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

United States Courts
Southern District of Texas
JUN 1 3 2003
Michael N. Milby, Clerk

IN RE ENRON CORPORATION SECURITIES LITIGATION	
This Document Relates To:	
MARK NEWBY, et al., Individually and On Behalf of All Others Similarly Situated, Plaintiffs, v. ENRON CORP., et al., Defendants.	Consolidated Civil Action Case No.: H-01-CV-3624 (Jury)
THE REGENTS OF THE UNIVERSITY OF CALIFORNIA, et al., Individually and On Behalf of All Others Similarly Situated, Plaintiffs, v. KENNETH L. LAY, et al., Defendants.	

DEFENDANTS J.P. MORGAN CHASE & CO., J.P. MORGAN SECURITIES INC., AND JPMORGAN CHASE BANK'S MOTION TO DISMISS THE FIRST AMENDED CONSOLIDATED COMPLAINT AND BRIEF IN SUPPORT

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Public Company Accounting Reform and Investor Protection Act of 2002 (the "Sarbanes-Oxley Act"), Pub. L. No. 107- 204 § 804(b), 116 Stat. 745 (2002) 6, 12

Defendants J.P. Morgan Chase & Co. ("JPMC"), J.P. Morgan Securities Inc. ("JPMSI") and JPMorgan Chase Bank ("JPMCB") (collectively, the "JPMorgan Chase Entities") respectfully submit this Memorandum of Law in support of their motion to dismiss Plaintiffs' First Amended Consolidated Complaint for Violation of the Securities Laws (the "Amended Complaint" or "Am. Compl.").

PRELIMINARY STATEMENT

Plaintiffs' original Consolidated Complaint (the "Original Complaint") named only one JPMorgan Chase Entity – JPMC – as a defendant in this action and asserted claims under Section 10(b) of the Securities Exchange Act of 1934 (the "1934 Act") and Article 581-33(A)(2) of the Texas Securities Act, contending that JPMC knowingly participated in Enron Corporation's ("Enron") scheme to defraud its shareholders. This Court denied JPMC's motion to dismiss the Original Complaint, concluding that Plaintiffs' allegations, if ultimately proved to be true, would state a claim for relief against JPMC.

This motion does not seek to reargue that prior decision, which, of course, is based on allegations that remain unproven.[1] When the evidence is presented, it will instead show that the JPMorgan Chase Entities did not violate any federal or state securities laws in their dealings with Enron. Moreover, the facts will show that JPMorgan Chase extended substantial amounts of credit to Enron – of which it has little hope for recovery – because it genuinely believed Enron was a financially healthy and creditworthy company. Before late 2001, when

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[1] JPMC, now joined by JPMSI and JPMCB, continues to maintain that Plaintiffs' claims are defective and inactionable under *Central Bank of Denver v. First Interstate Bank of Denver,* 511 U.S. 164 (1994), for all of the reasons expressed in JPMC's May 8, 2002 and June 24, 2002 briefs in support of its motion to dismiss.

Enron began its precipitous descent into bankruptcy, the JPMorgan Chase Entities, just as dozens of other financial institutions that dealt with Enron, and the majority of analysts, rating agencies and commentators that followed Enron, believed Enron to be a dynamic and innovative company, managed by some of the best and brightest financial and industry professionals in the world, overseen by a prestigious board of directors and audited by one of the world's oldest and most respected accounting firms.

If Enron's sudden and catastrophic demise proves anything, it is that corporate insiders were terribly effective at deceiving Enron's shareholders, creditors, government regulators and the financial community at large. Indeed, it is unlikely that there is anyone who will lose more from Enron than JPMorgan Chase. At the time of Enron's bankruptcy, JPMorgan Chase's total exposure including secured, unsecured, and positions subsequently written down, amounted to *$2.6 billion*. This stark reality must be contrasted with the Plaintiffs' unproven and conclusory allegations.

This motion targets the deficiencies in Plaintiffs' new pleading – a 648-page Amended Complaint that adds 18 new defendants, 140 pages of allegations, and a new legal claim based on certain private offerings of securities by Enron-related entities. The Amended Complaint must be dismissed as to JPMC, JPMSI and JPMCB because:

First, all the federal claims asserted against JPMSI and JPMCB (Counts I and IV), as well as the associated controlling person claims against JPMC, are time-barred. JPMSI and JPMCB were not added to this action until May 2003 – more than 18 months after Enron's collapse. Although named as a Section 10(b) defendant in April 2002, the Section 20(a) claim in Count I and the Section 15 claim in Count IV were not asserted against JPMC until May 2003. The statute of limitations applicable to all these claims requires that a defendant be named in the

action within one year of discovery of the facts leading to the underlying allegations. That time expired no later than December 2, 2002 (and perhaps earlier) – one year after the Enron bankruptcy filing.

Second, all fraud-based claims against the JPMorgan Chase Entities fail to meet the pleading requirements of the Private Securities Litigation Reform Act of 1995 ("PSLRA") (Count I) and Rule 9(b) (Counts I and V). The Amended Complaint fails to differentiate the allegations directed to JPMC from those directed to JPMSI from those directed to JPMCB. It is therefore not possible from reading the Amended Complaint to determine what, if anything, each of the separate corporate entities is said to have done or known. As this Court noted in its January 28, 2003 decision regarding the individual Arthur Andersen defendants, such impermissible "group pleading" mandates dismissal.

Third, Plaintiffs' Count IV fails to allege, as Section 12 of the Securities Act of 1933 (the "1933 Act") requires, that JPMSI directly sold any of the securities in question to any Plaintiff or that any of the Plaintiffs purchased the securities in question in a public offering.

Fourth, in addition to being time-barred, Plaintiffs' claims of controlling person liability against JPMC fail because Plaintiffs have not alleged facts necessary to show that JPMC controls JPMSI or JPMCB within the meaning of Section 20(a) and Section 15 and Plaintiffs have not stated a claim for a requisite primary violation to support these controlling person claims.

Finally, Count V, brought under the Texas Securities Act, still fails to allege either a primary violation of the Texas Securities Act or that the Washington Board – the only plaintiff named with respect to this count – was in privity with any of the JPMorgan Chase Entities.

