

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

United States Courts
Southern District of Texas
ENTERED

SEP 30 2003

MDL-1446

Michael N. Milby, Clerk of Court

In Re Enron Corporation §
Securities, Derivative & §
"ERISA Litigation §

THIS DOCUMENT RELATES TO: §
§
G-02-299; G-02-463; G-02-585; §
G-02-723 §

MARK NEWBY, ET AL., §
§
Plaintiffs §

VS. §
§
ENRON CORPORATION, ET AL., §
§
Defendants §

CIVIL ACTION NO. H-01-3624
CONSOLIDATED CASES

AMERICAN NATIONAL INSURANCE §
COMPANY; AMERICAN NATIONAL §
INVESTMENT ACCOUNTS, INC; SM&R §
INVESTMENTS, INC.; AMERICAN §
NATIONAL PROPERTY AND CASUALTY §
COMPANY; STANDARD LIFE AND §
ACCIDENT INSURANCE COMPANY; §
FARM FAMILY LIFE INSURANCE §
COMPANY; FARM FAMILY CASUALTY §
INSURANCE COMPANY; AND NATIONAL §
WESTERN LIFE INSURANCE COMPANY, §
§
Plaintiffs §

VS. §
§
J.P. MORGAN CHASE AND COMPANY, §
§
Defendant. §

CIVIL ACTION NO. G-02-0299

AMERICAN NATIONAL INSURANCE §
COMPANY, FARM FAMILY LIFE §
INSURANCE COMPANY, AND §
SECURITIES RESEARCH & §
MANAGEMENT, INC., §
§
Plaintiffs, §

VS. §
§
LEHMAN BROTHERS HOLDINGS, INC., §
LEHMAN BROTHERS, INC., LEHMAN §
BROTHERS COMMERCIAL PAPER, INC., §

CIVIL ACTION NO. G-02-463

1714

AND JOHN PRUSER,	§	
	§	
Defendants.	§	
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AMERICAN NATIONAL INSURANCE	§	
COMPANY, AMERICAN NATIONAL	§	
INVESTMENT ACCOUNTS, INC.,	§	
SM&R INVESTMENTS, INC.,	§	
AMERICAN NATIONAL	§	
PROPERTY AND CASUALTY COMPANY,	§	
STANDARD LIFE AND ACCIDENT	§	
INSURANCE COMPANY, FARM FAMILY	§	
LIFE INSURANCE COMPANY, FARM	§	
CASUALTY INSURANCE COMPANY, AND	§	
NATIONAL WESTERN LIFE INSURANCE	§	
COMPANY,	§	
	§	
Plaintiffs,	§	
	§	
	§	
VS.	§	CIVIL ACTION NO. G-02-723
	§	
CITIGROUP, INC., SALOMON SMITH	§	
BARNEY, INC., JAMES P. REILLY,	§	
JR., C. SCOTT BRUIN, MERRILL	§	
LYNCH, PIERCE, FENNER & SMITH,	§	
INC., MERRILL LYNCH & COMPANY,	§	
INC., SCHUYLER TILNEY, AND	§	
ROBERT THERRIOT,	§	
	§	
Defendants.	§	

MEMORANDUM AND ORDER

Pending before the Court are related motions in G-02-299, G-02-463, and G-02-723 concerning federal subject matter jurisdiction, in particular the propriety of removal of these cases under "related to" bankruptcy jurisdiction, pursuant to 28 U.S.C. § 1334 and 1452, based on Defendants' potential, contingent claims for contribution and/or indemnity that might have a conceivable effect upon Enron Corporation's ("Enron's") bankruptcy

estate.¹ These suits were initially filed in Texas state court and assert causes of action under Texas state law only. Enron is not a party to these actions. After removal they were transferred to this Court where all federal court Enron-related civil litigation under MDL 1446 is pending and is being coordinated with the Enron bankruptcy proceeding in the Southern District of New York under the Honorable Arthur J. Gonzalez.

¹ The Court is aware that G-02-463 asserts other grounds for removal (diversity jurisdiction and fraudulent joinder; All Writs Act). The Court will address those later in this memorandum and order. It also asserts an additional ground for "related to" bankruptcy jurisdiction: as a holder of Enron securities and as a Defendant in *Newby*, Lehman Brothers Inc., like Defendant J.P. Morgan Chase in G-02-299, is involved in litigation that may affect the Enron bankruptcy estate.

Under the facts asserted in these state-law non-class actions and others, in a memorandum and order of August 12, 2002 the Court previously rejected two of the proposed grounds for removal here, i.e., (1) preemption by the Securities Litigation Uniform Standards Act of 1995 ("SLUSA") because they did not meet statutory requirements, and (2) supplemental jurisdiction merely because the cases are based on the same common nucleus of operative facts as other Enron-related cases already before the Court in MDL 1446. The Court incorporates that decision here. #995 in *Newby*; #7 in G-02-299; now available as *Newby v. Enron Corp.*, Nos. MDL 1446, Civ. A. H-01-3624, Civ. A. G-02-299, 2002 WL 32107216 (S.D. Tex. 2002).

G-02-299, G-02-463, and G-02-723 assert securities-related claims under Texas Business & Commerce Code Ann. § 27.01, as amended ("Fraud in Real Estate and Stock Transactions"), Texas Revised Civil Statutes Annotated art. 581-1 *et seq.* (Texas Blue Sky Laws), Texas Revised Civil Statutes Annotated art. 581-33, as amended, and Texas common law fraud, conspiracy aiding and abetting, negligence/professional malpractice, and/or breach of fiduciary duty. G-02-299 asserts that J.P. Morgan's "trades" with Enron through Mahonia Ltd. were vehicles to misrepresent Enron's financial condition to Enron investors, *inter alia*, by transferring losses from one financial reporting period to another. G-02-463 charges that investment banker Lehman Brothers *et al.* participated in the Enron Ponzi scheme and misrepresented Enron's financial condition while selling Plaintiffs Enron investments. G-02-723 brings similar charges against other Enron investment banks and their officers.

In these three cases Defendants present three grounds for "related to" jurisdiction based on their potential claims for contribution and/or indemnity: Texas common law, a Texas statute, and Enron's directors and officers ("D&O") \$450 million liability insurance policies. The notice of removal at 9 in G-02-299 states that if Plaintiffs prevail, J.P. Morgan "may have an action against Enron for indemnity or contribution under the applicable common law," and that its rights to contribution "are expressly recognized by the very [statute] upon which Plaintiffs' claims are based," i.e., Tex. Rev. Stat. Ann. art. 581-33(F)(3) (Vernon Supp. 2002) ("There is contribution as in cases of contract among the several persons so liable."). The notice of removal at 5 in G-02-463 claims that Enron and Defendants who "conspired with and aided and abetted Enron" are "co-tortfeasors",² and that if Plaintiffs prevail in this case, Defendants will have an action for contribution and/or indemnity against them based on Tex. Rev. Stat. Ann. art. 581-33(F)(3).³ They also have a contribution claim from Defendant Enron officers and directors based on D&O

² Under the Texas Securities Act, Texas Rev. Civ. Stat. Ann. art. 581-33F(2), "A person who . . . aids [an] . . . issuer of a security [in a fraud] is liable . . . jointly and severally with the . . . issuer." The original petition in G-02-463 alleges that Defendants aided and abetted Enron's Ponzi scheme.

³ Plaintiffs point out that the Court previously recognized that the Texas Civil Practice and Remedies Code §§ 32 and 33 also provide rights of contribution to Defendants. #995 at 12. Although Plaintiffs argue that these claims are therefore not "speculative," the Court notes that they fail to distinguish between statutory *rights* to contribution and *proving* their claims so that they have an enforceable judgment awarding them contribution.

liability insurance policies purchased by Enron that "may correctly be considered part of the Enron estate." The notice of removal in G-02-723 at 7 identifies the same statute and the liability insurance policies as the bases for Defendants' potential contribution claims. Defendants bear the burden of demonstrating that federal jurisdictional requirements have been satisfied. *Manguno v. Prudential Property and Casualty Co.*, 276 F.3d 720, 723 (5th Cir. 2002).

In G-02-299, the Court addresses the following motions: (1) Plaintiffs American National Insurance Company et al.'s motion for reconsideration of the Court's order of August 12, 2002,⁴ or, in the alternative, request for permission to appeal pursuant to 28 U.S.C. § 1292(b) (#1024 in *Newby*, #14 in G-02-299); (2) Plaintiffs' request for court consideration of supplemental authority (duplicatively filed in *Newby* as #1254 and 1255, and #9 in G-02-299); (3) Plaintiffs' second request for court consideration of supplemental authority (#1283 in *Newby*, #10 G-02-299); (4) Plaintiffs' third request for court consideration (#1360 in *Newby*, #13 in G-02-299); and (5) Defendant J.P. Morgan Chase & Co.'s motion for court consideration of additional authority (#1295 in *Newby*, #12 in G-02-299).

Pending in or related to G-02-463 are the following motions: (1) Plaintiffs American National Insurance Company, Farm

⁴ See Instrument #995 in *Newby*, concluding that removal based on SLUSA or supplemental jurisdiction (relating to claims in other cases) was not sustainable, but finding that the Court did have and would exercise "related to" bankruptcy jurisdiction.

Family Life Instance Company, and Securities Research and Management, Inc.'s motion to remand to the 56th Judicial District Court of Galveston County, Texas (#7 in G-02-463); (2) Plaintiffs' request for court consideration of supplemental authority (#1255 in *Newby*, #11 in G-02-463); (3) Plaintiffs' second request for court consideration of supplemental authority⁵; (4) Plaintiffs' third request for court consideration of supplemental authority (#1359 in *Newby*, #17 in G-02-463).

Finally, pending in G-02-723 is Plaintiffs American National Insurance Company et al.'s motion to remand (#13 in G-02-723) to the 10th Judicial District Court of Galveston County, Texas.

As housekeeping matters, the Court grants all requests for court consideration of various decisions; it has reviewed all cases cited. The key issue of the remaining motions in the above referenced cases, which assert only Texas state-law claims against Defendants, is whether "related to" bankruptcy jurisdiction under 28 U.S.C. §§ 1334(b)⁶ and 1452(a)⁷ supports their removal from

⁵ Although the Court has not been able to find this motion with regard to G-02-463 in that action nor in *Newby*, the Court presumes it relates to and duplicates the same motions filed by Plaintiffs' counsel in G-02-299 (#1283 in *Newby*) and G-02-0585 (#1284 in *Newby*, to which a copy of the unpublished decision cited as authority by Plaintiffs is attached).

⁶ Section 1334 (a) and (b) provides,

(a) Except as provided in subsection (b) of this section, the district courts shall have original and exclusive jurisdiction of all cases under title 11.

(b) Notwithstanding any Act of Congress that

state court and provides jurisdiction by this Court, in effect sitting as a bankruptcy court over proceedings "related to" Enron's bankruptcy proceeding here, based on Defendants' allegations that they potentially may assert claims for indemnity and contribution against Enron's bankruptcy estate. After the parties have submitted more focused briefs and this Court has

confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11.

