

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

United States Court
Southern District of Texas
FILED

JUN 24 2002 LF

Michael N. Milby, Clerk

MARK NEWBY, ET AL.,

Plaintiffs,

v.

ENRON CORPORATION, ET AL.,

Defendants.

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CIVIL ACTION NO: H-01-3624
AND CONSOLIDATED CASES

**DEFENDANT KENNETH L. LAY'S REPLY BRIEF IN SUPPORT OF HIS
MOTION TO DISMISS PLAINTIFFS' CONSOLIDATED COMPLAINT**

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9/16

TABLE OF CONTENTS

TABLE OF CONTENTS	i
TABLE OF AUTHORITIES	iii
I. Introduction	1
II. The Plaintiffs’ 10b-5 Claims Must be Dismissed Because Their Allegations of Scienter Are Insufficient.	2
A. The Benchmark For Pleading Scienter Is Whether the Plaintiffs Have Pleaded Facts Raising a Strong Inference of Scienter	2
B. Plaintiffs’ Allegations Regarding Ken Lay’s Option Exercises and Stock Sales Fail To Raise Any Inference of Scienter	6
1. Lay’s Pattern of Sales and Option Exercises Rebuts Any Inference of Scienter	6
2. Plaintiffs Therefore Ask The Court To Do Anything But Review The Actual Facts About Ken Lay’s Option Exercises And Sales	8
a. Plaintiffs Misrepresent The Facts About Ken Lay’s Transactions	9
b. Plaintiffs Simply Ignore or Brush Off Compelling Facts About Ken Lay’s Transactions in Enron Stock and Employee Options That Rebut Any Inference of Scienter	19
c. Plaintiffs Argue Improperly For a Theory of Collective Scienter, And Ask the Court to Analyze Defendants’ Stock Sales as a Group, Rather Than Ken Lay’s Stock Sales Individually	22
d. Plaintiffs Seek To Substitute the Unsubstantiated Opinions of a Paid Expert for the Actual Facts Concerning Key Lay’s Transactions	25
e. Plaintiffs Try to Inject New, Irrelevant Allegations to Divert Attention Away from the Facts Concerning Ken Lay’s Exercises of Options and Sales of Enron Stock	26
3. Conclusion	28
C. Plaintiffs’ Remaining Scienter Allegations Fail to Create a Strong Inference of Scienter	28
1. Pleading Mr. Lay’s Position as CEO is Insufficient To Raise a Strong Inference of Scienter	28
2. Lay’s Observations About Enron’s Business and Prospects Do Not Support An Inference of Scienter	31
3. Plaintiffs’ Allegation that Lay Approved of the Formation of the LJM Partnerships Is Insufficient to Support Their Claim of Securities Fraud .	33
4. Enron’s Alleged GAAP Violations and the “Magnitude” of the Restatement Do Not Support a Strong Inference of Scienter by Lay	35
5. Plaintiffs’ Claim that Scienter May Be Inferred from Temporal Proximity Has No Merit	38

6.	Ken Lay’s Appropriate Handling of Ms. Watkins’ Letter Does Not Raise Any Inference of Scienter	39
7.	The Fact That Lay Signed Some of Enron’s Financial Statements Does Not Raise an Inference of Scienter	42
III.	Plaintiffs Do Not Adequately Plead Misrepresentations by Lay.	42
A.	Plaintiffs’ Improper Reliance on Group Pleading Should be Rejected	43
B.	Plaintiffs’ Response Confirms Their Failure to Plead with Particularity that Lay’s Alleged Misrepresentations Were False When Made	45
1.	The Consolidated Complaint Is Structurally Deficient	45
2.	Plaintiffs Fail to Allege Adequately Facts Supporting Their Conclusion That Misrepresentations Attributed to Lay Were False When Made	46
3.	Most of the Alleged Misrepresentations Attributed to Lay Constitute Nothing More than Inactionable Puffing	49
4.	Several of Lay’s Comments Were Forward-Looking Statements Protected By The PSLRA Safe Harbor and the Bespeaks Caution Doctrine	52
IV.	Plaintiffs Fail in Their Attempt to Recast Their Claim Under the Texas Securities Act.	54
V.	Plaintiffs Have Failed to Plead Control Person Liability Against Mr. Lay.	56
VI.	Plaintiffs Cannot Maintain a Section 11 Claim Against Mr. Lay.	58
VII.	Plaintiffs Have Not Pleaded a § 20A Claim Against Lay.	60
VIII.	Conclusion.	60

TABLE OF AUTHORITIES

<u>Cases</u>	<u>Page</u>
<i>Abbott v. Equity Group, Inc.</i> , 2 F.3d 613 (5th Cir. 1993), <i>cert. denied</i> , 510 U.S. 1177 (1994)	55
<i>ABC Arbitrage Plaintiffs Group v. Tchuruk</i> , --- F3d ---, No. 01-40645, 2002 WL 975299 (5th Cir. May 13, 2002) ..	1, 3, 4, 30, 32, 36, 44, 47, 49
<i>Abrams v. Baker Hughes, Inc.</i> , --- F3d ---, No. 01-20514, 2002 WL 1018944 (5th Cir. May 21, 2002)	1, 12, 24, 29, 30, 32
<i>Acito v. IMCERA Group, Inc.</i> , 47 F.3d 47 (5th Cir. 1995)	40
<i>Anderson v. Abbott Labs.</i> , 140 F. Supp. 2d 894 (N.D. Ill.), <i>aff'd</i> , 269 F.3d 806 (7th Cir. 2001)	40
<i>Berger v. Compaq Computer Corp.</i> , No. H-98-1148, slip op. (S.D. Tex. Dec. 22, 1999)	49, 50
<i>Branca v. Paymentech, Inc.</i> , No. 3:97-CV-2507, 2000 WL 145083 (N.D. Tex. Feb. 8, 2000)	4, 36, 60
<i>Brosious v. Children's Place Retail Stores</i> , 189 F.R.D. 138 (D.N.J. 1999)	59
<i>Cheney v. Cyberguard Corp.</i> , No. 98-6879-CIV-GOLD, 2000 WL 1140306 (S.D. Fla July 31, 2000)	42
<i>City of Philadelphia v. Fleming Cos., Inc.</i> , 264 F.3d 1245 (10th Cir. 2001)	48
<i>Coates v. Heartland Wireless Communications, Inc.</i> , 26 F. Supp. 2d 910 (N.D. Tex. 1998)	22, 42
<i>Collmer v. U.S. Liquids, Inc.</i> , No. 99-2785, 2001 U.S. Dist. LEXIS 23518 (S.D. Tex. Jan. 23, 2001)	3-5, 22, 29, 30
<i>Copperstone v. TCSI Corp.</i> , No. 97-3495, 1999 WL 33295869 (N.D. Cal. Jan. 19, 1999)	46
<i>Epstein v. Itron, Inc.</i> , 993 F. Supp. 1314 (E.D. Wash. 1998)	28, 30
<i>Fecht v. Price Co.</i> , 70 F.3d 1078 (9th Cir. 1995), <i>cert denied</i> , 517 U.S. 1136 (1996)	53

<i>Frank v. Bear, Stearns & Co.</i> , 11 S.W.3d 380 (Tex. App. -- Houston [14th Dist.] 2000, pet. denied)	55, 56
<i>Gannon v. Continental Ins. Co.</i> , 920 F. Supp. 566 (D. N.J. 1996)	59
<i>Gaylinn v. 3Com Corp.</i> , No. C-99-2185, 2000 WL 33598337 (N.D. Cal. June 9, 2000)	19
<i>Gelfer v. Pegasystems, Inc.</i> , 96 F. Supp. 2d 10 (D. Mass. 2000)	38
<i>Greebel v. FTP Software, Inc.</i> , 194 F.3d 185 (1st Cir. 1999)	3, 19, 23, 50
<i>Grossman v. Novell, Inc.</i> , 120 F.3d 1112 (10th Cir. 1997)	51, 53
<i>Gustafson v. Alloyd Co., Inc.</i> , 513 U.S. 561 (1995)	58, 59
<i>Haack v. Max Internet Communications, Inc.</i> , No. Civ. A. 3:00-CV-1662-G, 2002 WL 511514 (N.D. Tex. Apr. 2, 2002)	37, 51
<i>In re Azurix Corp. Sec. Litig.</i> , 198 F. Supp. 2d 862 (S.D. Tex. 2002)	20, 51, 58, 59
<i>In re Brightpoint, Inc. Sec. Litig.</i> , No. IP 99-0870-C-H/G, 2001 WL 395752 (S.D. Ind. Mar. 29, 2001)	41
<i>In re Browning-Ferris Indus. Inc. Sec. Litig.</i> , 876 F. Supp. 870 (S.D. Tex. 1995)	50
<i>In re Burlington Coat Factory Sec. Litig.</i> , 114 F.3d 1410 (3d Cir. 1997)	52
<i>In re Comshare, Inc. Sec. Litig.</i> , 183 F.3d 542 (6th Cir. 1999)	36
<i>In re Donald J. Trump Casino Sec. Litig. -- Taj Mahal Litig.</i> , 7 F.3d 357 (3d Cir. 1993), cert. denied, 510 U.S. 1178 (1994)	53
<i>In re Dura Pharm., Inc. Sec. Litig.</i> , No. 99CV0151, 2000 WL 33176043 (S.D. Cal. July 11, 2000)	46
<i>In re Gupta Corp. Sec. Litig.</i> , 900 F. Supp. 1217 (N. D. Cal. 1994)	44
<i>In re HealthCare Compare Corp. Sec. Litig.</i> , 75 F.3d 276 (7th Cir. 1996)	38-41
<i>In re Hunter Environmental Services, Inc. Sec. Litig.</i> , 921 F. Supp. 914 (D. Conn. 1996)	34

<i>In re International Bus. Mach. Corp. Sec. Litig.</i> , 163 F.3d 102 (2d Cir. 1998)	52, 56
<i>In re Landry's Seafood Restaurants, Inc. Sec. Litig.</i> , No. H-99-1948, slip op. (S.D. Tex. Feb. 20, 2001)	6, 7, 33, 34, 45
<i>In re MCI WorldCom, Inc. Sec. Litig.</i> , 191 F. Supp. 2d 778 (S.D. Miss. 2002)	36, 61
<i>In re MicroStrategy, Inc. Sec. Litig.</i> , 115 F. Supp. 2d 620 (E.D. Va. 2000)	37
<i>In re NAHC, Inc. Sec. Litig.</i> , No. CIV. A-00-4020, 2001 WL 1241007 (E.D. Pa. Oct. 17, 2001)	4
<i>In re Oak Tech. Sec. Litig.</i> , No. 96-20552, 1997 WL 448168 (N.D. Cal. Aug. 1, 1997)	46
<i>In re Oxford Health Plans, Inc.</i> , 187 F.R.D. 133 (S.D.N.Y. 1999)	22
<i>In re Quintel Entm't Inc. Sec. Litig.</i> , 72 F. Supp. 2d 283 (S.D.N.Y. 1999)	52
<i>In re Read-Rite Sec. Litig.</i> , No. C 98-20434 JF, 2000 WL 1641275 (N.D. Cal. Oct. 13, 2000)	29
<i>In re Republic Servs., Inc. Sec. Litig.</i> , 134 F. Supp. 2d 1355, 1360-61 (S.D. Fla. 2001)	39
<i>In re Sec. Litig. BMC Software, Inc.</i> , 183 F. Supp. 2d 860 (S.D. Tex. 2001) ..	27, 33, 35, 38, 39, 43, 60
<i>In re Silicon Graphics, Inc. Sec. Litig.</i> , 970 F. Supp. 746 (N.D. Cal. 1997)	44
<i>In re SmarTalk Teleservices, Inc. Sec. Litig.</i> , 124 F. Supp. 2d 527 (S.D. Ohio 2000)	44, 45
<i>In re Splash Tech. Holdings, Inc.</i> , 160 F. Supp. 2d 1059 (N.D. Cal. 2001)	45, 46
<i>In re Summit Med. Sys. Inc. Sec. Litig.</i> , 10 F. Supp. 2d 1068 (D. Minn. 1998)	59
<i>In re Sunterra Corp. Sec. Litig.</i> , 199 F. Supp. 2d 1308 (M.D. Fla. 2002)	42
<i>In re Syntex Corp. Sec. Litig.</i> . 95 F.3d 922 (9th Cir. 1996)	48

<i>In re Triton Energy Ltd. Sec. Litig.</i> , No. 5:98-CIV-256, 2001 WL 872019 (E.D. Tex. Mar. 30, 2001)	37
<i>In re U.S. Liquids Sec. Litig.</i> , No. H-99-2785, slip op. at 14 (S.D. Tex. Apr. 30, 2002)	58, 59
<i>In re WRT Energy Sec. Litig.</i> , No. 96-3610, 96-3611, 1997 WL 576023 (S.D. N.Y. Sept. 15, 1997)	59
<i>Kurtzman v. Compaq Computers Corp.</i> , No. H-00-779, slip op. (S.D. Tex. April 1, 2002)	19, 31, 35, 39, 53
<i>Lemmer v. Nu-Kote Holding, Inc.</i> , No. Civ. A. 398CV0161, 2001 WL 1112577 (N.D. Tex. Sept. 6, 2001)	4
<i>Marksman Partners, L.P. v. Chantal Pharmaceutical Corp.</i> , 927 F. Supp. 1297 (C.D. Cal. 1996)	37
<i>Marra v. Tel-Save Holdings, Inc.</i> , No. 98-3145, 1999 WL 317103 (E.D. Pa. May 18, 1999)	22
<i>Melder v. Morris</i> , 27 F.3d 1097 (5th Cir. 1994)	28
<i>Nathenson v. Zonagen</i> , 267 F.3d 400 (5th Cir. 2001)	1, 2, 7, 19, 22-24, 26, 28, 30, 31, 36, 50
<i>Raab v. General Physics Corp.</i> , 4 F.3d 286 (4th Cir. 1993)	50, 54
<i>Reiger v. Price Waterhouse Coopers LLP</i> , 117 F. Supp. 2d 1003 (S.D. Cal. 2000), <i>aff'd</i> , 288 F.3d 385 (9th Cir. 2002)	36, 61
<i>San Leandro Emer. Med. Group Profit Sharing Plan v. Philip Morris Cos., Inc.</i> , 75 F.3d 801 (2d Cir. 1996)	45, 53
<i>Schiller v. Physicians Res. Group, Inc.</i> , No. CIV.A 3:97-CV-3158L, 2002 WL 318441 (N.D. Tex. Feb. 26, 2002)	3, 22
<i>Schlagal v. Learning Tree Int'l</i> , No. CV 98-6384 ABC, 1998 WL 1144581 (C. D. Cal. Dec. 23, 1998)	44
<i>Thornton v. Micrografx, Inc.</i> , 878 F. Supp. 931 (N.D. Tex. 1995)	20, 33
<i>TSC Indus., Inc. v. Northway, Inc.</i> , 426 U.S. 438 (1976)	53
<i>Tuchman v. DSC Communications Corp.</i> , 14 F.3d 1061 (5th Cir.), <i>reh'g denied</i> , 20 F.3d 1172 (5th Cir. 1994)	20

<i>United States ex rel. Wilkins v. North Am. Constr. Corp.</i> , 173 F. Supp. 2d 601 (S.D. Tex. 2001)	3, 9, 57
<i>Warden v. Crown Am. Realty Trust</i> , No. 96-25J, 1998 WL 725946 (W.D. Pa. Oct. 15, 1998) , <i>aff'd</i> , 229 F.3d 1140 (3d Cir. 2000)	59
<i>Wenger v. Lumisys, Inc.</i> , 2 F. Supp. 2d 1231 (N.D. Cal. 1998)	46, 49
<i>Williams v. WMX Tech. Inc.</i> , 112 F.3d 175 (5th Cir.), <i>cert. denied</i> , 522 U.S. 966 (1997)	44
<i>Yourish v. California Amplifier</i> , 191 F.3d 983 (9th Cir. 1999)	39
<i>Zishka v. American Pad & Paper Co.</i> , No. Civ. A-398CV0660M, 2001 WL 1645500 (N.D. Tex. Dec. 20, 2001)	30, 31

Statutes, Rules and Regulations

15 U.S.C. § 78u-4(b)(1)	2, 3, 22
15 U.S.C. § 78u-5	53
17 C.F.R. § 240.16a-3(f)	27
FED. R. CIV. P. 15(a)	54
S.E.C. 16a-3(f)	27

Other Authorities

H.R. Rep. No. 85, 73d Cong., 1st Sess., 5 (1933)	59
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TO THE HONORABLE JUDGE MELINDA HARMON:

Defendant Kenneth L. Lay submits this reply brief in support of his motion to dismiss plaintiffs' Consolidated Complaint ("Compl.") and respectfully shows the Court as follows:

I. Introduction.

In the first paragraph of plaintiffs' response, they disclose the basis for their claims against Ken Lay and other defendants: they argue that "everyone knows" that the claims have merit. Plaintiffs' Memorandum of Law in Opposition to Motions to Dismiss Filed by Enron Defendants Buy, Causey, Derrick, Fastow, Frevert, Hannon, Harrison, Hirko, Horton, Kean, Koenig, Lay, Mark-Jusbasche, McMahon, Olson, Pai, Rice, Skilling, Sutton, and Whalley ("Response"), p. 1. The rest, as far as plaintiffs are concerned, is simply "going through the motions." It does not matter how fast and loose they play with the facts or the law, or how often they make misrepresentations to the Court, the claims against Ken Lay cannot be dismissed because "everyone knows."

Oddly enough, the recent trio of Fifth Circuit decisions construing the Private Securities Litigation Reform Act of 1995 ("PSLRA") did not find "everyone knows" to be a valid basis for sustaining a 10b-5 claim. *See Abrams v. Baker Hughes, Inc.*, --- F3d ---, No. 01-20514, 2002 WL 1018944 (5th Cir. May 21, 2002); *ABC Arbitrage Plaintiffs Group v. Tchuruk*, --- F3d ---, No. 01-40645, 2002 WL 975299 (5th Cir. May 13, 2002); *Nathenson v. Zonagen*, 267 F.3d 400 (5th Cir. 2001). Instead, the Fifth Circuit requires that plaintiffs substantiate their allegations of fraud with contemporaneous documents or credible witnesses. The reasonable inferences from the facts so substantiated must then raise a strong inference that the defendants acted with scienter. If "everyone knows," as plaintiffs contend, then it should be an easy matter for plaintiffs to satisfy this burden. As it turns out, plaintiffs fail to plead with particularity in the Consolidated Complaint that they have found a single person who knows facts raising a strong inference that Ken Lay acted with scienter,

or that they have located a single contemporaneous document that contradicted representations made by Ken Lay. The facts contained in the SEC filings allegedly relied on by plaintiffs concerning Ken Lay's exercises of stock options and sales of Enron stock actually rebut any inference of scienter.

When the Court carefully examines the particular facts alleged by plaintiffs about Ken Lay -- stripped of the hyperbole, mischaracterizations, and downright misrepresentations -- it will find that they portray the normal activities of a senior executive: participating in board meetings, talking periodically with analysts, signing certain SEC filings, and exercising a portion of the employee stock options he received as compensation. It should be obvious to the Court then that there is an unbridgeable chasm between what "everyone knows" and plaintiffs' wholly inadequate pleading of securities fraud claims against Ken Lay.

