

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

In re ENRON CORPORATION SECURITIES
LITIGATION

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

§

§ CLASS ACTION

This Document Relates To:

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

Plaintiffs,

vs.

ENRON CORP., 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.

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DECLARATION OF ROMAN L. WEIL

I, Roman L. Weil, declare as follows:

I. QUALIFICATIONS

1. I am the V. Duane Roth Professor of Accounting at the Graduate School of Business of the University of Chicago. I co-founded and am the Director of Directors' Consortium of the University of Chicago, which, with its predecessor programs, has been in existence for ten years. I head faculty governance at the University, in my role as Spokesman of the Committee of the Council of the University Senate.

2. I have been a member of the faculty of the University of Chicago since 1965. I have taught graduate courses in economics, mathematical economics, applied economics, accounting, corporate finance, mathematics and computer science. During this time, I have accepted visiting appointments to the faculties of other universities, including Visiting Professor of Accounting and Visiting Professor of Economics at Stanford University and Visiting Professor of Accounting and Law at the New York University School of Law. During the academic years 1990/91 through 1995/96, I was Visiting Professor at the Stanford University School of Law, teaching courses in economics and accounting.

3. For the past 13 years, I have taught classes on accounting and audit committee issues at Stanford University School of Law's Directors' College. In my roles at Chicago's and Stanford's Directors' Colleges, I teach members of corporate boards of directors and general counsel of corporations about the tasks of board members, particularly as audit committee members. I educate audit committee members about the attempts of manipulating managers to adjust reported income numbers to present a picture more favorable than they would otherwise show.

4. I received a Bachelor of Arts degree in economics and mathematics from Yale University in 1962. In 1965, I received a master of science degree in industrial administration from Carnegie Mellon University. In 1966, I received a Ph.D. in economics from Carnegie Mellon.

5. I am a Certified Public Accountant and a Certified Management Accountant. I have been a member of the Financial Accounting Standards Advisory Council and of the Financial Accounting Standards Board Task Force on Financial Instruments. I have consulted with the U.S. Treasury Department, including the Internal Revenue Service, and the U.S. Securities and Exchange Commission ("SEC").

6. I have participated in the publication of several professional periodicals. I have held, at various times, the responsibilities of associate editor, departmental editor and member of the editorial board. I am the author or co-author of several books, articles, notes and reviews concerning accounting and economics. I serve on the board of directors of, and chair the audit committee of, the Mainstay Funds of New York Life Insurance Company. I have significant experience in quantification of damages in securities fraud cases. A complete list of my professional activities and works appears in my curriculum vitae, which I have attached to this Declaration as Exhibit A.

7. I have previously testified as an expert witness before various federal and state courts and administrative agencies, as well as in several arbitration proceedings. Several courts have qualified me to provide expert testimony on issues related to the calculation of damages for violations of the federal securities laws. In *In re Cendant Corp. Litig.*, No. 98-1664 (WHW) (D.N.J.), I submitted an affidavit evaluating the methods used in the plan of allocation to decide whether it was fair, reasonable and adequate and I opined on whether the court should reject plaintiffs' proposed plan of allocation in favor of an objector's proposal. My opinion was accepted by the court and cited in *In re Cendant Corp. Sec. Lit.*, 109 F. Supp. 2d 235 (D.N.J. 2000), *aff'd*, 264 F.3d 201 (3d Cir. 2001). Exhibit B, attached, lists my sworn testimony from 2007 back through 2000 and Exhibit C attached, lists the documents supplied to me by the attorneys in this case.

8. I charge \$1,500 per hour for my time.

II. ASSIGNMENT

9. Counsel for the Lead Plaintiff, The Regents of the University of California (“The Regents”), has asked me to answer the following question. Is the proposed Plan of Allocation fair, reasonable, and adequate? Yes.

