

UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF TEXAS  
HOUSTON DIVISION

United States Courts  
Southern District of Texas  
FILED JUN 24 2002  
Michael N. Milby, Clerk

In re ENRON CORPORATION SECURITIES  
LITIGATION

This Document Relates to:

MARK NEWBY, Individually and On Behalf of All  
Others Similarly Situated,

Plaintiff,

v.

ENRON CORP., et al.,

Defendants.

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

Plaintiff,

v.

KENNETH L. LAY, et al.,

Defendants.

Civil Action No. H-01-3624  
(Consolidated)

CLASS ACTION

DEFENDANT JEFFERY K. SKILLING'S REPLY BRIEF IN SUPPORT OF MOTION TO  
DISMISS CONSOLIDATED COMPLAINT

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## PRELIMINARY STATEMENT

The temptation of plaintiffs in every securities class action is to cast as wide a net as possible. This is especially true where plaintiffs look to other deep pockets from which to recover due to Enron's bankruptcy. And in this regard, plaintiffs in this case have not disappointed, suing 97 defendants including 57 current and former Enron officers and directors. Among them is former Enron CEO Jeffrey K. Skilling, who departed Enron in August 2001, well before Enron and its auditors determined to restate earnings, and well before Enron experienced any of the financial difficulties which ultimately led to its bankruptcy filing. Many of these defendants, including Mr. Skilling, appear from the Newby Consolidated Complaint ("NCC") to have been sued based solely on their positions within the company, with no other evidence—much less particularized evidence—of participation in the fraud alleged by plaintiffs.

Allegations of "guilt by association" fail as a matter of law under today's securities laws: The Private Securities Litigation Reform Act ("PSLRA") makes sure of that. But that is all that plaintiffs have managed to conjure up in their opposition to Mr. Skilling's Motion to Dismiss. When put to the task of demonstrating that their 500 page complaint satisfied the PSLRA's particularized pleading requirements as to Mr. Skilling, plaintiffs managed to cite but one single conclusory allegation from the Consolidated Complaint ("NCC"),<sup>1</sup> which they distort,<sup>2</sup> wholly unrelated to the accounting issues resulting in the restatement or to the fraud plaintiffs attempt to conjure up but fail adequately to allege. That plaintiffs could not muster a single allegation against Mr. Skilling from their behemoth complaint demonstrates not only the lack of any proof

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<sup>1</sup> According to their opposition, "Skilling knew that the \$2.8 billion purchase of Wessex Water and the establishment of Enron's global water business were not the result of careful risk analysis. ¶ 121(h), 155(n)." Pls.' Mem. Of Law In Opp'n To Mots. To Dismiss Filed By Enron Defs. Buy, Causey, Derrick, Fastow, Frevert, Hannon, Harrison, Hirko, Horton, Kean, Koenig, Lay, Mark-Jusbasche, McMahon, Olson, Pai, Rice, Skilling, Sutton & Whalley ("Pl. Opp'n Br.") at 64.

<sup>2</sup> See *infra* Section II.A. and App. A, attached hereto, allegation no. 2.

of wrongdoing by Mr. Skilling, but underscores that plaintiffs have failed to plead fraud sufficiently to withstand a motion to dismiss.

Perhaps more telling is the fact that plaintiffs abruptly abandon their complaint in their opposition and attempt to replead their allegations against Mr. Skilling through numerous references to the Powers Report, which are not contained in the NCC. In fact, plaintiffs never cited the Powers Report, never incorporated any of its findings, and never relied on it as their basis for any of their claims against Mr. Skilling.<sup>3</sup> Yet now, in the face of Mr. Skilling's Opening Brief demonstrating that plaintiffs have failed to plead fraud with particularity against Mr. Skilling, plaintiffs embrace the Powers Report for the first time to support all but one of the 19 new allegations they raise against Mr. Skilling. Plaintiffs' eleventh hour effort to salvage their irretrievably flawed complaint against Mr. Skilling fails. Not only is it impermissible for plaintiffs to attempt to replead their case in their brief, the new allegations they make suffer from the same infirmities endemic to their complaint—the allegations without fail are conclusory, lack the particularized facts necessary to survive a motion to dismiss. Moreover, the allegations fail to demonstrate any knowledge of the alleged fraud by Mr. Skilling.

Perhaps plaintiffs believed that the sheer volume of their complaint in the current state of sensationalism surrounding the Enron case would suffice. But press clippings, rumor, innuendo, hunches and unsupported conclusions, no matter the volume, are legally insufficient to allow this case to proceed against Mr. Skilling.

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<sup>3</sup> Plaintiffs made only passing references to the Powers Report in their claims against Vinson & Elkins. NCC ¶¶ 404, 406, and 419-21.

**I. PLAINTIFFS' SECURITIES FRAUD CLAIMS SHOULD BE DISMISSED PURSUANT TO FED. R. CIV. P. RULE 8 BECAUSE PLAINTIFFS FAIL TO MAKE DIRECT, CONCISE FACTUAL ALLEGATIONS SUFFICIENT TO STATE A CLAIM FOR RELIEF AGAINST MR. SKILLING.**

Plaintiffs insist that they have complied with Mr. Skilling's request for a short and plain statement showing that they are entitled to relief against him for securities fraud, as required under Federal Rule of Civil Procedure 8(a)(2). Plaintiffs concede, as they must, the applicability of Rules 8 and 9(b) and the PSLRA to their consolidated complaint. (*See* Rule 8 Pl. Opp'n Br. at 5.) Taken together, these pleading rules require plaintiffs to provide a short and plain statement, comprised of direct and concise allegations, sufficient to state a claim for securities fraud against each defendant. In particular, under the PSLRA, plaintiffs must allege *facts* (*i.e.*, not conclusions) giving rise to a strong inference of scienter on the part of *each defendant*. *See generally* Section V *infra*.<sup>4</sup>

The interplay of these rules does not, as plaintiffs suggest, relieve plaintiffs of their duty to provide Mr. Skilling with a clear and specific statement of how and why they are entitled to relief *from him*. On the contrary, these rules work *together* to require plaintiffs to state their securities fraud claims simply and with factual particularity. This is precisely what plaintiffs have failed to do.

Plaintiffs urge the Court to liberally construe Rule 8 and to find that their general 45-page "summary" allegations regarding the reasons behind Enron's collapse are sufficient to satisfy this pleading rule. (*See* Pls.' Opp'n To Motion Of Certain Current And Former Directors To Dismiss Pursuant To Fed. R. Civ. P. 8 And Request For Leave To Amend ("Rule 8 Pl. Opp'n Br.") at 2.) Plaintiffs' "summary", however, not only fails to provide a short and plain statement of

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<sup>4</sup> *See, e.g., Wenger v. Lumisys, Inc.*, 2 F. Supp. 2d 1231, 1239 (N.D. Cal. 1998) ("The heightened pleading standard of Rule 9(b) is not an invitation to disregard the requirement of simplicity, directness, and clarity of Fed. R. Civ. P. 8.

plaintiffs' securities fraud claims against Mr. Skilling, but also fails to meet the particularized pleading requirements under the PSLRA and Rule 9(b). Neither short nor plain, plaintiffs' 45-page summary—longer than most complaints—provides no facts showing plaintiffs are entitled to relief from Mr. Skilling. Therein, Plaintiffs make bold, conclusory assertions that, as a group, the defendants “knew” certain statements regarding Enron’s business and financial condition were false (*see, e.g.*, NCC ¶ 24) and assert their own conclusions as to the reasons behind Enron’s collapse (NCC ¶¶ 61–74). Rule 8 requires more.

Moreover, plaintiffs never provide a clear statement of facts showing that Mr. Skilling acted with the state of mind (*scienter*) required of a defendant in a securities fraud suit. Without such a statement, plaintiffs fail to show they are entitled to any relief. Under settled law, plaintiffs may not rely on allegations levied against a group of defendants to meet these statutory requirements. *See e.g. In re Landry’s Seafood Rest., Inc. Securities Litigation*, No. H-99-1948, slip op., at 53–55 (S.D. Tex. Feb. 20, 2001) (concluding that “the group pleading doctrine is at odds with the PSLRA and has not survived the amendments”).<sup>5</sup> Nor may plaintiffs presume the requisite *scienter* on Mr. Skilling’s part due to his position as an executive officer of Enron. *See Abrams v. Baker Hughes, Inc.*, No. 01-20514, 2002 U.S. App. LEXIS 9565, at \*16-17 (5th Cir. May 21, 2002) (knowledge of falsity may not be imputed to executives due to their positions within the corporation). Finally, plaintiffs’ prolixity and redundancy of their 45-page summary and the remaining pages of their 500-page complaint do not substitute for the particularized

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<sup>5</sup> *See also Coates v. Heartland Wireless Communications, Inc.*, 26 F. Supp. 2d 910, 916 (N.D. Tex. 1998) (since PSLRA requires plaintiffs to set forth facts raising strong inference of *scienter* that each defendant acted with the required state of mind, group pleading is inconsistent with 15 U.S.C. § 78u-4(b)(2), as well as contrary to its underlying policy of protecting defendants from unwarranted claims and strike suits), cited with approval by the Court in *In re Landry’s Seafood*, slip op., at 53.

factual allegations required to state a securities fraud claim.<sup>6</sup> Many courts have drawn this same conclusion and no case cited by plaintiffs holds otherwise.<sup>7</sup>

Plaintiffs' reliance on cases construing Rule 8 outside the context of a securities fraud claim as well as pre-PSLRA is misplaced given the heightened pleading requirements under the PSLRA. *See, e.g., In re RasterOps Corp. Securities Litigation*, No. C92-20349 1993 WL 476661, at \*4 (N.D. Cal. Aug. 13, 1993) (pre-PSLRA case finding general conclusory allegations of knowledge were sufficient to plead scienter). Similarly, plaintiffs' citation to a recent decision by the District Court of New Jersey<sup>8</sup> in support of their argument here that the 500-page complaint is short and plain enough to state a claim for securities fraud against Mr. Skilling is equally unavailing. Not only does the Third Circuit apply a different standard for pleading securities fraud claims than the Fifth Circuit,<sup>9</sup> but the *Honeywell* complaint was one-fifth the size of the NCC, pled only "one overarching misrepresentation and omission, namely the financial success or failure of the Honeywell-Allied Signal merger" and involved a far shorter (6 month) class period.<sup>10</sup> Even so, the Court in *Honeywell* still found that the allegations—including the summary allegations—were "inadequate to state a charge of scienter" as to four of the seven individual defendants, and sustained their motion to dismiss. *Honeywell*, 182 F. Supp. 2d at 427.

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<sup>6</sup> *See* Jeffrey K. Skilling's Mot. to Dismiss Consolidated Compl. Pursuant to Fed. R. Civ. P. 12(B)(6) for Failure to State a Cause of Action & Mem. of Law in Support Thereof ("Skilling Br.") at 64–65.

<sup>7</sup> Plaintiffs quote *Atwood v. Humble Oil & Refining Co.*, 243 F.2d 885, 888 (5th Cir. 1957) for the proposition that an attorney has wide latitude in "getting his client's claim before the court." (Rule 8 Pl. Opp'n Br., at 8.) Plaintiffs conveniently ignore the next portion of the *Atwood* opinion where the Court states that "[t]he latitude referred to is subject, of course, to the requirement that pleadings must conform to established principles as they are defined in applicable statutes, the Rules of Procedure, and authoritative court decisions construing them." *Atwood*, 243 F.2d, at 888 (emphasis added).

<sup>8</sup> *In re Honeywell International Inc. Securities Litigation*, 182 F. Supp. 2d 414 (D.N.J. 2002).

<sup>9</sup> In the Third Circuit, particularized allegations of motive and opportunity *alone* may suffice to plead scienter. *See In re Advanta Corp. Securities Litigation*, 180 F.3d 525, 534–35 (3d Cir. 1999).

<sup>10</sup> *See Honeywell*, 182 F. Supp. 2d at 416–17 (six-month class period following merger).

Simply put, plaintiffs' 500-page complaint in this case is nothing more than a "great web of scattered, vague, redundant and often irrelevant allegations." *Wenger v. Lumysis*, 2 F. Supp. 2d at 1243. It patently fails to satisfy Rule 8's requirement that it provide a short and plain statement of the claim for relief, justifying its dismissal. And, plaintiffs' 45-page summary on conclusory and non-particularized allegations does nothing to remedy that shortcoming.

**II. PLAINTIFFS' CONSOLIDATED COMPLAINT FAILS TO ADEQUATELY ALLEGE FACTS SUFFICIENT TO SUPPORT A 10b-5 CLAIM AGAINST MR. SKILLING.**

**A. PLAINTIFFS' SUDDEN AND BELATED RELIANCE ON THE POWERS REPORT AND RECHARACTERIZATION OF THE CONSOLIDATED COMPLAINT ARE INSUFFICIENT TO STATE A CLAIM FOR SECURITIES FRAUD AGAINST MR. SKILLING.**

In his Opening Brief, Mr. Skilling detailed the legal and factual reasons why the allegations in plaintiffs' complaint are too vague and conclusory to satisfy the standards of the PSLRA and Rule 9(b). The NCC does not plead with adequate particularity what Mr. Skilling allegedly knew or did, how or why his actions or statements were fraudulent, or what specific facts give rise to a strong inference of Mr. Skilling's scienter. (See Skilling Br. at 6-81.) Recognizing these fatal deficiencies, instead of defending the NCC, plaintiffs try improperly to amend it by adding new allegations based on mischaracterizations of the Powers Report, or by recasting their original allegations. (See Pl. Opp'n Br. at 64-65.)

Plaintiffs' efforts cannot salvage their complaint for four reasons. *First*, it is black letter law that a party cannot resolve fatal flaws in a complaint by making new allegations in its opposition brief to a motion to dismiss. Plaintiffs' new found reliance on the Powers Report and distortion of the NCC must thus be disregarded. *Second*, plaintiffs' post-hoc repleading of the very complaint they defend as adequate is tantamount to a concession that the NCC fails to adequately plead fraud. *Third*, these new allegations are facially unreliable and imprecise, as

they rest upon, and misrepresent, the admittedly limited and unreliable Powers Report. *Finally*, even if the Court were to consider these new allegations, which it must not, plaintiffs would still fail to state a claim for fraud.

**1. PLAINTIFFS' ATTEMPT TO MAKE NEW ALLEGATIONS NOT PLEADED IN THE CONSOLIDATED COMPLAINT IS NOT PERMITTED UNDER THE LAW.**

Recognizing that they have failed to plead specific facts sufficient to state a claim under 10b-5 against Mr. Skilling, plaintiffs now attempt to meet their pleading burden by adding new allegations from the Powers Report in their opposition brief. (*See* Pl. Opp'n Br. at 64-65.) Setting aside, for the moment, the substantive inadequacy of these new allegations, such an attempt to amend their complaint is inappropriate as a matter of law. *See, e.g., In re Securities Litigation BMC Software, Inc.*, 183 F. Supp. 2d 860, 915 (S.D. Tex. 2001); *In re Baker Hughes Securities Litigation*, 136 F. Supp. 2d 630, 646 (S.D. Tex. 2001). In fact, as this Court has previously recognized, factual allegations must be pled in the complaint, and "it is axiomatic that the Complaint cannot be amended by the briefs in opposition to a motion to dismiss." *BMC Software*, 183 F. Supp. 2d at 915. *See Baker Hughes*, 136 F. Supp. 2d at 646. This Court should reject plaintiffs' gamesmanship and simply consider information that purports to "encompass a level of particularity that does not exist in the Complaint." *Baker Hughes*, 136 F. Supp. 2d at 646 (*quoting O'Brien v. National Prop. Analysts Partners*, 719 F. Supp. 222, 229 (S.D.N.Y. 1989)). After putting Mr. Skilling to the task of sifting through a 500-page complaint to attempt to decipher the allegations against him, allowing plaintiffs to bolster their anemic allegations at this late juncture would thwart the strict pleading requirement of the PSLRA.

**2. PLAINTIFFS’ ATTEMPT TO MAKE NEW ALLEGATIONS NOT PLEADED IN THE CONSOLIDATED COMPLAINT CONCEDES THE FACT THAT THE CONSOLIDATED COMPLAINT IS INSUFFICIENT.**

In the same conclusory manner that they pled their complaint, plaintiffs in their opposition argue that the sufficiency of their allegations regarding Mr. Skilling’s knowledge and participation in Enron’s purportedly fraudulent schemes is obvious. To support this assertion, they point to nineteen so-called examples of Mr. Skilling’s “intimate” involvement. (*See* Pl. Opp’n Br. at 64-65.) Tellingly, the *only* reference to the Consolidated Complaint concerns Mr. Skilling’s alleged knowledge of risk analysis relating to the Wessex Water purchase, purportedly taken from two paragraphs (NCC ¶¶ 121(h) & 155(n)) in the complaint. (Pl. Opp’n Br. at 64.) Even this example distorts the original complaint. Contrary to plaintiffs’ characterization of the complaint, these two paragraphs *do not* allege that Mr. Skilling knew the Wessex purchase was allegedly improperly vetted. The only mention of Mr. Skilling in either paragraph is in reference to the allegation that Ms. Mark-Jubasche headed Enron’s International business only after she lost corporate favor to Mr. Skilling. (*See* NCC ¶121(h).) Paragraph 155(n), meanwhile, makes *no mention* of Mr. Skilling at all, and neither paragraph even hints that Mr. Skilling had knowledge of the risk analysis relating to Wessex Water.<sup>11</sup>

The remaining eighteen paragraphs of Mr. Skilling’s alleged involvement all cite the Powers Report—*not* the NCC—as the basis for plaintiffs’ “claims.” Not only is this a blatant attempt by plaintiffs to improperly import new allegations in direct contravention of controlling law, but their need to distort and supplement the NCC concedes the insufficiency of the very complaint that plaintiffs purport to defend.

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<sup>11</sup> Moreover, there is no explanation of how or why an inadequate risk analysis would be fraudulent, in the first place.

**3. PLAINTIFFS' NEW ALLEGATIONS ARE UNRELIABLE AND MERITLESS ON THEIR FACE, AND ARE BASED ON DISTORTIONS OF THE POWERS REPORT.**

The new allegations cited by plaintiffs are explicitly based on the Powers Report. Plaintiffs' reliance on that report, however, is misplaced—as the report is inherently unreliable. Moreover, plaintiffs have gone one step further by distorting the report's conclusions to suit their needs, and ignoring the fact that the report itself belies the very allegations made by plaintiffs. The mischaracterizations by plaintiffs set forth in their new accusations underscores the need for this Court to focus solely on the contents of the NCC, all of which are too vague and conclusory to state any valid claim.

