

uncertain, and thorny issue.¹¹⁴ The Court addresses the developing doctrine.

"State law" is broadly defined by ERISA as including "all laws, decisions, rule, regulations, or other State action having the effect of law." 29 U.S.C. § 1144(c)(1).

There are two conceptually distinct doctrines of preemption of state law under ERISA: (1) "ordinary" preemption (also called "express" or "conflict" preemption) under § 514, 29 U.S.C. § 1144(a), which occurs when a state law that conflicts with federal law is the basis of the petition, and preemption is asserted as an affirmative defense to the complaint; and (2) "complete" preemption under § 502(a), 39 U.S.C. § 1132(a), the civil enforcement section (constituting the exclusive remedy for rights guaranteed under ERISA, discussed earlier under the "Standing and Remedies Under ERISA" section in this memorandum and order). Both ordinary and complete preemption result in the displacement of state law by federal law, but only complete preemption under § 502(a) provides removal jurisdiction. *Haynes v. Prudential Health Care*, 313 F.3d 330, 333-34 (5th Cir. 2002). In other words, only state law

¹¹⁴ See, e.g., *Rush Prudential HMO, Inc. v. Moran*, 536 U.S. 355, ___, 122 S.Ct. 2151, 2158 (2002) ("The 'unhelpful' drafting of [the express preemption provisions under § 514] occupies a substantial share of this Court's time."); *California Division of Labor Standards v. Dillingham*, 519 U.S. 316, 335 (1997) (Justice Scalia noted that despite fourteen attempts by the Supreme Court to resolve preemption issues in cases since the 1974 enactment of ERISA, "our prior decisions have not succeeded in bringing clarity to the law"); *Carpenters Local Union No. 26 v. U.S. Fid. & Guar. Co.*, 215 F.3d 136, 139 (1st Cir. 2000) (the Supreme Court has "been at least mildly schizophrenic in mapping [the] contours" of ERISA's preemption phrase, 'relate to any employee benefit plan.'").

claims that duplicate or seek relief falling within the scope of ERISA's § 502(a) are completely preempted. *Metropolitan Life Ins. Co. v. Taylor*, 481 U.S. 58, 64-66 (1987); *Roark v. Humana, Inc.*, 307 F.3d 298, 305 (5th Cir. 2002), *petition for cert. filed*, 71 U.S.L.W. 3791 (June 20, 2003) (No. 02-1845). The Court examines the preemption issue in greater detail below.

Of the two types of ordinary preemption, express preemption occurs by express statutory term, as reflected in § 514(a) of ERISA. *Heimann v. National Elevator Industry Pension Fund*, 187 F.3d 494, 500 (5th Cir. 1999). "Conflict preemption," on the other hand, occurs (1) when there is a direct conflict between the operation of federal and state law so that it is impossible to comply with both, or (2) when the state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress" in the federal statute. *Boggs v. Boggs*, 520 U.S. 833, 844 (1997); *Crosby v. Nat'l Foreign Trade Council*, 530 U.S. 363, 372-73 (2000); *Id.*

Ordinary preemption falls under § 514(a) of ERISA, 29 U.S.C. § 1144(a) (" . . . [T]his provision . . . of this chapter shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan . . . "), and preempts such laws unless that state law asserted "regulates insurance" under the savings clause in § 514(b) ("nothing in this title shall be construed to exempt or relieve any person from any law of any State which regulates insurance, banking or securities").¹¹⁵ *McClelland*

¹¹⁵ See, e.g., *Pilot Life Ins. Co. v. Dedeaux*, 481 U.S. 41, 47, 52-54 (1987); *Christopher v. Mobil Oil Corp.*, 950 F.2d

v. *Gronwaldt*, 155 F.3d 507, 517 (5th Cir. 1998), *overruled on other grounds*, *Arana v. Ochsner Health Plan*, ___ F.3d ___, ___, No. 01-30922, 2003 WL 21554491 (5th Cir. July 10, 2003)¹¹⁶; *Haynes*, 313 F.3d at 334.

Traditionally, under the "well pleaded complaint rule," the plaintiff is the master of his complaint, may choose whether to bring his claim under state or federal law, and must assert a federal cause of action on the face of a complaint before a defendant may remove the case from state court on federal question jurisdiction grounds. *Louisville & Nashville Ry. Co. v. Mottley*, 211 U.S. 149 (1908). "The presence of a federal question . . . in a defensive argument does not overcome" the well pleaded complaint rule. *Caterpillar Inc. v. Williams*, 482 U.S. 386, 398-99 (1987) (emphasis added). Thus "ordinary" federal preemption, which occurs where a federal law claim serves only as an affirmative defense, does not appear on the face of the complaint, and does not provide federal question jurisdiction for purposes of removal. *Franchise Tax Bd. of State of Cal. v. Construction Laborers Vacation Trust for Southern Cal.*, 463 U.S. 1, 9-12, 25-27 (1983).

Ordinary preemption under § 514(a), in contrast to the jurisdictional scope of complete preemption, "governs the law that will apply to state law claims, regardless of whether the case is

1209, 1217 (5th Cir. 1992), *cert. denied*, 506 U.S. 820 (1992).

¹¹⁶ The Fifth Circuit has recently overruled its previous holding that both kinds of preemption were required for removal to federal court, and now requires only complete preemption under § 502(a). *Arana v. Ochsner Health Plan*, ___ F.3d ___, ___, No. 01-30922, 2003 WL 21554491, *4-5 and n.11 (5th Cir. July 10, 2003).

brought in state or federal court." *Haynes*, 313 F.3d at 334. Thus if the case is brought in state court, without a basis for federal jurisdiction, ERISA would preempt or extinguish the state law claims, but the case would remain in state court.

An exception to the well pleaded rule occurs where Congress intends that a federal statute have "extraordinary preemptive power" and so "completely preempts" a particular field of law that "a state common law complaint [is converted] into one stating a federal claim for purposes of the well-pleaded complaint rule." *Metropolitan Life Ins. Co. v. Taylor*, 481 U.S. 58, 63 (1987); see also *Rivet v. Regions Bank of Louisiana*, 522 U.S. 470, 475 (1998); *McClelland v. Gronwaldt*, 155 F.3d at 516-17 (complete preemption not only displaces substantive state law, but also 'recharacterizes' preempted state law as 'arising under' federal law for the purposes of determining federal question jurisdiction, typically making removal available to the defendant. Thus 'complete preemption' is less a principle of substantive preemption than it is a rule of federal jurisdiction. In other words, complete preemption principally determines not whether state or federal law governs a particular claim, but rather whether that claim will, irrespective of how it is characterized by the complainant, be treated as 'arising under' federal law."). "Complete preemption" is sometimes called "implied preemption" or "field preemption." See, e.g., *Orson, Inc. v. Miramax Film Corp.*, 189 F.3d 377, 380-81 (3d Cir. 1999), *cert. denied*, 529 U.S. 1012 (2000).

The civil enforcement cause of action, § 502(a), 29 U.S.C. § 1132(a), constitutes the complete preemption provision under

ERISA; it "functions as an exception to the well-pleaded complaint rule" and "completely preempts any state cause of action seeking the same relief, regardless of how artfully pleaded as a state action." *Haynes*, 313 F.3d at 334 (citations omitted). Whether a state-law claim is subject to complete preemption by ERISA is determined by whether it falls within the scope of the civil enforcement provision of § 502(a). *McClelland*, 155 F.3d at 517 & nn.30 & 31. The Fifth Circuit has succinctly restated the rule for complete preemption: "States may not duplicate the causes of action listed in ERISA § 502(a)." *Roark v. Humana, Inc.*, 307 F.3d at 310-11.

The complete preemption doctrine is something of a misnomer because it does not completely preempt all state-law claims; only where a state law claim is found to fall "within the scope" of a statute's preemption provision is it considered to be converted to a federal cause of action. *Metropolitan Life*, 481 U.S. at 64-66. In *Metropolitan Life* the Supreme Court examined the language and structure of ERISA and the legislative history to conclude that the statute completely preempted state law contract and tort claims because the plaintiff's claim for benefits was within the scope of § 502(a)(1)(B), 29 U.S.C. § 1132(a), and that the "ultimate touchstone" guiding that determination is Congressional intent. *Id.* at 65-66. The Fifth Circuit interprets the scope of complete preemption as encompassing the whole § 502(a) provision, even though it acknowledges there is some uncertainty about whether its scope is limited to claims falling within § 502(a)(1)(B), which was the only section at issue in *Metropolitan Life*. *McClelland*, 155 F.3d at 517 n.34.

It is important to note that a federal remedy need not be available under the federal statute for federal preemption of a state law cause of action. *Lister v. Stark*, 890 F.2d 941, 946 (7th Cir. 1989), *cert. denied*, 498 U.S. 1011 (1990). *See, e.g., Pilot Life*, 481 U.S. at 54 ("The policy choices reflected in the inclusion of certain remedies and the exclusion of others under the federal scheme would be completely undermined if ERISA-plan participants and beneficiaries were free to obtain remedies under state law that Congress rejected in ERISA."); *Agrawal v. Paul Revere Life Ins. Co.*, 205 F.3d 297, 302 (6th Cir. 2000) ("As a general rule, the absence of a remedy under ERISA does not mean that state-law remedies are preserved."); *Hubbard v. Blue Cross & Blue Shield Ass'n*, 42 F.3d 942 (5th Cir. 1995) (summary judgment appropriate where preempted claim had no remedy under the statute), *cert. denied*, 515 U.S. 1122 (1995).¹¹⁷ See also *Caterpillar*, 482 U.S. at 391 n.4 (*rejecting* Court of Appeals' holding that "a case may not be removed on the ground that it is completely pre-empted unless federal cause of action relied upon provides the plaintiff with a remedy.").

After the enactment of ERISA, the Supreme Court initially read the ordinary preemption clause very broadly. It found that Congress intentionally drafted the provisions of ERISA to be expansive and to "establish pension plan regulation as exclusively

¹¹⁷ This Court notes that the Fifth Circuit has made an exception under ERISA, not applicable here, to the general rule that availability of a remedy under federal law is not a prerequisite where a claim is brought under ERISA by a third-party health care provider that has provided medical services to a plan participant. *Memorial Hospital Sys. v. Northbrook Life Ins. Co.*, 904 F.3d 236, 248 & n.16 (1990).

a federal concern." *Alessi v. Raybestos-Manhattan, Inc.*, 451 U.S. 504, 523 (1981). See also *FMC Corp. v. Halliday*, 498 U.S. 52, 58 (1990) ("[T]he ERISA preemption clause is conspicuous for its breadth. It establishes as an area of exclusive federal concern the subject of every state law that relates to an employee benefit plan governed by ERISA."). Thus the phrase, "relate to" in § 514(a) was construed in its "broad" common-sense meaning as "hav[ing] a connection with or reference to such plan" and as not limited to "state laws specifically designed to affect employee benefit plans." *Metropolitan Life Ins. Co. v. Massachusetts*, 471 U.S. 724, 739 (1985); *Shaw v. Delta Airlines, Inc.*, 463 U.S. 85, 98 (1983); *Reliable Home Health Care, Inc. v. Union Central Ins. Co.*, 295 F.3d 505, 515 (5th Cir. 2002). Courts have also held that state law causes of action were preempted by 29 U.S.C. § 1144(a) when two elements are present: 1) the state laws "address an area of exclusive federal concern, such as the right to receive benefits under the terms of an ERISA plan; and 2) the claims directly affect the relationship [among] the traditional ERISA entities--the employer, the plan and its fiduciaries, and the participants and beneficiaries." *Hollis v. Provident Life and Acc. Ins. Co.*, 259 F.3d 410, 414 (5th Cir. 2002); 29 C.F.R. § 2510.3-3(b) (2001); *Memorial Hosp. Sys. v. Northbrook Life Ins. Co.*, 904 F.2d 236, 245 (5th Cir. 1990).

In recent years the Supreme Court has shown greater deference to state law in finding its early definition of "relates to" overly inclusive and in narrowing the scope of and establishing a stricter standard for ERISA's § 514(a) preemption. See, e.g.,

Arizona Carpenters, 125 F.3d at 723 ("[T]he 'relates to' test may lead to an overly expansive view of preemption."), citing *New York State Conference of Blue Cross and Blue Shield Plans v. Travelers Ins. Co.*, 514 U.S. 645 (1995).¹¹⁸ Noting that even if the state law does not "refer to" ERISA plans, it may still be preempted if it has a "connection with" such plans, the Supreme Court realized that "an uncritical literalism" in applying the standard of a "connection with" ERISA plans was not very useful in determining Congress' intent regarding the scope of preemption under § 514(a). *Travelers*, 514 U.S. at 656. Acknowledging ERISA's "unhelpful text and the frustrating difficulty of defining its key terms," the Supreme Court began focusing instead on the "federal interest in uniformity" and the objectives of the statute "as a guide to the scope of the state law that Congress understood would survive." *Bullock v. Equitable Life Ass. Soc. Of U.S.*, 259 F.3d 395, 399 and nn. 10 & 11 (5th Cir. 2001), quoting *inter alia De Buono v. NYSA-ILA Med. & Clinical Servs. Fund*, 520 U.S. 806, 813-15 (1997). ERISA's primary objectives are to "protect . . . the interests of participants . . . and their beneficiaries, by requiring the disclosure and reporting . . . of financial and other information . . . by establishing

¹¹⁸ In *Travelers*, the Supreme Court noted that the literal language of § 514(a) is "clearly expansive," but emphasized that the text could not be read to "extend to the furthest stretch of its indeterminacy, [or] for all practical purposes preemption would never run its course for '[r]eally, universally, relations stop nowhere' . . . [citations omitted]." 514 U.S. at 655. See also *California Div. of Labor Standards v. Dillingham*, 519 U.S. 316, 335 (1997) (Scalia, J., joined by Ginsberg, J., concurring) ("[A]pplying the 'relate to' provision according to its terms was a project doomed to failure, since, as many a curbstome philosopher has observed, everything is related to everything else.").

standards of conduct, responsibility, and obligation for fiduciaries of employee benefit plans, . . . providing for appropriate remedies, sanctions, and ready access to the Federal courts, and by improving the equitable character and soundness of such plans by requiring them to vest the accrued benefits of employees with significant periods of service, to meet minimum standards of funding, and requiring plan termination insurance." 29 U.S.C. § 1001(b) and (c). In *California Labor Standards*, the Supreme Court added that the objectives of ERISA should be used to consider the "nature of the effect of the state law on ERISA plans." 519 U.S. at 325. Moreover, Congressional intent focused on the need for uniformity of law regulating ERISA employee benefit plans

to ensure that plans and plan sponsors would be subject to a uniform body of benefits law; the goal was to minimize the administrative and financial burden of complying with conflicting directives among States or between States and the Federal Government . . . , [and to prevent] the potential for conflict in substantive law . . . requiring the tailoring of plans and employer conduct to the peculiarities of the law of each jurisdiction.

