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 RE J.P. MORGAN DEFENDANTS' MOTION TO DISMISS

Pending before the Court in the above referenced cause is Defendants J.P. Morgan Chase & Co., J.P. Morgan Securities Inc., and JPMorgan Chase Bank's (collectively, "J.P. Morgan Defendants'") motion to dismiss (#1498) the First Amended Consolidated Complaint (#1388).

Of the three, only J.P. Morgan Chase & Co. was named in the First Consolidated Complaint, and the Court found that Lead Plaintiff had stated claims against it under § 10(b) of the Securities Exchange Act of 1934 and possibly under Article 581-33A

of the Texas Securities Act, but ordered the latter claim to be repled. In the First Amended Consolidated Complaint, the two newly named J.P. Morgan Defendants are sued under § 10(b), and a § 20(a) control person liability claim is asserted against J.P. Morgan Chase & Co. Lead Plaintiff further sues J.P. Morgan Securities Inc. under § 12(a)(2) and J.P. Morgan Chase & Co. under § 15 of the Securities Act of 1933, based on the 7/12/01 offering by Marlin Water Trust II and Marlin Water Capital Corporation of 6.31% Senior Secured Notes and 6.19% Senior Secured Notes, both due in 2003.

The J.P. Morgan Defendants move for dismissal on five grounds. First they argue that the federal claims against J.P. Morgan Securities Inc. and JPMorgan Chase Bank under both statutes are time-barred. Second, Lead Plaintiff has failed to meet the pleading requirements of the Private Securities Litigation Reform Act of 1995 ("PSLRA") and Fed. R. of Civ. P. 9(b) for all fraud-based claims and failed to differentiate the allegations directed to J.P. Morgan Securities Inc. from those directed to JPMorgan Chase Bank, but instead indulged in impermissible group pleading. Third, the § 12(a)(2) claim fails because no plaintiff has alleged that he purchased the Marlin Water securities from J.P. Morgan Securities Inc. or that any plaintiff purchased them in a public offering. Fourth, Lead Plaintiff failed to plead facts necessary to show that J.P. Morgan Chase & Co. was a control person within

the meaning of § 20(a) and § 15. Fifth, the Texas Securities Act claim, arising out of the sale to the Washington Board and the "Note Subclass" of $250 million of 6.96% Notes due on 7/15/28 and $250 million of 6.40% Notes due 7/15/06 by J.P. Morgan and Lehman Brothers allegedly issuing false and misleading selling documents, fails because Lead Plaintiff has not alleged a primary violation of article 581-33A(2) nor shown that the Washington Board was in privity with any of the J.P. Morgan Defendants.

The Court hereby incorporates its previous memoranda and orders in *Newby*, in particular #1194, #1269, the recent memoranda and orders regarding ICERS' motion to intervene (#1999) and Merrill Lynch and Deutsche Bank Entities' motions to dismiss (#2036), and its new orders on various Bank Defendants' motion to dismiss (#2042, 2043, 2044, 2048, and 2050). Because the Court has already ruled on all the arguments put forth by J.P. Morgan Defendants for dismissal, it merely summarizes those conclusions and applies them here.

1. Statute of Limitations

Lampf's and Section 13's one-year/three-year statute of limitations/statute of repose governs Lead Plaintiff's claims against the J.P. Morgan Defendants. #1999 at 24-63.

The first *Newby* complaint alleging § 10(b) and § 20(a) claims was filed on October 22, 2001 and initially covered a Class Period from July 13, 2001-October 16, 2001, subsequently expanded

to cover from October 19, 1998-November 27, 2001 after a number cases were consolidated into *Newby* and Lead Plaintiff was appointed and filed the First Consolidated complaint. Thus the *Newby* action's Exchange Act claims were filed within the three-year statute of repose and both the first Complaint and the First Consolidated Complaint, filed on April 8, 2002, were filed within one year of any inquiry notice of fraud relating to Enron that has been urged by Defendants.