STATEMENT OF FACTS

As it concerns the JPMorgan Chase Entities, the Amended Complaint changes the Original Complaint by:

- Adding JPMSI and JPMCB as defendants – without in most cases specifying what they knew or did or separating their alleged knowledge or actions from the knowledge or actions of each other or JPMC. *See* Am. Compl. ¶¶ 100(b)-(c), 652-673.

- Adding a claim for violation of Sections 12 and 15 of the 1933 Act against JPMSI and JPMC, respectively. *Id.* ¶¶ 1016.1-1016.9. These claims are based on the allegation that JPMC and/or JPMSI were underwriters/initial purchasers of Marlin Water Trust II and Marlin Water Capital Corp. II Notes (the "Marlin II Notes"). *Id.* ¶ 641.38. The Marlin II Notes were part of a private offering.

- Repleading the Texas Securities Act Claim. This claim is based on the allegation that JPMC and/or JPMSI underwrote $250 Million of 6.95% Notes Due 7/15/28 and $250 Million of 6.40% Notes Due 7/15/06, and were in privity with the Washington Board. *Id.* ¶ 1016.15.

ARGUMENT

JPMC, now joined by JPMSI and JPMCB, expressly preserve the arguments made in JPMC's motion to dismiss the Original Complaint, including those advanced with respect to (1) Plaintiffs' failure to state a securities fraud claim under *Central Bank* and its progeny and Plaintiffs' failure to satisfy the pleading requirements of the PSLRA and the Rule

9(b),[2] and (2) Plaintiffs' failure to allege a nexus of the allegations related to their Texas state law claims to Texas. Those arguments are not repeated in detail here. Below, we set forth the additional grounds for dismissal of the Amended Complaint in its entirety.

I. Plaintiffs' Section 10(b) Claims Against JPMSI And JPMCB And Section 20(a) Claim Against JPMC Are Time-Barred

The newly asserted Section 10(b) and Section 20(a) claims in Count I against JPMSI, JPMCB, and JPMC are time-barred. For proceedings commenced prior to July 30, 2002, Section 10(b) and Rule 10b-5 claims must be commenced within one year after the discovery of the facts constituting the violation and within three years after such violation. *Lampf, Pleva, Lipkind, Prupis & Petigrew v. Gilbertson*, 501 U.S. 350, 364 (1991). Because Plaintiffs' Section 20(a) is merely derivative of the Section 10(b) claim, it is subject to the same limitations period. *See Theoharous v. Fong*, 256 F.3d 1219, 1228 n.12 (11th Cir. 2001); *In re Enron Sec., Derivative & ERISA Litig.*, 235 F. Supp. 2d 549, 595 (S.D. Tex. 2002) (noting that Section 20(a) is derivative of Section 10(b)).

This proceeding was commenced on October 22, 2001 and, therefore, is subject to the one-year/three-year limitations period established in *Lampf*. *See* 501 U.S. at 364. The change in the statute of limitations effectuated through the Public Company Accounting Reform

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[2] JPMC's arguments regarding *Central Bank* are further supported by at least one decision that post-dates this Court's December 20, 2002 decision. *See In re Homestore.com, Inc. Sec. Litig.*, 252 F. Supp. 2d 1018 (C.D. Cal. 2003) (where plaintiffs alleged that corporation and third parties engaged in a scheme to defraud, by which the third parties arranged "improper transactions" that boosted revenues for the corporation and allowed the corporation to issue financial statements falsely inflating the value of the corporation's stock, the court held that (1) the third parties were not primary violators because they did not "employ" the scheme to defraud and (2) plaintiffs failed to show reliance on the scheme which was "one step removed" from plaintiffs' injury).

and Investor Protection Act of 2002 (the "Sarbanes-Oxley Act"), Pub. L. No. 107- 204 § 804(b), 116 Stat. 745 (2002), does not alter the limitations periods applicable here. That change of limitations period to the earlier of two years after discovery of the violation or five years after the violation occurred only applies to certain "proceedings commenced on or after July 30, 2002." In fact, this Court has already held that the amended limitations period found in the Sarbanes-Oxley Act does not apply to this proceeding. *In re Enron Sec., Derivative & ERISA Litig*, No. Civ. A. H-01-3624, MDL No. 1446, 2003 WL 1089307, at *12 n.20 (S.D. Tex. Mar. 12, 2003).

Plaintiffs discovered or should have discovered the facts constituting the primary violations they allege against JPMSI and JPMCB well over a year before filing the Amended Complaint. By Plaintiffs' own admission, Enron, on October 16, 2001, "shocked the markets with revelations of $1.0 billion in charges and a reduction of shareholders' equity by $1.2 billion." Am. Compl. ¶ 61. The SEC commenced an investigation shortly thereafter, *id.*, and the first complaint in this consolidated action was filed just six days later. In November 2001 Enron made further announcements that restated its financial results for 1997 through 2000. *Id.* ¶¶ 61-63. Moreover, throughout November 2001, it was public knowledge that JPMorgan Chase entities assisted Enron in its efforts to merge with Dynegy. *Id.* ¶¶ 64-66. Finally, on December 2, 2001, Enron's demise reached its nadir as the company filed "the largest bankruptcy in history." *Id.* ¶ 66.

