UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

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

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

ARTHUR ANDERSEN LLP'S REPLY
MEMORANDUM OF LAW IN FURTHER SUPPORT OF ITS
MOTION TO DISMISS THE CONSOLIDATED COMPLAINT

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Defendant Arthur Andersen LLP ("Andersen") respectfully submits this reply memorandum of law in further support of its motion to dismiss plaintiffs' Consolidated Complaint dated April 8, 2002 pursuant to Rules 9(b) and 12(b)(6) of the Federal Rules of Civil Procedure.

PRELIMINARY STATEMENT

Despite its excessive length, the Consolidated Complaint lacks allegations giving rise to a strong inference of fraud by Andersen. In particular, the Consolidated Complaint is silent on the crucial issue of when Andersen accountants actually learned facts showing that Enron's audited financial statements for 1997 through 2000 purportedly did not, in certain respects, comport with generally accepted accounting principles ("GAAP"). In any event, plaintiffs' allegations do not support a strong inference that Andersen acted fraudulently, or was so severely reckless as to constitute fraud. Absent any particularized allegations that, if proved, would indicate that Andersen accountants possessed scienter at the time of their Enron audits, plaintiffs' claim for securities fraud under Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5 does not satisfy the pleading requirements of Rule 9(b) and the Private Securities Litigation Reform Act of 1995 ("PSLRA").

Allegations regarding the timing of when Andersen learned crucial facts are particularly significant in this case, in which plaintiffs allege that Enron insiders and outside advisers other than Andersen concealed key facts, and in which Enron announced on November 8, 2001 its intention to restate its financial statements. This announcement makes it clear that Andersen *eventually* learned facts that revealed that Enron had not accounted for certain transactions in accordance with GAAP. Under these circumstances, allegations that Andersen knew these facts at an unspecified time are not probative of Andersen's scienter. Such allegations are consistent

with Andersen having learned the facts as a prelude to the November 8, 2001 announcement, as opposed to earlier when Andersen issued its audit reports on Enron's financial statements. The timing of Andersen's knowledge – and, in particular, what Andersen knew when it issued its audit reports – is a crucial issue. Yet the Consolidated Complaint is silent on this issue with respect to the key facts.

Similarly, the Consolidated Complaint does not plead particularized facts that, if proved, would show that alleged accounting errors were intentional, or resulted from recklessness so severe as to constitute fraud, as opposed to misjudgments. In short, plaintiffs' allegations suggest nothing more than that Andersen, due to misjudgments or lack of timely information, mistakenly concluded that Enron's audited financial statements comported, in all material respects, with GAAP – and then later corrected these mistaken conclusions. These allegations do not state a claim for fraud.

Confronted with the Consolidated Complaint's lack of allegations probative of scienter by Andersen, plaintiffs implicitly concede this dispositive deficiency in at least two ways. First, instead of pointing to particularized allegations in the Consolidated Complaint that, if proved, would give rise to the requisite strong inference of fraud by Andersen, plaintiffs argue that their allegations suggest that Andersen "should have" known of facts that would have alerted Andersen to the alleged fraud. Plaintiffs thus highlight the lack of specific allegations that Andersen accountants actually were aware of such facts at the time of their audits.

Second, plaintiffs attempt to use their memorandum in opposition to Andersen's motion to dismiss to amend their Consolidated Complaint, including through citations to newly submitted exhibits, the transcript of Andersen's recent trial, and newspaper articles. But as this Court has explained, "it is axiomatic that [a] Complaint cannot be amended by the briefs in

opposition to a motion to dismiss." In re Baker Hughes Sec. Litig., 136 F. Supp. 2d 630, 646-47 (S.D. Tex. 2001) (quoting O'Brien v. Nat'l Prop. Analysts Partners, 719 F. Supp. 222, 229 (S.D.N.Y. 1989)); see also Hernandez v. Ciba-Geigy Corp., 200 F.R.D. 285, 294 n.8 (S.D. Tex. 2001) (plaintiffs "cannot supplement the complaint with factual allegations contained outside the four corners of the pleadings in order to establish the elements" of their claims). Plaintiffs' desperate and improper attempt to plug the leaks in the Consolidated Complaint reflects their recognition that the complaint is fatally flawed.[1]

In addition, plaintiffs' claim under Section 11 of the Securities Act of 1933 fails to adequately plead reliance or consent. Like plaintiffs' federal securities fraud claim, plaintiffs' claim under the Texas Securities Act fails to plead fraud with the particularity required by Rule 9(b). Accordingly, the Consolidated Complaint should be dismissed.

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[1] The Consolidated Complaint constitutes an amendment to plaintiffs' prior complaints. If plaintiffs want to amend their complaint again to incorporate new allegations based on exhibits, the trial transcript, and newspaper articles, plaintiffs should move for leave to amend pursuant to Rule 15(a). See Fed. R. Civ. P. 15(a). If leave to amend is granted, then Andersen will answer, move to dismiss, or otherwise respond to the amended complaint in a timely fashion. But Andersen will make no response to the improperly invoked exhibits, transcripts and articles at this time.

ARGUMENT

I. THE CONSOLIDATED COMPLAINT FAILS TO ADEQUATELY PLEAD A SECURITIES FRAUD CLAIM AGAINST ANDERSEN UNDER SECTION 10(b) OF THE SECURITIES ACT OF 1934 OR SEC RULE 10b-5

A. Andersen Cannot Be Held Liable for Aiding and Abetting Alleged Fraud by Enron and Others

Plaintiffs concede that under Central Bank v. First Interstate Bank, 511 U.S. 164 (1994), "no aiding and abetting liability exists under the 1934 [Securities Exchange] Act."[2] Opp. at 47.[3] Nonetheless, plaintiffs argue that the Consolidated Complaint states a claim against Andersen under Section 10(b) of the Securities Exchange Act of 1934 (the "Act") and Rule 10b-5 promulgated thereunder based on allegations other than Andersen's statements in its audit reports because (i) Andersen supposedly played a "significant role" in drafting Enron's alleged misstatements, see Opp. at 49-51, (ii) Section 10(b) and Rule 10b-5 impose "scheme" liability, see id. at 41-48, and (iii) Andersen had a "duty to correct" its audit reports, see id. at 52-53. But the Consolidated Complaint fails to state a claim under any of these asserted theories of liability.

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[2] See also Motion of Securities and Exchange Commission for Leave, as *Amicus Curiae*, to Submit Briefs Pertinent to Certain Legal Issues Raised by Motions to Dismiss (hereinafter "SEC Mot."), at 2 ("there is no aiding and abetting liability in private actions under Section 10(b)"); Amicus Curiae Memorandum of the State Attorneys General Relating to Defendants' Motions to Dismiss (hereinafter "States' Mem."), at 16 ("aiding and abetting, as opposed to primary manipulative or deceptive acts, is insufficient for liability").

Significantly, the SEC "takes no position on whether the motions to dismiss should be granted or denied or on whether the complaint satisfies the pleading requirements of Rule 9(b) of the Federal Rules of Civil Procedure or the Private Securities Litigation Reform Act, 15 U.S.C. § 78u-4(b)(2)." SEC Mot. at 2.

[3] Plaintiffs' Opposition to Arthur Andersen LLP's Motion to Dismiss, dated June 10, 2002, will be cited as "Opp."

1. Allegations that Andersen Was Involved in the Misrepresentations of Others Do Not State a Claim Under Section 10(b)

Plaintiffs allege that the Enron Defendants had "control" over the contents of Enron's unaudited quarterly financial statements and press releases. Compl. ¶ 397.[4] In contrast, plaintiffs allege, conclusorily, that Andersen "reviewed" and "approved" these disclosures. See Compl. ¶¶ 897, 905. Plaintiffs do not allege that Andersen drafted or edited or disseminated any of these disclosures, or that the disclosures even mentioned Andersen.[5] Nor do Plaintiffs allege that Andersen's "review" impacted the content of these disclosures or that the content was conditioned on Andersen's "approval." Indeed, plaintiffs do not – and could not – allege that Enron did not repeatedly ignore Andersen's comments on press releases. See Compl. ¶¶ 95, 966.

Plaintiffs now argue that these flimsy allegations somehow state a claim against Andersen for alleged "misrepresentations in Enron's interim financial reports and press releases" under the "substantial participation" theory of liability. Opp. at 49. But these allegations do not state a fraud claim because (i) the "substantial participation" theory, adopted by the Ninth Circuit alone among Courts of Appeals, is not recognized by the Fifth Circuit, (ii) plaintiffs' allegations do not amount to substantial participation by Andersen, and (iii) plaintiffs' allegations do not satisfy the pleading requirements of Rule 9(b) and the PSLRA, as demonstrated in Part I.B.

Prior to Central Bank's elimination of secondary liability under Section 10(b), the Fifth Circuit explained that the theory that "an accountant may be liable [under Rule 10b-5] for

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[4] Plaintiffs also allege that Enron's outside law firm "*drafted* and/or approved the adequacy of Enron's press releases, shareholder reports and SEC filings." Compl. ¶ 801 (emphasis added).

[5] Plaintiffs baldly assert in their brief that Andersen "drafted [documents] for express release to the press or for filing with the SEC." Opp. at 51. Plaintiffs do not cite to the Consolidated Complaint, which is devoid of any allegation that Andersen drafted Enron's unaudited quarterly reports and press releases. Thus, plaintiffs once again try to improperly amend their inadequate complaint. See Baker Hughes, 136 F. Supp. 2d at 648.

knowingly joining and *substantially assisting* in the misrepresentations of another, regardless of whether he makes any false statements of his own" is an "aiding and abetting" theory. Akin v. Q-L Invs. Inc., 959 F. 2d 521, 526 (5th Cir. 1992) (emphasis added); see also Bane v. Sigmundr Exploration Corp., 848 F.2d 579, 581 (5th Cir. 1988); Woodward v. Metro Bank of Dallas, 522 F.2d 84, 97 (5th Cir. 1975).