II. The Plaintiffs' 10b-5 Claims Must be Dismissed Because Their Allegations of Scienter Are Insufficient.

A. The Benchmark For Pleading Scienter Is Whether the Plaintiffs Have Pleaded Facts Raising a Strong Inference of Scienter.

Congress and the Fifth Circuit have made it clear that allegations of scienter succeed or fail on the basis of *facts* pleaded in the complaint. *See* 15 U.S.C. § 78u-4(b)(1); *Nathenson*, 267 F.3d at 411. To analyze plaintiffs' scienter allegations, therefore, the Court must sift through the unsupported conclusions and demonstrably false allegations to identify the *facts* pleaded in the Consolidated Complaint.

Plaintiffs acknowledge that in ruling on a motion to dismiss, the Court must accept as true only their *well pleaded allegations*. Response, p. 30 (emphasis added). Plaintiffs' unsupported conclusions and internally inconsistent "facts" are not "well-pleaded allegations" that must be accepted as true by the Court. The Fifth Circuit and this Court have explained repeatedly that "conclusory allegations or legal conclusions masquerading as factual conclusions will not suffice

to prevent dismissal under Rule 12(b)(6).” *ABC Arbitrage*, 2002 WL 975299, at *8; *Collmer v. U.S. Liquids, Inc.*, No. 99-2785, 2001 U.S. Dist. LEXIS 23518, at *4 (S.D. Tex. Jan. 23, 2001). Similarly, incorrect assertions of “fact” are not admitted as true when contradicted by facts pleaded elsewhere in the complaint or presented in documents incorporated into the complaint. *See United States ex rel. Wilkins v. North Am. Constr. Corp.*, 173 F. Supp. 2d 601, 617 & n.6 (S.D. Tex. 2001) (Rosenthal, J.).

Moreover, pleading scienter in accordance with the high standard set by Congress in the PSLRA requires more than just “well pleaded allegations.” “While under Rule 12(b)(6) all inferences must be drawn in plaintiffs’ favor, inferences of scienter do not survive if they are merely reasonable. . . . Rather, inferences of scienter survive a motion to dismiss only if they are both reasonable and ‘strong’ inferences.” *Greebel v. FTP Software, Inc.*, 194 F.3d 185, 195-96 (1st Cir. 1999) (emphasis in original); *see also Schiller v. Physicians Res. Group, Inc.*, No. CIV.A 3:97-CV-3158L, 2002 WL 318441, at *6 (N.D. Tex. Feb. 26, 2002) (“These facts, when ‘assumed to be true’ must ‘constitute pervasive, effective, and cogent evidence from which it can logically be deduced that defendants acted with intent to deceive, manipulate, or defraud.’ . . . ‘A mere reasonable inference is insufficient to survive a motion to dismiss.’”).

Recently, the Fifth Circuit confirmed that significant factual detail must be pleaded to support allegations made on information or belief.¹ *See ABC Arbitrage*, 2002 WL 975299, at *10-*12.

¹ The PSLRA states that, for allegations made on information and belief, the plaintiff must state with particularity all facts on which the belief is formed. 15 U.S.C. §78u-4(b)(1). The Fifth Circuit explained that allegations in a complaint are pleaded on information and belief when they are not based on the plaintiff’s personal knowledge. *ABC Arbitrage*, 2002 WL 975299, at *10. Plaintiffs do not, and cannot, claim that they have personal knowledge of the information regarding Lay or Enron pleaded in the Consolidated Complaint. As a result, their allegations are pleaded entirely on information and belief.

Plaintiffs must “plead with particularity *sufficient facts* to support their allegations.” *Id.* at *11 (emphasis in original). To plead sufficient facts, plaintiffs must provide documentary evidence and/or a sufficient description of the personal sources for their beliefs. *Id.* at *10. Unsupported general claims of the existence of confidential company reports that contradict the defendant’s representations are insufficient to meet this standard. *Id.* at *13. A plaintiff must identify such internal reports, who prepared them, how frequently they were prepared, and who reviewed them. *Id.* If documentary evidence does not provide a basis for believing the defendant’s statements were false, and the description of the personal source supporting an allegation of falsity is not sufficiently particular to establish that a person in the position occupied by the source would possess the information pleaded, the complaint must name the personal source. *Id.* at *12.

The Fifth Circuit’s decision in *ABC Arbitrage* confirms that decisions rendered by this Court and others requiring plaintiffs to plead scienter with factual specificity have applied the PSLRA pleading standard properly. *See, e.g., U.S. Liquids*, 2001 U.S. Dist. LEXIS 23518, at *97 (“Indeed, the purpose of the PSLRA’s particularized pleading requirement leads this court to find that [imputing knowledge to the defendant] without some additional facts such as exposure to content-identified internal corporate documents (and who drafted them, who received them, or how plaintiffs learned of them) or specific conversations or attendance at specified management or board meetings dealing with such problems, is inadequate to plead scienter.”); *Branca v. Paymentech, Inc.*, No. 3:97-CV-2507, 2000 WL 145083, at *10 (N.D. Tex. Feb. 8, 2000) (“Plaintiffs have pleaded no facts indicating that at the time the allegedly false statements were made, Defendants had actual knowledge of contradictory facts, and thus their Complaint does not state a claim for securities fraud.”); *Lemmer v. Nu-Kote Holding, Inc.*, No. Civ. A. 398CV0161L2001, WL 1112577, at *11 (N.D. Tex. Sept. 6, 2001) (same); *see also In re NAHC, Inc. Sec. Litig.*, No. Civ. A. 00-4020, 2001

WL 1241007, at *19-*20 (E.D. Pa. Oct. 17, 2001) (“Where plaintiffs contend that the defendants had access to contrary facts, they must specifically identify the reports or statements containing this information.”).

With this standard in mind, the Court must strip plaintiffs’ Consolidated Complaint of its unsupported conclusory allegations and inconsistent factual contentions to determine whether plaintiffs have pleaded particular facts (supported by documentary evidence or appropriate identification of sources) that raise a strong inference of scienter. *See U.S. Liquids*, 2001 U.S. Dist. LEXIS 23518, at *90 (“Thus, the court pursues a fact-intensive review of this particular case to see whether Plaintiffs have pleaded sufficient facts to state the requisite scienter.”).

Stripped of its conclusory allegations, the Consolidated Complaint alleges the following facts regarding Lay: (1) Lay exercised some of his options and sold some of his Enron stock during the class period; (2) Lay was chairman of Enron’s board and, for part of the time period relevant to the complaint, he was the company’s CEO; (3) in his capacity as CEO, Lay made some statements about Enron’s business and its future; (4) as a board member Lay approved formation of the LJM partnerships and waiver of Enron’s conflict of interest policy; (5) in August 2001, Sherron Watkins delivered a letter to Lay expressing concern about Enron’s accounting practices; and (5) Lay signed some of Enron’s SEC filings. These allegations, individually and collectively, fail to raise a strong inference of scienter.

B. Plaintiffs' Allegations Regarding Ken Lay's Option Exercises and Stock Sales Fail To Raise Any Inference of Scienter.

As explained in Lay's Motion to Dismiss,² the cornerstone of plaintiffs' scienter allegations rests on the fact that Lay exercised some options and sold some Enron stock during the class period. The allegations in plaintiffs' Consolidated Complaint, however, fail to meet the standard of "well pleaded" allegations raising a strong inference of scienter. After one sifts through plaintiffs' unsupported conclusions and inconsistent facts, it is clear that plaintiffs' cornerstone has crumbled.

1. Lay's Pattern of Sales and Option Exercises Rebut Any Inference of Scienter.

In his Motion to Dismiss, Ken Lay presents facts -- drawn from the same SEC filings on which plaintiffs rely in their Consolidated Complaint -- demonstrating that his exercises of Enron stock options and his sales of Enron stock not only fail to *raise* a strong inference of scienter, but also *rebut* any inference of scienter. Motion to Dismiss, pp. 4-29. In their response, plaintiffs insist that the defendants' sales of Enron stock during the class period, when considered collectively, support an inference of scienter because they demonstrate a pattern of increased sales at or near the time at which Enron was trading at its highest price. Response, p. 106. Indeed, they go so far as to compare the trading by Enron insiders to trading by insiders discussed in this Court's opinion in *In re Landry's Seafood Restaurants, Inc. Securities Litigation*, No. H-99-1948, slip op. at p. 25 (S.D. Tex. Feb. 20, 2001). See Response, p. 107. The chart reproduced from the *Landry's* complaint in plaintiffs' response shows selling by insiders concentrated at or near the peak price at which Landry's Seafood stock traded during the class period. *Id.* at p. 107. In addition, this Court noted

² "Motion to Dismiss" refers to "Defendant Kenneth L. Lay's Motion to Dismiss Plaintiffs' Consolidated Complaint and Supporting Brief."

in its opinion that Landry's chief executive officer "sold 1,090,000 shares of his Landry's stock in March 1998 at [or] near the record high [price]" *Landry's*, slip op. at p. 26.

Plaintiffs' analysis falls apart, however, when Mr. Lay's sales are separately considered, as they must be, because they reveal a pattern *diametrically opposite* to the pattern discussed in *Landry's*. Mr. Lay sold most of his Enron shares well before the stock price reached its peak of \$90 per share in August 2000, and well after it had declined from its peak. *See* charts in Motion to Dismiss at pp. 15, 25. As a result, the average price at which Mr. Lay sold stock during the class period was \$47.99, approximately one-half of Enron's trading high. *See* Motion to Dismiss, Exhibit 3; *see also* Declaration of Scott D. Hakala ("Hakala Decl.") (Exhibit B to Lead Plaintiffs' Appendix of Exhibits in Support of Consolidated Complaint), Exhibit E, p. 2 (calculating average sales price per share of \$47.05 for "Net Sales of Shares Reported for Kenneth Lay by Month and Details June 1996 to October 2001."). Thus, by plaintiffs' own theory, the pattern of Ken Lay's sales *contradicts* any inference of insider trading. Indeed, in *Nathenson*, the Fifth Circuit found it significant that an individual insider's sales were at "only about half the price to which plaintiffs allege defendants inflated the market [price]. . . ." *Nathenson*, 267 F.3d at 420.

Unable to do anything with the pattern of Ken Lay's sales, plaintiffs take a novel approach, arguing that the pattern of Ken Lay's exercises of Enron stock options raises an inference of scienter. Plaintiffs theorize that when insiders exercise stock options to sell stock long before the options expire for a relatively small amount of intrinsic value (the difference between the market price and the exercise price), they are engaged in economically irrational behavior that is consistent only with a desire to extract value from the options as soon as possible before the stock price collapses. Aside from whether this is a valid theory, it simply does not apply to Mr. Lay's exercises because, once again, the hard facts in the SEC filings demonstrate that he consistently exercised options for

intrinsic values well within the range that plaintiffs' own expert (and the one scholarly article that addressed the issue) posits as evidencing normal executive behavior. *See* Motion to Dismiss, pp. 11-13 & n.6.

2. Plaintiffs Therefore Ask The Court To Do Anything But Review The Actual Facts About Ken Lay's Option Exercises And Sales.

Confronted with irrefutable facts that the pattern of Ken Lay's stock option exercises and stock sales *rebutts* any inference of scienter, plaintiffs engage in at least five stratagems to try to convince the Court otherwise:

First, plaintiffs demonstrably -- and brazenly -- misrepresent the information contained in the SEC filings on which they rely in the Consolidated Complaint to analyze Ken Lay's exercises of Enron options and sales of Enron stock.

Second, plaintiffs simply ignore or try to brush off compelling facts reflected in the SEC filings negating any inference of scienter. For example, plaintiffs never acknowledge or address Mr. Lay's need to exercise options expiring in the class period. They also refuse to consider their own allegations in other pleadings filed with the Court that Ken Lay had liquidity problems, which provide a logical and compelling reason for Mr. Lay's stock sales in the fall of 2001, after Enron's stock price had plummeted. They try to dismiss Ken Lay's implementation of a 10b5-1 selling program promptly after the SEC's adoption of Rule 10b5-1 through the circular argument that he must have adopted the program in bad faith because he was engaged in fraud at the time.

Third, they ask this Court to accept a legal concept of "collective scienter" demonstrated through the artificially aggregated sales of insiders, despite the PSLRA's mandate that plaintiffs allege specific facts raising a strong inference of scienter as to each defendant separately.

Fourth, plaintiffs shamelessly attempt to substitute the unsubstantiated opinions of a paid expert for the actual facts set forth in the SEC filings and then insist that the Court must accept those opinions as true.

Lastly, plaintiffs attempt to introduce irrelevant allegations not stated in their Consolidated Complaint about Mr. Lay's revolving credit line with Enron, designed to divert the Court from the compelling evidence in the SEC filings negating any inference of scienter by Ken Lay.

While these stratagems are breathtaking in their audacity, they betray plaintiffs' desperate inability to identify particular facts that raise any inference of scienter, much less a strong inference.

a. Plaintiffs Misrepresent The Facts About Ken Lay's Transactions.

For their analysis of Ken Lay's trading, plaintiffs claim that they rely upon information contained in the proxy statements filed by Enron from 1996 through 2001, and in Ken Lay's Form 4 and Form 5 filings. Hakala Decl. ¶ 28; *see also* Response, p. 119. The Forms 4 and 5 filed by Ken Lay with the SEC from 1996 through 2001 ("Forms 4 and 5") are included in Tab 1 in the Appendix to Kenneth L. Lay's Motion to Dismiss Plaintiffs' Consolidated Complaint ("Lay App."). Enron's proxy statements filed with the SEC from 1996 through 2001 are in the Master SEC Appendix ("Master SEC App.") filed with the Joint Brief at tabs 20-22 and 86-88. This Court is not required to accept as true allegations by plaintiffs contradicted by the information contained in the SEC filings relied on by plaintiffs. *See United States ex rel. Wilkins*, 173 F. Supp. 2d at 617 & n.6. It may be an easier task to identify plaintiffs' calculations that are *consistent* with the SEC filings, because few indeed are consistent with those filings. Nor are these merely differences in interpretation; plaintiffs' numbers just do not add up. Plaintiffs demand that the Court accept as true factual assertions about Ken Lay's option exercises and sales that are the equivalent of pleading $1 + 1 = 3$.

To begin with, plaintiffs incorrectly allege in the Consolidated Complaint that Ken Lay sold 54.85% of his available holdings during the class period. *See* Compl. ¶ 402. The complaint discloses as the source for this calculation the proxy statement filed by Enron in 2001. But the proxy statement contradicts the holdings information used in plaintiffs' calculation. When corrected, plaintiffs' calculations should show that Ken Lay sold 43.86% of his available holdings during the three-year class period. This calculation is in line with Mr. Lay's determination, using the same information, that he sold 46.24% of his available holdings during the class period. *See* Exhibit 1 to Motion to Dismiss. Thus, plaintiffs have *inflated* the percentage of holdings sold by Ken Lay by nearly 30%.

The table in paragraph 402 of the Consolidated Complaint shows Ken Lay's "Total" holdings on February 15, 2001, as reflected in Enron's 2001 Proxy Statement, as 5,392,718 shares of Enron common stock and vested options to buy Enron common stock. Page 9 of the 2001 Proxy Statement shows, however, that he had sole voting and investment power over 5,392,718 shares and vested options *and* shared voting and investment power over an additional 2,367,897 shares and vested options, for a total of 7,760,615 shares and vested options.³ Inexplicably, plaintiffs simply failed to include the shares and vested options over which Ken Lay had shared voting and investment power in their calculation of "Total" holdings.⁴ Lay's total holdings, after adjustment for shares in a

³ Attached hereto as Exhibits A and B, respectively, for the Court's convenience are copies of the relevant pages of the Consolidated Complaint and of the 2001 Proxy Statement.

⁴ Plaintiffs consistently include shares over which Ken Lay had shared voting and investment power elsewhere in the table in paragraph 402 and in their analysis of his option exercises and sales. The table in paragraph 402 shows the total "Options" held by Ken Lay as of February 15, 2001, as reflected in the 2001 Proxy Statement, as 5,285,542. This amount is shown on page 10 of the Proxy Statement in footnote 1. The same footnote, however, expressly states that Mr. Lay had shared voting and investment power over 1,828,210 of the shares represented by these
(continued...)

charitable foundation in which he did not have a pecuniary interest, should have been correctly shown by plaintiffs as 7,220,928 shares and vested options.⁵ The correct number of shares owned by him as of February 15, 2001, was 1,935,386 instead of 107,176, as incorrectly shown in the table in paragraph 402.⁶

Plaintiffs calculated the “Available Holdings” in the table in paragraph 402 -- that is shares that Mr. Lay allegedly could have sold during the class period -- by adding the incorrect “Total” holdings reflected in the 2001 Proxy Statement to the “Shares Sold [by Ken Lay] Prior to Report Date [2/15/01].”⁷ According to their calculations, the prior shares sold were 1,903,515. The

⁴ (...continued)

options. Plaintiffs also include sales of shares by the Lay family partnership in which Ken Lay had shared voting and investment power in their schedule of Ken Lay’s sales. Compare Forms 4 and 5 with Exhibit E to Hakala Decl. Thus, plaintiffs could have no reasonable basis to exclude from their calculation of Ken Lay’s holdings shares over which he had shared voting and investment power. As a result of this error, plaintiffs also misstate the number of common shares owned by Ken Lay as 107,176 because they simply subtract the correct “Options” total of 5,285,542 from the incorrect “Total” holdings of 5,392,718 shares to back into the number of common shares held by Ken Lay as 107,176.

⁵ The total amount of shares over which Ken Lay had sole voting and investment power and shared voting and investment power on February 15, 2001, as shown in the Proxy Statement was 7,760,615. After deducting 539,687 shares held in a charitable foundation in which Mr. Lay had no pecuniary interest, as disclosed in Footnote 6 on page 11 of the Proxy Statement, the remainder of 7,220,928 shares and options accurately reflects his “Total” holdings as shown in the Proxy Statement.

⁶ This amount is calculated by subtracting the total options held by Ken Lay, accurately shown in the table in paragraph 402 as 5,285,542, from the correct “Total” holdings number of 7,220,928, resulting in a remainder of 1,935,386.

⁷ Plaintiffs’ holding calculations also omit options that vested between February 15, 2001, and November 30, 2001, the end of the class period, as well as additional vested options granted to Mr. Lay during that time frame. To avoid this inaccuracy, Mr. Lay calculated his holdings of Enron stock and vested options for purposes of Exhibit 1 attached to his Motion to Dismiss as of the end of the class period, on November 30, 2001, based on the same SEC filings that plaintiffs relied upon. *See* Motion to Dismiss, pp. 16-17, n.8 & Exhibit 1. Mr. Lay calculated his total

(continued...)

