UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

In re ENRON CORPORATION SECURITIES LITIGATION	§	Civil Action No. H-01-3624 **(Consolidated)**
This Document Relates To:	§	CLASS ACTION
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.	§	

MEMORANDUM OF POINTS AND AUTHORITIES IN OPPOSITION TO MOTION TO DISMISS BY KIRKLAND & ELLIS

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I. INTRODUCTION AND FACTUAL OVERVIEW[1]

In the face of a 500-page complaint alleging the largest and worst securities fraud in the history of the United States[2] in excruciating detail, every single defendant – including Kirkland & Ellis 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.

Kirkland & Ellis attempts to portray itself as an innocent victim of the Enron debacle – a law firm that was merely rendering routine legal services to entities doing business transactions with Enron when it became engulfed in the Enron conflagration. But this is not what is pleaded in the Consolidated Complaint ("CC")[3] and what is pleaded is what controls in the motion to dismiss

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[1] 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.

Unless otherwise noted, all emphasis is added and citations are omitted.

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

[3] All references to "¶__" are to paragraphs of CC filed 4/8/02.

context. What the CC pleads and what now must be accepted as true is that Kirkland & Ellis is liable under the 1934[4] Act because it (i) employed acts and contrivances 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").

As detailed in the CC, Kirkland & Ellis was present at the creation of – and then actively and continuously participated in – the fraudulent scheme throughout the Class Period. Kirkland & Ellis represented purportedly independent partnerships and Special Purpose Entities (SPEs) doing legitimate business deals with Enron. But in fact Kirkland & Ellis was secretly acting for and at the direction of Enron and Enron's top insiders – to repeatedly structure non-arm's-length contrived transactions involving entities and persons Kirkland & Ellis knew Enron controlled and which were 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 reported financial results and condition, artificially inflating the prices of Enron's publicly traded securities and thus deceiving investors.

A. Year-End 97 Crisis

The fraudulent scheme and course of business involving Enron as set forth in the CC finds its origin in mid 97 when Enron encountered problems due to a huge ($400+ million) loss on a British natural gas transaction and a $100 million charge due to MTBE transactions, which called into question its trading skills and risk management capabilities and which resulted in analysts downgrading Enron's stock and lowering their forecasts of Enron's future earnings per share ("EPS") growth. Enron's stock price lost one-third of its value and Enron's executives' bonuses were slashed. Enron's top executives and Board members were determined to halt Enron's stock price decline and get the stock 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 Enron to credibly forecast stronger future revenue and earnings growth. Unfortunately, Enron's actual business operations were not capable of generating such results. ¶8.

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4 15 U.S.C. §78a *et seq.*

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 JEDI's outside investor was going to withdraw from JEDI. This created a crisis. Because of the involvement of the outside investor in JEDI, JEDI had been treated as independent of Enron. Thus, Enron had been able to do transactions with JEDI as an independent third party, recognize profits from those transactions and not carry JEDI's debt on Enron's books. However, in late 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 – $45 million (40% of that year's profits) – put some $700 million of JEDI's debt back on Enron's balance sheet – and lose the ability to generate profits from similar such deals with JEDI or its successor going forward.*** ¶9.

Enron ***could not find a legitimate buyer for the outside investor's interest*** in JEDI. So in late 12/97 Lay, Skilling and Fastow hand picked Kirkland & Ellis to help create and supposedly represent a new entity called Chewco and Chewco's investors. They quickly formed Chewco, which Enron and an Enron executive controlled, to buy the outside investor's interest in JEDI. Chewco ***lacked both money and any legitimate outside equity investors. So Enron got Barclays Bank to loan $240 million to Chewco, providing Barclays with a secret guarantee of repayment, so that Chewco could get the money needed to invest in JEDI. Barclays also loaned money to two straw parties (Little River and Big River – which were also represented by Kirkland & Ellis) to provide $11.4 million for a purported "equity" investment in Chewco. But because the purported equity investors in Chewco were, in fact, "strawmen" for Enron, Barclays also required Chewco to secretly support the purported "equity loans" via a secret cash $6.6 million reserve with Barclays.*** Because there was no legitimate independent outside investor in Chewco, Chewco was not independent of Enron and lacked economic substance. Thus, Chewco/JEDI was required to have been consolidated with Enron and ***all of Enron's 97 profits generated by transactions with JEDI should have been eliminated and $700 million in debt put back on Enron's books.*** ¶10.

By forming Chewco at year-end 97 and structuring the contrived JEDI buyout, Kirkland & Ellis enabled Enron to avoid a disaster by keeping Enron's previously recorded 97 profits from deals with JEDI in place, thus inflating Enron's 97 reported profits by $45 million. They also kept as much as $700 million worth of debt off Enron's books, making Enron look much more creditworthy and liquid than it actually was. The scheme had been launched. And Chewco was now also positioned to serve as a controlled entity which Enron could use going forward to do more and more non-arm's-length contrived transactions with, ***which would ultimately create $350 million in phony profits for Enron and allow Enron to conceal the true state of its indebtedness by improperly moving billions of debt off its balance sheet and onto the books of Chewco***. Between 98 and 01, Enron and Kirkland & Ellis would also create other partnerships and SPEs that Enron secretly controlled and use them to generate hundreds of millions of additional phony profits for Enron and to conceal billions more of Enron's debt by moving it off Enron's balance sheet. ¶11.

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

As Enron reported its ***better-than-expected year-end 97 financial performance***, Enron's stock began to move higher, more than recovering all it had lost in 97. Then, during 98-01, 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. ¶12.

Throughout 98-00, Enron reported record annual profits and a very strong financial position consistently stressing the success of its wholesale and retail energy operations, its international prospects and operations, its broadband content delivery and intermediation businesses, its strong financial condition and earnings and its prospects for continued strong earnings growth. As a result of its apparent success, Enron's stock price climbed to as high as $90-3/4 per share in late 8/00, giving Enron a market capitalization of over $70 billion – one of the largest in the world. The Company was repeatedly cited in financial and academic circles as one of the world's most innovative companies and success stories of modern capitalism, with Enron's top executives being praised for their skill, creativity and entrepreneurial and financial ability. ¶13.

However, the apparent success of Enron was a grand illusion – a false picture created by manipulative and deceptive acts, devices and contrivances, a scheme to defraud and a wrongful course of business by defendants that operated as a fraud and deceit on the purchasers of Enron's publicly traded securities. Defendants' scheme was accomplished by, *inter alia*, Enron and Kirkland & Ellis – a law firm hand picked by Enron's CFO Fastow to participate in structuring contrived financial transactions to falsify Enron's financial results while providing purportedly independent representation to the partnerships and SPEs, which Enron was using as artifices to defraud. ¶17.

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 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 misuse and 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 to not only 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. To make matters worse, Enron had capitalized SPEs it controlled and was doing phony deals with – SPEs supposedly represented by Kirkland & Ellis – with shares of Enron stock and Enron ***had agreed to issue millions and millions more shares of its stock to these entities if Enron's stock price declined below certain so-called "trigger prices."*** Because of the triggers and the way Enron capitalized the SPEs, it was absolutely vital that Enron's stock continue to trade at high levels and that Enron maintain its "investment grade" credit rating, otherwise defendants' scheme would unravel. ¶18.[5]

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5 Enron's investment grade credit rating was indispensable to enabling it to get counterparties to do huge trading transactions with it – transactions others would not do unless assured of Enron's creditworthiness. 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.***" ***In 10/99, Skilling said "Retaining a high investment-grade rating is critical to the success of our energy franchises .... If we were downgraded, we could lose critical market share in North America.***" ¶19.

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 hundreds of millions of dollars of new 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 independent entities which Kirkland & Ellis supposedly represented, but which, in fact, Enron secretly controlled and was using to structure contrived transactions with 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 debt of those entities if Enron lost its investment grade credit rating.*** ¶20.

C. The Partnerships and SPEs

To manipulate and thus falsify Enron's financial condition and inflate its reported results, Enron and Kirkland & Ellis structured a series of transactions involving SPEs. A public company that conducts business with an SPE may treat that SPE as if it were an independent entity ***only*** if it does not control the SPE. At a bare minimum, two additional conditions must be met: (i) an owner independent of the company must make an equity investment of ***at least 3% of the SPE's assets, and that 3% must remain at risk throughout the transaction***; and (ii) ***the independent owner must exercise control of the SPE***. ¶21.

In 99, Enron and Kirkland & Ellis created two ***LJM partnerships which Enron and Enron's CFO Fastow controlled. Over the next few years, Enron engaged in a series of transactions – which were, in fact, contrived and deceptive devices with the LJM SPEs which enabled Enron to inflate its reported financial results by more than a billion dollars – at the same time enriching Fastow and his friends and several of Enron's bankers who were allowed to invest in the LJM2 partnership – by tens of millions of dollars. The reason for establishing these 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. The LJM1 and LJM2 transactions were structured, reviewed and approved by Kirkland & Ellis. ¶23.

One of the primary vehicles used to falsify Enron's financial results during the Class Period was LJM2, which was secretly controlled by Enron and used to help create numerous SPEs (including the "Raptors") which Enron used to engage in transactions to artificially inflate its profits while concealing billions of dollars in debt that should have been included on Enron's balance sheet. Kirkland & Ellis knew that because LJM2 was going to be utilized to engage in transactions with Enron where Enron insiders would be 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 early 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 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 to investors in that private equity entity, Enron's top insiders, Kirkland & Ellis and Merrill Lynch decided that in funding LJM2, they would ***allow certain favored investment banks and high-level officers of those investment banks and other favored Merrill Lynch clients to invest in 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 by which Enron and Merrill Lynch brought investors into the partnership – ***which was not a public document*** – contained an invitation to benefit from the insider self-dealing transactions that LJM2 would engage in. 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 non-public offering memorandum was an invitation to join in the benefits of self-dealing transactions with Enron. Enron's bankers and the top executives of those banks were permitted to invest in LJM2, ***as a reward to them for their ongoing participation in the scheme – a sure thing for them.*** ¶25.

It was indispensable to the fraudulent scheme that LJM2 be formed before year-end 99 because of the need to use it as a vehicle to consummate some transactions with Enron before year-end 99 to create huge profits for Enron in the 4thQ 99 so that Enron could meet and exceed its forecasted 99 earnings. However, as had been the case with Chewco at year-end 97, there was tremendous time pressure and Merrill Lynch could not raise the money from outside investors in LJM2 in time to fund LJM2 by year-end 99 with sufficient capital to enable it to do the desperately needed transactions with Enron. So, in an extraordinary step, in 12/99, Enron, Fastow, Kopper, Andersen, Vinson & Elkins and Kirkland & Ellis, Enron's banks and bankers (JP Morgan, CIBC, Deutsche Bank, CS First Boston, Lehman Brothers and Merrill Lynch), knowing that LJM2 was going to be an extraordinarily lucrative investment anyway, created documentation that enabled the banks to advance virtually 100% of the monies needed to initially fund LJM2, *i.e.*, many times more than their allocated shares in 12/99. Then, 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. ¶26.

To ensure that LJM2 could be an effective instrumentality of defendants' scheme to manipulate Enron's reported profits and financial condition and enable Enron to conceal the true extent of its debt, LJM2 needed bank financing. So JP Morgan initially provided a $65 million line of credit to LJM2 – later, increased to $120 million with CS First Boston doing the lending – to facilitate and finance LJM2's illicit deals and manipulative or deceptive devices with Enron. ***In addition, JP Morgan and CitiGroup administered all the financial affairs of LJM2, i.e., profit***

distributions and capital calls, and were completely knowledgeable about the details of LJM2's deals, finances and distributions. ¶27.

The reason the banks put up virtually all the money to pre-fund LJM2 in 12/99 was that they knew Enron doing the 99 year-end deals with the LJM2 and its SPEs was indispensable to Enron avoiding reporting a very bad 4thQ 99 – which would have caused its stock to plunge. These vital year-end 99 deals – arranged by Fastow and Kirkland & Ellis – 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 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.

D. Enron Broadband

A purported growth area of Enron's business was its broadband services business, which included building out an 18,000-mile fiber optic network which Enron was constructing. Enron presented its broadband business as poised to achieve and later as actually achieving huge success, reporting that its fiber optic network was being and had been successfully constructed, was state of the art and provided unparalleled quality of service. ¶39.

Another example of how Kirkland & Ellis participated in the scheme and the falsification of Enron's financial results was Enron's joint venture with Blockbuster Entertainment, announced with great fanfare in 7/00. Enron presented this 20-year agreement as having a billion dollar value, that it was a first-of-its-kind agreement whereby consumers would obtain video-on-demand 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***. Abusing mark-to-market accounting, Fastow used an SPE created and represented by Kirkland & Ellis to create an astonishing $110+ million profit on this deal for Enron 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 a digital format, the only format which could be utilized for VOD. ¶40.[6] The supposedly independent SPE used in this deal obtained

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[6] Just eight months after announcing this contract with great fanfare and just weeks after representing that testing of the system in four cities had ***succeeded*** and that the service was being launched nationwide, Enron was forced to 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 which would obligate Enron to pay off investors in the SPEs. ¶41.

its bank financing for the transaction ***only*** because Enron provided the banks with a secret no-loss guarantee.

E. New Power

Another example of how Kirkland & Ellis participated in the falsification of Enron's reported financial results involved the New Power IPO, by which Enron improperly created $370 million in bogus profits in the 4thQ 00. Enron did a huge New Power IPO – 27.6 million shares at $21 per share in 10/00. After the IPO, Enron continued to hold millions of New Power securities. With the participation of Kirkland & Ellis – in a deal secretly arranged by Fastow before the IPO – Enron created the huge phony profit using an LJM2 SPE called Hawaii 125-0 which Kirkland & Ellis had created and was representing. Enron transferred millions of its New Power securities to Hawaii 125-0 and thus created a huge $370 million "profit" on the purported gain on those New Power securities. Enron's banks made a "loan" of $125 million to Hawaii 125-0 to enable it to buy certain New Power securities from Enron, ***but secretly received a "total return swap" guarantee*** from Enron to protect them against ***loss***! Hawaii 125-0 supposedly "hedged" the warrants with another Enron controlled entity called "Porcupine," (represented by Kirkland & Ellis). To supposedly capitalize Porcupine, LJM2 (represented by Kirkland & Ellis) put $30 million into Porcupine to facilitate the so-called hedge of the New Power warrants, but, 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 converting Enron's gain on its New Power equity holdings into a huge loss early in 01 – a loss of about $250 million – which was concealed until 10/01 – when Enron shocked the markets by revealing a $1 billion write-off and $1 billion reduction in shareholders' equity ¶42.

F. Enron's Access to the Capital Markets

Enron needed constant access to huge amounts of capital, which required that Enron keep its investment grade credit rating and keep its stock price high. 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, with 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 LJM1 and LJM2 partnerships. The creation of these SPEs and the billions of dollars of non-arm's-length contrived transactions Enron engaged in with them, was accomplished with the knowing and active participation of Kirkland & Ellis and enabled Enron to conceal hundreds of millions of dollars of losses and generate hundreds of millions of dollars of phony profits, while concealing billions of dollars of debt that belonged on its balance sheet and inflating its reported stockholders' equity by billions of dollars. As a result of reporting strong earnings, and a strong balance sheet as well as the apparent success of its business and its future earnings growth forecasts, Enron had unlimited access to the capital markets, borrowing billions of dollars in the commercial paper markets and selling Enron securities to the public. ¶48.

G. 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 its reported earnings, the success and strength of its business and its solid prospects for continued strong profit growth, Enron stock began to decline. 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 Chewco, LJM1 and LJM2 SPEs represented by Kirkland & Ellis would be triggered, ***which would require Enron to issue over 100 million shares of its common stock to those entities, 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 these consequences, *i.e.*, the collapse of the scheme, Enron and Kirkland & Ellis "restructured" the Raptor vehicles by transferring ***more than $800 million of contracts to receive Enron's own stock to them just before quarter-end, which permitted the continued concealment***

of the substantial losses in Enron's merchant investments, kept billions of dollars of debt off Enron's balance sheet and allowed the scheme to continue. ¶53.

H. The Impending Collapse

On 8/14/01, when Enron announced that Skilling – who had become Enron's CEO just months earlier – was resigning, they said it was for "***personal reasons***." While this resignation fanned the controversy over the true nature of Enron's finances and the condition of Enron's business, Lay, Fastow, Skilling, and Enron's other top executives lied to investors, telling them that Skilling's resignation was only for personal reasons and did not raise "***any accounting or business issues of any kind***" and that Enron's financial condition "***had never been stronger***" and its "***future had never been brighter***." They said there was "***nothing to disclose***," Enron's "***numbers look good***," there were "***no problems***" or "***accounting issues***." According to them, the Enron "***machine was in top shape and continues to roll on – Enron's the best of the best***." ¶57.

I. The Attempted Coverup

By 8/01, inside Enron management employees were complaining to Enron's Board that the fraud at Enron was so widespread it was out of control. In 8/01, two employees complained to the Board (¶59):

(a) One employee wrote:

> 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.
>
> * * *
>
> We have recognized over $550 million of fair value gains on stock 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....***
>
> ***[W]e 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*****.....**

* * *

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

* * *

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

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*****....**

(b) A second employee wrote:

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 ... 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]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.... Starwood is also mad since EES has not invested the $45MM in equipment under the agreement.... Now you will loose [sic] at least $45MM on the deal.... You should also check on the Safeway contract, Albertson's, IBM and the California contracts that are being negotiated.... 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.

You, the board have a big task at hand. You have to decide the moral, or ethical things to do, to right the wrongs of your various management teams.

*   *   *

... But all of the problems I have mentioned, they are very much common knowledge to hundreds of EES employees, past and present.

J. The Collapse 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 LJM SPEs, which Kirkland & Ellis had acted as counsel for over the past three plus years, 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. This retroactive consolidation resulted in a massive reduction in Enron's reported net income and massive increase in its reported debt.*** Enron then 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 and to put over $2 billion in debt back on its books 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, LJM1 and LJM2 – ***were used by Enron to enter into transactions that Enron could not, or would not, do with unrelated commercial entities***. These transactions were designed ***to and did create phony profits or to improperly offset losses***. These transactions 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 – that is, that a third party was obligated to pay Enron the amount of those losses, when in fact that third party was simply an entity in which only Enron had a substantial economic stake and in fact controlled. The Raptors transactions alone – where Kirkland & Ellis had acted as counsel for the SPE, 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.[7]

By 11/28/01, Enron's publicly traded debt had been downgraded to "junk" status and on 12/2/01, Enron filed for bankruptcy – ***the largest bankruptcy in history***. Enron's publicly traded securities have suffered massive price declines, inflicting billions of dollars of losses on purchasers of those securities. ¶66.

As *Newsweek* has written (¶69):

> In the late 1990s, by my count, Enron lost about $2 billion on telecom capacity, $2 billion in water investments, $2 billion in a Brazilian utility and $1 billion on a controversial electricity plant in India. Enron's debt was soaring. If these harsh truths became obvious to outsiders, Enron's stock price would get clobbered – and a rising stock price was the company's be-all and end-all. Worse, what few people

[7] 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. ¶63.

> knew was that Enron had engaged in billions of dollars of off-balance-sheet deals that would come back to haunt the company if its stock price fell.

Newsweek, 1/21/02.