This Court has previously rejected the argument that Plaintiffs had inquiry notice of their Foreign Debt Securities claims against secondary actors as early as the October 2001, when Enron startled Wall Street with announcements of its restatement and when plaintiffs filed their first lawsuit (which did not name any secondary actors or assert 1933 Act claims and was limited to a few Enron officers), especially in light of the extraordinary complex and extent of the schemes involved.

The Court has found that the First Amended Consolidated Complaint does not "relate back" to the First Consolidated Complaint with respect to the added bank subsidiaries and claims against them under Federal Rule of Civil Procedure 15(c). Nevertheless, under the circumstances of this litigation, detailed in #2036 at 53-75, and pursuant to Federal Rule of Civil Procedure 15(a), the Court has found good cause for construing and has construed the January 14, 2003 letter from Lead Plaintiff's

counsel as a motion for leave to amend to name the subsidiaries of Bank Defendants and finds that January 14, 2003 was therefore the date the Amended Consolidated Complaint was timely filed for limitations purposes. #2036 at 66-74.

The Court has also found that Lead Plaintiff has timely asserted within the one-year statute of limitations the 1933 Act claims based on the Foreign Debt Securities (#1388 at 409-10, ¶ 641.2), since the earliest potential storm warnings to trigger notice inquiry for the Foreign Debt Securities Offerings were in the fall of 2002, and the motion for leave to amend, and therefore the amended complaint, were deemed filed on January 14, 2003, within one year of notice inquiry. Regarding the § 12(a)(2) claims against J.P. Morgan Securities Inc., and the derivative control person liability § 15 claim against J.P. Morgan Chase & Co., the offering by Marlin Water Trust II and Marlin Water Capital Corp. II occurred on July 12, 2001, within the three year period of repose.

2. Pleading Sufficiency under § 10(b), the PSLRA, and Rule 9(b)

In *McNamara v. Bre-X Minerals Ltd.*, 57 F. Supp. 2d 396, 428 (E.D. Tex. 1999), the district court recognized the general rule that "a subsidiary's [alleged] fraud cannot be automatically imputed to its corporate parent". *Id.*, quoting *In re Baesa Sec. Litig.*, 969 F. Supp. 238, 242 (S.D.N.Y. 1997). The district court in *Bre-X Minerals* noted that while the general rule is that fraud

must be pled with particularity as to each defendant in a multi-defendant case, an exception was recognized by this lower court in the Fifth Circuit, and as indicated by its cited authority, in the Third Circuit: "'[C]ourts should be 'sensitive' to the fact that application of the Rule prior to discovery 'may permit sophisticated defrauders to successfully conceal the details of their fraud.' *In re Burlington Coat Factory Litig.*, 114 F.3d 1410, 1418 (3d Cir. 1997). Accordingly, the normally rigorous particularity rule has been relaxed somewhat when the facts are exclusively within the defendant's knowledge or control, *Shapiro v. UJB Fin. Corp.*, 964 F.2d 272, 284-85 (3d Cir. 1992)," especially where "'defendants are insiders or affiliates participating in the statement at issue,'" as Lead Plaintiff contends is the case with the J.P. Morgan Defendants here. *McNamara v. Bre-X Minerals Ltd.*, 197 F. Supp. 2d 622, 672 E.D. Tex. 2001).

In a multi-defendant suit, the *Bre-X* court required more particularization **where possible** in the pleadings and insisted that "the Plaintiffs should, when possible, avoid attributing actions to the Kilborn Defendant's [*sic*] collectively. When not possible, the Plaintiffs should, when possible, offer an explanation as to why that is the case." 57 F. Supp. 2d at 428 The district court further discussed the rule that "a subsidiary's fraud cannot be automatically imputed to its corporate parent,"

but appeared to place the emphasis on "automatically" and required only something "more than the [mere] fact" that it was a parent company. *Id.*