Thus, when the Supreme Court held in Central Bank that there is no secondary liability under Section 10(b) and Rule 10b-5, the "substantial assistance" theory of liability no longer was viable in the Fifth Circuit. Cf. Wright v. Ernst & Young LLP, 152 F.3d 169, 176 (2d Cir. 1998) (where "knowledge and substantial assistance [were] two of the three prongs for pre-Central Bank aiding and abetting liability," after Central Bank "secondary actors . . . may no longer be held primarily liable under § 10(b) for mere knowledge and assistance in the fraud").

Other Circuits have concluded that primary liability for misrepresentations under Section 10(b) and Rule 10b-5 requires that the alleged misstatement or omission relied upon by the plaintiff be publicly attributable to the defendant. See Wright, 152 F.3d at 175-76; Ziemba v. Cascade Int'l, 256 F.3d 1194, 1205 (11th Cir. 2001) ("[T]he alleged misstatement or omission must have been publicly attributable to the defendant at the time plaintiff's investment decision was made.").[6]

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[6] Plaintiffs argue that "Central Bank cannot mean that a defendant cannot be liable under § 10(b) unless it made misleading statements." Opp. at 46-47. But the decisions on which plaintiffs rely merely confirm that Section 10(b), in addition to prohibiting misrepresentations, also proscribes other "manipulative or deceptive device[s] or contrivance[s]." See SEC v. Zandford, __ U.S. __, 122 S. Ct. 1899, 1903 (2002); U.S. v. O'Hagan, 521 U.S. 642, 651 (1997); Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 10 (1971).

These decisions *do not* hold that a defendant can be held liable under Section 10(b) in the absence of a "misrepresentation" by the defendant; there still must be deception. In O'Hagan, the basis of liability was '[d]eception by nondisclosure," 521 U.S. at 654. The defendant lawyer traded on inside information gained from his colleague without telling the colleague that he planned to misappropriate the inside information. See id. at 660 ("[I]t was O'Hagan's failure to disclose his personal trading to Grand Met and Dorsey, in breach of his duty to do so, that

(continued...)

Under this majority approach, plaintiffs' allegations fail to state a claim against Andersen. See Mot. at 4-6;[7] see also Ziemba, 256 F.3d at 1205 ("Plaintiffs base their claim on [defendant law firm's alleged] 'significant role in drafting, creating, reviewing or editing allegedly fraudulent letters or press releases.' Such allegations of substantial assistance in the alleged fraud were the kinds of allegations that were rejected in Central Bank."); In re Kendall Square Research Corp. Sec. Litig., 868 F. Supp. 26, 28 (D. Mass. 1994) ("allegations that Price Waterhouse reviewed and approved the quarterly financial statements and the Prospectuses do not constitute the making of a material misstatement; at most, the conduct constitutes aiding and abetting and is thus not cognizable under Section 10(b)" (citing Vosgerichian v. Commodore Int'l, 862 F. Supp. 1371 (E.D. Pa. 1994)).[8] Because Enron's unaudited interim financial reports and press releases were not publicly attributed to Andersen, Andersen cannot be liable for them (even if plaintiffs had alleged – which they do not – that Andersen had drafted portions of them).

Moreover, in enacting the PSLRA, Congress expressly considered overturning Central Bank, but decided not to do so because "amending the 1934 Act to provide explicitly for private aiding and abetting liability action under Section 10(b) would be contrary to [the PSLRA's] goal

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[6] (...continued)
makes his conduct 'deceptive' within the meaning of section 10(b)." (internal quotations and citations omitted)). Similarly, in Zandford, the broker defendant stole his client's securities "without [their] knowledge or consent." 122 S. Ct. at 1901; see id. at 1904 (the act "was deceptive because it was neither authorized by, nor disclosed to, the [victim]").

Here, plaintiffs fail to state a claim for liability under either the misrepresentation prong or the "scheme" prong of Rule 10b-5. See infra at I.A.2.

[7] Arthur Andersen LLP's Motion to Dismiss the Consolidated Complaint, dated May 8, 2002, will be cited as "Mot."

[8] Indeed the SEC has acknowledged that "'[p]ersons who knowingly or recklessly assist the perpetration of a fraud may be insulated from liability to private parties if they act behind the scenes and do not themselves make statements, directly or indirectly, that are relied upon by investors.'" S. Rep. No. 104-98 (1995), reprinted in 1995 U.S.C.C.A.N. 679, 727-28 (quoting testimony of Arthur Levitt, then Chairman of the Securities and Exchange Commission, at a May 12, 1995 congressional hearing).

of reducing meritless securities litigation." See S. Rep. No. 104-98 (1995), reprinted in 1995 U.S.C.C.A.N. 679, 727-28.[9]

In this context, plaintiffs' reliance on cases holding that so-called "substantial participation" in the misstatements of another person state a federal securities fraud claim is misplaced. See Opp. at 49-50. The "substantial participation" approach is fundamentally flawed because it provides no principled distinction between conduct that is inactionable under Central Bank and conduct that triggers primary liability. The inevitable results are unpredictable and potentially limitless liability under Section 10(b) and Rule 10b-5, and *ad hoc* decision making – precisely the outcome the Central Bank Court sought to avoid. See 511 U.S. at 188. Thus, the "substantial participation" test has the potential to completely undermine Central Bank. See, e.g., Anixter v. Home Stake Prod. Co., 77 F.3d 1215, 1226 n.10 (10th Cir. 1996). ("To the extent these cases allow liability to attach without requiring a representation to be made by defendant, and reformulate the 'substantial assistance' element of aiding and abetting liability into primary liability, they do not comport with Central Bank of Denver."); Wright, 152 F.3d at 175 ("'If Central Bank is to have any real meaning, a defendant must actually make a false or misleading statement in order to be held liable under Section 10(b). Anything short of such conduct is merely aiding and abetting, and no matter how substantial that aid may be, it is not enough to trigger liability under Section 10(b).'") (quoting Shapiro v. Cantor, 123 F.3d 717, 720 (2d Cir. 1997)).

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[9] Instead Congress – recognizing that Central Bank's bar on claims based on theories of secondary liability applies only to private plaintiffs, and not the Securities and Exchange Commission ("SEC") – merely codified the SEC's authority to bring claims against aiders and abettors. See 15 U.S.C. § 78t(e) ("For purposes of any action brought by the [SEC] under paragraph (1) or (3) Section 21(d) [15 U.S.C. § 78u(d)(1) or (3)], any person that knowingly provides substantial assistance to another person in violation of [15 U.S.C. Chapter 2B, which includes § 10(b)], or of any rule or regulation issued under this chapter [including Rule 10b-5], shall be deemed to be in violation of such provision to the same extent as the person to whom such assistance is provided.").

Plaintiffs' attempt to invoke "substantial participation" liability against Andersen is particularly misguided in this case, in which the relevant allegations are merely generalized assertions that Andersen "reviewed" and "approved" interim financial statements and press releases. See Compl. ¶¶ 897, 905. Plaintiffs do not allege that the content of disclosures was determined by Andersen or dependent on its review and approval. Indeed, plaintiffs do not – and could not – allege that Enron did not repeatedly ignore Andersen's comments on press releases. See Compl. ¶¶ 95, 966.

Given these allegations, even if the "substantial participation" theory were viable in this Circuit, the Consolidated Complaint does not allege that Andersen engaged in the type of conduct that plaintiffs suggest constitutes "substantial participation." In In re Software Toolworks Sec. Litig., 50 F.3d 615 (9th Cir. 1995), for example, the Ninth Circuit held that primary liability was pleaded by allegations that an accounting firm had a "significant role in drafting and editing" its client's allegedly deceptive letters to the SEC. See id. at 628 n.3. But as noted above, plaintiffs do not allege that Andersen drafted or edited Enron's alleged misstatements.[10]

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[10] Similarly, plaintiffs' cursory allegation that Andersen "reviewed and approved" Enron's unaudited quarterly financial statements and press releases would not give rise to "substantial participation" liability under other cases relied on by plaintiffs and amici, which involved substantially more participation by the defendant in the alleged misstatement than "review and approval." See Howard v. Everex Sys., 228 F.3d 1057, 1061 (9th Cir. 2000) (defendant CEO signed an SEC filing containing alleged misstatements); Cooper v. Pickett, 137 F.3d 616, 624 (9th Cir. 1998) (defendant was "alleged to have made misleading statements to [securities] analysts with the intent that the analysts communicate those statements to the market"); McGann v. Ernst & Young, 102 F.3d 390, 397 (9th Cir. 1996) ("Plaintiffs allege that E&Y produced a fraudulent audit report for [its client], knowing that [the client] would include this report in its Form 10-K filed with the SEC."); McNamara v. Bre-X Minerals Ltd., No. 5:97-CV-159, 2001 U.S. Dist. LEXIS 4571, at *139-40 (E.D. Tex. Mar. 30, 2001) (defendant "vouch[ed]" for its client's alleged misstatements by allowing its name to be used publicly); Young v. Nationwide Life Ins., 2 F. Supp. 2d 914, 921 (S.D. Tex. 1998) (some allegations implicated defendant "directly" in alleged misstatements); Flecker v. Hollywood Entm't Corp., No. 95-1926, 1997 WL 269488, at *9 (D. Or. Feb. 12, 1997) (defendants participated in drafting alleged misstatements); Cashman v. Coopers & Lybrand, 877 F. Supp. 425, 432 (N.D. Ill. 1995) (under "substantial participation" test, accounting firm is not subject to primary liability unless alleged misstatement is "certified, audited, prepared or reported"); Employers Ins. v. Musick, Peeler & Garett, 871 F. Supp. 381, 388-89 (S.D. Cal.