**a. The Powers Report Was Prepared In An Admittedly Unreliable Fashion**

The Powers Report is at most the result of an incomplete internal review performed under the pressures of public outcry. The conclusions or views expressed in the document are not “facts” and cannot be viewed as such for pleading – or any other – purpose. The authors of the Powers Report themselves never intended for the report to be used for anything other than for “a private internal inquiry,” for corporate purposes. (*See Powers Report at 33.*) Indeed, the methodologies used by the Powers Committee to satiate the urgent demand for a report to Enron's Board, severely diminish the reliability of the Powers Report, as the committee readily admits.

The Powers Report is based on mere summaries of voluntary, informal interviews conducted by outside attorneys. These summarizing memoranda upon which the Powers Report is based, place a clear disclaimer on the accuracy of their contents. Each one contains a similar paragraph stating:

This memorandum has been prepared by counsel in anticipation of possible litigation arising from a Securities and Exchange

Commission (“SEC”) investigation and any parallel or related proceedings. This memorandum incorporates the mental impressions, analyses and opinions of counsel. *As such, this memorandum is intended solely to assist counsel in providing legal representation and advice to the Special Committee of Enron’s Board of Directors, and is not intended to provide a substantially verbatim recital of [the interviewee’s] statements.* The interview was based on WCP’s understanding of the facts and review of documents as of the date of the interview. Furthermore, [the interviewee] has not reviewed this memorandum. *Therefore, this memorandum may contain inaccuracies and the following discussion of certain events may be incomplete or lack context.*<sup>12</sup>

The Powers Committee acknowledges that these constraints undercut any potential accuracy of its findings or conclusions.

There also may be differences between information obtained through voluntary interviews and document requests and information obtained through testimony under oath and by compulsory legal process. *In particular, there can be differences between the quality of evidence obtained in informal interviews (such as the ones we conducted) and information obtained in questioning and cross-examination under oath. Moreover, given the circumstances surrounding Enron’s demise and the many pending governmental investigations, some of the people we interviewed may have been motivated to describe events in a manner colored by self-interest or hindsight.*

Powers Report at 34 (emphasis added).<sup>13</sup>

The Powers Committee also notes that it did not interview certain witnesses or have access to their documents, and warns that this negates the value of the opinions and views expressed therein:

Certain former Enron employees who (we were told) played substantial roles in one or more of the transactions under

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<sup>12</sup> See, e.g., Wilmer, Cutler & Pickering Interview Memorandum of Kenneth Lay, dated January 16, 2002, at 1 (available at <http://energycommerce.house.gov/107/hearings/02142002Hearing489/hearing.htm#docs> (Tab 24)) (emphasis added).

<sup>13</sup> Not only were these informal discussions voluntary, they were not necessarily accurately memorialized. Memorandum of these off-the-record discussions were prepared, in some instances as long as three months following the interview from notes by an attorney who may not have even taken the notes at the meeting. See Wilmer, Cutler & Pickering Interview Memorandum of Jordan Mintz, dated January 22, 2002, at 1 (memorializing an October 20, 2001 interview).

investigation—including Fastow, Michael J. Kopper, and Ben F. Glisan, Jr.—declined to be interviewed either entirely or with respect to most issues. We have had only limited access to certain workpapers of Arthur Andersen LLP (“Andersen”), Enron’s outside auditors, and no access to materials in the possession of the Fastow partnerships or their limited partners. ***Information from these sources could affect our conclusions.***

Powers Report at 1-2 (emphasis added). As the Committee indicated:

[W]e have not had access to information and materials in the possession of many of the relevant third parties. Arthur Andersen LLP (“Andersen”) permitted the Committee to review some, but not all, of its workpapers relating to Enron. It did not provide copies of those workpapers or allow the Committee to interview knowledgeable Andersen personnel. Representatives of LJM1 and LJM2 (collectively, “the LJM partnerships”) declined to provide documents to the Committee and, in light of a confidentiality agreement between those entities and their limited partners, the Committee has not had access to materials in the possession of the limited partners.

*Id.* at 34.

Thus, the Powers Report is nothing more than subjective conclusions, hastily drawn from admittedly unreliable and incomplete summaries of informal discussions. Accordingly, even if this court allowed plaintiffs’ use of the Powers Report to supplement their complaint, the court should disregard these new allegations as not within the purview of “facts,” necessary to support a claim. Even a cursory review of the numerous qualifications, warnings, and limitations identified by the authors of the report compels the conclusion that the Powers Report is an insufficient source upon which to base either knowledge or belief. Under the PSLRA, plaintiffs are held to a higher pleading standard, and the Court should “not accept as true,” allegations based on nothing more than a collection of “conclusory allegations [and] unwarranted deductions of fact.” *Tuchman v. DSC Communications Corp.*, 14 F.3d 1061, 1067 (5th Cir. 1994).

**b. Plaintiffs' New Allegations Distort The Powers Report, Which Itself Belies Plaintiffs' Allegations.**

Despite the sweeping conclusions of the Powers Report, plaintiffs still find little in it to bolster their efforts to allege fraud with particularity against Mr. Skilling. In fact, plaintiffs have resorted to distorting the Power Report's findings in an attempt to concoct a claim against Mr. Skilling. As detailed in Appendix A, the new allegations that plaintiffs claim are contained in the Powers Report, in fact, are blatant mischaracterizations of its findings. Three examples underscore plaintiffs' disingenuous tactic.

Plaintiffs rely on the Powers Report to allege that Fastow controlled Chewco and that Mr. Skilling "approved of Fastow's participation in Chewco." Pl. Opp'n Br. at 64. In fact, both of these allegations grossly misrepresent the Powers Report. First, the Powers Committee does not conclude that Fastow had any role whatsoever in Chewco. Second, at the cite used by plaintiffs to support their characterizations of the Powers Report, the actual statement is that "Fastow told Enron employees that Jeffrey Skilling, then Enron's President and Chief Operating Officer ("COO") had approved his participation in Chewco as long as it would not have to be disclosed in Enron's proxy statement." Powers Report 43-44. There is no other support for Fastow's statement, nor does the Report adopt this assertion, presumably by Fastow or even a third-party employee. Indeed, the Report notes that Mr. Skilling recalled Mr. Fastow proposing that members of Fastow's wife's family be allowed to act as outside investors to Chewco, an idea which Mr. Skilling did not approve. Powers Report at fn. 7.

Plaintiffs also cite the Powers Report in support of their newly-minted allegation that Mr. Skilling approved Mr. Kopper's role in Chewco. According to plaintiffs:

Skilling was aware of and approved Fastow-protégé Michael Kopper's participation in Chewco, knowing it violated Enron's Code of Conduct.

(Pl. Opp'n Br. at 64 (citing Powers Report at 46).)<sup>14</sup> The Powers Report, however, does not support such an allegation. The Powers Report merely states that “Skilling told us that, *based on Fastow's recommendation*, he approved Kopper's role in Chewco.” Powers Report at 47 (emphasis added). The Powers Report does *not* say that Skilling *knew* that Kopper's role violated the Code of Conduct, or that he knew his own alleged approval was insufficient under the Code.

Second, plaintiffs introduce a new allegation in their Opposition Brief that Mr. Skilling and Mr. Lay were appointed to a committee to review changes to the RhythmsNet hedge.

Plaintiffs allege that :

Skilling and Lay were appointed as a committee of the Board to determine if the consideration received by Enron in connection with the Rhythms hedge was sufficient, in the event of a change in the terms of the transaction from those presented to the Board.

(Pl. Opp'n Br. at 64 (citing Powers Report at 82).)<sup>15</sup> Disturbingly, plaintiffs fail to inform the Court that the Powers Report – in the very next sentence – admits that the committee “*found no evidence that any of the changes implemented [to the RhythmsNet hedge] ... were presented to Lay or Skilling for approval,*” thereby negating any inference that Mr. Skilling had a role in designing or approving changes to the structure, as implied by plaintiffs. Powers Report at 82 n.29 (emphasis added).<sup>16</sup>

Third, plaintiffs now allege that “Skilling consistently reviewed all disclosures of related-party transactions.” (Pl. Opp'n Br. at 65 (citing Powers Report at 182).)<sup>17</sup> This allegation also perverts statements contained in the Powers Report. The Report actually states: (1) that both

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<sup>14</sup> See App. A, attached hereto, allegation No. 8.

<sup>15</sup> See App. A, attached hereto, allegation No. 12.

<sup>16</sup> We do not accept or adopt anything from the Powers Report. We point out this additional statement in the Powers Report merely to demonstrate how the plaintiffs attempt selectively to use the Report to their advantage.

<sup>17</sup> See App. A, attached hereto, allegation No. 19.

Arthur Andersen and Vinson & Elkins reviewed and commented on related party disclosures; (2) that Mr. Causey made the final decision as to their contents; and (3) that Mr. Skilling reviewed disclosures only *after* legal and accounting experts made a final decision regarding the disclosures.<sup>18</sup> Plaintiffs, however, conveniently ignore and distort these aspects of the report, and instead imply in their Opposition Brief that Mr. Skilling played a part in the disclosure process well beyond the limited role described by the Powers Report.

In their attempts to survive Mr. Skilling's Motion to Dismiss, plaintiffs have resorted to distorting and misrepresenting the very report upon which they purportedly rely. This tactic not only fails to overcome the substantive failing of the NCC and plaintiffs' opposition, but it is so disingenuous as to further discredit plaintiffs' new claims and justifies dismissing their claims against Mr. Skilling.

**4. EVEN IF PLAINTIFFS' NEW ALLEGATIONS ARE CONSIDERED, THERE IS NO VALID CLAIM OF FRAUD UNDER SECTION 10(b) AGAINST MR. SKILLING.**

Plaintiffs argue, through these new claims, that Mr. Skilling is liable for fraud because he was aware of certain arrangements or transactions. Yet these new claims together with the NCC *still* fail to allege facts showing how the transactions were fraudulent, or, even if they were, how

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<sup>18</sup> Enron's related-party disclosures in its proxy statements, as well as in the financial statement footnotes in its periodic reports, resulted from collaborative efforts among Enron's Senior Management, employees in the legal, accounting, investor relations, and business units, and outside advisors at Andersen and Vinson & Elkins. Nevertheless, it appears that no one outside of Enron Global Finance, the entity principally responsible for the related-party transactions, exercised significant supervision or control over the disclosure process concerning these transactions. ...

*We were told that Causey, Enron's Chief Accounting Officer, was the final arbiter of unresolved differences among the various contributors to the financial reporting process. Causey told us that, while he signed the public filings and met with Andersen engagement partner Duncan to resolve certain issues, he relied on the Financial Reporting Group, lawyers, and transaction support staff for the disclosures. The Audit and Compliance Committee reviewed drafts of the financial statement footnotes and discussed them with Causey. During the relevant period, Skilling reviewed the periodic filings after the accountants and lawyers had agreed on the proposed disclosures.*

Powers Report at 181-82 (emphasis added).

Mr. Skilling knew of the fraud or impropriety. Further, none of these allegations refute the fact that Mr. Skilling relied on the expert advice of both in-house and outside business professionals, accountants and attorneys. Indeed, as demonstrated point-by-point in Appendix A, every new “example” of Mr. Skilling’s knowledge of or participation in the purported fraud is insufficient under the PSLRA and Rule 9(b), and likewise fails to give rise to a strong inference of scienter.

For example, plaintiffs’ new allegations concerning Mr. Skilling’s attendance at certain Board meetings, or unspecified “support” for certain activities,<sup>19</sup> fail to identify how Mr. Skilling’s mere presence or alleged support is indicative of knowledge of, or participation in, a fraudulent scheme. These additional allegations are nothing more than plaintiffs’ continuing attempt to plead fraud and scienter through Mr. Skilling’s title and position alone, instead of through particularized facts. Even if Mr. Skilling supported the particular business strategies or transactions, as alleged, there exists no support for plaintiffs’ claim of fraud because plaintiffs still have failed to adequately plead (either by their new allegations or in the NCC): (1) that the activities, strategies or transactions in question were, in fact, fraudulent; (2) that Mr. Skilling knew or was reckless in not knowing of the purported fraud; and (3) that he acted with scienter. At most, plaintiffs have alleged nothing more than Mr. Skilling’s presence and tangential involvement at Board meetings. Their attempt to parlay title and position, physical proximity or generalized knowledge into a claim of fraud under §10(b) cannot withstand a motion to dismiss. *See, e.g., Hirschler v. GMD Investment Ltd.*, Civ. A. No. 90-1289-N, 1990 WL 263438, at \*6 (E.D. Va.) (“Guilt by association is not sufficient to meet the strict requirements of Rule 9(b).”) (citing *Landy v. Mitchell Petroleum Technology Corp.*, 734 F. Supp. 608, 620 (S.D.N.Y. 1990)); *DiVittorio v. Equidyne Extractive Industries, Inc.*, 822 F.2d 1242, 1247 (2d Cir. 1987) (in a

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<sup>19</sup> *See* Pl. Opp’n Br. at 64-65; App. A, attached hereto, allegations No. 3, 4, 10, 11, 15, 16.

multiple defendant case, complaint must describe with particularity each defendant's participation in allegedly fraudulent scheme).

Plaintiffs also attempt to use their post-hoc amendments to connect the NCC's allegations concerning the RhythmsNet and Raptor-related hedges to Mr. Skilling.<sup>20</sup> These new allegations, however, fail for the same reasons the claims in the NCC fail—there are no particularized allegations that Mr. Skilling knew or was reckless in not knowing that such hedges were allegedly structured improperly or fraudulently or were allegedly enacted to further anything other than legitimate business objectives.<sup>21</sup> Plaintiffs at most have pled a failed business decision (with which we take issue) which simply cannot give rise to fraud. *See, e.g., Melder v. Morris*, 27 F.3d 1097, 1101 n.8 (“These allegations boil down to plaintiffs' attempt to chastise as fraud business practices that, in hindsight, might have been more cautious. Misjudgments are not, however, fraud.”).

Likewise, plaintiffs make new contentions that Mr. Skilling played an unspecified yet fraudulent role in approving related party transactions and disclosures relating to them.<sup>22</sup> Again, however, these attempted amendments to the NCC do not remedy fatal flaws in the complaint. There are still no fact-based allegations that Mr. Skilling knew or had reason to know that any related party transactions were allegedly fraudulent or improper in any way, and plaintiffs do not contest the fact that Mr. Skilling relied on other members of the Board, management and outside accounting and legal experts to make any decisions relating to these transactions.<sup>23</sup>

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<sup>20</sup> *See* Pl. Opp'n Br. at 64-65; App. A, attached hereto, allegations No. 7, 11, 12, 13, 14, 15, 16, 17, 18.

<sup>21</sup> *See* Skilling Br. at 17-18, 24-28, 33-38.

<sup>22</sup> *See* Pl. Opp'n Br. at 64-65; App. A, attached hereto, allegations No. 1, 3, 4, 5, 6, 8, 9, 10, 13, 19.

<sup>23</sup> In addition to the examples discussed in the text herein, Appendix A details the substantial insufficiencies for each and every new allegation made by plaintiffs in their Opposition with respect to Mr. Skilling.

In sum, none of the new allegations adequately allege fraud, much less Mr. Skilling's knowledge of fraud. Absent particularized allegations that: 1) Enron's activities were, in fact, fraudulent; and 2) that Mr. Skilling knew such activities to be fraudulent, plaintiffs have simply not stated a claim under §10(b) against him—with or without the new allegations they have smuggled into their opposition.

**III. NEITHER ENRON'S RESTATEMENT NOR ITS ALLEGED GAAP VIOLATIONS ESTABLISH A STRONG INFERENCE OF SCIENTER.**

Rather than responding directly to Mr. Skilling's argument that their complaint is legally insufficient with respect to allegations of scienter based upon the restatement, plaintiffs try to divert this Court's attention by misconstruing and misrepresenting a few inapposite restatement cases. Specifically, plaintiffs' opposition incorrectly asserts that: (1) a violation of GAAP, in and of itself, is sufficiently dispositive of fraud; and (2) the mere size of a restatement can be dispositive of scienter. Both of these arguments have been soundly rejected by the Fifth Circuit.

**A. A VIOLATION OF GAAP IS NOT ENOUGH TO SUPPORT A SHOWING OF SCIENTER.**

Plaintiffs open their opposition to Mr. Skilling's argument by quoting a Central District of California case for the proposition that "a violation of Generally Accepted Accounting Principles ("GAAP") may be used to show that a company overstated its income, which may be used to show the scienter for a violation of Section 10(b) and Rule 10b-5." *Marksman Partners, L.P. v. Chantal Pharm. Corp.*, 927 F. Supp. 1297, 1313 (C.D. Cal. 1996). However, two sentences later, this same district court confirms that "it is true that a violation of GAAP in itself will generally not be sufficient to establish fraud." *Id.* In fact, as Mr. Skilling demonstrated in his Opening Brief, it is well-settled in the Fifth Circuit that a violation of GAAP does not suffice to establish fraud. Skilling Br. at 8-9 (collecting cases); *see also Abrams v. Baker Hughes, Inc.*,

2002 U.S. App. LEXIS 9565, at \*16 (5th Cir. 2002) (“[T]he mere publication of inaccurate accounting figures or failure to follow GAAP, without more, does not establish scienter.”).

**B. THERE IS NO AUTHORITY FOR THE PROPOSITION THAT THE DOLLAR AMOUNT OF THE RESTATEMENT IS PROBATIVE OF SCIENTER.**

Equally unavailing is plaintiffs’ argument that there exists authority for the proposition that scienter may be inferred from the size of the restatement. In fact, no such authority exists notwithstanding plaintiffs’ misstatement of the holdings in *Microstrategy*, *Rothman*, *Gelfer*, and *Rehm*, (Pl. Opp’n Br. at 104.) In fact, just last month, the Fifth Circuit rejected allegations that a strong inference of scienter could be found where Baker Hughes restated earnings resulting in a \$31 million reduction in reported profits and took a \$130 million pre-tax charge to dispose of certain assets and equipment. *Abrams v. Baker Hughes*, No. 01-20514, 2002 U.S. App. LEXIS 9565 (5th Cir. Tex. May 21, 2002). Therefore, plaintiffs’ suggestion that a strong inference of scienter can be drawn from a blind comparison of the amount of the Enron restatement to the amount of other restatements is simply wrong.