The Court has already found that Lead Plaintiff stated a claim in the First Consolidated Complaint against J.P. Morgan Chase & Co. under § 10(b) based on numerous allegations,[1] some of which challenged actions are now directed at the new Defendants. In response to the motion to dismiss the new complaint, the Court finds that Lead Plaintiff does assert liability by J.P. Morgan Defendants based on facts beyond J.P. Morgan Chase & Company's control as a parent company. Lead Plaintiff argues that J.P. Morgan Chase & Company's Answer (#1206) to the First Consolidated Complaint demonstrates that the J.P. Morgan Defendants know which of them is responsible for which actions described in the Amended Complaint and at times identify the involved entity. *See, e.g.*,

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[1] Lead Plaintiff provides a copy of the SEC's complaint against J.P. Morgan Chase & Co. for aiding and abetting a violation of § 10(b), which became Civil Action No. H-03-287. #1685, Ex. A. The Court takes judicial notice of the fact that in H-03-287 the SEC and J.P. Morgan Chase & Co. ultimately entered into a consensual final judgment that included a permanent injunction against the bank barring it from violating § 10(b) and the payment by J.P. Morgan Chase & Co. of a total of $135,000,000: $65,000,000 as disgorgement and $65,000,000 in civil penalty, plus $5,000,000 in prejudgment interest. *See* instruments #4 and 7 in H-03-2877.

Moreover, the Court judicially notices that in *JP Morgan Chase Bank ex rel. Mahonia Ltd. v. Liberty Mutual Life Ins. Co.*, No. 01 CIV. 11523, JP Morgan sued to enforce surety bonds related to the allegedly fraudulent Mahonia deals; Judge Rakoff of the Southern District of New York found there were genuine material issues of fact for trial about whether the Mahonia deals were disguised loans and whether the bank was involvement in the fraud.

¶¶ 29, 48, 64, 65, 288,365, 389, 391, 496, 605, 652 and 690 of #1206. The Court views these as judicial admissions. *See* #2044 at 12 & n.4. Furthermore in Lead Plaintiff has submitted a copy of a summary, provided by JPMorgan Chase to Congressional investigators, detailing various securities underwriting, advisory and credit facilities these Defendants performed for Enron. The summary indicates the name of each project and which entity (usually J.P. Morgan Securities Inc. and/or JPMorgan Chase Bank and their predecessors in interest) was involved, as well as which other Bank Defendants participated. Ex. 37 to #1575.

Moreover, the First Consolidated Complaint and the First Amended Consolidated Complaint allege that J.P. Morgan Chase & Co. acted through its wholly owned subsidiaries, divisions, and/or affiliates to effect the fraudulent Ponzi scheme. Lead Plaintiff also contends, not for the first time, that under established agency law, both the agent and the principal are liable for the acts of the agent. As urged by Lead Plaintiff, and the Court agrees, "The number of different J.P. Morgan entities all working at the direction of the parent pursuant to a maze of corporate interconnections, in addition to the sheer complexity of the Enron fraudulent scheme and its thousands of affiliates and related entities, cautions against a hyper-technical application of the particularity requirements." #1574 at 92. Lead Plaintiff points out the J.P. Morgan's analyst reports bear the logo "J.P. Morgan"

and identify it as "the marketing name for J.P. Morgan Chase & Co.., and its subsidiaries and affiliates worldwide." #1575, Ex. 38. These reports are issued worldwide by multiple J.P. Morgan entities, an the parent and subsidiaries share similar names and hold themselves out as affiliates and are often referred to synonomously.

