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

In Re Enron Corporation Securities, Derivative & "ERISA Litigation	§	MDL-1446
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.	§	

ORDER

Pending before the Court in the above referenced cause are the following motions from individual Defendants relating to Lead Plaintiff's First Amended Consolidated Complaint (#1388): (1) Joseph M. Hirko's ("Hirko's") motion to dismiss (#1448); (2) Hirko's motion to strike from the record "Exhibit A" to Plaintiff's memorandum of law in opposition to Hirko's motion to dismiss (#1542); (3) Ken Harrison's motion to dismiss first amended complaint (#1494); and (4) Certain Officer Defendants' (Steven J. Kean, Lawrence Greg Whalley, Mark A. Frevert, Mark E.

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Koenig, Cindy K. Olson, Richard B. Buy,[1] Richard A. Causey, and Jeffrey McMahon's) motions[2] to dismiss first amended complaint (#1509).

Hirko's Motions

The arguments in Hirko's motion to dismiss and motion to strike overlap. The Court first addresses the issue of striking Exhibit A because it is critical to the issue of the sufficiency of the pleading of Plaintiff's First Amended Consolidated Complaint.

Exhibit A is a copy of the detailed first amended complaint filed by the Securities and Exchange Commission, *SEC v. Kevin A. Howard, Michael W. Krautz, Kevin Hannon, Joseph Hirko, Kenneth D. Rice, Rex T. Shelby, and Scott Yeager*, Civil Action No. H-03-0905, charging Defendants with a fraudulent scheme involving the Enron Broadband Service, Inc. ("EBS") and Project Braveheart "to deceive the investing public and others about the technology, financial condition, performance and value of EBS" and thereby to manipulate and inflate the value of Enron stock. It alleges four causes of action, but only the first applies to Hirko: (1) violations of § 10(b), 15 U.S.C. §78j(b), of the 1934 Exchange Act and Rule 10b-5, 17 C.F.R. § 240.10b-5; (2) § 17(a), 15 U.S.C. § 77q(a) of the Securities Act of 1933; (3) aiding and abetting

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[1] Lead Plaintiff was granted leave to supplement its complaint against Richard Buy. *See* #1569 and 1839. The "proposed additions to paragraph 83" are attached as Ex. A to both #1569 and #1571.

[2] Although Certain Officer Defendants filed this instrument "as a single document, it is intended as individual motions on behalf of each." #1509 at 2 n.1.

violations of § 13(a), 15 U.S.C. §78m(a), of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13, 17 C.F.R. § 240.12b-20, 240.13a-1, 240, 13a-13; and (4) aiding and abetting violations of §13(b)(2)(A) and §13(b)(2) of the Exchange Act, 15 U.S.C. § 78m(b)(2)(A) and 78m(b)(2)(B) and Rule 13b2-1, 17 C.F.R. § 240.13b2-1). Hirko allegedly was involved in the advanced software-driven broadband "intelligent" telecommunications network ("EIN") from its inception, supported it, was in charge of reviewing and providing input on numerous press releases about it during the Class Period (10/19/98-11/27/01), personally contributed a number of false or misleading statements about it, knew that the statements at analysts conferences and press releases about it were false and misleading, knew from participation in weekly staff meetings with the engineers that the development of EIN's software intelligence was not complete, participated in particular the January 20, 2000 analyst conference at which he was informed extensively about the incompleteness in the software development, but still made numerous false and misleading statements, sat on the technology steering committee responsible for solving EBS' technological problems, and received bi-weekly management reports and e-mails about the software intelligence. In particular the indictment charges Hirko with using the scheme for insider trading in breach of his fiduciary duty to Enron to sell large amounts of his Enron stock at what he knew were inflated prices while in possession of material non-public information, pocketing unlawful profits of $52,998,781.

Clearly many of the indictment's factual allegations are along the same line as those in the *Newby* consolidated complaints, along with additional criminal allegations of money laundering.

