

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

United States Courts
 Southern District of Texas
 ENTERED

NOV 13 2003

In Re ENRON CORPORATION §
 SECURITIES, DERIVATIVE & § MDL 1446 Michael N. Milby, Clerk of Court
 "ERISA" LITIGATION, §

THIS MEMORANDUM AND ORDER §
 RELATES TO H-02-851 §
 MARK NEWBY, ET AL., §
 Plaintiffs §
 VS. § CIVIL ACTION NO. H-01-3624
 ENRON CORPORATION, ET AL., § AND CONSOLIDATED CASES
 Defendants §

PAMELA M. TITTLE, on behalf of §
 herself and a class of persons §
 similarly situated, ET AL., §
 Plaintiffs §
 VS. § CIVIL ACTION NO. H-01-3913
 ENRON CORP., an Oregon § CONSOLIDATED WITH
 Corporation, ET AL., §
 Defendants §

KEVIN LAMKIN, JANICE SCHUETTE, §
 ROBERT FERRELL, AND STEPHEN §
 MILLER, Individually and on §
 Behalf of All Others Similarly §
 Situated, §
 Plaintiffs, §
 VS. § CIVIL ACTION NO. H-02-0851
 UBS PAINWEBBER, INC. AND §
 UBS WARBURG, LLC, §
 Defendants. §

MEMORANDUM AND ORDER

Pending before the Court are the following motions:

- (1) Defendants' UBS Paine Webber, Inc. and UBS Warburg LLC's

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motion to dismiss (#32 in H-02-851); (2) Defendants' motion for reconsideration (#1177 in *Newby*; #524 in *Tittle*; and #49 in H-02-851) of the Court's consolidation order of November 22, 2002¹; and (3) Defendants' motion to stay related NASD arbitration (#53 in H-02-851).²

Plaintiffs Kevin Lamkin, Janice Schuette, Robert Ferrell, and Stephen Miller, individually and on behalf of all others similarly situated who were shareholders of Enron Corporation or recipients of Enron stock options, had brokerage accounts at UBS PaineWebber, and "owned, held, sold and/or acquired" Enron stock or stock options during the Class Period, from October 2, 2000 to December 2, 2001, have brought their claims under § 10(b) of the Securities Act of 1934, and Rule 10b-5, and under §§ 11, 12(a)(2), and 15 of the 1933 Securities Act, 15 U.S.C. §77k, §77l(a)(2), and § 77o. The Court hereby incorporates its analysis of some of these statutes and the case law relating to them in the Court's December 19, 2002 memorandum

¹ The order of consolidation is #1155 in *Newby*; #516 in *Tittle*; and #48 in H-02-851.

² In instrument #115 in MDL 1446, Defendants have notified the Court that Defendant UBS PaineWebber, Inc., which provided brokerage services and acted as an administrator of Enron's stock option plan, as well as of the stock option plan of spin-off EOG Resources, Inc. f/k/a Enron Oil & Gas Co. ("EOG"), has changed its name to UBS Financial Services, Inc. They further state that Defendant UBS Warburg LLC, an investment bank providing analysis and research opinions, has changed its name to UBS Securities LLC. The two entities are subsidiaries of UBS AG, a Swiss Banking Conglomerate. Plaintiffs' Response (#37) at 1 n.1. In this memorandum and order, to avoid confusion, the Court henceforth refers to these entities collectively as "UBS" or individually under the prior names that were used throughout the pleadings.

and order (#1194) and in its March 12, 2003 memorandum and order (#1269), both in *Newby*, as well as its recent memorandum and order (#635) in *Tittle*.

Defendants' Motion to Reconsider

The Court has reviewed Defendants' motion to reconsider the Court's order consolidating this action with *Newby* and *Tittle*, but disagrees with UBS' arguments and finds that the facts and causes of action alleged in H-02-851 substantially overlap those in the lead cases, particularly in *Newby*, and therefore discovery in these cases will coincide. While not characterized by Plaintiffs here as a Ponzi scheme, the alleged fraud on UBS' stock-option-exercising and stock-purchasing clients and on the market alleged in Plaintiffs' Second Amended Complaint (#20 in H-02-851) in actuality constitutes part of the *Newby* Ponzi scheme: it is based on the same type of conspiratorial and mutually lucrative interrelationship of UBS and Enron and the same kind of fraudulent acts to hide Enron's financial status, to pump up the price of Enron stock, and to increase its credit rating for Defendants' own gain.³

For example, Plaintiffs, who were retail customers of UBS' brokerage service, assert that they were induced by UBS'

³ As a cautionary step in the event that Plaintiffs seek to amend, although Plaintiffs have not asserted a claim under ERISA, the Court also consolidated H-02-851 with *Tittle* because the allegations relate to Enron employee stock option plans apparently administered by UBS PaineWebber (whether in a fiduciary or merely administrative capacity is undetermined) and to one named Plaintiff's 401(k) plan serviced by PaineWebber.

representations and "STRONG BUY" recommendations, and by its material omissions, to purchase or hold Enron stock and to develop portfolios overly concentrated in Enron stock by such UBS employees as UBS Warburg's research analyst Ron Barone, who "facilitated the continuing fraud on the Representative Plaintiffs and Class Members" by "rely[ing] heavily upon information obtained from Enron's upper management to the exclusion of a hard analysis of the financials that Enron made available in its public filings." Complaint at 27.

Meanwhile, according to the complaint, in undisclosed lucrative arrangements UBS, *inter alia*, was providing underwriting services to Enron, including underwriting the initial public offerings of Azurix and New Power; had an exclusive and highly profitable arrangement with Enron to be the primary brokerage company for all Enron employees and Enron affiliates' employees with respect to their stock option and deferred benefit plans (a "captive broker arrangement"); sold "massive" amounts (\$150,000,000) of Enron stock for top Enron insiders/clients (including Kenneth Lay, Cindy K. Olson, Jeffrey Skilling, Ken Rice, Cliff Baxter, and Lou Pai)⁴ while Enron and UBS simultaneously touted the stock to employees and outsiders; and "caved into Enron's [in particular, Cindy K. Olson's] demands for termination" of a UBS PaineWebber broker, Chung Wu, who had been

⁴ The complaint, at 20, states, "A majority (if not all) of the insider trading that is alleged to have occurred and as set forth [in] *In re Enron Corporation Securities Litigation*, Civil Action No. H-01-3624[,] occurred at UBS PaineWebber."

recommending diversification of portfolios to his clients for months and who informed them by e-mail on August 21, 2001⁵ of his increasing concerns over Enron's deteriorating financial condition,⁶ after which UBS contacted Wu's clients and

⁵ The August 21, 2001 e-mail recited,

Financial situation is deteriorating in Enron and price drops another \$7.00 from last P/E report while most of the others stay the same or improve. . . . I would advise you to take some money off the table even at this point. For those who still has [sic] problems separating themselves from the stocks or vested options, please think about selling 'Call' against the long positions or selling 'Uncovered Call' against the vested options with the consideration of having sufficient assets to satisfy the maintenance requirement. . . . Time is value and waiting to make a decision would cost you a fortune.

Complaint at 24; Ex. AA to #22.

⁶ As an example of the purported cozy and conflicted relationship between Enron and UBS, the complaint alleges that after Enron learned of Wu's admonitions to his clients about the deteriorating situation at Enron, Enron executive Aaron Brown sent a copy of Wu's e-mail to UBS PaineWebber Customer Relations Manager Kevin Grunsfeld and to Wu's Houston branch office manager, Patrick Mendenhall, with a request, "Please handle this situation This is extremely disturbing to me." Second Amended Class Action Complaint at 14, 24. Enron's Mary Joyce, who with Aaron Brown was responsible for administering Enron's stock option plan, also pushed UBS PaineWebber's home office to fire Wu and "expressed her extreme displeasure that the email had been sent to dozens of Enron employees, requested that the Firm address the situation promptly, and in words or tone expressed her view that strong disciplinary action be taken." Complaint at 24. A few hours later, Mendenhall sent to Mary Joyce what the complaint characterizes as a "groveling E-mail to Enron, practically begging forgiveness," stating,

I apologize for how I handled the conversation. I was and still am so upset and frustrated at the e-mail that I still haven't calmed down. I should have known that if I was this frustrated, that you, as

"aggressively retract[ed] Wu's representations." All the while UBS purportedly knew or had reason to know that Enron was "cooking the books."

From the Court's memorandum and order (#1194) construing the law and applying it to similar claims and parties (recommendations of strong support of deteriorating Enron from research analysts of investment banks financially entangled with Enron's facade of success) in *Newby*, it should be apparent that Plaintiffs' allegations constitute actionable conduct under Section 10(b) and Rule 10b-5, which reach beyond misrepresentations and omissions to deceptive contrivances and devices, schemes to deceive and courses of business used to defraud in connection with the purchase or sale of securities.

our client, were more so. It is not my intent to hide behind anyone. I take full responsibility and will remedy the situation. We will get your approval prior to any retraction being sent. The Financial Advisor has been terminated. Once again I'm sorry.

