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

United States Courts
Southern District of Texas
ENTERED
FEB 13 2002
Michael N. Milby, Clerk of Court

MARK NEWBY, ET AL., Plaintiffs	§	
VS.	§	CIVIL ACTION NO. H-01-3624 AND CONSOLIDATED CASES
ENRON CORPORATION, ET AL., Defendants	§	
PIRELLI ARMSTRONG TIRE CORPORATION RETIREE MEDICAL BENEFITS TRUST, Derivatively On Behalf of ENRON CORPORATION, ET. AL., Plaintiffs	§	
VS.	§	CIVIL ACTION NO. H-01-3645 LEAD CASE
KENNETH LAY, ET AL., Defendants	§	
WILLIAM COY AND CANDY MOUNTER, Individually and on Behalf of All Similarly Situated Stockholders of Enron Corporation, Plaintiffs,	§	
VS.	§	CIVIL ACTION NO 01-4248
ARTHUR ANDERSEN LLP, DAVID DUNCAN, D. STEPHEN GODDARD, JR., JOHN NIEMANN, WILLIAM SWANSON, DEAN SWICK, AND TOM ELSENBROOK, Defendants.	§	

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MICHAEL N. MILBY, Clerk
By _____ Deputy Clerk

United States Courts
Southern District of Texas
ENTERED
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MEMORANDUM AND ORDER

Pending before the Court in the above referenced, consolidated, shareholders derivative action are an objection to consolidation (instrument #28 in the Lead Case H-01-3645, which

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alone of all member cases consolidated into Pirelli remains open) and a motion to remand to the 55th Judicial District Court in Harris County, Texas (#6 in Member Case No. 01-4248), filed by Plaintiffs William Coy ("Coy") and Candy Mounter ("Mounter"), individually and on behalf of all similarly situated stockholders of Enron. Because a determination of the motion to remand affects whether there should even be consoldiation, the Court addresses the motion first.

Coy and Mounter's Motion to Remand

In their motion to remand pursuant to 18 U.S.C. § 1447(c), Coy and Mounter argue that Defendants improperly removed this action from state court on alleged federal question jurisdiction based on their Second Amended Petition. Coy and Mounter contend that Defendants, despite Plaintiffs' exclusively Texas common-law causes of action (for fraud, negligent misrepresentation, accounting misrepresentation, breach of fiduciary duty, and breach of implied and express warranties), wrongly argue that this suit is a "covered" class action involving a "covered" security that is not maintainable under state law and is removable under the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"), Pub. L. No. 105-353, 112 Stat. 3227, codified as amended in part at 15 U.S.C. §§ 77p and 78bb(f)(in relevant part stating that "no covered class action based upon the statutory or common law of an State or subdivision thereof may be maintained in any State or Federal court by any private party alleging . . . an untrue statement or omission of a material fact in connection with the purchase or sale of a covered security . .

. ."). Coy and Mounter insist SLUSA is inapplicable because they have not alleged any fraud "in connection with the purchase or sale of a covered security," but only in connection with a class of shareholders merely "holding" Enron stock. Gordon v. Bunrock, 2001 WL 556763, *3 (N.D. Ill. Apr. 28, 2000)(in an accounting malpractice action, because plaintiffs only assert claims against Arthur Anderson LLP relating to the reduction in value of their Enron stock arising from Anderson's alleged misrepresentations and did not allege that these misrepresentations occurred "in connection with the purchase or sale" of a covered security, the court concluded that SLUSA did not apply and there was no federal jurisdiction to sustain removal); Lolandriz v. USA Networks, 68 F. Supp. 2d 285 (S.D.N.Y.)(remanding action alleging breach of fiduciary duty in misleading press releases because the allegations related to holding the security, not to purchasing or selling it); Gutierrez v. Deloitte & Touche, 147 F. Supp. 2d 584 (W.D. Tex. 2001)(court held that plaintiff entities' action against accounting firm for erroneous audit reports inducing holders to keep securities did not assert or relate to the sale or purchase of securities and remanded it).[1]

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[1] Although Defendants do not explain the legal rationale underlying such decisions, it is important.