(continued...)

Plaintiffs also argue that this Court's decision in In re Sec. Litig. BMC Software, Inc., 183 F. Supp. 2d 860 (S.D. Tex. 2001), supports their position. See Opp. at 49 (quoting 183 F. Supp. 2d at 905). The passage from BMC Software that plaintiffs quote is not this Court's reasoning, however, but rather the Court's summary of the BMC Software plaintiffs' argument. See 183 F. Supp. 2d at 905; see also id. at 903 (section of BMC Software opinion quoted by Newby plaintiffs is headed "Plaintiffs' Memorandum in Opposition (#79)").[11] This Court rejected the BMC Software plaintiffs' arguments and dismissed their complaint, see id. at 916-

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[10] (...continued)
1994) ("As with the attorney defendants, plaintiffs allege that the accountants were architects of the prospectus which contained specific misrepresentations attributable to them."); In re ZZZZ Best Sec. Litig., 864 F. Supp. 960, 966 (C.D. Cal. 1994) (auditor was "actively involved in the *writing* and reviewing of the financial reports and press releases provided to the public" by its client) (emphasis added).

The State Attorneys General rely on a decision from the Southern District of Ohio that has no bearing on plaintiffs' claim that Andersen "reviewed and approved" Enron's allegedly false quarterly financial statements and press releases. See States' Mem. at 8 n.3 (citing In re Dublin Sec., 197 B.R. 66, 66-73 (S.D. Ohio 1996), aff'd on other grounds, 133 F.3d 377 (6th Cir. 1997)). In Dublin, the defendant attorneys allegedly provided legal services to a securities firm that perpetrated fraudulent initial public stock offerings. See 133 F.3d at 379. In the course of determining that the bankruptcy trustee for the securities firm had no standing to sue the defendants, the court concluded that because "an attorney may be liable for direct participation in securities fraud," defrauded investors who brought separate actions in state and federal court had "direct avenues of relief" against the defendant attorneys. 197 B.R. at 72-73. It is clear from the court's statement that "[t]here may, of course, be bars to such claims" that the conclusion that there were "avenues" of relief did not amount to a holding that those plaintiffs would be able to state a claim against the attorneys. Id. at 73 n.9. Plaintiffs and the State Attorneys General also rely on a decision in which the court concluded that an accounting firm had "significantly participat[ed]" in its client's unaudited financial statements and press releases, but the factual basis for this conclusion is not apparent from the court's opinion. See Adam v. Silicon Valley Bancshares, 884 F. Supp. 1398, 1401 (N.D. Cal. 1995).

[11] Nor is SEC v. First Jersey Sec., 101 F.3d 1450, 1471 (2d Cir. 1996), the case invoked by the BMC Software plaintiffs, helpful to plaintiffs here. As the Second Circuit has explained:

> "In First Jersey, we affirmed the imposition of primary liability under § 10(b) on Robert Brennan, the president, chief executive and sole owner of First Jersey Securities, Inc. Brennan had *directed* his employees to make false and misleading statements to customers. We held Brennan liable for securities fraud in his capacity as a 'controlling person,' that is, for fraud *planned and directed by upper level management.*"

Wright, 152 F.3d at 176 (emphasis added). In Wright, the Second Circuit distinguished First Jersey from the case before it, in which the court "confront[ed] alleged fraud by accountants – secondary actors who may no longer be held primarily liable under § 10(b) for mere knowledge and assistance in the fraud." Wright, 152 F.3d at 176 (citing Central Bank, 511 U.S. at 177). First Jersey is distinguishable from the case at bar for the same reasons, including that plaintiffs do not – and could not – allege that Andersen controlled Enron.

17, reasoning that the Court "fully agree[d] with Defendants' arguments," 183 F. Supp. 2d at 917, which included the argument that the plaintiffs had not "specifically alleged how the individual nonspeaking Defendants have participated in the alleged scheme to defraud or how they could have controlled misstatements by other named Defendants." Id. at 915.

2. The Consolidated Complaint Does Not State a Claim Against Andersen Under Plaintiffs' "Scheme" Theory of Liability

The Consolidated Complaint fails to state a fraud claim against Andersen on a "scheme" theory of liability for at least three reasons. First, the gravamen of plaintiffs' fraud claim is a misrepresentation theory, not a scheme theory. Second, and more important, the Consolidated Complaint's express allegations that Andersen "helped" and "assisted" Enron's perpetration of a fraudulent scheme unambiguously assert an inactionable claim of secondary liability. Third, plaintiffs' allegations fail to satisfy the pleading requirements of Rule 9(b) and the PLSRA. See infra Part I.B.

Plaintiffs spill a great deal of ink making the uncontroversial point that Section 10(b) and Rule 10b-5 reach some types of fraudulent "schemes" and "courses of business" (both of which will be referred to herein as "schemes" for simplicity). Plaintiffs fail, however, to provide any support for their novel theory of an alleged "scheme" to misrepresent, under which the same underlying allegations somehow give rise to simultaneous liability under both Rule 10b-5's prohibition on misrepresentations and the rule's proscription of fraudulent "schemes." Indeed plaintiffs' theory of a "scheme" to misrepresent is nothing more than an impermissible attempt to evade Central Bank's proscription of secondary liability for misrepresentations.

Although couched in part as a fraudulent "scheme," the gravamen of plaintiffs' Section 10(b) claim is misrepresentation. The alleged aim of the "scheme" was to misrepresent Enron's financial condition to the investing public – to create "a grand illusion" and "false picture" that Enron was a success. Compl. ¶ 17. The alleged manipulative devices – "phony, non-arm's-length transactions and improper accounting tricks" – allegedly were employed to inflate profits and conceal debt in Enron's financial statements. See, e.g., Compl. ¶ 18. Thus, plaintiffs' purported scheme claim, at core, sounds in misrepresentation.[12] Under these circumstances, plaintiffs' assertion of a "scheme to misstate" is nothing more than an attempt to circumvent Central Bank's bar on secondary liability for misstatements.

Tellingly, Andersen's issuance of audit reports is the only alleged conduct by Andersen on which plaintiffs specifically allege that they relied. See Compl. ¶ 956. In contrast, plaintiffs claim that they were unaware of the allegedly "concealed" SPEs and related transactions underlying their purported "scheme" theory. Plaintiffs' allegations of reliance are particularly important to determining the gravamen of plaintiffs' federal securities fraud claim against Andersen because the Central Bank Court – as plaintiffs acknowledge, see Opp. at 45 –

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[12] See Huddleston v. Herman & MacLean, 640 F.2d 534, 548 (5th Cir. 1981), aff'd in part and rev'd in part, 459 U.S. 375 (1983) (claim in which "defendants did not 'stand mute' in the face of a duty to disclose," but "undertook instead to disclose relevant information in a [public disclosure] now alleged to contain certain misstatements of fact and to fail to contain other facts necessary to make the statements made, in light of the circumstances, not misleading" is misrepresentation claim under Rule 10b-5(b), not a "scheme" claim under Rule 10b-5(a) or (c)").

Moreover, "manipulative" device is a very narrow concept under Section 10(b). The Supreme Court has interpreted "manipulation" as "virtually a term of art when used in connection with the securities markets. The term refers generally to practices such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity." Santa Fe Indus. v. Green, 430 U.S. 462, 476 (1977); Shivangi v. Dean Witter Reynolds, Inc., 825 F.2d 885, 889 (5th Cir. 1987). Plaintiffs do not allege that Andersen engaged in any of these practices..

emphasized that there should be no liability for securities fraud if reliance, "one element critical for recovery," is absent. Central Bank, 511 U.S. at 180.

In any event – and more important – plaintiffs' argument that Section 10(b) and Rule 10b-5 impose "scheme" liability is irrelevant to this case because plaintiffs do not allege that Andersen *perpetrated* an actionable scheme, but merely allege that Andersen *aided* the perpetrators of a scheme. The Consolidated Complaint alleges that Andersen's role was to "assist" or "help" Enron structure entities, arrange transactions, and make accounting judgments. See, e.g., Compl. ¶ 646 ("LJM2 was a privately held entity *created by Enron with the help* of Merrill Lynch, Andersen, Vinson & Elkins and Kirkland & Ellis") (emphasis added); Compl. ¶ 909 (Andersen "*assist[ed]* Enron in *Enron's* improper accounting") (emphasis added); Compl. ¶ 946 ("Andersen provided *significant assistance* in structuring and reviewing the transaction" creating Chewco) (emphasis added); Compl. ¶ 947 ("Andersen helped Enron improperly keep the Chewco deal off the books"); Compl. ¶ 959 (Andersen "helped develop the accounting for" the Raptors); see also Compl. ¶¶ 278, 361, 910, 922. *Plaintiffs' use of "help[ing]" and "assist[ing]" – synonyms for "aiding" and "abetting"*[13] *– indisputably establishes that plaintiffs are alleging inactionable secondary liability.*[14] See, e.g., Akin, 959 F.2d at 526 (explaining that liability for "knowingly joining and substantially assisting" another person's fraud is secondary liability). *Because their Consolidated Complaint expressly characterizes Andersen's role as*

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[13] See, e.g., Webster's Collegiate Thesaurus 2 (1st ed. 1976) (synonyms for "abet" include help, aid and assist).