⁷ Section 1452(a) and (b) reads,

(a) A party may remove any claim or cause of action in a civil action other than a proceeding before the United States Tax Court or a civil action by a governmental unit to enforce such governmental unit's police or regulatory power, to the district court for the district where such civil action is pending, if such district court has jurisdiction of such claim or cause of action under section 1334 of this title.

(b) The court to which such claim or cause of action is removed may remand such claim or cause of action on any equitable ground. An order entered under this subsection remanding a claim or cause of action, or a decision not to remand, is not reviewable by appeal or otherwise by the court of appeals under section 158(d), 1291, or 1292 of this title or by the Supreme Court of the United States under section 1254 of this title.

Nevertheless, the Fifth Circuit has held that where a district court denies a motion to remand based not upon equitable reasons, but upon a determination that it does have "related to" bankruptcy subject matter jurisdiction over a removed case, the decision may be reviewed by the appellate court under 28 U.S.C. § 1447(d) and 1452(b). *Bissonnet Investments LLC v. Quinlan (In the Matter of: Bissonnet Investments LLC)*, 320 F.3d 520, 525 (5th Cir. 2003).

performed its own research, the Court finds that the motion to reconsider should be granted and a more thorough examination of the question be made because of the complexity of this issue, which has created division among courts. Indeed panels within the Fifth Circuit have issued several opinions relating to the question that have caused confusion.

APPLICABLE LAW

After researching the law relating to the issue of "related to jurisdiction," the Court has concluded that the following law applies in this Circuit.

"Related to" bankruptcy jurisdiction arises in two kinds of suits: (1) causes of action that belong to the debtor and become property of the bankruptcy estate under 11 U.S.C. § 541; and (2) suits between third parties that may affect the bankruptcy estate. *Celotex Corp. v. Edwards*, 514 U.S. 300, 308 n. 5 (1995); *Arnold v. Garlock*, 278 F.3d 426, 434 (5th Cir. 2002). It is the latter category into which the cases *sub judice* fall.

Subject matter jurisdiction is determined at the time of removal. *Arnold v. Garlock*, 278 F.3d 426, 434 (5th Cir. 2002). Federal court "are courts of limited jurisdiction, and "[a] bankruptcy court's jurisdiction is especially circumscribed and wholly 'grounded in, and limited by statute.'" *In re Bissonnet Investments LLC*, 320 F.3d 520, 525 (5th Cir. 2003), quoting *Celotex Corp. v. Edwards*, 514 U.S. 300, 307 (1995). Nevertheless, Congressional intent in enacting 28 U.S.C. § 1334 was "to grant comprehensive jurisdiction to the bankruptcy courts so that they

might deal efficiently and expeditiously with all matters connected with the bankruptcy estate." *Celotex*, 514 U.S. at 308. Therefore, although not "limitless," bankruptcy jurisdiction does cover "more than simply proceedings involving the property of the debtor or the estate." *Id.* The Supreme Court also suggested that "related to" jurisdiction may be broader in a Chapter 11 reorganization proceeding than in a Chapter 7 liquidation proceeding. *Id.* at 310.

As the Court indicated in its earlier order (#995), like the majority of its sister Circuit Courts of Appeals, the Fifth Circuit has adopted the test for "related to" bankruptcy jurisdiction from *Pacor, Inc. v. Higgins (In re Pacor)*, 743 F.2d 984, 994 (3d Cir. 1984): whether "the outcome of the proceeding could conceivably have any effect on the estate being administered in bankruptcy." *In re Canion*, 196 F.3d 579, 585 (5th Cir. 1999); *Wood v. Wood (In re Wood)*, 825 F.2d 90, 93 (5th Cir. 1987). Therefore "the proceeding need not necessarily be against the debtor or against the debtor's property." *Pacor*, 743 F.2d at 994. Nor is certainty or likelihood of that effect necessary; "jurisdiction will attach on a finding of any conceivable effect. *In re Canion*, 196 F.3d at 587 and n.30; *Arnold*, 278 F.3d at 434. "An action is related to bankruptcy if the outcome could alter the debtor's rights, liabilities, options, or freedom of action (either positively or negatively) and . . . in any way impacts upon the handling and administration of the bankruptcy estate." *Walker v. Caddle Co. (In re Walker)*, 51 F.3d 562, 569 (5th Cir.

1995), quoting *FDIC v. Majestic Energy Corp. (In re Majestic Energy Corp.)*, 835 F.3d 87, 90 (5th Cir, 1987), and *Pacor*, 743 F.2d at 994.⁸ The test is conjunctive; both prongs must be satisfied for jurisdiction to attach. *Bass v. Denney (Matter of Bass)*, 171

⁸ The United States Supreme Court agreed with several points set out in *Pacor* regarding the broad scope of "related to" bankruptcy jurisdiction, but did not conclude that the Third Circuit's test was the only appropriate one.

The jurisdictional grant in [Section] 1334(b) was a distinct departure from the jurisdiction conferred under previous acts, which had been limited to either possession of property by the debtor or consent as a basis for jurisdiction. We agree with the views expressed by the Court of Appeals for the Third Circuit in *Pacor* . . . that "Congress intended to grant comprehensive jurisdiction to the bankruptcy courts so that they might deal efficiently and expeditiously with all matters connected with the bankruptcy estate," and that the "relate to" language of § 1334(b) must be read to give district courts (and bankruptcy courts under § 157(a)) jurisdiction over more than simply proceedings involving the property of the debtor or the estate. We also agree with that court's observation that a bankruptcy court's "related to" jurisdiction cannot be limitless.

Celotex Corp. v. Edwards, 514 U.S. 300, 308 & n.6 (1995). The high court expressly stated that actions "related to" a bankruptcy proceeding included "suits between third parties which have an effect on the bankruptcy estate." *Id.* at n.5. The Supreme Court noted that most Circuit Courts of Appeals had adopted the *Pacor* test, with only the Second and Seventh Circuits applying a slightly narrower test than that in *Pacor*. *Id.* at 308 n.6, citing *In re Turner*, 724 F.2d338, 341 (2d Cir. 1983) (holding that a proceeding is related to a bankruptcy if there is a "significant relationship," which can be something other than the monetary effect on the debtor's estate, between them); *In re Xonics, Inc.*, 813 F.2d 127, 131 (7th Cir. 1987) ("related to" means "that it affects the amount of property [in the debtor's estate] available for distribution or allocation among creditors); and *Home Ins. Co. v. Cooper & Cooper Ltd.*, 889 F.2d 746, 749 (7th Cir. 1988) (same). The high court was careful to say, "But whatever test is used, these cases make clear that bankruptcy courts have no jurisdiction of proceedings that have no effect on the debtor." 514 U.S. at 308 n.6.

F.3d 1016, 1022 (5th Cir. 1999). "'Related to' is a term of art in bankruptcy jurisdiction, where its meaning is not as broad as it is in ordinary parlance, i.e., where it means 'having some connection with'"; instead it has a "cause component," i.e., "the proceeding must be capable of affecting the bankruptcy estate." *Id.* at 1022-23; *In re Canion*, 196 F.3d at 585. See *Pacor*, 743 F.2d at 994 ("For ['related to'] subject matter jurisdiction to exist, . . . there must be some nexus between the 'related' civil proceedings and the title 11 case.").

The Fifth Circuit has pointed out that "'a vast majority of cases find that 'related to' jurisdiction is lacking in connection with third party complaints.'" *Walker*, 51 F.3d at 569. See also *Feld v. Zale Corp. (Matter of Zale Corp.)*, 62 F.3d 746, 752 (5th Cir. 1995) ("As a dispute becomes progressively more remote from the concerns of federal law claimed to confer jurisdiction over it, the federal interest in furnishing the rule of decision for the dispute becomes progressively weaker."). It has further held that unlike a district court, a bankruptcy court cannot exercise supplemental jurisdiction (previously known as ancillary jurisdiction) or pendent party jurisdiction, because doing so "could subsume the more restrictive 'relate to' and 'arising in' jurisdiction, such that the latter would be rendered substantially, if not entirely superfluous [citations omitted]." *Walker*, 51 F.3d at 570-73. The Fifth Circuit has also identified additional considerations which may be present in the

Enron litigation before this Court, but that will not, by themselves, support "related to" bankruptcy jurisdiction:

Shared facts between the third-party action and a debtor-creditor conflict do not in and of themselves suffice to make the third-party action "related to" the bankruptcy. Moreover judicial economy alone cannot justify a court's finding jurisdiction over an otherwise unrelated suit. . . . [T]he district court's desire to "foster and encourage and then preserve settlement in federal court" does not in and of itself confer jurisdiction. [citations and footnotes omitted]

Feld v. Zale Corp. (Matter of Zale Corp.), 62 F.3d 746, 753 (5th Cir. 1995). See also *Pacor*, 743 F.2d at 994 ("[T]he mere fact that there may be common issues of fact between a civil proceeding and a controversy involving the bankruptcy estate does not bring the matter within the scope of section 1471(b).⁹ Judicial economy itself does not justify federal jurisdiction.").

The Bankruptcy Code broadly defines the property of the estate as consisting of "all legal and equitable interests of the debtor in property as of the commencement of the case" and "proceeds . . . of or from the property of the estate." 11 U.S.C.

⁹ Title 28 U.S.C. § 1471(b), by which "Congress intended to grant comprehensive jurisdiction to the bankruptcy courts so that they might deal efficiently and expeditiously with all matters connected to the bankruptcy estate" according to *Pacor*, 743 F.2d at 994, provides,

Notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district court shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11 or arising in or related to cases under title 11.

§ 541(a)(1) and (6). The Supreme Court has pronounced, "The scope of [§ 541(a)(identifying what property is included in debtor's bankruptcy estate)] is broad. It includes all kinds of property, including tangible or intangible property, causes of action, . . . and all other forms of property currently specified in section 70a of the Bankruptcy Act." *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 204-05 & n.9 (1983). "The language of § 541(a) is unquestionably broad enough to cover a debtor's interest in liability insurance." *Homsy v. Floyd (Matter of Vitek, Inc.)*, 51 F.3d 530, 533 (5th Cir. 1995) ("'[a] products liability policy . . . is a valuable property of a debtor, particularly if the debtor is confronted with substantial liability claims.'").