Travelers Ins. Co., 514 U.S. at 656-57, quoting *Ingersoll-Rand Co. v. McClendon*, 498 U.S. 133, 142 (1990).

As previously discussed, in *Shaw* the Supreme Court defined § 514(a)'s "relates to" an employee benefit plan as "hav[ing] a connection with or reference to" such a plan. 463 U.S. at 96-97. The Supreme Court subsequently has attempted to refine and to limit the meaning of the phrase, "reference to."

In *Mackey v. Lanier Collection Agency & Service, Inc.*, 486 U.S. 825 (1988), a collection agency obtained money judgments

against some participants in an ERISA employee welfare benefit plan. The Supreme Court, reviewing two Georgia statutes, found there was no preemption by ERISA of a state garnishment statute of general applicability that was applied to collect the judgments against ERISA plan fiduciaries even though it might burden the administration of that plan. It reached this determination on the grounds that Congress did not intend ERISA to forbid garnishment of welfare benefit plans and because the statute made no reference to ERISA plans, did not require that a plan be established or maintained, and did not regulate the terms or conditions of the plan. In contrast the Supreme Court found that another statute that expressly singled out ERISA plans for protective treatment was preempted by § 514(a), i.e., because it was "related" by express reference to ERISA plans and was specifically designed to affect ERISA plans. Furthermore the preemption occurred even though the statute might have been enacted to effect ERISA's underlying objectives, because § 514(a) "'displaces all state laws that fall within its sphere, even including those that are consistent with ERISA's substantive requirements.'" *Id.* at 829, quoting *Metropolitan Life*, 471 U.S. at 739.

While most of the cases dealing with the more restrictive preemption analysis concern statutes, in *Ingersoll-Rand Co. v. McClendon*, 498 U.S. 133 (1990), the Supreme Court addressed a wrongful discharge claim brought under state tort and contract theories and seeking compensatory and punitive damages. In that action the plaintiff-employee alleged that his employer wrongfully discharged him, mainly to avoid having to contribute to and pay him

benefits under his ERISA pension fund plan. When the litigation had earlier reached the Texas Supreme Court, the state high court had recognized that an at-will employee can state a cause of action for wrongful discharge where the alleged motive was contrary to public policy, in this instance that the employee was fired by the employer to deprive the employee of pension benefits. *McClendon v. Ingersoll-Rand Co.*, 779 S.W.2d 69, 70-71 (Tex. 1989), *rev'd*, 498 U.S. 133 (1990).

On final appeal, the United States Supreme Court focused on Congressional intent behind ERISA by examining ERISA's language, structure, and purposes to determine if the common law claim was preempted. *McClendon*, 498 U.S. at 137-38. The Supreme Court held that there was express preemption by ERISA, under the language of § 514(a), of the common-law wrongful discharge claim, because the plaintiff had pleaded and the trial court ultimately found (1) as "the critical factor," the existence of an ERISA pension plan, and (2) a "pension-defeating motive" for the termination of plaintiff's employment, which thus "relates to" that plan. *Id.* at 139-40. The Court also emphasized that to allow state-law suits such as this wrongful discharge action to go forward would impose burdensome administrative and financial costs of complying with differing requirements among states or between a state and the federal government and potential conflicts in substantive law contrary to the purposes of § 514(a). *Id.* at 142. Moreover, the Supreme Court concluded that there was also conflict preemption in *McClendon* because the state common-law claim conflicts with ERISA § 510, 29 U.S.C. § 1140, which prohibits interference with rights provided to

plan participants by the statute, including the termination of any plan participant in order to interfere with his attainment of any right . . . under the plan," in combination with the limitations of the civil enforcement provision in § 502(a) with its explicit exclusive federal court jurisdiction and remedy for violation of participants' rights guaranteed by ERISA. *Id.* at 142-44.¹¹⁹ The high court emphasized, "[T]he mere existence of a federal regulatory or enforcement scheme" by itself was not sufficient to imply preemption; the added "special feature" was § 514(a)'s exclusive jurisdiction and remedies for participants deprived of their rights under ERISA, which warranted preemption, even when state law authorized a remedy not available under ERISA. *Id.* at 143-44.

In *Travelers Ins. Co.*, the Supreme Court determined that a state statute that mandated surcharges on hospital rates for patients with commercial health plans, but not for patients from some HMOs, had too indirect an economic effect on the ERISA plan to "relate to" the plan. *Travelers Ins. Co.*, 514 U.S. at 668. The high court approached the issue of preemption with the "starting presumption that Congress [did] not intend to supplant state law . . . in fields of traditional state regulation." *Id.* at 654-55. Moreover although the "relate to" language appears to be broad, the

¹¹⁹ For another case alleging wrongful denial of benefits to an ERISA plan beneficiary where a statute was not at issue and the existence of an ERISA plan was essential to finding preemption, see *Pilot Life*, 481 U.S. at 48 (holding that state common-law tort and contract actions were preempted under § 514(a) because they were based on "alleged improper processing of a claim for benefits under an insured employee benefit plan").

Supreme Court acknowledged that an expansive approach to it would "read the presumption against pre-emption out of the law." *Id.* at 655. In addition, the high court "recognized that an 'uncritical literalism' in applying [the "connection with"] standard offered scant utility in determining Congress' intent as to the extent of § 514(a)'s reach." *Id.* at 656, cited by *California Division of Labor*, 519 U.S. at 325, another key case reflecting the shift in ERISA preemption jurisprudence.

The Supreme Court decided that to define what was a "forbidden connection" under § 514(a), it should examine "'the objectives of the ERISA statute as a guide to the scope of the state law that Congress understood would survive'" and to the "'nature of the effect of the state law on ERISA plans.'" *California Division of Labor*, 519 U.S. at 325, citing *Travelers*, 514 U.S. at 656, 658-59. Furthermore, where "'federal law is said to bar state action in fields of traditional state regulation,'" the Supreme Court has approached the issue with the "'assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress.'" *California Division of Labor*, 519 U.S. at 325, citing *Travelers*, 514 U.S. at 655. Nevertheless because "[t]he basic thrust of the ["relates to"] pre-emption clause was [a] nationally uniform administration of employee benefit plans," the high court has also concluded that ERISA "pre-empts state laws that mandated employee benefit structures or their administration" and "all state laws providing alternative enforcement mechanisms" because such

requirements constituted "connections with" ERISA plans. *California Division of Labor*, 519 U.S. at 328; *Travelers*, 514 U.S. at 657-58.

In *California Division of Labor*, 519 U.S. at 325, the Supreme Court examined both the objectives of ERISA and the nature of the effect of a California prevailing wage statute on ERISA plans and stated that where a state law "acts immediately or exclusively upon ERISA plans . . . or where the existence of ERISA plans is essential to the law's operation," the "'reference' will result in preemption" of the state law. *Id.* at 325. The Court highlighted its established approach that where "federal law is said to bar state action in fields of traditional state regulation, . . . we have worked on the 'assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress [citations omitted].'" *Id.* It then observed that "apprenticeship standards and the wages paid on state public works have long been regulated by the States," while they were also "quite remote from areas with which ERISA is expressly concerned--"'reporting, disclosure, fiduciary responsibility and the like.'" *Id.* at 330, quoting *Travelers*, 514 U.S. at 661. The Supreme Court in *California Division of Laborers* found that California's prevailing wage law and the regulations promulgated pursuant to it did not make "reference to" ERISA plans, nor did they have a "connection with" the ERISA plans at issue, and therefore the wage law was not preempted.

In contrast, the Court has concluded that denial of benefits "is an area of core ERISA concern." *Egelhoff v. Egelhoff*, 532 U.S. 141, 147 (state statute requiring plan administrators to

pay beneficiaries chosen by state law rather than those identified in plan documents, as required by ERISA, "implicates as area of core ERISA concern"). See also *Rush Prudential*, 122 S. Ct. at 2166 ("Congress ha[s] so completely preempted the field of benefits law that an ostensibly state cause of action for benefits was necessarily a 'creature of federal law' removable to federal court.").

The high court has also recognized that even where there may be a reference to an employee benefit plan, a narrow exception to the federal preemption doctrine under ERISA exists for state law claims that only tenuously, remotely or peripherally relate to an ERISA plan. *Bullock*, 259 F.3d at 399, citing *Shaw*, 463 U.S. at 100 n.21. See, e.g., *Mackey v. Lanier Collection Agency & Service*, 486 U.S. 825, 833 (1988) (ERISA does not preempt "run-of-the-mill state-law claims such as unpaid rent, failure to pay creditors, or even torts committed by an ERISA plan," even though such claims "obviously affect[] and involv[e] ERISA plans and their trustees").

The Ninth Circuit summarizes that the United States Supreme Court has concluded that Congress intended to preempt state law claims in at least three areas: (1) state laws that control employee benefit structures or their administration; (2) state laws tying employers or plan administrators to particular choices or barring uniform administrative practice so as to regulate the plan; and (3) state laws that establish alternative enforcement mechanisms for a participant or beneficiary to obtain ERISA plan benefits. *Arizona Carpenters*, 125 F.3d at 723, citing *Travelers*, 514 U.S. at 655-61, and *Coyne & Delany Co. v. Selman*, 98 F.3d 1457, 1468 (4th

Cir. 1996). In light of these determinations, the Ninth Circuit has held "that where state law claims fall outside the three areas of concern established in *Travelers*, arise from state laws of general application, do not depend upon ERISA, and do not affect the relationships between the principal ERISA participants[,] the state law claims are not preempted." *Arizona Carpenters*, 125 F.3d at 724.

The Fifth Circuit has previously concluded that § 514(a) preempts state-law civil conspiracy claims that involve misuse of an ERISA plan's assets. See, e.g., *McDonald v. Provident Indemnity Life Ins. Co.*, 60 F.3d 234, 237 (5th Cir. 1995), cert. denied, 516 U.S. 1174 (1996). It has also determined that a state-law cause of action relating directly to the operation of an ERISA employee benefit plan is preempted even if it arises under a law of general application that has no connection to employee benefit plans. *Christopher v. Mobil Oil Corp.*, 950 F.2d 1209, 1218-19 (5th Cir. 1992), cert. denied, 506 U.S. 820 (1992). To determine whether there is preemption, a court must consider whether "the underlying conduct" that forms the basis of the claim could "be divorced from its connection to the employee benefit plan." *Id.* at 1220.

Moreover, any state law that does relate to an ERISA plan and that "provides a form of ultimate relief in a judicial forum that add[s] to the judicial remedies provided by ERISA . . . patently violates ERISA's policy of inducing employers to offer benefits by assuring a predictable set of liabilities, under uniform standards of primary conduct and a uniform regime of ultimate remedial orders and awards when a violation has occurred." *Rush Prudential HMO v. Moran*, 536 U.S. 355, 379 (2002). As noted, even

if ERISA provides only a limited remedy or even no remedy at all to a plaintiff whose state law claim is preempted, preemption may still occur. *Pilot Life*, 481 U.S. 41.

b. The Securities Litigation Uniform Standards Act of 1998 (SLUSA)

If those Tittle Plaintiffs who have standing under the federal securities statutes (and many do not, as will be explained) were to recharacterize and bring their claims under those statutes, or if they were to join the Newby class, or if they were to file their class action (meeting SLUSA's standards) under state law in state court asserting claims based on an alleged misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security and/or use by the defendants of a manipulative or deceptive device or contrivances in connection with the purchase or sale of Enron stock, their common law claims of conspiracy and negligence would be preempted by SLUSA for the reasons explained below.