“Available Holdings,” according to plaintiffs’ methodology, should therefore be 9,124,443, representing the addition of the correct “Total” holdings as of February 15, 2001, of 7,220,928 and plaintiffs’ prior shares sold calculation of 1,903,515. When the correct “Available Holdings” number of 9,124,443 is divided by the “CP [Class Period] Shares Sold,” calculated by plaintiffs as 4,002,259, the resulting percentage is 43.86%, *not* the 54.85% incorrectly represented by plaintiffs. Thus, plaintiffs’ corrected analysis reflects that Ken Lay sold on average 14.62% of his holdings each year over the three-year class period, which is certainly not unusual in light of the large number of vested options -- over 5,000,000 -- accumulated by him as executive compensation. In *Abrams*, by comparison, the court did not find “suspicious” an insider’s sale of 16.9% of his holdings during a ten month class period. *Abrams*, 2002 WL 1018944, at *8.

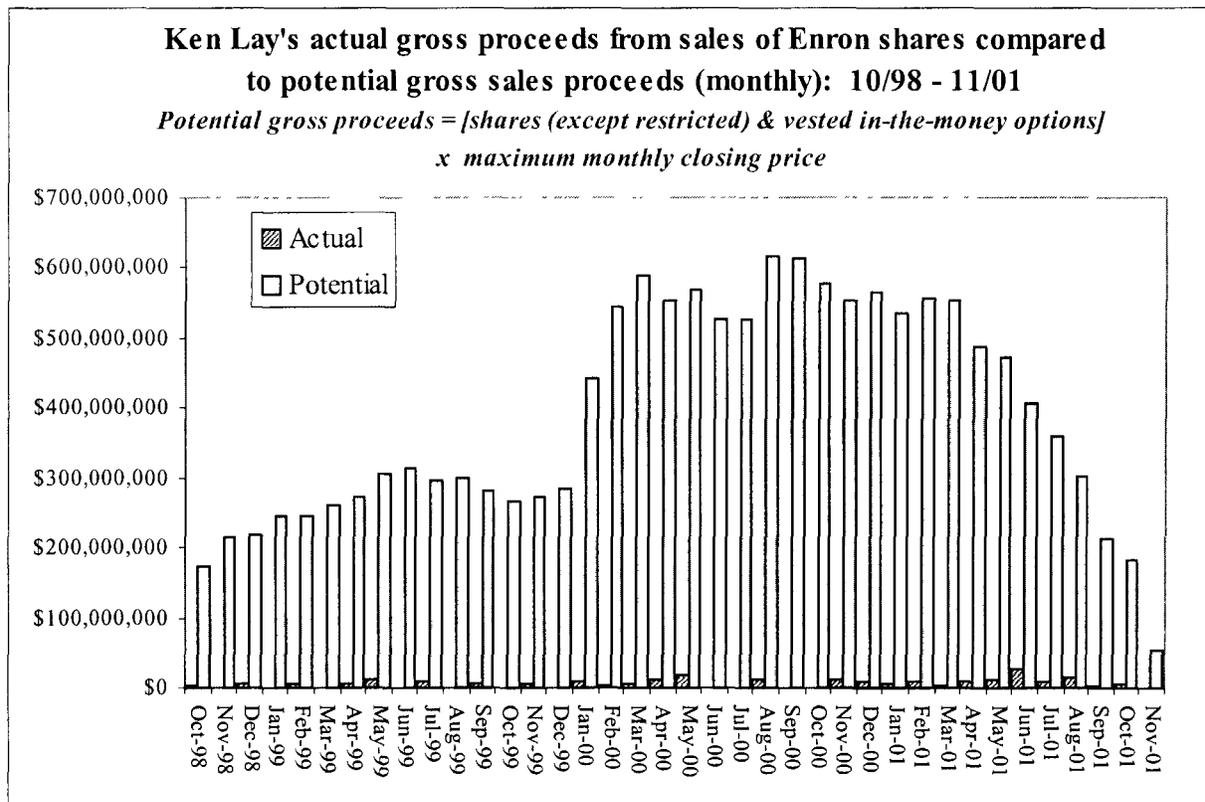
Plaintiffs complain in their response that Mr. Lay calculated the percentage of his shares sold during the class period out of his total holdings (46.24%) by determining his holdings as of a fixed date and adding the sales prior to that date. Response, p. 126. In other words, plaintiffs criticize Mr. Lay for using the same methodology that they used. The only difference in plaintiffs’ methodology is that they fixed “holdings” as of February 15, 2001, based upon the 2001 Proxy Statement, and Mr. Lay fixed holdings as of November 30, 2001, at the end of the class period. Moreover, the methodology by which Mr. Lay calculated holdings is clearly shown on the charts presented at pages

⁷ (...continued)

holdings at the end of the class period as 5,671,828 vested options and shares. Using the same methodology as plaintiffs, Mr. Lay then added to the “holdings” shares previously sold during the class period in the amount of 4,878,700, for a “total holdings” calculation of 10,550,528. As noted by Mr. Lay in his Motion to Dismiss at footnote 8 on page 16, Mr. Lay calculates the number of shares sold on a gross basis while plaintiffs have attempted to net the shares sold by him against purchases and against shares sold to pay the exercise price of options. Regardless of the difference in methodology, the two approaches result in similar percentages: Mr. Lay’s analysis shows that 46.24% of his holdings were sold during the class period and plaintiffs’ methodology, as corrected, reflects 43.86% of his holdings were sold.

15 and 25 of his Motion to Dismiss. These charts show how the 46.24% of his Enron holdings sold was distributed monthly during the class period. If Mr. Lay had done as plaintiffs now suggest and recalibrated the holdings for each month in which Mr. Lay sold shares, then the Court would not be able to determine how the 46.24% of holdings sold was distributed during the class period. Lacking a common denominator, the percentage of shares sold in any given month would not relate to the percentage sold in any other month.

Moreover, Mr. Lay already has presented to the Court another chart that does just what plaintiffs suggest: it recalibrates the available holdings each month. The chart at page 23 of his Motion to Dismiss, reproduced below, compares monthly during the class period the potential gross proceeds that Mr. Lay actually achieved from sales of Enron shares to the potential gross sales proceeds that he would have achieved if he had sold his entire position:



The chart clearly states that the potential gross proceeds are determined by multiplying the number of outstanding shares, except for restricted stock, and vested in-the-money options times the maximum monthly closing price. As the chart demonstrates, Mr. Lay realized only a small percentage of the potential gross proceeds he could have generated through the sale of his total holdings every month throughout the class period.

In their misguided attempt to criticize defendant's charts, plaintiffs do much more damage to their own credibility. At page 126 of their response, plaintiffs proudly declare, in bold print, that "***Lay actually sold close to 60 percent of his remaining holdings*** of shares [between 8/01 and 10/01]." Plaintiffs apparently calculated this percentage by determining that, as of December 31, 2001, Mr. Lay "had beneficial holdings and options of 1.6 million shares but held only approximately 1.1 million shares that had intrinsic value." *Id.* Plaintiffs also claim that Mr. Lay reported selling 918,104 shares from August 21, 2001 to October 26, 2001. *Id.* From this data, they calculated that Mr. Lay sold close to 60% of his remaining holdings in those three months.

Even if these holdings data were correct (and the data are clearly in error), and even if it were fair to determine Mr. Lay's holdings after Enron was in bankruptcy and all of his options were worthless (and it is grossly unfair to do so), plaintiffs still cannot get the math right. During this three-month period, according to plaintiffs' calculations, Mr. Lay had 2,018,104 shares available to be sold (the 918,104 shares that were sold and the 1.1 million shares with intrinsic value at the end of the period). Thus, according to plaintiffs' own inaccurate numbers, Mr. Lay sold close to 46% of his remaining holdings in those three months, not "60%."⁸

⁸ This percentage is calculated by dividing 918,104 by 2,018,104.

According to the 2001 Proxy Statement, however, Mr. Lay held vested options and common stock totaling 7,220,928 as of February 15, 2001. *See* 2001 Proxy Statement pp. 9 & 11 n.6. Plaintiffs allege in their Consolidated Complaint that from February 15, 2001, to the end of the class period, Mr. Lay sold 2,098,744 shares. Compl. ¶ 402.⁹ Thus, as Mr. Lay made no sales in December 2001, plaintiffs should have advised the Court that he held 5,122,184 shares and vested options at the end of December 2001.

Plaintiffs do not provide any citation or substantiation for the contention in their response that Mr. Lay had beneficial holdings and options of 1.6 million shares on December 31, 2001. *See* Response, p. 126. This number is simply fabricated out of whole cloth. The Form 5 filed by Mr. Lay for 2001 shows that at the end of the year he owned a beneficial interest in stock totaling 1,202,682 Enron shares (excluding options). Perhaps plaintiffs derive from this filing their assertion that he held “only approximately 1.1 million shares that had intrinsic value” as of December 31, 2001. It is extraordinarily misleading, however, to exclude all of Mr. Lay’s vested stock options from his available holdings from August through October 2001, because they *later* became worthless when Enron went into bankruptcy in December. From August 21, 2001, to October 26, 2001, Mr. Lay certainly had vested options with substantial value, as shown in the chart reproduced above at page 13.¹⁰

⁹ This amount is determined by subtracting the “Shares Sold Prior to Report Date” of 1,903,515 from the “CP [Class Period] Shares Sold” of 4,002,259, as shown in the table in ¶ 402 of the Consolidated Complaint.

¹⁰ Plaintiffs contend in their response that “Enron Insiders sold 362,057 shares of stock for over \$6 million in 10/01 -- immediately following positive statements accompanying the announcement of Enron’s \$1-billion write off -- and two months before Enron filed for bankruptcy.” Response, p. 117. Ken Lay’s first sale of shares in October 2001 was on October 23, 2001, for a price of \$19.79 per share, *one week* after the October 16 announcement of the write-down and *after* (continued...)

Plaintiffs conclude this progression of math errors, made up numbers, and meaningless calculations with the remarkable assertion that “Lay’s chart merely reflects his wishful thinking concerning the facts of this case.” Response, p. 126. Truer words could not be said of plaintiffs’ analysis of Mr. Lay’s trading or, for that matter, the allegations made in the Consolidated Complaint as a whole.

Plaintiffs also continue to make the demonstrably false contention that Ken Lay exercised to *sell* 25,000 stock options on August 20, 2001. Plaintiffs’ purported expert, Dr. Hakala, uses this exercise as his *sole* example of an excessive sacrifice by Mr. Lay of option value, ignoring, as he must, Lay’s many other option exercises, which demonstrate that he exercised options to sell shares only when they had significant intrinsic value. *See* Hakala Decl. ¶ 34; Motion to Dismiss, pp. 11-13. The problem with this one example, however, is that it is an exercise to *hold* shares rather than to sell shares. This inconvenient fact turns Hakala’s analysis on its head and makes this exercise compelling evidence that, as of August 20, 2001, Mr. Lay believed that Enron stock would *appreciate* in value, not decline.

As shown in his Motion to Dismiss, if Mr. Lay believed Enron’s stock price would appreciate over the long term, it was in his economic interest to exercise these options early and to hold the shares *before* the stock price appreciated, so that he could achieve substantial tax benefits (application of a long-term capital gains rate) upon the later sale of the shares. Motion to Dismiss, p. 10 & n. 5. Conversely, it would have made no sense for Mr. Lay to have paid \$519,530.50 to

¹⁰ (...continued)

Enron’s stock price had fallen from a \$33.84 close on October 16. *See* Compl., Exhibit C to Lead Plaintiffs’ Appendix of Exhibits in Support of Consolidated Complaint; Lay App., tab 2. It would be foolish for plaintiffs to contend that this sale was designed to capitalize on inside information about the October 16 announcement.

exercise the options and to have incurred a tax liability (on the difference between the exercise price and the market price at the time of exercise at the ordinary income rate) to hold these shares, rather than sell them immediately, if he had thought that Enron was a house of cards about to collapse.

Because it is so devastating to Hakala's analysis and to plaintiffs' scienter argument if this were an exercise to hold, plaintiffs wilfully and falsely insist that it was an exercise to sell in the face of incontrovertible evidence in the SEC filings to the contrary. Indeed, plaintiffs are shameless enough to criticize Mr. Lay for not including this exercise to *buy and hold* shares in the charts on pages 11 and 12 of his Motion to Dismiss, which are clearly labeled "Employee Stock Option Exercises by Ken Lay to *Sell* Enron Shares." (Emphasis added.) In typical broad brush fashion, plaintiffs then attempt to dismiss these charts as inaccurate for the sole reason that this exercise on August 20, 2001, is not included. Response, p. 124. Despite access to the precise data used to calculate the information in these charts in Mr. Lay's SEC filings, plaintiffs do not -- and cannot -- challenge a single calculation. The charts on pages 11 and 12 of the Motion to Dismiss correctly show the intrinsic value and ratio of intrinsic value to exercise price for every exercise by Ken Lay to sell shares during the class period. The hollowness in plaintiffs' dismissive approach to these charts is transparent.

Even more absurd is plaintiffs' attempt to use the August 20, 2001, exercise to challenge Mr. Lay's credibility when in fact their characterization of this exercise only further damages what little credibility plaintiffs may have left. The Form 4 filed by Mr. Lay for August 2001 reflects that he acquired 25,000 shares of Enron common stock on August 20, 2001, for the Lay family partnership, paying \$519,530.50 to exercise the options. See August 2001 Form 4, Lay App., tab 1. The same filing shows that at the end of August, the family partnership beneficially owned 100,000 shares of Enron common stock. The next filing made by Mr. Lay was a Form 5 "Annual Statement of

Changes in Beneficial Ownership” that reported that the family partnership still owned 100,000 shares of Enron common stock at the end of 2001. *See* 2001 Form 5, Lay App. tab 1. Thus, these SEC filings conclusively show that Mr. Lay still held those shares through the end of the year, when they were essentially worthless.

Plaintiffs cannot, and do not, address these irrefutable facts. Instead, they attempt to confuse the Court by pointing to sales of other shares by Mr. Lay *for his personal account* at the end of August and early September, 2001. Response, p. 123. The Form 4 filing for August 2001 reflects that -- in addition to the acquisition of 25,000 shares for the family partnership -- Lay exercised stock options on August 21, 2001, at a cost of \$1,479,618.75 to acquire an additional 68,620 shares for his personal account. *See* August 2001 Form 4, Lay App., tab 1. At the end of the year he directly owned for his personal account 1,082,223.19 shares of Enron common stock, all of which were essentially worthless. *See* 2001 Form 5, Lay App., tab 1. If Lay had not made the August 21, 2001, acquisition of an additional 68,620 shares, he would have owned 68,620 fewer worthless shares at the end of 2001, and would have owned 1,479,618 more dollars. Thus, this acquisition is inconsistent with Hakala’s theory that Lay exercised the options with the expectation that the price of Enron stock would drop. Rather, it is consistent with rational economic behavior only if Lay believed that Enron stock price would increase in the future.

All told, in June, July, and August 2001, Ken Lay paid \$4,635,873.75 and incurred tax liabilities to exercise options to acquire and hold 218,620 shares of Enron stock. *See* Motion to Dismiss, p. 24; 2001 Forms 4, Lay App., tab 1. These exercises *added* to Mr. Lay’s inventory of shares at a time when plaintiffs contend that he was desperately unloading his position at fire sale prices. As a result of adding these shares to his inventory, he owned a total of 1.2 million worthless shares (not including options) when Enron went into bankruptcy. *See* 2001 Form 5, Lay App., tab

1. This Court recently noted as significant evidence rebutting an inference of scienter in *Kurtzman v. Compaq Computers Corp.*, No. H-00-779, slip op. at p. 50 (S.D. Tex. April 1, 2002), that an insider had exercised to hold 4,000 shares of Compaq stock during the class period. Ken Lay, by contrast, exercised to hold 218,620 shares of Enron stock during the class period, over 54 times the number of shares this Court found to be significant in *Compaq*.

Consistent with plaintiffs' Alice in Wonderland approach to this case, when Mr. Lay exercises options to hold shares, plaintiffs see exercises to sell shares, and when Mr. Lay engages in behavior that clearly evidences an expectation that the price of Enron stock will increase, plaintiffs see evidence that Mr. Lay believed that the price of Enron stock would decrease. Fortunately, this Court is not required to view facts through a looking glass but, as *Nathenson* dictates, through the perspective of reason and experience. *Nathenson*, 267 F.3d at 412.

b. Plaintiffs Simply Ignore or Brush Off Compelling Facts About Ken Lay's Transactions in Enron Stock and Employee Options That Rebut Any Inference of Scienter.

Much of plaintiffs' response is remarkable for what it fails to address. Mr. Lay showed that he was required to exercise options on 1,079,601 Enron shares, or 10.33 percent of his holdings during the class period, because the options were scheduled to expire during the class period. Motion to Dismiss, p. 19 and Exhibit 1. Plaintiffs fail to address these sales and the authorities cited by Mr. Lay establishing that such sales cannot raise an inference of scienter. *See, e.g., Greebel*, 194 F.3d at 206-07; *Gaylinn v. 3Com Corp.*, No. C-99-2185, 2000 WL 33598337, at *12 (N.D. Cal. June 9, 2000). Plaintiffs also ignore pleadings they filed with this Court noting that Ken Lay had a liquidity problem, and fail to address the relationship of this problem to his sales in the fall of 2001. Motion to Dismiss, p. 27. In addition, plaintiffs try, ineffectively, to sweep aside the reasonable inference from Ken Lay's decision to step down as CEO of Enron in December 2000 that he was

taking steps toward retirement, and would therefore have added reason to sell shares. Motion to Dismiss, p. 28. Plaintiffs meekly argue that Ken Lay did not formally announce his retirement. Response, pp. 126-127. Plaintiffs also note that Mr. Lay increased his sales of Enron stock after he stepped back into the position of CEO in August of 2001, but ignore that the stock price had fallen dramatically and that these sales logically coincided with the liquidity problem that they brought to the attention of the Court.

In his Motion to Dismiss, Mr. Lay demonstrated that 657,109 Enron shares, or 6.22 percent of his holdings during the class period, were sold pursuant to 10b5-1 selling plans. Motion to Dismiss, pp. 16-18. The selling plans were put into effect on November 1, 2000, within eight days after Rule 10b5-1 became effective. Motion to Dismiss, p. 17. Plaintiffs have failed to plead particular facts in the Consolidated Complaint demonstrating that the selling plans were adopted in bad faith. They nevertheless contend in their response that Ken Lay devised the selling plans because he knew that Enron's financial condition was deteriorating throughout 1999, and he wanted to insulate the sales from liability. Response, pp. 124-25.

Notably, these allegations are not contained in the Consolidated Complaint, which makes the conclusory allegation that the plans were adopted when the individuals "were already in the midst of pursuing the fraudulent scheme and course of business that operated as a fraud or deceit on purchasers of Enron securities." Compl. ¶ 405. As Mr. Lay explained in his Motion to Dismiss, such conclusory allegations must be ignored by the Court. *Tuchman v. DSC Communications Corp.*, 14 F.3d 1061, 1067-68 (5th Cir.), *reh'g denied*, 20 F.3d 1172 (5th Cir. 1994); *In re Azurix Corp. Sec. Litig.*, 198 F. Supp. 2d 862, 877 (S.D. Tex. 2002). These additional allegations may not be considered by the Court because they are not included in the Consolidated Complaint. *Thornton v. Micrografx, Inc.*, 878 F. Supp. 931, 933 (N.D. Tex. 1995). If they were to be considered, however,

they would add nothing to plaintiffs' essentially circular argument that the 10b5-1 sales must have been part of a fraudulent scheme because they were made when Mr. Lay was allegedly engaged in a fraudulent scheme.