Id. at 14-15, 26; Ex. DD to #22. None of this conduct or the nature of UBS' relationship to Enron was revealed to UBS investor-clients. Contacting Wu's clients, UBS then retracted Wu's statements and urged that UBS' current recommendation regarding Enron stock was "STRONG BUY." *Id.* at 15. Moreover, according to the complaint, UBS "did not know enough about the individual portfolios to retract Wu's recommendations to diversify and instead steered these already over concentrated Enron employees and EOG employees into an aggressive buying stance with a prediction of \$60 per share Enron stock" without any reasonable basis. *Id.* at 15. The complaint criticizes PaineWebber's sacrifice of its retail clients in favor of its lavishly remunerative client, Enron: "Such a conflict of interest between the issuer client and the private investment retail clients is unacceptable and violative of federal securities laws." *Id.* at 26.

For these reasons the Court denies the motion to reconsider.

Section 10(b) and Rule 10b-5 Claims

Defendants move to dismiss the Second Amended Class Action Complaint for failure to state a claim under Federal Rule of Civil Procedure 12(b)(6), failure to plead fraud with particularity pursuant to Federal Rule 9(b) and the Private Securities Litigation Reform Act ("PSLRA"), failure to plead an actionable statement (material misrepresentation or omission),⁷ and failure to plead scienter as required by the PSLRA for claims under § 10(b). Again, for a discussion of the law that this Court has concluded should apply, especially to claims under § 10(b), the Court refers the parties to #1194 in *Newby*.

As indicated, and in accordance with #1194, Plaintiffs have alleged material misrepresentations, omissions and actions, beyond the Warburg "STRONG BUY" recommendation, effected by UBS with knowledge of, or severe recklessness regarding, their falsity or fraudulent nature, that would be actionable under the securities laws for primary liability against Defendants, as well as facts supporting control person liability against Ron Barone,

⁷ As noted, § 10(b) is not limited to misrepresentations and/or omissions, but covers action that constitutes a deceptive contrivance or device, scheme to deceive, and course of business used to defraud in connection with the purchase or sale of securities.

Patrick Mendenhall, and Rocky Emery.⁸ It is apparent from the briefing that the critical issue for Plaintiffs' § 10(b) primary liability claims, with respect to Defendants' motion to dismiss, is whether Plaintiffs have adequately (and with particularity) pleaded facts giving rise to a strong inference of scienter, i.e., intent to deceive, manipulate or defraud. *Abrams v. Baker Hughes, Inc.* 191 F.3d 424, 430 (5th Cir. 2002). As in *Newby*, the Court finds that it is the combined allegations of facts and circumstances, viewed cumulatively rather than individually, that sufficiently give rise to a strong inference of severe recklessness here. *Id.*

The facts alleged imply that Enron pulled the strings of and "called the shots" for its puppet, UBS, which not only knew who was boss, but which willingly participated in the scheme to defraud investors and the public and mouthed Enron's praises in return for substantial monetary gain. The complaint also pleads events suggesting Defendants knew or should have known, but fraudulently concealed from their retail clients, not only the deteriorating condition of Enron, but also their own blatant conflicts of interest (at specific times and relating to specific matters detailed in the complaint) in serving as the investors'

⁸ Broker Rocky Emery and his organization, the Emery Group, were acquired by PaineWebber in 1996 and handled personal brokerage accounts for Kenneth Lay, Jeffrey Skilling, Ken Rice, and Lout Pai. Emery established the exclusive captive broker arrangement whereby PaineWebber became the only brokerage firm that Enron or an Enron affiliate's employees could use for exercising stock options and deferred benefit plans. Complaint at 11-12, ¶¶ 18-19.

broker and Enron's stock option plan administrator in order to stay on the Enron "gravy train." The complaint makes clear that many UBS PaineWebber brokers did not agree with, but were afraid to challenge and so passed on to their Enron employee clients, the Warburg "STRONG BUY" recommendation written by Ron Barone. Indeed, according to the complaint, Ron Barone, even after some of the most catastrophic events occurred at Enron during 2001, continued to deliver the same, unwavering, and increasingly inaccurate message about Enron securities to investor clients.⁹

The complaint draws the picture of a brokerage firm where employees were afraid to say publicly anything negative about Enron Corporation for fear of losing their jobs and where standard broker practices of fiduciary loyalty, independent, unbiased research and expert advice were trampled or circumvented to accommodate Enron in UBS' determined effort to paint only a

⁹ As red flags that should have alerted top research analyst Ron Barone, presumably an expert, to Enron's deteriorating financial condition and obfuscation of its disclosure practices, the complaint cites *inter alia* the sharp increase in total capitalization and in the rise in the percentage of that capitalization that was debt between December 1999-December 2000, the risk of financial contracts with third parties if Enron's common stock value fell below the \$28-\$55 price range (*Newby's* "sham" hedging) or if credit ratings for unsecured, senior long-term debt obligations fell below investment grade, abrupt changes in the way Enron utilized accounting for poor risk management and for computing equity investments so as to make it impossible to determine who the securitized parties were and how they were securitized, drastic increase in credit risk exposure from 1999 to 2000, modifications in methods of "disclosing" related party transactions to eliminate any specific information about who, what, where, when and why and any identification of limited partnerships, lack of real interest in net income despite substantial increased sales, and a drastic decrease in Enron's profit margin in 2000.

glowing picture of Enron's financial future. In essence, the "Warburg STRONG BUY" recommendation became the investment firm's never-changing mantra, no matter what was going on at Enron. The complaint asserts that UBS' uninformed retail customers

did not know that UBS PaineWebber forbade adverse opinions [about Enron] to be made without giving the customer[s] the Warburg Strong Buy recommendation. Furthermore, little did the retail group know that even advising a diversification could get a registered representative fired, that independent thought about diversification (if Enron found out about it) and review of outside information concerning Enron was discouraged and that there was a motive at UBS PaineWebber to make Enron very happy all of the time.

Complaint at 12. Nevertheless, as 2001 wore on, apparently in private, "UBS PaineWebber registered representatives and a UBS PaineWebber analyst commonly joked about Enron's 'stability' and discussed financial reports inside the PaineWebber office. During the summer of 2001, the UBS PaineWebber registered representatives' internal joke was that Enron needed to sharpen its pencils 'to cook those books' [sic]," and one uninformed analyst at a meeting with PaineWebber brokers brought nervous laughs when he referred to "good old 'cook the books' Enron." Complaint at 22-23, 54.

According to the complaint, John Doe Two, a former financial advisor/broker at PaineWebber, allegedly claimed that management (Rocky Emery and Patrick Mendenhall) completely controlled the downtown Houston office, told brokers to provide no advice to Enron employees about their stock options, made

brokers get permission before they could recommend that a client sell Enron stock, and required the brokers to give such clients the Warburg "STRONG BUY" analysis¹⁰ and report and get permission before giving any advice other than the "STRONG BUY" recommendation. Even though "[t]he entire office knew that their clients who were Enron/Former Enron employees were severely over-concentrated in Enron stock," the brokers were not allowed to advise that the clients diversify their holdings; he compared the brokers' dilemma to "deer caught in headlights." Complaint at 52-53.¹¹

As a central example of UBS PaineWebber's alleged subservient, indeed sycophantic, behavior, involving concealment and deception, the complaint asserts that research analyst Ron Barone constantly promulgated the firm's "STRONG BUY" recommendation regarding Enron stock throughout the entire year prior to Enron's bankruptcy, specifically from November 2000-November 21, 2001, despite rumblings that all was not well at

¹⁰ The complaint states that "UBS Warburg analyst Ron Barone's 'STRONG BUY' research reports were the only written correspondence that the brokers were allowed to send regarding Enron." Complaint at 55.

¹¹ The complaint makes a similar allegation about the Wall Street establishment, citing to articles and pointing to accounting experts and analysts who warned of darker facts about Enron's risky business actions and questionable financial picture. Complaint at 34-36. For instance Howard M. Schilit, head of the Center for Financial Research and Analysis, stated that starting in March 2000, "there were a string of warning signs in Enron's public securities filings," but that analysts were intimidated to refrain from "question[ing] the value of a popular company": "'If you want to move up the hierarchy of the Wall Street establishment, you don't rock the boat.'" Complaint at 34, citing an article.