SLUSA, which amended the Securities Act of 1933 and the Securities and Exchange Act of 1934, aimed to protect corporations from securities fraud strike suits and "meritless class actions" and abusive discovery practices of litigious investors by making federal courts the exclusive venue for securities class actions¹²⁰ and establishing various procedural hoops and pleading requirements

¹²⁰ SLUSA was enacted to cure a perceived "loophole" in the PSLRA, which permitted investors to avoid the requirements of the PSLRA by bringing claims against issuers in state court. When the numbers of such state-court filed suits increased dramatically, Congress passed SLUSA to close the loophole. See, e.g., *Dudek v. Prudential Securities, Inc.*, 295 F.3d 875, 877 (8th Cir. 2002); *Gutierrez v. Deloitte & Touche*, 147 F. Supp. 2d 584, 589 (W.D. Tex. 2001).

designed to screen out frivolous suits. *Spielman v. Merrill Lynch Pierce, Fenner & Smith*, ___ F.3d ___, No. 01-9189, 2003 WL 21363387, *2-3 (2d Cir. June 13, 2003). SLUSA does not completely preempt the field of securities regulation; instead its preemptive scope is limited by the substantive requirements of its removal provisions, its unique definition of class action, and its automatic dismissal of certain kinds of securities-related claims. *Id.* at *3, 5.

The statute provides in relevant part,

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.

Securities Act of 1933, 15 U.S.C. §77p(b); Securities and Exchange Act of 1934, 15 U.S.C. § 78bb(f)(1).

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 than 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. Enron's stock was listed on the New York Stock Exchange throughout the relevant period.

SLUSA thus provides for mandatory removal and/or 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 any 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). See, e.g., *Dudek v. Prudential Securities Inc.*, 295 F.3d 875, 877 (8th Cir. 2002); *Falkowski v. Imation Corp.*, 309 F.3d 1123, 1128 (9th Cir. 2002), *amended on other grounds*, 320 F.3d 905 (9th Cir. 2003); *Behlen v. Merrill Lynch*, 311 F.3d 1087, 1091-93 (11th Cir. 2002), *cert. denied*, 123 S.Ct. 2583 (2003).

Thus a claim falls within the preemptive scope of SLUSA if it meets four requirements: (1) the suit is a "covered class action" as defined in the statute; (2) the action is brought under state law; (3) the plaintiffs allege that the defendants misrepresented a material fact or omitted a material fact or used or employed a manipulative or deceptive device or contrivance; and (4) the plaintiffs allege that defendants' wrongful conduct was "in connection with" the purchase or sale of a "covered security." *Green v. Ameritrade*, 279 F.3d 590, 596 (8th Cir. 2002).

Not only SLUSA, but § 10(b) of the 1934 Act and Rule 10b-5 provide a cause of action based on practices prohibited therein, qualified *inter alia* by the phrase, "in connection with the purchase or sale" of a security. 15 U.S.C. § 78j(2)(b); 17 C.F.R. 240.10b-5. SLUSA preempts all state law class actions based upon alleged untrue statements or omissions of material

fact, or use of manipulative or deceptive devices or contrivances, in connection with the purchase or sale of a covered security, as those terms are defined in the statute. 15 U.S.C. § 78bb(f). Although SLUSA does not define "in connection with the purchase or sale of a covered security," and the Supreme Court has only minimally addressed the issue,¹²¹ most courts addressing the question have applied the judicial construction of the parallel phrase in § 10(b).¹²² Most of these cases have dealt only with alleged material misrepresentations or omissions "in connection with the purchase or sale of a covered security." See, e.g., *Riley v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 292 F.3d 1334, 1342 (11th Cir.), cert. denied, 537 U.S. 950 (2002); *Falkowski v. Imation Corp.*, 309 F.3d 1123, 1129 (9th Cir. 2002), amended on

¹²¹ See *SEC v. Zandford*, 535 U.S. 813, 122 S.Ct. 1899 (2002), in which a unanimous Supreme Court read the "in connection with the purchase or sale of any security" very flexibly to reach the fraudulent practices of a broker with authorization to manage his client's investment accounts who wrote checks to himself from his clients' accountant that required the sale of securities for payment. The Supreme Court found that stock sales and the broker's fraudulent actions were interdependent and coincidental with the stock sales and that the sales furthered the broker's scheme to defraud his clients and misappropriate their assets.

¹²² But see *Shaw v. Charles Schwab & Co.*, 128 F. Supp. 2d 1270, 1273-74 (C.D. Cal. 2001) ("Although Sections 10(b) and 78bb(f) may be phraseologically homologous, the Court cannot simply assume that the two statutes produce meaning in the same way. Different congressional intents gird the two statutes."), *appeal dismissed for lack of appellate jur.*, 45 Fed. Appx. 651, 2002 WL 1929469 (9th Cir. Aug. 21, 2002). In this case, the district court explained that while § 10(b)'s primary purpose is "to protect investors from false and misleading practices," SLUSA's is "to protect the interest of shareholders and employees of public companies that are the target of meritless 'strike' suits." *Id.* at 1273-74. Therefore the district court refused to construe "in connection with" as broadly in the SLUSA context as it would in a § 10(b) context. *Id.* at 1273-74.

other grounds, 320 F.3d 905 (9th Cir. 2003); *Behlen v. Merrill Lynch*, 311 F.3d 1087, 1093 (11th Cir. 2002), petition for cert. filed, No. 02-1520, 71 U.S.L.W. 3680 (Apr. 14, 2003); *Green v. Ameritrade, Inc.*, 279 F.3d 590, 597-98 (8th Cir. 2002); *Gutierrez v. Deloitte & Touche, L.L.P.*, 147 F. Supp. 2d 584, 595 (W.D. 2001); *Shaev v. Claflin*, No. C 01-0009, 2001 WL 548567, *4 (N.D. Cal. May 17, 2001); *Shen v. Bohan*, 2002 WL 31962136, *3 (C.D. Cal. Oct. 17, 2002); *Zoren v. Genesis Energy, L.P.*, 195 F. Supp. 2d 598, 605 (D. Del. 2002); *Gordon v. Buntrock*, No. 00 CV 303, 2000 WL 556763, *3 (N.D. Ill. 2000). A few did address manipulative or deceptive devices or contrivances "in connection with the purchase or sale of a covered security." See, e.g., *Burns v. Prudential Securities*, 116 F. Supp. 2d 917, 921-23 (N.D. Ohio 2000); *Denton v. H&R Block Financial Advisors, Inc.*, No. 01 C 4185, 2001 WL 1183292,*4 (N.D. Ill. Oct. 4, 2001) ("While it is true that allegations of breach of fiduciary duty alone will not sufficiently plead a securities fraud claim, a breach of fiduciary duty may give rise to a Rule 10b-5 claim where the alleged conduct 'can fairly be viewed as manipulative or deceptive conduct within the meaning of the [Securities Act].'" (quoting *Santa Fe Indus. Inc. v. Green*, 430 U.S. 462, 473-74 (1977))); *Shaw v. Charles Schwab & Co.*, 128 F. Supp. 2d 1270, 1272 (C.D. Cal. 2001), appeal dismissed for lack of appellate jur., 45 Fed. Appx. 651, 2002 WL 1929469 (9th Cir. Aug. 21, 2002).

In *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975) (affirming the rule of *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir. 1952)), the Supreme Court held that claimants

contending that they were defrauded into not purchasing stock or defrauded into continuing to hold stock, in other words claimants that did not actually sell or purchase stock because of the alleged misrepresentation, have no right of action under § 10(b). *Blue Chip Stamps*, 421 U.S. at 727. The Supreme Court further observed, "Obviously, this disadvantage is attenuated to the extent that remedies are available to nonpurchasers and nonsellers under state law." 421 U.S. at 739 n.9. Thus, as the Eleventh Circuit has commented, while the high court in *Blue Chip Stamps* "recognized that 'holding' claims are not actionable under federal securities laws, they may well be actionable under state laws that are more stringent than their federal counterparts." *Riley*, 292 F.3d at 1343. See generally *Ameritrade*, 279 F.3d 590 (absent allegations of the sale and purchase of a covered security, SLUSA did not preclude a state law claim for breach of contract); *Guttierrez v. Deloitte & Touche*, 147 F. Supp. 2d at 592 (allegations that accounting misfeasance caused plaintiffs to hold securities that they otherwise would have sold are not barred by SLUSA); *Shen v. Bohan*, 2002 WL 31962136 at *3 (where plaintiffs alleged only that the defendants diluted their shareholder voting rights when stock was issued to acquire another company, their suit was not brought in connection with the purchase or sale of securities and may not be removed under SLUSA); *Shaeve v. Caflin*, No. C 01-0009 MJJ, 2001 WL 548567 at *5 (N.D. Cal. 2001) (where claims are not based on purchase or sale of stock but on dilution of a present shareholder's interests, "the complaint essentially claimed that the value of existing shareholder's ownership

interests were reduced . . . by the stock option adjustment" and does not meet the "in connection with" requirement for removal under SLUSA); *Gordon v. Buntrock*, No. 00 CV 303, 2000 WL 556763 at *3 (N.D. Ill. Apr. 28, 2001) (complaint alleging common law claims for breach of fiduciary duty, recognized under Delaware law, and seeking damages for lost value caused by holding onto securities, but not purchase or sale, was not properly removable).

Thus the courts agree that "SLUSA does not apply to claims dealing solely with the retention of securities, rather than with purchase or sale." *Riley*, 292 F.3d at 1345. Where a plaintiff alleges that a misrepresentation caused him to purchase more stock as well as to hold a particular security, however, as is the case in the *Tittle* complaint, the Eleventh Circuit has concluded that the plaintiff "may not avoid SLUSA's restrictions," the complaint does fall within the ambit of SLUSA, and the rule that SLUSA does not apply to holding claims is not applicable. *Id.* In accord, *In re WorldCom, Inc.*, 263 F. Supp. 2d 745, 771 (S.D.N.Y. 2003). Such a rule makes good sense to this Court, in light of the concerns that led Congress to enact the PSLRA. Typically plaintiffs will have both transactional and holding claims and could otherwise easily avoid the more stringent requirements of the federal statute by asserting both. Courts have reach the same decision about hybrid complaints based on both covered and non-covered securities or on securities and non-securities. See *Kenneth Rothschild Trust v. Morgan Stanley Dean Witter*, 199 F. Supp. 2d 993, 1000 n.21 (C.D. Cal. 2002) ("When a claim concerns a transaction that involves both covered and non-

covered securities as alleged, the entire claim is subject to removal under SLUSA), citing *Lasley v. New England Variable Life Ins. Co.*, 126 F. Supp. 2d 1236, 1238-39 (N.D. Cal. 1999) (holding that a complaint alleging fraud in connection with the purchase of a variable life insurance policy (a covered security) and ordinary life insurance (a non-security) was removable under SLUSA); *Kenneth Rothschild Trust v. Morgan Stanley Dean Witter*, 999 F. Supp. 2d 993, 1000 n.21 (C.D. Cal. 2002).

Tittle Plaintiffs argue that in the ESOP, all shares of Enron stock were distributed by the end of 1996, the Class Period did not begin until January 20, 1998, and thus all the participants' claims are solely holding claims because none of the participants or beneficiaries bring claims "in connection with the purchase or sale of a covered security." 15 U.S.C. § 78bb(f)(1). Thus they maintain that the claims of the ESOP participants are not within the preemptive scope of SLUSA, and that any state law claim as to them, such as the civil conspiracy cause of action, is not preempted by that statute. Nor, Plaintiffs insist, has there been any purchase or sale of securities relating to Plaintiffs' phantom stock/compensation claims,¹²³ the Cash Balance Plan offset based on inflated price of Enron stock on specified dates, and the Savings Plan employer matching contributions. In sum, insist Defendants, because these fail to fall under the securities laws, the civil conspiracy claim related to them is not preempted.

¹²³ As the Court explains in footnote 2 and on pages 231-37 and nn. 126-30 of this memorandum and order, the federal securities laws do not apply to bonus plans like the phantom stock program.

Nevertheless, the language of the complaint differs from Plaintiffs' current account and plainly states that Plaintiffs were deceived into both holding and/or purchasing Enron stock in the ERISA-governed plans. See, e.g., Complaint at 4, ¶5 ("Andersen's actions also caused employees to invest in or hold their Enron stock in their ESOP and Savings accounts rather than to diversify or put their retirement funds in safer investments."); at 5, ¶8 ("Participants in the Savings Plan, the ESOP and the Cash Balance plans, having no knowledge of the accounting improprieties, and further encouraged by the statements of officers of Enron regarding the financial strength of the Company[,] continued to add more Enron stock to their accounts . . . and/or continued to retain Enron shares instead of diversifying their holdings.").

There is no dispute that Savings Plan participants and beneficiaries bring both holding and purchasing claims, and therefore their interests in that portion of the Plan involving the purchase and/or sale of stock might constitute a "security" and be actionable under the securities laws. If Plaintiffs were to replead these claims under the federal securities laws, the related common law conspiracy and negligent misrepresentation claims would be preempted by SLUSA.

Plaintiffs have also argued that the misstatements made by Lay, Skilling, Fastow and other Enron insiders to Enron employees as part of the conspiracy to fraudulently induce them to retain and acquire Enron stock, as alleged in their complaint, are not actionable under the securities laws because they are not

public statements intended to artificially inflate the stock's price (under a fraud on the market theory), but statements made inside in-house publications or at employee meetings as part of a fraudulent scheme to convince the employees to keep their retirement assets in, or to accept compensation in the form of, over-valued Enron stock to free up cash for Defendants' personal enrichment. The Court concludes that such an arbitrary division between "non-public" statements made only to employees and statements of virtually identical import to the public at large, included in *Newby*, constitutes the kind of manipulative pleading to circumvent the PSLRA and SLUSA that has not been permitted by most courts.

