United States Courts
Southern District of Texas
ENTERED

JUN 15 2004

Michael N. Milby, Clerk of Court

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 H-03-862	§	
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.	§	
WAI CHINN, Individually and on Behalf of All Those Similarly Situated, Plaintiff,	§	
VS.	§	CIVIL ACTION NO. H-03-862
ROBERT A. BELFER, ET AL., Defendants.	§	

MEMORANDUM AND ORDER

Pending before the Court in member case H-03-862, alleging that Defendants disseminated SEC filings, financial statements, and auditor opinion letters that misrepresented the financial condition of Enron Corporation on which Plaintiff and a

putative class relied in deciding to hold onto their Enron securities, is a motion to remand (instrument #9) filed by Plaintiff Wai Chinn on behalf of herself and all others similarly situated.

H-03-862 was originally filed in the Multnomah County Circuit Court in the State of Oregon on January 9, 2002 on behalf of current and former owners of Enron securities who purchased these instruments before October 16, 1998 and held them through November 27, 2002, the proposed "Class Period." The suit alleges negligent misrepresentation, common law fraud, and breach of fiduciary duty under Oregon state law against all of the Defendants, who are composed of former Enron officers, directors, outside auditor, and privately held affiliates.

This Court hereby incorporates previous memoranda and orders issued in *Newby* and member cases, in particular #995, 1714, #45 (reconsidering the applicability of the unanimity rule to § 1452 removals) in H-03-2345, *Walker et al. v. Arthur Andersen, et al.*, #2143 in *Newby*, and #12 in H-02-1922, *Barsky v. Arthur Andersen, et al.*[1]

Procedural History

On February 1, 2002, the suit was jointly removed by the Outside Director Defendants (Robert A. Belfer, Norman P. Blake, Jr., Richard Causey, Ronnie C. Chan, John H. Duncan, Joe E. Foy, Wendy L. Gramm, Robert Jaedicke, Charles LeMaistre, John

[1] Harrison has provided a copy of this last order, Ex. 3 to #16 (Declaration of Zachary W.L. Wright), in H-03-862.

Mendelsohn, Paulo V. Ferraz Pereira, Frank Savage, John Wakeham, Charles Walker, and Herbert S. Winokur, Jr.) and by Arthur Andersen, LLP[2] to the United States District Court for the District of Oregon under the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"), 15 U.S.C. § 78p *et seq.* At that time Defendant Ken L. Harrison ("Harrison") had not been served. The federal district court remanded the suit to state court by order dated September 23, 2002 because Plaintiff asserted only "holding" claims and there was no purchase or sale of securities to support a federal securities claim.[3]

On October 10, 2002, Harrison served notice of his waiver and acceptance of service of the original complaint and, within thirty days, filed a notice of removal asserting "related to" bankruptcy jurisdiction[4] under 28 U.S.C. § 1334 and § 1452 and

---

[2] Copy of notice of notice of removal is attached to #1.

[3] Copies of the magistrate's findings of fact and conclusions of law (determining it lacked subject matter jurisdiction under SLUSA because there was no purchase or sale of securities to support a federal securities claim) and of the district court's order, adopting them and remanding the case, are attached as Exs. 2 and 1, respectively, to #11.

[4] The Enron Chapter 11 bankruptcy proceedings were filed in the United States Bankruptcy Court for the Southern District of New York, *In re Enron Corp., et al.*, No. 01-16034, on December 2, 2001, before this action was commenced.

Bankruptcy proceedings for LJM2 Co-Investment L.P. ("LJM2"), which, along with its "manager" Andrew Fastow, is a Defendant in this suit, were filed on September 25, 2002 in the United States Bankruptcy Court for the Northern District of Texas, Dallas Division.

Removing this action within thirty days after waiving service on October 10, 2002, Harrison has asserted that this suit is "related to" both bankruptcies. This Court has previously ruled that the unanimity rule does not apply to removals under § 1452. (# 2143).

Bankruptcy Rule 9027, a ground for removal not previously claimed. That notice of removal was joined in and consented to by the Outside Director Defendants and Defendant Jeffrey K. Skilling. The suit was subsequently transferred by the Judicial Panel on Multidistrict Litigation to the undersigned judge under 28 U.S.C. § 1407 for inclusion in MDL 1446.

Arguments of the Parties

Plaintiff Wai Chinn's motion to remand rests on two arguments. First, he insists, "related to" bankruptcy jurisdiction does not exist over a class action alleging state-law claims against non-debtor defendants, including officers and directors of the debtor corporation, who allegedly defrauded plaintiffs in a Ponzi scheme. *In re ACI-HDT Supply Co. v. Kuhlman*, 205 B.R. 231 (9th Cir. 1997)(holding "related to" bankruptcy jurisdiction did not exist in a case alleging a Ponzi scheme where the debtor was not named as a defendant, the claims were "non-core" and based solely on state law, the plaintiff sought redress for conduct of defendants for which they were jointly and separately liable, and there was no attempt to usurp causes of action belonging to the bankruptcy trustee).[5] Second,

[5] The facts in the case *sub judice* are distinguishable from those in *ACI-HTD*. In the latter suit, the debtor was not a named defendant, nor were any of its affiliates. 205 B.R. at 232. Here LJM2 was named, since it did not go into bankruptcy until September 2002, but Enron could not be named as a defendant because it went into bankruptcy before the suit was filed. Significantly, in *ACI-HDT* there were no liability insurance policies involved for third-party claims of indemnity and contribution. Furthermore, although the *ACI-HDT* court did state that state law claims could exist outside bankruptcy court and that the claims asserted against the debtor were not core proceedings, it also observed that such claims

Plaintiff contends that Enron Bankruptcy Judge Arthur Gonzalez has ordered *Chinn* to proceed in Oregon state court, where the state court was also to determine whether Plaintiffs may assert a claim for fraudulent inducement to hold securities, a "direct" as opposed to "derivative" (and therefore property of the Enron estate) claim, under Oregon law.[6] Chinn further contends that the "second removal is simply another attempt to get this action transferred to the Southern District of Texas--a forum wholly unrelated to the bankruptcy proceedings" and "to deprive Oregon state court of a case it should decide." Of course that issue is moot in light of the transfer by the Judicial Panel for Multidistrict Litigation.