> The key to the Enron mess is that the company was allowed to give misleading financial information to the world for years. Those fictional figures, showing nicely rising profits, enable Enron to become the nation's seventh largest company, with $100 billion of annual revenues. Once accurate numbers started coming out in October, thanks to pressure from stockholders, lenders and the previously quiescent SEC, Enron was bankrupt in six weeks. The bottom line: we have to change the rules to make companies deathly afraid of producing dishonest numbers, and we have to make accountants mortally afraid of certifying them. Anything else is window dressing.

Newsweek, 1/28/02.

The scheme to defraud Enron investors was extraordinary in its scope, duration and size. Billions of dollars in phony profits were reported. Billions of dollars of debt was hidden. Enron's shareholders' equity was overstated by billions of dollars. This was accomplished over a multi-year period through contrived non-arm's-length fraudulent transactions and misrepresentations in Enron SEC filings (Enron's 10-Ks, 10-Qs and Registration Statements), which repeatedly assured investors that Enron's transactions with its "unconsolidated affiliates" were negotiated on an arm's-length basis with senior officers of Enron other than Mr. Fastow and were on terms "reasonable" and/or "no less favorable" than those that could be obtained from "unrelated third parties," which 10-Ks were incorporated into Registration Statements utilized to raise billions of dollars of new 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 via the active and knowing involvement of the law firm for Chewco/JEDI and the LJM1 and LJM2 private equity partnerships and their SPEs, Kirkland & Ellis.***[8] These entities were the vehicles that drove the fraud – a fraud involving not one or a few contrived deals but repeated non-arm's-length fraudulent transactions that took place continuously over three plus years, with Kirkland & Ellis participating in contrived deal after contrived deal which were essential to the fraudulent scheme and course of

[8] Kirkland & Ellis was not the only "professional" participating in the scheme to defraud involving Enron. This brief focuses on the involvement and legal responsibility of Kirkland & Ellis. Obviously, these complex contrived transactions and the repeated misrepresentations required the participation of other lawyers, accountants and banks. The participation of those parties and their legal liability is discussed in separate briefs opposing their motions to dismiss.

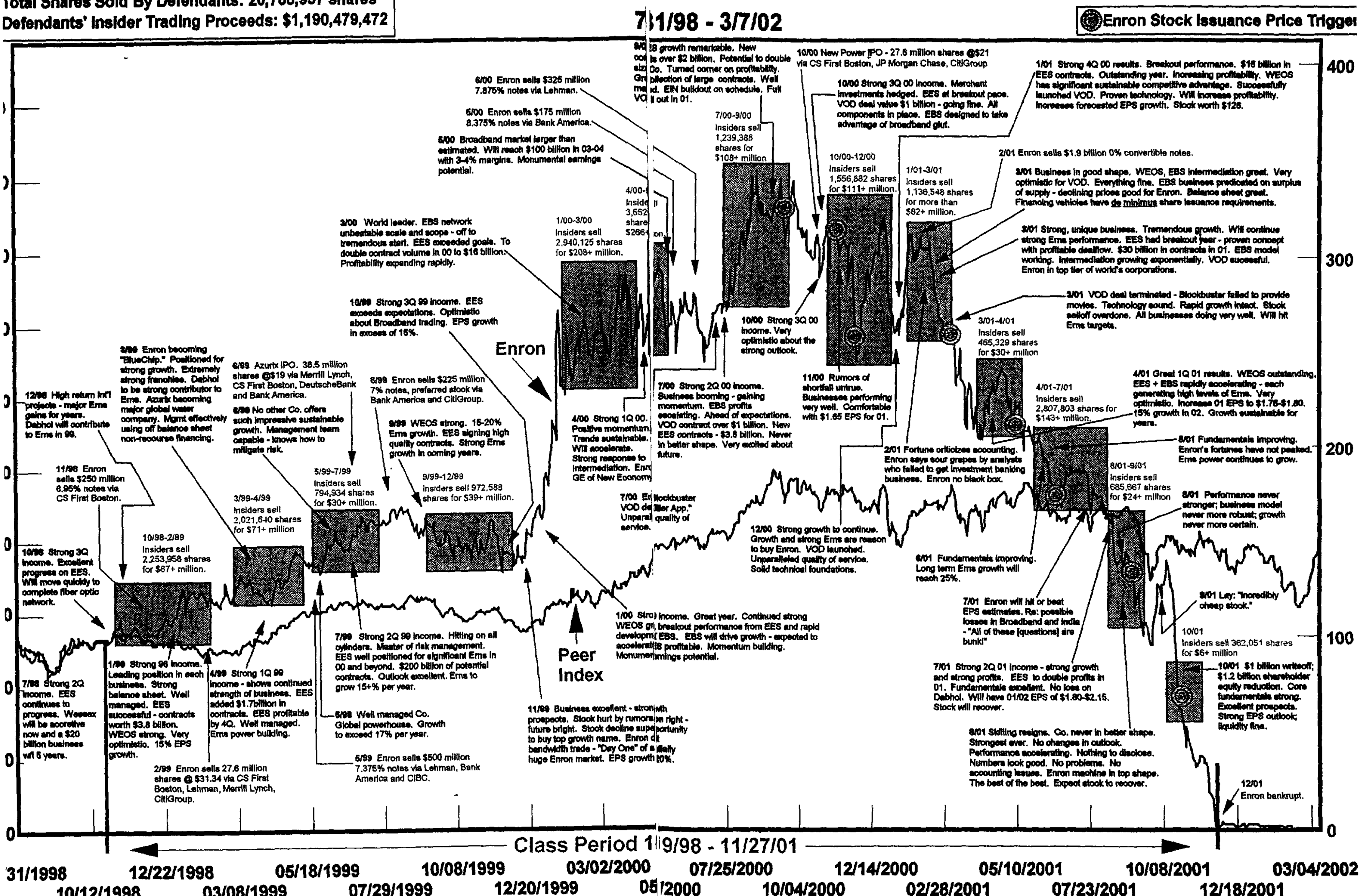
business. Kirkland & Ellis participated in setting up and structuring Chewco, JEDI, LJM1 and LJM2 and virtually ***all*** of the subsequent SPE transactions, ***doing Enron's bidding and not providing separate or independent representation of those entities Enron secretly controlled***. Kirkland & Ellis issued opinions on the legitimacy of these phony deals it knew were false and reviewed and approved key language in Enron's SEC filings that lied about the true nature of Enron's related party transactions, while Kirkland & Ellis was hand-picked by Enron to provide "independent" representation for Chewco, JEDI, LJM1 and LJM2 and other SPEs, but, in fact, Kirkland & Ellis ***worked at the direction of Enron and its top insiders*** in helping to structure those entities and transactions – which were really contrivances to falsify Enron's financial condition and results and deceive investors. ¶¶70, 73.

The graphic that follows present the rise and demise of Enron (¶74):

Total Shares Sold By Defendants: 20,788,957 shares
Defendants' Insider Trading Proceeds: $1,190,479,472

Enron Timeline

7/31/98 - 3/7/02



II. DETAILED FACTUAL ALLEGATIONS REGARDING KIRKLAND & ELLIS

> 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-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). 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."[9]

These elementary principles are of unusual importance in dealing with Kirkland & Ellis's motion to dismiss since Kirkland & Ellis has so brazenly disregarded or transmogrified the actual allegations against it in an effort to make it look like Kirkland & Ellis is being sued only because it was providing ordinary legal services to independent entities doing legitimate business transactions with Enron, which had little or nothing to do with the Enron fraud. But the actual allegations of the

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[9] Kirkland & Ellis makes the point that the 500-page CC uses the words "help" or "helped," "enabled," "facilitated" or "allowed" to describe its conduct vis-à-vis Enron on some occasions. Seizing on these words, Kirkland & Ellis claims that their use conclusively shows that the true core allegation against it here is one of aiding and abetting, which is barred by *Central Bank*. This argument is wrong. First of all, persons who participate in a scheme to defraud or a course of business that operates as a fraud or deceit on purchasers of a public company's securities or employ acts or manipulative or deceptive devices are actually "helping" to defraud investors "enabling" "allowing" or "facilitating" the commission of the fraud. In any event, this is not medieval England where meritorious actions were dismissed because pleaders used an ambiguous word or mischaracterized a claim for relief. Fortunately, in the United States today, complaints are to be construed ***in favor of the pleader with all ambiguities resolved and inferences drawn in the pleader's favor***. And the CC clearly does repeatedly allege that Kirkland & Ellis participated in a fraudulent scheme or course of business while employing acts and manipulative or deceptive devices and/or contrivances. That conduct is actionable under the text of §10(b) and Rule 10b-5 the wealth of decisions cited in this brief show.

CC are far more sinister – and it is those allegations – not Kirkland & Ellis's self serving sanitized version that must control the fate of CC's claims against Kirkland & Ellis.

Kirkland & Ellis's relationship with Fastow – Enron's CFO, who was a principal engineer of the falsification of Enron's financial statements that is at the center of the fraud – long preceded his employment at Enron. That relationship began in the 80's when Fastow worked at Chicago's Continental Bank. Fastow developed a close relationship with certain Kirkland & Ellis partners, who would later participate with him in the fraudulent scheme involving Enron. ¶858. Kirkland & Ellis was hand picked by Fastow and other top Enron insiders to provide representation to entities and SPEs Enron secretly controlled and was doing contrived deals with to create phony income and hide debt. In fact, Kirkland & Ellis was not acting at the direction of, or in the interests of those entities but ***was beholden to and working for Enron, taking orders from Fastow and other top Enron insiders***. Indeed, the relationship between Fastow and Kirkland & Ellis was so close that Mintz, the V.P. and General Counsel for Enron Global Finance, referred to Kirkland & Ellis as "***Fastow's attorneys***."

Kirkland & Ellis participated in structuring Enron's most important secretly controlled private equity partnerships (Chewco/JEDI and the LJMs) and the most important bogus SPEs (Raptors/Condor/Hawaii 125-0, Braveheart, etc.) ***knowing these were contrivances – devices to deceive – which falsified Enron's reported financial results and financial condition by huge amounts. Kirkland & Ellis issued "true sale" opinions on these deals or other opinions to the effect that they were legitimate business transactions, when Kirkland & Ellis knew they were non-arm's-length contrivances involving secretly controlled entities, secret guarantees against loss and the secret use of Enron's own assets to "hedge" gains, which deprived these transactions of an economic substance and the transaction counter-parties of any independence from Enron. Kirkland & Ellis knew that the true purpose and impact of these deals was to artificially inflate Enron's reported profits and hide billions of dollars of debt that belonged on Enron's balance sheet, thus deceiving the markets and investors.*** ¶99.

A. Kirkland & Ellis's Role in the Secretly Controlled Partnerships and SPEs

Kirkland & Ellis's ostensibly separate legal representation of the private equity partnerships and SPEs Enron used to falsify its financial results was a sham, used to create an appearance of independence for those entities and SPEs. In fact, Kirkland & Ellis was picked by Fastow for this role because of ***Kirkland & Ellis's willingness to take direction from Fastow and Enron*** and work as an active participant to further the fraudulent scheme. Kirkland & Ellis's participation in the scheme was essential. Kirkland & Ellis is an exceptionally sophisticated law firm in matters financed involving both private equity entities like Chewco/JEDI and the LJM's and public companies like Enron and thus provided the expertise necessary to create transactions that would superficially appear to be arm's-length transactions with independent entities, when in fact they were not. Working with other participants in the scheme, Kirkland & Ellis structured the deceptive devices and contrivances ***that formed the very core of the fraudulent scheme, including LJM1, LJM2, Chewco/JEDI*** and their associated SPEs, which were used to artificially inflate Enron's reported results by hundreds of millions while hiding billions in debt. ¶859.

Kirkland & Ellis ***knew*** of the defects in and lack of *bona fides* of the SPEs it created and that these transactions were not arm's-length from Enron but, in fact, were contrived deals made at Fastow's direction to deceive investors by artificially boosting Enron's reported financial results. Kirkland & Ellis also knew that because these entities were not independent of Enron, ***it was not representing independent entities nor was it providing representation to those entities to protect their separate interests but, in fact, was acting under the control of and at the direction of Fastow, Kopper, Skilling, Lay and other top Enron insiders, to paper transactions and close deals as they directed without regard to the economic substance of the transactions or the legal or economic interests or rights of the entities Kirkland & Ellis purportedly represented.*** ¶861.

As part of structuring Enron's secretly controlled SPE's and Enron's non-arm's-length deals with them, Kirkland & Ellis issued legal opinions in connection with the formation of and later transactions with Enron's secretly controlled entities and their SPEs. These opinions – "true sale" opinions – or opinions that the transactions were "legitimate" – were essential to allow the deals between Enron and the partnerships and SPE's to ***have a superficial appearance of being legitimate business deals with independent third parties***. But these opinions were false because these transactions were actually sham contrivances involving secret no-loss guarantees, straw persons, entities not independent of Enron and the use of Enron's own assets to "hedge" gains on Enron investments and which artificially inflated Enron's reported financial results, while siphoning off Enron's assets for the benefit of favored insiders and others, *i.e.*, the looting of Enron by Fastow, his cronies and certain favored investors in LJM2, *i.e.*, including top executives of Enron's banks and the banks themselves. ¶862.

Kirkland & Ellis structured and issued false opinions related to at least the following transactions and entities, including (¶863):

Chewco/JEDI I Big River LLC Little River LLC LJM1 LJM2 Raptor I Raptor II (Timberwolf) Raptor III (Condor) Raptor IV (Bobcat) Honer	Bob West Treasure LLC Cortez LLC ENA CLO Yosemite Securities Southhampton Place Condor SONR#1 LLC SONR#2 LLC

As a result of its participation in the scheme, Kirkland & Ellis received tens of millions of dollars for "representing" the Chewco/JEDI, LJM1 and LJM2 private equity partnerships and their SPEs. ***In fact, even though Kirkland & Ellis was supposed to be providing separate representation to independent third parties with economic interests adverse to Enron, Kirkland & Ellis acted at Enron's and Fastow's instructions and direction and much of Kirkland & Ellis's fees were paid directly or indirectly by Enron***. ¶864.

Kirkland & Ellis's willingness to structure these contrived SPEs and issue false opinions as part of the scheme continued ***throughout the Class Period*** as the SPE transactions in which Kirkland & Ellis was involved ***were the primary devices used to secretly shift billions of dollars of debt from Enron's balance sheet and artificially inflate Enron's income by hundreds of millions of dollars during 97-01***, to enable Enron to project a false picture of a financially sound company with an investment grade credit rating and strong revenue and earnings growth, thus permitting the Enron Ponzi scheme, from which Kirkland & Ellis was profiting, to continue. ¶865.

1. Chewco

In late 12/97, Enron learned that its JEDI private equity partnership had to be quickly restructured, as the outside investor was going to withdraw. This created a major crisis. Because of the involvement of the outside investor in JEDI, JEDI had been independent of Enron and had ***not*** been consolidated into Enron's financial statements and results. Thus, Enron had been able to engage in transactions with JEDI as an independent third party, recognize revenue and profits from those transactions and not carry JEDI's debt on Enron's books. However, unless JEDI could now 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 – put hundreds of millions of dollars of JEDI's debt back on Enron's balance sheet – and lose the ability to generate profits from similar such deals with JEDI or its successor going forward.*** ¶866. Given Enron's prior problems during 97 when it incurred huge trading losses, and its stock fell by over 30%, such a development would have been a disaster and crushed Enron's stock even further and possibly resulted in the ouster of Enron's top management team. Had this happened there never would have been the Enron scheme complained of in the CC.

Enron could not find a legitimate buyer for the outside investor's interest in JEDI in time for 97 year end. Thus, Kirkland & Ellis, as directed by Fastow and Enron, quickly formed a new entity called Chewco, which Enron and Fastow were to control, to buy the outside investor's interest in JEDI. Kirkland & Ellis was supposedly to provide legal representation of Chewco and Chewco's "equity investors," Big River Funding and Little River Funding, which together would "purchase" the outside investor's interest in JEDI. While ***Kirkland & Ellis was supposedly providing independent representation of Chewco and Big and Little River funding (Chewco's purported equity investors), in fact, it took direction from Enron and its top insiders***. ¶867.

Kirkland & Ellis, which was extremely experienced in structuring complex financial transactions, 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 independent. Because Chewco was really just***

a shell created by Enron to purchase the JEDI interest, to provide the funds Chewco needed, Enron, Fastow and Kirkland & Ellis arranged for Barclays Bank to loan $240 million to Chewco to allow it to buy out the partner's interest in JEDI and also to loan the money to two straw parties to provide funds for their purported "equity" investment in Chewco. But because Chewco was nothing more than an Enron created shell and lacked economic substance, Kirkland & Ellis knew that Barclays insisted that Enron secretly guarantee repayment of Barclay's $240 million loan. And because the purported equity investors in Chewco (which Kirkland & Ellis also supposedly represented), were, in fact, nothing more than "strawpersons" for Enron, Kirkland & Ellis knew that Barclays also required Chewco to support the purported "equity" loans Barclays made to the two "strawmen" via a secret $6 million cash offset deposit with Barclays! Kirkland & Ellis knew that this transaction was nothing more than a last minute contrivance – which lacked the involvement of any independent third parties – as well as independent economic substance and had been quickly cobbled together to avoid Enron having to wipe out 40% of its 97 profits and put $700 million of debt back on its books – ***which had it occurred would have stopped the scheme in its tracks***! By forming Chewco at year-end 97, Kirkland & Ellis avoided a disaster for Enron by keeping Enron's previously recorded profits from transactions with JEDI in place. Had proper accounting procedures been followed, because there was no legitimate independent outside investor in Chewco, Chewco was required to have been consolidated with Enron and ***all of Enron's 97 profits generated by transactions with JEDI would have been eliminated***! ¶868.

Kirkland & Ellis prepared the documentation for Chewco's formation and funding and falsified these documents so as to make it appear that Chewco was independent, when it was not. Even though Kirkland & Ellis knew Chewco had to be funded by at least 3% equity from independent investors to be legitimate, ***with just one day left in 97, Kirkland & Ellis (and Vinson & Elkins) drafted a 12/30/97 side agreement providing that Enron would provide the necessary equity cash to fund Chewco via clandestine reserve accounts for Big River Funding and Little River Funding ... Chewco's purported equity investors. The side agreement concocted by Kirkland & Ellis made it clear that no outside equity was used to fund Chewco and thus Chewco***

was not a legitimate SPE. Rather, Chewco was an artifice to further a fraud and deceive by falsifying and inflating Enron's financial statements. ¶869.

Kirkland & Ellis also took affirmative steps to conceal the Chewco buyout of the prior partner's interest in JEDI and Enron's resulting control of JEDI, so that the fraudulent scheme would not be discovered by regulators or investors. As the Chewco deal was first set up, ***Fastow was to have had managerial control of Chewco***. However, Kirkland & Ellis, realized that if Fastow – Enron's CFO – had that position ***Enron would have to disclose this interest in Enron's SEC filings***, which would likely expose the non-arm's-length relations between Enron and Chewco/JEDI and Enron's control of Chewco/JEDI – causing unwelcome scrutiny at a minimum and likely resulting in the scheme unraveling at the outset. ***So Kirkland & Ellis and Fastow arranged for a lower level Enron employee Kopper, Fastow's subordinate, to be substituted as the purported manager of Chewco, although Fastow in fact continued in that function, and by this subterfuge conceal the Chewco/JEDI transaction and Enron's involvement therein from Enron's shareholders and investors***. ¶870.