Moreover, if the 10b5-1 sales plans were devised as an exit strategy by Ken Lay to cash in his Enron shares and options before the alleged "house of cards" collapsed, they were poorly designed indeed. As the chart on page 19 of the Motion to Dismiss reflects, he sold less than one percent of his total holdings during the class period each month from November 2000 through July 2001 pursuant to the 10b5-1 selling plans. As noted above, the 2001 Enron Proxy Statement reflects that Ken Lay owned 7,220,928 Enron shares and vested options as of February 15, 2001. The same Proxy Statement reflects that he owned 1,451,763 options that were not exercisable but that would vest within three years or less. *See* 2001 Proxy Statement pp. 16-17, 24. Adding back the shares sold pursuant to the selling plans before February 15, 2001, Lay had 8,952,799 Enron shares and vested and unvested options that he was supposedly seeking to cash in beginning November 1, 2000, before the "house of cards" collapsed. *See* Forms 4, Lay App., tab 1, and Exhibit E to Hakala Decl.

At the average rate of 73,000 shares per month that he exercised options and sold shares pursuant to the selling plans, it would have taken Ken Lay over 122 months or more than *ten years and two months* to completely liquidate his holdings through this alleged device to cash in his shares and options and insulate himself from liability. *See* Forms 4, Lay App., tab 1, and Exhibit E to Hakala Decl. If, as plaintiffs allege, Ken Lay knew that Enron was a house on fire, he was creeping very slowly for the exit. Moreover, if Ken Lay had designed the selling plans to cash in his position, it would have made absolutely no sense for him to terminate them at the end of July 2001. The termination of his 10b5-1 selling plans was consistent, rather, with a belief that the price of Enron stock was then undervalued at \$45 per share.

c. Plaintiffs Argue Improperly For a Theory of Collective Scienter, And Ask the Court to Analyze Defendants' Stock Sales as a Group, Rather Than Ken Lay's Stock Sales Individually.

In arguing for acceptance of a theory of collective scienter, plaintiffs use a hackneyed rhetorical device. They set up a straw man by arguing that Ken Lay has confused “group pleading” with pleading scienter, and then argue that the group pleading presumption does not apply to an analysis of scienter. Plaintiffs even cite to a page in Mr. Lay’s Motion to Dismiss where this argument is supposedly made. See Response, p. 118, referring to the Motion to Dismiss at p. 28. But once again plaintiffs have simply fabricated the facts to suit their purposes. Lay does not make this argument. Instead, he cites to two cases that have rejected plaintiffs’ attempt to plead a collective state of mind among defendants. *Schiller*, 2002 WL 318441, at *10 n.10; *Coates v. Heartland Wireless Communications, Inc.*, 26 F. Supp. 2d 910, 916-17 (N.D. Tex. 1998). This Court has expressly approved of *Coates* and other authorities that have rejected a collective scienter approach. See *U.S. Liquids*, 2001 U.S. Dist. LEXIS 23518, at *99-*101 (agreeing with, among other cases, *Coates*, 26 F. Supp. 2d at 916, cited for the proposition that “PSLRA requires plaintiffs to set forth facts raising a strong inference that each defendant acted with the required state of mind”; and with *Marra v. Tel-Save Holdings, Inc.*, No. 98-3145, 1999 WL 317103, at *5 (E.D. Pa. May 18, 1999) (cited for the same proposition)). This Court has also disapproved of contrary authority relied upon by plaintiffs. See *U.S. Liquids*, 2001 U.S. Dist. LEXIS 23518, at *100-*01 (disagreeing with, among other cases, *In re Oxford Health Plans, Inc.*, 187 F.R.D. 133, 142 (S.D.N.Y. 1999)).

The Fifth Circuit in *Nathenson*, 267 F.2d at 467, emphasized the plain language of the PSLRA, which requires that the plaintiff “state with particularity facts giving rise to a strong inference that *the defendant* acted with the required state of mind.” 15 U.S.C. § 78u-4(b)(2) (emphasis added). Throughout *Nathenson*, the court repeatedly quoted with approval the First

Circuit's opinion in *Greebel v. FTP Software, Inc.*, 194 F.3d 185 (1st Cir. 1999), including the propositions that "whatever the characteristic pattern of the facts alleged, those facts must now present a *strong* inference of scienter," and that "mere pleading of insider trading, without regard to either context or the strength of the inference to be drawn, is not enough." *Nathenson*, 267 F.3d at 411-12 (quoting *Greebel*, 194 F.3d at 196, 198) (emphasis in original). The Fifth Circuit itself recognized that the "probative force of facts alleged ultimately depends on reason and experience." *Nathenson*, 267 F.3d at 412.

Thus, in determining whether other defendants' sales should be taken into account in analyzing whether Lay's stock sales raise an inference of scienter, the Court must first ask whether there is any logical connection between Lay's sales and the other defendants' sales. Plaintiffs have not pleaded that Ken Lay's sales were conducted in coordination with any other defendant's sales. Nor have they pleaded facts -- such as identically timed selling -- that might evidence that their sales were coordinated in some fashion. More fundamentally, it is illogical to presuppose that Ken Lay engaged in a scheme to inflate the price of Enron stock so that other defendants could sell their shares at or near the trading high while Ken Lay sold his shares at prices averaging approximately one-half of the trading high.

In their response, plaintiffs nevertheless claim that *Nathenson* holds that "when evaluating scienter, courts are required to consider the sales of all defendants and not view an individual's sales in isolation." Response, p. 105. *Nathenson* does not remotely make any such holding. The court, rather, observes that "[t]he fact that other defendants did *not* sell their shares during the relevant class period *undermines* plaintiffs' claim." *Nathenson*, 267 F.3d at 421 (citing *Acito v. IMCERA Group, Inc.*, 47 F.3d 47, 54 (5th Cir. 1995) (emphasis added)). It is instructive as to plaintiffs' misuse of authority throughout their response that they turn this statement inside out and interpret

it as a mandate for a collective determination of scienter. Consistent with *Nathenson's* analysis, it is perfectly logical for a court to infer that when other insiders, who were purportedly necessary participants in an alleged scheme to defraud investors and to inflate the company's stock, did not sell shares, there was no such scheme. This does not mean that when the officers of a company receive a substantial portion of their compensation in the form of stock options, and different officers exercise options and sell different amounts of shares according to different patterns at different times, the court must aggregate all of the sales and draw an inference of scienter from the collective pattern. Under *Nathenson*, the court is to determine whether scienter has been pleaded based upon the particular facts pleaded in each particular case as to each defendant. Where, as here, plaintiffs have not pleaded facts demonstrating that the sales of any other defendants were related to sales by Mr. Lay, and in fact it would have been illogical for Mr. Lay to have coordinated his stock selling to allow other officers to profit by selling at or near the high while he sold at half the price, it makes no sense to consider other sales by defendants in relation to Mr. Lay's sales.

Plaintiffs also cite *Abrams*, but this case does not help them either. The issue in *Abrams* was not whether a court should aggregate sales of all defendants in determining whether any one defendant had the requisite scienter. The issue instead was whether the district court could compartmentalize the facts and circumstances relating to different theories of scienter raised by the plaintiffs, or whether it had to consider together all of the relevant facts and circumstances relating to all of the theories in analyzing scienter as to each defendant. *Abrams*, 2002 WL 1018944, at *4. Nothing in *Abrams* suggests that a court is required to consider facts and circumstances *irrelevant* to an allegation of scienter against one defendant, even though the same facts and circumstances might logically apply to another defendant. Thus, plaintiffs cannot artificially fill the gaping hole in their analysis of Ken Lay's pattern of trading, which demonstrates that his sales *decelerated* when

Enron's price increased and *accelerated* when Enron's price decreased, by simply plugging in unrelated sales by other defendants.

d. Plaintiffs Seek To Substitute the Unsubstantiated Opinions of a Paid Expert for the Actual Facts Concerning Key Lay's Transactions.

Plaintiffs also continue to insist that the declaration of their paid expert, Scott Hakala, salvages their failure to identify particular facts from which the Court may draw a strong inference of scienter. Mr. Lay has already addressed at length Hakala's Declaration in his Motion to Dismiss (see pages 5-15) and in his motion to strike Hakala's Declaration and his reply brief in support of that motion.¹¹ Simply put, plaintiffs have repeatedly misrepresented to the Court what Hakala has concluded; what he has done; what the articles cited by him say; and what information he has provided in his declaration. They also ask this Court to accept the absurd proposition that Hakala has been able to scientifically determine that Mr. Lay engaged in insider trading, despite Hakala's failure to follow elementary scientific procedures, which would require that he first determine and analyze all the different potential reasons for Mr. Lay's sales of Enron stock and then test and analyze those reasons to determine whether they are valid.

None of the tests, calculations, or statistical studies are included in Hakala's Declaration. Instead, he provides a vague and confusing description of his methodologies and then leaps to his ultimate conclusions. Plaintiffs omit the critical contents of his alleged analysis from the declaration for very good reason: whenever plaintiffs have provided formulas or calculations that can be tested, Lay has been able to establish that their calculations are wrong and that their formulas negate any inference of scienter when applied to Lay's actual exercises of Enron options and sales of stock. See

¹¹ See Defendant Kenneth L. Lay's Motion to Strike Declaration of Scott D. Hakala and Supporting Brief (Docket #730) and Reply Brief in Support of Defendant Kenneth L. Lay's Motion to Strike the Declaration of Scott D. Hakala (Docket #825).

Motion to Dismiss, pp. 9-15; pp. 10-19, *supra*. Thus, aside from the bizarre notion that Hakala could have conducted any statistical analysis to “scientifically” prove insider trading at this stage of the proceeding, when he does not know the reasons for each defendant’s sales of Enron stock, the declaration fails to provide sufficient information for Mr. Lay to identify, replicate, and understand his methodologies and tests. Hakala ultimately asks this Court to accept on faith, as an *ipse dixit*, that his opinions are supported by proper methodologies properly applied to the facts of this case.

Plaintiffs also repeat the blatantly inaccurate assertion that the journal articles cited by Hakala describe the methodologies that he used. Response, p. 112. None of the articles includes any methodology designed to determine whether an insider has engaged in improper insider trading. Nor do any of the articles cited by him suggest in any way that three years is a proper time frame for analyzing insider trading, as plaintiffs now argue. *Id.* at 113.

At bottom, even plaintiffs concede that the Court should only consider particular *facts* asserted in Hakala’s Declaration. *Id.* at 112. The only facts referred to by Hakala in his declaration concerning Lay are in his summary of Lay’s exercises of stock options and sales of Enron stock purportedly extracted from his Form 4 and Form 5 filings. All else is opinion -- and sheer speculation at that. Under *Nathenson*, the Court can draw its own conclusions about whether the particular facts concerning Ken Lay’s option exercises and stock sales raise a strong inference of scienter. No amount of unsubstantiated theorizing by a paid expert should change the Court’s own common sense approach to analyzing those facts.

e. Plaintiffs Try to Inject New, Irrelevant Allegations to Divert Attention Away from the Facts Concerning Ken Lay’s Exercises of Options and Sales of Enron Stock.

Since the facts about Ken Lay’s option exercises and stock sales do not raise a strong inference of scienter, plaintiffs attempt to inject new allegations, not pleaded in the Consolidated

Complaint, about Ken Lay's borrowing from Enron in 2001. Response, p. 125. To begin with, if plaintiffs wish to add new allegations, they must first seek leave to amend. They are not entitled to add new allegations in a response brief in an attempt to defeat a motion to dismiss. *In re Securities Litigation BMC Software, Inc.*, 183 F. Supp. 2d 860, 915 (S.D. Tex. 2001).

Plaintiffs acknowledge that Ken Lay disclosed the information about his sales of stock to Enron to repay loans from the company in a Form 5 filing on February 14, 2002, nearly three months before plaintiffs filed their Consolidated Complaint. Plaintiffs nevertheless misrepresent to this Court that their calculation of total shares sold by Lay "substantially understate[s] Lay's sales during the Class Period because the proceeds from an additional \$80+ million in sales back to Enron which have not been included in this total as they were only recently reported." Response, p. 123. Exhibit C attached to the Lead Plaintiff's Appendix of Exhibits in Support of Consolidated Complaint, however, includes these very sales in plaintiffs' calculation of 4,002,259 shares sold by Lay during the class period. Indeed, in this exhibit plaintiffs took care to place an asterisk next to each sale of shares by Ken Lay to Enron, and expressly noted in the exhibit that they were "Stock Sales to Enron." All of Lay's charts and analyses also include these sales. *See, e.g.*, Motion to Dismiss, p. 16, n. 8 and Exhibit 1 (expressly identifying loan repayments in 2001 which generated gross proceeds of \$70,105,844). It is a measure of plaintiffs' desperation that they would seek to inject new pleadings at this stage about sales by Ken Lay that were disclosed months before plaintiffs filed their Consolidated Complaint and that were fully taken into account by plaintiffs and by Ken Lay in their analyses of stock sales.

In his Motion to Dismiss, Mr. Lay explained that he was required to file with the SEC a Form 5 describing these loan repayment transactions within 45 days after the end of the fiscal year in which they were done. *See id.*; S.E.C. 16a-3(f); 17 C.F.R. § 240.16a-3(f). Thus, what plaintiffs

characteristically describe as “hidden” sales were merely sales that were reported timely by Mr. Lay in compliance with SEC rules.

Even if the Court were to consider plaintiffs’ new allegations concerning the manner in which Mr. Lay drew on his revolving credit line with Enron, those allegations do not raise any inference of scienter. Plaintiffs fail to plead any facts demonstrating that Lay used the proceeds of these loans for any improper purpose.

3. Conclusion.

The facts and circumstances surrounding Ken Lay’s exercises of Enron stock options and sales of Enron shares, taken as a whole or separately, do not raise a strong inference that Ken Lay knew, or was severely reckless in not knowing, that the stock price was artificially inflated or that Enron was a “house of cards” about to collapse.

C. Plaintiffs’ Remaining Scienter Allegations Fail to Create a Strong Inference of Scienter.

Plaintiffs’ remaining allegations of scienter may be easily disposed of because they are insufficient to raise a strong inference of scienter.

1. Pleading Mr. Lay’s Position as CEO is Insufficient To Raise a Strong Inference of Scienter.

An officer’s position with a company does not suffice to create an inference of scienter. *Nathenson*, 267 F.3d at 424 (applying the PSLRA standard); *Melder v. Morris*, 27 F.3d 1097, 1103 (5th Cir. 1994) (applying Rule 9(b)). Plaintiffs try to distort this firmly established Fifth Circuit precedent and argue that knowledge of facts relating to Enron’s business (including the alleged “true state of affairs” pleaded by plaintiffs) should be imputed to Lay because he was a member of senior management. *See* Response, pp. 98-99. In support of this contention, plaintiffs cite *Epstein v. Itron*,

Inc., 993 F. Supp. 1314, 1326 (E.D. Wash. 1998). This Court, however, has addressed precisely this issue and refused to adopt the *Epstein* presumption.

Indeed, the purpose of the PSLRA's particularized pleading requirements leads this Court to find that such an imputation, without some additional facts such as exposure to content-identified internal corporate documents (and who drafted them, who received them, or how plaintiffs learned of them) or some conversations or attendance at specified management or board meetings dealing with such problems, is inadequate to plead scienter.

U.S. Liquids, 2001 U.S. Dist. LEXIS 23518, at *97-*98 (citing *In re Splash Tech. Holdings, Inc.*, No. C 99-00109 SBA, 2000 WL 1727377, at *21 (N.D. Cal. Sept. 29, 2000)).¹²

Similarly, in *Abrams*, the Fifth Circuit refused to infer that senior executives knew that alleged statements regarding internal accounting and financial controls were false. *Abrams*, 2002 WL 1018944, at *5. The court explained that “[a] pleading of scienter may not rest on the inference that defendants must have been aware of the misstatement based on their positions within the company.” *Id.* The court noted that the plaintiffs failed to support an inference of knowledge by identifying particular reports or other information available to the defendants, before the financial restatements, that were contrary to the restatements. *Id.* at *6-*7 (affirming district court’s dismissal of plaintiff’s complaint).

In support of their argument that the Court should impute knowledge of alleged improprieties to Lay, the plaintiffs merely restate their laundry list of alleged “undisclosed factors affecting Enron’s contracts and core businesses.” *See Response*, pp. 100-01. Conspicuously absent, however,

¹² In *U.S. Liquids*, the Court cited *In re Read-Rite Sec. Litig.*, No. C 98-20434 JF, 2000 WL 1641275, at *6 n. 2 (N.D. Cal. Oct. 13, 2000), explaining that: “The *Read-Rite* court noted, ‘Generally all of the cases cited by Plaintiffs in which scienter was found to be adequately pleaded via the Epstein presumption either are pre-Reform Act or out-of-circuit decisions.’” *U.S. Liquids*, 2001 U.S. Dist. LEXIS 23518, at *98 n. 22.

is any reference to the kind of contemporaneous documentation detailing these “undisclosed factors” required in *ABC Arbitrage*, *Abrams*, and *U.S. Liquids*.

Plaintiffs also cite *Nathenson* for the proposition that they have adequately pleaded scienter against Mr. Lay under the *Epstein* presumption. Response, p. 98. The facts of *Nathenson*, however, are easily distinguished from this case. Acknowledging that the question of whether the plaintiffs had adequately pleaded scienter against the CEO was “a close one,” the Fifth Circuit explained that a number of special circumstances tipped the scales, “if perhaps only barely so,” towards a finding that the facts pleaded raised an inference of scienter. *Nathenson*, 267 F.3d at 424-25. In *Nathenson*, the CEO allegedly misrepresented that the company had acquired a patent covering a drug that was its leading product. *Id.* The court’s conclusion rested largely on the CEO’s statements in press releases about the patent and in a later magazine article conceding that there was no patent covering the drug. *Id.* at 425; *see also Zishka v. American Pad & Paper Co.*, No. Civ. A-398CV0660M, 2001 WL 1645500, at *4-*5 (N.D. Tex. Dec. 20, 2001).

Plaintiffs make no such allegation about Ken Lay. Moreover, in stark contrast to Enron’s multi-faceted international business, operating on five continents with over 20,000 employees, the company in *Nathenson* was small, with only one product and 35 full-time employees. *Nathenson*, 267 F.3d at 425; *see Master SEC App.*, tab 15, Enron 10-K (year ending Dec. 31, 2000) at 1, 5, 12. The Fifth Circuit further noted that the CEO in *Nathenson* had an extensive background in engineering, including a master’s degree in chemical engineering. *Nathenson*, 267 F.3d at 424 n.26. Plaintiffs do not plead that Ken Lay has an advanced degree in accounting or any other accounting experience that would equip him to discover the technical and complex accounting errors pleaded in the Consolidated Complaint.

Nathenson cannot be read to support a presumption that high-level officers know facts or events critical to a company's business. In *Zishka v. American Pad & Paper Co.*, 2001 WL 1645500, at *4-*5, the court rejected this very argument, stating "[n]owhere does the *Nathenson* court advocate a presumption-of-knowledge doctrine for corporate officers. Instead, the court posits that, 'normally[,] an officer's position with a company does not suffice to create an inference of scienter.'" *Id.* at *4 (granting reconsideration of CEO's motion to dismiss in light of *Nathenson* and dismissing CEO as a defendant in the case).

