UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

In re ENRON CORPORATION SECURITIES LITIGATION	§	Civil Action No. H-01-3624 **(Consolidated)**
	§	<u>CLASS ACTION</u>
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 MOTION TO DISMISS FILED BY VINSON & ELKINS L.L.P.

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LEGISLATIVE HISTORY

I. Introduction and Factual Overview

In the face of a 500-page complaint alleging the largest and worst securities fraud in the history of the United States[1] in excruciating detail, every single defendant – including Vinson & Elkins – has moved to dismiss. Some claim it is too detailed. Some claim it is not detailed enough. Everyone denies responsibility and not one defendant has seen fit to answer. Every defendant seeks to avoid accountability by raising technical pleading arguments based on the Private Securities Litigation Reform Act of 1995 ("95 Act") which was meant to deter the filing of ***frivolous*** suits – which everyone knows, except apparently the defendants, this case is not. While it does appear that the 95 Act was successful, at least in this case, in deterring plaintiffs' securities lawyers from filing cookie-cutter complaints, it does not appear to have had the same salutary impact with respect to deterring defendants from filing meritless motions to dismiss.

Vinson & Elkins attempts to portray itself as an innocent victim of the Enron debacle – a law firm that was merely rendering routine legal services to Enron to facilitate ordinary business transactions when it became engulfed in the Enron conflagration. But this is not what is pleaded in the Consolidated Complaint ("CC")[2] and what is pleaded is what controls in the motion to dismiss context. What the CC pleads and what now must be accepted as true is that Vinson & Elkins is liable under the 1934[3] Act because it (i) employed acts, contrivances and devices to deceive; (ii) made or substantially participated in making false or misleading statements; and (iii) participated in a scheme to defraud and a course of business that operated as a fraud or deceit on purchasers of Enron's securities between 10/18/98 and 11/27/01 (the "Class Period").

> In reviewing the sufficiency of a complaint in response to a motion to dismiss for failure to state a claim under Fed. R. Civ. P. 12(b)(6), before any evidence has been submitted, the district court's task is limited. *Scheuer v. Rhodes*, 416 U.S. 232, 236 (1974). The issue is not whether a plaintiff will ultimately prevail but whether the claimant is entitled to offer evidence to support its claims. *Id.* The district court should consider all allegations in favor of the plaintiff and accept as true all well-

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1 *See* John C. Coffee, "Guarding the Gatekeepers," *New York Times*, 5/13/02, at A19 (referring to Enron as a "[m]ajor debacle[ ] of historic dimensions."

2 All references to "¶__" are to paragraphs of the CC filed 4/8/02. Unless otherwise noted, all emphasis is added and citations are omitted throughout.

3 15 U.S.C. §78a, *et seq.*

pleaded facts in the complaint. *Lawal v. British Airways, PLC*, 812 F. Supp. 713, 716 (S.D. Tex. 1992). Dismissal is not appropriate "unless it appears beyond a doubt that the plaintiff can prove no set of facts in support of [his] claim which would entitle him to relief." *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957).

In re Landry's Seafood Restaurants, Inc. Sec. Litig, No. H-99-1948, slip op. at 4 n.8 (S.D. Tex. Feb. 20, 2001).[4] The Fifth Circuit has stated, "we will accept the facts alleged in the complaint as true and construe the allegations in the light most favorable to the plaintiffs." *Nathenson v. Zonagen Inc.*, 267 F.3d 400, 406 (5th Cir. 2001). This Court must consider the allegations in their entirety. As Judge Buchmeyer stated in *STI Classic Fund v. Bollinger Indus.*, No. 3-96-CV-823-R, 1996 U.S. Dist. LEXIS 21553, at *5 (N.D. Tex. Oct. 25, 1996), it is improper to isolate "the circumstances alleged in plaintiffs' amended complaint rather than to consider them in their totality."

These elementary principles are of unusual importance in dealing with Vinson & Elkins' motion to dismiss since it has so disregarded the actual allegations against it in an effort to make it look like Vinson & Elkins is being sued only because it was providing legal services to Enron, which had little or nothing to do with the Enron fraud. But the actual allegations of the CC are far more sinister – and it is those allegations, not Vinson & Elkins' self-serving sanitized version, that must control the fate of the CC's claims against Vinson & Elkins.

Vinson & Elkins was corporate counsel to Enron for many years and Enron was Vinson & Elkins' largest client. Vinson & Elkins participated in the negotiations for, prepared the transaction documents for, and structured Enron's Chewco/JEDI and LJM partnerships and virtually all of their

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4 Because any changes to the pleading requirements were not intended to prevent aggrieved parties from obtaining redress for their valid claims "courts still apply Rule 12(b)(6) principles to motions to dismiss securities class action cases." *In re Boeing Sec. Litig.*, 40 F. Supp. 2d 1160, 1166 (W.D. Wash. 1998) (collecting cases); *see also Bryant v. Avado Brands, Inc.*, 187 F.3d 1271, 1273 n.1 (11th Cir. 1999). Consequently, the court must accept as true all well-pleaded allegations in the complaint and construe them in the light most favorable to plaintiff. *Scheuer v. Rhodes*, 416 U.S. 232 (1974); *Calliott v. HFS, Inc.*, No. 3:97-CV-0924-I, 2000 U.S. Dist. LEXIS 4368, at *8 (N.D. Tex. Mar. 31, 2000); *Zuckerman v. Foxmeyer Health Corp.*, 4 F. Supp. 2d 618, 621 (N.D. Tex. 1998) (Maloney, R.) (stressing that "the complaint is to be liberally construed in favor of the plaintiff"); *Young v. Nationwide Life Ins. Co.*, 2 F. Supp. 2d 914, 919 (S.D. Tex. 1998); *Lawal v. British Airways, PLC*, 812 F. Supp. 713, 716 (S.D. Tex. 1992). "A motion to dismiss for failure to state a claim under Fed. R. Civ. P. 12(b)(6) 'is viewed with disfavor and is rarely granted.'" *Calliott*, 2000 U.S. Dist. LEXIS 4368, at *7. Dismissal is appropriate only if it appears that no relief could be granted under any set of facts that could be proven consistent with the allegations. *Rubinstein v. Collins*, 20 F.3d 160, 166 (5th Cir. 1994) (citing *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957)); *Tuchman v. DSC Communications Corp.*, 818 F. Supp. 971 (N.D. Tex. 1993), *aff'd*, 14 F.3d 1061 (5th Cir. 1994); *Calliott*, 2000 U.S. Dist. LEXIS 4368, at *3.

related special purpose entity ("SPE") transactions with Enron – transactions which were contrivances and deceptive devices which falsified Enron's reported profits and financial condition, thus misleading investors. These entities were the main engines of the Enron fraud. Vinson & Elkins knew that these partnership entities were ***not*** independent of Enron and their SPEs were ***not*** legitimate, independent entities, but rather, entities being utilized to artificially inflate Enron's financial results. Nevertheless, Vinson & Elkins repeatedly gave "true sale" and other opinions that were false – but were indispensable for those deals to take place and the fraudulent scheme to continue. Vinson & Elkins also drafted and approved Enron's SEC filings – including 10-Ks and Registration Statements used to sell billions of dollars of securities to public investors – which it knew contained false statements regarding Enron's transactions with its "unconsolidated affiliates," as well as financial results, which Vinson & Elkins knew were false and misleading as well. Finally, Vinson & Elkins participated in the fraudulent scheme and course of business by conducting a whitewash investigation of what it knew were accurate allegations of fraudulent misconduct to cover up that misconduct – which Vinson & Elkins itself had been involved in. ¶801.

Vinson & Elkins' involvement in Enron's contrived non-arm's-length fraudulent transactions with its unconsolidated affiliates was extensive. Vinson & Elkins participated in structuring and prepared the transaction documents (including opinions) for deals involving at least the following entities (¶802):

Azurix
Canvasback
CASHCo.
Cayco
Condor
Cortez Energy
EES
Egret
Enron Brazil
Enron Broadband
Enron Global Power
Firefly
Iguana
JEDI
JEDI/Big River/Little River
JEDI/Condor
JEDI/Osprey/Whitewing/Condor
JEDI/Whitewing
JEDI II
JEDI II/Ontario
LJM
LJM/Condor/Raptor
LJM/Brazil Power Plant
LJM2
LJM2/Chewco
LJM2/Raptors I, II, III, IV
Mahonia Ltd.
Marengo
Marlin
Newco
Osprey
Red River
Sonoma
Sundance
Wessex
Whitewing
Yosemite
Yukon

As detailed in the CC, Vinson & Elkins was present at the creation of – and then actively and continuously participated in – the fraudulent scheme throughout the balance of the Class Period. Vinson & Elkins worked with Enron to do billions of dollars of deals with purportedly independent partnerships and SPEs which were supposedly legitimate arm's-length business deals. But in fact Vinson & Elkins was participating with Enron's top insiders to repeatedly structure non-arm's-length contrived deals involving secret no loss guarantees and cash offset deposits with controlled entities. Vinson & Elkins knew that Enron's secret control of its counterparties and the secret no loss guarantees deprived these transactions of economic substance and the involvement of independent third parties which were at economic risk. In fact, these deals were nothing more than contrivances – devices to deceive – being used to create hundreds of millions of dollars of phony profits and hide billions of dollars of debt, thus falsifying Enron's financial results contained in Enron's false SEC filings. In combination, these contrivances, devices to deceive and false statements – which were at the very heart of the scheme to defraud – artificially inflated the prices of Enron's publicly traded securities, deceiving and damaging investors.

A. The Year-end 97 Crisis - Formation of Chewco

The fraudulent scheme and course of business involving Enron finds its origin in 97. During mid-97, Enron encountered problems due to a $400+ million loss on a British natural gas transaction and a $100+ million loss due to MTBE transactions, which called into question Enron's trading skills and risk management capabilities and resulted in analysts downgrading Enron's stock and lowering their forecasts of Enron's future earnings per share ("EPS") growth. Enron's stock lost one-third of its value and Enron's executives' performance-based bonuses were slashed. These events were very disturbing to Enron's top insiders who were determined to halt Enron's stock price decline and get the stock to move back to much higher levels. They knew this could only be accomplished by having Enron report stronger-than-expected financial results going forward, thus enabling it to credibly forecast stronger future revenue and earnings growth. Unfortunately, Enron's actual business operations were not capable of generating such results. ¶8.

To make matters worse, in late 97, Enron learned that an entity it had established with an outside investor a few years earlier, Joint Energy Development Incorporated ("JEDI"), had to be restructured, as the outside investor was going to withdraw from JEDI. This created a crisis. Because the outside investor in JEDI was independent of Enron, Enron had been able to engage in transactions with JEDI, recognize revenue and profits on those transactions and not carry JEDI's debt on its books. However, in 12/97, unless JEDI could be quickly restructured by having a new, independent investor come forward, ***Enron would have to wipe out all of the profitable transactions it had done with JEDI in 97 – 40% of that year's profits – and put $700 million of JEDI's debt on Enron's balance sheet and lose the ability to generate profits from similar such deals with JEDI going forward***. ¶9.

Given the events to date in 97, a wipe-out of Enron's previously reported 97 profits and putting millions of dollars of debt back on Enron's balance sheet would have been a catastrophe. Unfortunately, Enron ***could not find a legitimate buyer for the outside investor's interest*** in JEDI by year-end 97. So, in late 12/97, Lay, Skilling and Fastow and Vinson & Elkins, quickly formed a new entity called Chewco, which Enron and an Enron employee (Michael J. Kopper ("Kopper")) who worked for Enron's CFO, Fastow, controlled, to buy the outside investor's interest in JEDI. But, Chewco had no assets; it was just a shell. ***Nor did Chewco have an outside equity investor willing to commit a 3% stake – the minimum required to enable Chewco/JEDI to be a legitimate SPE or treated as independent. So, to avoid the looming catastrophe, Enron and Vinson & Elkins got Barclays Bank to loan $240 million to Chewco so that Chewco could buy the independent investor's investment in JEDI. But because Chewco had no assets and was nothing more than an Enron shell, Barclays required a secret guarantee of repayment from Enron. Barclays also loaned the money to two straw parties (Little River and Big River) to provide $11.4 million for the purported "equity" investment in Chewco. But because the purported equity investors in Chewco were nothing more than "strawmen" for Enron, Barclays also required Chewco to secretly support the purported "equity loans" via a $6.6 million cash reserve with Barclays***! With just one day left in 97, Vinson & Elkins drafted a secret side agreement dated 12/30/97, providing that ***Enron would provide the necessary $6.6 million in cash to fund Chewco's clandestine reserve accounts for Big River Funding and Little River Funding***. The Kopper/Enron side agreement concocted by Vinson & Elkins made it clear that ***no outside equity was used to fund Chewco and thus Chewco was not a legitimate SPE***. ¶808.

Vinson & Elkins also knew that while the shell Chewco and its strawparty "investors" were purportedly being provided independent representation by a separate law firm –Kirkland & Ellis –

in fact, Kirkland & Ellis had been hand picked by Fastow to play that role, was being paid by Enron and was taking its instructions from Fastow and Enron. Thus, Kirkland & Ellis was not providing any separate independent representation of Chewco or its equity investors. Because there was no legitimate independent outside investor in Chewco, the Chewco/JEDI deal was nothing more than a contrivance and device to deceive, a sham deal with no economic substance or risk transfer or involvement of parties independent of Enron. Thus, Chewco was required to have been consolidated with Enron and ***all of Enron's 97 profits generated by transactions with JEDI should have been eliminated***. ¶10. But they were not.

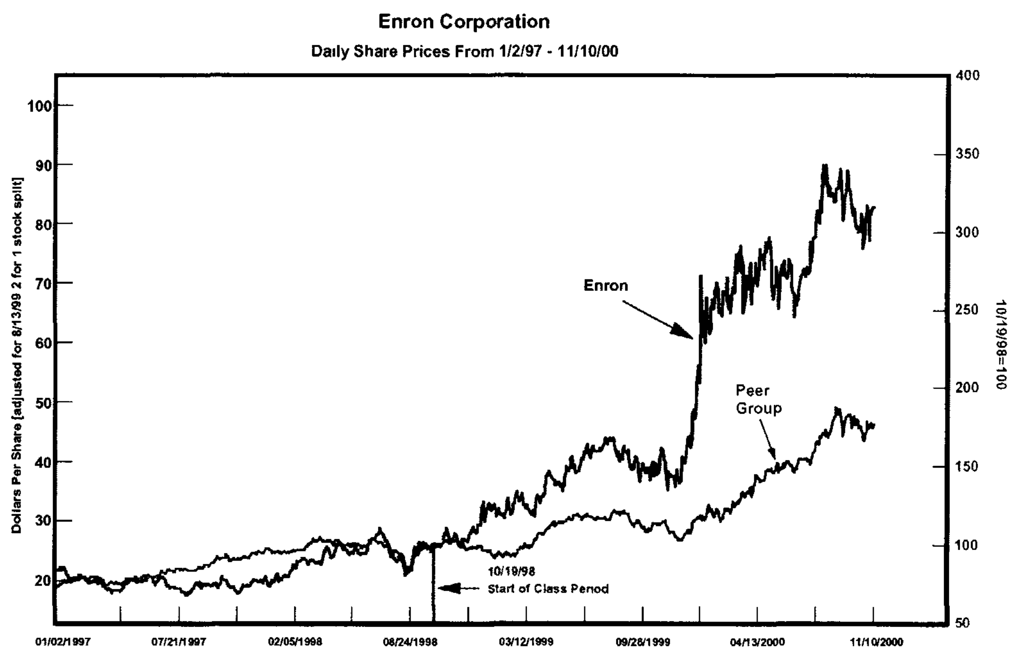
Vinson & Elkins also took additional steps to conceal Chewco's buyout of the partner's interest in JEDI and Enron's secret control of JEDI. Initially, Fastow was to have managerial control of Chewco, but the participants realized that because Fastow was Enron's CFO, Fastow could not have that position ***without Enron having to disclose this conflict of interest in Enron's SEC filings***. This, of course, would have brought unwanted scrutiny and likely resulted in the scheme to falsify Enron's financial results via non-arm's-length deals being exposed at the outset. So Vinson & Elkins and Fastow arranged for Kopper to be substituted as the manager of Chewco, and by this subterfuge concealed the true nature of the Chewco/JEDI buy out and Enron's control of Chewco/JEDI. ¶809. ***The sole purpose for this change was to conceal the Chewco/JEDI transactions***. Prior to the closing of the Chewco deal, Kopper expressed concern over his improper conflict of interest to Vinson & Elkins. Notwithstanding Kopper's complaint to Vinson & Elkins about the non-arm's-length nature of this transaction, Vinson & Elkins and Enron went ahead and closed the deal. ¶810.

By forming Chewco at year-end 97, and arranging the bogus JEDI buyout, Enron and Vinson & Elkins avoided a disaster by keeping Enron's previously recorded profits from transactions with JEDI in place, thus inflating Enron's 97 reported profits by $45 million. They also kept $700 million worth of debt off Enron's books, making Enron look more creditworthy and liquid than it actually was. More importantly, Enron and Vinson & Elkins had now created a secret vehicle that was positioned to serve as a secretly controlled entity which Enron could use going forward to do non-arm's-length transactions with. ***In fact, over the next three years, Vinson & Elkins participated in creating phony profits for Enron (at least $350 million) and allowing Enron to keep billions of***

dollars of debt off its balance sheet and onto Chewco's books, as Vinson & Elkins documented, structured and participated in deal after deal with JEDI/Chewco – non-arm's-length and fraudulent all. ¶11

B. The 97-00 Successes – Enron's Stock Soars

As Enron reported its ***better-than-expected year-end 97 financial results,*** Enron's stock began to move higher, more than recovering the ground it lost in 97. Then, during 98 through mid-01, Enron appeared to evolve into an enormously profitable high-growth enterprise, reaching annual revenues of $100 billion by 00, with net income in excess of $1.2 billion, presenting a very strong balance sheet that entitled it to an investment grade credit rating. As Enron consistently reported ***higher-than-forecasted earnings each quarter***, it forecasted ***continued strong growth going forward***. ¶12. As a result of Enron repeatedly reporting strong EPS, making positive statements about its business, and forecasting continuing strong earnings growth, Enron's stock, debt and preferred securities traded at artificially inflated prices, reflecting Enron's apparent strong financial condition and investment grade credit rating. Enron stock soared to its all-time high of $90-3/4 on 8/23/00 and continued to trade at this high level for months, as shown below (¶15):



However, the apparent success of Enron was an illusion – a false picture created by contrivances and devices to deceive – a scheme to defraud and a wrongful course of business by

Enron and Vinson & Elkins that operated as a fraud and deceit on the purchasers of Enron's publicly traded securities. ¶17.[5]

By 97-98, Enron had become completely dependent on maintaining its investment grade credit rating and a high stock price so that Enron could continue to have access to the capital markets to borrow billions in commercial paper and to enable it to periodically raise the hundreds of millions of dollars of new longer term capital it needed to repay its commercial paper debt and the short-term loans it was receiving from its banks to sustain its business operations, and so the stock issuance "triggers" would not be hit, which would force Enron into a death spiral. To secure financing for the entities Enron controlled and was using to structure manipulative devices to improperly boost its reported profits, Enron had agreed to issue massive amounts of its common stock or otherwise make payments to those entities if Enron's common stock fell below certain so-called "trigger" levels – $83, $81, $79, $68, $60, $57, $52, $48, $34 and $19 per share – and to become liable for the debts of those entities if Enron lost its investment grade credit rating. ¶20.

Enron's investment grade credit rating was indispensable.[6] This investment grade credit rating gave Enron access to the commercial paper market – a market reserved for America's largest and most creditworthy corporations – so that it could borrow billions of dollars to maintain its liquidity and finance its capital-intensive business. It also meant that Enron could easily sell debt securities to public investors to raise long-term capital, using the proceeds to reduce its short-term commercial paper and other bank debt. Finally, Enron's investment grade credit rating was critical to the scheme, because under the terms of the partnership/SPE deals, if Enron's debt was downgraded to below investment grade, the debt of those entities that Enron had told the securities markets was non-recourse as to Enron would become recourse to Enron, which could cause the house of cards to topple.

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5 Obviously, there were other participants in the fraudulent scheme in addition to Vinson & Elkins. However, this brief focuses on Vinson & Elkins' role.

6 As Enron's CFO stated in a 10/01 conference call: "***We understand that our credit rating is critical to both the capital markets as well as our counterparties.***" Earlier, Fastow stated to *CFO Magazine*: "***My credit rating is strategically critical.***" ¶19.

By 97-98, Enron was a hall of mirrors inside a house of cards – reporting hundreds of millions of dollars of phony profits each year while concealing billions of dollars of debt that should have been on its balance sheet, thus inflating its shareholder equity by billions of dollars. Enron had turned into an enormous Ponzi scheme – the largest in history – constantly raising money from public offerings of its securities or those of related entities to sustain itself, while appearing to achieve successful growth and profits. But, because most of Enron's reported profits were being generated by phony, non-arm's-length transactions and improper accounting tricks – including the abuse of "mark-to-market" accounting techniques to accelerate the recognition of hundreds of millions of dollars of profits to ***current periods*** from transactions in which Enron was only entitled to receive ***cash over many future years*** (if ever) – Enron was cash starved. Yet to continue to report ***growing*** profits, Enron was forced not only to continue to engage in such phony transactions and improper accounting tricks, ***but to accelerate the number and size of such transactions it engaged in***, which created a vicious cycle only further exacerbating Enron's need to obtain cash financing from these transactions. ¶18.

C. The LJM Partnerships and SPEs

To falsify Enron's financial condition and inflate its reported results during 99-01, Enron and Vinson & Elkins structured a series of purported "partnership" and "related party" transactions that generated hundreds of millions of dollars in bogus profits while hiding billions of dollars of debt. ¶21. In 99, Enron and Vinson & Elkins participated in the creation of the two ***LJM partnerships that Enron and its CFO Fastow secretly controlled. Over the next few years, Enron engaged in a series of transactions – which were contrivances and deceptive devices – between Enron and the LJM partnerships and LJM SPEs which enabled Enron to falsify its financial results. At the same time, these non-arm's-length deals secretly enriched Fastow and his cronies – as well as several of Enron's bankers who were allowed to get into the LJM2 partnership – by many millions of dollars. Vinson & Elkins knew that the reason for establishing the LJM partnerships was that they would permit Enron to accomplish transactions it could not otherwise accomplish with an independent entity, by providing Enron with a buyer of assets that Enron wanted to sell*** and that those deals were being done on terms unfair to Enron – in effect permitting the looting of Enron for the benefit of the LJM investors, including Fastow, Fastow's cronies and Enron's banks and the top executives of the banks. ¶23. All the non-arm's-length LJM and LJM2 transactions during 99-01 were structured, reviewed and approved by Vinson & Elkins. ¶811.

One of the primary vehicles used to falsify Enron's financial results and deceive investors, was LJM2. Enron and Vinson & Elkins knew that because LJM2 was going to be utilized to engage in transactions with Enron where Enron insiders (Fastow) were on both sides of the transactions, the LJM2 partnership would be extremely lucrative – ***a deal that was virtually guaranteed to provide huge returns to LJM2's investors as the Enron Ponzi scheme went forward***. In fact, Fastow's dual role by which he could self-deal on behalf of the LJM2 partnership with Enron's assets was so important ***that investors in LJM2 were assured, in documents which Vinson & Elkins helped prepare, that they did not have to make any additional capital contributions if Fastow's dual role ended***. ¶24.

Because the LJM2 partnership was potentially so lucrative, Enron's top insiders decided that in funding LJM2, they would ***allow certain of Enron's favored banks and high-level officers of those banks to get in on LJM2 because they knew the investment was virtually guaranteed to produce exceptional returns as the Enron Ponzi scheme continued***. In fact, the offering memorandum for the LJM2 partnership (***not a public document***), which Vinson & Elkins participated in writing, contained an invitation to benefit from the insider self-dealing transactions that LJM2 would engage in with Enron. It stressed the "***unusually attractive investment opportunity***" resulting from LJM2's connection to Enron. It emphasized Fastow's position as Enron's CFO, and that LJM2's day-to-day activities would be managed by Enron insiders Fastow, Kopper, and Ben Glisan, Enron's Treasurer. It explained that "***[t]he Partnership expects that Enron will be the Partnership's primary source of investment opportunities***" and that it "***expects to benefit from having the opportunity to invest in Enron-generated investment opportunities that would not be available otherwise to outside investors.***" It specifically noted that Fastow's "***access to Enron's information pertaining to potential investments will contribute to superior returns.***" ***In addition, investors were told that investors in a similar Fastow-controlled partnership (JEDI) that had done deals with Enron like the ones LJM2 would do had tripled their investment in just two years and***

that overall returns of 2,500% to LJM2 investors were actually anticipated. In short, the offering memorandum, which Vinson & Elkins participated in preparing, was an invitation to join in the fruits of self-dealing transactions with Enron – the looting of Enron. ¶25.

