liability

Section 15 is remedial in nature and should be construed liberally. *See, e.g., Myzel v. Fields*, 386 F.2d 718, 738 (8th Cir. 1967). Under §15, liability attaches to one who "controls" a person who violates any provision of the securities laws. To state a valid claim under §15, a plaintiff need only allege: (i) a violation of the securities laws; and (ii) the defendant was a controlling person with respect to the violation within the meaning of §§15 and 20.[13] *See In re Landry's Seafood*

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[13] Although worded differently, the control person liability provisions of §15 of the 1933 Act and §20(a) of the 1934 Act are interpreted in the same way. *See First Interstate Bank v. Pring*, 969 F.2d 891, 897 (10th Cir. 1992), *rev'd on other grounds sub nom., Central Bank, N.A. v. First Interstate Bank, N.A.*, 511 U.S. 164 (1994). Section 15 of the 1933 Act, 15 U.S.C. §77o, provides:

> Every person who, by or through stock ownership, agency, or otherwise, or who, pursuant to or in connection with an agreement or understanding with one or more other persons by or through stock ownership, agency, or otherwise, controls any

Restaurants, Inc. Sec. Litig., No. H-99-1948, slip op. at 11 n.14 (S.D. Tex. Feb. 20, 2001)[14] (citing *Ellison v. Am. Image Motor Co.*, 36 F. Supp. 2d 628, 637-38 (S.D.N.Y. 1999)); *Christoffel v. E.F. Hutton & Co.*, 588 F.2d 665, 667 (9th Cir. 1978); *Stern v. Am. Bankshares Corp.*, 429 F. Supp. 818, 823 (E.D. Wis. 1977). As the Fifth Circuit held in *Thompson*, 636 F.2d at 957, "[t]he term 'control' ... means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise." *Id.* (citing 17 C.F.R. §230.405(f)). *See also Landry's*, slip op. at 12 n.14 (citing *Ellison*, 36 F. Supp. 2d at 638); *SEC v. First Jersey Sec.*, 101 F.3d 1450, 1473 (2d Cir. 1996).

To successfully plead control person liability, plaintiffs need ***not*** allege the controlling person actually participated in the securities violation. "The Fifth Circuit has stated that a plaintiff need only show that the alleged control persons possessed ***'the power to control*** [the primary violator], not the exercise of the power to control.'" *In re Sec. Litig. BMC Software, Inc.*, 183 F. Supp. 2d 860, 869 n.17 (S.D. Tex. 2001). Similarly, in *Abbott*, the Fifth Circuit held plaintiffs need ***only*** show the power to control, "not the actual exercise of that power." 2 F.3d at 620. As this Court noted in *Landry's*, control may be established by

> demonstrating that the defendant possessed the power to direct or cause the direction of the management and policies of a person through ownership of voting securities,

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> person liable under section 11 or 12 [15 USCS §77k or 77l], shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist.

Id. Section 20(a) of the 1934 Act, 15 U.S.C. §78t(a), contains an analogous control person provision:

> Every person who, directly or indirectly, controls any person liable under any provisions of this title or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

Id.

[14] Due to the length of this opinion, and the fact that this Court has access to it, it is not being attached to this brief.

> by contract, ***business relationships, interlocking directors***, family relationships, and ***the power to influence and control the activities of another***.

Landry's, slip. op. at 12, n.14 (citing *Ellison*, 36 F. Supp. 2d at 638). Thus, courts will generally find control person liability if plaintiffs make a *prima facie* showing defendants had the abstract, indirect power, whether exercised or not, to control a primary violator – and such power was possessed via business relationships, directorships, or even the power to "influence" the activities of another. *See Abbott*, 2 F.3d at 620; *BMC Software*, 183 F. Supp. 2d at 869 n.17; *Ellison*, 36 F. Supp. 2d at 638.

Plaintiffs' CC need not contain detailed allegations concerning the specific aspects of control, especially where, as here, the underlying claim is a §11 non-fraud claim. There is no fraud involved in ***either*** Savage's §11 violation ***or*** Alliance's alleged control of Savage under §15. Alliance argues plaintiffs' control person allegation purportedly fails because "the mere fact of ***Savage's affiliation with Alliance Capital*** is insufficient as a matter of law to make Alliance Capital a 'controlling person.'" Alliance Brf. at 2. But that is ***not*** what is alleged.