The plaintiffs also deceptively quote this Court's opinion in *Kurtzman*, in apparent support of their presumption-of-knowledge argument. Response, pp. 98-99. The statement quoted by the plaintiffs, however, appears in the portion of the *Kurtzman* opinion setting forth the plaintiff's allegations, not the Court's holding. *Kurtzman*, slip op. at 38. In fact, the Court *refused* to adopt the presumption, stating: "Plaintiff's additionally weak factual allegations, including knowledge based on the officers' positions in the company, [and] the assertions that as officers they must have had knowledge [of] core business activities . . . under the circumstances of this action are not sufficiently persuasive, individually nor in concert, to give rise to a *strong* inference of scienter." *Id.* at 47 (emphasis in original). The Court explained that the plaintiffs had failed to present any information providing a link between the alleged fraudulent activity and the CEO. *Id.* at 45-46.

The overwhelming weight of authority, therefore, argues against adoption of the *Epstein* presumption advanced by the plaintiffs.

2. Lay's Observations About Enron's Business and Prospects Do Not Support An Inference of Scienter.

Plaintiffs claim that Lay's alleged statements pleaded in the Consolidated Complaint about Enron's business and prospects support a strong inference of scienter. Response, p. 98. Plaintiffs,

however, fail to support their allegation that Lay knew that these statements were false when made with the type of documentary evidence or specific detail regarding reliable sources required by *ABC Arbitrage*, 2002 WL 975299, at *11-*12.

For example, plaintiffs allege that Lay made a misrepresentation in connection with Jeff Skilling's resignation when he stated, "there is absolutely no problems that had to do with Jeff's departure . . . no accounting issues." Compl. ¶ 344. Recently, the Fifth Circuit held that a virtually identical statement made by a CEO -- who stated upon the resignation of the company's CFO that there were "no accounting issues" -- failed to support a pleading of scienter. *See Abrams*, 2002 WL 1018944, at *7.

[N]othing in the complaint points to any information that would indicate that either the resigning officials, their replacements or other defendants knew of any accounting irregularities or that such irregularities were the reason for their resignations. According to the complaint, [the company] reported that these officials resigned to "pursue other interests." [A news organization] reported that the CFO resigned because of cost overruns and operational glitches associated with the implementation of SAP. Neither reason has any scienter implications.

Id. at *7¹³ (affirming district court's dismissal of complaint because plaintiffs failed to raise a strong inference of scienter). Like the *Abrams* plaintiffs, plaintiffs here have pleaded no particular, credible information indicating that Lay was aware of accounting irregularities at the time of Skilling's resignation. As a result, plaintiffs have failed to plead a strong inference of scienter based on Lay's statement.

¹³ Plaintiffs also allege that statements regarding Skilling's departure were false because Skilling did not resign for "personal reasons" but rather because he knew that the "scheme to defraud" was falling apart. Compl. ¶ 359. The Fifth Circuit confirmed in *Abrams*, however, that such generalized allegations have no scienter implications. *Abrams*, 2002 WL 1018944, at *7 (allegation that company's announcement that a key accounting officer resigned "to pursue other interests" conflicted with other reports that the officer left because of financial and operational problems failed to raise any inference of scienter).

3. Plaintiffs' Allegation that Lay Approved of the Formation of the LJM Partnerships Is Insufficient to Support Their Claim of Securities Fraud.

Plaintiffs allege that Lay approved the formation of LJM2 and waived Enron's conflict of interest policy for Fastow in connection with LJM2. Response, p. 36. Plaintiffs plead, further, that Lay authorized the Rhythms transaction in connection with the formation of LJM1. *Id.*

Plaintiffs do not, however, allege that Lay was responsible for supervising the Rhythms transaction or Enron's transactions with LJM2. To the contrary, plaintiffs plead that another member of Enron's senior management was responsible for supervising the LJM relationship. *See* Response, p. 64.¹⁴

Plaintiffs introduce allegations regarding Lay's approval of LJM2's formation in their response brief by citing to the Powers Report, not their Consolidated Complaint. *See* Response, p. 36 (citing the Powers Report for the propositions that Lay approved the creation of the LJM2 Partnerships and a waiver of Enron's conflict of interest policy). When considering a Rule 12(b)(6) motion to dismiss, however, the court must exclude from consideration matters presented outside the pleadings. *Thornton*, 878 F. Supp. at 933. The plaintiffs may not amend their complaint through their brief in opposition to a motion to dismiss. *See BMC Software*, 183 F. Supp. 2d at 915. The Court, therefore, should ignore the new information presented by the plaintiffs in their response, including references to the Powers Report.

¹⁴ This situation, therefore, is significantly different than the situation presented in *In re Landry's Seafood Restaurants, Inc. Securities Litigation*, No. H-99-1948, slip op. (S.D. Tex. Feb. 20, 2001), a case that plaintiffs rely on heavily throughout their response. The defendants in *Landry's* expressly admitted in their SEC filings that they "monitored the business continuously and closely on a daily basis from internal spreadsheets and reports from each Landry Restaurant." *Landry's*, slip op. at 64. Plaintiffs point to no such admission by Lay in this case and, as a result, their reliance on *Landry's* is misplaced.

If, however, the Court considers the information from the Powers Report introduced in Response, the Court should also consider other facts contained in the Report relevant to plaintiffs' claims.¹⁵ For example, the Special Investigation Committee (the "Committee") explained that according to the proposal regarding LJM2 presented to the Board, the principal stated advantage of Fastow's involvement with LJM2 was that LJM2 could purchase assets that Enron wanted to sell more quickly and with lower transaction costs. *See Powers Report*, p. 151. The Committee confirmed that "[t]his was a legitimate potential advantage of LJM2, and it was proper for the Board to consider it." *Id.* Moreover, the Powers Report confirms that the Enron Board understood that Lay was *not* responsible for supervising the LJM Partnership. *See id.*, p. 20; *see also id.* at 169 ("It does not appear that Lay had, or was intended to have, any managerial role in connection with LJM once the entities became operational. His involvement was principally on the same basis as other Directors."); *id.* at 170 ("Likewise, the Enron employees we interviewed did not recall discussing LJM matters with Lay after the entities were created other than at Board and Board Committee meetings, except in two instances after he resumed the position of CEO in August and September 2001 (the Watkins letter . . . and the termination of the Raptors)").

Moreover, although Lay and the rest of Enron's Board approved the original Rhythms transaction executed between LJM1 and Enron (and in the process obtained a fairness opinion from PricewaterhouseCoopers (*see Powers Report* at p. 81)), the Committee found no evidence that

¹⁵ If a plaintiff quotes from a document in his complaint, the defendants are permitted to refer the Court to other information in the document. *See Landry's*, slip op. at 4 ("The Court may also consider the full text of documents that are partially quoted to or referred to in the complaint."); *In re Hunter Environmental Services, Inc. Sec. Litig.*, 921 F. Supp. 914, 917-18 (D. Conn. 1996) ("If a plaintiff has selectively introduced material in the complaint but has omitted critical portions of the documents, the defendant is allowed to introduce the full text of the materials for the court's consideration."). The same standard should apply if the Court considers new information introduced for the first time in the plaintiffs' response.

changes to the initial structure of the transaction implemented thereafter were presented to Lay for approval. Powers Report, p. 82 n.29. The Committee also found no evidence that the Board, including Lay, was informed of the transaction unwinding the Rhythms hedge. *Id.* at 89.

Plaintiffs also cite the Powers Report in support of their claim that Lay (and Enron's Board) authorized three of the Raptor vehicles. Response, p. 36. Plaintiffs, however, fail to include the Committee's finding that Lay was not made aware of the Raptors' growing credit shortfall before he stepped down as CEO in the first quarter of 2001. Powers Report, pp. 121-22.

4. Enron's Alleged GAAP Violations and the "Magnitude" of the Restatement Do Not Support a Strong Inference of Scienter by Lay.

Ultimately, plaintiffs are left with only their generalized allegations that Enron's alleged GAAP violations and the "magnitude" of the restatement on November 8, 2001, support a strong inference of scienter. *See* Response, pp. 103-105. This Court, however, has previously dismissed similar claims of fraud by hindsight, because after-the-fact statements "may not be used to demonstrate Defendants' state of mind at the time they made their alleged misrepresentations or false statements." *Kurtzman*, slip op. at pp. 39-40 and n.9.¹⁶ As one district court succinctly explained:

Inferring scienter from the magnitude of fraud invites a court to speculate as to the existence of specific (but unpled and unidentified) warning signs that show the [defendant] acted with scienter. To travel from the magnitude of fraud to evidence of scienter, the court must blend hindsight, speculation and conjecture to forge a tenuous chain of inferences: (1) because the magnitude of the fraud was large, conspicuous warning signs must have existed; (2) these warning signs must have been available to the [defendant]; (3) these warning signs must have made the fraud obvious and conspicuous to the [defendant]; and therefore (4) the [defendant] must

¹⁶ In this vein, plaintiffs try to inject new allegations about an "additional \$14 billion dollar write down new management believes needs to be recorded." *See* Response, p. 104. While this allegation about what new management concluded long after the fact cannot support an inference of scienter under *Kurtzman*, it was not pleaded in the Consolidated Complaint and therefore may not be considered by the Court in ruling on the Motion to Dismiss. *See BMC Software*, 183 F. Supp. 2d at 915.

have known of the fraud. The factual assumptions incorporated into this inferential chain lack evidentiary support in many securities fraud cases, and obscure the potentially infinite number of innocuous reasons [a defendant] may fail to detect a fraud of large magnitude.

Reiger v. Price Waterhouse Coopers LLP, 117 F. Supp. 2d 1003, 1013 (S.D. Cal. 2000), *aff'd*, 288 F.3d 385 (9th Cir. 2002).

Plaintiffs ask this Court to construct precisely such a “tenuous chain of inferences” to reach a conclusion that plaintiffs have raised an inference of scienter. Such inferential leaps unsupported by factual allegation, however, are foreclosed by *Nathenson* and *ABC Arbitrage*. See *Nathenson*, 267 F.3d at 411 (the special pleading standard for scienter established by Congress “may only be met on the basis of ‘facts’ which are ‘state[d] with particularity’ in the pleading”); *ABC Arbitrage*, 2002 WL 975299, at *11 (“a plaintiff must ‘plead with particularity *sufficient* facts to support’ their allegations of false or misleading statements”) (emphasis in original); see also *In re Comshare, Inc. Sec. Litig.*, 183 F.3d 542, 553 (6th Cir. 1999) (“Although Plaintiffs speculate that it is unlikely that Defendants knew of the GAAP violations because they occurred over a long period of time, claims of securities fraud cannot rest on ‘speculation and conclusory allegations.’”) (internal citation omitted). Plaintiffs’ allegation that the “magnitude” of the restatements alone is sufficient to raise a strong inference of scienter, therefore, has no merit. See, e.g., *Branca*, 2000 WL 145083, at *10-*11 (alleged “magnitude” of GAAP errors failed to raise a strong inference that defendants knowingly or recklessly misled the investing public, even though the CEO was a CPA); *In re MCI WorldCom, Inc. Sec. Litig.*, 191 F. Supp. 2d 778, 791 (S.D. Miss. 2002) (declining to hold that the sheer size of the company’s write off by itself evidenced fraudulent intent). To hold otherwise would eviscerate the strict requirements for pleading scienter under the PSLRA and Rule 9(b) by

allowing a plaintiff to plead a strong inference of scienter through the simple expedient of alleging a fraud of sufficient “magnitude.”

The cases relied upon by the plaintiffs in support of inferring scienter based on the “magnitude” of the alleged fraud are easily distinguished. *Marksman Partners, L.P. v. Chantal Pharmaceutical Corp.*, 927 F. Supp. 1297 (C.D. Cal. 1996), for example, involved a CEO who was also the principal financial and accounting officer of the company, which marketed only one product. *Marksman*, 927 F. Supp. at 1301. The company in *Haack v. Max Internet Communications, Inc.*, No. CIV.A. 3:00-CV-1662-G, 2002 WL 511514, at *1 (N.D. Tex. Apr. 2, 2002), also manufactured and marketed only one product. Similarly, in *In re Triton Energy Ltd. Securities Litigation*, No. 5:98-CIV-256, 2001 WL 872019 (E.D. Tex. Mar. 30, 2001), the plaintiffs alleged that a few assets accounted for virtually all of Triton’s market value and that Triton failed to take a timely write down against its only revenue-producing asset. *Id.* at *10. Enron, in contrast, pursued multiple business lines, employed more than 20,000 employees, and maintained operations over five continents. Inferring scienter for Ken Lay under these circumstances would be unreasonable.

In *In re MicroStrategy, Inc. Securities Litigation*, 115 F. Supp. 2d 620 (E.D. Va. 2000), the court explained that the alleged accounting principle at issue was relatively simple and a violation of it would be obvious:

To be sure, the application of accounting principles often involves details and minutiae, but the accounting principle violated here boils down to the well-worn adage, “Don’t count your chickens before they hatch.” These common sense observations compel the conclusion that the alleged simplicity of the GAAP rules violated here are relevant and contribute probative weight to an inference of scienter.

Id. at 638. In sharp contrast, the Powers Report described the transactions between Enron and the investment partnerships giving rise to the Enron’s restatements as “extraordinarily complex.” See Powers Report, pp. 29, 35 n.6.

Plaintiffs also rely on *Gelfer v. Pegasystems, Inc.*, 96 F. Supp. 2d 10, 15-16 (D. Mass. 2000). There, however, the alleged improper accounting practices at issue had been brought to light in an earlier lawsuit against the defendants, who were therefore on notice about the improper accounting practices. *Gelfer*, 96 F. Supp. 2d at 15.

5. Plaintiffs' Claim that Scienter May Be Inferred from Temporal Proximity Has No Merit.

Plaintiffs next contend that a strong inference of scienter may be inferred from the temporal proximity between Enron's demise and allegedly inconsistent statements about Enron's financial health. Specifically, plaintiffs point to Ken Lay's statement on August 14, 2001, immediately after he had resumed duties as CEO, that there were no accounting problems or other unknown problems, and they then contend that scienter may be inferred due to the statement's alleged close proximity to the following: the October 16, 2001, write-down, the November 8, 2001, restatement, Enron's November 28, 2001, bankruptcy filing, and subsequent management's alleged admission that an additional write-down of assets will be required. Response, p. 103.

Significantly, plaintiffs do not cite a single case supporting their position. *Id.* In fact, it is well established that mere temporal proximity cannot satisfy plaintiffs' burden of pleading with particularity a strong inference of scienter. *See, e.g., In re HealthCare Compare Corp. Sec. Litig.*, 75 F.3d 276, 283 (7th Cir. 1996) ("The mere temporal proximity of the conflicting statements is not sufficient"); *BMC Software*, 183 F. Supp. 2d at 911 n. 49 (temporal proximity between alleged misstatements and disclosures, standing alone, is insufficient to allege scienter). Moreover, Lay's statement was made immediately after he resumed duties as CEO and more than two months before the October 16, 2001, write-down, and nearly three months before the November 8, 2001, restatement. Plaintiffs fail to cite the date for new management's alleged statement about a future

write-down, presumably due to its remoteness in time.¹⁷ Response, p. 103. Because this Court and many others have refused to infer scienter based on temporal proximity in situations involving two months or less between the alleged misstatement and the subsequent disclosure, the Court certainly should reject plaintiffs' misguided attempt to establish a strong inference of scienter against Lay based on a longer period of time. *See BMC Software*, 183 F. Supp. 2d at 911 n.49 (rejecting alleged temporal proximity of two weeks, and noting that Court rejected one month period in *Kurtzman*); *HealthCare Compare*, 75 F.3d at 282-83 (five weeks between comfort statement and subsequent disclosure insufficient); *Yourish v. California Amplifier*, 191 F.3d 983, 997 (9th Cir. 1999) (1 to 2 months did not satisfy Rule 9(b)); *In re Republic Servs., Inc. Sec. Litig.*, 134 F. Supp. 2d 1355, 1360-61 (S.D. Fla. 2001) (one month difference insufficient).

6. Ken Lay's Appropriate Handling of Ms. Watkins' Letter Does Not Raise Any Inference of Scienter.

According to plaintiffs' version of reality, Ken Lay instructed Vinson & Elkins to perform a "whitewash" investigation of the allegations of Sherron Watkins (an investigation which was not completed until October 15, 2001), but Mr. Lay then proceeded on October 16, 2001, and November 8, 2001, to disclose to the market a write-down and restatement addressing the issues raised by Ms. Watkins. Not surprisingly, the law does not support an inference of scienter against Ken Lay.

Plaintiffs therefore engage in their well worn (but legally insufficient) tactic of introducing a new legal theory in their response. Plaintiffs now claim that Ken Lay had a duty to disclose Ms. Watkins' allegations. Because this claim was never pleaded, plaintiffs' argument should be rejected. *See BMC Software*, 183 F. Supp. 2d at 915. Moreover, although plaintiffs allege that Mr. Lay

¹⁷ Plaintiffs' reliance on new management's subsequent statement also constitutes an impermissible attempt to plead fraud by hindsight. *See Kurtzman*, slip op. at 39-40.

received the Watkins letter at an unspecified time in “mid-8/01” (*see* Response, p. 7), the Powers Report confirms that Lay did not receive Watkins’ letter until after his August 14, 2001, statements that there were no accounting issues or other issues connected with Jeffrey Skilling’s departure. *See* Powers Report, p. 172 (noting that Watkins sent a letter to Lay “[s]hortly after Enron announced Skilling’s unexpected resignation on August 14, 2001”); *id.* at 174 (“On August 22, one week after [Watkins] sent her letter, she met with Lay”). Thus, even if the Court were to consider this unpleaded allegation, the relevant inquiry would be whether Lay had a duty to disclose Watkins’ allegations before the write-down and restatement. As a matter of law, Mr. Lay owed no such duties.

To trigger a duty to disclose, an allegation relating to adverse information must exceed a high threshold. *See HealthCare Compare*, 75 F.3d at 282 (holding that 6 week delay in correcting prior statement was not actionable because “plaintiffs can only show that a duty to correct arose by alleging facts sufficient to demonstrate that the internal memorandum was certain and reliable, not merely . . . tentative”); *Anderson v. Abbott Labs.*, 140 F. Supp. 2d 894, 900, 904 (N.D. Ill.) (no duty to disclose FDA warning letter identifying several continuing violations and threatening immediate enforcement action because letter “was not . . . a legal finding of past violations”), *aff’d*, 269 F.3d 806 (7th Cir. 2001). Although Mr. Lay treated Ms. Watkins’ letter as a serious issue that should be investigated, her letter nonetheless initially represented one employee’s characterization of Enron’s accounting practices. Indeed, if an FDA warning issued after several on-site inspections is not sufficient to trigger a duty to disclose, then one or two employees’ uncorroborated allegations surely are insufficient. *See Anderson*, 140 F. Supp. 2d at 900, 904; *see also Acito v. IMCERA Group, Inc.*, 47 F.3d 47, 50, 52-53 (2d Cir. 1995).