It was indispensable to the scheme that LJM2 be formed before year-end 99 because Enron needed to use it as a vehicle with which it could consummate transactions to create profits in the 4thQ 99. However, as had been the case with Chewco at year-end 97, there was tremendous time pressure and Enron could not fully form or fund LJM2 by year-end 99. Because Enron could not raise the money from outside investors in LJM2 in time to fully fund LJM2 by year-end 99 and enable it to do the desperately needed transactions with Enron, Enron and Vinson & Elkins took other action to get these deals done. In an extraordinary step, on 12/22/99, Enron, Fastow, Kopper and Vinson & Elkins created documentation for LJM2 that enabled certain of Enron's banks and top executives in these banks to secretly "***pre-fund***" LJM2, *i.e.*, advance monies in an amount many times more than their allocated shares in LJM2, so LJM2 had enough capital to do the four desperately needed 99 year-end deals. ¶26.[7] The reason LJM2 had to be "***pre-funded***" in late 12/99 was, as Vinson & Elkins knew, Enron had to do four 99 year-end deals with LJM2 SPEs to enable Enron to avoid reporting very bad 4thQ 99 EPS – which would have caused its stock to plunge. During the last week of 99, Vinson & Elkins worked feverishly with Fastow to structure these four sham contrived transactions between LJM2 and Enron ***prior to year-end 99***. While these four transactions were ***all*** structured in the last week of 99 to enable Enron to report strong 99 EPS, as Vinson & Elkins knew, ***the transactions were then to be reversed during 1stQ 00***.

These vital year-end 99 deals, which Vinson & Elkins participated in structuring, included:

(a) ***Collateralized Loan Obligations ("CLOs"). On 12/22/99***, Enron pooled purchaser CLO rights and sold the lowest-rated tranche to Whitewing LLP (an Enron affiliate) and LJM2. Whitewing loaned LJM2 the money to purchase its interest in the CLOs. Enron secretly

[7] After LJM2 was fully funded in 00 and other investors' money flowed into LJM2, those banks' initial "over-funding" in 12/99 was adjusted for in subsequent capital contributions to LJM2 during 00. ¶26.

guaranteed Whitewing's investment and loan to LJM2. This transaction allowed Enron to record the sale of millions of dollars in the 4thQ 99 to an entity that should have been consolidated.

(b) ***Nowa Sarzyna (Poland Power Plant). On 12/21/99***, Enron sold LJM2 a 75% interest in the Nowa Sarzyna power plant. Enron had tried to sell this interest by year-end to an independent buyer but could not find an independent buyer in time, so it used LJM2, which paid $30 million. This transaction moved millions of dollars of debt off Enron's balance sheet. This was a sham transaction. The debt financing required Enron to maintain ownership of at least 47.5% of the equity until the project was completed. However, the lender ***granted a waiver*** of this until 3/31/00, at which time Enron and Whitewing reacquired LJM2's equity interest and repaid that loan.

(c) ***MEGS, LLC. On 12/29/99***, Enron sold LJM2 a 90% equity interest in MEGS, a natural gas system in the Gulf of Mexico. This allowed Enron to avoid consolidating the asset at year-end 99, avoiding millions of dollars of debt on Enron's balance sheet. Enron repurchased LJM2's interest in MEGS in early 00.

(d) ***Yosemite. On 12/29/99***, Enron purportedly sold certificates in Yosemite to LJM2, however, in fact, this transaction did not occur until 2/28/00. The transaction was made to appear to occur at year-end 99 to reduce Enron's interest in Yosemite from 50% to 10% so Enron would not have to disclose its ownership of these certificates in Enron's 99 financial statements and that, in effect, Enron owned some of its own debt. On 12/29/99, Condor (an affiliate of Whitewing), which was controlled by Enron, loaned the $35 million to LJM2 to buy the certificates. On 12/30/99, LJM2 transferred the certificates to Condor, satisfying the one-day loan. ¶28.

These LJM2 12/22/99 deals, structured and implemented by Vinson & Elkins and Enron, were all non-arm's-length deals – contrivances and deceptive devices – that lacked economic substance or the involvement of independent parties. They were contrivances to falsify Enron's financial results and deceive investors.

The Yosemite deal highlights how phony these 99 year-end deals actually were. Enron had purchased certificates issued by a trust affiliated with Enron called "Yosemite" in order to help conceal disguised loans CitiGroup had made to Enron. Thus, it was important that Enron's intent in Yosemite not be disclosed. However, the only way Enron could avoid disclosing Enron's holdings in Yosemite was to reduce Enron's interest in Yosemite to less than 10% by year-end 99. ***Because no bona fide purchaser would buy Enron's interest in Yosemite, Vinson & Elkins and Fastow concocted a series of transactions designed to make it appear – at least for the last week between 12/25/99 and 1/2/00 – that the Yosemite certificates were not owned by Enron but rather by a "third party," LJM2***. In fact, LJM2 "owned" the Yosemite certificates it bought from Enron for ***a single day***, immediately reselling the Yosemite certificates to another Enron controlled LJM2/SPE, Condor. The Yosemite transaction created and structured by Fastow and Vinson & Elkins was a sham. ¶884.

In mid-12/99, Vinson & Elkins participated in another fraudulent contrivance to help Enron artificially inflate its 4thQ 99 profits. In mid-12/99 – at the same time that Vinson & Elkins was participating in arranging the "***pre-funding***" of LJM2 to permit Enron to conclude four other major transactions before year-end – Vinson & Elkins and Enron structured another phony transaction whereby Merrill Lynch would appear to buy electricity producing barges located off the coast of Nigeria from Enron, which Enron had tried to sell to others without success. This allowed Enron to book a phony $12 million profit. However, as Vinson & Elkins knew, the transaction was a contrivance and device to deceive because McMahon, the treasurer of Enron, ***promised Merrill Lynch that Enron would arrange for Merrill Lynch's investment to be bought-back in mid-00 and that Merrill Lynch would be guaranteed a $500,000 profit from its participation in this deal. McMahon assured Merrill Lynch "We'll make sure you'll get taken out" in the first half of 00. In fact, in mid-00 Enron and Vinson & Elkins arranged for LJM2 to re-purchase Merrill Lynch's purported investment in the SPE they had formed to facilitate the electricity producing barge transaction,[8] the same LJM2 Vinson & Elkins had helped structure in 12/99***.

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8 According to a *Wall Street Journal Article*:

> "This looks like manufactured earnings" says John Coffee, a Columbia University Law School professor. He says that the principle violation ... is "fabricating a structure where they can call it a sale" and thereby book an earnings gain.

Anita Raghavan, "Enron's McMahon: Hero or Collaborator? Current Company President Took Part in a Sale That Helped Give Profits an Artificial Boost," *Wall St. J.*, 4/9/02.

Another non-arm's-length fraudulent deal Vinson & Elkins participated in to artificially boost Enron's 99 profits involved Enron's sale of a 13% stake in a company building a power plant in Cuiaba, Brazil for $11.3 million in 9/99. This "sale" reduced Enron's ownership to the point where Enron purportedly did not control the entity and therefore did not have to consolidate its interest. ***This "sale" enabled Enron to improperly realize $34 million of mark-to-market income in the 3rdQ 99, and another $31 million of mark-to-market income in the 4thQ 99***. LJM1's equity investment in Cuiaba, however, was never "at risk" because, as Vinson & Elkins knew, ***Enron had agreed to make LJM1 whole for its investment at the outset***, thus, depriving the transaction of economic substance. ***And in 8/01, Enron repurchased LJM1's interest in Cuiaba for $14.4 million***! ¶818.

From 6/99 through 6/01, Enron, with the participation of Vinson & Elkins, entered into deal after deal with LJM SPEs, to sell assets to LJM that Enron wanted to get off its books on terms that no independent third party would ever have agreed to. For instance, near the end of the 3rdQ and 4thQ 99, Enron sold interests in seven assets to LJM and LJM2 in transactions structured by Vinson & Elkins. The transactions permitted Enron to conceal its true debt levels by removing the assets from Enron's ***balance sheet and, at the same time, record large gains. However, (i) as it had agreed to do in advance, Enron bought back five of the seven assets after the close of the financial reporting period; (ii) the LJM partnerships made large profits on every transaction, even when the asset they had purchased actually declined in market value; and (iii) those transactions generated "earnings" for Enron of $229 million in the second half of 99 out of total earnings for that period of $549 million. Thus, the LJM partnerships functioned only as vehicles to accommodate the falsification of Enron's reported financial results***. ¶32.[9]

Another example of how Enron and Vinson & Elkins falsified Enron's financial results involved Enron's joint venture with Blockbuster Entertainment. Announced in 7/00, Enron presented this deal as having a billion dollar value – a first-of-its-kind video product whereby consumers would

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[9] The LJM partnerships and SPEs were supposedly being provided separate independent representation by Kirkland & Ellis but as Vinson & Elkins knew this was also a sham as Kirkland & Ellis had been hand picked by Fastow and was actually working for and take its instructions from Fastow and Enron. ¶70.

obtain video-on-demand ("VOD") content to be provided by Blockbuster in their home as if they were watching the movie on their own VCR and that this incredible advance in technology was made possible due to the ***high quality of Enron's fiber optic network***. In a deal structured by Vinson & Elkins, Enron used an LJM2 SPE and abused mark-to-market accounting ***to create an astonishing $110+ million profit on this deal in the 4thQ 99 and 1stQ 00, even though the project was nothing more than a failed pilot project – failing in its test markets because Enron did not have the technology to deliver the product as represented – which was unable to go forward because Blockbuster had not yet obtained and could not obtain the legal right to deliver movies from movie studios in digital format, the only format which could be utilized for VOD***. ¶40.[10] ***Vinson & Elkins knew that CIBC, which purportedly invested in the LJM2 SPE used to do this deal, got a secret no loss guarantee from Enron***. Again the transaction lacked economic substance or the involvement of an independent third party which was at economic risk.

Another way Vinson & Elkins participated in falsifying Enron's financial results was by repeatedly structuring transactions where Enron recognized profits on asset transfers, where Enron's gain or profit was "hedged" with Enron's own stock. One "hedging" transaction with LJM1 in 6/99 involved Rhythms NetConnections ("Rhythms") stock owned by Enron. To "hedge" Enron's huge gains in Rhythms stock and enable Enron to create a huge profit, Enron transferred its own stock to the SPE to "hedge" the gain. Thus, if the SPE were required to pay Enron on the "hedge," Enron's own stock would be the source of payment. Other similar "hedging" transactions occurred in 00 and 01 and involved SPEs known as the "Raptors." These were also structures, funded with Enron's own stock, that were intended to "hedge" against declines in the value of Enron's merchant investments. But none of these transactions were true economic hedges. They actually were contrivances devised to circumvent accounting rules. The economic reality was that Enron never escaped the risk of loss

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[10] Just eight months after announcing this contract with great fanfare, Enron abandon the venture due to the failure of Enron's technology and the inability of Blockbuster to obtain the ability to provide content in digital format. But Enron did not reverse the huge profits it had secretly recorded and improperly reported on this transaction earlier, for to do so would have not only exposed its ongoing abuse and misuse of mark-to-market accounting, but also would have crushed Enron's stock at a time when Enron and the other participants in the scheme were desperately attempting to support Enron's then falling stock price so that it would not fall below certain trigger prices in the SPE agreements. ¶41.

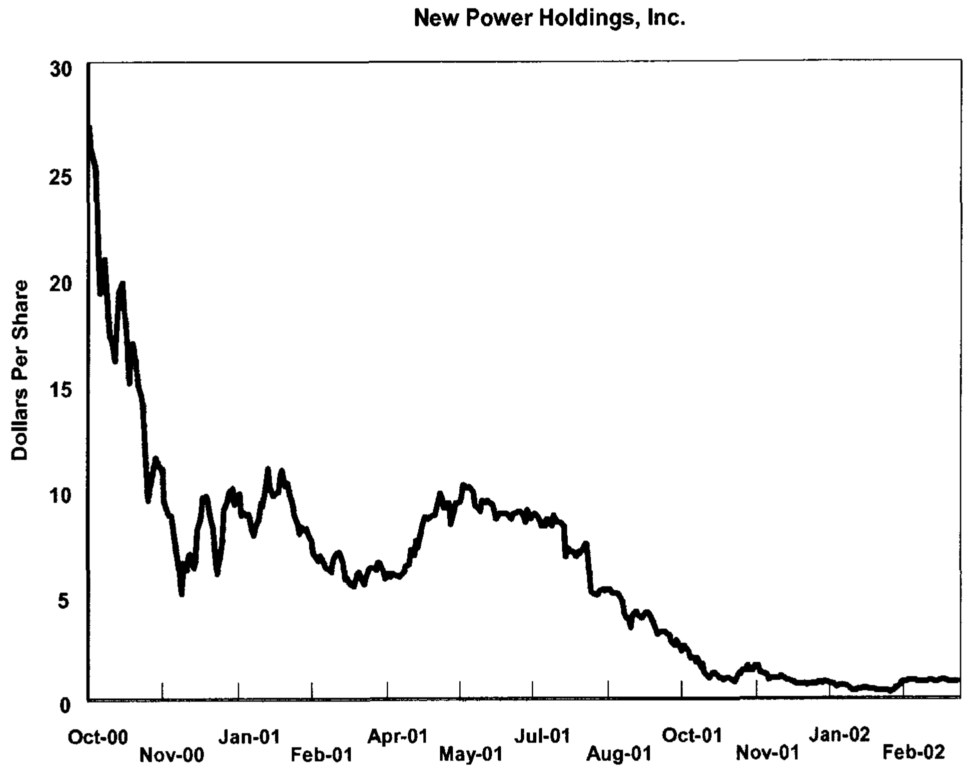
because it had provided the bulk of the capital with which the SPEs would pay Enron. Enron and Vinson & Elkins used these LJM contrivances and deceptive devices to inflate Enron's reported financial results. ***In 99, Enron created income of over $100 million by the Rhythms "hedging" transaction. In the last two quarters of 00, Enron recognized earnings of $530 million on several transactions with the Raptor entities out of reported earnings of $650 million.*** The ***"earnings" from the Raptor contrivances created more than 80% of Enron's total income in that period.*** ¶33.

Yet none of this income was real, as it was created via artificial non-economic hedges where economic risk had not passed from Enron and the profit remained dependent on the value of Enron's own assets, *i.e.*, its stock price.

Hedging Enron's investment gains with Enron's stock not only deprived the transactions of economic substance, it also created an enormous and unusual motive for the participants in the fraudulent scheme to keep Enron stock trading at inflated levels. This was because if the value of the investments fell at the same time as the value of Enron stock fell, the SPEs would be unable to meet their obligations and the "hedges" would fail. This happened in late 00 and meant the Raptor SPEs lacked sufficient credit capacity to pay Enron on the "hedges." In 12/00, Enron's gain on these transactions was over $500 million. Enron could recognize these gains only if the Raptors had the capacity to make good on their debt to Enron. If they did not, Enron would be required to record a "credit reserve." Such a "credit reserve," *i.e.*, loss, would defeat the very purpose of the Raptors, which was to shield Enron's financial statements from losses on its merchant investments. ¶34.

Thus, as year-end 00 approached, two of the Raptor SPEs were in danger of coming unwound as they lacked sufficient credit capacity to support their obligations. If something were not done, Enron would have to take a multi-million dollar charge against earnings which would expose the prior falsification of Enron's financial results and result in Enron's stock plunging, more and more of the stock issuance "triggers" would begin to be hit, and a vicious fatal down-cycle would kick in. To avoid this, Vinson & Elkins and Enron restructured the Raptor SPEs at year-end 00 via contrived transactions ***which did nothing more than transfer rights to receive even more shares of Enron stock to these entities, creating ever-increasing pressure on Enron and the other participants in the scheme to support Enron's stock price.*** This was nothing more than an enormous double down bet on an illegitimate losing hand. But this contrivance enabled Enron to avoid recording a huge credit reserve for the year-ending 12/31/00.

Another example of how Enron and Vinson & Elkins falsified Enron's financial results is the New Power transaction. In the 4thQ 00, Enron desperately needed to create more profits to perpetuate the scheme. Because Enron owned millions of shares of New Power stock and warrants, if Enron could take New Power public and create a trading market in its stock, then Enron could recognize a profit on the gain in value on its New Power securities by "hedging" that gain via yet another non-arm's-length transaction with an LJM2/SPE entity. In 10/00, Enron and Vinson & Elkins pulled off the New Power IPO. Then, via a deal Vinson & Elkins knew had been secretly agreed to before the IPO, Enron created a huge phony profit. Enron and Vinson & Elkins created an LJM2 SPE called "Hawaii 125-0." Enron's banks made a $125 million "loan" to Hawaii 125-0 to fund the deal ***but again received a secret "total return swap" guarantee from Enron to protect the banks against any loss***. Enron transferred New Power securities to Hawaii 125-0 to "secure" the banks' loan and thus created a huge $370 million "profit" on the purported gain in value of its New Power securities. Hawaii 125-0 simultaneously supposedly "hedged" the New Power securities with another entity created and controlled by Enron called "Porcupine." To capitalize Porcupine, LJM2 put $30 million into Porcupine to facilitate the "hedge" of the New Power securities, but just one week later, Porcupine paid the $30 million ***back to LJM2 plus a $9.5 million profit*** – leaving Porcupine with no assets. During 01, New Power stock collapsed:



This collapse converted Enron's gain on its New Power equity holdings into a huge loss – $250 million – which Enron and Vinson & Elkins concealed. ¶42. Again, the transaction lacked economic substance and did not involve independent third parties who were at economic risk

D. Dark Fiber Swaps

By late 9/01, Enron stock was falling, piercing equity issuance "trigger" prices. While Enron now knew it was going to have to take large asset writedowns in its 3rdQ 01 results, Enron was desperate to find a way to limit the size of these writeoffs and generate apparently healthy "operating" earnings. So, on Sunday, 9/30/01, Enron, with the participation of Vinson & Elkins, arranged a huge "swap" of fiber optic assets with Qwest. This Qwest-Enron deal, one of the largest ever recorded, allowed Enron to avoid recording a huge loss by selling an asset whose value had, in fact, plummeted. "***Qwest said we will overpay for the assets, and you will overpay me on the contract,***" one former Enron executive said. ¶43. Again a transaction with no economic substance.

E. Hidden/Disguised Loans

Another tactic utilized by Enron and Vinson & Elkins to falsify Enron's financial condition and hide the true extent of its debt levels involved phony commodity transactions with J.P. Morgan. These contrived transactions involved a J.P. Morgan entity known as "Mahonia," located in the Channel Islands off England. J.P. Morgan and Enron utilized an artifice by which large loans were disguised as commodity trades. In fact, offsetting trades were arranged with the ultimate cost differential being in favor of the bank, representing the interest rate on the disguised loan. ***Enron got Vinson & Elkins to give a false opinion that these transactions were in fact legitimate commodities trades***, *i.e.*, not disguised loans. Thus, by utilizing this contrivance and deceptive device, Vinson & Elkins and Enron further falsified Enron's financial condition to make it appear much stronger and more liquid than it really was, ***concealing some $3.9 billion in debt, which, had it been disclosed, would likely have resulted in Enron losing its investment grade credit rating with all the negative consequences that would flow from that.*** In a suit by Enron against certain insurers, where the insurers alleged that in fact the commodity trades were a fraudulent subterfuge to conceal the real nature of the transactions, *i.e.*, done for the purpose of disguising loans, ***a federal district court judge has ruled that there is significant evidence to support the insurers' claims of fraud and deception and that these commodity swaps were, in fact, disguised loans***. ¶44.

F. Enron's Corporate Culture

Inside Enron there was a fixation on the price of Enron stock and doing whatever was necessary to generate the financial results necessary to push the stock ever higher. For instance, throughout Enron's corporate headquarters in Houston were TV monitors that constantly displayed the price of Enron stock. Inside Enron there was a saying that managers were to always be "***ABC***ing," meaning to "***a***lways ***b***e ***c***losing" deals to generate revenues and profits, even if the economics of the deal were suspect – a practice facilitated by a compensation system inside Enron for corporate managers and executives that directly rewarded them financially for ***closing*** transactions and placing a high (*i.e.*, inflated) value on them, regardless of the true economic substance of the deal, so long as the deal generated an apparent profit when "marked to market." ¶50.

Inside Enron, the pressures applied to corporate managers by the top executives to do anything necessary to enable Enron to make its numbers was widespread, as was the knowledge that Enron's revenues and earnings were being falsified at the direction of top executives who rewarded the lower level managers who engaged in such conduct with bonuses in larger amounts to those who were willing to facilitate what had become a Company-wide fraudulent pattern of behavior. Former insiders have been quoted as saying "***[y]ou don't object to anything***" and "***[t]he whole culture at the vice-president level and above just became a yes-man culture***."

> But that culture had a negative side beyond the inbred arrogance. ***Greed was evident, even in the early days. "More than anywhere else, they talked about how much money we would make," says someone who worked for Skilling. Compensation plans often seemed oriented toward enriching executives rather than generating profits for shareholders. For instance, in Enron's*** energy services division, which managed the energy needs of large companies like Eli Lilly, executives were compensated based on a market valuation formula that relied ***on internal estimates. As a result, says one former executive, there was pressure to, in effect, inflate the value of the contracts – even though it had no impact on the actual cash that was generated.***

Fortune, 12/24/01.

> ***"If your boss was [fudging], and you have never worked anywhere else, you just assume that everybody fudges earnings," says one young Enron control person. "Once you get there and you realized how it was, do you stand up and lose your job? It was scary. It was easy to get into 'Well, everybody else is doing it, so maybe it isn't so bad.***"
>
> *   *   *
>
> ***The flaw only grew more pronounced as Enron struggled to meet the wildly optimistic expectations for growth it had set for itself. "You've got someone at the top saying the stock price is the most important thing, which is driven by earnings," says one insider. "Whoever could provide earnings quickly would be promoted.***"
>
> ***The employee adds that anyone who questioned suspect deals quickly learned to accept assurances of outside lawyers and accountants. She says there was little scrutiny of whether the earnings were real or how they were booked. The more people pushed the envelope with aggressive accounting, she says, the harder they would have to push the next year. "It's like being a heroin junkie," she said. "How do you go cold turkey?"***

Business Week, 2/25/02. In fact, in mid-8/01, an Enron executive (who was a former Andersen accountant) wrote Lay, telling him the Company was "***nothing but an elaborate accounting hoax***," and, in referring to the SPE transactions, that nothing "***will protect Enron if these transactions are***

ever disclosed in the bright light of day*"** – warning that many employees believed "[W]e're such a crooked company*.**" ¶51.

G. Enron's Access to the Capital Markets

Because of the nature and the rapid expansion of Enron's business, Enron constantly needed access to huge amounts of capital. Enron's apparent financial success gave Enron ready access to the capital markets from which Enron, with the participation of Vinson & Elkins, raised billions of dollars of new capital to fund Enron's rapidly expanding businesses by selling Enron securities to public investors. ¶16. But Enron's investment grade credit rating and high stock price could ***only*** be maintained by (i) limiting the amount of debt shown on Enron's balance sheet; (ii) reporting strong current period earnings; ***and*** (iii) forecasting strong future revenue and earnings growth. Yet Enron was able to achieve these ends only through pursuing an increasing number of phony transactions, many of which were accomplished by increasing the number and size of transaction entities which were supposedly independent of Enron but which, in fact, Enron controlled through a series of secret understandings and illicit financing arrangements, including the LJM and LJM2 partnerships. The creation of these SPEs and the billions of dollars of non-arm's-length transactions Enron engaged in with them were accomplished with the active participation of Vinson & Elkins. Enron's illicit financial transactions with the SPEs, including those identified above, allowed Enron to generate hundreds of millions of dollars of phony profits, while concealing billions of dollars of debt – inflating its stockholders' equity by billions of dollars. ***Then, using false and misleading Registration Statements written by Vinson & Elkins, Enron raised billions of dollars in new capital from public investors through numerous securities offerings between 97 and mid-01, thus raising the money necessary to allow Enron pay down its short-term debt and continue to operate.*** These offerings are shown below (¶48):

ENRON SECURITIES UNDERWRITINGS	
Date of Offering	**Security Sold**
5/98	35 million shares of common stock at $25 per share raising $870 million

Date of Offering	Security Sold
7/98	$250,000,000 6.40% Notes due 7/15/2006 $250,000,000 6.95% Notes due 7/15/2028
9/98	$250,000,000 Floating-rate Notes due 3/30/2000
11/98	$250,000,000 6.95% Notes due 7/15/2028
2/99	27.6 million shares of common stock at $31.34 raising $870 million
5/19/99	$500,000,000 7.375% Notes due 5/15/2019
8/10/99	$222,500,000 7% Exchangeable Notes due 7/31/2002
5/00	$500,000,000 Notes due 5/23/2005 and 6/15/2003
2/01 (private placement) 7/01 (resales)	$1,907,698,000 0 Coupon Convertible Notes due 2021.