Enron. Even when Jeffrey Skilling suddenly resigned as Enron's President and CEO on August 14, 2001, after only a few months on the job, "for personal reasons," shaking up Wall Street, three days later, after meeting with Enron's senior officials, Barone issued a report reiterating the same "STRONG BUY" recommendation and reassured investors that Enron was still "poised for unprecedented growth." Indeed only on November 28, 2001, four days before Enron filed for bankruptcy and approximately two weeks after Enron had publicly disclosed that it would incur losses of at least \$1 billion, announced that it would have to restate its financials for 1997, 1998, 1999, 2000, and the first half of 2001, revealed that its proposed merger with Dynegy had failed, and Enron stock had essentially become worthless, did Barone downgrade his recommendation to "HOLD," and even then, not to "SELL". Complaint at 17, 18, 60.¹² Barone also demanded that Chung Wu be

¹² The complaint does assert that on November 1, 2001 Barone did state in a research report for the very first time that "ENE shares remain a high-risk investment vehicle, not appropriate for risk-averse individuals." Complaint at 60. On November 15, 2001 he conceded that Enron's valuation was "now tied to Dynegy" and the proposed merger. *Id.* Yet despite this concession, while Barone continued recommending "STRONG BUY," "Paine Webber took no action to diversify or save the retirement of the thousands of retail clients who had Enron stock." *Id.* at 61.

The complaint also quotes one commentator's snide reaction to Barone's downgrade:

On Wednesday morning UBS Warburg analyst Ronald Barone downgraded Enron from strong buy to hold. This advice to ditch Enron—a huge help if you hadn't noticed its stocks sliding from \$85.00 to \$4.00 over the last year—came the very morning that Enron's debt got downgraded to junk, Dynegy called off its purchase of the company, and Enron's shares started selling for less than a gallon of

terminated for going against UBS PaineWebber's Enron-appeasement policy during 2001 and "complained that he [Barone] had to come back from his vacation to deal with an outraged Enron." Complaint at 25. The complaint emphasizes Barone's allegedly severe recklessness or deliberate ignorance:

45. To maintain his "STRONG BUY" position, Barone had to ignore the mass exodus of Enron's upper and middle management employees, had to ignore the sell-off of \$150,000,000.00 of Enron stock by top executives through PaineWebber and had to ignore the plummeting stock price. In addition, Barone also had to ignore the worsening debt and credit conditions that Enron was reporting in its public filings. His research recommendation on Enron thus was made without a reasonable basis in fact.

46. Barone's ignorance continued after Enron filed its 2000 Form 10-K with the SEC that stated Enron's debt associated with its unconsolidated partners was \$20,000,000,000 and excluding Enron's pipelines and power plants, Enron's other divisions had earnings before interest and income of \$1,800,000,000. Barone ignored Enron's practice of booking its income at present value. "Present value" is an economic slight of hand that is a best guess of the long term value of multiple year contracts and which serves as a mere projection of income. If Barone had done more research and reviewed the 2000 10-K, and excluded income generated by Enron's pipelines and power plants division, he would have seen that Enron does not appear to make much more than that specified in its "price risk management" income valued at its present value of \$1,800,000,000.

48. "Price risk management" is . . . [Enron's] best guess on the value of its long-term contracts. . . . Barone did not

gas.

Complaint at 64, quoting from George Mannes, "The Five Dumbest Things on Wall Street This Week," TheStreet.com, November 30, 2001.

analyze how much of Enron's income was real and how much was . . . simply a guess as to the book value of [an] entire contract, which may or may not have come to pass. Barone either refused, or simply failed to consider any of Enron's public filings in which this looming debt, abandonment of foreign assets and falling income were set forth, and instead took Enron's word that things could be turned around.

48. . . . [I]n his August 17, 2001 report . . . , Barone mentions that he is well aware of the loss of substantial employee talent over the last 12 months, and that Enron has been plagued "with a series of negative issues while its overall quality of earning has deteriorated, its level of behind-the-scenes financial engineering has increased and its overall standing with the Street has plunged." Even in the face of these most basic concerns, Barone instead decided to blindly accept Enron upper management's nonsensical explanations and ignore the hard data contained in the financials that Enron posted. . . .

Complaint at 27-29. The complaint at 66-70 goes into more detail about the information revealed in, or significantly absent from, Securities Exchange Commission ("SEC") reports, and at 70-82 about Barone's purportedly deceptive and/or severely reckless analyses of Enron's financial information and his blind or determined adherence to the word of Enron's upper management during the Class Period, even as the price of Enron stock plummeted and as his own research reports in the final months before Enron's bankruptcy reflected knowledge of significant problems at Enron, in sharp contrast to his persistent and consistent "STRONG BUY" recommendation. Complaint at 60-61, 79-81; Barone's research reports. Exs. JJ-NN, QQ, TT-UU, to #22.

The complaint asserts that PBS PaineWebber broker Chung Wu performed independent research and, beginning in March 2001, came to the conclusion and informed his clients over the following months that Enron stock was a potentially dangerous investment and that his clients should diversify their portfolios. According to the complaint at 25, "Mendenhall, Wu's supervisor at UBS PaineWebber, informed Wu that, [sic] even though his observations about Enron were correct, his putting those observations and concerns in writing offended Enron and that the pressure to terminate him was mounting." As noted supra, upon Enron's discovery of the e-mails, in particular the one on August 21, 2001, Enron's demand that PaineWebber immediately "take care" of the matter and the extent of PaineWebber's intense response reflected that the matter was of great import to both: PaineWebber officials cowered, fired Wu the same day, issued to Wu's clients a "retraction" of Wu's statements that had been pre-approved by Enron, reurged the Enron-sanctioned "STRONG BUY" message to Wu's clients through e-mails and personal visits of its agents such as Scott Bower, who maintained that Wu was giving erroneous information, and sent clients a UBS research report with a \$60 per share target for Enron stock. The complaint emphasizes, "Contrary to the duties imposed upon them, Defendants did not even bother to analyze Wu's position and determine whether his research was correct" Complaint at 25, 59. Plaintiffs' pleadings argue that diversification is a standard in securities investment which, particularly under the declining situation at Enron, served

as a touchstone to highlight Defendants' wrongdoing, as later reflected in a March 14, 2002 letter from Congressman Henry Waxman to Joseph J. Granno, Chairman and Chief Executive of UBS PaineWebber, Ex. C at 2 to #22, to Plaintiffs' Second Amended Complaint (#20). Noting that Wu was not disciplined for earlier e-mails to his clients but was "fired only after his August 21 e-mail advising Enron employees to sell Enron stock because the '[f]inancial situation is deteriorating in Enron,'" Congressman Waxman commented,

The two August 21 e-mails raise serious questions about the conduct of PaineWebber. Wu's advice was unquestionably right and not just in hindsight. It is a widely accepted principle that individual investors should diversify their holdings. By suggesting that Enron employees reduce their holdings of Enron stock, Wu was clearly giving these employees sound financial advice. As he correctly predicted, not following his advice "would cost you a fortune." I do not understand how a PaineWebber manager could justify telling Enron employees to ignore Wu's advice. PaineWebber's response to Wu's e-mail appears to be a breach of PaineWebber's fiduciary duty to its client.

Furthermore, the complaint claims that the whole time that UBS PaineWebber was representing that all was well with Enron and that its future was rosy, according to the complaint, it was selling massive amounts of Enron stock for a number of Enron top management officials, identified *supra*, as well as watching "a mass exodus of talent from Enron," including Rocky Emery and the Emery Group in July 2001 and Jeffrey Skilling in August 2001. Complaint at 12-13, 23, 55. As an additional conflict of interest, also undisclosed, in August 2001, UBS AG and UBS Warburg

LLC were trying to sell \$250,800,000 of Enron's unsecured Zero Coupon Convertible Notes, which they had acquired from first-tier purchasers in a private placement. Complaint at 7, 38-40. Thus they had a substantial monetary interest in keeping the price of Enron stock high until they sold those notes; now they are unsecured creditors in Enron's bankruptcy proceeding.

The complaint points out that Enron's Cindy K. Olson was not only a "chief engineer of Chung Wu's termination," but that she also was "the driving force of the over concentration of Enron stock into Enron employees['] 401(k) accounts," telling employees "that they should 'absolutely invest all of their 401(k) savings in Enron stock'"; yet during late 2000 and early 2001 she "sold 83,183 shares of her own Enron stock to create a \$6,505,870 nest egg." Complaint at 16-17.