Citing *Lemanik, S.A. V. McKinley Allsopp, Inc.*, 125 F.R.D. 602, 607 (S.D.N.Y. 1989), as authority, Defendants have argued that because the plan itself held the Enron stock in the plan and owned the legal interest in those assets, the plan record holder is the real party in interest and the plan participants and beneficiaries, who hold only the equitable interest, cannot bring securities law claims.¹²⁴

This Court disagrees. Federal Rule of Civil Procedure 17(a) provides in relevant part, "Every action shall be prosecuted in the name of the real party in interest. An . . . administrator, . . . trustee of an express trust, . . . or a party

¹²⁴ The Court distinguishes the issue of beneficial versus legal ownership from the issue of whether the participants' interest in each of the plans or phantom stock constitutes a "security" within the meaning of the federal securities laws, to be discussed later. See pages 231-37 of this memorandum and order.

authorized by statute may sue in his own name without joining with him the party for whose benefit the actions is brought." Defendants' authority, *Lemanik*, merely held that the record keeper of a plan is a party-in-interest, but not the only one, who could bring suit for securities violations. The established rule is that "nothing in the real party in interest rule precludes a beneficial owner from commencing an action or joining an action with the legal title holder, if the beneficial owner has a right which can be enforced in a court action." 25 Federal Procedure, Lawyers Ed. § 59:54 (Database updated May 2003), citing *Beasoechea v. Sverdrup & Parcel and Associates, Inc.*, 486 F. Supp. 169, 173 (E.D. Pa. 1980) ("The permissive language of [Rule 17(a)] does not preclude the beneficial owner from suing or joining with the legal title holder if the beneficial owner has the right sought to be enforced.").

Furthermore it is not the procedural rule alone, but the substantive law that determines whether the plaintiff is actually the real party in interest. See *Lubbock Feed Lots, Inc. v. Iowa Beef Processors, Inc.*, 630 F.2d 250, 256-57 (5th Cir. 1980) ("the mere fact that a plaintiff falls within one class of persons enumerated in Rule 17(a) is not dispositive of the real party in interest question, for the rule assumes that the enumerated persons are granted the right to sue by the applicable substantive law."); *HB General Corp. v. Manchester Partners L.P.*, 95 F.3d 1185, 1196-97 (3d Cir. 1996); *Certain Interested Underwriters at Lloyd's, London, England v. Layne*, 26 F.3d 39, 43 (6th Cir. 1994). The civil enforcement provisions of ERISA, embodied in § 502(a),

29 U.S.C. 1132(a), expressly give plan participants the right to bring suit. See also *Isola v. Hutchinson*, 780 F. Supp. 1299 (N.D. Cal. 1991) (sole remaining participant in plan with "a beneficial interest in recovering assets that may have been fraudulently removed from the Plan" held to be an appropriate plaintiff under § 502(a)(3)). The same is true of beneficial interest holders under RICO. Title 18 U.S.C. § 1964(c) grants standing to "[any] person injured in his business or property by reason of a violation of section 1962" In turn, under 18 U.S.C. § 1961(3), "person" is defined as "includ[ing] any individual or entity capable of holding a legal or beneficial interest in property." See, e.g., *Joseph v. Algemene Bank Nederland, N.V.*, 592 F. Supp. 141, 148 (W.D. Pa. 1984).

In construing § 10(b)'s use of the term "device," the Supreme Court, relying on *Webster's International Dictionary* (2d ed. 1934), found that the term involved "knowing and intentional conduct" and equated the word, *inter alia*, with a "scheme; often a scheme to deceive" *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 & n.20 (1976). Moreover, Rule 10b-5 makes it unlawful for any person "to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security." There are a number of state-law claims, such as breach of contract, breach of fiduciary duty, conversion or negligence, which by themselves, would not fall within the proscriptions of § 10(b), but when they become part of a larger deception, a scheme to defraud, would constitute a violation of the federal statute.

For example a number of courts faced with the question of whether unauthorized trading by a broker states a claim for violation of the Securities Act have concluded that unauthorized trading alone does not establish scienter and does not state a claim under the Securities Act. *Burns*, 116 F. Supp. 2d at 923-25 (and cases cited therein). Nevertheless, when such misconduct is alleged to be part of a larger deception, a scheme to defraud, coupled with scienter (specific facts giving rise to a strong inference of severe recklessness or intent to deceive, manipulate or defraud), the allegations are sufficient to trigger the preemptive effect of SLUSA. *Id.* at 925. See also *SEC v. Zandford*, 535 U.S. 813, ___, 122 S. Ct. 1899, 1903 (2002) (although the "statute must not be construed so broadly as to convert every common-law fraud that happens to involve securities into a violation of § 10(b), neither the SEC nor this Court has ever held that there must be a misrepresentation about the value of a particular security in order to run afoul of the Act"; the high court found that securities sales and a broker's unauthorized fraudulent acts were not independent events, but coincided because each sale was made to further broker's fraudulent scheme for his own benefit)¹²⁵;

¹²⁵ In *Zandford*, the SEC's complaint alleged "a fraudulent scheme in which the securities transactions and the breaches of fiduciary duty coincide." 122 S.Ct. at 1906. Thus the connection or nexus requirement of "in connection with" need not be causation: the fraud may be "in connection with" the securities purchases or sales if the fraud "coincides" with those transactions. Nevertheless, even with such an expansive and flexible construction of the phrase, some kind of "nexus between the alleged fraud and a securities transaction" must be alleged to satisfy the "in connection with" element. *French v. First Union Securities, Inc.*, 209 F. Supp. 2d 818, 827 (M.D. Tenn. 2002).

Prager v. Knight/Trimark Group, Inc., 124 F. Supp. 2d 229, 234-35 (D.N.J. 2000) ("It must be concluded, therefore, that plaintiff has pleaded what are, in essence, securities fraud claims [for breach of contract, violation of the implied covenant of good faith, breach of fiduciary duty, unjust enrichment, and violation of New Jersey's Consumer Fraud Act], even though they were framed as state law claims, and that SLUSA governs."); *Behlin*, 311 F.3d at 1093-95.

A misrepresentation by a person, whose position made it reasonable for a plaintiff to rely upon that misrepresentation, about the value of a security, which was subsequently bought or sold by the plaintiff in reliance upon that statement, will satisfy the requisite "in connection with" a security for a § 10(b) claim. See, e.g., *In re Ames Dept. Stores, Inc. Stock Litig.*, 991 F.2d 953, 967 (2d Cir. 1993).

Only a purchaser or seller of "securities" may bring a private action for damages under § 10(b) and Rule 10b-5. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 731-33 (1975). Many of the Tittle Plaintiffs lack an interest in a "security" or a connection with the purchase or sale of a "security," and thus lack standing to bring a claim under § 10(b) and Rule 10b-5. Whether an employee's interest in an employee benefit retirement (pension) plan constitutes a "security" within the meaning of the Securities Act of 1933 and the Securities Exchange Act of 1934¹²⁶

¹²⁶ Section 2(1) of the 1933 Act, as amended, 15 U.S.C. §77(b)(1), defines a "security" as

any note, stock, treasury stock, bond,

does not depend upon whether it is a defined benefit or defined contribution plan; instead it depends on whether the plan is "voluntary or involuntary, and contributory or noncontributory." The S.E.C. defined a "'voluntary' plan [as] 'one in which the employees may elect whether or not to participate,'" while a "contributory" plan is "one in which employees make direct payments, usually in the form of cash or payroll deductions, to the plan." SEC Release No. 33-6188, 1980 WL 29482, at *33 nn. 19 and 20 (Feb. 1, 1980). In other words, a "noncontributory" plan

debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchases, any of the foregoing.

The definition in § 3(a)(10) of the Securities Exchange Act of 1934, 15 U.S.C. §78c(a)(10), is nearly identical, and coverage under the two Acts is regarded as the same. *International Brotherhood of Teamsters, Chauffeurs, Warehousemen and Helpers of America v. Daniel*, 439 U.S. 551, 557 n.7 (1979). Neither statutory provision refers to any kind of pension plan. *Id.* at 558. Section 2(3) of the 1933 Act provides that "[t]he term 'sale' or 'sell' shall include every contract of sale or disposition of a security or interest in a security for value." Similarly, Section 3(a)(14) states, "[t]he terms 'sale' and 'sell' each include any contract to sell or otherwise dispose of." See, e.g., *Yoder v. Orthomolecular Nutrition Institute*, 751 F.2d 555, 556 (2d Cir. 1985) (concluding that an individual, who accepted an employment contract from a corporation in return for that corporation's stock or promise of stock was an "investor" and the issuance or transfer of stock was a "sale" (disposition of a security for value) under the federal securities laws).

would be one where the employer makes all the contributions. The interests of employees in an employee benefit plan "are securities only when the employees voluntarily participate in the plan and individually contribute thereto." *Id.* at *7, *2. On the other hand, " . . . the Securities Acts do not apply to a noncontributory, compulsory plan." *Id.* at *8, citing *International Brotherhood of Teamsters, Chauffeurs, Warehousemen and Helpers of America v. Daniel*, 439 U.S. 551, 570 (1979). The SEC has long taken the position that interests in voluntary contribution pension and profit-sharing plans are "securities" because "such interests constitute investment contracts, although it has also been suggested that they may be 'certificates of interest or participation in a profit-sharing agreement' as well."

1980 WL 29482, at *9. The SEC's Chairman stated before the Senate Committee on Human Resources on the antifraud provisions of the proposed ERISA Improvements Act of 1979 (S. 209),

. . . An employee who is given a choice whether to participate in a voluntary pension plan, and decides to contribute a portion of his earnings or savings to such plan, has clearly made an investment decision, particularly when his contribution is invested in securities issued by his employer. Employees making such decisions should continue to be afforded the protections of the antifraud provisions of the federal securities laws.

Id. (noting that the reasoning in *Daniel* supports the view that the employee's interest in a voluntary, contributory plan is an investment contract).

The Supreme Court in *Daniel* looked to an "economic realities" test (substance over form) in *SEC v. W.J. Howey Co.*,

328 U.S. 293, 301 (1946), to determine whether a particular financial relationship constitutes an investment contract: "whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others.'" 439 U.S. at 558.¹²⁷ The Supreme Court explained in *Daniel*,

An employee who participates in a noncontributory, compulsory pension plan by definition makes no payment into the pension fund. He only accepts employment, one of the conditions of which is eligibility for a possible benefit on retirement. . . . In every decision of this Court recognizing the presence of a 'security' under the Securities Acts, the person found to have been an investor chose to give up a specific consideration in return for a separable financial interest with the characteristics of a security. . . . Even in those cases where the interest acquired had intermingled security and nonsecurity aspects, the interest obtained had "to a very substantial degree the elements of investment contracts" In every case the purchaser gave up some tangible and definable consideration in return for an

¹²⁷ In contrast, in a noncontributory, compulsory pension plan, the investment is a minor part of the employee's compensation package and the employee can only in the most abstract sense be viewed as exchanging part of his labor for the possible benefits of the plan; "[h]e surrenders his labor as a whole, and in return receives a compensation package that is substantially devoid of aspects resembling a security [A]n employee is selling his labor primarily to obtain a livelihood, not making an investment." *Daniel*, 439 U.S. at 560. The pension fund is largely derived from employer contributions, not earnings from its assets, and does not depend on the efforts of its managers. *Id.* at 562. The employee's expectations of participating in earnings from the plan's assets is only a small part of the total compensation package and is "'far too speculative and insubstantial to bring the entire transaction within the Securities Acts'." *Id.* at 562. The high court further emphasized, "unlike the Securities Acts, ERISA deals expressly and in detail with pension plans," and thus ERISA's comprehensive legislative scheme for such plan "undercuts all arguments for extending the Securities Act to noncontributory, compulsory pension plans." *Id.* at 569-70.

interest that had substantially the characteristics of a security. [citations omitted]

439 U.S. at 559-560 (concluding that an employee's participation in a noncontributory, compulsory pension plan does not constitute a "security" or an "investment contract").

In contrast to a noncontributory, involuntary pension plan like that in *Daniel*, a voluntary, contributory plan, such as that portion of the Savings Plan other than the employer match contributions¹²⁸ in *Tittle*, has been found to be a "security" for purposes of securities fraud claims under the federal securities statutes. See *Dubin v. E.F. Hutton Group, Inc.*, 695 F. Supp. 138, 144-47 (S.D.N.Y. 1988); *Hood v. Smith's Transfer Corp.*, 762 F. Supp. 1274, 1284 (W.D. Ky. 1991). Thus any state-law claim relating to it might fall within the preemptive scope of SLUSA if the statute's other requirements are met. The intermingling of the employer matching contributions portion to the Savings Plan with the voluntary contributions on which the employer match depends appears to fall within *Daniel*'s "cases where the interest acquired had intermingled security and nonsecurity aspects" and thus "to a very substantial degree the elements of investment contracts," making it a "security." 439 U.S. at 560.

The ESOP at issue in *Tittle* is an involuntary, noncontributory plan,¹²⁹ but a plan in which employee participation

¹²⁸ The employer match contributions, furthermore, were made in Enron stock, but not "in connection with the purchase or sale" of these securities.