H. Enron's False and Misleading SEC Filings

Vinson & Elkins drafted and approved Enron's SEC filings, which misrepresented and concealed material facts concerning the JEDI/Chewco and LJM transactions, in the following SEC filings of Enron (¶824):

Quarterly Reports

Report on Form 10-Q, filed 8/16/99
Report on Form 10-Q, filed 11/15/99
Report on Form 10-Q, filed 5/15/00
Report on Form 10-Q, filed 8/14/00
Report on Form 10-Q, filed 11/14/00
Report on Form 10-Q, filed 5/15/01
Report on Form 10-Q, filed 8/14/01

Annual Reports

Report on Form 10-K, filed 3/31/98
Report on Form 10-K, filed 3/31/99
Report on Form 10-K, filed 3/30/00
Report on Form 10-K, filed 4/02/01

Annual Proxies

Annual Proxy, filed 3/30/99
Annual Proxy, filed 5/02/00
Annual Proxy, filed 5/01/01

Other Reports

Report on Form 8-K, filed 2/28/01

Enron's related-party disclosures from Enron's previous 10-Ks and 10-Qs were incorporated by reference into the following Enron Registration Statements for major securities offerings during the Class Period (¶824):

- Resale of Zero Coupon Convertible Senior Notes due 2021, filed 7/25/01
- 7.875% Notes due 6/15/03, filed 6/2/00
- 8.375% Notes due 5/23/05, filed 5/19/00
- 7% Exchangeable Notes due 7/31/02, filed 8/11/99
- 7.375% Notes due 5/15/2019, filed 5/20/99
- Common stock, filed 2/12/99
- 6.95% Notes due 7/15/2028, filed 11/30/98

Vinson & Elkins drafted and approved Enron's SEC filings (10-Ks, 10-Qs and Registration Statements), specifically as they related to Enron's transactions with its "unconsolidated affiliates," *i.e.*, related party transactions. While Enron's SEC-filed reports disclosed the existence of the LJM partnerships, ***they did not reveal the essence of the transactions completely or clearly, and failed to convey the substance of what was going on between Enron and the partnerships, and the self dealing and looting of Enron they were resulting in. The SEC filings also did not fully disclose the nature or extent of Fastow's financial interest in the LJM partnerships. This was the result of Enron and Vinson & Elkins' determination to avoid disclosing Fastow's financial interest and to downplay the significance of the related-party transactions and to disguise their substance and import. The SEC filings also represented that Enron's transactions with its unconsolidated affiliates were negotiated on an arm's-length basis by Enron officers other than Fastow and were on terms reasonable compared to, or on terms no less favorable than could have been obtained in, transactions with third parties when, in fact, they were not. These misleading statements were written by Vinson & Elkins and were false statements that helped to artificially inflate the price of Enron's publicly traded securities***.

Far from being fair to Enron, the non-arm's-length related party transactions in fact were part of the looting of Enron and were extraordinarily lucrative for Fastow and others. The LJM partnerships and their investors were richly rewarded by the looting of Enron resulting from repeated non-arm's-length unfair deals that Vinson & Elkins and Fastow structured. Fastow and other Enron employees received tens of millions of dollars at Enron's expense – enriched, in the aggregate, ***by tens of millions of dollars they should never have received – Fastow by at least $30 million, Kopper by at least $10 million, two other Enron employees by $1 million each and still two more by hundreds of thousands of dollars***. ¶67.

Vinson & Elkins knew that those related party transactions were unfair to Enron and that Enron's representations that the transactions were negotiated at arm's-length by Enron officers other than Fastow on terms reasonable compared to or no less favorable than those that could have been obtained for independent third parties were false. After all, Vinson & Elkins had structured the Chewco/JEDI, LJM and LJM2 vehicles and the non-arm's-length SPE deals. Thus, Vinson & Elkins actually witnessed the favored investors in LJM2, like Fastow and his Enron cronies, as well as Enron's banks and top executives at the banks, ***benefit from*** a series of extraordinary payouts from the Raptor SPEs which LJM2 controlled, securing hundreds of millions of dollars in distributions from the Raptors to LJM2 and ***then to themselves*** – cash generated by the illicit and contrived transactions Enron was engaging in with the Raptors to falsify its financial results, and which Vinson & Elkins was helping to structure and implement.

According to *The New York Times*:

> ***Enron Ex-Chief Said to Voice Suspicion of Fraud***
>
> Jeffrey K. Skilling, the former chief executive of Enron, has told investigators that the top flight financial returns that investors made from a partnership that did business with the company could have been achieved only if the corporation was defrauded, according to documents and people involved in the case.... He indicated to the S.E.C. and to investigators for a special committee of the Enron board that such returns – which were as high as 2,500 percent in one transaction – ***could not have been achieved through arm's-length transactions, according to these people and investigative notes.***

Kurt Eichenwald,"Enron Ex-Chief Said to Voice Suspicion of Fraud," *New York Times*, 4/24/02.

Skilling's recent testimony to the SEC that, upon reviewing LJM2 documents, the returns the LJM2 investors got from the deals LJM2 was getting via SPE deals with Enron – ***as it was immediately apparent to him*** (a man who claims to lack financial sophistication) – were so huge – ***so lavish – that they had to be due to non-arm's-length fraudulent transactions, is key. What does***

this testimony say about the knowledge of a financially sophisticated law firm like Vinson & Elkins – which professes to have great expertise in private equity entities and deals – whose client, Enron, was using the LJM2 private equity partnership to distribute the fruits of those fraudulent non-arm's-length transactions as LJM2 and Fastow looted Enron for their own gain! If poor Mr. Skilling, who has publicly protested his lack of financial sophistication could immediately figure out ***LJM2 was a vehicle to defraud Enron, then it is a reasonable inference that sophisticated commercial lawyers, like Vinson & Elkins, knew it all along***.

Because Vinson & Elkins had participated in structuring one non-arm's-length fraudulent deal after another for Enron with Enron's secret control of the counterparty or its providing secret no loss or repurchase guarantees which deprived the deals of economic substance or an independent third party at risk, Vinson & Elkins knew Enron's SEC filings and the representations and financial statements contained in those SEC filings were false. For instance, Vinson & Elkins' involvement in forming Chewco/JEDI at year-end 97 to avoid reversal of 40% of Enron's previously reported 97 profits and keep hundreds of millions of dollars of debt off its books, and the LJM2 "***pre-funding***" on 12/22/99 to enable LJM2 to engage in four non-arm's-length transactions with Enron in the last days of 99 to create bogus income and hide debt, shows that Vinson & Elkins ***knew (or recklessly disregarded)*** that Enron's 97-00 financial statements were false and its financial condition was being misrepresented.

This also shows Vinson & Elkins knew or recklessly disregarded that the Enron SEC filings it reviewed and approved concerning Enron's transactions with its unconsolidated affiliates, *i.e.*, Chewco/JEDI and the LJMs and their SPEs, which Vinson & Elkins represented were negotiated on an arm's-length basis by Enron officers other than Fastow and on terms reasonable compared to or no less favorable than what could have been obtained from third parties, were false. In fact, they were fraudulent non-arm's-length transactions arranged by Fastow with entities secretly controlled by Enron, which enabled Enron to artificially inflate its reported results and Fastow, Enron banks and the other LJM2 investors to enjoy the profits flowing to them from the looting of Enron.

I. Late 00/Early 01 Prop-Up

In late 00/early 01, Enron's financial results began to come under scrutiny from a few accounting sleuths and short-sellers who began to question the quality of Enron's reported financial results. While Enron assured investors of the correctness of Enron's accounting and the high quality of Enron's earnings, the success and strength of its business and its solid prospects for continued strong profit growth, in part because of this increasing controversy, Enron stock declined. As this price decline accelerated, it put pressure on Enron's top executives to do something – anything – to halt the decline in the price of the stock as they knew that if that price decline continued and the stock fell to lower levels, more and more of the Enron stock "triggers" contained in agreements for deals with the Chewco, LJM and LJM2 entities would be triggered, ***which would require Enron to issue over 100 million shares of its common stock to those partnerships, causing a huge reduction in Enron's shareholders' equity***. ¶52.

In late 3/01, inside Enron it appeared that Enron would be required to take a pre-tax charge against earnings of more than $500 million to reflect a shortfall in credit capacity of the Raptor SPEs, which would have been catastrophic and exposed the scheme. Rather than take that loss and face those consequences, Enron and Vinson & Elkins again" restructured" the Raptor vehicles by transferring ***more than $800 million of contracts to receive Enron's own stock to them just before quarter-end. This was nothing more than a triple down bet on an illegitimate losing hand – but it permitted Enron to conceal huge losses in its merchant investments, keep billions of dollars of debt off Enron's balance sheet and allowed the Ponzi scheme to continue. This was another transfer of huge value for no consideration just compounding the earlier artifices that Enron and Vinson & Elkins had used to create illusory hedges of Enron's gains – gains that were phony in the first place and now were evaporating. This contrivance permitted the continued concealment of the substantial losses in Enron's merchant investments and let the fraudulent scheme continue***. ¶¶53, 823.

J. The Impending Collapse and Attempted Coverup

By the Summer of 01, Enron's top insiders realized that Enron would not be able to continue to sustain the illusion of strong profitable growth and that it would have to take large write-offs in the second half of 01 that, in turn, could result in a downgrade of Enron's critical investment grade credit rating – an event that they knew would mean that debt on the books of the SPEs Enron did business with (and partnerships controlled by them), which debt Enron had assured investors was "***non-recourse***" to Enron, would, in fact, become Enron's obligation. ¶55. Faced with this impending catastrophe, on 8/14/01, Enron announced that Skilling – who had become Enron's CEO just months earlier – was resigning. They said it was for "***personal reasons***." ¶57.

In mid-8/01, just as Skilling resigned, a management level Enron employee (Sherron Watkins) sent Lay a letter laying bare the huge fraud at Enron – focusing on the bogus partnerships and SPE transactions. Her letter stated (¶850):

> Skilling's abrupt departure will raise suspicions of accounting improprieties and valuation issues. Enron has been very aggressive in its accounting – most notably the Raptor transactions and the Condor vehicle. We do have valuation issues with our international assets and possibly some of our EES MTM positions.
>
> The spotlight will be on us, the market just can't accept that Skilling is leaving his dream job.... How do we fix the Raptor and Condor deals?... [W]e will have to pony up Enron stock and that won't go unnoticed.
>
> * * *
>
> We have recognized over $550 million of fair value gains on stocks via our swaps with Raptor, much of that stock has declined significantly – Avici by 98%, from $178 mm to $5 mm. The New Power Co. by 70%, from $20/share to $6/share. The value in the swaps won't be there for Raptor, so once again Enron will issue stock to offset these losses. Raptor is an LJM entity. It sure looks to the layman on the street that we are hiding losses in a related company and will compensate that company with Enron stock in the future.
>
> ***I am incredibly nervous that we will implode in a wave of accounting scandals.... [T]he business world will consider the past successes as nothing but an elaborate accounting hoax***. Skilling is resigning now for "personal reasons" but I think he wasn't having fun, looked down the road and knew this stuff was unfixable and would rather abandon ship now than resign in shame in 2 years.
>
> Is there a way our accounting guru's can unwind these deals now? I have thought and thought about how to do this, but I keep bumping into one big problem – ***we booked the Condor and Raptor deals in 1999 and 2000, we enjoyed a wonderfully high stock price, many executives sold stock, we then try and reverse or fix the deals in 2001 and it's a bit like robbing the bank in one year and trying to pay it back 2 years later. Nice try, but investors were hurt, they bought at $70 and $80/share looking for $120/share and now they're at $38 or worse***. We are under too much scrutiny and there are probably one or two disgruntled "redeployed" employees who know enough about the "funny" accounting to get us in trouble.
>
> * * *

I realize that we have had a lot of smart people looking at this .... ***None of that will protect Enron if these transactions are ever disclosed in the bright light of day.***

* * *

My concern is that the footnotes don't adequately explain the transactions. If adequately explained, the investor would know that the "Entities" described in our related party footnote are thinly capitalized, the equity holders have no skin in the game, and all the value in the entities comes from the underlying value of the derivatives (unfortunately in this case, a big loss) AND Enron stock and N/P. ***Looking at the stock we swapped, I also don't believe any other company would have entered into the equity derivative transactions with us at the same prices or without substantial premiums from Enron.***

* * *

Raptor looks to be a big bet, if the underlying stocks did well, then no one would be the wiser. If Enron stock did well, the stock issuance to these entities would decline and the transactions would be less noticeable. ***All has gone against us. The stocks, most notably Hanover, The New Power Co., and Avici are underwater to great or lesser degrees.***

* * *

I firmly believe that the probability of discovery significantly increased with Skilling's shocking departure. Too many people are looking for a smoking gun.

Summary of Raptor Oddities:

* * *

2. ***The equity derivative transactions do not appear to be at arms length.***

    a. Enron hedged New Power, Hanover, and Avici with the related party at what now appears to be the peak of the market. New Power and Avici have fallen away significantly since. The related party was unable to lay off this risk. This fact pattern is once again very negative for Enron.

    b. ***I don't think any other unrelated company would have entered into these transactions at these prices.*** What else is going on here? What was the compensation to the related party to induce it to enter into such transactions?

3. ***There is a veil of secrecy around LJM and Raptor. Employees question our accounting propriety consistently and constantly.*** This alone is cause for concern.

    a. Jeff McMahon was highly vexed over the inherent conflicts of LJM. ***He complained mightily to Jeff Skilling*** .... 3 days later, Skilling offered him the CEO spot at Enron Industrial Markets ....

    b. ***Cliff Baxter complained mightily to Skilling and all who would listen about the inappropriateness of our transactions with LJM.***

c. I have heard one manager level employee ... say "***I know it would be devastating to all of us, but I wish we would get caught. We're such a crooked company."... Many similar comments are made when you ask about these deals.***

On 8/29/01, a management level employee at Enron's EES operation sent a letter to Enron's Board which laid out and detailed the fraud that was going on in Enron's EES operation (¶853):

To the Board of Directors:

One can only surmise that the removal of Jeff Skilling was an action taken by the board to correct the wrong doings of the various management teams at Enron. However, based on my experience at this company, I'm sure the board has only scratched the surface of the impending problems that plague Enron at the moment. (*i.e.*, EES's ... hiding losses/SEC violations ... lack of product, etc.).

... I feel it is my responsibility to bring to the Board's attention the various ongoing [sic] that I observed during my short tenure (9 months) with the company.

EES Management

... [I]t became obvious that EES had been doing deals for 2 years and was losing money on almost all the deals they had booked. (JC Penney being a $60MM loss alone, then Safeway, Albertson's, GAP, etc.). Some customers threatened to sue if EES didn't close the deal with a loss (Simon Properties – $8MM loss day one).... Overnight the product offerings evaporated. The only product left is for the hotel and mall customers. Except that Starwood is also mad since EES has not invested the $45MM in equipment under the agreement. Enron was supposed to invest $45MM over the first 3 years of the contract. The people who negotiated the contract FORGOT to put in, at Enron's discretion ... it turns out that it doesn't make financial sense for Enron to put in the equipment, but Starwood wants it. Now you will loose [sic] at least $45MM on the deal. The Crisis was set in motion. You should also check on the Safeway contract, Albertson's, IBM and the California contracts that are being renegotiated.... It will add up to over $500MM that EES is losing and trying to hide in Wholesale. Rumor on the 7th floor is that it is closer to $1 Billion....

This is when they decided to merge the EES risk group with Wholesale to hide the $500MM in losses that EES was experiencing. But somehow EES, to everyone's amazement, reported earnings for the 2nd quarter. According to FAS 131 – Statement of Financial Accounting Standards (SFAS) #131, "Disclosures about Segments of an Enterprise and related Information," EES has knowingly misrepresented EES' earnings. This is common knowledge among all the EES employees, and is actually joked about....

There are numerous operational problems with all the accounts.

* * *

... Some would say the house of cards are falling....

You are potentially facing Shareholder lawsuits, Employee lawsuits ... Heat from the Analysts and newspapers. The market has lost all confidence, and its obvious why.

Watkins' letter made clear that Vinson & Elkins had been involved in the fraud and had a clear conflict of interest. Nevertheless, Lay contacted top Vinson & Elkins partners to figure out how to cover up these allegations. ¶851. Vinson & Elkins, despite its clear conflict, agreed to conduct a "purported" investigation into these charges, to limit the scope of its inquiry and to issue a report dismissing the allegations of fraud – even though they knew them to be true. ¶851.

Between 8/15/01 and 10/15/01, Vinson & Elkins conducted a purported investigation of the assertions of wrongdoing – which was actually a cover up. Vinson & Elkins interviewed only top-level Enron executives who had been involved in the fraudulent scheme and a few top Andersen partners on the Enron account, people Vinson & Elkins knew would deny any wrongdoing and be knowledgeable and skillful enough to create a record to cover up what was occurring. On 10/15/01, Vinson & Elkins issued a letter to Enron which basically dismissed ***all*** of Watkins' assertions even though, from its own involvement in the fraud, Vinson & Elkins knew they were true. Vinson & Elkins' 10/15/01 letter belittled and trivialized the assertions – constantly referring to them as coming from an anonymous source – even though Vinson & Elkins well knew who Watkins was and that she was in a position to know what she was asserting. The report concluded (¶855):

> ***In summary, none of the individuals interviewed could identify any transaction between Enron and LJM that was not reasonable from Enron's standpoint or that was contrary to Enron's best interests.***

This was a whitewash report dismissing detailed accounts of fraud, that Vinson & Elkins knew to be true. ¶60.

K. The End of Enron

On 10/16/01, Enron shocked the markets with revelations of $1.0 billion in charges and a reduction of shareholders' equity by $1.2 billion. Within days, *The Wall Street Journal* began an exposé of the JEDI, Chewco and the LJM SPEs, the SEC announced an investigation of Enron, and Fastow resigned. In 11/01, Enron was ***forced to admit that Chewco had never satisfied the SPE accounting rules and – because JEDI's non-consolidation depended on Chewco's status – neither did JEDI, and Enron consolidated Chewco and JEDI retroactive to 97. Enron also admitted it had failed to correct $51 million in errors found by Andersen for 97. This retroactive consolidation resulted in a massive reduction in Enron's reported net income and massive***

increase in its reported debt. Enron revealed that it was restating its 97, 98, 99 and 00 financial results to eliminate $600 million in previously reported profits and approximately $1.2 billion in shareholders' equity as detailed below (¶61):

ENRON ACCOUNTING RESTATEMENTS				
	1997	1998	1999	2000
Recurring Net Income Amount of Overstatement	$ 96,000,000	$113,000,000	$250,000,000	$ 132,000,000
Debt Amount of Understatement	$711,000,000	$561,000,000	$685,000,000	$ 628,000,000
Shareholders' Equity Amount of Overstatement	$313,000,000	$448,000,000	$833,000,000	$1,208,000,000

These partnerships – Chewco, LJM and LJM2 – ***were used by Enron to enter into transactions that Enron could not do with unrelated commercial entities.*** The most significant transactions were designed to ***accomplish favorable financial results, i.e., not to achieve bona fide economic objectives or to transfer risk.*** These transactions allowed Enron to conceal from the market ***very large losses resulting from Enron's merchant investments by creating hedges that were not real hedges – that is, where a third party was obligated to pay Enron the amount of those losses. In fact, in the deals structured by Enron and Vinson & Elkins, that third party was simply an entity in which only Enron had a substantial economic stake. The Raptors transactions alone resulted in Enron reporting earnings from the 3rdQ 00 through the 3rdQ 01 that were almost $1 billion higher than should have been reported!*** ¶62.[11]

L. Exposure of Vinson & Elkins' Complicity in the Fraud

The scheme to defraud Enron investors was extraordinary in scope, duration and size. Hundreds of millions of dollars in phony profits were reported. Billions of dollars of debt was hidden. Shareholders' equity was overstated by billions. This was accomplished over a multi-year

[11] As huge as the 11/01 restatements of Enron's 97-00 financial statements were, they just scratched the surface of the true extent of the prior falsification of Enron's financial statements, failing to eliminate additional hundreds of millions of dollars of phony profits as Enron and Vinson & Elkins were still trying to keep Enron afloat and trying to conceal how extensive the fraud had really been. ¶63.

period through repeated contrivances, devices to deceive and misrepresentations in Enron releases and SEC filings, including the false Registration Statements utilized to raise the billions of dollars of capital which was indispensable to keep Enron afloat. This fraudulent scheme could not have been and was not perpetrated only by Enron and its insiders. It was perpetrated only with the active and knowing involvement of Enron's general counsel, Vinson & Elkins. ¶70.

The apparent complicity of Vinson & Elkins in the scheme to defraud Enron investors has received attracted extensive media interest and coverage. ¶856. "Vinson & Elkins may have to fight for its reputation because of its close ties to Enron, which has become embroiled in a financial scandal that has culminated in the nation's largest-ever bankruptcy filing.... ***[T]he Enron scandal is creeping into the vaunted halls of Vinson & Elkins.***" ¶800.

> By the late 1990s, as Enron muscled its way to an energy trading powerhouse, it became Vinson & Elkins' ***largest client***, accounting for more than 7 percent of the firm's revenues, and helping fuel growth in the firm's securities, corporate and project finance practices. The ties between the firm and Enron were close, and the link was cemented as about 20 Vinson & Elkins lawyers, including recently retired general counsel James V. Derrick, left the firm over the years and accepted jobs in Enron's legal department.

The Recorder, 3/14/02.

> Near the end of Sherron Watkins' extraordinary August memo to her boss, Kenneth Lay, outlining concerns about Enron's accounting practices, ***she cautions against having the company's regular outside counsel Vinson & Elkins investigate the issues she raised.***
>
> ***"Can't use V&E due to conflict," she wrote, "they provided some 'true sale' opinions on some of the deals."***
>
> But Enron did tap Houston-based V&E to handle the investigation. The result was a nine-page letter to Enron's general counsel (and former V&E partner) James Derrick Jr., on Oct. 15 from partner Max Hendrick that, in effect, ***brushed Watkins' concerns aside....***
>
> ***The letter is striking for the narrowness of the investigation, the key people who were not interviewed, and for the way in which it fails to fully probe bombshell allegations .... Despite that, V&E found that none of Watkins' allegations warranted further investigation ....***

The Daily Deal, 1/17/02.

> Just six weeks after Enron Corp. directed its lawyers at Vinson & Elkins to investigate allegations about its secret partnerships, a report came back Oct. 15 ***saying everything was just fine. No need for "further widespread investigation," the lawyers added.***

The very next day, Enron delivered the first in a series of shocks when it slashed shareholder equity by $1.2 billion, partly due to the partnerships. Sixteen days later the board of directors launched their own inquiry, ***which quickly found massive improprieties***.

"Even as the Titanic was sinking, there were certain rooms that were perfectly dry," said Matthew Spitzer, USC Law School dean. "If you asked someone in one of those rooms, 'See any water?,' they'd say no. ***That's the sort of investigation Vinson & Elkins did***."

Los Angeles Times, 3/14/02.

[R]ecent documents released by congressional committees investigating Enron, as well as a scathing report produced by the Enron board's own investigating committee, suggest that [Vinson & Elkins] ***may have been too cozy with its biggest client***.

* * *

In 1997, when Enron launched a new strategy to move debt off its books by using partnerships operated by its own financial officer, it turned to Vinson & Elkins for guidance on how to make the deals work.

Enron's management and board of directors relied heavily on the perceived approval by Vinson & Elkins of how the deals were structured and reported, according to the board's special investigating committee.... [I]t ... said it observed an absence of "objective and professional advice by outside counsel at Vinson & Elkins."

Among the report's allegations:

The law firm was "***consulted frequently***" on the transaction documents for partnership deals that allowed Enron to get around accounting rules. ***The firm accommodated Enron's desire for one partnership, Chewco, to be formed quickly, completing the necessary legal documentation in 48 hours***.

* * *

The firm shared in the failure to disclose the extent to which Enron Chief Financial Officer Andrew Fastow was benefitting from his ownership in the partnerships doing business with Enron.

The firm agreed to investigate the allegations that Watkins raised, even though she said the firm had an inherent conflict of interest. The Powers Report, which was released Feb. 1, said that by limiting the scope of the Vinson & Elkins probe, Enron predetermined the outcome: ***No further investigation was merited***.

* * *

Moreover, in one memo to Lay, Watkins said that on Oct. 16 ***she told Joe Dilg, Vinson & Elkins' managing partner, that Enron ought to "come clean and admit problems." She said the company should restate its 2000 financial earnings to incorporate the ledgers of the partnerships known as Raptors***.

((

Watkins said Dilg replied, "Are you suggesting that Ken Lay should ignore the advice of his counsel and auditors concerning this matter?"

The Fort Worth Star Telegram, 2/24/02.