Alliance suggests plaintiffs merely plead "Alliance controlled and directed Savage in his activities as a director of Enron" and nothing more. Alliance Brf. at 6. Alliance further suggests that while the ***only*** factual basis for plaintiffs' claim is his employment status at Alliance, the claim is not based on any act Savage performed as an Alliance employee or Board member. Alliance Brf. at 7. These fact-based arguments – entirely ***inappropriate*** on a 12(b)(6) motion – utterly ignore the allegations of the CC. The CC actually alleges:

> Defendant Frank Savage ("Savage") was a director of Enron from 99 through 01, and was a member of its Finance Committee while he was on the Board. Savage signed the false and misleading Enron Registration Statement filed and effective with the SEC on 6/1/01, which was used to sell the following Enron securities as to which §11 claims under the 1933 Act are asserted:
>
> 7/18/01 $1.9 billion Zero Coupon Convertible Senior Notes Due 2021
>
> Since 95, Savage has been Chairman of Alliance Capital Management International (a division of defendant Alliance Capital Management L.P.). Savage was also a director of defendant Alliance Capital Management L.P. ("Alliance"), a large financial services company which provides a broad variety of financial and investment management services and owns, operates and markets a series of mutual funds known as Alliance Mutual Funds. During 00-01, ***Alliance was the largest single institutional shareholder of Enron owning over 43 million shares*** of Enron stock in Alliance mutual funds. In addition, in its investment management business, ***Alliance had purchased millions of shares of Enron stock for the account of several of its large institutional investor clients. Alliance (and Savage) had a huge***

> ***motive to keep Enron stock trading at very high levels. Savage sat on Enron's board to protect Alliance interests and so Alliance would receive the benefits of what Savage learned as a director of Enron and a member of its Finance Committee. Alliance controlled and directed Savage in his activities as a director of Enron.*** A key to keeping Enron's stock high was Enron maintaining its investment grade credit rating and its apparently strong financial condition – which required Enron to constantly raise new capital – an activity which was under the Enron Board's Finance Committee's control. Savage is sued under §11 of the 1933 Act for the above-referenced securities offering. Alliance is sued as a controlling person of Savage and is liable under §§11 and 15 of the 1933 Act.
>
> The individuals named as defendants in ¶¶83(a)-(ee) are referred to herein as the "Enron Defendants." Because of their positions with the Company, each Enron ***Defendant had access to the adverse non-public information about the Company's business, finances, products, markets and present and future business prospects via access to internal corporate documents*** (including the Company's product sales, operating plan, budget and forecast and product sales reports of actual operations compared thereto), ***conversations and connections with other corporate officers and employees, attendance at management and Board of Directors meetings*** and committees thereof and ***via reports and other information provided to them in connection therewith.***
>
> * * *
>
> The Finance Committee monitored, reviewed and approved Enron's financial activities. The Finance Committee reviewed the financial plans and proposals of Enron's management.

¶¶83(ee), (ff), 85(b). Finally, in ¶86, plaintiffs plead that Savage served on Enron's Board of Directors in 00-01, and served on Enron's Finance Committee in 00-01, and on the Compensation & Management Development Committee as of 3/00. These allegations must be accepted as true at this time for purposes of resolving this 12(b)(6) motion.

In *Stern*, 429 F. Supp. at 823, defendants argued plaintiffs must aver "'specific aspects of activity on the part of the defendant which would support a claim of "control"'" and must further allege specific facts regarding the effective exercise of control. The *Stern* court rejected these contentions:

> There need be no allegation of the exercise of control. ***Nor must there be factual allegations showing control.*** *Burkhart v. Allison Realty Trust*, 363 F. Supp. 1286, 1289 (N.D. Ill. 1973); *Harriman v. EI Dupont De Nemours & Co*, 372 F. Supp. 101, 105 (D. Del. 1974) ("since one may be a controlling person without having in fact exercised control, a plaintiff can state a cause of action under Sections 10b-5 and 20(a) of the Act without alleging any affirmative action on the part of the defendant.").

