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Thomas H. Bauer, Michael L. Bennett, Joseph F. Berardino, Debra A. Cash, Donald Dreyfus, James A. Friedlieb, D. Stephen Goddard, Jr., Gary B. Goolsby, Gregory W. Hale, Michael D. Jones, Michael M. Lowther, Benjamin S. Neuhausen, Richard R. Petersen, John E. Stewart, William E. Swanson, Nancy A. Temple and Roger D. Willard (collectively, the “Individual Andersen Defendants” or the “Individual Defendants”)<sup>1</sup> respectfully submit this memorandum in further support of their motion to dismiss Count I of plaintiffs’ Consolidated Complaint as against each one of them.

#### PRELIMINARY STATEMENT

Plaintiffs’ Consolidated Complaint (the “Complaint”) fails to state a claim against any of the Individual Andersen Defendants. As detailed in the Individual Andersen Defendants’ Motion to Dismiss, plaintiffs’ 500-page, 1000-paragraph Complaint contains barely a reference to these defendants. The Complaint makes two sets of sweeping and conclusory allegations against the Individual Defendants: it alleges that some were “an integral part of the Enron audit and consulting engagements,” see, e.g., Compl.<sup>2</sup> ¶¶ 93(b),(d),(g)-(m),(o)-(p),(r), and that some were “an integral part of the destruction of Andersen’s documents relating to Enron.” See, e.g., Compl. ¶¶ 93(e),(f). For some of the Individual Defendants, such a single, conclusory allegation is all that is alleged. For others, there may be only one additional allegation, such as participation

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<sup>1</sup> The Individual Andersen Defendants also include Michael C. Odom, although Mr. Odom will be filing a separate Reply Memorandum. Two individuals who originally joined the Individual Andersen Defendants’ Motion to Dismiss – Danny D. Rudloff and John E. Sorrells – were voluntarily dismissed by plaintiffs. See Notice of Dismissal filed June 13, 2002.

<sup>2</sup> Citations to “Compl.” refer to the Consolidated Complaint; citations to “Individuals’ Motion” refer to the Individual Andersen Defendants’ Motion to Dismiss; citations to “Opp.” refer to plaintiffs brief in Opposition to the Individual Andersen Defendants’ Motion to Dismiss; citations to “Andersen Mot.” refer to Andersen’s Motion to Dismiss.

in a conference call, Compl. ¶¶ 930, or attendance at a meeting, Compl. ¶¶ 966. See Individuals' Motion at 5-6. At bottom, and regardless of the minor differences in the quantum of allegations regarding the Individual Defendants, the Complaint does not state a claim for securities fraud against any one of the Individual Defendants under *any* theory of liability.

First and foremost, none of the Individual Defendants made any misstatement. In their massive Complaint and 67-page Opposition, plaintiffs have not identified a single alleged misstatement made by any of the Individual Defendants. Although plaintiffs concede that it is their burden to allege “the Andersen Partners’ statements” and they identify 26 separate paragraphs of their Complaint where they contend that they have “specif[ied] what was said, who said it, and where and when it appeared,” Opp. at 28 (citing 26 paragraphs of Complaint), not a single Individual Defendant partner is even *mentioned* in those paragraphs. Indeed, the only individuals mentioned by name in those paragraphs are officials of Enron.

Plaintiffs devote four pages of the argument section of their Opposition to what they describe as “The Andersen Partners’ Material Misrepresentations.” See Opp. at 29-33. Yet each of those alleged “misrepresentations” is in fact a statement in Enron’s financial statements audited by Andersen. Although the references to statements by Andersen in those paragraphs might identify allegedly false statements of Andersen, these simply are not statements of the Individual Defendants, either individually or collectively. No court has endorsed such a gross form of the group published information doctrine – attributing all statements made by an entity to any individual associated with it – and no court could do so in light of the mandate of the Private Securities Litigation Reform Act of 1995 (the “PSLRA”). See 15 U.S.C. § 78u-4(b). Indeed, this Court has explicitly rejected this theory. See In re BMC Software, Inc. Sec. Litig., 183 F.

Supp. 2d 860, 902 n.45 (S.D. Tex. 2001) (Harmon, J.). In the absence of any alleged misstatement made by the Individual Defendants, the claims against them must be dismissed.

Second, plaintiffs ask this Court to relieve them of their burden to show that the Individual Andersen Defendants made any false statement. But no amount of legal gymnastics can avoid the Supreme Court's holding in Central Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164 (1994), and its progeny "that secondary actors such as accountants may not be held primarily liable unless they themselves have made a material misstatement (or omission)." Wright v. Ernst & Young LLP, 152 F.3d 169, 177 (2d Cir. 1998) (applying Central Bank). Plaintiffs fail to cite a single case for the extraordinary proposition that an individual accountant may be held liable under § 10(b) for the statements of the individual's firm. Indeed, the Individual Andersen Defendants are not aware of any court that has so held, and this court should decline plaintiffs' invitation to be the first. Even more fundamentally, plaintiffs nowhere allege facts against any one of these 19 Individual Defendants that amount to a viable claim under any of the alternative theories raised in their opposition brief, even assuming, *arguendo*, that they survive Central Bank.

Plaintiffs' Complaint should be dismissed for a third and independent reason. Even if the Complaint identified any misstatement made by any Individual Defendant, it fails to allege facts establishing a strong inference of scienter with respect to each of the Individual Defendants as required by the PSLRA.

Finally, plaintiffs fail to state a claim against any of the Individual Andersen Defendants as controlling persons under § 20(a) because the allegations in the Complaint do not attribute to any of these defendants the degree and type of control required under § 20(a).

The implicit premise of plaintiffs' Complaint and Opposition is that if they state a claim against Andersen or Enron or some other entity or group, they have stated a claim against the Individual Defendants. That is not the law.<sup>3</sup> Having made the choice to sue *individuals*, it is plaintiffs' obligation to allege *every* element of *every* claim against *every* Individual Defendant. They have not done and cannot do so. The claims against the Individual Defendants should be dismissed.