Aftershocks from the collapse of Enron Corp. have rocked the energy giant's auditors, bankers – ***and now its attorneys. Houston law firm Vinson & Elkins was the latest to be hit when news broke that it had shrugged off allegations of accounting fraud by whistle-blower Sherron S. Watkins. That's an incendiary revelation, for certain....***

... Most experts agree that V&E's seemingly dismissive attitude about the Watkins allegations – months after the transactions she complained about took place – probably does not meet the standard for either criminal or civil liability. ***But that verdict might be different if it turns out that the firm's attorneys also helped Enron devise some of the complex deals that wound up sinking the company in the first place.***

There are growing indications that may just be the case. In her missive to Enron chairman and CEO Kenneth L. Lay, Watkins suggested that the law firm wrote so-called opinion letters vouching for the legality of some of the deals now under scrutiny. ***And according to two ex-Enron executives contacted by BusinessWeek, Vinson & Elkins played a creative role in structuring and managing some of the company's controversial "special purpose" partnerships. One former executive in the company's Houston office says employees would approach Vinson & Elkins lawyers "and say, 'this thing needs to work. How do we make it work?'" This source adds that the firm also gave Enron advice on how much information it had to disclose about its financial machinations in its 10K and 10Q reports to the SEC.***

... "***Under those fact scenarios, they could have real problems***," says [University of Illinois law professor Ronald D. Rotunda, an expert in legal ethics].

* * *

... And Enron is V&E's single largest customer. ***In 2001, Enron accounted for more than 7% of V&E's $450 million in revenue.*** The law firm had several lawyers working virtually full-time on company business, including some permanently stationed in its offices. ***By contrast, Enron contributed less than 1% to auditor Arthur Andersen's revenues.***

... In her letter, Watkins claimed that the firm "***provided some true sale opinions on some of the deals" related to the so-called Condor and Raptor deals.... [T]rue sale opinions are letters that law firms write vouching for the fact that business transactions meet particular legal requirements.*** So, for example, they might certify that title has passed in a particular deal or that it was conducted between two legally independent parties. Such documents would have been important to Enron, since many of its deals took place with partnerships in which it held a large stake.

* * *

According to one former Enron employee, the company might not have been able to pull off many of the transactions now under investigation with Vinson &

Elkins' opinion letters. The company "opinion-shopped for what it needed," says this source. ***"If it hadn't gotten the opinion letters, it couldn't have done the deals."***

BusinessWeek, 1/28/02.

For weeks, the press and public talked around the edges of the quality of the legal work Vinson & Elkins did for the disgraced and embattled Enron Corp.

Then the Powers Report laid it bare.

Prepared by a former enforcement director of the Securities and Exchange Commission, Wilmer, Cutler & Pickering partner William McLucas, the Feb. 1 report on behalf of a special committee of the Enron Corp. board contends that Vinson & Elkins ***was in fact involved in many of Enron's most controversial deals – and was also involved in decisions about how to disclose those deals to the public.***

The document ... sharply criticizes the firm for "***an absence of ... objective and critical professional advice.***"

* * *

The Powers Report focuses on the formation and activities of Enron's now-infamous partnerships – known as JEDI, Chewco, LJM1, LJM2 and the cluster of entities dubbed the Raptors.

The report's summary of Enron's use of Chewco, LJM1 and LJM2 is particularly damning.

"***Many of the most significant transactions apparently were designed to accomplish favorable financial statement results, not to achieve bona fide economic objectives or to transfer risk.***"

It continues, "Other Transactions were implemented – improperly, we are informed by our accounting advisors – to offset losses. They allowed Enron to conceal from the market very large losses resulting from Enron's merchant investments by creating an appearance that those investments were hedged ... when in fact that third party was simply an entity in which only Enron had a substantial economic stake."

The report asserts that these deals "resulted in" Enron overstating its earnings from the third quarter of 2000 through the third quarter of last year by almost $1 billion.

* * *

... ***[T]he report also asserts that Vinson & Elkins played a significant role.***

According to the Powers document, the law firm "***provided advice and documentation" for many of these partnership deals and "assisted Enron with the preparation of its disclosures of related-party transactions in the proxy statements and the footnotes to the financial statements in Enron's periodic SEC filings.***"

Enron's managers and its board "***relied heavily on the perceived approval by Vinson & Elkins of the structure and disclosure of the transactions," the report***

> ***claims.... [T]he report concludes, the firm "should have brought a stronger, more objective and more critical voice to the disclosure process."***

Legal Times, "Vinson & Elkins Shoots Back," 2/11/02.

> ***Newsweek has obtained confidential legal documents showing that Enron knew about a disastrous accounting error months before mentioning it in a crucial Oct. 16 meeting with investors. And that lawyers probing Sherron Watkins's allegations of accounting irregularities found the error, yet didn't put it in their report.***
>
> A memo written by Max Hendrick III of Vinson & Elkins, Enron's outside law firm, ***shows that Enron's chief accounting officer knew in August that Enron had made a huge mistake accounting for one of its controversial off-the-books partnerships***.... "Causey pointed out that an unfortunate error will require an adjustment to the third quarter [financial] statements" during an Aug. 31 interview, the memo says. "Causey characterizes this as a simple mistake that now requires correction." That "simple mistake" forced a $1.2 billion reduction of Enron's net worth. That reduction – and Enron's failure to produce a quick, clear explanation for it – ***sowed mistrust of all Enron's numbers. That mistrust was a crucial factor in Enron's implosion. So how could V&E not mention the bookkeeping problem in its Oct. 15 report to Enron***?

Newsweek, 2/25/02.

> Lawyers for Andrew Fastow, Enron's former chief financial officer, told investigators that he was not responsible for signing off on the accounts for the controversial private partnerships that brought the company down.
>
> Instead, his attorneys ***pointed the finger at the company's lawyers*** and accountants, ***saying Mr. Fastow relied on them for disclosing and approving any questionable deals***.

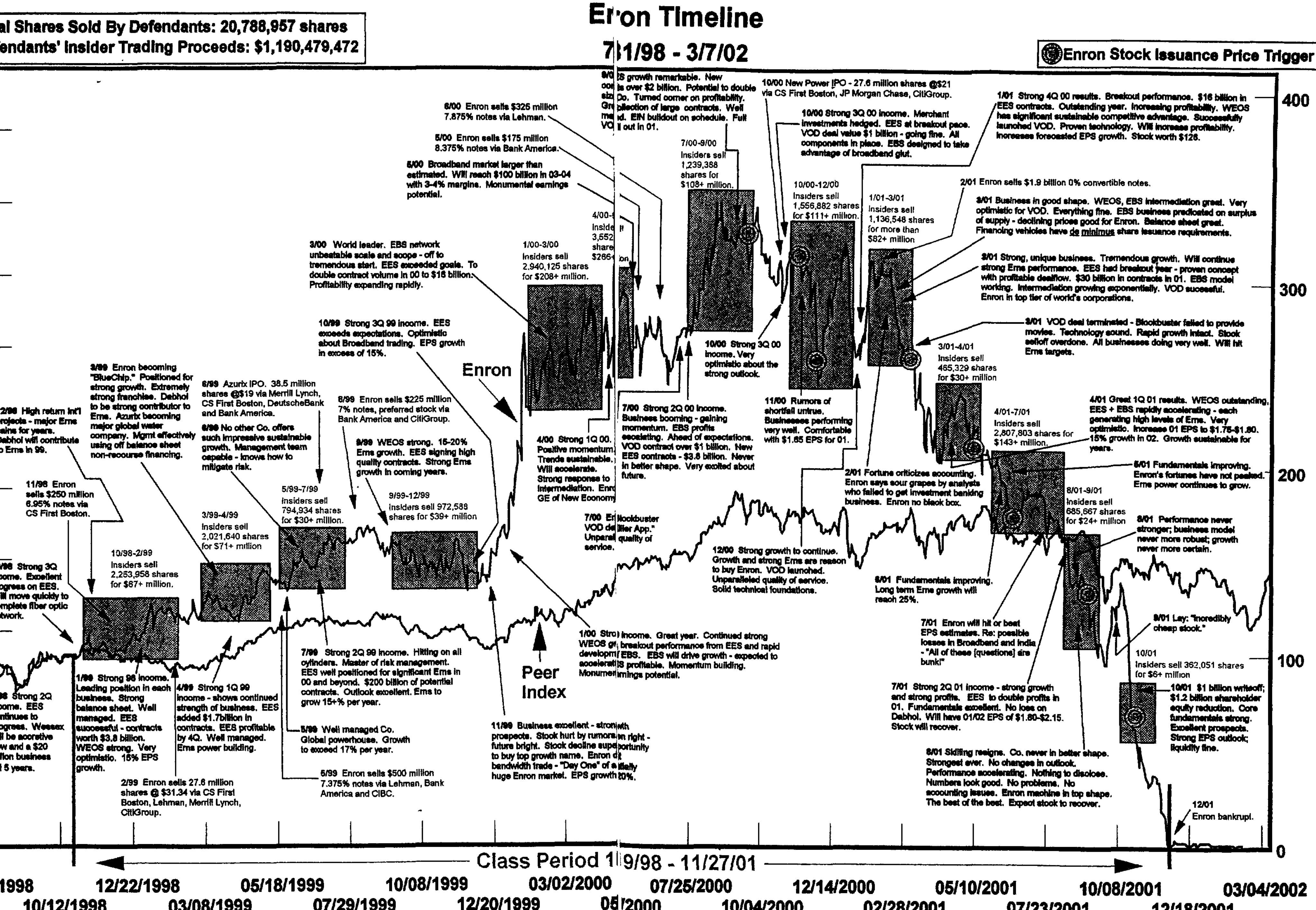
Financial Times, 3/20/02.

Vinson & Elkins issued "true sale" opinions it knew were false and opined on the bogus commodity trades used by J.P. Morgan and Enron to hide billions of dollars of Enron debt. Vinson & Elkins participated in writing Enron's SEC filings, which it knew were false. Vinson & Elkins participated in setting up Chewco, JEDI, LJM and LJM2 and virtually ***all*** of the related SPE transactions which involved Enron shells, straw parties, controlled entities, secret "no loss" or "repurchase" guarantees and the use of Enron's own assets to "hedge" gains it reported as profits. And when the Enron scheme was unraveling in 8/01, Vinson & Elkins participated in the cover-up of the fraudulent scheme by writing a report which whitewashed allegations of fraud that Vinson & Elkins knew were true because of its own involvement in many of the bogus transactions. Vinson & Elkins also knew that Kirkland & Ellis had been hand-picked by Fastow to provide "independent" representation for Chewco, JEDI, LJM and LJM2 and other SPEs, but, in fact, worked under the control of Fastow in helping to structure those partnerships and their related transactions. ¶70. This frenzy of fraud created enormous financial benefits for the participants, including Vinson & Elkins which received over $100 million in legal fees from Enron. ¶73.

The graphic that follows outlines the rise and demise of Enron:

Enron Timeline

7/1/98 - 3/7/02



II. The CC Properly Alleges Primary Liability of Vinson & Elkins Under §10(b) and Rule 10b-5

Claiming that plaintiffs do not adequately allege Vinson & Elkins' liability under the federal securities laws, Vinson & Elkins contradicts longstanding precedent of the Supreme Court and the Fifth Circuit. For example, at pages 6-7 of its motion, Vinson & Elkins attempts a rewrite of the federal securities laws, eliminating §10(b) and Rule 10b-5 liability for employing a scheme or engaging in acts that would operate as a fraud or deceit on investors. *See, e.g.,* 17 C.F.R. §240.10b5-(1), (3) (proscribing same); *Shores v. Sklar*, 647 F.2d 462, 469-71 (5th Cir. 1981). As the Supreme Court recently reaffirmed in *Zandford*, neither the SEC nor the Supreme Court has ever held a defendant must make a misrepresentation to be liable under §10(b). *See infra* §II.F. Elsewhere, Vinson & Elkins contorts plaintiffs' allegations as merely claims for aiding and abetting, not misrepresentation under Rule 10b-5(2), which the allegations clearly encompass, and which even Vinson & Elkins admits is a violation of the federal securities laws. *See* Mot. at 6, 11-15.

Nothing in §10(b) or Rule 10b-5 promulgated thereunder so limits their application as Vinson & Elkins asks this Court to do. To the contrary, "the purposes of the securities acts and rule 10b-5 are far broader than merely proving full disclosure or fostering informed investment decisions." *Shores*, 647 F.2d at 470. And the federal securities laws are "to be construed 'not technically and restrictively, but flexibly to effectuate [their] remedial purposes.'" *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 151 (1972); *accord Long v. Shultz Cattle Co.*, 881 F.2d 129, 142 (5th Cir. 1989); *Shores*, 647 F.2d at 470. Plaintiffs properly alleges that Vinson & Elkins violated the federal securities laws under each prong of Rule 10b-5. *See infra* §II.B.-C., F. Each claim is well grounded under Fifth Circuit law, as demonstrated herein.

Lawyers are not an immunized class under the federal securities laws. *See infra* §II.A. Vinson & Elkins suggests that *Central Bank*, 511 U.S. 164, forecloses its liability as lawyers. But the Supreme Court in that case held that its decision did not protect lawyers from primary liability under the federal securities laws. *Id.* at 192. Moreover, Vinson & Elkins does not (and cannot) cite any case or policy which justifies excepting Vinson & Elkins from liability because it was engaged as a lawyer by Enron while it violated the federal securities laws. In fact, the Fifth Circuit has already rejected the argument that lawyers should be entitled special consideration under the federal securities laws:

> [W]e reject the contention that our holding imposes new burdens on defendants or enhances their liability. Lawyers, underwriters, and accountants who participate in bond issues in good faith are unaffected by our decision. Liability results only if they act with intent to deceive or defraud.

Shores, 647 F.2d at 471.

Quite the contrary, under the law which Vinson & Elkins claims to interpret from out-of-circuit decisions, a secondary actor who is the actual creator and author of a material misstatement could avoid liability by concealing its identity. Law firms could knowingly draft false and misleading statements in a client's securities filings and avoid liability by not placing their name on the filing. The same clients could avoid liability by saying they relied on the advice of counsel who drafted the filing. For these reasons, among others, courts and the Securities and Exchange Commission reject the arguments Vinson & Elkins asserts. *See infra* §II.B.

Notwithstanding Vinson & Elkins' suggestion that it was only an aider and abettor, Vinson & Elkins' conduct sets it apart from those identified as aiders and abettors by courts outside of the Fifth Circuit. Vinson & Elkins structured bogus transactions for Enron and failed to disclose the nature and effect of those transactions, as called for in the very securities disclosures which Vinson & Elkins drafted and approved. Moreover, Vinson & Elkins' claim that it was merely an aider and abettor because it did not stamp its name on each of the false and misleading statements which it drafted in securities filings for Enron is inconsistent with law of the land, including the most basic principles of the fraud-on-the-market presumption. It would be quite an immunity for lawyers indeed if Vinson & Elkins could avoid liability here because it did not herald its name in each false and misleading statement which it drafted and approved. *See infra* §II.E.

In its last purported basis for moving to dismiss the CC, Vinson & Elkins claims that despite its conduct in creating the bogus transactions which falsified Enron's financial statements, Vinson & Elkins lacked scienter because it did not have the accounting expertise to understand what it was doing. As stated by professor Cunningham, former deal lawyer at Cravath, Swaine & Moore, Vinson & Elkins' arguments "defy reality." Vinson & Elkins understood the purpose of the transactions which it created. Indeed, Vinson & Elkins' lawyers admitted to investigators of the Powers Committee that they understood the accounting issues involved. It does not take great sophistication to understand the fraudulent nature of the transactions Vinson & Elkins created. As Sherron Watkins suggested, "it looks to the layman on the street" that Enron is hiding losses. Moreover, one need only look at Vinson & Elkins' Web site to see that Vinson & Elkins is one of the most sophisticated law firms in the United States and that Vinson & Elkins holds itself out to understand even complex accounting and financial issues (*e.g.*,"Vinson & Elkins has extensive experience in creating specialized finance structures to achieve targeted financial reporting and tax goals"). Plaintiffs have alleged a strong inference of scienter. Vinson & Elkins simply does not (and cannot) cite any authority or give any adequate reason to the contrary. *See infra* §II.G.

A. Vinson & Elkins' Characterization that It Was Merely "Assisting Enron" Does Not Immunize Vinson & Elkins From Primary Liability Under *Central Bank*

Vinson & Elkins says that it was only "assisting Enron" (Mot. at 11), but nowhere in Vinson & Elkins' brief does it define its meaning of the word "assisting." Apparently Vinson & Elkins suggests that everything it did in this case was "assistance," by definition, because it is a law firm. Thus, according to Vinson & Elkins, "no matter what label" is placed upon its acts, Vinson & Elkins is a "secondary actor," and therefore, even if it knowingly made false and misleading statements in Enron's public documents, such "activity cannot give rise to primary liability" under the federal securities laws. Mot. at 11. Vinson & Elkins is wrong. Indeed, the proposition that a law firm can avoid liability for knowingly making false and misleading statements in securities filings or for other fraudulent conduct just because the law firm is corporate counsel and not the issuer of the securities in question is ***not*** the law.

1. Following *Central Bank*, Numerous Courts Have Held Lawyers and Other "Secondary Actors" Subject to Primary Liability Under §10(b) and Rule 10b-5

Central Bank was an individual securities case (not a class action) in which plaintiffs sued several defendants after a public building corporation defaulted on bonds held by plaintiffs. 511 U.S. at 166-68. One of the defendants was Central Bank of Denver, who acted as indenture trustee for the bond issues. *Id.* Plaintiffs "concede[d] that Central Bank did not commit a manipulative or deceptive act [but instead] was 'secondarily liable under § 10(b) for its conduct in aiding and abetting the fraud.'" *Id.* at 191. The Court held "[b]ecause ... there is no private aiding and abetting liability under § 10(b), Central Bank may not be held liable as an aider and abettor." *Id.*

In addition to the narrow expression of its holding, in *Central Bank* the Supreme Court cautioned that:

> ***The absence of § 10(b) aiding and abetting liability does not mean that secondary actors in the securities markets are always free from liability under the securities Acts.*** Any person or entity, including a ***lawyer***, accountant, or bank, who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser or seller of securities relies may be liable as a primary violator under 10b-5.

Id. Besides disclaiming immunity for lawyers and other "secondary actors in the securities markets," in *Central Bank* the Supreme Court did not discuss what facts constitute aiding and abetting. In rendering its holding, the Court instead relied on plaintiffs' express limitation of their claims as for aiding and abetting in plaintiffs' complaint. For all these reasons, *Central Bank* cannot be fairly read to provide the immunities for lawyers claimed by Vinson & Elkins.

Since *Central Bank*, district judges in Texas, including Judge Kent in this district, have rejected motions to dismiss by so-called secondary actors (including lawyers) raising arguments such as Vinson & Elkins does to assert "aider and abettor" status and avoid liability. *See, e.g.*, *McNamara v. Bre-X Minerals Ltd.*, No. 5:97-CV-159, 2001 U.S. Dist. LEXIS 4571, at *132 & n.17 (E.D. Tex. Mar. 30, 2001) (Folsom, J.) ("'significant role' in preparing a false statement actually uttered by another" sufficient to impose primary liability); *Hartsell v. Source Media, Inc.*, No. CA 3:98-CV-1980-M, 2000 U.S. Dist. LEXIS 4964, at *15 (N.D. Tex. Apr. 15, 2000) (Buchmeyer, J.) (rejecting argument that accountant is not liable for client's financial statements under *Central Bank*); *McNamara v. Bre-X Minerals, Ltd.*, 57 F. Supp. 2d 396, 429 (E.D. Tex. 1999) (Folsom, J.) (no requirement that the alleged violator directly communicate misrepresentations; "'significant role' in preparing a false statement actually uttered by another" sufficient to impose primary liability); *Young*, 2 F. Supp. 2d at 921 (Kent, J.) (rejecting argument that statements or omissions of other cannot be attributed to defendant under *Central Bank*).

And a number of courts elsewhere have also rejected the arguments raised by Vinson & Elkins here in an attempt to improperly extend *Central Bank. See, e.g., Howard v. Everex Sys.*, 228 F.3d 1057, 1061 n.5 (9th Cir. 2000) ("substantial participation or intricate involvement in the preparation of fraudulent statements is grounds for primary liability"); *Whirlpool Fin. Corp. v. GN Holdings*, 873 F. Supp. 111, 119 (N.D. Ill.), *aff'd*, 67 F.3d 605 (7th Cir. 1995) (defendant who "prepared" private placement memorandum subject to primary liability); *In re Software Toolworks Sec. Litig.*, 50 F.3d 615, 628 & n.3 (9th Cir. 1995) (accountant subject to primary liability for "significant role in drafting and editing" letter sent by client to SEC); *Carley Capital Group v. Deloitte & Touche, L.L.P.*, 27 F. Supp. 2d 1324, 1334 (N.D. Ga. 1998) ("a secondary actor can be primarily liable when it, acting alone or with others, creates a misrepresentation even if the misrepresentation is not publicly attributed to it"); *Murphy v. Hollywood Entm't Corp.*, No. 95-1926-MA, 1996 U.S. Dist. LEXIS 22207, at *17 (D. Or. May 9, 1996) ("'collateral' participants[ ] may still be liable as a 'primary violator' under § 10(b)"); *Cashman v. Coopers & Lybrand*, 877 F. Supp. 425, 432 (N.D. Ill. 1995) (accountants who "played a central role in the drafting and formation of the alleged misstatements" in client's SEC filings subject to primary liability); *Adam v. Silicon Valley Bancshares*, 884 F. Supp. 1398, 1401 (N.D. Cal. 1995) (accountant involvement in financial statements, press statements, and report of client subjected accountant to primary liability); *In re ZZZZ Best Sec. Litig.*, 864 F. Supp. 960, 968 (C.D. Cal. 1994) (rejecting accountant's argument that *Central Bank* "'eliminate[s] claims brought against all those alleged to have "participated" in the primary wrongdoer's statement but not to have made a statement' to the public directly"); *Employers Ins. v. Musick, Peeler & Garrett*, 871 F. Supp. 381, 389 (S.D. Cal. 1994) (lawyers subject to primary liability for "drafting and editing" securities filings; accountants subject to primary liability for "'significant role'" in creating securities filing).

2. Out-of-Circuit Cases Cited by Vinson & Elkins Do Not Support Vinson & Elkins' Proposition that It Is Merely an "Aider and Abettor"

Ignoring Fifth Circuit law, which demonstrates plaintiffs adequately plead Vinson & Elkins' primary liability, *see infra* §II.A.3, Vinson & Elkins cites several out-of-circuit cases in an effort to characterize its conduct as aiding and abetting. *See* Mot. at 11-13. Assuming *arguendo* these cases could support the proposition that Vinson & Elkins is not liable for misrepresentations (the cases do not) they are inconsistent with decisions in the Fifth Circuit Vinson & Elkins fails to identify and reconcile with its characterization of the law. For example, Vinson & Elkins purports that these out-of-circuit cases require reliance on a ***defendant's role in the preparation of*** a false and misleading statement. *See id.* That is not the law anywhere, and most clearly not in the Fifth Circuit. *See infra* §II.B., E.

If one were to apply the law which Vinson & Elkins claims to interpret from the out-of-circuit decisions it cites, lawyers could avoid liability for drafting false and misleading statements in securities filings by not placing their names therein, and issuers could then avoid liability by claiming reliance on the advice of the lawyers. In any event, the cases Vinson & Elkins cites are factually distinguishable, do not necessarily stand for the proposition Vinson & Elkins asserts, and (with some decisions) have been rejected by district judges in Texas and elsewhere. Moreover, none of the cases Vinson & Elkins cites addressed liability of defendants who allegedly committed other fraudulent acts in addition to misrepresentations. *See infra* §II.F.

In *Ziemba v. Cascade Int'l, Inc.*, 256 F.3d 1194 (11th Cir. 2001), the plaintiffs alleged a law firm had a "significant role" in preparing fraudulent letters or press releases. *Id.* at 1205. Far different from the allegations here, in *Ziemba* the plaintiffs alleged that the press releases at issue were "'drafted by a ***different*** law firm,'" and that the law firm: (1) "'recommended that [its client] correct any inaccuracies'" in its public filings; (2) "'made no effort to cause [its client] to issue'" corrective press releases; (3) wrote a memorandum for an individual defendant "'suggesting'" statements that could be issued in a document that eventually was issued by another defendant and "'based'" on but apparently not repeating the statements. *Id.* at 1199-1200. Accordingly, the plaintiffs in *Ziemba* never alleged that the law firm ever made the statements at issue or even alleged facts demonstrating the "significant role" of the law firm in making statements. The Eleventh Circuit found the allegations were ones merely of "substantial assistance," *i.e.*, aiding and abetting. *Id.* at 1205-06.

Compared to the factual allegations against the law firm in *Ziemba*, Vinson & Elkins' conduct here is not "substantial assistance." In this case, Vinson & Elkins actually drafted – "made" the statements – in securities filings for Enron. And many of the statements were very serious ones; disclosures where (among other things) the nature and effect of the transactions which led to Enron's downfall had to be revealed. Vinson & Elkins drafted those statements in securities filings for Enron and approved them for dissemination. Finally, to the extent Vinson & Elkins claims *Cascade* support the proposition that primary inability turns on indemnification of the defendant itself, *Cascade* would be contrary to the law of the land and should be rejected, as Judge Folsom did in *McNamara*. *See infra* §§II.B.2, E.