Under conflicting case law, resolution of the issue of whether third-party Defendants' claims for indemnity and/or contribution against a debtor's bankruptcy estate in the bankruptcy court are within the court's "related to" bankruptcy jurisdiction because they could conceivably have an effect on the debtor's estate or estate administration, may depend on several factors and on the particular court that is presiding over the issue. For example, the nature of the parties (debtor, nondebtor, creditor) to the claims may be relevant. As noted, the debtor Enron is not a party to any of these three suits, but, as indicated, its presence is not required to establish "related to" jurisdiction. Another key factor is the source giving rise to the Defendants' contribution/indemnity claim, e.g., a contractual provision or debtor's agreement to indemnify, an insurance policy

and its proceeds and whose property they are, the bylaws of the corporate debtor,¹⁰ a statute, or allegations of wrongful conduct under common law. Where a D&O liability insurance policy is involved, as here, the related to jurisdiction depends in part upon whether proceeds from the policy are considered property of the bankruptcy estate or of a third-party policy beneficiary. Another is the "ripeness" of the claim: because a claim for indemnity and/or contribution may necessitate another lawsuit or adversary proceeding, a finding of "related to" jurisdiction may depend upon whether the presiding court recognizes as sufficient for "related to" jurisdiction a merely contingent, unliquidated claim, or requires that the defendant have already filed a proof of claim and a suit and litigation is ongoing, or insists that the defendant have already obtained a judgment based on his contribution/indemnification claim.

The Fifth Circuit has expressly held that a claim for a third-party claim for contribution may support "related to" bankruptcy jurisdiction only in certain kinds of insurance policy cases. "Those cases in which courts have upheld 'related to' jurisdiction over third party actions do so because the subject of the third-party dispute is the property of the estate, or because

¹⁰ For example, although not involved here because Defendants are not former Enron directors and officers, Enron's Articles of Incorporation provide that any director or officer who is made a defendant to any action by reason of his service as an Enron director or officer shall be indemnified and held harmless "to the fullest extent authorized by the Oregon Business Corporation Act." Amended and Restated Articles of Incorporation of Enron Oregon Corp., Art. VIIB, as amended, Ex. D to #110 in G-02-585.

the dispute over the assets would have an effect on the estate." *Feld v. Zale Corp. (In re Zale Corp.)*, 62 F.3d 746, 753 (5th Cir. 1995). The appellate court has emphasized that "'it is the relation of the dispute to estate, and not of party to estate, that establishes jurisdiction [citations omitted].'" *Id.* at 755. Therefore, where, as here, the assets at issue are the proceeds of an insurance policy, "the destination of the proceeds from a lawsuit" is the determining factor. *Bass v. Denney (In re Bass)*, 171 F.3d 1016, 1023 (5th Cir. 1999), *citing Miller v. Kemira, Inc. (In re Lemco Gypsum, Inc.)*, 910 F.2d 784, 789 (11th Cir. 1990).

A number of courts have found that the Fifth Circuit's law regarding ownership of insurance policies and/or their proceeds to be somewhat convoluted. *See, e.g., In re Sfuzzi, Inc.*, 191 B.R. 664 (Bankr. N.D. Tex. 1996) (examining and attempting to reconcile the apparent conflict in the Fifth Circuit cases regarding whether the insurance policy proceeds belong to the debtor's estate and therefore affect it, the court followed the test established in *Houston v. Edgeworth (In re Edgeworth)*, 993 F.2d 51, 55-56 (6th Cir. 1993); *American Nuclear Insurers v. Babcock and Wilcox Co.*, Nos. CIV. A. 01-2751, 00-10992, 00-1188, 1002 WL 1334882, *4 (E.D. La. June 14, 2002) ("This Court acknowledges that the Fifth Circuit jurisprudence on policy/policy proceeds dichotomy is somewhat muddled."); *Davis v. Life Investors Ins. Co. of America*, 282 B.R. 186, 196 n.1 (S.D. Miss. 2002). Nevertheless, this Court attempts to unscramble and explain it.

The Fifth Circuit has held that usually an insurance policy owned by the debtor is considered part of the debtor's estate because irrespective of who the insured is, "the debtor retains certain contract rights under the policy itself" and "[a]ny rights the debtor has against the insurer, whether contractual or otherwise, become property of the estate"; nevertheless, the answer to the more important question, i.e., whether the proceeds of a particular policy become property of the debtor's estate, depends on the nature of the policy and the recipient of the funds. *Edgeworth*, 993 F.2d at 55; see also *In re Equinox Oil Co., Inc.*, 300 F.3d 614, 618 (5th Cir. 2002); *In re Louisiana World Exposition, Inc.*, 832 F.2d 1391, 1399 (5th Cir. 1987) ("The question is not who owns the policies, but who owns the liability proceeds."); *Zale*, 62 F.3d at 757-58 ("We have excluded the proceeds of director and officer liability policies from property of the estate . . . when those proceeds [are] directly paid the individual officers and not the debtor.").¹¹ A court needs to examine "whether, in the absence of the bankruptcy proceeding, the proceeds of the policy would belong to debtor when the insurer pays a claim." *In re Equinox*, 300 F.3d at 618. Phrased otherwise,

[t]he overriding question when determining whether proceeds are property of the estate is whether the debtor would have a right to receive and keep those proceeds when the insurer paid on a claim. When a payment by

¹¹ But see *Zale*, 62 F.3d at 758 ("We need not decide whether the *proceeds* are property of the estate, if we find that the disputes over the . . . *policy* can have an effect on the estate.").

the insurer cannot inure to the debtor's pecuniary benefit, then that payment should neither enhance nor decrease the bankruptcy estate. In other words, when the debtor has no legally cognizable claim to the insurance proceeds, those proceeds are not property of the estate.

In re Edgeworth, 993 F.2d at 55-56.

Unlike the majority of courts, the Fifth Circuit has drawn "a technical distinction between the ownership of insurance policies and the ownership of proceeds of these policies" *In re Vitek*, 51 F.3d at 534. While most courts view both as "valuable properties of debtors' bankruptcy estates,"¹² under Fifth Circuit law it depends upon to whom the policy proceeds would go. Under casualty, collision, life, and fire insurance policies, where the debtor is the beneficiary and the recipient of the policy's proceeds, the proceeds would be property of and affect the debtor's estate, while under liability policies whose proceeds, pursuant to the terms of the insurance contract, are generally paid to third-parties injured by the insured, the proceeds would not be the property of the debtor or affect the debtor's estate. *In re Equinox*, 300 F.3d at 618, *citing Edgeworth*, 993 F.2d at 56 (holding that although medical malpractice liability policy was the property of the debtor's estate, the proceeds were not claimed by the physician debtor but went only to the malpractice victims and their relatives and were not property of the estate). In one suit where the proceeds of a D&O liability policy covering any liability and related legal

¹² Quoting *In re Vitek*, 51 F.3d at 534.

expenses that the directors and officers might incur while serving the subsequently bankrupt corporation would go to these insured directors and officers personally,¹³ the Fifth Circuit found that the proceeds would not go to, and therefore would not affect or belong to, the debtor's estate. *In re Louisiana World Exposition, Inc.*, 832 F.2d 1391 (5th Cir. 1987).¹⁴ However, in the more "typical situation in which a debtor corporation's liability policies provide the debtor and thus the estate with direct coverage against third party claims, virtually every court to have considered the issue has concluded that the policies--and clearly the proceeds of those policies-- are part of debtor's bankruptcy estate, irrespective of whether those policies also provide

¹³ Nevertheless, although ignored by the Fifth Circuit, one "effect" on the bankruptcy estate of such a ruling is that the proceeds would not be available to increase the size of the estate for distribution to other creditor claimants.

¹⁴ In *Vitek*, the panel emphasized that the liability insurance policies in *In re Louisiana World Exposition* did not cover the debtor corporation directly for any liability to third-party claimants, thus making the debtor's legal ownership of the policies insufficient to transform the proceeds of the policies into the property of the bankruptcy estate. 51 F.3d at 534. If the debtor were also covered under a policy for judgments against itself or losses that it incurred, then the debtor would be deemed to own both the policy and the proceeds. *Id.* at 534 n. 17, citing *In re Louisiana*, 832 F.2d at 1399-1400. The Fifth Circuit also noted cases where other courts have rejected the policy/proceeds dichotomy that the Fifth Circuit applies because they fear that whenever the potential loss is greater than the limit of the policies, such a rule would encourage a rush to the courthouse to get the first judgments against the non-bankrupt insureds. *Id.* at 534-35 & nn. 20 & 21.

liability coverage for the debtor's directors and officers."
*Id.*¹⁵

Because the Fifth Circuit, *en banc*, has not rejected its policy/proceeds approach, if this Court were to apply Fifth Circuit law, it appears that the proceeds of the D&O policies at issue, which would flow not to the debtor's estate, but to the current and former Enron officers and directors covered by the policies, and that they would not be property of the bankruptcy estate or related to the bankruptcy.

Nevertheless, the jurisdictional issue is complicated with respect to MDL 1446 by the fact that the Enron bankruptcy court is in the Southern District of New York and applies to its proceedings Second Circuit law relating to jurisdiction. Although the Second Circuit adopted the *Pacor* "any conceivable effect" test, it does not apply the Fifth Circuit's policy/proceeds dichotomy, to the issue of "related to" bankruptcy jurisdiction. *In re Cuyahoga Equipment Co.*, 980 F.2d 110, 114 (2d Cir. 1992) (adopting "any conceivable effect" test); *Hesselman v. Arthur Anderson, LLP (In re Global Crossing Ltd. Sec. Litig.)*, Nos. 02 Civ. 910 GEL, 02 Civ. 10199, 2003 WL 21659360 (S.D.N.Y. July 15,

¹⁵ This Court observes that the Fifth Circuit, itself, seems skeptical about the policy/proceeds dichotomy, noting that while the dichotomy principle was introduced in *Louisiana World Exposition*, the panel in *In re Edgeworth*, 993 F.2d at 56, noted that the language was dicta. *Vitek*, 51 F.3d at 534 n.17. The *Vitek* panel, furthermore, emphasizing that "the vast majority of courts" do not make the distinction, observed that "the scope of the policy/proceeds distinction enshrined in *Louisiana World Exposition*, is still in ferment: Whether that distinction will be extended more broadly has yet to be determined." *Id.*

2003). Under orders issued in the Enron proceedings by Judge Gonzales, it appears that, like the majority of courts, he views the policy and policy proceeds as part of the debtor's estate. See, e.g., *In re Enron Corp.*, No. 02-16034 (AJG), 2002 WL 1008240 (Bankr. S.D.N.Y. May 17, 2002) (granting insurance company's motion for relief from the automatic stay to pay or advance defense costs, under D&O and ERISA Fiduciary policies, for lawsuits and proceedings against covered present and former officers and directors and outside directors of Enron). Furthermore, district courts in the Second Circuit have departed from *Pacor*, which "rejected 'related to' bankruptcy jurisdiction on the basis of a potential claim for contribution"; instead New York federal district courts have held that "the possibility that litigation against an officer of a bankrupt corporation could lead to a claim against the corporation for contribution based on the wrong doing of other corporate employees would certainly have a 'conceivable effect' on the bankrupt estate." *In re Global*, 2003 WL 21659360 *1 & n.2; see also *New York City Employees' Retirement System v. Ebbers (In re WorldCom, Inc. Sec. Litig.)*, 293 B.R. 308, 317-24 (S.D.N.Y. 2003), order issued, 2003 WL 685099 (S.D.N.Y. Mar. 3, 2003). They also have found "related to" bankruptcy jurisdiction when a claim for indemnification or contribution has a "'reasonable legal basis.'" *Id.* at 318, citing *In re Cuyahoga*, [980 F.2d 114].