**1. PLAINTIFFS MISCHARACTERIZE VARIOUS HOLDINGS IN RESTATEMENT CASES.**

Plaintiffs cite *In re Microstrategy, Inc. Securities Litigation*, 115 F. Supp. 2d 620 (E.D. Va. 2000), for the proposition that the difference between a reported net income of \$18.9 million and a restated loss of \$36 million, as well as the overstatement of revenue by \$66 million were, in and of themselves, held to compel “an inference that fraud or reckless[ness] was afoot.” (Pl. Opp’n Br. at 104.) In fact, the court reached that conclusion only after finding many other facts supporting a strong inference of scienter, including: the errors leading to the restatement were repetitive and reoccurring over seven consecutive quarters; the erroneously applied accounting principles were simple; by virtue of these errors, Microstrategy reported positive net income

when, in fact, the Company actually incurred a net loss; and the subject accounting principles were selectively misapplied only to the company's three largest contracts. *Microstrategy*, 115 F. Supp. 2d at 636. The court simply never suggested that scienter was inferred based on the size of the restatement.

Similarly, plaintiffs incorrectly cite *Rothman v. Gregor* for the proposition that the sheer magnitude of GT Interactive Software's \$73.8 million write-off, coupled with allegations of poor sales, was enough to support a strong inference of scienter. (Pl. Opp'n Br. at 104.) Again, the court did not hold that the absolute amount had any particular significance; rather, the court relied upon the fact that "the writedown represented [84] percent of [the company's] previously capitalized royalty advances, and was more than ten times [the company's] average reported quarterly earnings" during the Class Period. *Rothman v. Gregor*, 220 F.3d 81, 92 (2d Cir. 2000). The court found a strong inference of scienter based upon that fact viewed together with the company's failure to disclose the "poor performance of its products after a disappointing year of sales," and that the company knew that certain software titles were not commercially viable based upon allegations the company made in lawsuits it filed against various software developers. *Id.*

Plaintiffs cite *Gelfer* for the proposition that a restatement as small as an \$18 million revenue overstatement and an \$11 million income overstatement were found to be sufficient to infer scienter, and as such suggest that Enron's larger restatement in absolute terms must be enough to establish scienter. (Pl. Opp'n Br. at 104.) *Gelfer v. Pegasystems, Inc.*, 96 F. Supp. 2d 10, 16 (D. Mass. 2000). Again, plaintiffs ignore the numerous additional facts that the court set forth to support its opinion. In fact, what *Gelfer* found to be the most compelling fact demonstrating scienter was that the company had engaged in the same allegedly improper

accounting practices in an earlier case. *Gelfer*, 96 F. Supp. 2d. at 15. This, the court said, was probative of scienter because the defendants were on notice that they were employing improper accounting practices. *Id.* The court noted three additional factors supporting a strong inference of scienter: (1) The magnitude and frequency of the company's restatements, specifically the court noted that the \$18 million overstatement in revenue represented an overstatement of 27%, and the overstatement of income was 110%; *id.* at 16; (2) the company's accountants, Ernst & Young ("E&Y"), had warned them not to follow these practices and, after E&Y's resignation, the company's new accountant, Arthur Andersen, wrote a letter putting them on notice that they had "material weaknesses in the Company's internal control environment" and recommended changes in "revenue recognition and financial reporting" which they ignored; *id.* at 17; and (3) that the company was violating its own internal policies regarding revenue recognition. *Id.* at 17 n.9.

Finally, plaintiffs refer to, as they characterize it, the "massive" year-end increase of \$5 million in credit-loss reserves and a restatement of earnings from \$3.5 million to \$325,000 in *Rehm*, by defendant Eagle Financial Corp., a "specialized financial services company engaged primarily in the acquisition and service of automobile and retail installment sales contracts by 'sub-prime' consumers." *Rehm v. Eagle Fin. Corp.*, 954 F. Supp. 1246, 1256 (N.D. Ill. 1997). It was not the amount, \$5 million, of the credit loss reserve restatement upon which the inference of scienter was based, as plaintiffs would have this court believe, but rather the Eagle court emphasized it was the fact that it was a 300% increase over what was previously reported by defendant Eagle, and credit-loss reserves was "Eagle's most critical financial indicator." *Id.* at 1257. At most, like the other cases cited by plaintiffs, *Rehm*, at most stands for the unremarkable

proposition that restatement amounts should be considered relative to the numerous other facts and circumstances surrounding a restatement.

Each of Enron's restatement items were "one-off" transactions and involved complex accounting issues and admitted mistakes by Enron's auditors—none of which had been previously raised as problematic. There simply was nothing either systemic or repetitive about the allegedly erroneously applied accounting principles.<sup>24</sup>

- According to Enron, the consolidation of JEDI and Chewco from January 1, 1997 was due to the fact that the structure did not meet specific accounting requirements for non-consolidation. A one-time misjudgment or lack of sufficient information resulted in the decision not to consolidate. No revenue or monies received by Enron from JEDI or due to Enron from JEDI were reversed or found not to have existed.
- According to Enron, the reclassification of the note receivable to a reduction in shareholders' equity was a result of a one-time error in the application of GAAP.
- Enron's auditors, Arthur Andersen, have stated that due to their misjudgment, an LJM1 subsidiary was found to be inadequately capitalized.
- The restatement of \$87 million over four years in past audit adjustments related to amounts previously deemed immaterial.

Aside from a restatement of financial results, there are no similarities between the cases that plaintiffs this case and cite in support of their contention that it is permissible to draw an inference of scienter based upon the mere size of Enron's restatement. More importantly, plaintiffs have not alleged any facts demonstrating that Mr. Skilling was aware of, involved in, or counseled any of these alleged accounting errors.

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<sup>24</sup> Although Enron made the restatement at issue, it is not a party to this action. We not agree that Enron needed to restate its financial results and reserve the right to argue that accounting principles were not erroneously applied.

**C. PLAINTIFFS OFFER NO REASON WHY THE VAGUE AND CONCLUSORY ALLEGATIONS OF IMPROPER OR FRAUDULENT BUSINESS PRACTICES BY ENRON ARE SUFFICIENT TO STATE A CLAIM FOR SECURITIES FRAUD AGAINST MR. SKILLING**

**1. PLAINTIFFS CANNOT REFUTE THAT ALLEGATIONS REGARDING ENRON'S BUSINESS PRACTICES FAIL TO PLEAD ANY SPECIFIC FACTS TO SUPPORT FRAUD BY ENRON.**

Mr. Skilling's Opening Brief and the Joint Brief explain the propriety of mark-to-market accounting, as well as the legitimacy of the challenged business practices in Enron's Wholesale, Retail, Broadband and International businesses.<sup>25</sup> In response, plaintiffs' Opposition Brief offers no substantive support for their conclusory beliefs and claims, and in many instances simply fails to even defend plaintiffs' sweeping allegations.

For example, plaintiffs do not dispute that the use of mark-to-market accounting was required by EITF No. 98-10 beginning in 1999, that it was used routinely by most energy traders prior to 1999, and that Enron fully disclosed its use of mark-to-market accounting and the risks intrinsic to it.<sup>26</sup> In the face of these facts, plaintiffs in opposition only echo their conclusory refrain of "misuse and abuse."<sup>27</sup> Plaintiffs do not provide any specific facts demonstrating how Enron allegedly used mark-to-market accounting in a fraudulent manner or any examples of the alleged "misuse" to which they repeatedly refer.<sup>28</sup> And without exception, they never explain Mr. Skilling's role or scienter with respect to the alleged abuse of mark-to-market accounting.

Likewise, plaintiffs provide no explanation or support for their vague allegations of fraudulent business practices concerning Enron's Wholesale, Retail, Broadband, or International

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<sup>25</sup> See Pl. Opp'n Br. at 24-25 and accompanying citation to Joint Brief.

<sup>26</sup> See Pl. Opp'n Br. at 34-36..

<sup>27</sup> See, e.g., Pl. Opp'n Br. at 8 n.5, 16, 37, 39, 93.

<sup>28</sup> See Reply to Mot. to Strike Joint Br. at Mark-To-Market Section. As before, for the Court's convenience and to avoid unnecessary duplication, Mr. Skilling incorporates these arguments from the Joint Reply by reference, specifically reserving his right to take contrary positions in the future.

businesses.<sup>29</sup> They repeat allegations about Enron's announcement of each Sector's quarterly and annual results relating to these businesses, coupled with an unrelated restatement,<sup>30</sup> but ignore the fact that a restatement is not evidence of fraud,<sup>31</sup> and, indeed, that the restatement did not relate to many of these businesses, and fail to explain or to specify how the legitimate goals and disclosed risks inherent in these lines of business were consistent with or evidence of a fraudulent scheme. For example, plaintiffs are unable to explain how the lack of success of Enron's Broadband business was in any way the result of a fraud (as opposed to the industry-wide downturn in the broadband sector generally), especially in light of Enron's repeated disclosures of the risks associated with that business and the continuing, disclosed losses associated with it.<sup>32</sup> Although plaintiffs' opposition brief contends that EBS was "a complete fiction," the underlying allegations in the NCC are inadequate in that they still do not identify any specific allegations to support such a conclusion, and allege nothing that goes beyond, possibly, claims of mismanagement.<sup>33</sup>

Rather than explain how the allegations in the NCC related to fraudulent business practices are adequately specific, which they cannot do, plaintiffs instead spend an entire subsection of their Opposition Brief arguing, in a vacuum, the legal proposition that knowing participants in a fraudulent scheme are liable under § 10(b).<sup>34</sup> This legal truism, however, completely ignores the fact that plaintiffs' complaint has failed to adequately plead that Enron engaged in a fraudulent scheme or that Mr. Skilling knowingly participated therein.

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<sup>29</sup> See Reply to Mot. to Strike Joint Br. at WEOS, EES, EBS & International Sections.

<sup>30</sup> See, Pl. Opp'n Br. at 65-66.

<sup>31</sup> See *supra* Section IV.

<sup>32</sup> See Joint Brief at 123-126, 145; *cf.* Pl. Opp'n Br. at 101.

<sup>33</sup> See Reply to Mot. to Strike Joint Br. at Broadband Section.

<sup>34</sup> See Pl. Opp'n Br. at 69-74.

In fact, nowhere in plaintiffs' five-page digression purporting to demonstrate how the Insiders were "Liable for Primary Violations of § 10(b) as Participants in a Fraudulent Scheme," do plaintiffs ever refer to their own complaint or cite to specific, factual allegations to support their claim in *this* case. Plaintiffs have offered no specific factual allegations of their claims here, and have thus perpetuated their "cut and paste" pleading style evident in the NCC by inserting in their Opposition Brief this irrelevant and unsupported argument that does nothing to rebut Mr. Skilling's grounds for dismissal. Because plaintiffs have not adequately pled that Enron was engaged in any fraudulent business practices, they necessarily have failed to allege that Mr. Skilling participated in any purported fraudulent scheme.

**2. ALLEGATIONS THAT ENRON'S BUSINESS PRACTICES WERE IMPROPER OR FRAUDULENT ARE IMPERMISSIBLY GROUP-PLED AGAINST MR. SKILLING.**

Plaintiffs' opposition brief ignores the fact that throughout the NCC, plaintiffs have indiscriminately grouped defendants together contrary to the requirements under "the PSLRA [that] plaintiffs ... 'distinguish among those they sue and enlighten *each defendant* as to his or her particular part in the alleged fraud.'"<sup>35</sup> *Schiller v. Physicians Res. Group, Inc.*, 2002 WL 318441, at \*5 (N.D. Tex. Feb. 26, 2002) (quoting *In re Silicon Graphics, Inc.*, 970 F. Supp. 2d 746, 752 (N.D. Cal. 1997) (emphasis in original)). Instead, plaintiffs attempt to divert the Court's attention from this fundamental failing of their Consolidated Complaint by focusing on the academic question (soundly rejected in this Circuit) of whether the presumption permitting group pleading survived the PSLRA.<sup>36</sup>

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<sup>35</sup> See Skilling Br. at 25-26 (listing examples of where the NCC has improperly grouped defendants together in a failed attempt to plead participation in a fraudulent scheme).

<sup>36</sup> See Pl. Opp'n Br. at 34-36. As made clear both in the Opening Brief and here, *infra*, the presumption that permitted group pleading prior to the PSLRA did not survive the enactment of the PSLRA. See, e.g., *BMC Software, Inc.*, 183 F. Supp. 2d 860, 902 n.45 (S.D. Tex. 2001).

Plaintiffs admit that the PSLRA requires them to specify the “who, what, where, when, why and how” of their allegations.<sup>37</sup> Yet, they do nothing to explain how the group-pled allegations of fraud in the NCC satisfy that burden. Plaintiffs merely argue that certain groups of defendants signed, made or helped prepare allegedly fraudulent statements by Enron and that such allegations adequately state a claim against individual defendants within those groups for alleged misstatements. Even if that limited point were persuasive, which it is not,<sup>38</sup> it fails to refute Mr. Skilling’s well supported arguments demonstrating the insufficiency of plaintiffs’ group-pled allegations of fraudulent conduct.

- For example, as explained in Mr. Skilling’s Opening Brief at 25-36, plaintiffs have attempted to implicate Mr. Skilling individually by indiscriminately making allegations about what certain groups of defendants supposedly did or knew.

Plaintiffs’ concentration on defending their practice of grouping defendants together with respect to statements made or reports filed,<sup>39</sup> however, leaves unopposed the point in Mr. Skilling’s Opening Brief regarding these group-pled allegations—that claims of Mr. Skilling’s involvement in or knowledge of Enron’s allegedly fraudulent business practices inadequately fail to specify Mr. Skilling’s personal role.

Allegations, for example, that “Enron Defendants engaged in several accounting manipulations with respect to broadband”<sup>40</sup> do not specify what *Mr. Skilling* did, when *he* did it, or how *he* was, in any way, personally involved in the purported manipulations. Indeed, such allegations do not even delineate the alleged manipulations at issue. Plaintiffs’ opposition brief never claims that these allegations are sufficiently pled—because plaintiffs could not seriously make such an argument. Thus, plaintiffs essentially concede that these and other similarly

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<sup>37</sup> See Pl. Opp’n Br. at 31.

<sup>38</sup> See *supra* Section IV.

<sup>39</sup> Pl. Opp’n Br. at 34-35.

<sup>40</sup> NCC ¶ 520.

group-pled allegations of conduct do not adequately specify the role Mr. Skilling played in the claimed frauds. To the extent plaintiffs attempt to evade the requirements of the PSLRA by grouping defendants together without allegations specifying the role of each defendant, their complaint fails as a matter of law. *See, e.g., Schiller*, 2002 WL 318441, at \*5; *Skilling Br.* at 24-28.<sup>41</sup>

**3. PLAINTIFFS FAIL TO REFUTE THE ARGUMENT THAT ALLEGATIONS OF MR. SKILLING’S KNOWLEDGE OF OR PARTICIPATION IN ENRON’S ALLEGEDLY IMPROPER OR FRAUDULENT BUSINESS PRACTICES ARE INSUFFICIENT UNDER THE PSLRA.**

Plaintiffs have answered Mr. Skilling’s arguments that the NCC failed to allege particularized facts of his personal liability for fraud by restating, amending, and distorting the Consolidated Complaint.<sup>42</sup> Their reliance on the Powers Report and abandonment of their original allegations is not only improper and substantively insufficient—as set forth in full above and in Appendix A<sup>43</sup>—but also underscores plaintiffs’ acknowledgment of the deficiencies in the NCC. Indeed, nowhere in the 160 pages of plaintiffs’ opposition brief are they able to rebut Mr. Skilling’s argument that, even where the NCC names him specifically, the allegations do not plead a claim for fraud under the PSLRA, and they are unable to point to particularized allegations in the NCC that Mr. Skilling knew of, much less was involved in, a fraudulent scheme.

**a. Plaintiffs Fail To Demonstrate That They Have Adequately Pled Allegations That Mr. Skilling Failed To Respond To Internal Complaints.**

Plaintiffs do not directly address the fact that the NCC fails to specify the who, what, where, when, why and how of allegations relating to Mr. Skilling’s response to supposed internal

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<sup>41</sup> Pl. Opp’n Br. at 100-101 (making either no reference to who at Enron was involved, or referring generally to “Enron Insiders”).

<sup>42</sup> *See* Pl. Opp’n Br. at 64-65.

complaints.<sup>44</sup> Even buttressing their opposition brief with references to the Powers Report,<sup>45</sup> plaintiffs are *still* unable to cite any specifics of the meetings Mr. Skilling allegedly had with EBS personnel (failing to allege who was at the meeting, or what “actual” numbers were revealed) and do not explain how such unspecified meetings evidence Mr. Skilling’s participation in or knowledge of fraud.<sup>46</sup> Tellingly, even plaintiffs’ broad-brushed attempts to link allegations of internal complaints to the “conscious misbehavior or recklessness” of defendants do not specify *Mr. Skilling’s* knowledge of or involvement in fraud as supposedly evidenced by those complaints, nor can plaintiffs even cite to one paragraph in their Consolidated Complaint which does so.<sup>47</sup> Although plaintiffs make reference to two internal complaints received by management that allegedly demonstrate involvement, or at least knowledge, of the frauds alleged, both complaints were—by plaintiffs’ own admission—made after Mr. Skilling left Enron.<sup>48</sup> Plaintiffs do nothing to respond to Mr. Skilling’s arguments that the complaints allegedly referenced by the Watkins’ letter do not specify *what* the alleged complaints concerned, or *how* those complaints, in any way, exhibit Mr. Skilling’s foreknowledge of or participation in a fraud. The underlying allegations, therefore, remain

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<sup>43</sup> See *supra* Section II.A.

<sup>44</sup> See Pl. Opp’n Br. at 29-31 (addressing allegations in the NCC related to alleged complaints received by Mr. Skilling).

<sup>45</sup> See Pl. Opp’n Br. at 64-65.