In *Shapiro v. Cantor*, 123 F.3d 717, 719-20 (2d Cir. 1997), plaintiffs did not allege that accounting firm Touche Ross created misrepresentations. Touche Ross prepared projections in *Shapiro*, but the projections were based on the "'knowledge and belief'" of issuer's management, not Touche Ross. *Id.* Indeed, the complaint at issue was drafted before the Supreme Court's decision in *Central Bank* and specifically alleged that the defendant in question "'aided and abetted' the other defendants in their fraudulent schemes." *Id.* at 719. Obviously, here plaintiffs do not allege Vinson & Elkins "aided and abetted" the other defendants in either form or substance. (Judge Folsom rejected *Shapiro* in *McNamara* to the extent defendants in *McNamara* argued that the distinction between aiding and abetting and primary liability turns on identification of the defendant on the statement itself.) *See supra* §II.B.2.

Under *Anixter v. Home-Stake Prod.*, 77 F. 3d 1215 (10th Cir. 1996), contrary to what Vinson & Elkins suggests, actors like Vinson & Elkins who draft false and misleading statements may be liable for a primary violation of §10(b). In *Anixter*, a general verdict was rendered on jury instructions that included "aiding and abetting" as well as primary liability. *Id.* at 1227-28. Concerning the defendant accountant the court held that the "record support[ed] finding [the accountant] liable for a primary violation of 10(b)," but that it was "not clear from the jury verdict whether [the accountant's] liability under Rule 10b-5 rested on finding a primary or aiding and abetting violation." *Id.* at 1227. Applying the Tenth Circuit's decision in *Anixter*, "[t]here is no requirement" that Vinson & Elkins "directly communicate misrepresentations to plaintiffs for primary liability to attach." *Id.* at 1226. All that need be shown is that Vinson & Elkins "knew or should have known that [its] representation would be communicated to investors." *Id.* As with the other out-of-circuit decisions, Vinson & Elkins' conduct here is not "assistance" under *Anixter*.

In *Wright v. Ernst & Young LLP*, 152 F.3d 169, 171 (2d Cir. 1998), plaintiff tried to hold an accountant liable for financial information in a client's press release that explicitly stated it was "unaudited and without mention of its outside auditor." Vinson & Elkins' involvement here was not nearly as attenuated. Further, the plaintiff in *Wright* tried to assert that the press release was "an ***implied*** statement to the public that Ernst & Young had approved" the financial statements. *Id.* at 172. Both the district and circuit courts rejected this argument because that claim "was refuted" by the press release's ***express*** disclaimer that the results were "'unaudited'" and because "transforming" a disclaimer "into a guarantee of the statement's accuracy would 'seriously deter disclosure of unaudited financial information.'" *Id.* Here, Vinson & Elkins never expressly disclaimed preparing the statements at issue, and did not merely approve or participate in preparing statements made by another, but rather, actually drafted – "made" – the statements in Enron's securities filings.

Each of the out-of-circuit district cases cited at footnotes 8 and 9 of Vinson & Elkins' Motion are likewise of no persuasive or precedential value. Contrary to the allegations leveled against Vinson & Elkins here, the facts alleged in those cases did not demonstrate that the "secondary actors" ***made*** false and misleading statements. In addition, two of those cases, *Cascade* and *Vosgerichian v. Commodore Int'l*, 862 F. Supp. 1371 (E.D. Pa. 1994), were rejected by Judge Folsom in *McNamara*, to the extent defendants argued to Judge Folsom that the distinction between aiding and abetting and primary liability turns on identification of the defendant on the statement itself. *See supra* §II.B.2.

3. Congressional Inaction After *Central Bank* Does Not Mean Primary Liability Under §10(b) Is Limited

Vinson & Elkins contends that because "[i]n the wake of *Central Bank*, Congress chose ***not*** to pass laws that would have held attorneys liable," Vinson & Elkins' narrow interpretation of primary liability under §10(b) is supported by Congress. Mot. at 21 (emphasis in original). Whether or not Congress agreed with the holding in *Central Bank* is of no import; plaintiffs' claims comport with the law of the land. Defendants' attempt to ally Congress with their position is both incorrect as a matter of law and history. As demonstrated above, the Supreme Court did not overturn Rule 10b-5. Therefore, Congress did not have to reinstate "scheme" liability.

Additionally, Congress's intent in passing the 95 Act is perfectly consistent with plaintiffs' reading of *Central Bank*, not defendant's. For example, Senator D'Amato, in arguing against the creation of a private cause of action for aiding and abetting during a debate on the 95 Act, stated:

> Of course, if someone has knowingly, intentionally misled investors ***or been involved in committing fraud***, they are no longer just aiders and abettors, and can be held liable for their actions.... [P]eople who commit fraud will be treated ***as primary wrongdoers***, as the culpable party, and can be held jointly and severally.

141 Cong. Rec. S9111 (June 27, 1995). Senators Dodd and D'Amato further stated:

> Mr. D'Amato. If one is tangentially involved, let us say an accountant, and knowingly an intentionally participates in a fraud, is that person, regardless of their portion of liability, held jointly-and-severally liable?
>
> Mr. Dodd. Absolutely. Absolutely.
>
> Mr. D'Amato. So that a person, would be considered as a minor participant, an aider and abettor, as a result of this amendment. We have made very clear, that if they knowingly and intentionally participate in fraud, that defendant can really be held as a primary culprit, so to speak; he or she would be [liable] for all the damages under the present situation; is that not true?
>
> Mr. Dodd. My understanding is that is correct.

141 Cong. Rec. S9085 (June 19, 1995).

In truth, the Congressional record supports the conclusion that Congress understood *Central Bank* did ***not*** eliminate primary liability of secondary actors, not vice-versa, as Vinson & Elkins claims.

B. Under Fifth Circuit Law Vinson & Elkins Is Subject to Primary Liability for Drafting and Approving False and Misleading Statements

Federal Courts in Texas, consistent with the Fifth Circuit's decisions in *Shores* and *Abell*, and federal appellate and district courts across the country, uphold claims against legal and financial professionals (so-called secondary actors) who make false and misleading statements in the perpetration of a fraud, as Vinson & Elkins did here.

1. **Vinson & Elkins Made False and Misleading Statements Under the Fifth Circuit's Decisions in *Shores v. Sklar* and *Abell v. Potomac Insurance Co.***

Vinson & Elkins cites many distinguishable out-of-circuit decisions, including pre-*Central Bank* decisions, to characterize its conduct as "aiding and abetting." Yet nowhere does Vinson & Elkins reconcile its purported interpretation of the law with the Fifth Circuit's decisions in *Shores* and *Abell v. Potomac Ins. Co.*, 858 F.2d 1104 (5th Cir. 1988), *vacated on other grounds sub nom. Fryar v. Abell*, 492 U.S. 914 (1989), both of which considered primary liability of lawyers for making false and misleading statements.

In *Shores*, 647 F.2d 462, the Fifth Circuit, sitting *en banc*, determined whether "reliance" was adequately established in a case based on an offering circular containing material misrepresentations, but where the plaintiff admitted he never read or otherwise relied on the offering circular. *Id.* at 464, 468. Plaintiff alleged that a lawyer, Sklar, made untrue statements of material fact. As identified by the Fifth Circuit, the lawyer "***drafted*** the Offering Circular" which contained false and misleading statements. *Id.* at 465-66. The Fifth Circuit ruled that the requisite causation in fact was established and upheld Rule 10b-5 claims against the lawyer. *Id.* at 471-72.

In *Abell*, 858 F.2d at 1123, the Fifth Circuit, in its "reliance" analysis, determined whether plaintiffs had proven primary liability of a law firm for violating Rule 10b-5 "directly." Necessary to its holding concerning reliance, the court ascertained which statements were made by the law firm, "WLJ." Consequently, to determine the law firm's liability, the Fifth Circuit discussed whether the false and misleading statements were (1) "authorized" by the law firm or (2) "checked and revised" by the law firm. *Id.* Concerning a flyer that "had ***not*** been ***authorized*** by WLJ," the court held that it was not "anything which WLJ said or did." *Id.* The Fifth Circuit further observed that the only statements in which WLJ had a role were statements in an offering statement which the law firm "checked and revised." *Id.* The court therefore went on to determine whether that offering statement was relied upon and concluded neither plaintiff testified that he relied upon the offering statement. *Id.*

Plaintiffs' allegations are consistent with the Fifth Circuit's decisions in *Shores* and *Abell*. Not only did Vinson & Elkins ***draft*** the false and misleading statements here, it ***authorized*** (as pleaded, "approved") them. Vinson & Elkins made the false and misleading statements, it did not just provide "assistance."

2. Vinson & Elkins Made False and Misleading Statements Under District of Texas Decisions Post-*Central Bank*

Nor does Vinson & Elkins identify decisions by district judges in Texas who have addressed liability of "secondary actors" for making false and misleading statements notwithstanding *Central Bank*. Plaintiffs' allegations against Vinson & Elkins ***exceed*** the standard articulated by numerous district judges in Texas.

Judge Kent, in *Young*, rejected the same argument made by Vinson & Elkins here, namely that attribution of a defendant is necessary for that defendant to make a statement:

> [Defendant] American Century ... argues that the statements or omissions of Nationwide cannot be attributed to American Century because there is no aider or abettor liability under Rule 10b-5. While Defendants are correct in asserting that there is no aider and abettor liability under 10b-5, *see Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 114 S. Ct. 1439, 128 L. Ed. 2d 119 (1994), it is not factually clear that American Century did not have a ***more substantial role*** in the alleged misrepresentations. Furthermore, some of the Plaintiffs' allegations are sufficient to implicate American Century directly.

2 F. Supp. 2d at 921.

In his 99 decision in *McNamara,* Judge Folsom held that there is no requirement that the alleged violator directly communicate misrepresentations notwithstanding *Central Bank*. 57 F. Supp. 2d at 429. In so doing, Judge Folsom rejected *Cascade* and *Vosgerichian*, cited by Vinson & Elkins. *Id.* at 428-30. Although defendants, engineers, did not themselves "make statements to the public," *id.* at 430, Judge Folsom found they could still be liable for primary violations under either of two theories. ***First,*** if a secondary actor made a false or misleading statement that it knew or should have known would reach potential investors, it could be liable. *Id.* at 430. ***Second,*** if a secondary actor "played a significant role in developing allegedly false statements" attributable to others it could be liable. *Id.* Later in *McNamara*, Judge Folsom upheld plaintiffs' claims against engineers for playing "a '***significant role***' in preparing a false statement actually uttered by another." 2001 U.S. Dist. LEXIS 4571, at *132.

In *Hartsell*, the defendant accounting firm, E&Y, claimed that it could not have played a role in plaintiffs' stock transactions under *Central Bank* and thus was not subject to primary liability.

2000 U.S. Dist. LEXIS 4964, at *14. Judge Buchmeyer observed that the holding in *Central Bank* did not mean secondary actors may not be held liable for violations of the federal securities laws, and rejected E&Y's argument. *Id.* at *15.

In the case before this Court, Vinson & Elkins did have a "more substantial role" than a mere aider and abettor. Vinson & Elkins drafted and approved for dissemination the false and misleading statements and knew that statements would reach investors – many of the false and misleading statements were very serious "disclosures" in Enron's SEC filings.

3. Vinson & Elkins Made False and Misleading Statements According to the Securities and Exchange Commission

The SEC rejects the "secondary actor" arguments made by Vinson & Elkins here. As Judge Thrash held in *Carley Capital Group*:

> The SEC believes that the test should look to what a secondary actor does in "creating a misrepresentation" to determine when that actor makes a misrepresentation in violation of Section 10(b). The views of the SEC are entitled to consideration and some deference. See Basic Inc., 485 U.S. at 239, fn16, 108 S. Ct. at 987. ***This Court adopts the standard urged by the SEC and concludes that a secondary actor can be primarily liable when it, acting alone or with others, creates a misrepresentation even if the misrepresentation is not publicly attributed to it.***

27 F. Supp. 2d at 1334. Rejecting *Wright* and *Shapiro*, cited by Vinson & Elkins here, Judge Thrash held that the standard set forth by the SEC was consistent with *Central Bank*. *Id.* at 1333-34.

The Third Circuit, in *Klein v. Boyd*, [1998 Transfer Binder] Fed. Sec. L. Rep (CCH) ¶90,136 (3d Cir. 1998), a vacated panel opinion, also ruled consistent with the SEC's position:

> We hold that when a person participates in the creation of a statement for distribution to investors that is misleading due to a material misstatement or omission, but the person is not identified to the investors, the person may still be liable as a primary violator of section 10(b) and Rule 10b-5 so long as (1) the person know (or is reckless in not knowing) that the statement will be relied upon by investors, (2) the person is aware (or is reckless in not being aware) of the material misstatement or omission, (3) the person played such a substantial role in the creation of the statement that the person could fairly be said to be the "author" or "co-author" of the statement, and (4) the other requirements of primary liability are satisfied.

Id. at 90,325. The panel's decision in *Klein* was vacated when the Third Circuit granted rehearing *en banc*, but no subsequent authority was ever issued because during the interim the case settled. At page 12 of its Motion, Vinson & Elkins asserts that *Klein* has no precedential effect. Regardless of whether *Klein* has precedential value as a Third Circuit decision or even as a vacated decision under Third Circuit rules, the logic of the decision in *Klein* is persuasive and may be cited by plaintiffs for that purpose. *See, e.g., United States v. Richardson*, 925 F.2d 112, 118 n.19 (5th Cir. 1991) ("Although this case has no precedential value under the rules of the Fourth Circuit, we find the logic of the opinion persuasive.").

Indeed, Vinson & Elkins does not dispute that *Klein* may have persuasive value. Nor does Vinson & Elkins dispute that the views of the SEC are entitled to consideration and some deference.

Plaintiffs' allegations against Vinson & Elkins ***meet*** the standard set forth by the SEC and adopted by the courts in *Carley Capital Group* and *Klein*. Vinson & Elkins drafted the false and misleading statements it knew would be disseminated to investors. The matters which Vinson & Elkins assumed the responsibility for drafting and approving were not mere scrivener's items, they included very serious issues of disclosure bearing upon the bogus transactions at issue in this case. Vinson & Elkins understood the purpose of those transactions because it structured, documented, and in some instances negotiated the transactions. As a drafter, Vinson & Elkins' role in the origination and creation of the false and misleading statements cannot be disputed to be none other than an "author" or "co-author."

4. Vinson & Elkins Made False and Misleading Statements Under Well-Reasoned Law Outside the Fifth Circuit Which Vinson & Elkins Avoids or Attempts to Distinguish

Plaintiffs' allegations that Vinson & Elkins made false and misleading statements also ***exceed*** the standards applied in numerous decisions by courts in the Seventh, Eleventh, and Ninth Circuits. *See supra* §II.A.1. Vinson & Elkins attempts to distinguish the Ninth Circuit's decision in *Software Toolworks*, claiming there was disclosure of an accounting firm's role in making false and misleading statements, unlike Vinson & Elkins' situation Vinson & Elkins says. Mot. at 15. That does not distinguish the case for a number of reasons. For example, as Vinson & Elkins admits, there was more than one missive at issue – two false and misleading letters to the SEC. The Ninth Circuit concluded that the second false and misleading letter, which had no attribution to the accountants, could also support primary liability under §10(b). 50 F.3d at 628 n.3. Numerous courts outside the

Ninth Circuit have followed *Software Toolworks*, finding that it is not inconsistent with *Central Bank.*[12]

C. The CC Alleges with the Requisite Particularity that Vinson & Elkins Made False and Misleading Statements

Vinson & Elkins' argument at page 8 of its Motion that it did not make any statements demonstrates the poverty of Vinson & Elkins' position. Vinson & Elkins says "[p]laintiffs do not allege that Vinson & Elkins made any misrepresentations directly to them or to the market," and it refers the Court to general paragraphs in the CC. Mot. at 8 & n.3.[13] But Vinson & Elkins fails to reference or otherwise address the specific and detailed allegations in the CC, including the serious false and misleading statement allegations made by plaintiffs at ¶¶824-848.

1. Allegations of False and Misleading Statements

For example, the CC alleges Vinson & Elkins drafted and approved Enron's related-party disclosures, which concealed material facts concerning the JEDI/Chewco, LJM, or Raptors transactions, in the following SEC filings of Enron identified at ¶824:

Quarterly Reports	**Annual Reports**
Report on Form 10-Q, filed 8/16/99	Report on Form 10-K, filed 3/31/98
Report on Form 10-Q, filed 11/15/99	Report on Form 10-K, filed 3/31/99
Report on Form 10-Q, filed 5/15/00	Report on Form 10-K, filed 3/30/00
Report on Form 10-Q, filed 8/14/00	Report on Form 10-K, filed 4/02/01
Report on Form 10-Q, filed 11/14/00	
Report on Form 10-Q, filed 5/15/01	
Report on Form 10-Q, filed 8/14/01	

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12 *See, e.g.*, *Carley Capital Group*, 27 F. Supp. 2d at 1334; *Bre-X Minerals*, 2001 U.S. Dist. LEXIS 4571, at *131 & n.17; *Phillips v. Kidder, Peabody & Co.*, 933 F. Supp. 303, 315 (S.D.N.Y. 1996), *aff'd*, 108 F.3d 1370 (2d Cir. 1997); *O'Neil v. Appel*, 897 F. Supp. 995, 1000 (W.D. Mich. 1995).

13 Vinson & Elkins says that plaintiffs do not allege reliance upon the false "opinion letters" which Vinson & Elkins issued during the Class Period. Mot. at 8 n.3. That is incorrect. The false "opinion letters" were one integral part of the fraudulent scheme, because they were used to give the false appearance of legitimacy to bogus transactions. ¶¶800, 803, 807. Vinson & Elkins does not (and cannot) dispute the material effect the bogus transactions had on Enron's financial statements and the price of Enron's stock. *See* ¶¶814-816, 821, 823. This is all that is necessary to invoke the presumption of reliance to which plaintiffs are entitled and establish the causal connection between Vinson & Elkins' false "opinion letters" and the losses of plaintiffs and the Class. *See infra* §II.E.

Annual Proxies	**Other Reports**
Annual Proxy filed 3/30/99 Annual Proxy filed 5/02/00 Annual Proxy filed 5/01/01	Report on Form 8-K, filed 2/28/01

a. Vinson & Elkins' False and Misleading "Disclosures" Concerning JEDI/Chewco

At ¶824 of the CC, plaintiffs allege that in Enron's reports on Form 10-K for the years ended 97 through 00, Vinson & Elkins approved JEDI's description as an unconsolidated affiliate purportedly only "50 percent" owned by Enron. In Enron's report on Form 10-K filed 3/30/00, Vinson & Elkins drafted and approved as adequate disclosure the following: "At December 31, 1999, JEDI held approximately 12 million shares of Enron Corp. common stock. The value of the Enron Corp. common stock has been hedged. In addition, an officer of Enron has invested in the limited partner of JEDI and from time to time acts as agent on behalf of the limited partner's management." Those "disclosures" were false and misleading. The existence of Chewco, that Chewco was not independent, was not capitalized with outside equity at risk but instead was capitalized by JEDI and an Enron guaranty, or that Chewco was a limited partner of JEDI was never disclosed until Enron announced its massive restatement on 11/8/01. Nor was it disclosed that JEDI transactions were ***not*** true commercial, economic transactions, comparable to transactions with independent third parties. Nor was the substance and effect of the JEDI transactions on Enron and the Company's financial statements disclosed. ¶826.

At ¶¶827-829, the CC further details the false and misleading statements made by Vinson & Elkins concerning JEDI/Chewco.

b. Vinson & Elkins' False and Misleading "Disclosures" Concerning the LJM Partnerships and Raptors

As the Powers Report stated, the related-party disclosures drafted and approved by Vinson & Elkins were

> obtuse, did not communicate the essence of the transactions completely or clearly, and failed to convey the substance of what was going on between Enron and the partnerships. The disclosures also did not communicate the nature or extent of Fastow's financial interest in the LJM partnerships. This was the result of an effort to avoid disclosing Fastow's financial interest and to downplay the significance of the

related-party transactions and, in some respects, to disguise their substance and import.

¶830.

At ¶831 of the CC, plaintiffs allege that the related-party "disclosures" which Vinson & Elkins drafted and approved concealed and/or misrepresented material matters known to Vinson & Elkins, such as: (i) that the related-party transactions were ***not*** true commercial, economic transactions, comparable to transactions with independent third parties (*e.g.*, the purpose or bogus nature of the transactions); (ii) the substance and effect of related-party transactions on Enron and the Company's financial statements (*e.g.*, the transactions should have been consolidated in Enron's financial statements); and (iii) Fastow's true financial interest in or compensation from the LJM partnerships.

At ¶¶832-849 of the CC, plaintiffs detail by example the false and misleading statements which Vinson & Elkins made in SEC reports filed for Enron:

- Vinson & Elkins concealed the phony nature of the LJM and Raptors transactions by suggesting the deals were fair and legitimate, *i.e.*, comparable to similar transactions with unrelated third parties. ¶¶832-834.
- Vinson & Elkins concealed the phony nature of the LJM and Raptors transactions by false and misleading descriptions of the transactions. ¶¶835-846.
- Vinson & Elkins concealed the phony nature of the LJM and Raptors transactions by misrepresenting or omitting Fastow's interest in the deals. ¶¶847-849.

As plaintiffs allege, Vinson & Elkins made these false and misleading statements. Vinson & Elkins does not (and cannot) dispute that it knew these statements would be, and in fact were, made to investors and the market.

2. The CC Satisfies Rule 9(b)'s Particularity Requirements

Vinson & Elkins claims that plaintiffs fail to "specify" the statements it contends are fraudulent, "identify the speaker, state when and where the statements were made, and explain why the statements were fraudulent." Mot. at 24. Plaintiffs' allegations demonstrate Vinson & Elkins is incorrect.

Vinson & Elkins' first claims that the CC does "not identify any particular alleged misstatements by V&E attorneys." Mot. at 25. As shown above, plaintiffs attributed specific false and misleading statements Vinson & Elkins made in the securities filings plaintiffs identified. By way of further example, at ¶¶839-841, plaintiffs quote the related-party disclosures concerning the Raptors transactions in Enron's Form 10-Q filings dated 8/14/00 and 11/14/00 and Form 10-K filing dated 4/2/01. Each of these verbatim quotations is clearly identified by the date it was issued and, as plaintiffs allege, was drafted and approved by Vinson & Elkins. ¶824. Plaintiffs also reference other similarly worded third-party disclosures, but without actual quotation for the sake of avoiding undue repetition. ¶842. Vinson & Elkins does not (and cannot) cite authority for its claim that this is inadequate.

Vinson & Elkins also claims plaintiffs must plead the evidence demonstrating "input V&E had in Enron's disclosures." Mot. at 25. Again, Vinson & Elkins cites no authority for its claim. *Friedman v. Arizona World Nurseries Ltd. Partnership*, 730 F. Supp. 521 (S.D.N.Y. 1990), *aff'd*, 927 F.2d 594 (2d Cir. 1991), and *Luben v. Sybedon, Corp.*, 688 F. Supp. 1425 (S.D. Cal. 1988), cited by Vinson & Elkins, do ***not*** require plaintiffs to plead evidence of what Vinson & Elkins calls its "suggestions." In both *Friedman* and *Luben*, claims were dismissed because the plaintiffs did not attribute any specific misrepresentations to the law firms. *Friedman*, 730 F. Supp. 533 ("Plaintiffs do not attribute any specific misrepresentations to counsel ...."); *Luben*, 688 F. Supp. at 1444 (plaintiff "lists the ... misstatements" but "neither attributes these statements to the stating defendant nor differentiates among the defendant[s]"). Plaintiffs allege that Vinson & Elkins "drafted and approved" false and misleading statements and specifically identify those statements, their dates, and why the statements were false and misleading. This is more than adequate.

Vinson & Elkins' final explanation for its incredible assertion that its statements are not pleaded with particularity is that plaintiffs' allegations are "essentially an extreme version of the group-pleading doctrine." Mot. at 25. Plaintiffs do not invoke the "group pleading" doctrine or whatever "extreme version" of the doctrine Vinson & Elkins conjures. Obviously, plaintiffs are pleading the liability of a single defendant, Vinson & Elkins, and have identified what that defendant did in making false and misleading statements. Plaintiffs are ***not*** "group pleading" the liability of individual defendants for their collective work in drafting a company's statements. *See In re*

Glenfed, Inc. Sec. Litig., 60 F.3d 591, 593 (9th Cir. 1995) (discussing scope of "group pleading" doctrine).

In essence, Vinson & Elkins claims here that the false and misleading statements which plaintiffs allege Vinson & Elkins made were in fact made by Enron because the false and misleading statements were in Enron's securities filings and Vinson & Elkins was merely one of Enron's "outside consultants." Mot. at 25. This is neither a pleading defense, nor a defense to liability. *See supra* §§II.A., B., *see infra* §§E.-F.

