

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

United States District Court  
Southern District of Texas  
FILED  
JUN 24 2002

Michael N. Milby, Clerk

MARK NEWBY, *et al.*, Individually and §  
On Behalf Of All Others Similarly §  
Situating, §  
§  
Plaintiffs, §  
§  
v. §  
§  
ENRON CORP., *et al.*, §  
§  
Defendants. §

CIVIL ACTION NO. H-01-3624  
(Consolidated)

REPLY OF CERTAIN OFFICER DEFENDANTS TO  
PLAINTIFFS' OPPOSITION TO MOTIONS TO DISMISS

921

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On May 8, 2002, Richard B. Buy, Richard A. Causey, Mark A. Frevert, Stanley C. Horton, Steven J. Kean, Mark E. Koenig, Michael S. McConnell, Jeffrey McMahon, Cindy K. Olson, Kenneth D. Rice, and Lawrence Greg Whalley filed individual Motions to Dismiss and a Joint Brief in support of their motions (“Joint Brief”). Plaintiffs have filed their Opposition (“Opposition” or “Opp.”) to the Motions to Dismiss of all but one of those defendants.<sup>1</sup> This Reply is filed on behalf of the remaining ten officers (the “Officer Defendants”).

## I.

### Introduction

Plaintiffs’ Opposition – which is directed at the Officer Defendants as well as other officers and/or directors – is 160 pages long. It contains many points, arguments, and citations of doubtful merit, both legally and factually. In light of the massive amount of briefing this Court must consider in connection with the myriad pending motions to dismiss, this Reply does not address each and every questionable point, argument, or citation. Instead, it focuses on several of the more important points raised in the Officer Defendants’ Motions to Dismiss that Plaintiffs have muddled or obscured in their Opposition, and on the more suspect points or arguments from the Opposition. If, because of its relative brevity, this Reply does not address one or more issues of concern to the Court, the Officer Defendants are confident that the other defendants will do so.

Part II of this Reply sets forth those additional points that pertain to all of the Officer Defendants filing this Reply. Part III contains additional arguments that further support the individual Officer Defendants’ respective motions to dismiss.

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<sup>1</sup> On June 12, 2002 Plaintiffs filed a motion to dismiss Michael S. McConnell as a defendant. Accordingly, this Reply does not address the claims that had been asserted against him.

## II.

### Reply of Officer Defendants

#### A. Plaintiffs Still Refuse to Plead Fraud with Particularity.

The central point of the Officer Defendants' motions to dismiss was that Plaintiffs, in their Consolidated Complaint, had failed to particularize their cases as to individual defendants, that instead they asserted their case against all Officer Defendants (and indeed against all defendants) in a collective, broad brush, conclusory fashion. In their Opposition, Plaintiffs continue this group approach, frequently lumping together all officer defendants in sweeping statements about what the "Insiders" supposedly did, said, and knew.<sup>2</sup> In a misleading variation on this approach, the Opposition also frequently attributes to all "Insiders" an argument that in fact only one or two of the officer defendants made in their individual motions to dismiss. It thus is evident that just as the Consolidated Complaint pled this case as one of collective or group liability, Plaintiffs tend to brief the motions to dismiss the same way. But each of the Officer Defendants (as well as each of the other defendants) is entitled to have his or her Motion to Dismiss determined on the basis of the allegations and claims asserted against him or her, specifically and individually.

That assertion, of course, is the core message of numerous opinions – namely, that in a securities fraud case, plaintiffs are "obligated to 'distinguish among those they sue and enlighten each defendant as to his or her part in the alleged fraud.'" *Coates v. Heartland Wireless*

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<sup>2</sup> For example, see Opp. at 28-29; 35 ("Insiders were involved in preparation of false statements as part of Enron's fraudulent scheme."); 75 ("The Insiders' misstatements concern the condition of Enron's assets and its finances."); 78 ("Insiders made positive statements during the Class Period relating specifically to the various failing business conditions and known problems Insiders knew about or were severely reckless in not knowing about."); 81 ("The Insiders played a significant role in preparing Enron's false and misleading SEC filings, registration statements, and prospectuses."); 108 ("The circumstantial evidence of the Insiders' scienter is overwhelming.").

*Communications, Inc.*, 26 F. Supp. 2d 910, 915 (N.D. Tex. 1998), quoting *In re Silicon Graphics, Inc. Sec. Litig.*, 970 F. Supp. 746, 752 (N.D. Cal. 1997), *aff'd*, 183 F.3d 970 (9<sup>th</sup> Cir. 1999). “To comply with the PSLRA, Plaintiffs thus must plead with particularity their allegations against *each individual defendant*.” *Zishka v. American Pad & Paper Co.*, No. 98-CV00660, 2000 WL 1310529, at \*1 (N.D. Tex. Sept. 13, 2000) (emphasis added). “Plaintiffs must allege what actions *each Defendant* took in furtherance of the alleged scheme and specifically plead what he learned, when he learned it, and how Plaintiffs know what he learned.” *In re BMC Software, Inc. Sec. Litig.*, 183 F. Supp. 2d 860, 885 (S.D. Tex. 2001) (emphasis added).<sup>3</sup>

The failure to plead with particularity as to each individual defendant is the critical flaw of the Consolidated Complaint. For example, it is not sufficient to assert, as Plaintiffs do, that “[t]he Insiders played a significant role in preparing Enron’s false and misleading SEC filings, registration statements, and prospectuses.” Opp. at 81, citing Consolidated Complaint ¶ 90. Instead, as to *each Officer Defendant*, Plaintiffs must allege with reasonable particularity what *he* or *she* did in connection with preparing any SEC filing, registration statement, or prospectus that Plaintiffs allege was false and misleading. In other words, they must allege what Mr. Horton did, specifically and individually; what Ms. Olson did, specifically and individually; and so on.

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<sup>3</sup> See also *Kennilworth Partners L.P. v. Cendant Corp.*, 59 F. Supp. 2d 417, 430 (D.N.J. 1999):

The plaintiffs here lump the defendants together and make general conclusory allegations of wrongdoing. By this, the plaintiffs do not afford the defendants the necessary opportunity to know exactly of what each is accused. . . . Most importantly, the plaintiffs do not sufficiently link the defendants, directly and specifically, with incidents or circumstances which, apart from their positions or roles within the various companies, connect them to wrongdoing and create a “strong inference” of scienter.

If Plaintiffs are held to that requirement, the resulting Complaint will be a much different document; the case will progress in a more orderly and efficient fashion (no doubt against fewer defendants); and the drain on insurance policies now funding the defense in this case will be eased.

**B. This Court’s Decision in *Landry’s* Does Not Support Puzzle Pleadings.**

Plaintiffs begin their defense of the Consolidated Complaint by arguing that it does not constitute “puzzle pleading,” which has been roundly condemned by the federal courts.<sup>4</sup> (Opp., at 1-2.) Plaintiffs’ defense is that the Consolidated Complaint is “of the same style and format as that sustained by this Court in *In re Landry’s Seafood Restaurants, Inc. Sec. Litig.*, No. H-99-1948 (S.D. Tex. Feb. 20, 2001).” (Opp., at 1.) Whether or not the Consolidated Complaint truly is “puzzle pleading” is, perhaps, an academic question. But the Plaintiffs’ argument on this point – that the style and format of the Consolidated Complaint was “approved” by this Court in *Landry’s* – must be examined.

To be sure, plaintiffs in *Landry’s* used a pleading format similar to the one here, in that they divided the class period into smaller time frames, and for each time frame they devoted a section consisting of (a) numerous paragraphs containing a collection of statements by and about the defendant company, followed by (b) a summary paragraph, asserting that all statements in that section were false or misleading and listing the allegedly “true and concealed facts” (without attempting to tie any specific misstatements to any specific “true facts”). The fact that this Court did not dismiss the *Landry’s* Consolidated Complaint hardly constitutes judicial approval of that format,

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<sup>4</sup> *E.g.*, *In re GlenFed, Inc. Sec. Litig.*, 42 F.3d 1541, 1553-54 (9<sup>th</sup> Cir. 1994) (en banc); *In re Dura Pharmaceuticals, Inc. Sec. Litig.*, No. 99CV0151-L, 2000 WL 33176043, at \*20-21 (S.D. Cal. July 11, 2000); *Schiller v. Physicians Resource Group, Inc.*, No. Civ. A. 97-CV-3158-L, 2002 WL318441, at \*16-17 & n.3 (N.D. Tex. Feb. 26, 2002); *In re Splash Tech. Holdings, Inc.*, 160 F. Supp. 2d 1059, 1073-75 (N.D. Cal. 2001); *Wenger v. Lumisys, Inc.*, 2 F. Supp. 2d 1231, 1243-44 (N.D. Cal. 1998).

especially when expanded to the bloated proportions of the *Newby* Consolidated Complaint. Indeed, it appears from a review of the motions to dismiss filed in the *Landry's* case that none of them attacked that Complaint as an example of “puzzle pleading.”

