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

In Re Enron Corporation Securities, Derivative & "ERISA Litigation	§	MDL-1446
THIS DOCUMENT RELATES TO: All Cases	§	
MARK NEWBY, ET AL., Plaintiffs	§	
VS.	§	CIVIL ACTION NO. H-01-3624 CONSOLIDATED CASES
ENRON CORPORATION, ET AL., Defendants	§	
THE REGENTS OF THE UNIVERSITY OF CALIFORNIA, ET AL., Individually and On Behalf of All Others Similarly Situated, Plaintiffs,	§	
VS.	§	
KENNETH L. LAY, ET AL., Defendants.	§	

MEMORANDUM AND ORDER *RE* ENRON INSIDER DEFENDANTS

STANLEY C. HORTON, CINDY K. OLSON, LAWRENCE GREG WHALLEY,

MARK A. FREVERT, MARK E. KOENIG, STEVEN J. KEAN,

AND JOSEPH W. SUTTON

The above referenced putative class action, brought on behalf of purchasers of Enron Corporation's publicly traded equity

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The above referenced putative class action, brought on behalf of purchasers of Enron Corporation's publicly traded equity and debt securities during a proposed federal Class Period from October 19, 1998 through November 27, 2001, alleges securities violations (1) under Sections 11 and 15 of the Securities Act of 1933 ("1933 Act"), 15 U.S.C. §§ 77k and 77o; (2) under Sections 10(b), 20(a), and 20A of the Securities Exchange Act of 1934 ("Exchange Act" or "the 1934 Act"), 15 U.S.C. §§ 78j(b), 78t(a), and 78t-1, and Rule 10b-5 promulgated thereunder by the Securities and Exchange Commission ("SEC"), 17 C.F.R. § 240.10b-5; and (3) under the Texas Securities Act ("TSA"), Tex. Rev. Civ. Stat. Ann., article 581-33 (Vernon's Supp. 2002).

Pending before the Court *inter alia* are motions to dismiss pursuant to Rules 8, 9(b), and 12(b)(6) of the Federal Rules of Civil Procedure, and section 21D(b)(3) of the Exchange Act, as amended, the Private Securities Litigation Reform Act of 1995 (the "PSLRA"), codified at 15 U.S.C. §78u-4(b)(3)(A), from the following Enron Insider Defendants:

> (1) Stanley C. Horton, Chairman and Chief Executive Officer of Enron Transportation Services in 2000, previously Chairman and CEO of Enron Gas Pipeline Group from 1997-99 , and

currently in charge of Enron's pipeline operations[1] (instrument #638);

(2) Cindy K. Olson, Executive Vice President, Human Resources (#641);

(3) Lawrence Greg Whalley, President and Chief Operating Officer of Enron since August 2001, and previously President and Chief Operating Officer of Enron North America or Enron Capital Wholesale Services (1999 and 2000) (#643)[2];

(4) Mark A. Frevert, Chairman and Chief Executive Officer of Enron's Wholesale Services since June 2000, and previously Chairman and Chief Executive Officer of Enron Europe from March 1997 until June 2000 (#646)[3];

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[1] Unlike other top insiders who were terminated, Horton emphasizes that he is still working for Enron and that none of the fraud alleged by Lead Plaintiff occurred in his business unit. Motion to Dismiss (#638) at 3 n.2.

[2] Whalley indicates that he, too, remained with Enron after others left, until January 2002 when UBS Warburg purchased Enron's wholesale trading business and Whalley accordingly went to work for UBS Warburg.

[3] Frevert claims that Lead Plaintiff's allegation that "virtually all of Enron's top insiders have been kicked out of the Company" does not apply to him because "upon the initiative of Mr. Frevert, he and the Company agreed to terminate his employment inasmuch as there was little for him to do after the Company's bankruptcy." #646 at 3 n.2.

(5) Mark E. Koenig, Executive Vice President, Investor Relations[4] (#656);

(6) Steven J. Kean, Executive Vice President and Chief of Staff since 1999, previously Senior Vice President, Public Affairs in 1998 (#657); and

(7) Joseph W. Sutton, Vice Chairman until early 2001 [until October 2000 when he left the company] (#686).