<sup>46</sup> Pl. Opp’n Br. at 52, 64-65. See, e.g., *Arazie v. Mullane*, 2 F.3d 1456, 1467 (7th Cir. 1993) (“[R]eferences to unreleased or internal information that allegedly contradict[s] [defendants’] public statements” should indicate such matters as “who prepared the projected figures, when they were prepared, how firm the numbers were, or which [company] officers reviewed them.”); *Schiller*, 2002 WL 318441 at \*10 n.9 (“an ‘unsupported general claim of the existence of confidential company reports is insufficient to survive a motion to dismiss’ ... to support an inference of fraud, Plaintiffs must ‘provide more details about the alleged negative internal reports, such as the report titles, when they were prepared, who prepared them, to whom they were directed, their content, and the sources from which plaintiffs obtained this information.’”) (quoting *Coates v. Heartland Wireless Communications, Inc.*, 26 F. Supp. 2d 910, 920 (N.D. Tex. 1998)).

<sup>47</sup> Pl. Opp’n Br. at 101-102.

<sup>48</sup> Pl. Opp’n Br. at 102 (citing Watkins’ letter to Lay and a letter from an unspecified EES manager to Enron’s Board); see also, e.g., Pl. Opp’n Br. at 15 (noting that letter from EES manager was written “just after Skilling ‘resigned’”).

nothing less than hindsight conclusions of fraud, drawn from unsuccessful results and alleged accounting errors, without any specifics linking Mr. Skilling to impropriety.

**b. Plaintiffs Essentially Concede That Allegations That Mr. Skilling Directed Others Fail To State A Claim.**

Plaintiffs' opposition brief does not address the inadequacy of the isolated allegations in the NCC with respect to Mr. Skilling's purported role in directing others in the course of a fraudulent scheme.<sup>49</sup> Not only do these allegations fail to specify how, when or what Mr. Skilling allegedly directed others to do, but they do not even adequately explain how the alleged conduct—for example, deciding not to write down certain assets, or allegedly encouraging the use of accounting methods established by FASB—was fraudulent, even if Mr. Skilling was involved.<sup>50</sup>

**c. Allegations Regarding Mr. Skilling's Role In Forming, Adjusting, Or Discontinuing Hedging Activities Fail To State A Claim.**

Nowhere in their opposition brief do plaintiffs explain how the NCC specifies what Mr. Skilling personally did or knew with respect to the RhythmsNet and Raptor-related hedges. And nowhere in their complaint have plaintiffs alleged that Mr. Skilling was aware that those hedges were structured improperly or fraudulently. Nor have plaintiffs explained how Mr. Skilling's alleged desire to protect Enron's investments was improper or fraudulent.<sup>51</sup> Their attempt to shore up these fatal flaws with references to the Powers Report in their opposition does nothing, as even those new allegations offer no specific allegations with respect to Mr. Skilling and

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<sup>49</sup> See Skilling Br. at 31-33 (addressing allegations that Mr. Skilling directed others).

<sup>50</sup> Again, plaintiffs' reliance on the Powers Report to replead these allegations fails, for reasons set forth above. See *supra* Section II.A.. Not only are their "new" allegations improper and inadequate standing alone, they cannot and do not even attempt to address, much less correct, the deficiencies of the allegations in the NCC with respect to Mr. Skilling's alleged personal role in directing others to carry out a purported fraudulent scheme. *Id.*; see also App. A, attached hereto.

<sup>51</sup> See Skilling Br. at 33-38 (addressing allegations of Mr. Skilling's involvement in the RhythmsNet and Raptor-related hedges).

provide no basis for fraud.<sup>52</sup> In their opposition brief, plaintiffs do not even attempt to defend the NCC's untenable position that the encouragement of the legitimate business goals of protecting and increasing corporate investment values somehow evidences fraud or fraudulent intent.<sup>53</sup> Rather, they merely repeat generalized and group-pled accusations that Mr. Skilling's unspecified involvement, urgings, or desires relating to these hedges necessarily states a claim for fraud.<sup>54</sup> However, these hindsight conclusions are unsupported by any factual allegations of fraud specific to Mr. Skilling, and therefore fail as a matter of law. *See, e.g., Melder*, 27 F.3d at 1101 n.8 ("These allegations boil down to plaintiffs' attempt to chastise as fraud business practices that, in hindsight, might have been more cautious. Misjudgments are not, however, fraud.").

**d. Plaintiffs Essentially Concede That General Allegations Regarding Mr. Skilling's Supposed Knowledge Of Alleged Frauds Prior To His Resignation Fail To State A Claim.**

Plaintiffs' opposition does not even contest that the allegations relating to Mr. Skilling's resignation are unsuitably vague and otherwise fail to state a claim of fraud.<sup>55</sup> Accordingly, neither the accusations of Mr. Skilling's knowledge of fraud prior to his departure, nor the alleged falsity of the reasons he stated publicly for leaving, can survive dismissal.

**IV. THE SPECIFIC STATEMENTS PLAINTIFFS SEEK TO ATTRIBUTE TO MR. SKILLING ARE INSUFFICIENT, AS A MATTER OF LAW, TO STATE A CLAIM FOR SECURITIES FRAUD.**

Plaintiffs seek to attribute certain of Enron's public statements to Mr. Skilling but do not explain how these alleged statements support a claim for securities fraud, either against Enron or

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<sup>52</sup> *See supra* Section II.3.b.; *see also* App. A, attached hereto, allegations No. 7, 11, 12, 13, 14, 15, 16, 17 (discussing Pl. Opp'n Br. at 64-65).

<sup>53</sup> *See, e.g.,* Skilling Br. at 33-38 (addressing NCC ¶¶ 454, 457, 465, 490).

<sup>54</sup> *See, e.g.,* Pl. Opp'n Br. at 28 ("Enron Insiders ... engaged in transactions with related companies that Enron controlled and counted them as profits ... "); at 101 ("results of WEOS ... were manipulated and falsified by ... phony or illusory hedging transactions ... ").

against Mr. Skilling. Plaintiffs cite no NCC allegations, for example, showing how Mr. Skilling may be held liable for his accurate public recitation, on conference calls and elsewhere, of Enron's reported business and financial results. Plaintiffs may not simply point to Enron's November 2001 restatement and plead "fraud by hindsight" as to Mr. Skilling's prior recitation of Enron's reported results. (*See, e.g., Skilling Br. at 58–60.*) Despite all their efforts, plaintiffs have failed to identify any facts giving rise to a strong inference that Mr. Skilling knew, or was severely reckless in not knowing, that Enron's reports were false or misleading *at the time they were released to the public*. The forward-looking statements plaintiffs attribute to Mr. Skilling are protected as well: whether contained in Annual Reports or made on analyst conference calls, each such statement is protected under the PSLRA safe harbor, the "bespeaks caution" doctrine, or as optimistic projections about Enron's business prospects. (*See Skilling Br. at 45–55.*) Plaintiffs also fail to state any securities fraud claim based on statements made in third party analyst reports and news publications.

**A. THE PSLRA "SAFE HARBOR" BARS PLAINTIFFS' CLAIMS BASED ON MR. SKILLING'S ALLEGED FORWARD-LOOKING STATEMENTS IN ENRON'S ANNUAL REPORTS AND ON ANALYST CONFERENCE CALLS.**

The statutory safe harbor under the PSLRA applies to protect all forward-looking statements in Enron's Annual Reports for 1999 and 2000, such as those alleged at paragraph ¶ 215 ("[t]he market for bandwidth intermediation will grow from \$30 billion in 2000 to \$95 million in 2004" (NCC ¶215)) and paragraph 293 ("Enron is laser-focused on earnings per share, and we expect to continue strong earnings performance" and "In 2001 we expect to close approximately \$30 billion in new total contract value" *id.* ¶293). (*See Skilling Br. at 45–48; and see Skilling Br., Ex. A at A-1 and A-4* (extensive cautionary language contained in those Annual

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<sup>55</sup> *See Skilling Br. at 38-40* (addressing allegations concerning Mr. Skilling's resignation).

Reports). Plaintiffs do not oppose this aspect of Mr. Skilling's motion, which is a concession to its merit.

With respect to forward-looking statements made on Enron conference calls, plaintiffs object to Enron's practice of directing listeners to press releases containing the required PSLRA safe harbor language. For example, at an April 12, 2000 conference call with analysts, Mr. Skilling is alleged to have made the following forward-looking statement regarding Enron's future earnings per share: "...Enron was forecasting 00 and 01 EPS of \$1.37 and \$1.56+." (*See* NCC ¶ 224.) The call transcript, however, shows that participants were explicitly directed to the public earnings announcement<sup>56</sup> released by Enron earlier that day which, in turn, contained extensive cautionary language. (*See* Skilling Br. at 47 (setting forth cautionary statement); *see also* Skilling Br. at 45–48, Ex. A (listing forward-looking conference call statements alleged at NCC ¶ 247, 263, 282, 317, 328, 329 and 337 (all quoting required safe harbor language directly from referenced Enron press releases of the same date)).)

Plaintiffs argue that the safe harbor is not available in these cases because Enron failed (1) to direct participants to the *specific* cautionary language in the releases, (2) to *separately* identify their particular statements as "forward-looking" and (3) to recite the required cautionary language directly on the conference calls. (*See* Pl. Opp'n Br. at 83, 84.) But the law does not require this. *Crossman v. Novell, Inc.*, 120 F.3d 1112, 1122 (10th Cir. 1997). Moreover, the cited forward-looking conference call statements are further protected under the "bespeaks caution" doctrine, due to the extensive contemporaneous cautionary language in Enron's press releases and SEC filings.<sup>57</sup>

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<sup>56</sup> *See* Skilling Br., Ex. A at A-1 ("Earlier today we reported our first-quarter 2000 results. We hope you have seen the release.").

<sup>57</sup> *See, e.g.*, Skilling Br. at 52, and Ex. B.

**B. EXTENSIVE RELEVANT DISCLOSURES RENDER ANY “FORWARD-LOOKING” STATEMENTS INACTIONABLE UNDER THE BESPEAKS CAUTION DOCTRINE.**

Plaintiffs argue that statements made by Enron executives in conference calls are not “forward looking” and that, in any event, the bespeaks caution doctrine does not apply because the alleged statements were made “in bad faith and with no reasonable basis.” (*See* Pl. Opp’n Br. at 87.) For example, on April 13, 1999, plaintiffs assert that Mr. Skilling’s alleged statement regarding projected contract volume (*i.e.*, sales) for EES in 1999 does not qualify as a “forward-looking” statement. (*See* NCC ¶ 145 and Pl. Opp’n Br. at 86 (also arguing that an October 13, 1998 statement that “EES would be profitable by the 4th Q99” was not forward-looking).) But plaintiffs ignore the fact that a statement about Enron’s expected future business performance falls directly under the PSLRA definition. (*See* Skilling Br. at 45–46 (“forward looking statements” include, *e.g.*, “a statement of future economic performance” and “a statement of the plans and objectives of management for future operations”).)

Plaintiffs apparently concede that the rest of the statements about Enron’s business prospects listed in Ex. B are “forward-looking” but argue that such statements do not qualify for protection under the “bespeaks caution” doctrine because they were made in bad faith and without any reasonable basis. For example, with respect to the projections in paragraph 145, plaintiffs assert in conclusory terms that “these statements [about EES] were made in bad faith and were not reasonably supported by available evidence” (NCC ¶ 145) and refer the Court to paragraphs 121(g) and 155(e), (f), (g), and (o). None of these cited paragraphs, however, plead any facts establishing plaintiffs’ self-serving assertion that EES “lost money on each contract it signed.” (*See* Pl. Opp’n Br. at 86.) Moreover, plaintiffs fail to identify what *facts* are supposed to show that Mr. Skilling lacked any reasonable basis for his belief that the statements were accurate when made. Plaintiffs seem to ignore their own allegations against Arthur Andersen

and other defendants, which show that Mr. Skilling relied on the judgment of experts and professionals as to the proper application of accounting rules and as to the fair and proper presentation of Enron's financial statements.

Plaintiffs next resort, by now quite predictably, to their signature conclusory style of argument: "Skilling *knew* that, at any point if Enron properly accounted for its business activities it would not be able to meet the stated projections." (Pl. Opp'n Br. at 87 (emphasis added).) Plaintiffs also assert that they "have demonstrated that the Insiders did not believe their projections and other forward-looking statements to be true." (*Id.*) However, plaintiffs fail to identify even a *single* NCC allegation in support of this conclusory assertion as to Mr. Skilling, *i.e.*, that he knew the EES projections – or any other forward-looking statement – were false or misleading when made.

Nor do plaintiffs' emphatic insistence satisfy the need to plead specific facts giving rise to a strong inference that Mr. Skilling acted with the necessary scienter with respect to the accounting or business issues affecting the cited projections. Plaintiffs provide *no authority* for their conclusory argument that the selected conference call statements are "material, actionable misrepresentations." (*Id.*) The authority cited by Mr. Skilling, on the other hand, demonstrates that these statements are *not* actionable. (*See* Skilling Br. at 52–55 (*citing, e.g., Nathensen v. Zonagen, supra*); *see also* Skilling Br. at 46 (listing 15 NCC paragraphs containing similar statements attributed to Mr. Skilling).)

Lastly, plaintiffs argue that the bespeaks caution doctrine should not be applied at the pleading stage. (*See* Pl. Opp'n Br. at 88.) Although the doctrine is not a *per se* bar to a claim for securities fraud, it provides a legal basis for dismissing a complaint where the alleged misstatements are immaterial in light of relevant and specific risk disclosures:

Where the warning is in specific language and relates not only the riskiness of the investment but directly addresses the substance of the statement challenged by plaintiffs, a reasonable factfinder could not conclude that the alleged misrepresentation “would influence a reasonable investor’s investment decision.”

*In re Landry’s Seafood*, slip op., at 36-37 (quoting *In re Trump Casino Securities Litigation*, 7 F.3d 357, 369 (3d Cir. 1993)); *see also, e.g., Grossman v. Novell, Inc.*, 120 F.3d 1112, 1120 n.7 (10th Cir. 1997) (“The ‘bespeaks caution’ doctrine may properly be applied in considering a motion to dismiss”) (collecting cases); *Skilling Br.* at 50–51.

Courts have repeatedly held that specific and tailored cautionary language like that disseminated by Enron during the class period<sup>58</sup> justifies dismissal of allegations of fraud premised on projections of future success.<sup>59</sup>

Plaintiffs allege throughout the consolidated complaint that they relied to their detriment on Enron’s SEC filings and other public statements released during the class period. In light of the extensive relevant cautionary language contained in these documents, Mr. Skilling’s alleged forward-looking statements are not actionable.

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<sup>58</sup> *See Skilling Br.* at 49–52, and Ex. B attached thereto.

<sup>59</sup> *See, e.g., Parnes v. Gateway 2000, Inc.*, 122 F.3d 539, 548-49 (8th Cir. 1997) (affirming dismissal of complaint where plaintiffs alleged “that the quality and desirability of Gateway’s portable computer products was misrepresented” because Gateway “warn[ed] potential investors that, due to the nature of a volatile industry, new product lines of computers represent a risky venture ... the prospectus warned that ‘[t]here can be no assurance that these products or features will be successful’”) (citation omitted); *In re Trump Casino Securities Litigation*, 7 F.3d at 365, 371-72 (affirming dismissal on pleadings where plaintiffs alleged fraud based on statement that “[t]he Partnership believes that funds generated from the operation of the Taj Mahal will be sufficient to cover all of its debt service (interest and principal),” (citation omitted) because “the cautionary statements were tailored precisely to address the uncertainty concerning the Partnership’s prospective ability to repay the bondholders”); *In re USEC Securities Litigation*, 190 F. Supp. 2d 808, 814, 825 (D. Md. 2002) (dismissing claim under Fed. R. Civ. P. 12(b)(6) where plaintiffs alleged “the prospectus was materially false and misleading in that it misrepresented that USEC had a viable core business model, the cornerstone of which was the deployment of a new ... technology” because “extensive cautionary language [concerning the development of the new technology] ... rendered immaterial as a matter of law the alleged misrepresentations and omissions relied upon by plaintiffs”); *Millcreek Assocs., L.P. v. Bear, Stearns & Co.*, \_\_ F. Supp. 2d \_\_, No. A:01CV822, 2002 WL 1066689, at \*6, \*16 (W.D. Tex.) (granting 12(b)(6) motion to dismiss plaintiffs’ securities fraud claims where alleged misstatements regarding the “financial projections and generalized statements concerning the likely post-IPO returns [of an investment]” were rendered immaterial as a matter of law because the offering documents “... contain[ed] extensive cautionary and qualification language as to the safety of the money invested, i.e., that it all could be lost [and because] [t]he marketing materials

**C. PLAINTIFFS CITE NO AUTHORITY TO OPPOSE DISMISSAL OF SECURITIES FRAUD CLAIMS AGAINST MR. SKILLING BASED ON MERE OPTIMISTIC STATEMENTS ABOUT ENRON'S BUSINESS CONDITION AND OUTLOOK**

It is well-settled that generalized positive statements about a company's outlook may not form a basis for securities fraud liability. (*See Skilling Br.* at 52–54 (*citing, e.g.,* the Fifth Circuit's decision in *Nathenson v. Zonagen, Inc.*, 267 F.3d 400, 419 (5th Cir. 2001) and *In re Securities Litigation BMC Software, Inc.*, 183 F. Supp. 2d 860, 904 (S.D. Tex. 2001)).) Sifting through the entire consolidated complaint are discovered that there are only 42 NCC paragraphs containing optimistic statements about Enron's business outlook that plaintiffs might possibly seek to attribute to Mr. Skilling. (*See Skilling Br.*, Ex. C (identifying each NCC paragraph and quoting each such statement).) As vague and nonquantifiable expressions of corporate optimism, these statements are not actionable as a matter of law. (*See Skilling Br.* at 52–54.) Plaintiffs challenge four<sup>60</sup> of these 42 paragraphs in their Opposition, each of which also contains statements protected by the bespeaks caution doctrine and, in certain cases, by the PSLRA safe harbor.<sup>61</sup>

At paragraph 145, plaintiffs allege that on April 13, 1999, Enron held a conference call for analysts and investors to discuss Enron's results of operations for the first quarter of 1999 and Enron's business outlook. At paragraph 224, plaintiffs allege that on April 12–13, 2000, Messrs. Lay, Skilling, Koenig, Causey and Fastow participated in Enron's analyst conference call and the Enron Analyst Meeting in Houston, where they discussed Enron's reported first quarter results

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presented ... contain[ed] numerous qualifications that the numbers expressed were estimates and dependent upon market conditions and ... financial projections”).