These events during the fall of 2001 culminating in Enron's bankruptcy put Plaintiffs on notice of the facts underlying their claims no later than December 2, 2001. *See, e.g.*, *Jensen v. Snellings*, 841 F.2d 600, 607 (5th Cir. 1988) ("[I]nvestors are not free to ignore 'storm warnings' which would alert a reasonable investor to the possibility of fraudulent statements or omission in his securities transaction"); *Hallman v. Northwestern Nat'l Ins. Co.*,

766 F. Supp. 575, 579 (S.D. Tex. 1991) ("[I]nquiry notice is triggered by evidence of the *possibility* of fraud, not full exposition of the scam itself") (citations omitted); *Reed v. Prudential Sec. Inc.*, 875 F. Supp. 1285, 1289 (S.D. Tex. 1995) (observing that a sharp drop in stock price triggers inquiry notice). The statute of limitations on Plaintiffs' Section 10(b) claim therefore ran by December 2, 2002. Plaintiffs did not assert their Section 10(b) claims against JPMSI and JPMCB until May 14, 2003. That plainly is too late.[3] Plaintiffs' Section 10(b) claims against JPMSI and JPMCB (and, by necessity, the Section 20(a) controlling person claim against JPMC) must be dismissed.[4]

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[3] To the extent that Plaintiffs' primary claims against JPMSI and JPMCB and controlling person claims against JPMC are based on alleged conduct that occurred prior to May 14, 2000, *see, e.g.*, Am. Compl. ¶ 669 (alleging that certain JPMorgan Chase affiliates invested in LJM2 on or about December 22, 1999), such claims are time-barred by the three-year limitations period. *See Lampf*, 501 U.S. at 359-60 (holding that 10b-5 claims must be commenced within three years of the alleged violation); *see also* 15 U.S.C. § 77m (same for Section 12 claims).

[4] Plaintiffs have known for well more than a year that JPMSI and JPMCB are subsidiaries of JPMC, *see, e.g.*, Compl. ¶¶ 100, 665. Plaintiffs' failure to include these entities in the Original Complaint was by choice. Plaintiffs therefore cannot successfully argue that, pursuant to Federal Rule of Civil Procedure 15(c), their failure to include these entities in the Original Complaint was a mistake. The claims against JPMSI and JPMCB do not "relate back" to the filing date of the Original Complaint. *See Jacobsen v. Osborne*, 133 F.3d 315, 321-22 (5th Cir. 1998) (no relation back when amendment is for reasons other than mistake or misidentification); *Cornwell v. Robinson*, 23 F.3d 694, 705 (2d Cir. 1994) (addition of new defendants does not relate back when plaintiff's failure to name those defendants in original complaint was "a matter of choice, not mistake"); *Cargill Ferrous Int'l v. M/V Emma Oldendorff*, No. Civ. A. 00-0247, 2001 WL 179924, at *1-*2 (E.D. La. Feb. 20, 2001) (observing that Rule 15(c)(3) requires plaintiff to show a mistake of identity, not strategic choice).

II. The Complaint Fails To State A Section 10(b)/Rule 10b-5 Claim Against JPMC, JPMSI And JPMCB Because "Group Pleading" Is Impermissible Under The PSLRA And Rule 9(b)

The Amended Complaint collectively, and indistinctly, groups JPMC, JPMSI, and JPMCB into a single defined term "JP Morgan." Am. Compl. ¶ 100(a). Plaintiffs have, therefore, failed to plead with particularity facts that a *specific* defendant made a misleading statement, or committed a manipulative act, or was involved in a scheme that was false and misleading, and that the *specific* defendant did so with the requisite scienter. This impermissible group pleading cannot sustain Plaintiffs' Section 10(b) claim. *See In re Enron Sec., Derivative and ERISA Litig.*, No. Civ. A. H-01-3624, MDL No. 1446, 2003 WL 230688, at *5-*6 (S.D. Tex. Jan. 28, 2003) (acknowledging that the concept of "group pleading," which permits a plaintiff to "attribute all the statements to all the defendants as 'collective actions,'" is "completely at odds" with the PSLRA's intent "to stop 'sue first and ask questions later' tactics").

The PSLRA mandates that a securities fraud plaintiff plead fraud with particularity, and that the plaintiff plead facts giving rise to a "strong inference" of scienter. *See Nathenson v. Zonagen,* 267 F.3d 400, 412 (5th Cir. 2001).[5] Where the complaint fails to meet the PSLRA's strict specificity requirements, dismissal is mandated. *Id.* ("[T]he PSLRA provides

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[5] In order to satisfy this standard in the Fifth Circuit, Plaintiffs' allegations must, at minimum, show "severe recklessness." *Nathenson*, 267 F.3d at 409. Severe recklessness is *not* merely an extreme form of negligence, *see In re Baker Hughes Sec. Litig.*, 136 F. Supp. 2d 630, 647-48 (S.D. Tex. 2001), but is "limited to those highly unreasonable omissions or misrepresentations that involve not merely simple or inexcusable negligence, but an extreme departure from the standards of ordinary care, and that present a danger of misleading buyers or sellers which is either known to the defendant or is so obvious that the defendant must have been aware of it." *Nathenson*, 267 F.3d at 408 (quoting *Broad v. Rockwell,* 642 F.2d 929, 961 (5th Cir. 1981)).

that if the complaint does not meet those requirements 'the court shall, on motion of any defendant, dismiss the complaint.'"); *In re Enron Sec., Derivative & ERISA Litig.,* 235 F. Supp. 2d at 570. Moreover, because Section 10(b) claims are fraud claims, a securities fraud plaintiff must also satisfy the pleading requirements of Rule 9(b). *See Abrams v. Baker Hughes Inc.*, 292 F.3d 424, 430 (5th Cir. 2002). Rule 9(b) requires that a plaintiff specify "the statements contended to be fraudulent, identify the speaker, state when and where the statements were made, and explain why the statements were fraudulent." *Id.* at 431; *Nathenson,* 267 F.3d at 412 (same) (citation omitted); *Ziemba v. Cascade Int'l, Inc.*, 256 F.3d 1194, 1202 (11th Cir. 2001) (indicating that to comply with Rule 9 (b), plaintiffs must plead, *inter alia* "the time and place of each such statement and the *person responsible for making* . . . same") (emphasis added).