As noted by many courts, SLUSA does not define the phrase, "in connection with the purchase or sale of a covered security." Because the phrase echoes language in Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5, many courts use case law arising under that statute to interpret SLUSA's provision. See, e.g., Gutierrez, 147 F. Supp.2d 584, 594 (W.D. Tex. 2001); Green v. Ameritrade, Inc., 120 F. Supp.2d 795, 798 (D. Neb. 2000); Burns v. Prudential Securities, 116 F. Supp.2d 917, 923 (N.D. Ohio 2000); Abada v. Charles Schwab & Co., Inc., 68 F.

Coy and Mounter's Objection to Consolidation

Objecting to consolidation with other shareholder derivative suits, Coy and Mounter argue that because their claims are based solely on Texas state law, while those of the other Plaintiffs consolidated into Pirelli are based on federal securities law or ERISA, the consolidation is unfair and inefficient for them, especially in view of the procedural requirements under the Private Securities Reform Act of 1995, 15 U.S.C. § 77z-1 that will greatly delay this suit. They also emphasize that since their case is not brought on behalf of or

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Supp.2d 1160, 1166 (S.D. Cal. 1999), vacated on other grounds on reconsideration, 127 F.Supp.2d 1001, 1003 (S.D. Cal. 2000); Shaev v. Claflin, No. C 01-0009, 2001 WL 548567, *4-6 (N.D. Cal. May 17, 2001); Spielman v. Merrill Lynch, Pierce, Fenner & Smith, Inc., No. 01 CIV. 3023 (DLC), 2001 WL 1182927, *2-3 (S.D.N.Y. Oct. 9, 2001); Hardy, 2001 WL 1524471 at *4.

Section 10(b) requires that fraud forbidden by the statute must be in connection with the sale of a security; specifically it makes it unlawful "[t]o use or employ in connection with the purchase or sale of any security . . . , any manipulative or deceptive device or contrivance . . . ." 15 U.S.C. § 78j(b). Rule 10b-5, 17 C.F.R. § 240.10b-5, makes it unlawful "[t]o make any untrue statement of material fact or to omit to state a material fact . . . in connection with the purchase of any security." They also note that in Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 12 (1971), the Supreme Court instructed, "Section 10(b) must be read flexibly, not technically and restrictively." Nevertheless these courts frequently cite the holding in Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975), that claims brought on behalf of persons alleging that they were defrauded into not purchasing stock were not cognizable under Section 10(b) and the Supreme Court's observed that "this disadvantage is attenuated to the extent that remedies are available to nonpurchasers and nonsellers under state law." Id. at 725, 738 n.9, and 755. The courts have extended the rule from this proposition to conclude that shareholders allegedly defrauded into holding their stock, but not selling or purchasing it because of the claimed misrepresentations or omissions, cannot state a claim under Section 10(b), but have valid state theories of recovery that do not implicate federal securities laws.

against Enron Corporation, it will not be stayed by Enron's bankruptcy proceedings. Instead, the targets of their claims are breaches of duty by Arthur Andersen, L.L.P.

Procedural Posture of this Action

Coy and Mounter's Original Petition, filed on November 5, 2001, in state court was facially designated as a hybrid shareholder derivative action and a securities fraud class action, but named only Arthur Anderson L.L.P. as a defendant. This Court notes that the original petition, which did not name Enron as a party, was therefore not a properly pled derivative action. Under Texas law, just as under federal law, the corporation must be named as a nominal defendant in a shareholder's derivative action, and indeed, in actuality is the real plaintiff, and any recovery would redound to its benefit, not its detriment. Tex. Bus. Corp. Act Art. 5.14 (Vernon 2000); DeBord v. Circle Y of Yoakum, Inc., 951 S.W.2d 127, 134 (Tex. App.--Corpus Christi 1997), rev'd on other grounds sub nom. Stary v. DeBord, 967 S.W.2d 352 (1998).