### ARGUMENT

I. PLAINTIFFS HAVE FAILED TO PLEAD A CLAIM UNDER SECTION 10(b) OR RULE 10b-5 AGAINST ANY OF THE INDIVIDUAL ANDERSEN DEFENDANTS

A. Plaintiffs Have Failed to Plead That Any of the Individual Andersen Defendants Made a Material Misstatement or Omission, or Any Other Element of Section 10(b)

As demonstrated in the Individuals Defendants' Motion to Dismiss, and as shown by a review of the Complaint and plaintiffs' Opposition, none of the essential elements of a § 10(b) claim has been alleged as against any one of the Individual Defendants. Plaintiffs try to excuse their deficient pleading, arguing that based upon ABC Arbitrage Plaintiffs Grp. v. Tchuruk, No. 01-40645, 2002 U.S. App. LEXIS 9112 (5th Cir. May 13, 2002), and similar cases, they need not allege "all facts" related to their purported securities claims. The issue is not whether plaintiffs should be required to allege "all facts" related to their claims; the issue is that plaintiffs have failed to allege *any facts* that state a claim against *any Individual Defendant*. Plaintiffs cite no

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<sup>3</sup> Plaintiffs also seem to assume that because the Individual Defendants have jointly submitted this Motion to Dismiss, allegations against one can be attributed to others. Plaintiffs are wrong and their references to the Individual Defendants as a collective entity, including the attribution of acts by one to another, have no basis in law or fact. The Individual Defendants have jointly submitted this brief solely to conserve the parties' and the Court's resources and because the legal deficiencies of the Complaint apply to each one of them.

case that relieves them of their obligation of alleging as to *each* defendant *facts* with respect to each essential element of § 10(b).

Plaintiffs attempt to use their opposition brief to amend their Complaint with citations to new exhibits, the transcript of the recent Andersen trial and newspaper articles. 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); 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’ attempt to plug the holes in the Complaint by such a tactic reflects their recognition that the Complaint is fatally deficient. Even considering this information, the claims against the Individual Defendants should be dismissed.

1. Plaintiffs Have Failed to Plead Any Misstatement or Omission

The Complaint does not contain a single allegation in its more than 500 pages that any one of the Individual Defendants made a material misstatement or omission of material fact. Nor do plaintiffs argue otherwise in their Opposition.<sup>4</sup> That fact alone requires that the claims against the Individual Defendants should be dismissed.

Unable to attribute any statement to any Individual Defendant, plaintiffs retreat to the grossest form of group pleading by arguing that Andersen’s public statements (its opinions on Enron’s annual financial statements) are chargeable to each Individual Defendant by virtue of his

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<sup>4</sup> Plaintiffs also argue in their opposition brief that the term “we” in an audit opinion issued by Andersen refers to the Individual Defendants. Opp. at 40. In that context, however, the term “we” obviously refers to Andersen the firm, not to any of the hundreds of individuals who constitute the firm.

or her position at Andersen. Plaintiffs do not cite to a single case to support the novel proposition that an individual partner can be charged with a primary violation of § 10(b) based upon a statement of the partnership.

The four cases plaintiffs rely upon, In re Securities Group, 926 F.2d 1051 (11th Cir. 1991), Suez Equity Investors, L.P. v. Toronto-Dominion Bank, 250 F.3d 87 (2d Cir. 2001), United States v. Natelli, 527 F.2d 311 (2d Cir. 1975), and United States v. Simon, 425 F.2d 796 (2d Cir. 1969), are inapposite.<sup>5</sup> Some stand for the basic and unremarkable proposition that a partnership is bound by the acts of its partners, so long as the partner is acting within the scope of the partnership, and others stand for the equally basic proposition that a person is liable for his own wrongful acts. But no case holds what plaintiffs suggest – that a partner can be personally charged with wrongdoing under §10(b) based upon allegations of wrongful conduct by the partnership; and allegations based on such a “guilt by association” theory violate the PSLRA and this Court’s holding that group pleading is not permitted. See In re BMC Software, 183 F. Supp. 2d at 902 n.45 (concluding that “the group pleading doctrine is at odds with the PSLRA and has not survived the amendments”); Coates v. Heartland Wireless Communications, Inc., 26 F. Supp. 2d 910, 916 (N.D. Tex. 1998); Allison v. Brooktree Corp., 999 F. Supp. 1342, 1350 (S.D. Cal. 1998); Marra v. Tel-Save Holdings, Inc., No. 98-3145, 1999 U.S. Dist. LEXIS 7303, 1999 WL 317103 \*5 (E.D. Pa. May 18, 1999).

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<sup>5</sup> Simon, and Natelli were brought under § 32(a) rather than § 10(b) – a different provision of the securities laws which permits a finding of liability not only for the making of a misstatement, but also for causing a misstatement to be made by someone else. See Natelli, 527 F.2d at 314 n.1 (quoting statute). The Individual Defendants are aware of no case citing Simon or Natelli to support the finding of an actionable misstatement under § 10(b). Suez Equity Investors stands merely for the proposition that an individual may be liable for fraudulent statements that he personally made, with scienter, to the plaintiffs. Id. at 93-94 (detailing actions attributable to individual defendant).

2. The Plaintiffs Have Failed to Plead Facts to Support Any of the New Alternative Theories Argued in Their Opposition

Unable to demonstrate that any one of the Individual Defendants affirmatively made a misstatement, plaintiffs grasp at three alternative theories – arguing that the individuals are liable for fraud based on their alleged participation in a scheme to defraud, or on “substantial participation” in the drafting of Enron’s alleged misstatements, or on a duty to correct those alleged misstatements. Yet, none of those theories suffice to cure the deficiencies in the Complaint.