[14] The canned *amicus* brief submitted by the State Attorneys General and the recycled *amicus* briefs submitted by the SEC fail to take account of these pivotal allegations that Andersen merely "helped" Enron perpetrate the alleged scheme. See SEC Mot. at 2 (SEC "takes no position on the facts of this case or on the application of the legal principles to those facts"); States' Mem. at 7 ("None of the bank, law firm, or accountant Defendants is alleged to be a mere aider and abettor."). Because *amici* all concede that there is no "aider or abettor" liability under Section 10(b) and Rule 10b-5, see supra n.2, the remaining arguments of *amici* regarding "scheme" liability have no significance to plaintiffs' fraud claim against Andersen.

"help[ing]" and "assist[ing]" Enron's perpetration of a fraud, plaintiffs cannot now argue that they are asserting primary "scheme" liability against Andersen. See, e.g., Baker Hughes, 136 F. Supp. 2d at 646-47 ("[I]t is axiomatic that [a] Complaint cannot be amended by the briefs in opposition to a motion to dismiss" (quoting O'Brien v. Nat'l Prop. Analysts Partners, 719 F. Supp. at 229)).

Plaintiffs' allegations that Andersen "assisted" Enron's perpetration of a scheme contrast starkly with the allegations in Finkel v. Docutel/Olivetti Corp., 817 F.2d 356 (5th Cir. 1987) – a decision featured prominently in plaintiffs' argument, see Opp. at 43-44 – that the defendant perpetrated a scheme. In Finkel, the plaintiffs alleged that "Olivetti, by virtue of its 46% interest in Docutel, controlled Docutel and used that control to hide losses in Olivetti of America." 817 F.2d at 358. In particular, "Olivetti forced Docutel to take worthless inventories without disclosing that fact in the market place." Id. at 363. The Court held that "if proved, that conduct could equate with a scheme to defraud or course of business operating as a fraud in violation of 10b-5(1) and (3)." Id. at 363-64. Here plaintiffs allege that Andersen "helped" Enron perpetrate a scheme, not that Andersen "controlled" Enron or "forced" the company to do anything. To the contrary, plaintiffs allege, for example, that when Andersen proposed numerous audit adjustments to Enron, the company refused to make them. See Compl. ¶¶ 517, 923, 955.[15]

Thus, plaintiffs do not state a viable claim against Andersen for "scheme" liability under Section 10(b) and Rule 10b-5. In any event, for the reasons set forth below, plaintiffs' allegations do not satisfy the pleading requirements of Rule 9(b) of the Federal Rules of Federal

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[15] Plaintiffs also cite Heller v. Am. Indus. Props. REIT, C.A. No. SA-97-CA-1315-EP, 1998 WL 1782550, at *3 (W.D. Tex. Sept. 28, 1998), for the uncontroversial proposition that Rule 10b-5 prohibits certain fraudulent schemes and courses of conduct. See Opp. at 44.

Procedure and the PSLRA, so their fraud claim fails under either a misrepresentation theory or a "scheme" theory. See infra Part I.B.

3. Plaintiffs Fail to State a Claim that Andersen Violated a "Duty to Correct"

Plaintiffs cite cases holding generally that Section 10(b) imposes on accountants, in some situations, a duty to correct prior statements. Opp. at 52. But plaintiffs fail to cite authority establishing that their allegations against Andersen, if proved, would be sufficient to show that Andersen was under a duty to correct its audit reports prior to the November 8, 2001 announcement that these reports "should not be relied upon." Compl. ¶ 956. In order to state a claim for violation of a duty to correct arising under Section 10(b), plaintiffs must plead that (i) defendants had knowledge of a material error requiring correction and (ii) defendants, intentionally or as a result of recklessness so severe as to constitute fraud, failed to make the correction.

Courts have held that the duty to correct extends only to material misstatements that the defendant actually "discovered." Rudolf v. Arthur Andersen & Co., 800 F.2d 1040, 1043 (11th Cir. 1986) (quoting ITT, An Int'l Inv. Trust v. Cornfeld, 619 F.2d 909, 927 (2d Cir. 1980)); U.S. v. Natelli, 527 F.2d 311, 319 (2d Cir. 1975); In re Acceptance Corp. Sec. Cases, 513 F. Supp. 608, 636 (N.D. Ga. 1981); see also Opp. at 52 ("an auditor who *discovers* . . . that his audit opinion was false or misleading") (emphasis added). Once the duty arises, a defendant has a "reasonable time" in which to correct the prior statement. Stransky v. Cummins Engine Co., Inc., 51 F.3d 1329, 1331 (7th Cir. 1995).

Plaintiff's erroneously rely on the February 5, 2001 client retention meeting as support for its contention that Andersen's duty to correct arose prior to the announcement that its audit

reports should not be relied upon. See Opp. at 52-53. But plaintiffs do not cite any cases holding that an accounting firm's forward-looking discussion of *potential* risks posed by an audit engagement somehow triggers a duty to "correct" past audit reports. Indeed, plaintiffs fail to allege that the participants in the February 5, 2001 meeting "discovered" any facts demonstrating that Andersen's prior audit reports contained misstatements (much less material misstatements). In fact, the memorandum summarizing the meeting, on which plaintiffs rely, does not contain one reference to Andersen's prior audit opinions or make the slightest suggestion that those opinions might no longer be reliable. See Ex. A.

As plaintiffs acknowledge in the Consolidated Complaint, within less than three months after Sherron Watkins, a former Andersen employee, raised with an Andersen partner concerns about Enron's accounting, Compl. ¶¶ 933-34, it was announced that Enron would restate its financial statements and that Andersen's accompanying audit reports "should not be relied upon." Compl. ¶¶ 61, 419-21, 956. Plaintiffs' assertion that Andersen never made corrections or responded to Ms. Watkins' concerns is belied by the allegations in the Consolidated Complaint concerning this announcement. Id. Moreover, plaintiffs cite no authority suggesting that the announcement that Andersen's prior audit reports should not be relied on was untimely.

In addition, "a private cause of action for damages will not lie under § 10(b) and Rule 10b-5 in the absence of an allegation of scienter." Aaron v. SEC, 446 U.S. 680, 689 (1980). Accordingly, even if the duty to correct were triggered, plaintiffs must plead that defendants, intentionally or with recklessness so severe as to constitute fraud, violated the duty.[16] The Consolidated Complaint does not assert that Andersen violated a duty to correct arising under the

[16] For example, if a defendant's failure to correct in a timely manner were due to negligence, such circumstances would not satisfy Section 10(b)'s scienter requirement.

federal securities laws. This fraud theory is distinct from the purported (and inadequately pleaded) claim that Andersen's audit reports were fraudulent, and it cannot be asserted for the first time in plaintiffs' opposition to Andersen's motion to dismiss. See Wright, 152 F.3d at 177-78. The closest plaintiffs come to pleading that Andersen violated a duty to correct is their assertion – despite the announcement that Andersen's audit reports should not be relied upon – that Andersen violated professional accounting standards by *negligently* failing to correct its audit reports. See Compl. ¶ 968. However, even if Andersen were negligent in failing to correct Enron's financial statements (which Andersen denies), negligence can never establish the scienter required to state a claim for securities fraud. See Rudolf, 800 F.2d at 1045 n.7 (allegations of negligent failure to correct do not state fraud claim); see also In re Barry C. Scutillo, 74 S.E.C. Docket 1944, Rel. No. ID-183, 2001 WL 461287, at *26 (May 3, 2001).

In any event, as with any federal securities fraud claim, a "duty to correct" claim is subject to the heightened pleading standards of Rule 9(b) and the PSLRA. See Mot. at 10-12. Because plaintiffs have not pleaded particularized allegations of fact that, if proved, (i) would identify the specific times at which Andersen accountants discovered specific errors, see In re Burlington Coat Factory Sec. Litig., 114 F.3d 1410, 1431 (3d Cir. 1997), and (ii) would give rise to a strong inference of scienter, see 15 U.S.C. § 78u-4(b)(2), plaintiffs have failed to state a fraud claim under a duty to correct theory.

B. Plaintiffs Have Not Adequately Alleged that Andersen Is Liable as a Principal Under Section 10(b) or Rule 10b-5

1. The Consolidated Complaint Fails to Plead the Alleged Fraud by Andersen with the Requisite Particularity

In opposing Andersen's motion to dismiss, plaintiffs assume that it is sufficient to rely on "reasonable inferences" drawn in their favor from their allegations. See, e.g., Opp. at 56. But on this motion, in which plaintiffs do not dispute that their fraud claims are subject to the heightened pleading requirements of both Federal Rule of Civil Procedure 9(b) and the PSLRA, "factual allegations must transcend rational or reasonable inferences, and must instead raise a 'strong inference of scienter.'" Reiger v. Price Waterhouse Coopers LLP, 117 F. Supp. 2d 1003, 1011 (S.D. Cal. 2000) (quoting 15 U.S.C. § 78u-4(b)(2)), aff'd sub nom., DSAM Global Value Fund v. Altris Software, Inc., 288 F.3d 385 (9th Cir. 2002); see also Abrams v. Baker Hughes Inc., No. 01-20514, 2002 U.S. App. LEXIS 9565, at *9 (5th Cir. May 21, 2002) ("Under the PSLRA, to allege scienter: the complaint shall, with respect to act or omission alleged to violate this chapter, state with particularity facts giving rise to a *strong inference* that the defendant acted with the required state of mind.") (emphasis added).

The required state of mind is scienter, which is satisfied only by intentional deception or recklessness so severe as to constitute fraud. See Nathenson v. Zonagen Inc., 267 F.3d 400, 407-08 (5th Cir. 2001) Plaintiffs do not – and could not – contest that such severe recklessness is

> "limited to those highly unreasonable omissions or misrepresentations that involve not merely simple or even inexcusable negligence, but an extreme departure from the standard of ordinary care, and that present a danger of misleading buyers or sellers which is either known to the defendant or is so obvious that the defendant must have been aware of it."

Abrams, 2002 U.S. App. LEXIS 9565, at *11 (quoting Nathenson, 267 F.3d at 408).