On November 29, 2001 Plaintiffs filed a First Amended Petition, adding another Plaintiff, Shirley J. Pratz, and deleting references to a shareholder derivative action and making it only a shareholder class securities fraud action. After Enron filed for bankruptcy in New York on December 2, 2001, any derivative action would become the property of the estate under the jurisdiction of the New York court and subject to the automatic stay. 11 U.S.C. § 362(a)(1) and (3); Texas Bus. Corp. Act Ann.

art. 5.14(D) (Vernon 2000); Matter of Consolidated Bancshares, Inc., 785 F.2d 1249, 1253 (5th Cir. 1986); Mitchell Excavators, Inc. by Mitchell v. Mitchell, 734 F.2d 129 (2d Cir. 1984); In re Interpictures, Inc., 86 B.R. 24, 28 (Bankr. E.D.N.Y. 1988). Although Defendant Arthur Anderson L.L.P., in its response in opposition to the motion to remand, joined by Defendant David Duncan, argues that the First Amended Petition was filed on December 6, 2001 after Enron filed for bankruptcy and therefore the amended pleading is null and void because of the automatic stay under 11 U.S.C. § 362(a)(1), the record reflects that it was filed beforehand, on November 29, 2001.[2] Under the lenient Texas Rule of Civil Procedure 63,[3] at this stage of the litigation, before Arthur Andersen L.L.P. had even filed a responsive pleading, Plaintiffs did not need approval of the state court to amend their pleadings.

On December 7, 2001, Coy and Mounter filed a Second Amended Petition, like the First Amended Petition framed as a

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[2] It was also filed before Enron filed a notice of stay on November 30, 2001 under Texas Business Corporation Act Ann. art. 5.14(D)(1) to trigger an automatic stay while its special litigation committee investigated the allegations in this and other shareholder derivative actions pending in state court.

[3] Rule 63 provides in relevant part,

> Parties may amend their pleadings . . . by filing such pleas with the clerk at such time as not to operate as a surprise to the opposite party; provided that any pleadings . . . offered for filing within seven days of the date of trial or thereafter, or after such times as may be ordered by the judge under Rule 166, shall be filed only after leave of the judge is obtained . . . .

putative stockholder class action against Arthur Andersen, L.L.P. and individually against six of its officers asserting six Texas statutory or common law causes of action. Because Enron was still not a party and because the suit had not been designated a shareholder derivative action since the first amendment, the automatic stay under 11 U.S.C. § 362(a)(1) did not bar the second amendment. Defendants removed the case on December 10, 2001, presumably based on the superseding Second Amended Petition because the notice of removal discusses all three petitions.

Initially, despite the First Amended Petition's deletion of the derivative allegations prior to the bankruptcy and the filing of the superseding Second Amended Petition, this case was erroneously grouped with the Pirelli shareholder derivative action, when it clearly does not meet the requirements of one, as noted above. Instead this case is facially characterized as a stockholder class action against Enron's accountant and auditor to recover the reduction in value of their stock because of alleged misrepresentations and omissions inter alia about the propriety and legality of the entities set up by Enron with the aid of Arthur Andersen L.L.P..

Thus the threshold issue here is whether removal under SLUSA was proper. If SLUSA applies, the removal was proper and the court must dismiss the state law claims. 15 U.S.C. § 78bb(f)(1). If removal was proper as to some state-law claims that are preempted pursuant to SLUSA and not others, after dismissing the preempted claims falling within the ambit of SLUSA,

the Court must next determine whether to exercise supplemental jurisdiction under 28 U.S.C. § 1367(c)(3) over the remaining viable state law claims or sever them and remand them to state court. If there are only viable state law claims to which SLUSA is inapplicable, the suit should be remanded.

Plaintiffs' Second Amended Petition

Plaintiffs' Second Amended Petition alleges that Defendants Arthur Andersen, L.L.P., Enron's accountant and auditor, and its officers employees fraudulently and intentionally misrepresented to Plaintiffs, all stockholders of Enron, inter alia the propriety and legality of entities set up by Enron, in particular LJM2, LJM-C, and Chewco. The Second Amended Petition asserts that Defendants knowingly or recklessly, or alternatively negligently, misrepresented transactions involving these entities, including that they conformed with Generally Accepted Accounting Principles. It further alleges that Defendants breached their duty to act in the best interests of plaintiffs and their duty to exercise reasonable and ordinary care and diligence, and breached their fiduciary duties in their accounting and auditing when they failed to inform Plaintiffs of the impropriety and illegality of these entities' transactions. Finally Plaintiffs complain that Defendants breached implied and express warranties in promising that their accounting representation would be of the highest quality and caliber, when in fact they failed to advise Plaintiffs

of the impropriety and illegality of these transactions, among other unidentified acts.

Applicable Law

Defendants, who removed this action based on 28 U.S.C. § 1331 ("The district courts shall have original jurisdiction of all civil actions arising under the Constitution, laws, or treaties of the United States."),[4] have the burden of proving that this Court has jurisdiction over this suit.