In *In re WorldCom, Inc. Sec. Litig.*, 293 B.R. at 321, Judge Cote found that there was "a reasonable basis" for the

contribution claims in a removed state court securities action against the debtor's former executive officers, underwriters and directors because a finding that the

Director or Underwriter Defendants are liable is entirely dependent on a finding that WorldCom engaged in wrongful conduct. Since the conduct of WorldCom and these Defendants was indisputably intertwined, the theories of liability pressed by NYCERS are necessarily interconnected with these Defendants' rights to contribution. Because the effect of contribution claims on the bankruptcy estate is at the very least "conceivable," the NYCERS action is related to the bankruptcy and subject to the jurisdiction of this Court.

Id. at 321. The same rationale is applicable here. As instances of courts "concluding that . . . third party litigation is related to the bankruptcy proceeding" based upon "[t]he existence of strong interconnections between the third party action and the bankruptcy," Judge Cote cited *In re Dow Corning*, 86 F.3d 482 (6th Cir. 1996), to be discussed subsequently in this memorandum and order. Furthermore, although the court recognized that under section 502(e)(1)(B), 11 U.S.C. § 502(e)(1)(B), distribution from the estate may not be based on contingent contribution claims that have not yet been reduced to judgment, Judge Cote maintained, "Claims that are contingent today nonetheless have a 'conceivable' effect on the bankruptcy." *Id.* at 323.¹⁶

¹⁶ As an example of the appellate court's inconsistencies in this area of law, the Court notes that in *In re Canion*, 196 F.3d at 485-86, the Fifth Circuit found that if a pending litigation alleging various tort theories against the debtor's friends, relatives, business associates and employees were successful, even though the panel considered success unlikely, it found that the resulting decrease in claims against the bankruptcy estate would

Because this Court is sitting in bankruptcy, in lieu of Judge Gonzalez, over those Enron civil cases where "related to" bankruptcy jurisdiction is the sole basis of its jurisdiction, and thus this Court's "related to" bankruptcy jurisdiction derives from that New York bankruptcy proceeding, this Court accordingly follows the controlling law in the Second Circuit.

Moreover, there is an additional basis for recognizing "related to" bankruptcy jurisdiction here. The Fifth Circuit has repeatedly revealed concern about situations in which, and implied that "related to" bankruptcy jurisdiction might exist where, non-debtor co-defendants are involved in mass tort litigation against a Chapter 11 debtor and the assets of the policies in dispute and of the estate are grossly insufficient to cover all the claims against the debtor, even where the contribution claim is only contingent. See, e.g., *Arnold*, 278 F.3d at 435 (citing *In re Dow Corning*, 86 F.3d 482 (6th Cir. 1996)).¹⁷ As noted above, so do Second Circuit courts.

inure to the benefit of all other unsecured creditors and thus affect the bankruptcy estate. Therefore it found "related to" jurisdiction over the suit.

¹⁷ The concern is evident even in *In re Edgeworth*, although it involved a single physician in Chapter 7 bankruptcy who was sued for malpractice. Two bases for the determination that the victim plaintiffs could file a claim against the physician's insurer, although not against the physician personally, after the physician debtor was discharged from bankruptcy, even though these plaintiffs had never filed a claim in the bankruptcy proceeding, were that there was no claim that the policy limits were inadequate to cover the plaintiffs or any competing claims to the policy proceeds and the fact that the policy proceeds were not available to any creditors other than the malpractice victims and their families, so there would not be any secondary impact on the estate. 993 F.3d at 56.

A significant factor in the decision *In re Edgeworth* was that the limits of the policy at issue were sufficient to cover all claims to the proceeds in that action and fully protected the debtor from losses. The panel noted in contrast to the situation before it,

In the mass tort context, the decision by several courts to include the proceeds as the property of the estate would be motivated by a concern that the court would not otherwise be able to prevent a free-for-all against the insurer outside the bankruptcy proceeding. There was also a threat that, unless the policy proceeds were marshalled in the bankruptcy proceeding, they would not cover plaintiffs' claims and would expose the debtor's estate.

Id. at 56 n. 21. See *In re Sfuzzi Inc.*, 191 B.R. 664 (Bankr. N.D. Tex. 1996) (highlighting the distinction made in *Edgeworth*).

It is a concern that continues to inform the Fifth Circuit's opinions, as will be discussed. This Court observes that in essence this civil Enron multidistrict litigation, though alleging financial rather than personal injury, is far more analogous to a mass tort action than to a single claimant suit; MDL 1446 is a massive litigation with multiple plaintiffs alleging torts including fraud, breach of fiduciary duty, negligence and malpractice, and it is very obvious that the limits of liability in Enron's D&O policy or policies are woefully inadequate to cover the claims asserted against Enron's officer and directors as well as against third parties by nondebtor Defendants, should they prevail.

In *In re Vitek* (holding *inter alia* that although corporate debtor owned the insurance policies, policy proceeds going to two of its directors and officers, Charles and Ann Homsys, were not part of the debtor's estate), which involved this question in the context of product liability suits against a debtor corporation in Chapter 7 bankruptcy and some of its officers and directors. Judge Weiner, writing for the panel, suggested in a footnote,

The issues here considered are more frequently encountered in Chapter 11 reorganizations than in Chapter 7 liquidations. Consequently, any analogical crossovers into Chapter 11 jurisprudence is [sic] problematical, particularly those Chapter 11 proceedings that implicate mass tort litigation, e.g., asbestos, birth control devices, etc. In the same vein, the precedential--or even merely instructional--value of this opinion to future Chapter 11 cases should probably be "little or none."

51 F.3d 533 n.3.

Enron's bankruptcy is a Chapter 11 reorganization proceeding. Furthermore, evaluating the Fifth Circuit's dichotomy between policy ownership and proceeds ownership, the Fifth Circuit has recognized other Circuits' underlying policy reasons in rejecting the distinction

because it exposes a debtor's insurance policies to suit outside the ambit of the bankruptcy estate. These courts evidently fear that splitting the proceeds of a liability policy between bankrupt and nonbankrupt insureds would create a race to the courthouse whenever potential liability exceeds total proceeds, as creditors scurry to see who can be first to get a judgment against the non-bankrupt insureds (worth a dollar on the dollar) instead of a claim

against a bankrupt debtors estate (often worth but pennies on the dollar, if anything).
[footnotes omitted]

51 F.3d at 534-35. Moreover, the Fifth Circuit panel acknowledged that the picture might not be so simple as the dichotomy implied and remarked,

In this circuit, we are therefore in the position of knowing how to resolve cases on either end of the continuum, but we have not yet decided how to resolve cases lying somewhere along the continuum. On one extreme, when a debtor corporation owns a liability policy that exclusively covers its directors and officers, we know from *Louisiana World Exposition* that the proceeds of that D&O policy are not part of the debtor's bankruptcy estate. On the other extreme, when a debtor corporation owns an insurance policy that covers its own liability vis-a-vis third parties, we like almost all other courts that have considered the issue-declare or at least imply that both the policy and the proceeds of that policy are property of the debtor's bankruptcy estate. But we have not yet grappled with how to treat the proceeds of a liability policy when (1) the policy-owning debtor is but one of two or more coinsureds or additional named insureds, (2) the rights of other coinsured(s) or additional named insureds) are not merely derivative of the rights of one primary named insured, and (3) the aggregate potential liability substantially exceeds the aggregate limits of available insurance coverage. [footnotes omitted]

51 F.3d at 535.

An examination of several Circuit Courts of Appeals cases that dealt with the *Pacor* ruling and with distinguishing mass tort litigation is revealing.

In *Pacor*, John and Louise Higgins sued Pacor for work-related injury to John Higgins from exposure to asbestos that had

been supplied by Pacor. Pacor impleaded Johns-Manville Corporation in a third-party action as the alleged manufacturer of the asbestos. Subsequently Johns-Manville filed a chapter 11 petition in bankruptcy, and Pacor tried to remove the personal injury suit to the bankruptcy court in part on "related to" bankruptcy jurisdictional grounds. After setting out its broad test for such jurisdiction, the Third Circuit found that the personal injury suit between the Higginses and Pacor would have no effect on the Manville bankruptcy estate:

At best, it is a mere precursor to the potential third-party claim for indemnification by Pacor against Manville. Yet the outcome of the Higgins-Pacor action would in no way bind Manville, in that it could not determine any rights, liabilities, or course of action of the debtor. Since Manville is not a party to the Higgins-Pacor action, it could not be bound by *res judicata* or collateral estoppel. . . . Even if the Higgins-Pacor dispute is resolved in favor of Higgins (thereby keeping open the possibility of a third party claim), Manville would still be able to relitigate any issue or adopt any position in response to a subsequent claim by Pacor. Thus the bankruptcy estate could not be affected in any way until the Pacor-Manville third party action is actually brought and tried.

Pacor, 743 F.2d at 995 ("any judgment received by the plaintiff Higgins could not itself result in even a contingent claim against Manville, since Pacor would still be obligated to bring an entirely separate proceeding to bring indemnification.").

The Third Circuit distinguished the situation in *Pacor*, from that in *In re Brentano's*, 27 B.R. 90 (Bankr. S.D.N.Y. 1983). In *Brentano's*, a nondebtor, MacMillan Inc., executed an indemnity

agreement to serve as a guarantor of Brentano's obligations under a lease of certain premises from Pine Realty, Inc. After Brentano's filed a Chapter 11 bankruptcy petition, Pine Realty filed a proof of claim in the bankruptcy court for pre-petition rent and an administrative claim for post-petition amounts due on the leased premises and then sued MacMillan under the guaranty agreement in California state court. In the state court action MacMillan moved to stay Pine Realty from proceeding against MacMillan in any forum other than the bankruptcy court, and a stay was granted. One issue that emerged in the Brentano bankruptcy court was whether the bankruptcy court had "related to" jurisdiction over the state court suit. The *Brentano's* bankruptcy court pointed to established law that a bankruptcy court has jurisdiction over an action of a creditor against a non-debtor, third-party guarantor of a debt owed by the debtor, because the guarantor could then recover against the debtor under the indemnification agreement, thereby ultimately affecting the estate's assets and the effort to reorganize the debtor. The court affirmed the stay granted in the state court.

According to the *Pacor* panel, not only was it "clear that the action between the landlord and MacMillan could and would affect the estate in bankruptcy" because under the indemnification agreement in *Brentano's*, if the landlord won a judgment, indemnification liability against Brentano's would *automatically*

result. 743 F.2d at 995.¹⁸ In contrast, because the indemnification claim in *Pacor* was grounded only in common law and would require intervening litigation,

there would be no automatic creation of liability against Manville against Pacor. Pacor is not a contractual guarantor of Manville, nor has Manville agreed to indemnify Pacor, and thus a judgment in the Higgins-Pacor action could not give rise to any automatic liability on the part of the estate. All issues regarding Manville's possible liability would be resolved in a subsequent third party impleader action. Moreover Higgins is not a creditor of Manville and has filed no claim against Manville. Any judgment obtained would thus have no effect on the arrangement, standing, or priorities of Manville's creditors. There would therefore be no effect on administration of the estate until such time as Pacor may choose to pursue its third party claim.