During the last days of 12/97, Kirkland & Ellis made other last minute changes to the structure of the Chewco/JEDI transaction to allow Enron to conceal Enron's secret control of Chewco and the non-arm's-length nature of the Chewco/JEDI deal. Kirkland & Ellis also converted the general partner of Chewco from a limited liability company to a limited partnership, and put Kopper in instead of Fastow as the owner of Chewco's general partner. The sole purpose for this contrivance – which did not reflect reality – was to permit concealment of the Chewco/JEDI transactions at year end 97. However, prior to the closing of the Chewco/JEDI deal, Kopper protested this conflict of interest since as an Enron employee he would now act also as the owner of both the general partner of Chewco ***and*** the owner of the equity of the Chewco partner, Big River Funding. ***Notwithstanding the fact Kopper complained to Kirkland & Ellis about the sham nature of the transaction, Kirkland & Ellis went ahead and completed the deal, tweaking it to facilitate concealment of Kopper's dual conflicting roles***. Kirkland & Ellis and Fastow ***concealed Kopper's true managerial position with Chewco by "transferring" Kopper's ownership interest in Big River Funding and***

Little River Funding to his domestic partner Dodson and then completing the "purchase" of the 50% interest in JEDI by Chewco. ¶871.

Kirkland & Ellis was thus "present at the creation" of the fraudulent scheme involving Enron. Without the 97 year-end Chewco/JEDI contrivance - a completely phony non-arm's-length deal – the scheme never gets off the ground. ***Kirkland & Ellis knew from day one that Chewco/JEDI was not a valid SPE meeting the requirements for non-consolidation but rather a contrivance to enable Enron to falsify its financial results and deceive investors.*** Chewco in reality and economic substance was Enron – Enron buys the partner's interest in JEDI - so that now Enron in substance owned and controlled Chewco/JEDI – which Kirkland & Ellis represented. Kirkland & Ellis did not withdraw from its involvement in the scheme or insist on disclosure of this conflict of interest in Enron's SEC filings – ***despite these clear red flags of impropriety.*** ¶871. Kirkland & Ellis also knew that Chewco was also now positioned to serve as a controlled entity which Enron could use ***going forward*** to do more non-arm's-length transactions with, which Kirkland & Ellis would structure, and ***which would create huge amounts of phony profits for Enron (at least $350 million) and allow Enron to conceal billions of dollars of debt over the next three years.*** ¶872.

Thus, Kirkland & Ellis not only participated in the launch of the fraudulent scheme, it was an essential participant in the fraudulent scheme going forward as it continued to participate with Enron and Fastow to create contrived transactions to falsify Enron's financial results via repeated non-arm's-length deals. During 98-01, Kirkland & Ellis engaged and participated in the creation of numerous other controlled partnerships and entities and used them to generate billions of dollars of additional phony profits for Enron and to conceal billions of dollars of Enron debt by moving it off Enron's balance sheet, including those described below. ¶873.

2. The LJM Partnerships

During 99, Kirkland & Ellis participated in the creation of two additional private equity ***partnerships which Enron and Fastow secretly controlled, known as LJM1 and LJM2. Kirkland & Ellis knew that, as had been the case with Chewco/JEDI, the LJM partnerships were also contrivances – devices to mislead. They were to be used by Enron to artificially inflate its reported financial results while at the same time enriching Fastow and his friends and several of Enron's***

bankers who were secret investors in the LJM2 partnership, and who would pocket millions and millions of dollars from the looting of Enron. Kirkland & Ellis knew that the reason for establishing these two LJM partnerships was that they would permit Enron to do transactions it could not otherwise accomplish with an independent entity. The LJM1 and LJM2 partnerships were structured and approved by Kirkland & Ellis which was purportedly providing independent representation of the separate interests of these LJMs and their SPEs but, in fact, because Kirkland & Ellis had been hand picked by Fastow and Enron for its role – Kirkland & Ellis continued to be beholden to and take instructions from them, and not its purported "clients". ¶874.

The importance of the LJMs to the fraudulent scheme cannot be overstated. They, along with Chewco/JEDI, were the primary vehicles that enabled Enron – with Kirkland & Ellis – (and others) to perpetrate the ***largest financial fraud in history.*** During 6/99-6/01, Enron entered into numerous transactions with the LJMs (or their SPEs), in which Kirkland & Ellis purportedly represented those partnerships and SPE's. Enron sold assets to LJM that it wanted to get off its books on terms that no independent third party would ever have agreed to. As had been the case with the year end 97 Chewco/JEDI deal, ***the transactions between the LJMs and Enron frequently occurred close to the end of financial reporting periods to artificially boost reported results to meet financial forecasts Enron and other participants in the scheme had been making.*** For instance, near the end of the 3rdQ and 4thQ 99, Enron sold interests in seven assets to LJM1 and LJM2 ***in transactions structured and approved by Kirkland & Ellis.*** The transactions permitted Enron to conceal its true debt levels by removing debt and overvalued assets from Enron's ***balance sheet and, at the same time, record large gains. However, as Kirkland & Ellis knew – (i) as Enron had agreed in advance it would do, Enron bought back five of the seven assets shortly after the close of the financial reporting period; (ii) consistent with the looting of Enron the LJM partnerships made large profits on every transaction, even when the asset it had purchased actually declined in market value; and (iii) these "round trip" transactions generated "earnings" for Enron of $229 million in the second half of 99 out of total earnings for that period of $549 million. In the transactions where Enron ultimately bought back LJM's interest, Enron had***

secretly agreed in advance to protect the LJM partnerships against any loss. Thus, as Kirkland & Ellis knew would be the case, the LJM partnerships were functioning as nothing more than vehicles to effectuate the falsification and artificial inflation of Enron's reported financial results, and to deceive investors. ¶875.

One phony LJM transaction where Kirkland & Ellis was initially involved was the purchase of an equity interest in an Enron power plant in Cuiaba, Brazil (the "Cuiaba plant"). Enron had substantial debt related to the Cuiaba plant – an asset which was grossly overvalued on its books. Enron wanted to get that debt off its books. So Enron sought to sell an equity stake in the Cuiaba plant to an independent third party. But, Enron could not find a third party purchaser to buy this loser project. So, in order to get this debt off its books and make Enron's balance sheet appear more healthy, Enron and Kirkland & Ellis structured a transaction whereby LJM1 would "buy" an equity stake in the Cuiaba plant. ***This was not an arm's-length or bona fide transaction***. ¶876.

Effective 9/99, Enron sold LJM1 a 13% stake in the company building the Cuiaba power plant ***secretly agreeing*** to repurchase that stake. This 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 deal enabled Enron to improperly create and realize $34 million of income in the 3rdQ 99, and another $31 million of income in the 4thQ 99 and got the unwanted debt off Enron's balance sheet. Then, following the pattern of the 99 LJM deals, having created the needed profit and gotten the debt off its books, during 01, Enron repurchased LJM1's interest in Cuiaba for $14.4 million***! However, as was the case with many of these deals, LJM1's purported equity investment in Cuiaba was never "at risk" ***because Enron had secretly agreed to make LJM1 whole for its investment***. Thus, Enron was required to consolidate the SPE Kirkland & Ellis created for this contrived deal. ¶877.

Another LJM1 "hedging" transaction with LJM that Kirkland & Ellis structured for Enron in 6/99 involved Rhythms stock owned by Enron, which enabled Enron ***to "hedge" Enron's huge gains in Rhythms stock and thus create and report a huge profit. Enron transferred its Rhythms stock to an LJM SPE in exchange for a note. As the deal was structured, if the SPE were required to pay Enron on the "hedge" the Enron stock would be the source of payment. In 99,***

Enron improperly recognized millions of dollars of income from the Rhythms' "hedging" transaction. Other "hedging" transactions that were structured by Kirkland & Ellis occurred in 00 and 01 and involved SPEs known as the "Raptor" vehicles. These were also structures funded principally with Enron's own stock, that were intended to "hedge" against declines in the value of certain of Enron's merchant investments. As Kirkland & Ellis knew, these transactions were not true economic hedges, – they were contrivances and devices devised to deceive and circumvent accounting rules. The economic reality was that Enron never escaped the risk of loss, because it had provided the bulk of the capital with which the SPEs would pay Enron. Kirkland & Ellis helped Enron use these contrivances and devices to deceive to inflate Enron's reported financial results throughout 00-01. ¶878.

One of the primary devices used to falsify Enron's financial results from 12/99 going forward was LJM2. LJM2 was supposedly formed in 12/99 and, like Chewco/JEDI and LJM1, was secretly controlled by Enron and Fastow. LJM2 was a very large partnership with $390 million in "private equity" and over $100 million in bank loans which was used to create numerous SPEs – which engaged in transactions to artificially inflate Enron's profits while concealing billions of dollars in debt that should have been included on Enron's balance sheet. Kirkland & Ellis, which Enron and Fastow selected to be counsel to LJM2, knew that because LJM2 was going to be used to engage in transactions with Enron where Enron insiders would be 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***. 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 Kirkland & Ellis participated in preparing) that they did not have to make any additional capital contributions if Fastow's dual role ended***. ¶879.

Because the LJM2 partnership was to be so lucrative to investors in that private entity, it was decided that in funding LJM2 ***certain favored banks, high-level officers of those banks (and favored clients of those banks) which did business with Enron would be allowed to get in on LJM2 – because LJM2 was virtually guaranteed to produce exceptional returns as the Enron Ponzi scheme continued***. In fact, the offering memorandum for the LJM2 partnership (which

Kirkland & Ellis participated in preparing and ***which was not a public document***) contained an invitation to benefit from the insider self-dealing transactions that LJM2 would engage in with Enron – the looting of 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 Glisan. 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 a similar Enron 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 non-public offering memorandum, written in substantial part by Kirkland & Ellis, was an invitation to join in the benefits of self-dealing transactions with Enron – ***the looting of Enron***. ¶880.

At year-end 99, Enron again encountered a crisis reminiscent of year-end 97 – Enron was again in danger of missing its "numbers" which would have caused Enron's stock to collapse, endangering the continuation of the scheme. It was indispensable that LJM2 be formed before year-end 99 so Enron could consummate several transactions before year-end 99, to move debt off Enron's balance sheet and to create profits for Enron so it could meet its forecasted 99 results. But, as had been the case with Chewco at year-end 97, there was tremendous time pressure and LJM2 could not be fully formed or funded by year end. The money from the outside investors in LJM2 could not be raised in time to provide sufficient capital to enable LJM2 to do the desperately needed transactions with Enron by 12/31/99. So, in the last days of 12/99, Fastow and Kirkland & Ellis, which supposedly represented LJM2 but in fact continued to work at Enron's and Fastow's direction, arranged for and ***created interim documentation that enabled*** several of Enron's banks or top executives of the banks, ***to "pre-fund" LJM2 i.e., advance sufficient monies needed to enable LJM2 in the last days of 12/99 to do four contrived non-arm's-length deals with Enron. These***

"pre-funding" advances were extraordinary as they were in amounts many times more than these investors' allocated shares in LJM2. Kirkland & Ellis knew the reason the banks or top executives of the banks, put up the money to pre-fund LJM2 in 12/99 was that they knew Enron doing the 99 year-end deals with LJM2 SPEs ***was indispensable to avoiding Enron reporting a very bad 4thQ 99 – which would have caused its stock to plunge*** and exposed or ended the Ponzi scheme Kirkland & Ellis was participating in. Kirkland & Ellis helped structure each of these 99 year-end contrived, non-arm's-length and fraudulent transactions for Enron, again supposedly representing LJM2 and its SPE's, but in fact secretly acting at Enron's and Fastow's direction and providing the acts and opinions necessary to close these deals which inflated Enron's year end 99 results and thus deceived investors. ¶881.

The key 99 year-end contrived deals were (¶882):

a. ***Collateralized Loan Obligations ("CLOs").***

b. ***Nowa Sarzyna (Poland Power Plant).***

c. ***MEGS, LLC.***

d. ***Yosemite.***

During the last week of 99, Kirkland & Ellis worked feverishly with Fastow, Merrill Lynch and Vinson & Elkins to create these four sham contrived transactions between LJM2 and Enron ***prior to year end 99***. These four transactions were ***all*** structured in the last week of 99 to enable Enron to report strong 99 EPS. However, as Kirkland & Ellis knew was to occur, ***the transactions were then to be reversed during 1Q00. Each of these transactions was nothing more than a deceptive device and contrivance designed by Kirkland & Ellis and others to falsify Enron's financial results and deceive investors.*** ¶883.

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, Kirkland & Ellis 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, Kirkland & Ellis was a sham. ***In fact, the deal was not really closed until 2/00, but the legal documents created by Kirkland & Ellis for this contrived deal were deliberately back-dated during 2/00 in order to justify the continued concealment from Enron's shareholders and investors of the existence of the fraudulent scheme.*** ¶884.

The other vital year-end 99 deals 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 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.

In each instance, Kirkland & Ellis structured and documented these contrived deals for LJM2 and the SPEs involved and was aware of Enron's repurchase obligations.

During 00, Enron continued to use LJM2 and its SPEs to falsify its balance sheet and reported results via more and more non-arm's-length fraudulent transactions with LJM2 which Kirkland & Ellis participated in structuring. For instance, on 3/20/00 – just before the end of Enron's 1stQ 00 – at the direction of Fastow and Enron, Kirkland & Ellis created a partnership called Southhampton Place for the purpose of acquiring a portion of the interest held in LJM1 by an existing limited partner, Fastow, and Kopper and Kirkland & Ellis – created the Southampton entity which was then funded with $70,000 of capital contributions ***from several Enron employees, including Glisan, Mordaunt, Lynn and Patel***. ¶886. This was clearly a non-arm's-length transaction to benefit Enron insiders – part of the falsification of Enron's financial results and the ongoing looting of Enron. Enron's Ben Glisan objected to Kirkland & Ellis, demanding that at a minimum Southampton should be described as a related-party transaction. However, in furtherance of the fraudulent scheme – and to conceal Enron's ongoing non-arm's-length deals that were being used to falsify Enron's results – ***Kirkland & Ellis falsely opined that the involvement of these Enron employees in the Southampton partnership and the Southampton partnership's transaction with LJM1 and/or Enron did not have to be disclosed***. ¶887. Thus, the Southampton contrivance was secretly implemented and Enron's financial results were further falsified.

In 5/00, Enron realized that it was – yet again – going to be unable to meet its earnings forecasts for the 2ndQ 00, without additional financial manipulations. So in 5/00, Kirkland & Ellis participated in structuring yet another contrived, sham transaction between Enron and LJM2 that enabled Enron to create phony income and thus report earnings in line with its forecasts for the quarter. Enron had attempted to generate revenue in its fiber optic business, (EBS), by selling a portion of its fiber optic cable lines. ***However, no legitimate purchaser could be found prior to the end of the 2ndQ 00***. Enron, once again, turned to Kirkland & Ellis and LJM2 to falsify Enron's finances. With just a few days left in the quarter, Enron had to have LJM2 purchase the fiber optic cable. The sale was structured by Fastow and Kirkland & Ellis. There was tremendous pressure to complete the transaction prior to the end of the quarter, as the only reason Enron was engaging in the sale with LJM2 was to artificially inflate its earnings via the sham transaction. The deal with LJM2 was not an arm's-length sale but rather a sham to concoct earnings for Enron. The dark fiber wasn't worth anywhere near $100 million, yet Enron and LJM2 placed a value of $100 million on the sale. Enron recognized $67 million in pre-tax earnings in 2ndQ 00 on this deal. Another deal with LJM occurred in the 3rdQ 00 worth more than $300 million to Enron but the fiber sold again was not worth near that much. These transactions could not have been entered into with unrelated parties because they never would have agreed to pay such inflated prices. The sole reason for the deal was for Enron to make its numbers. ¶888.

During 00, Enron, Fastow and Kirkland & Ellis structured increasingly more aggressive SPEs to enable Enron to create artificial profits or shift overvalued assets and/or debt off Enron's balance sheet at the end of reporting periods to artificially inflate Enron's reported income and improve its balance sheet. ***Operating at Fastow's and Enron's direction while functioning formally as counsel to LJM2 during 00***, Kirkland & Ellis devised mechanisms and structures to enable Enron to create phony income, including the structuring of four infamous SPE's named Raptor I, Raptor II, Raptor III and Raptor IV. The Raptors' SPEs were structured as "mark-to-market" contrivances and were used to off-load assets from Enron and/or create income from the shifting of assets held by Enron to the Raptors. ¶890.

Another example of how Kirkland & Ellis participated in falsifying Enron's results in late 00 involves the New Power IPO, by which Enron improperly created a huge but bogus $370 million profit in the 4thQ 00. In the 4th Q 00, Enron desperately needed to create profits to perpetuate the Ponzi scheme. Because Enron owned millions of shares of New Power stock, 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 shares by "hedging" that gain via yet another non-arm's-length transaction with an LJM2 entity. Enron did the huge New Power IPO – 27.6 million shares at $21 per share in 10/00. After the IPO, Enron continued to hold millions of shares of New Power stock and warrants. With the participation of Kirkland & Ellis, ***in a deal already secretly agreed to before the IPO***, Enron quickly moved to create the huge phony profit on its New Power securities using LJM2. Kirkland & Ellis created an SPE called Hawaii 125-0. Several of Enron's banks made a "loan" of $125 million to Hawaii 125-0 to help fund this deal, ***but as Kirkland & Ellis*** knew secretly received a ***"total return swap" no loss guarantee from Enron to protect CIBC and the banks against any***

loss. Enron transferred millions of its New Power securities to Hawaii 125-0 to "secure" the banks' loan and thus created a huge $370 million "profit" on the purported gain on the New Power securities. Hawaii 125-0 simultaneously supposedly "hedged" the warrants with another LJM2 SPE created by Kirkland & Ellis and controlled by Enron called "Porcupine." To supposedly capitalize Porcupine, LJM2 put $30 million into Porcupine to facilitate the so-called hedge of the New Power securities but, ***one week later, Porcupine paid the $30 million back to LJM2 plus a $9.5 million profit – leaving Porcupine with no assets***. ¶893. This transaction was a sham – a non-arm's-length contrivance done for no purpose other than to generate phony profits for Enron. Kirkland & Ellis played a virtual role in this fraudulent deal as it created and supposedly represented Hawaii 125-0 and Porcupine and knew of the secret no-loss guarantee from Enron to the lending banks.

During the Class Period, Kirkland & Ellis not only repeatedly structured the LJM2 SPEs' contrived transactions with Enron in the first place to enable Enron to falsify its financial results, but Kirkland & Ellis also participated in repeatedly "***restructuring***" the SPE's as the Class Period went on, so as to conceal those fraudulent transactions, avoid reversal of Enron's previously reported bogus income and permit the fraudulent scheme to continue. ¶889.

Hedging Enron's investments with the value of Enron's stock – as Kirkland & Ellis knew was being done in the Raptor SPE deals it was structuring – created an enormous danger for Enron's financial structure and thus motive for all participants in the scheme to keep Enron stock trading at inflated levels. Kirkland & Ellis knew that it and Enron had structured these transactions so that 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 early 01 and the Raptor SPEs lacked sufficient credit capacity to pay Enron on the "hedges." In 12/00, Enron calculated its net gain on these transactions to be slightly over $500 million. Enron could recognize these gains as income 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 loss reserve would defeat the very purpose of the Raptors, which was to shield Enron's financial statements from reflecting the change in value of its merchant investments. ¶891.