¹²⁹ The ESOP plan at § 5.1 states, "Members shall neither be required nor permitted to contribute to the Plan." In contrast,

is compulsory, and the shares distributed represent a mandatory portion of the employees' compensation, not securities that are purchased or sold. See discussion *infra*; *International Brotherhood of Teamsters, Chauffeurs, Warehousemen and Helpers of America v. Daniel*, 439 U.S. 551 (1979); *Bauman v. Bish*, 571 F. Supp. 1054, 1064 (N.D.W.Va. 1983) (ESOP plan more "a method of deferring income" than an investment in securities.¹³⁰). "[A] grant of stock under an Employee Stock Ownership Plan or similar stock bonus program is generally not a 'sale' under the 1933 Act." *Falkowski v. Imation Corp.*, 309 F.3d at 1130, citing *Int'l Brotherhood of Teamsters v. Daniel*, 439 U.S. 551 (1979) (holding that an interest in a compulsory, noncontributory pension plan is not a 'security.'), and SEC Release No. 33-6188, 1980 SEC LEXIS 2141, at *52-53 (Feb. 1, 1980). Moreover, according to the complaint at 51, ¶¶170-171, Enron closed the ESOP to new employees at the end of 1994 and all the shares in the ESOP were distributed

Enron "shall contribute to the Trustee . . . the amount, if any, authorized by its Board of Directors."

¹³⁰ As the *Bauman* court, in concluding that an ESOP created when employees bought a corporation did not fall within the scope of the Securities Acts, explained,

Participation in the ESOP for employees of the proposed company is not voluntary and is, in a sense, compulsory. Each participant who meets certain minimum hours of service will have stock allocated to his or her account. Thus there is no affirmative investment decision. More importantly, there is no furnishing of "value" by participating employees. Instead of giving up some tangible and definable consideration, participants earn stock through labor for the employer.

571 F. Supp. at 1064.

by the end of 1996; therefore any claims by ESOP participants arising during the Class Period appear to be holding claims,¹³¹ another reason why the federal securities laws do not apply, because there was no "connection with the purchase and sale of a covered security." 15 U.S.C. § 78bb(f)(1).

The Court lacks sufficient information about the program for compensating employees with phantom stock, but given the nature of the program, presumably the recipients are participating in a compulsory, noncontributory program and would not be subject to the Securities Act. See footnote 2 of the memorandum and order.

Although the Court again cannot be certain from the record before it, the Cash Balance Plan, in which the defined benefit is a mixture of an employee's averaged pay benefit offset by the value of one fifth of the Enron stock allocated to his individual ESOP account, calculated at market price on the first day of each of five years, also does not appear to be a security under *Daniel*. As noted, an employee's ESOP account does not appear to qualify as a security under *Daniel*, nor, under the Cash Balance Plan, is there any "connection with the purchase or sale" of Enron securities, but merely a reference to the market price of the stock on five days in five years. The averaged pay calculation is not a voluntary "contribution." Thus the Cash

¹³¹ The Court has pointed out contrary statements in the complaint. Since, as explained, neither the ESOP nor the Cash Balance Plan qualifies as a security, the federal securities laws do not apply.

Balance Plan would also appear not to be a "security" and not to be subject to the federal securities laws.

In addition to that law, the Court notes that the *Newby* class description restricts the number of *Tittle* plaintiffs that would be eligible to join the *Newby* class. In the first consolidated complaint the class action was brought by Plaintiffs "on behalf of all persons who purchased Enron securities including . . . Enron employees who purchased Enron stock individually or for their 401(k) retirement plans during the Class Period." #441 at ¶986 in H-01-3624 [emphasis added]. The recent first amended consolidated complaint, which supersedes the former, has modified that definition and brings suit "on behalf of purchasers of Enron Corporation's publicly traded equity and debt securities between 10/19/98 and 11/27/01." #1388 at 3. The definition implicitly incorporates the bar against pure holding claims to limit that group.

The fact that plaintiffs may plead state law claims that do not meet the pleading of scienter required by the federal law, i.e., § 10(b) and Rule 10b-5's severe recklessness, does not prevent preemption by SLUSA, which does not mention scienter. This Court agrees with the reasoning in *Feitelberg v. Merrill Lynch & Co., Inc.*, 234 F. Supp. 2d 1043, 1051 (N.D. Cal. 2002), where the district court explained,

[I]f by merely omitting scienter allegations plaintiff can avoid SLUSA's preemption effect, SLUSA would be totally eviscerated. If in fact the claims allege misrepresentations or omissions or use of manipulative or deceptive devices in connection with the purchase of sale of securities and otherwise come within

the purview of SLUSA, artful avoidance of those terms or scienter language will not save them from preemption. In other words, if it looks like a securities fraud claim, sounds like a securities fraud claim and acts like a securities fraud claim, it is a securities fraud claim, no matter how you dress it up.

Id. at 1051.¹³²

The Court observes that negligence is not actionable under § 10(b), which requires that scienter at minimum reach the level of "severe recklessness," which is "properly defined and adequately distinguished from mere negligence," i.e., as "those highly unreasonable omissions or misrepresentations that involve not merely simple or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and that present a danger of misleading buyers or sellers which is either known to the defendant or is so obvious that the defendant must have been aware of it." *Nathenson v. Zonagen, Inc.*, 267 F.3d 400, 408 (5th Cir. 2001), *citing inter alia Broad v. Rockwell Intern. Corp.*, 642 F.2d 929, 961-62 (5th Cir. 1981), *cert. denied*, 454 U.S. 965 (1981).

If those Tittle Plaintiffs with claims that are cognizable under the federal securities laws were to replead to assert securities violations or to join the class in *Newby*, or to bring suit in state court alleging the same facts under state law, the common law claims of conspiracy and negligent

¹³² *But see Burns v. Prudential Sec.*, 116 F. Supp. 2d 917 (N.D. Ohio 2000) (holding that SLUSA does not preempt state law claims for conversion, breach of contract, breach of fiduciary duty and negligent supervision where the federal securities law standards for scienter are not satisfied by the pleadings).

misrepresentation would also be preempted by SLUSA. The *Tittle* Plaintiffs' suit, with more than fifty plaintiffs, meets the definition of "covered class action" under SLUSA; shares of Enron stock are a "covered security" within the meaning of SLUSA; the complaint alleges that Defendants have misrepresented or omitted material facts and have used manipulative or deceptive devices and contrivances in connection with the purchase or sale of Enron securities; and Plaintiffs' civil conspiracy and negligent misrepresentation claims relating to what are actually securities violations are common-law causes of action that fall within the preemptive reach of SLUSA.

Even though there may be no remedy under the federal securities statutes, were Plaintiffs to assert violation of the securities laws, Plaintiffs' state-law negligent misrepresentation claim against Arthur Andersen LLP in Count VIII would be preempted by SLUSA because SLUSA expressly preempts all state law class action claims based on alleged false statements or omissions of material fact or the use of a manipulative device or contrivance in connection with the purchase or sale of a covered security. 15 U.S.C. § 77p(b) (Securities Act of 1933); 15 U.S.C. § 78bb(f)(1) (Securities Exchange Act of 1934). This Court finds that under the facts alleged here, as part of a scheme by Defendants for personal enrichment, Arthur Andersen's alleged fraudulent accounting practices purportedly served to persuade the plan participants to retain and to purchase Enron stock for their retirement funds and thus "were in connection with the purchase or sale of securities," the fraud coincides with the Savings Plan

participants' purchase of Enron stock during the Class Period. Furthermore, as noted in the Court's discussion of the RICO Amendment, the scheme encompassed far more than plan participants; Arthur Andersen's accounting misrepresentations were embodied in public records and relied on by investors in the public at large just as they were by plan participants and beneficiaries. The ERISA plan participants constitute only one slice in the pie in the Ponzi scheme set out in the *Newby* securities class action.

Similarly the facts supporting the state-law conspiracy claim in Count IX duplicate many of those constituting the Ponzi scheme actionable under § 10(b) and Rule 10b-5. SLUSA preempts all state law class actions based upon alleged untrue statements or omissions of material fact, or use of manipulative or deceptive devices or contrivances in connection with the purchase or sale of a covered security, as those terms are defined in the statute. 15 U.S.C. § 78bb(f).

In sum, as indicated, for those *Tittle* Plaintiffs who have standing to sue under the federal securities laws, or who join the *Newby* class, or who attempt to file claims in state court based on the same facts and alleging under state law that they purchased Enron stock based on alleged misrepresentation, omissions, deceptive devices and contrivances, their common law claims of conspiracy and negligent misrepresentation are preempted by SLUSA.

2. ERISA Preemption and Plaintiffs' Common-Law Civil Conspiracy Claim

A civil conspiracy is a combination by two or more persons to accomplish an unlawful purpose or a lawful purpose by unlawful means. *Ernst & Young, L.L.P. v. Pacific Mutual Life Ins. Co.*, 51 S.W.3d 573, 583 (Tex. 2001); *Operation Rescue-Nat'l v. Planned Parenthood of Houston & S.E. Tex., Inc.*, 975 S.W.2d 546, 553 (Tex. 1999).¹³³ A plaintiff must prove (1) two or more persons are involved, (2) an object to be accomplished, (3) a meeting of the minds on the object or course of action, (4) one or more unlawful, overt acts, and (5) damages. *Id.* The plaintiff must prove specific intent to cause injury, "to agree to accomplish an unlawful purpose or to accomplish a lawful purpose by an unlawful means"; moreover the conspirators must be aware of the harm or wrongful conduct when they commence the combination or agreement. *Juhl v. Arlington*, 936 S.W.2d 640, 644 (Tex. 1996); *Triplex Communications, Inc. v. Riley*, 900 S.W.2d 716, 719 (Tex. 1995).

More important for our analysis, conspiracy is a derivative tort, so a plaintiff must prove the elements of an underlying tort in which the defendant participated in order to prevail on a civil conspiracy claim. *Tilton v. Marshall*, 925 S.W.2d 672, 681 (Tex. 1996).

Here by the specific factual allegations regarding the scheme of the conspirators, the underlying tort would be fraud, which would embrace both fraudulent misrepresentation and fraudulent inducement. Under Texas law to prevail on such a claim, a plaintiff must prove (1) a material misrepresentation (2)

¹³³ The Court presumes this cause of action is brought under Texas law.

that was false, (3) that was known to be false when made or made without knowledge of the truth, (4) that was intended to be acted upon, (5) that was relied upon, and (6) that caused the plaintiff injury. *Formosa Plastics Corp. U.S.A. v. Presidio Eng'rs & Contractors, Inc.*, 960 S.W.2d 41, 47 (Tex. 1998); *DeSantis v. Wackenhut Corp.*, 793 S.W.2d 670, 688 (Tex. 1990), cert. denied, 498 U.S. 1048 (1991). Texas law requires actual reliance; the presumption of reliance under the theory of fraud on the market does not apply. *Steiner v. Southmark Corp.*, 734 F. Supp. 269, 279, clarified on other grounds, 739 F. Supp. 1087 (N.D. Tex. 1990); *Griffin v. GK Intelligent Sys., Inc.*, 87 F. Supp. 2d 684, 690 (S.D. Tex. 1999); *McNamara v. Bre-X Minerals Ltd.*, 197 F. Supp. 2d 622, 697-98 (E.D. Tex. 2001).

Furthermore tort damages, including exemplary damages, are available for a common-law fraud claim. *Formosa Plastics*, 960 S.W.2d at 46-47 (tort damages, including exemplary damages, are recoverable for fraud claims sounding in tort, such as fraudulent inducement by misrepresentation, "irrespective of whether the fraudulent misrepresentations are later subsumed in a contract or whether the plaintiff only suffers economic loss related to the subject matter of the contract"). "'Exemplary damages' means any damages awarded as a penalty or by way of punishment. 'Exemplary damages' includes punitive damages." Tex. Civ. Prac. & Rem. Code Ann. § 41.001(5) (Vernon's 2003).

As noted, the Texas state-law cause of action for civil conspiracy is not an independent cause of action, but is based on an underlying substantive wrong, a tort committed by the alleged

conspirators. Therefore liability is not based on the conspiracy, but on the underlying tort. See *Gaming Corp. of America v. Dorsey & Whitney*, 88 F.3d 536, 551 (8th Cir. 1996) ("the gist of the action is not the conspiracy charged, but the tort working the damage to the plaintiff"; the real purpose of a conspiracy claim is "to show facts for vicarious liability of defendants or for the acts committed by others, joinder of joint tortfeasors, and aggravation of damages") (citing and quoting *Harding v. Ohio Casualty Ins. Co.*, 230 Minn. 327, ___, 41 N.W.2d 818, 825 (1950)); *Halberstam v. Welch*, 705 F.2d 472, 479 (D.C. Cir. 1983) ("Since liability for civil conspiracy depends on the performance of some underlying tortious act, the conspiracy is not independently actionable; rather, it is a means for establishing vicarious liability for the underlying tort."); *In re Orthopedic Bone Screw Products Liability Litig.*, 193 F.3d 781, 789-90 & n.7 (3d Cir. 1999) (and cases cited therein).

If the alleged underlying tort of the conspiracy, here fraud, falls within the scope of a federal statute's "complete" preemption,¹³⁴ the conspiracy claim is deemed to arise under the federal law; the conspiracy allegations do not change the nature of the cause of action since liability is based on the underlying tort. *Gaming Corp. of America v. Dorsey & Whitney*, 88 F.3d at 551 ("claims that fall within the preemptive scope of the particular statute . . . are considered to make out a federal question") (citing *Metropolitan Life Ins. Co. v. Taylor*, 481 U.S.

¹³⁴ See pages 201-06 of this memorandum and order.

58, 64-66 (1987) (extending doctrine of complete preemption to ERISA)).¹³⁵ In such a case, to allow the civil conspiracy cause to go forward under state law would allow litigants to "avoid federal question jurisdiction and create causes of action where Congress intended there to be none." *Id.* at 551.