As an initial matter, each of those theories must fail as a matter of law because they attempt to impose secondary liability on the Individual Defendants in violation of the holdings of Central Bank and its progeny. See Wright, 152 F.3d at 177.<sup>6</sup> But even if plaintiffs could overcome the insurmountable legal hurdles to their theories of secondary liability, their theories fail because they have not alleged – and cannot allege – facts to support these theories of liability.

a. No Scheme to Defraud Is Alleged

First, plaintiffs argue that each one of the Individual Defendants can be charged with primary liability under § 10(b) for having participated in a scheme to defraud that purportedly occurred over a period of years involving masses of people. Plaintiffs further state that to advance this theory, they must allege “that *each defendant committed a manipulative or deceptive act in furtherance of a scheme.*” Opp. at 36 (quoting Cooper v. Pickett, 137 F. 3d 616, 624 (9th Cir. 1998) (emphasis added).

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<sup>6</sup> Plaintiffs theories are, in effect, efforts to impose secondary liability on the Individual Defendants in violation of Central Bank. Sections I.A.1 and I.A.2 of Arthur Andersen LLP’s Reply Memorandum of Law in Further Support of Its Motion To Dismiss the Consolidated Complaint (“Andersen’s Reply”) discuss in greater detail why the “scheme liability” theory cannot apply in this case and why “substantial participation” fails as a matter of law after Central Bank. Those arguments apply with equal force to the Individual Defendants and, rather than being repeated, are incorporated herein by reference.

To state plaintiffs' argument is to defeat it. As is evident from the allegations of the Complaint, see Individuals' Motion at 3-8, plaintiffs do not allege any *facts* to suggest that *any* of these Individual Defendants engaged in a scheme to defraud. Far from alleging a manipulative or deceptive act by each defendant in furtherance of a scheme, plaintiffs allege merely the status of the individuals as partners of Andersen, and offer general allegations regarding participation in Andersen's audits; allegations regarding attendance at internal meetings and discussions regarding Enron as a client; and allegations of disagreements among or knowledge of disagreements among certain partners concerning the application of generally accepted accounting principles. The acts alleged are for the most part, non-specific, random and isolated but, most importantly, they are not manipulative or deceptive.

The Supreme Court has declined invitations to construe the term "manipulation" broadly, stating that "[m]anipulation' is 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) (internal citations omitted); Shivangi v. Dean Witter Reynolds, Inc., 825 F.2d 885, 889 (5th Cir. 1987). None of the Individual Defendants is alleged to have engaged in any such activity. The allegations in the Complaint are also insufficient under Fed. R. Civ. P. 9(b) and the PSLRA, which apply equally to alleged scheme violations arising under Rule 10b-5(a) and Rule 10b-5(b). See, e.g., Lemmer v. Nu-Kote Holding Inc., No. Civ. A. 398CV0161L, 2001 WL 1112577, at \*7-8 (N.D. Tex. Sept. 6, 2001); In re BMC Software, 183 F. Supp. 2d at 885-86, 916-17 (endorsing argument that allegations were deficient for failure to allege "what actions each Defendant took in furtherance of the alleged scheme").

b. No Substantial Participation Is Alleged

Plaintiffs also argue that each of the Individual Defendants is liable for alleged false statements made by Enron in its interim financial reports and unidentified press releases because plaintiffs *now* assert for the first time in their Opposition that the Individual Defendants “substantially participated in drafting them.” Opp. Br. at 41-43.<sup>7</sup> At best, plaintiffs have alleged that through *non-fraudulent, non-deceptive* acts the Individual Defendants *may* have given aid to an alleged primary violator; but that amounts to no more than an aiding and abetting allegation, barred by Central Bank.

Moreover, plaintiffs do not identify a single allegation in the Complaint specifying any Individual Defendant who drafted, substantially or otherwise, any Enron interim financial statement or any press release. Nevertheless, plaintiffs argue that “[t]here is no question that Andersen Partners reviewed and edited Enron’s press releases regarding quarterly results. Defendant Nancy Temple ordered Enron engagement partners to delete their conclusion that an imminent Enron press release was false.” Opp. at 41-42 (citing Compl. ¶ 966). A review of the Complaint shows that what plaintiffs now argue is not what they alleged in the Complaint. The Complaint alleges that Ms. Temple instructed Andersen personnel to delete their conclusion “from draft accounting memoranda.” Compl. ¶ 966. The significance of the distinction cannot be overstated, because an internal Andersen memorandum – which is what the Complaint alleged – could not constitute an actionable public statement.

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<sup>7</sup> Plaintiffs erroneously cite this Court’s decision in In re BMC Software, to support their argument that the substantial participation test applies in a § 10(b) case. Their citation is not to this Court’s holding, but instead is to portion of the Opinion in which the Court merely recites the plaintiff’s argument. Opp. at 42. In fact, the Court rejected plaintiffs’ argument in its entirety and dismissed the complaint. In re BMC Software, 183 F. Supp. 2d at 915-17.

In addition, the allegation in the Complaint does not identify anyone to whom Ms. Temple spoke, and it says nothing about the role, if any, of any Individual Defendant in purportedly drafting the Enron financial statement release. The allegation demonstrates that individuals within Andersen *disagreed* with Enron and *opposed* Enron's issuance of this statement.<sup>8</sup> Thus, putting aside the issue of whether such a claim of substantial participation could even be stated after Central Bank, the fact remains that there is not a single allegation in the Complaint regarding any level of participation by any Individual Defendant, let alone substantial participation, in the drafting of Enron statements to support this theory as against any defendant.

c. No Duty to Correct Is Alleged

Plaintiffs have not stated a claim against any one of the Individual Defendants for a violation of an alleged duty to correct. First, this theory, like their initial misrepresentation theory is premised on Andersen's alleged misrepresentations and not upon any alleged statement by any individual. Obviously, if a defendant did not make a statement, she can be under no duty to correct it. See Solomon v. Peat, Marwick, Main & Co., No. 91-55453, 1992 U.S. App. LEXIS 24326, \*8-9, (9th Cir. Sept. 21, 1992) ("the duty to speak arises from a party's previous decision to speak," and there is no "broad duty to correct statements made by other parties before the accountant has ever spoken himself.").