As year-end 00 approached, Enron faced another crisis – just as it had at year-end 97 and 99, which threatened to cause the fraudulent scheme to come apart. Two of Enron's Raptor SPEs were in danger of coming unwound as they lacked sufficient credit capacity to support their obligations, let alone continue to engage in similar transactions with Enron. If something were not done to prevent the unwinding of these SPEs, Enron would have to take a multi-million charge against earnings which would expose the prior falsification of Enron's financial results and result in Enron stock plunging, more and more of the stock issuance "triggers" would begin to be hit, and a vicious – likely fatal – down-cycle would kick in. And again, just as it had done at year-end 97 with Chewco/JEDI and at year-end 99 with LJM2, Kirkland & Ellis was there, acting at Enron's instruction to restructure and capitalize the Raptor SPEs at year-end 00 via artificial transactions which did nothing more than transfer rights ***to 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 exacerbated the huge risk already present from the use of Enron stock to capitalize the SPEs Kirkland & Ellis had structured and supposedly was representing. But this subterfuge enabled Enron to avoid recording a huge credit reserve for the year ending 12/31/00 and the Ponzi scheme continued. ¶892.

In late 3/01, the continuation of the fraudulent scheme was again threatened when 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 allow Enron to take that loss and face the consequences – exposure of prior falsification of Enron's financial results and a stock price collapse that would expose the fraudulent scheme, Kirkland & Ellis engaged and participated in yet another "restructuring" of the Raptor vehicles by having Enron transfer ***more than $800 million of contracts to receive Enron's own stock to them just before quarter-end. This was a transfer of huge value for no consideration – a move clearly contrary to the interests of the "client" Kirkland & Ellis purportedly represented. It also violated governing accounting rules, and it also permitted the participants in the scheme to continue the concealment of the substantial losses in Enron's***

merchant investments, to keep billions of dollars of debt off Enron's balance sheet, and allowed the Enron Ponzi scheme to continue. ¶894.

B. Kirkland & Ellis Reviewed and Approved Enron's False and Misleading SEC Filings

Kirkland & Ellis reviewed and approved Enron's various SEC filings (10-Ks, 10-Qs and Registration Statements) as they related to Enron's related party transactions. ¶896.

While Enron's SEC-filed reports disclosed the existence of the LJM partnerships, ***these disclosures 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 an effort 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 disclosures 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 reasonable compared to, or on terms no less favorable than could have been obtained in, arm's-length transactions with third parties when, in fact, they were not. These misleading disclosures were reviewed and approved by Kirkland & Ellis, as relating to the Chewco/JEDI and LJM partnerships***! Enron's manipulative and deceptive devices, related-party transactions were extraordinarily lucrative for Fastow and others. In exchange for their passive and largely risk-free roles in these transactions, the LJM partnerships and their investors were richly rewarded from the looting of Enron resulting from repeated non-arm's-length unfair deals. Fastow and other Enron employees received tens of millions of dollars at Enron's expense. Enron employees involved in the partnerships were 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.

Kirkland & Ellis ***knew that those related party transactions were unfair to Enron and that Enron's assertion that the transactions were negotiated at arm's-length by Enron officers other***

than Fastow and terms reasonable to or no less favorable than those that could have been obtained for independent third parties was false. After all Kirkland & Ellis had structured the Chewco/JEDI, LJM1 and LJM2 vehicles – and represented them – as they repeatedly engaged in non-arm's-length transactions with Enron.

Thus, Kirkland & Ellis actually witnessed the favored investors in its client 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 Kirkland & Ellis was helping to structure and implement. ¶649.

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.
>
> When shown records that laid out the details of the financial returns during his testimony several months ago before the S.E.C., Mr. Skilling was said to have grown agitated as he described his opinion of the information.... In the LJM2 presentation, investors were told that the partnership had generated rates of return on its investments in the Raptor ranging from just more than 150 percent to 2,500 percent.

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

Although Kirkland & Ellis knew that the federal securities laws demanded that Enron make truthful disclosure of the SPEs, including LJM2, Kirkland & Ellis continued to evade and/or manipulate applicable disclosure requests by, among other things, having Fastow and Kopper sell some of their ownership interests to others. ¶895. In fact, late in the Class Period, Kirkland & Ellis openly admitted to a senior Enron employee responsible for preparing Enron's SEC disclosures, ***that Kirkland & Ellis's rationalization for non-disclosure of the various LJMs and LJM transactions was without any basis in precedent.***

III. KIRKLAND & ELLIS MAY BE LIABLE UNDER 1934 ACT §10(b) AND RULE 10b-5 (i) FOR MAKING OR SUBSTANTIALLY PARTICIPATING IN MAKING FALSE STATEMENTS, OR (ii) FOR PARTICIPATING IN A FRAUDULENT SCHEME OR COURSE OF BUSINESS THAT OPERATED AS A FRAUD OR DECEIT ON PURCHASERS OF ENRON'S SECURITIES, OR (iii) FOR EMPLOYING ACTS OR MANIPULATIVE DEVICES TO DECEIVE

Plaintiffs here have pleaded and are pursuing theories of recovery against Kirkland & Ellis that are well-grounded in the express language of §10(b) of the 1934 Act which states:

> Manipulative and deceptive devices
>
> It shall be unlawful for any person, directly or indirectly ...
>
> * * *
>
> (b) [t]o use or employ, in connection with the purchase or sale of any security registered on a national securities exchange ... ***any manipulative or deceptive device or contrivance*** in contravention of such rules and regulations as the Commission may prescribe the necessary or appropriate in the public interest or for the protection of investors.[10]

15 U.S.C. §78j(b).

Rule 10b-5 promulgated by the SEC flows directly from the language of §10(b) itself and 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 the 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.

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[10] Note that §10(b) itself does not expressly prohibit untrue statements of material facts or material omissions. This prohibition, like the prohibition against fraudulent schemes and fraudulent courses of business, are in Rule 10-5.

Not only does Rule 10b-5 forbid the making of "any untrue statement of a material fact," it also provides for scheme liability. Scheme liability is authorized by the text of §10(b). According to the Supreme Court, §10(b)'s prohibition of "any ***manipulative or deceptive device or contrivance***" necessarily encompasses any "***scheme to defraud.***" In *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), the Court referred to the dictionary definitions of §10(b)'s words, to find that a "device" is "'[t]hat which is devised, or formed by design; a contrivance; an invention; project; ***scheme; often, a scheme to deceive***; a stratagem; an artifice.'" *Id.* at 199 n.20 (quoting *Webster's International Dictionary* (2d ed. 1934)). The Court found that a "contrivance" means "'***a scheme, plan, or artifice.***'" *Id.* (quoting *Webster's International Dictionary*); *see also Aaron v. SEC*, 446 U.S. 680, 696 n.13 (1980). Clearly, "scheme" is encompassed in the broad language of §10(b).

Thus Rule 10b-5 – adopted by the SEC to implement §10(b) – makes it unlawful for any person "***directly or indirectly***" to employ "***any*** device, ***scheme***, or artifice ***to defraud***," "***to make any untrue statement[s]***," or to "***engage in any act, practice, or course of business which operates ... as a fraud or deceit upon any person.***" 17 C.F.R. §240.10b-5. *See also U.S. Quest, Ltd. v. Kimmons*, 228 F.3d 399, 407 (5th Cir. 2000).

For instance, in *Finkel v. Docutel/Olivetti Corp.*, 817 F.2d 356 (5th Cir. 1987), plaintiffs sued under §10(b) and Rule 10b-5, claiming that the stock of Docutel was inflated due to false financial reports. According to plaintiff, Olivetti (which owned 46% of Docutel and controlled it) forced Docutel to buy Olivetti's excess inventories at inflated prices so Olivetti could hide losses it was suffering. Docutel concealed this financial manipulation for some time but, when its auditors discovered the financial manipulation and forced a large inventory writedown, huge losses were disclosed and Docutel stock fell. The district court dismissed the complaint against Olivetti and Docutel because plaintiff failed to allege reliance on any of the false statements in Docutel's SEC filings that were alleged in the Complaint.

> But the fact that the complaint lists a number of documents filed with the SEC does not limit plaintiff's claim to subsection (2) only. For, as in *Shores*, plaintiff's lack of reliance on these documents does not resolve the claims made under 10b-5(1) and (3). ***We find that plaintiff's complaint properly alleges a scheme to defraud or course of business operating as a fraud for purposes of the first and third subsections; plaintiff's complaint, taken as a whole, alleges that Olivetti forced***

> ***Docutel to take its worthless inventories, that this scheme or course of business was not disclosed, and that the effect was to defraud certain purchasers of Docutel.***
>
> * * *
>
> The most significant event which allegedly led to the loss by plaintiff is the claim that Olivetti forced Docutel to take worthless inventories without disclosing that fact in the marketplace; ***if proved, that conduct could equate with a scheme to defraud or course of business operating as a fraud in violation of 10b-5(1) and (3)***. Thus, we conclude that the district court erred in its dismissal of the complaint as to plaintiff's claims under 10b-5(1) and (3).

Id. at 363-64; *accord Heller v. Am. Indus. Props. Reit*, No. SA-97-CA-1315-EP, 1998 U.S. Dist. LEXIS 23286, at *14 (W.D. Tex. Sept. 28, 1998) ("The first and third subsections, on the other hand, ***create a duty not to engage in a fraudulent scheme or course of conduct*** ....").

Thus, the Fifth Circuit sitting *en banc* held that a defendant lawyer who did not himself make the statements in a misleading Offering Circular could be held primarily liable ***as a participant in a larger scheme to defraud of which that Offering Circular was only a part: "Rather than containing the entire fraud, the Offering Circular was assertedly only one step in the course of an elaborate scheme."*** *Shores v. Sklar*, 647 F.2d 462, 468 (5th Cir. 1981).

The fraudulent scheme and course of business involving Enron ***was worldwide in scope, years in duration and unprecedented in scale*** and required the skills and active participation of lawyers, bankers and accountants to help design, implement, conceal and falsely account for the contrivances they and Enron were using to falsify Enron's reported profits and financial condition and to continue its fraudulent course of business.

Kirkland & Ellis really pounds the table in arguing that the federal securities laws do not regulate the practice of law. But we agree with that statement. However, it is equally true that the federal securities laws ***do regulate the conduct of lawyers who practice securities law and prohibit them from engaging in schemes to defraud or substantially participating in the making of false and misleading statements i.e., violating §10(b) and Rule 10b-5***. What Kirkland & Ellis does not seem to appreciate is that its license to practice law is not a license to lie or participate in defrauding investors. And no matter what Kirkland & Ellis's "ethical duties" to its "clients" were the CC makes clear that Kirkland & Ellis did not honor them, since Kirkland & Ellis acted at the direction of and for the benefit of Enron and Fastow not its "purported client." And whatever a lawyer's ethical duties to his client are under state law they ***can not shield the lawyer for liability under federal law for participating in a scheme to defraud.***

A license to practice law is not a defense to allegations that a law firm has committed securities fraud. "A lawyer has no privilege to assist in circulating a statement with regard to securities which he knows to be false .... [A] lawyer, ***no more than others***, can escape liability for fraud by closing his eyes to what he saw and could readily understand." *SEC v. Frank*, 388 F.2d 486, 489 (2d Cir. 1968); *see also Kline v. First W. Gov't Sec.*, 24 F.3d 480, 490-91 (3d Cir. 1994) (Law firm liable for not disclosing known facts casting doubt upon a statement of its belief.).

As Judge Friendly eloquently articulated nearly 40 years ago:

> In our complex society the accountant's certificate and the lawyer's opinion can be instruments for inflicting pecuniary loss more potent than the chisel or the crowbar. Of course, Congress did not mean that any mistake of law or misstatement of fact should subject an attorney or an accountant to criminal liability simply because more skillful practitioners would not have made them. But Congress equally could not have intended that men holding themselves out as members of these ancient professions should be able to escape criminal liability on a plea of ignorance when they have shut their eyes to what was plainly to be seen or have represented a knowledge they did not possess.

United States v. Benjamin, 328 F.2d 854, 863 (2d Cir. 1964).

The issue of whether lawyers who participate in a scheme to violation of federal securities law can be liable under §10b/Rule 10b-5 even if they do not directly make a false statement which is attributed to them has been conclusively settled in this Circuit by the *en banc* decision in *Shores*, 647 F.2d 462. In this case, Bishop purchased industrial municipal bonds in a new issuance accomplished via a false Offering Circular. When the underlying industrial project failed the bonds declined in value. Bishop sued several parties, including a lawyer involved in the offering – one Sklar. After Bishop admitted he never read or relied on the Offering Circular the district court threw his case out. The 5th Circuit reversed. The 5th Circuit characterized Bishop's claim as one that the bonds had been "fraudulently marketed" via a "***fraudulent scheme***," and stated:

> We reheard this case *en banc* to determine whether a plaintiff must rely specifically on material misrepresentations or omissions in a single disclosure document when, in addition to charges based on its untrue statements or misleading omissions, other allegations would admit proof that the existence of the security in the marketplace resulted from the successful perpetration of a fraud on the investment community and that he purchased in reliance on the market. We hold the securities laws and regulations have a purpose broader than merely criticizing ever-lengthening, complex

> prospectuses. ***They cover deliberate, manipulative schemes to defraud which can annul not only the purpose of disclosure but also the market's honest function. Since plaintiff's pleadings would permit such proof, his suit should not have been dismissed at this initial stage.***

Id. at 464.

The 5th Circuit ruled that the District Court erred in construing the complaint narrowly and requiring reliance on the Offering Circular because "***Rather than containing the entire fraud, the Offering Circular was assertedly only one step in the course of an elaborate scheme,***" (*id.* at 468) concluding:

> ***Bishop has alleged the necessary elements of an action under 10b-5(1) or (3). In the literal words of rule 10b-5, he must be able to show a "scheme to defraud or (an) act, practice or course of business which operates as a fraud or deceit upon (him) in connection with the sale of (the Bonds).***"

Id. at 469.

The 5th Circuit then engaged in a discussion of Sklar. Sklar was involved ***in the documentation of*** the underlying industrial transaction and ***participated in drafting*** the Offering Circular. The Offering Circular contained false statements about the underlying project and ***audited*** financial statements that were false because of the deficiencies in the underlying project. Thus, Sklar allegedly knew or recklessly disregarded the deficiencies in underlying industrial transactions and the falsity of the audited financial statements in the Offering Circular. *Id.* In addressing the liability of lawyer Sklar the 5th Circuit held:

> First, the 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)." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 195, 96 S. Ct. 1375, 1382, 47 L. Ed. 2d 668, 667 (1976). ***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*** ...." and the promotion of free and honest securities markets .... ***The acts reach complex fraudulent schemes as well as lesser misrepresentations or omissions.***
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> * * *
>
> [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. None of these parties may be held liable for mere negligent performance of whatever role they choose to play, for the plaintiff

must prove that the defendants acted with requisite scienter. See *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 96 S. Ct. 1375, 47 L. Ed. 2d 668 (1976); *Aaron v. SEC*, 446 U.S. 680, 100 S. Ct. 1945, 64 L. Ed. 2d 611 (1980).

* * *

> ***Ute expressly recognized that rule 10b-5 was not limited to dealing with misrepresentation or omission cases under 10b-5(2), but reached "a "course of business' or a "device, scheme or artifice' that operated as a fraud.*** " 406 U.S. at 153, 92 S. Ct. at 1472.... The most significant common thread in all these precedents 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. at 470-72. *See also SEC v. U.S. Envtl., Inc.*, 155 F.3d 107, 112 (2d Cir. 1998) (while there is no aiding and abetting, where complaint properly alleged defendant to be primary violator because he "'***participated in the fraudulent scheme,***'" noting "***lawyers, accountants, and banks who engage in fraudulent or deceptive*** practices at their client's direction [are] a primary violator").

The notion that *Central Bank, N.A. v. First Interstate Bank, N.A.*, 511 U.S. 164 (1994), issued a broad edict that lawyers, bankers and accountants are immune from liability for their participation in complex securities frauds – as asserted by Kirkland & Ellis – in essence that it overturned precedents like *Shores*, is nonsense. *Central Bank* expressly recognized: "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 ... or bank who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser ... relies may be liable as a primary violator under 10b-5.... In any complex securities fraud, moreover, there are likely to be multiple violators.***" *Id.* at 191. A scheme to defraud often will involve a variety of actors, and investors are entitled to allege "***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.***" *Cooper v. Pickett*, 137 F.3d 616, 624 (9th Cir. 1998); *accord SEC v. First Jersey Sec.*, 101 F.3d 1450, 1471 (2d Cir. 1996); *In re Health Mgmt. Inc. Sec. Litig.*, 970 F. Supp. 192, 209 (E.D.N.Y. 1997); *Adam v. Silicon Valley Bancshares*, 884 F. Supp. 1398, 1401 (N.D. Cal. 1995); *In re ZZZZ Best Sec. Litig.*, 864 F. Supp. 960, 969-70 (C.D. Cal. 1994).[11]

In *Central Bank*, 511 U.S. 164, a public building authority issued bonds to finance public improvements. Central Bank served as indenture trustee. The bonds were secured by liens covering property. The bond covenants required that the liened land be worth at least 160% of the principal amount of the bonds. Central Bank got a letter expressing fear that property values were declining and that perhaps the 160% value test was no longer met. The bank did nothing. Soon afterwards, the public building authority defaulted on the bonds. The bonds were not publicly traded. Central Bank, which had no commercial lending relationship with the municipal entity involved and which was not an investment bank, issued no analysts' reports about the issuer of the municipal bonds and thus made no statement and took no affirmative act that could have affected the trading price of the municipal bonds in issue. Clearly, this is a significantly different fact pattern from the Enron situation.

The *Central Bank* majority noted that their reasoning was "confirmed" by the fact that if they accepted the plaintiffs' aiding and abetting argument it would impose §10(b)5 liability when "at least one element critical for recovery" was absent, *i.e.*, reliance. *Id.* at 180 (citing *Basic Inc. v. Levinson*, 485 U.S. 224, 243 (1988), the Supreme Court's "***fraud-on-the-market***" decision) for the proposition that a plaintiff must show reliance to recover under 10b-5.) "Were we to allow the aiding and abetting action proposed in this case, the defendant could be liable without any showing that the plaintiff relied upon the aider and abettor's statements ***or actions***." *Id.* The Court found that

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[11] In a case with less involvement by the law firm and less egregious fraudulent activities overall, *Wenneman v. Brown*, 49 F. Supp. 2d 1283 (D. Utah 1999), denied the law firm's motion to dismiss. The *Wenneman* court summed up the allegations before it as follows:

> It is undisputed that defendant [law firm] held numerous meetings with the principals of the Wellshire entities, performed legal research, drafted opinion letters on topics such as the necessity for registration as a broker dealer and the applicability of U.S. law–particularly Regulation S–and German law, and gave advice on business organization and structuring. Plaintiffs contend that [defendant law firm] was a primary participant in the scheme to defraud ....