In any event, in the 73-page *Landry's* Consolidated Complaint, the format, arguably, was manageable. There, a six-month class period was subdivided into five sections of allegedly false statements (each followed by a paragraph of “true but concealed facts”), and the *longest* such section was 12 paragraphs. Here, in contrast, a three-year class period is divided into seven sections (one of which alone extends over one year and takes up 85 paragraphs of the Consolidate Complaint), and the *shortest* such section is 12 paragraphs, while the others range from 26 to 85 paragraphs.

This is not trivial nit-picking. It creates real problems for the Court, the defendants, and the process. By its design, the format turns into guesswork the task of determining *which* statements are allegedly false and *why* they are false; and the more bloated the format, the more guesswork is required and the more uncertain it becomes.<sup>5</sup>

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<sup>5</sup> A few examples from the *Newby* Consolidated Complaint illustrate the problems. At the end of each section, plaintiffs assert: “*Each* of the statements made between [beginning date and end date] were false or misleading when issued.” (See ¶¶ 121, 155, 214, 300, 339, 359, and 390.) But plainly Plaintiffs do not really contend that every statement in the preceding section is false. Many of the sentences in the referenced paragraphs of the Consolidated Complaint are uncontroversial factual matters of public record (for example, statements concerning Enron’s registration statements, offerings of notes, or its stock price, *see, e.g.*, ¶¶ 124, 126, 134, 235, and 236). And even if Plaintiffs’ sweeping assertion that “each” statement was false is interpreted to apply only to those “statements” attributed to Enron or one of the defendants, many such “statements” still are innocuous, non-controversial, or demonstrably true. To cite just a few such examples:

Enron Corp. announced today the formation of a new company to pursue opportunities in the global water business. The new water company will own and operate strategic water and wastewater assets, such as local distribution systems and treatment facilities, and develop related infrastructure. (¶ 114)

Enron Corp. announced today that it has begun construction on a long-haul fiber-optic route that will span from Salt Lake City to Houston. The route will add 2,300

**C. Plaintiffs Cannot Rely on New Allegations to Defeat Motions to Dismiss.**

In connection with the Motions to Dismiss, the Officer Defendants sought to identify each allegation individually directed to that defendant and address each such allegation in the relevant Motion to Dismiss. Plaintiffs do not point out any such individualized allegations that were overlooked. They do, however, include in their Opposition dozens of *new* allegations of a factual or evidentiary nature. The Opposition contains more than 40 allegations directed at the Officer Defendants that were not pled in the Consolidated Complaint; it contains at least as many new allegations directed at other officer defendants. For many of these new allegations, Plaintiffs cite

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route miles to Enron Communications' existing 3,400-mile backbone network and will connect through Denver, Dallas/Fort Worth and San Antonio. (¶ 122)

Enron announced today that its retail energy marketing subsidiary, Enron Energy Services, has signed a \$1.1 billion ten year total energy management outsourcing contract with Owens Corning . . . (¶ 171)

In 1999 we started up the first phase of the Dabhol Power Project, an 826-megawatt power plant . . . (¶ 216)

Recently announced long-term energy management customers include Owens-Illinois, Quaker Oats, Eli Lilly, JCPenney and Saks Incorporated. (¶ 316)

Accordingly, because of the “puzzle pleading” format, it is impossible for the reader to conclude with reasonable certainty which of the recited statements are alleged *misstatements* upon which Plaintiffs predicate their case of fraud; and, because it is impossible to correlate specific alleged misstatements with specific “true facts,” it is impossible for the reader (including both the defendants and the Court) to know why, in the Plaintiffs’ view, the alleged misstatements are false or misleading.

as their source the Powers Report;<sup>6</sup> other new allegations are purportedly based on selected minutes of meetings of the Enron Board of Directors or Committees of the Board.

Such extensive reliance on new allegations is tantamount to a concession that the Consolidated Complaint was inadequate, at least as to some defendants. In any event, the Motions to Dismiss must be determined on the basis of *what has been pled*, and not allegations in the Opposition, in some other pleading, or in the newspaper. *In re Baker Hughes Sec. Litig.*, 136 F. Supp. 2d 630, 646-47 (S.D. Tex. 2001) (“[I]t is axiomatic that the Complaint cannot be amended by the briefs in opposition to a motion to dismiss.”), quoting *O’Brien v. National Property Analysts Partners*, 719 F. Supp. 222, 229 (S.D.N.Y. 1989); see *Coates v. Heartland Wireless Communications, Inc.*, 55 F. Supp. 2d 628, 644 n.26 (N.D. Tex. 1999) (Because allegation made in plaintiff’s brief opposing motion to dismiss “is not contained in the amended complaint, plaintiffs may not rely on it.”). If after these Motions to Dismiss some of the defendants must file answers in this case, they must answer the allegations in the Consolidated Complaint, *not* the new allegations contained in the Opposition.

**D. Zandford, ABC Arbitrage, and Abrams Do Not Support Plaintiffs’ Claims.**

Plaintiffs’ Opposition gives prominent place to discussion of three recent decisions – one from the Supreme Court, *SEC v. Zandford*, 122 S. Ct. 1899 (2002), and two from the Fifth Circuit, *ABC Arbitrage v. Tchuruk*, No. 01-40645, 2002 WL 975299 (5<sup>th</sup> Cir. May 13, 2002), and *Abrams v. Baker Hughes Inc.*, No. 01-20514, 2002 WL 1018944 (5<sup>th</sup> Cir. May 21, 2002). Notwithstanding

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<sup>6</sup> The Powers Report, of course, was available to Plaintiffs before they filed the Consolidated Complaint. Indeed, they cited it several times in the section of the Consolidated Complaint that addressed “The Involvement of the Law Firms,” see, e.g., ¶ 825. Evidently, however, they consciously chose – at least initially – to avoid mentioning the Powers Report in pleading their case against the Enron officers and directors and did not incorporate it into the Consolidated Complaint.

the emphasis Plaintiffs give to these decisions, they do not undermine the arguments the Officer Defendants advanced in their Motions to Dismiss and accompanying Joint Brief.

First, the Plaintiffs trumpet the Supreme Court's opinion in *Zandford* as re-enforcing their particular construction of *Central Bank v. First Interstate Bank*, 114 S. Ct. 1439 (1994). *See, e.g.*, Opp. at 74, 83, 160. Extensive briefing has been devoted to the proper reading of *Central Bank* and whether or not it authorizes Section 10(b) and Rule 10b-5 liability for non-speakers who allegedly participate in a scheme to defraud. But the Officer Defendants did not argue *Central Bank* in connection with their motions to dismiss, for this reason: *even under Plaintiffs' expansive interpretation* of 10b-5 liability under *Central Bank*, Plaintiffs have altogether failed to plead particularized facts as to how each of the Officer Defendants participated in their alleged scheme. Neither *Central Bank* nor *Zandford* saves the Consolidated Complaint from that glaring, elementary defect.

In *ABC Arbitrage*, the Fifth Circuit held that “plaintiffs who rely on confidential sources are not always required to name those sources, even when they make allegations on information and belief concerning false or misleading statements.” 2002 WL 975299, at \*10. This holding is irrelevant to the Officer Defendants, inasmuch as Plaintiffs did not base any of their allegations against eight of the Officer Defendants (Messrs. Buy, Frevert, Horton, Kean, Koenig, McMahon, Olson, or Whalley) on confidential or anonymous sources.<sup>7</sup> The more relevant aspect of *ABC Arbitrage* is its reiteration of the particularized pleading requirements under Rule 9(b) and the

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<sup>7</sup> Several of the allegations in the Consolidated Complaint regarding Mr. Causey and Mr. Rice obviously were based on anonymous sources, but that was not a major consideration in the discussion and analysis of the claims asserted against either of them.

PSLRA. “[D]irectly put, the who, what, when, and where must be laid out *before* access to the discovery process is granted.” *Id.* at \*8.<sup>8</sup>

In *Abrams*, the Fifth Circuit affirmed Judge Gilmore’s dismissal of a securities fraud class action for pleading failures under Rule 9(b) and the PSLRA. The opinion is instructive on the issue of determining whether a strong inference of scienter has been raised. In this regard, the most pertinent point to this case is the Court of Appeals’ clear, unequivocal statement: “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.* at \*5.<sup>9</sup>

**E. Plaintiffs’ Fraudulent Scheme Allegations Fail for Lack of Particularity.**

In the same vein, Plaintiffs urge this Court to uphold their allegations of violation of section 10(b) by participation in a fraudulent scheme. They argue that such allegations do not contravene *Central Bank*. *Central Bank* is not what stands in the way of Plaintiffs’ fraudulent scheme allegations against the Officer Defendants. The flaw in these allegations is much more serious—Plaintiffs have not alleged with particularity what any one of these Officer Defendants did

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<sup>8</sup> See also the summary of Rule 10b-5 pleading requirements, quoted in note 15 below.

<sup>9</sup> Also of importance is the following passage from the Fifth Circuit opinion:

The plaintiffs’ allegations regarding non-specific internal reports are also inadequate. An unsupported general claim about the existence of confidential corporate reports that reveal information contrary to reported accounts is insufficient to survive a motion to dismiss. Such allegations must have corroborating details regarding the contents of allegedly contrary reports, their authors and recipients. Also, the mere publication of inaccurate accounting figures or failure to follow GAAP, without more, does not establish scienter. The party must know that it is publishing materially false information, or must be severely reckless in publishing such information.