The Court hereby incorporates its summaries of the alleged facts and applicable law in its prior memoranda and orders of December 20, 2002 (#1194), of January 28, 2003 (#1241), and of March 12, 2003 (#1269).

The Insider Defendants in the above listed motions are sued only under the Exchange Act, specifically §§ 10(b), 20(a), and 20A.

Having reviewed the complaint and all pleadings relating to the motions to dismiss, without summarizing the arguments made by the parties the Court directly addresses the pleading sufficiency of the complaint with respect to the above listed Insider Defendants.

I. Sections 10(b) and 20A

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[4] Koenig is still employed by Enron.

Enron's sudden plunge from seventh on the Fortune 500 list of America's biggest corporations into bankruptcy, with essentially no cash and within just a few weeks, demands explanation. Lead Plaintiff, even without benefit of discovery, has presented a detailed, year-by-year picture of Enron's sham success and inevitable collapse. The illusory "hall of mirrors inside a house of cards" is painted as built of redundant and cumulative deceptive devices and contrivances, "a fraud [that] was widespread, involving frequent manipulations of Enron's public disclosures and financial reports via ***huge*** transactions-many of which were entered into at or near the end of reporting periods" and "transactions [that] were [so] highly structured and complex, requiring the ***personal attention*** of several top executives of Enron, especially those sitting on the Enron Management Committee." #856 at 12, 82. Nevertheless each Insider Defendant maintains that he or she heard, saw, did, and knew no evil.

Every corporate Insider Defendant had intimate personal involvement in Enron's daily business operations, combined with long-term membership on the Enron Management, or Executive, Committee. To obtain formal permission for corporate acts, again and again this key Committee was presented with successive requests to authorize virtually the same modes enabling fraud and self-aggrandizement throughout the vast business empire of Enron, yet the Committee continued to issue rubber-stamp approvals, while its

members pocketed increasing compensation, and many received enormous bonuses,[5] based on the artificially inflated financial picture of Enron that they projected to the SEC and the investing public. Viewing the circumstances of the full scale, expansive, long-term scam detailed in the complaint as a whole, the Court finds that the motions to dismiss should be denied.

As a threshold matter, the Court notes that unlike the Outside Directors, who were not involved in the day-to-day operations of Enron or Rebecca Mark-Jusbache, whose duties centered on operations of a subsidiary or an affiliate, the other Insider Defendants were in charge of actually running the day-to-day business of Enron Corporation or the sham SPEs and partnerships at the core of the alleged fraud over the critical years prior to and during the Class Period. Furthermore during that time, the alleged fraud was not an occasional isolated occurrence; according to the complaint, with substantial supporting factual detail, the fraud

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[5] The complaint asserts that five of of these Insider Defendants received the following bonuses based on Enron's sham reports of its financial status:

> 1. Horton received bonus payments of over $3.1 million in 1997, 1998, 1999, and 2000;
> 2. Olson received bonus payments of over $1 million in 1997, 1998, 1999, and 2000;
> 3. Frevert received bonus payments of over $5.3 million in 1997, 1998, 1999, and 2000;
> 4. Koenig received bonus payments of over $1 million in 1997, 1998, 1999 and 2000; and
> 5. Sutton received bonus payments of $2.3 million in 1997, 1998, 1999, and 2000, and retired in early 2001.

was so pervasive, so extensive in scope, so frequent, and involved such huge dollar sums, including ventures that had never had any economic viability, like Blockbuster and Braveheart, or transactions to rid Enron of failing companies that no objective purchaser would acquire, that those working within the company for years had to be aware of the enormous gap between the brilliant but sham public facade fabricated by Enron and contrary reality of the corporation's finances and business failures. The complaint reflects the prevalent awareness among the Enron workforce of wrong doing in its numerous quotations of statements by non-defendant employees involved various Enron departments and ventures for whom the sham was not only a normal topic of conversation, but at times a matter for satiric jokes. *See, e.g.*, #1194 at 123 n.58; 126 at n.61; 127 at n.62; 145-46, 145-51 nn.75 and 76; 173-74; 178-79 n.86.[6]