Hirko's motion to strike argues that Exhibit A to Plaintiff's memorandum in opposition to Hirko's motion to dismiss, and all references to it in Plaintiff's memorandum, should be stricken because the SEC's first amended complaint was not attached to, nor incorporated into, Lead Plaintiff's First Amended Consolidated Complaint in *Newby*. Furthermore, insists Hirko, it is black-letter law that a complaint cannot be amended by briefs in opposition to a motion to dismiss. *Car Carriers, Inc. v. Ford Motor co.*, 745 F.2d 1101, 1107 (7th Cir. 1984)("[I]t is axiomatic that a complaint may not be amended by the briefs in opposition to a motion to dismiss."), *cert. denied*, 740 U.S. 1054 (1985). He objects to Plaintiffs' request that the Court take judicial notice of the filed SEC complaint when the First Amended Complaint's allegations against Hirko remain virtually the same as those in the earlier one, which this Court has already dismissed as inadequate. "Normally, in deciding a motion to dismiss for failure to state a claim, courts must limit their inquiry to the facts stated in the complaint and in the documents either attached to or incorporated in the complaint. *Lovelace v. Software Spectrum, Inc.*, 78 F.3d 1015, 1017 (5th Cir. 1996).[3] He further argues that in *Lovelace*, the Fifth Circuit adopted the Second

[3] Hirko conveniently leaves out the Fifth Circuit's following sentence: "However courts may also consider matters of which they may take judicial notice." *Id.* at 1107-08.

Circuit's "public disclosure" exception to the general rule restricting the Court's inquiry to the four corners of the complaint to public documents that are required to be, and are actually, filed with the SEC, e.g., prospectuses, quarterly financial statements, etc. *Lovelace*, 78 F.3d at 1018 ("We stress that our holding relates to public disclosure documents required by law to be filed and actually filed, with the SEC . . . ."). The public disclosure exception does not reach the SEC's complaint, and, as noted, the SEC's complaint was not attached to nor incorporated in the *Newby* complaint.

The Court observes that Lead Plaintiff has included as Exhibit B in the Appendix of Exhibits (#1389), **filed with** and in support of its First Amended Consolidated Complaint, a copy of the superseding indictment in a criminal case filed against Hirko and others allegedly involved in EBS and Project Braveheart, *United States of America v. Kenneth Rice, Joseph Hirko, Kevin Hannon, Kevin Howard, Scott Yeager, Rex Shelby, and Michael Krautz*, #16 in Criminal Action No. H-03-93, based on the same scheme alleged in detail in the *Newby* complaints.[4]

With respect to this superseding indictment, Hirko objects to Plaintiffs' bald assertion that criminal standards are more stringent than the PSLRA's civil fraud standards. He contends that an indictment need not allege in detail the factual proof supporting the criminal charges, while the PSLRA requires

[4] Since that time, a second superseding indictment has been filed, on September 15, 2003, #113 in Criminal Action No. H-03-93. The Court *sua sponte* takes judicial notice of it.

the plaintiff to "specify each statement alleged to have been misleading, [and] the reason or reasons why the statement is misleading" and to "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)(1), (2). Hirko insists that Lead Plaintiff has failed to satisfy the heightened pleading requirements under the PSLRA.

Furthermore in both motions Hirko also argues that the Court's April 24, 2003 order dismissing the claims against Hirko was an adjudication on the merits for purposes of *res judicata*. He insists that because the Court dismissed all claims, Fifth Circuit law mandates that the dismissal is with prejudice. *Fernandez-Montes v. Allied Pilots Ass'n*, 987 F.2d 278, 284 n.8 (5th Cir. 1993)("[I]t is well established that a dismissal is presumed to be with prejudice unless the order explicitly states otherwise."). Moreover the Court granted Hirko's motion without conditions and that motion had specifically requested dismissal with prejudice. *Nationwide Mutual Ins. Co. v. Unauthorized Practice of Law Comm.*, 283 F.3d 650, 655 n.26 (5th Cir. 2002)(that the motion granted had requested dismissal with prejudice, in addition to the rule in *Fernandez-Montes*, constituted the basis of the court's determination that the dismissal was with prejudice). Hirko emphasizes Plaintiffs have not moved to revive those claims under Federal Rule of Civil Procedure 60(b). Hirko also maintains that in the April 24, 2003 order wherever the Court contemplated that Plaintiffs might be able to cure their pleading deficiencies,

the Court expressly said so. The Court responds to this argument that, from reports in the news media, it knew more about certain alleged transactions involving the Enron collapse than others and that its suggestions for curing inadequacies were not meant to be exclusive of other potential claims nor mandates that Lead Plaintiff had to follow.