*Id.* at \*6.

to further the alleged scheme. Surely, to allege scheme liability, Plaintiffs must allege facts showing specific acts of involvement by each alleged schemer.

One Texas District court has clarified what *Central Bank* did and did not have to say about fraudulent schemes in these terms:

For the “scheme to defraud” argument, [plaintiff] relies on *Cooper v. Pickett*, 137 F.3d 616 (9<sup>th</sup> Cir. 1997), which held that participants in a scheme to defraud can be held liable for violations of §10(b) and Rule 10b-5. *Id.* at 624-25. This argument is disingenuous at best. *Cooper* addressed the distinction between aiding and abetting liability, prohibited for securities fraud in *Central Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164 (1994), and direct liability. Significantly, *Cooper* held that “*Central Bank* does not preclude liability based on allegations that a group of defendants acted together to violate the securities laws, as long as each defendant committed a manipulative or deceptive act in furtherance of the scheme.” *Cooper*, 137 F.3d at 624.

*Lemmer v. Nu-Kote Holding, Inc.*, No. Civ. A. 398-CV-00161-L, 2001 WL 1112577, at \*8 (N.D. Tex. Sept. 6, 2001). The *Lemmer* court, finding no allegations of specific acts attributed to certain defendants, and only vague, general and unsupported allegations of a scheme to defraud, held that:

Allowing such general, unsupported allegations of a fraudulent scheme, without any details that support a strong inference of such a scheme *such as acts of participation by each of the Defendants*, would vitiate the particularity requirements of the PSLRA. This approach is precluded for the same reasons that the group pleading doctrine is precluded.

*Id.* Like *Lemmer*, Plaintiffs in this case have pled no specific acts of participation in Plaintiffs’ alleged scheme. Plaintiffs’ vague, general unsupported allegations do not pass muster under the PSLRA.

**F. Plaintiffs Mock “Pleading with Particularity” by Attributing Statements from Analysts Conferences to Every Officer Defendant Who (Allegedly) Was Present.**

Plaintiffs attempt to portray seven of the ten Officer Defendants as “speakers” of alleged misstatements by glossing over who actually said what during fifteen different conference calls with,

or presentations to, analysts and investors.<sup>10</sup> See Opp. at 33-34. Because a defendant allegedly was present during a conference call or a presentation, Plaintiffs' position is that *all* statements made by any Enron representative during that call or presentation may be attributed to that defendant, *even though* transcripts exist that show who actually said what and that the defendant in question did *not* make any of the statements identified in the Consolidated Complaint. This is but a variation of the discredited group pleading doctrine, and might well be termed the "group speaking" theory. See Opp. at 33 ("Fifteen Consolidated Complaint paragraphs cite specific misstatements of *small groups* of named Insiders," emphasis added).

Plaintiffs cite three cases as authority for attributing statements to a group: *In re Silicon Graphics*, 970 F. Supp. at 764<sup>11</sup>; *In re SmarTalk Teleservices, Inc. Sec. Litig.*, 124 F. Supp. 2d 527, 543 (S.D. Ohio 2000)<sup>12</sup>; *Schlagel v. Learning Tree Int'l*, No. CV-98-6384 ABC, 1998 WL 1144581,

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<sup>10</sup> Those seven defendants are Causey (see Causey Mtn to Dismiss, at 3-4); Frevert (Mtn to Dis., at 4-5); Kean (Mtn to Dis., at 3-4); Koenig (Mtn to Dis., at 3-4); McMahon (Mtn to Dis., at 7); Rice (Mtn to Dis., at 5); and Whalley (Mtn to Dis., at 4-5). For Frevert, Kean, Koenig, and Whalley, there are *no other* allegations in the Consolidated Complaint that they are directly responsible for any specific alleged misstatement.

<sup>11</sup> Actually, although the opinion is somewhat ambiguous, the better reading of *Silicon Graphics* on this point is that the District Court held that the *statements* had been identified with sufficient particularity and did not address whether each such statement had to be attributed to a specific speaker. 970 F. Supp. at 764 ("The Court first evaluates whether plaintiffs' complaint meets the . . . mandate to specify each statement alleged to have been misleading and the reason or reasons why the statement is misleading," which is followed by the discussion Plaintiffs cite on page 34 of the Opp.) In the end, however, the District Court dismissed the claims (and the Ninth Circuit affirmed) for failure to meet the requisite standards for pleading scienter.

<sup>12</sup> Although that case adopts the position Plaintiffs espouse, it is a position that follows from the *SmarTalk* court's adherence to the "group pleading" doctrine, which that court erroneously concluded had "survived the PSLRA," 124 F. Supp. 2d at 545.

at \* 5-6 (C.D. Cal. Dec. 23, 1998).<sup>13</sup> For the reasons alluded to in the footnotes, those cases are not particularly strong authority, but the compelling reason they cannot justify “group speaking” is the consistent line of Fifth Circuit holdings, recently reiterated by the Court in *ABC Arbitrage*,<sup>14</sup> that pleading fraud with particularity includes, among other things, “the identity of the person making the representation.” *E.g.*, *Williams v. WMX Technologies, Inc.*, 112 F.3d 175, 177 (5<sup>th</sup> Cir. 1997); *Tuchman v. DSC Communications Corp.*, 14 F.3d 1061, 1068 (5<sup>th</sup> Cir. 1994); *see also Nathenson v. Zonagen Inc.*, 267 F.3d 400, 412 (5<sup>th</sup> Cir. 2001). In the specific context of statements uttered in a group setting, this requirement means that “Plaintiffs [must] identify the particular individual who made the misstatement or omission.” *Schiller v. Physicians Resource Group, Inc.*, 2002 WL 318441 at \*6 (“Plaintiffs cannot avoid the bar on group pleading by simply identifying the constituents of a group of defendants in rote and conclusory fashion.”); *see also Klein v. General Nutrition Cos.*, 186 F.3d 338, 345 (3<sup>rd</sup> Cir. 1999) (“The complaint fails to attribute the statement to any specific member of GNC management.”); *Elliott Associates, L.P. v. Covance, Inc.*, 2000 WL 1752848, at \*12

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<sup>13</sup> As with *SmarTalk*, the authoritative significance of this decision is undermined by the fact that the court subscribed to the group pleading doctrine, even in the wake of the PSLRA. *Id.* at \*6.

<sup>14</sup> To summarize, a plaintiff pleading a false or misleading statement or omission as the basis for a section 10(b) and Rule 10b-5 claim must, to avoid dismissal . . . :

- (1) specify each statement alleged to have been misleading, *i.e.*, contended to be fraudulent;
- (2) *identify the speaker*;
- (3) state when and where the statement was made;
- (4) plead with particularity the contents of the false representations;
- (5) plead with particularity what the person making the misrepresentation obtained thereby; and
- (6) explain the reason or reasons why the statement is misleading, *i.e.*, why the statement is fraudulent.

*Id.* at \*9 (emphasis added).

(S.D.N.Y. 2000) (“To allow group pleading in the context of oral statements would unduly expand its ambit . . . .”); *Pegasus Holdings v. Veterinary Centers of America, Inc.*, 38 F. Supp. 2d 1158, 1165 (C.D. Cal. 1998).

What is particularly objectionable about Plaintiffs’ reliance on “group speaking” is their deliberate refusal to acknowledge and to use any of the transcripts of the analyst calls and presentations in question.<sup>15</sup> Plaintiffs undoubtedly referred to transcripts for the statements they paraphrase or quote in the Consolidated Complaint. But then they studiously ignore the fact that, at least for most of those statements, the transcripts identify the speaker(s), leaving inescapable the conclusion that their “group speaking” approach is an effort to tar or implicate *non*-speakers unfairly.<sup>16</sup>

**G. Plaintiffs’ Group Scierer Allegations are Insufficient to State a Claim against the Officer Defendants.**

In addition to the “group speaking” theory, the other key theory on which Plaintiffs rely for their case against the Officer Defendants is what might be termed “group scierer.” Although they do not (understandably) express it so boldly, Plaintiffs base their Opposition on the contention that in the circumstances of Enron and this case, all of the Officer Defendants can be charged with

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<sup>15</sup> These transcripts are discussed in a footnote (note 3, 4, or 5) to the Motions to Dismiss of Causey, Frevert, Kean, Koenig, and Whalley. Two of the transcripts are attached as Exhibits 38 and 49 to the Appendix filed in Support of the Enron Disclosure Brief.

<sup>16</sup> The transcripts reflect that some of the defendants who are alleged to have been present do not speak at all, while others speak to subjects about which plaintiffs do not complain or their comments simply cannot be construed to be material *mis*statements.