Id. at 824. The court denied defendants' motion to dismiss, noting that ***the nature and extent of plaintiffs' case regarding control could be more readily determined through effective utilization***

of the discovery process. *Id.* Likewise, plaintiffs here have more than met their minimal pleading burden, and Alliance's arguments are really thinly-veiled fact arguments not appropriate at the 12(b)(6) stage.

2. Alliance's Control over Savage Is a Fact Issue that Cannot Be Resolved on a Motion to Dismiss

As this Court has recognized, "whether a defendant is a control person is usually a question of fact." *Landry's*, slip op. at 12 n.14. Indeed, the determination of whether one is a controlling party under §15 is "generally a fact intensive question," *Paracelsus*, 6 F. Supp. 2d at 633, rendering it inappropriate for resolution at the 12(b)(6) stage. ***To grant a dismissal of plaintiffs' control person claim against Alliance "would be a determination of the ultimate fact question" that Alliance is not a controlling person, while a "den[ial] [of] the motion[] to dismiss however cannot and should not be read to imply an ultimate finding that [Alliance is a] ... 'controlling person[],' but only that thus far the court does not have sufficient evidence before it to be able intelligently to rule on the question***." *Klapmeier v. Telecheck Int'l, Inc.*, 315 F. Supp. 1360, 1361 (D. Minn. 1970). *See Harvey M. Jasper Retirement Trust v. Ivax, Corp.*, 920 F. Supp. 1260, 1268 (S.D. Fla. 1995) ("'whether a person is a "controlling person" within the meaning of federal securities law presents a question of fact which cannot ... be resolved at the pleading stage'"); *Rubinstein v. Collins*, 20 F.3d 160, 166 n.15 (5th Cir. 1994).

Alliance's claim that a corporate entity cannot control its employees defies logic, defies common sense, and has been rejected by the courts. Contrary to Alliance's limited reading of §15 (Alliance Brf. at 4-5), the provision has been liberally construed and broadly applied. *See, e.g.*, *Myzel*, 386 F.2d at 738; *Hawkins v. Merrill, Lynch, Pierce Fenner & Beane*, 85 F. Supp. 104 (W.D. Ark. 1949) (Merrill Lynch liable as a control person of a non-employee correspondent, notwithstanding lack of discernible control structure or influence). Of course, employers control their employees: if their employees do not do what they are told they are disciplined or, if necessary, fired – and this applies to high ranking as well as more ordinary employees. Indeed, with respect to a high-ranking employee like Savage, plaintiffs need not rely on the doctrine of *respondeat superior* as Alliance suggests, to hold Alliance liable – simple agency theories apply. *Sharp v. Coopers &*

Lybrand, 649 F.2d 175 (3d Cir. 1981). The *Sharp* Court, relying on *Holmes v. Bateson*, 583 F.2d 542 (1st Cir. 1978), noted:

> [H]igh ranking officers in a corporation, or partners in a partnership, present a different situation from lower level employees. Officers are able to make policy and generally carry authority to bind the corporation. Their action in behalf of the corporation is therefore primary, and holding a corporation liable for their actions does not require *respondeat superior*. The First Circuit apparently recognized this precept, stating in *Holmes* that the corporation "cannot escape its primary liability to the party defrauded." 583 F.2d at 561.

649 F.2d at 182 n.8. Nonetheless, financial and other institutions have repeatedly been held to control employees much lower in rank and stature than Savage. *See, e.g., Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1573 (9th Cir. 1990) ("broker-dealer" is a "controlling person" of its registered agents under §20(a)).

In *Robertson v. Strassner*, 32 F. Supp. 2d 443, 444, 450 (S.D. Tex. 1998), plaintiffs alleged a partnership, NGP, "had the ability to exercise influence over OEDC through Albin," a member and ***manager at NGP who sat on OEDC's Board***. *Id.* And while the basic nature of the fact allegations in *Robertson* are similar to Enron and Alliance, the control ***allegations upheld*** by the *Robertson* court were significantly ***less*** detailed than plaintiffs' detailed allegations here. *Id.* at 450-51.