10. I have studied the Plan of Allocation described in the Notice of Hearing for Final Approval of Plan of Allocation of Settlement Proceeds, and some of its predecessor drafts. I have seen at least some of the comments to the initial Plan which Lead Counsel distributed in July/August, 2007 for public comments. I have some familiarity with the changes that have occurred in the Plan from initial conception through this final Plan, including changes to the Plan in response to the comments.

11. Counsel informs me that I should interpret “fair, reasonable, and adequate” as a single four-word phrase, rather than attempt to analyze each of the component notions separately. I will refer to the notion as FRA, rather than write out the phrase.

12. No plan of allocation can be uniquely FRA – that is, the given plan is FRA and no others can be. Fair stems from underlying assumptions and choices. The preceding statement is not an axiom of economics¹ but results from my judgment, which I have reached by observing lawyers, judges, estate planners, parents and children.

13. *Example.* Estate lawyers know that both “per stirpes” and “per person” distributions of assets to a decedent’s heirs are workable and that some testators prefer per stirpes, while others prefer per person. No principle other than a starting assumption will tell an estate planner which to

¹ One of the nation’s top young economists, Gregory Mankiew of Harvard, former chairman of the President’s Council of Economics Advisors said in the *New York Times*, July 15, 2007: “Fairness is not an economic concept. If you want to talk fairness, you have to leave the department of economics and head over to philosophy.”

prefer over the other. A beneficiary child, himself childless, who argues that a distribution per person to children and grandchildren is unfair, because he gets less than his sister's branch of the family gets, has focused on per stirpes as fair. He isn't right. We have no way to judge the merits of his arguments. We can see only if we have distributed assets as the testator has wanted. The testator has been fair, as well as reasonable and adequate. There is, however, no unique notion of fair.

14. Parents know that our child often labels our treatments of his/her siblings as "unfair" when we don't treat them all the same. But they don't analyze whether we are equalizing the inputs to them, or the outputs. Or, we might intend to give to each according to his need (the learning disabled child gets special, high-cost education) or to each according to his ability to exploit the gift (the analytically talented child gets tuition paid for law school, while the less talented mind gets tuition paid only for trade school). All are fair, reasonable, and adequate. None is uniquely so.

15. In this case, a similar issue arises with respect to treatment of what Counsel refers to as *claims rate*. Imagine two classes of securities, Note A with claims totaling \$300 (held by eight people each with \$37.50 claims, of whom six show up with valid claims) and Preferred B with claims totaling \$100 (held by five people each with \$20 claims, of whom four show up with valid claims). Ten authorized claimants qualify for distribution. Assume, further, that the plan of distribution has \$120 to distribute.

(a) One reasonable and systematic plan of allocation splits the \$120 based on the face value of the claims: $300/(300 + 100) = 75\%$, or \$90, to the Note A claimants and 25% (= $\$100/\400) of \$120, or \$30, to the Preferred B claimants. Then, each of the Note A six authorized claimants gets \$15.00 (= $\$90/6$), while each of the Preferred B four authorized claimants gets \$7.50 (= $\$30/4$).

(b) Another reasonable and systematic plan of allocation splits the \$120 equally between the ten authorized claimants, so each gets $\$12 = \$120/10$.

(c) Another reasonable and systematic plan treats all valid claimants equally in giving each the same percentage of his recognized claims. In the example, it works this way: Six claimants each have a \$37.50 loss, totaling \$225, and four claimants each have \$20 of loss, totaling \$80. The ten valid claims total losses of \$305 = \$225 + \$80. These \$305 of claims each get $\$120/305 = \$.3944$ per dollar of claim. The six purchasers of A securities each get \$14.75 (= $.3944 \times \$37.50$) and the four purchasers of B securities each get \$7.87 (= $.3944 \times \$20$).

16. The first treats securities equally. The second treats authorized claimants equally – one cannot gain because others holding the same security as you fail to valid claims. The third combines the two principles. None of these is fairer than the others until one states assumptions as to what the plan should treat equally.