A number of factors need to be considered here. Although the courts have differed on when a dismissal on Rule 12(b)(6) grounds constitutes an adjudication on the merits barring another action on *res judicata* grounds, the Fifth Circuit has concluded that a dismissal under Rule 12(b)(6) is with prejudice unless the Court specifies otherwise. *Fernandez-Montes*, 987 F.2d 278. Nevertheless, it is also true that a complaint should not be dismissed unless the plaintiffs can prove no set of facts in support of their claims that would entitle them to relief. *Spector v. Norwegian Cruise Line Ltd.*, 356 F.3d 641, 644 (5th Cir. 2004). Indeed, the Fifth Circuit has long held that

> [O]ur cases support the premise that "[g]ranting leave to amend is especially appropriate . . . when the trial court has dismissed the complaint for failure to state a claim [,]" *Griggs v. Hinds Junior College*, 563 F.2d 179, 180 (5th Cir. 1977)(per curiam)(addressing 12(b)(6) dismissal). In view of the consequences of dismissal on the complaint alone, and the pull to decide cases on the merits rather than on the sufficiency of pleadings, district courts often afford plaintiffs at least one opportunity to cure the pleading deficiencies before dismissing a case, unless it is clear that the defects are incurable or the plaintiffs advise the court that they are unwilling or unable to amend in a manner that will avoid dismissal.

Great Plains Trust Co. v. Morgan Stanley Dean Witter & Co., 313 F.3d 305, 329 (5th Cir. 2002). Therefore a court should give a plaintiff an opportunity to amend; indeed it should explain the reasons for its decision that the complaint fails to state a claim so that the plaintiff can make an informed decisions whether he is able to and should amend his complaint.

In this litigation, not only the enhanced pleading requirements of the PSLRA, but the novel, cutting-edge issues that this Court has had to resolve, along with the absence of any showing that amendment would be futile or that Lead Plaintiff declined the opportunity to offer additional facts, made it both legally and equitably appropriate to provide Lead Plaintiff with the opportunity to amend once the Court ruled on the motions to dismiss. A review of all the Court's orders regarding the various motions to dismiss reflects that it clearly contemplated that Lead Plaintiff would be permitted to amend to attempt to cure any pleading deficiencies. None of the dismissals was final or finalized. Indeed, shortly after the first memorandum and order (#1194), dealing with motions to dismiss of the secondary actors, Lead Plaintiff sent a letter to the Court on January 14, 2003, asking immediately about amending or supplementing or filing a new complaint. Exhibit 1 to #1575. At that point, numerous motions to dismiss were still pending. On January 27, 2003, the Court issued an order in which it responded to that letter request and stated, "It makes no sense to establish a schedule, including for amendment of pleadings, without knowing all that needs to be

done." It ordered Lead Plaintiff to wait "so that all amendment or supplementation can be efficiently and timely accomplished in one instrument." #1238 in *Newby* and #551 in *Tittle*, at 2-3. As pointed out by Lead Plaintiff, moreover, other subsequent orders of the Court indicate its intention to permit amendment where Lead Plaintiff could cure its pleading deficiencies. Moreover, once the motions to dismiss were resolved and plaintiff moved for leave to amend with respect to all the orders, the Court gave the parties an opportunity to file objections to permitting such. The only party to do so was Deutsche Bank, which had also had its motion to dismiss granted and which stated that it would raise its objections to the First Amended Consolidated Complaint in a forthcoming motion to dismiss it. The Court did grant that motion for leave to amend, and the First Amended Consolidated Complaint is now the controlling pleading in this action.

Furthermore, the Court may take judicial notice of matters of public record. *Davis v. Bayless*, 70 F.3d 367, 372 n.3 (5th Cir. 1995); *Watson v. Bally Mfg. Corp.*, 844 F. Supp. 1533, 1535 n.1 (S.D. Fla. 1993)("In determining whether to grant a Rule 12(b)(6) motion, the court primarily considers allegations in the complaint, although matters of public record, orders, items appearing in the record of the case, and exhibits attached to the complaint may also be taken into account.")(*citing* 5A Charles A Wright and Arthur R. Miller, *Federal Practice and Procedure* § 1357, at 299 (1990)("In determining whether to grant a Rule 12(b)(6) motion, the court primarily considers the allegations in

the complaint, although matters of public record . . . may be taken into account."), *aff'd*, 84 F.3d 438 (11th Cir. 1996)(Table). While the Court agrees with Hirko that the Fifth Circuit's holding in *Lovelace*, 78 F.3d at 1018, dealt only with consideration of relevant public disclosure documents that "(1) are required to be filed with the SEC, and (2) are actually filed with the SEC," it did not address other types of materials. In essence, it and other courts in accord "treated SEC documents as public records capable of being judicially noticed at the motion to dismiss stage without requiring an automatic conversion to the summary judgment stage . . . ." *Bryant v. Avado Brands, Inc.*, 187 F.3d 1271, 1286 (11th Cir. 1999), *citing Lovelace*, 78 F.3d at 1018, and *Menowitz v. Brown*, 991 F.2d 36, 39 (2d Cir. 1993). Furthermore, this Court presumes that the SEC's civil complaint against Hirko and the others necessarily must be based in large part upon the documents that were filed with the SEC; stretching the *Lovelace* rule to include the SEC's own complaint does not offend the principles of reliability underlying the rule.