While Plaintiffs have amended their Original Complaint to include additional JPMorgan Chase Entities, they have not, in accordance with the PSLRA and Rule 9(b), identified the specific JPMorgan Chase Entity that made alleged misstatements, or employed alleged manipulative acts. Instead, in stark violation of the applicable pleading requirements, the Amended Complaint is no more than generalized and conclusory allegations about "JPMorgan's" participation in an alleged scheme to defraud. Under the PSLRA and Rule 9(b), Plaintiffs simply may not lump together or "group plead" the JPMorgan Chase Entities in such a fashion. *See McNamara v. Bre-X Minerals Ltd.*, 57 F. Supp. 2d 396, 428 (E.D. Tex. 1999) (warning plaintiffs of dismissal if allegations fail to identify the conduct of each specific defendant or to explain why such pleading is not possible); *see also Kunzweiler v. Zero.net, Inc.*, No. 3:00-CV-2553-P, 2002 U.S. Dist. LEXIS 12080, at *49 n.17 (N.D. Tex. July 3, 2002) ("General allegations, which lump all defendants together failing to segregate the alleged wrongdoing of one from those of another, do not meet the requirements of Rule 9(b)."); *Double*

Alpha, Inc. v. Mako Partners, L.P., No. 99 Civ. 11541, 2000 U.S. Dist. LEXIS 10454, at *7 (S.D.N.Y. July 27, 2000) ("[W]hen fraud is alleged against multiple defendants, a plaintiff must . . . set [] forth separately the acts complained of by each defendant.").[6]

It is impossible here to differentiate in the voluminous Amended Complaint the alleged actions or knowledge of one JPMorgan Chase Entity from those of another. This flaw, which requires dismissal of Count I of the Amended Complaint, is not a mere technicality nor is it an effort by JPMC to re-argue its prior motion to dismiss. Plaintiffs remain the master of their own Complaint. The current pleading is deficient because it does not allege with the particularity required by the law the requisite elements of Plaintiffs' claims as to any of the JPMorgan Chase Entities.

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[6] Although the Court concluded in its December 20, 2002 Order that Plaintiffs sufficiently pled JPMC's scienter, the Court also stressed that generalized, non-specific allegations, which Plaintiffs again rely on in the Amended Complaint, are unacceptable. *See In re Enron Sec. Litig.*, 235 F. Supp. 2d at 687. The Court reasoned:

> The third-party entities have objected with justification to the undifferentiated, boiler-plate allegations repetitively applied to all or many defendants or with generalized references to 'the bank defendants' . . . without the requisite entity-specific and particularized factual allegations for pleading fraud under § 10(b), as required by Rule 9(b) and the PSLRA.

Id. Further, the Court warned that conclusory allegations as to what "Defendants knew" do not satisfy Rule 9(b) and the PSLRA.

III. Plaintiffs' Section 12(a)(2) And Section 15 Claims Against JPMSI And JPMC Are Both Time Barred And Inadequately Pled

Count IV of the Amended Complaint, alleging claims under Sections 12(a)(2) and 15 of the 1933 Act, is an entirely new cause of action asserted for the first time on May 14, 2003 against JPMSI and JPMC, respectively. Under Section 12(a)(2) (formerly Section 12(2)) of the 1933 Act, buyers have an express cause of action for rescission against sellers who make material misstatements or omissions "by means of a prospectus." 15 U.S.C. § 77l(a)(2); *Gustafson v. Alloyd Co.*, 513 U.S. 561, 564 (1995). Plaintiffs purport to bring such an action against JPMSI with respect to an offering of $475 million 6.31% Senior Secured Notes due 2003 and € 515 million 6.19% Senior Secured Notes due 2003 issued by Marlin Water Trust II and Marlin Water Capital Corp. II (the "Marlin II Notes"). Plaintiffs also assert a claim pursuant to Section 15 of the 1933 Act against JPMC as an alleged "controlling person" of JPMSI with respect to the Marlin II Notes offering. This Count must be dismissed in its entirety against these defendants because (1) the claims are time-barred and (2) Plaintiffs fail to state a claim upon which relief may be granted.

A. Section 13 Of The 1933 Act Bars Plaintiffs' Claims As Untimely

Claims brought under Section 12(a)(2) are subject to the express one-year/three-year statute of limitations found in Section 13 of the 1933 Act:

> No action shall be maintained to enforce any liability created under section [11] or [12(a)(2)] of this title unless brought within one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence . . . . In no event shall any such action be brought to enforce a liability created . . . under section [12(a)(2)] more than three years after the sale.

15 U.S.C. § 77m (2003). Because liability of a "controlling person" pursuant to Section 15 is derivative of Section 12(a)(2), the limitations period is the same. *See Herm v. Stafford*, 663 F.2d 669, 679 (6th Cir. 1981).[7]

Plaintiffs were on notice of the alleged facts underlying their Section 12 and 15 claims against JPMSI and JPMC no later than the day Enron filed for bankruptcy, December 2, 2001. *See* Point I, *supra*. Because Plaintiffs filed these claims on May 14, 2003, well over a year later, the claims are barred under Section 13. *See Topalian v. Ehrman*, 954 F.2d 1125, 1134-35 (5th Cir. 1992).

B. Plaintiffs Fail To State A Claim Under Section 12(a)(2) And Section 15 Of The 1933 Act

Plaintiffs' Section 12(a)(2) claim also fails because (1) the named Plaintiffs did not buy the Marlin II Notes and therefore lack standing to assert a claim with respect to them, (2) the Amended Complaint contains no allegation, as required under Section 12(a)(2), that JPMSI directly sold any of the securities in question to any identified Plaintiff, and (3) the Amended Complaint does not allege that Plaintiffs purchased the Marlin II Notes in an initial public offering.

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[7] The Sarbanes-Oxley Act did not amend the limitations period set forth in Section 13 because the amendment applies only to causes of action that involve "a claim of fraud, deceit, manipulation, or contrivance." A Section 12(a)(2) claim does not require proof of fraud. *See Gustafson*, 513 U.S. at 579; *cf.* Am. Compl. ¶ 1016.3 ("Plaintiffs assert negligence claims in this Claim for Relief."). The Sarbanes-Oxley Act's amended limitations period does not apply to this action in any event. *See* Point I, *supra*.