Plaintiffs assert claims under Texas common law. Generally federal jurisdiction exists only if the federal question is facially evident in the plaintiff's well-pleaded complaint. Caterpillar Inc. v. Williams, 482 U.S. 386, 392 (1987); Terrebonne Homecare, Inc. v. SMA Health Plan, Inc., 271 F.3d 186, 188 (5th Cir. 2001). Moreover, a plaintiff is master of his complaint and may choose the law, on which he wishes to rely to avoid removal to federal court. Carpenter v. Wichita Falls Indep. School Dist., 44 F.3d 362, 366 (5th Cir. 1995).

As a narrow exception to the well pleaded complaint rule, the artful pleading doctrine, applies where federal law completely preempts the field and prevents a plaintiff from precluding removal by failing to plead necessary federal questions. Id.; Waste Control Specialists, LLC v. Envirocare of Texas, Inc., 199 F.3d 781, 783 (5th Cir. 2000), citing Rivet v.

[4] There is no diversity jurisdiction here because Mounter and a number of Defendants are citizens of Texas.

Regions Bank of La., 522 U.S. 470 (1998)("The artful pleading doctrine allows removal where federal law completely preempts a plaintiff's state-law claim. . . . Although federal preemption is ordinarily a defense, once the area of state law has been completely considered, any claim purportedly based on the pre-empted state law is considered from its inception, a federal claim and therefore arises under federal law."). Thus Defendants bear the burden of demonstrating that a federal right is an essential element of Plaintiffs' claims and that Congress intended SLUSA to preempt Plaintiffs' claims.

Federal law may preempt state law in any of three ways: (1) Congress may expressly define the extent to which it intends to preempt state law; (2) Congress may indicate an intent to occupy an entire field of regulation; or (3) Congress may preempt a state law that conflicts with federal law even when it has not expressly preempted the state law nor indicated an intent to occupy the field. New Orleans Public Service, Inc. v. Council of City of New Orleans, 911 F.2d 993, 9998 (5th Cir. 1990)(citing Michigan Canners and Freezers Assoc. v. Agricultural Marketing and Bargaining Board, 467 U.S. 461, 469 (1984)), cert. dismissed, 502 U.S. 954 (1991).

Congress has enacted several federal statutes[5] in the past few years to attempt to establish uniformity in the

[5] See also the National Securities Markets Improvement Act of 1996 ("NSMIA"), Pub. L. No. 104-290, 110 State. 3416 (1996), codified in part in 15 U.S.C. § § 77r, 80a, which preempts state "Blue Sky" laws.

securities markets. The Private Securities Litigation Reform Act of 1995 ("PSLRA"), 15 U.S.C. §§ 77z-1, 78u, which amended the 1933 Securities Act and the 1934 Securities Exchange Act, set out heightened pleading requirements[6] and for complaints under Rule 10b-5 mandated pleading of specific facts creating a strong inference of scienter for private class actions and other suits alleging securities fraud in an effort to minimize meritless lawsuits. 15 U.S.C. § 78 et seq. H. Conf. Rep. No. 105-803 (1998). When, as a result, plaintiffs began filing in state rather than federal court, asserting claims under state statutory or common law to avoid the PSLRA's stringent procedural and pleading hoops, Congress passed SLUSA in 1998 to close the loophole. 144 Cong. Rec. H10771 (daily ed. Oct. 13, 1998, 1998 WL 712049). SLUSA in essence made federal court the exclusive venue for securities fraud class actions meeting its definitions and ensured they would be governed exclusively by federal law. 15 U.S.C. § 77p(b)-(c). Congress' purpose in enacting the statute was to "'prevent plaintiffs from seeking to evade the protections that Federal law provides against abusive litigation by filing suit in State court, rather than Federal court.'" Korsinsky v. Salomon Smith Barney, Inc., No. 01 6085(SWK), 2002 WL 27775, *3 (S.D.N.Y. 2002) quoting H.R. Conf. Rep. No. 105-803 (1998). Moreover, the Court observes that the same report indicates that

[6] The PSLRA requires plaintiffs to plead with particularity any alleged misrepresentations, misleading statements or omissions, including the reasons why plaintiffs think there was an omission or which statements were misleading and why.

in SLUSA Congress did not evidence an intent to occupy the entire field of securities regulation, but expressly delineated the scope of preemption:

> [I]n order to prevent certain State private securities class action lawsuits alleging fraud from being used to frustrate the objectives of the Private Securities Litigation Reform Act of 1995, it is appropriate to enact national standards for securities class action lawsuits involving nationally traded securities, while preserving the appropriate enforcement powers of State securities regulators and not changing the current treatment of individual lawsuits.