Although J.P. Morgan Defendants have charged Lead Plaintiff with group pleading, this Court observes that the judge-created group pleading rule was applied to individuals, i.e., officers and occasionally directors, in securities fraud case; it allowed a plaintiff to allege that these individuals were part of a group that published a statement and that because of their positions in that group, there was a presumption that these individuals participated in the making of that statement. *See, e.g., Wool v. Tandem*, 818 F.3d 1433, 1440 (9th Cir. 1987)("In the case of corporate fraud where the false or misleading information is conveyed in prospectuses, registration statements, annual reports, press releases, or other 'group-published information,' it is reasonable to presume that these are the collective actions of the officers."); *Luce v. Edelstein*, 802 F.2d 49, 55 (2d Cir. 1986)("[N]o specific connection between fraudulent representations in the Offering Memorandum and particular defendants is necessary where, as here, defendants are insider or affiliates participating the offer of the securities in question."); William O. Fisher,

Don't Call Me a Securities Law Groupie; The Rise and Possible Demise of the 'Group Pleading' Protocol in 10b-5 Cases, 56 Bus. Law 991 (2001). Thus it is not applicable nor employed here, where Lead Plaintiff is not suing individual members of the J.P. Morgan entities.

In light of all these circumstances, this Court agrees that the situation warrants relaxation of Rule 9's strict requirements, especially in light of the stay on discovery under the PSLRA and the earlier finding of this Court that no reasonable person could characterize this litigation as the kind of "strike suit" that the PSLRA was designed to eliminate. If after discovery, J.P. Morgan Defendants wish to contest their inclusion in this litigation, they may do so by summary judgment motion.

3. Standing and Private Offering under § 12(a)(2)

As discussed in #1999 at 65-66, 72-74, Lead Plaintiff, as distinguished from a class representative, has standing to sue for the § 12(a)(2) claims. Moreover, intervenor Plaintiff ICERS purchased Marlin Notes from the offering underwritten in part by J.P. Morgan Securities Inc., although it is not clear from which Defendant ICERS bought them. If, at the time of class certification, there is no class member that can demonstrate has standing to serve as a class representative for those who purchased Marlin Water Trust Notes from J.P. Morgan Securities Inc., the § 12(a)(2) against it and the derivative § 15 claim

against J.P. Morgan Chase & Co. will be dismissed. #1999.

As detailed in #2036 at 76-90, given Lead Plaintiff's allegations about the nature of the Foreign Debt Securities offerings, under Fifth Circuit law whether the offerings are public or private for purposes of § 12(a)(2) liability is a fact issue not properly resolved in the 12(b)(6) motion stage. It is CIBC Defendants' burden to prove an affirmative defense of exemption from the registration requirements or that the Marlin Water Trust Notes Offering was private.

4. Pleading Control Person Liability under § 20(a) and § 15

For control person liability generally and Lead Plaintiff's pleading burden, see #1194 at 64-67, 71-73; #1241 at 24-42. Because the Court has found that Lead Plaintiff has pled predicate securities violations under §§ 10(b) and 12(a)(2), it has pled the basis for a derivative control-person liability claim against J.P. Morgan Chase & Co. under § 20(a) and § 15.

In *Newby*, the Court has discussed not only the lack of clarity in the Fifth Circuit's position regarding the pleading requirements for control person liability (*see, e.g.*, #1241 at 24-31), but also its more lenient standards compared with those of other Circuit Courts of Appeals. As discussed in #1241, it appears that the Fifth Circuit requires the pleading, in addition to status or position, of some facts that show the defendant had power to directly or indirectly control or influence corporate

policy, e.g., through ownership of voting securities, contract, etc., or had knowledge of the primary violation by the controlled person. As elements of a *prima facie* case of controlling person liability, the Fifth Circuit has expressly rejected more stringent requirements such as actual participation in the primary violation and/or the actual exercise of the controlling person's power to control. This Court has also held that notice pleading under Rule 8 (a "short plain statement of the claim showing the pleader is entitled to relief"), rather than heightened pleading under Rule 9, applies to control person liability claims, and thus a plaintiff need not allege facts to support every element of a *prima facie* case (#1241 at 31-42). Discovery is available to flesh out the facts.