1. Named Plaintiffs Do Not Have Standing Because None Has Certified That It Purchased Marlin II Notes

Plaintiffs lack standing to assert their Section 12(a)(2) claim against JPMSI because no named Plaintiff is alleged to have purchased any Marlin II Notes. In order to maintain a class action, the named plaintiffs must first establish that they have a valid claim with respect to the securities that they purchased. If the named plaintiffs have no cause of action in their own right, the claim must be dismissed, even though the facts set forth in the complaint may show that others might have a valid claim. *In re Initial Public Offering Sec. Litig.*, 214 F.R.D. 117, 122-23 (S.D.N.Y. 2002); *see also In re Taxable Mun. Bond Sec. Litig.*, 51 F.3d 518, 522 (5th Cir. 1995) ("It is well-established that to have standing to sue as a class representative it is essential that a plaintiff must be part of that class . . . .") (internal quotations and alterations omitted).

Although the text of the Amended Complaint contains a single conclusory allegation that "Plaintiffs or members of the Class" purchased Marlin II Notes, Am. Compl. ¶ 1016.4, the certifications of the named Plaintiffs belie the assertion and plainly demonstrate that no named Plaintiff acquired any Marlin II Notes. *See* Am. Compl., Ex. D; *see also* Compl., Lead Pl.'s First and Second Apps. Of Certifications.[8] Because they do not allege that they purchased any of the Marlin II Notes, the named Plaintiffs do not have standing to assert a Section 12(a)(2) claim on the basis of those securities. *See Ratner v. Sioux Nat. Gas Corp.*, 770 F.2d 512, 518 (5th Cir. 1985); *Dartley v. Ergobilt Inc.*, No. Civ. A. 398CV1442M, 2001 WL 313964, at *2

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[8] Plaintiffs The Regents of the University of California, Washington State Investment Board, Staro Asset Management LLC, Robert V. Flint, John Zegarski, Mervin Schwartz, Jr., Steven Smith, and Nathaniel Pulsifer have incorporated by reference their certifications attached to the original complaint. Am. Compl. ¶ 81(a), (e), (i), (j), (l), (q).

(N.D. Tex. Mar. 29, 2001) (dismissing Section 12(a)(2) claim because plaintiffs did not allege that they purchased any securities directly from underwriter defendants). Moreover, Plaintiffs cannot maintain their Section 12(a)(2) claim even if "members of the Class" may have purchased the Marlin II Notes. *See In re Taxable Mun. Bond*, 51 F.3d at 522. Accordingly, the Section 12(a)(2) claim against JPMSI must be dismissed for lack of standing. By necessity, the Section 15 controlling person claim against JPMC must also be dismissed.

2. Plaintiffs Do Not Allege That JPMSI Was A "Seller" Under Section 12(a)(2)

As Plaintiffs fail to allege that they purchased any Marlin II Notes, they likewise fail to allege that JPMSI sold any of the Marlin II Notes to Plaintiffs. Plaintiffs' indecisive allegation that "Plaintiffs ***or*** members of the Class" purchased securities from JPMSI cannot save their claim. Am. Compl. ¶ 1016.4. Nor is it sufficient for Plaintiffs to allege in wholly conclusory fashion that JPMSI "by means of the false and misleading Offering Memoranda . . . sold the Foreign Debt Securities to plaintiffs and/or Class members, who were damaged thereby." *Id.* ¶ 1016.5.

It is well-settled that Section 12(a)(2) extends liability only to "sellers" – those persons who actively, directly and "successfully solicit[] the purchase" of the security sued upon. *Pinter v. Dahl*, 486 U.S. 622, 647 (1988); *Cyrak v. Lemon*, 919 F.2d 320, 324-25 (5th Cir. 1990). The Fifth Circuit has applied the Supreme Court's decision in *Pinter* to hold that a Section 12(a)(2) claim may only be asserted against a defendant "(1) who passed title to plaintiff or solicited the transaction in which title passed, and (2) from whom the plaintiff bought the security." *Cyrak*, 919 F.3d at 325 n.10. Accordingly, if there is no "allegation of direct contact between defendants and plaintiff-purchasers, as a matter of law the defendants are not statutory sellers." *In re Azurix Corp. Sec. Litig.*, 198 F. Supp. 2d 862, 892 (S.D. Tex. 2002), *aff'd sub*

nom. Rosenzweig v. Azurix Corp., _ F.3d _, 2003 WL 21242319 (5th Cir. June 13, 2003). Just this past week the United States Court of Appeals for the Fifth Circuit reiterated that "the seller must, at a minimum, directly communicate with the buyer" for the buyer to maintain a Section 12(a)(2) claim. *Rosenzweig*, 2003 WL 21242319, at *14.

The Amended Complaint does not contain a single well-pleaded factual allegation that JPMSI directly solicited any Plaintiff to purchase Marlin II Notes. Instead, Plaintiffs allege only that JPMSI, in its role as an "underwriter/initial purchaser" "sold" the Marlin II Notes. Am. Compl. ¶ 641.37. Underwriters, however, are not liable under Section 12(a)(2) unless they actively participated in negotiations with the plaintiff. *See Pinter*, 486 U.S. at 650; *Dartley*, 2001 WL 313964, at *2. Because the Amended Complaint contains no allegations that JPMSI was directly and immediately involved in the negotiation and sale of the Marlin II Notes to Plaintiffs, Plaintiffs' Section 12(a)(2) claim against JPMSI (and likewise the Section 15 claim against JPMC) must be dismissed.

3. The Marlin II Notes Were Not Sold In An Initial Public Offering

Section 12(a)(2) extends liability only to those persons that immediately and directly sell a security by means of a "prospectus" that contains a material misstatement or omission. In *Gustafson v. Alloyd Co.*, the U.S. Supreme Court held that a "prospectus" is a document that relates only to a public offering. *Gustafson*, 513 U.S. at 577-78. Therefore, Section 12(a)(2) imposes no liability for sales of securities other than in an initial public offering. *See, e.g.*, *id.* at 578; *Lewis v. Fresne*, 252 F.3d 352, 357 (5th Cir. 2001) (holding that Section 12 did not apply to a private transaction in connection with a company's private placement of stock); *Kauthar SDN BHD v. Sternberg,* 149 F.3d 659, 662 (7th Cir. 1998) (affirming dismissal of Section 12(2) claim "because that section does not apply to private sales of stock and Kauthar

had failed to allege sufficient facts to indicate that the transaction involved was not a private placement").