But even in a situation where an allegation potentially may give rise to a duty to disclose, the corporation still has a reasonable amount of time to investigate and confirm adverse information

before disclosing such information to the market. *See HealthCare Compare*, 75 F.3d at 282 (5 week delay not actionable); *In re Brightpoint, Inc. Sec. Litig.*, No. IP 99-0870-C-H/G, 2001 WL 395752, at *22 (S.D. Ind. Mar. 29, 2001) (corporations “are not expected to announce publicly each emerging revenue trend before they have a reasonable opportunity to investigate the scope of the problem and make a reasonably certain estimate of its bottom line impact”). Obviously, if Ken Lay was required to disclose immediately an employee allegation before conducting an investigation, he would run the substantial risk of prematurely disclosing adverse information to the market.¹⁸ Here, plaintiffs cannot credibly allege that the amount of time between Watkins’ letter and the subsequent write-down and restatement was an unreasonable amount of time. The Powers Committee indisputably had far more time than Lay to consider the issues raised by Watkins’ letter, but the Committee carefully noted that an “exhaustive investigation of these related-party transactions would require time and resources beyond those available to the Committee,” thus forcing the Committee to do “its best, given the available time and resources.” Powers Report, p. 1. Further, as plaintiffs allege, Vinson & Elkins did not complete its investigation until October 15, 2001 (Response, p. 47; Compl. ¶ 855). Even though Vinson & Elkins did not conclude that an accounting adjustment was needed, the write-down and restatement followed shortly thereafter. Compl. ¶ 855.

¹⁸ Plaintiffs also refer to a letter a former EES employee wrote to the Board of Directors and a separate internal complaint about “snowballing.” Response, pp. 101-02. Because plaintiffs have made only the general allegation that the letter about EES was sent to the Board of Directors and have not alleged specifically that Ken Lay received this letter, it is simply irrelevant to Mr. Lay’s state of mind. Moreover, the vague and amorphous nature of the allegations in this letter render it too uncertain and tenuous to require Mr. Lay to disclose it. *See HealthCare Compare*, 75 F.3d at 282. Further, the alleged complaint about snowballing involved a statement allegedly made to Defendant Causey (Comp. ¶ 581), and plaintiffs make no allegation that this complaint was ever communicated to Mr. Lay.

In sum, contrary to plaintiffs' new, unpleaded allegation in their Response, Ken Lay had no obligation as a matter of law to disclose Ms. Watkins' allegations before the write-down and the restatement, and Ms. Watkins' letter raises absolutely no inference that Mr. Lay acted with the requisite scienter.

7. The Fact That Lay Signed Some of Enron's Financial Statements Does Not Raise an Inference of Scienter.

Finally, it is well established that plaintiffs' allegation that Lay signed some of Enron's public filings does not establish scienter. *See Coates*, 26 F. Supp. 2d at 916 (asserting that defendants signed prospectuses containing alleged misrepresentations will not prevent dismissal of plaintiffs' complaint); *In re Sunterra Corp. Sec. Litig.*, 199 F. Supp. 2d 1308, 1330 (M.D. Fla. 2002) (defendants' signatures on Forms 10-K do not raise a strong inference of scienter); *Cheney v. Cyberguard Corp.*, No. 98-6879-CIV-GOLD, 2000 WL 1140306, at *9 (S.D. Fla July 31, 2000) (allegations that a director or officer signed public disclosures will not satisfy the pleading requirements of the PSLRA or Rule 9(b)).

III. Plaintiffs Do Not Adequately Plead Misrepresentations by Lay.

In his motion to dismiss, Ken Lay demonstrated that plaintiffs have not alleged properly that he made any actionable misrepresentations. Significantly, plaintiffs' response does not address several of Lay's arguments, including his arguments that (1) he cannot be held liable for alleged pre-class misrepresentations, Motion to Dismiss, p. 41; (2) several of his alleged misrepresentations constitute immaterial recitations of historical facts, *id.* at pp. 61-62; and (3) his alleged statement to employees was not a public statement, *id.* at p.63. By their silence, plaintiffs effectively have conceded the validity of Mr. Lay's arguments. Moreover, Plaintiffs' 10b-5 claim against Mr. Lay

must be dismissed for the additional reason that the alleged misrepresentations are not pleaded properly pursuant to Rule 9(b) and the PSLRA.

A. Plaintiffs' Improper Reliance on Group Pleading Should be Rejected.

After expressly invoking the group pleading doctrine in their complaint (Compl. ¶¶ 89-90), plaintiffs now meekly retreat to the position that their complaint does not “substantially rely” on group pleading. Response, p. 34. Significantly, plaintiffs make no attempt to defend their blanket attempt to hold Ken Lay liable for all of Enron’s press releases and for alleged misstatements by other persons. See Response, pp. 34-36. The Court therefore should dismiss paragraphs 10, 51, 55, 57, 60, 83(ff), 89, 90, 313-14, 324, 351, 360, 395, 397-400, 510, 522, 536, 587, 594, 601, and 985 of plaintiffs’ complaint because of plaintiffs’ impermissible attempt to hold Ken Lay liable on a group pleading theory.¹⁹ See, e.g., *BMC Software*, 183 F. Supp. 2d at 902-03 n. 45.

Despite their general retreat from group pleading, plaintiffs nonetheless defend their refusal to identify any specific alleged misrepresentations made by Lay during certain conference calls and meetings. Response, pp. 33-35. Plaintiffs concede that fifteen paragraphs in their complaint cite numerous alleged misrepresentations by so-called “small groups” of Enron insiders during conference calls and analyst meetings (Response, p. 33), but plaintiffs appear to contend that the prohibition against group pleading applies only to written statements. Response, p. 35. Plaintiffs also cite three district court cases for the proposition that their pleading technique is appropriate.

¹⁹ Similarly unavailing is plaintiffs’ argument that Mr. Lay should be held liable for alleged misrepresentations made by third-party analysts. Although plaintiffs contend that Mr. Lay may be held liable for allegedly using analysts “as conduits,” Response, p. 97, they ignore completely this Court’s holding in *BMC Software* “that there must be alleged facts showing some involvement and control over the content of the analysts’ reports by the defendants to hold them liable.” *BMC Software*, 183 F. Supp. 2d at 872 n. 21. Because plaintiffs’ complaint contains no allegations showing that Mr. Lay had such control, the Court should reject plaintiffs’ attempt to hold him liable for alleged misrepresentations by third-party analysts.

Plaintiffs are simply wrong to the extent they contend that they may rely upon group pleading for oral statements. As one of the cases cited by plaintiffs notes, “[t]he Reform Act has only strengthened the requirement that allegations of oral misrepresentations be attributed to specific individuals rather than lumping defendants together.” *Schlagal v. Learning Tree Int’l*, No. CV 98-6384 ABC, 1998 WL 1144581, at *5 (C. D. Cal. Dec. 23, 1998); *see also In re Gupta Corp. Sec. Litig.*, 900 F. Supp. 1217, 1239 (N. D. Cal. 1994) (noting that “it is not reasonable to presume that oral statements by individual defendants are the product of . . . collective efforts”) (quoting *In re Rasterops Corp. Sec. Litig.*, No. C-92-20349, 1994 WL 374332 (N.D. Cal. April 20, 1994)).

Further, the Court should not follow the district court cases relied upon by plaintiffs. The *Schlagal* case and the two other cases cited by plaintiffs held that it is sufficient for the plaintiffs to identify the time, location, and content of the alleged misstatements during conference calls, while not identifying the specific executives who made the statements. *Schlagal*, 1998 WL 1144581, at *5; *In re SmarTalk Teleservices, Inc. Sec. Litig.*, 124 F. Supp. 2d 527, 543 (S.D. Ohio 2000); *In re Silicon Graphics, Inc. Sec. Litig.*, 970 F. Supp. 746, 764 (N.D. Cal. 1997). The reasoning of these cases is suspect because all three cases make the same mistake of allocating to the defendant the burden of ascertaining exactly who made the alleged misstatement. *Schlagal*, 1998 WL 1144581, at *5 (citing *In re Silicon Graphics*); *In re SmarTalk*, 124 F. Supp. 2d at 543. In the Fifth Circuit, however, the plaintiff clearly has the burden of identifying the speaker for each allegedly misleading statement. *See ABC Arbitrage*, 2002 WL 975299, at *9. Plaintiffs’ cases effectively hold that the plaintiffs may allege only the “what, when, where, and how,” leaving it to the defendants to figure out the “who” element. Because the Fifth Circuit strictly interprets Rule 9(b) to apply “with force, [and] without apology,” *Williams v. WMX Technologies, Inc.*, 112 F.3d 175, 178 (5th Cir. 1997), *cert. denied*, 522 U.S. 966 (1997), the Court should dismiss plaintiffs’ generalized, undifferentiated

allegations that Lay and others made alleged misrepresentations during conference calls and meetings.²⁰ See Compl. ¶¶ 145, 224, 343, 353-354, 366, 377, and 388.

B. Plaintiffs' Response Confirms Their Failure to Plead with Particularity that Lay's Alleged Misrepresentations Were False When Made.

1. The Consolidated Complaint Is Structurally Deficient.

In defense of their failure to explain why each of Lay's alleged misrepresentations was false when made, plaintiffs chastise Lay for supposedly ignoring this Court's decision in *Landry's*. Response, p. 1. Plaintiffs then analogize their complaint to a puzzle that a child could assemble readily. *Id.* Neither contention withstands scrutiny.

Plaintiffs' reliance on *Landry's* is as perplexing as the complaint they have drafted. The defendants there apparently did not challenge plaintiffs' pleading style, and the Court thus did not consider the case authority relied upon by Mr. Lay.²¹ The issue simply was not before the Court. The Court's decision in *Landry's* therefore has no relevance to the issue before the Court in this case.

Unlike *Landry's*, several cases have addressed the sufficiency of complaints employing a pleading style virtually identical to that employed by plaintiffs here. In those cases, the courts have rejected such complaints because they either failed to comply with Rule 9(b) and the PSLRA, or

²⁰ Nor may Lay be held liable for failing to correct alleged misstatements by other people. Plaintiffs' reliance on *In re SmarTalk Teleservices, Inc. Securities Litigation*, 124 F. Supp. 2d 527 (S. D. Ohio 2000) is misplaced, because an officer's duty to correct another person's alleged misstatement applies only when the non-speaking officer says nothing while "*knowing* that another official is making false statements." *Id.* at 543 (emphasis added). For the reasons set forth in section II herein, plaintiffs have not alleged any facts showing that Lay knew the alleged statements by others were false.

²¹ The *Landry's* opinion cites for very different legal propositions two cases cited by Mr. Lay in his motion to dismiss for the purpose of establishing the structural deficiency of plaintiffs' complaint: *In re Splash Tech. Holdings, Inc.*, 160 F. Supp. 2d 1059 (N.D. Cal. 2001) and *San Leandro Emer. Med. Group Profit Sharing Plan v. Philip Morris Co., Inc.*, 75 F.3d 801 (2d Cir. 1996)). *Landry's*, slip op. at pp. 5, 52.

failed to comply with Rule 8, or both. See *In re Splash Tech. Holdings, Inc.*, 160 F. Supp. 2d 1059, 1073-75 (N.D. Cal. 2001); *Copperstone v. TCSI Corp.*, No. 97-3495, 1999 WL 33295869, at *6 (N.D. Cal. Jan. 19, 1999); *Wenger v. Lumisys, Inc.*, 2 F. Supp. 2d 1231, 1243-44 (N.D. Cal. 1998); *In re Dura Pharm., Inc. Sec. Litig.*, No. 99CV0151, 2000 WL 33176043, at *6-*11 (S.D. Cal. July 11, 2000); *In re Oak Tech. Sec. Litig.*, No. 96-20552, 1997 WL 448168, at *9-*12 (N.D. Cal. Aug. 1, 1997). Plaintiffs do not attempt to distinguish, and cannot distinguish, these adverse cases, especially given the frequent disconnect between Lay’s alleged misrepresentations and the supposedly “true but concealed facts.”²² Because of the structural deficiency of plaintiffs’ complaint, the Court should dismiss plaintiffs’ complaint in its entirety.

2. Plaintiffs Fail to Allege Adequately Facts Supporting Their Conclusion That Misrepresentations Attributed to Lay Were False When Made.

In their response, plaintiffs now attempt -- albeit ineffectively and for only a handful of their allegations -- to do what they should have done in their complaint: specify with particularity why each alleged misrepresentation by Mr. Lay was false when made. Response, pp. 36-41. The underlying theme pervading plaintiffs’ response is that everybody supposedly knows (due to the sensationalized media coverage) that Enron was a fraud. Based on the generalized nature of plaintiffs’ response, their sub-theme appears to be that everybody supposedly knows that every single statement made by Ken Lay was false when made. Upon scrutinizing the hyperbolic accusations, however, the Court will discover that plaintiffs only make generalized allegations about

²² Despite their analogy to childhood puzzles, plaintiffs never address the troubling examples provided in Lay’s Motion to Dismiss. For example, plaintiffs allege Lay stated that “Bandwidth trading could provide us with our highest potential growth,” and further stated that Enron hoped to capture 10-20% of a market Enron expected to grow to \$95 billion per year by 2004. Compl. ¶ 212. Upon inspecting the supposed “true but concealed facts,” the Court will discover that plaintiffs never mention the growth potential for fiber optic trading, the market for bandwidth trading, or Enron’s ability to capture market share. Compl. ¶ 214.

problems at Enron that became known later, and allegations which do not satisfy plaintiffs' burden to plead particularized facts showing that Lay's statements were false when made.

Plaintiffs' superficial attempt to explain the falsity of Lay's statements about the joint venture with Blockbuster illustrates the fundamental deficiency of their allegations against Mr. Lay.²³ Plaintiffs quote the following statement by Lay in a July 19, 2000, Enron press release:

Entertainment on-demand is perhaps the most visible example of the power of Enron's broadband applications. With Blockbuster's extensive customer base and content, and Enron's network delivery application and the capabilities of the distribution providers, we have put together the "killer app" for the entertainment industry Under the agreement, Blockbuster will provide content for the entertainment service Enron will encode and stream the entertainment over its global broadband network infrastructure . . . and provide an unparalleled quality of service.

Response, p. 39 (citing Compl. ¶ 240).

Plaintiffs then contend Lay's statements were false because "Lay knew" that Blockbuster did not have the legal right to distribute electronically the movies and that Enron could not transmit the movies due to alleged technical problems with its broadband network. Response, p. 39 (citing Compl. ¶¶ 300(o), 339(o)). What plaintiffs fail to recognize is that they must allege specific facts showing that these problems existed on July 19, 2000, and they must further show that Ken Lay knew about these alleged problems at the time of his statement. *ABC Arbitrage*, 2002 WL 975299, at *13 (to show a statement is false when made based on information and belief, "a plaintiff needs to specify the internal reports, who prepared them and when, how firm the numbers were or which

²³ While discussing the particularity (or lack thereof) of their allegations against Mr. Lay, plaintiffs repeatedly contend that "Lay knew" certain facts. See Response, pp. 36-43. As discussed in section II herein, plaintiffs' complaint actually provides only a few specific allegations of information allegedly available to Lay, none of which is sufficient to support a strong inference that Lay knew his statements were false when made.

company officers reviewed them” (internal quotations and citation omitted)). Despite plaintiffs’ conclusory allegation about what “Lay knew,” their complaint is deficient on both grounds.

Plaintiffs’ factual allegations simply do not show that Lay’s statements were false on July 19, 2000. Although plaintiffs allege that Blockbuster did not have the legal right to provide the movie content, Lay’s statement said only that Blockbuster had agreed to do so. Other than Blockbuster’s ultimate failure to perform, plaintiffs point to no facts showing that Blockbuster did not intend to perform, much less that Lay or anyone else at Enron had advance knowledge that Blockbuster ultimately would not be able to perform. Compl. ¶¶ 300(o), 339(o). Similarly, plaintiffs fail to identify the exact nature of the software problems, and they certainly allege no facts showing either that the alleged problem existed on July 19, 2000, or that it was viewed by Enron as a problem that could not readily be fixed. Compl. ¶¶ 300(o), 339(o). As a result, plaintiffs’ allegation of falsity ultimately relies on nothing more than the eventual termination of the Blockbuster joint venture. Thus, plaintiffs improperly have attempted to plead fraud by hindsight, and their complaint therefore does not allege properly that Lay’s statements were false when made. *See, e.g., City of Philadelphia v. Fleming Cos., Inc.*, 264 F.3d 1245, 1260 (10th Cir. 2001) (“Plaintiffs should not be allowed to proceed with allegations of fraud by hindsight”) (internal quotation omitted); *In re Syntex Corp. Sec. Litig.*, 95 F.3d 922, 929 (9th Cir. 1996) (fact that statement “may have proved to be wrong” does not make it actionable).

Additionally, plaintiffs have not alleged any specific facts showing that Ken Lay had knowledge of the alleged problems. In fact, the two paragraphs cited by plaintiffs do not even mention Ken Lay’s name. Response, p. 39 (citing Compl. ¶¶ 300(o), 339(o)). Instead, plaintiffs rely on colorful references to “Enron Kool-Aid,” and they purport to quote an unnamed former employee who allegedly stated that the “Blockbuster deal was a fraud, and Enron’s top management knew it.”

Compl. ¶¶ 300(o), 339(o). These conclusory allegations cannot satisfy plaintiffs' burden of pointing "to contemporaneous, inconsistent statements by defendants or showing that information available to defendants showed different results than defendants predicted." *Wenger*, 2 F. Supp. 2d at 1240; *see also ABC Arbitrage*, 2002 WL 975299, at *13. The Blockbuster deal provides just one example of plaintiffs' complete failure to allege with particularity that Lay's statements were false when made.

3. Most of the Alleged Misrepresentations Attributed to Lay Constitute Nothing More than Inactionable Puffing.

In his motion to dismiss, Ken Lay demonstrated that most of the alleged misrepresentations attributed to him are nothing more than inactionable puffery. Motion to Dismiss, pp. 47-52. Plaintiffs' response is deceptively simple. Because they cannot effectively challenge the vague and general nature of Lay's statements, plaintiffs urge the Court to view Lay's statements "in context" and to hold Lay responsible for alleged non-disclosures of material fact. Response, pp. 91-93. But the alleged non-disclosures apparently constitute everything negative plaintiffs have alleged about Enron (Response, p. 94-95), even though plaintiffs have not alleged with particularity any facts showing that Ken Lay knew about any of the alleged problems at the time his statements were made. *See* Section II, herein.²⁴ Indeed, plaintiffs accuse Mr. Lay of ignoring the supposedly controlling case of *Berger v. Compaq*; however, the *Berger* court found the defendant's statements potentially actionable only because, unlike here, the allegations were sufficient to show knowledge of actual

²⁴ As one of plaintiffs' three examples, they refer to Lay's statement in describing the Blockbuster deal that "we bring in our technology and our broadband system, worldwide." Response, p. 95. Plaintiffs claim the statement is not puffery because "Enron's broadband network was plagued by persistent technical difficulties and intractable problems, including the lack of a viable InterAgent program." *Id.* But Mr. Lay has already shown in his reply that plaintiffs have not alleged that these problems existed at the time of his statement, much less that he had any knowledge of the alleged software problem. *See* Section III(B)(2), herein.

falsity. *See Berger v. Compaq Computer Corp.*, No. H-98-1148, slip op. at 11 (S.D. Tex. Dec. 22, 1999) (Gilmore, J.) (allegation that Compaq's CFO admitted to Wall Street Journal that accounts receivable were factored in 2nd, 3rd, and 4th quarters of 1997 for purpose of inflating return on investment, while company had previously attributed increase in return on investment to other factors). Thus, the Court should reject plaintiffs' bootstrap argument that Lay's statements are somehow rendered specific and actionable by facts not known by Mr. Lay.