3. ERISA Preemption and Claim of Negligent Misrepresentation against the Andersen Defendants

Plaintiffs assert that the Andersen Defendants performed improper accounting and negligently certified the accuracy of financial statements that they knew or should have known to be false and misleading for Enron and the Savings Plan, reiterated these false statements in Andersen's capacity as auditor of the Savings Plan during part of the Class Period, and helped structure and conceal improper transactions of Enron Defendants, all in order to mislead Plaintiffs, persuade them to retain and add Enron stock to their retirement savings, and thereby enable Defendants to enrich themselves.

In dealing with a duty to use reasonable care in providing information to customers or potential customers, the

¹³⁵ *Gaming Corp.* dealt with the Indian Gaming Regulatory Act, 25 U.S.C. §§ 2701 et seq., which completely preempts state law relating to the governance of gaming activities, including management of casinos on Indian lands. The case alleged that a law firm representing a Native American tribe during a process for licensing tribal casino management violated the Indian Civil Rights Act. A concurrent cause of action under Michigan law alleging a civil conspiracy to violate the Indian Civil Rights Act was dismissed because (1) it was determined that the conspiracy's underlying tort was completely preempted by the IGRA and (2) because the conspiracy claim arose under the Indian Civil Rights Act, which did not provide for a private cause of action, it had to be dismissed.

elements of negligent misrepresentation under Texas law are (1) a false representation is made by a defendant in the course of its business or in a transaction in which the defendant has a pecuniary interest; (2) the defendant supplies "false information" for the guidance of others in their business; (3) the defendant fails to exercise reasonable care or competence in obtaining or communicating the information; and (4) the plaintiff suffers financial loss by justifiably relying on the representation. *Federal Land Bank Ass'n of Tyler v. Sloane*, 825 S.W.2d 439, 442 (Tex. 1991) (agreeing with the definition of Restatement (Second) of Torts § 552 (1977), which *inter alia* restricts damages to "those necessary to compensate the plaintiff for the pecuniary loss to him of which the misrepresentation is legal cause"). Reliance may not be presumed under Texas law. *McManus v. Fleetwood Enterprises, Inc.*, 320 F.3d 545, 549 (5th Cir. 2003).

The Tittle consolidated complaint has alleged the elements and supporting facts to state a claim for negligent misrepresentation under Texas common law. It identifies a number of misrepresented transactions and examples of false information in certified financial statements and audit reports that the Andersen Defendants provided as auditor of both Enron and of the Savings Plan and as an Enron consultant, allegedly without the degree of care, skill and competence exercised by a competent member of the accounting profession. The complaint asserts that Andersen issued such information, which it purportedly knew or should have known was materially false and misleading and would be used, and was used and relied upon, by Plaintiffs in their

decision whether to acquire and/or retain Enron stock in the plans, and it demonstrates Andersen's pecuniary interest in substantial fees for its services in providing that information. The complaint further describes the plan's resulting loss.

Under the Restatement (Second) of Torts § 552, which has been adopted by Texas courts, an accountant may be liable for negligent misrepresentations in financial statements to a third party whom the maker of the misrepresentation intends to benefit or to a limited group of persons for whose benefit the maker of the misrepresentation intends to provide the information or knows that the recipient intends to provide the information. *Steiner v. Southmark Corp.*, 739 F. Supp. 1087, 1088 (N.D. Tex. 1990). Texas courts have expanded the parameters of the tort of negligent misrepresentation in § 552 to include not only those that the defendant actually knows will receive the misrepresentation, but to those the accountant should know will receive it. *Blue Bell, Inc. v. Peat Marwick, Mitchell & Co.*, 715 S.W.2d 408, 411-13 (Tex. App.-Dallas 1986, writ ref'd); *Scottish Heritable Trust, PLC v. Peat Marwick Main & Co.*, 81 F.3d 606, 614 & n.35 (5th Cir. 1996), cert. denied, 519 U.S. 869 (1996). See generally #1194 at 90-98 in *Newby*. Whether a person falls within the class is a fact question related to the risk to which a particular victim is exposed and depends on such factors as "(1) the extent to which the transaction was intended to affect the plaintiff; (2) the foreseeability of harm to the plaintiff; (3) the closeness of the connection between the defendant's conduct and the injury suffered; and (4) the potential liability." *Steiner*, 739 F. Supp.

at 1088, citing *Cook Consultants, Inc. v. Larson*, 700 S.W.2d 231, 235 (Tex. App.--Dallas 1985, writ ref'd n.r.e.). The complaint's allegations address each of these elements.

In essence, with respect to issues of preemption by ERISA, Tittle Plaintiffs' state-law claims against Arthur Andersen for negligent misrepresentation are claims of professional negligence, or malpractice, for providing substandard accounting services to the Plans and Enron. As previously discussed, providing regular professional services to a plan does not make the professional a fiduciary of the plan and relates to the ERISA plan only in a peripheral manner. Nearly every court addressing the issue has held that ERISA does not preempt state-law professional negligence or malpractice claims relating to the provision of services to the plan. See, e.g., *Gerosa*, 329 F.3d at 324 ("[C]ourts routinely find that garden-variety state-law malpractice or negligence claims against non-fiduciary plan advisors, such as accountants, attorneys, and consultants, are not preempted" by ERISA); *Dudley Supermarket, Inc. v. Transamerica Life Ins. and Annuity Co.*, 302 F.3d 1, 4-5 (1st Cir. 2002); *Arizona State Carpenters Pension Trust Fund*, 125 F.3d at 723-24. citing *Coyne & Delany Co. v. Selman*, 98 F.3d 1457, 1467-72 (4th Cir. 1996) (holding that professional malpractice claims are not preempted by ERISA); *Custer v. Sweeney*, 89 F.3d 1156, 1162, 1166-67 (4th Cir. 1996) (attorney representing ERISA plan) (and cases cited therein); *Airparts Co. v. Benefit Services of Austin, Inc.*, 28 F.3d 1062, 1065-66 (10th Cir. 1994) (plan consultant); *Painters of Philadelphia Dist. Council No. 21 Welfare Fund v. Price*

Waterhouse, 879 F.2d 1146, 1152-53 & n. 7 (3d Cir. 1989) (auditor); *Pappas v. Buck Consultants, Inc.*, 923 F.2d 531, 540 (7th Cir. 1991) (refusing to imply cause of action under ERISA for malpractice by an actuary); *Bourns, Inc. v. KPMG Peat Marwick*, 876 F. Supp. 1116, 1122 (C.D. Cal. 1994) (auditor); *Pension Plan of Public Serv. Co. of New Hampshire v. KPMG Peat Marwick*, 815 F. Supp. 52, 57-58 (D.N.H. 1993) (auditor); *Carl Colteryahn Dairy, Inc. v. Western Pa. Teamsters & Employers Pension Fund*, 785 F. Supp. 536, 543 (W.D. Pa. 1992) (accountants and actuaries); *Richards v. Union Labor Life Ins. Co.*, 804 F. Supp. 1101, 1105-06 (D. Minn. 1992) (actuary); *Framingham Union Hospital, Inc. v. Travelers Ins. Co.*, 721 F. Supp. 1478, 1490 (D. Mass. 1989).

III. APPLICATION OF THE LAW TO COMPLAINT'S ALLEGATIONS

A. Procedural Objections

A number of Defendants have argued that Tittle Plaintiffs have violated Judge Rosenthal's December 13, 2001 order, which consolidated all securities violation cases into *Newby* and all ERISA-controlled employee benefit plan cases into *Tittle*, by amending their complaint to add RICO claims. Defendants maintain that the RICO claims were asserted to reach the "deep pocket" Defendants that *Newby's* Lead Plaintiff sued under the federal securities statutes, but that could not be sued by the Tittle Plaintiffs under ERISA because these newly named Defendants have no relationship to, nor involvement in, the ERISA retirement plans. For example, Tittle Plaintiffs have no claim for mishandling the plans' assets or for breach of fiduciary duty

in connection with the retirement plans under ERISA against the investment banks or Vinson & Elkins lawyers. By extension, urge Defendants, the *Tittle* Plaintiffs have also disregarded the appointment of Lead Plaintiff and Lead Counsel in *Newby* specifically to prosecute under the PSLRA the securities fraud claims common to all shareholders of the corporation. Such circumvention also results in the inapplicability of the PSLRA, which requires the Court to select as Lead Plaintiff the party with "the largest financial interest in the relief sought by the class" with interests strongly aligned with the prospective class of shareholders to prosecute the action and to retain control over the litigation. 15 U.S.C. § 78u-4(a)(3)(B)(iii)(I).

The Court is not perturbed by the fact that the complaint was amended to assert causes of action in addition to ERISA claims. The Court did not expressly restrict the complaint to its original causes of action, and it has allowed new claims to be asserted in the *Newby* class action. Thus the Court addresses each to determine whether the *Tittle* Plaintiffs have pleaded a viable cause of action for which relief may be provided.

B. RICO Amendment

After a careful examination of the *Tittle* and *Newby* complaints and a review of the applicable law, the Court concludes that the RICO claims asserted here are barred by § 107 of the PSLRA, 18 U.S.C. § 1964(c). The alleged enterprises acting to conceal Enron's financial condition and defraud current and future shareholders are based on virtually the same conduct by Defendants that is the basis for, or relates to similar conduct that could

have been alleged as further evidence of, the securities fraud Ponzi scheme alleged in *Newby* under the federal securities statutes. As will be discussed, the alleged predicate acts are an integral part of and/or support the securities fraud Ponzi scheme asserted in *Newby*. Plaintiffs attempt to bring RICO claims to sue deep-pocket parties that they cannot reach under ERISA because these Defendants have no fiduciary relationship to the employee benefit pension plans at issue.

As a side note, the *Tittle* Plaintiffs, both named and putative class members, who have 401(k) Savings Plans individual accounts with mixed holding and purchasing claims or that purchased Enron securities during the Class Period, are expressly included in the definition of the *Newby* class. Other *Tittle* Plaintiffs cannot sue under the federal securities laws. Nevertheless as emphasized in the earlier discussion of the RICO Amendment, the fact that a particular plaintiff may not have a cognizable claim under the securities law is not the issue under the RICO Amendment bar; the focus is on whether the alleged wrongful conduct could be challenged as a violation of the securities laws.

The *Tittle* complaint expressly alleges that Defendants participated "in a far-ranging multilayered scheme designed to conceal Enron's financial condition" while they personally profited and maintained "the illusion of Enron's profitability and financial strength, and the illusion that Enron was a legitimate enterprise and profitable company, and thereby induced Enron's

24,000 employees to invest in and retain Enron stock in their retirement plans." Complaint at ¶3.

Although draped in the language of RICO,¹³⁶ the *Tittle* Plaintiffs' allegations of wrongdoing in carrying out a scheme to defraud through various combinations of Defendants, characterized as "RICO enterprises," by means of "predicate acts" of embezzlement, mail and wire fraud, obstruction of justice, and interstate transportation offenses, are substantively virtually identical to the Ponzi-scheme allegations brought in *Newby*, against nearly the same Defendants.¹³⁷ The alleged acts are all offenses constituting misrepresentations or concealment of Enron's real financial condition to inflate the value of Enron stock and to keep investor money flowing into the alleged lucrative pyramid scheme that permitted Defendants to loot the corporation, and are actionable as parts of the *Newby* Ponzi scheme. *Bald Eagle*, 189 F.3d at 330 (Where alleged RICO predicate offenses are an integral part of and sustain an alleged securities fraud Ponzi scheme, they are intrinsically conduct undertaken "in connection with the purchase or sale of securities" and are barred by the RICO Amendment; allowing a surgical presentation of parts of that scheme would "undermine the congressional intent behind the RICO

¹³⁶ *Bald Eagle*, 189 F.3d at 329-30 ("[A] plaintiff cannot avoid the RICO Amendment's bar by pleading mail fraud, wire fraud and bank fraud as predicate offenses in a civil RICO action if the conduct giving rise to those predicate offenses amounts to securities fraud.").

¹³⁷ The RICO claims in *Tittle* target the same kinds of groups, other than Enron directors and employees, as the securities violation claims in *Newby*: investment banks, Arthur Andersen and accountants, and Vinson & Elkins, L.L.P. and lawyers.

Amendment"). The RICO and state-law civil conspiracy and accountant negligent misrepresentation claims of Tittle are also actionable as securities fraud claims and have been so characterized in *Newby*.

Defendants allegedly conspired to commit a pattern of racketeering activity that equates to the Ponzi scheme of *Newby* and engaged in many of the same transactions that support the conspiracies alleged under ERISA and the federal securities statutes to create the same illusion of financial strength by means of (1) the same or same kinds of "extensive 'off-book' transactions to hide and shift debt from its balance sheets," (2) making, certifying, and issuing false financial statements that violated GAAP and GAAS and filing misleading reports with the SEC with the knowledge or reckless disregard that they were false, (3) painting false financial pictures of Enron for the public, investors, and the plan participants, as well as the analysts, credit raters, and lenders and (4) concealing material conflicts of interest, all in connection with the purchase of Enron securities. See, e.g., *id.* at ¶¶3, 5, 203-41, 242-43. Both suits challenge the same allegedly false financial statements, SEC reports, and oral and written misrepresentations to the securities market, the public, and Enron employees, and the involvement of the investment banks, Vinson & Elkins lawyers, and Arthur Andersen accountants in creating parts of and perpetuating the scheme.