Federal Rule of Evidence 201 allows courts to take judicial notice, whether requested or not, under specified circumstances at any stage of the proceeding where the judicially notice matter must be "one not subject to reasonable dispute in that it is . . . capable of accurate and ready determination by resort to sources whose accuracy cannot be reasonably be questioned." Here judicial notice may be taken of the SEC's complaint, not for the truth of the matters asserted, but for what

allegations have been made by the government and the factual bases for them, including assertions by Defendants in their SEC filings; these allegations also serve as the factual underpinnings for Lead Plaintiff's claims against Hirko in *Newby*. Moreover the allegations in the SEC complaint are completely relevant to and consistent with the allegations in the *Newby* complaint and should have come as no surprise to Hirko.

Furthermore, unlike the SEC's civil complaint, the copy of the superseding indictment **was attached** to the First Amended Consolidated Complaint and it, too, is a document of public record. Thus the Court finds that it can take judicial notice of that indictment. Moreover, the Court finds that the allegations in that indictment, although they did not have to be, are sufficiently factually detailed to satisfy the stringent requirements of the civil statute, the PSLRA.

For these reasons the Court denies Hirko's motion to strike and motion to dismiss.

Harrison's Motion to Dismiss

Harrison, who was Chief Executive Officer of Portland General Electric, an Enron subsidiary acquired by Enron in 1997, and an inside director of Enron, argues that for the reasons that the Court previously dismissed the claims against Outside Directors, James Derrick, Joseph Hirko, and Rebecca Mark-Jusbasche,[5] the Court should have acted consistently and dismissed

[5] The Court dismissed all claims against Derrick and, as previously indicated, against Hirko for failure to state a claim and dismissed all but § 11 claims against Mark-Jusbasche.

all claims against Harrison. He objects overall to the absence of specificity in the pleadings against him. In summary, Harrison argues that like Hirko he remained in Oregon, that he never received bonuses, that he left EBS not only before the alleged fraud took place, but before Hirko left, and that he only sold significant amounts of his Enron stock after his options vested and when he was retiring from Portland General Electric in the spring of 2000. He also maintains that Lead Plaintiff has failed, from all the circumstances, to plead scienter. Moreover, because Lead Plaintiff has failed to plead the requisite § 10(b) claims, urges Harrison, any derivative claim for controlling person liability under § 20(a) also fails. Similarly there can be no claim under § 20A without an independent predicated violation of the Exchange Act. As for the allegations under § 20A, Harrison argues that no proposed plaintiff traded "contemporaneously" with him; regarding his challenged trades on May 11 and 16, 2000, Harrison maintains that plaintiffs' trades took place the day before Harrison sold his stock.[6] Finally, Harrison requests the

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[6] For discussion of the contemporaneity requirement, *see* #1269 at 31-35. In response to Harrison's challenge, Lead Plaintiff cites *In re American Business Computers Security Litigation*, MDL No. 913, 1994 WL 848690 (S.D.N.Y. 1994). In that opinion Judge Brieant broadly construed "contemporaneously," finding that the term "may embrace the entire period while relevant non-public information may remain undisclosed," and he concluded that "the better rule with respect to standing seems to be that a class action may be maintained on behalf of all persons who purchased stock on an exchange during the period that defendants were selling that stock on the basis of insider information. . . . [T]his is an issue appropriately reserved for the trier of fact." *Id.* at *4. This Court agrees that it is premature to decide the contemporaneity issue here before a class is certified and discovery taken. *See, e.g., In re Motel 6 Securities Litig.*, No.

dismissal of all claims against him be with prejudice as Lead Plaintiff has had ample opportunity to amend to correct pleading deficiencies by now.

Because the First Amended Consolidated Complaint is now the governing pleading, the Court examines it in addition to the First Consolidated Complaint to determine if a claim has been stated by Lead Plaintiff against Harrison.