Similarly, in *Ruiz v. Charles Schwab & Co.*, 736 F. Supp. 461 (S.D.N.Y. 1990), plaintiffs alleged defendant Schwab, a discount brokerage firm, was liable as a controlling person of an independent investment advisor, Peskin, who was neither a Schwab employee nor agent. *Id.* at 462-64. Schwab moved for ***summary judgment*** on plaintiffs' §20(a) claim (among others), which the court ***denied***, finding "***Schwab's influence over Peskin*** and its arguable culpability therefore ***is a genuine issue of material fact still in dispute***." *Id.* at 464. This analysis demonstrates why Alliance's fact-based arguments in its motion to dismiss require this Court to resolve disputed factual issues in Alliance's favor. Notwithstanding plaintiffs' ultimate ability to prove its control person allegations at trial, at this stage of the litigation, the Court must accept as true plaintiffs' allegations concerning Alliance's control of Savage. *See* 18-19, *supra*. Alliance's reliance on *Sennott v. Rodman & Renshaw*, 474 F.2d 32 (7th Cir. 1973) to support its argument that plaintiffs have not properly pleaded their control person allegations is thus misplaced. *See* Alliance Brf. at 8. *Sennott* was decided after a ***full evidentiary hearing*** in which the court found that the weight of the ***evidence*** did

not support a control person finding. *Id.* at 39-40. This case has no bearing on this Court's determination of whether plaintiffs have met their minimal pleading burden.

Alliance argues it cannot be liable for Savage's §11 violation under §15 because it could not be held liable under the doctrine of *respondeat superior*, since plaintiffs cannot demonstrate Savage's acts were within the scope of his employment at Alliance. Alliance Brf. at 7-10. ***First***, Alliance's arguments that Savage was acting outside the scope of his employment at Alliance would require the resolution of disputed factual issues not appropriate at the 12(b)(6) stage.

Second, Alliance apparently does not understand that §15 liability is ***not*** synonymous with *respondeat superior* liability. Section 15 was intended to supplement – not eliminate – the common law theory of *respondeat superior*. *See Paul F. Newton & Co. v. Texas Commerce Bank*, 630 F.2d 1111 (5th Cir. 1980). Thus, a finding of liability under the doctrine of *respondeat superior* is not a prerequisite to a finding of §15 liability. In fact, §15 "'was enacted to ***expand*** rather than to restrict the scope of liability under the securities laws.'" *Hollinger*, 914 F.2d at 1577. Indeed, to the extent that plaintiffs plead (and at trial, prove) *respondeat superior* liability, the "good faith" defense – which Alliance strenuously argues it is entitled to – is inapplicable, and defendants cannot avoid liability by demonstrating facts that would ordinarily entitle it to the defense. *Paul F. Newton*, 630 F. 2d at 1118-119. Thus, "[w]hen both remedies are available, then the agent who personally committed the wrong is primarily liable ... the principal who acts through the agent ... is secondarily liable; and ***other persons who are not subject to respondeat superior but who nevertheless control the wrongdoer can be held liable" under §15***. *Hollinger*, 914 F.2d at 1577-78. However, "[b]ecause the ***liability of persons under [§15] represents an extension of liability, beyond that imposed by the common law***, such persons are afforded statutory defenses not available in the principal-agent context." *Id.* at 1578.

Third, the suggestion that Savage, in serving on Enron's Board, was on a frolic and detour is preposterous. Alliance was a major shareholder of Enron – in fact, the ***single largest*** outside shareholder. Alliance had a huge interest in the performance of Enron's stock and in obtaining accurate information about Enron's business condition, financial prospects, etc. Thus, the CC quite literally and properly alleges Savage "***sat on Enron's board to protect Alliance's interests***" and so

Alliance would get the benefits of what Savage learned as an Alliance director and member of Enron's Board and key finance committee. ¶83(ee). *See, e.g., In re Falstaff Brewing Corp. Antitrust Litig.*, 441 F. Supp. 62, 68 (E.D. Mo. 1978) ("The allegation that the lender defendants controlled the daily affairs of [defendant] ... is surely sufficient under §20(a).").