The Complaint alleges that other UBS figures also continued to support the purchase of Enron stock throughout the disastrous fall of 2001. It points to Tim Kruger, manager of the UBS Florida office, who pushed the stock and bought it for a number of discretionary accounts under his control during the last few months before Enron filed for bankruptcy. It further discusses the role of the Emery Group and its founder, Rocky Emery, in the stock option holdings for Enron executives and in the insider sell-off of Enron stock being dumped by these high Enron officials, in perpetrating the fraud on the market and on UBS' retail clients. The complaint also refers to certain John Does who formerly served as brokers/financial analysts at

PaineWebber and whose purported testimony about confidential activities at PaineWebber during 2000-01 supports allegations that the firm was totally controlled by Enron's need to feed the frenzied Ponzi scheme, that the brokers were aware of concerns about Enron, and that PaineWebber allegedly sacrificed its retail customers for its more lucrative client, Enron.¹³

In its summation, the complaint zealously advocates, hammering the key points,

The fraud PaineWebber perpetrated upon its retail clients is exactly the type of scheme that the PSLRA was enacted to prevent. The facts pled above show that PaineWebber made false statements of material fact, as well as omitted to state material facts about Enron which facts were necessary for the Plaintiffs to make informed decisions. To make an informed decision about their Enron stocks and options, Plaintiffs needed to know the very facts that Wu pointed out to his clients. They needed to know that the top employees were putting their stock on the

¹³ Although Defendants argue that under *ABC Arbitrage Plaintiffs Group v. Tchuruk*, 292 F.3d 336, 353-54 (5th Cir. 2002), the Fifth Circuit requires a complaint to name confidential sources where the allegations do not provide an adequate basis for believing the confidential source and the confidential source is not described with sufficient particularity to know if he possesses the information at issue, the Court disagrees with their reading of the case and their application of the holding to the facts alleged here. The Fifth Circuit held in relevant part that where alleged facts, i.e., documentary evidence, are inadequate to show that defendants' statements or omissions were false, the plaintiff need not name the confidential source if the plaintiff identifies the confidential source through a general description of that individual with sufficient particularity to support the probability that he would possess information pleaded in the complaint. *Id.* at 353. The complaint here identifies that all three John Does worked as brokers/analysts at UBS PaineWebber during the Class Period at the time it administered Enron's stock option plans and thus they had relevant information from personal experience about the firm's pressure on and the attitudes of the brokers there.

clearance racks. They needed to know that their own brokers were prohibited from providing any adverse information about Enron unless approved by UBS PaineWebber management and that the client was also provided with the UBS Warburg "STRONG BUY" position. . . . [Scienter] allowed Enron to call the shots regarding the termination of an employee who dared to tell clients the truth. It allowed brokers to flat out lie to clients and claim that Wu's statements were false when they were completely accurate. It wholesale retracted Wu's email to his own clients, without performing an analysis of the clients' accounts to determine whether the stock was even suitable for them. It refused to take any action to save its clients, even after Ron Barone opined that the stock was a risky investment not suitable for the risk-averse. PaineWebber stood by Warburg's "STRONG BUY" recommendation on Enron as it watched the value of the stock tumble and watched its clients lose everything.

Complaint at 61-62. The Court finds that Plaintiffs have pleaded facts giving rise to a strong inference of scienter and have stated a claim under § 10(b) and Rule 10b-5.

Sections 11 and 12(a)(2) Claims

Plaintiffs Lamkin and Ferrell, as purchasers of Enron securities who were allegedly unaware of any misrepresentations or omissions and on behalf of a similarly situated subclass that acquired Enron stock through UBS PaineWebber pursuant to ten of Enron's registrations statements filed with the SEC on Form S-8 Filings, boosted by UBS PaineWebber's oral and written persuasion, assert claims against UBS PaineWebber, but not against UBS Warburg, under § 11(a) (imposing civil liability where a

registration statement¹⁴ contains "an untrue statement of material fact or omit[s] to state a material fact¹⁵ required to be stated therein or necessary to make the statements therein not misleading"¹⁶) and § 12(a)(2)¹⁷(imposing liability on any person

¹⁴ Plaintiffs here base their § 11 claims on ten registration statements that were filed by the issuer Enron with the SEC on Forms S-8, that became effective from 1995 to early 2001, and that incorporated by reference Enron's allegedly false financial statements (10-Ks) from 1997-2000, and which allegedly "contained untrue statements and omitted material facts concerning the financial stability and valuation of Enron." Complaint at 85. Among these are the incorporation of Enron's admittedly false financial statements for 1997-2000, misrepresentations of Enron's earnings, debt-to-equity ratio, total debt, fraudulent accounting, and shareholder equity because of the nonconsolidation of non-qualifying SPEs. Complaint at 86-87.

¹⁵ A misrepresentation or omission is "material" if there is a "substantial likelihood that the disclosure . . . would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available" and would have actual significance in the deliberations of a reasonable shareholder in investment decisions. *Basic, Inc. v. Levinson*, 484 U.S. 224 (1976); *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 445 (1976).

¹⁶ Under the broad wording of the statute, "any person acquiring such security" may sue under § 11 for losses caused by the registration statement's misrepresentations or omissions. The statute has been construed to give standing to anyone who purchased in the initial offering under that challenged registration statement or who is able to trace the shares that he purchased to those sold in that registered offering, unless at the time of acquisition, he knew of the alleged untruth or omission. *Hertzberg v. Dignity Partners, Inc.*, 191 F.3d 1076, 1080 (9th Cir. 1999); *Rosenzweig v. Azurix Corp.*, 332 F.3d 854, 873 (5th Cir. 2003). Thus Section 11 applies to initial offering and aftermarket purchasers. *Rosenzweig*, 332 F.3d at 871.

Those who can be sued as defendants under § 11(a) include every person who signed the registration statement, the directors of the issuer, an accountant that is named as having prepared or certified the registration statement, and "every underwriter with respect to such security." 15 U.S.C. § 77k(a); *Ehlert v. Singer*, 245 F.3d 1313, 1315 (11th Cir. 2001).

There is no scienter requirement for § 11. *In re NationsMart Corp. Sec. Litig.*, 130 F.3d 309, 314 (8th Cir. 1997)(citing *Herman & MacLean v. Huddleston*, 459 U.S. 375, 382

who "offers or sells a security . . . by means of a prospectus or oral communication, which includes an untrue statement of material fact or omits to state a material fact necessary in order to make the statements, in light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission)" of the 1933 Act, 15 U.S.C. § 77k(a) and § 77l(a)(2), respectively.¹⁸ Plaintiffs also allege control person

(1983)), *cert. denied*, 524 U.S. 927 (1998). Generally a plaintiff need not prove reliance on the challenged registration statement; the only exception is where he has "acquired the security after the issuer has made generally available to its security holders an earnings statement covering a period of at least twelve months beginning after the effective date of the registration statement." Section 11(a), 15 U.S.C. § 77k(a). Section 11 imposes "a stringent standard of liability on the parties who play a direct role in a registered offering" and therefore the plaintiff has a light burden to show only that the plaintiff purchased the security and that the registration statement contained a material misrepresentation and omission. *Herman & MacLean*, 459 U.S. at 381-82; *NationsMart*, 130 F.3d at 314-25.

¹⁷ Because Congress added a subsection to § 12 in 1995, the Private Security Litigation Reform Act, Pub. L. No. 104-67, § 105, 109 Stat. 737, 757, codified at 15 U.S.C. § 77l, § 12(1) and § 12(2) became § 12(a)(1) and § 12(a)(2), although they are frequently referred to by their old designations. See, e.g., *Maher v. Durango Metals, Inc.*, 144 F.3d 1302, 1303 n.1 (10th Cir. 1998).

Section 12(a)(2) ("[a]ny person who . . . sells . . . shall be liable . . . to the person purchasing such security from him . . ."), allows a buyer of a security to recover against his immediate seller. The Supreme Court has concluded that Section 12(a)(2) does not apply to aftermarket purchasers, but only to direct initial public offering purchasers who purchase directly from the defendants; and it applies only to public offerings, and not to private, secondary sales. *Gustafson v. Alloyd Corp.*, 513 U.S. 561 (1995).

¹⁸ According to Plaintiffs, the prospectuses at issue, which did not have to be filed with the SEC but did have to be provided in writing to Enron employees for whom the offerings were extended, and which are incorporated into the registration statements, necessarily included Enron's 1997-2001 restated financials, which were allegedly untrue.

liability under § 15 (making control person jointly and several liable with primary violators of §§ 11 and 12(a)(2)), 15 U.S.C. § 77o, of the 1933 Act.

Defendants urge the Court to dismiss the § 11 and § 12(a)(2) claims because they are grounded in fraud and fail to meet the pleading requirements of Federal Rule of Civil Procedure. They further urge that some of § 11 claims are time-barred. The key substantive issues in Defendants' motion to dismiss regarding these claims are (1) whether PaineWebber qualifies as an "underwriter" so as to be potentially liable under § 11(a)(5), 15 U.S.C. §77k(a)(5),¹⁹ and as a "seller" for liability under § 12(a)(2), and (2) whether a number of Plaintiffs' § 11 claims are barred by the statute of limitations.

a. Rule 9(b) Pleading

Defendants object that the complaint has "wholesale adopt[ed] . . . the allegations under the securities fraud claims" for the § 11 and § 12(a)(2) claims and therefore the latter must be pleaded, but have not been, with particularity as required by Federal Rule of Civil Procedure 9(b).