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<sup>8</sup> Plaintiffs improperly cite the Andersen trial transcript, a matter outside four corners of the Complaint, to try to support their argument. Aside from the impropriety of this effort to amend, see In re Baker Hughes Sec. Litig., 136 F. Supp. 2d at 646-47, plaintiffs only selectively quote from the transcript. For instance, they ignore portions of the transcript that indicate that certain of the individual defendants did *not agree* with the statements in the press release and that Enron was informed of that disagreement. See e.g., U.S. v. Andersen Trial Transcript ("Trial Tr.") 5/14/02 at 1793:24-1800:7 (Testimony of David Duncan).

Second, this theory is improperly alleged in plaintiffs' Opposition for the first time because plaintiff cannot seek to amend its complaint in opposition to a motion to dismiss. See Baker Hughes, 136 F. Supp. 2d at 646-47. Plaintiffs have not pleaded particularized allegations of fact that, if proved, would identify specifically which defendant made a misstatement and when that defendant discovered his specific error. See In re Burlington Coat Factory Sec. Litig., 114 F.3d 1410, 1431 (2nd Cir. 1997). They have pleaded no facts that would give rise to a strong inference of scienter. See 15 U.S.C. § 78u-4(b)(2). As a result, plaintiffs fail to state a claim against any Individual Defendant under a duty to correct theory. See also Andersen Reply, Section I.A.3, which is also incorporated herein by reference.

B. Plaintiffs Have Failed To Plead Particularized Facts Which, If Proven, Would Give Rise to a Strong Inference That Any of the Individual Andersen Defendants Possessed Scienter

1. The Applicable Legal Standard Requires Plaintiffs to Plead Facts Giving Rise to a Strong Inference of Scienter

Plaintiffs' claims against each one of the Individual Defendants must also be dismissed because plaintiffs have failed to meet the PSLRA's requirement that "the complaint shall, with respect to *each* 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." 15 U.S.C. § 78u-4(b)(2) (emphases added).

A "strong inference" of scienter is one that leaves "little room for doubt as to misconduct." Helwig v. Vencor, Inc., 251 F.3d 540, 553 (6th Cir. 2001), cert. denied, 70 U.S.L.W. 3269 (June 20, 2002). To support a strong inference, allegations must "constitute persuasive, effective, and cogent evidence from which it can logically be deduced that defendants acted with intent to deceive, manipulate, or defraud." Coates v. Heartland Wireless

Communications, Inc., 100 F. Supp. 2d 417, 422 (N.D. Tex. 2000). “A mere reasonable inference is insufficient to survive a motion to dismiss.” Greebel v. FTP Software, Inc., 194 F.3d 185, 196 (1st Cir. 1999) (emphasis added); see also Reiger v. PriceWaterhouseCoopers LLP, 117 F. Supp. 2d 1003, 1011 (S.D. Cal. 2000) (“[F]actual allegations must transcend rational or reasonable inferences, and must instead raise a ‘strong inference’ of scienter.”).

Plaintiffs’ allegations, which are sparse and conclusory to begin with, do not support a strong inference that *any* Individual Defendant, much less all of them, acted with the requisite degree of scienter. Instead, plaintiffs’ Opposition improperly relies on sweeping group allegations and on efforts to attribute the thoughts or acts of one person to others. Plaintiffs must allege facts giving rise to a strong inference of scienter as to *each defendant*.

2. Plaintiffs’ Generalized and Conclusory Allegations Regarding Each Individual Andersen Defendant’s Role with Respect to the Enron Engagement Do Not Give Rise to a Strong Inference of Scienter

As the Individuals’ Motion described, and as the Complaint reveals, the vast majority of the allegations contained in the Complaint are impersonal and conclusory. For example, with respect to Mr. Hale the plaintiffs’ sole allegation is that he “was integral to the Enron auditing and consulting engagements.” Compl. ¶ 93(r). With respect to others, there is barely more. See Individuals’ Motion at 5-6. This Court has held that plaintiffs cannot plead scienter merely through allegations about the defendant’s executive position, day-to-day responsibilities, and/or the location of his or her office. See In re BMC Software, 183 F. Supp. 2d at 915-17 (noting that plaintiffs must plead “specific facts relating to each statement to demonstrate that it was misleading and to each Defendant-speaker sufficient to give rise to a strong inference that the speaker knew his statement was false when it was made”). Thus, the allegations that certain of

the Individual Andersen Defendants served in management roles either on a firmwide basis or in the Houston office are patently insufficient to allege scienter. See Compl. ¶ 93(a) (Berardino), ¶ 93(g) (Goddard), ¶ 93(h) (Goolsby), ¶ 93(o) (Swanson).

In addition, mere allegations of access to information do not support the required inference of scienter. See In re BMC Software, 183 F. Supp. 2d at 910, 917 (granting motion to dismiss where plaintiffs alleged such access); In re SCB Computer Tech., Inc. Sec. Litig., 149 F. Supp. 2d 334, 361 (W.D. Tenn. 2001) (noting that inferring scienter from mere possession of documents “invites too much speculation to satisfy either the particularity or strong inference requirements of the [PSLRA]”); In re Landry’s Seafood Rest., Inc. Sec. Litig., No. H-99-1948 (S.D. Tex. Feb. 20, 2001) (holding allegation of underwriter defendants’ access to information insufficient where plaintiffs “failed to identify any specific information communicated by document or conversations to the . . . Defendants or uncovered by them in their due diligence investigation”).

Even where plaintiffs point to purported “red flags” relating to Enron entities and transactions of which they allege Andersen was aware, Compl. ¶ 946-47 (cited in Opp. at 46), they make no attempt to connect any Individual Defendant to Andersen’s alleged knowledge. Here, as elsewhere in their Opposition, plaintiffs mistakenly refer to allegations aimed at Andersen as though they could be used to satisfy pleading requirements for claims against the Individual Defendants; and they erroneously assume that the mere allegation of a general role in Enron audits, combined with a general allegation of accounting errors, is effective to plead scienter with respect to each of the Individual Andersen Defendants.<sup>9</sup> It is not. See, e.g., Abrams

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<sup>9</sup> For example, in support of their argument that the “Andersen Partners Knew Chewco and JEDI SPE’s Were Fraudulent,” Opp. at 52, plaintiffs fail to cite a single paragraph of the Complaint that mentions any individual  
(continued...)