The Amended Complaint does not contain any well-pleaded factual allegations demonstrating that any Plaintiff purchased the Marlin II Notes in a public offering. To the contrary, the Offering Memoranda for the Marlin II Notes, on their face, contradict any assertion by Plaintiffs that the Marlin II Notes were offered publicly.[9] The Offering Memoranda explicitly state, *inter alia*, that the Marlin II Notes are exempt from registration under federal and state securities laws and that they were offered only to a limited number of qualified purchasers.[10] These disclaimers demonstrate that the Marlin II Notes were placed in a private transaction not subject to Section 12(a)(2) liability. *See, e.g., Vannest v. Sage, Rutty & Co.*, 960 F. Supp. 651, 655 (W.D.N.Y. 1997) (dismissing Section 12(2) claims, as a matter of law, because private placement memorandum "expressly (and repeatedly)" stated that transaction was exempt from registration); *In re JWP Inc. Sec. Litig.*, 928 F. Supp. 1239, 1259 (S.D.N.Y. 1996) (holding that

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9 A court may consider documents integral to and explicitly relied on in the complaint. *See In re Sec. Litig. BMC Software, Inc.*, 183 F. Supp. 2d 860, 881-82 (S.D. Tex. 2001).

10 For example, the Offering Memoranda contain the following warning:

> THE SENIOR NOTES HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE UNITED STATES SECURITIES ACT OF 1933 . . . AND MAY NOT BE OFFERED OR SOLD EXCEPT PURSUANT TO AN EXEMPTION FROM, OR IN A TRANSACTION NOT SUBJECT TO, THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT . . . .

Marlin II Offering Memoranda, cover page. Due to the voluminous nature of the Offering Memoranda, the JPMorgan Chase Entities incorporate by reference Exhibits 1 and 2 of the Appendix to Defendant Bank of America Corporation's and Banc of America Securities LLC's Motion to Dismiss the First Amended Consolidated Complaint.

Section 12(2) claim cannot stand, as a matter of law, where offering documents indicated transaction was exempt from registration under the federal securities law).

Plaintiffs' conclusory allegation that the Marlin II Notes were publicly "traded" on the Luxembourg Exchange, Am. Compl. ¶ 641.37, does not save their claim. The Supreme Court, in *Gustafson*, held that Section 12(a)(2) reaches only a plaintiff's purchases of securities in an initial public offering – not private offerings and not secondary trades whether public or private. *See Gustafson*, 501 U.S. at 578; *Rosenzweig*, 2003 WL 21242319, at *15 (explaining that *Gustafson* "held § 12 not applicable to private, *secondary* transactions.") (emphasis added). Because the Marlin II Notes were not initially sold by means of a "prospectus" in a public offering, Plaintiffs' Section 12(a)(2) claim must be dismissed.

IV. Plaintiffs Fail To Allege Controlling Person Liability Against JPMC

The Amended Complaint newly alleges that JPMC is subject to "controlling person" liability under Section 20(a) of the 1934 Act (Count I) and Section 15 of the 1933 Act (Count IV). Am. Compl. ¶¶ 995.1, 1016.2. These claims must be dismissed because Plaintiffs (1) have not adequately alleged facts demonstrating JPMC's "control" of JPMSI and JPMCB and (2) have not stated a claim for any primary violation by JPMC's subsidiaries JPMSI and JPMCB.

A. Plaintiffs Do Not Allege Any Facts Showing JPMC's "Control"

Plaintiffs cannot state a claim for controlling person liability merely by stating, as they do, that JPMC "controlled" its subsidiaries JPMSI and JPMCB. *See, e.g.*, Am. Compl. ¶ 1016.2. To the contrary, a plaintiff is required to allege facts showing that a defendant "controls" the purported controlled persons within the meaning of the statute and to allege "particularized facts as to the controlling person's culpable participation in (exercising control over) the fraud perpetrated by the controlled person." *In re Enron, Sec., Derivative & ERISA Litig.*, 235 F. Supp. 2d at 598 (internal quotations omitted); *see Dennis v. General Imaging, Inc.*,

918 F.2d 496, 509 (5th Cir. 1990) (to state a *prima facie* case of controlling person liability "plaintiff must prove that 1) each had actual power or influence over the controlled person and 2) each induced or participated in the alleged violation").[11] The Amended Complaint contains no such allegations.

The Fifth Circuit has held that control is "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through ownership of voting securities, by contract, or otherwise." *Dennis*, 918 F.2d at 509 (quoting 17 C.F.R. § 230.405(f)). To properly allege that a defendant possesses control under this definition, Plaintiffs must "allege some facts beyond a defendant's position or title that show that the defendant had actual power or control over the controlled person." *In re Enron Sec., Derivative & ERISA Litig.*, 235 F. Supp. 2d at 595 (citing *Dennis*, 918 F.2d at 509-10). The Amended Complaint does not do so.

Instead the Amended Complaint relies on bald conclusions that JPMSI and JPMCB "act[] at the direction of an under the control of" JPMC and that JPMC "controlled each of [its] respective subsidiaries and affiliates." Am. Compl. ¶¶ 100(a), 995.1. These factually unsupported legal conclusions should not be accepted by the Court. *See Tuchman v. DSC Communications Corp.*, 14 F.3d 1061, 1067 (5th Cir. 1994); *In re Enron, Sec. Derivative & ERISA Litig.*, 235 F. Supp. 2d at 564 n.3. Even if accepted, these allegations establish only JPMC's status as the ultimate corporate parent of JPMSI and JPMCB, which, as a matter of law, does not demonstrate that JPMC either had the power to control its subsidiaries or that it actually

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[11] "Although worded in different ways, the control person liability provisions of § 15 of the 1933 Securities Act and § 20(a) of the 1934 Exchange Act are interpreted the same way." *In re Enron Sec., Derivative & ERISA Litig.*, 235 F. Supp. 2d at 594.

controlled them. *See Novak v. Kasaks*, 997 F. Supp. 425, 435 (S.D.N.Y. 1998) (dismissing Section 20(a) claim because allegation that entity is a parent corporation is insufficient), *rev'd on other grounds*, 216 F.3d 300 (2d Cir. 2000); *cf. McNamara*, 57 F. Supp. 2d at 428 (observing that the mere allegation that defendant is a parent corporation of an alleged primary violator is insufficient to state a claim against the parent).