Id. at 995-96. The Third Circuit therefore found there was no "related to" jurisdiction and remanded the case. *Id.* at 996. It has subsequently reaffirmed its *Pacor* holding that "related to" jurisdiction does not exist if a separate lawsuit is necessary to impose liability on the debtor. *In re Federal-Mogul Global, Inc.*, 300 F.3d 368 (3d Cir. 2002), *cert. denied sub nom. DaimlerChrysler*

¹⁸ Similarly, in *Owens-Illinois, Inc. v. Rapid American Corp.* (*In re The Celotex Corporation*), 124 F.3d 619, 627 (4th Cir. 1997), in part because Rapid American Corporation's claim for contribution and indemnification was based on a written indemnification agreement, the Fourth Circuit found "related to" jurisdiction existed because "we believe that the situation before us is more analogous to the situation in *In re Brentano's* than the situation in *Pacor*."

Corp. v. Official Committee of Asbestos Claimants, 537 U.S. 1148 (2003).¹⁹

In the *Newby*-related litigation before this Court, because Enron is in bankruptcy, it is not a named defendant, but the complaints characterize it as a central participant in the alleged Ponzi scheme. Under the reasoning of *Pacor*, because Enron is not a party to these three removed cases currently in front of the Court, under the principles of *res judicata* or collateral estoppel it will not be bound by the outcome of these state-law actions and therefore these suits would not affect the bankruptcy court. See also *Bethlahmy v. Kuhlman (In re ACI-HDT Supply Co.)*, 205 B.R. 231 (9th Cir. BAP 1997) (in a suit brought under state law brought by allegedly defrauded investors against nondebtor participants in a Ponzi scheme and that does not name the debtor as a defendant, the court found that the situation was "even more attenuated than the facts presented in *Pacor*" and concluded there was no "related to" subject matter jurisdiction). Furthermore, because the contribution and indemnification claims in this litigation are contingent and not litigated, under *Pacor* there would be no "related to" jurisdiction.

¹⁹ A number of courts had viewed an intervening Third Circuit case appeared to rule that a potential claim for indemnity and contribution against the debtor can support "related to" bankruptcy jurisdiction. *Belcufine v. Aloe*, 112 F.3d 633, 636-37 (3d Cir. 1996), which held that "related to" bankruptcy jurisdiction existed based on the debtor's and the debtors' officers' right of indemnification in the debtors' by laws, relying on *A.H. Robins Co. Inc. v. Piccinin*, 788 F.2d 994, 1001 (4th Cir.), cert. denied, 479 U.S. 876 (1986).

Other Circuit Courts of Appeals, although adopting the *Pacor* test, have disagreed with the Third Circuit and have found "related to" bankruptcy jurisdiction existing even where a separate suit was necessary to obtain a judgment imposing liability on the debtor under an indemnity agreement, in particular in these mass tort type actions. See, e.g., *In re Celotex Corp.*, 124 F.3d 619, 626-27 (4th Cir. 1996) and *In re Dow Corning*, 86 F.3d 482, 491-92 (6th Cir. 1996), which the Fifth Circuit and district courts in the Second Circuit have cited as authority with respect to recognizing "related to" jurisdiction in third-party indemnification and/or contribution actions. See also *Arnold*, 278 F.3d at 440 & n.12 (approving of "related to" jurisdiction over contribution claims in the mass tort actions where there is a "unity of identity" between the debtor and defendants, as determined on a case-by-case basis); *In re WorldCom, Inc. Sec. Litig.*, 293 B.R. at 321 (intertwined theories of liability of debtor and defendants, interconnected with defendants' rights to contribution, have a "conceivable" effect on bankruptcy estate).

In *Dow Corning*, the Sixth Circuit distinguished *Pacor*, a single suit for an indemnification claim, from its own situation in *Dow Corning*, where it was faced with thousands of claims against the Debtor Dow Corning and against nondebtor co-defendants relating to their manufacture of silicon gel breast implants,²⁰

²⁰ Dow Corning Corporation not only manufactured nearly fifty percent of the silicone gel breast implants on the market, but also supplied the silicone materials to other manufacturers who became

including contingent claims for contribution and indemnification and cross-claims brought by Dow Chemical and Corning Inc. against each other and against Dow Corning.²¹ Taking a pragmatic approach to the question of whether the district courts, sitting as bankruptcy courts, had "related to" subject matter jurisdiction over claims against not only the debtor Dow Corning, but claims against nondebtor defendants, the Sixth Circuit first emphasized that it was facing "one of the world's largest mass tort litigations" and "recognize[d] that our decision will

codefendants, including Dow Chemical Company, Corning Incorporated, Minnesota Mining and Manufacturing Company, Baxter Healthcare Corporation, Baxter International Incorporated, Bristol-Meyers Squibb Company, and Medical Engineering Corporation. 86 F.3d at 485. Dow Chemical and Corning Incorporated were shareholders of Dow Corning. *Id.* at 486.

²¹ Before Dow Corning filed for bankruptcy, the Federal Judicial Panel on Multidistrict Litigation consolidated the breast implant cases and referred them to Chief Judge Samuel Pointer of the Northern District of Alabama, who certified a class for settlement purposes only and subsequently approved a settlement. The cases before the Sixth Circuit were those whose plaintiffs opted out of the settlement class. The Chapter 11 bankruptcy automatically stayed claims against Dow Corning, but not against other manufacturers, including its shareholders, Dow Chemical and Corning Inc., who were co-insured with Dow Corning under a number of liability policies.

Dow Chemical and other manufacturers filed motions to transfer certain breast implant cases that had been removed from state court to the district court with jurisdiction over its Chapter 11 proceedings. The district court in the Eastern District of Michigan, sitting as a bankruptcy court over proceedings "related to" the Dow Corning's Chapter 11 proceedings, granted some motions to transfer, but denied others on the grounds that the claims against the non-debtor defendants were not "related to" the Dow Corning bankruptcy estate. The district court also ordered individual federal courts around the country to dismiss or else sever Dow Corning and/or remand their opt-out suits to state court. Moreover, it enjoined nondebtor codefendants from removing any additional cases from state court. The Fourth Circuit held that the district court's order was appealable and reversed the district court. 86 F.3d at 488.

significantly impact the future course of this massive litigation."²² 86 F.3d at 486, 487.

Realizing that we cannot satisfy all competing interests perfectly, our primary goal is to establish a mechanism for resolving the claims at issue in the most fair and equitable manner possible. In seeking to achieve that goal, we are called upon to balance four different, and frequently competing interests: those of the individuals who have brought and will bring breast implant claims; Dow Corning's interests with regard to its attempt to formulate a successful reorganization plan; Dow Chemical and Corning Incorporated's interests in shareholders of Dow Corning; and the judicial system's interest in allocating its limited resources effectively and efficiently.

Id. at 487. Reiterating the pronouncements in *Pacor*, *id.* at 489, discussed *supra*, and *Pacor*'s conclusion that "the possibility of contribution or indemnification should only be regarded as relevant if and when judgments are actually entered against

²² The Sixth Circuit summarized the defendants' arguments for subject matter jurisdiction under § 1334(b), which the panel found persuasive:

Specifically, the defendants argued that contingent claims for contribution and indemnification, jointly-held insurance policies, the possibility of collateral estoppel with a corresponding increased exposure to liability, and the burden of defending against the overwhelming number of breast implant claims all give rise to the possibility of the Dow Corning estate will be seriously impacted if the claims at issue, all of which to some degree affect the reorganization of Dow Corning under Chapter 11, are permitted to proceed in separate forums nationwide.

Id. at 490.

nondebtors," *id.* at 491, the Sixth Circuit panel maintained that after *Pacor* even the Third Circuit, emphasizing that the "key word in [the *Pacor*] test is 'conceivable,'" has found that "'automatic' liability is not necessarily a prerequisite for a finding of 'related to' jurisdiction." *Id.* at 491, citing *In re Marcus Hook Dev. Park, Inc.*, 943 F.2d 261, 264 (3d Cir. 1991).

The Sixth Circuit further emphasized that it had previously and expressly held that "Section 1334(b) 'does not require a finding that of definite liability of [an] estate as a condition precedent to holding an action related to a bankruptcy proceeding.'" *Id.*, citing *Kelley v. Nodine (In re Salem Mortgage Co.)*, 783 F.2d 626, 635 (6th Cir. 1986). In *Dow Corning* it made that conclusion very clear:

We find that it is not necessary for the appellees first to prevail on their claims against the nondebtor defendants, and for those companies to establish joint and several liability on Dow Corning's part, before the civil actions pending against the nondebtors may be viewed as conceivably impacting Dow Corning's bankruptcy proceedings. The claims currently pending against the nondebtors give rise to contingent claims against Dow Corning which unquestionably could ripen into fixed claims. The potential for Dow Corning's being held liable to the nondebtors in claims for contribution and indemnification, or vice versa, suffices to establish a conceivable impact on the estate in bankruptcy. Claims for indemnification and contribution, whether asserted against or by Dow Corning, obviously would affect the size of the estate and the length of time the bankruptcy proceedings will be pending, as well as Dow Corning's ability to resolve its liabilities and proceed with reorganization. In addition, we believe there is a qualitative difference between the single suit involved in *Pacor* and

the overwhelming number of cases asserted against Dow Corning and the nondebtor defendants in this action. A single possible claim for indemnification or contribution does not represent the same kind of threat to a debtor's reorganization plan as that posed by thousands of potential indemnification claims at issue here.

Id. at 494. Although the Sixth Circuit recognized that "'related to' jurisdiction cannot be limitless," it found that "the possibility of contribution and indemnification liability in this case is far from attenuated," and concluded it had jurisdiction over the actions against the manufacturers. *Id.* As noted, the Second Circuit courts have also rejected the requirement that a contingent contribution be reduced to judgment before they have a conceivable effect on the debtor's bankruptcy. *WorldCom*, 293 B.R. at 322-23.

In *Dow Corning*, the Sixth Circuit further pointed out that the Fifth Circuit relied on *In re Salem* in its decision in *In re Wood*, 825 F.2d at 93-93 ("when the plaintiff alleges liability resulting from the *joint conduct* of the debtor and non-debtor defendants, bankruptcy jurisdiction exists over all claims under section 1334 [emphasis added]"; finding that "the complaint [was] sufficiently related to the pending bankruptcy to exercise jurisdiction under section 1334."). *Dow Corning*, 86 F.3d at 492.