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 each 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.”)

3. Plaintiffs’ Allegations of an Internal Disagreement Within Andersen Regarding the Accounting Treatment for Certain Transactions Do Not Give Rise to a Strong Inference That Any of the Individual Andersen Defendants Acted with Scienter

Plaintiffs rely most heavily upon allegations relating to the views purportedly expressed by Carl Bass concerning the treatment of the LJM, Raptor, and (now also in the Opposition) the Braveheart transactions. However, as already demonstrated in the Individuals’ Motion, mere knowledge on the part of some of the Individual Defendants that Mr. Bass disagreed with some of the very complex accounting judgments relating to Enron does not support a strong inference that any of those defendants believed that the accounting judgments were incorrect or that they acted recklessly in arriving at those judgments. The intricacy of the accounting judgments involved, along with the flexibility of accounting rules, simply does not permit the inference of scienter from disagreements between accountants. See Lovelace v. Software Spectrum, Inc., 78 F.3d 1015, 1021 (5th Cir. 1996) (“[A] difference in judgment about generally accepted

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<sup>9</sup> (...continued)

defendant by name, relying instead on allegations directed only at Andersen or at the Andersen partners as a group; and they endeavor to supplement their pleading with extraneous matter – for example citing to their Exhibit 15 for the assertion that Mr. Bauer had access to Chewco documents, a charge that, as noted above, cannot support an inference of scienter.

accounting principles does not establish conscious behavior on the part of Defendants.”).<sup>10</sup>

Individuals’ Motion, at 15-19.

Plaintiffs contend that the fact that certain of the Individual Defendants did not share Mr. Bass’s views represented the sort of “egregious refusal to see the obvious, or to investigate the doubtful” that some courts have held contributes to an inference of scienter. Opp. at 52, 54. But this argument suffers from at least two deficiencies. First, Mr. Bass’s concerns do not suggest the existence of any facts inconsistent with any Andersen statements relating to Enron finances. Rather, his views represented a different judgment expressed as part of an internal debate about the proper accounting of Enron entities or transactions. Second, that debate was itself the “investigation” of Bass’s concerns. The mere fact that Bass’s views did not persuade his Andersen colleagues, even assuming that in hindsight he was right, does not raise a strong inference that those who knew of his differing views were engaged in fraud or were acting with severe recklessness. Indeed, this vigorous internal debate, far from creating an inference of scienter, was a sign of diligence, as plaintiffs recognize. See Compl. ¶¶ 966 (suggesting that adding Bass’s criticisms back into memos would “give the impression that Andersen had been

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<sup>10</sup> Plaintiffs argue that Mr. Stewart’s awareness of Bass’s “removal” from one position within Andersen to another – allegedly at Enron’s behest – supports an inference of scienter on Stewart’s part. Opp. Br. at 47. (For the allegation of Stewart’s awareness of the circumstances of Bass’s departure, plaintiffs impermissibly cite in their Opposition Brief to trial testimony from United States v. Arthur Andersen, LLP, No. H-02-121.) But Bass’s removal does not support a strong inference of scienter on Stewart’s part. If it contributes at all to the analysis, the allegation of Bass’s change of position reinforces the inference that his disagreements with other Andersen auditors were (and were perceived even by him) to be matters of professional judgment. The fact that he accepted another position within Andersen would suggest to anyone aware of the move that Bass saw himself not as someone blowing the whistle on a fraud but as someone raising an objection to what he saw as incorrect accounting. It is also worth noting that John Stewart, whose testimony plaintiffs cite for the allegation that Bass was removed at Enron’s behest, noted that he (Stewart) had concurred with Bass on the decisions that supposedly prompted Enron to request the reassignment. Trial Tr., 5/30/02 at 5392:7-5394:2. The fact that Enron did not object to Stewart, even though he expressed the same views, undermines the argument that the Individual Andersen Defendants should have seen Bass’s removal as an indication of fraud.

more critical of Enron's accounting than it really had been"). Plaintiffs' own equivocation as to the significance of Bass' disagreement means they cannot raise a strong inference of fraud.

4. Plaintiffs' Allegations Regarding the February 5, 2001 Risk Assessment Meeting Do Not Give Rise to a Strong Inference That Any of the Individual Andersen Defendants Acted with Scienter

Plaintiffs also rely repeatedly and heavily on allegations relating to a February 5, 2001 meeting and conference call at which issues arising from the Enron engagement were discussed.<sup>11</sup>

Plaintiffs overstate and misinterpret the significance of the meeting. Contrary to plaintiffs' assertions, the short memorandum memorializing the meeting does not indicate that the accounting treatment utilized by Enron was unjustified or improper, nor does it suggest that information regarding Enron's transactions was improperly concealed or that there was a basis for withholding Andersen's opinion for the year end 2000 Enron financial statements. 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 Exhibit A to Declaration of Andrew Ramzel.

Accordingly, the February 5, 2001 meeting bespeaks the diligence with which those in attendance (and Andersen as an entity) analyzed and attempted to address the issues raised by the Enron engagement. It indicates neither involvement in, knowledge of nor reckless indifference to securities fraud. "When the allegations of the Complaint are clearly refuted by an attached

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<sup>11</sup> With respect to Messrs. Bennett, Goddard, Goolsby, and Jones, allegations relating to participation in that meeting are the only allegations in the entire Complaint of any specific involvement with Andersen's work for Enron.

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)).

In their Opposition to the Andersen Motion (at p. 60), plaintiffs attempt to dismiss Andersen’s showing that this memorandum, read as a whole, is favorable to Andersen by arguing that Andersen is raising a factual dispute. But as this Court has expressly held, because plaintiffs referenced and relied on parts of the memorandum, the entire document is incorporated in the Complaint; and accordingly Andersen and the Individual Defendants may introduce the entire text in support of their motions to dismiss. See In re BMC Software, 183 F. Supp. 2d at 882-83. Under these circumstances, Andersen’s reliance on the entire document does not raise a fact dispute for the jury, but rather is equivalent to citing plaintiffs’ own pleading. 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. For the reasons set forth above, the memorandum summarizing the February 5, 2001 meeting does not give rise to such an inference.