In response (#15), Harrison insists that he has satisfied his burden under the "any conceivable effect test" for

---

might still fall within the "otherwise related to" bankruptcy jurisdiction if the proceedings could alter the debtor's rights, liabilities, options, or freedom of action and in any way impact upon the handling and administration of the debtor's estate. 205 B.R. at 235, 236, 237.

[6] Enron and some of its subsidiaries, as debtors and debtors in possession, filed a motion in the Enron bankruptcy proceedings for a "Global Order Pursuant to Section 362(a) of the Bankruptcy Code, to Enforce the Automatic Stay and Prevent Plaintiffs from Prosecuting Derivative Claims in Violation Thereof ('Motion to Stay'." Plaintiff contends that Judge Gonzalez denied the motion on the ground that it implicated a novel question of Oregon state law, i.e., whether Oregon recognizes a shareholder's direct action for a director's breach of fiduciary duty or common law fraudulent inducement, and that he ordered the suit to proceed in Oregon state court. As noted, the Oregon federal district court, adopting its magistrate's recommendations, had previously remanded the case to Oregon state court for that reason and because "the factors of judicial economy, fairness, and comity all point toward remand rather than toward the exercise of supplemental jurisdiction." Ex. 2, at 15, to #11.

"related to" bankruptcy jurisdiction,[7] established in *Pacor, Inc. v. Higgins*, 743 F.2d 984, 994 (3d Cir. 1984), *overruled on other grounds, Things Remembered, Inc. v. Petrarca*, 516 U.S. 124 (1995). Harrison further argues that Plaintiff has mischaracterized Judge Gonzalez's Memorandum Decision (Ex. 9 to #11) regarding the motion for global stay. Harrison points out that Judge Gonzalez issued his order after this case had been remanded to state court for lack of jurisdiction under SLUSA, and six days before Harrison would remove it to federal court a second time under § 1452. Thus Judge Gonzalez, who was attempting to determine what claims in proceedings in other courts would be subject to the § 362 automatic stay in the Enron bankruptcy, in light of the recent remand of *Chinn*, expected the Oregon state court to address the undecided question whether the shareholders can assert direct claims for breach of fiduciary duty and fraudulent inducement under Oregon state law; Judge Gonzalez did not know at the time that a second removal to federal court would soon occur. Judge

---

[7] In *Celotex Corp. v. Edwards*, 514 U.S. 300, 308 n.6 (1995), the Supreme Court observed that the Third Circuit's *Pacor* test has been adopted "with little or no variation" by the First, Fourth, Fifth, Sixth, Eighth, Ninth, Tenth, and Eleventh Circuits. The Second Circuit initially adopted what appeared to be a stricter test, i.e., whether the suit had a "significant connection" to the bankruptcy proceedings. *In re Turner*, 724 F.2d 338, 341 (2d Cir. 1983). Subsequently the Second Circuit announced that its "significant connection" test was the same as *Pacor's* "any conceivable effect" test. *In re Cuyahoga Equipment Corp.*, 980 F.2d 110, 114 (2d Cir. 1992). The Seventh Circuit has a much narrower test for related to bankruptcy jurisdiction: "when the dispute 'affects the amount of property for distribution or the allocation of property among creditors." *In re Memorial Estates, Inc.*, 950 F.2d 1364, 1368 (7th Cir.), *cert. denied*, 504 U.S. 986 (1992); *Matter of FedPak Systems, Inc.*, 80 F.3d 207, 213-14 (7th Cir. 1996).

Gonzalez did not order that the Oregon state court, rather than the federal district court, should address the question nor that the state court could decide whether the federal district court has subject matter jurisdiction. Now that the case has been removed again, as well as transferred, Harrison maintains that this court has an obligation to determine its own subject matter jurisdiction, regardless of whether it involves a novel question of state law. *Marbury v. Madison*, 5 U.S. 137, 1 Cranch 137 (1803).

Furthermore, Harrison points out that Judge Gonzalez lifted the automatic stay to allow the proceeds of those D&O liability policies to be advanced for defense costs after Defendants argued that if Enron had any interest in the policy proceeds (which Defendants tried to deny), that interest was subordinate to Defendants' right to the proceeds for their defense expenses. Judge Gonzalez agreed that the bankruptcy estate's interest was sufficient to require an order lifting the automatic stay so that they could use the insurance monies for defense costs. Ex. 5 (transcript of proceedings before Judge Gonzalez) at 13, 16 to #16.

Furthermore, argues Harrison, contrary to Plaintiff's claims, it has long been established under Oregon state law that a shareholder does not have a personal right of action based on harm to the corporation and cannot maintain an action against a third party for a wrong to the corporation that results in diminution of the value of his stock. *Smith v. Bramwell*, 146 Or.

611, 615 31 P.2d 647, 649 (1934); *Weiss v. Northwest Acceptance Corp.*, 274 Or. 343, 348-49, 546 P.2d 1065. 1069-70 (1976).[8] When the injury from claimed corporate mismanagement and fraud is diminution of the corporation's stock, the shareholder's causes of action are derivative. *Smith*, 146 Or. at 617; *Loewen v. Galligan*, 130 Or. App. 222, 228 882 P.2d 104, 111 (Or. App. 1994), *rev. denied*, 310 Or. 493, 887 P.2d 793 (Or. 1994). Only where the shareholder has a "special injury," i.e., a wrong suffered by him that is not suffered generally by the other shareholders or a violation of a contractual right of the shareholder that is distinct to him, can a shareholder assert a direct claim. *Loewen*, 130 Or. App. at 228.

Moreover, Harrison points to paragraph 15 in his supplemental amended notice of removal (#3), which identified a number of reasons why this action is likely to have a significant effect on the Enron bankruptcy estate. He now emphasizes three: "(1) plaintiff's claims are derivative claims and therefore property of the bankruptcy estate[9]; (2) his claims directly give

---

[8] This Court notes that Judge Gonzalez discussed *Weiss* in his Memorandum Decision at 11. Ex. 9 to #11.