¹⁹ Section 11(a)(5) provides in relevant part,

In case any part of the registration statement, when such part became effective, contained an untrue statement of material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security . . . may either at law or in equity, in any court of competent jurisdiction, sue . . . every underwriter with respect to such security.

After reviewing the complaint, the Court disagrees. Plaintiffs have pleaded their claims under § 11 and § 12(a)(2) claims as strict liability claims, reviewable under the traditional standard for 12(b)(6) motions. The Court finds that the complaint is adequately pleaded under the rule of *Lone Star Ladies Investment Club v. Schlotzky's, Inc.*, 238 F.3d 363 368 (5th Cir. 2001) ("Where averments of fraud are made in a claim in which fraud is not an element, an inadequate averment of fraud does not mean that no claim has been stated. The proper route is to disregard averments of fraud not meeting Rule 9(b)'s standard and then ask whether a claim has been stated."). Moreover, although Plaintiffs' claim against PaineWebber is for strict liability, that remedy is actually available only against an issuer and an affirmative defense is available to PaineWebber as an alleged statutory underwriter. Under §§ 11 and 12(a)(2), with their "lower threshold of liability" than § 10(b), "[t]he liability of an issuer to a plaintiff who purchases a security issued pursuant to a registration statement for a material misstatement or omission is 'virtually absolute.'²⁰ 'Defendants other than an issuer can avoid liability by demonstrating due diligence.'" *Lone Star Ladies Investment Club*, 238 F.2d at 369, quoting *Herman & MacLean*, 459 U.S. at 382.

²⁰ The issuer's liability is absolute if the plaintiff demonstrates that the registration statement is actionable and the defendant cannot prove that the plaintiff knew the truth when he purchased the security under it. 15 U.S.C. 77k(a); see, e.g., *McFarland v. Memorex Corp.*, 96 F.R.D. 357, 362 (N.D. Cal. 1982).

b. Statutory underwriter Under Section 11

Arguing that it qualifies as a "statutory underwriter" under § 11 and emphasizing that they are handicapped by the lack of discovery at this stage, Plaintiffs underline certain points. They highlight the fact that Enron told its employees that "PaineWebber is Enron's exclusive broker for employee stock options." They maintain that UBS PaineWebber participated in the sale and distribution of Form S-8-registered Enron securities by and through the various employee stock option plans. Because of the captive broker status that UBS PaineWebber enjoyed, Enron employees had to open a UBS PaineWebber account before any stock options could be bought or sold, and then UBS PaineWebber would lure eligible participants in an attempt to keep their accounts at the firm (according to the complaint, at least 1/3 of the wealth evidenced by the Enron stock options) by waiving standard fees, custom designing portfolios for each individual's objectives and risk tolerance, financing, and offering free stock option analysis for timing the exercise of the options to those who opened accounts.

Distinguishing between the common and statutory definitions, Plaintiffs contend that in administering the Enron Stock Option Plans and deferred compensation plans, for which UBS PaineWebber was paid, UBS PaineWebber has gone beyond being simply a broker to being a "statutory underwriter" in a continuous offering of stock registered under the Forms S-8. They describe UBS PaineWebber as "the gatekeeper to the initial market and the

secondary market" for plan participants because of this special and lucrative "captive broker status" arrangement with Enron. Complaint at 92. Plaintiffs rely on a brochure, "A Guide to Exercising Your Stock Options Online,"²¹ published by UBS PaineWebber and given by Enron to its employees (eligible plan participants) from 1996-the present. Plaintiffs refer to the brochure to delineate UBS PaineWebber's role as administrator of the stock option plans. Plaintiffs insist that UBS PaineWebber qualified as, and is strictly liable as, an "underwriter" under § 11 by virtue of PaineWebber's participation in the sale and distribution of Enron stock to representative Plaintiffs Lamkin and Ferrell and putative class members who were participants in Enron's employee stock option plans and received Enron stock by and through UBS PaineWebber pursuant to the Form S-8 registration statements at issue. Thus Plaintiffs conclude,

Enron may not have retained UBS PaineWebber to perform all of the traditional lead underwriting functions in the distribution of the offer and sale of the Form S-8 registered stock, but compensated UBS PaineWebber to assist it in placing the shares, from which UBS PaineWebber received enormous financial benefit. Under these circumstances, as captive broker and gatekeeper into the initial and secondary market for 100,000,000 Enron shares over six (6) years, UBS PaineWebber must be classified as an underwriter for statutory and liability purposes. UBS PaineWebber had a virtual gridlock on the "assets," which was the wealth tied up in the Enron shares for its retail clients. . . . UBS PaineWebber participated in the distribution of Enron

²¹ Ex. xx to Plaintiffs' Second Amended Complaint Exhibit List (#22).

stock through an initial bona fide offering registered by the public filing of a Form S-8, which also mandated a written Prospectus to its offerees, was the first source of information about the investment in and exercise of the Enron stock options that all Enron employees were directed towards by Enron management as well as through UBS PaineWebber literature given to these offerees, and UBS PaineWebber either assisted in the sale and hold of Enron common stock, or sold and assisted in the diversification of those portfolio funds if the Enron employee determined that he or she desired to sell off some of or all of his or her Enron stock options.

Complaint at 99-100.

Defendants disagree and insist UBS PaineWebber's role was limited to that of a plan administrator and that it was not acting as an underwriter, as evidenced by the following facts: PaineWebber is not listed as an underwriter on any of the ten registrations statements at issue; PaineWebber had no control over the representations made in these registration statements; Enron, not PaineWebber, drafted the registration statements and sent information to Enron employees; Enron distributed the offerings at issue; Enron provided the employees with the PaineWebber brochure explaining the mechanics of exercising stock options; PaineWebber did not sell Enron employees their stock options, but only maintained a website that allowed the Enron employees, themselves, to calculate the value of their stock options and to exercise their options by calling a PaineWebber broker, who would perform the service for free; if an employee decided to trade after exercising his options or chose to open a brokerage account (separate from the stock option account), PaineWebber was paid

appropriate standard commissions for any such services; the letter agreement between Enron and PaineWebber (Ex. B-2 to Appendix to Defendants' Motion to Dismiss) expressly and in careful detail restricts PaineWebber's role to "broker financing" and "recordkeeping services" for the employee stock option plans and limits PaineWebber's right to use any information it gleans from that role to solicit additional business from the plan participants as well as Enron's obligations with respect to such additional business. Defendants read the statute narrowly and technically and argue that PaineWebber's obligations were limited, ministerial, and mechanical.²²

²² A court construing a provision of a statute must initially examine the plain language, the specific context in which the language is used, and the broader context of the statute as a whole in order to determine whether it is plain and unambiguous, and only turn to legislative history if it concludes that the language is "opaque," "translucent" or ambiguous. *Robinson v. Shell Oil Co.*, 519 U.S. 337, 340-41 (1997); *Aviall Services, Inc. v. Cooper Industries, Inc.*, 312 F.3d 677, 679, 680 n.3, 684 (5th Cir. 2002), *petition for cert. filed*, 71 USLW 3552 (Feb. 12, 2001).

Nevertheless, without examining the statutory language first and urging the Court to adopt a narrow construction of the term, Defendants have referred the Court directly to part of a discussion of the definition of "underwriter" in the legislative history, H.R. No. 85, 73d Cong., 1st Sess. 13 (1933), Ex. A-16 to Defendants' Memorandum in support of their Motion to Dismiss (#33):

Paragraph (11) [of the bill] sets forth the important definition of "underwriter." The term is defined broadly enough to include not only the ordinary underwriter, who for a commission promises to see that an issue is disposed of at a certain price, but also includes as an underwriter the person who purchases an issue outright with the idea of then selling that issue to the public. The definition of underwriter is also broad enough to include two other groups of persons

who perform functions, similar in character, in the distribution of a large issue. The first of these groups may be designated as the underwriters of the underwriter, a group who, for a commission, agree to take over pro rata the underwriting risk assumed by the first underwriter. The second group may be termed participants in the underwriting or outright purchase, who may or may not be formal parties to the underwriting contract, but who are given a share of interest therein.

Defendants contend that PaineWebber does not fall into any of these categories and thus was not an "underwriter" under the statute. Defendants have omitted Congress's subsequent amendment of the definition emphasizing the participation element, Conf. Rep. No. 152, 73d Cong., 1st Sess. 24 (1933):

The substitute amends the definition of underwriter in the House Bill so as to make clear that a person merely furnishing an underwriter money to enable him to enter into an underwriting agreement is not an underwriter. Persons, however, who participate in any underwriting transaction or who have a direct or indirect participation in such transaction are deemed to be underwriters. The test is one of participation in the underwriting undertaking rather than that of a mere interest in it.