Harrison argues that he, like Mark-Jusbasche with the Azurix Corporation, was not involved in and did not manage the day-to-day operations of Enron in Houston, but instead managed the operations of a remote subsidiary, i.e., in Harrison's case the largest electric utility in Oregon, where he resided. He asserts that Portland General Corporation had no alleged connection to the purported fraud at Enron. In its order dismissing Mark-Jusbasche, the Court found that her job was not with the day-to-day operations of Enron in Houston,[7] but those of Azurix Corporation, a global water and wastewater company with bases *inter alia* in England and Argentina, and that Lead Plaintiff had not stated a claim of wrongdoing against Mark-Jusbasche's Azurix in the alleged Ponzi scheme. Indeed this Court noted Judge Lake's dismissal of

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93 CIV 2183 and 93 CIV 2866 (JFK), 1997 WL 154011, *2 (S.D.N.Y. 1997)("any more detailed examination of the representative Plaintiffs' contemporaneous trading status before discovery and the development of the record would be premature . . . .").

[7] Initially, based on the pleadings, the Court dismissed Hirko and Derrick in part because neither was alleged to have been involved in the workplace in the day-to-day operations of Enron's business where he would have been directly exposed to the alleged patterns of wrongdoing, employee gossip, jokes, etc.

a civil securities fraud case against Azurix for failure to state a claim; Judge Lake's ruling has since been upheld by the Fifth Circuit. *In re Azurix Corp. Sec. Litig.*, 198 F. Supp. 2d 862 (S.D. Tex. 2002), *aff'd, Rosenzweig v. Azurix Corp.*, 332 F.3d 854 (5th Cir. 2003). Moreover the SEC has not filed a civil suit against Mark-Jusbasche or Azurix, nor has any criminal proceeding been initiated against them. [8]

Harrison's representation that Portland General Corporation was not involved in the Ponzi scheme needs to be clarified in light of Enron's acquisition of Portland General Corporation in 1997 and expansion of its telecommunications division, First Point Communications, Inc., which Enron renamed Enron Communications ("ECI") in 1998 and then Enron Broadband Services ("EBS") in January 2000. A number of Enron officials (Hirko, the only Oregon resident, and Houston area residents Kenneth Rice, Kevin Hannon, Kevin Howard, Scott Yeager, Rex Shelby and Michael Krautz) were indicted in the spring of 2003 for securities and wire fraud and conspiracy from April 1999-May 14, 2001 that deceived the investing public and others about the available technology, value, earnings, and poor performance of EBS while selling large quantities of Enron stock for personal gain according to the second superseding indictment[9] #113 in CR No. H-

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[8] There are a number of member civil actions in this MDL that have asserted claims against Azurix.

[9] Indeed, according to the superseding indictment at ¶ 15, the role of Portland General Corporation in the alleged scheme began early, and thereafter continued to expand:

03-93. The Court takes judicial notice of the second superseding indictment, not for the truth of the allegations, but for the fact that they have been made and the factual bases asserted for those charges. It also notes that the SEC has filed a civil suit against the same Defendants for violations of the Securities Exchange Act of 1934. Civ. No. H-03-905.

Not only was Ken Harrison not among those indicted or sued civilly by the SEC, but from allegations in the complaint it appears that he was in the process of retiring and winding up his involvement with Enron and Portland General Corporation in the early spring of 2000, including the sale of his vested options, when the alleged EBS conspiracy was just getting underway.[10] The timing of Harrison's participation in Enron/Portland General diminishes any involvement he may have had in the creation of EBS, though it does not necessarily exonerate him, and it does not relieve him of potential liability for his actions from 1997-2000 relating to Enron. Indeed, given his background at Portland General, Enron's swift focus on that company's telecommunications division and development of EBS following acquisition and the fact

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> In the summer of 1999, Enron announced that EBS would become a "core" Enron business and a major part of Enron's overall business strategy. In early November 1999, Enron senior management, HIRKO and RICE[,] decided to make EBS the centerpiece of Enron's annual presentation to equity analysts, scheduled for January 20, 2000.

[10] EBS' agreement with Blockbuster was executed on April 5, 2000, and the deal was announced publicly in a July 19, 2000 press release, while Project Braveheart was hatched the following fall.

that Harrison was placed on Enron's board give rise to an inference that the alleged Enron Defendants were utilizing his expertise in moving toward the alleged broadband scam and constitutes one factor to be considered in a totality-of-circumstances review. Moreover, as put by Lead Plaintiff, Hirko's indictment and the SEC suit against him "call[] into serious question Harrison's contention that his purported presence in Portland *ipso facto* mean Harrison was not involved in the Enron fraud." #1570 at 6.