<sup>60</sup> NCC ¶¶ 145, 224, 263 and 282. Each of these paragraphs identifies statements made by Mr. Skilling and others on conference calls discussing Enron's actual reported results for different reporting periods: 1Q99, 1Q00, 3Q00 and 4Q00. Plaintiffs do not argue that any statement from the other 38 NCC paragraphs identified in *Skilling Br.*, Ex. C, is actionable.

<sup>61</sup> *See Skilling Br.*, Ex. A at A-1, A-2 and A-3; *see also id.*, Ex. B at B-2, B-10, B-15, and B-21.

and expectations going forward.<sup>62</sup> Similarly, plaintiffs allege at paragraph 263 that on October 17, 2000, Messrs. Skilling, Koenig, Causey, Frevert and Fastow participated in a conference call “to discuss Enron’s 3rdQ 00 results and its business and its prospects.” According to paragraph 282, a similar conference call was held on January 21, 2001.

Plaintiffs assert that the statements made on these conference calls are actionable as “misrepresentations about Enron’s financial condition and specific businesses ... [which] were material in light of, among other things, Enron’s inflation of its earnings, and concealment of billions of dollars of debt.” (*See* Pl. Opp’n Br. at 96.) The alleged statements plainly refer to recently reported financial results and otherwise contain vague and nonquantifiable expressions of optimism regarding Enron’s future business prospects. As such, they are not the kind of statements that a reasonable investor relies upon in making an investment decision. *See, e.g., Skilling Br. at 53.*

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<sup>62</sup> Despite their general retreat from group pleading, plaintiffs nonetheless defend their refusal to identify any specific alleged misrepresentations made by Mr. Skilling during conference calls and meetings. (Pl. Opp’n Br. at 33-35.) Plaintiffs concede that fifteen paragraphs in their complaint cite numerous alleged misrepresentations by so-called “small groups of Enron insiders during conference calls and analyst meetings” (*see id.* at 33), but appear to contend that the group-pleading doctrine does not apply to these small groups. (*See id.* at 35.) As support for their position, plaintiffs cite three district court cases. (*See id.*) However, plaintiffs’ reliance is simply misplaced. First, none of the cases are from any Fifth Circuit court, and as this court is well aware, pleading standards can vary slightly from circuit to circuit. Second, the *Schlagal* case and the two other cases cited by plaintiffs held that it is sufficient for the plaintiffs to identify the time, location, and content of the alleged misstatements during conference calls, while not identifying the specific executives who made the statements. *Schlagal*, 1993 U.S. Dist. LEXIS 20306, at \*15; *In re SmarTalk Teleservices, Inc. Securities Litigation*, 124 F. Supp. 2d 527, 543 (S.D. Ohio 2000); *In re Silicon Graphics, Inc. Securities Litigation*, 970 F. Supp. 746 (N.D. Cal. 1997). However, such reasoning of these cases is suspect because all three cases make the same mistake of allocating to the defendant the burden of ascertaining exactly whom made the alleged misstatement. In the Fifth Circuit, however, the plaintiff clearly has the burden of identifying the speaker for each allegedly misleading statement. *See ABC Arbitrage Plaintiffs Group v. Tchuruk*, --- F.3d ---, No. 01-40645, 2000 WL 975299, \*9-10 (5th Cir. May 13, 2002). Plaintiffs’ cases effectively hold that a plaintiffs may allege only the “what, when, where, and how ... leaving it to the defendants to figure out the” who element. *Cf. id.* Such an approach has been repeatedly rejected by the Fifth Circuit. *See id.* Rather, the Fifth Circuit strictly interprets Rule 9(b) to apply “with force, [and] without apology....” *Williams v. WMLX Technologies, Inc.*, 112 F.3d 175, 178 (5th Cir. 1997). Consequently, the Court should dismiss as inadequate plaintiffs’ generalized allegations that Skilling and others made alleged misrepresentations during conference calls and meetings.

**D. PLAINTIFFS FAIL TO IDENTIFY ANY FACTUAL NCC ALLEGATIONS SHOWING MR. SKILLING CONTROLLED OR APPROVED ANALYST REPORTS OR NEWS ARTICLES.**

Plaintiffs cite *Robertson v. Strassner*, 32 F. Supp. 2d 443, 450 (S.D. Tex. 1998) in support of the general proposition that “Corporate defendants may be directly liable under 10b-5 for providing false or misleading information to third-party securities analysts. [Defendants] cannot escape liability simply because [they] carried out [the] alleged fraud through the public statements of third parties.” (See Pl. Opp’n Br. at 97.) Plaintiffs ignore the rule that individual defendants may be liable for such third-party statements only if the particularity requirements of Rule 9(b) are met. See, e.g., *In re Landry’s Seafood*, slip op., at 61–62, n. 27 (quoting *Allison v. Brooktree Corp.*, 999 F. Supp. 1342, 1349 (S.D. Cal. 1998) and *Picard Chemical, Inc. Profit Sharing Plan v. Perrigo Co.*, 940 F. Supp. 1101, 1126 (W.D. Mich. 1996)).

Plaintiffs have failed to meet their burden under Rule 9(b). They have failed to allege facts detailing the who, what, when and where of any conversations during which Mr. Skilling knowingly communicated false statements to analysts. As argued in the Opening Brief at 57, plaintiffs have failed to plead with particularity facts showing how Mr. Skilling could have controlled the content of the cited analyst reports or that Mr. Skilling, as an *individual* defendant, ever endorsed or approved the reports in question. (See *generally* Skilling Br. at 55–58.) In the absence of factual allegations detailing entanglement, control or approval, as required under Rule 9(b), the claims against Mr. Skilling based on the reports of securities analysts must be dismissed.

Similarly, plaintiffs may not rely on the content of news articles referring to Mr. Skilling as a basis for their securities fraud claims. (See Skilling Br. at 44 (citing NCC ¶¶ 129, 160, 175, 178, 202, 228, 289, 330 and 337), and 55–58 (citing extensive authority that such statements are legally insufficient in the absence of factual allegations showing Mr. Skilling’s effective control

over such news articles).) While plaintiffs refer the Court to these articles, they point to no factual allegations showing Mr. Skilling's effective control over their authors, and cite *no authority* in support of their apparent position that Mr. Skilling may nevertheless be held liable for their content. (*See Pl. Opp'n Br. at 65.*) Plaintiffs' mere reference to news articles, without more, fails to state any claim against Mr. Skilling.

V. **PLAINTIFFS' CONSOLIDATED COMPLAINT FAILS TO ADEQUATELY ALLEGE FACTS SUFFICIENT TO SUPPORT A STRONG INFERENCE OF SCIENTER WITH RESPECT TO MR. SKILLING.**

In Mr. Skilling's Opening Brief, he demonstrated how the plaintiffs' consolidated complaint relied exclusively on allegations of motive and opportunity, and failed to plead any specific facts sufficient to support a strong inference that Mr. Skilling had the requisite scienter. (*Skilling Br. at 60-81.*) Specifically, the Opening Brief pointed out that the only specific allegations adduced in support of a strong inference of scienter as to Mr. Skilling were: (1) that Mr. Skilling was an Officer and Director of Enron; (2) that Mr. Skilling exercised some of his options and sold some of his stock in Enron during that period, and (3) that Mr. Skilling resigned from Enron in August of 2001. (*Id. at 62.*) None of these allegations, either alone or together are sufficient to establish the strong inference of scienter necessary to support a claim under Exchange Act Section 10(b) and Rule 10b-5. (*Id. at 76-77.*)

In their opposition, plaintiffs attempt to cure their consolidated complaint's fatal flaws by arguing fraud and scienter. Yet plaintiffs' most recent efforts are no more successful against Mr. Skilling than was the consolidated complaint. *First*, plaintiffs attempt to supplement their bare bones allegations focusing solely on Mr. Skilling's positions at Enron with new allegations of "undisclosed factors" regarding Enron's contracts and core businesses, which plaintiffs flatly assert Mr. Skilling must have been aware of because of his position at Enron. As this Court has

already held on numerous occasions, such allegations are insufficient to support scienter as against any one individual. Rather, plaintiffs must “*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) (2001) (emphasis added). Plaintiffs have simply failed to do so in the NCC.

*Second*, in response to a thorough and detailed analysis demonstrating why Mr. Skilling’s sales of Enron stock were not unusual, plaintiffs only address select arguments leaving the analysis unrefuted as a whole. Moreover, the responses plaintiffs do provide are either devoid of legal support or supported by law that is inapposite.

*Finally*, plaintiffs’ opposition fails to even address Mr. Skilling’s argument that his resignation from Enron cannot, as a matter of law, be used to support a strong inference of scienter. Consequently, the Court should consider it undisputed that those allegations are insufficient to state a claim.

**A. PLAINTIFFS HAVE NOT PLED WITH PARTICULARITY FACTS INDICATING THAT MR. SKILLING CONSCIOUSLY MISBEHAVED OR ACTED WITH SEVERE RECKLESSNESS.**

No doubt recognizing that their Consolidated Complaint failed to allege specific facts sufficient to support a strong inference of scienter against Mr. Skilling, plaintiffs now attempt to satisfy their pleading burden by adding new allegations in their opposition brief. (Pl. Opp’n Br. at 100-101.) Setting aside, for the moment, the substantive inadequacy of these new allegations, as discussed in detail above in Section II.A.1, such an attempt to amend the complaint is inappropriate as a matter of law. *See, e.g., In re Securities Litigation BMC Software, Inc.*, 183 F. Supp. 2d at 915; *In re Baker Hughes Securities Litigation*, 136 F. Supp. 2d 630, 646 (S.D. Tex. 2001). The Court should simply refuse to consider any of these new allegations.

Moreover, even with these new allegations, Plaintiffs’ opposition brief essentially contends that, at a minimum, Mr. Skilling—and all the other “Enron Insiders”—acted with

severe recklessness in not knowing that Enron's statements concerning its "state of affairs" were allegedly false. For example, plaintiffs claim that one of the "undisclosed factors" that affected Enron's financial condition adversely was the "known EES contract deficiencies." (Pl. Opp'n Br. at 100-101.) However, plaintiffs do not allege a single fact that even suggests Mr. Skilling ever knew about these purported deficiencies.

Plaintiffs also cite a laundry list of additional alleged "undisclosed factors affecting Enron's contracts and core businesses ..." to attempt to support a strong inference of scienter. (Pl. Opp'n Br. at 100-101.)<sup>63</sup> Accepting all of the foregoing allegations as true, plaintiffs still have not provided *a single specific allegation* from which one could conclude that Mr. Skilling knew any of the alleged undisclosed factors affecting Enron's business or that he was reckless in disregarding them. Rather, plaintiffs contend that this Court should impute scienter to Mr. Skilling since the alleged problems with Enron's business "would have been obvious to Insiders."<sup>64</sup> (Pl. Opp'n Br. at 98.) Such "should have known allegations" are insufficient as a matter of law to plead scienter. The Fifth Circuit addressed similar scienter allegations in

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<sup>63</sup> Among these "factors" are:

- Allegedly undisclosed information about Enron's Dabhol, India power-plant disaster.
- Enron International's alleged expensive failed projects.
- The allegedly undisclosed but foregone conclusion that Azurix would not become a major global water company or be accretive to Enron's earnings.
- The alleged failure to disclose that Enron's VOD/Blockbuster venture and related delivery technology and expertise, and necessary fiber-optic communications network "were a complete sham" from inception.
- Alleged undisclosed "realities" of Enron's transactions with SPEs, which were a massive and widespread part of Enron's "business."
- Alleged undisclosed financial fraud and fraudulent course of business permeating virtually all aspects of Enron's operations, including all three core business operations: WEOS, EES and EBS.

Pl. Opp'n Br. at 100-101.

<sup>64</sup> In support of this position, plaintiffs direct this Court to four cases. *See* Pl. Opp'n Br. at 98-99. Interestingly, the plaintiffs do not cite *Abrams v. Baker Hughes, Inc.*, No. 01-20514, 2002 U.S. App. LEXIS 9565, at \*16-17 (5th Cir. May 21, 2002), the Fifth Circuit's most recent and controlling opinion addressing this particular issue. As discussed below, *Abrams* completely contradicts plaintiffs' argument that scienter can be imputed to officers of a corporation based upon what they should have known. *Id.*, at \*16-17.

*Abrams v. Baker Hughes, Inc.*, No. 01-20514, 2002 U.S. App. LEXIS 9565 at \*16-17 (5th Cir. May 21, 2002) last month and flatly rejected them. There, as here, plaintiffs brought claims under Section 10(b) and Rule 10b-5 based upon alleged accounting irregularities against officers and directors of Baker Hughes. *See id.* at \*4-5. Like the consolidated complaint here, the complaint in *Abrams* failed to allege any specific facts showing that any of the officers or directors were aware of the alleged accounting irregularities. *See id.* at \*16-17. Based on these deficiencies, the district court dismissed the complaint, and the Fifth Circuit affirmed:

Plaintiffs point to no allegations that the defendants *knew* about the internal control problems, only that they *should have known or that their lack of knowledge based on their corporate positions demonstrates recklessness*. A pleading of scienter may not rest on the inference that defendants *must have been aware of the misstatement based on their positions within the company*.

... *An unsupported general claim about the existence of confidential corporate reports that reveal information contrary to reported accounts is insufficient* to survive a motion to dismiss. Such allegations must have corroborating details regarding the contents of allegedly contrary reports, their authors and recipients. Also, the mere publication of inaccurate accounting figures or failure to follow GAAP, without more, does not establish scienter. The party must know that it is publishing materially false information, or must be severely reckless in publishing such information. The plaintiffs point to no specific internal or external report available at the time of the alleged misstatements that would contradict them.

*Id.*, at \*15-17 (footnotes omitted).

Plaintiffs' consolidated complaint is similarly deficient. Setting aside the fact that plaintiffs' entire consolidated complaint is comprised of "unsupported general claim[s]" about the existence of information contrary to corporate reports, *see id.*, the complaint does not contain a single allegation that Mr. Skilling: (1) knew about any of the allegedly "undisclosed factors"; (2) knew that any statement he made concerning Enron's performance or future business prospects was false when made; or (3) was severely reckless in not knowing either of the former.

Absent such specific allegations, plaintiffs have failed to plead any facts supporting a strong inference of scienter with respect to Mr. Skilling. *See id.*

Finally, plaintiffs' new allegations set forth in their Opposition suffer from the same terminal case of group-pleaditis as their Complaint. As demonstrated in Mr. Skilling's Opening Brief, a plaintiff cannot satisfy its burden of pleading a strong inference of scienter by resorting to group allegations. (See Skilling Br. at 77-79 and cases cited therein.) Yet, all that plaintiffs can point to in their opposition as support for any inference of scienter are precisely the sort of group-pled allegations that courts have consistently found insufficient. (See Pl. Opp'n Br. at 98-103.) For instance, plaintiffs claim that "internal complaints made to Insiders—about accounting practices—for one, failing EES contracts, for another, and snowballing costs, for a third" demonstrate severe recklessness sufficient to support scienter. (See Pl. Opp'n Br. at 101.) However, plaintiffs fail to cite a single "internal complaint" made to Mr. Skilling, from which knowledge or severe specific recklessness could be inferred. (*See id.*) Similarly, as set forth in detail above, plaintiffs cite a litany of "undisclosed factors affecting Enron's contracts and core businesses . . . that support a strong inference of scienter." *See supra.* But all of these allegations are inappropriately group-pled as well and insufficient to support any inference of scienter as against Mr. Skilling. The total dearth of any specific allegations concerning Mr. Skilling necessitates dismissal of the consolidated complaint for failure to adequately plead scienter.

**B. MR. SKILLING'S PATTERN OF TRADING ACTIVITY IS NOT "UNUSUAL" SO AS TO CREATE A STRONG INFERENCE OF SCIENTER.**

Aside from the fact that Mr. Skilling was an officer and director at Enron, the only other fact that plaintiffs cite as support for a strong inference of scienter is that he sold some portion of his Enron stock during the putative class period. Plaintiffs summarily assert—based solely upon the "expert" opinions provided by Hakala—that such sales were unusual and support a strong

inference of scienter. As demonstrated in our Opening Brief, Mr. Skilling's pattern of trading activity was not the type of trading activity from which scienter could properly be inferred. (Skilling Br. at 62-74.)

Ignoring many of the arguments in the Opening Brief, plaintiffs contend that a strong inference of scienter is appropriate based on the following factors: (1) inclusion of the Hakala Declaration in the consolidated complaint was appropriate and should have been considered; (2) plaintiffs have adequately accounted for Mr. Skilling's pre-class period sales; (3) trades made by Mr. Skilling pursuant to his 10b5-1 plan are not entitled to the statutory presumption; (4) the fact that Mr. Skilling retained a large portion of his stock does not undercut an inference of scienter; and (5) Mr. Skilling's explanation of the dividend, diversification and tax implications that drove his trading patterns do not undermine an inference of scienter. However, none of plaintiffs' arguments are supported by either the allegations in the consolidated complaint or applicable law. Rather, when stripped of rhetoric and baseless arguments, all plaintiffs have pleaded are conclusory allegations that Mr. Skilling's trading pattern was "clearly unusual." (Pl. Opp'n Br. at 132-33.) Such conclusory allegations of insider trading are insufficient to give rise to a strong inference of scienter. *See In re Securities Litigation BMC Software, Inc.*, 183 F. Supp. 2d 860, 901 (S.D. Tex. 2001).

**1. PLAINTIFFS' RELIANCE ON THE HAKALA DECLARATION IS INAPPROPRIATE AND INEFFECTIVE.**

In his Opening Brief, Mr. Skilling demonstrated in detail why plaintiffs' inclusion of the Hakala Declaration in the consolidated complaint was, as a matter of law, inappropriate, why the declaration itself was analytically flawed, and why the Court should simply strike the declaration. Specifically, the brief demonstrated that "a plaintiff must plead *specific facts, not mere conclusory allegations.*" *Tuchman*, 14 F.3d at 1067 (emphasis added) (quoting *Guidry v.*

*Bank of LaPlace*, 954 F.2d 278, 281 (5th Cir. 1992), and the Hakala Declaration is nothing more than the untested view of someone claiming to be an expert in the area covered by the opinions he has been hired to provide. *Cf. DeMarco v. Depotech Corp.*, 149 F. Supp. 2d 1212, 1220-22 (S.D. Cal. 2001).