5. Plaintiffs’ Allegations Regarding Document Destruction  
Fail to Plead Facts That, If True, Would Give Rise to a  
Strong Inference That Any Individual Andersen Defendant  
Acted with Scienter

Plaintiffs contend that their allegations of document destruction by certain of the Individual Defendants support a strong inference of scienter. This is the only allegation as to defendants Dreyfus, Friedlieb, Temple, and Willard.<sup>12</sup>

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<sup>12</sup> With respect to Roger Willard, plaintiffs impermissibly state in their Opposition Brief that he “devised” the accounting for the Braveheart transaction. Opp. at 53. There is no such allegation in the Complaint.

The passing reference to Messrs. Dreyfus and Friedlieb describes *no conduct or statement* by any of them and *no knowledge* they possessed. Compl. ¶ 966 (alluding to a meeting “including” Messrs. Dreyfus and Friedlieb without any reference to what was discussed). Nevertheless, plaintiffs’ Opposition elevates this fleeting reference to a charge of participation in document destruction. It is a completely baseless leap, unsupported by a single factual allegation.

The allegation against Mr. Berardino is even more cursory, indicating only that he was “aware” of the destruction of Enron-related documents. Compl. ¶ 966. There is no allegation as to when he gained this knowledge, and certainly no suggestion that he had contemporaneous knowledge of such destruction. That he learned of it at approximately the time it was disclosed publicly would surely not indicate any wrongdoing on his part, and there is no indication that he knew of it at any other time.

None of the allegations regarding document destruction, more than half a year after Andersen’s last audit opinion, support any inference that any of the Individual Defendants knew of any fraud in Andersen’s work for Enron – completed months and years earlier. *Scienter* must be shown to have existed at the time the allegedly misleading statement was made and must be shown to have resided within the person who made the statement. See Schiller v. Physicians Res. Group, Inc., No. 3:97-CV-3158L, 2002 WL 318441, at \*14; SEC v. Fox, 654 F. Supp. 781, 792-93 (N.D. Tex. 1986).

6. Plaintiffs' Allegations Regarding Compensation Do Not Give Rise to a Strong Inference That Any Individual Andersen Defendant Acted with Scienter

Plaintiffs' allegations of motive do not lend any support to an inference of scienter with respect to any of the Individual Defendants. The Complaint fails to describe with any particularity what, if anything, any of these individuals had to gain through Andersen's relationship with Enron. In any event, the incentive scheme plaintiffs describe does not provide the sort of motive upon which an inference of scienter can be based. See Melder v. Morris, 27 F.3d 1097, 1102, 1103 (5th Cir. 1994) (allegation that "defendant officers and directors were motivated by incentive compensation" was insufficient [to give rise to strong inference of 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."); Acito v. IMCERA Group, Inc., 47 F.3d 47, 54 (2d Cir. 1995) (allegations that "defendant officers [of a company] were motivated to inflate the value of [that company's] stock because the increase in stock price [would have] a direct effect on their executive compensation" were insufficient to give rise to a strong inference of scienter); see also Nathenson v. Zonagen, Inc., 267 F.3d 400, 410-12 (5th Cir. 2001) (allegations of a defendant's motive and opportunity to commit fraud virtually never sufficient by themselves to plead scienter under the PSLRA).

7. The Alleged Simplicity or Magnitude of Accounting Errors Does Not Support a Strong Inference of Scienter

Plaintiffs' suggestion that the simplicity, Opp. at 46-47, or the magnitude, Opp. at 58, of an accounting error can by itself provide the basis for an inference of scienter is legally and factually unsound.

As several courts have noted, inferring scienter from misstatements or omissions alone, no matter what their type or magnitude, would render the scienter requirement meaningless. Reiger, 117 F. Supp. 2d at 1013 (“Inferring scienter from the magnitude of fraud invites a court to speculate as to the existence of specific (but unpleaded and unidentified) warning signs. . . .”); In re SmarTalk Teleservices, Inc. Sec. Litig., 124 F. Supp. 2d 505, 517 (S.D. Ohio 2000) (rejecting attempts to establish scienter though the magnitude and nature of accounting errors as too general and too speculative); Cheney v. Cyberguard Corp., No. 98-6879-CIV-GOLD, 2000 WL 1140306, at \*12 (S.D. Fla. July 31, 2000) (finding that allegations concerning the obviousness of accounting errors simply restated GAAP violations); see also Zucker v. Sasaki, 963 F. Supp. 301, 308 (S.D.N.Y. 1997) (holding that plaintiff failed to establish scienter where plaintiff’s “allegations refer simply to violations of basic auditing principles without reference as to how [auditor’s] violations were the result of intentional deceit or how they rise to the level of recklessness”).

The suggestion that the mere fact of accounting inaccuracy can support an inference of scienter against individual accountants is particularly dangerous where there have been no allegations regarding the particular roles of each individual and his or her involvement with specific information relating to an audit.

8. Allegations Relating to Adjustments in Enron’s 1997 Financials Do Not Give Rise to a Strong Inference of Scienter

In support of their argument that *Andersen’s* treatment of proposed adjustments to Enron’s 1997 financial statements supports inferences of scienter against the *Individual Andersen Defendants*, Opp. at 55, Plaintiffs cite no allegations whatsoever against specific individuals. In

addition, because determining the materiality of a proposed adjustment is a matter of “professional judgment,” allegations that an auditor erred in such a determination do not raise a strong inference of scienter. In re SCB Computer, 149 F. Supp. 2d at 366.

Plaintiffs’ contention that Andersen knowingly ignored material adjustments says nothing about any individual defendant and is belied by the very allegations made in the Complaint. 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. As explained in the Andersen Motion, Andersen 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.