The Court has previously admitted its confusion, created in part by a change in the names of the Management Committee to the Enron Executive Committee in 1999 and the Enron Corporate Committee in 2000,[11] but not made clear in the complaint, and in part by the similarities in allegations between the Management Committee composed of Enron officers and the Executive Committee of the Board of Directors.[12] It now distinguishes some of those allegations and explains why its ultimate findings are not undermined by that confusion.

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[11] See First Consolidated Complaint at 91-93, ¶88. Lead Plaintiff has pointed out that the Insider Defendants, themselves used the terms "Executive" and "Management interchangeably in their 1998 and 1999 Annual Report excerpts to refer to the same committee on which they sat. #1338 at 2-3.

[12] This Court in ruling on the motions to dismiss of the "remaining insiders" (#1347 at 17-18), who have challenged the Court's muddling of the two committees, also mistook as the minutes of a November 5, 1997 meeting (Ex. 21 to #856) of the Management Committee what were actually minutes of the Executive Committee. Certain Officer Defendants have also pointed out that the Board of Directors, not the Management Committee, approved the waiver of Fastow's conflict of interest.

Lead Plaintiff alleged in the First Consolidated Complaint at 89, ¶ 85(c),[13] that the Executive Committee of the Board "met on a frequent basis to oversee and review Enron's business and had the power to exercise all the powers of the Board of Directors."

The complaint also alleged at #441 at 91, ¶88 (#1388 at 105, ¶ 88), "The day-to-day business of Enron was conducted by Enron's top executives and its 'Management Committee,' a collection of top officers 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." In ¶ 1(a) of both consolidated complaints, Harrison is immediately identified as one of these "Enron's top executives and directors." Moreover, in ¶ 397 at 256, Lead Plaintiff again stated,

> The Enron Defendants who were on Enron's Management Committee were the top executives of Enron. They had daily contact with each other while running Enron as "hands-on" managers, dealing with the important issues facing Enron's business, i.e., WEOS, EES,[14] EBS, its JEDI and LJM partnerships, and the related SPEs and Enron's future revenues and profits. The Enron Defendants controlled and/or possessed the power and authority to control the contents of Enron's Registration Statements, its Form 10-K SEC filings and its quarterly and annual reports and press

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[13] Also #1388 at 103, ¶ 85(c).

[14] WEOS stands for Enron's Wholesale Energy trading business, while EES was Enron Energy Services, a retail business. *See, e.g.*, #1388 at 4, ¶2, and 29-31, ¶¶ 37-38.

> releases, and were provided with copies of the filings, reports and releases alleged herein to be misleading prior to or shortly after their issuance and had the ability and opportunity to prevent their issuance or cause them to be corrected.

Paragraph 309 alleges regarding the claimed "manipulation of Enron's public disclosures and financial reports via **huge** transactions,"

> [T]hey were also highly structured and complex, requiring the personal attention of several top executives of Enron, especially those sitting on the Enron Management Committee, and the review and approval of board members, especially those sitting on Enron Board's Executive, Finance, and Audit Committees, which had direct jurisdiction over these types of corporate transactions and activities. Thus, it is logical, if not obvious, that all of Enron's officers and directors knew of, or at a minimum acted in reckless disregard of, the falsification of Enron's financial reports and the other false and misleading statements being made about its business operations.

The complaint (#441) at 89-96, ¶¶ 86-88 (#1388 at 103-09), identified who was on which committees and the board during which years.

Paragraph 86 represents that Harrison was on the Enron Board of Directors from 1998-2000, but not on any of the Board committees, while paragraph 88 indicates that Harrison was on the Management Committee from 1997-98 as well as in 1999 when it was renamed the Enron Executive Committee. Harrison points out that Mark-Jusbashe (1997-1999), Derrick (1997-2000) and Hirko (1997-1999) were on the Management Committee for as long or longer than Harrison (1997-1999). He further complains that, as with Hirko,

the complaint does not allege what Management Committee meetings, if any, that he attended or what was discussed by whom. Nor Harrison insists can the general allegations give rise to a strong inference of Harrison's scienter.

The Court refers Harrison to #1299, #1300, and #1347. A critical distinction between Harrison and Mark-Jusbasche was the latter's short tenure (about a year in 2000) on the Enron Board of Directors, while Harrison served from 1998-2000. First Consolidated Complaint at ¶ 86. In light of Certain Defendants' insistence that the members of the Board, not of the Management Committee, made the key decisions, including waiver of Fastow's conflict of interest regarding LJM2, this distinction becomes important. Moreover, Harrison sat on Enron's Board of Directors (1998-2000) and on the Management Committee **for years and during key periods of the alleged repetitive, fraudulent activity** at Enron and the alleged revamping of Portland General for development of the broadband scheme.