In opposition, plaintiffs respond with what amounts to an opposition to a *Daubert* motion contending that: (1) the Hakala Declaration provides relevant circumstantial evidence of scienter; and (2) statistical demonstrations of intent as supported by the methodology on which the Hakala Declaration is based are proper and accepted. (*See* Pl. Opp'n Br. at 110-112.) But, plaintiffs' attempt to defend the Hakala Declaration on *Daubert* grounds merely underscores that the Declaration is an **expert opinion**, not specific well-pled factual allegations (as plaintiffs argue).

Reliance on expert testimony at the pleading stage is inappropriate. In fact, the only court to address the issue soundly rejected a virtually identical attempt by the same counsel currently representing plaintiffs here. *See DeMarco*, 149 F. Supp. 2d at 1220-22. Plaintiffs have not cited a single case that reaches a result different than *Demarco*. Claiming that the Hakala Declaration provides relevant circumstantial evidence of scienter, plaintiffs cite several cases, none of which supports the proposition that reliance on expert opinion in a securities case at the pleading stage is appropriate. For instance, plaintiffs cite a group of cases for the unremarkable proposition that motions to strike **factual allegations** contained in a complaint are viewed with disfavor.<sup>65</sup> However, none of plaintiffs' cases address the issue of whether it is appropriate for

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<sup>65</sup> *See, e.g., Lazar v. Trans Union LLC*, 195 F.R.D. 665, 669 (C.D. Cal. 2000) (denying motion to strike **factual allegations** contained in a complaint alleging breach of contract based on the fact that the events described in the complaint occurred prior to the statute of limitations imposed by the Fair Credit Reporting Act); *In re Gaming Lottery Securities Litigation*, No. 96 Civ. 5567, 1998 U.S Dist. LEXIS 7926, at \*26 (S.D.N.Y. May 27, 1998) (granting defendants' motion to strike the **factual allegation** from paragraph 59 of the complaint that a fire was reportedly the result of arson since the allegation was irrelevant to the claims and unfounded); *LeDuc v. Kentucky Central Life Insurance Co.*, 814 F. Supp. 820, 830 (N.D. Cal. 1992) (granting in part defendants' motion to strike **factual allegations** contained in a complaint alleging fraudulent investment practices stating that plaintiff "believe[d] that certain members of [the Board] ... may have engaged in improper and unlawful actions" because it

the Court to strike an *expert opinion* from a complaint alleging violations of Section 10(b) and Rule 10b-5 of the Exchange Act. This omission is particularly glaring in light of the fact that the PSLRA and Federal Rule of Civil Procedure 9(b) require that a plaintiff “state with particularity *facts* giving rise to a strong inference that the defendant acted with the required state of mind.” 15 U.S.C. § 78u-4(b)(2) (emphasis added).

Plaintiffs also seek to support the Hakala Declaration with the claim that “[s]tatistical demonstrations of intent are well established in the law .... Hence, Insiders cannot possibly assert that the declaration ‘could have no possible bearing on the subject matter of the litigation.’”<sup>55</sup> (Pl. Opp’n Br. at 109-110.) However, the only cases that plaintiffs cite in stretching to find support for their novel proposition are Title VII and 42 U.S.C. § 1983 Section 1983 discrimination cases.<sup>66</sup> As this Court is aware, a complaint alleging discrimination under Title VII or Section 1983 need not allege the requisite mental state with particularity. *Swierkiewicz v. Sorema, N.A.*, 122 S. Ct. 992, 998 (2001) By comparison, to adequately allege scienter as an element of a claim under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, a plaintiff must “state with *particularity facts* giving rise to a strong inference that the defendant acted with the required state of mind.” 15 U.S.C. § 78u-4(b)(2) (emphasis added).

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was framed as a question and the language was part of a longer allegation that cites specific acts of misconduct by the board); *Lentz v. Woolley*, No. 89-0805, 1989 WL 91148 (C.D. Cal. 1989) (denying motion to strike statement of jury’s findings from prior litigation in a RICO and securities fraud complaint since the *allegations* were relevant to the issue of a pattern of racketeering conduct); *Magnavox Co. v. APF Electronics, Inc.*, 496 F. Supp. 29, 35-36 (N.D. Ill. 1980) (granting in part, defendants’ motion to strike three counts contained in a patent infringement complaint as irrelevant).

Moreover, three of these decisions actually granted the defendants’ motions to strike various portions of the complaints at issue. See *In re Gaming Lottery Securities Litigation*, 1998 U.S. Dist. LEXIS 7926, at \*26; *LeDuc v. Kentucky Central Life Ins. Co.*, 814 F. Supp. at 830; *Magnavox Co.*, 496 F. Supp. at 35-36. Thus, where appropriate, the court will grant such a motion to strike.

<sup>66</sup> See, e.g., *Mayor of Philadelphia v. Education Equality League*, 415 U.S. 605, 620 (1974) (finding that statistical analyses serve an important role as one indirect indicator of racial discrimination); *McDonnell Douglas Corp. v. Green*, 411 U.S. 792, 805 (1973) (finding statistics as to a petitioner’s employment policy and practice may be helpful to determination of whether petitioner’s refusal to hire respondent conformed to general pattern of discrimination); *Turner v. Fouche*, 396 U.S. 346, 360-361 (1970) (same); *United States v. Ironworkers Local 86*, 443 F.2d 544, 551 (9th Cir. 1971) (same).

This fundamental difference between the pleading standards for scienter and the standard for pleading intent in a discrimination case renders plaintiffs' analogy meaningless.

**2. COMPARISON OF MR. SKILLING'S SALES OF ENRON STOCK WITH SALES MADE DURING THE CLASS PERIOD DOES NOT PERMIT A STRONG INFERENCE OF SCIENTER.**

Plaintiffs also seek to bolster their baseless contention that Mr. Skilling's trading was "unusual" by claiming that Mr. Skilling's "pre-Class Period sales were dwarfed by [his] Class-Period sales." (Pl. Opp'n Br. at 114.) Plaintiffs ignore the most significant facts and overwhelming number of cases that have held that trading patterns similar to Mr. Skilling's do not support a strong inference of scienter.

The vast majority of the options and stock received by Mr. Skilling as compensation was received during the class period. (Skilling Br. at 69-71.) Moreover, many of the options that Mr. Skilling received before the class period did not vest until the class period. (*See id.*) Consequently, the mere fact that Mr. Skilling's sales during the class period were larger than his sales prior to the class period is meaningless. Obviously, an insider cannot exercise options that have not yet vested, or sell stock that he does not yet possess. Thus, any comparison between Mr. Skilling's pre-class period sales and those sales made during the class-period cannot be probative of scienter.

Moreover, where, as here, an insider does not possess any meaningful pre-class trading history, then no inference of scienter can be drawn by comparing pre-class sales with those made during the class period. *See* Skilling Br. at 73-74 (collecting cases).

**3. SALES MADE PURSUANT TO MR. SKILLING'S 10B5-1 PLAN CANNOT SUPPORT A STRONG INFERENCE OF SCIENTER.**

Mr. Skilling's Opening Brief demonstrated how a large portion of his sales were made pursuant to a statutorily protected 10b5-1 plan. (*See* Skilling Br. at 71-72.) The Opening Brief

further cited authority for the proposition that such sales cannot provide a basis for a strong inference of scienter. *See, e.g., Miller v. Pezzani (In re Worlds of Wonder Securities Litigation)*, 35 F.3d 1407, 1427-28 (9th Cir. 1994) (finding no scienter where sales were made pursuant to predetermined plan in accordance with SEC Rule 144).

In opposition, plaintiffs allege in conclusory terms that at the time he adopted his 10b5-1 program, Mr. Skilling was “already in the midst of pursuing a fraudulent scheme and course of business” and therefore was not entitled to the statutory protection.

((Pl. Opp’n Br. at 124-25) (citations in original).)

In fact, the argument is nothing more than a baseless attempt to bootstrap sales made pursuant to a protected plan into evidence of scienter. If a civil plaintiff could use sales made pursuant to a protected plan as evidence of scienter by alleging that there was a fraud in progress at the time the plans were created, the protection of a 10b5-1 plan would be meaningless. Congress certainly did not intend such circular reasoning to undermine 10b5-1(c)(1)(i)(A). The logic behind allowing a plaintiff to rely on stock sales to raise an inference of scienter is that an individual defendant, while in possession of material, negative nonpublic information would likely sell as much of his stock as he could. The fact that Mr. Skilling set up a plan that only sold 10,000 shares a week—a number that would guarantee he never really dipped below what he would be acquiring through stock option grants each year—is inconsistent with any inference of scienter.

Moreover, a 10b5-1 plan can be terminated or changed. *See* 10b5-1(c)(1)(i)(A). Mr. Skilling never changed his plan to increase the number of shares he was selling. If, as plaintiffs contend, Mr. Skilling knew that the ship was sinking, and his stock sales can be indicative of scienter, he would undoubtedly have increased the number of shares that he was selling pursuant to his plan. Yet he did not. Finally, the fact that Mr. Skilling terminated his 10b5-1 plan in June

of 2001, is completely inconsistent with any inference of scienter. Rather, the only rational inference that can be drawn from such a fact is that Mr. Skilling believed that Enron stock was undervalued at the time, and he wanted to hold it, instead of selling.

In fact, the reality of Mr. Skilling's trading pattern is that he locked himself into a 10b5-1 plan that guaranteed he would always hold about a million shares of Enron. (Skilling Br. at 74-80.) As demonstrated in his opening brief, from the middle of 1999--when Mr. Skilling's Enron holding first topped more than 1,000,000 shares--until he left Enron, Mr. Skilling maintained a consistent net long position in actual shares of Enron stock of over one million shares. (*See id.*) Mr. Skilling's selling pattern from 1999 to 2001 shows that he was exercising options and selling shares at about the same rate that he was acquiring new shares and new options were vesting. (*See id.*) Such a pattern is completely inconsistent with any inference of scienter, let alone a strong inference.

**4. THE FACT THAT MR. SKILLING RETAINED FIFTY-EIGHT PERCENT OF HIS ENRON HOLDINGS AT THE TIME HE LEFT THE COMPANY REBUTS ANY INFERENCE OF SCIENTER.**

In his Opening Brief, Mr. Skilling demonstrated how the fact that he retained substantial holdings in Enron also rebuts any inference of scienter. (*See* Skilling Br. at 74 (citing *San Leandro Emergency Med. Group Profit Sharing Plan v. Philip Morris Cos.*, 75 F.3d 801, 813-14 (2d Cir. 1996) (where insiders retain substantial holdings, inference of scienter is inappropriate).) In response, plaintiffs rely exclusively on *Florida State Board of Administration v. Green Tree Financial Corp.*, 270 F.3d 645, 665 (8th Cir. 2001) to support their contention that "the mere fact that some Insiders ... retained portions of their shares when Enron filed for bankruptcy does not undercut the strong inference of scienter." However, plaintiffs' position is disingenuous at best. As the Eighth Circuit made clear, the *Green Tree* plaintiffs did not

seek to establish the defendants' scienter based upon historical stock trading patterns. *See Fla. State Bd. Of Admin.*, 270 F.3d at 663. In fact, "the complaints [did] not [even] allege that the executives sold their stock during the class periods," and the plaintiffs actually sought to exclude executive's stock transactions as "outside the four corners of the complaints and ... therefore not to be considered on a motion to dismiss." *See id.* Rather, the *Green Tree* plaintiffs sought an inference of scienter based upon a variety of other facts, none of which are present here.

Here, the *only* scienter allegation that plaintiffs have made against Mr. Skilling, individually, is that his trading in Enron stock was "unusual." *Green Tree* simply does not address such a scenario at all. Moreover, as *San Leandro*, makes clear, where a plaintiff seeks to establish a strong inference of scienter based upon an insider's trading in the company stock, the fact that the insider retained substantial holdings severely undercuts any such inference. *San Leandro*, 75 F.3d at 813-14. Consequently, the fact Mr. Skilling retained more than a million shares in Enron through his departure from the company and continues to hold a significant number of shares today rebuts any permissible inference of scienter.

**5. PLAINTIFFS HAVE NOT, AND CANNOT, REFUTE THAT WEALTH DIVERSIFICATION AND INCOME TAX IMPLICATIONS WERE THE PRIMARY FACTOR THAT DROVE MR. SKILLING'S TRADING PATTERNS.**

Mr. Skilling also set forth in his Opening Brief a thorough explanation of how wealth diversification and capital gains tax implications were the driving force behind his trading, not the use of inside information. (Skilling Br. at 65-68.) Plaintiffs' sole contention in opposition is set forth in the same unsupported conclusory terms endemic to its complaint:

Whether or not this argument has merit is beside the point. Skilling's entire theory hinges on an assumption that is inapplicable to him. Skilling assumes that the individual exercising the options is able to take advantage of the long-term capital gains tax that

kicks in at one year; Skilling was not such an individual. Therefore Skilling did not exercise his options to take advantage of this hypothetical tax advantage.

(Pl. Opp'n Br. at 132-33.)

Curiously, plaintiffs seem to imply that the tax code provisions cited in Mr. Skilling's Opening Brief somehow fail to apply to Mr. Skilling. However, plaintiffs cite no statute, regulation, or case to support their contention. We are unaware of any provision that requires Mr. Skilling to have his taxes treated differently than those of every other American citizen. In the absence of such authority, plaintiffs' unsubstantiated argument should be disregarded.

**6. MR. SKILLING'S TRADES OF ENRON STOCK SIMPLY WERE NOT UNUSUAL.**

There is simply nothing in either the consolidated complaint or plaintiffs' opposition brief from which one could conclude that Mr. Skilling's trading pattern or trading history was unusual. As demonstrated in detail in his Opening Brief: (1) Mr. Skilling did not sell an unusually large portion of his Enron holdings; (2) his trading pattern evidences a rational desire to liquidate some of his Enron holdings and diversify his personal holdings, while still maintaining a substantial position in Enron's securities; and (3) Mr. Skilling retained a large portion of his Enron holdings through the company's bankruptcy filing. (*See* Skilling Br. at 62-74.)

Neither the consolidated complaint nor plaintiffs' opposition brief refutes any of these facts. Moreover, neither filing explains how a strong inference of scienter is appropriate in light of these facts. Instead plaintiffs flatly assert, without any support, that Mr. Skilling's trading pattern was clearly suspicious. (Pl. Opp'n Br. at 133.) But nothing could be further from the truth, as demonstrated from the trading history described in the Opening Brief. Specifically, from July 1999 through his departure from Enron, Mr. Skilling's net long position in Enron stock remained relatively stable, and never fell below one million shares after achieving that level in

1999. (*See Skilling Br. at 70.*) Mr. Skilling's selling pattern from 1999 to 2001 shows that he was exercising options and selling shares at about the same rate that he was acquiring new shares and new options were vesting. (*See id.*) Such a regular pattern is simply not the sort of unusual trading that permits an inference as a matter of law. (*See Skilling Br. at 70 (collecting cases).*)

**VI. PLAINTIFFS' CLAIM UNDER SECTION 20A OF THE EXCHANGE ACT FAILS BECAUSE THERE IS NO PREDICATE VIOLATION.**

As Mr. Skilling correctly asserted in his opening brief, a claim under Section 20A of the Exchange Act cannot survive where plaintiffs have failed to adequately plead an underlying violation of the Exchange Act. *In re Cendant Corp. Litig.*, 60 F. Supp. 2d 354, 378 (D.N.J. 1999). Plaintiffs' response is that they have adequately pleaded a predicate claim under Section 10(b) and Rule 10b-5. However, none of the twenty-nine paragraphs of the NCC which plaintiffs cite in their opposition as support for their 10(b) and derivative 20A claim, nor the remainder of the complaint, contains any specific allegations as to what material non-public information Mr. Skilling knew and how Mr. Skilling acted with scienter when selling a fraction of his Enron stock. For example, plaintiffs argue that paragraph 83(b) is one of the many portions of the complaint which details Mr. Skilling's trading on the basis of material non-public information. However, paragraph 83(b) demonstrates precisely the *inadequacies* of plaintiffs' pleading: "During the Class Period, while in possession of adverse undisclosed information about the Company, Skilling sold 1,307,678 shares of his Enron stock \$70,687,199 in illegal insider trading proceeds. . . ." Without alleging specifically *what* material non-public information Mr. Skilling possessed, plaintiffs have failed to plead a prima facie case for a 10(b) violation. *See United States v. O'Hagan*, 521 U.S. 642, 649 (1997) (listing elements of a prima facie case under Section 10(b) and Rule 10b-5). Hence, plaintiffs' Section 20A claim fails as well.

**VII. PLAINTIFFS AVOID ADDRESSING DISPOSITIVE ISSUES WITH RESPECT TO SECTION 11.**

**A. PLAINTIFFS' ALLEGATIONS PLEAD AN AFFIRMATIVE DEFENSE FOR MR. SKILLING AND THEREFORE MANDATE DISMISSAL.**

Plaintiffs failed to address Mr. Skilling's argument that the plaintiffs pled facts that established an affirmative defense for any § 11 liability with respect to Mr. Skilling. Because the plaintiffs fail to conclusively demonstrate that Mr. Skilling is entitled to an affirmative defense, their claims against him should be dismissed. (Skilling Br. at 82-87.) Erroneously, plaintiffs assert that Mr. Skilling's reliance on expertized opinions is merely an affirmative defense that cannot be resolved at the pleading stage. (Pl. Opp'n Br. at 151.) While reliance on expertized opinions is indeed an affirmative defense, when the complaint itself pleads the affirmative defense, as a matter of law, dismissal of the claim is appropriate. (*See* Skilling Br. at 8.) Not surprisingly, plaintiffs are silent on this point.