[9] Harrison *inter alia* cites as authority, *Smith v. Bramwell*, 146 Or. at 615 (derivative claims belong to bankruptcy estate); *Mitchell Excavating, Inc. v. Mitchell*, 734 F.2d 129, 131-32 (2d Cir. 1934)(only bankruptcy trustee may decide whether to pursue claims on behalf of the estate), as well as this Court's Order Denying Remand, Consolidating [with *Pirelli*] and Administratively Closing Action, #12 in H-02-1922, *Barsky, et al. v. Arthur Andersen, LLP, et al.* (copy attached as Ex. 3 to #16 in H-03-862), because this Court determined that it had "related to" bankruptcy jurisdiction over claims similar to those asserted by Chinn and because it found that Barsky's claims were derivative holding claims.

rise to cross- and third-party claims that will affect Enron's bankruptcy estate[10]; and (3) his claims will affect any interest Enron's bankruptcy estate may have in the proceeds of its directors and officers liability insurance policies."[11] #15 at 4-5.

Harrison also claims that this action also "relates to" LJM2's bankruptcy proceedings because of potential cross- and third-party claims, especially because Plaintiff has named LJM2 as a defendant and has alleged that it and its manager directly participated in the conduct giving rise to the claims asserted here. Harrison further contends that Plaintiff's attempt to voluntarily dismiss LJM2 from this action (#6) was ineffective because Plaintiff failed to secure an order from the Court, as required by Fed. R. Civ. P. 23(e) and the Ninth Circuit, *Diaz v.*

This Court notes that in the Enron bankruptcy, no trustee was appointed, but the bankruptcy judge approved the corporation's restructuring by Stephen Cooper, an executive experienced in such matters, and Enron thus remains a debtor-in-possession.

[10] Harrison cites this Court's Memorandum and Order at 14-16, #1714 in *Newby*, holding that potential third-party claims for contribution and indemnity can sustain "related to" bankruptcy jurisdiction. He represents that many of the defendants here are in the same position as J.P. Morgan Chase And Company in the suit addressed by that order. He also points to Oregon Revised Statutes § 60.391 to show that under that state's law a corporation may indemnify its officers and directors against claims based on their service to the corporation, and that Enron's corporate governance documents expressly assert that obligation. Moreover, Oregon common law also provides a basis for indemnity claims. *Fulton Ins. Co. v. White Motor Corp.*, 261 Or. 206, 210, 493 P.2d 138 (1972). Harrison states that to the extent he prevails, defendants are likely to seek recovery from Enron.

[11] Harrison has attached a copy of one of Enron's D&O insurance policies as Ex. 4 to #16.

Trust Territory of Pacific Islands, 876 F.2d 1401, 1408 (9th Cir. 1989).

Finally, Harrison maintains that even if this Court lacks original jurisdiction, it has supplemental jurisdiction under 28 U.S.C. § 1367. This Court has previously held that it cannot have supplemental jurisdiction, under 28 U.S.C. § 1367, without the existence initially of original federal subject matter jurisdiction over at least some claim in the same suit at the time when the action was filed in or removed to federal court. *See, e.g.*, #995 at 4-5. Thus if there is no "related to" bankruptcy jurisdiction, the Court lacks supplemental jurisdiction over remaining claims.

In reply, Plaintiff insists that, as recognized by Judge Gonzalez,[12] her claims are not derivative, but direct holder claims

---

[12] Despite Plaintiff's characterization, Judge Gonzales did not "recognize" that her claims were direct rather than derivative. He discussed cases from Oregon as well as other states putting forth the majority rule that for a direct action, a shareholder must have an injury that is separate and distinct from that suffered by the corporation and one not suffered by all shareholders. Memorandum Decision at 11. Moreover, about *Malone* he wrote,

> The *Malone* court recognized the possibility for a shareholder to assert a direct action for a director's breach of fiduciary duty when making misrepresentations even in the absence of a request for shareholder action. Although the *Malone* court did allow for the possibility that a direct action could be asserted by a shareholder based on a directors [*sic*] breach of its fiduciary duty to the shareholder in making false disclosures, the *Malone* court, nevertheless, recognized the continued viability of the distinction between direct and derivative actions and the need for a party to adequately set forth the predicates for the particular type of action pled.

under the holding of *Malone v. Brincat*, 722 A.2d 5 (Del. Supr. 1998)(holding that a holder of a corporation's securities may sue in his individual capacity under state common law theories for damages against directors where such defendants have breached duties to the shareholders by misrepresenting the financial condition of the corporation), and progeny. Global Stay Order, Ex. 9 of affidavit of Robert Banks, #11.[13] She argues that even

---

> *Malone v. Brincat*, 722 A.2d at 14. In allowing the plaintiffs an opportunity to replead what appeared to be a derivative claim, the court noted that "[t]his will require an articulation of the classic 'direct v. derivative' theory." *Id.* at 14 n.45. The *Malone* court also acknowledged that damages based on "injury to the corporation" are derivative. *Id.* at 14.

Memorandum Decision at 13-14.

[13] Chinn also claims that United States Magistrate Judge Steward recognized that Chinn's claims were direct claims in the Magistrate's Findings and Recommendations supporting remand (see Ex. to #11, Affidavit of Robert Banks, Jr. or Ex. 1 to #22, First Supplemental Declaration of Zachary W.L. Wright), which were adopted by the Oregon federal district court judge (Ex. 1 to #11, adopting magistrate's recommendation "in its entirety") when she recommended remanding the case for lack of jurisdiction under SLUSA. Specifically Magistrate Judge Stewart wrote in her Findings and Recommendations at 15:

> [T]he only claims plaintiffs assert raise novel issue under state law, namely whether and under what circumstances a plaintiff may assert a claim that he or she was fraudulently induced to hold securities. Given this circumstance, principles of comity weigh heavily against retaining this action.