In drawing a strong inference of scienter from the complaint's allegations, this Court emphasized (#1347 at 7-8) the red flags created by the repetition of fraudulent practices, which would apply to all those involved in running Enron, whether as Board members or Management Committee members, according to allegations of their duties and actions in the complaint:

> The persistent patterns by which the alleged Ponzi scheme were effected were unmistakable and any executive sitting for a length of time on the Management Committee, which was repeatedly asked to approve these deceptive devices and contrivances, would have had to

> be aware of or have recklessly disregarded the warning signs. The Committee members three times approved a waiver of Fastow's [and Michael Kopper's] conflicts of interest, contrary to Enron's own Code of Conduct, and sanctioned the creation of most of the SPEs and partnerships and the illusory transactions among them and Enron, all too frequently and blatantly created at critical SEC-reporting times when Enron was in danger of not "making its numbers" and artfully manipulated by acknowledged, high-risk, aggressive accounting. The complaint paints a picture of these individuals actively and knowingly participating in a corporate culture of brazen ambition toward the appearance of ever increasing success, which was simultaneously being undermined by their blatant self-dealing for personal enrichment. Their greed was rewarded by high salaries, extraordinary bonuses, and the exercise of Enron stock options or sale of company stock, the value of which was continuously inflated by their manipulation of Enron's financial reports. In other words, despite the repetitive patterns of fraud constituting red flags, the Management Committee repeatedly rubber-stamped the deceptive devices and contrivances and practices of SPEs abusive accounting used to move debt off Enron's balance sheet and to claim sham revenue, while providing them with lucrative returns for the alleged Ponzi scheme. Moreover, Lead Plaintiff has shown that these Insider Defendants also sold Enron stock after becoming aware of the company's nonpublic information relating to the scheme while serving on the Management Committee, without disclosure of that information to the shareholders.

Regardless of whether the Management Committee or the Board was directly involved in decisions about the deceptive devices and practices, Harrison was involved in both, and Lead Plaintiff has alleged that both played decisive roles in reviewing and approving "all significant business transactions of Enron, including each of the partnership/SPE deals" of the alleged Ponzi scheme. Although

Harrison argues that the complaint does not allege which meetings he attended during the three years that he purportedly sat on the Board, without discovery Lead Plaintiff had provided documentation of Harrison's attendance at the Enron Board Meeting in October 1999 when the board approved the creation of LJM2 and waived the Fastow-Enron conflict of interest (#858 at Ex. 24) and, even though Harrison was not a member, at the Board's Finance Committee meeting on May 1, 2000, at which Fastow reported on LJM2, Jeffrey McMahon discussed Enron's guarantee portfolio, including Enron's guarantees to the Raptors, and Enron's need for more borrowing capacity (*id.* at Ex. 26). Indeed his non-member attendance at the latter meeting implies Harrison sought out and obtained a broader awareness of, or recklessly disregarded, the deceptive devices and contrivances employed to conceal Enron's financial situation from the public. The complaint also alleged that Harrison signed a number of specified 10-Ks and registration statements filed with the SEC over those years when he was a member of the Management Committee and of the Board of Directors and either knew or was severely reckless in ignoring the repetitive deceptive devices placed before him for review and approval. See #1299 at 8-11 and #1347 at 6-9. Given that role, he also allegedly breached his fiduciary duty when he sold his stock without disclosing nonpublic information learned while he served on the Board and on the Management Committee and allegedly violated § 20A. Furthermore, given his positions on the Management Committee and the Board, Lead Plaintiff has alleged that his voting power allowed him to

control Enron's policies and actions and thus he is purportedly liable under § 20(a).

Harrison also argues that he was in a position like that of Derrick, against whom the Court dismissed Lead Plaintiff's claims. The Court concedes that the sufficiency of the pleading as to Derrick was a close and difficult decision. Lead Plaintiff has painted a picture of Harrison as a business man, who, following Enron's purposeful acquisition of Portland General, was involved in Enron's day-to-day business operations and the swift development of telecommunications at Portland General, purportedly being exploited by Enron in its transformation into another major, central fraudulent device of the Ponzi scheme, the EBS/Broadband/VOD scam. In contrast, the complaint in essence attempted to state a claim against Derrick as a lawyer, based on Derrick's role as Enron's General Counsel and his involvement with the law firm of Vinson & Elkins. There were no specific allegations of his involvement with any of the major players in the alleged Ponzi scheme. The complaint did not allege that Derrick signed any SEC-filed documents or made false statements to the market. More important, the Batson report relied upon by Lead Plaintiff to state its claim against Derrick undermined the very allegations in the complaint for the reasons pointed out in #1347 at 33-36.