Under §11, a showing of due diligence or reliance on expertized opinion in connection with the registration statement avoids liability for a non-expert, non-issuer signatory, or director, such as Mr. Skilling, and provides an affirmative defense barring relief. 15 U.S.C. § 77k (b)-(c)(3)(c); *see also* (Skilling Br. at 83 (collecting cases).) Throughout their complaint, plaintiffs provide extensive support for Mr. Skilling's reasonable reliance on the expert authority of Arthur Andersen and Vinson & Elkins with respect to the financial disclosures in the registration statements. (*See, e.g.*, NCC ¶¶ 897, 899, 903-904.) Plaintiffs fail to aver a single fact demonstrating that Mr. Skilling had no reasonable basis to believe that such financial statements were untrue or that his reliance on Arthur Andersen was unreasonable. Similarly, plaintiffs fail to rebut the established line of cases (Skilling Br. at 83) barring claims where the affirmative defense is pled in plaintiffs' Complaint. Here, plaintiffs' own allegations establish that their Section 11 claim against Mr. Skilling is barred by the affirmative defense of reliance on

expertized reports. Since plaintiffs have successfully pled Mr. Skilling's affirmative defense to Section 11 liability for him, this Court should dismiss that claim. *See* cases cited *supra*.

**B. PLAINTIFFS FAIL TO ALLEGE PARTICULAR FACTS SHOWING THAT THE REGISTRATION STATEMENT CONTAINED A FALSE STATEMENT.**

Plaintiffs' pleadings with respect to their §11 claims must also fail because they do not meet the particularity requirements of Rule 9(b). "[W]here §11 claims sound in fraud rather than negligence, the plaintiff is required to plead the circumstances constituting the alleged fraud with particularity under Rule 9(b)." *In re Landry's Seafood Restaurant, Inc. Securities Litigation*, Civ. No. H-99-1948, slip op., at 59 (S.D. Tex. 2001) (*citing Melder v. Morris*, 27 F.3d 1097, 1100 n.6 (5th Cir. 1994) ("When 1933 Securities Act claims are grounded in fraud rather than negligence ... Rule 9(b) applies"; because plaintiffs' complaint contained a "wholesale adoption of the allegations under the securities fraud claims for purposes of the Securities Act claim," such claims were dismissed for failure to satisfy Rule 9(b)); *In re Stac Electronics Securities Litigation*, 89 F.3d 1399, 1404-05 (9th Cir. 1996); *Shapiro v. UJB Fin. Corp.*, 964 F.2d 272, 288 (3d Cir. 1992); *Sears v. Likens*, 912 F.2d 889, 892-893 (7th Cir. 1990).

Plaintiffs have attempted to avoid *Melder* by arguing that they have carefully pleaded their Section 11 claim so that it sounds in negligence, rather than fraud. (Pl. Opp'n Br. at 146-147; NCC ¶1005.) However, the allegations in their complaint belie their representation that they have "disclaim[ed] any allegation that could be construed as alleging fraud or intentional or reckless misconduct." (*Id.*) Indeed, the complaint specifically alleges that the Registration Statements were false. (NCC ¶¶ 612-641.) And, while in their § 11 claim, plaintiffs avoid assigning knowledge to potential §11 defendants in connection with the Registration Statements, (*id.*) the core of the allegations in plaintiffs' complaint is that these same defendants allegedly knew of the precise issues that made the Registration Statements false and misleading. (NCC ¶¶

395-417.) The same allegations of knowledge leveled at bankers and lawyers (non-§11 defendants) with respect to the Registration Statements, (NCC ¶¶612-641), are leveled against the §11 defendants in the scienter sections, (NCC ¶¶ 395-417). Therefore, while plaintiffs have purportedly disclaimed allegations of fraud with respect to §11 claims, “[t]hese nominal efforts are unconvincing where the gravamen of the complaint is plainly fraud and no effort is made to show any other basis of the claims levied at the Prospectus.” *In re Stac Electronics Securities Litigation*, 89 F.3d 1399, 1405 n.2 (9th Cir. 1996) (holding that when the §11 claims are grounded in fraud rather than negligence the pleading requirements of Rule 9(b) apply).

**VIII. PLAINTIFFS HAVE FAILED TO STATE A CLAIM FOR CONTROLLING PERSON LIABILITY.**

Rather than respond to the three arguments raised in Mr. Skilling’s Motion to Dismiss that were clearly dispositive of plaintiffs’ Sections 15 and 20(a) claims for controlling person liability, plaintiffs reject the mere notion of his challenging their allegations as “comical.” (Pl. Opp’n Br. at 154.) Far from comical, Mr. Skilling raised dispositive legal issues demonstrating that dismissal is appropriate, and plaintiffs responded with a resounding silence.

**A. SINCE PLAINTIFFS ASSERT PRIMARY LIABILITY AGAINST MR. SKILLING, A CONTROL PERSON CLAIM IS NOT AVAILABLE AND DISMISSAL IS MANDATED.**

Plaintiffs do not challenge that as a matter of law, control person liability cannot be asserted against a defendant, such as Mr. Skilling, who has also been charged with a primary violation of the derivative section. (Skilling Br. at 91-92.) Claims of primary liability and secondary liability are mutually exclusive. Put differently, a plaintiff alleging primary violations against a defendant cannot supplement or tack on claims for secondary liability against the defendant. *Lemmer v. Nu-Kote Holding, Inc.*, 2001 U.S. Dist. LEXIS 13978, at \*41-42 (N.D. Tex. 2001) (Where plaintiffs claimed both §10(b) and §20(a) liability against the Chairman and

CEO of Nu-Kote, David Brigante, the Court found that since primary liability had already been pled against Mr. Brigante, he was entitled to dismissal of the §20(a) claim.) (*citing Kalnit v. Eichler*, 85 F. Supp. 2d 232, 246 (S.D.N.Y. 1999) (Because the individual Directors of MediaOne were alleged to be primary violators under §10(b), plaintiffs' §20(a) claim had to be dismissed as a matter of law.)). Because plaintiffs chose to assert §11 and §10(b) claims *directly* against Mr. Skilling, they are precluded from asserting claims against him pursuant to § 15 and §20(a) as well. *Lemmer*, 2001 U.S. Dist. LEXIS 13978, \*42.

**B. PLAINTIFFS FAIL TO MAKE *PRIMA FACIE* CASE FOR LIABILITY.**

In their opposition, plaintiffs fail to explain how their complaint satisfactorily pleads control person liability. To establish a *prima facie* case of liability under either §15 or the Securities Act or §20(a) of the Exchange Act, plaintiffs must show (1) a primary violation of the federal securities laws and (2) that the alleged controlling person possessed, directly or indirectly, the power to direct or cause the direction of management and policies of the individual allegedly liable for the primary violation. Plaintiffs have not adequately shown that anyone was a primary violator of the federal securities law, nor have they identified the person(s) that Mr. Skilling allegedly controlled. This is an unavoidable, unwaivable requirement. *See In re Blech Securities Litigation*, 961 F. Supp. 569, 586-87 (S.D.N.Y. 1997). Merely pleading a defendant's status as an officer and director to establish control under §15 or §20(a) is not enough. *See Dennis v. General Imaging, Inc.*, 918 F.2d 496, 509 (5th Cir. 1990) (A defendant's "status alone [as director] will not automatically cause [the defendant] to be deemed a Section 15 or 20 controlling person."). Likewise, allegations that the defendant owns stock do not state a claim for controlling person liability. *See id. Dennis v. General Imaging, Inc.*, 918 F.2d 496 (5th Cir. 1990) (minority shareholder status insufficient). Because plaintiffs have done no more than this, their claim should be dismissed.

**C. PLAINTIFFS PLEAD MR. SKILLING'S AFFIRMATIVE DEFENSE AND THEREFORE DISMISSAL IS MANDATED.**

Finally, plaintiffs fail to rebut Mr. Skilling's argument that a defendant can avoid liability as a control person by affirmatively proving good faith. (*See Skilling Br.* at 89-91.) The allegation in plaintiffs' complaint with respect to Arthur Andersen's representations regarding the adequacy of Enron's system of controls conclusively establish Mr. Skilling's good faith. Based upon Arthur Andersen's unqualified certifications as pled in plaintiffs own complaint, Mr. Skilling had no reasonable grounds to believe that any of Enron's system of controls was anything but proper. Where, as here, plaintiffs allege facts within their own document that support a defendant's affirmative defense, dismissal is appropriate. *Kaiser Aluminum & Chemical Sales, Inc. v. Avondale Shipyards, Inc.*, 677 F.2d 1045, 1050 (5th Cir. 1982) (A complaint that shows relief would be barred by an affirmative defense is subject to dismissal for failure to state a cause of action.) Plaintiffs fail to rebut this argument in their Opposition. Accordingly, plaintiffs §§15 and 20(a) claims against Mr. Skilling should be dismissed.

**IX. PLAINTIFFS HAVE OFFERED NO VALID REASON WHY THEIR CLAIMS UNDER THE TEXAS SECURITIES ACT SHOULD NOT BE DISMISSED.**

Plaintiffs' attempt to rebut the reasons for dismissing their Texas Securities Act ("TSA") claim by ignoring the important distinctions between Article 581-33A, which defines direct liability under the TSA, and Article 581-33F, which defines aider and abettor liability. In so doing, plaintiffs have distorted the fundamental nature of the TSA as amended in 1977, have relied on case law that was expressly rejected by the Texas legislature, and have conceded the very arguments made in Mr. Skilling's Motion to Dismiss. The text of the TSA, the legislative history which enacted that text, and case law interpreting it, all reveal plaintiffs' arguments as wrong, both legally and logically.

**A. PLAINTIFFS' ARGUMENTS REGARDING THE TEXAS SECURITIES ACT MISREPRESENT THE LAW.**

The NCC makes a generalized claim against Mr. Skilling under the TSA, citing Article 581-33. Liability under the TSA against an individual actor, however, attaches in only two ways: Direct liability under Article 581-33A(2), or liability for aiding and abetting a violation of the act under Article 581-33F(2). These two provisions have *critical distinctions*. Article 581-33A(2) provides liability for the fraudulent acts of “a person who *offers or sells* a security” without regard to intent or recklessness of the actor. In other words, 581-33A(2) provides direct liability of a “seller” without the necessity of showing scienter. By contrast, Article 581-33F(2) imposes liability on a person who, “*with intent ... materially aids* a seller, buyer, or issuer” in defrauding investors. Although Article 581-33F(2) broadens the scope of potential defendants by including non-sellers, unlike 581-33A(2), it requires a showing of intent. As Mr. Skilling’s Opening Brief sets forth in detail (*see* Skilling Br. at 92-98), plaintiffs failed to allege liability under either of these subsections of the TSA.

Plaintiffs’ rebuttal, however, carelessly or disingenuously disregards these obvious distinctions in the law, and does nothing to substantively defend their allegations as they apply to either subsection. Unable to garner logical support for their claims, plaintiffs instead appear to suggest that the court conflate both 581-33A and 581-33F to allow persons tangentially involved in the offering process to be held directly liable without any allegation, much less a showing, of scienter—thus allowing the broader pool of remote defendants, potentially liable for aiding and abetting, to be subject to liability under the less stringent standards set for primary actors. (*See* Pl. Opp’n Br. at 154-156.)

Plaintiffs attempt to support their argument that the NCC adequately pleads a claim against Mr. Skilling under the TSA by asserting that a narrow definition of “seller” under the

TSA is contrary to legislative history, the purpose of the act, and the case law interpreting it. (*Id.*) However, 581-33A(2), which governs claims of direct liability against defendants, does *not* construe the term “sellers” to encompass those who are alleged to have merely participated in the preparation of an offering. As set forth in detail in Mr. Skilling’s Opening Brief at 92-95, the 1977 amendments to the TSA expressly rejected a broad definition of “seller” under 581-33A. “[T]he TSA [is limited] to those who are actively engaged in the sale process and [does not] reach[] those who merely participate in preparing an offering.” *Huddleston v. Herman & MacLean*, 640 F.2d 534, 551 (5th Cir. 1981), *aff’d in part and remanded on other grounds*, 459 U.S. 375 (1983); *see also Marshall v. Quinn-L Equities, Inc.*, 704 F. Supp. 1384, 1389-91 (N.D. Tex. 1988); Skilling Br. at 93-95.

The opposition brief does little to refute this established legal principle. Plaintiffs cite to a pre-amendment Texas appellate court decision that relies on *Brown v. Cole*, 155 Tex. 624 (1956), for the proposition that “seller” is to be interpreted broadly.<sup>67</sup> They also claim that a narrow interpretation of the term under the TSA would “render not only the language of the [TSA] meaningless, but limit the reach of the statute in direct contradiction of the Texas’ [*sic*] legislature’s intent.”<sup>68</sup> Yet, plaintiffs entirely ignore the fact that the Texas legislature, in amending the TSA in 1977 rejected *Brown* and explained that the legislature, in considering whether and to what extent to hold remote defendants liable, had added section 581-33F to subject remote actors to liability only in appropriate circumstances:

Old § 33A allowed recovery only from “any person who sells.” ... [T]he phrase would presumably be broadly construed, *see Brown v. Cole*, 155 Tex. 652, 291 S.W.2d 704, 59 ALR 2d 1011 (1956).... In any event, ***Brown v Cole should have no application to the new law, since § 33F provides quite specifically who,***

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<sup>67</sup> See Pl. Opp’n Br. at 155.

<sup>68</sup> *Id.*

*besides a person who buys or sells, is liable, and the criteria for such liability.*

Tex. Rev. Civ. Stat. Ann. art. 581-33, cmt. (Vernon Supp. 1998) (emphasis added).

Plaintiffs seek to rely on cases interpreting *581-33F*, *not 581-33A*, to support their erroneous argument that subsequent to the 1977 amendments, remote actors in the offering process remained liable under the TSA. Plaintiffs have conveniently failed to make clear, however, that the 1977 amendments that added 581-33F retained liability for indirect actors *only upon a showing of intent to defraud or reckless disregard for the truth*.<sup>69</sup>

Plaintiffs' conflation of the two distinct subsections of 581-33 relevant to the individual defendants fails to offer any legal or logical rebuttal to the legal arguments that compel dismissal, as set forth in Mr. Skilling's Opening Brief. Thus, for reasons set forth below, plaintiffs have failed to state a valid claim against Mr. Skilling under the prevailing legal standards of *either* 581-33A or 581-33F.

**B. PLAINTIFFS HAVE FAILED TO ALLEGE THE NECESSARY ELEMENTS OF A DIRECT LIABILITY CLAIM UNDER THE TEXAS SECURITIES ACT.**

**1. PLAINTIFFS CONCEDE THAT THEY HAVE FAILED TO ALLEGE THAT MR. SKILLING DIRECTLY OFFERED OR SOLD ENRON NOTES.**

As set forth above and in the Opening Brief, 581-33A provides liability only for those defendants who have been active participants in the sale or offering of the securities involved. *See, e.g., Marshall*, 704 F. Supp. at 1389-91; Skilling Br. at 94-95. The NCC's vague allegations that Mr. Skilling may have prepared, reviewed, or signed documents relating to the notes are

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<sup>69</sup> Plaintiffs' reliance on *Texas Capital Sec., Inc. v. Sandefer*, 58 S.W.3d 760 (Tex. App. 2001), is likewise misplaced. *See* Pl. Opp'n Br. at 155. *Texas Capital* addressed whether the term "seller" included "purchases of securities sold in public secondary markets" by a *broker and his brokerage firm*. Thus, unlike Mr. Skilling, the defendants in *Texas Capital* were not at most tangentially involved in the offering process, but rather were unarguably actively engaged in the selling process. *Tex. Capital Sec., Inc.*, 58 S.W.3d at 775-76. The court's analysis of whether these direct sellers were liable under the TSA for a sale in the secondary public market has no bearing on whether Mr. Skilling, as a defendant remote from the sale or offering, is liable under 581-33A.

insufficient to establish direct liability, even if true. *Marshall*, 704 F. Supp. at 1389-91; *see also*, *e.g.*, *Huddleston*, 640 F.2d at 551. Tellingly, the opposition brief does not even attempt to defend these vague allegations as adequate to demonstrate Mr. Skilling's direct and personal role in the sale of the subject securities, as necessary under the TSA.

**2. PLAINTIFFS HAVE FAILED TO ALLEGE THAT MR. SKILLING INDUCED THEM TO PURCHASE THE NOTES.**

Direct liability under the TSA also requires plaintiffs to allege that statements by the defendant induced the purchase of the securities involved. *See, e.g., Crescendo Investment, Inc. v. Brice*, 61 S.W.3d 465, 475 (Tex. App. 2001); *Skilling Br.* at 96. In their opposition brief, plaintiffs attempt to support this aspect of their claim by relying solely on the fact that at least certain allegedly fraudulent events took place prior to the purchase of the notes at issue.<sup>70</sup> They are still unable, however, to point to any paragraph in their 500 page complaint where they have alleged that any statement by Mr. Skilling induced them to purchase those notes.

Plaintiffs make conclusory assertions that because allegedly false statements were incorporated into the relevant Registration Statements, "it is quite clear that ... improper conduct ... induced [plaintiffs'] purchases."<sup>71</sup> Yet despite plaintiffs' conclusion, the mere allegation of the existence of a false statement does not also constitute an allegation of inducement. The holes in plaintiffs' claims could only be filled by allegations that plaintiffs heard or read those allegedly false statements *and* based their investment decision upon them. These holes, however, remain gaping and unfilled, and thus plaintiffs have failed to state a valid claim under the TSA.

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<sup>70</sup> *See* Pl. Opp'n Br. at 156-157.

<sup>71</sup> *See* Pl. Opp'n Br. at 157.

**3. PLAINTIFFS CONCEDE THAT THEY HAVE FAILED TO ALLEGE THE NECESSARY PRIVACY BETWEEN MR. SKILLING AND PLAINTIFFS.**

Privacy is also a necessary element of a claim under 581-33A. Tex. Rev. Civ. Stat. Ann. art. 581-33 cmt.; Skilling Br. at 97. Nevertheless, plaintiffs have not even attempted to argue that the NCC adequately pleads privacy as between Mr. Skilling (or any other defendant) and plaintiffs. Their failure to plead privacy alone justifies dismissal of their claim brought under 581-33A.

**C. PLAINTIFFS CONCEDE THAT THEY HAVE FAILED TO ALLEGE AIDER AND ABETTOR LIABILITY UNDER TEXAS SECURITIES ACT, ARTICLE 581-33F(2), WHICH CONTAINS A SCIENTER REQUIREMENT.**

As stated above, and set forth in detail in the Opening Brief, scienter is a necessary element of an aiding and abetting claim under the TSA. *See* Tex. Rev. Civ. Stat. Ann. art. 581-33F(2) & cmt.; Skilling Br. at 97-98. Plaintiffs do not, and cannot, refute the plain text of the statute, and, in fact, have repeatedly quoted case law that makes clear that a showing of intent to deceive or reckless disregard for the truth is essential for liability under 581-33F.<sup>72</sup> Despite their explicit acknowledgement of this necessary element, nowhere in the NCC have plaintiffs alleged the requisite scienter; nor did plaintiffs even attempt to argue that they had done so in their opposition brief. Without this basic and necessary allegation, their claim against Mr. Skilling under Article 581-33F of the TSA must be dismissed.