The *SmarTalk* opinion, quoted at Opp. at 34, implies that the non-speakers nonetheless had a duty to correct any misrepresentations, but in this case, Plaintiffs have not alleged sufficient grounds to create such a duty in the non-speakers, including nonconclusory allegations that the non-speaker had knowledge that a statement was false or that it was material.

knowledge of everything that (allegedly) happened within Enron, without any further allegations about what each Officer Defendant said, did, or knew. As Plaintiffs put it, “Scienter may be alleged by specifying problems that, if true, would have been obvious to the Insiders,” and “Facts critical to a business’s operations or an important customer generally are so well known to senior executives that knowledge may be attributed to them for pleading purposes.” Opp. at 98.

As authority for this sweeping proposition, Plaintiffs miscite this Court’s opinion in *Kurtzman v. Compaq Computer Corp.*, No. H-99-779, slip. op at 38 (S.D. Tex. April 1, 2002). To be sure, the Court’s opinion contains the sentence, “Courts have continuously held that knowledge of core business matters can be inferred to the officers and directors of a company.” *Id.* As is crystal clear, however, at least to all those who will see, that sentence comes from a portion of the Court’s opinion that recites the arguments advanced by the plaintiffs – arguments this Court declined to follow. After acknowledging the plaintiffs’ arguments, the Court’s actual decision was that those arguments – including the one based on officers’ supposed knowledge of “core business matters” – failed to carry the day.

Plaintiffs’ . . . weak factual allegations, including knowledge based on the officers’ positions in the company, the assertion that as officers they must have had knowledge of core business activities, the reliance on the temporal proximity of the alleged false statements to the disclosure of a severe drop in earnings in April 1999, and the sudden resignations after the April 9<sup>th</sup> disclosures, 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 opinion). Accordingly, this Court *granted* the defendants’ motion to dismiss.

See also *BMC Software*, 183 F. Supp. 2d at 886 n.34; *Collmer v. U.S. Liquids, Inc.*, No. 99-2785 (S.D. Tex. Jan. 23, 2001), slip op. at \*77-8, 81-2.

Plaintiffs also claim the Fifth Circuit’s decision in *Nathenson* as authority for their group scienter theory. Opp. at 98 (“Scienter was adequately pleaded in *Nathenson* for statements about patent protection for a product that was ‘obviously important,’ involved substantial company efforts, and about which the CEO had ‘ample opportunity to become familiar.’”). In point of fact, however, the Fifth Circuit in *Nathenson* found that the pleadings raised a strong inference as to only one officer, *not* a group of officer defendants. Moreover, that one officer was the CEO of the company, the company was relatively small (about 35 employees), it was “essentially a one product company,” that one product depended on patent protection, the alleged misstatement involved the patent status of that single product, and it was the CEO who had made the statement at issue. 267 F.3d at 425. Even given all those factors – none of which apply here – the Fifth Circuit characterized the question of scienter as “a close one,” *id.* at 424, and its ultimate conclusion that, when all those factors were taken together, there was a strong inference of scienter as to the CEO was qualified with the phrase, “if perhaps only barely so,” *id.* at 425.<sup>17</sup>

That *Nathenson* does not stand for some sort of group scienter theory is underscored by the Fifth Circuit’s recent decision in *Abrams*. In that case, the plaintiffs had sought to impute knowledge of alleged accounting irregularities to senior level executives of Baker Hughes who allegedly “were intimately familiar with the inner working of the company” and allegedly “received unidentified daily, weekly and monthly financial reports” and “had the power and influence to cause Baker Hughes to issue the false statements.” Slip op. at \*5. The Fifth Circuit, affirming Judge Gilmore’s

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<sup>17</sup> Plaintiffs also cite as support for their position *In re NetSolve, Inc. Sec. Litig.*, 185 F. Supp. 2d 684 (W.D. Tex. 2001), in which the court upheld allegations of scienter against four top officers of the company. Although the case can be distinguished from this one, it would be more straightforward to suggest that the court set too low the threshold for a “strong” inference of scienter, perhaps because the decision was rendered before, and without the benefit of, the Fifth Circuit’s opinion in *Nathenson*.

dismissal on the basis that the pleadings of scienter were inadequate, held “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.*, citing *In re Advanta Corp. Sec. Litig.*, 180 F.3d 525, 539 (3d Cir. 1999). Moreover, the Court held that before scienter could adequately be pled through allegations about officers having access to confidential internal financial reports that were contrary to published financials, those allegations “must have corroborating details regarding the contents of [the] contrary reports, their authors and recipients.” *Id.* at \*6.

Thus, with respect to pleading knowledge of the “true but concealed facts” on the part of officers or other insiders, the relevant controlling cases remain decisions like *Coates*, 26 F. Supp. 2d at 920-21; *Schiller*, 2002 WL 318441 at \*10 n.10; *BMC Software*, 183 F. Supp. 2d at 915-16; *In re Waste Management, Inc. Sec. Litig.*, No. H-99-2183, slip op. at 188 (S.D. Tex. Aug. 16, 2001) (“While Plaintiff claims that Proto and DeFrates were regularly receiving DSO reports and other reports, Plaintiff fails to plead specifically when, what was in them, who prepared them, and why they should have been reliable . . . . Indeed, Plaintiff’s reliance on Proto and DeFrates’ positions in the corporation to account for their knowledge of its problems is also inadequate.”); *Zishka*, No. 98-CV00660, 2001 WL 1645500 (N.D. Tex. Dec. 20, 2001), at \*4 (rejecting plaintiffs’ argument that *Nathenson* authorized a “a presumption-of-knowledge doctrine for corporate officers” and declining to find that two high-level officers could be “presumed to have had knowledge of facts or events critical to a company’s business, including knowledge of misstatements made by the company”). In short, Plaintiffs simply are wrong when they contend that “[s]cienter may be alleged by specifying problems that, if true, would have been obvious to the Insiders.” *Opp.* at 98.

## H. Bonus Payments Do Not Connote Fraud.

At page 134, Plaintiffs argue that the performance bonuses allegedly paid to some (but not all) of the Officer Defendants “support” a strong inference of scienter. The Officer Defendants had anticipated this argument in their Joint Brief, citing cases from the Southern District of Texas and the Fifth Circuit to the effect that incentive compensation does not *per se* demonstrate scienter. (Joint Brief, at 9-10.) Plaintiffs do not address the case law authority cited by the Officer Defendants, no doubt because it was not particularly helpful to Plaintiffs’ position. Instead, Plaintiffs cite *Florida State Board of Admin. v. Green Tree Fin. Corp.*, 270 F.3d 645, 661 (8<sup>th</sup> Cir. 2001), in which the Eighth Circuit, Plaintiffs represent, held that “magnitude of officer’s compensation package, together with coincident overstatement of earnings, ‘provides an unusual, heightened showing of motive to commit fraud.’” Opp. at 134. In point of fact, the executive compensation arrangement at issue in *Green Tree* truly was extraordinary,<sup>18</sup> so much so that it is of a different magnitude altogether from Enron’s bonus plan,<sup>19</sup> and not pertinent to this case. But rather than wrestle with the applicability of *Green Tree*, this Court obviously should look to the Southern District of Texas and Fifth Circuit authorities cited in the Joint Brief, as to which the latest word is from the Fifth Circuit in *Abrams*

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<sup>18</sup> The CEO’s contract for 1996 awarded him, in addition to a base salary, 2.5% of Green Tree Financial’s pre-tax income. The plaintiffs alleged that this feature contributed to his being the most highly paid business executive in the United States in 1996 (\$102 million). Moreover, that particular contract expired at the end of 1996 (the year of the overstatement of earnings upon which plaintiffs’ fraud case was based), to be replaced by a contract without such a lucrative bonus feature (under which the CEO earned \$97 million *less* in 1997). *Id.* at 650, 661.

<sup>19</sup> Plaintiffs allege that twelve Enron officer-defendants received almost \$61 million in bonuses for the years 1997 to 2000 (in contrast to the \$100+ million the Green Tree CEO received for one year).

*v. Baker Hughes*.<sup>20</sup> With regard to the Enron plan, a more instructive case is *In re Azurix Corp. Sec. Litig.*, 198 F. Supp. 2d 862 (S.D. Tex. 2002), in which Judge Lake rejected the proposition that the executive compensation program at Azurix (an affiliate of Enron with a similar incentive compensation program) constituted sufficient motivation to support a strong inference of scienter. *Id.* at 890.

**I. Plaintiffs Have Wholly Failed to Plead with Particularity Insider Trading Against the Officer Defendants.**

Consistent with Plaintiffs' overall approach to this case as one of collective or group liability, the Opposition begins its discussion of insider trading issues with an argument based on the collective trading of Enron stock by Enron "Insiders." Opp. at 105-07. Here, too, Plaintiffs' group approach is contrary to the law. "Since scienter must be pled as to each defendant, the court analyzes the stock sales of each defendant." *Allison v. Brooktree Corp.*, 999 F. Supp. 1342, 1352 (S.D. Cal. 1998); see also *In re Splash Technology Holdings, Inc.*, 160 F. Supp. 2d at 1082 ("In evaluating scienter, the PSLRA 'requires the Court to consider each defendant's sales separately.'") (quoting *In re Silicon Graphics, Inc. Sec. Litig.*, 970 F. Supp. at 767); *Zishka*, 2000 WL 1310529 at \*2 (the court reviews scienter allegations in the complaint as to each defendant). Accordingly, in *BMC Software*, 183 F. Supp. 2d at 901-03, this Court conducted a defendant-by-defendant review of the insiders' sales to determine whether any of those sales were "unusual," that is, occurring at

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<sup>20</sup> "Allegations of motive and opportunity, standing alone, are no longer sufficient to plead a strong inference of scienter, although *appropriate* allegations of motive and opportunity may enhance *other* allegations of scienter." Slip op. at \*4 (emphasis added), (citing *Nathenson*).

suspicious times and in suspicious amounts, out of line with prior trading practices.<sup>21</sup> So, too, must the trading practices of the Officer Defendants be examined on a defendant-by-defendant basis.