17. Counsel tells me, and my discussions confirm this, that The Regents have thought about these alternatives for this choice and have said that the plaintiff prefers the third of these. We can describe it as seeing that the recovery of a class member does not depend on the behavior of other class members, who may, or may not, qualify their losses as valid claims.

18. So, when I opine that the distribution plan is FRA, I do not mean that it is uniquely FRA.

19. The plan results from a series of stated assumptions and procedures (such as the one above as to how to treat the claims rate issue), which I list below. For some of these, I describe rejected alternatives. Some of the alternatives would give allocations that I'd also judge to be FRA.

20. Counsel tells me that there are more than a million class members who may submit claims and later receive distributions under the allocation and that, inevitably, some of them will complain that the plan is unfair, at least to them.

21. To those, I lay down the challenge: don't tell me that you find the outcomes unfair. Tell me what about the rules and procedures, from which Counsel and the Lead Plaintiff have derived the Plan, are wrong.

22. One who complains, merely, that he doesn't like the outcome and gives some reason why the outcome appears not FRA needs to say what about the rules, which generated that outcome, is not FRA. Otherwise, I think the Court should ignore such complaints.

23. The facts and principles underlying the Plan as well as the algorithm/procedure for devising it include the following.

- (a) The total estimated losses sum to approximately \$44.0 billion.
- (b) The pot, which the plan must allocate to the losses, exceeds \$7.2 billion.
- (c) Two categories of securities have potential recoveries from the net settlement fund: securities which the Newby complaint includes (hereafter referred to as Category 1 securities) and securities that the settling defendants have added to the set of securities subject to the settlements (hereafter referred to as Category 2 securities). Some of the Category 2 securities had price movements which reacted to the disclosure of the alleged Enron fraud. Purchasers of such Category 2 securities – those whose price movements reacted to disclosure of the Enron fraud – need show proof only of their purchase and sale/hold activity. Purchasers of all other Category 2 securities must show the relation of the security's price movements to disclosure of the Enron fraud and must provide the prices at which they bought and sold. The Plan excludes securities from receiving distributions when the analysis cannot show a relation between the security's price movements and disclosure of the Enron fraud.
- (d) Some of the losses result from damages under §11 and all the others from damages under §10(b). The Plan allocates to claims for losses under §11 in proportion to the settlements of the pure §11 claims. One settling defendant, Lehman Brothers ("Lehman"), faced

only § 11 claims at the time of settlement. Lehman settled \$545 million of claims for \$222.2 million, or \$.55 cents per dollar of claim. Another defendant, Bank of America (“BofA”), set aside claims with private claimants, and settled for \$.45 cents per dollar with the remaining class claimants. From these two observations, whether using either one alone or the simple average of the two, the Plan derives multipliers for all the § 11 claims. That multiplier is not sensitive to whether the input datum is .45 (BofA) or .50 (average) or .55 (Lehman).

(e) Acquirers of securities receive a distribution from the net settlement fund only if the acquirer acquired the security between 9/9/97 and 12/2/01, inclusive.² An alternative start date considered and rejected was 10/19/98. An alternative end date considered and rejected was 11/27/01.

(f) For the acquirer of a security to be entitled to a distribution from the net settlement fund, the price of the security must have declined as a result of disclosure of the Enron fraud.³ In implementing this rule for debt securities, the Plan requires that the acquirer hold the debt past 10/16/01 or have purchased it after that date. 10/16/01 is the date when Enron released information about its third quarter results, which began to reveal the true condition of Enron in such a way as to affect the prices of debt.

(g) In general, each Authorized Claimant will receive an amount determined by multiplying the net settlement fund by a fraction, the numerator of which is the authorized claimant’s

² Note that such acquirers don’t automatically receive a distribution. They must pass this test to be eligible for other screens before they become entitled.

³ In practice, this rule affects two sorts of issues: debt instruments that matured before disclosure of the fraud in October 2001 and certain Category 2 securities, as discussed above.