H.R. Conf. Rep. 105-803, *2.

With respect to removal, the plain language of SLUSA, 15 U.S.C. § 77p(c), evidences Congress' intent to preempt a specific category of state-law class actions, which it defines as follows: "Any covered class action brought in any State Court involving a covered security, as set forth in subsection (b), shall be removable to the Federal district court for the district in which the action is pending . . . ." Title 15 U.S.C. § 78bb(f)(5)(B) defines a "covered class action" as

> (i) any single lawsuit in which--
> (I) damages are sought on behalf of more that 50 persons or prospective class members, and questions of law or fact common to those persons or members of the prospective class, without reference to issues of individualized reliance on an alleged misstatement or omission, predominated over any question affecting only individual persons or members or
> (II) one or more named parties seek to recover damages on a representative basis on behalf of themselves and other unnamed parties similarly situated, and questions of law or fact common to those persons or members of the prospective

class predominate over any questions affecting only individual persons or members; or
(ii) any group of lawsuits filed in or pending in the same court and involving common questions of law or fact, in which--
(I) damages are sought on behalf of more than 50 persons; and
(II) the lawsuits are joined, consolidated, or otherwise proceed as a single action for any purpose.

15 U.S.C. § 78bb(f)(5)(B).

A "covered security" is defined as "a security that satisfies the standards for covered security specified in paragraph (1) or (2) of section 77r(b) of this title, at the time during which it is alleged that the misrepresentation, omission, or manipulative or deceptive conduct occurred . . . ." 15 U.S.C. § 77p(f)(3). Section 77r(b), adopted by § 78bb(f)(5)(E), defines a "covered security" as one listed on the New York Stock Exchange, the American Stock Exchange, or the Nasdaq National Market, or a security issued by an investment company that is registered, or for which a registration statement has been filed under the Investment Company Act of 1940. SLUSA provides for mandatory removal and dismissal of a specific kind of class action:

(f) LIMITATIONS ON REMEDIES.--
(1) CLASS ACTION LIMITATIONS.--No covered class action based upon the statutory or common law of any state or subdivision thereof may be maintained in any State or Federal court by any private party alleging--
(A) a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security; or
(B) that the defendant used or employed any manipulative or deceptive device or contrivance in connection with the purchase or sale of a covered security.
(2) REMOVAL OF COVERED CLASS ACTIONS.--Any covered class action brought in an State court

> involving a covered security, as set forth in paragraph (1), shall be removable to the Federal district court for the district in which the action is pending, and shall be subject to paragraph (1).

15 U.S.C. § 78bb(f)(1)(A),(B) & (2). Thus SLUSA authorizes the removal of all private actions that are actually traditional securities claims that fall within its ambit to be removable to federal court and makes the state law claims subject to dismissal. 15 U.S.C. § 78bb(f)(1)-(2). Korsinsky, No. 01 6085(SWK), 2002 WL 27775 at *3; Hardy v. Merrill Lunch, No. 01 Civ. 5973(NRB), 2001 WL 1524471, *2 (S.D.N.Y. Nov. 30, 2001).

To defeat a motion to remand for improper removal under SLUSA, Defendants must show that (1) the action is a "covered class action" under SLUSA; (2) that the causes of action on their face are based on state statutory or common law; (3) that it involves a "covered security" under SLUSA; (4) that it alleges Defendants have misrepresented or omitted material facts; and (5) that the alleged misrepresentation or omission was made "in connection with" the purchase or sale of the covered security. Korsinsky, 2002 WL 27775, *3; Hardy, 2001 WL 1524471 at *3.