Plaintiffs further contend that their allegations as to “the suspicious amount and time of the Insiders’ trading” – *i.e.*, whether the sales were “unusual” – cannot be resolved “as a matter of law” at the pleading stage. Opp. at 108. That contention, too, is belied by *BMC Software*, as well as numerous other decisions in which courts have held that sales by insider defendants, as alleged, were not “unusual” so as to be probative of scienter. *E.g.*, *Nathenson*, 267 F.3d at 421 (“‘Insider’ trading must be ‘unusual’ to have meaningful probative value. . . . Sales such as Blasnik’s which are ‘so inauspiciously timed’ do not meet this test.”); *Zishka*, 2001 WL 1645500, at \*4; *In re Apple Computer Sec. Litig.*, 886 F.2d 1109, 1118 (9<sup>th</sup> Cir. 1989).

**J. Failure to Consider Pre-Class Period is Fatal to Plaintiffs’ Insider Trading Claims.**

At pages 13-14 of the Joint Brief, the Officer Defendants, refer to the requirement – as recognized by various courts, including this one in *BMC Software*, 183 F. Supp. 2d at 901 – that one factor that must be considered in determining whether the trading of an insider defendant was sufficiently “unusual” is that defendant’s trading practices *before* the class period. Plaintiffs obviously were mindful of this requirement, for in the Consolidated Complaint they constructed graphs for each officer defendant in a way that purported to depict “Pre-Class Period Shares Sold.” For all but one (Stan Horton) of the Officer Defendants, Plaintiffs’ graphs show *no* pre-Class Period

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<sup>21</sup> Plaintiffs strongly suggest that in *Landry’s* this Court evaluated the insider trading allegations involving five insiders on a collective basis, and found that the collective volume of insiders’ trades was sufficient to support scienter. Opp. at 107, 108. However, the Court made clear that its finding that trading by Landry’s insiders contributed to a strong inference of scienter was based on the entire context of the trades: (1) the defendants possessed specific, detailed, non-public information at the time they traded; (2) their sales were highly coordinated and occurred in conjunction with misrepresentations; and (3) they admitted to closely monitoring the business on a daily basis.

sales. The point made in the Joint Brief was that the Court would not be justified in concluding (or even assuming) on the basis of the Plaintiffs' presentation and graphs that any particular Officer Defendant had not sold Enron stock before the Class Period. First, an Officer Defendant might not even have acquired any Enron stock before the Class Period. Second, the Officer Defendant might have sold Enron stock before the Class Period but the sale was not reported on SEC Forms 4 and 5 because, at the time of the sale, that defendant was not required to file Forms 4 and 5. Third, the Plaintiffs might have overlooked or ignored sales duly reported on Forms 4 and 5; and, as pointed out, Plaintiffs *did* fail to take into account SEC filings of pre-Class Period sales for at least two Officer Defendants (Richard Causey and Stan Horton). Joint Brief, at 14 & n.6.

Plaintiffs attempt to side-step this issue as “a factual argument [that] is not appropriate here.” Opp. at 114. But it is deeper than a simple factual dispute. It goes to whether the Plaintiffs have provided the Court with a sufficiently thorough and reliable presentation of the circumstances surrounding the history and practices of each individual Officer Defendant in acquiring and selling Enron stock for the Court to determine, for each individual, whether the alleged sales during the Class Period were “unusual,” or “out of line with prior trading practice.” Admittedly, for some defendants there are gaps in the available information at this stage of the proceedings, but that does not give the Plaintiffs license to fill in those gaps however they wish (as, for example, alleging that an individual Officer Defendant did not sell any Enron stock before the Class Period when Plaintiffs have no information whatsoever about that person's stock holdings or sales before the Class Period).<sup>22</sup>

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<sup>22</sup> This unwarranted assumption of “no pre-Class Period sales” also extends to the analysis and conclusions of Dr. Hakala. Plaintiffs repeatedly allege, based on Dr. Hakala's analysis, that the premature exercises of stock options by Enron insiders “were inconsistent with those individuals' prior economic behavior.” *E.g.*, Opp. at 111. A critical fallacy of this conclusion is that, at least for

**K. Plaintiffs' Calculation of Percentages of Shares Sold by the Officer Defendants is Flawed.**

Along similar lines, the Officer Defendants argued in the Joint Brief, at 15-17, that Plaintiffs' allegations of the percentages of Enron stock sold by each insider during the Class Period were not reliable. Plaintiffs purport to address this point in the Opposition, at 119, but they still do not explain how they derived the percentage figures advanced in the Consolidated Complaint. Specifically, they do not respond to or clarify the problems and ambiguities associated with their apparent methodology, as outlined in footnote 7 of the Joint Brief (pages 16-17). Hence, the conclusion stands: "[T]he Complaint fails to set forth a sufficient basis for this Court to rely on the percentages of stock sales alleged by Plaintiffs in paragraphs 83(a) - 83 (cc) and 402."

**L. Plaintiffs Have Not Tied the Officer Defendants' Trades to Misrepresentations or Nondisclosures.**

Another criticism made in the Joint Brief was that Plaintiffs did not tie or otherwise associate any of defendants' supposedly tainted sales of Enron stock to specific events – that is, public statements containing material misrepresentations, or situations in which Enron had failed to timely disclose material information. Joint Brief, at 15. In their Opposition, Plaintiffs advance two replies. Opp. at 115-17.

First, they claim that such correlation of insider trades and specific events is not necessary when "the Enron Defendants inflated the stock price over three years by manipulating accounting practices." Opp. at 115. Once again, Plaintiffs immediately resort to conclusory allegations of

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many of the Enron insiders, there simply is no evidence of their prior economic behavior. Again, the evidence may not presently be available to them, but that does not justify Plaintiffs' or Dr. Hakala's misrepresenting the situation.

collective liability without having detailed with particularity what each defendant did to justify including him or her in that massive fraudulent scheme.

Second, Plaintiffs contend that in fact they did “demonstrate that the Insiders’ sales during the Class Period were tied to their positive statements.” Opp. at 115. The vehicle by which they say they did so was a chart that (a) supposedly was included as paragraph 74 of the Consolidated Complaint filed with the Court, but was not electronically served on these Officer Defendants, and (b) supposedly is re-published at page 27 of the Opposition. That chart, as it appears on page 27, depicts collective sales by *all* “Insiders” in blocks of time ranging from two to four months. For purposes of tying any defendant’s sales to any specific misrepresentations or omissions, the chart is doubly flawed. First, of course, it is a collective or group pleading; it contains no information specific to any individual. Second, it still does not tie or correlate stock sales to specific misrepresentations or omissions in any meaningful or probative way. For example, sales that were made up to four months after alleged false positive statements (or up to four months before disclosures of previously undisclosed material information) are too remote. *See In re Baker Hughes, Inc.*, 136 F. Supp. 2d at 646.

Both of these flaws are highlighted in the argument Plaintiffs make at the end of their discussion of this issue: “Moreover, Enron Insiders sold 362,051 shares of stock for over \$6 million in 10/01 – immediately following positive statements accompanying the announcement of Enron’s \$1-billion writeoff – and two months before Enron filed for bankruptcy.” Opp. at 117. The Officer Defendants do not accept Plaintiffs’ characterization of these sales as “immediate,” which the Officer Defendants understand is disputed. Moreover, Plaintiffs’ attribution to “Enron Insiders” is

misleading because in Exhibit C to the Consolidated Complaint Plaintiffs attribute the sale of these shares to one person; none of the sales was by any of the Officer Defendants.<sup>23</sup>

**M. The Retention by Certain Officer Defendants of Large Enron Holdings is a Factor to be Considered in Assessing Scienter.**

Plaintiffs argue that “the fact that some of the Insiders did not sell all of their stock does nothing to negate the inference of scienter.” Opp. at 117. On the contrary, courts routinely consider the retention of stock by individual defendants in determining whether plaintiffs have pled facts supporting a strong inference of scienter. *In re Baker Hughes Sec. Litig.*, 136 F. Supp. 2d at 646 (fact that one defendant retained a substantial percentage of his holdings and other defendants did not trade fell short of creating a strong inference of scienter); *In re Advanta Corp. Sec. Litig.*, 180 F.3d at 541 (“Far from supporting a ‘strong inference’ that defendants had a motive to capitalize on artificially inflated stock prices, [retained holdings] suggest [that] they had every incentive to keep Advanta profitable”); *In re Silicon Graphics Inc. Sec. Litig.*, 183 F.3d at 987-88 (where collective retention by all defendants aggregated 90%, no motive stated by individual’s sales of 43.6%); *San Leandro Emergency Med. Group Profit Sharing Plan v. Philip Morris Cos., Inc.*, 75 F.3d 801, 813-14 (2d Cir. 1996) (where insiders retained holdings, sales did not constitute scienter).