Recognized Claim and the denominator of which is the total Recognized Claims of all Authorized Claimants.⁴

(h) Treat all authorized claimants in a way so as to nullify the effect of differential claims rate, as illustrated above.

(i) Neither the Plan's authors nor the Claims Administrator will know the various claims rates until after the Plan is approved and is well on its way to implementation. Thus, the Plan cannot use as input the various claims rates on the various securities.

(j) Compute the recognized loss based upon the law relevant to each type of security – §§11, 10(b), and Texas Securities Act. In practice, this means that securities subject to the Texas Securities Act get rescissionary damages, §10(b) securities get inflation adjusted losses, and Section 11 securities get damages subject to some constraints in §11. For §10(b) losses, there are no statutory measures, only case law measures. Case law suggests that the Plan measures losses based on inflation in prices, not on market prices themselves. Example. Assume that on 9/15/98, an investor purchased one share of Enron common stock for \$20. At that time, the inflation in the market price was 12 percent, or \$2.40. That is, the value line establishes that the market price overstated the true value. The market price contains inflation of 12 percent, so that the true value was only \$17.60 (= \$20.00 - \$2.40). This investor held the share until 12/3/01, when it had a market price of \$.60 and the true value was also \$.60 – that is, price inflation of zero. This investor had a market loss of \$19.40 (= \$20.00 - \$0.60), but an inflation-adjusted loss of only \$2.40 (= \$2.40 – zero). The notion here is that such an investor paid \$17.60 (= \$20.00 - \$2.40) for the true value of an Enron share in 1998. That investor paid an additional \$2.40 as a result of the fraud. The Plan

⁴ Recognized Claim is a term used in this report and in the Plan of Allocation with a precise technical meaning, which I discuss later.

recognizes the investor's loss as \$2.40 and that is the basis for the proposed distribution to this investor.

(k) Measuring inflation itself requires judgments and assumptions. I have examined the ones underlying the Plan's analysis and find these FRA. The measure of inflation depends on a so-called value line, construction of which is standard in measuring class damages. Constructing the value line requires answers to some factual and theoretical questions. Here are the major ones for this Plan's value line:

- When should Enron's insolvency have been disclosed? The major choices are: the beginning of the class period and 3/30/00, when Enron published its 1999 Form 10-K report. The Plan uses 3/30/00. Others might propose earlier dates, but this is the latest date one could choose and therefore the date on which nearly all, except defendants who might argue that Enron was never insolvent, could agree that assuming Enron was insolvent, then it was insolvent by this date.
- Which approach to estimating the value line should the analysis use? The major choices are to construct the value line from industry and market indices or from Enron-specific disclosures and news stories that are in public view. The Lead Plaintiff prefers the latter of these because, as I understand, The Regents think using Enron-specific news makes more sense for constructing the value line. *A priori*, I have no reason to think either is better than the other and I have seen the results of using both. Whichever approach the analysis uses makes trivial differences in the Plan's proposed distributions between various claimants.
- Should the value line be based on stair-step, discrete events, or smoothed between the periodic dates when information comes to the public? The Plan uses the discrete date method because the information would have become public on discrete dates when Enron would have released its true financial statements.
- On what basis should Enron's true financial condition be based? The Plan based its view of Enron's true state on the financial restatements prepared by expert Saul Solomon. Among the various restated financial measures, the Plan uses cash flow from operations, rather than rejected alternatives such as revenues and net income. I concur that cash flow from operations likely gives a more accurate view of Enron's situation for these time periods than would revenues or net income.
- In using statistical regression analysis to estimate the value line, what choices of exogenous variables should the analysis use for market index, industry index, and control period. The plan uses the NYSE/AMEX/NASDAQ index, as compiled by the Center for Research in Securities Prices of the University of Chicago. This is unexceptional. For industry index, the Plan uses one constructed after analysis of dozens of alternatives. The components of the six-company index all have in common that they were in one of Enron's lines of business and, so far as I can tell, were not themselves tainted with the effects of fraud. The control