With respect to claims against auditors, the requirements for pleading scienter under the PSLRA are extremely demanding. For example, In re MicroStrategy, Inc. Sec. Litig., 115 F. Supp. 2d 620 (E.D. Va. 2000), on which plaintiffs heavily rely, explains that a plaintiff must "allege facts tending to show that the accounting practices were so deficient that the audit amounted to no audit at all or that no reasonable accountant would have made the same decisions if confronted with the same facts." Id. at 651 (internal quotations omitted). Furthermore,

> "the lack of a rational economic incentive for an independent accountant to participate in fraud, the client's central role in providing information to the accountant, and the complex professional judgment required to perform an audit, make it exceedingly difficult for a securities plaintiff to plead facts suggesting that an independent accountant acted with the deliberate state of mind now required to withstand a motion to dismiss."

Reiger, 117 F. Supp. 2d at 1008; accord In re SCB Computer Tech., Inc. Sec. Litig., 149 F. Supp. 2d 334, 356 (W.D. Tenn. 2001). Plaintiffs have failed to meet this demanding pleading requirement.

Rather than try to demonstrate the adequacy of the Consolidated Complaint, plaintiffs' opposition to Andersen's motion to dismiss underscores the complaint's insufficiency. In their opposition, plaintiffs do not direct the Court to allegations in the Consolidated Complaint giving rise to a strong inference of scienter by Andersen. Instead, plaintiffs improperly attempt to amend their complaint by submitting an appendix of 38 exhibits and relying heavily on citations to these exhibits and other sources either not contained in, attached to or otherwise incorporated by reference in the Consolidated Complaint. See Baker Hughes, 136 F. Supp. 2d at 646-47 ("[I]t is axiomatic that [a] Complaint cannot be amended by the briefs in opposition to a motion to dismiss.") (internal quotations omitted); see also Hernandez, 200 F.R.D. at 294 n.8 (S.D. Tex.

2001) (plaintiffs "cannot supplement the complaint with factual allegations contained outside the four corners of the pleadings in order to establish the elements" of their claims).

Given the excessive length of the Consolidated Complaint, there is no better demonstration of the inadequacy of the pleading than plaintiffs' need to look beyond it to oppose Andersen's motion to dismiss. To the extent plaintiffs do rely on allegations in the Consolidated Complaint, they merely reiterate the structure of the transactions at issue. But the relative particularity with which plaintiffs summarize the nature of these transactions merely highlights the absence of specific allegations concerning Andersen's knowledge or involvement.

Plaintiffs do not contest Andersen's demonstration that an audit is not designed to discover fraud and, thus, the failure of an auditor to discover fraud cannot lead to the conclusion that the auditor is complicit in it. See Mot. at 12 ("Because of the characteristics of fraud, particularly those involving concealment and falsified documentation . . . , a properly planned and performed audit may not detect a material misstatement. . . . [A]uditing procedures may be ineffective for detecting an intentional misstatement that is concealed through collusion among client personnel and third parties or among management and employees of the client." (quoting AU § 230.12)).

In this case, plaintiffs have alleged that Enron insiders were engaged in a massive fraud. Plaintiffs have further alleged the involvement of numerous third parties, other than Andersen, including multiple law firms and banks, and Enron insiders who allegedly were primarily responsible for structuring the transactions at issue. According to the Consolidated Complaint and accepting its allegations as true for purposes of this motion, Enron's outside law firms allegedly falsified documents to indicate that non-consolidated SPEs were independent of Enron, see Compl. ¶¶ 808, 869 (law firms allegedly falsified documentation for Chewco's financing "to

make it appear that Chewco was independent"); Compl. ¶¶ 817, 884 (alleging that legal documents drafted by outside law firms were "deliberately back-dated" to conceal Enron's ownership interest in Yosemite), drafted a "side agreement" relating to a "clandestine reserve account," Compl. ¶¶ 808, 869, and repeatedly opined that Enron's transactions with SPEs were "true sales" or otherwise were "legitimate business transactions." Compl. ¶¶ 98-99, 801, 807. Even plaintiffs urge that their allegations must be considered in their entirety, see Abrams, 2002 U.S. App. LEXIS 9565, at *12, and against this backdrop, the allegations simply do not support the requisite strong inference of scienter on the part of Andersen.[17]

a. Plaintiffs Have Failed to Adequately Allege that Andersen Knew About the Alleged Fraud at the Time It Performed the Enron Audits

Plaintiffs assert repeatedly that Andersen knew certain information which supposedly would have revealed Enron's alleged fraud. See Opp. at 54-65. But plaintiffs fail to adequately plead when Andersen came by that knowledge or how, and thus its conclusory claims regarding Andersen's knowledge are flawed. The unremarkable fact that Andersen knew about the inaccuracies in Enron's financial statements as of the time Enron announced it would restate them is insignificant in this context. To adequately plead scienter, plaintiffs must allege that Andersen possessed the requisite knowledge at the time it opined on Enron's financial statements. In re IKON Office Solutions, Inc., 277 F.3d 658, 670, 673 (3d Cir. 2002); Schiller v. Physicians Res. Group, Inc., No. Civ. A. 3:97-CV-3158-L, 2002 WL 318441, at *14 (N.D. Tex. Feb. 26, 2002). Plaintiffs have not proffered such allegations.

[17] Andersen does not mean to suggest that the allegations relating to these other defendants are sufficient to state a claim against those defendants, but only that they tend to negate any inference, let alone a strong inference, of scienter as to Andersen.

"The Reform Act does not permit district courts to speculate as to the existence of unpled and unidentified facts that could raise a strong inference of scienter." Reiger, 117 F. Supp. 2d at 1011.[18] With respect to the Chewco and JEDI SPEs for example, plaintiffs argue that "it is *reasonable* to infer Andersen read all the documents Enron considered sufficiently important to provide." Opp. at 56 (emphasis added). The PSLRA requires more than a reasonable inference to establish scienter. As the Fifth Circuit has noted on two recent occasions, the heightened pleading requirements of the PSLRA demand that there be a "strong inference" of scienter in order for plaintiffs to maintain a securities fraud cause of action. See Abrams, 2002 U.S. App. LEXIS 9565, at *9; see also Nathenson, 267 F.3d at 407; Reiger, 117 F. Supp. 2d at 1011 ("Under the Reform Act . . . factual allegations must transcend rational or reasonable inferences, and must instead raise a 'strong inference of scienter."). Accordingly, even if the inferences plaintiffs urge were reasonable – and they are not – these proffered inferences are insufficient as a matter of law.

In addition, plaintiffs' theory "invites too much speculation to satisfy either the particularity or strong inference requirements of the Reform Act." Reiger, 117 F. Supp. 2d at 1012. Andersen may very well have reviewed all of the documents provided by Enron, but plaintiffs have not specified, as they must, what documents were in fact provided and what the vast majority of those documents contain. See Baker Hughes, 136 F. Supp. 2d at 648. Nor do

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[18] Reiger also involved an action against an outside auditor, PriceWaterhouseCoopers, for securities fraud following the restatement of nearly two years of financial statements for one of PriceWaterhouseCooper's clients. Plaintiffs unsuccessfully attempt to distinguish Reiger on the basis that in that case the plaintiffs alleged nothing more than that PriceWaterhouseCooper's had knowledge of accounting violations based on its access to its clients files. However, the allegations in Reiger were not limited as such, but rather were similar in scope to the allegations asserted here. The plaintiffs in Reiger were unable to establish scienter on the part of the defendant outside auditors despite arguments, also made by the Plaintiffs in the case at bar, relating to the presence of red flags, GAAP violations, and the magnitude of the fraud. As such Reiger is clearly apposite to the case at bar.

plaintiffs acknowledge the very real possibility that Enron withheld essential information to conceal its fraud from its auditor. Indeed, "because an independent accountant often depends on its client to provide the information base for the audit, it is almost always more difficult to establish scienter on the part of the accountant than on the part of its client." In re Sunterra Corp. Sec. Litig., 199 F. Supp. 2d 1308, 1338 (M.D. Fla. 2002) (internal quotations and citation omitted). For example, it is not enough for plaintiffs to assert that Enron's Executive Committee meeting minutes reveal that Enron had guaranteed a bridge loan so Chewco could acquire the limited partner's interest in JEDI. Opp. at 55. They must also allege that Andersen possessed this knowledge, as well as how and when it came by that knowledge.

Similarly, plaintiffs' contentions that the alleged fraud was so obvious that Andersen should have been aware of it, see Opp. at 55-56, 61, are belied by the extensive and complicated explanations of Enron's elaborate financial structures and transactions at issue. See, e.g., Compl. ¶ 440 ("*simplified* diagram of the Chewco transaction") (emphasis added). In any event, an "alleged obviousness of accounting errors fails to support a strong inference of scienter." SCB Computer Tech., 149 F. Supp. 2d. at 357; see also Cheney v. Cyberguard Corp., No. 98-6879-CIV-GOLD-SIMONTON, 2000 U.S. Dist. LEXIS 16351, at *43 (S.D. Fla. Nov. 15, 2000). Plaintiffs' allegations such as those concerning the allegedly premature recognition of shareholder equity relating to the Raptor transactions which involved a "basic accounting rule" are insufficient as a matter of law. See Compl. ¶¶ 951-52. Merely alleging "violations of GAAP . . . do[es] not support a securities fraud claim," even a violation of a "basic and fundamental accounting principle." Duncan v. Pencer, No. 94 Civ. 0321 (LAP), 1996 U.S. Dist. LEXIS, at *35 (S.D.N.Y. Jan. 18, 1996) (internal quotations and citations omitted; ellipsis in original).