**II. PLAINTIFFS HAVE FAILED TO STATE SUFFICIENT ALLEGATIONS THAT ANY OF THE INDIVIDUAL ANDERSEN DEFENDANTS IS LIABLE AS A CONTROLLING PERSON UNDER SECTION 20(A).**

In their Opposition Brief, plaintiffs impermissibly attempt to cure the ambiguity of their Complaint by arguing that all the Individual Andersen Defendants are liable as controlling persons under § 20(a).<sup>13</sup> However, plaintiffs have not purported to allege a claim of controlling person liability with respect to any of the Individual Defendants, with the exception of Mr. Berardino; and as to him, the allegations are inadequate to support the claim because, among other failings, plaintiffs do not allege that he had the authority to control the audits or the issuance of the audit reports that provide the gravamen of their securities fraud claims.

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<sup>13</sup> In the Complaint, plaintiffs named only Mr. Berardino and three others as controlling persons, pursuant to § 20(a) or §15. See Compl. ¶ 96. Plaintiffs allegation that “defendants violated §§ 10(b) *and/or* 20(a) of the 1934 Act.” Compl. ¶ 995 (emphasis added), itself demonstrates a lack of compliance with Rule 8 of the Federal Rules of Civil Procedure that requires dismissal by this Court.

Nevertheless, out of an abundance of caution, the Individual Defendants address the controlling person claim argument asserted in plaintiffs' opposition.

First, as set forth in the Individuals Defendants' Motion to Dismiss, there can be no § 20(a) liability where there has been no underlying fraud. Individuals' Motion at 27; See Coates v. Heartland Wireless Communications, Inc., 26 F. Supp. 2d 910, 923 (N.D. Tex. 1998).

Because plaintiffs do not allege an underlying § 10(b) violation by Andersen, there can be no controlling person liability.

In any event, as also explained in the Individuals' Motion at 28, the Fifth Circuit has, at a minimum, determined that in order to establish that a defendant is a controlling person under § 20(a), a plaintiff must show that the defendant has actual control, both over the general entity and over the specific transaction that gives rise to primary liability, see Brown v. Mendel, 864 F. Supp. 1138, 1144 (M.D. Ala 1994) (applying Fifth Circuit law and discussing Abbot v. Equity Group, Inc., 2 F.3d 613, 620 (5th Cir 1993)), aff'd 84 F.3d 393 (11th Cir. 1996); McNamara v. Bre-X Minerals Ltd., 46 F. Supp. 2d 628, 638 (E.D. Tex 1999) (discussing Abbot and G.A. Thompson & Co. v. Partridge, 636 F.2d 945, 958 (5th Cir. 1981)). Other circuits go further and explicitly require not only that a defendant possess this level of actual control, but also that he or she in fact actively exercised that control. See Brown, 864 F. Supp. at 1143-44 (discussing cases). In the Fifth Circuit actual *participation* in the primary violation may be required for controlling person liability. See id. (noting conflict between Dennis v. General Imaging, Inc., 918 F.2d 496, 509 (5th Cir. 1990) and Thompson, 636 F.2d at 958).

Even under the most lenient standard, however, plaintiffs do not adequately plead that the Individual Defendants meet the definition of controlling persons under § 20(a). Plaintiffs do not allege actual control, over both the general entity and the specific transaction that gives rise to

primary liability. Under the heightened standards, the inadequacy of plaintiffs' allegations is even more obvious.

The Complaint fails to allege that the Individual Defendants had the general power to control operations at Andersen. While almost all of the defendants were either partners in Andersen or at an equivalent level, at the relevant time Andersen had hundreds of partners in the United States. An allegation that an individual defendant was a partner at Andersen, and/or that he or she held a specific title within Andersen, does not provide sufficient basis for alleging that he or she was a controlling person. See Lane Hartman Ltd., v. P.R.O. Missions, Inc., No. 3:95-CV-0869-P, 1997 WL 457512, \* 5 (N.D. Tex Aug. 5, 1997) (citing Dennis v. General Imaging, Inc., 918 F.2d 496, 509-10 (5th Cir. 1990)) (“[C]ontrol person liability cannot hinge merely upon a party’s position and title.”).<sup>14</sup>

The Complaint also fails to sufficiently allege specific control over the transactions for all of the individual defendants. Here plaintiffs once again repeatedly mischaracterize their own allegations and impermissibly attempt to supplement them with accusations based on extraneous materials. Although argued in their Opposition, there is, for example, no allegation in the Complaint that Mr. Bauer “ran” the audit of Enron’s commodity trading,” or that Ms. Cash “had control” over decisions arising from Sherron Watkins’s concerns, or that Mr. Goolsby or Mr. Swanson “oversaw” the Enron audit. Opp. at 62-66. Nor do plaintiffs offer even one single detail on Mr. Hale’s new found “important role” in Enron audits. Opp. at 66. Mr. Dreyfus’s, Mr. Friedlieb’s and Ms. Temple’s purported controlling person liability is predicated on the

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<sup>14</sup> Plaintiffs’ implicit theory that all Andersen partners remotely connected to work for Enron were controlling persons with respect to that work is especially ironic given that one of the recurring themes of the Complaint is that Andersen partners disagreed with each other and repeatedly disregarded advice they received from one another.

conclusory allegation relating to the destruction of documents, an event that is removed temporally and in all other respects from the audits and the audit opinions. Even if the Complaint adequately described a “controlling” rather than advisory or secondary role (if any) for them in such activity (which it does not), it would not adequately state a claim for liability against them under § 20(a) because, as already discussed, the alleged destruction of documents was not a primary violation of Rule 10b-5.