D. The CC Does Not Allege "Failure to Disclose"/"Nondisclosure"

Vinson & Elkins references ¶995(b) of the CC and asserts that plaintiffs allege that it "failed to disclose to the public the allegations leveled by Ms. Watkins." Mot. at 9. Paragraph 995(b) alleges, *inter alia*, violation of §10(b) and Rule 10b-5 because Vinson & Elkins "[m]ade untrue statements of material fact or omitted to state material facts necessary in order to make statements made, in light of the circumstances under which they were made, not misleading." Plaintiffs do not assert "nondisclosure" under these allegations. "The Attempted Coverup" alleged at ¶¶850-856 demonstrates Vinson & Elkins' (i) scienter arising out of Vinson & Elkins' efforts to conceal, *see infra* §II.G.4., (ii) acts in furtherance of the fraudulent scheme under Rule 10b-5(1) & (3), *see infra* §II.F.3., and (iii) additional material facts that made Vinson & Elkins' statements false and misleading. To the extent that Vinson & Elkins suggests any of the remainder of the CC alleges "nondisclosure" against Vinson & Elkins, that too, is incorrect.

Accordingly, Vinson & Elkins' argument that it had no "duty of disclosure" is completely irrelevant here. Plaintiffs allege false and misleading statements. *See supra* §II.C. And Vinson & Elkins does not dispute that if one makes a statement under §10(b), there is a duty to speak the full truth. As the Fifth Circuit held in *First Virginia Bankshares v. Benson*, 559 F.2d 1307 (5th Cir. 1977):

> ***[A] duty to speak the full truth arises when a defendant undertakes to say anything.***

Id. at 1317; *accord Helwig v. Vencor, Inc.*, 251 F.3d 540, 561 (6th Cir. 2001) (*en banc*) (defendant "may choose silence or speech elaborated by the factual basis as then known – but it may not choose half-truths"), *pet. for cert. filed* (Sept. 27, 2001); *Ackerman v. Schwartz*, 947 F.2d 841, 848 (7th Cir. 1991) ("Under Rule 10b-5 ... the lack of an independent duty does not excuse a material lie."); *see also Shores*, 647 F.2d at 465-66, 468 (lawyer liable for misrepresentations in an offering circular); *Abell*, 858 F.2d at 1119-23 (lawyer subject to, but not held liable for, misrepresentations).

Vinson & Elkins cites the Fifth Circuit's decision in *Abell* and other out-of-circuit cases for the common proposition that silence, absent a duty to disclose, is not actionable when one has not made material statements in the first place. Mot. at 9-10. This does not provide guidance because plaintiff alleges Vinson & Elkins made false and misleading statements, not that Vinson & Elkins is liable for nondisclosure.

For example, *Abell's* "Duty to Disclose" analysis was to determine "***WLJ's [p]otential [v]icarious [l]iability***" in response to plaintiffs' arguments that the law firm "had a special duty, as underwriters' counsel, to the investing public to ferret out and disclose publicly any fraud," and that WLJ rendered "substantial assistance to the fraudulent scheme" as an aider and abettor. 858 F.2d at 1123-24. Plaintiffs do not allege nondisclosure or aiding and abetting claims. In *Abell* there were both misrepresentation and nondisclosure/aiding and abetting claims and the Fifth Circuit treated each under significantly different analyses. Indeed, just before their "***[v]icarious [l]iability***" analysis, the Fifth Circuit treated WLJ's direct misrepresentations separately, not finding a duty lacking, but instead proceeding to whether reliance was demonstrated. *Id.* at 1123. Thus neither *Abell*, nor any other decision cited at page 10 of Vinson & Elkins' Motion, immunizes lawyers who make false and misleading statements.[14]

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[14] None of the cases cited by Vinson & Elkins deal with a situation where, as here, the defendants are charged with making affirmative misstatements. Rather, cases Vinson & Elkins cites involve nondisclosure. *See, e.g.*, *Ziemba*, 256 F.3d at 1207 n.7 (noting plaintiffs conceded that the law firm had no independent duty to make any disclosures regarding the Cascade fraud); *Austin v. Bradley, Barry & Tarlow, P.C.*, 836 F. Supp. 36 (D. Mass. 1993) (on appeal of summary judgment where there was no challenge to accuracy of tax opinion and plaintiffs did not allege any prior affirmative misrepresentations or misleading disclosures court found counsel had no duty to disclose fraud); *Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490 (7th Cir. 1986) (on appeal of summary judgment, court held plaintiffs claim of scheme or conspiracy could not be inferred from silence); *Renovitch v. Kaufman*, 905 F.2d 1040 (7th Cir. 1990) (appeal of summary judgment on aiding and abetting claim, court held attorneys who had no role other than that they failed to disclose properly granted summary judgment).

Courts expressly considering the issue in the context of misrepresentation claims hold that lawyers who make statements have a duty to speak truthfully just like every other actor in the securities markets. *See, e.g., Rubin v. Schottenstein, Zox & Dunn*, 143 F.3d 263, 268 (6th Cir. 1998) ("[W]hile an attorney representing the seller in a securities transaction may not always be under an independent duty to volunteer information about the financial condition of his client, ***he assumes a duty to provide complete and non-misleading information with respect to subjects on which he undertakes to speak***."); *Kline v. First W. Gov't Sec.*, 24 F.3d 480, 491-92 (3d Cir. 1994) ("[W]hen a professional 'undertakes the affirmative act of communicating or disseminating information,' there is 'a general obligation or "duty" to speak truthfully.'"); *In the Matter of Keating, Muething & Klekamp*, SEC Release No. 15982, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶82,124, at 81,989 (S.E.C. 1979) ("A law firm has a duty to make sure that disclosure documents filed with the Commission include all material facts about a client of which it has knowledge as a result of its legal representation of that client.").

E. Vinson & Elkins Does Not (and Cannot) Rebut the Presumption of Reliance to Which Plaintiffs and the Class Are Entitled Under the Fraud-on-the-Market Theory

Vinson & Elkins says that because it is an aider and abettor, plaintiffs cannot establish reliance. Mot. at 17 ("For the same reason that Plaintiffs have not pled a direct statement that satisfies *Central Bank*, they also fail the 'reliance requirement.'"). According to Vinson & Elkins it was required to be announced to investors as the one making false and misleading statements in order for there to be reliance under §10(b) and Rule 10b-5.

The market did not have to know Vinson & Elkins' role in making the false and misleading statements it made in Enron's securities filings in order for the price of Enron's stock to be affected by those statements. No case has never imposed this novel requirement of Vinson & Elkins in order for a plaintiff to demonstrate the necessary causation through reliance. Reliance demonstrates causation and a statement may produce causation regardless of whether there is attribution to a particular actor – the statement need merely "touch" upon the price of the security. *See, e.g., Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 12-13 (1971); *Smith v. Cooper/T. Smith Corp.*, 846 F.2d 325, 328 (5th Cir. 1988). What Vinson & Elkins seeks is not required to state a claim under the fraud-on-the-market theory. Plaintiffs and the Class are entitled to a presumption of reliance and the fact that Vinson & Elkins made false and misleading statements without heralding its name does not rebut that presumption.

1. Reliance Under the Fraud-on-the-Market Presumption

Plaintiffs pursue their claims under the fraud-on-the-market presumption. A central tenet of the federal securities laws, the fraud-on-the-market presumption, has existed for decades. As the Supreme Court stated in *Basic Inc. v. Levinson,* 485 U.S. 224 (1988):

> An investor who buys or sells stock at the price set by the market does so in reliance on the integrity of that price. Because most publicly available information is reflected in market price, ***an investor's reliance on any public material misrepresentations, therefore, may be presumed for purposes of a Rule 10b-5 action***.

Id. at 247. Nowhere in the Supreme Court's holding is there a requirement that investors must rely on the defendant's role in preparing a false and misleading statement. Such a requirement would destroy the broad standard of causation which reliance is used to demonstrate.

As the Ninth Circuit stated in the seminal case, *Blackie v. Barrack*, 524 F.2d 891 (9th Cir. 1975):

> [p]roof of subjective reliance on particular misrepresentations is unnecessary to establish a 10b-5 claim for a deception inflating the price of stock traded in the open market.... ***Proof of reliance is adduced to demonstrate the causal connection between the defendant's wrongdoing and the plaintiff's loss***. We think causation is adequately established in the impersonal stock exchange context by proof of purchase and of the materiality of misrepresentations, without direct proof of reliance. ***Materiality circumstantially establishes the reliance of some market traders and hence the inflation in the stock price – when the purchase is made the causational chain between defendant's conduct and plaintiff's loss is sufficiently established to make out a prima facie case.***

Id. at 906; *accord Basic*, 485 U.S. at 244; *Shores*, 647 F.2d at 469. This holding has been relied upon by courts in the Fifth Circuit, many other circuits, and the Supreme Court. Yet, again, nowhere in this holding is the requirement that a defendant's role in the preparation of a statement must be disclosed in order for the statement to be material or to otherwise establish causation.

Plaintiffs are also entitled to the presumption of reliance in bringing claims against Vinson & Elkins under Rule 10b-5(1) & (3) for fraudulent schemes, devices, acts, practices or courses of conduct. As the Fifth Circuit stated in *Shores*:

> [t]he reason for the reliance requirement "is to certify that the conduct of the defendant actually caused the plaintiff's injury." ... ***Whenever the rule 10b-5 issue shifts from misrepresentation or omission in a document to fraud on a broader scale, the search for causation must shift also. The "reliance" that produces causation in the latter type of case cannot come from reading a document.***

647 F.2d at 472. The Fifth Circuit went on to give examples of such cases, including a "scheme to manipulate the market." *Id.* "The most significant common thread in all these precedents," the Fifth Circuit wrote, "***is that rule 10b-5 is not limited to a narrow right to recover for knowing fraudulent misrepresentations or omissions in disclosure documents which mislead a securities buyer. The rule is recognized also to provide the basis for a federal cause of action for more elaborate, intentional schemes which deceive or defraud purchasers of securities***." *Id.*

Nowhere in *Shores* (or any other Fifth Circuit case of which plaintiffs are aware) is there a requirement that a defendant's role in the fraud must be disclosed in order for there to be reliance.

Indeed, in *Shores*, the lawyer, Sklar, drafted a false and misleading offering circular but apparently there was no attribution to Sklar in the offering circular. *Id.* at 465-66. Rather, Sklar incorporated into the offering circular false financial statements expressly certified by an accountant whose certifying letter was attached to the offering circular. *Id.* at 466. Despite the fact that the plaintiff testified he did not rely on the offering circular, Sklar was still held liable for primary violations of Rule 10b-5 because the offering circular played a causal role in the fraud. *Id.* at 470-71.

Shores has been repeatedly cited before and after *Central Bank*. Vinson & Elkins fails to reconcile its purported interpretation of the law with *Shores* or any of the other cases cited herein which form the bedrock of securities law.

2. *Central Bank* Did Not Alter Principles of Reliance Under the Fraud-on-the-Market Presumption

Vinson & Elkins incorrectly suggests that *Central Bank* silently changed well established principles of reliance, causation, and materiality under the fraud-on-the-market presumption. *See* Mot. at 12, 17. According to Vinson & Elkins, under *Central Bank*, now the market must be "informed of the attorneys' role in drafting the representations at issue." Mot. at 12. Neither *Central Bank* nor the out-of-circuit cases Vinson & Elkins cites support Vinson & Elkins' proposition.

Vinson & Elkins' claim that *Central Bank*, an aiding and abetting case, silently rewrote the federal securities laws concerning reliance, causation, and materiality for primary §10(b) claims brought under the fraud-on-the-market presumption is incredible. *Central Bank* was ***not*** a fraud-on-the-market case. It was an individual action. *See* 511 U.S. at 168. Nor did the Court in *Central Bank* ever discuss the fraud-on-the-market presumption. As Vinson & Elkins concedes when it cites the Court to page 180 of the opinion in *Central Bank*, the Supreme Court narrowly circumscribed its discussion of reliance to cases involving aiding and abetting liability only. Mot. at 17. The Supreme Court in *Central Bank* expressly predicated its decision upon the fact that plaintiffs conceded Central Bank did ***not*** commit a primary violation for a manipulative or deceptive act, but only alleged secondary liability, aiding and abetting. *See* 511 U.S. at 192. In contrast, plaintiffs allege primary violations of §10(b) under all three prongs of Rule 10b-5.

Moreover, as Judge Thrash held in *Carley Capital Group*, responding to the same "reliance" argument Vinson & Elkins makes here:

> ***There is nothing in Central Bank with regard to its use of the terms "makes" or "making a material misstatement" that limits liability to those individuals who sign documents or are otherwise identified to investors. The standard adopted by the Court is consistent with the "directly or indirectly" language in Section 10(b).***

27 F. Supp. 2d at 1334. District judges in Texas have also rejected similar causation-related arguments. *See Hartsell*, 2000 U.S. Dist. LEXIS 4964, at *14-*15; *Young*, 2 F. Supp. 2d at 921-22. Likewise, Judge Lew held:

> ***While the investing public may not be able to reasonably attribute the additional misstatements and omission to E&Y, the securities market still relied on those public statements and anyone intricately involved in their creation and the resulting deception should be liable under Section 10(b)/Rule10b-5.***

ZZZZ Best, 864 F. Supp. at 970. The logic of the vacated panel decision of the Third Circuit in *Klein* is also persuasive:

> ***Section 10(b) and Rule 10b-5 require the plaintiff to demonstrate reliance on the misleading statement; they do not require the plaintiff to demonstrate that he or she relied on the defendant's role in the preparation or dissemination of the statement.*** When an investor reasonably relies on a materially misleading statement in connection with the purchase or sale of a security, ***the author of the statement should not be allowed to escape liability under the federal securities laws merely because the author is unknown to the investor.***

¶90,136, at 90,324; *see also id.* at 90,326 n.7 (finding *ZZZZ Best* and *Software Toolworks* consistent with *Central Bank*).

Vinson & Elkins cites two cases, *Ziemba* and *Dinsmore*, in support of its claim that *Central Bank* silently rewrote decades of law under the fraud-on-the-market presumption. *See* Mot. at 12-13, 17. Neither case supports Vinson & Elkins' contention. In *Dinsmore v. Squadron, Ellenoff, Plesent, Shein & Sorkin*, 135 F.3d 837 (2d Cir. 1988), the "sole issue" before the court was whether Central Bank precludes a cause of action for conspiracy liability. *Id.* at 840. The court's discussion of reliance was similarly constrained by the narrow issue before the court. *Id.* at 843. Because the Second Circuit's analysis was limited to reliance under a cause of action for secondary liability, *Dinsmore* is inapplicable here.

Ziemba is also inapplicable here because Vinson & Elkins' conduct is not "substantial assistance," and therefore Vinson & Elkins is not merely an aider and abettor. *See supra* §II.A.2. However, Vinson & Elkins says, according to *Ziemba*, for defendants alleged as primary violators – not just aiders and abettors – the market must rely on the defendants' ***role*** in making false and misleading statements, *i.e.*, a defendant must be identified to the market. Mot. at 12-13, 17. If so, then §10(b) liability for those who engage or employ a fraudulent scheme, act, practice, or course of conduct (hereinafter, "scheme") is a ***nullity***, because, by definition, a scheme does not require a statement to the market. In fact, Vinson & Elkins' position, indeed an essential element of Vinson & Elkins' argument, is that "[p]rimary liability for deceptive conduct under Section 10(b) depends on a direct representation or omission by the defendant on which the plaintiff relies." Mot. at 15-16.[15]

But that is not the law of the Fifth Circuit, as demonstrated in *Shores*, nor the law of the land. *See SEC v. Zandford*, ____ U.S. ____, No. 01-147, 2002 U.S. LEXIS 4023 (June 3, 2002). As the

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15 *See also* Mot. at 6-7 ("Section 10(b)'s deceptive-act prong imposes liability on only those persons who themselves make misstatements or omissions. The manipulative-act prong concerns only market manipulation, such as wash sales and rigged prices. The Complaint does not allege that Vinson & Elkins engaged in either type of conduct, and therefore it fails as a matter of law to state a claim that Vinson & Elkins violated Section 10(b)."); Mot. at 16 ("And as interpreted in *Central Bank*, Section 10(b) forecloses deceptive conduct claims against persons who did not make misstatements or omissions, regardless of the label plaintiffs affix to their claim.").

Supreme Court recently reaffirmed in *Zandford*, "***neither the SEC nor this Court has ever held that there must be a misrepresentation about the value of a particular security***" to violate §10(b). *Id.* at *13. *See also infra* §II.F. Accordingly, to the extent *Ziemba* is construed by Vinson & Elkins as requiring that a false and misleading statement publicly attributable to the defendant must be made in order for §10(b) liability to attach, *Ziemba* it is inconsistent with the law of the land.

F. Plaintiffs Properly Allege Vinson & Elkins' Liability Under §10(b) and Rule 10b-5(1) & (3)

Vinson & Elkins asserts:

> Section 10(b)'s deceptive-act prong imposes liability on only those persons who themselves make misstatements or omissions. The manipulative-act prong concerns only market manipulation, such as wash sales and rigged prices. The Complaint does not allege that V&E engaged in either type of conduct, and therefore it fails as a matter of law to state a claim that V&E violated Section 10(b).

Mot. at 6-7. Accordingly, as Vinson & Elkins suggests, Rule 10b-5 exceeds the scope of its enabling statute, §10(b), and therefore no liability exists for plaintiffs' allegations that Vinson & Elkins employed a scheme to defraud or engaged in acts, practices, or a course of conduct that operated as a fraud or deceit. Mot. at 15-16.

Vinson & Elkins fails to reconcile its rewrite of the federal securities laws with Fifth Circuit law. And its version of liability under §10(b) is not recognized anywhere.[16] *Central Bank* did not change the scope of primary liability under §10(b), as Vinson & Elkins suggests. Indeed, the Supreme Court, in a unanimous opinion, recently reaffirmed:

- ***"[N]either the SEC nor this Court has ever held that there must be a misrepresentation about the value of a particular security" to violate §10(b).*** *Zandford*, 2002 U.S. LEXIS 4023, at *13.
- ***"The scope of Rule 10b-5 is coextensive with the coverage of § 10(b)*** ...." *Id.* at *7 n.1.

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[16] Vinson & Elkins cites several cases at page 16 of its Motion in an attempt to support its claim that primary §10(b) scheme liability no longer exists. But these cases involved secondary liability claims or primary liability claims that were only conclusory. *See Erickson v. Horing*, No. 99-1468-JRT/FLN, 2001 WL 1640142, at *12 & n.12 (D. Minn. Sept. 21, 2001) ("[C]onspiracy-like allegations ... fail as a matter of law."); *In re Lake States Commodities*, 936 F. Supp. 1461, 1472 (N.D. Ill. 1996); *Primavera Familienstiftung v. Askin*, No. 95-Civ-8905(RWS), 1996 WL 494904, at *7 (S.D.N.Y. Aug. 30, 1996) (scheme allegations "conclusory," however "'*Central Bank* does not limit the liability of those who participate in a scheme to defraud.'"). To the extent any of these cases hold that defendant must make a statement or omit a material fact in order to be liable under §10(b), they are inconsistent with decisions of this Court, the Fifth Circuit, and the Supreme Court.

- ***Allegations that defendant "engaged in a fraudulent scheme" or "'course of business that operated as a fraud or deceit'" stated a §10(b) claim.*** *Id.* at *13, *17.

Plaintiffs allege viable theories of recovery under §10(b) and each prong of Rule 10b-5.

1. Broad Range of Prohibited Conduct Under §10(b) and Rule 10b-5(1) & (3)

Rule 10b-5, promulgated by the SEC pursuant to §10(b), provides:

> §240.10b-5 Employment of manipulative and deceptive devices
>
> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.

17 C.F.R. §240.10b-5.

As Vinson & Elkins admits, the CC "track[s] language found in Rule 10b-5." Mot. at 15. The CC does in fact invoke the full range of Rule 10b-5's prohibitions, as plaintiffs intended. And the scope of conduct prohibited under Rule 10b-5 (1) & (3) is very broad, which this Court has recognized. *See In re Sec. Litig. BMC Software, Inc.*, 183 F. Supp. 2d 860, 905 (S.D. Tex. 2001); *Landry's*, slip op. at 9 n.12.

As the Supreme Court recently stated in *Zandford*, §10(b) "should be 'construed" not technically and restrictively, but flexibly to effectuate its remedial purposes."'" 2002 U.S. LEXIS 4023, at *12. This has been the law for decades:

> [T]he 1934 Act and its companion legislative enactments [including the 1933 Act] embrace a "fundamental purpose ... to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry. "... Congress intended securities legislation enacted for the purpose of avoiding frauds to be construed "not technically and restrictively, but flexibly to effectuate its remedial purposes."

Affiliated Ute Citizens, 406 U.S. at 151.[17] Thus, there is no limitation on the scope of fraudulent conduct prohibited under §10(b) and Rule 10b-5:

> "[We do not] think it sound to dismiss a complaint merely because the alleged scheme does not involve the type of fraud that is usually associated with the sale or purchase of securities. We believe that § 10 (b) and Rule 10b-5 prohibit ***all*** fraudulent schemes in connection with the purchase or sale of securities, whether the artifices employed involve a garden type variety of fraud, or present a unique form of deception. Novel or atypical methods should not provide immunity from the securities laws."

Bankers Life, 404 U.S. at 11 n.7 (quoting *A. T. Brod & Co. v. Perlow*, 375 F.2d 393, 397 (2d Cir. 1967)) (emphasis in original).

The Fifth Circuit has always applied §10(b) and Rule 10b-5 flexibly, to achieve the remedial purposes of the 1934 Act. Sitting *en banc*, in *Shores*, the Fifth Circuit stated the securities laws have a purpose "broader" than policing disclosure. 647 F.2d. at 470. Rather the securities laws "cover deliberate, manipulative schemes to defraud which can annul not only the purpose of disclosure but also the market's honest function." *Id.* In so holding, the Fifth Circuit stated:

> [T]he purposes of the securities acts and rule 10b-5 are far broader than merely providing full disclosure or fostering informed investment decisions. The Supreme Court has held that the acts were designed "to protect investors against fraud and to promote ethical standards of honesty and fair dealing. *See* H.R. Rep. No. 85, 73d Cong., 1st Sess., 1-5 (1933)." This court has held that "(t)he basic intent of section 10(b) and rule 10b-5 and indeed, of the Exchange Act, is to protect investors and instill confidence in the securities markets by penalizing unfair dealings." Thus, the central purpose of the acts is the protection of investors, and the promotion of free and honest securities markets. ***The acts reach complex fraudulent schemes as well as lesser misrepresentations or omissions***.

647 F.2d at 470.[18] Accordingly, following the Supreme Court's decision in *Affiliated Ute*, the Fifth Circuit recognized that Rule 10b-5 "was not limited to dealing with misrepresentation or omission

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[17] *Accord Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 477 (1977) ("No doubt Congress meant to prohibit the full range of ingenious devices that might be used to manipulate securities prices."); *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186 (1963) (§10(b) should be construed "not technically and restrictively, but flexibly to effectuate its remedial purposes").

[18] *Accord Meason v. Bank of Miami*, 652 F.2d 542, 549 (5th Cir. 1981) ("[T]he Court has concluded that the Exchange Act and the Securities Act should be construed broadly to effectuate the statutory policy affording extensive protection to the investing public. *See Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967); *see also* S. Rep. No. 47, 73d Cong. 1st Sess. 1 (1933) (indicating legislative intent of the Securities Act to protect the public from the sale of fraudulent and speculative schemes)."); *Paul F. Newton & Co. v. Texas Commerce Bank*, 630 F.2d 1111, 1118 (5th Cir. 1980) ("The federal securities statutes are remedial legislation and must be construed broadly, not technically and restrictively.").

cases under 10b-5(2), but reached 'a course of business' or a 'device, scheme or artifice' that operated as a fraud." *Id.* at 471-472 (quoting *Affiliated Ute Citizens*, 406 U.S. at 153).

It follows that a defendant need not make false and misleading statements to be liable under §10(b) and Rule 10b-5. As the Supreme Court held in *Zandford*, "neither the SEC nor this Court has ever held that there must be a misrepresentation about the value of a particular security" to violate §10(b). 2002 U.S. LEXIS 4023, at *13. Previously, in *United States v. O'Hagan*, 521 U.S. 642 (1997), the Supreme Court reversed a ruling of the Eighth Circuit that, under *Central Bank*, "§10(b) covers ***only*** deceptive statements or omissions on which purchasers and sellers, and perhaps other market participants, rely." *Id.* at 664. The Supreme Court held that because §10(b) prohibits "'any manipulative or deceptive device or contrivance'" a defendant is subject to primary liability for employing "[any] deceptive device," whether or not the defendant spoke. *Id.* at 651, 653. And, in *Superintendent of Ins.*, a ***unanimous*** Supreme Court upheld a §10b/Rule10b-5 complaint involving a "fraudulent scheme" involving the sale of securities where ***no*** false statement was alleged because:

> ***There certainly was an "act" or "practice" within the meaning of Rule 10b-5 which operated as "a fraud or deceit" on Manhattan, the seller of the Government bonds.***

404 U.S. at 9.

Finally, citing *O'Hagan*, this Court has stated: "***A defendant need not have made a false or misleading statement to be liable.***" *Landry's*, slip op. at 9 n.12; *In re Waste Mgmt., Inc. Sec. Litig.*, No. H-99-2183, slip op. at 75 (S.D. Tex. Aug. 16, 2001);[19] *BMC Software*, 183 F. Supp. 2d at 869.[20]

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[19] Due to the length of these opinions, and the fact that this Court has access to them, they have not been attached to this brief.