See J. Williams Hicks, 17 Civil Liabilities: Enforcement and Litigation Under the 1933 Act § 4:33 (Section 2(a)(11) Underwriter Status) at n.4 (Database Updated Oct. 2003). Hicks observed,

The 1933 Act imposes liability on those persons who sell or aid in selling securities to the public. Those who have control over the statements made in a registration statement are made liable for false statements or omissions. The underwriters are subjected to liability because they hold themselves out as professionals who are able to evaluate the financial condition of the issuer. The public relies on their expertise and reasonably expects that they have investigated the offering with which they are involved.

is defined in very broad terms²³ under section 2(11) of the 1933 Act, 15 U.S.C. § 77b(11):

The term "underwriter" means any person who has purchased from an issuer with a view to,

Id. at § 4:33. Plaintiffs here have alleged that top UBS Warburg research analyst Ron Barone wrote the "STRONG BUY" recommendation, that UBS required that it be distributed to all Enron plan participants seeking advice about exercising options and selling or buying Enron securities, and that Barone (and the brokers under PaineWebber's control, as mandated) continued to promulgate it until immediately before Enron filed for bankruptcy despite numerous red flags, some of which should have been obvious to a layman (such as plummeting stock price), no less to an expert analyst.

²³ The Supreme Court examined Congressional intent regarding the scope of liability under § 11, in light of § 11's enumerated, varied types of defendants, to that under § 12, which makes no expansion of its defendant pool. The high court concluded that anyone who "participates" or "takes part in" an underwriting is subject to section 11 liability, in contrast to § 12(1) restriction of defendants to direct sellers. *Pinter v. Dahl*, 486 U.S. 622, 650 n. 26 (1988):

Congress knew of the collateral participation concept and employed it in the Securities Act. . . . Liabilities and obligations expressly grounded in participation are found elsewhere in the [Securities Act of 1933], see, e.g., § 15 U.S.C. § 77b(11) (defining "underwriter," who is liable under § 5, as including direct and indirect participants). Section 11 of the Securities Act, 15 U.S.C. § 77k, lends strong support to the conclusion that Congress did not intend to extend § 12 primary liability to collateral participants in the unlawful securities sales. That section provides an express cause of action for damages to a person acquiring securities pursuant to a registration statement that misstates or omits a material fact. Section 11(a) explicitly enumerates the various categories of persons involved in the registration process who are subject to suit under that section. . . . There are no similar provisions in § 12, and therefore we may conclude the Congress did not intend such persons to be defendants.

or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a participation in the direct or indirect underwriting of any such undertaking; but such term shall not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors' or sellers' commission. As used in this paragraph, the term "issuer" shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer.

Section 11, written in the disjunctive, addresses four types of statutory underwriters, including the two relevant here, one who "offers or sells for an issuer in connection with . . . the distribution of a security" and a person who "participates or has a participation in the direct or indirect underwriting of any such undertaking." Even the term "offer" is defined in Section 2(a)(3) to encompass "every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security , for value." See also *SEC v. Van Horn*, 371 F.2d 181, 188 (7th Cir. 1966) ("Thus, the statutory definition specifically covers every person who participates in a distribution of securities.") (construing "underwriter" under § 5); *Harden v. Raffensperger, Hughes & Co., Inc.*, 65 F.3d 1392, 1400-01 & n.5 (7th Cir. 1995) (construing § 2(11) for statute generally); *SEC v. Int'l Chemical Dev. Corp.*, 469 F.2d 20, 32-33 (10th Cir. 1972) (same). Indeed, according to the SEC, the words "participates" and "participation" include anyone "enjoying substantial relationships with the issuer or underwriter, or engaging in the performance of

any substantial functions in the organization or management of the distribution." Opinion of General Counsel Securities Act Release No. 33-1862 (Dec. 14, 1938), cited, Amy Bowerman Freed and Thomas S. Brennan, *Overview-The Underwriter Concept*, SH030 ALI-ABA 171, 175 (2003). Moreover, the term "issuer" broadly includes "any person directly or indirectly . . . controlled by the issuer" Section 2(11), 15 U.S.C. § 77b(11).

In addition Defendants have insisted that the § 11 claims based on registration statements issued prior to March 7, 1999 (and going back to 1995) are time-barred under § 13, 15 U.S.C. § 77m, even if Plaintiffs were not able to discover the alleged misleading statements or omissions earlier, because there is no equitable tolling of the statute. *Summer v. Land & Leisure, Inc.*, 664 F.2d 965, 968 (5th Cir. 1984). As part of their response, Plaintiffs argue that these were "shelf registrations"²⁴

²⁴ A "shelf registration" statement, filed with the SEC, allows an issuer to register in a single registration statement a quantity of securities that will not be concurrently offered but will be issued on a "continuous" or "delayed" schedule for a period of up to two years. 17 C.F.R. § 230.415(a). Under SEC Rule 415(a), a shelf registration may only encompass the number of securities that "is reasonably expected to be offered and sold within two years from the initial effective date of the registration"; requires that the registrant update the statement through amendments and prospectus supplements "[t]o reflect in the prospectus any facts or events arising after the effective date of the registration statement . . . which, individually or in the aggregate, represent a fundamental change in the information set forth in the registration statement."). As described by the First Circuit Court of Appeals,

The need for complete and prompt disclosure is particularly keen when a corporation issues stock pursuant to a "shelf registration" under SEC Rule 415(a) The shelf registration rule permits a company

and that a Letter Agreement between Enron and PaineWebber (App. B-2 to Defendants' motion to dismiss) established PaineWebber as the exclusive ("captive") broker for them, a special arrangement that made PaineWebber a statutory underwriter for Enron's stock option plans. Plaintiffs point out that under SEC rules, in particular 46 Fed. Reg. 43002, "any market professional--a market maker specialist, or ordinary broker-dealer-who . . . sells [a registered] security for the registrant as agent ordinarily would be deemed a statutory underwriter under Section 2(11) of the Securities Act even in the absence of a specific written agreement between the issuer and that market professional." Thus Plaintiffs argue that PaineWebber further qualifies under the SEC rules as a statutory underwriter. For factual support Plaintiffs point to the complaint's allegations that it functioned as the "exclusive conduit" for the Enron stock option plan participants and the

to file a single registration statement covering a certain quantity of securities (register securities "for the shelf"), and then over a period of up to two years, with appropriate updates of information, issue installments of securities under that registration statement (Take the securities "down from the shelf") almost instantly, in amounts and at times the company and its underwriters deem most propitious. [citations and footnotes omitted]

See generally Shaw v. Digital Equipment Corp., 82 F.3d 1194, 1208-1209 & nn. 17 & 18 (1st Cir. 1996). Shelf registration allows the issuer not only to time offerings to its advantage, but also to reduce the costs of raising capital for repeated offerings, but creates problems regarding the timeliness, accuracy, and adequacy of information provided to investors about each offering, which Rule 415(a) and Item 11(a) of SEC Form S-3 attempt to remedy by requiring continuous disclosure of current information about "material changes." *Id.*

"sole gatekeeper to the initial market and secondary market for the 100,000,000 securities issued pursuant to the respective Enron Registration Statements, which spawned enormous financial value to" PaineWebber. Moreover under the procedure it established, for a plan participant to obtain PaineWebber's advice on exercising a plan participant's stock options, how to value stock options, financing to effect the exercise of the stock options, and to actually exercise stock options, the stock option holder was first required to open an account with PaineWebber. In all these ways, Plaintiffs insist, PaineWebber participated in the distribution of the Enron securities.

Defendants challenge Plaintiffs' argument and contend that they cite the wrong regulation and selectively quote from it while ignoring the distinction in Rule 415 between two types of shelf registration, i.e., an "at-the-market offering" (to a trading market) for which an underwriter is required, and an employee benefit plan, such as the stock option plan, where an underwriter is not required.

There is an inadequate record and insufficient briefing to allow the Court to make a determination at this point regarding the shelf registration issue here. What is clear is that Defendants seeks to segregate PaineWebber's role as an ministerial administrator of the stock option plan from its role as an independent broker for personal brokerage accounts for those employees who chose to open one after exercising stock options. Plaintiffs, alleging a scheme between Enron and PaineWebber that

involves the nonexercise of stock options and new purchase of the stock, plead their claims in an effort to integrate the two.

The Court finds that the complaint's allegations regarding Defendants' purported overlapping and intertwined roles and conflicts of interest, manipulated to achieve their own monetary gain in the context of a larger and more encompassing scheme with Enron, raise genuine issues of material fact regarding PaineWebber's level of "participation" in the Enron securities distributions at issue," i.e., "enjoying substantial relationships with the issuer . . . , or engaging in the performance of any substantial functions in the organization or management of the distribution" of Enron securities. The complaint draws the picture of an intense, but unequal and hidden relationship of a very controlling Enron and subservient PaineWebber, that undermines the compartmentalization of their roles advocated by Defendants. These issues need to be flushed out through discovery.