Moreover, the Sixth Circuit also cited another significant decision, *A.H. Robins*, 788 F.2d 994, the Fourth Circuit mass tort case comprised of thousands of federal and state lawsuits against A.H. Robins Company and other nonbankrupt manufacturers for personal injuries or wrongful deaths allegedly

caused by use of the intrauterine contraceptive device known as the Dalkon shield. In that suit, reviewing a challenge to the district court's issuance of a stay against A.H. Robins' nondebtor codefendants under 11 U.S.C. § 362(a), which is usually applicable only to a debtor, the Fourth Circuit found that "proceedings against nonbankrupt codefendants may be stayed by a bankruptcy court where there are 'unusual circumstances.'" *Dow Corning*, 86 F.3d at 493, quoting *A.H. Robins*, 788 F.2d at 999. It further explained that such "unusual circumstances" occur "when 'there is such identity between the debtor and the third-party defendant that the debtor may be said to be the real party defendant and that a judgment against a third-party defendant will in effect be a judgment or finding against the debtor.'" *Id.*, citing *id.* As an example, the panel cited "a suit against a third-party who is entitled to absolute indemnity by the debtor on account of any judgment that might result against them [sic] in the case," as where "codefendant liability is 'directly attributable to the debtor.'" *Id.*, citing *id.* at 999 and 1004. Thus the "degree of identity between a debtor and nondebtor codefendants" was central to finding "related to" bankruptcy jurisdiction over all alleged joint tortfeasors. *Id.* at 492-93. The Sixth Circuit in *Dow Corning*, relying on the Fourth Circuit's conclusions in *A.H. Robins*, concluded that it had "related to" bankruptcy jurisdiction over breast implant actions against the nonbankrupt manufacturer defendants because of their close relationship.

In *Arnold*, the Fifth Circuit cited a law review article arguing that bankruptcy "related to" jurisdiction should not be applied to mass tort nondebtor codefendants because of comity and federalism concerns and remarked, "We would not go so far as to bar such consolidation in the face of a coordinated federal bankruptcy scheme. Instead, we would balance each case individually, as we have herein, for the relationship or unity of identity of the co-defendants and the debtor(s), the uniformity of source of the injury or wrongful death, and the general status of pending cases in the state courts and the effect a consolidation would have on them." 278 F.3d at 440.

This Court finds that a similar interconnection or "unity of identity" of the debtor Enron and the co-Defendants exists here, with alleged liability based on the same nucleus of wrongdoing, i.e., participation in a Ponzi scheme to hide Enron's financial condition while personally enriching themselves, in a massive multidistrict litigation where claims vastly outstrip the assets available for recovery should Plaintiffs prevail, will conceivably have an enormous impact on the bankruptcy estate. Thus this Court finds that it has "related to jurisdiction" over the claims for contribution and/or indemnity against the insurance policies. Moreover it notes that Enron has just filed suit against a number of entities, including those involve in these actions, providing additional support for related to bankruptcy jurisdiction to "deal efficiently and expeditiously with all

matters connected with the bankruptcy estate" that are encompassed in MDL 1446.

Plaintiff have made objections under Texas law to the existence of related to bankruptcy jurisdiction. Maintaining that Defendants have no valid contribution or indemnity claims, Plaintiffs have argued that in *Arnold*, 278 F.3d at 439, the Fifth Circuit concluded that "It is well established under Texas law that neither contribution nor indemnification can be recovered from a party against whom the injured party has no cause of action," and thus Plaintiffs have no contribution or indemnity claims against Enron. They further cite Texas Civil Practice & Remedies Code Annotated § 33.011, which bars contribution claims against a debtor in bankruptcy as a "responsible third party"; but in full, the statute adds, "*except to the extent that liability insurance or other source of their party funding is available,*" as is purportedly the case here. Plaintiffs also argue that because under Fifth Circuit law the policy proceeds are not payable to the debtor's estate, there is no relation to the bankruptcy estate. As noted, this Court finds that the Fifth Circuit policy/proceeds law is not applied by the Second Circuit.

As Defendants have pointed out, Plaintiffs have brought claims under the Texas Securities Act, which expressly establishes for such liability. Texas Revised Civil Statutes Annotated article 33F(2) provides for aider and abettor liability: "A person who . . . aids [an] . . . issuer of a security [in a fraud] is liable . . . jointly and severally with the . . .

issuer." Article 581-33F(3) provides, "There is contribution as in cases of contract among the several persons so liable." Moreover, this Court previously stated that Texas Civil Practices & Remedies Code Annotated §§ 32 and 33 give Defendants rights of contribution. These statutory rights to contribution against Enron's officers and directors that are covered by the liability insurance policies could apply to the aiding and abetting and conspiracy claims alleged against them. In turn, Enron might have claims against these insureds. Moreover, two of the defendant banking institutions in these suits, J.P. Morgan Chase and Lehman Brothers, are creditors in the Enron bankruptcy proceeding. These possible conflicting claims could alter the debtor's rights, liabilities, options, or freedom of action (either positively or negatively) and . . . in [a] way [that] impacts upon the handling and administration of the bankruptcy estate." *In re Walker*, 51 F.3d at 569; *In re Majestic Energy Corp.*, 835 F.2d at 90; and *Pacor*, 743 F.2d at 994. Thus the Court finds Plaintiffs' argument lacks merit.

Defendants in G-02-463 have raised two alternative grounds (in addition to SLUSA and supplemental jurisdiction, which have been rejected by this Court, and "related to" bankruptcy jurisdiction) for federal jurisdiction, i.e., (1) diversity jurisdiction without the alleged fraudulent joinder of Plaintiff Farm Family Life Insurance Company and of Defendant John Pruser and (2) the All Writs Act, 28 U.S.C. § 1651(a) ("The Supreme Court and all courts established by Act of Congress may issue all writs

necessary or appropriate in aid of their respective jurisdictions and agreeable to the usages and principles of law.").

Title 28 U.S.C. § 1441(b) permits removal on diversity grounds "only if none of the parties in interest properly joined and served as defendants is a citizen of the State in which such action is brought." Moreover, under 28 U.S.C. § 1441(b), if any plaintiff and any defendant are citizens of the same state, diversity is destroyed. *Indianapolis v. Chase National Bank*, 314 U.S. 63, 69-70 (1941).

Plaintiff American National Insurance Company is a Texas corporation with its principal place of business in Texas, while Plaintiff Securities Management & Research, Inc. is a Florida corporation with its principal place of business in Texas. Defendants Lehman Brothers Holdings, Inc. and Lehman Brothers, Inc. are Delaware corporations with their principal places of business in New York, while Lehman Brothers Commercial Paper, Inc. is a New York corporation with its principal place of business in New York.

Plaintiff Farm Family Life Insurance Company, allegedly joined to defeat diversity jurisdiction, is a wholly owned subsidiary of American National Insurance Company, acquired in 2001, with its principal place of business in Glenmont, New York. Thus its citizenship is not diverse from that of the three Lehman entity Defendants. Defendant John Purser is a Lehman Brothers broker who is a resident of Texas, employed by Lehman Brothers in

Dallas, Texas. Thus his citizenship is not diverse from that of Plaintiffs American National Insurance and Securities Management.

An out-of-state removing defendant bears a heavy burden of demonstrating by clear and convincing evidence that the joinder of a nondiverse defendant is fraudulent by showing either that the plaintiff has no possibility of establishing a state-law cause of action against the nondiverse defendant or that the plaintiff's pleading of jurisdictional facts is patently fraudulent. 28 U.S.C. § 1441(b); *Getty Oil Corp. v. Insurance Co. of North America*, 841 F.2d 1254 (5th Cir. 1988); *Green v. Amerada Hess Corp.*, 707 F.2d 201, 205 (5th Cir. 1983), cert. denied, 464 U.S. 1039 (1984); *B., Inc. v. Miller Brewing Co.*, 663 F.2d 545 (5th Cir. 1981); *Burden v. General Dynamics Corp.*, 60 F.3d 213, 217 (5th Cir. 1995); *Griggs v. State Farm Lloyds*, 181 F.3d 694, 698 (5th Cir. 1999). The Fifth Circuit has recently clarified the standard, which has been confused by the use of two tests, "no possibility" versus "'there must be some reasonable basis for predicting" that state law would impose liability on the allegedly fraudulently joined party. It examined their use in several Fifth Circuit opinions, found that the two tests were presented as restatements of each other, and thus assumed that these tests are equivalent; therefore a federal district court reviewing a motion to remand for fraudulent joinder must determine if there is arguably "a reasonable basis," and "not merely a theoretical one," "for predicting when that state law might impose liability." *Ross v. Citifinancial, Inc.*, _____ F.3d ____, Nos. 02-60608 and 02-

60609, 2003 WL 22026346, *3 (5th Cir. Aug. 29, 2003), citing *Travis v. Irby*, 326 F.3d 644, 648 (5th Cir. 2003) ("Any argument that a gap exists between the 'no possibility' and 'reasonable basis' of recovery language was recently narrowed, if not closed."), and *Great Plains Trust Co. v. Morgan Stanley Dean Witter & Co.*, 313 F.3d 305, 312 (5th Cir. 2002).

The district court must examine all factual allegations in a light most favorable to the plaintiff and resolve all fact issues in his favor. *B., Inc.*, 663 F.2d at 549. All ambiguities of state law must also be construed in favor of the non-removing party. *Travis*, 326 F.3d at 649. Nevertheless the court may not consider post-removal filings "when or to the extent that they present new causes of action or theories not raised in the controlling petition filed in state court. *Griggs v. State Farm*, 181 F.3d 694, 700 (5th Cir. 1999), citing *Cavallini v. State Farm Mutual Auto Ins. Co.*, 44 F.3d 256, 263 (5th Cir. 1995).

The federal district court may, in its discretion, determine whether fraudulent joinder exists without a hearing by piercing the pleadings and considering all evidence in the record in a "summary judgment-like procedure." *Travis*, 326 F.3d at 648-49, citing *Carriere v. Sears, Roebuck & Co.*, 893 F.2d 98, 100 (5th Cir.), cert. denied, 498 U.S. 817 (1990), citing *B., Inc.*, 663 F.2d at 549; *Badon v. RJR Nabisco, Inc.*, 236 F.3d 382, 389 n.10 (5th Cir. 2000). In determining whether the defendant was properly joined, the court may rely upon affidavits and summary judgment type evidence. *Cavallini v. State Farm Mutual Auto Ins. Co.*, 44

F.3d 256, 263 (5th Cir. 1995). When the Court does not pierce the pleadings, it then limits its review to allegations in the complaint to determine whether a non-diverse party was fraudulently joined. *Hart v. Bayer Corp.*, 199 F.3d 239, 246 (5th Cir. 2000).

While "fraudulent joinder" of plaintiffs is not as common as that of Defendants, it is recognized. Complete diversity requires that every plaintiff be diverse from every defendant. *Strawbridge v. Curtiss*, 3 Cranch (7 U.S.) 267 (1806).