**N. The Hakala Declaration Should Not be Considered.**

In pleading their case of “insider trading,” both as an independent primary violation and as evidence of scienter, Plaintiffs have relied heavily on the Declaration of Dr. Hakala. That Declaration was sharply criticized in virtually every motion to dismiss filed by an Enron officer or

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<sup>23</sup> According to Exhibit C to the Consolidated Complaint, the ten Officer Defendants made their last sales of Enron stock on the following dates: Buy (3/5/01); Causey (8/2/01); Frevert (12/20/00); Horton (6/1/01); Kean (1/31/01); Koenig (5/2/01); McMahon (3/16/00); Olson (3/8/01); and Rice (8/2/01). The Consolidated Complaint contains no information about Mr. Whalley’s sales, if any.

director, and with good reason. In particular, in addition to their own Motions and Joint Brief, the ten Officer Defendants, refer to Court to the Memoranda in Support of their Motions to Dismiss of Jeffery K. Skilling (pages 66-68)<sup>24</sup> and Rebecca Mark-Jusbache (pages 27-31,37-38).

If the Court considers Hakala's Declaration, in addition to everything else that has been said regarding it, the Court should bear in mind the fact that Hakala is a professional witness. The resume he attached to his Declaration<sup>25</sup> reflects that between January 1998 and March 2002, he testified in 51 different cases; in many of those cases, he testified two or more times; and in 21 of those cases he testified at trial or at a hearing. He is in such demand that on several occasions he had to testify in three or four separate cases within the space of a week. Moreover, it appears from his resume that he is an all-purpose expert, at least for matters economic or financial, having testified on subjects ranging from the valuation of various businesses (including a large dairy operation, a physician's practice, and a tattoo parlor), to the arbitrariness of the Florida state process of selecting insurance carriers, to anti-competitive practices and duties of financial advisors, to standards of professional appraisal practice (including ethical requirements for disclosure of relationships and conflicts by business appraisers), to valuation of oil and gas reserves, to the current job market and likelihood of employment for an individual claiming to have been wrongfully terminated, to the

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<sup>24</sup> Mr. Skilling underscores the significance of two glaring omissions of Dr. Hakala: he ignores the fact that Enron stock paid dividends and, particularly problematic, he does not take into account the different tax considerations between an early exercise of a stock option and waiting to exercise the option until just before it expires. As Mr. Skilling cogently points out, for a holder of vested options who believes the price of the underlying stock will continue to rise, the economically rational course might well be to exercise the options as soon as they vest (contrary to Dr. Hakala's premise) in order to obtain favorable capital gains tax treatment.

<sup>25</sup> See Exhibit A (pages 4-8) to the Declaration of Scott D. Hakala, which in turn is Exhibit B in Plaintiff's Appendix of Exhibits in Support of Consolidated Complaint.

subject he recently has been repeatedly engaged to testify on – namely, materiality, causation, and damages in securities fraud litigation.

### III.

#### Replies of Individual Officer Defendants

In addition to the foregoing Reply on behalf of the Officer Defendants as a group, the Officer Defendants submit the following arguments in further support of their individual motions to dismiss the Consolidated Complaint.

##### A. **Richard B. Buy**

Obviously reflecting the weakness of the Consolidated Complaint's claims against Mr. Buy, Plaintiffs attempt to bolster their case by making new allegations against him derived from their selectively skewed reading of the Powers Report. *See Opp.* at pp. 43-44. These newly minted allegations are not properly pled in the Consolidated Complaint, and are not before this Court on Mr. Buys' Motion to Dismiss. That the Plaintiffs felt compelled to cite the Powers Report seven times in a single page of text in its Opposition to Mr. Buy's motion is telling. The Consolidated Complaint, standing alone as it must on this motion, fails to state a claim against him. Moreover, what the Powers Report has to say about Mr. Buy, even if accepted as true, would not support a securities fraud claim.

Plaintiffs' insider trading allegations against Mr. Buy are simply restated in summary form. Plaintiffs' assertions that no more specificity is required is dealt with in Mr. Buy's Motion to Dismiss and those of the other Officer Defendants, as well as above.

Plaintiffs have sued Mr. Buy under the Texas Securities Act. Regarding Washington Board's claim under the Texas Securities Act, Art. 581-33, V.T.C.A., Plaintiffs virtually concede what they

must – that this claim should, at a minimum, be replied. Opp. at 160, n.60. The Texas statute contains four different categories of possible defendants in actions brought by plaintiff purchasers of securities: Sellers (art. 581-33A(1) and (2)); Nonselling Issuers (art. 581-33C); Control Persons (art. 581-33F(1)); and Aiders (art. 581-F(2)). To put it charitably, the Consolidated Complaint is less than transparent in its reference to the basis for Mr. Buy’s alleged liability under this statute. It fails to cite the relevant subsections. Plaintiffs’ Opposition purports to cure this defect, but the rules require clarity in the pleading, not subsequent filings. For the first time in Plaintiffs’ Opposition, for example, Plaintiffs claim Mr. Buy is liable for aiding and abetting violations of the statute. A defendant is entitled to read about a claim made against him first in the plaintiff’s complaint

For some inexplicable reason, Plaintiffs still seek to hold Mr. Buy liable under the Texas statute as a “control person” of, apparently, Enron Corp. They do this in the face of facts pled in the Consolidated Complaint that show Mr. Buy was not an officer of Enron Corp., nor was he on Enron Corp.’s Management Committee (to the extent that Plaintiffs presume that such membership connotes control person status) when the Registration Statement for the subject notes became effective.

Finally, Plaintiffs quote a snippet from Sherron Watkins’ multi-page letter to Kenneth Lay as a putative booster to their allegations of scienter against Mr. Buy: “Personnel to quiz confidentially to determine if I’m all wet: . . . Rick Buy.” Ms. Watkins’ supposition that Mr. Buy could corroborate some unspecified portion of her letter to Mr. Lay does not connote involvement in securities fraud. On the contrary, if any meaning can be drawn from the cursory reference to Mr. Buy, it is that Ms. Watkins found him to be an honest and credible individual.

**B. Richard A Causey**

Virtually every allegation against Mr. Causey cited in specific opposition to his motion to dismiss is based on the Powers Report or Minutes of Board or Board Committee meetings appended and referred to for the first time in Plaintiffs' Opposition. Opp. at 44-46. These allegations, accordingly, are not properly pled as part of the Consolidated Complaint. With their reliance on these unpled materials, Plaintiffs concede that the Consolidated Complaint cannot stand on its own; therefore, it must be dismissed.

Plaintiffs add nothing to their insider trading allegations against Mr. Causey. Plaintiffs' Opposition simply restates sales figures in summary form, providing no further detail to even hint at suspicious timing or motivation for Mr. Causey's sales transactions. Perhaps the failure is calculated, not slipshod. The facts found in Mr. Causey's SEC Form 4's for 2001, the year in which insiders were supposedly bailing out of Enron stock, show that Mr. Causey sold 7,513 shares of the 30,665 he acquired that year – curious behavior for one allegedly fleeing a sinking ship. Plaintiffs again seek to tar Mr. Causey with misrepresentations by alleging his presence at analyst conference calls. Mere presence is not enough, as the Officer Defendants re-urge at Section II.F. above. Mr. Causey is also sued for allegedly violating the Texas Securities Act. The discussion of this claim with regard to Richard Buy, above, is equally applicable here. At a minimum, this claim must be repled.

Alone among these Officer Defendants, Mr. Causey is charged with violating section 11 of the 1933 Act. In order to avoid unduly extending the length of this Reply, Mr. Causey respectfully adopts and incorporates the arguments against section 11 liability asserted in the Outside Directors' Reply in support of their pending motion to dismiss

**C. Mark A. Frevert**

Plaintiffs can allege nothing more about Mr. Frevert than that he sold stock during a three-year period. The insider trading allegations against him are merely restated in summary form in Plaintiffs' Opposition. No facts support any allegation that his sales were in suspicious amounts or at suspicious times or were motivated by any impermissible reason. Indeed, Mr. Frevert's last sale of Enron stock, according to Exhibit C to the Consolidated Complaint, was on December 20, 2000 – nearly a year before the close of the Class Period. During 2001, when the “scheme” was allegedly unraveling and the “Insiders” “bailing out,” Mr. Frevert sold no shares.

In their Opposition, Plaintiffs charge that Mr. Frevert “made false and misleading statements regarding Enron's financial position and business success” in two analysts' conference calls a year apart. What they actually pled is much less dramatic. In the Consolidated Complaint, Plaintiffs simply assert that Mr. Frevert was one of five Enron officers who participated in an analysts' call on October 17, 2000, and one of seven such individuals involved in a similar call on October 16, 2001. On neither occasion do Plaintiffs attribute any specific statements to Mr. Frevert. Simply being present at a conference call, without more, is not enough, as the Officer Defendants re-urge at section II.F. above.