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<sup>72</sup> *See* Pl. Opp'n Br. at 157-158 (quoting *Frank v. Bear*, 11 S.W.3d 380, 384 (Tex. App. 2000) (“In order to establish [aiding and abetting] liability ... plaintiff must demonstrate ... that the alleged aider either a) intended to deceive plaintiff or b) acted with reckless disregard for the truth of the representations made by the primary violator.”)).

**D. PLAINTIFFS CONCEDE THAT THE COURT MAY DECLINE TO EXERCISE SUPPLEMENTAL JURISDICTION OVER THEIR TEXAS SECURITIES ACT CLAIMS.**

Plaintiffs do not contest this Court's authority, under 28 U.S.C. § 1367(c), to decline to exercise supplemental jurisdiction over their TSA claims in light of the failure of their federal securities law claims.

**X. CONCLUSION**

For all of the foregoing reasons, Jeffrey K. Skilling's Motion To Dismiss Consolidated Complaint For Failure To State A Cause of Action should be granted.

Date: June 24, 2002

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**Appendix A**  
**Chart of New Allegations Made Against Jeffrey K. Skilling In Plaintiffs' Opposition**

<b>New Allegations Raised By Plaintiffs*</b>	<b>Reasons Why These New Allegations Fail to State a Claim Against Mr. Skilling under §10(b)</b>
<p>1. The formation of Fastow-controlled Chewco in 11/97, making it possible for Enron to continue to transact business with JEDI and artificially inflate its reported results. ¶ 10 He approved of Fastow's participation in Chewco. Powers Report at 43.</p>	<p>Grossly misrepresents Powers Report. First, far from controlling Chewco, the Report does not conclude that Fastow had any role whatsoever in Chewco. Second, at the cite used by plaintiffs to support their characterizations of the Powers Report, the actual statement is that "Fastow told Enron employees that Jeffrey Skilling, then Enron's President and Chief Operating Officer ("COO") had approved his participation in Chewco as long as it would not have to be disclosed in Enron's proxy statement." Powers Report 43-44. There is no other support for Fastow's statement, nor does the Report adopt its factual allegations. Indeed, the Report notes that Mr. Skilling recalled Mr. Fastow proposing that members of Fastow's wife's family be allowed to act as outside investors to Chewco an idea which Mr. Skilling did not like. Powers Report at fn. 7.</p> <p>Even if it properly characterized the Powers Report, plaintiffs are alleging that Mr. Skilling's role as an officer and a Board member is sufficient to infer scienter because the Board approved a transaction which plaintiffs have alleged to be fraudulent. As a matter of law, the Fifth Circuit has held that a pleading of scienter cannot rest upon the inference that a defendant must have been aware of the alleged fraudulent act simply because of his management position. <i>Abrams v. Baker Hughes</i>, 2002 U.S. App. LEXIS 9565, *15-16 (5th Cir. 2002). To sufficiently plead scienter, plaintiffs must allege that Mr. Skilling knew, at the time of the approval, that such an arrangement was fraudulent. <i>Id.</i> Related party transactions are not improper, and without particularized allegations that Mr. Skilling was aware that the Chewco/JEDI arrangement was fraudulent at the time it was formed, plaintiffs have failed to state a claim.</p>

\* These allegations are taken, verbatim, from plaintiffs' Opposition. Opp. Br. at 64-65.

New Allegations Raised By Plaintiffs*	Reasons Why These New Allegations Fail to State a Claim Against Mr. Skilling under §10(b)
<p>2. Skilling knew that the \$2.8 billion purchase of Wessex Water and the establishment of Enron's global water business were not the result of careful risk analysis. ¶¶121(h), 155(n).</p>	<p>Contrary to plaintiff's implication, the paragraphs of the NCC to which they cite <i>do not</i> allege that Mr. Skilling knew the Wessex purchase was improperly vetted. In fact, the only mention of Mr. Skilling in either of those paragraphs is in reference to the allegation that Ms. Mark-Jubasche headed Enron's International business after she lost corporate favor to Mr. Skilling. <i>See</i> NCC ¶121(h). Moreover, paragraph, NCC ¶155(n), to which they cite for support, makes no mention of Mr. Skilling whatsoever. Finally, neither paragraph alleges that Mr. Skilling knew that Wessex Water was allegedly purchased without proper risk analysis. These allegations fail to state a claim under §10(b).</p>
<p>3. He was a senior member of management responsible for the LJM relationship, and he approved of and participated in the presentation of LJM1 to the Board on 6/28/99. Powers Report at 20, 69.</p>	<p>Plaintiffs again are alleging that because of Mr. Skilling's management role, and because, as a Board member he approved a relationship which plaintiffs allege was later involved in fraud, that his scienter can be inferred. It can not. <i>Abrams v. Baker Hughes</i>, 2002 U.S. App. LEXIS 9565, *15-16 (5th Cir. 2002). Without allegations of Mr. Skilling's knowledge, at the time of the approval, that this arrangement was fraudulent, plaintiffs fail to allege scienter. <i>Id.</i></p> <p>Moreover, the allegation distorts the Powers Report, which concluded that Mr. Skilling's role was limited to calling on Fastow to present LJM1 to the Board. Powers Report at 69.</p>
<p>4. Skilling supported the Board's decision to permit Fastow to proceed with LJM, notwithstanding the CFO's conflict of interest. Powers Report at 20-21.</p>	<p>Once again, plaintiffs do nothing more than allege fraud based upon Mr. Skilling's management position and that he, as a Board member, approved decisions that later have been alleged to be fraudulent. This is not enough to infer scienter. <i>Abrams v. Baker Hughes</i>, 2002 U.S. App. LEXIS 9565, *15-16 (5th Cir. 2002). To state a claim under §10(b) plaintiffs must allege that Mr. Skilling knew, at the time of the decision, that this was fraudulent. <i>Id.</i> Moreover, related party transactions are not illegal or fraudulent, and without specific factual allegations of fraud this fails to state a claim.</p>

New Allegations Raised By Plaintiffs*	Reasons Why These New Allegations Fail to State a Claim Against Mr. Skilling under §10(b)
<p>5. Skilling, who was proud of the risk-management controls he installed at Enron, bears substantial responsibility for the failure of the system of internal controls to mitigate the risk inherent in the relationship between Enron and the Fastow-controlled LJM partnerships. Powers Report at 20-21.</p>	<p>Plaintiffs allege that because of Mr. Skilling's management role that his scienter can be inferred. It cannot. <i>Abrams v. Baker Hughes</i>, 2002 U.S. App. LEXIS 9565, *15-16 (5th Cir. 2002). The allegation that the "system of internal controls to mitigate the risk[s]" associated with related party transactions failed, does not allege that Mr. Skilling participated in or had knowledge of a fraudulent scheme, or that he personally was, in any way, involved in the alleged failure of this system. Such allegations would be necessary to state a claim pursuant to §10(b).</p>
<p>6. Skilling was advised by Treasurer McMahon in 3/00 that Fastow was pressuring Enron employees who were negotiating with LJM. Powers Report at 21.</p>	<p>Plaintiffs fail to allege how Mr. Skilling's receipt of this alleged complaint evidences his participation in or knowledge of fraud. Plaintiffs fail to make any allegations that Mr. Skilling failed to properly respond to this alleged complaint, or that his response knowingly furthered any alleged fraud. At most, this is merely a claim that Mr. Skilling was aware of a complaint regarding internal management.</p>
<p>7. Skilling approved a transaction that was designed to conceal substantial losses in Enron's merchant investments by approving the Raptor restructuring transaction. Powers Report at 21.</p>	<p>This allegation, culled from the Executive Summary of the Powers Report, is taken out of context. Inartfully (or artfully) worded, it implies that the Powers Report has concluded that Mr. Skilling approved a transaction (the Raptor Restructuring) that he allegedly knew was designed to conceal losses. Such a reading of this allegation is not supported by the body of the Powers Report which contains no conclusions of the sort. Powers Report at 121.</p>

<b>New Allegations Raised By Plaintiffs*</b>	<b>Reasons Why These New Allegations Fail to State a Claim Against Mr. Skilling under §10(b)</b>
<p>8. Skilling was aware of and approved Fastow-protégé Michael Kopper's participation in Chewco, knowing it violated Enron's Code of Conduct. Powers Report at 46.</p>	<p>As a threshold matter, plaintiffs fail to allege any impropriety in connection with Mr. Skilling's alleged approval of Michael Kopper's role with respect to Chewco. Second, they do not allege that Mr. Skilling had knowledge of any fraud to be perpetrated in connection with this alleged approval. Therefore, this allegation facially fails to state a claim under §10(b).</p> <p>Moreover, plaintiffs misquote the Powers Report. The Report does not say that Mr. Skilling knew that Mr. Kopper's role violated Enron's Code of Conduct. The Powers Report states "Skilling's approval, however, did not satisfy the requirements of the Code of Conduct." Powers Report at 46. Plaintiffs have plead Mr. Skilling's knowledge with absolutely no support whatsoever.</p>
<p>9. He approved the additional \$2.6 million Enron paid Chewco in connection with the Chewco buyout. Powers Report at 65-66.</p>	<p>First, plaintiffs fail to allege any fraud in connection with the buyout of Chewco. Therefore, the allegation facially fails to state a claim for fraud. Second, this allegation entirely misquotes the Powers Report. The Powers Report says that "Fastow told Enron's counsel that he [Fastow] had spoken with Skilling and that Skilling (who Fastow said was familiar with the Agreement and the buyout transaction) had decided that the payment should be made." Powers Report at 65-66. Had plaintiffs not mischaracterized the Report and not taken the information contained therein out of context, it would have been clear that the Powers Committee found no one to corroborate Mr. Fastow's information and, they noted, Mr. Fastow himself "declined to respond to questions on the subject." Powers Report at 66.</p>
<p>10. Skilling attended the 10/11/99 Finance Committee meeting when the Board approved Fastow's participation in LJM2. Powers Report at 71.</p>	<p>Plaintiffs again are alleging that because of Mr. Skilling's management role, his scienter can be inferred. As a matter of law, this is not sufficient. <i>Abrams v. Baker Hughes</i>, 2002 U.S. App. LEXIS 9565, *15-16 (5th Cir. 2002). Moreover, there is no allegation supporting that any of this was fraudulent or perceived as such at the time.</p>

New Allegations Raised By Plaintiffs*	Reasons Why These New Allegations Fail to State a Claim Against Mr. Skilling under §10(b)
<p>11. Skilling approved of Fastow's presenting his proposal to hedge the Rhythms investments to the Board on 6/28/99. Powers Report at 79.</p>	<p>Plaintiffs again are alleging that Mr. Skilling's scienter can be inferred from his management role and position on the Board. As a matter of law this is insufficient. <i>Abrams v. Baker Hughes</i>, 2002 U.S. App. LEXIS 9565, *15-16 (5th Cir. 2002). To sufficiently state a claim plaintiffs need to show that Mr. Skilling knew at the time of the alleged approval that the transaction was fraudulent and approved it anyway. <i>Id.</i> They failed to do so.</p>
<p>12. Skilling and Lay were appointed as a committee of the Board to determine if the consideration received by Enron in connection with the Rhythms hedge was sufficient, in the event of a change in the terms of the transaction from those presented to the Board. Powers Report at 82.</p>	<p>First, plaintiffs are alleging, yet again, that Mr. Skilling's management role is sufficient to infer his scienter. This is not the case as a matter of law. <i>Abrams v. Baker Hughes</i>, 2002 U.S. App. LEXIS 9565, *15-16 (5th Cir. 2002). Second, this allegation selectively ignores that the Powers Report itself which stated that the Committee "found no evidence that any of the changes implemented in July or August were presented to Lay or Skilling for approval." Powers Report at 82 n.29. Therefore, even if plaintiffs could sufficiently allege fraud by merely pleading Mr. Skilling's status, it is meaningless without an allegation that there was some kind of fraud or knowledge of fraud associated with this role. Even if there were fraud inherent in "the change in the terms of the transaction," as alleged by plaintiffs, the Powers Report makes clear that it was kept from Mr. Skilling and Mr. Lay. Therefore, plaintiffs have failed to state a claim for fraud.</p>
<p>13. Skilling decided to liquidate Enron's Rhythms position in 1stQ 00, which necessitated an unwind transaction that resulted in huge windfalls to LJM1 and its SPE subsidiaries to the detriment of Enron. Powers Report at 89-90.</p>	<p>Plaintiffs again imply things that are not in the Powers Report. Powers Report at 89-90. Plaintiffs are attributing alleged actions to Mr. Skilling with absolutely no basis.</p> <p>Moreover, even if this claim were true, it does not allege that there was anything fraudulent about the alleged decision to liquidate Enron's position.</p> <p>For both reasons, plaintiffs' allegations fail to support a claim for fraud.</p>

New Allegations Raised By Plaintiffs*	Reasons Why These New Allegations Fail to State a Claim Against Mr. Skilling under §10(b)
<p>14. In late-99, at Skilling's urging, a group of Enron commercial and accounting professionals devised a mechanism to allow Enron to hedge a portion of its merchant-investment portfolio, which created the Raptors. Powers Report at 99-100.</p>	<p>First, plaintiffs fail to allege any fraud in connection with Mr. Skilling's alleged interest in creating a hedge. Second, as has become their pattern, plaintiffs self-servingly cull from the Powers Report to disingenuously support their case. For example, the Report goes on to state that "[d]ue to the size and illiquidity of many of these investments, they could not practicably be hedged through traditional transactions with third parties." <i>Id.</i> This allegation fails to support a claim against Mr. Skilling under §10(b).</p>
<p>15. Skilling was present when Enron-controlled Raptor I was presented to the Finance Committee on 5/1/00. Powers Report at 105.</p>	<p>Plaintiffs once again allege that because of Mr. Skilling's management role, scienter can be inferred. This has been soundly rejected as insufficient. <i>Abrams v. Baker Hughes</i>, 2002 U.S. App. LEXIS 9565, *15-16 (5th Cir. 2002). In order to survive a motion to dismiss plaintiffs must allege that, at the time of the presentation, Mr. Skilling knew of some alleged fraud. <i>Id.</i></p>

New Allegations Raised By Plaintiffs*	Reasons Why These New Allegations Fail to State a Claim Against Mr. Skilling under §10(b)
<p>16. Skilling was present when Enron-controlled Raptor IV was presented to the Finance Committee of the Board on 8/7/00. And he advised the Board that the Executive Committee had approved Raptor II at its June meeting and that Raptor IV would “provide additional mechanisms to hedge the profit and loss volatility of the Company’s investments.” Powers Report at 112.</p>	<p>Once more, plaintiffs are alleging that because of Mr. Skilling’s management role, his scienter can be inferred. This has been soundly rejected as insufficient. <i>Abrams v. Baker Hughes</i>, 2002 U.S. App. LEXIS 9565, *15-16 (5th Cir. 2002). To survive a motion to dismiss, plaintiffs must allege that, at the time of these meetings, that Mr. Skilling knew of some alleged fraud. <i>Id.</i> They cannot do so. Their allegation fails to support a claim pursuant to §10(b).</p>
<p>17. Skilling signed the LJM2 approval sheet for Raptor IV six months after the deal had closed and the Board had approved the transaction. Powers Report at 113 n.54.</p>	<p>Plaintiffs have failed to allege that Mr. Skillings’ signature on the LJM2 approval sheet was either done with, or indicative of, any knowledge of the alleged fraud. Once again, plaintiffs try to make Mr. Skillings’ management role probative of fraud. This is insufficient. <i>Abrams v. Baker Hughes</i>, 2002 U.S. App. LEXIS 9565, *15-16 (5th Cir. 2002). They also fail to allege why it is significant, if it is, that Mr. Skilling signed the sheet six months after the deal had closed and the Board had approved the transaction. Without more, this allegation is meaningless and fails to support a claim under §10(b) against Mr. Skilling.</p>

<b>New Allegations Raised By Plaintiffs*</b>	<b>Reasons Why These New Allegations Fail to State a Claim Against Mr. Skilling under §10(b)</b>
<p>18. Skilling was aware that the credit capacity of the Raptors was declining and in 1stQ 01 he believed that this problem was one of the Company's highest priorities. Powers Report at 121.</p>	<p>Plaintiffs fail to identify what was fraudulent about Mr. Skillings' alleged awareness of the declining credit capacity of the Raptors. Moreover, they misquote the Powers Report at their cited page which actually reads "Skilling said that <i>fixing</i> the Raptors' credit capacity problem was one of the Company's highest priorities." Powers Report at 121. They fail to allege that there was anything fraudulent about Mr. Skillings' alleged awareness or his alleged belief that fixing the problem was fraudulent. Therefore, plaintiffs' allegation fails to state a claim under §10(b).</p>
<p>19. Skilling consistently reviewed all disclosures of related-party transactions. Powers Report at 182.</p>	<p>The allegation that Mr. Skilling "reviewed" all related party disclosures is an insufficient basis for fraud. First, nowhere have plaintiffs sufficiently alleged that such disclosures were, in any way, inadequate, improper or fraudulent. Second, there have been no allegations that the disclosures were, in any way, inconsistent with what Mr. Skilling knew or believed to be reality. Finally, there have been no particularized allegation that Mr. Skilling knew or should have known that Enron's related party transactions were fraudulent or intended to be so, as plaintiffs allege. Without all such allegations plaintiffs fail to state a claim for fraud.</p>

**CERTIFICATE OF SERVICE**

I hereby certify that on this 24th day of June, 2002 I caused a true and correct copy of the foregoing:

- Defendant Jeffrey K. Skilling's Reply Brief in Support of Motion to Dismiss Plaintiffs' Consolidated Complaint Pursuant to Federal Rule of Civil Procedure 12(b)(6) and Memorandum of Law in Support Thereof;

to be served on all counsel of record service electronically by e-mail, facsimile, or first-class mail pursuant to the Court's April 4, 2002 order regarding service and notice of papers.

A handwritten signature in black ink, appearing to read 'RMS', written over a horizontal line.

Robert M. Stern

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