Moreover, Plaintiffs' lone paragraph of generic and indistinguishable allegations against all of the "bank holding company entities," Am. Compl. ¶ 99.1, does not contain the "particularized facts" this Court requires to state a claim of controlling person liability. These wholly-conclusory allegations are readily contrasted with the detailed assertions on which this Court relied to sustain Plaintiffs' Section 20(a) claims against several Andersen partners:

> [I]n addition to stating their positions as upper echelon partners ("the de jure source of authority to control") and *distinguishing the ways each was involved in the Enron engagement*, [Plaintiffs have] made sufficient general allegations regarding "the conduct that facilitated the Securities Act violations," that suggest the partners had the power to control and/or, in fact, did "control" Enron's auditor by *initiating, ratifying, and implementing Arthur Andersen's policies, or overseeing and monitoring those effectuating Andersen's policies and decisions.*

In re Enron Sec., Derivative & ERISA Litig., 2003 WL 230688, at *19 (emphasis added). The Amended Complaint contains nothing "distinguishing the ways" JPMC itself was involved with Enron nor does it any manner indicate how, if at all, JPMC initiated, ratified, implemented, oversaw or monitored the policies and decisions of JPMSI and JPMCB, much less did so in a way that facilitated the alleged primary violations by these subsidiaries. Accordingly, the Section 20(a) and 15 claims against JPMC must be dismissed.

B. Plaintiffs Have Not Stated A Claim For A Predicate Primary Violation

Plaintiffs' controlling person claims against JPMC also must be dismissed for the simple additional reason that the Amended Complaint fails to state primary violations against

JPMSI and JPMCB. Controlling person liability under Section 20(a) and Section 15 is merely derivative of primary liability under Section 10(b) and Section 12, respectively. *Lone Star Ladies Inv. Club v. Schlotzsky's, Inc.*, 238 F.3d 363, 370 n.33 (5th Cir. 2001); *In re Enron Sec., Derivative & ERISA Litig.*, 235 F. Supp. 2d at 597. As discussed above, Points I-III, *supra*, Plaintiffs' primary claims against JPMSI and JPMCB under Section 10(b) and Section 12(a)(2) must be dismissed.

V. Plaintiffs Fail To State A Claim Against JPMC, JPMCB And JPMSI For A Violation Of The Texas Securities Act

In its March 12, 2003 Order,[12] the Court made clear that Plaintiffs must satisfy two requirements to state a claim for a primary violation of the Texas Securities Act ("TSA"): (1) clarify with particularity the charges they assert, and (2) adequately allege that the Washington Board was in privity with the alleged violators. *See In re Enron Sec., Derivative & ERISA Litig.*), 2003 WL 1089307, at *12, *49-*50, and n.70. The Amended Complaint does not fulfill either requirement.

A. The Amended Complaint Fails To Plead A Primary Violation Of The Texas Securities Act With Particularity

The Court ruled in its March 12 Order that "to insure justice is done," it would permit Plaintiffs to replead their claims under the TSA, directing that the "amended pleading must be clear with respect to the appropriate provisions and the elements of the claims." *Id.* at *50. Plaintiffs were ordered "to clarify which section(s) of the statute [they] sue[] each

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[12] Although the Court's March 12, 2003 Order principally addressed the motions to dismiss of Enron's outside directors, the Court ordered Plaintiffs to replead, if they could, their claims under the Texas Securities Act against the outside directors "as well as against . . . JP Morgan." *In re Enron Sec., Derivative & ERISA Litig.*, 2003 WL 1089307, at *50.

defendant under and to amend/supplement [the] complaint to meet the pleading requirements for each section applicable to that defendant." *Id.* at *12. The pleading standard for claims alleging fraud under the TSA is found in Rule 9(b).[13] *See* Fed. R. Civ. P. 9(b) (applying to "all averments of fraud"); *Hermann Holdings Ltd. v. Lucent Techs., Inc.*, 302 F.3d 552, 566 (5th Cir. 2002) (affirming dismissal of Texas state securities claim for failure to plead with particularity as required by Rule 9(b)); *Northwestern Mut. Life Ins. Co. v. Banc of Am. Sec. LLC*, 254 F. Supp. 2d 390, 403 (S.D.N.Y. 2003) (dismissing Wisconsin blue sky law claim for failure to plead with particularity pursuant to Rule 9(b)); *Mann v. St. Laurent*, 229 F. Supp. 2d 1133, 1139 (D. Or. 2002) (dismissing Oregon blue sky law claim for failure to plead with particularity pursuant to Rule 9(b)). Plaintiffs have not met Rule 9(b)'s heightened pleading requirements, as discussed above. *See* Point II, *supra*. Plaintiffs not only fail to distinguish their claims among JPMC, JPMSI and JPMCB, but also fail to allege other specifics, such as what, if any, contact the Washington Board had with any JPMorgan Chase Entity, and who in particular sold the Notes to the Washington Board.

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[13] Plaintiffs allege fraud in their Texas Securities Act claim. *See* Am. Compl. ¶¶ 1016.10 (incorporating fraud allegations included in ¶ 1-991), 1016.13, 1016.15 (alleging misstatements and omissions of material facts).

B. The Amended Complaint Fails To Allege That The Washington Board Purchased The Notes From JPMC, JPMSI And JPMCB

Plaintiffs' failure to identify the "seller" of the Washington Board's Notes is especially significant given the Court's second direction to Plaintiffs in its March 12, 2003 Order:

> With respect to the secondary actors, it appears that the underwriters *may* be suable under art. 581-33A(2) because Lead Plaintiff *may* be able to allege that they were in privity with and actively solicited the sale of securities to the Washington Board.