Likewise, plaintiffs' contention that Andersen knowingly ignored material adjustments to Enron's 1997 financial statements, see Opp. at 62-63, is belied by the very allegations made in the Consolidated Complaint. See Compl. ¶¶ 517, 955. Plaintiffs concede that Andersen concluded that the adjustments were not material, but take issue with the method by which Andersen arrived at this conclusion. Compl. ¶ 955. As explained in Andersen's Motion to Dismiss, see Mot. at 19, GAAS expressly permits the type of calculation employed by Andersen and affords auditors discretion to determine when the use of a concept such as normalized earnings is appropriate. See AU §§ 9312.13 and 9312.14. Notably, Plaintiffs do not dispute Andersen's analysis or cite any authority to the contrary.

b. The Amount of Fees Earned and Hours Worked by Andersen on the Enron Engagement Do Not Support a Strong Inference that Andersen Possessed the Requisite Scienter

Plaintiffs urge this Court to infer Andersen's knowledge of the alleged fraud based primarily on the amount of fees Andersen earned for work performed in connection with the Enron audits, in effect arguing that due to Andersen's extensive involvement, it should have known about the alleged fraud. See Compl. ¶¶ 925, 942, 946, 951; see also Opp. at 54. As an initial matter, plaintiffs do no more than speculate about the number of actual hours of work performed and allege no particular facts about the fee arrangement or the specific services provided. In any event, the fact that Andersen devoted substantial time to one of its larger clients is not surprising, nor is it indicative of fraud.

To the contrary, these allegations undermine plaintiffs' assertions that Andersen was willfully blind or failed to properly investigate or analyze Enron's financial information. Allegations that "Andersen should have thoroughly investigated the business purpose and substantive reasons for" certain accounting, Compl. ¶ 949(b), sound in negligence not fraud. See

Scutillo, 2001 WL 461287, at *24 ("it is not enough . . . to show that a reasonable accountant 'would, might, or should have handled the matter differently'"); see also In re Cendant Corp. Litig., 60 F. Supp. 2d 354, 364 (D.N.J. 1999) ("Plaintiffs' theory of liability . . . that defendants had not made a reasonable investigation . . . sounds in negligence, not in fraud" (internal quotations and citation omitted)). "[N]o degree of negligence can satisfy the substantive element of scienter, or raise a strong inference of scienter under the [PSLRA]," nor can a plaintiff "bootstrap its way to victory in an auditing recklessness case by stringing together separate acts of auditing negligence." Scutillo, 2001 WL 461287, at *26 (internal quotations and citation omitted).

c. Plaintiffs' Reliance on the February 5, 2001 Client Retention Meeting and Andersen Partner Carl Bass's Disagreement with Certain Accounting Treatments Is Misplaced

Plaintiffs rely heavily on allegations regarding a meeting of Andersen partners on February 5, 2001 and a few e-mails written by Andersen partner Carl Bass as the purported evidence of Andersen's knowledge of the alleged fraud. However, plaintiffs overstate and misinterpret the significance of these events. Contrary to plaintiffs' suggestions, the short memorandum memorializing the February 5, 2001 meeting does not indicate that Andersen was aware that Enron's financial statements were materially misstated, nor does it suggest that information regarding Enron's transactions was improperly concealed. Rather, it shows that Andersen engaged in "significant discussion" regarding issues relating to the Enron audit, that "significant judgment" was required with respect to several transactions, and that Andersen was committed to "testing of such transactions to ensure that we fully understand the economics and substance of the transactions," and "ensur[ing] that we are not making decisions in isolation."

See Ex. A. Accordingly, the February 5, 2001 meeting bespeaks neither involvement in, knowledge of nor reckless indifference to securities fraud.

Plaintiffs insinuate that Andersen's issuance of an unqualified audit opinion for Enron's year 2000 financial statements after the February 5, 2001 meeting was somehow improper or inconsistent. See Opp. at 59, 61. However, nothing in the summary of the meeting suggests that Andersen was aware at that time of a basis for withholding such an opinion. Indeed, the focus of the meeting was discussion of whether Andersen would retain Enron as a client going forward, not the issuance of an audit opinion on Enron's annual financial statements for 2000. See Ex. A.

Plaintiffs attempt to dismiss Andersen's demonstration that this memorandum, read as a whole, is favorable to Andersen by arguing that Andersen somehow is raising a factual dispute. See Opp. at 60. But plaintiffs cannot selectively quote from a document, see Compl. ¶¶ 912, 930, and then argue that isolated excerpts from it give rise to a strong inference of scienter. In deciding a motion to dismiss, the court may "consider documents integral to and explicitly relied on in the complaint . . . as well as the full text of documents that are partially quoted or referred to in the complaint." BMC Software, 183 F. Supp. 2d at 882. As this Court has expressly held, by referencing and relying on parts of the memorandum, the entire document is incorporated in the Consolidated Complaint and Andersen may introduce the entire text in support of its motion to dismiss. See id. at 882-83. Under these circumstances, Andersen's reference to the entire document does not raise a fact dispute, but rather is equivalent to citing plaintiffs' own pleading. See Collins v. Morgan Stanley Dean Witter, 224 F.3d 496, 498-99 (5th Cir. 2000) ("[d]ocuments that a defendant attaches to a motion to dismiss are considered part of the pleadings if they are referred to in the plaintiff's complaint and are central to her claim"). *At this point, the inquiry becomes whether the document as a whole – as opposed to selected excerpts – gives rise to a*

strong inference of fraud on Andersen's part. "When the allegations of the complaint are clearly refuted by an attached document, the Court need not accept conflicting allegations of the complaint as true and may dismiss the claim." Dryden v. Sun Life Assurance Co. of Canada, 737 F. Supp. 1058, 1066 (S.D. Ind. 1989) (citing Associated Builders, Inc. v. Alabama Power Co., 505 F.2d 97, 100 (5th Cir. 1974)), aff'd, 909 F.2d 1486 (7th Cir. 1990) (unpublished opinion). For the reasons set forth above, the memorandum summarizing the February 5, 2001 meeting – when read in its entirety – does not give rise to such an inference.

The Carl Bass e-mail messages are similarly insufficient to establish Andersen's scienter. The mere fact that a single partner expressed his differing opinion with respect to the accounting for certain transactions falls far short of the type of allegations required to support a strong inference that Andersen was engaged in fraud. The Fifth Circuit has held that:

> "a difference in judgment about generally accepted accounting principles does not establish conscious behavior on the part of Defendants. The term generally accepted accounting principles, as we have often noted, is a term of art encompassing a wide range of acceptable procedures, such that an ethical, reasonably diligent accountant may choose to apply any of a variety of acceptable accounting procedures when that accountant prepares a financial statement."

Lovelace v. Software Spectrum, Inc., 78 F.3d 1015, 1021 (5th Cir. 1996) (internal quotations and citation omitted).

Plaintiffs question why Bass ultimately was relieved of his responsibilities in connection with the Enron audit. See Opp. at 59. But plaintiffs' blatant speculation that Bass was reassigned because he was aware of fraud, as supposedly reflected in his e-mail messages challenging some of Enron's accounting methods, ignores that Bass's e-mail messages began well over a year earlier. In addition, plaintiffs' speculation concerning Bass is precisely the type of pleading that the PSLRA is intended to curb. Plaintiffs equivocate over the significance of Bass's challenges, alleging both that it supports a finding that Andersen had knowledge of the

alleged fraud and alternatively that it is a sign of Andersen's diligence. Compare Compl. ¶¶ 928-29 with ¶ 966 and Opp. at 32. As reflected by plaintiffs' attempt to have it both ways, these allegations cannot possibly support a strong inference of scienter.

d. Plaintiffs' Allegations Concerning "Other Red Flags" Are Unavailing

Unable to allege specific facts linking Andersen to the alleged fraud, plaintiffs try to draw unsupported inferences from generalized allegations, including the magnitude of the restatement that Enron announced it would issue. See Opp. at 65-67. These allegations, however, will not satisfy the strict pleading requirements of the PSLRA. As one court 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 accountant acted with scienter. To travel from 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 outside accountant during the audit; (3) these warning signs must have made the fraud obvious and conspicuous to the accountant; and therefore (4) the accountant must 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 an accountant may fail to detect a fraud of large magnitude. For example, the magnitude of fraud could flow from improprieties in transactions that fell outside the scope of the audit, *or from manipulations the company concealed from its accountant and the public.* See In re Livent, Securities Litig., 78 F. Supp. 2d 194, 217 (S.D.N.Y. 1999) (refusing to infer accounting firm's scienter from large magnitude of fraud where "the magnitude of the fraud was accompanied by the thoroughness of its concealment"). To avoid undermining the policies of the Reform Act through reliance on hindsight and speculation, a court should not infer an independent accountant's scienter based solely on the magnitude of its client's fraud."

Reiger, 117 F. Supp. 2d at 1013 (emphasis added).

Several other courts have also noted that inferring scienter from misstatements or omissions alone, no matter what their type or magnitude, would render the scienter requirement

meaningless. See SCB Computer Tech., 149 F. Supp. 2d at 357 ("Generally speaking, the magnitude of an erroneous financial statement caused by allegedly fraudulent representations, without more, cannot sustain a finding that an auditor acted with scienter."); In re SmarTalk Teleservs., Inc. Sec. Litig., 124 F. Supp. 2d 505, 517 (S.D. Ohio 2000) (rejecting the magnitude of accounting errors as the basis for demonstrating a strong inference of scienter as "too general and speculative"); Scutillo, 2001 WL 461287, at *24.