In light of the alleged relationship between Enron and PaineWebber, which even beyond the formal and exclusive "captive broker" arrangement, reflects Enron's tight control over UBS, and in view of PaineWebber's alleged subservience, the Court finds that PaineWebber's solicitation of and "participation" in the distribution of Enron securities to putative class members raise sufficient issues to avoid dismissal under Rule 12(b)(6).

c. Seller Under Section 12(a)(2)

Since the Prospectuses for the Forms S-8 at issue purportedly contained untrue statements of material facts and/or omitted material facts necessary to make the statements not misleading under the circumstances, and because UBS PaineWebber did not challenge the Prospectuses or give its clients additional information to allow them to make informed investment decisions, Plaintiffs insist that they have also stated a claim against UBS PaineWebber under § 12(a)(2).

Defendants move to dismiss the § 12(a)(2) claims against them on the grounds that Plaintiffs cannot identify any actionable statements in a prospectus or oral communication made in connection with the prospectus²⁵ and because they cannot demonstrate that PaineWebber was a seller of Enron stock through the employee stock option program." The two statements challenged by Plaintiffs are (1) the "STRONG BUY" recommendation, which Defendants contend is not actionable because it is merely a general analyst recommendation to all PaineWebber's clients and because it was not made in connection with a prospectus issued or prepared or disseminated by PaineWebber, but by Enron; and (2) Enron's prospectus for the stock option plan, which Defendants contend was issued by Enron, not by PaineWebber, which was not involved at all in its preparation. Complaint at ¶ 194.

With respect to the "STRONG BUY" recommendation, in accord with the Fifth Circuit's fact-specific, case-by-case approach to such issues, this Court finds that in the context of

²⁵ See *Gustafson*, 513 U.S. at 569.

the picture presented in the complaint, the facts asserted suggest knowing and intentional deception of Plaintiffs by PaineWebber in repeatedly giving such advice and that the Warburg recommendation is actionable under the circumstances. Second, PaineWebber did not have to prepare the prospectuses to be liable as a seller under § 12.

A person who "offers or sells" a security may be subject to liability under § 12(a)(2) to any person "purchasing such security from him." 15 U.S.C. § 771(2). Finding that "Congress expressly intended to define broadly" the concept of seller to "encompass the entire selling process, including the seller/agent transaction," the Supreme Court has construed a § 12(a)(1) "seller" to include not only the person who actually passes title to the buyer, but also "the person who successfully solicits the purchase, motivated at least in part by a desire to serve his own financial interests or those of the securities owner." *Pinter v. Dahl*, 486 U.S. 622, 643, 647 (1988); see also *Crawford v. Glenns, Inc.*, 876 F.2d 507, 510-11 (5th Cir. 1989) (A "seller" under § 12 is "either one who owns a security and transfers it for consideration or one who successfully promotes or solicits the purchase 'motivated at least in part by a desire to serve his own interests or those of the securities owner.'"). Although the Supreme Court in *Pinter* addressed only § 12(1), now § 12(a)(1), because § 12(a)(2) has "identical language" to that in § 12(a)(1) courts have applied the *Pinter* construction of the liability of a seller to both provisions. See, e.g., *Azurix*, 332 F.2d 854 n.

10, citing *Cyrak v. Lemon*, 919 F.2d 320, 324-25 (5th Cir. 1990) (applying *Pinter* definition of "seller" to § 12(1) and to § 12(a)(2) because they use identical language); *Cortec Indus., Inc. v. Sum Holding LP*, 949 F.2d 42, 49 (2nd Cir. 1991); *Moore v. Kayport Package Express, Inc.*, 885 F.3d 531, 536 (9th Cir. 1989); *Schlifke v. Seafirst Corp.*, 866 F.2d 935, 940 (7th Cir. 1989).

In *Pinter* the Supreme Court did not define "solicit," but emphasized that

solicitation of a buyer is perhaps the most critical stage of the selling transaction . . . [and] brokers are well positioned to control the information flow to a potential purchaser, and, in fact, such persons are the participants in the selling transaction who most often disseminate material information to the investor. The solicitation is the state at which an investor is most likely to be injured, that is, by being persuaded to purchase securities without full and fair information. Given Congress' overriding goal of preventing this injury, we may infer that Congress intended solicitation to fall under the mantle of § 12(1).

Pinter, 486 at 646-47.

Appellate courts have held that "solicitation" requires that a seller must, at least, communicate directly with the buyer. *Craftmatic Sec. Litig. v. Kraftsow*, 890 F.2d 628, 363 (3d Cir. 1989) ("The purchaser must demonstrate direct and active participation in the solicitation of the immediate sale to hold the issuer liable as a § 12[(a)](2) seller."), cited for that proposition, *Rosenzweig v. Azurix Corp.*, 332 F.3d at 871; *Shaw v. Digital Equipment*, 82 F.3d at 1215. The First Circuit has observed, "For example, a broker or agent who solicits a purchase

'would commonly be said . . . to be among those 'from' whom the buyer 'purchased' even though the agent himself did not pass title," especially in light of the fact that "'solicitation is the stage at which an investor is most likely to be injured,'" so long as "the non-owner of securities . . . is 'motivated at least in part by a desire to serve his own financial interests or those of the securities owner.'" *Shaw v. Digital Equipment*, 82 F.3d at 1215, quoting *Pinter*, 486 U.S. at 644, 646, 647. The Fifth Circuit, quoting *Pinter v. Dahl*, 486 U.S. at 644, highlights the potential liability of a broker as one who solicits: "'a securities vendor's agent who solicited the purchase would commonly be said, and would be thought by the buyer, to be among those 'from' whom the buyer 'purchased,' even though the agent himself did not pass title,' for example a broker acting for an issuer." *Lone Star Ladies Investment Club, v. Schlotzky's, Inc.*, 238 F.3d 363 367, 370 (5th Cir. 2001).

J. William Hicks, in 7B Exempted Transactions Under the Securities Act of 1933 § 16:81 ("Successful Solicitor-Solicitation") (Database updated Aug. 2003), points out that in *Pinter* the Supreme Court used the word "urges" four times to explain what it means by "solicits": 486 U.S. at 644 ("A natural reading of the statutory language would include in the statutory seller status at least some persons who urged the buyer to purchase"); *id.* at 647 ("When a person who urges another to make a securities purchase acts merely to assist the buyer, not only is it uncommon to say that the buyer 'purchased' from him,

but it is also strained to describe the giving of gratuitous advice, even strongly or enthusiastically, as 'soliciting'); *id.* ("The person who gratuitously urges another to make a particular investment decision is not, in any meaningful sense, requesting value in exchange for his suggestion or seeking the value the titleholder will obtain in exchange for the ultimate sale"); *id.* at 655 ("The District Court made no findings that focused on whether Dahl urged the purchases in order to further some financial interest of his own or of Pinter."). He also cites two cases treating the Supreme Court's use of "urge" and a synonym for "solicit." *Wiley v. Hughes Capital Corp.*, 746 F. Supp. 1264 (D.N.J. 1990), and *Buford White Lumber Co. Profit Sharing and Sav. Plan & Trust v. Octogon Properties Ltd.*, 740 F. Supp. 1553 (W.D. Okla. 1989).

From his review of relevant case law, Hicks concludes that some "general principles" emerge from judicial interpretations of the "'successful[ly] solicits' aspect of the *Pinter* test" for defining a statutory seller:

Solicitation does not include ministerial acts, such as mailing an offering document at the seller's request . . . [because] it does not involve any exercise of judgment. Also, a person is unlikely to be deemed a solicitor of sales by making a general presentation to a group of potential investors at a seminar or any other mass meeting. A finding of successful solicitation is more probable where the defendant touts the investment directly to the purchaser. Indeed some courts have indicated that the allegation of direct and active participation in the solicitation of the immediate sale is necessary for solicitation liability.