Furthermore, the plan participants' actual losses in essence are the same financial losses suffered by all Enron shareholders: the artificial and fraudulent inflation of value of

Enron stock followed by a precipitous decline in price after revelations of Enron's actual financial condition. The fraud was perpetrated on all Enron securities holders, not only on ERISA retirement plan participants and phantom stock recipients. Thus in the larger picture, the RICO claims brought by *Tittle* Plaintiffs are in essence brought in their capacity as Enron shareholders, directly or indirectly, and not merely as plan participants. The fact that the participants' loss was in a retirement plan "pot," stock which the plans purchased and/or held on their behalf, as opposed to in an individual shareholder's portfolio, does not change the fact that in actuality they suffered the same injury, i.e., loss in value of Enron securities, purportedly caused by the same alleged wrongdoing of parties named in both *Newby* and *Tittle*.

Although Plaintiffs have argued that Defendants' conduct caused them merely to hold onto Enron stock, thus having no connection with the purchase or sale of securities, the Court agrees with what Vinson & Elkins has argued,

[T]he conduct that allegedly caused some investors to hold stock would, on the facts pleaded, be the same conduct that allegedly caused others to purchase or sell. The fact that the conduct pleaded could have caused some of Enron's employee-investors to continue purchasing Enron stock is sufficient for purposes of the PSLRA bar, even if other employee-investors suffered harm only by holding stock. *Ikon*, 86 F. Supp. 2d at 487 (finding that the fact that the plaintiff was harmed by actions other than securities fraud does not negate the applicability of the PSLRA bar when the conduct pleaded is actionable securities fraud); see *Bald Eagle*, 189 F.3d at 330 (holding that "surgical presentation of the cause of action . . . would undermine the

congressional intent behind the RICO Amendment); *Burton v. Ken-Crest Servs., Inc.*, 127 F. Supp. 2d 673, 677 (E.D. Pa. 2001) ("Plaintiff cannot magically revive his claim by picking out discreet [sic] details of his allegations and then claiming that they are not actionable as securities fraud.").

#232 at 10-11.

The *Tittle* Plaintiffs attempt to argue that their claims are not actionable under securities law by narrowly focusing on the effects of the extensive fraud on the plan participants only, rather than viewing them in their broader context. For instance Plaintiffs argue that the securities laws do not apply because the misrepresentations and omissions made by Lay and Olson to them were not public, but instead occurred during employee meetings or were made in in-house publications. Nevertheless, the alleged misrepresentations were precisely the same kind being made by Enron officials and other Defendants to the public at large to entice more investors to purchase more stock and to retain what they already owned to keep the Ponzi scheme fed. Were Lay, Olson, or any Enron official to paint a different, inconsistent picture to the many thousands of plan participants than the one presented by these and other Defendants to the public at large, the SEC, and the market, they would not only violate insider trading laws, but the Ponzi scheme would have quickly been exposed and undermined.

Tittle Plaintiffs have construed § 10(b) and Rule 10b-5 narrowly and attempt to limit their reach merely to material misrepresentations and omissions. Even if the reach of § 10(b) were so restricted, the content of the alleged misinformation and misrepresentation to plan participants and beneficiaries was

parallel to and redundant of that made publicly by the same or other Defendants at other times and has been challenged in *Newby*. Plaintiffs also claim that the conduct of most of the Defendants cannot be reached under the federal acts. This Court has ruled otherwise. See #1194 in *Newby*.¹³⁸

The alleged "predicate acts," a RICO term manipulated by Plaintiffs to cordon off acts that by another name would be "course of business," a "deceptive device," and/or a "scheme or artifice that operated as a fraud on sellers or purchasers of securities" under the securities laws, all relate to, are part of, and are the direct or indirect effects of the alleged Ponzi scheme to defraud investors in connection with the purchase or sale of securities in *Newby*. The nature of the RICO predicate offenses of embezzlement, mail fraud, wire fraud, interstate transportation, and obstruction of justice arise from the same nucleus of facts and serve the identical scheme alleged in *Newby* for concealing Enron's actual financial condition from investors and creditors, for identical purposes, i.e., ensuring a successful public image and high credit ratings that induced continuing investment in and retention of Enron securities, ultimately for Defendants' personal enrichment.

¹³⁸ Even if this Court has read *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1993), and the statute too expansively in concluding that Defendants may be primarily liable under § 10(b) and Rule 10b-5, under a narrow construction the SEC would still have standing to pursue claims against the various Defendants who are not plan fiduciaries for aiding and abetting a securities law violation under § 10(b) and Rule 10b-5 in a civil enforcement action. See, e.g., *SEC v. Fehn*, 97 F.3d 1276, 1284 (9th Cir. 1996), cert. denied, 522 U.S. 813 (1997).

The *Tittle* Plaintiffs' asserted predicate acts are integral parts of the Ponzi securities fraud scheme alleged in *Newby*. For example, *Tittle* Plaintiffs identify as an alleged embezzlement predicate act, "Enron Insider Defendants embezzled Plan assets within the meaning of Section 664 by intentionally investing and continuously reinvesting Plan assets in Enron stock, and by diverting Plan assets away from other available investment vehicles" Complaint at 273, ¶791.¹³⁹ The embezzlement of plan funds included Defendants' making matching contributions in artificially inflated Enron stock in lieu of actual compensation value in cash. That substitution of Enron stock for actual cash value, buttressed by the alleged fraudulent inducement of plan participants to request the trustee to purchase more Enron stock at excessive prices for their individual accounts, ultimately functioned to line Defendants' own pockets in the form of increased salaries and bonuses, according to Plaintiffs.

The acts of alleged wire and mail fraud include numerous allegations parallel to those in *Newby*, such as the following:

(1) "Merrill Lynch used the wires and mails on dozens of occasions

¹³⁹ The purported substitution of the deceptively over-valued stock for cash compensation, effectively cheating pension plan participants of the true value of compensation, is integral to the *Newby* Ponzi scheme to fraudulently enhance Enron's financial condition to obtain analysts' "buy" recommendations and more credit, to lure more and more investors to purchase Enron securities and to feed the frenzied Ponzi beast. Not only were plan participants subjected to the same alleged misrepresentations about Enron and investment in it, but that fraud on plan participants provided an added avenue of revenue for the Ponzi scheme when the overpriced Enron stock was substituted for cash for the retirement pensions, so that Defendants could allocate the undistributed funds to their own pockets as increased salaries and bonuses.

between 1998 and 2001 to promote Enron stock to clients" (complaint at 277, ¶795(vii)); "Fastow, Kopper and Merrill used the mails and wires to obtain investors in LJM2." (*id.* at ¶795(ix)); and "CFSB used the wires and mails to help Enron Defendants create approximately 3,500 off balance sheet partnerships whose major purpose was to hide Enron debt and in so doing used the mails and wires on thousands of assets." (*id.* at ¶795 (xi)). Tittle Plaintiffs have alleged that Defendants used the mails and wire facilities "in furtherance of the unlawful scheme in order to (i) encourage employees to invest money in the Savings Plan; (ii) encourage Enron employees to accept over-valued Enron stock as compensation in the Savings Plan." *Id.* at ¶¶798; 826; 830.

The interstate transportation predicate acts involve allegations that Enron Insider Defendants, Arthur Andersen Defendants, and some Investment Banking Defendants conspired to induce Enron employees "to travel . . . in the execution of the wrongful scheme alleged herein, . . . to Houston, Texas, to attend meetings conducted by the Enron Insider Defendants at which ECSP participants were reassured that their 401(k) funds were safely invested and that they should hold and maintain their investments in Enron stock." (*Id.* at 281-82, ¶796). The interstate transportation of monies into the plans for fraudulent purposes and for convincing plan participants at meetings in Houston that their Enron investments were safe again were substantively part and parcel of the same kind of wrongful conduct directed at the public at large and challenged in *Newby*. Like the *Newby* Lead

Plaintiff alleging that Defendants employed all kinds of deceptive devices, contrivances, and misrepresentations in a constant struggle for more funds through the sale of more overpriced Enron securities, the *Tittle* Plaintiffs claim that all these racketeering acts fraudulently induced plan participants to accept as part of their retirement benefits and/or to direct the trustee to acquire, and/or to hold Enron securities.

Finally, the obstruction of justice charge against Arthur Andersen LLP, while not a securities violation in itself, was part of the alleged Ponzi scheme's concealment of its earlier accounting misrepresentations in audits and SEC filings and ultimately of Enron's real worth and financial condition, and serves as evidence of scienter.

Furthermore the SEC has filed a number of civil enforcement actions under the securities statutes against parties that are defendants in the *Tittle* RICO claims. Moreover Joseph Hirko and Kenneth Rice, Defendants in *Tittle*, have been indicted for securities violations related to their roles in Enron's broadband business.

Thus the Court finds that the RICO claims are based on conduct actionable as securities fraud, indeed the same or similar conduct that has been or could have been alleged in *Newby* under the federal securities laws, and are therefore barred by the RICO Amendment. Because the RICO Defendants' alleged wrongful conduct is actionable as securities fraud, the *Tittle* Plaintiffs' RICO claims (Counts VI and VII), including the claim under § 1962(d)

for conspiracy to violate § 1962(a) and (c),¹⁴⁰ must be dismissed. The dismissal is proper even though many of the Tittle plaintiffs may not have a remedy under the 1933 and 1934 Acts because the Tittle plan participants' interests in the ERISA plans and phantom stock compensation are not deemed securities under, and their pure holding claims are not reached by, the securities laws.

Finally, because no Defendant's criminal conviction is final, the Court concludes that the criminal exception to the RICO Amendment is at this point inapplicable.

C. ERISA BREACH OF FIDUCIARY AND CO-FIDUCIARY DUTY

ERISA does not have heightened pleading requirements, but is subject to the notice pleading standard of Fed. R. of Civ. Procedure 8, i.e., "a short and plain statement of the claim showing that the pleader is entitled to relief" and that provides a defendant with fair notice of the claim against him. *Heimann v. National Elevator Industry Pension Fund*, 187 F.3d 493, 509, 511 (5th Cir, 1999) ("technical forms of pleading are not required"), *overruled on other grounds, Arana v. Ochsner Health Plan*, ___ F.3d ___, ___, No. 01-30922, 2003 WL 21554491 (5th Cir. July 10, 2003). "The complaint must be liberally construed in favor of the plaintiff, and all the facts pleaded must be taken as true," with dismissal proper only if "it appears beyond doubt that the

¹⁴⁰ *Lightning Lube, Inc. v. Witco Corp.*, 4 F.3d 1153, 1191 (3d Cir. 1993) ("Any claim under section 1962(d) based on conspiracy to violate the other subsections of 1962 necessarily must fail if the substantive claims are themselves deficient."); *In re Ikon*, 86 F. Supp. 2d at 487 (where predicate acts are dismissed because they are actionable as securities fraud, a § 1962(d) conspiracy claim to violate the other subsections of § 1962 must fail because the substantive claims are deficient).

plaintiff can prove no set of facts that would entitle him to relief. [citations omitted]" *Haynes v. Prudential Health Care*, 313 F.3d 330, 333 (5th Cir. 2002).

1. Count I (Plaintiffs on behalf of the Savings Plan and the ESOP sue Enron and the Enron ERISA Defendants for inducing and mandating the acquisition and retention of Enron stock in the Savings Plan and the ESOP); AND

Count V (Plaintiffs, on behalf of the Savings Plan, the ESOP, and the Cash Balance Plan sue Enron, Lay,¹⁴¹ and the Compensation Committee Defendants for failure to monitor the Plans' investment fiduciaries and/or disclose to the investing fiduciaries (not limited to the Administrative Committee) material facts regarding Enron's financial condition)

With respect to Counts I-V generally, the provisions of the Enron Corporation Savings Plan (Ex. A to #322) set out the

¹⁴¹ Lay has argued that Count I does not allege a claim for failure to monitor against him and that Count V does not mention him at all. The amended complaint at 235-36, ¶674 asserts,

Under the terms of the [Savings] Plan, the Committee members were selected and monitored by "Enron Corp." Plan § XIII.1. On information and belief, selection and monitoring of the Committee members was performed by the Compensation and Management Development Committee of the Board of Directors ("Compensation Committee"), Lay and others. Enron itself acted as a fiduciary in selecting, monitoring, and removing other plan fiduciaries, such as the members of the Administrative Committee, and overseeing their investment of Plan assets.

The Court finds these allegations are sufficient to assert a claim against Lay for breach of his fiduciary duty to select and monitor, encompassed within Count V. It appears that Plaintiffs' reference to Count I was a clerical error.

fiduciary obligations of the various players and echo the law established under ERISA, discussed previously.

Under § XIII.1, Enron Corporation has the duty to appoint the members of a Committee which will serve as the Plan administrator and is designated a named fiduciary with respect to general administration of the Plan, except for investment of the assets in the trust fund. Moreover under § XIII.8, Enron must provide the Administrative Committee with "any information that the Committee determines is necessary for the proper administration of the Plan" and to the Trustee any such "facts as are deemed necessary for the Trustee to carry out the Trustee's duties under the Plan."