Id. at 1286. The *Wenneman* court analyzed and relied on *Central Bank* (*id.* at 1288-89) holding the complaint adequately alleged that the law firm had played "an active role in the alleged scheme to defraud." *Id.* at 1289.

allowing plaintiffs to "circumvent the reliance requirement would disregard the careful limits on 10b-5 recovery as mandated by our earlier cases." *Id.* Kirkland & Ellis's claim that it is immune from liability because the reliance element is not satisfied is wrong as, in this case, the alleged scheme and fraudulent course of business ***inflated*** the prices of Enron's ***publicly traded*** securities. ¶¶74, 418-424, 857-896. Thus, the reliance element is not "***absent***" and the Supreme Court's prior decision in *Basic* is not circumvented – it is satisfied.[12]

Central Bank denied recovery to victims of an alleged securities fraud who pleaded only one theory of recovery against the defendant bank – secondary liability dubbed "aiding and abetting." 511 U.S. at 191. However, the words aiding and abetting do not appear in §10(b) or Rule 10b-5. The Court said "***[T]he text of the 1934 Act does not itself reach those who aid and abet a §10(b) violation ... that conclusion resolves the case.***" *Id.* at 177. The *Central Bank* plaintiffs did not, as the plaintiffs do here, plead or pursue recovery under the theory that the law firm defendant employed manipulative and deceptive devices, a fraudulent scheme, engaged in an act or course of business that operated as a fraud or deceit on purchasers of the securities in issue or substantially participated in making false and misleading statements in the SEC filings of the issuer or issued false and misleading opinion letters in connection with the purchase or sale of securities. In the words of the Court, the plaintiffs "concede that Central Bank did not commit a manipulative or deceptive ***act*** within the meaning of §10(b)." *Id.* at 191. Plaintiffs make no such concession here as to Kirkland & Ellis. Thus, because the *Central Bank* plaintiffs pursued a theory of recovery which found ***no support in the text of either the statute or the rule, they lost.***

Central Bank cannot mean that a defendant cannot be liable under §10(b) unless it made misleading statements because the Court rejected that argument in *United States v. O'Hagan*, 521 U.S. 642 (1997). The Eighth Circuit had held 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 Court reversed, holding that §10(b) does not require a defendant to speak. *Id.* Because §10(b) prohibits "'any manipulative or deceptive device or contrivance'" in

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[12] *Shores* expressly recognized the concept of reliance on the integrity of the market where a scheme caused sale of securities at inflated prices. 647 F.2d at 468.

contravention of SEC rules, this reaches "any deceptive device," whether or not the defendant spoke. *Id.* at 653. *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6 (1971), is consistent with *O'Hagan*. In *Superintendent of Insurance*, a ***unanimous*** 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.***

Id. at 9 (footnote omitted).

This Court has stated, citing *O'Hagan*, that:

> ***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);[13] *In re Sec. Litig. BMC Software, Inc.*, 183 F. Supp. 2d 860, 869 (S.D. Tex. 2001).[14] As argued below, Kirkland & Ellis actually made false statements by issuing false opinions

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[13] Due to the length of these opinions, and the fact that this Court has access to them, they are not being attached to this brief.

[14] Defendant's citation of *Pegasus Holding v. Veterinary Ctrs. of Am., Inc.*, 38 F. Supp. 2d 1158 (C.D. Cal. 1998), is extremely misleading. The *BMC Software* opinion states:

> Nor have Plaintiffs specifically alleged how the individual nonspeaking Defendants have participated in the alleged scheme to defraud or how they could have controlled misstatements by other named Defendants, Watson and Austin, who were their superiors at BMC. Compaq, sl. op at 126; *Pegasus*, 38 F. Supp. 2d at 1164, 1166 (rejecting claims against non-speaking defendants where plaintiffs failed "to address how the non-speaking individuals ***were involved in the scheme***, and the acts each performed (or omitted) which further the conspiracy").

BMC Software, 183 F. Supp. 2d at 915. Thus, *BMC Software* supports plaintiffs, not Kirkland & Ellis because BMC agrees with *Pegasus's* ***holding that liability attaches to non-speaking individuals involved in a scheme who furthered the scheme with a specific act.***

Pegasus helps plaintiffs. ***First***, the *Pegasus* court followed *Cooper* and specifically stated that: "Cooper is entirely consistent, therefore, with Central Bank's requirement that wrongful conduct be alleged against each defendant." 38 F. Supp. 2d at 1165. "[T]he Court cannot, in good conscience, extend blame to the non-specking defendants ***without some facts suggesting involvement*** .... Plaintiffs fail to address how the non-speaking individuals were involved in the scheme, and the acts each performed (or omitted) which furthered the conspiracy." *Id.* at 1164. Plaintiffs have done that as to Kirkland & Ellis in the CC. ***Third***, defendants in *Pegasus* were merely alleged to have "willfully consented" to the scheme. *Id.* Here active participation by Kirkland & Ellis is alleged.

on continued non-arm's-length deals ***and*** also substantially participating in the preparation of publicly disseminated documents *i.e.*, Enron's SEC filings. However, even without considering those allegedly false and misleading statements, Kirkland & Ellis is liable for its participation in the alleged fraudulent scheme and course of business.

That this reading of §10(b)/Rule 10b-5 is clearly correct is shown by a new ***unanimous*** Supreme Court decision – *SEC v. Zandford*, __ U.S. __, No. 01-147, 2002 U.S. LEXIS 4023 (June 3, 2002). In *Zandford*, the Court repeatedly cited with approval its seminal "***fraudulent scheme***" case *Superintendent of Ins.*, and reversed dismissal of a §10(b)/Rule 10b-5 complaint making the following key points:

- ***"The scope of Rule 10b-5 is coextensive with the coverage of §10(b) ...."*** *Id.* at *7 n.1.
- ***"[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).*** *Id.* at *13.[15]

Abell v. Potomac Ins. Co., 858 F.2d 1104, 1123 (5th Cir. 1988), *vacated on other grounds sub nom*, *Fryar v. Abell*, 492 U.S. 914 (1989), is also distinguishable. The 5th 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 Fifth Circuit ascertained which statements were made by the law firm, "WLJ." Consequently, to determine the law firm's liability, the Fourth Circuit discussed whether the false and misleading statements were (1) "authorized" by the law firm or (2) "checked and revised" by the law firm. 858 F.2d at 1123. 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 revised." *Id.* The court therefore went on to determine whether that statement was relied upon ***in a non-fraud on the market case*** and concluded neither plaintiff testified that he relied upon that statement. *Id.* The CC allegations are consistent with the Fifth Circuit's decision in *Shores* and *Abell*. Kirkland & Ellis made the false and misleading statements here as it reviewed and approved them, it did not just provide "assistance."

[15] To the extent *Ziemba v. Cascade Int'l, Inc.*, 256 F.3d 1194, 1205 (11th Cir. 2001), seems to require a statement be made about a company which is "publicly attributable to the defendant at the time that the plaintiff's investment decision was made," it is inconsistent with *Zandford*.

In *Ziemba* the plaintiffs had 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, less, alleged facts demonstrating the "significant role" of the law firm they claimed. The Eleventh Circuit found the allegations were ones merely of "substantial assistance," *i.e.*, aiding and

- 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, *14-*17.

Central Bank clearly – ***but merely*** – stands for the proposition that no aiding and abetting liability exists under the 1934 Act because neither §10(b) nor Rule 10b-5 contain "aiding and abetting" language. The decision in *Central Bank* is ***quite narrow***. By contrast, the language of §10(b) and Rule 10b-5 is ***very broad***. Also the purposes of §10(b) and Rule 10b-5 are remedial, intended to provide access to federal court to persons victimized in securities transactions:

> [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 v. United States, 406 U.S. 128, 151 (1972). As noted by the Fifth Circuit:

> [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*, 389 U.S. at 336, 88 S. Ct. at 553. *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***).

Meason v. Bank of Miami, 652 F.2d 542, 549 (5th Cir. 1981). "The federal securities statutes are remedial legislation and must be construed broadly, not technically and restrictively." *Paul F. Newton & Co. v. Texas Commerce Bank*, 630 F.2d 1111, 1118 (5th Cir. 1980).[16]

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abetting. *Id.* at 1205-06.

[16] The broad purposes of §10(b)'s prohibition of securities fraud and the Supreme Court's longstanding recognition of such broad purposes also support conspiracy and scheme liability. *See, e.g., 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."); *Affiliated Ute Citizens*, 406 U.S. at 152-53 (proscriptions of §10(b) and Rule 10b-5 "are broad and, by repeated use of the word 'any,' are obviously meant to be inclusive. The Court has said that the 1934 Act and its companion legislative enactments 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'") (quoting *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186 (1963)); *Capital Gains Research*, 375 U.S. at 186 (§10(b) should be construed "not technically and restrictively, but flexibly to effectuate its remedial purposes"); *Bankers Life.*, 404 U.S. at 11 n.7 ("'[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.'") (quoting *A.T. Brod & Co. v. Perlow*, 375 F.2d 393, 397 (2d Cir.

Kirkland & Ellis's claim that *Central Bank* eliminated scheme liability is flawed. Notwithstanding *Central Bank*, liability based on participation in a scheme in violation of and schemed to defraud a course of business that operated as a fraud or deceit on securities purchasers on subsections (a) or (c) of Rule 10b-5 continue to be viable theories of liability. Fraudulent scheme or course of business liability is viable because:

- It is encompassed by the ***express language*** of the statute, which prohibits the "direct or indirect" "use or employment" of "any manipulative or deceptive device or contrivance";
- It is encompassed by the ***express language*** of Rule 10b-5;
- It comports with the ***broad antifraud purposes*** of the statute;
- It has ***long been upheld*** by the courts; and
- It imposes liability based on a ***primary*** violation of the federal securities laws committed directly by the defendant that goes beyond merely assisting another in committing a violation.

In Central Bank, the plaintiffs did not allege primary liability against the bank, did not allege a scheme to defraud, did not allege a fraudulent practice or course of business and did not invoke subsections (a) or (c) of Rule 10b-5.[17] The plaintiffs alleged only that the bank was "'***secondarily*** liable under § 10(b) for its conduct in ***aiding and abetting the fraud***.'" 511 U.S. at 168. The Court, therefore, did not address other liability theories. Yet defendants offer up numerous rationales as to why *Central Bank* eliminated Rule 10b-5(a) and (c) liability. They are:

1. ***The "Textualist" Rationale***. The court took a strict textualist approach in concluding that there is no private aiding and abetting liability under §10(b). Just as the statute does not explicitly mention "aiding and abetting," it also does not mention "scheme," "act," "practice," or "course of business."

2. ***The "Manipulation and Misrepresentation Is It" Rationale***. The court stated that "the statute prohibits only the making of a material misstatement (or omission) or the commission

1967)) (emphasis in original).

[17] The *Central Bank* decision did not distinguish among the different subsections of Rule 10b-5.

of a manipulative act," *Central Bank*, 511 U.S. at 177, which must be interpreted to mean that liability can only be premised upon conduct falling within subsection (b) of Rule 10b-5.

3. ***The "No More Secondary Liability" Rationale.*** The court's opinion holds that only primary violators may be held liable. Because scheme liability is a secondary liability theory similar to aiding and abetting, it is precluded.

None of the rationales as to how *Central Bank* eliminated Rule 10b-5(a) and (c) liability hold water.

- ***The Flaws of the "Textualist" Rationale***

A major flaw of the textualist rationale is that scheme liability is ***firmly based*** on the language of both the statute and the rule. The statute itself contains only the general "***manipulative or deceptive device[s] or contrivance[s]***" language, leaving it to the SEC to more specifically proscribe fraudulent conduct. The SEC's rule-making authority would be superfluous if the rules it adopted had to use precisely the same words as in the statute. To be sure, "the private plaintiff may not bring a 10b-5 suit against a defendant for acts not prohibited by the text of § 10(b)," *Central Bank*, 511 U.S. at 173, and "'the 1934 Act cannot be read more broadly than its language and the statutory scheme reasonably permit,'" *id.* at 174 (quoting *Chiarella v. United States*, 445 U.S. 222, 234 (1980)). But it is patently reasonable for the SEC to have determined that the "employment" of a "scheme to defraud" and the "engagement" in a fraudulent "act, practice, or course of business" constitute the "use or employ[ment]" of a "manipulative or deceptive device or contrivance."[18]

In *Ernst & Ernst*, the Court implicitly found that a "scheme to defraud" falls within the meaning of the "manipulative or deceptive device or contrivance" language of §10(b). 425 U.S. at 199 n.20. The Court relied in part on the 1934 dictionary definitions of "device" and "contrivance." *See id.*; *see also Aaron*, 446 U.S. at 696 n.13 (relying on same definitions to find scienter

[18] No subsection of Rule 10b-5 has ever been successfully challenged in any court as being outside the scope of §10(b) in the 60-year existence of the Rule.

requirement under §17(a)(1) of 1933 Act). Both of those definitions included a "scheme." *See Ernst & Ernst*, 425 U.S. at 199 n.20.[19]

The Court itself showed that *Central Bank* should not be interpreted as ushering in a new era of strict textualist construction of the federal securities laws. In upholding the misappropriation theory of insider trading in *O'Hagan*, 521 U.S. 642, the Court upheld a non-textual form of securities fraud and, in doing so, again exposed the long familiar broad expressions of the remedial purposes of the statute.[20]

- ***The Flaws of the "Manipulation and Misrepresentation Is It" Rationale***

The Court in *Central Bank* said that §10(b) "prohibits only the making of a material misstatement (or omission) ***or the commission of a manipulative act***." 511 U.S. at 177. It also indicated §10(b) liability existed where there was reliance on a defendant's "statements or actions." *Id.* at 180; *see also id.* at 191 ("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, assuming ***all*** of the requirements for primary liability under Rule 10b-5 are met.") (emphasis in original).

There is absolutely nothing in the language of the statute, the legislative history, or the rule that warrants restricting liability solely to misrepresentations or omissions or certain technical forms of manipulation. The express language of §10(b) clearly allows for liability by a person who does

[19] The statutory prohibition against "directly or indirectly" violating §10(b) must cover a scheme to commit manipulative or deceptive acts. It is unlikely that Congress would have prohibited the direct commitment of a fraudulent act and yet approved the commission of the same fraudulent act through joint activity – *i.e.*, a scheme. The "directly or indirectly" language in §10(b) was not enough for the Supreme Court to save aiding and abetting liability in *Central Bank*. But that was because aiding and abetting liability covered a broader range of conduct than the direct commission of a manipulative or deceptive act. Scheme conduct, however, involves joint action to commit a manipulative or deceptive act that should itself be considered, directly or indirectly, a manipulative or deceptive act by each of the schemers.

[20] The Court also noted that the misappropriation theory is designed to protect the integrity of the securities markets against abuses and that the 1934 Act was enacted in part to insure the maintenance of fair and honest markets and thereby promote investor confidence. *O'Hagan*, 521 U.S. at 652, 657-59. For example, the Court stated that "[t]he theory is also well-tuned to an animating purpose of the Exchange Act: to insure honest securities markets and thereby promote investor confidence." *Id.* at 658. The Court detailed how investors would be hesitant to invest in an unfair market. *See id.*

not actually make a statement or omit to say something he is under a duty to disclose. The statutory language "directly or indirectly, ... [t]o use or employ" in §10(b) is much broader than simply "directly to make." Similarly, the statutory language "any manipulative or deceptive device or contrivance" is much broader than simply "a misrepresentation or omission." Therefore, if the starting point in interpreting a statute is the language itself, *see Central Bank*, 511 U.S. at 173, there is no reason why liability under §10(b) must be limited to directly making misstatements or omissions or manipulating securities prices through certain specific technical or mechanical means.[21]

In addition, the SEC, in adopting subsections (a) and (c) of Rule 10b-5, implicitly recognized this. ***Unless this Court would strike down a rule that has been upheld for 60 years, the language "employ any device, scheme, or artifice to defraud" and "engage in any act, practice, or course of business which operates or would operate as a fraud or deceit" in subsections (a) and (c) of Rule 10b-5 is much broader than simply "make a misrepresentation or omission."***[22]

If the court in *Central Bank* meant to strike down subsections (a) and (c) of Rule 10b-5, the court certainly would have explicitly said so. To the contrary, the courts have long recognized that the scope of liability under subsections (a) and (c) of Rule 10b-5 is broader than that under subsection (b) and that those who engage in a fraudulent scheme may be liable in the absence of misrepresentations or omissions. *See, e.g., Affiliated Ute Citizens*, 406 U.S. at 152-53 (subsections (a) and (c) are broader than subsection (b) of Rule 10b-5); *First Jersey*, 101 F.3d at 1471-72; *SEC v. Seaboard Corp.*, 677 F.2d 1301, 1312 (9th Cir. 1982); *Shores*, 647 F.2d at 468 (*en banc*); *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 v. Barrack*, 524 F.2d 891, 903 n.19 (9th Cir. 1975) ("Rule 10b-5 liability is not

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21 As the Supreme Court has stated, "***[n]o doubt Congress meant to prohibit the full range of ingenious devices that might be used to manipulate securities prices.***" *Santa Fe*, 430 U.S. at 477.

22 Even from a common sense standpoint, schemes, acts, practices, and courses of conduct can readily be manipulative or deceptive, irrespective of any statements or omissions.

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

- ***The Flaws of the "No More Secondary Liability" Rationale***

The principal flaws of this rationale are that *Central Bank* did not strike down every form of "secondary" liability and that, in any event, violations through fraudulent schemes, acts, practices, or courses of business constitute primary violations of § 10(b). In *Central Bank*, the Court did not make fine distinctions between conduct that constitutes a "primary" as opposed to that which constitutes a "secondary" violation of the statute. Nor did it hold that only "primary" violations are cognizable. It held that aiding and abetting could not constitute a violation because, as interpreted by the courts, aiders and abettors did not commit violations ***but only assisted them***, and the statute holds liable only those who commit violations.

Fraudulent acts, practices and scheme liability and course of business are ***primary*** liability theories in the sense that the defendant is directly liable for committing a violation of the statute. ***The fraudulent scheme, act, practice, or course of business is a direct violation of §10(b) and Rule 10b-5***. With respect to fraudulent acts, practices and a participation in the scheme to defraud or fraudulent course of business is itself the manipulative or deceptive act, even without the making of misrepresentations or omission. There is nothing derivative, vicarious, or secondary about it.

All three subsections of Rule 10b-5 proscribe conduct for which a defendant may be ***primarily*** liable. Therefore, liability for a scheme to defraud or fraudulent act, practice, or course of business does not run afoul of *Central Bank*'s elimination of aiding and abetting liability. Cases both before and after *Central Bank* have recognized that scheme liability is a form of primary liability. *Hill v. Hanover Energy, Inc.*, No. 91-1964 (JHG), 1991 U.S. Dist. LEXIS 18566 (D.D.C. Dec. 16, 1991) is an example of such a pre-*Central Bank* case. In *Hill*, the defendant argued that the

§10(b) claim should be dismissed for failure of the plaintiffs to allege any misrepresentations or omissions of material facts. *Id.* at *10-*11. The court rejected that argument, specifically finding that *Santa Fe* does not restrict §10(b) liability to misrepresentations or omissions. *See id.* at *11-*12. Rather, the court found that the alleged conduct of the defendant Hanover Energy, which included fraudulently inducing the plaintiff to give up his rights to acquire certain stock and to post a letter of credit, could fairly be viewed as manipulative or deceptive within the meaning of § 10(b) and an unlawful scheme to defraud within the meaning of subsection (a) or (c) of Rule 10b-5. *See id.*[23]

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[23] District court decisions after *Central Bank* have continued to recognize scheme liability as a form of primary liability. For example, in *BMC Software*, 183 F. Supp. 2d at 885-86, this court seemed to recognize scheme liability, although it found that the plaintiffs had failed to satisfy the pleading requirements. In *BMC Software*, when discussing the pleading requirements in securities fraud cases and what must be pled to support scheme allegations this Court stated:

> As its first ground for dismissal, Defendants emphasize that the amended complaint fails to allege with any particularity that nine of the eleven individual Defendants made any representations or participated in any way in the alleged scheme to defraud.... ***Plaintiffs must allege what actions each Defendant took in furtherance of the alleged scheme and specifically pled what he learned, when he learned it, and how Plaintiffs know what he learned.***
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> * * *
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> "***Primary liability may be imposed 'not only on persons who made fraudulent misrepresentations but also on those who had knowledge of the fraud and assisted in its perpetration.***'"

Id. at 885-86, 904-05.