With Mr. Frevert, and continuing with several of these Officer Defendants, Plaintiffs invoke a formulaic litany – that based on the individual's “intimate[] involve[ment] in the day-to-day operations of Enron ... it is inconceivable that he was not aware of the massive, sophisticated fraud being perpetrated.” Opp. at 51. This is nothing more than a conclusory allegation based on Mr. Frevert's job at Enron. The law does not condemn as guilty of securities fraud an officer of a company merely because he or she is one. See Joint Brief at pages 7-9; section II.G above.

**D. Stanley C. Horton**

Plaintiffs' allegations regarding Mr. Horton are the most sparse, and some of them are demonstrably wrong. In making their formulaic scienter argument – Horton's "intimate involvement" renders it "inconceivable that he was not aware of the massive, sophisticated fraud being perpetrated" – Plaintiffs state that he was "intimately involved in the day-to-day operations of EBS [Enron Broadband Services]." *Opp.* at 54. However, the Consolidated Complaint, Plaintiffs' Opposition earlier in that same paragraph, and historical facts establish that Mr. Horton was an officer of Enron Transportation Services, not EBS. Moreover, his position, with whatever entity, is not alone enough to support an allegation of scienter against Mr. Horton. This is nothing more than a conclusory allegation based on position. The law does not condemn as guilty of securities fraud an officer of a company merely because he or she is one. *See* Joint Brief at pages 7-9; section II.G. above.

It is undisputed that Mr. Horton was with Enron Transportation Services or its predecessor, Enron Gas Pipeline Group, throughout the Class Period. While it is difficult to speak in absolute terms about a 500-page Complaint and a 160-page Opposition, Officer Defendants' review of the allegations in this case find none that relate to the business operations of Mr. Horton's group. Considering the otherwise vast reach of Plaintiffs' charges, it is a telling omission.

Plaintiffs restate their conclusory allegation that Mr. Horton engaged in illegal insider trading. First, Plaintiffs do not — and cannot — allege a "pattern" of trading by Mr. Horton. He had sales transactions in 14 separate months, from October 1998 to June 2001. He sold at prices from \$26 a share to \$85 a share. The vast majority of his sales, according to Plaintiffs' own figures, came at prices below the market peak. Sixty percent of the shares he sold were sold, again using Plaintiffs'

figures, by the end of March 2000 – well before the market peak, before most of the alleged wrongdoing, and twenty months before the end of the Class Period.

**E. Steven J. Kean**

In trying to hold Mr. Kean in this case, Plaintiffs assert the following: “Board minutes show that Kean was present at and participated in approving many of the fraudulent transactions detailed in the Consolidated Complaint, including Chewco. *See Ex. 21.*” Opp. at 54. That statement is false.

Exhibit 21, appended for the first time to Plaintiffs’ Opposition, appears to be an unsigned draft of Minutes of the November 5, 1997, meeting of the Executive Committee of the Enron Board (not the full Board of Directors). These draft minutes reflect that Mr. Kean, though not a member of the Board, attended at least part of the meeting, and, on page 3, they report that he updated the Committee on certain changes being contemplated in a proposal to the Pennsylvania Public Utility Commission. Beyond that, the minutes are wholly silent as to Mr. Kean. He is not mentioned in connection with the discussion of JEDI and Chewco. Exhibit 21 does not mention or bear on any of the other transactions about which Plaintiffs complain in the Consolidated Complaint. Indeed, this meeting pre-dates the beginning of the Class Period by nearly a year. Mr. Kean was neither a Director of Enron nor a member of the Board’s Executive Committee, so it cannot be presumed that he joined in or otherwise participated in any resolutions or decisions made at the meeting. In light of these factors, all of which are obvious upon even a cursory reading of Exhibit 21, it is irresponsible to assert on the basis of that document, as Plaintiffs do, that “Board minutes show that Kean was present at and participated in approving many of the fraudulent transactions detailed in the Consolidated Complaint, including Chewco.” The author of the statement is ill-positioned to complain about material misrepresentations.

Plaintiffs further assert that Mr. Kean made “false statements” in four analysts’ conference calls. Again, the facts are to the contrary. In paragraphs 282, 329, 343, and 366 of their Consolidated Complaint, Plaintiffs allege that Mr. Kean was one of a group of Enron officers who participated in discussions with analysts and investors about Enron’s businesses and financial performance. In each of these paragraphs, Plaintiffs allege that the Enron representatives “stated” various matters set forth in bold, italicized bullet points. In none of those four paragraphs do Plaintiffs attribute any specific statement(s) to Mr. Kean. Instead, in each instance, Mr. Kean is lumped in with four other Enron representatives. In the end, then, there are *no* allegations as to what statements *Mr. Kean* made, *if any*. Simply being present at a conference call is not enough to support a claim, see Section II.F. above.

In arguing further against dismissal, Plaintiffs restate their previous insider trading allegation. They still fail to point out anything suspicious, unusual or unseemly about Mr. Kean’s two sales during the Class Period.

Finally, Plaintiffs invoke their formulaic refrain: Mr. Kean “was intimately involved in the day-to-day operations of Enron and it is inconceivable that he was not aware of the massive, sophisticated fraud being perpetrated.” Opp. at 54. This is nothing more than a conclusory allegation based on defendant’s position at Enron. See Joint Brief at pages 7-9; section II.G. above.

**F. Mark E. Koenig**

In their Opposition, Plaintiffs assert: “Board minutes show that Koenig was present for and participated in approving many of the fraudulent transactions detailed in the Consolidated Complaint, particularly Chewco and LJM2. See Exs. 21, 24, 26, and 27.” Opp. at 55. That statement is false. Plaintiffs made a similar assertion about Steven Kean. As discussed above, that

assertion was a gross distortion of the minutes cited as the source for the allegation. The assertion as to Mr. Koenig is at least as irresponsible and reckless.

The referenced Exhibit 21 was described above. Everything said there with regard to Mr. Kean also applies to Mr. Koenig, except that where Mr. Kean is reported to have spoken about an unrelated matter, Mr. Koenig is not reported to have said anything at all in the meeting. Exhibit 24 purports to be Minutes of the Enron Board Meeting on October 11-12, 1999. Those minutes reflect that Mr. Koenig was present during the meeting on October 11, but not during the session on October 12. On October 11, Mr. Koenig gave “an investor relations update.” Ex. 24 at 3. There is no other mention of Mr. Koenig in the Exhibit’s 28 pages, including the three pages (17-19) that discuss Board approval of LJM2. Exhibits 26 and 27 appear to be minutes of meetings of the Board’s Finance Committee. Both reflect Mr. Koenig’s attendance at the respective meetings, but he is not reported to have said or contributed anything to discussions or decisions.

In sum, as with Mr. Kean, the newly referenced sources cited by Plaintiffs to defeat the dismissal motion by alleging Mr. Koenig’s “participation in approving many of the fraudulent transactions” fail to support that assertion. Those sources, properly considered, tend to engender skepticism for the reliability and integrity of Plaintiffs’ factual assertions.

Plaintiffs also assert in their Opposition that they have pled with particularity against Mr. Koenig by referencing a dozen paragraphs from the Consolidated Complaint regarding “false and misleading ... statements issued” by Mr. Koenig. The facts as pled are quite different. Again here, Plaintiffs merely lump Mr. Koenig in with a group of four to seven Enron officers who participated in the referenced analysts’ conference calls and meetings. Plaintiffs wholly fail anywhere in the

Consolidated Complaint to attribute any statement(s) to Mr. Koenig. There simply are no allegations properly pled that Mr. Koenig issued *any* statements, “false and misleading” or otherwise.

Nothing is added by Plaintiffs to buttress their insider trading charges against Mr. Koenig. There remains no allegation of anything improper, unusual, or illegal about Mr. Koenig’s sales of Enron stock.

Finally, Plaintiffs again employ their catchall claim: because of Mr. Koenig’s intimate involvement in “day-to-day operations of Enron...it is inconceivable that he was not aware of the massive, sophisticated fraud.” Opp. at 55. As with the others, this is nothing more than a conclusory allegation based on defendant’s position at Enron. *See* Joint Brief at pages 7-9; section II.G. above.

**G. Jeffrey McMahon**

Apparently conceding the manifest deficiency of their effort to turn Mr. McMahon’s one sale of stock twenty months before the close of the Class Period into actionable insider trading, Plaintiffs rely on unpled materials and new allegations to counter his motion to dismiss. Their effort is unavailing. Their allegations derived from the Powers Report and minutes of a meeting of the Board’s Finance Committee cannot properly first be “pled” in Plaintiffs’ Opposition.

Further, the referenced materials do not show what Plaintiffs allege – that Mr. McMahon was aware of “fraudulent transactions” when he made his one sale of stock in March 2000. His discussion with his superior, Mr. Skilling, did not entail or evidence any awareness on the part of Mr. McMahon of Plaintiffs’ “fraud.” Opp. at 57, citing Powers Report at 21. That fellow officers disagreed over business practices and discussed them does not translate into awareness on the part of one participant of fraudulent transactions. By Plaintiffs’ own reckoning, the Finance Committee

meeting was held two months after Mr. McMahon's stock sale. How anything Mr. McMahon knew or said two months after he sold stock is relevant is left unexplained in Plaintiffs' Opposition.