In re Enron Sec., Derivative & ERISA Litig., 2003 WL 1089307, at *50 n.70 (emphasis added). "To impose seller liability under article 581-33(A)(2), a plaintiff must be in privity with the defendant, i.e., the plaintiff must have bought his securities from the defendant whom the plaintiff is suing." *Id.* at *14.[14] *See also Frank v. Bear, Stearns & Co.*, 11 S.W.3d 380, 383 (Tex. App.-Houston [14th Dist.] 2000, pet. denied). Despite a conclusory statement that "JP Morgan and Lehman Brothers" were in privity with the Washington Board, Plaintiffs have not

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[14] Despite the specific privity requirement, the Court indicated that the terms "sale," "sell," and "offer for sale" within the meaning of the TSA "still remain broad." *In re Enron Sec., Derivative & ERISA Litig.*, 2003 WL 1089307, at *14. None of the cases cited by the Court, however, point toward a finding of liability for JPMC, JPMSI or JPMCB, as they all involved a defendant that either had direct contact with the plaintiff/purchaser or was deemed to have had such contact based on an agency theory of liability. *See, e.g., Lone Star Ladies*, 238 F.3d at 370 (an issuer may be liable as a "seller" under Section 12 where the "issuer is sufficiently active in promoting the securities as to essentially become the vendor's agent"); *Texas Capital Sec., Inc. v. Sandefer*, 58 S.W.3d 760, 775 (Tex. App.–Houston [1st Dist.] 2001, review denied) (brokerage firm can be held liable for untruths or omissions by stockbroker that directly sold securities to plaintiffs); *Lutheran Bros. v. Kidder Peabody & Co.*, 829 S.W.2d 300, 306-07 (Tex. App.–Texarkana 1992) (placement agent who acted as seller's agent and dealt directly with plaintiffs was "seller" for purposes of TSA). Plaintiffs do not allege that JPMC, JPMSI or JPMCB had an agency relationship with the entity from which the Washington Board purchased the Notes.

alleged any facts demonstrating that the Washington Board "bought" the Notes from JPMC, JPMSI or JPMCB. Moreover, in its Certification, the Washington Board does not identify the "seller" of its Notes.

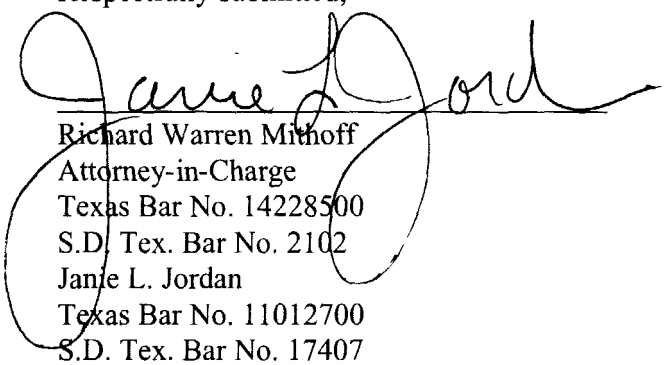
In its March 12, 2003 Order, the Court looked to Section 12 of the 1933 Act to interpret Section 33 of the TSA. *In re Enron Sec., Derivative & ERISA Litig.*, 2003 WL 1089307, at *15-*16; *see also Akin v. Q-L Invs., Inc.*, 959 F.2d 521, 532 (5th Cir. 1992) ("Texas courts generally look to decisions of the federal courts to interpret the Texas Securities Act because of obvious similarities between the state and federal laws"); *Huddleston v. Herman & MacLean*, 640 F.2d 534 (5th Cir. 1981), *aff'd in part and rev'd in part on other grounds*, 459 U.S. 375 (1983) ("We find further support for this construction of the Texas cases in the TSA's legislative history and analogy to the federal provisions on which the Texas statute was based."). As discussed above, *see* Point III.B.2, *supra,* underwriters are not sellers within the meaning of Section 12 unless they actively participate in the negotiations with the plaintiff/purchaser. *See Pinter*, 486 U.S. at 650; *see also Azurix*, 198 F. Supp. 2d at 892 ("Absent any allegation of direct contact between defendants and plaintiff-purchasers, as a matter of law the defendants are not statutory sellers"); *Dartley*, 2001 WL 313964, at *2 ("Plaintiffs do not allege any facts to support the conclusion that [the Underwriters] were statutory sellers as to any of the Plaintiffs . . . . If Plaintiffs did not buy from [the Underwriters] and were not solicited by them, they cannot sue [the Underwriters] for § 12(a)(2) violations"). Despite this second chance, Plaintiffs still have not alleged any contact between the Washington Board and JPMC, JPMSI, or JPMCB. As such, Count V should be dismissed against the JPMorgan Chase Entities.

CONCLUSION

For the foregoing reasons and for the reasons set forth in JPMC's May 8, 2002 and June 24, 2002 briefs, JPMC, JPMSI and JPMCB respectfully request that this Court dismiss the Amended Complaint in its entirety and with prejudice.

Dated: Houston, Texas
June 18, 2003

Respectfully submitted,



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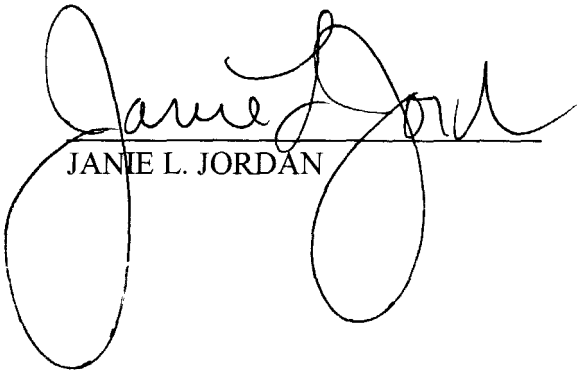
CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing Motion to Dismiss the First Amended Consolidated Complaint and Brief in Support, filed by Defendants J.P. Morgan Chase & Co., J.P. Morgan Securities, Inc. and JPMorgan Chase Bank, as well as the Proposed Order, have been served upon all known counsel of record by electronic mail to the ESL Website on this 18st day of June, 2003.



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