Application of the Law Here

It is not disputed here Enron Corporation common stock is a covered security because its shares are listed on the New York Stock Exchange. 15 U.S.C. § 77r(b)(1)(A). This action is a "covered class action" because it is brought on behalf of plaintiffs and all similarly situated shareholders "who own, or owned, Enron stock since January 1, 1997 and have suffered a

decline in value of the stock because of the actions of the Defendants," a group which clearly encompasses more than fifty people, and regarding which the Second Amended Petition states that there are common questions of law and fact that predominate over issues affecting only individual members of the proposed class. Plaintiffs' Second Amended Petition at 4-5. 15 U.S.C. § 77p(f)(2)(A)(i)(II), § 78bb(f)(5)(B)(i)(II). Furthermore, it alleges that Defendants "falsely represented" the accounting transactions and lack of conformity with GAAP and illegality involving entities including LJM2, LJM-C, and Chewco to Enron shareholders.

Although Plaintiffs' pleading does not identify the exact time(s) of the alleged misrepresentations and omissions, Paragraph 26 of the Second Amended Petition states, "The facts alleged in this petition occurred since January 1997."

The only issue here is whether these alleged misrepresentations and omissions were made "in connection with" the purchase or sale of Plaintiffs' Enron stock so that the removal under SLUSA was proper.

Defendants' Opposition

As noted, Plaintiffs contend they do not bring claims for the purchase or sale of covered securities, but only to recover for a reduction in the value of the stock that the putative class held onto during the relevant period.

Urging denial of the motion to remand, Defendants characterize Plaintiffs' "attempt to assert 'holding claims' on behalf of purchasers and sellers" is "a transparent attempt to evade SLUSA, which, if successful, would eviscerate the statute." Defs.' Memorandum of Law in Opposition at 2. Defendants maintain that the petition is "broadly framed to include the claims of purchasers and sellers of Enron stock." Paragraph 16 of the Second Amended Petition states,

> Coy and Mounter bring suit on behalf of all other shareholders (both individuals and entities) who were and are shareholders of Enron at the time of the acts of Andersen described herein, and who were damaged by the misrepresentations of Andersen and the reduction in value of their Enron stock arising from the acts of Andersen. The class is fully defined in paragraph number twenty-seven.

Paragraph 27 of the Second Amended Petition "fully defines" the purported class as "[a]ll shareholders who own, or owned, Enron stock since January 1, 1997, and have suffered a decline in the value of the stock because of the actions of Andersen." Plaintiffs also assert that Andersen Defendants made misrepresentations about Enron accounting on which Plaintiffs relied, but they do not identify what actions Plaintiffs took in that reliance.

Defendants contend that the class of all persons who "own, or owned, Enron shares since January 1, 1997" is not restricted to persons who bought Enron stock before the class period and have held it since then, but also shareholders who purchased and/or sold shares during the class period.

Specifically, all shareholders who bought shares since January 1, 1997, regardless of whether they still own them, are included in the class of persons who have "owned" shares since that date. Second, all shareholders who today own shares also fall within the class definition even if they purchased shares during the class period. Third, Defendants insist that Plaintiffs' inclusion within the proposed class of all persons who "owned" Enron stock but no longer own it today reflects Plaintiffs' intent to bring claims on behalf of persons who sold shares during the class period.

In support of their opposition to remand, Defendants cite Hardy, 2001 WL 1524471 at *3, in which the plaintiffs moved for remand on the ground that their claim did not relate to the purchase or sale of Internet Capital stock, but only their decision to hold the stock. The court rejected that argument and concluded that the plaintiffs failed "to distinguish between customers who purchased before and after" Merrill Lynch's alleged misrepresentations. Id. at *4. Since the proposed class included persons with claims who traded Internet Capital shares during the class period, i.e., persons who "purchased stock in reliance on the alleged misstatement . . . in connection with the purchase or sale of a security. . . ," the court denied the remand motion and dismissed the case. Id.

Defendants also distinguish Plaintiffs' authority Gutierrez, 147 F. Supp.2d 584, from the instant action. In Gutierrez, the state court class action against Deloitte & Touche

for malpractice in auditing issuers of securities held by the investor plaintiffs was removed and plaintiffs filed a motion to remand. The controlling pleading asserted claims for three subclasses, two of which did not hold "covered" securities within the definition of SLUSA. The third subclass was defined as "[a]ll persons or entities that held any 'covered security as that term is defined in [the PSLRA] at all relevant times through 1993 through present and did not sell or otherwise dispose of said products prior to June 1999 . . . .(Emphasis added)." Thus it was expressly limited to damages caused by the holding of the covered securities. Id. at 592. Such is not the case here, Defendants have argued.