In sum, for these reasons the Court denies Harrison's motion to dismiss.

Certain Officer Defendants' Motions to Dismiss

First Amended Complaint

In addition to standing by its memorandum and order of April 24, 2003 (#1299), the Court has already responded to a number of the challenges raised by Certain Officer Defendants in #1345 and in this memorandum and order. Although these Defendants were not members of the Board of Directors, each was identified in paragraph 1 as a "top executive" and the Court has previously cited the years each was a member of the Management Committee overseeing and sanctioning the allegedly crucial, repetitive fraudulent transactions. The complaint charges that Committee with significant duties in serially reviewing and approving a clear pattern of these critical transactions. In particular the Court has addressed the allegations against Cindy Olson, which have been expanded in ¶ 83(q) of the First Amended Consolidated Complaint, and found that they were sufficient to state a claim. Similarly, Lead Plaintiff has added particular allegations regarding McMahon's role in the 1999 Nigerian barge deal with Merrill Lynch. It also supplemented claims against Whalley by describing his role in the purported bogus power swaps between Enron and Merrill Lynch in 1999. Moreover, viewed in the totality of all the allegations made against these individuals, including sale of their Enron securities in violation of the fiduciary duty to disclose, the Court finds that Lead Plaintiff has stated claims against these top officers.

The Court judicially notes that Richard Causey has also been indicted for conduct embraced by the *Newby* complaint. CR No.

H-04-25. The fifty-seven-page, forty-two-count superseding indictment (instrument #16) alleges many of the same facts as those detailed in the *Newby* complaint and charges Causey and Jeffrey K. Skilling with conspiracy to commit securities and wire fraud,[15] scheming to manipulate Enron's financial results to defraud the investing public, the SEC, the rating agencies and others about Enron's actual financial performance, securities and wire fraud, and insider trading. Moreover, the amended complaint brings new allegations against Causey with respect to his role in the alleged bogus power swaps between Enron and Merrill Lynch in 1999.

Furthermore, Lead Plaintiff's supplement to paragraph 83(i)'s allegations against Richard Buy[16] draws on findings in the Powers Report. In particular it alleges that Buy served on Enron's Management Committee, was Chief Risk Officer, was present at Board meetings when the alleged SPE transactions were reviewed and approved, and represented to the Board that continually increased procedures and controls were being implemented over related-party transactions, including all LJM transactions. According to the allegations, the Board assigned Buy a substantial oversight role with respect to Enron's dealings with the LJM

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[15] The indictment also asserts that others Enron executives, including Andrew Fastow and Ben F. Glisan, Jr. were co-conspirators. Both have been indicted and have pled guilty, and Glisan is serving a five-year sentence, based on alleged facts that conform to allegations in the *Newby* complaint. CR No. H-02-665-01 and -02.

[16] *See* #1569, Ex. A; also #1571, Ex. A.

partnerships, which Buy was supposed to carefully review and approve, but that he failed to fulfill that duty. In particular, with respect to the Board's waiver of Fastow's conflict of interest, "Board members and Finance Committee members were told at meetings on 10/11/99 and 10/6/00 that one of the major safeguards checking Fastow's power would be that all transactions involving Fastow, Enron and the LJM partnerships would be reviewed and approved by Buy and Causey." There are also allegations, also based on the Powers Report, that the head of Enron's research group informed Buy about specific deceptions and flaws involved in the Rhythms NetConnection put-options strategy, and of Buy's specific role in implementing and concealing the Raptors fraud. The Court finds that Lead Plaintiff has satisfied the pleading requirements for its claims against Buy.

Thus for the reasons indicated above, the Court ORDERS that

(1) Hirko's motion to dismiss (#1448) and motion to strike (#1542) are DENIED;

(2) Harrison's motion to dismiss first amended complaint (#1494) is DENIED; and

(3) Certain Officer Defendants' motions to dismiss first amended complaint (#1509) are

DENIED.

SIGNED at Houston, Texas, this 15th day of March, 2004.

MELINDA HARMON
UNITED STATES DISTRICT JUDGE