This Court observes that, contrary to Plaintiff's argument, Magistrate Judge Stewart made no determination whether the claims were direct or derivative, but made clear the issue had not been addressed by the state's courts and, since there was no federal jurisdiction, left it to them to decide. Because there was no jurisdiction under SLUSA, her remarks regarding comity are dicta.

though Oregon courts have not addressed *Malone*, Oregon law is consistent with its holding and would follow it. Moreover, when Judge Gonzalez left the issue to the Oregon state court to decide, he knew that it would not be addressing whether a federal district court had jurisdiction, as Defendants have argued, but whether such a direct claim exists under Oregon state law.

Chinn also contends that she does not seek any relief from LJM2 and does not intend to violate the automatic stay in its bankruptcy, and thus there is no risk of cross-claims or third-party claims that would affect that debtor's bankruptcy estate. Chinn maintains that hypothetical indemnification and contribution claims do not affect the bankruptcy estates at issue and do not support "related-to" bankruptcy jurisdiction here. Finally, she reiterates that Rule 23(e) does not apply to pre-class-certification dismissals under Fed. R. Civ. P. 41(a)(1)(i).

Court's Decision:

Chinn's Rule 41(a)(1) Notice of Dismissal of LJM2

Shortly after this second removal, Plaintiff filed a unilateral notice of [voluntary] dismissal of LJM2 and affiliated entities without prejudice pursuant to Fed. R. Civ. P. 41(a)(1)(i)[14] (#6). In most circumstances such a notice would effect Plaintiff's absolute right to dismiss that party. *Williams*

---

[14] Rule 41(a)(1)(i) allows a plaintiff to voluntarily dismiss an action, without prejudice, and without a court order "by filing a notice of dismissal at any time before service by the adverse party of an answer or of a motion for summary judgment . . . ." No answers or motions for summary judgment have been filed in *Chinn*.

v. Ezell, 531 F.2d 1261, 1263-64 (5th Cir. 1976)("a plaintiff is entitled as a matter of right to dismiss its complaint where no responsive pleading has been filed . . . ."); *Carter v. U.S.*, 547 F2d 258, 258-59 and n.1 (5th Cir. 1977)("plaintiff has an absolute right to dismiss a lawsuit before defendant files an answer or a motion for summary judgment" and "Defendants who desire to prevent plaintiffs from invoking their unfettered right to dismiss actions under rule 41(a)(1) may do so by taking the simple step of filing an answer.").

As a threshold matter, this Court observes that although some courts have held that Fed. R. Civ. P. 41(a)(1)'s dismissal of an "action" by notice or stipulation refers only to dismissal of the entire action, the Fifth Circuit has rejected that view and concluded that the rule does allow a plaintiff to dismiss fewer than all the named defendants that have not filed an answer or a motion for summary judgment. *Plains Growers, Inc. v. Ickes-Braun Glasshouses, Inc.*, 474 F.2d 250, 253 (5th Cir. 1973); *Oswalt v. Scripto*, 616 F.3d 191, 194 (5th Cir. 1980). The Ninth Circuit, in which this case was initially filed, is in accord. *Pedrina v. Chun*, 987 F.2d 608 (9th Cir. 1993), *cited for that proposition, Duke Energy Trading and Marketing L.L.C. v. Davis*, 1042, 1049 (9th Cir. 2001), *cert. denied*, 535 U.S. 1112 (2002).

Rule 41(a)(1) expressly states that its provisions are subject to Rule 23(e). This suit was brought as a class action. After the 2003 Amendments, Fed. R. Civ. P. 23(e)(1)(A) now provides, "The court must approve any settlement, voluntary

dismissal, or compromise of the claims of a certified class." Prior to the Amendment, Rule 23(e) read "of a class action"[15]

---

[15] Harrison's argument that Plaintiff's dismissal was ineffectual is based on the predecessor rule. Addressing the former version and adopting the interpretation of the majority of courts, the Ninth Circuit, from which this case was transferred, held that Rule 23(e) applied to class action suits prior to class certification. *Diaz v. Trust Territory of Pacific Islands*, 876 F.2d 1401, 1408 (9th Cir. 1989). The Third and Seventh Circuits were in agreement. *Kahan v. Rosenstiel*, 424 F.2d 161, 169 (3d Cir. 1970)("[A] suit brought as a class action should be treated as such for purposes of dismissal or compromise, until there is a full determination that the class action is not proper."), *cert. denied*, 398 U.S. 950 (1970); *Glidden v. Chromalloy American Corp.*, 808 F.2d 621, 626 (7th Cir. 1986); *Baker v. America's Mortgage Servicing, Inc.*, 58 F.3d 321, 324 (7th Cir. 1995). *See also* 7B Charles Alan Wright, Arthur R. Miller, and Mary Kay Kane, *Federal Practice and Procedure: Civil 2d* § 1797 at 346-50 (2d ed. 1986)("courts generally have agreed that actions filed as class suits are within the scope of Rule 23(e) even though they have not been formally certified at the time a settlement is reached"); 4 Alba Conte & Herbert Newberg, *Newberg on Class Actions* § 11.13 (2002)("Under certain circumstances, settlement with a class plaintiff before class certification may be available, with approval of the court."). *But see Shelton v. Pargo*, 582 F.2d 1298 (4th Cir. 1978)(Rule 23(e) does not apply before a class has been certified). In *McArthur v. Southern Airways, Inc.*, 556 F.2d 298, 302 (5th Cir. 1977), *op. withdrawn and superseded on rehearing*, 569 F.2d 276 (5th Cir. 1978), the panel concluded that "[a] complaint that contains class action allegations is presumed to be a proper class suit between the time it is filed and the district court determines whether it satisfies the requirements of rule 23." 556 F.2d at 302. On rehearing, however, the appellate court in a *per curiam* opinion withdrew the prior opinion "in its entirety . . . so as to leave open in this circuit all issues decided there." 569 F.2d at 277. While the Second Circuit had not directly addressed the issue, a few district courts cases recognized the majority rule. *See, e.g., Goldstein v. Delgratia Mining Corp.*, 176 F.R.D. 454, 457 and n.3 (S.D.N.Y. 1997)("[T]he Southern District of New York, as most other districts, and all other leading authorities are of the view that court approval for dismissal of class action lawsuits is mandatory. . . . This is true even in the context of pre-certification."; "Thus, as the rules indicate, 'Rule 23(e) . . . plainly takes away a class action plaintiff's right under Rule 41(a)(1) to voluntary dismissal merely by filing with the court a notice of dismissal.'")(and cases cited therein); *In re Austrian and German Bank Holocaust Litigation*, No. 98 CIV 3938 SWK , 2001 WL 228107, *3-4 & nn. 8 & 9 (S.D.N.Y. Mar. 8, 2001)(noting that several district courts in the Second Circuit have adopted as the