District court decisions prior to *Central Bank* also recognized scheme liability. In *ZZZZ Best*, the district court directly addressed Ernst & Young's liability under subsections (a) and (c) of Rule 10b-5, explicitly recognizing that liability under Section 10(b) and Rule 10b-5 is not restricted to material misstatements and omissions. 864 F. Supp. at 971-72 ("It appears that the scope of deceptive devices or schemes prohibited by subsections (a) and (c) [of Rule 10b-5] is quite extensive."). The plaintiffs alleged that Ernst & Young, hired to review the company's financial statements, was primarily liable because it participated in the creation of publicly released statements, issued a review report, and failed to disclose additional material facts unrelated to the review report. Ernst & Young moved for dismissal on the grounds that it was really being charged with aiding and abetting liability precluded by *Central Bank*. The court denied the motion, concluding that the facts taken as a whole as to Ernst & Young's participation and knowledge could render it liable under a scheme to defraud. *Id.* at 969-72.

In *Adam*, the plaintiffs alleged that Deloitte & Touche was primarily liable under §10(b) for misrepresentations and "participation in a scheme to defraud" through its involvement with the issuer's press releases and financial statements. 884 F. Supp. at 1401. The plaintiffs also alleged that Deloitte knew of the inadequate controls and deviated from conducting its audits in accordance with

A scheme is "'[a] plan or program of something to be done.'"[24] A "scheme to defraud" encompasses any "plan designed or concocted for perpetrating a fraud." *Ballentine's Law Dictionary* ("scheme to defraud") 1142 (3d ed. 1969). It has long included any scheme to defraud investors by causing securities to trade at fraudulently inflated prices.[25] When §10(b) was enacted such conduct already was an unlawful "scheme to defraud" under the mail fraud statute, and today it is called a "fraud on the market" that is actionable under §10(b). *See Basic*, 485 U.S. at 241-47; *Lipton v. Documation, Inc.*, 734 F.2d 740, 744-47 (11th Cir. 1984). Every person who intentionally engages in a "scheme" to defraud is thus ***a primary violator*** of Rule 10b-5 and §10(b).

In *Affiliated Ute Citizens*, the Court observed that "the second subparagraph of the rule specifies the making of an untrue statement of a material fact and the omission to state a material fact," 406 U.S. at 152-53, but held that "[t]he first and third subparagraphs are not so restricted." *Id.* at 153. It held that the defendants violated Rule 10b-5 when they participated in ***"a 'course of business' or a 'device, scheme or artifice' that operated as a fraud"*** – ***even though these***

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generally accepted auditing standards. *Id.* at 1399. The court denied the accounting firm's motion to dismiss because it found that its participation in the preparation of the issuer's statements was part of a scheme to defraud, making the firm primarily liable under Rule 10b-5. *Id.* at 1399-1401. In so holding, the court recognized that Rule 10b-5(b) "essentially outlaws the making of a material misrepresentation or omission," but that subsections (a) and (c) of the Rule "also" outlaw fraudulent schemes and courses of conduct. *Id.* at 1400.

In *In re Union Carbide Corp. Consumer Prods. Bus. Sec. Litig.*, 676 F. Supp. 458, 467-70 (S.D.N.Y. 1987), Morgan Stanley's liability did not depend on whether it "certified or made other public representations about a corporation's allegedly misleading statements," rather its "alleged role in knowingly or recklessly preparing the projections could constitute the employment of a 'device, scheme, or artifice to defraud' in violation of 10b-5(1) or an 'act, practice, or course of business which operates or would operate as a fraud or deceit upon any person' in violation of 10b-5(3)."

24 *Aaron*, 446 U.S. at 696, n.13 ("Webster's International Dictionary (2d ed. 1934) defines ... 'scheme' as '[a] plan or program of something to be done; an enterprise; a project; as a business ***scheme*** [, or a] crafty, unethical project ...."). To "scheme" is "[t]o form plans or designs; to devise intrigue." *Webster's International Dictionary* 2234 (2d ed. 1934). *The Oxford English Dictionary* 616 (2d ed. 1989) defines "scheme": "A plan, design; a programme of action .... Hence, [a] plan of action devised in order to attain some end; a purpose together with a system of measures contrived for its accomplishment; a project, enterprise." *Black's Law Dictionary* 1344 (6th ed. 1990) defines "scheme": "A design or plan formed to accomplish some purpose; a system."

25 In *Harris v. United States*, 48 F.2d 771 (9th Cir. 1931), for example, "[t]he fraudulent scheme charged ... was one for the sale of [a mining company's] corporate stock ... by the manipulation of the price of the stock on the [stock exchanges] and the circulation of false reports concerning the mine through the mails." *Id.* at 774. "In fact, the whole scheme centered around the establishment of an alleged stock exchange value which is in fact wholly fictitious." *Id.* at 775.

defendants had never themselves said anything that was false or misleading. *Id.* ***"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.'"*** *Competitive Assocs.*, 516 F.2d at 814. "Fraudulent devices, practices, schemes, artifices and courses of business are also interdicted by the securities laws." *Id.*

Subsections (a) and (c) of Rule 10b-5 thus are aimed at "broader schemes of securities fraud" than are necessarily embodied in a single misleading statement or document, and the "'classic' fraud on the market case [which] ***arises out of transactions on an open and developed market" easily fits within the expansive language of Rule 10b-5(1) and (3).*** *Lipton*, 734 F.2d at 744-45, 747; *Shores*, 647 F.2d at 468.

In *Cooper*, defendants argued that "plaintiffs cannot allege a 'scheme' to defraud, because ***those are conspiracy allegations foreclosed by Central Bank.***" 137 F.3d at 624. However, the Ninth Circuit rejected this argument, stating that the complaint "alleges a 'scheme' in which Merisel and the other defendants directly participated, tracking the language of ***Rule 10b-5(a), which makes it unlawful for any person 'to employ any device, scheme, or artifice to defraud.'"*** *Id.* Moreover, "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.***" *Id.* Furthermore:

> "[t]he 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) ... may be liable as a primary violator under 10b-5....*** In any complex securities fraud, moreover, there are likely to be multiple violators ...."

Id. at 624-25.

In *First Jersey*, 101 F.3d 1450, a top First Jersey corporate official who had not made any false statement claimed he should not be held liable under §10(b) of the 1934 Act for an extensive violation of §10(b) and Rule 10b-5 by First Jersey. The Second Circuit stated:

> Brennan contends that even if First Jersey committed fraud, he should not have been held personally liable for any violation ... as a primary violator of the securities laws....

1. Primary Liability

> "Any person or entity ... 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 [federal securities law], assuming all of the requirements for primary liability ... are met." *Central Bank v. First Interstate Bank*, 511 U.S. 164, 191, 128 L. Ed. 2d 119, 114 S. Ct. 1439 (1994) (emphasis omitted). ***Primary liability may be imposed "not only on persons who made fraudulent misrepresentations but also on those who had knowledge of the fraud and assisted in its perpetration."*** *Azrielli v. Cohen Law Offices*, 21 F. 3d 512, 517 (2d Cir. 1994).
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> ***The evidence presented at trial sufficed to establish that Brennan had knowledge of First Jersey's frauds and participated in the fraudulent scheme.***
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> * * *
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> ***In light of the evidence presented at trial with regard to Brennan's hands-on involvement in the pertinent decisions, we conclude that the trial court did not err in finding that Brennan knowingly participated in First Jersey's illegal activity and that he should be held primarily liable for its violations of the securities laws.***

Id. at 1471-72.

Kirkland & Ellis cannot escape liability by claiming that the illicit SPEs and contrived transactions detailed in the CC do not meet the technical definition of a "manipulative device." It is of no moment that certain cases, purportedly building on *Santa Fe*, 430 U.S. 462, appear to have expressly read into §10(b)'s manipulation language a limited and restrictive congressional intent to simply prohibit such "practices in the marketplace which have the effect of either creating the false impression that certain market activity is occurring when in fact such activity is unrelated to actual supply and demand or tampering with the price itself." *Hundahl v United Benefit Life Ins. Co.*, 465 F. Supp. 1349, 1360 (N.D. Tex. 1979); *see also Schreiber v. Burlington N., Inc.*, 568 F. Supp. 197 (D. Del. 1983), *aff'd*, 731 F.2d 163 (3d Cir. 1984); *In re Commonwealth Oil/Tesoro Petroleum Sec. Litig.*, 484 F. Supp. 253 (W.D. Tex. 1979). ***First***, whether or not the SPEs and transactions are technically "market manipulation" devices is academic even under these very cases. The SPE transactions have been pleaded as both contrivances and deceptive devices – and each was clearly deceptive for they falsified Enron's financial condition – thereby allowing for Rule 10b-5 scheme liability to attach. *See, e.g., Hundahl*, 465 F. Supp. at 1360 ("Few efforts to play with the price of a traded stock can be successful without running afoul of section 10(b)'s other weapon deception.").[26] ***Second***, *Santa Fe* is not so restrictive as defendants and certain courts would make it seem. Indeed, the Court clearly expressed its approval of reading the manipulation language of §10(b) broadly by stating: "No doubt Congress meant to prohibit ***the full range of ingenious devices*** that might be used to manipulate securities prices." *Santa Fe*, 430 U.S. at 477.[27] ***Third***, *Santa Fe*, *Hundahl*, *Schreiber* and *Commonwealth Oil/Tesoro Petroleum* are all clearly off-point because each case really involved what was merely a state law breach of fiduciary duty cause of action, stemming from a corporate merger or acquisition, dressed up in ill-fitting federal securities law garb.[28] This case is not a mere mismanagement or breach of fiduciary duty case. Without question, it is properly before the court as a federal securities action alleging fraud and deception. No one could plausibly suggest otherwise.

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[26] Liability under §10(b) and Rule 10b-5 may be imposed for actions either manipulative or deceptive. *See, e.g., Cooper*, 137 F.3d at 624 (Each defendant is a primary actor liable under §10(b) "as long as each defendant committed a ***manipulative*** or ***deceptive*** act in furtherance of the ***scheme***.").

[27] *See also Santa Fe*, 430 U.S. at 475 ("Those cases forcefully reflect the principle that '[§]10(b) must be 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....").

[28] *See, e.g., Santa Fe*, 430 U.S. at 480 ("There may well be a need for uniform federal fiduciary standards to govern mergers such as that challenged in this complaint. But those standards should not be supplied by judicial extension of §10(b) and Rule 10b-5....") ; *Schreiber*, 568 F. Supp. at 205 ("This case is the perfect example of a plaintiff, who may have nonfrivolous claims based on state law for breach of contract, tortious interference with contract, breach of fiduciary duties and perhaps even conspiracy, attempting to characterize those state law claims as violations of the federal securities laws."); *In re Commonwealth Oil/Tesoro Petroleum*, 484 F. Supp. at 259 (plaintiffs bringing additional claims for "breach of fiduciary duty" stemming from merger activities); *Hundahl*, 465 F. Supp. at 1362 ("[F]ederalism supports this court's definition of manipulation. The court in Santa Fe stated its reluctance to imply a federal cause of action for a claim 'traditionally relegated to state law.'" "[T]he acts of which plaintiffs complain ... are classic breaches of fiduciary duty.").

IV. KIRKLAND & ELLIS MADE FALSE AND MISLEADING STATEMENTS BY ISSUING FALSE OPINIONS AND SUBSTANTIALLY PARTICIPATING IN THE PREPARATION OF FALSE ENRON REGISTRATION STATEMENTS AND OTHER SEC FILINGS

Kirkland & Ellis's claim that the CC does not allege that it made or participated in making false statements in Enron's SEC filings is inaccurate. Kirkland & Ellis reviewed Enron's SEC filings (10-Ks, 10-Qs[29] and Registration Statements) as they related to Enron's related party transactions (¶896) and ***knew that those related party transactions were unfair to Enron and that Enron's assertion that the transactions were negotiated on an arm's-length basis by officers other than Fastow and were on terms reasonable to or no less favorable than those that could have been obtained from independent third parties was false.***

Courts have held under §10(b), primary liability attaches if a defendant played a "significant role" in preparing a false or misleading statement actually uttered by another. *McNamara v. Bre-X Minerals Ltd.*, No. 5:97-CV-159, 2001 U.S. Dist. LEXIS 4571, at *131 (E.D. Tex. Mar. 30, 2001). *See In re Software Toolworks Sec. Litig.*, 50 F.3d 615, 628-29 (9th Cir. 1995) (accountant primarily liable under §10(b) for role in drafting letter that client sent to SEC); *Phillips v. Kidder, Peabody & Co.*, 933 F. Supp. 303, 316 (S.D.N.Y. 1996), *aff'd without op.*, 108 F.3d 1370 (2d Cir. 1997); *Cashman v. Coopers & Lybrand*, 877 F. Supp. 425, 432-34 (N.D. Ill. 1995); *Whirlpool Fin. Corp. v GN Holdings*, 873 F. Supp. 111, 119 (N.D. Ill.), *aff'd*, 67 F.3d 605 (7th Cir. 1995); *ZZZZ Best*, 864 F. Supp. at 968.

In *Bre-X*, plaintiffs alleged violations of Section 10(b) and Rule 10b-5 arising from securities fraud scheme involving officers, directors, investment bankers and engineers concerning Bre-X's mineral rights to a mining area called "Busang." The defendants falsely represented to the public that Busang contained one of the richest gold deposits ever discovered. *Bre-X*, 2001 U.S. Dist. LEXIS 4571, at *5-*6. During the Class Period, Bre-X made increasingly optimistic statements about Busang's gold deposits – with each announcement, "the potential gold reserve at Busang increased." *Id.* at *22.

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[29] Enron's 10-K's were, as Kirkland & Ellis knew they would be, incorporated into Enron's Registration Statements used to sell billions of dollars of securities to investors during the Class Period.

In truth, Bre-X was a fraud. Bre-X's officers, directors, investment bankers and engineers "consciously disregarded multiple red flags and other warning signs that Busang was a fraud of unparalleled proportions." *Id.* at *22. The fraud was accomplished via behind-the-scenes tampering of geological data, optimistic press releases and analyst reports based on this data, and the conscious disregard of evident signs of fraud. *Id.* at *33-*45. The fraud was so apparent that an independent expert, within days of being hired, had alerted defendants to serious questions concerning the trustworthiness of Bre-X's data.[30] *Id.* at *78-*85. But even after being alerted to the expert's serious questions concerning the trustworthiness of the facts concerning Bre-X, defendants continued to issue false and misleading press releases, analyst reports, conference calls and other market statements. *See, e.g., id.* at *114, *166-*168.

Judge Folsom of the Eastern District of Texas held defendants could be held primarily liable for the Bre-X securities fraud scheme if "they played a 'significant role' in preparing a false [financial] statement actually uttered by another." *Id.* at *132. Thus, where plaintiffs alleged engineering defendants significantly participated in the preparation of studies that were used to attract investors, the allegations were "sufficient to plead [defendant] played a significant role" and thus could be held liable under the federal securities laws. *Id.* at *135.

Notably, in *Bre-X* defendants argued plaintiffs failed to meet their Rule 9 burden because plaintiffs did not plead with particularity each defendants' "precise role" in preparing the misleading reports. *Id.* at *134. The *Bre-X* court disagreed, holding plaintiffs need not plead with particularity the "precise role" of the defendants, especially where such information is "within the exclusive control" of the defendants. As Judge Folsom emphasized, overzealous application of Rule 9(b) "'prior to discovery "may permit sophisticated defrauders to successfully conceal the details of their fraud."'"[31] *Id.*

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30 "Plaintiffs allege that by conducting even the most basic data variability checks, which is standard industry practice and which [the expert] was able to do in just a few hours, [defendants] would have discovered the glaring problems with the data." *Id.* at *86.

31 Judge Folsom also rejected the argument that omission claims are not pleaded with particularity when plaintiffs fail to allege the date on which a defendant learned of the fraud. *Id.* at *168-*169. Plaintiffs need only plead with particularity "those facts that they allege put [defendant] on notice of the severe risk for fraud." *Id.* at *168. It is the jury's role to determine the "exact date

Similarly, Judge Kent has held defendants who do not themselves make statements are primarily liable for securities fraud when plaintiffs allege they played a substantial role in another's misrepresentations. *Young*, 2 F. Supp. 2d at 921. In *Young*, American Century, an advisor, claimed that statements or omissions made by Nationwide could not be attributed to it because aider and abettor liability was eliminated by *Central Bank. Id.* But the court held American Century could be liable because it was "not factually clear that American Century did not have a more substantial role in the alleged misrepresentations." *Id.*

And this court has recognized, "'Primary liability may be imposed" not only on persons who made fraudulent misrepresentations but also on those who had knowledge of the fraud and assisted in its perpetration."'"[32] *BMC Software*, 183 F. Supp. 2d at 905. *Accord First Jersey*, 101 F.3d at 1471; *Azrielli v. Cohen Law Offices*, 21 F.3d 512, 517 (2d Cir.1994).

The 9th Cir. reached a similar result in *Software Toolworks.* The 9th Cir. held a defendant may be found primarily liable under section 10(b) for its "significant role" in preparing misrepresentations or omissions. *Software Toolworks*, 50 F. 3d at 628 n.3. In *Software Toolworks*, plaintiffs alleged an accounting firm violated Section 10(b) through ***its participation in drafting*** two false and misleading letters ***the corporation sent to the SEC.*** *Id.* at 628. The accountant's participation included "'extensive review and discussions'" with the corporation and a "significant role in drafting and editing" the letters. *Id.* at 628 n.3. The district court, interpreting plaintiff's allegations as aiding and abetting claims, dismissed pursuant to *Central Bank. Id.* The 9th Cir. reversed, holding "plaintiffs' complaint clearly alleges that [defendant] is primarily liable under section 10(b) for the SEC letters" and evidence that defendant played a "significant role" "is sufficient to sustain a primary cause of action under section 10(b)." *Id.* And the 9th Cir. recently reaffirmed its position. *See 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

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on which [a defendant's] failure to correct its previous statement became severely reckless." *Id.* at *168-*169.

[32] Additionally, the Court recognized this principle in *Landry's*, slip op. at 9 n.12 (defendants "need not have made a false or misleading statement to be liable" under Section 10(b) (citing *O'Hagan*, 521 U.S. at 652).

grounds for primary liability even though that participation might not lead to the actor's actual making of the statements.").