Here the First Amended Consolidated Complaint at 116, ¶99.1, has alleged that

> Each of the bank holding company entities sued as defendants herein conducts business affairs through a series of wholly owned and controlled subsidiaries where the bank holding company directly or indirectly owns 100% of the stock of the subsidiaries and completely directs and controls their business operations through the selection and appointment of their officers and, where necessary, directors. These controlled subsidiaries are also the agents of the bank holding company entities and include investment bank subsidiaries as well as other specialized subsidiaries rendering financial advice and services to public companies, including Enron. The financial operations and condition of these subsidiaries are--for financial reporting and other purposes--consolidated with the bank

> holding company's financial statements. Thus, all revenues, earnings and income of the bank holding company subsidiaries are upstreamed to and belong to the bank holding companies. The bank holding companies named as defendants in this action all participated in the fraudulent scheme and course of business complained of, not only by way of the actions of the holding company itself, but also by way of the actions of numerous of its controlled subsidiaries and agents, some of which have been named as defendants in this action as well.

The Court finds that Lead Plaintiff has given sufficient notice and stated a claim for controlling person liability against J.P. Morgan Chase & Co. under § 20(a) of the Exchange Act and, arising from the sale of the Marlin Water Trust notes, under § 15 of the 1933 Act.

5. Texas Securities Act Claim

Lead Plaintiff's Fifth Claim for Relief on behalf of Plaintiff/purchaser the Washington Board and the "Note subclass" ("all other States, political subdivisions thereof and/or State Pension Plans") based on alleged violation of Article 581-33A(2) for primary liability against the two underwriters, JP Morgan and Lehman Brothers, which are asserted to have jointly issued or participated in the issuance of material misrepresentations or omissions in the registration statement and prospectus in the sale of $250 million of 6.95% Notes due 7/15/28 and $250 million of 6.40% Notes due 7/15/06.

Lead Plaintiff has alleged privity between the plaintiffs and either Lehman Brothers or J.P. Morgan, the two lead

underwriters the Enron notes could be purchased. Lead Plaintiff has also provided documentary evidence of Lehman Brothers confirming the purchase by the Washington State Board. Ex. 25 to #1575. Lead Plaintiff now argues that since Washington Board was in privity with Lehman Brothers, it can represent a sub-class of plaintiffs who are in privity with either of the two underwriters.

As noted previously (#1194 at 9), where the Texas statute is similar to the federal securities statutes, in this case § 12(a)(2) of the 1933 Act, Texas courts look to cases construing the federal statutes for guidance. *In re Westcap Enterpises*, 230 F.3d 717, 726 (5th Cir. 2000); *Beebe v. Compaq Computer Corp.*, 940 S.W.2d 304, 306-07 (Tex. App.-Houston [14th Dist.] 1997, no writ); *Searsy v. Commercial Trading Corp.*, 560 S.W.2d 637, 629 (Tex. 1977). As this Court previously held, article 581-33A(2) requires a showing of privity between the statutory "seller" and a plaintiff/purchaser of the security, but no demonstration of reliance or scienter (#1269 at 37-49).

In its discussion of article 581-33A(2) of the Texas Securities Act (#1269 at 37-49), relying on the Supreme Court's construction of § 12 in *Pinter v. Dahl*, 486 U.S. 622 (1988), this Court has previously concluded that for primary liability under the Texas statute the purchaser/plaintiff may sue only his immediate "seller" (i.e., the person and/or his agent who successfully passes title who actively solicited the purchase).

Thus, as with § 12(b)(2), Washington Board may only sue the underwriter which passed title or successfully solicited its purchase of the Notes. Given the evidence submitted, it appears that underwriter is Lehman Brothers, not J.P. Morgan. As with the § 12(b)(2) claims, Lead Plaintiff, as distinguished from a class representative, may allege article 581-33A(2) against J.P. Morgan Defendants, but by class certification time must either identify a qualified class representative to prosecute such claims on behalf of the subclass or the claims against J.P. Morgan Defendants will be dismissed.

Accordingly, for the reasons stated, the Court

ORDERS that the J.P. Morgan Defendants' motion to dismiss is DENIED.

SIGNED at Houston, Texas, this 31st day of March, 2004.

MELINDA HARMON
UNITED STATES DISTRICT JUDGE