instead of "a certified class." The Notes of the Advisory Committee make clear that the 2003 version of the rule "resolves the ambiguity in former Rule 23(e)'s reference to dismissal or compromise of 'a class action. . . . The new rule requires approval only if the claims, issues, or defenses of a **certified** class are resolved by a settlement, voluntary dismissal, or compromise [emphasis added]." Thus the Court finds that Plaintiff's notice of dismissal of LJM2 was effective and dismisses those parties named in the notice.

"Related To" Bankruptcy Jurisdiction

Nevertheless, the debtor need not be a named defendant in a suit for the Court to have "related to" bankruptcy jurisdiction over claims that might have a conceivable effect on the bankruptcy estate. As indicated in earlier orders, this Court follows Second Circuit precedent with respect to actions removed solely on "related to" bankruptcy jurisdiction. *See, e.g.*, #995 at 19-22; #2143 at 38. This Court has previously held in *Newby* that the broad grant of "related to" bankruptcy jurisdiction reaches the kinds of claims asserted by Plaintiff here. See #1714 at 8-37, which rejected the holding in *In re ACI-HDTMay 14, 2004*, 205 B.R. 231, urged by Plaintiff.

Derivative or Direct Claims

---

test for approval of a precertification dismissal a two-prong test: whether the dismissal is the product of collusion and whether the dismissal would prejudice absent class members); *McDowell v. Cogan*, 216 F.R.D. 46, 48 & n.1 (E.D.N.Y. 2003).

Although the parties have relied on such case law, it is moot in light of the 2003 Amendment to Rule 41(a)(1), as explained in the text of this memorandum and order.

As discussed in other memoranda and orders, SLUSA was intended to bring all "covered" class actions (defined as any single suit in which damages are sought on behalf of more than fifty class members or suits seeking to recover damages on a representative basis on behalf of plaintiffs and other unnamed, similarly situated parties, asserting false and misleading statements in "connection with the purchase or sale" of nationally traded securities), into federal court and under federal law, exclusively. 15 U.S.C. § 77p(f)(1)(barring private party from bringing a "covered action" alleging misrepresentation or omission of material fact or use of any manipulative device or contrivance in connection with the sale or purchase of a covered security that is grounded in state statutory or common law) and (2)("Any covered class action brought in any State court involving a covered security as set forth in paragraph (1) shall be removable to Federal District court for the district in which the action is pending and shall be subject to paragraph (1)."); 15 U.S.C. § 78bb(f)(5)(B); *Malone*, 722 A.2d at 13. The federal district court judge and his magistrate judge relied on the fact that there was no purchase or sale of the securities held by Chinn and his putative class and thus no jurisdiction under SLUSA.

In addition to that basis, in a savings clause SLUSA provided two exceptions to its preemptive reach known as the "Delaware carve outs," which allowed class actions, based on the statutory or the common law of the state in which the corporation is incorporated, to proceed in state court if the suit is an

"'exclusively derivative action brought by one or more shareholders on behalf of a corporation'" or "where state law already provides that corporate directors have fiduciary disclosure obligations to shareholders."[16] While Chinn insists her suit is not a derivative suit, which would fall under the first category, she claims she falls within the second "Delaware carve-out" and relies on the holding of *Malone v. Brincat*, which she insists the Oregon courts would adopt if presented to them. This Court disagrees.

---

[16] The court quoted SLUSA, Pub. L. No. 105-353, § 16(d), 112 Stat. 3227 (1998):

> Preservation of Certain Actions.--
> (1) Actions under state law of state of incorporation.--
> (A) Actions preserved.-Notwithstanding subsection (b) of (c), a covered class action described in subparagraph (B) of this paragraph that is based upon the statutory or common law of the State in which the issuer is incorporated . . . may be maintained in a State or Federal court by a private party.
> (B) Permissible actions.-A covered class action is described in this subparagraph if it involves
> (i) the purchase or sale of securities of the issuer or an affiliate of the issuer exclusively from or to holders of equity securities of the issuer; or
> (ii) any recommendation, position, or other communication with respect to the sale of the securities of an issuer that--
> (I) is made by or on behalf of the issuer or an affiliate of the issuer to holders of equity securities of an issuer; and
> (II) concerns decisions of such equity holders with respect to voting their securities, acting in response to a tender or exchange offer, or exercising dissenters' or appraisal rights.

In *Malone*, shareholders of Mercury Finance Company stock filed suit under Delaware law "on behalf of the named plaintiffs and all persons (excluding defendants) who owned common stock of Mercury from 1993 through the present and their successors in interest, heirs and assigns (the 'putative class')" against the directors of the corporation for breach of the fiduciary duty of disclosure (and a contingent aiding and abetting claim against its accounting firm) because, according to the complaint, on numerous occasions over a four-year period the director defendants knowingly and intentionally overstated the financial condition of Mercury, and that "'as a direct result of the false disclosures . . . the Company has lost all of its value (about $2 billion)." 722 A.2d at 8.[17] The directors moved for summary judgment on the grounds that they owed no fiduciary duty of disclosure under the circumstances alleged by plaintiffs. The Court of Chancery dismissed the complaint for failure to state a claim because under Delaware law, a fiduciary duty to disclose existed only when there was a request for shareholder action:

> The federal securities laws ensure the timely release of accurate information into the marketplace. The federal power to regulate should not be duplicated or impliedly usurped by Delaware. When a shareholder is damaged merely as a result of the release of inaccurate information into the marketplace, unconnected with any Delaware corporate governance issue, that shareholder must seek a remedy under federal law.