Despite plaintiffs' diversionary tactics, they cannot obfuscate the fact that most of Ken Lay's alleged misrepresentations are exactly the type of vague and general statements of corporate optimism upon which no reasonable investor would rely. Among many other examples, plaintiffs rely on Lay's statements such as "We have experienced a strong market reception [for Wholesale Energy Operations and Services]" and "[W]e are positioned to be the leading player in the largest and fastest growing markets in the world." Compl. ¶¶ 128, 156. Courts repeatedly have found strikingly similar statements to be mere puffery. *See, e.g., Nathenson*, 267 F.3d at 419 (describing new drug as "fast acting" and "improved formulation" was "nothing more than inactionable puffing"); *Raab v. General Physics Corp.*, 4 F.3d 286, 289 (4th Cir. 1993) (saying company "is poised to carry the growth and success of 1991 well into the future" not actionable); *In re Browning-Ferris Indus. Inc. Sec. Litig.*, 876 F. Supp. 870, 885-86, 879 (S.D. Tex. 1995) (Rosenthal, J.) (statements that "the future prospects of our core solid waste collection and disposal business are extremely attractive" and that company's "growth prospects are just as attractive today as they have been in the last few years" were puffery); *Greebel*, 194 F.3d at 190, 207 (statements that software

product would “lead the market” and that networking business was “cash cow” that would fund development of other businesses “are not actionable”).²⁵

Plaintiffs’ criticism that Mr. Lay attacks only “selective statements” also misses the mark. Response, p. 91. Unlike the defendants in *Haack v. Max Internet Communications, Inc.*, 2002 WL 511514, who attacked only a few stray sentences as puffery, Mr. Lay contends that most of his alleged misrepresentations are too vague and general to be actionable. See Motion to Dismiss, pp. 47-52. In any event, *Haack* stands for the uneventful proposition that defendants cannot obtain “dismissal of [their] case by selectively picking out a few statements.” *Haack*, 2002 WL 511514, at *14. The casebooks are replete with cases that dismiss securities claims in part on puffery grounds, and in part on other grounds. It is therefore absurd for plaintiffs to suggest that it is somehow inappropriate to dismiss certain alleged misrepresentations as puffery. See, e.g., *Grossman v. Novell, Inc.*, 120 F.3d 1112, 1121-22 (10th Cir. 1997).

Plaintiffs’ contention that Ken Lay failed to correct his alleged misstatements represents yet another improper attempt to introduce an argument plaintiffs have not pleaded in their complaint. See *BMC Software*, 183 F. Supp. 2d at 915. The substance of plaintiffs’ argument also lacks merit. In certain circumstances, there is a duty to correct a historical statement within a reasonable time of

²⁵ Nor do plaintiffs even attempt to respond to Mr. Lay’s argument that his alleged misstatements in the fall of 2001 plainly were not material since Enron’s stock price continued to plummet. *Azurix Corp. Sec. Litig.*, 198 F. Supp. 2d at 886-887. (“Because plaintiffs fail to allege that defendants’ favorable and allegedly false and/or misleading statements had a correspondingly favorable impact on Azurix’s share price, and because plaintiffs’ complaint demonstrates that these statements did not have a favorable effect on Azurix’s share price, the court concludes that these statements, even if misleading, were not material and that plaintiffs did not rely on them.”) This omission is not particularly surprising given that plaintiffs repeatedly criticized Lay and others for *unsuccessfully* attempting to support the stock price. See Compl. ¶ 342 (“Despite efforts . . . to support Enron’s stock during 5/01-7/01, it continued to erode”), ¶ 360 (“While Enron . . . made a valiant effort during the last half of 8/01 and 9/01 to assure investors . . . , Enron’s stock price continued to decline”).

subsequently discovering information that the statement was false. *In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1431 (3d Cir. 1997). But there is no duty to correct a vague and general statement that is not material to the market. *See In re Quintel Entm't Inc. Sec. Litig.*, 72 F. Supp. 2d 283, 292 (S.D.N.Y. 1999) (“there is no duty to update mere expressions of opinion or exclusively forward-looking statements”); *see also In re International Bus. Mach. Corp. Sec. Litig.*, 163 F.3d 102, 109 (2d Cir. 1998) (“highly qualified expression of optimism” triggered no duty to correct). Thus, even setting aside plaintiffs’ failure to allege that Lay came into possession of any information that would trigger a duty to correct,²⁶ Lay’s vague and general statements of corporate optimism cannot subject him to such a duty.

4. Several of Lay’s Comments Were Forward-Looking Statements Protected By The PSLRA Safe Harbor and the Bespeaks Caution Doctrine.

After conceding that “some of [Lay’s] examples appear to be forward-looking,” plaintiffs nonetheless accuse Lay of disguising in his motion to dismiss surrounding statements that they contend are not forward-looking.²⁷ Response, p. 86-87. Plaintiffs then criticize Lay for challenging only the forward-looking portions, while plaintiffs challenge all of the sentences as actionable. *Id.* at 87. In their only example, plaintiffs highlight a sentence Lay did not even identify as forward-looking in his motion, and then proudly proclaim that the sentence is not forward-looking. *Id.* Though perhaps demonstrating mastery of the obvious, plaintiffs’ argument also confirms that the forward-looking statements that Lay does actually identify in his motion to dismiss never should

²⁶ For the reasons discussed in Section II, herein, plaintiffs have not alleged that Lay possessed any information that would trigger such a duty.

²⁷ Plaintiffs provide only one example of a statement that was purportedly disguised. Response, pp. 86-87. Far from disguising this statement, Lay provided the Court with this exact quote and challenged it in his motion to dismiss as an inactionable recitation of past historical fact. Motion to Dismiss, p. 62.

have been included in their complaint, and therefore should be dismissed.²⁸ See 15 U.S.C. § 78u-5(c)(1)(A).

Plaintiffs next contend that Lay's statements made during conference calls cannot be protected by the statutory safe harbor because of Enron's alleged failure to identify forward-looking statements. Response, p. 86. Plaintiffs rely on *Fecht v. Price Co.*, 70 F.3d 1078 (9th Cir. 1995), *cert. denied*, 517 U.S. 1136 (1996), for the proposition that the bespeaks caution doctrine applies only to statements in the same document. Although the court in *Fecht* described the standard as "whether the *mix* of information in the document is misleading," (*Id.* at 1082) this language is dicta because the court decided the case based on the quality of the cautionary language, not whether such language was contained in the same document as the alleged misstatement. *Fecht*, 70 F.3d 1079-80. Moreover, the apparent suggestion in *Fecht* that a court should only consider the mix of information in the document is contradicted by the fundamental premise of the bespeaks caution doctrine that courts must examine the "total mix" of information. *In re Donald J. Trump Casino Sec. Litig. -- Taj Mahal Litig.*, 7 F.3d 357, 371 (3d Cir. 1993), *cert. denied*, 510 U.S. 1178 (1994); *see also TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976) (noting that materiality is determined by the total mix of information available). This Court therefore should follow the same approach as other courts that "have not required cautionary language to be in the same document as the alleged misrepresentation or omission" when applying the bespeaks caution doctrine. *Grossman v. Novell, Inc.*, 120 F.3d 1112, 1122 (11th Cir. 1997); *see also San Leandro Emer. Med. Group Profit Sharing Plan v. Philip Morris Cos., Inc.*, 75 F.3d 801, 811 (2d Cir. 1996) (alleged misstatement in Reuter's

²⁸ To the extent plaintiffs are inartfully suggesting that Lay's statements contain both historical comments and future predictions, the Court should treat such statements as forward-looking and dismiss them in their entirety. See *Kurtzman*, slip op. at 59 n.17 ("Where a statement is 'mixed,' . . . the whole statement is viewed as forward-looking").

report was protected by cautionary language in annual report); *Raab v. General Physics Corp.*, 4 F.3d 286, 289 (4th Cir. 1993) (press release negated alleged misrepresentation in annual report under bespeaks caution doctrine).

In their zeal to condemn as fraudulent all things related to Enron, plaintiffs also engage in a wholly superficial analysis of the meaningful cautionary language that either accompanied Lay's statements or was publicly available in the marketplace. Although plaintiffs criticize Enron's cautionary language as "boilerplate" and Enron's disclosures as "indecipherable," they never bother to provide an example of the supposedly defective language. Response, pp. 88-91. The omission is telling but not surprising, given that the market was well aware of many facts plaintiffs contend were fraudulently concealed. For example, although plaintiffs contend Ken Lay's description of Enron Energy Services's results was false because Enron agreed to spend millions at the onset of its deals to upgrade customer equipment and because Enron accounted for the revenue in the same quarter using mark-to-market accounting (Response, p. 95), the market was well aware of these facts. *See, e.g.*, Master Appendix filed with the Joint Brief, tab 21, at 4 and tab 16, at 6-7.

IV. Plaintiffs Fail in Their Attempt to Recast Their Claim Under the Texas Securities Act.

In tacit recognition that they have failed to plead a claim under the Texas Securities Act ("TSA"), plaintiffs try to use their response improperly to shoehorn a new "aider and abettor" theory into their complaint. *See* FED. R. CIV. P. 15(a). The Consolidated Complaint, however, merely alleges that "Defendants participated in the offer to sell and sold" certain notes using a materially misleading Registration Statement and Prospectus. Compl. ¶¶ 1020, 1021. Even applying the liberal pleading requirements of Rule 8,²⁹ plaintiffs' TSA claim arises solely under article 581-33A(2) for

²⁹ Of course, as Lay stated in his Motion to Dismiss, Rule 9(b) applies to plaintiffs' TSA
(continued...)

alleged misrepresentations made by “[a] person who offers or sells a security.” But, as stated in Lay’s Motion to Dismiss, 33A(2) has a privity requirement that emasculates this TSA claim, because plaintiffs have not alleged that Lay sold them anything. Motion to Dismiss, p. 70. For the reasons discussed above at pp. 27, 33, plaintiffs may not avoid dismissal by making new allegations of aider and abettor liability in their response.

Even if the Court were to consider plaintiffs’ new claim of “aider and abettor” liability, it would fail because neither the complaint nor plaintiffs’ response makes the allegations necessary to satisfy the elements of such liability. Response, p. 157 (citing *Frank v. Bear, Stearns & Co.*, 11 S.W.3d 380, 384 (Tex. App. -- Houston [14th Dist.] 2000, pet. denied)). For example, there are no allegations that Lay was “generally aware” that he played a role in a primary securities violation by Enron. *Frank*, 11 S.W.3d at 384. Rather, plaintiffs contend that they “need not allege that each Insider was aware of his/her role in the underwriters’ violations of the Texas Securities Act . . . because each Insider materially aided Enron’s . . . violations of the Texas Securities Act,” citing only the TSA for this proposition. Response, p. 158. In other words, plaintiffs presuppose a violation of the statute, which allows them to conclude that there was a violation of the statute, which (plaintiffs claim) excuses them from meeting their pleading obligations. Such sophistry does not withstand a motion to dismiss. *Cf. Abbott v. Equity Group, Inc.*, 2 F.3d 613, 621 (5th Cir. 1993) (affirming summary judgment and cautioning courts to “be exacting in determining whether aider and abettor liability can be demonstrated”), *cert. denied*, 510 U.S. 1177 (1994).

²⁹ (...continued)

claim, and the Complaint does not satisfy that rule’s heightened pleading requirement. Motion to Dismiss, p. 69 n.43. Plaintiffs did not even respond to this argument. Consequently, the TSA misrepresentation claims must be dismissed.

Nor do plaintiffs allege that Ken Lay “rendered ‘substantial assistance’ in [Enron’s] violation” of the TSA, or that he either “intended to deceive plaintiff” or “acted with reckless disregard for the truth of the representations made by” Enron. *Frank*, 11 S.W.3d at 384. Indeed, after reciting these essential elements, plaintiffs never address them -- let alone plead them with any sort of particularity. Instead, plaintiffs allege that Mr. Lay and other insiders are liable “by virtue of their positions as directors and/or senior officers of Enron.” Compl. ¶ 1028. But if this allegation were enough, the elements articulated by the *Frank* court and recited by plaintiffs would be superfluous. Plaintiffs simply have not pleaded a TSA violation.

Finally, plaintiffs cannot deny that their putative class period runs “between 10/19/98 and 11/27/01” (Compl. ¶ 1), or that the allegedly false statements in the Registration Statement and Prospectus were made months before this period began. Master SEC App., tab 83, at 1. As such, those claims must be dismissed. *In re International Bus. Mach. Corp. Sec. Litig.*, 163 F.3d 102, 107 (2d Cir. 1998) (representations made one day before the class period are not actionable; “a defendant . . . is liable only for those statements made during the class period”). Plaintiffs do not contest this statement of law. They also admit their Complaint does not state a separate class period for the TSA claim that differs from the putative class period defined in the first paragraph of their 1030-paragraph Complaint. Response, p. 160 n.60. Therefore, by plaintiffs’ own admission, their TSA claim must be dismissed.

V. Plaintiffs Have Failed to Plead Control Person Liability Against Mr. Lay.

Plaintiffs apparently believe that they may plead control person liability by alleging nothing more than the fact that Lay had the “abstract power” to control something or someone. *See* Response, pp. 153-54. This is, of course, not the law. At a minimum, plaintiffs must identify who or what it is that Lay controlled. *See* Motion to Dismiss, p. 65. Importantly, despite the fact that

Lay raised this issue in his motion to dismiss, plaintiffs do not address it at all in their response (no doubt because they cannot disagree with such a basic proposition of notice pleading). For this reason, plaintiffs' control person liability claim must be dismissed.

Plaintiffs' control person claim must be dismissed for the additional reason that they fail to plead with particularity allegations that Lay possessed the power to control the specific transactions or activities upon which the primary violation is predicated. *See* Motion to Dismiss, pp. 65-66. Plaintiffs, themselves, acknowledge they must make a showing of the power to control the transactions in question. *See* Response, p. 154. As discussed in Lay's Motion to Dismiss, however, they have failed to do so. *See* Motion to Dismiss, pp. 66-67.

Plaintiffs do not allege, for example, that Lay was responsible for supervising the LJM relationship -- upon which plaintiffs base many of the allegations in their complaint. In fact, plaintiffs allege that another senior executive, not Lay, was responsible for supervising the LJM relationship. *See* Response, p. 64. The Powers Report (relied upon by plaintiffs in their response) confirms that Lay was not responsible for supervising the LJM relationship. *See* Powers Report, pp. 20, 169 ("It does not appear that Lay had, or was intended to have, any managerial role in connection with LJM once the entities became operational."). Plaintiffs, therefore, have pleaded themselves out of a control person claim against Lay regarding activities related to the LJM partnerships. *See United States ex rel. Wilkins*, 173 F. Supp. 2d at 617. Plaintiffs have not pleaded that Lay had the power to control Enron's accounting decisions relating to its treatment of revenues and expenses in connection with its various business units. Plaintiffs have not pleaded facts indicating that Lay controlled the disclosure of Enron's related party disclosures. In fact, the Powers Report dictates that other executives supervised those activities. *See* Powers Report, pp. 181-83 ("Lay was generally involved in the disclosure process only to the same extent as the outside directors."); *id.* at 183. As

a result of their failure to plead facts specifically linking Lay's management responsibilities to the misrepresentations complained of, plaintiffs' claims based on control person liability must be dismissed.

VI. Plaintiffs Cannot Maintain a Section 11 Claim Against Mr. Lay.

Plaintiffs note in their response that in *In re U.S. Liquids Securities Litigation*, No. H-99-2785, slip op. at 14 (S.D. Tex. Apr. 30, 2002) ("*U.S. Liquids IP*"), this Court rejected the defendants' argument that standing under Section 11 was limited to direct purchasers of an initial public offering. However, Mr. Lay respectfully requests that the Court reconsider this decision in light of an inconsistent, published opinion issued by a court in this district in *In re Azurix Corp. Securities Litigation*, 198 F. Supp. 2d 862 (S.D. Tex. 2002) (Lake, J.) prior to the issuance of this Court's decision in *U.S. Liquids II*.

In *Azurix*, Judge Lake, relying on Supreme Court precedent in *Gustafson v. Alloyd Co., Inc.*, 513 U.S. 561 (1995), found that "because it is undisputed that plaintiffs did not purchase their shares of Azurix stock pursuant to the company's initial public offering, the court concludes that plaintiffs have failed to state any actionable claim under §§ 11. . . ." *In re Azurix*, 198 F. Supp. 2d at 893. As the *Azurix* opinion recognized, the logic of the Supreme Court's *Gustafson* decision regarding claims under § 12(2) of the 1933 Act applies equally to § 11 claims. The *Gustafson* court reasoned that "the primary innovation of the 1933 Act was the creation of federal duties -- for the most part, registration and disclosure obligations -- in connection with public offerings." *Gustafson*, 513 U.S. at 571.³⁰

³⁰ Other courts which have applied *Gustafson* to section 11 claims have noted that the dissents of Justice Ginsburg and Justice Thomas in *Gustafson* also support this application. Justice Ginsburg stated in her dissent: "The Report's broad address thus takes in § 11 . . . and § 12(1) There is no dispute that the latter two provisions apply only to public offerings -- or, to be precise, to transactions subject to registration." *Gustafson*, 513 U.S. at 600 n. 4. Justice Thomas stated: "Nor

(continued...)

Judge Lake's holding regarding the direct purchase requirement is also clearly supported by the legislative history of the 1933 Act, which states: "The bill affects only new offerings of securities. . . . It does not affect the ordinary redistribution of securities unless such redistribution takes on the characteristics of a new offering." H.R. Rep. No. 85, 73d Cong., 1st Sess., 5 (1933). Many district courts have agreed that the principles announced in *Gustafson* should apply with full force to claims brought under Section 11. See *Brosious v. Children's Place Retail Stores*, 189 F.R.D. 138, 144 (D.N.J. 1999) (holding that aftermarket purchasers lacked standing under § 11); *In re Summit Med. Sys. Inc. Sec. Litig.*, 10 F. Supp. 2d 1068, 1070 (D. Minn. 1998) (same); *Warden v. Crown Am. Realty Trust*, No. 96-25J, 1998 WL 725946, at *3 (W.D. Pa. Oct. 15, 1998) (holding that "the Securities Act exists to protect investors in initial offerings, not those who purchase on the secondary market, who are protected by the Exchange Act"), *aff'd*, 229 F.3d 1140 (3d Cir. 2000); *In re WRT Energy Sec. Litig.*, No. 96-3610, 96-3611, 1997 WL 576023, at *6-*7 (S.D. N.Y. Sept. 15, 1997) (finding "the standing principals the Supreme Court announced in *Gustafson* apply equally to section 11 claims"); *Gannon v. Continental Ins. Co.*, 920 F. Supp. 566, 575 (D. N.J. 1996) (similar).