On the other hand, factors pointing in the direction of solicitation for purposes of the Pinter test include control over the amount and content of information to be provided to potential investors and control over the persons to be contacted for possible sales. Even where a participant does not package the selling information or generate the list of prospective purchasers, he will successfully solicit a sale if he uses the issuer's disclosure in communications with offerees and presents them with the information that is need to finalize the sale. [footnotes omitted]

Id. Because drawing a clear line between ministerial conduct that is collateral to the transaction and conduct that goes to the core of the sales is difficult and likely to raise factual issues, Hicks observes that "a defendant's status as a seller is unlikely to be determined on a motion for summary judgment." *Id.*

The Court finds that the allegations against PaineWebber in the complaint satisfy the solicitation prong for pleading seller liability under § 12(a)(2). PaineWebber never "owned" the securities in the sense of taking title to them. There is no firm commitment underwriting²⁶ alleged here, but underwriting either

²⁶ In a firm commitment underwriting, the issuer sells all the stock of an offering to underwriters, and the underwriters then sell to the public, i.e, plaintiff class members. *Lone Star Ladies Investment Club v. Schlotzky's, Inc.*, 238 F.3d 363 387, 369 (5th Cir. 2001). Thus the underwriter becomes liable as the seller in a firm commitment offer. Because the issuer in a firm commitment underwriting does not pass title to the securities directly to the purchasers, it cannot be held liable as a seller to those ultimate buyers unless it actively solicited the plaintiffs' purchases of the securities to further its own and/or the issuer's financial interests. *Id.* at 369-70, citing *Shaw v. Digital Equipment Corp.*, 82 F.3d at 1215.

implicitly on a "best efforts" basis²⁷ or, as urged by Plaintiffs, based on shelf registration. The Court finds that according to the complaint's allegations PaineWebber, functioning not only pursuant to an agreement to act as Enron's exclusive administrator for the stock option and deferred benefit plans, but also pursuant to a scheme to increase the sales and price of Enron stock and the financial image of the corporation for mutual gain, was purportedly directly soliciting Enron employees on a one-on-one basis, often customizing its services, to persuade them to purchase Enron securities for their portfolios, acting beyond merely presenting the "STRONG BUY" recommendation. The complaint alleges that to a significant extent PaineWebber, through its brokers, was selecting and controlling the nature of information, in accordance with Enron's direction, including that information provided in the prospectuses, to these Enron employees regarding stock options and investments. Furthermore PaineWebber's special relationship to these investors based on its status as Enron's exclusive agent spilled over into, and provided it with an advantage in obtaining, the establishment of brokerage accounts

²⁷ In contrast to a firm commitment underwriting, in a best efforts underwriting the underwriter does not purchase the securities but functions as a broker or agent for the issuer. In a best efforts underwriting, the underwriter does not assume any risk but agrees to use its best efforts to offer and sell the issuer's securities for which in return it receives a commission on any sales that it makes and returns those it does not. Dana B. Klinges, *Expanding the Liability of Managing Underwriters Under the Securities Act of 1933*, 53 Fordham L. Rev. 1063, 1064 (Apr. 1985). In comparison, in a firm commitment underwriting the underwriter purchases the securities and takes the risk that it may not sell the securities. *Id.*

for the employees' assets, through its personal investment services. As the complaint asserts, the free stock option analysis, financial planning, and advisory services provided by UBS PaineWebber "were designed as a hook to capture all of the 'assets' owned by the Enron employees and Enron's affiliates' employees" as it "tried to capture at least 1/3 of the assets generated from the exercise of those stock options" and, still under Enron's control, to steer them toward purchasing Enron securities. Indeed, as noted, the complaint makes a number of allegations about Enron's and PaineWebber's effective pressure on PaineWebber brokers to persuade the plan participants to invest in and/or hold Enron securities in overly concentrated portfolios. Moreover, Plaintiffs have clearly alleged that the financial interests of both PaineWebber and Enron were at the core of the stock option plan arrangement and their larger scheme. Thus PaineWebber could be a "seller" under the accepted liberal reading of the statute.

Therefore Court finds that dismissal prior to discovery relating to the role of UBS PaineWebber as a statutory underwriter under § 11 and as a "seller" under § 12(a)(2) is not appropriate here.

d. Statute of Limitations under § 77m

Sections 11, 12 and 15 of the 1933 Act, 15 U.S.C. § 77k, § 77l(a)(2), and § 77o, are all governed by the statute of limitations in Section 13 of the 1933 Act, 15 U.S.C. § 77m, which reads in relevant part,

No action shall be maintained to enforce any liability created under section 77k or 771(a)(2) of this title unless brought within one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence In no event shall any such action be brought to enforce a liability created under section 77k . . . of this title more than three years after the security was bona fide offered to the public, or under section 771(a)(2) of this title more than three years after the sale.

In most cases a security is "bona fide offered to the public" as of the effective date of the registration statement and any § 11 or § 12(a)(2) claims must be brought within three years from that date. *Id.*; *Finkel v. Stratton Corp.*, 962 F.2d 169, 173 (2d Cir. 1992); *Dodds v. Cigna Securities, Inc.*, 12 F.3d 346, 349-50 & n.1 (2d Cir. 1993), *cert. denied*, 511 U.S. 1019 (1994). Plaintiff has the burden of proof that he complied with the statute of limitations. *Cook v. Avien, Inc.*, 573 F.2d 685, 695 (1st Cir. 1978); Harold S. Bloomenthal and Samuel Wolff, *Burden of Proof and Pleading Time of Discovery*, 3C Sec. & Fed. Corp. Law § 17:35 (Database updated Aug. 2003).

The effective dates of the ten registration statements at issue here range from June 30, 1995-June 26, 2001. Defendants argue that the Court must dismiss the § 11 claims based on three of the registrations statements that were issued more than three years prior to the filing of this suit on March 7, 2002,²⁸ specifically the registration statements dated June 30, 1995,

²⁸ In other words, that were dated before March 7, 1999.

January 3, 1997, and March 18, 1998. Plaintiffs object that they are shelf-registered securities excepted from the general rule.

With respect to shelf-registered securities with their on-going offerings, an issuer is required by SEC Regulation S-K Item 512, 17 C.F.R. § 229.512,²⁹ to update the public with

²⁹ Title 17 C.F.R. § 229.512(a)(1) and (2) (2003) provides in relevant part that the registrant is

(1) To file, during any period in which offers or sales are being made, a post-effective amendment to this registration statement

(ii) To reflect in the prospectus any facts or events arising after the effective date of the registration statement (or the most recent post-effective amendment thereof) which, individually or in the aggregate, represent fundamental change in the information set forth in the registration statement. . . .

Provided, however, That paragraph[]
(a)(1)(ii) of this section [does] not apply if the registration statement is on Form S-3 (§ 239.13 of this chapter), Form S-8 (§ 239.16b of this chapter) or Form F-3 (§ 239.33 of this chapter), and the information required to be included in a post-effective amendment by those paragraphs is contained in periodic reports filed with or furnished to the Commission by the registrant pursuant to section 13 or section 15(d) of the Securities Exchange Act of 1934 that are incorporated by reference in the registration statement.

(2) That for the purpose of determining any liability under the Securities Act of 1933, each such post-effective amendment shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

Plaintiffs' registration statements were filed with the SEC on

continuous reports or "post-effective amendments," under 17 C.F.R. § 230.415. The date of a post-effective amendment to the registration statement is then deemed the offering date for those buying securities under it, instead of the initial registration date; thus the three-year limitations would begin to run from the date of the post-effective amendment. Regulation 512(a)(2) ("for the purposes of determining any liability under the 1933 Act, each such post-effective amendment shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof").

Although contending that the shelf registration regulation protects their claims based on registration statements originally dated before March 7, 1999 from being time-barred, Plaintiffs fail to identify any specific post-effective amendments or reports to the SEC to any of the three challenged registration statements, nor have they expressly claimed that they purchased Enron securities at the times when the updated reports or post-effective amendments were filed with the SEC, but only conclusorily urge, "Because Plaintiffs unquestionably may prove a set of facts that support their Section 11 claims, even considering the 1933 Act's limitations period," PaineWebber's motion to dismiss should be denied.

Because it is clear that Plaintiffs' claims based on seven of the registration statements are timely, and because

Forms S-8, according to the complaint at 85.

discovery will determine whether those relating to the other three are, the Court will not dismiss the latter claims now on limitations grounds. If appropriate, Defendants' arguments may be raised subsequently in a motion for summary judgment.

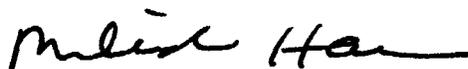
From all these various allegations, the Court finds that Plaintiffs have adequately stated a claim against PaineWebber as a statutory underwriter under § 11 and as a seller under § 12(a)(2) and that dismissal prior to discovery relating to the statutory underwriting and solicitation roles of UBS PaineWebber would not be proper here.

Motion to Stay Arbitration

Finally, because the Court has now resolved the motion to dismiss, the motion to stay arbitration is moot.

Accordingly, for the reasons indicated above, the Court ORDERS that Defendants' motion for reconsideration (#49) is DENIED; Defendants' motion to dismiss (#32) is DENIED; and Defendants' motion to stay (#53) is MOOT.

SIGNED at Houston, Texas, this 12th day of November, 2003.



MELINDA HARMON
UNITED STATES DISTRICT JUDGE