---

[17] As is the situation here, the shareholders did not purchase or sell their securities, but were "holders," 722 A.2d at 12, precluding any claim under § 10(b) and Rule 10b-5, and their class action was not preempted by SLUSA.

722 A.2d at 8.

On appeal, recognizing that "holders" had no remedy under federal law, the Delaware Supreme Court found that a state-law suit by stock holders for breach of fiduciary duty to disclose might proceed in state court. The Delaware Supreme Court affirmed the lower court's dismissal of the complaint based on different reasoning, but reversed in part because it concluded that the lower court should have granted the plaintiffs leave to amend to clarify their pleadings, which failed to distinguish between and to plead correctly either a derivative action and/or an individual claim on behalf of a class action, but instead confused the two.

Specifically, *Malone* addressed the second "Delaware carve-out" exception to ERISA preemption. 722 A.2d at 13 ("[T]he second [exception preserves the availability of state court class actions, where state law already provides that corporate directors have fiduciary disclosure obligations to shareholders."). Under Delaware law, officers and directors of a corporation owe shareholders a constant duty of good faith, due care, and loyalty. *Malone*, 722 A.2d at 10. The Delaware Supreme Court observed that the corporate director's and officer's fiduciary duties of due care, good faith and loyalty, long recognized under Delaware law "did not operate intermittently," but were "unremitting," although "that responsibility will change with the specific context of the action the director is taking with regard to either the corporation or its shareholders." *Id.* at 10.

Nevertheless, the Delaware Supreme Court pointed out that Delaware General Corporation Law "does not require directors to provide shareholders with information concerning the finances or affairs of the corporation," nor, even when the directors notice a proposed shareholder action, does the statutory law "require directors to convey substantive information beyond a statutory minimum." *Id.* at 11. As for common law, the Delaware Supreme Court noted that previously Delaware courts had recognized such a duty of honest disclosure, and an equitable cause of action by shareholders against directors, only when the directors requested shareholders to act or to not act.[18] *Id.* at 9, 11. "The duty of disclosure obligates directors to provide the stockholders with accurate and complete information material to a transaction or other corporate event that is being presented to them for action." *Id.* at 10.

In *Malone* the high court expanded the circumstances in which that judicially imposed duty of candor in disclosures to shareholders applied; it held that the directors' constant duties of care, loyalty, and good faith give rise to a duty of disclosure and that the fiduciary duties applied "[w]henever directors communicate publicly or directly with shareholders about the corporation's affairs," regardless of whether shareholder action was requested, and emphasized that "the *sine qua non* of directors' fiduciary duty to shareholders is honesty." *Id.* at 10, 11-12.

---

[18] Shareholder action would include involvement in transactions such as mergers, proxies, solicitations, and tender offers.

Nevertheless, the Delaware Supreme Court found that the plaintiffs before it had not adequately pleaded such a claim. The plaintiffs had alleged that the action was brought on behalf of the named plaintiffs and the putative class, yet asserted as their "injury" that the corporation lost about two billion dollars in value. In other words, in a class action on behalf of themselves they stated an injury to the corporation, "a *nonsequitur*" according to the court; either plaintiffs should have properly asserted a derivative claim on behalf of the corporation, which would "require an articulation of the classic 'direct v. derivative' theory,"[19] and meeting the procedural requirements of Chancery Rule 23.1,[20] and/or an individual cause of action or class

---

[19] 722 A.2d at 14 & n.45, *citing Grimes v. Donald*, 673 A.2d 1207 (Del. Supr. 1996)(distinguishing individual and derivative actions). This Court notes that in *Grimes*, the Delaware Supreme Court reiterated the traditional rule that "[t]o pursue a direct action, the stockholder-plaintiff 'must allege more than an injury resulting from a wrong to the corporation.' The plaintiff must state a claim 'for an injury which is separate and distinct from that suffered by other shareholders,' . . . or a wrong involving a contractual right of a shareholder . . . which exists independently of any right of the corporation. [citations omitted]" *Id.* at 1213. It also found "helpful" § 701 of *American Law Institute Principles of Corporate Governance: Analysis and Recommendations* (1992) in distinguishing between direct and derivative claims and particularly noted its comment (c): "courts have been more prepared to permit the plaintiff to characterize the action as direct when the plaintiff is seeking only injunctive relief." *Id.* Chinn's action seeks only monetary damages.

[20] Chancery Rule 23.1, entitled "Derivative Actions by Shareholders," provides in relevant part:

> In a derivative action brought by 1 or more shareholders or members to enforce a right of a corporation or of an unincorporated association, the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint

> shall allege that the plaintiff was a shareholder or member at the time of the transaction of which the plaintiff complains or that the plaintiff's share or membership thereafter devolved on the plaintiff by operation of law. **The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and the reasons for the plaintiff's failure to obtain the action or for not making the effort.** . . . [emphasis added by the Court]

The Delaware Supreme Court in *Brehm v. Eisner*, 746 A.2d 244, 254-55 (2000) discussed the stringent requirement that the plaintiff in a shareholder derivative complaint plead with particularity, setting forth "facts raising reasonable doubt that the corporate action being questioned was properly the product of business judgment." It explained,

> The demand requirement serves a salutary purpose. First, by requiring exhaustion of intracorporate remedies, the demand requirement invokes a species of alternative dispute resolution procedure, which might avoid litigation altogether. Second, if litigation is beneficial, the corporation can control the proceedings. Third, if demand is excused or wrongfully refused, the stockholder will normally control the proceedings.
> The jurisprudence of *Aronson* and its progeny is designed to create a balanced environment which will: (1) on the one hand, deter costly, baseless suits by creating a screening mechanism to eliminate claims where there is only a suspicion expressed solely in conclusory terms; and (2) on the other hand, permit suit by a stockholder who is able to articulate particularized facts showing that there is a reasonable doubt either that (a) a majority of the board in independent for purposes of responding to the demand, or (b) the underlying transaction is protected by the business judgment rule.