This court has recognized that "there is a division of opinion among lower courts" with regard to this issue. Now, as a result of this Court's statement in *U.S. Liquids II*, there is a division among the judges in this district. Therefore, Mr. Lay respectfully requests that this Court reconsider its decision in *U.S. Liquids II* and follow *Azurix*. It should therefore dismiss plaintiffs' § 11 claims because they have failed to plead that they purchased Enron securities in the initial public offering.

³⁰ (...continued)

did Congress limit § 12(2) to issuers, as it chose to do with other provisions that are limited to initial distributions. See § 11 of the 1933 Act. . . ." *Id.* at 590.

VII. Plaintiffs Have Not Pleaded a § 20A Claim Against Lay.

In their response, plaintiffs do nothing to salvage their hopelessly inadequate Section 20A claim against Mr. Lay. This claim must independently satisfy the requirements of the PSLRA and Rule 9(b). Plaintiffs must therefore allege specifically what non-public information each defendant used to trade and how they knew such information was material or non-public. *See BMC Software*, 183 F. Supp. 2d at 916. Nowhere in the 500 pages of the complaint do plaintiffs identify any specific, material, non-public information that Ken Lay allegedly knew before making any particular sale of Enron shares, or how he knew the information was material or non-public. Instead, plaintiffs allege in the broadest possible terms that *all* of the defendants had possession of material, non-public information “about the adverse information detailed herein,” referring to all 500 pages of the complaint. Compl. ¶ 1002. If this were enough to satisfy Rule 9(b) and the PSLRA, then the strict pleading requirements mandated by these provisions would be meaningless. In their response, plaintiffs are equally vague and conclusory, asserting without reference to any particular defendant or citing any particular portion of the Consolidated Complaint that “[t]he material, non-public information possessed by the Insiders is well documented in the CC, as are their stock sales.” Response, p. 137. This Court should not tolerate plaintiffs’ cavalier disregard for Rule 9(b) and the PSLRA. Their Section 20A claim against Mr. Lay must be dismissed.

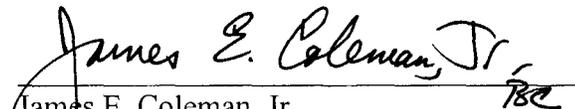
VIII. Conclusion.

Mr. Lay respectfully requests that the claims asserted against him in the Consolidated Complaint be dismissed with prejudice.

The decision of whether to allow amendment of the pleadings is within the sound discretion of the district court. *Branca*, 2000 WL 145083, at *12 (citing *Norman v. Apache Corp.*, 19 F.3d 1017, 1021 (5th Cir. 1994)). The Court may consider a number of factors when making this

determination, including the futility of amendment and whether the plaintiff has previously amended. *Id.*; *Reiger*, 117 F. Supp. 2d at 1014. The plaintiffs before this Court have already amended their complaint once and, despite the unprecedented amount of information available to them regarding the circumstances at issue in this litigation, have failed to plead a cause of action against Mr. Lay. As demonstrated by the inadequacy of the new allegations they have improperly attempted to inject through their response, plaintiffs have provided no indication that they could cure the defects fatal to the Consolidated Complaint if given an opportunity to replead. As a result, the Consolidated Complaint must be dismissed with prejudice. *See Reiger*, 117 F. Supp. 2d at 1014-15; *MCI WorldCom*, 191 F. Supp. 2d at 794.

Respectfully submitted,


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CERTIFICATE OF SERVICE

The undersigned certifies that a copy of the foregoing instrument was served upon the attorneys of record of all parties as per the attached Exhibit A in accordance with the Court's Order of April 4, 2002, and Rule 5, Federal Rules of Civil Procedure, on this 24th day of June, 2002.



Bruce W. Collins

The Service List
Attached
to this document
may be viewed at
the
Clerk's Office

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.

CONSOLIDATED COMPLAINT FOR
VIOLATION OF THE SECURITIES LAWS

THE REGENTS OF THE UNIVERSITY OF
CALIFORNIA, et al., Individually and On
Behalf of All Others Similarly Situated,

Plaintiffs,

vs.

KENNETH L. LAY, JEFFREY K. SKILLING,
ANDREW S. FASTOW, RICHARD A.
CAUSEY, JAMES V. DERRICK, JR.,

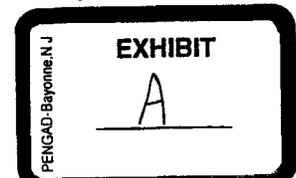
[Caption continued on following page.]

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Mark	1,895,631	\$ 82,536,737
McConnell	32,960	\$ 2,506,311
McMahon	39,630	\$ 2,739,226
Olson	83,183	\$ 6,505,870
Pai	3,912,205	\$ 270,276,065
Rice	1,234,009	\$ 76,825,145
Skilling	1,307,678	\$ 70,687,199
Sutton	688,996	\$ 42,231,283
Whalley	**	**
TOTAL:	20,788,957	\$1,190,479,472

* Belfer's stock sales consist of \$294,120 shares sold for \$16,436,692 on the open market; 770,927 shares, with a value of \$35,378,483, transferred to an exchange fund and 1,000,000 shares, with a value of \$60,126,025, hedged through costless collars. The aggregate value of these dispositions was \$111,941,200.

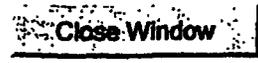
** Unknown but substantial.

402. These stock sales, in most instances, were large percentages of the Enron insiders' holdings of Enron stock plus vested options, as shown below:

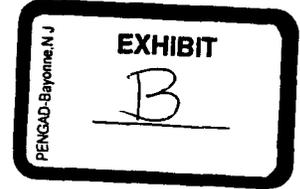
Insider	Source	Common	Options	Total	Shares Sold Prior to Report Date	Available Holdings	CP Shares Sold	Proceeds	Percent of Shares Sold		
Baxter	1/01 Form 4	5,996	250,848	256,844	619,898	876,742	619,898	\$34,734,854	70.70%		
Belfer	2001 Proxy	8,407,084	31,755	8,438,839	1,651,213	10,090,052	2,065,137	\$111,941,200	20.47%		
Blake	2001 Proxy	6,456	18,155	24,611	21,200	45,811	21,200	\$1,705,328	46.28%		
Buy	3/01 Form 4	6,662	25,643	32,305	140,234	172,539	140,234	\$10,656,595	81.28%		
Caussey	8/01 Form 4	77,372	0	77,372	208,940	286,312	208,940	\$13,386,896	72.98%		
Chan	2001 Proxy	2,724	16,475	19,199	8,000	27,199	8,000	\$337,200	29.41%		
Derrick	6/01 Form 4	81,873	0	81,873	230,660	312,533	230,660	\$12,563,928	73.80%		
Duncan	2001 Proxy	134,498	39,755	174,253	0	174,253	35,000	\$2,009,700	20.09%		
Fastow	11/00 Form 4	29,336	0	29,336	687,445	716,781	687,445	\$33,675,004	95.91%		
Foy	1/00 Form 4	27,468	13,098	40,566	38,160	78,726	38,160	\$1,639,590	48.47%		
Freyvert	2001 Proxy	215,149	1,052,202	1,267,351	986,898	2,254,249	986,898	\$54,831,220	43.78%		
Gramm	12/98 Form 4	1,374	652	2,026	10,328	12,354	10,328	\$278,892	83.60%		
Harrison	2001 Proxy	79,312	858,950	938,262	1,011,436	1,949,698	1,011,436	\$75,416,636	51.88%		
Hirko	5/00 Form 4	181,334	1,730,000	1,911,334	473,837	2,385,171	473,837	\$35,168,721	19.87%		
Horton	2001 Proxy	117,390	240,322	357,712	747,082	1,104,794	830,444	\$47,371,361	75.17%		
Jaediche	2001 Proxy	17,332	39,755	57,087	5,360	62,447	13,360	\$841,438	21.39%		
Kean	1/01 Form 4	24,105	24,678	48,783	64,932	113,715	64,932	\$5,166,414	57.10%		
Koenig	5/01 Form 4	21,694	15,981	37,675	129,153	166,828	129,153	\$9,110,466	77.42%		
Lay	2001 Proxy	107,176	5,285,542	5,392,718	1,903,515	7,296,233	4,002,259	\$184,494,426	54.85%		
Lemaistre	2001 Proxy	16,532	39,755	56,287	9,344	65,631	17,344	\$841,768	26.43%		
Mark	5/00 Form 4	0	0	0	1,895,631	1,895,631	1,895,631	\$82,536,737	100.00%		
McConnell	3/00 Form 4	26,357	36,722	63,079	32,960	96,039	32,960	\$2,506,311	34.32%		
McMahon	3/00 Form 4	8,885	87,222	96,107	39,630	135,737	39,630	\$2,739,226	29.20%		
Olson	3/01 Form 4	9,298	5,893	15,191	83,183	98,374	83,183	\$6,505,870	84.56%		
Pai	6/01 Form 4	0	0	0	3,912,205	3,912,205	3,912,205	\$270,276,065	100.00%		
Rice	2001 Proxy	21,164	1,447,969	1,469,133	770,410	2,239,543	1,234,009	\$76,825,145	55.10%		
Skilling	2001 Proxy	1,117,339	824,038	1,941,377	1,137,678	3,079,055	1,307,678	\$70,687,199	42.47%		
Sutton	9/00 Form 4	283,646	194,306	477,952	688,996	1,166,948	688,996	\$42,231,283	59.04%		
								<u>40,815,599</u>	<u>20,788,957</u>	<u>\$1,190,479,472</u>	<u>50.93%</u>

403. These defendants' illegal insider selling escalated massively as Enron's stock moved to more inflated levels during the Class Period and also when internally they knew the scheme was unraveling, especially after the termination of the Blockbuster deal, as the chart below shows:

Choose Print from the File menu and then close this window.



1



UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

SCHEDULE 14A
(RULE 14a-101)

INFORMATION REQUIRED IN PROXY STATEMENT

SCHEDULE 14A INFORMATION

PROXY STATEMENT PURSUANT TO SECTION 14(a) OF THE SECURITIES
EXCHANGE ACT OF 1934 (AMENDMENT NO.)

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement
- Definitive Proxy Statement
- Definitive Additional Materials
- Soliciting Material Pursuant to Rule 14a-12
- Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))

ENRON CORP.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

- No fee required.
- Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

- (13) Includes 52,942 shares held by Mr. Saltz's wife as trustee for her children and 1,974 shares held by a charitable foundation in which Mr. Saltz has no pecuniary interest.
- (14) Pursuant to the terms of the Savings Plan, shares allocated to employee accounts are voted by the Savings Plan trustee as instructed by the employees. If the trustee receives no voting directions from the respective employees, then all such shares are to be voted by the trustee in the same proportion as the allocated shares that are voted by employees.
- (15) Includes 1,911,280 shares of Common Stock that would be acquired upon the conversion of the Preferred Convertible Stock.

STOCK OWNERSHIP OF MANAGEMENT AND BOARD OF DIRECTORS AS OF FEBRUARY 15, 2001

TITLE OF CLASS	NAME	AMOUNT AND NATURE OF BENEFICIAL OWNERSHIP			PERCENT OF CLASS
		SOLE VOTING AND INVESTMENT POWER (1)	SHARED VOTING AND INVESTMENT POWER (1)	SOLE VOTING AND LIMITED OR NO INVESTMENT POWER (2) (3)	
Enron Corp. Common Stock	Robert A. Belfer.....	8,438,839 (4)	29,514 (5)	23,475	1.12
	Norman P. Blake, Jr.....	24,611			*
	Ronnie C. Chan.....	19,199			*
	John H. Duncan.....	174,253	59,584		*
	Mark A. Frevert.....	1,267,351	15,966		*
	Ken L. Harrison.....	938,262		16,430	*
	Stanley C. Horton.....	357,712	3,608	23,223	*
	Robert K. Jaedicke.....	57,087			*
	Kenneth E. Lay.....	5,392,719	2,367,897 (6)	170,282	1.05
	Charles A. LeMaistre.....	56,297			*
	John Mendelsohn.....	5,563			*
	Jerome J. Meyer.....	17,400			*
	Paulo V. Ferraz Pereira.....	3,195			*
	Kenneth D. Rice.....	1,469,133		22,793	*
	Frank Savage.....	4,005			*
	Jeffrey K. Skilling.....	1,941,377		180,152	*
	John A. Urquhart.....	47,795			*
	John Wakeham.....	20,997			*
	Herbert S. Winokur, Jr.....	107,755	12,000 (7)		*
	All directors and executive officers as a group (30 in number).....	23,379,222	2,473,254	736,395	3.44

(Table continues on following page)

7

10

TITLE OF CLASS	NAME	AMOUNT AND NATURE OF BENEFICIAL OWNERSHIP			PERCENT OF CLASS
		SOLE VOTING AND INVESTMENT POWER (1)	SHARED VOTING AND INVESTMENT POWER (1)	SOLE VOTING AND LIMITED OR NO INVESTMENT POWER (2) (3)	
Enron Corp. Preferred Convertible Stock	Robert A. Belfer.....	214,580	627 (8)		17.66
	All directors and executive officers as a group (30 in number).....	214,580	627		17.66
EOTT Energy Partners, L.P. Common Units	Norman P. Blake, Jr.....	1,300			*

	John H. Duncan.....	3,500		.
	Stanley C. Horton.....	10,000		.
	Kenneth L. Lay.....		5,000	.
	All directors and executive officers as a group (30 in number).....	19,500	5,000	.
Northern Border Partners, L.P. Common Units	Robert A. Belfer.....	30,500	16,500(9)	.
	Norman P. Blake, Jr.....	1,500		.
	Stanley C. Horton.....	10,000		.
	All directors and executive officers as a group (30 in number).....	42,500	16,500	.
NewPower Holdings, Inc. Common Stock	Mark A. Frevert.....	58,450		.
	Kenneth L. Lay.....	150,000		.
	Kenneth D. Rice.....	27,426		.
	All directors and executive officers as a group (30 in number).....	3,668,976		6.32

* Less than 1%.

- (1) The number of shares of Enron Common Stock subject to stock options exercisable within 60 days after February 15, 2001, which number is included in the number of shares shown as beneficially owned as of such date, is as follows: Mr. Belfer, 31,755 shares; Mr. Blake, 18,155 shares; Mr. Chan, 16,475 shares; Mr. Duncan, 39,755 shares, for which he has shared voting and investment power for 32,384 of such shares; Mr. Frevert, 1,052,202 shares; Mr. Harrison, 858,950 shares; Mr. Horton, 240,322 shares; Dr. Jaedicke, 39,755 shares; Mr. Lay, 5,285,542 shares, for which he has shared voting and investment power for 1,828,210 of such shares; Dr. LeMaistre, 39,755 shares; Dr. Mendelsohn, 5,451 shares; Mr. Meyer, 10,491 shares; Mr. Pereira, 3,195 shares; Mr. Rice, 1,447,969 shares; Mr. Savage, 3,195 shares; Mr. Skilling, 824,038 shares; Mr. Urquhart, 31,755 shares; Lord Wakeham, 18,075 shares; Mr. Winokur, 31,755 shares; and all directors and executive officers as a group (30 in number), 12,611,385 shares.
- (2) Includes restricted shares of Enron Common Stock held under Enron's 1991 and 1994 Stock Plans (the "Plans") for certain individuals. Participants in the Plans have sole voting power and no investment power for restricted shares awarded under the Plans until such shares vest in accordance with the Plans' provisions. After vesting, the participant has sole investment and voting powers.
- (3) Includes shares held under the Savings Plan and/or the Enron Corp. Employee Stock Ownership Plan ("ESOP"). Participants in the Savings Plan instruct the Savings Plan trustee as to how the participant's shares should be voted. Additionally, participants have limited investment power with respect to shares in the Savings Plan. Participants in the ESOP have sole voting power and no investment power prior to distribution of shares from the ESOP. Includes 2,598 shares held by the spouse of Mr. Horton, for which he may be deemed to have shared voting and investment power. Total shares held by the group includes 8,863 shares with shared voting power.

(Notes continue on following page)

- (4) Includes 5,858,892 shares that would be acquired upon the conversion of the Preferred Convertible Stock shown in the table as being beneficially owned by Mr. Belfer with sole voting and investment power.
- (5) Includes 12,360 shares held by Mr. Belfer's wife and 34 shares owned by a

limited partnership in which Mr. Belfer is the grantor. Also includes 17,120 shares that would be acquired upon the conversion of the Preferred Convertible Stock shown in the table as being beneficially owned by Mr. Belfer with shared voting and investment power.

- (6) Includes 539,687 shares held in a charitable foundation in which Mr. Lay has no pecuniary interest.
- (7) Shares held in a charitable foundation in which Mr. Winokur has no pecuniary interest.
- (8) Includes 625 shares held by Mr. Belfer's wife and two shares held by a trust in which Mr. Belfer is co-trustee, in all of which shares Mr. Belfer disclaims beneficial ownership.
- (9) Includes 13,500 shares held in trust in which Mr. Belfer's son or wife is trustee or in which Mr. Belfer is trustee or a co-trustee and 3,000 shares held by Mr. Belfer's wife.

BOARD OF DIRECTORS AND COMMITTEES

The Board of Directors held five regularly scheduled meetings and four special meetings during the year ended December 31, 2000. The Executive Committee meets on a less formal basis and may exercise all of the powers of the Board of Directors, except where restricted by Enron's bylaws or by applicable law. During the year ended December 31, 2000, the Executive Committee met seven times. The Executive Committee is currently composed of Messrs. Duncan (Chairman), Belfer, Lay, LeMaistre, Skilling and Winokur.

The Board of Directors uses working committees with functional responsibility in the more complex recurring areas where disinterested oversight is required. The Audit and Compliance Committee reviews the scope and results of the audits, the notice and application of accounting principles and the effectiveness of internal controls. The Audit and Compliance Committee met five times during the year ended December 31, 2000. The Audit and Compliance Committee is currently composed of Messrs. Jaedicke (Chairman), Chan, Mendelsohn, Pereira, Wakeham and Dr. Gramm.

The Compensation and Management Development Committee's responsibility is to establish Enron's compensation strategy and to ensure that the senior executives of Enron and its wholly owned subsidiaries are compensated effectively in a manner consistent with the stated compensation strategy of Enron, internal equity considerations, competitive practices and the requirements of appropriate regulatory bodies. In meeting ten times during the year ended December 31, 2000, the Compensation and Management Development Committee also continued to monitor and approve awards earned pursuant to Enron's comprehensive executive compensation program, monitor Enron's employee benefit programs and review matters relating to management development and management succession. The Compensation and Management Development Committee is currently composed of Messrs. LeMaistre (Chairman), Blake, Duncan, Jaedicke and Savage.

The Finance Committee serves as a monitor of Enron's finance activities. In meeting five times during the year ended December 31, 2000, the Finance Committee reviewed the financial plans and proposals of management, including equity and debt offerings, changes in stock dividends and the equity repurchase program, the changes in the risk management policy, the transaction approval process and the policy for approval of guarantees, letters of credit, letters of indemnity, and other support arrangements and recommended action with regard thereto to the Board of Directors. The Finance Committee is currently composed