[20] *See also Affiliated Ute Citizens*, 406 U.S. at 152-53 (subsections (a) and (c) are broader than subsection (b) of Rule 10b-5); *SEC v. First Jersey Secs.*, 101 F.3d at 1450, 1471-72 (2d Cir. 1996); *SEC v. Seaboard Corp.*, 677 F.2d 1301, 1312 (9th Cir. 1982); *Shores*, 647 F.2d at 468; *Competitive Assocs., Inc. v. Laventhol, Krekstein, Horwath & Horwath*, 516 F.2d 811, 814-15 (2d Cir. 1975) ("Not every violation of the anti-fraud provisions of the federal securities law can be, or should be, forced into a category headed 'misrepresentations' or 'nondisclosures'. ***Fraudulent devices, practices, schemes, artifices and courses of business are also interdicted by the securities laws.***"); *Blackie*, 524 F.2d at 903 n.19 ("Rule 10b-5 liability is not restricted solely to isolated misrepresentations or omissions; ***it may also by predicated on a 'practice, or course of business which operates ... as a fraud ....'***"); *Richardson v. MacArthur*, 451 F.2d 35, 40 (10th Cir. 1971) ("Rule 10b-5 is a remedial measure of far greater breadth than merely prohibiting misrepresentations and nondisclosures concerning stock prices. No attempt is made in 10b-5 to specify what forms of deception are prohibited; rather, ***all fraudulent schemes in connection with the purchase and sale of securities***

2. The CC Does *Not* Allege Market Manipulation, Nor Does It Allege Mere "Assistance" to Enron in Structuring and Documenting Bogus Transactions

At pages 18-20 of its Motion, Vinson & Elkins claims plaintiffs' allegations that it structured bogus transactions for Enron are not viable. According to Vinson & Elkins, plaintiffs may allege a claim for "manipulation," and Vinson & Elkins' conduct does not fall within the definition of "manipulation," which constitutes either "wash sales, matched orders, or rigged prices." Mot. at 18. This is incorrect. Use of the term "manipulative" throughout the CC refers to the heading of Rule 10b-5, and the full range of conduct prohibited thereunder, not market manipulation. The CC expressly invokes the full range of proscriptions under Rule 10b-5. *See* ¶995. And, contrary to what Vinson & Elkins says, Rule 10b-5(1) & (3) do not merely proscribe market manipulation, as shown above.[21]

At pages 20-21 of its Motion, Vinson & Elkins claims that because it was "not a principal" in the bogus transactions alleged by plaintiffs (*i.e.*, it only created the bogus transactions) Vinson & Elkins should not be liable. Vinson & Elkins repeats its invalid theme, namely that notwithstanding Vinson & Elkins' knowledge of and participation in the fraudulent scheme, Vinson & Elkins should not be liable because it is the lawyer and not the client. Once again this is inconsistent with the law.

The Supreme Court never intended to allow professionals to avoid scheme liability by hiding behind their clients.

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are prohibited.") (emphasis in original and added).

[21] Moreover, "manipulative conduct" is not so narrowly defined as Vinson & Elkins claims. As the Supreme Court stated in *Santa Fe*, 430 U.S. 462 "[n]o doubt Congress meant to prohibit ***the full range*** of ingenious devices that might be used to manipulate securities prices." 430 U.S. at 477. In *Hundahl v United Ben. Life Ins. Co.*, 465 F. Supp. 1349 (N.D. Tex. 1979), Judge Higginbotham, although finding conduct merely constituting breach of fiduciary duty was not prohibited by Rule 10b-5, recognized there is a broad range of prohibited manipulative conduct that falls between market manipulation and breach of fiduciary duty. *Id.* at 1360. Judge Higginbotham further stated, "[f]ew efforts to play with the price of a traded stock can be successful without running afoul of section 10(b)'s other weapon deception." *Id.* at 1362. Although the cases actually support plaintiffs' claims, *Santa Fe*, *Hundahl*, *Schreiber*, and *Commonwealth Oil/Tesoro* are all factually distinguishable because each case was merely a state law breach of fiduciary duty cause of action, stemming from a corporate merger or acquisition. *See Schreiber v. Burlington Northern, Inc.*, 568 F. Supp. 197, 205 (D. Del. 1983) ("nonfrivolous claims based on state law for breach of contract, tortious interference with contract, breach of fiduciary duties"); *In re Commonwealth Oil/Tesoro Petroleum Sec. Litig.*, 484 F. Supp. 253, 259 (W.D. Tex. 1979) ("breach of fiduciary duty").

> [L]awyers, accountants, and banks who engage in fraudulent or deceptive practices at their clients' direction, [are] primary violator[s] despite the fact that someone else directed the ... scheme. The Supreme Court in Central Bank never intended to restrict § 10(b) liability to supervisors or directors of securities fraud schemes while excluding from liability subordinates who also violated the securities laws.

SEC v. U.S. Entl., Inc., 155 F.3d 107, 112 (2d Cir. 1998). A ***"primary violator is one who 'participated in the fraudulent scheme'*** or other activity proscribed by the securities laws." *Id.* at 111 (citing *First Jersey*, 101 F.3d at 1471).[22]

Indeed, long ago the Fifth Circuit rejected the argument that lawyers should be entitled special consideration due to the breadth of scheme liability under Rule 10b-5:

> [W]e reject the contention that our holding imposes new burdens on defendants or enhances their liability. Lawyers, underwriters, and accountants who participate in bond issues in good faith are unaffected by our decision. Liability results only if they act with intent to deceive or defraud.

Shores, 647 F.2d at 471.

And, in *Molecular Technology Corp. v. Valentine*, 925 F.2d 910, 917 (6th Cir. 1991), the Sixth Circuit held that a law firm and certain of its lawyers could be subject to scheme liability under §10(b) and Rule 10b-5:

> Section 10(b)/rule 10b-5 is not limited to claims based on misrepresentations and omissions but, rather, has been applied to a wide variety of ***fraudulent schemes***:
>
> "[The] cases forcefully reflect the principal that [§] 10(b) must read flexibly, not technically and restrictively and that the statute provides a cause of action for any plaintiff who 'suffer[s] an injury as a result of deceptive practices touching its sale [or purchase] of securities....'"

Id. (quoting *Santa Fe*, 430 U.S. at 475-76). Applying these principals, the court held there was sufficient evidence for the jury's finding of primary "fraudulent scheme" liability for the defendant lawyers' "involvement with [a] shell transaction." *Id.* at 918. The facts alleged against Vinson & Elkins are substantially more detailed, and rise to a much more substantial level of involvement, than the law firm defendants in *Molecular Technology*.

A defendant may be held liable for participating in a scheme to defraud simply if it knowingly commits manipulative or deceptive acts in furtherance of the scheme. *See, e.g., BMC*

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22 *See also Shores*, 647 F.2d at 465-66, 468; *Abell*, 858 F.2d at 1119-23; *Rubin*, 143 F.3d at 268; *Kline*, 24 F.3d at 491-92; *In the Matter of Keating, Muething & Klekamp*, SEC Release No. 34-15982, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶82,124, at 81,989 (S.E.C. 1979).

Software, 183 F. Supp. 2d at 885-86, 905, 915; *Cooper v. Pickett*, 137 F.3d 616, 624 (9th Cir. 1998) ("*Central Bank* does not preclude liability based on allegations that a group of defendants acted together to violate the securities laws, as long as each defendant committed a manipulative or deceptive act in furtherance of the scheme."); *First Jersey*, 101 F.3d at 1471; *Lemmer v. Nu-Kote Holding, Inc.*, No. 3:98-CV-0161-L, 2001 U.S. Dist. LEXIS 13978, at *26-*27 (N.D. Tex. Sept. 6, 2001); *In re Health Mgmt. Inc. Sec. Litig.*, 970 F. Supp. 192, 209 (E.D.N.Y. 1997); *Adam*, 884 F. Supp. at 1401; *ZZZZ Best*, 864 F. Supp. at 967-72. Whether a defendant has engaged in a scheme to defraud (or whether the complaint has sufficiently alleged so) should be determined by viewing the defendant's conduct (or the allegations of the complaint) ***as a whole***. *See Blackie*, 524 F.2d at 903 n.19 (for scheme liability, complaint should not be fragmented into individual, isolated acts but should be considered as a single overall scheme to defraud).

Furthermore, with respect to scheme liability, a defendant may be liable for participating in a scheme even if it did not interact with all the other participants, was unaware of the identity of each of the other participants, did not know about the specific roles of the other participants in the scheme, did not know about or participate in all of the details of each aspect of the scheme, or joined the scheme at a different time than the other participants. *See United States v. Craig*, 573 F.2d 455, 483-84 (7th Cir. 1977) (scheme to defraud under mail fraud statute). Under the federal mail fraud statute, 18 U.S.C. §1341, primary actors in a scheme to defraud are liable for the acts of the other actors, so long as they committed one fraudulent act in furtherance of the scheme. *See, e.g., United States v. Humphrey*, 104 F.3d 65, 70 (5th Cir. 1997); *United States v. Lothian*, 976 F.2d 1257 (9th Cir. 1992); *United States v. Maxwell*, 920 F.2d 1028, 1035 (D.C. Cir. 1990); *United States v. Lanier*, 838 F.2d 281, 284 (8th Cir. 1988); *United States v. Wiehoff*, 748 F.2d 1158, 1161 (7th Cir. 1984); *Craig*, 573 F.2d at 483-84. Vinson & Elkins committed not one act, but multiple related acts over several years.

3. Vinson & Elkins' Conduct in Violation of Rule 10b-5(1) & (3)

Plaintiffs allege multiple theories of liability under §10(b) and Rule 10b-5 against Vinson & Elkins. While the CC alleges that Vinson & Elkins made false statements, Vinson &Elkins' liability is ***not limited*** to those allegedly false and misleading statements. The CC also alleges Vinson & Elkins' liability for Vinson & Elkins' conduct in the scheme to defraud or in engaging in any act, practice, or course of business that operated as a fraud and deceit on purchasers of Enron's publicly traded securities under Rule 10b-5(1) & (3). These are distinct liability theories – one based on ***statements***, under Rule 10b-5(2), the others based on ***conduct*** – which can result in liability, either in combination or separately. The CC details extensive conduct of Vinson & Elkins in violation of Rule 10b-5(1) & (3). Examples include the following.

At ¶802, plaintiffs allege that Vinson & Elkins structured bogus off-balance-sheet transactions and prepared the bogus transaction documents (including opinions) for deals involving the following entities:

Azurix	JEDI	Mahonia Ltd.
Canvasback	JEDI/Big River/Little River	Marengo
CASHCo.	JEDI/Condor	Marlin
Cayco	JEDI/Osprey/Whitewing/Condor	Newco
Condor	JEDI/Whitewing	Osprey
Cortez Energy	JEDI II	Red River
EES	JEDI II/Ontario	Sonoma
Egret	LJM	Sundance
Enron Brazil	LJM/Condor/Raptor	Wessex
Enron Broadband	LJM/Brazil Power Plant	Whitewing
Enron Global Power	LJM2	Yosemite
Firefly	LJM2/Chewco	Yukon
Iguana	LJM2/Raptors I, II, III, IV	

At ¶803 of the CC, plaintiffs allege that Vinson & Elkins issued opinions to Enron, Mahonia and J.P. Morgan representing that billions of dollars in forward sales contracts of natural gas and oil by Enron were legitimate commodities trades when, in fact, as Vinson & Elkins knew, the trades were bogus – manipulative devices to disguise loans from J.P. Morgan to Enron so those loans would not have to be shown as debt on Enron's balance sheet. No physical delivery of product was required or contemplated. Rather, the transactions were disguised loans through Mahonia, an entity set up by and controlled by J.P. Morgan. Mahonia and the bogus trades were an artifice to allow Enron to keep some $3.9 billion in debt off its balance sheet.

At ¶806 of the CC, plaintiffs allege that when Enron could not find a legitimate buyer for the outside investor's interest in JEDI, Vinson & Elkins along with Enron quickly formed a new entity called Chewco, which Enron and an Enron executive (Kopper) controlled, to buy the outside investor's interest in JEDI. Vinson & Elkins knew Chewco did not have an outside equity investor with a 3% stake – the minimum required to enable Chewco or JEDI to be treated as an independent third party. Barclays loaned some $240 million to JEDI (guaranteed by Enron) to allow it to do the deals with Enron necessary to artificially boost Enron's reported results and also loaned the money to two straw parties to provide the funds for the "equity" investment in Chewco. But because the purported equity investors in Chewco – Kopper and his partner – were, in fact, "strawmen" for Enron, Barclays required Chewco to secretly guarantee the purported "equity" loans Barclays made to the two "strawmen" via a $6.6 million secret cash deposit with Barclays and Enron provided directly or indirectly the balance of the "equity" money.

At ¶808, the CC further alleges Vinson & Elkins prepared the documentation for Chewco's financing and ***falsified*** these documents so as to make it appear that Chewco was independent. For non-consolidation, Chewco had to be funded by at least 3% equity from independent investors. With just one business day left in 97, in order to prevent the consolidation of hundreds of millions of dollars in debt and losses on Enron's financial statements when the year closed, Kirkland & Ellis and Vinson & Elkins drafted a side agreement providing that Enron would provide the necessary $6.6 million in cash to fund Chewco via clandestine reserve accounts for Big River Funding and Little River Funding. The side agreement was dated 12/30/97. The Kopper/Enron side agreement concocted by Vinson & Elkins and Kirkland & Ellis made it clear that no outside equity was used to fund Chewco and thus Chewco was not a viable SPE.

Vinson & Elkins' extensive involvement in structuring and preparing the illicit partnership and bogus SPE deals, and in issuing the false opinion letters affirming bogus deals were legitimate is detailed at ¶¶811-823 of the CC.

At ¶¶824-825 of the CC, plaintiffs detail how Vinson & Elkins concealed the phony nature of Enron's SPEs in Enron's public filings.

And at ¶¶850-856, plaintiffs allege Vinson & Elkins' involvement in an attempt to cover up and minimize employees' allegations that a huge fraud was occurring at Enron. While the cover-up was successful, Enron avoided disclosure of the fraud and kept its stock price artificially inflated.

In its 1/28/02 issue, *Business Week* described Vinson & Elkins' integral role in the overall scheme as follows:

In her missive to Enron chairman and CEO Kenneth L. Lay, Watkins suggested that the law firm wrote so-called opinion letters vouching for the legality of some of the deals now under scrutiny. And according to two ex-Enron executives contacted by *Business Week*, ***Vinson & Elkins played a creative role in structuring and managing some of the company's controversial "special purpose" partnerships. One former executive in the company's Houston office says employees would approach Vinson & Elkins lawyers "and say, 'this thing needs to work. How do we make it work?'"*** This source adds that the firm also gave Enron advice on how much information it had to disclose about its financial machinations in its 10K and 10Q reports to the SEC.

... "***Under those fact scenarios, they could have real problems***," says [University of Illinois law professor Ronald D. Rotunda].

* * *

... And Enron is V&E's single largest customer. ***In 2001, Enron accounted for more than 7% of V&E's $450 million in revenue***. The law firm had several lawyers working virtually full-time on company business, including some permanently stationed in its offices. ***By contrast, Enron contributed less than 1% to auditor Arthur Andersen's revenues***.

... In her letter, Watkins claimed that the firm "***provided some true sale opinions on some of the deals" related to the so-called Condor and Raptor deals.... [T]rue sale opinions are letters that law firms write vouching for the fact that business transactions meet particular legal requirements***. So, for example, they might certify that title has passed in a particular deal or that it was conducted between two legally independent parties. Such documents would have been important to Enron, since many of its deals took place with partnerships in which it held a large stake.

* * *

According to one former Enron employee, the company might not have been able to pull off many of the transactions now under investigation without Vinson & Elkins' opinion letters. The company "opinion-shopped for what it needed," says this source. "***If it hadn't gotten the opinion letters, it couldn't have done the deals***."

¶800.

G. Plaintiffs Properly Allege a Strong Inference of Scienter Notwithstanding Vinson & Elkins' Claims that It Did Not Understand What It Was Doing

Vinson & Elkins asserts that the "nature" of its alleged conduct does not demonstrate a strong inference of scienter. Mot. at 27. It is no wonder that Vinson & Elkins does not cite any authority which supports its claim. Vinson & Elkins also suggests that it did not know it was falsifying Enron's financial statements as a result of the bogus transactions, side agreements, backdated documents, illicit partnerships, and false opinion letters that Vinson & Elkins created. Its reason is that even for sophisticated lawyers like Vinson & Elkins, accounting rules are "properly the province of accountants, not lawyers." Mot. at 27. That is nonsense.

As stated by professor Lawrence Cunningham, a former deal lawyer at Cravath, Swaine & Moore:

> ***"It would be astonishing if business lawyers at Vinson & Elkins did not seek to understand, discuss, and negotiate the accounting treatment of transactions in the ordinary course of events." ... Vinson's statements to the contrary ... "defy reality" and smack of "post hoc" advocacy.***

Otis Bilodeau, "Firms Urge Dismissal of Enron Suits," *Legal Times*, 5/14/02. The substance of the transactions, the timing of the entry of the transactions, the identity of the parties, and the context in which the transactions occurred, each demonstrate a strong inference of scienter.[23]

The transactions which Vinson & Elkins structured and prepared had no purpose other than to falsely manipulate Enron's financial statements. They were bogus, non-economic transactions. Vinson & Elkins had to understand the purpose of these transactions in order to perform its role in creating them. Vinson & Elkins turns the reasonable inference to which plaintiffs are entitled on its head, when it suggests the contrary.

Plaintiffs need not show Vinson & Elkins' own representations about its capabilities to be entitled to a strong inference of scienter from the facts plaintiffs allege. However, if there is any possible doubt that Vinson & Elkins did not understand what it was doing, examples of Vinson & Elkins' claims about its capabilities from Vinson & Elkins' Web site should remove that doubt.

Structured Finance

> ***Vinson & Elkins has extensive experience in creating specialized finance structures to achieve targeted financial reporting*** and tax goals.... ***Firm attorneys are well-versed in the use of special-purpose entities such as trusts, partnerships, limited liability companies, and offshore entities in financing transactions***. The firm also assists in structuring financings for purposes of (a) achieving true-sale and ***off-balance-sheet treatment for accounting***, bankruptcy, or state law purposes

[23] Plaintiffs must "'plead specific facts giving rise to a "strong inference" of scienter.'" *Abrams v. Baker Hughes Inc.*, Civ. No. 01-20514, 2002 U.S. App. LEXIS 9565, at *10 (5th Cir. May 21, 2002) (quoting *Nathenson v. Zonagen Inc.*, 267 F.3d 400, 407 (5th Cir. 2001)). "Circumstantial evidence can support a strong inference of scienter." *Id.* at *11. In addition, "motive and opportunity may be considered as a factor in determining whether a strong inference has been raised." *Id.* at *7. Under Fifth Circuit law, courts "consider whether all facts and circumstances 'taken together' are sufficient to support the necessary strong inference of scienter on the part of the plaintiffs." *Id.* at *12.

> (while, in many cases, maintaining loan treatment for federal income tax purposes), (b) assuring the bankruptcy remoteness of each structure, and (c) minimizing adverse state or foreign tax consequences.

See Ex. 33 to plaintiffs' Appendix. Representative matters from Vinson & Elkins' "structured finance" practice include the following examples:

- Formed seven credit-linked note trusts to acquire structured obligations linked to publicly held companies and, through a combination of credit derivatives, synthetically converted the CLN trusts' debt to mimic the companies' public bonds. The bonds were issued in seven different transactions, raising funds in three currencies.

- Secured twenty-two sub-prime loans aggregating over $360 million in eight tranches of investment and non-investment grade bonds. The loans were to borrowers in six different industries; the CLO bonds were sold in the 144A capital market.

- Securitized a total return swap covering over $200 million of loan participation receivables in senior convertible, revolving and subordinated loans. The senior secured notes were sold to qualified institution buyers in a private placement.

- Monetized the value of appreciated assets in a wide variety of transactions, each involving transfer of the assets to a bankruptcy remote entity and creating contractual frameworks to satisfy applicable regulatory requirements, yet allowing favorable accounting and tax treatment. The assets monetized have included airport landing rights, emissions allowances, and ownership interests in special purpose entities.

Id. Vinson & Elkins also represents accounting firms:

> ***Our lawyers are well-versed in an accountant's duties;*** measures of damages; comparative fault; allegations of accountant's fraud; civil conspiracy; the installation of and consulting work related to automated financial systems; choice of law between various states and between the United States and other foreign jurisdictions; the Texas Deceptive Trade Practice Act and its application to accountants; ***fiduciary duties; detection and disclosure of illegal acts, errors, and irregularities; NOLs; independence; staffing and supervision; internal controls; loan loss reserves; conflicts of interest; related-party transactions; inventory; adequacy of workpapers; equity method of accounting; acquisition audits; due diligence examinations; regulatory accounting principles; resignation of an auditor and the withdrawal of audit opinions; and general audit questions concerning the role of the auditor and the comparative duties of management.***

Id.

But Vinson & Elkins' attorneys did not need all of the expertise they claim to have in order to understand the import of their conduct. As former Enron employee Watkins wrote concerning Raptor/LJM transactions in which Vinson & Elkins was involved:

It sure looks to the layman on the street that we are hiding losses in a related company and will compensate that company with Enron stock in the future.

¶850.

Case law supports the common sense proposition that allegations of significant conduct in creating fraudulent transactions demonstrates knowledge of fraudulent purpose of those transactions. *See, e.g.*, *In re Livent, Inc.*, 174 F. Supp. 2d 144, 151-52 (S.D.N.Y. 2001) (participation in a transaction designed to disguise cash received as loan as a sale establishes scienter); *U.S. Envtl.*, 155 F.3d at 112 (commission of a manipulative act under §10(b) establishes scienter); *In re MicroStrategy Inc. Secs. Litig.*, 115 F. Supp. 2d 620, 641 (E.D. Va. 2000) ("[A]ttempts at covering-up the truth are probative of a culpable state of mind ...."). For example, in *Livent* Judge Marrero found it was reasonable to infer that in entering with its client into a "bridge loan transaction and secret side agreements" CIBC understood the concealing purpose of the transaction. 174 F. Supp. 2d at 151. Vinson & Elkins simply defies reality when it claims it did not understand the fraudulent purpose of the deceptive transactions it created.

The duration and scope of Vinson & Elkins' conduct in structuring and preparing Enron's fraudulent transactions also demonstrates a strong inference of scienter. This is not an instance where a law firm was recruited by a public company to structure discrete, isolated, or otherwise limited deals. As the CC sets forth in detail at ¶¶800-856, Vinson & Elkins' conduct was continuous. It started before the Class Period and persisted throughout the Class Period. And the fraudulent transactions were interrelated. Vinson & Elkins structured and prepared three of the most significant vehicles of the Enron fraud – Chewco/JEDI, LJM and LJM2 – and the bogus deals Enron entered with those entities. Vinson & Elkins' conduct also involved the creation of other fake SPEs – entities purportedly independent but largely capitalized with Enron's stock and controlled by Enron executives. Then Vinson & Elkins created the fraudulent transactions between Enron, the fake SPEs, and the LJM partnerships run by Fastow, Kopper, and certain bank defendants.

And the fraudulent transactions between Enron, the LJM partnerships and the fake SPEs were manufactured – simply created on paper with no economic purpose. The bogus deals occurred frequently at year or quarter end and involved backdating of documents, side agreements with no-loss guarantees and other non-economic terms, the use of Enron employees as strawmen, and other artifices aimed at concealment. The bogus deals also obviously lacked arm's-length negotiations – they occurred instantaneously and were negotiated between Enron executives, not any independent entity or person. Plaintiffs' allegations that Vinson & Elkins structured and prepared fraudulent transactions, over and over again for years, in bogus deals totaling billions of dollars, undisputedly raise a strong inference of scienter.

Relevant examples from plaintiffs' allegations include, but are not limited to, the following.