Id. at 255. If the plaintiff fails to meet this heavy pleading burden and to rebut the presumption that the board's decisions were the product of a valid exercise of the business judgment rule, the complaint may be dismissed for failure to show that the demand was

with an alleged injury to them "separate and distinct from that suffered by other shareholders" and in accordance with Court of Chancery Rule 23.[21] They also failed to identify whether they sought damages or equitable remedies for either type of action. The high Court concluded that the plaintiffs should have an opportunity to replead. 722 A.2d at 14.

The high court admonished, however, that on repleading, any putative class action suit would have to be consistent with Chancery Rule 23 and the high Court's holding in *Gaffin v. Teledyne, Inc*, 611 A.2d 467, 474 (1992): "A class action may not be maintained in a purely common law or equitable fraud case since individual questions of law or fact, particularly the element of justifiable reliance, will inevitably predominate over common questions of law or fact." *Id.* at 14 n.47, and citing *inter alia Cimino v. Raymark, Industries, Inc.*, 151 F.3d 297 (5th Cir.

---

excused under *Aronson*. *White v. Panic*, 783 A.2d 543 (Del. Supr. 2001).

Moreover generally a plaintiff is not allowed to amend a derivative complaint after the Supreme Court affirms the lower court's decision to dismiss the suit, but an exception is made, as in *Malone*, where the Supreme Court "announces a new rule of law or clarifies pleading standard that apply to the plaintiff's cause of action." *Id.* at 555. In *Malone* the Supreme Court directed that the plaintiffs be permitted to replead because for the first time explicitly recognized "that a board may breach its fiduciary duty of good faith by issuing false public statements that injure the corporation or individual shareholders, even if the board's false disclosures were not related to a request for shareholder action." *Id.* at 556.

[21] Rule 23 addresses the requirements for bringing class actions, including that "questions of law or fact common to members of the class predominate over any questions affecting only individual members." Chancery Court Rule 23(b)(1)(B)(3).

1998)[22]; *Amchem Products, Inc. v. Windsor*, 521 U.S. 591 (1997). Indeed, "in deference to the panoply of federal protections," the *Malone* court expressly refused to replicate federal law by recognizing a Delaware state cause of action for "fraud on the market." 722 A.2d at 12-13. Thus the high court indicated that under Delaware law such direct-claim class actions would be very limited.[23]

There are actually two issues here: would Oregon courts recognize direct claims by a holders of securities for breach of fiduciary duty, negligence, and fraud under the circumstances alleged here, and, if it would, may such a claim be brought as a class action.

This Court finds that Chinn has mischaracterized the focus and holding of *Malone* and finds unpersuasive Plaintiff's contention that Oregon would recognize a direct claim against the directors for breach of fiduciary duty based on the rationale in *Malone*.

As a procedural matter, Chinn's suit is framed as a class action. Under *Malone* a shareholder's right to bring a

---

[22] This Court notes that in *Arnold v. Garlock, Inc.*, 288 F.3d 234, 243 (5th Cir. 2002), the Fifth Circuit stated, "in *Cimino v. Raymark Industries, Inc.*, . . . we emphasized that federal rules for providing for aggregation of claims--specifically, Fed. R. Civ. P. 23 and 42--cannot override the necessity of proving causation as to each defendant, a requirement of the state law providing the cause of action . . . ."

[23] The Court notes that the other case cited by Chinn in support of her direct claim, *Small v. Fritz Companies, Inc.*, No. S091297 (Cal. Apr. 7, 2003)(recognizing a "holder" cause of action under California law), is not a class action. Ex. G to #29.

direct-claim class action under Delaware common law in state court is qualified by the Delaware's procedural rules relating to class actions. *Malone* pointed out that even where direct claims of breach of fiduciary duty based on misrepresentation may be brought, class actions are unlikely to be certified because the individual issue of actual, justifiable reliance for each plaintiff would predominate over common issues of law and fact, precluding class action status. In contrast, however, Oregon's amended Rule of Civil Procedure 32 is quite liberal and, unlike Fed. R. of Civ. P. 23(b)(3), does not require that common issues of fact and law predominate over individual issues for certification in Oregon state court. Oregon Rule of Civil Procedure 32(B)(3)(listing as one of a number of matters "pertinent" to the trial court's findings, "[t]he extent to which questions of law or fact common to the members of the class predominate over any questions affecting only individual members")(adopted in 1992); *Shea v. Chicago Pneumatic Tool Co.*, 164 Or. App. 198, 207, 990 P.2d 912, 917 (Or. App. 1999)("The current formulation of [Rule 32(B)(3)] thus includes the predominance of common questions of law and fact as a 'pertinent' matter that the trial court must consider. It does not *require* predominance as a *sine qua non* of certification of any class.[emphasis in text]"), *rev. denied*, 330 Or. 252, 6 P.3d 1099 (Or. 2000)(Table). *See also Decisions Interpreting Rule 32 of the Oregon Rules of Civil Procedure*, American Bar Association Survey of State Class Action Law, SSCLASSACT OREGON (Database updated

Dec. 2003). The procedural rule, however, does not get Chinn past the obstacle of the substantive issue of a derivative claim.

The Delaware Supreme Court did recognize the right of class action plaintiffs, who "held" their stock during the proposed class period, action alleging, under the law of the state in which the corporation at issue was incorporated, misrepresentations by the company's directors about the company's value that resulted in diminishment of value of shareholders' securities, to be exempt from SLUSA's preemption not only because there was no purchase or sale of the securities, as required by federal securities law, but also under the "Delaware carve-out" provisions and to proceed in state court. Indeed, that part of its holding has had much greater impact on other courts that what Chinn argues.

Malone, however, addressed a claim based explicitly on Delaware common law, for the substance of which there is no counterpart in the law of Oregon. The significance of *Malone* was the expansion under Delaware common law of the circumstances under which the fiduciary duty to disclose material information with candor to shareholders exists to encompass any public statements by the officers, not merely statements relating to requests for shareholder action. Moreover, *Malone* was issued in 1998, six years ago, and its influence in cases not grounded in Delaware law, which is distinctive, has been negligible.