In *ZZZZ Best*, the court held primary liability under Section 10(b) would lie where defendants were "***intricately involved***" in misrepresentations or nondisclosures made by others. 864 F. Supp. at 970. In *ZZZZ Best*, plaintiffs alleged a "massive fraud was perpetrated in connection with the public trading of Z Best securities and the sale of Z Best shares." *Id.* at 964. Defendant accounting firm Ernst & Young ("E&Y") argued "all the financial reports, press releases, supplements to the prospectus, etc., that were released to the public by Z Best and attributable only to Z Best or others, ***even if reviewed, edited or approved by E&Y, are not actionable against E&Y as violations of Section 10(b)/Rule 10b-5***." *Id.* at 966. The plaintiffs alleged that although certain defendants did not actually issue the statements, these defendants knew the false and misleading statements were based on their work, hence these defendants were primary violators due to their active participation in the creation of the misleading statement issued by the primary actor. *Id.* at 966. The *ZZZZ Best* court agreed, holding that while plaintiffs did not allege public attribution of the alleged misstatements to the accountants, the accounting firm nonetheless could be held primarily liable under Section 10(b) and Rule 10b-5 where it was "intricately involved" in the creation of the primary actor's material misstatements and omissions. *Id.* at 970.

The SEC, relying on its special expertise in interpreting the securities laws, has urged courts to hold primarily liable those who substantially participate in securities fraud. Arguing as amicus in *Klein v. Boyd*, No. 97-1143 (3d Cir. 1998), the SEC was concerned "corporate officials and employees could avoid liability for misrepresentations they created, as long as their identities were not made known to the public." Amicus Brief at 10.[33] According to the SEC, permitting defendants who do not make a statement to the market to escape liability, no matter how significant their participation in the underlying fraud – Kirkland & Ellis's argument here – is inconsistent with the language of §10(b), which makes it unlawful for "any person, ***directly or indirectly*** ... [t]o use or employ ... any manipulative or deceptive device or contrivance." Hence, in *Klein* the SEC pointed

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[33] The SEC amicus brief in *Klein v. Boyd* is attached as Ex. 34 to plaintiffs' Appendix.

out that a person who creates a misrepresentation, but takes care not to be identified publicly with it, "indirectly" uses or employs a deceptive device or contrivance and thus is a primary violator of Section 10(b).

The SEC's analysis was adopted by Judge Thrash in the Northern District of Georgia, who applied the "substantial participation" theory in *Carley Capital Group v. Deloitte & Touche, L.L.P.*, 27 F. Supp. 2d 1324 (N.D. Ga. 1998). In *Carley Capital*, plaintiffs alleged Deloitte not only made false and misleading statements in connection with its audit opinion ***but also participated in press releases that contained false and misleading statements***. *Id.* at 1329-30. The press releases included financial results that included bogus revenue and income. Plaintiffs alleged Deloitte "participated in making" false statements by "***reviewing and approving***" the press releases before they were issued. *Id.* at 1330. Deloitte argued it did not make a statement, claiming plaintiffs' allegations were "nothing more than aiding and abetting" claims prohibited by *Central Bank*. *Id.* at 1334. Judge Thrash disagreed, adopting the standard urged by the SEC in *Klein*, and holding "***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***." *Id.*

Indeed, lawyers who make statements have a duty to speak truthfully just like every other actor in the securities market. *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*, 24 F.3d at 491-92 ("[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. 34-15982, [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.").

Accordingly, any claim that Kirkland & Ellis had no "duty of disclosure" is irrelevant. The CC alleges false and misleading statements, and Kirkland & Ellis cannot 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"), *petition 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.").[34]

The severe restriction on primary liability urged by Kirkland & Ellis runs counter to the public interest. It would encourage "behind the scenes involvement" in the fraud by experts who could orchestrate the fraud knowing they were immune from responsibility or accountability:

> There is little sense, however, in limiting fraud liability to those whose involvement is public and direct. The vast bulk of securities law makes clear that behind the scenes involvement in fraudulent disclosure (or actionable nondisclosure), as opposed to mere participation in the fraud, by no means absolves the participant from culpability. The very nature of securities fraud often involves obscuring the source and interests of its authors. People can have a significant influence on how fraudulent disclosure is packaged, and hence how effective it is, without being identifiable to the victim.

Donald C. Langevoort, *Words From on High About Rule 10b-5: Chiarella's History, Central Bank's Future*, 20 Del. J. Corp. L. 865, 889 (1995) (footnotes omitted). Similarly, if a law firm "can never be responsible for another's statements ... puppeteers who manipulate fraudulent schemes from behind the scenes by pulling the strings and making others talk will go unpunished." Robert A. Prentice, *Locating That "Indistinct" and "Virtually Nonexistent" Line Between Primary and Secondary Liability Under Section 10(b)*, 75 N.C.L. Rev., 691, 729 (1997). In today's securities markets where fraud is ever more rampant, any "bright line" rule that immunizes securities professionals like sophisticated law firms from liability so long as they themselves do not make a

[34] The Fifth Circuit's decision in *Abell*, 858 F.2d 1104, which indicates that silence, absence a duty to disclose, is not actionable when one has not made material statements in the first place is not surprising. This does not help Kirkland & Ellis here because the CC alleges Kirkland & Ellis made false and misleading statements.

false statement that is attributed to them would do nothing more than encourage more fraud – certainly not a desirable result.

V. KIRKLAND & ELLIS ACTED WITH SCIENTER, *I.E.*, WITH "THE REQUIRED STATE OF MIND" AS IT KNOWINGLY OR RECKLESSLY MADE OR PARTICIPATED IN MAKING FALSE STATEMENTS, EMPLOYED DECEPTIVE ACTS AND CONTRIVANCES TO DECEIVE AND PARTICIPATED IN A FRAUDULENT SCHEME OR COURSE OF BUSINESS THAT OPERATED AS A FRAUD OR DECEIT ON PURCHASERS OF ENRON SECURITIES

Kirkland & Ellis can claim neither ignorance nor innocence with respect to the Enron debacle. Kirkland & Ellis had an extensive and extremely close relationship with Enron –for years pretending to provide separate representation to purportedly independent entities, when in fact it was working for, often being paid by and always taking its instructions from Enron and Fastow, while continually participating in non-arm's-length deals with these secretly controlled entities, that falsified Enron's financial results and condition, thus deceiving investors. During the several years Kirkland & Ellis played this role it gained knowledge of Enron's fraudulent scheme and course of business, as it repeatedly took affirmative steps to further it. Kirkland & Ellis participated in the fraudulent scheme and course of business in several ways – employing contrivances, devices to deceive and actually making false or misleading statements. Kirkland & Ellis participated in creating and structuring the most important of Enron's secretly controlled private equity partnerships – including Chewco/JEDI, LJM1 and LJM2 and their SPEs – to facilitate numerous illicit and contrived transactions which artificially inflated Enron's reported profits and enabled Enron to hide billions in debt. Because Kirkland & Ellis created and represented the LJM2 partnership it knew of the 12/99 "pre-funding" of LJM2 to enable it to complete four year end "round trip" bogus deals with Enron and of the secret (and extraordinary) involvement of top bank executives as favored investors in LJM2. Since Kirkland and Ellis continued to represent LJM2 during 00-01, it knew Fastow and his cronies were self dealing with Enron's assets, and actually witnessed Fastow, his cronies and those favored LJM2 investors ***directly profit from the looting of Enron*** that took place via the repeated non-arm's-length fraudulent LJM2/SPE transactions with Enron during 00-01, which Kirkland & Ellis actually structured and approved by ***issuing false and misleading opinions on those bogus deals. All the while Kirkland & Ellis was reviewing and approving Enron's SEC***

filings which falsely stated Enron's transaction with "its unconsolidated equity affiliates ... are reasonable compared to those which could have been obtained from third parties," and " were negotiated on a non-arm's-length basis with senior officers of Enron other than Mr. Fastow" and were on terms "no less favorable than the terms of similar arrangements with unrelated third parties," statements that were clearly false. As alleged in the CC, this is intentional participation in the falsification of Enron's financial statements and SEC filings and thus in the fraudulent scheme.

Kirkland & Ellis tries to portray itself as a financially unsophisticated firm that acted as a scrivener in the Chewco/JEDI and LJM "private equity" deals; it could not have understood the SEC disclosure implications of the complex accounting issues involved in the Enron SPE deals it participated in or the significance of the repeated secret side agreements and no-loss guarantees involved in those deals it structured between those private equity partnerships and Enron. But Kirkland & Ellis should not be so modest. According to its website, Kirkland & Ellis has vast experience and expertise in these exact areas:

> In the corporate area, Kirkland is known for its ability to negotiate and close ***highly sophisticated transactions***, representing public and private companies and venture capital investors in merger and acquisition, securities, spin-off, split-off, and private equity transactions. The Firm has a ***premier private equity practice*** representing private investment funds, ***the private equity groups at several major money center banks*** and other participants in this industry. During the last seven years, Kirkland's private equity practice has represented clients in hundreds of leveraged acquisitions and other types of transactions and has been principal counsel in approximately $65 billion in fund formations.
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> * * *
>
> ***Kirkland & Ellis has one of the nation's preeminent practices in the area of private investment fund formation***, regularly representing general partners and major limited partners in the formation of a wide variety of private equity funds. Funds where Kirkland represented the general partner or one or more major limited partner investors raised over $65 billion in new capital commitments in approximately the last seven years alone. ***Kirkland's regular representation of both general partners and major limited partner investors provides Kirkland a unique in-depth understanding of private investment from a variety of perspectives***. Furthermore, because Kirkland frequently continues to represent the fund after it has been formed, our lawyers are sensitive to the problems that can arise over the life of the fund ..
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> * * *
>
> Kirkland is actively engaged in counseling management and boards of directors ***with respect to all corporate and securities law issues, including fiduciary duty issues,***

obligations of directors and officers under the securities laws when buying or selling company securities, and general disclosure obligations. The Firm often assists public companies in preparing or reviewing filings under the Securities Exchange Act of 1934 (e.g., 10-Ks, 10-Qs, and proxy statements), in reviewing press releases, annual and quarterly reports and other public disclosures ....

* * *

In representing [private equity] investors, Kirkland & Ellis used a "team" approach. ***Venture capital/private equity lawyers with broad transactional experience and an understanding of the myriad legal, accounting, and regulatory issues that investors typically encounter, work together with transactional tax attorneys who have special experience in structuring venture capital/private equity transactions.***

Kirkland & Ellis was no Atticus Finch practicing law out of a storefront office, exchanging legal work for groceries. Kirkland & Ellis is a huge firm, with exceptional expertise in complex financial matters – especially private equity partnerships. And it is without a doubt a for profit enterprise that obtained millions and millions of dollars of fees for playing a key role in participating in the fraudulent course of business alleged here.

A professional firm's lust for substantial fees can be the catalyst to abandon its independence and integrity. *See In re Complete Mgmt. Sec. Litig.*, 153 F. Supp. 2d 314, 335 (S.D.N.Y. 2001); *In re Microstrategy Inc. Sec. Litig.*, 115 F. Supp. 2d 620, 655 (E.D. Va. 2000). Kirkland & Ellis attempts to trivialize its economic motives, claiming it is irrational to risk its international reputation to commit fraud on Enron's behalf. But in *Frymire-Brinati v. KPMG Peat Marwick*, 2 F.3d 183, 191 (7th Cir. 1993), Judge Easterbrook rejected a similar argument from a large accounting firm that its auditor 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.

By taking "on a vested interest in the performance and profitability of" Enron through increased fees, Kirkland & Ellis "has weakened its ability to rely on its reputation in countering as 'irrational' allegations that it participated in a client's fraud." *Microstrategy*, 115 F. Supp. 2d at 655.

In evaluating the adequacy of the CC's scienter allegations against Kirkland & Ellis, it is important to keep in mind the different liability theories being alleged under §10(b) and Rule 10b-5 against Kirkland & Ellis. While the CC alleges that Kirkland & Ellis substantially participated in making false statements, Kirkland & Ellis's liability is ***not limited*** to those allegedly false and misleading statements. The CC also alleges Kirkland & Ellis's liability for ***its*** conduct in participating in the scheme to defraud or course of business that operated as a fraud and deceit on purchasers of Enron publicly traded securities. This distinction is important because ***if*** the CC fails to adequately allege Kirkland & Ellis's substantial participation in making false and misleading statements ***or*** Kirkland & Ellis's knowledge of or reckless disregard of the falsity of those statements, the CC may still adequately allege that Kirkland & Ellis knowingly or recklessly employed deceptive acts or participated in the fraudulent scheme or course of business ***or vice versa***. These are distinct liability theories – one based on ***statements*** – the other based on ***conduct***, which can result in liability, either in combination or separately.

It is clear that for §10(b)/Rule 10b-5 liability to attach under either theory, ***scienter must be present***, *i.e.*, either intentional or reckless conduct. Thus, with respect to Kirkland & Ellis's alleged deceptive acts and participation in the fraudulent scheme or course of business, scienter would be adequately pleaded if the facts pleaded give rise to a "strong inference" that in committing those acts, Kirkland & Ellis acted with the "required state of mind," *i.e.*, it acted intentionally or recklessly. This would be so even if Kirkland & Ellis had no knowledge that its ***own statements*** were false and misleading, for as this Court has recognized, ***it is not necessary that a defendant have made a false statement to be liable under §10(b) or Rule 10b-5***. *Landry's*, slip op. at 9 n.12.

A defendant may be held liable for participating in a scheme to defraud if it has knowledge of the scheme and commits manipulative or deceptive acts in furtherance of it.[35] *See BMC Software*, 183 F. Supp. 2d at 885-86, 905, 915; *Cooper*, 137 F.3d at 624 ("Central Bank does not preclude

[35] We stress that the existence of the scheme and Kirkland & Ellis's participation in it are highly factually-dependent questions that either should not be resolved on a motion to dismiss or should be resolved in favor of the plaintiffs. *Richardson*, 451 F.2d at 40 (Whether the defendant's conduct amounts to a manipulative or deceptive act "depends upon the facts and circumstances developed at trial.").

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); *Health Mgmt.*, 970 F. Supp. at 209; *Adam*, 884 F. Supp. at 1401; *ZZZZ Best*, 864 F. Supp. at 967-72. Recklessness satisfies the scienter requirement. *See Nathenson*, 267 F.3d 400.

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); *cf. Affiliated Ute Citizens*, 406 U.S. at 151 ("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.'") (quoting *Capital Gains Research*, 375 U.S. at 186).

It is axiomatic that 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); *United States v. Elam*, 678 F.2d 1234, 1246 (5th Cir. 1982) (conspiracy); *United States v. Alvarez*, 625 F.2d 1196, 1198 (5th Cir. 1980) (*en banc*) (conspiracy).[36]

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[36] As the Supreme Court has stated with respect to conspiracy liability: "[T]he law rightly gives room for allowing the conviction of those discovered [to be participants in a conspiracy] upon showing sufficiently the essential nature of the plan and their connections with it, without requiring evidence of knowledge of all its details or of the participation of others. Otherwise ... conspirators would go free by their very ingenuity." *Blumenthal v. United States*, 332 U.S. 539, 557 (1947) (footnote omitted).

Plaintiffs cite these conspiracy cases not because they allege conspiracy liability here – they do not. However, since scheme liability is expressly provided for by the language of §10b/Rule 10b-5 and the extent of the scheme liability is ***at least as broad*** a conspiracy liability would be these

Scheme to defraud and conspiracy liability theories, while they share some similarities, are separate and distinct liability theories and the elements of the two theories are not identical. *See United States v. Read*, 658 F.2d 1225, 1239 (7th Cir. 1981). Most significantly, a conspiracy requires an ***agreement*** and imposes liability based on the act of joining that agreement as well as on acts taken in furtherance of the conspiracy. *See id.* at 1240. A scheme to defraud, on the other hand, requires neither an agreement nor the joining of a scheme; liability is imposed based on using the mails or securities exchanges to further the fraudulent scheme. *See id.* Therefore, if knowledge of all the other details, activities, and participants in a scheme is not essential for conspiracy liability, which requires an agreement among the participants, then such knowledge certainly is not necessary for scheme liability, which does not require an agreement.

A defendant who participates in a scheme to defraud is liable for the damages caused by all of the acts taken by the participants in the scheme in furtherance of the fraud. *See Software Toolworks*, 50 F.3d at 627-29 & n.3 (participants in scheme to defraud can be liable for statements made by others in the scheme); *Adam*, 884 F. Supp. at 1401 (same); *ZZZZ Best*, 864 F. Supp. at 968-72 (same); *SEC v. Nat'l Bankers Life Ins. Co.*, 324 F. Supp. 189, 194-95 (N.D. Tex.), *aff'd*, 448 F.2d 652 (5th Cir. 1971) (same).[37] A scheme to defraud is a unitary violation, such that the plaintiff need

conspiracy cases are useful in determining the parameters of scheme liability.

[37] Similarly, under the federal mail fraud statute, 18 U.S.C. § 1341, participants in a scheme to defraud are liable for the acts of the other participants in the scheme, even if the others committed the key acts. *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.

This principle also applies to conspiracy liability. *See Read*, 658 F.2d at 1231-40 (conspirator liable for acts of co-conspirators even if statute of limitations has run on its own acts); *Dasho v. Susquehanna Corp.*, 380 F.2d 262 (7th Cir. 1967) (conspirator liable even for acts of co-conspirators occurring after its own last act); *In re Nissan Motor Corp. Antitrust Litig.*, 430 F. Supp. 231, 233 (S.D. Fla. 1977) (conspirator liable even for acts of co-conspirators occurring prior to its joining conspiracy).

The common law also recognized this with respect to contributing tortfeasors or persons acting in concert, such as through a conspiracy or scheme. *See Restatement (Second) of Torts* §875 (1979) ("Each of two or more persons whose tortious conduct is a legal cause of a single and indivisible harm to the injured party is subject to liability to the injured party for the entire harm."); *id.* §876(a) ("For harm resulting to a third person from the tortious conduct of another, one is subject to liability if he (a) does a tortious act in concert with the other or pursuant to a common design with not prove transaction causation with respect to any particular misrepresentations or omissions or other components of the scheme. *See Shores*, 647 F.2d at 469, 472 ("The concept of [a] scheme to defraud satisfies the requirement of 'transaction causation....' It has as its core objective that the potential victim engage in the transaction for which the scheme was conceived."); *Schlick v. Penn-Dixie Cement Corp.*, 507 F.2d 374, 380-81 (2d Cir. 1974); *ZZZZ Best*, 864 F. Supp. at 973 (to satisfy reliance requirement for scheme liability, it need only be shown that market relied on overall fraudulent scheme rather than on individual statements or omissions).

Nat'l Bankers Life, 324 F. Supp. at 189 – a pre-*Central Bank* case – recognized that participants in a scheme to defraud under Rule 10b-5 may be held liable for all of the acts involved in the scheme. In that case, the SEC brought an action against 28 defendants for participating in a conspiracy to defraud and a scheme to defraud. *See id.* at 193-94. Since this was a pre-*Central Bank* case, the SEC did not focus on the difference between conspiracy and scheme liability, treating them essentially as synonymous, and the court did not focus on the difference between primary violators and aiders and abettors, instead assuming that the SEC intended to hold the co-schemers liable as aiders and abettors rather than as primary violators. *See id.* at 195. But although the court considered the scheme liability of the defendants under the rubric of aiding and abetting, it could just as well have considered it under the rubric of primary liability. Nevertheless, the important point is the court's recognition that co-schemers may be liable for all aspects of the scheme:

> In the narrow sense, a defendant could have aided and abetted a particular fraudulent act under 10(b)(5)(2) or 10(b)(5)(3) or use of a particular device under 10(b)(5)(1) and thus be liable for only the results of that specific violation. In the more expansive sense, a defendant could have aided and abetted a ***general scheme*** under 10(b)(5)(1) and ***thus be liable for the results of all aspects of the scheme*** (assuming the scheme was a broad one).