Court's Decision

Perhaps contrary to Plaintiffs' intent to restrict their class, this Court agrees with Defendants that the ambiguous loose construction and language of the class definition can be read to include not only shareholders who purchased their stock before or on January 1, 1997 and still own it, but persons who bought and "owned" the stock since Janaury 1, 1997, and others in both these categories who sold it after the alleged misrepresentations.

This Court finds that more about the Hardy case, 2000 WL 1524471, cited by Defendants needs to be examined and considered. Filing in state court in New York, the plaintiffs in that suit alleged that Merrill Lynch, which managed the initial public offering for the stock and began trading on August 5, 1999, on

August 30, 1999 gave the stock a rating of "Near-Term Accumulate/Long-Term Buy," which Merrill Lynch subsequently did not change. The stock issued at $6 per share and continued to appreciate until it reached $200 per share on January 3, 2000, even though Internet Capital had not yet made a profit and Merrill Lynch was aware of its precarious financial status. According to Hardy's pleadings, Merrill Lynch underwrote additional debt and equity offerings for Internet Capital stock in December 1999. The stock prices dropped in 2000 and the company began running short of money. Hardy alleged that Merrill Lynch breached its fiduciary duty to its brokerage customers by continuing positive recommendations of Internet Capital to obtain further underwriting business for itself at the expense of the stockholders when Merrill Lynch knew that Internet Capital was facing serious financial difficulties. Only on November 9, 2000, when the stock was trading at $10 per share, did Merrill Lynch only slightly lower its rating to "Near-Term Accumulate/Long-Term Accumulate." Hardy filed his class action suit in state court on June 22, 2001 when the price had dropped to $2 per share, but when Merrill Lynch continued with the same positive rating. Hardy defined the class as persons that purchased shares of Internet Capital between August 5, 1999, the day after the initial offering, and the date the complaint was filed.

The case was removed to the federal district court for the Southern District of New York under SLUSA, 15 U.S.C. § 77(p)(c) and § 78bb(f)(2), and 18 U.S.C. § 1331 and § 1441.

Plaintiffs filed a motion to remand, and the defendants filed a motion to dismiss the suit under SLUSA.

The district court, noting that SLUSA does not define the term "in connection with the purchase or sale" of a covered security, divided the shareholders of the potential class into three groups. 2001 WL 1524471 at *4. For those who only held onto their stock, the Hardy court followed those courts that have held that state law claims of misrepresentation or omission that induce a plaintiff to refrain from selling their stock (see footnote 1 of this Memorandum and Order) do not raise federal securities issues, can only be asserted under common law, and thus do not fall within the ambit of SLUSA and cannot properly be removed from state court. Id. The second group contained all persons who purchased their stock after August 30, 1999 and before the date on which Merrill Lynch's stock recommendation purportedly became a misrepresentation of the company's financial condition and who continued to hold onto the stock after that recommendation proved incorrect. Id. at *5. The court concluded that this group also could raise only state-law claims that could not be removed under SLUSA. The court categorized as a third group all persons who bought their shares after the date that Merrill Lynch's recommendation allegedly misrepresented the company's condition and concluded that these shareholders did raise a federal securities claim that is subject to removal and dismissal under SLUSA because they purchased their shares in reliance on an alleged misrepresentation. Id.

The Hardy court found that the complaint made no attempt differentiate among these three groups of shareholders nor to identify and separate the claims of any that could have purchased shares in reliance on Merrill Lynch's recommendations. Nor did it indicate whether Hardy, the named plaintiff and prospective class representative, had a viable state-law claim not subject to removal under SLUSA. Id. at *5. The court saw it had three options to resolve the issue of remand: (1) divide the prospective class in two and remand one (containing the first two groups) to state court and dismiss the other under SLUSA; (2) remand the entire case to state court for a determination of which class members have properly brought state law claims and which implicated federal securities laws and are therefore removable under SLUSA; or (3) deny the motion to remand and dismiss the complaint under SLUSA and allow the plaintiffs to bring a new complaint, expressly limited to those class members who true state law claims. Id. The court chose the third avenue because it decided that it had insufficient information to identify which prospective class members had viable state law claims and because remanding it for the state court to make that determination would undermine Congressional intent in passing SLUSA to prevent securities claims from being brought in state court. Id. The court denied the motion to remand and granted defendants' motion to dismiss without prejudice. Id. at *2, 5.