Citing six paragraphs of the Consolidated Complaint, Plaintiffs charge Mr. McMahon as among a group of individuals who "signed Enron's public filings containing misstatements." The six paragraphs do not mention Mr. McMahon.

Mr. McMahon is also charged with making "false and misleading statements" in a single analysts' conference call on November 14, 2001. The Consolidated Complaint merely alleges that Mr. McMahon was one of four participants in that call. It wholly fails to attribute any false and misleading statement to him; indeed, it attributes no statement at all. Simply being present at a conference call is not enough. See Section II.F. above.

#### **H. Cindy K. Olson**

In the single page of their Opposition directed at Ms. Olson, Plaintiffs twice use the phrase "[b]eyond her participation in the fraudulent scheme." Opp. at 58. But Plaintiffs allege no facts showing any such participation. Even by their relaxed standards, Plaintiffs do not charge Ms. Olson with making any misleading statements to the market – there are no allegations of participation in conference calls, signing of Registration Statements, or membership on the Management Committee. Instead, Plaintiffs quote from extraneous materials to make charges not pled in the Consolidated Complaint. The references to commentary on her congressional testimony by politicians and quotes from magazines and newspapers do not suffice to defend Plaintiffs' failure to state a claim.

That she sold shares of stock is all Plaintiffs allege. Even so, they fail to show that her sales were suspicious or unusual. They fail to allege facts showing that "she was privy to inside, material,

adverse information,” or what that specific information was, when she sold stock. Plaintiffs’ unspecific, conclusory assertion does not make it so.

#### **I. Kenneth D. Rice**

Apparently ignoring every assertion detailed in Mr. Rice’s Motion to Dismiss, Plaintiffs do not even attempt to bolster their case against Mr. Rice by making new allegations in their Opposition; instead, they selectively recycle the same insufficient allegations regarding Mr. Rice found in Plaintiffs’ Consolidated Complaint.

Plaintiffs first revisit their allegation that Mr. Rice made false and misleading statements at a Bank of America investment conference in late 9/99. While Plaintiffs cite to a few fragments of statements that they claim were made by Mr. Rice, the source of the statements, a Bank of America report, was written by a third party. Further, Plaintiffs fail to allege that Mr. Rice ever saw them, endorsed them, adopted them, or “entangled” himself in their making. *See In re BMC*, 183 F. Supp. 2d at 871.

Plaintiffs next restate their claim that Mr. Rice’s quotes in Enron’s 12/18/00 press release relating to the Blockbuster video-on-demand deal were not true: that EBS was going to “deliver the entertainment-on-demand service to consumers’ televisions by the end of this year,” that the “infrastructure [was] in place” and “[c]ustomers have been extremely receptive” to the service. *Opp.* at 62-63. Plaintiffs’ only support for these allegations are two anonymous sources<sup>26</sup> who allegedly asserted that EBS did not have the technology or the expertise to transmit movies in a commercially

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<sup>26</sup>And, as argued above, even the holding cited by Plaintiffs that sometimes allows for reliance on confidential sources reiterates the particularized pleading requirements under Rule 9(b) and the PSLRA, dictating that the “who, what, when, and where must be laid out.” *ABC Arbitrage*, 2002 WL 975299, at \*8.

viable manner, yet *Plaintiffs themselves* admit in their Consolidated Complaint that Enron's plan was to introduce the service in multiple cities by year end and by the end of 2000, "there were ...test systems in four cities." Consolidated Complaint ¶ 40, 41, 524.

Plaintiffs also regurgitate the tired allegation with regard to Mr. Rice that his presence at two analysts' conference calls and one analysts' conference, without specific attribution of any particular statement to him, is enough to establish scienter. Simply being present at a conference call is not enough to support a claim. See section II.F above.

Next, Plaintiffs revive and attempt to bolster their claim that Mr. Rice was allegedly involved in the sale of certain telecommunications assets known as Backbone to Andrew "Fastow's LJM," which Plaintiffs represent was not an arm's length transaction. *Opp.* at 63. Building upon these suppositions, Plaintiffs allege that this involvement proves that Mr. Rice knew that Enron's third-party disclosures and financial statements in its SEC filings were false and misleading. These unsubstantiated, conclusory allegations that Mr. Rice was even involved in these negotiations, which he was not, much less that he "knew" Enron's SEC filings were false and misleading, cannot support Plaintiffs' claims.

Finally, Plaintiffs' Opposition simply restates their insider trading allegations against Mr. Rice in summary form. The insufficiency of these allegations are dealt with in Mr. Rice's Motion to Dismiss.

#### **J. Lawrence Greg Whalley**

In opposing Mr. Whalley's motion, Plaintiffs assert that he made "false and misleading statements to analysts on 10/16/01 and 11/14/01. ¶¶ 364, 388." *Opp.* at 67. One searches the referenced paragraphs in vain for any allegation that Mr. Whalley actually said anything at either

conference call. The Consolidated Complaint specifies no statements made by Mr. Whalley. Again, as with other defendants replying herein, his mere presence at a call or meeting is not sufficient to charge Mr. Whalley with securities fraud. But Plaintiffs' problems go deeper. The next sentence in their Opposition, citing paragraph 388 of the Consolidated Complaint, reads: "In fact, in the 11/14/01 conference call he told analysts and rating agencies that there were no additional partnerships that had undisclosed debt." One can reread paragraph 388 of the Consolidated Complaint, in which Plaintiffs set out in bullet points what the group of Enron officers allegedly said, until struck blind without reading that anyone, much less Mr. Whalley, "told analysts and rating agencies that there were no additional partnerships that had undisclosed debt." Poorly pled allegations are difficult to answer; imaginary ones even more so.<sup>27</sup>

Plaintiffs further allege Mr. Whalley's involvement in securities fraud based on his various positions with Enron or its affiliates. Their reference to his service as "Enron's Chief Executive Officer of Risk Management" is nowhere pled in the Consolidated Complaint and is apparently

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<sup>27</sup>Paragraph 388 of the Consolidated Complaint reads in its entirety:

"On 11/14/01, Enron executives Lay, Whalley, McMahon and Causey held a conference call for analysts and stated:

- ***Enron had made some very bad investments. Investments such as Azurix, India and Brazil had performed poorly. Because of these investments, Enron became over-leveraged. Enron entered into related-party transactions that produced various conflicts of interest.***
- ***Enron's core business was still the best franchise in the industry.***
- ***Enron remained optimistic that actions to prevent insolvency substantially answered Enron's credit and liquidity questions. Enron's current transaction levels, while lower than the recent averages, have remained strong.***

based on Exhibit 24 to their Opposition, a document not pled and not mentioned until their Opposition. Regardless of positions held, merely pleading that Mr. Whalley held certain jobs is insufficient to state a claim against him for securities fraud. See section II.G. above

As they did with Mr. Buy, Plaintiffs quote a snippet from Sherron Watkins' multi-page letter to Kenneth Lay: "Personnel to quiz confidentially to determine if I'm all wet: . . . Greg Whalley." Once again, Ms. Watkins' supposition that Mr. Whalley could corroborate some unspecified portion of her letter does not connote involvement in securities fraud.

Finally, with absolutely no facts for support, Plaintiffs maintain that Mr. Whalley engaged in insider trading during the Class Period. Plaintiffs have wholly failed to plead anything unusual, suspicious, or improper about Mr. Whalley's stock sales—unsurprising, since they plead no facts in this regard at all.

#### **IV.**

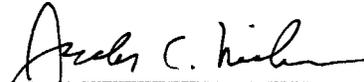
#### **Conclusion**

In their Opposition, just as they did in their Consolidated Complaint, Plaintiffs have substituted guesswork for notice, volume for accuracy, and obfuscation for particularity. A 500-page complaint of more than a thousand paragraphs, and a 160-page effort to salvage it, cannot mask what is glaringly apparent—Plaintiffs have failed to state a claim against the Officer Defendants. One can only suppose that the Plaintiffs rely on an "Enron exception" to allow them to proceed with a complaint plainly deficient under the PSLRA and the decisions of this Circuit, including at least four from this Court. Rather than calling for an unprincipled exception based upon notoriety, the legal system is best served by adherence to well-reasoned principles developed from many circumstances despite the publicity attaching to this case. When the public is watching is no time to abandon past

practices. At a minimum, the Plaintiffs should be required to replead in conformity with the law's requirements.

Dated: June 24, 2002

Respectfully submitted,



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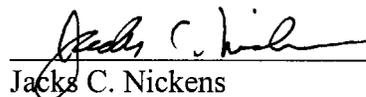
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**CERTIFICATE OF SERVICE**

I certify that a true and correct copy of the foregoing document was forwarded to all counsel of record by posting it on the website previously agreed to by the Plaintiffs and the Officer Defendants on this 24th day of June, 2002.



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Jacks C. Nickens