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[6] In the same vein, the Court points to the well-publicized PowerPoint presentation for the 2000 Christmas party at Enron. The program joked about Enron's video-on-demand venture with Blockbuster and Project Braveheart while satirizing the fraudulent accounting employed to effectuate the alleged scam. That PowerPoint presentation has since been incorporated into the indictment of former Enron Broadband Services employees, Kevin Howard and Michael Krautz, where it is no longer a laughing matter. Indeed that the Insiders knew and treated with jocularity the alleged shenanigans at Enron from early on is apparent in the also publicized 1997 video from the farewell party for former Enron President Rich Kinder, in which Jeffrey Skilling jests, "We're going to move from mark-to-market accounting to something I call HFV, or hypothetical future accounting. If we do that, we can add a kazillion dollars to the bottom line." "Black humor at Enron turns into evidence," *Houston Chronicle*, Business Section at 1B, 4B (March 13, 2003).

Significantly, the Insider Defendants were not only intimately involved in the company's daily business, but they also sat on the Management Committee, controlling the corporation during the critical years. According to the complaint,

> The day-to-day business of Enron was conducted by Enron's top executives and its "Management Committee," a collection of top offers who met regularly (weekly or bi-weekly) to oversee and review Enron's business. The Management Committee was aware of and approved all significant business transactions of Enron, including each of the partnership/SPE deals specified herein.

Complaint at 91, ¶88. The Executive Committee had "the power to exercise all of the powers of the Board of Directors." *Id.* at 89, ¶ 85(c). The Insider Defendants, whose motions are under review here, sat on the powerful Management Committee, as indicated below, during the years during which the asserted Ponzi scheme was established and nurtured:

Horton: 1997, 1998, 1999, 2000

Olson: 1998, 1999,

Whalley: 1999, 2000

Frevert: 1997, 1998, 1999, 2000

Koenig: 1997, 1998, 1999

Kean: 1997, 1998, 1999, 2000

Sutton: 1997, 1998, 1999

It was they who again and again provided the requisite authorizations for deceptive devices and contrivances at the core

of the alleged Ponzi scheme. As members of these committees, they had to approve not only the formation and financing, but the transactions of the SPEs and partnerships, which "miraculously" drew off debt and provided sham earnings at critical reporting times, again and again. The longer each Insider Defendant served on the Management Committee, the more frequently he or she would have been exposed and required to approve questionable or highly risky, cumulative misconduct, the formation and Enron-dependent financing of special purpose entities and partnerships, transactions effected solely to manipulate reported financial status, sham hedging, and increasing off-balance-sheet accounting that were repeated again and again at crucial times, according to Lead Plaintiff's complaint. Lead Plaintiff has described how accounting methods, such as mark-to-market accounting and snowballing, or the use of structured finance and SPEs, which in themselves need not be illegitimate, were repeatedly abused and manipulated throughout the business solely to manufacture positive financial statements, i.e., goals that Enron was driven to claim, but did not and could not realize. Specifically, in light of the remarkable repetitive use of such methods and devices, a distinguishing feature of Enron's alleged scam, the patterns of fraud must have grown more evident and more unmistakable to those involved in and regularly informed of internal operations over the years. Insider Defendants' successive resolutions at committee and

board meetings, again and again authorizing virtually identical deceptive devices and contrivances at critical reporting times, were essential to effectuating them and Enron's course of business. As pleaded in Lead Plaintiff's complaint, Insider Defendants' successive votes of approval, which sooner rather than later had to be made with full knowledge or severely reckless disregard of the fraudulent scheme they were erecting, comprised material deceptive acts or contrivances in furtherance of Enron's course of business and the alleged Ponzi scheme, intended to deceive investors, and thus constituted primary violations of § 10(b). So, too, did the allegedly false filings, misleading statements under the statute, authorized (i.e., effected, made) by them to be filed with the SEC. All the while Insider Defendants were being compensated with extraordinary salaries and stock options, plus substantial bonuses, based on these inflated and misleading financial statements filed with the SEC with Insider Defendants' imprimatur, on which investors claim to have relied in purchasing their securities. Such sums are significant factors in giving rise to a strong inference of scienter.