1. Vinson & Elkins Created the Bogus Transactions With the LJM Partnerships and Fake SPEs

a. Chewco

Vinson & Elkins structured and prepared the transactions at the center of the Enron fraud. For example, it created Chewco, the illicit partnership that bought out JEDI in late 97, in order to keep hundreds of millions of dollars in debt and losses off of Enron's financial statements. An independent entity had to acquire JEDI to maintain the propriety of the structure which Enron was using to keep debt and losses off of its financial statements. When the fiscal year-end approached and no independent investor had been identified, Vinson & Elkins created Chewco with "strawmen" controlled by Enron in order to disguise the true identity of Chewco. Barclays in part funded Chewco with a loan to the "strawmen" secretly guaranteed by Enron pursuant to a document generated by Vinson & Elkins. And when Barclays required Chewco to guarantee with $6.6 million cash the purported "equity" loans Barclays made to the two "strawmen," Vinson & Elkins falsified the formation documents for Chewco and drafted a side agreement providing that Enron would provide the necessary $6.6 million to fund Chewco via clandestine reserve accounts named Big River Funding and Little River Funding. ¶¶804-810.

The side agreement drafted by Vinson & Elkins, as concluded by Enron's Special Investigative Committee, was "fatal" to the propriety of Chewco.

b. Bogus Hedging Deals

During the Class Period Vinson & Elkins participated in the creation of the illicit LJM partnerships and structured and prepared a series of bogus transactions with those partnerships.

¶¶802-823. Vinson & Elkins structured and prepared bogus hedging transactions with the Raptors – phony entities created by Vinson & Elkins that were purportedly independent but in fact were capitalized with Enron's stock. Vinson & Elkins created non-economic paper transactions with those entities which had no purpose other than to manufacture profit or hide debt and losses. ¶¶811-823.

For example, one "hedging" transaction with LJM structured and prepared by Vinson & Elkins involved Rhythms stock owned by Enron. Enron and Vinson & Elkins created a fake SPE controlled by Fastow and capitalized with Enron stock in forward contracts. The bogus SPE then engaged in a hedging transaction structured by Vinson & Elkins which involved Rhythms stock. In the transaction Enron gave LJM Enron's stock and LJM gave Enron a note in exchange. LJM capitalized the fake SPE with Enron's stock and the fake SPE gave Enron a put option on Rhythms stock. Profit was then manufactured by Enron's receipt of the put option. All risk in the transaction ultimately rested with Enron because Enron's stock capitalized the fake SPE. In 99, Enron and Vinson & Elkins created over $100 million in profit for Enron by this bogus "hedging" transaction. ¶¶445, 816.

Other similar bogus "hedging" transactions, each structured and prepared by Vinson & Elkins, occurred in 00 and 01, and involved fake SPEs known as the "Raptors" and LJM2. ¶¶802, 811-823. Like the Rhythms "hedge," these transactions were 100% percent contrivance. There were no independent parties. The fake SPEs were capitalized with Enron stock and controlled by Fastow. Enron essentially "hedged" with itself and created profits in bogus transactions. ¶¶816, 819-823. In the last two quarters of 00, Enron recognized earnings of $530 million on several transactions with the Raptor entities out of reported earnings of $650 million. The "earnings" from the Raptor contrivances created more than 80% of Enron's total income in that period. ¶33.

Another salient fact about the fraudulent transactions which Vinson & Elkins created is the magnificent enrichment of LJM and LJM2 through Vinson & Elkins' deals despite the fact that LJM and LJM2 never bore risk. The returns reached 2,500% in a matter of months for one transaction alone. Vinson & Elkins watched all of this happen yet now it claims it did not understand that the transactions it created were fraudulent. Even Skilling, who claims lack of financial sophistication, declares that such lavish returns in the transactions *per se* demonstrate the transactions were not arm's-length, *i.e.,* were bogus.

c. Bogus Buybacks

Other phony transactions prepared by Vinson & Elkins include merchant asset and investment buybacks. Those transactions were created for the purpose of enabling Enron to sell an asset to the LJM entity just before the end of a quarter, in order to boost profits, and then buy back the asset shortly thereafter. ¶¶814, 818.

For example, in 99 Enron artificially boosted its profits from its "sale" of a 13% stake in a company building the power plant in Cuiaba, Brazil. The bogus transaction was structured and prepared by Vinson & Elkins as follows: Enron agreed to sell its stake for $11.3 million in 9/99 and thereafter buyback the stake if it could not be sold at a profit elsewhere, after the close of 99 – removing all risk to LJM in the transaction and making it non-economic. This "sale" reduced Enron's ownership to the point where Enron purportedly did not control the entity and therefore did not have to consolidate debt associated with its interest. This "sale" also enabled Enron to improperly realize $34 million of mark-to-market income in the 3rdQ 99, and another $31 million of mark-to-market income in the 4thQ 99. In 8/01, Enron repurchased LJM's interest in Cuiaba for $14.4 million. ¶818.

Deals like this happened repeatedly from 6/99 through 6/01. ¶¶814-815. Indeed, near the end of the 3rdQ and 4thQ 99, Enron sold interests in seven assets to LJM and LJM2 in transactions structured by Vinson & Elkins. The transactions permitted Enron to conceal its true debt levels by removing the assets from Enron's balance sheet and, at the same time, record large gains. However, as it had agreed to do in advance (i) Enron bought back five of the seven assets after the close of the financial reporting period; (ii) the LJM partnerships made large profits on every transaction, even when the asset they had purchased actually declined in market value; and (iii) those transactions generated "earnings" for Enron of $229 million in the second half of 99 out of total earnings for that period of $549 million. ¶815. These transactions alone made it apparent the LJM partnerships were created to falsify Enron's reported financial results. ¶32.

2. Vinson & Elkins Issued False Opinion Letters

The Mahonia phony commodities trades concealed billions of dollars of debt that should have been on Enron's balance sheet and fed Enron cash to stem its bleeding due to its hidden losses. The loans – from J.P. Morgan through an offshore entity, Mahonia – were disguised as forward sales contracts of natural gas and oil ("prepaid swaps") in 00. Vinson & Elkins issued opinions to Enron, Mahonia and J.P. Morgan representing that billions of dollars in those contracts were legitimate commodities trades when, in fact, as Vinson & Elkins knew, the trades were bogus. Indeed, on the face of the contracts it was apparent they were loans and not prepaid swaps. No physical delivery of gas or oil was required or contemplated by the contracts. In addition, the notional principal on the face of the contracts indicated *per se* the contracts were in fact loans and could not have been prepaid swap trades. ¶¶664-665, 803.

3. Vinson & Elkins Backdated Documents

Another example of Vinson & Elkins' knowing actions to perpetrate the fraudulent scheme is evidenced by the Yosemite transaction at year-end 99. ¶817. In order to falsify Enron's year-end financial results, Vinson & Elkins back-dated legal documents that were not completed until months after the end of the quarter. *Id.*

Enron had secret ownership in an entity that Enron manipulated, "Yosemite." While preparing its 99 report on Form 10-K in 2/00, Enron discovered that it would have to disclose in the "unconsolidated affiliates" footnote to Enron's 99 financial statements its secret interest in Yosemite. To avoid this Enron had to reduce its interest in Yosemite to less than 10% by year-end 99. However, the year-end had already occurred. No *bona fide* purchaser would buy Enron's interest in Yosemite, let alone back date documents in order to make it appear that Enron did not own Yosemite by year-end 99.

Thus, Vinson & Elkins and Kirkland & Ellis worked with Fastow to concoct a series of transactions designed to make it appear – at least for the last week between 12/25/99 and 01/2/00 – that the Yosemite certificates were not owned by Enron but rather by a "third party," LJM2. On paper, LJM2 "owned" the Yosemite certificates it bought from Enron for a single day, immediately reselling the Yosemite certificates to another SPE, Condor. The Yosemite transaction created and structured by Fastow, Vinson & Elkins, Kirkland & Ellis and others was a sham. In fact, the Yosemite transaction documents were deliberately back-dated by Vinson & Elkins and Kirkland & Ellis during 2/00. ¶817.

4. Vinson & Elkins Whitewashed Employee Allegations of Fraud to Minimize the Fallout from Enron's Financial Disaster

Vinson & Elkins' Motion is telling in some respects for what it does not dispute. The CC demonstrates Vinson & Elkins' scienter by detailing Vinson & Elkins' whitewash "investigation" of the Watkins letter, which described the fraud with great specificity and implicated Vinson & Elkins. ¶¶850-856. However, nowhere in its Motion does Vinson & Elkins dispute that its alleged whitewash "investigation" indicates scienter. And Vinson & Elkins simply cannot dispute this. Indeed, plaintiffs are not the only ones that regard Vinson & Elkins' "investigation" of the Watkins letter as a whitewash.

> ***Near the end of Sherron Watkins' extraordinary August memo to her boss, Kenneth Lay, outlining concerns about Enron's accounting practices, she cautions against having the company's regular outside counsel Vinson & Elkins investigate the issues she raised.***
>
> ***"Can't use V&E due to conflict," she wrote, "they provided some 'true sale' opinions on some of the deals."***
>
> ***But Enron did tap Houston-based V&E to handle the investigation. The result was a nine-page letter to Enron's general counsel (and former V&E partner) James Derrick Jr., on Oct. 15 from partner Max Hendrick that, in effect, brushed Watkins' concerns aside....***
>
> ***The letter is striking for the narrowness of the investigation, the key people who were not interviewed, and for the way in which it fails to fully probe bombshell allegations*** ....
>
> * * *
>
> If V&E downplayed the substance of Watkins' allegations, it clearly realized that Enron's accounting might not stand up well to public scrutiny and could be portrayed very poorly in the press or in shareholder actions. V&E precisely identified the areas in which the company's accounting was most suspect, including the use of Enron stock to capitalize the partnerships, and the recognition of earnings through transactions involving no true third party. These factors, and others, led V&E to conclude that Enron was at "serious risk for adverse publicity and litigation."
>
> ***Despite that, V&E found that none of Watkins' allegations warranted further investigation*** ....

The Daily Deal, 1/17/02 (¶800).

Just six weeks after Enron Corp. directed its lawyers at Vinson & Elkins to investigate allegations about its secret partnerships, a report came back Oct. 15 saying everything was just fine. No need for "further widespread investigation," the lawyers added.

The very next day, Enron delivered the first in a series of shocks when it slashed shareholder equity by $1.2 billion, partly due to the partnerships. ***Sixteen days later the board of directors launched their own inquiry, which quickly found massive improprieties***. And on Dec. 2, Enron filed for bankruptcy protection.

"Even as the Titanic was sinking, there were certain rooms that were perfectly dry," said Matthew Spitzer, USC Law School dean. "If you asked someone in one of those rooms, 'See any water?,' they'd say no. That's the sort of investigation Vinson & Elkins did."

Los Angeles Times, 3/14/02 (¶800).

The Vinson & Elkins investigation and resulting memorandum to Enron General Counsel and former Vinson & Elkins partner, James Derrick, cast a saga of concealment.

a. Vinson & Elkins Avoided Disinterested Knowledgeable Witnesses to Whom Vinson & Elkins Was Referred

Briefly comparing Vinson & Elkins' report to the Powers Report is illustrative. Lawyers for the Powers Committee interviewed approximately 100 witnesses, including knowledgeable witnesses who were not implicated by Watkins' allegations. Vinson & Elkins interviewed approximately 10 witnesses, primarily those who had substantial professional and personal stakes threatened by Watkins' allegations.

Congressional members of the Subcommittee on Oversight and Investigations were outraged by this. As Representative Greenwood stated to Vinson & Elkins partner Joe Dilg on 3/14/02:

> Sherron Watkins says these allegations about Fastow and other people wearing two hats, conflicts of interest – you go to them and basically say, "Do you have conflicts of interest? There are allegations that bankers felt that you were squeezing them on these deals. Did you do that?" They say, "No." You don't go to the bankers and say, "We heard you had complaints. What was your experience with Fastow that caused you to complain?" You didn't do that.

And, as the Powers Report at 176-77 stated:

> With the exception of Watkins, V&E spoke only with the very senior people at Enron and Andersen. Those people, with few exceptions, had substantial professional and personal stakes in the matter under review.

Representative Stupak echoed the concerns, stating, "that's probably troubling most of us."

The facts underlying the apparent superficiality of Vinson & Elkins' investigation are serious ones. When interviewed by Joe Dilg and Max Hendrick, Watkins detailed the bases for her allegations. Vinson & Elkins did not investigate all the bases. During the interview, Watkins also identified several very knowledgeable witnesses, witnesses which were identified by Vinson & Elkins as "possible sources of corroboration" for Watkins allegations and "sufficiently removed" from the allegations, and thus unbiased. The witnesses included, but were not limited to, Vince Kaminski and the late Clifford Baxter. However Vinson & Elkins never interviewed those witnesses – or if Vinson & Elkins did, Vinson & Elkins never reported it.

As it turned out, lawyers for the Powers Committee did interview the witnesses and learned from those witnesses material facts concerning the fraud. In contrast to Vinson & Elkins, the Powers Committee concluded:

> ***Watkins was right about several of the important concerns she raised. On certain points, she was right about the problem, but had the underlying facts wrong.*** In other areas, particularly her views about the public perception of the transactions, her predictions were strikingly accurate. ***Overall, her letter provided a road map to a number of the troubling issues presented by the Raptors.***

Powers Report at 176. Although the Powers Committee carefully worded its criticism of Vinson & Elkins' purported response to the Watkins letter, the implication is undeniable: "***The scope and process of [Vinson & Elkins'] investigation appear to have been structured with less skepticism than was needed to see through these particularly complex transactions.***" *Id.* at 177.

b. Vinson & Elkins Was Informed of Material Facts Constituting the Fraud but Did Not Report Them

Certain witnesses that Vinson & Elkins did interview essentially reported what Vinson & Elkins already knew based on its conduct in structuring and preparing bogus transactions for Enron. Enron was hiding hundreds of millions of dollars in debt and losses. Enron was capitalizing purportedly independent third parties and entering non-economic transactions with those entities to falsify its financial statements. Enron controlled the LJM partnerships through Enron's executives which were principals in or otherwise controlled those partnerships. But the facts were not reported or were glossed over by Vinson & Elkins. Indeed, nowhere in its report does Vinson & Elkins indicate there are material facts not disclosed in Enron's SEC filings, nor does Vinson & Elkins even attempt to quantify in general terms the errors in Enron's financial statements of which Vinson & Elkins was informed.

One example is particularly glaring. Interviewing Causey, Joe Dilg and Max Hendrick were informed by Causey that Enron's balance sheet contained a $1 billion error from a single set of transactions with one of Enron's illicit partnerships. Max Hendrick's interview memorandum states:

> Causey pointed out that an unfortunate error will require an adjustment to the third quarter statements. In the contingent fee/cross-collateralization transaction that occurred in the first quarter of 2001, the note taken by Enron was booked as a note receivable (an asset) and not a charge against equity. The note should have been booked as a charge against equity and this may have to be corrected in the third quarter statements. This amounts to approximately $800 million, and together with an expected $200 million in additional contingent share commitment that will be required in the third quarter, will amount to a $1 billion charge against equity. Causey characterizes this as a simple mistake that now requires correction.

Vinson & Elkins never reported this or investigated it further.

As *Newsweek* reported (¶800):

> That "simple mistake" forced a $1.2 billion reduction of Enron's net worth. That reduction – and Enron's failure to produce a quick, clear explanation for it – ***sowed mistrust of all Enron's numbers. That mistrust was a crucial factor in Enron's implosion. So how could V&E not mention the bookkeeping problem in its Oct. 15 report to Enron***?

c. Vinson & Elkins Concluded No Further Investigation Was Necessary Despite the Fact It Was Sitting on a Bombshell

Despite that it had developed from interviews and from its own involvement facts manifesting one of the largest financial frauds in history, Vinson & Elkins concluded what it knew did "***not*** warrant a further widespread investigation by independent counsel and auditors." Vinson & Elkins' conclusion regarding the bogus hedging transactions that were causing Enron to implode: "Potential Bad Cosmetics." As for Watkins' allegations, Vinson & Elkins told Derrick that Watkins should be assured they were "found not to raise new or undisclosed information."

As Representative Tauzin stated to Vinson & Elkins partner Joe Dilg on 3/14/02:

> ***How could you know whether a further review would be required, if you wouldn't even look at her allegations? How could you, the attorneys who advise the corporation on these deals - - how could you possibly give the company objective information as to whether or not an outside counsel or an outside auditor ought to look at them if you never even look at the deals again?***

Although Vinson & Elkins did not report all the facts, glossed over what it did report, and concluded no independent counsel or auditor ought to look any further, it did warn of the obvious: "Because of the bad cosmetics involving the LJM entities and Raptor transactions, coupled with the poor performance of the merchant investment assets placed in those vehicles and the decline in the value of Enron stock, there is a serious risk of adverse publicity and litigation."

d. Vinson & Elkins Told Enron to Tell Watkins Her Concerns Had Been Addressed and They Raised No New or Additional Information

As shown above, Vinson & Elkins did not adequately follow up on Watkins' claims, did not interview or report on significant witnesses Watkins identified, and overall employed an inappropriately narrow scope and process in its investigation. Notwithstanding, Vinson & Elkins concluded in its report:

> ***Finally, we believe that some response should be provided to Ms. Watkins to assure her that her concerns were thoroughly reviewed, analyzed, and although found not to raise any new or undisclosed information, were given serious consideration.***

Congressional members of the Subcommittee on Oversight and Investigations found this conclusion "troubling" in light of the inadequacy of Vinson & Elkins' investigation.

e. When Watkins Said that the Conclusions of Vinson & Elkins' Investigation Were a Mistake, Vinson & Elkins Essentially Told Her to Shut Up

Watkins' response to the conclusions of Vinson & Elkins' investigation was to follow up with Vinson & Elkins. Apparently, when she found Vinson & Elkins' response to her follow-up inadequate, she sought out Ken Lay. Watkins' talking points memorandum for her meeting with Lay discusses two mistakes. The first mistake is that the investigation is not being taken seriously enough. Watkins further states:

> b. Mistake #2: He relied on V&E and Arthur Andersen to opine on their own work. They advised him to unwind Raptor, but that the accounting was appropriate when recorded in 2000.
>
> ***Joe Dilg's Oct 16th comment to me when I said that Lay should probably come clean and admit problems and restate 2000, in order to preserve his legacy and possibly the company's was the following:***
>
> ***"Are you suggesting that Ken Lay should ignore the advise of his counsel and auditors concerning this matter?"***

Vinson & Elkins' statement to Watkins, taken in context, was another step to thwart Watkins from exposing the fraud.

5. Facts Demonstrating Vinson & Elkins' Motive and Opportunity "Enhance" Plaintiffs' Scienter Allegations, Which Stand Alone Based on the Allegations Detailing Vinson & Elkins' Conduct in the Fraud[24]

According to Vinson & Elkins, plaintiffs have not adequately pleaded "motive" to demonstrate scienter. Mot. at 27-29. Vinson & Elkins asserts that the "majority view" finds professional fees are not sufficient motive to plead scienter. Mot. at 29 & n.16. But none of the cases which Vinson & Elkins cites to support its claim addressed facts even remotely similar to this case.[25] The comparison of Andersen to Vinson & Elkins demonstrates just how significant Enron's fees were to Vinson & Elkins: as a percentage of overall revenues, the fees Vinson & Elkins generated were ***700% greater*** than the fees of Andersen.

Enron was Vinson & Elkins' largest client. And Vinson & Elkins was Enron's go-to firm for years, consistent with its extensive involvement in most of the bogus transactions which led to Enron's restatement. As reported:

> The ties between the firm and Enron were close, and the link was cemented as about 20 Vinson & Elkins lawyers, including recently retired general counsel James V. Derrick, left the firm over the years and accepted jobs in Enron's legal department.

¶800. The long-standing relationship was so close that many of the lawyers in Enron's legal department came from Vinson & Elkins, resulting in Enron's legal department being dubbed "Vinson & Enron" by those inside Vinson & Elkins and Enron.

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24 Circumstantial evidence alone can support a strong inference of scienter. *Abrams*, 2002 U.S. App. LEXIS 9565, at *11 & n.12 (citing *Zonagen*, 267 F.3d at 410); *BMC Software*, 183 F. Supp. 2d at 900; *see also U.S. Envtl.*, 155 F.3d at 112. "Allegations of motive and opportunity may ***enhance*** other allegations of scienter." *Abrams*, 2002 U.S. App. LEXIS 9565, at *11 & n.11 (citing *Zonagen*, 267 F.3d at 410-12).

25 The cases cited by Vinson & Elkins for its proposition that plaintiffs do not plead motive and opportunity are not applicable here. Vinson & Elkins' relationship with Enron is far more extensive than the relationships indicated in those cases, and the magnitude of the fees Vinson & Elkins garnered here dwarfs the apparent fees involved in those cases. Moreover, in the cases cited by Vinson & Elkins, plaintiffs had not otherwise pleaded circumstantial facts tending to demonstrate a strong inference of scienter. *See Ellison v. American Image Motor Co.*, 36 F. Supp. 2d 628, 639 (S.D.N.Y. 1999); *Zucker v. Sasaki*, 963 F. Supp. 301, 304, 310 n.11 (S.D.N.Y. 1997); *Arizona World Nurseries*, 730 F. Supp. at 529, 532; *Queen Uno Ltd. Pshp. v. Coeur D'Alene Mines Corp.*, 2 F. Supp. 2d 1345, 1350, 1360 (D. Colo. 1998).

As Vinson & Elkins concedes, authority holds that allegations of legal fees in combination with other allegations of recklessness may adequately demonstrate scienter. *See In re CFS-Related Sec. Litig.*, No. 99-CV-825-K(J), Report and Recommendation at 32 (N.D. Okla. Dec. 21, 2002); Mot. at 29 n.16. Moreover, when the magnitude of fees increases to the point that the client is not an ordinary or average client, substantial fees can provide motive for a professional firm. *See In re Complete Mgmt. Sec. Litig.*, 153 F. Supp. 2d 314, 335 (S.D.N.Y. 2001); *MicroStrategy*, 115 F. Supp. 2d at 655. In *Complete Mgmt.*, the court found that over $1 million in consulting work to an Andersen consulting group during a three-year period supported an inference of scienter on the part of Andersen's auditors to "maintain the considerable revenues" to the consulting group. 153 F. Supp. 2d at 335. Vinson & Elkins generated approximately ***$100 million*** in fees from Enron during the Class Period, and over ***$150 million*** in the past five years. In *MicroStrategy*, the court found that $188,000 in financial rewards in addition to consulting fees gave "more weight to a stronger inference of scienter." 115 F. Supp. 2d at 655-56. The financial incentive in *MicroStrategy*, as with *Complete Mgmt.*, pales in comparison to the fees Vinson & Elkins generated from Enron.

Enron was Vinson & Elkins' largest client and therefore the importance of Enron as a client and the magnitude of fees the Enron accounts generated stands for itself in demonstrating Vinson & Elkins' motive. In addition, the Seventh Circuit's decision in *Frymire-Brinati v. KPMG Peat Marwick*, 2 F.3d 183, 191 (7th Cir. 1993), illustrates how the fees of the firm translate into incentive of the individuals who work at the firm. In *Frymire-Brinati*, Judge Easterbrook, rejected the argument that accounting firm Peat Marwick would never participate in a fraud to collect just $25,000 in fees:

> Why, it asks, would it help Powers hoodwink investors? For the 1983 audit Peat Marwick collected less than $25,000. It would be insane to facilitate a securities fraud, and expose itself to huge liabilities, in exchange for this paltry sum, Peat Marwick insists, adding that when in the course of the 1984 audit it got a whiff of fraud it immediately withdrew. Maybe so, but the state of mind of the local auditors is imputed to the partnership, and one of the auditors in Oklahoma may have been trying to boost Pepco in the hope of enlarging the stream of revenue in future years.

Id. As reported in the media, one of Vinson & Elkins' top partners admits that Vinson & Elkins' work for Enron "grew dramatically" as Enron's revenues ballooned from $10.25 billion in 85 to $100 billion in 00. Among multiple factors demonstrating motive, the significant growth of Enron and its "dramatic" impact on Vinson & Elkins and Vinson & Elkins' top lawyers working for Enron is one more fact contributing to Vinson & Elkins' motive.

III. Conclusion

The federal securities laws do not only apply to issuers of securities. Law firms and other so-called "secondary actors" do not enjoy immunity. Plaintiffs properly allege that Vinson & Elkins committed securities fraud under §10(b) and each prong of Rule 10b-5. Vinson & Elkins' claim that it did not understand what it was doing simply defies reality. For all the reasons stated herein, Vinson & Elkins' motion to dismiss should be denied.[26]

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Respectfully submitted,

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[26] If the Court grants the Motion to Dismiss, plaintiffs should be entitled leave to amend for all the reasons herein and stated in Plaintiffs' Opposition to Motion of Certain Current and Former Directors to Dismiss Pursuant to Fed. R. Civ. P. 8 and Request for Leave to Amend at §II, which plaintiffs hereby incorporate by reference. Vinson & Elkins is incorrect in stating that controlling authority precludes the viability of any amendment. As the wealth of documents have become available in this case, plaintiffs have gathered, and will continue to gather, information which can provide even further evidentiary detail to bolster plaintiffs' allegations against Vinson & Elkins for violating each prong of Rule 10b-5.

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