Id. at 195.

As noted above, after *Central Bank*, a defendant may be held liable for participating in a scheme to defraud if it has knowledge and commits manipulative or deceptive acts in furtherance of it. Therefore, bringing the principle recognized in *Nat'l Bankers Life* in line with *Central Bank*,

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him ...."); *id.* §876, Comment on Clause (a) ("Whenever two or more persons commit tortious acts in concert, each becomes subject to liability for the acts of the others, as well as for his own acts.").

if a defendant with knowledge of a broad or general scheme to defraud commits manipulative or deceptive acts in furtherance of broad aspects of the scheme, the defendant may be held liable for all of the results of the scheme. *See generally Central Bank*, 511 U.S. at 191 ("In any complex securities fraud, moreover, there are likely to be multiple violators ....").[38]

In evaluating the CC's allegations that Kirkland & Ellis employed acts and devices and contrivances to deceive and participated in a fraudulent scheme and course of business, it is also important to focus on the ***type*** of actions Kirkland & Ellis is alleged to have committed in furtherance of the alleged fraudulent scheme or course of business. For instance, the phony Chewco/JEDI contrivance arranged in the last days of 12/97 involved by its very nature intentional

[38] In *Lemmer*, 2001 U.S. Dist. LEXIS 13978, the plaintiffs alleged a scheme to defraud and sought to hold certain of the alleged participants liable for the fraudulent acts of the other participants in the scheme. *See id.* at *25. The court held that, ***on the particular facts of the case before it***, such attribution could not be made because the plaintiffs had failed to sufficiently allege either the existence of the scheme or the defendants' manipulative or deceptive acts in furtherance of it. *See id.* at *26-*27. For example, the sole allegations as to the existence of the scheme were "vague, general, and unsupported by specific details that might support a strong inference of such a scheme." *Id.* at *26. In addition, the complaint made ***no*** allegations regarding the manipulative or deceptive acts of nearly all the defendants in furtherance of the scheme. *See id.* The scheme allegations of the *Lemmer* complaint consisted entirely of the following provision:

> "Each of the defendants actually knew the allegedly false statements about Nu-kote's business and future prospects were false and misleading when made. Each of the defendants is liable as a participant in a fraudulent scheme and course of business that operated as a fraud or deceit on purchasers of Nu-kote stock, including false and misleading statements and/or concealed material, adverse facts. The fraudulent scheme and course of business: (a) deceived the investing public regarding Nu-kote's products and business; (b) deceived the commercial markets regarding Nu-kote's success in integrating the Pelikan acquisition and developing new products; (c) created false financial results during the 4thQ of FY96 and the first three quarters of FY97; and (d) caused plaintiff and other members of the Class to purchase Nu-kote stock at inflated prices."

Id. at *26-*27. On these facts, the *Lemmer* court concluded that "[a]llowing such general, unsupported allegations of a fraudulent scheme, without any details that support a strong inference of such a scheme such as acts of participation by each of the Defendants, would vitiate the particularity requirements of the PSLRA." *Id.* at *27. In so finding, the court distinguished *Cooper*, 137 F.3d 616, in which the complaint was found to contain sufficient allegations of the defendant's participation in a scheme to defraud to support liability on that basis. *See* 2001 U.S. Dist. LEXIS 13978, at *26.

Unlike the complaint in *Lemmer*, and like the complaint in *Cooper*, the CC in this action includes specific, detailed, and substantial allegations concerning both the existence of a scheme to defraud and Kirkland & Ellis's participation in it through numerous manipulative and deceptive acts, as set forth above.

conduct. This multi-hundred million dollar deal in the last days of 99 allowed Enron to artificially boost its 97 profits and hide hundreds of millions in debt and could not have been the result of negligence ignorance. Why contrive this deal, use strawmen and secret cash offset deposits and have Enron provide Barclays Bank a secret no-loss guarantee unless the purpose of the deal was to conceal and deceive, as alleged?

In this regard, Kirkland & Ellis's participation in arranging pre-funding of LJM2 on 12/22/99 – ***before*** LJM2 was fully formed or funded – having Enron's banks and executives of the banks secretly put up much more money than its/their allocated share of LJM2's equity was or would have been – to fund four, non-arm's-length year-end 99 deals with Enron, ***which deals were then quickly unwound during 00, with huge returns to these LJM2 pre-funders is obviously intentional conduct – it was not and could not have been the result of negligence or inadvertence.***

The same is true of the Hawaii 125-0 deal in the 4thQ of 00 where a gigantic but phony $370 million profit based on the temporary increase in the price of New Power stock, was created in a transaction Kirkland & Ellis structured in representing the LJM2 SPE - but again involving a secret guarantee of the SPEs' bank loan by Enron, and the use of Enron's own assets to "hedge" the gain. Again, intentional conduct. If this was a legitimate deal with true economic substance why the need for a secret no-loss guarantee? And where is the economic substance of a deal where Enron's "profit" is "hedged" with Enron's own assets? The same is true of Braveheart, Cuiaba and the Raptor deals.

With respect to Kirkland & Ellis's liability under §10(b) and Rule 10b-5 for its own false and misleading ***statements***, it is necessary for the complaint to plead specific facts raising a "strong inference" that Kirkland & Ellis knew the statements were false or acted in reckless disregard of their truth or falsity. However, in this regard, Kirkland & Ellis's alleged conduct – its participating in the fraudulent scheme or course of business – remains highly relevant, for those ***acts*** themselves can show Kirkland & Ellis's ***knowledge*** of the falsity – or its reckless disregard for the truth or falsity – of the ***statements*** it was making.

For instance, Kirkland & Ellis's 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 Kirkland & Ellis ***knew (or recklessly disregarded)*** that Enron's 97-98-99-00 financial statements were false and its financial condition was being misrepresented. This also shows Kirkland & Ellis 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 Kirkland & Ellis represented, were negotiated on an arm's-length basis by Enron officers other than Fastow and none on terms reasonable or terms no less favorable to those compared to what could have been obtained from third parties were false. In fact, there 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. Kirkland & Ellis continued to represent LJM2 during 00-01 as LJM2 was constantly engaging in transactions with Enron where Enron insiders (Fastow, Kopper and Glisan) were on ***both sides*** of the transactions. And the LJM2 partnership was extraordinarily lucrative during this time – providing huge and indeed excessive returns to LJM2's investors – returns Skilling now says were only possible if the transactions were ***non***-arm's-length and fraudulent, *i.e.*, due to the looting of Enron. In this regard, Skilling's recent testimony to the SEC that – upon reviewing LJM2 documents and the returns the LJM2 investors got – ***it was immediately apparent to him*** – (a man who claims to lack financial sophistication) – that those returns from the deals LJM2 was getting via SPE deals with Enron were so huge – ***so lavish – that they had to be due to non-arm's-length fraudulent transactions is key***. 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.

When shown records that laid out the details of the financial returns during his testimony several months ago before the S.E.C., Mr. Skilling was said to have grown agitated as he described his opinion of the information. Had he known the magnitude of the profits, Mr. Skilling was said to have told the regulators, he would have immediately summoned Enron executives involved in the dealings and given them 24 hours to justify such outsize results.

* * *

Mr. Skilling made his statements to investigators after reviewing LJM2 records during his testimony to the S.E.C., according to documents and people involved in the case....

* * *

The information that upset Mr. Skilling during his S.E.C. testimony – which has not been made public – was on the 20th page of a long report to investors in LJM2. There, LJM2 summarized its investment activity, laying out the details of its performance on a series of transactions conducted with Enron.

* * *

In the LJM2 presentation, investors were told that the partnership had generated rates of return on its investments in the Raptor ranging from just more than 150 percent to 2,500 percent.

Kurt Eichenwald, "Enron Ex-Chief Said to Voice Suspicions of Fraud," *New York Times*, 4/24/02.[39]

What does this testimony say about the knowledge of a financially sophisticated law firm like Kirkland & Ellis – which professes to have great expertise in private equity entities and deals – whose "client" - *i.e.*, ***the LJM2 private equity partnership was reaping the very fruits of those fraudulent non-arm's-length transactions as LJM2 and Fastow looted Enron for their own gain***!

Let's not kid anybody - Kirkland & Ellis ***knew exactly what was going on with LJM2***. Kirkland & Ellis partners Michael Edsall and Martha Stuart attended the LJM2 Investments annual partnership meeting on 10/26/00, right when Enron's stock was trading near its all time high and the fraudulent scheme was operating full speed ahead. As if Kirkland & Ellis did not know all this already – ***set forth below are excerpts for the slide show presented to the LJM investors***:

- ***Fund created and managed by the CFO of Enron - Andrew S. Fastow***.

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[39] 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 Kirkland & Ellis, whose client LJM2 was actually reaping these fantastic returns, knew it all along***.

LJM Rationale: Why does Enron need private equity?

- Energy and communications assets typically ***do not generate earnings or cash flow within the first 1-3 years***
  - Investments are ***dilutive to Enron's current EPS***
  - Investments are ***dilutive to credit rating ratios***
- Solutions
  - ***Enron must deconsolidate assets***
  - Enron must create structures which ***accelerate projected earnings and cash flows***

This leads to opportunities for LJM

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Summary

- As expected
  - Types of transactions
  - ***Strategic importance to Enron***
  - ***Velocity (quick conversion to cash)***
  - ***Rates of return***
  - Use of leverage
- Not as expected
  - Higher level of deal flow
  - Greater ability to manage risk
  - More "permanent" investments

Now what does this document leave to the imagination? In plain English it says Enron has investments that are losing money and hurting Enron's EPS, therefore Enron needs to manipulate its earnings, which provides opportunities for LJM2 to profit. And, so far things are going as anticipated as LJM2 has achieved the profits and cash returns on the deals with Enron that Fastow was implementing.

Thus, Kirkland & Ellis not only put LJM2 together in the last days of 12/99 to save that year's results, it then actually ***witnessed*** its LJM2 client (and LJM2's investors – which ***incredibly*** included top executives at Enron's banks) ***benefit from*** a series of extraordinary payouts from the LJM2 SPEs – securing hundreds of millions of dollars in distributions from the SPEs to LJM2 and ***then to LJM2's investors – cash generated by the illicit and contrived transactions Enron was engaging in with the LJM2 SPEs to falsify its financial results***. Thus, Kirkland & Ellis's "client" – LJM2 – was not only ***a key vehicle to perpetrate the fraud it was a knowing participant in the Enron scheme to defraud, and a direct economic beneficiary of it – and of the looting of Enron***. ¶¶448-495, 857-896.

Assuming these allegations are true, then how was it possible for Kirkland & Ellis to be issuing opinions that these non-arm's-length Fastow engineered transactions were "true sales" or legitimate business deals or review and approve Enron SEC filings representing that Enron's transactions with its "unconsolidated affiliates" were negotiated on a non-arm's-length basis" with Enron executives other than Fastow and were on terms that were "reasonable" or "no less favorable" compared to what could be obtained from unrelated third parties, unless Kirkland & Ellis was deliberately lying or had simply closed its eyes in the blind pursuit of mammon.

The duration and scope of Kirkland & Ellis's involvement with Enron is also highly relevant in determining whether a strong inference of the required state of mind has been pleaded and raised by the CC. This is not an instance where a law firm was recruited by a public company to provide representation to an entity related to the public company for a one or even two, three, four or five shot deal(s). As the CC sets forth in detail, Kirkland & Ellis's involvement was continuous. It started before the Class Period and persisted throughout the Class Period. Kirkland & Ellis was involved in creating and structuring the three most significant vehicles of the Enron fraud – Chewco/JEDI, LJM1 and LJM2. These entities, and SPEs associated with them, engaged in a very large number of transactions with Enron, frequently at year or quarter end, that involved secret no-loss guarantees to lenders or investors, the use of Enron employees as strawpersons and the use of Enron's own assets to attempt to "hedge" its own transactional gains. In evaluating Kirkland & Ellis's scienter, the cumulative effect of its involvement must be given great weight. If you see something untoward one time, or even a few times, perhaps it can be set aside to a mistake, misjudgment or the like. ***But when these kinds of things go on in transaction after transaction***

over years in numerous deals involving billions of dollars, innocent explanations evaporate. At least at the motion to dismiss stage.

Thus, it is reasonable to infer as a result of its years long continuous participation with Enron in structuring non-arm's-length deals with controlled entities involving secret side agreements, no-loss guarantees and straw persons, Kirkland & Ellis obtained information concerning the actual financial condition of Enron and knew (or recklessly disregarded) that the actual operations and conduct of Enron and the actual business practices and conduct, condition of Enron's business, its finances and its financial condition was far different – ***worse*** – than was being publicly disclosed by Enron. Thus, Kirkland & Ellis knew (or was reckless in not knowing):

1. Enron had set up Chewco at year end 97 to avoid a reversal of millions of dollars of previously reported 97 profits and had set up LJM2 at year-end 99 to engage in critical non-arm's-length transactions at year end 99 to generate phony profits. During 98-00, Enron was continually engaging in non-arm's-length transactions with Chewco/JEDI, which was permitting Enron to artificially inflate its reported earnings while moving large amounts of debt off its balance sheet. LJM2 was engaging in many more non-arm's-length transactions during 00-01 which were enriching the investors in the LJM2 partnership – and, at the same time, enabling Enron to generate artificial profits and conceal its true debt level by moving billions of dollars of debt off its balance sheet and onto the balance sheet of LJM2's SPEs;

2. Enron's actual financial condition and results from operations were far worse than what was being publicly disclosed or presented: (i) because Enron was falsifying its financial results and misusing and abusing mark-to-market accounting, resulting in Enron's profitability being far less than publicly reported; (ii) because Enron was improperly moving debt off its balance sheet and onto the balance sheets of entities it secretly controlled, Enron's true debt level and leverage was much higher than what was being publicly presented; and (iii) because of the foregoing, Enron's liquidity and creditworthiness were far worse than publicly known and its financial condition much more leveraged and precarious than was being disclosed to public investors;

3. Enron had entered into a number of transactions with secretly controlled SPEs being funded by LJM2 – to finance transactions, which would require Enron to issue millions of shares of

Enron common stock, if Enron's common stock fell below trigger prices ranging from $83-$19 per share. Not only could Enron be required to issue huge amounts of additional stock, also, the debt of the SPEs with which Enron was doing business would not, in fact, be non-recourse to Enron as represented but, in fact, would become and be recourse to Enron if, as and when Enron's credit rating was lowered – something Kirkland & Ellis knew would occur if, as and when Enron's true financial condition became public or became known to the rating agencies.

Thus, this is ***not*** a situation of alleging scienter against a law firm that had only isolated or periodic contact with an issuer or its affiliates in the context of doing a single or even a few deals. Here, what is alleged, is Kirkland & Ellis's ***(i) participation in the key Chewco/JEDI contrived deal at year end 97 and the ongoing non-arm's-length Chewco/JEDI deals with Enron during 98-01 which generated hundreds of millions of dollars in phony profits while hiding billions of dollars of debt; (ii) participation in the formation of both of the secretly controlled LJM private equity entities which were primary vehicles to falsify Enron's financial results in 99-01; (iii) participation in the LJM Rhythms "hedge" deal in 6/99 which created millions in phony profits and the late 99 Cuiaba power plant deal which created $65 million in phony profits; (iv) participation in the structuring of LJM2 in the last days of 99, including the LJM2 99 year end pre-funding and bogus year end 99 deals (Collateralized Loan Obligations, Nowa Sarzyna, MEGS, LLC and Yosemite) and continued participation in LJM2/-SPE deals with Enron during 00-01, which generated hundreds of millions of phony profits while concealing billions of dollars of debt; (v) participation in the New Power IPO/Hawaii 125-0 and the Braveheart VOD deal which together created $480 million in phony profits in 00-01; (vi) participation in the Southampton Place non-arm's-length deal in 3/00; (vii) participation in the Raptors I, II, III and IV deals; (viii) participation in the 00 dark fiber deals which generated over $65 million in phony profits; (ix) knowledge that Enron's banks or top executives of its banks were secret investors in LJM2 which was doing non-arm's-length fraudulent transactions with Enron engineered by Fastow which were not only generating hundreds of millions of dollars of phony profits, while hiding billions of dollars of Enron's debt but also generating massive returns to Fastow, his cronies, the banks and/or their officers – the benefits from the looting of Enron***; ***and (x) review***

and approval of the false SEC filings stating Enron's deals with its affiliates were negotiated by Enron officers other than Fastow and on terms no less favorable than would have been obtained from unrelated third parties. With all due respect, if this does not allow Enron investors who lost billions of dollars to get past the pleading stage as to Kirkland & Ellis, then a law license really is a license to steal.

Of course, motive and opportunity remain relevant considerations in determining if scienter has been adequately alleged. Kirkland & Ellis had very strong economic motives to employ acts and contrivances to deceive and participate in the fraudulent scheme or course of business. So long as it helped perpetuate the Enron Ponzi scheme, ***while Kirkland & Ellis's "client" LJM2 pocketed huge returns*** created by the looting of Enron via the very manipulative and deceptive transactions between Enron and LJM2 entities which Kirkland & Ellis was participating in – transactions which were hiding billions of Enron's debt and artificially inflating its profits by hundreds of millions of dollars. ¶¶448-495, 857-896. Kirkland & Ellis was willing to engage and participate in the fraudulent scheme and course of business because its participation created enormous fees and profits ***for Kirkland & Ellis as long as the Enron scheme continued in operation*** – something that Kirkland & Ellis was in a position to contribute to.

No one had a greater motive than those who were secretly looting Enron, *i.e.*, Fastow, LJM2 and Enron's banks and bankers, to deceive investors as to the true state of Enron's financial condition and business prospects because that deceit was central to preserving Enron's access to public capital markets and keeping Enron's stock price inflated because that inflated stock price was the key supporting non-arm's-length fraudulent LJM transactions with SPEs that Kirkland & Ellis had participated in structuring. Kirkland & Ellis's "clients," LJM2 and the equity investors in LJM2 were getting lush returns, ***which returns were only possible because the transactions that were being constantly entered into with Enron were non-arm's-length and fraudulent – generating bogus profits for Enron while hiding debt and at the same time generating excessive returns for LJM2 with Fastow, Enron's CFO, operating the levers on both sides of all deals. Simply put, LJM2 and Fastow were engaged in looting Enron for their own personal profit***, and benefit of key allies in the scheme. This gave them – and Kirkland & Ellis which was working with and for them – a tremendous motive to keep Enron afloat and its stock price inflated so that Enron could consistently go back, with their help, to the capital markets to raise capital to keep the Enron Ponzi scheme going.

At the end of the day, the scienter allegations against Kirkland & Ellis in this CC are uniquely strong because of the unique circumstances of this case. Kirkland & Ellis chose to do business with Enron and to take its instructions and directions from Enron and its CFO and not provide the independent representation to the Enron controlled and dominated entities it supposedly represented. In so doing, it entangled itself in the affairs of the company that was committing the largest and worst securities fraud in the history of the United States. Kirkland & Ellis chose to facilitate and participate in that fraud. Now it must accept the consequences of its decisions and conduct.

VI. CONCLUSION

Law firms are not exempt from the federal securities laws. The CC alleges Kirkland & Ellis's participation in a fraudulent scheme and course of business involving its own use of contrivances and devices to deceive, as well as false statements. This states a §10(b)/Rule 10b-5 claim. Therefore, Kirkland & Ellis's motion to dismiss should be denied.

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