In most of the cases of the Insider Defendants whose motions are under review here, their trading of their Enron securities during the Class Period may not satisfy the requirements for pleading scienter, i.e., that such trading must be dramatically out of line with their prior trading history and suspicious and

unusual in timing and amount. Nevertheless, with the allegations noted above satisfying the pleading requirements for scienter, their trading clearly states a claim for a primary violation of § 10(b) as a breach of their fiduciary duty to disclose material confidential information, i.e., the repetitive fraudulent devices and transactions that they countenanced on the Management Committee, before they traded their Enron securities.

In addition, the complaint and accompanying graph at 71-72 alleges that Insider Defendant Cindy Olson, who had no prior trading history in Enron securities, sold 83,183 shares of Enron stock for $6,505,870 in four sales during the class period. Exhibit C of Lead Plaintiff's Appendix in support of its complaint indicates that all was sold at relatively high prices (between $70 and $86.40 per share).[7] In its response to her motion to dismiss, Lead Plaintiff asserts that Olson, who administered the Enron employees' pension plan, sold 85% of her Enron stock during the Class period. More telling, Lead Plaintiff's response focuses on an inquiry into her trading and her credibility during a Hearing before the Senate Commerce, Science and Transportation Committee on February 26, 2002. After sitting on the Management Committee through 1998 and 1999, during which she purportedly learned and

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[7] Enron stock peaked at $90 and 3/4 per share on August 23, 2000 and continued close to that high for months: $90 and 3/8 on mid September 2000, $88 and 11/16 in October and $83 and 13/16 in November. Complaint at 11, ¶ 11.

approved of numerous, repetitive fraudulent devices and contrivances that sustained the Ponzi scheme, she "led the cheering rally for Enron stock" and publically advised Enron employees in December 1999 to put all of their 401k plan funds into Enron stock. Yet a couple of months later, she began quietly selling off her own Enron stock, including a sale of over $1 million on February 18, 2000. Lead Plaintiff quotes a letter that Senator Waxman wrote to Senator Lieberman, stating that a videotape of Olsen's testimony "seems to conflict with Ms. Olson's testimony that she would have advised Enron employees to diversify if the law permitted such advice" and "appears to cast Ms. Olson's personal financial transactions in a new light." Olson claimed that on the advice of her financial adviser in late 2000 and early 2001 she sold $6.5 million of her Enron stock to diversify her portfolio. #856 at 58-59. Lead Plaintiff also points out that Olson was no layman to the accounting manipulations because before becoming head of Enron's human resources department, she had worked as an accountant for fifteen years. *Id.* at 59. In the interests of justice, the Court sees no reason why Lead Plaintiff should not be allowed to supplement its complaint with such telling factual allegations, which add to a strong inference of scienter for her role in the alleged scheme at Enron.

Because Lead Plaintiff has stated claims for primary violations of § 10(b), the Court finds that it has also stated a

derivative claims under § 20A for insider trading against these Insider Defendants.

Section 20(a)

Insider Defendants' positions on the all-powerful Management Committee and their votes while on that Committee demonstrate that they had the power to control Enron. The Court therefore finds that Lead Plaintiff has stated claims for controlling person liability against each Insider Defendant.

Accordingly, for the reasons indicated above, the Court ORDERS that the motions to dismiss filed by Stanley C. Horton (#638), Cindy K. Olson (#641), Lawrence Greg Whalley (#643), Mark A. Frevert (#646), Mark E. Koenig (#656), Steven J. Kean (#657), and Joseph W. Sutton (#686) are DENIED in full.

SIGNED at Houston, Texas, this 24th day of March, 2003.

MELINDA HARMON
UNITED STATES DISTRICT JUDGE