Related to this issue of fraudulent joinder is the doctrine of fraudulent misjoinder. In *In re Benjamin Moore & Co.*, 309 F.3d 296, 297 (5th Cir. 2002), the Fifth Circuit addressed the issue "whether diversity jurisdiction was fraudulently defeated because among the seventeen plaintiffs herein, who have nothing in common with each other, only four have asserted claims that relate in any way to the nondiverse defendants"; it cited the holding of *Tapscott v. MS Dealer Serv. Corp.*, 77 F.3d 1353, 1360 (11th Cir. 1996), *abrogated on other grounds*, *Cohen v. Office Depot, Inc.*, 204 F.3d 1069 (11th Cir. 2000). The Eleventh Circuit, whose focus was on a fraudulent misjoinder of two class actions and on defendants rather than plaintiffs, emphasized that "mere misjoinder is not fraudulent joinder"; however, when the plaintiffs did not allege joint liability or conspiracy and the alleged transactions involving nondiverse defendants were totally separate from the transactions involving the diverse defendants, it found that the plaintiffs' "attempt to join these parties is so

egregious as to constitute fraudulent joinder." *Id.*²³ The Fifth Circuit has cited *Tapscott* for the proposition that "misjoinder of plaintiffs should not be allowed to defeat diversity jurisdiction." *Benjamin Moore*, 309 F.3d at 297.

Under Fed. R. Civ. P. 20,

All persons may join in one action as plaintiffs if they assert any right to relief jointly, severally, or in the alternative in respect of or arising out of the same transactions or occurrences and if questions of law or fact common to all these persons will arise in the action. All persons . . . may be joined in one action as defendants if there is asserted against them jointly, severally, or in the alternative, any right to relief in respect of or arising out of the same transaction, occurrence, or series of transactions and occurrences and if any question of law or fact common to all defendants will arise in the action. A plaintiff or defendant need not be interested in obtaining or defending against all the relief demanded. Judgement may be given for one or more of the plaintiffs according to their respective rights to relief, and against one or more defendants according to their respective liabilities.

Here there is no contention that the complaint's jurisdictional facts are fraudulent, but only a dispute as to whether Plaintiff Farm Family and Defendant John Pruser, a broker for Lehman Brothers, are fraudulently joined to defeat diversity jurisdiction. Because a determination of fraudulent joinder must be based upon the petition at the time of removal, and because no

²³ The appellate court noted that the district court criticized the contention that "a mere allegation of a common business practice subjects all defendants to joinder" and held that there was "improper and fraudulent joinder, bordering on a sham." 77 F.3d at 1360.

evidence has been submitted to allow for a summary judgment-like review, the Court necessarily is "limited to a review of the allegations in the [petition]"²⁴ to determine whether Farm Family is properly joined (has a right to relief arising out of the same series of transactions or occurrences and has at least one question of law or fact in common with the other plaintiffs) and might have standing to bring one or more of the asserted causes of action against one or more of these defendants. It must also decide whether Plaintiffs have alleged facts that arguably constitute a reasonable basis for predicting that state law might impose liability on Pruser. Alternatively, the Court must consider whether the joinder of Farm Family and/or John Pruser is merely an artifice to defeat diversity jurisdiction in this Court.

The petition in G-02-463, pages 12-17, without clearly identifying which claims are brought against which defendants, asserts four causes of action under Texas law: violations of the Texas Securities Act, Tex. Rev. Civ. Stat. Ann. art. 581-1 et seq. (a/k/a the Texas Blue Sky Laws), in particular, art. 581-33; common-law fraud; common-law breach of fiduciary duty; and common-law negligence and malpractice. The allegations also imply claims for common law conspiracy and aiding and abetting.

As a threshold point to the fraudulent joinder review, this Court notes that, unlike Federal Rule of Civil Procedure 9(b), Texas Rules of Civil Procedure 45 and 47 do not require pleading fraud with particularity, but only that a petition give

²⁴ *Hart v. Bayer Corp.*, 199 F.3d 239, 247 (5th Cir. 2000).

fair and adequate notice of facts relied on by the petitioner to give defendant(s) sufficient notice to prepare a defense; the defendant(s) may then file special exceptions if he (they) need(s) more information. See, e.g., *Boyles v. Kerr*, 855 S.W.2d 593, 601 (Tex. 1993) ("We have recognized that in the absence of special exceptions, the petition should be construed liberally in favor of the pleader. A court should uphold the petition as to a cause of action that may be reasonably inferred from what is specifically stated, even if an element of the cause of action is not specifically alleged. [citations omitted]; *Fisher v. Yates*, 953 S.W.2d 370, 380 (Tex. App.-Texarkana 1997, review denied) (petitioner did not need to expressly plead fraud as long as his allegations met the elements of the cause of action).

In *Hart v. Bayer Corp.*, in the context of reviewing a motion to remand, where the defendants contended that a claim was deficient against one fraudulently joined defendant (Larry Makamson), individually, because the petition did not meet the heightened standards of Fed. R. Civ. P. 9(b), the Fifth Circuit reviewed the petition's allegations and decided that the defendants had failed to show that there was no possibility that the plaintiffs could establish a cause of action against him. 199 F.3d at 247. The panel noted that a Rule 12(b) dismissal is appropriate only where "the plaintiff can prove no set of facts in support of his claim which would entitle him to relief" and stated, "While the Court agrees that plaintiffs' allegations of deceitful or deceptive behavior by Makamson are somewhat

conclusory, we do not believe that the penalty should be dismissal with prejudice to re-filing. . . . [A] plaintiff's failure to meet specific pleading requirements should not automatically or inflexibly result in dismissal of the complaint with prejudice to re-filing. . . . Although a court may dismiss the claim, it should not do so without granting leave to amend, unless the defect is simply incurable or the plaintiff has failed to plead with particularity after being afforded repeated opportunities to do so. [citations omitted]" 199 F.3d at 247 n.6. The panel therefore found that "taking all allegations set forth as true and taking all inferences in a light most favorable to plaintiffs," the petition "at least raises the possibility that they could succeed in establishing a claim" and "Makamson's citizenship cannot be ignored." *Id.* at 248. Because, therefore, there was not complete diversity of citizenship, the Fifth Circuit remanded the case. *Id.*

The original petition's allegations against Pruser, individually, are few. In addition to conclusory allegations that Plaintiffs "have been customers of John Pruser and Lehman Brothers for a number of years and trusted Pruser and Lehman Bothers to provide accurate investment information, the other allegations expressly naming Pruser relate merely to purchases of Enron securities from Pruser, in his capacity as a broker. Petition at 9. In its claim for negligence and professional malpractice, the petition states, "Pruser is employed by Lehman Brothers, is privy to Lehman Brothers['] information and is bound by Texas security

regulations to comply with Texas law." Therefore he, too, "must be held to a standard of care commensurate with the duties imposed by their profession." Petition at 16-17.

Plaintiffs do not specify what part of article 581-33 they charge Defendants with violating, but given the allegations that Defendants "solicited to sell, offered to sell, and did sell Enron securities" through material misrepresentations or omissions in the "pronouncements, recommendations, SEC Filings and underwriting prospectuses," and that they "conspired to violate and/or aided and abetted violations" of the statute, at 12, the Court presumes it is article 581-33A(2), for seller strict liability, and article 581-33(F) for aider and abettor liability. The Court hereby incorporates pages 37-53 of its March 12, 2003 Memorandum and Order Regarding Enron Outside Director Defendants' Motions (#1269) in *Newby*.

This Court cannot say that there is no possibility that Plaintiffs could not establish a claim against Pruser under article 581-33 in state court. Pursuant to the statute's requirements as explained in #1269, because the allegations demonstrate that Pruser was, himself, a seller as well as an agent for the seller, actively engaged in the sale process, was in privity with and sold to Defendants certain Enron securities, Plaintiffs have stated a reasonable basis for the claim against Pruser under article 581-33A(2). Despite conclusory allegations, they have also provided a reasonable basis for imposing on him joint and several liability under article 581-33F(2) for "directly

or indirectly with intent to deceive or defraud with reckless disregard for the truth or the law materially aid[ing] a seller, buyer, or issuer of a security." *Insurance Co. of North America v. Morris*, 981 S.W.2d 667, 675 (Tex. 1998).

The elements of Texas common law fraud, or fraudulent inducement, are that (1) the defendant made a material representation, (2) it was false, (3) when the defendant made the representation he knew it was false or was made recklessly without any knowledge of the truth and as an affirmative assertion, (4) the defendant intended to induce investor Plaintiffs to act upon that representation, (5) the investor actually and justifiably did act in reliance on it, and (6) the investor suffered injury as a result. *Morris*, 981 S.W.2d at 674, citing *Green International, Inc. v. Solis*, 951 S.W.2d 384, 390 (Tex. 1997); *Ernst & Young, L.L.P. v. Pacific Mutual Life Ins. Co.*, 51 S.W.3d 573, 577 (Tex. 2001); *Lewis v. Bank of America NA*, ___ F.3d ___, No. 02-10605, 2003 WL 21954767, *4-5 (Sept. 2, 5th Cir. 2003) (applying Texas law and citing for fraudulent inducement *In re FirstMerit Bank, N.A.*, 52 S.W.3d 749, 758 (Tex. 2002)).

The Restatement (Second) of Torts § 531 (1977), states,

One who makes a fraudulent misrepresentation is subject to liability to the persons or class of persons whom he intends or has reason to expect to act or to refrain from action in reliance upon the misrepresentation, for pecuniary loss suffered by them through their justifiable reliance in the type of transaction in which he intends or has reason to expect their conduct to be influenced.

Ernst & Young, 51 F.3d at 578 (quoting § 531). After pointing out counterparts to § 531 in Texas common law illustrating that "a misrepresentation made through an intermediary is actionable if it is intended to influence a third person's conduct,"²⁵ the Texas Supreme Court has made clear, "Our jurisprudence, which focuses on the defendant's knowledge and intent to induce reliance, is consistent with the *Restatement* and with the law in other jurisdictions that have considered the issue." *Ernst & Young*, 51 F.3d at 578. In Texas "a defendant who acts with knowledge that a result will follow is considered to intend the result," in other words "section 531's reason to expect standard, which requires a degree of certainty that goes beyond mere foreseeability." *Id.* at 579-80. Thus "the alleged fraudfeasor must have 'information that would lead a reasonable man to conclude that there is an *especial likelihood* that it will reach those persons *and will influence their conduct.*" *Id.* at 580 [emphasis added], citing cmt. d to § 531. The Texas Supreme Court concluded, "In sum, the reason-to-expect standard requires more than mere foreseeability; the claimant's reliance must be 'especially likely' and justifiable, and the transaction sued upon must be the type the defendant contemplated." *Id.* Thus privity is not required to establish a cause of action for fraud. *Id.*

As noted, the petition does not distinguish among the Defendants in alleging misrepresentations made in providing

²⁵ See *Gainesville National Bank v. Bamberger*, 77 Tex. 48, 13 S.W. 959 (1890)); *American Indem. Co. v. Ernst & Ernst*, 106 S.W.2d 763, 765 (Tex. Civ. App.-Waco 1937, writ ref'd).

investment information to their Plaintiff-clients, in addition to providing Enron with statements for SEC filings, prospectuses for bond offerings, and "a steady stream of analyst reports" with "false and misleading statements and omissions about Enron's financial condition," intended to reach investors, while they collected large fees for their underwriting, banking, and brokerage services. Petition at 3-4. While Plaintiffs do not specify Pruser's participation in this scheme or any material misrepresentations and omissions he made directly or indirectly, with the intention or reasonable expectation that Plaintiffs and other clients would purchase Enron securities from him and his firm in reliance upon these misrepresentations, in light of his role as a broker this Court must find that it is possible that Plaintiffs could establish a fraud claim against Pruser.