Plaintiffs have attempted to supplement their otherwise deficient allegations of scienter with allegations concerning Andersen's purported motive for engaging in fraud. See Opp. at 69-71. However, plaintiffs allege nothing more than that Andersen was driven by a desire to earn fees from one of its many clients. It is well settled in the Fifth Circuit that the common, basic and understandable goal of earning compensation, increasing fees and boosting profits does not demonstrate scienter. "A contrary conclusion would universally eliminate the state of mind requirement in securities fraud actions against accounting firms. This follows from the indisputable proposition that accounting firms – as with all rational economic actors – seek to maximize their profits." Melder v. Morris, 27 F.3d 1097, 1103 (5th Cir. 1994). The Fifth Circuit has recently reaffirmed this principle, holding that the need to raise capital, the desire for enhanced incentive compensation and the desire to sell stock at inflated prices are all insufficient to support an inference of scienter. See Abrams, 2002 U.S. App. LEXIS 9565, at *23.

Plaintiffs concede that they have not adequately alleged the motivation for the destruction of Enron-related documents. See Opp. at 69 ("It is true plaintiffs do not quote Temple about her motivation for ordering Enron documents destroyed"). However, absent allegations of motive, plaintiffs have failed to link the destruction to Andersen's alleged involvement in securities fraud. Plaintiffs hope to excuse this conceded deficiency by noting that Nancy Temple has

exercised her Fifth Amendment rights. However, Ms. Temple and others' decision not to testify in other proceedings does not excuse plaintiffs from the strict pleading requirements imposed by the PSLRA. "The Reform Act does not permit district courts to speculate as to the existence of unpled and unidentified facts that could raise a strong inference of scienter." Reiger, 117 F. Supp. 2d at 1011. There is no exception to this rule.

Plaintiffs' reliance on cases allowing courts to draw an adverse inference in certain circumstances is misplaced. The cases cited by plaintiffs do not stand for the proposition that a court may draw an adverse inference at the pleading stage in the context of deciding a motion to dismiss. In SEC v. Cook, CA No. 3:00-CV-272-R, 2001 U.S. Dist. LEXIS 2601, at *11-12 (N.D. Tex. Mar. 8, 2001), the court drew an adverse inference against one of the defendants in connection with his assertion of an affirmative defense for which he bore the burden of proof. With respect to the securities fraud claim, of course, plaintiffs must plead allegations giving rise to a strong inference of scienter whereas Andersen bears no burden at all. Moreover, Cook did not concern the destruction of documents. Accordingly Cook is not applicable here.

Similarly, in Vick v. Texas Employment Comm'n, 514 F.2d 734, 737 (5th Cir. 1975), the court discussed whether an adverse inference should have been drawn at trial, not in deciding a motion to dismiss. Further, in Vick, the Court of Appeals emphasized that the propriety of drawing an adverse inference depends on a showing of bad faith. Id. Plaintiffs concede that they have not and cannot allege the motivation here. See Opp. at 69. As such, there is no allegation from which to draw an adverse inference. Plaintiffs have also failed to cite any authority for the proposition that the adverse inference they seek is equivalent to the strong inference of scienter required by the Reform Act. Thus, even if plaintiffs were entitled to an adverse inference, they still fall short of meeting the high threshold established by the PSLRA.

Again, implicitly acknowledging the insufficiency of their allegations, plaintiffs cite to testimony from the criminal trial in an improper attempt to amend the Consolidated Complaint via plaintiffs' opposition to the motion to dismiss. See Opp. at 59-60, 62, 69. Since this testimony was not included or incorporated by reference in the Consolidated Complaint – and, in fact, could not have been because such testimony did not exist at the time the pleading was filed – it should not be considered in ruling on the motion to dismiss. See Baker Hughes, 136 F. Supp. 2d at 646-47.

2. Plaintiffs' Allegations Regarding Andersen's Prior Audits Do Not Bolster Their Fraud Claim in Connection with the Enron Audit

Plaintiffs seek to divert this Court's attention from their failure to plead scienter adequately in connection with Andersen's audits of Enron by pointing to their allegations that Andersen previously has settled accusations of accounting fraud. See Opp. at 71. In doing so, however, plaintiffs completely ignore Andersen's demonstration that the mere "settlement of prior securities litigation is, of course, not probative of any fraudulent conduct in those cases, much less of any fraudulent intent in this entirely separate case." Mot. at 28.

Instead, plaintiffs suggest that Andersen's involvement in other litigation somehow "undermines the firm's reputation defense." Opp. at 71. As the Fifth Circuit has recognized, however, "[a]n accountant's greatest asset is its reputation for honesty, followed closely by its reputation for careful work." Melder, 27 F.3d at 1103 (quoting DiLeo v. Ernst & Young, 901 F.2d 624, 629 (7th Cir. 1990)). Plaintiffs cannot so easily overcome this truism with so spurious an argument. The mere fact that Andersen – at the relevant time one of the Big Five accounting firms – had been sued in other securities fraud actions is not indicative of fraud. Such actions against accounting firms are usual in the aftermath of a fraud, without regard to whether they are

meritorious. Nor is Andersen alone in this regard. See, e.g., Frymire-Brinati v. KPMG Peat Marwick, 2 F.3d 183 (7th Cir. 1993); Maley v. Del Global Technologies Corp.,186 F. Supp. 2d 358 (S.D.N.Y. 2002) (settlement of securities fraud class action brought against, *inter alia*, Deloitte & Touche); SCB Computer Tech., 149 F. Supp. 2d 334 (securities fraud action brought against, *inter alia*, Ernst & Young); Reiger v. Price Waterhouse Coopers, 117 F. Supp. 2d 1003.

The insinuation that Andersen would have engaged in fraud because it had no reputation to protect, see Opp. at 71, is not only unpersuasive, but also undermined by plaintiffs' own allegations. According to the Consolidated Complaint, Andersen's origins date back to 1913. Compl. ¶ 971. It grew into a worldwide organization, which included Andersen and foreign affiliated entities, which operated out of 390 offices in 84 countries and together "conduct[ed] more than 30,000 audits around the world every year." Compl. ¶¶ 971, 973-74. Plaintiffs cannot argue that Andersen's success and status as one of the premier accounting firms, which plaintiffs explicitly document in the Consolidated Complaint, was negated by Andersen's decision to settle a few unrelated cases in the past.

The fact that certain evidence relating to the Waste Management settlement was admitted into evidence at Andersen's trial for obstruction of justice as relevant to a potential motive for shredding documents has no bearing on the admissibility of this evidence, or other evidence relating to the Waste Management settlement, in this civil securities fraud action. See U.S. v. Gonzalez, 748 F.2d 74,78 (2d Cir. 1984) (holding that whereas Fed. R. Evid. 408 precludes admission of certain evidence at a civil trial, that same evidence may be admitted at a criminal trial); see also Fed. R. Evid. 408 (rule "does not require exclusion when the evidence is offered for another purpose, such as . . . proving an effort to obstruct a criminal investigation or

prosecution"). Accordingly, plaintiffs' assertion that this Court already has made an evidentiary determination applicable to this case, see Opp. at 71, is incorrect.

For these reasons, plaintiffs have not alleged facts giving rise to a strong inference of scienter and, therefore, the claim arising under Section 10(b) of the 1934 Act and Rule 10b-5 should be dismissed.

II. PLAINTIFFS HAVE FAILED TO ALLEGE A CLAIM AGAINST ARTHUR ANDERSEN UNDER SECTION 11 OF THE SECURITIES ACT OF 1933

Plaintiffs concede that their claims under Section 11 of the Securities Act of 1933 relating to two offerings of Enron debt securities – in particular, 7% exchangeable notes offered on August 10, 1999 and 8.375% notes offered on May 18, 2000 – fail to state a claim on which relief can be granted. See Opp. at 73 n.16. Plaintiffs' Section 11 claims relating to two other Enron debt offerings – 7.375% notes offered on May 19, 1999 and 7.875% notes offered on May 18, 2000 – also are fatally flawed.

Although it is not entirely clear from the Consolidated Complaint, it appears that plaintiffs are alleging that the 7.375% notes offered on May 19, 1999 were offered pursuant to a registration statement effective on February 5, 1999. See Compl. ¶ 1006 (7.375% notes were offered on May 19, 1999); Compl. ¶ 612 (notes offered on May 19, 1999 were offered pursuant to registration statement effective Feb. 5, 1999). But nowhere in the Consolidated Complaint do plaintiffs allege that Andersen consented to the incorporation of its audit reports in a February 5, 1999 registration statement. See Mot. at 29. Conceding this omission, plaintiffs point to Andersen's alleged consent to the use of its audit reports in a registration statement filed on January 12, 1999, see Opp. at 72 (citing Compl. ¶ 899(iv)), and assert that their complaint also alleges that the 7.375% notes were offered pursuant to a registration statement filed on January

12, 1999. See Opp. at 72 (citing Compl. ¶¶ 48, 612, 1006). But none of these paragraphs cited by plaintiffs alleges that a registration statement for the 7.375% notes was filed on January 12, 1999.[19] Thus, the Consolidated Complaint fails to allege that Andersen consented to the incorporation of its audit reports into the registration statement for the 7.375% notes.

Similarly, plaintiffs fail to allege that Andersen consented to the incorporation of its audit reports into the registration statement for the 7.875% notes offered on May 18, 2000. The Consolidated Complaint appears to allege that these notes were offered pursuant to a February 5, 1999 registration statement. See Compl. ¶ 1006 (7.875% notes were offered on May 18, 2000); Compl. ¶ 612 (notes offered "05/00" were offered pursuant to registration statement effective Feb. 5, 2000). Because plaintiffs do not allege consent by Andersen with respect to a February 5, 2000 registration statements, plaintiffs again cite paragraphs 48, 612 and 1006 of the Consolidated Complaint to claim that the 7.875% notes were offered pursuant to a registration statement filed on January 12, 1999 – but these paragraphs do not mention a January 12, 1999 registration statement.