While the case law relating to removal and dismissal under SLUSA is limited, it appears to this Court that a dismissal

with prejudice of claims within its ambit is in keeping with the language of 15 U.S.C. § 78bb(f) ("No covered class action based upon the statutory or common law of any state or subdivision thereof may be maintained in any State or Federal court by any private party . . . ."). This Court further observes that the Hardy court's solution does not necessarily avoid that pitfall of having all the claims refiled in state court. A number of courts have dismissed state-law securities claims under SLUSA with prejudice. See, e.g., Gilmore v. MONY Life Ins. Co. of America, 165 F. Supp.2d 1276 (M.D. Ala. 2001); Riley v. Merrill Lynch, 168 F. Supp.2d 1352 (M.D. Fla. 2001); Hines v. ESC Strategic Funds, Inc., No. 3:99-0530, 1999 WL 1705503, *5 (M.D. Ten. 1999); In re Livent, Inc. Noteholders Securities Litigation, 151 F. Supp.2d 371 (S.D.N.Y. 2001).

Since this Court finds that the inclusive language of the class definition, of all persons who "own, or owned, Enron shares since January 1, 1997" does encompass class members who purchased their stock on or before that date and sold it or class members who purchased Enron stock since that date in reliance on Merrill Lynch's allegedly misleading recommendations, it concludes that those claims fall within the ambit of SLUSA and should be dismissed with prejudice.

As to those claims that do not fall in this group and over which the Court has no federal question jurisdiction, it may exercise supplemental jurisdiction under 28 U.S.C. § 1367 over them because these state law claims "are so related to [the

properly removed claims over which the court has] original jurisdiction that they form part of the same case or controversy under Article III of the United States Constitution." 28 U.S.C. § 1367(a). While this Court is permitted to "decline to exercise supplemental jurisdiction" and "remand all matters in which state law predominates" after removal and dismissal of the federal claims, it is not required to do so. 28 U.S.C. § 1367(c); 28 U.S.C. § 1441(c). The Court finds that in this case the federal and state claims are not truly separate and distinct, but involve the same case or controversy over those in the consolidated class action. Indeed, all related Enron cases currently consolidated before this Court basically allege a fraudulent scheme by Enron, aided by Arthur Andersen L.L.P., with claims based on the same conduct, arising from the same nucleus of operative fact, resulting in a strong nexus between federal and state claims that supports federal jurisdiction here. Furthermore, especially here, in view of the common issues and the unavoidable overlapping discovery of millions of documents and depositions of numerous key witnesses,

> [r]emanding the state law claims could lead to unwieldy problems regarding the coordination of discovery between the federal and state cases, possibly even troublesome problems regarding differing rules on what is and is not discoverable. Given the inevitability of conflict during discovery, the Court sees absolutely no reason why these problems should only be magnified by splitting the resolution of this case.

See generally In re Lutheran Brotherhood Variable Insurance Products Co. Sales Practices Litigation, 105 F. Supp.2d 1036,

1042, 1044 (D. Minn. 2000). Finally, the Court finds that these claims "should remain in federal court to insure that state-law claims which are preempted by SLUSA do not creep back into the lawsuit." Green, 120 F. Supp.2d at 802.

Accordingly, for the reasons delineated above, the Court

ORDERS that Plaintiffs' claims relating to stockholders who purchased or sold their Enron stock during the class period in reliance on Merrill Lynch's recommendations are DISMISSED with prejudice under SLUSA. The Court further

ORDERS that all remaining state law claims shall remain pending before it pursuant to 28 U.S.C. § 1367. In addition, because this action should have been consolidated with Newby rather than Pirelli, the Court

ORDERS that the order consolidating H-01-4248 with H-01-3645 is VACATED and H-01-4248 is hereby CONSOLIDATED with H-01-3624, Newby et al. v. Enron Corp., et al. Finally the Court

ORDERS that for reasons of judicial economy and the orderly progress of discovery and pretrial proceedings, Plaintiffs' objection to consolidation is OVERRULED.

SIGNED at Houston, Texas, this 4th day of February, 2002.

MELINDA HARMON
UNITED STATES DISTRICT JUDGE