Oregon law addressing a corporate director's fiduciary duties to shareholders is substantially less developed than that

of Delaware and thus highly unlikely to adopt the narrow rule of *Malone*. In fact, the great majority of cases dealing with corporate fiduciary duties only address very conclusorily the duties of loyalty, good faith, fair dealing and full disclosure of majority shareholders to minority shareholders only in close corporations; where any detail is provided, at most they reference traditional trust and agency law in general terms relating to conflicts of interest between the director's personal interests and those of the corporation, and without dissecting the nature of any of these duties or providing factual scenarios to explain and develop them. *See, e.g., Noakes v. Schoenborn*. 116 Or. App. 464, 471-72, 841 P.2d 682, 686 (Or. App. 1992); *Hutchinson v. Bidwell*, 24 Or. 219, 222-24, 22 P. 560, 561 (1983)("'The law, for wise reasons, . . . will not permit one who acts in a fiduciary capacity to deal with himself in his individual capacity.' . . . The directors of a corporation occupy a fiduciary position. The are trustees and agents of the corporation and stockholders, and are governed by the same rules as are applied to dealings of other persons holding fiduciary relations."). Moreover, the cases continue to follow strictly the traditional rule and the "well recognized exception . . . that . . . shareholders may bring a direct action, rather than a derivative action, if they allege harm to themselves distinct from the harm to the corporation or a breach of a special duty owed by the defendant to the shareholders." *Noakes*, 116 Or. App. at 471, 841 P.2d at 686, citing Schumacher v. Schumacker, 469 N.W.2d 793, 798 (N.D. 1991);

Weiss, and *Smith v. Bramwell*. Of course, logically if the majority shareholders breach their fiduciary duties to the minority shareholders, the harm is both derivative and individual, since the minority has a distinct injury separate from that of the corporation and shares in the corporation's damages, and the minority may bring both derivative and direct suits. *Id.* at 116 Or. App. at 472, 841 P.2d at 687.

As for statutes, the only relevant one found by this Court allows circuit courts to dissolve a corporation in a suit brought by a shareholder in a corporation whose stock is traded on a national exchange where "the directors or those in control of the corporation have acted, are acting or will act in a manner that is illegal, oppressive or fraudulent." Or. Rev. St. Ann. § 60.661 (West 2004).

In sum, the Delaware Supreme Court still adheres to the traditional common law rule requiring that a shareholder have a distinct and separate special injury in order to bring a direct claim against the corporate directors and officers. Thus far Oregon common law also has not recognized a direct claim by shareholders, absent a particular injury, for breach of a constant fiduciary duty to shareholders to disclose that caused diminishment in the value of the company's stock. *Loewen*, 130 Or. App. at 228, 882 P.2d at 111 (holding that plaintiff-shareholders, who sued corporation's directors *inter alia* for

breach of fiduciary duty, negligence,[24] securities fraud, and common-law fraud under Oregon law, had no standing to bring what were derivative claims.)[25] Chinn has not distinguished her purportedly "direct" claim from a derivative claim, which she has no standing to bring, because she has not shown the requisite

---

[24] The *Loewen* court also recognized that the "gist" of the shareholders' allegations was that director defendants breached their fiduciary duty to the shareholders, the shareholders lacked standing to bring a direct negligence claim; "whether defendants 'negligently' breached those duties is irrelevant in determining whether plaintiffs may recover for a breach of fiduciary duty." 130 Or. App. at 230, 882 P.2d at 112.

[25] As the Court of Appeals wrote in *Loewen*, 130 Or. App. at 228, 882 P.2d at 111,

> The general rule is that a shareholder may not assert a direct claim against directors or officers who have defrauded or mismanaged a corporation if the only alleged injury is a diminution of share value, the claim is derivative. *Smith v. Bramwell*, 146 Or. 611, 615, 31 P.2d 647 (1934). If, however, a shareholder has a "special" injury, then the shareholder has standing to assert a direct claim. A special injury is established where there is a wrong suffered by the shareholder not suffered by all shareholders generally or where the wrong involves a contractual right of the shareholders, such as the right to vote. [citations omitted]

As the Supreme Court of Oregon stated in *Smith v. Bramwell*, 146 Or. at 615, 31 P.2d at 648, which is still good law,

> It is a well-established general rule that a stockholder of a corporation has no personal right of action against directors or officers who have defrauded it or mismanaged it and thus affected the value of his stock. The wrong is against the corporation and the cause of action belongs to it. Any judgment obtained by reason of such wrongs is an asset of the corporation, which inures first to the benefit of creditors and secondly to stockholders.

independent "special injury" to herself and the putative class. Furthermore, *Malone* hinted that where it is difficult to distinguish a direct from a derivative action, one factor that might support finding a direct claim is where the remedy sought is equitable. Chinn seeks only monetary damages.

Therefore for the reasons stated, the Court

ORDERS that, in accordance with Chinn's notice of [voluntary] dismissal (#6), Defendants LJM Cayman LP, LJM2 Cayman Co-Investment LP, Chewco Investments L.P., and Joint Energy Development Investments Limited Partnership are DISMISSED without prejudice, pursuant to Fed. R. Civ. P. 41(a)(1)(i). The Court further

ORDERS that Plaintiff's motion to remand is DENIED because this Court has "related to" bankruptcy jurisdiction over the claims asserted here. Finally, because Plaintiff has failed to demonstrate that her claims are direct rather than derivative, the Court finds that they are derivative and belong to debtors Enron and the LJM partnerships. Accordingly, the Court

ORDERS that H-03-862 is CONSOLIDATED with *Pirelli Armstrong Tire Corporation Retiree Medical Benefits Trust, et al., v. Kenneth Lay, et al.*, H-01-3645, and is ADMINISTRATIVELY CLOSED.

SIGNED at Houston, Texas, this 14th day of ~~May~~ June, 2004.

MELINDA HARMON
UNITED STATES DISTRICT JUDGE