Alliance feigns surprise at the suggestion that a major shareholder would place an employee/board member on another company's board to protect its financial interest. *See generally* Alliance Brf. at 8-11. But this is nothing new. *See Feder v. Martin Marietta Corp.*, 406 F.2d 260, 265 (2d Cir. 1969) (Second Circuit reversed district court's finding that defendant-corporation had not deputized a president/CEO with respect to his service on another public company's board). *Id.*[15] In *Feder*, the president/CEO of Martin Marietta, Bunker, took a seat on the board of Sperry Rand. Plaintiffs alleged Bunker sat on Sperry's Board for the benefit of Martin, in other words, that Martin deputized Bunker for Martin's benefit, and accordingly, Martin's short-swing profits should be disgorged under §16(b). Although the district court found for Martin, it noted that the inference that Bunker's sitting on Sperry's board would be to Martin's interest was "'obvious when we stop to consider that ***a directorship, by its very nature, carries with it potential access to information unavailable to the ordinary investor***.'" *Feder*, 406 F.2d at 265. The Second Circuit, reversing the trial court, held these facts "***support[ed] an inference that [Martin] deputized Bunker to represent its interests on Sperry's Board***." *Id.* at 265-66.

> It appears to us that a person in Bunker's unique position could act as a deputy for Martin Marietta even in the absence of factors indicating an intention or belief on the part of both companies that he was so acting.

Id. at 265. Similarly, Savage's "unique" position as a director for both Alliance and Enron inured to the benefit of Alliance, as plaintiffs have alleged.

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[15] "'Deputization' is a legal concept that can be used to bring within the coverage of section 16(b) a person or firm who, although not a director, officer, or greater-than-10% holder, has his, her, or its interest in a corporation represented by a person who sits on the board of directors." Larry D. Soderquist, *Understanding the Securities Laws* §13:2.2 (PLI 2001). *See Rattner v. Lehman*, 193 F.2d 564 (2d Cir. 1952) (J. Learned Hand, concurring); *Blau v. Lehman*, 368 U.S. 403, 408-10 (1962). Plaintiffs acknowledge under §16(b), however, defendants are not entitled to the "good faith" affirmative defense that is available to control persons.

3. Alliance's Public Policy Argument Is Erroneous

Alliance's "public policy" arguments also fail. Alliance argues if companies are automatically liable for their employees' misdeeds on other company boards, corporations will curtail such service, causing a void in qualified board members. Alliance Brf. at 10-11. However, a company is not an "insurer" of its representatives merely because it controls them. "The mere fact that a controlling person relationship exists does not mean that vicarious liability necessarily follows. Section 20(a) provides that the 'controlling person' can avoid liability ***if*** she acted in good faith .... By making the good faith defense available to controlling persons, Congress was able to avoid what it deemed to be an undesirable result, namely that of insurer's liability ...." *Hollinger*, 914 F.2d at 1575. Thus it simply is not true corporations will face "open-ended" liability, as Alliance claims. Alliance Brf. at 10. And, like most of Alliance's arguments, whether Alliance is entitled to this affirmative defense cannot be resolved at the 12(b)(6) stage.

III. CONCLUSION

Plaintiffs have met and exceeded their minimal pleading burden under Rule 8 for Alliance's control person liability. Alliance suggests plaintiffs must meet a heightened pleading standard in order to move past the 12(b)(6) stage, but that simply is not the law. *See Lone Star Ladies*, 238 F.3d 363; *Landry's*, 2000 U.S. Dist. LEXIS 7005. Alliance's argument that plaintiffs' allegations are somehow insufficient because they do not set forth the "specific manner" in which Savage protected its interest, or the "benefits" it received, were squarely rejected in *Stern*, 429 F. Supp. at 823-24. Recognizing the fallacy of its legal arguments, Alliance devotes the bulk of its 12-page brief to arguments requiring the resolution of disputed factual issues – whether Savage acted within the scope of his employment, whether any of the applicable affirmative defenses apply, or whether Alliance is a control person of Savage. These highly-factual inquiries concerning the nature and extent of Alliance's control of Savage can more readily be determined through the discovery process, but cannot be resolved here. Although plaintiffs believe they have satisfied their Rule 8 burden,

should the Court find any aspect of plaintiffs' CC deficient for any reason, plaintiffs hereby request the Court grant leave to amend.[16]

Plaintiffs respectfully request the Court deny Alliance's motion to dismiss, and permit plaintiffs the opportunity to seek discovery to prove their allegations.

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Respectfully submitted,

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[16] Plaintiffs incorporate by reference their request for leave to amend, filed concurrently herewith. *See* Plaintiffs' Opposition to Motion of Certain Current and Former Director to Dismiss Pursuant to Rule 8 and Request for Leave to Amend.

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