The Consolidated Complaint also fails to allege that subclass plaintiff representatives Hawaii Laborers and Archdiocese relied on a registration statement for the 7.875% notes as required by 15 U.S.C. § 77k(a)(4). In another example of plaintiffs' highlighting a deficiency in their pleading by asserting facts not alleged in the Consolidated Complaint, plaintiffs invoke a purported March 1, 2000 "post-effective" registration statement to argue reliance was not required. See Opp. at 73 (failing to cite the Consolidated Complaint). But, once again, plaintiffs "cannot supplement the complaint with factual allegations contained outside the four corners of

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[19] Moreover, paragraph 48 is not even among the selected paragraphs incorporated into plaintiffs' Section 11 claim. See Compl. ¶ 1005.

the pleadings in order to establish the elements" of their claims. Hernandez, 200 F.R.D. at 294 n.8; see also Baker Hughes, 136 F. Supp. 2d at 646-47.

For these reasons, the Consolidated Complaint fails to state a cause of action against Andersen under Section 11.

III. THE CONSOLIDATED COMPLAINT FAILS TO ADEQUATELY ALLEGE A CLAIM AGAINST ANDERSEN UNDER THE TEXAS SECURITIES ACT

A. Plaintiffs Fail to Allege an Essential Element of Their Claim Under Section 33C of the Texas Securities Act

Aiding and abetting liability under the Texas Securities Act (the "TSA") can attach only to a person who, acting with scienter, aids a primary violation of the TSA by a seller, buyer, or issuer of securities. See Tex. Rev. Civ. Stat. art. 581-33F(2). Because the Consolidated Complaint provides no notice of which alleged violation of the TSA Andersen purportedly aided, Andersen observed in its opening brief that plaintiffs' allegations relating to their TSA claim

> "are deliberately vague concerning what role each defendant played – i.e., seller, issuer, aider, or otherwise – and the manner in which they allegedly violated the statute. See Compl. ¶¶ 1017-30. Plaintiffs do not even specify on which sections of Article 581-33 they rely or their theory of liability as to any particular defendant. As such, plaintiffs allegations clearly fail to meet the requirements of Fed.R.Civ. P. 9(b) and even the liberal pleading standards of Rule 8."

Mot. at 33. Plaintiffs now clarify that their claim is that Andersen aided Enron, as an issuer, in allegedly violating Section 33C of Article 581 of the TSA. See Opp. at 74 ("*Andersen materially aided Enron's – the issuer's – violations* of the Texas Securities Act. 'A person who directly or indirectly with intent to deceive or defraud or with reckless disregard for the truth or the law materially aids . . . *[an] issuer of a security is liable under Section . . . 33C* jointly and severally with the . . . issuer, as to the same extent as if he were the . . . issuer.'" (quoting Tex. Rev. Civ. Stat. art. 581-33F(2)) (emphasis added).

But the Consolidated Complaint fails to allege an essential element of a Section 33C claim. In Section 33C, the Texas legislature expressly provided that "[t]his Section 33C applies *only* to an issuer which registers . . . its outstanding securities for offer and sale *by or for the owner of the securities*." Tex. Rev. Civ. Stat. art. 581-33C(1) (emphasis added). Despite this explicit statutory limitation, the Consolidated Complaint fails even to identify the owner of the securities at issue, much less to allege that Enron registered the securities at issue "for offer and sale by or for" this owner. See Mot. at 34. The lack of any allegation that, if proved, would show that Enron's registration satisfies this statutory requirement is fatal to plaintiffs' claim under Section 33C of the TSA. See, e.g., Kurtzman v. Compaq Computer Corp., C.A. No. H-99-779, mem. op. at 42-43 (S.D. Tex. Apr. 1, 2002) ("Dismissal is proper if the complaint lacks an allegation regarding a required element necessary to obtain relief . . . .") (internal quotations omitted).

Implicitly acknowledging the absence of such an allegation, plaintiffs argue that no such allegation is required because "not just a seller but also an 'issuer'" is potentially liable under Section 33C. Opp. at 75. The flaw in this argument is that not all issuers are liable under Section 33C – rather, by Section 33C's express terms, only those issuers that register securities "for offer and sale by the owner of the securities" are potentially liable under the section. Plaintiffs' Section 33C claim is doomed by their failure to allege that Enron is such an issuer.

B. Plaintiffs' Claim Does Not Plead Fraud with Sufficient Particularity

Plaintiffs acknowledge that in order to state a claim against Andersen for aiding Enron's alleged violation of the TSA, they must sufficiently allege that (1) Enron violated the TSA,[20] (2) Andersen had a "general awareness" of its role in Enron's alleged violation, (3) Andersen "substantially assisted" Enron in the company's alleged violation, and (4) Andersen intended to deceive the plaintiffs or "acted with reckless disregard for the truth of the representations made by [Enron]." Opp. at 73 (citing Frank v. Bear Stearns & Co., 11 S.W.3d 380, 384 (Tex. App. 2000), and Cresendo Invs., Inc. v. Brice, 61 S.W.3d 465, 472 (Tex. App. 2001)).

Plaintiffs also concede that their TSA claim is subject to Rule 9(b) of the Federal Rules of Civil Procedure. See Opp. at 75. Rule 9(b) requires "more than a simple allegation that a defendant had fraudulent intent." Tuchman v. DSC Communs. Corp., 14 F. 3d 1061, 1068 (5th Cir. 1994). Conclusory allegations as to state of mind do not suffice to meet the pleading requirements of Rule 9(b). See Lovelace v. Software Spectrum, Inc., 78 F.3d at 1019; Melder v. Morris, 27 F.3d at 1104. Rather, plaintiffs must allege specific facts that support an inference of fraud. See Tuchman, 14 F.3d at 1068.

Plaintiffs allege that Enron violated the TSA only in connection with the offering of certain 6.95% notes due July 15, 2028 and 6.40% notes due July 15, 2006. See, e.g., Compl. ¶ 1019. Plaintiffs appear to allege that these notes were issued in July and November 1998. See Compl. ¶ 48. They argue that their allegations regarding Enron's 1997 financial statements and the offering documents for these notes demonstrate scienter on Andersen's part. Opp. at 75.

[20] In particular, under plaintiffs' theory of their claim, see Opp. at 74, they must sufficiently allege that Enron violated Section 33C of the TSA. For the reasons set forth in the previous subsection, plaintiffs have not adequately alleged that Enron registered the securities at issue "for offer and sale by the owner of the securities."

Plaintiffs again highlight the deficiencies in their allegations by citing paragraphs in the Consolidated Complaint that do not allege the facts that they rely on in their brief. Plaintiffs argue that "Andersen consented to allow Enron to incorporate its unqualified opinion letter into the 7/7/98 offering documents." Opp. at 75 (citing Compl. ¶¶ 899, 945-947). But none of the paragraphs of the Consolidated Complaint that plaintiffs cite for this argument mention the date July 7, 1998, much less allege that Andersen consented to the use of its audit reports in any July 7, 1998 offering documents. See Compl. ¶¶ 899, 945-947. Plaintiffs also argue that "Andersen . . . was reckless in drafting the ratio of fixed earnings to fixed charges included in the offering documents for the 7/7/98 sale of $500 million of Enron notes." Opp. at 75 (citing Compl. ¶¶ 612-613, 899). But, again, these paragraphs do not allege Andersen's consent in connection with the July 7, 1998 offering documents, much less allege that Andersen "draft[ed] the ratio of fixed earnings to fixed charges" in these documents. See Hernandez, 200 F.R.D. at 294 n.8 (plaintiffs "cannot supplement the complaint with factual allegations contained outside the four corners of the pleadings in order to establish the elements" of their claims); see also Baker Hughes, 136 F. Supp. 2d at 646-47.

In any event, plaintiffs' allegations do not give rise to a strong inference of fraud by Andersen. In their argument that the Consolidated Complaint alleges scienter by Andersen in connection with the July 7, 1998 offering documents, plaintiffs rely solely on Enron's failure to consolidate Chewco in 1997 and early 1998. See Opp. at 75. But for the reasons set forth above, plaintiffs have failed to allege that Andersen possessed scienter in connection with the non-consolidation of Chewco. See supra at I.B.1.

Therefore, this Court should dismiss plaintiffs' claim that Andersen aided Enron's violation of Section 33 of Article 581 of the TSA.[21]

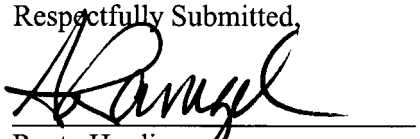
[21] Regardless whether Andersen-Puerto Rico and Andersen-Cayman Islands are legally separate from Andersen, the Consolidated Complaint does not state a claim against either office for the reasons set forth in Andersen's motion to dismiss and Andersen's motion to dismiss Andersen-Cayman Islands. See Mot. at 35-36; Andersen Motion to Dismiss Andersen-Cayman Islands.

CONCLUSION

For these reasons, plaintiffs' Consolidated Complaint fails to state a claim against Andersen upon which relief may be granted and should be dismissed against Andersen pursuant to Rules 9(b) and 12(b)(6) of the Federal Rules of Civil Procedure.

Dated: Houston, Texas
June 24, 2002

Respectfully Submitted,



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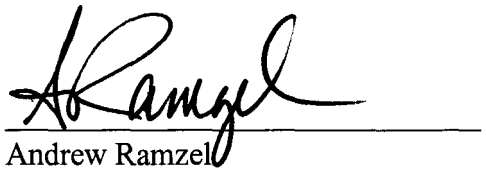
CERTIFICATE OF SERVICE

I hereby certify that on this 24 day of June, 2002, the forgoing pleading was served pursuant to the Court's April 5, 2002 Order.



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