There are no allegations that the individual defendants based outside of Houston had any controlling role in the issuing of audit reports, and even for most of the Texas-based individuals, the Complaint does little more than allege that they were partners in the Houston office and that they were an “integral part of the Enron audit and consulting engagements.” Compl. ¶ 93. As noted previously, alleging that an individual defendant is in a particular position does not establish general or specific control. See Lane Hartman, 1997 WL 457512, at \*5 (N.D. Tex) (Aug. 5, 1997) (citing Dennis, 918 F.2d at 509-10). Stating that someone is “part” of a group in no way indicates control over that group. The plaintiffs make no attempt to allege that the defendants had control over the alleged underlying fraudulent transaction of issuing incorrect audit reports.<sup>15</sup> Rather, they make broad allegations involving what defendants either individually or in masses supposedly “knew,” were a “part” of, “participated in,” or (a particular favorite) were “deeply involved in.” This is clearly not an adequate pleading of actual control, as it insufficiently supports allegations of either general control over the entity or specific control over the transactions at issue.

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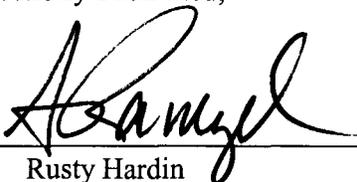
<sup>15</sup> Certainly, with respect to their alternative theories of liability, they do not allege that the Individual Defendants controlled Enron’s establishment of SPE’s or its issuance of press releases.

CONCLUSION

For the reasons set forth above and in their moving brief, the Individual Andersen Defendants respectfully request that Plaintiffs' § 10(b) claim against each of them in Count I of the Consolidated Complaint be dismissed.

Dated: Houston, Texas  
June 24, 2002

Respectfully Submitted,

By: 

Rusty Hardin  
State Bar No. 08972800  
S.D. Tex. I.D. No. 19424

RUSTY HARDIN & ASSOCIATES, P.C.  
1201 Louisiana, Suite 3300  
Houston, Texas 77002  
(713) 652-9000  
(713) 652-9800 (fax)

Attorney-in-Charge for  
Defendants Michael L. Bennett, Joseph F.  
Berardino, Donald Dreyfus, James A. Friedlieb,  
Gary B. Goolsby, Gregory W. Hale, Michael D.  
Jones, Benjamin S. Neuhausen, Richard R.  
Petersen, Danny R. Rudloff, John F. Sorrells, John  
E. Stewart and William E. Swanson

OF COUNSEL

Andrew Ramzel  
State Bar No. 00784184  
S.D. Tex. I.D. No. 18269  
RUSTY HARDIN & ASSOCIATES, P.C.

Daniel F. Kolb  
Sharon Katz  
DAVIS POLK & WARDWELL  
450 Lexington Avenue  
New York, New York 10017  
(212) 450-4000  
(212) 450-3633 (fax)

Scott B. Schreiber by  
Scott B. Schreiber  
(admitted pro hac vice) *Assumed with permission.*

ARNOLD & PORTER  
555 Twelfth Street, N.W.  
Washington, D.C. 20004  
(202) 942-5000  
(202) 942-5999 (fax)

Attorney-in-Charge for  
Defendant Thomas H. Bauer

OF COUNSEL

John C. Massaro  
Justin S. Antonipillai  
ARNOLD & PORTER

Clayton C. Cannon  
State Bar No. 03745200  
Fed. So. Dist. 13686  
STUMPF CRADDOCK MASSEY & PULMAN  
1400 Post Oak Blvd., Suite 400  
Houston, Texas 77056  
(713) 871-0919  
(713) 871-0408 (fax)

*Billy Shepherd by*  
Billy Shepherd  
State Bar No. 18219700 *signed with permission.*

CRUSE, SCOTT, HENDERSON & ALLEN, LLP  
600 Travis Street, Suite 3900  
Houston, Texas 77002-2910  
(713) 650-6600  
(713) 650-1720 (fax)

Attorney-in-Charge for  
Defendants Debra A. Cash, D. Stephen Goddard, Jr.  
and Michael M. Lowther

OF COUNSEL

Dennis H. Tracey  
David Wertheimer  
Brad M. Johnston  
HOGAN & HARTSON L.L.P.  
875 Third Avenue  
New York, New York 10022  
(212) 918-3000  
(212) 918-3100 (fax)  
Counsel for Debra A. Cash

Michael Warden  
SIDLEY AUSTIN BROWN & WOOD LLP  
1501 K Street, N.W.  
Washington, D.C. 20005  
(202) 736-8000  
(202) 736-8711 (fax)  
Counsel for D. Stephen Goddard, Jr.

Gary A. Orseck  
Lawrence S. Robbins  
ROBBINS, RUSSELL, ENGLERT, ORSECK & UNTEREINER LLP  
1801 K Street, N.W.  
Suite 411  
Washington, D.C. 20006  
(202) 775-4500  
(202) 775-4510 (fax)  
Counsel for Michael M. Lowther

Mark C. Hansen by  
Mark C. Hansen  
(admitted pro hoc vice) *by counsel with permission*

KELLOGG, HUBER, HANSEN, TODD &  
EVANS, P.L.L.C.  
1615 M Street, N.W. Suite 400  
Washington, D.C. 20036  
(202) 326-7900  
(202) 326-7999 (fax)

Attorney-in-Charge for  
Defendant Nancy A. Temple

OF COUNSEL

David E. Ross  
KELLOGG, HUBER, HANSEN, TODD  
& EVANS, P.L.L.C.

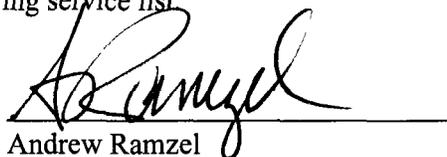
Amelia Toy Rudolph  
Amelia Toy Rudolph  
(admitted pro hac vice) *by counsel with*

SUTHERLAND ASBILL & BRENNAN LLP  
999 Peachtree Street, N.E.  
Suite 2300  
Atlanta, Georgia 30309  
(404) 853-8000  
(404) 853-8806 (fax)

Attorney-in-Charge for  
Defendant Roger D. Willard

CERTIFICATE OF SERVICE

I hereby certify that on this 24th day of June, 2002, the foregoing Motion of the Individual Andersen Defendants to Dismiss Plaintiffs' Consolidated Complaint was served on the counsel of record identified in the following service list



Andrew Ramzel