The alleged fraud also constitutes the underlying tort of Plaintiffs' conspiracy and aiding and abetting allegations. The elements of common law conspiracy are (1) a combination of two or more persons, (2) an object to be accomplished (an unlawful purpose of a lawful purpose by unlawful means) (3) a meeting of the minds on the object or course of acting, (4) one or more unlawful overt acts, and (5) damages as the proximate result. *Morris*, 981 S.W.2d at 675, citing *Massey v. Armco Steel Co.*, 652 S.W.2d 932, 934 (Tex. 1983). The meeting of the minds "must be an agreement or understanding between the conspirators to inflict a wrong against, or injury on, another, a meeting of the minds on the object or course of action, and some mutual mental action

coupled with an intent to commit the act which results in injury; in short, there must be a preconceived plan and unity of design and purpose, for the common design is of the essence of the conspiracy." *Schlumberger Well Surveying Corp. v. Nortex Oil & Gas Corp.*, 435 S.W.2d 854, 857 (Tex. 1968). Plaintiffs' Ponzi scheme allegations against the Defendants and Enron, while not specifically satisfying each element, do present a strong possibility that Plaintiffs can state a conspiracy claim and/or aiding and abetting claim against all Defendants here.

A fiduciary relation is not lightly created under Texas law. *Kline v. O'Quinn*, 874 S.W.2d 776, 786 (Tex. App.-Houston [14th Dist.] 1994, writ denied). Other than in formal fiduciary relationships, under Texas law, in confidential relationships arising when parties have had prior dealings with each other in such a manner over a long period of time, one party is justified in expecting the other to act in its best interest. *Morris*, 981 S.W.2d at 674-75, citing *Schlumberger Tech. Corp. v. Swanson*, 959 S.W.2d 171, 177 (Tex. 1997). There must be more than subjective trust; "to impose such a relationship in a business transaction, there must be a fiduciary relationship before, and apart from, the agreement made the basis of the suit." *Id.* In *Konkel v. Otwell*, 65 S.W.3d 183, 188 (Tex. App.--Eastland 2001, no writ), the appellate court stated, "A person acts in a fiduciary capacity"

when the business which he transacts, or the money or property which he handles, is not his or for his own benefit, but for the benefit of another person as to whom he stands in a relation implying and necessitating great confidence and trust on

the one part and a high degree of good faith on the other part.

Id., citing *Gonzalez v. State*, 954 S.W.2d 98, 103 (Tex. App.--San Antonio, no writ), and *Black's Law Dictionary* 625 (6th Ed. 1990). The Eastland court found that a stockbroker who handled investments for the plaintiffs, took large sums of money from them, and promised them a high return on their investment, but who plaintiffs proved misapplied those investment funds, acted in a fiduciary capacity for the investors and was liable for exemplary damages. *Id.* at 187-88. Here, too, the Court cannot find that there is no possibility that Plaintiffs cannot state a claim against Pruser, in light of the nature of his professional role, for breach of fiduciary duty.

Under Texas law, to prevail on a claim for professional negligence, a plaintiff must show that the defendant had a duty to the plaintiff, that he breached that duty, and that the plaintiff suffered damages proximately caused by that breach. *Great Plains Trust Co. v. Morgan Stanley Dean Witter & Co.*, 313 F.3d 305 (5th Cir. 2002). For negligent misrepresentation under Texas law, the plaintiff must demonstrate (1) the defendant made a representation in the course of his business or in a transaction in which he had a pecuniary interest, (2) the defendant provided false information to guide others in their business, (3) the defendant failed to exercise reasonable care or competence in obtaining or communicating information and (4) the plaintiff suffered monetary loss by justifiably relying on the representation. *Great Plains*, 313 F.3d at 318. Once again, given Pruser's professional role as

a broker selling Enron securities to Plaintiffs, it is possible that Plaintiffs can state such a claim against Pruser if they amend their pleadings to do so with particularity.

Thus this Court finds that Pruser's citizenship cannot be ignored and that it defeats diversity jurisdiction. Because the Court has found that it does have "related to" bankruptcy jurisdiction, Defendants' complaints about the vague and conclusory pleading should be addressed in a motion for more definite statement or a motion to dismiss.

As for the challenged joinder of Farm Family, according to the petition at 9, in 2001 American National acquired Farm Family, along with its portfolio containing \$1 million in Enron bonds plus some Enron equity securities. The petition also states that American became Farm Family's investment manager and would decide whether to sell Enron securities in Farm Family's portfolio. It does not state that Farm Family originally purchased its Enron securities from any of the Defendants and it does not allege that American National ever sold any.

Plaintiffs now argue that Farm Family was therefore a customer of Lehman Brothers through American National, which served as Farm Family's agent to buy, hold or sell Enron securities and that it also relied on Lehman Brothers' statements in making decisions about the purchase or sale of Enron securities, along with the other Plaintiffs. Plaintiffs also emphasize that Farm Family has been a party in two Enron-related actions (G-02-84 and G-02-299), filed before this case.

Because Plaintiffs fail to identify how the other two actions are related to the allegations here, the Court finds that their last point is irrelevant.

To determine whether Farm Family has been fraudulently joined (or misjoined), the Court examines Plaintiffs' petition to see whether it shows that Farm Family has standing and asserts a right to relief jointly and severally with the other Plaintiffs, or pleaded a claim arising out of the same transactions or occurrences with common questions of law or fact.

As noted the complaint does not state that Farm Family or that American National as investment manager for Farm Family ever bought more Enron securities for Farm Family from Defendants. In fact, it states only that American National's role as investment manager for First Farm was to "determine if and when to sell the Enron securities held in Farm Family's portfolio." Petition at 9. As this Court indicated in #1269 at 41-44, the Texas Securities Act requires that to sue under article 581-33A(2) a plaintiff must have been in privity with the seller and must have actually purchased his securities from that defendant. Thus the Court finds there is no reasonable basis for a claim by Farm Family under article 581-33A against Defendants. Nor does it state a claim under article 581-33F(2).

On the other hand, the Court finds there is a possibility that Farm Family can state a fraud claim, in that the petition in essence alleges that Farm Family and its investment manager justifiably relied upon material misrepresentations made

by Defendants about Enron's financial condition in deciding not to sell Farm Family's Enron securities and thereby Farm Family suffered a financial loss. Moreover Plaintiffs may be able to claim that Defendants had a reason to expect that its own investor clients would rely on Defendants' purported public misrepresentations. There is a possibility that Farm Family can also state a claim for common law conspiracy and/or aiding and abetting based on the underlying fraud tort.

Because Farm Family, purchased by American National only in 2001, unlike the other Plaintiffs was not a customer of Defendants for years and did not have a long course of dealings with them, the Court finds no reasonable basis for its having a breach of fiduciary relationship claim against Defendants.

The Court cannot state that there is no possibility that Farm Family could not sue Defendants for negligent misrepresentation.

Thus the Court finds that Farm Family has not been misjoined. Because both Farm Family's and Pruser's citizenships may not be ignored, the Court finds there is no diversity jurisdiction in G-02-463.

Although there has been substantial disagreement among courts relating to removal based on the All Writs Act, recently the United States Supreme Court unanimously held that the All Writs Act does not provide removal jurisdiction; removal is proper only where the federal court has an independent basis for original subject matter jurisdiction. *Syngenta Crop Protection, Inc. v.*

Henson, 537 U.S. 28, 123 S.Ct. 366 (2002); see also *Morris v. T.E. Marine Corp.*, ___ F.3d ___, No. 02031188, 2003 WL 22006844 (5th Cir. Aug. 26, 2003) (recognizing holding of *Syngenta*). The Court has concluded that there is a valid independent basis for removal presented by Defendants in G-02-463, i.e., related to bankruptcy jurisdiction, so remand is inappropriate.

Finally, in addition to the reasons the Court stated in #995 in *Newby* (also *Newby v. Enron Corp.*, 2002 WL 32107216 at *9) for determining that permissible and mandatory abstention are not appropriate, the Court also finds applicable to this Enron multidistrict litigation Judge Cote's reasoning in *WorldCom*, 293 B.R. at 332:

[I]t is beyond cavil that judicial economy and efficiency are best served by exercising jurisdiction that so clearly exists. The MDL Panel has consolidated scores of cases before this Court to promote the expeditious and efficient resolution of the claims arising from the collapse of WorldCom. The litigation is proceeding apace. Motions to remand, to sever and to dismiss have been fully briefed, and preliminary but important discovery issues addressed. With the consolidation of the litigation in one court, the motion practice and discovery process can be managed to protect the rights of all parties and to preserve, to the extent possible, the maximum amount of assets for recovery by plaintiffs with meritorious claims.

Accordingly, the Court

ORDERS that all motions for court consideration of supplemental authority are GRANTED. The Court further

ORDERS that American National Insurance Company et al.'s motion for reconsideration is GRANTED. Now, having reviewed the

"related to" bankruptcy jurisdiction issue anew and in much greater depth, for the reasons delineated above, the Court still finds that it has "related to" bankruptcy jurisdiction over these three actions. Therefore the Court

ORDERS that Plaintiffs' motions to remand are DENIED.

American National Insurance Company et al. have requested permission to effect an interlocutory appeal under 28 U.S.C. § 1292(b) on the grounds that the Court's decision involves a controlling question of law to which there is a substantial ground for difference of opinion. Plaintiffs' arguments are grounded in Fifth Circuit law regarding "related to" bankruptcy jurisdiction, in particular its proceeds/policy dichotomy. As this Court has indicated, with respect to these three cases, it is sitting in bankruptcy derived from the Enron bankruptcy court in the Southern District of New York, and thus Second Circuit law applies. Under that law, this Court, in its discretion, finds there is no substantial disagreement that in MDL securities-related cases such as this, the Second Circuit district courts have found "related to" jurisdiction for contingent contribution and indemnity claims. *WorldCom*, 293 B.R. 308; *Global Crossing*, 2003 WL 21659360. Indeed, as discussed, the Fifth Circuit has hinted that it might also find "related to" jurisdiction in such circumstances, although it has not addressed the issue directly. Furthermore to certify an interlocutory appeal and delay this litigation would undermine the MDL Panel's central goals of efficiency and economy. Accordingly the Court

ORDERS that the request for permission to appeal under § 1292(b) is DENIED.

Finally, the Court

ORDERS that G-02-299, G-02-463, and G-02-723 are hereby designated coordinated cases and that the Clerk shall enter them on the *Newby* docket sheet as such to insure that counsel receive copies of all instruments filed in that action.

SIGNED at Houston, Texas, this 30th day of September, 2003.



MELINDA HARMON
UNITED STATES DISTRICT JUDGE