Under §§ XIV.1 and XV.2, Enron has sole discretion in appointing, removing and replacing the Trustee.¹⁴² Enron, although a Plan sponsor, is also a fiduciary to the Plan to the extent it exercises discretionary control and authority over these specific matters.¹⁴³

The duties of the Administrative Committee appointed by Enron are laid out in § XIII.7 of the Savings Plan and include

¹⁴² In contrast, under § 16.1 of the ESOP Plan (Ex. C to #322) Enron's Board of Directors, specifically, has the power to appoint, remove and replace the trustee. Under § 16.8 of the ESOP Plan the trustee is authorized to invest the trust fund up to 100% in Enron stock, but the Administrative Committee "shall determine the extent to which the Trust Fund shall be invested in Company Stock and shall determine the price at which Company Stock will be purchased or sold. The Trustee shall act on the Committee's directions"

¹⁴³ Section XV.2 expressly states, "Each fiduciary with respect to the Plan shall have only those specific powers, duties, responsibilities, and obligations as are specifically given him under the Plan."

directing the Trustee "as to the investment of the Trust Fund in Enron Stock or EO&G Stock," "appoint[ing] investment managers pursuant to Section 15.5," and "direct[ing] the Trustee as to the exercise of rights or privileges to acquire, convert, or exchange Enron Stock or EO&G Stock." In § XV.2, the Savings Plan provides that the Administrative Committee, "as a co-fiduciary" to the Trustee, may "exercise its power given hereunder at any time, and from time to time, by written notice to the Trustee, to direct the Trustee in the management, investment, and reinvestment of the Trust Fund"

The Savings Plan Trust Agreement (Ex. B to #322) invests the Administrative Committee with additional obligations, some ministerial and some fiduciary. Article 1.1 expressly designates the Administrative Committee as "the named fiduciary for Plan administration" with "the responsibility for allocating the assets of the Fund among the Separate Accounts, for monitoring the diversification of the investments of the Fund, for assuring that the Plan does not violate any provision of ERISA limiting acquisition or holding of securities or other property of the Company, and for the appointment and removal of Investment Advisors"

Under Article Four ("Investment Funds") of the Savings Plan Trust Agreement, the Administrative Committee is to designate Investment Funds, such as a Company Stock Investment Fund, and "is authorized to terminate the existing Investment Funds" by written notice to the Trustee and "to direct the Trustee with respect to the allocation of assets to Investment Funds and with respect to transfers among such Investment Funds."

The Trustee, which is designated by § XIV.1 as "the 'named fiduciary' with respect to investment of the Trust Fund's assets," is invested by § XV.2 with "the sole responsibility for the administration, investment, and management of the assets held under the Plan," which makes it a fiduciary under ERISA, subject to the Administrative Committee's authority to direct it, as described in the above paragraph. The Plan qualifies that responsibility in § XIV.2, however: when the Administrative Committee, as a co-fiduciary, directs by a written notice "the Trustee in the management, investment, and reinvestment of the Trust Fund, then in such event the Trustee shall be subject to all proper directions of the Committee that are made in accordance with the terms of the Plan and the Act. It is intended under the Plan that each fiduciary shall be responsible for the proper exercise of his own duties, responsibilities, and obligations hereunder and shall not be responsible for any act or failure to act of another fiduciary except to the extent provided by law or as specifically provided herein." (Parallel provision in ESOP Plan § 17.2.) Plaintiffs have alleged that Northern Trust was the Trustee of the Savings Plan and of the ESOP, in accordance with the express terms of both, and a fiduciary with respect to powers allocated to it under the terms of those plans.

Section 1.24 of the Enron Corp. Savings Plan Trust agreement (Ex. B to #322) names the Northern Trust and any successor to it as the trustee for the Savings Plan. Article V, which identifies the powers of the trustee, charges Northern Trust, except as otherwise provided in the Savings Plan Trust

agreement, with holding, managing, caring for and protecting the assets of the Plan, including investing and reinvesting those assets, to sue or defend claims against the Trust Fund.¹⁴⁴

Article VI of the Savings Plan, addressing limitations on the trustee's power, sets out its fiduciary obligations and provides,

Notwithstanding Article Five:

6.1 The powers of the Trustee shall be exercisable for the exclusive purpose of providing benefits to the Participants and Beneficiaries under the Plan and in accordance with the standards of a prudent person under ERISA;

6.2 Subject to 6.1 and 6.3, the Trustee shall diversify the investments of that portion of the fund of which it has investment responsibility so as to minimize the risk of large losses;

6.3 Subject to 6.1, the Trustee shall, with respect to that portion of the Fund for which it has investment responsibility, follow the investment guidelines established by the Administrative Committee and shall act in accordance with the direction of the Administrative Committee.

6.7 No provisions of Sections 6.5 or 6.6 [addressing direction of the trustee by plan participants] shall prevent the Trustee from taking any action relating to its duties under Sections 6.5 or 6.6 if the Trustee determines in its sole discretion that such action is necessary in order for the Trustee to fulfill its fiduciary responsibilities.

Parallel provisions charging the Trustee and the Committee among others with the same fiduciary duties delineated in 6.1 and 6.2 of

¹⁴⁴ Section 5.12 of the trust agreement gives the trustee the right "[t]o compromise, contest, prosecute or abandon claims in favor of or against the Fund."

the Savings Plan are found in § 17.3 of the ESOP Plan and §§ 1.6, 4.1, and 4.4 of the ESOP Trust Agreement (Ex. D to #322).

As a threshold matter, the Court finds that Plaintiffs' pleadings have raised material issues as to whether the Savings Plan qualifies as a § 404(c) plan, entitling Defendants to immunity from liability for investment decisions controlled by plan participants, by allegations that the plan did not provide the requisite broad range of diversified investment options, liberal opportunities to transfer assets among allocations, and sufficient information to make sound investment decisions, nor notice to plan participants that it intended to qualify as such a plan. These issues and any defense under § 404(c) asserted by Defendants, on a 12(b)(6) motion review, must be construed in Plaintiffs' favor and cannot properly be resolved prior to discovery.

With respect to the claims in Count I, the Court finds that Plaintiffs have stated a claim, which is intertwined with Plaintiffs' contention that the fiduciaries failed to meet the requirements for a § 404(c) plan, against those Defendants who were authorized by the Plans to invest the Plan assets and who allegedly induced their uninformed Savings Plan participants to direct the fiduciaries to buy more or maintain Enron stock for their individual accounts, in breach of their duties of loyalty and prudence.

Second, some of the allegations under Count I relate to plan design, a settlor function, and do not trigger fiduciary duties: "allowing Savings Plan participants the ability to direct

the Plan's fiduciaries to purchase" Enron stock; and "imposing age and other restrictions on the ability of the participants to direct the Savings Plan's fiduciaries to transfer Savings Plan and ESOP assets" out of Enron stock. See *Lockheed Corp. v. Spink*, 517 U.S. 882, 887 (1996) ("Nothing in ERISA requires employers to establish employee benefit plans. Nor does ERISA mandate what kind of benefits employers must provide if they choose to have such a plan."); *Smith v. Contini*, 205 F.3d 597, 602 (3d Cir. 2000) ("ERISA neither mandates the creation of pension plans nor in general dictates the benefits to be afforded once a plan is created. . . . Thus ordinarily only the plan can create an entitlement to a benefit."), *cert. denied*, 531 U.S. 875 (2000); *Goldstein v. Johnson & Johnson*, 251 F.3d 433, 441 (3d Cir. 2001) ("ERISA was enacted to ensure that employer-provided benefit plans are safeguarded and maintained so as to be available to employees when they are due. The Act does not mandate that an employer provide benefits and has nothing to say about how these plans are designed."); *McGann v. H&H Music Co.*, 946 F.2d 401, 407 (5th Cir. 1999), *cert. denied sub nom. Greenberg v. H&H Music Co.*, 506 U.S. 981 (1993) (approving Sixth Circuit's comments in *Musto v. American General Corp.*, 861 F.2d 897, 912 (6th Cir. 1988) ("rejecting challenge to an employer's freedom to choose the terms of its employee pension plan"), *cert. denied*, 490 U.S. 1020 (1989): "In enacting ERISA, Congress continued its reliance on voluntary action by employers by granting substantial tax advantages for the creation of qualified retirement programs. Neither Congress nor the courts are involved in either the

decision to establish a plan or in the decision concerning which benefits a plan should provide. In particular, courts have no authority to decide which benefits employers must confer upon their employees"))¹⁴⁵; *Dzinglski v. Weirton Steel Corp.*, 875 F.2d 1075, 1078-79 (4th Cir.) ("Congress left employers much discretion in designing their plans under ERISA and in determining the level and conditions of benefits. The judicial role is not to rewrite plan provisions, but to assure that they are fairly administered. . . . [U]nder ERISA the institution of plans is largely voluntary and the fashioning of plan elements has been largely left in the hands of individual employers"), *cert. denied*, 493 U.S. 919 (1989). Moreover, "The specific payout detail of the [ERISA] plan was, of course a feature that the employer as plan sponsor was free to adopt without breach of any fiduciary duty under ERISA since an employer's decisions about the content of a plan are not themselves fiduciary acts." *Pegram v. Herdrich*, 530 U.S. 211, 226 (2000).

¹⁴⁵ The Fifth Circuit in *McGann*, 946 F.2d at 407 n.9, pointed out:

Musto involved an ERISA claim by retirees that their former employer violated contractual and fiduciary duties by changing the terms of their medical coverage. The court rejected plaintiffs' claim that they had a vested interest in the terms of their medical coverage. *Musto* . . . noted that "[t]here is a world of difference between administering a welfare plan in accordance with its terms and deciding what those terms are to be. A company acts as a fiduciary in performing the first task, but not the second."

Nevertheless, outside of challenging the establishment of these terms by the employer in its settlor, not fiduciary, capacity, the application of which terms Plaintiffs do not object until sometime in 1998 when the alleged scheme began, Plaintiffs have stated a claim for breach of their fiduciary duties of loyalty and prudence based on Defendants' alleged *inducement* of the plan participants to direct the trustee to invest in Enron stock for their individual Savings Plan accounts and inducing Savings Plan and ESOP participants to direct or allow the fiduciaries of both Plans to maintain such investments, under the circumstances from 1998-2000 set forth in the complaint. They also state a claim for breach of fiduciary duty in causing and allowing the Savings Plan to purchase or accept Enron's matching contributions in the form of Enron stock once the fiduciaries allegedly knew or should have known of the inherent risk of such stock in light of the circumstances alleged in the complaint.

A claim has also been stated in Count I against Enron and the Compensation Committee for breach of their fiduciary duty of providing information necessary for Plan Administration because they allegedly withheld from the Administrative Committee (which in turn purportedly failed in its fiduciary duty to investigate) material information regarding the actual financial condition of Enron. Despite alleged red flags and warnings, Olson¹⁴⁶ and

¹⁴⁶ Plaintiffs have alleged that Olson had read an article in the March 5, 2001 *Fortune* magazine that discussed Wall Street worries about Enron's increasing secrecy, growing debt, bullish expectations, "opaque accounting and dubious rationalizations" for its high stock price (then \$76 per share), all of which constitute a "red flag" that "may increase the chance of a nasty surprise,"

Prentice were among the members of the Administrative Committee who purportedly did nothing to protect plan participants and beneficiaries until November 2001, when Enron was near bankruptcy. The complaint asserts that Lay and Olson were not only forewarned by Enron vice president Sherron Watkins, formerly an Arthur Andersen accountant and thus highly knowledgeable about corporate accounting, of significant accounting malfeasance at Enron,¹⁴⁷ but

but did not share that information even with other members of the Administrative Committee. Complaint at 237, ¶¶679-80. Olson purportedly sold over \$2 million worth of Enron stock in January and February 2001 and another \$350,000 worth of Enron stock at \$71 per share on March 8, 2001. The complaint, at 238, ¶¶685-86 and 703, alleges that Olson also concedes that in August 2001 she was warned orally and in writing by Sherron Watkins about Watkins' concerns that the company "would implode in a wave of accounting scandals," and that Olson also learned that Fastow wanted Watkins fired for her warnings. Nevertheless, according to the complaint, Olson, in breach of her fiduciary duties did nothing, even while personally witnessing Lay repeatedly urge employees to invest in Enron stock. Olson purportedly admitted that only in November 2001 did the Committee seek legal and investment advice about the prudence of Enron stock as a Plan investment option. Prentice, who conceded that neither he nor the Committee members had ever questioned the prudence of Enron Stock as a Plan investment until November of 2001 and that he was not competent to evaluate the issue, is alleged to have sold \$900,000 worth of company stock in June 2001. Complaint at 240, ¶693.

¹⁴⁷ The complaint, at 238, ¶687, asserts,

Any prudent, disinterested fiduciary would at that point, among other things, have immediately convened an emergency meeting of the Plan Administrative Committee, made full disclosure of Watkins' allegations to the Committee, the Plan's counsel, the Plan's investment consultant and the Plan's participants; and taken actions to promptly suspend any further use of Enron stock as a Plan investment (based either on employee or employer contributions) pending a Committee investigation conducted independent of Enron, Andersen, and Vinson & Elkins and, upon receiving the result of such independent investigation, liquidate the Plan's Enron

as a result of Watkins' contentions, Lay became involved in setting up an "investigation" of the allegation by Vinson & Elkins, even though Watkins had voiced concern about the law firm's blatant conflict of interest in performing it. Furthermore, after Watkins' warning, Lay sold substantial amounts of his Enron stock holdings while contemporaneously and repeatedly exhorting plan participants and beneficiaries at meetings and by e-mail to buy more, touted Enron's financial strength, and made no disclosure of the material concerns, much of which Olson personally observed. He also purportedly misrepresented that the accounting for Enron's off-balance sheet partnerships and SPVs was approved by "all of our internal officers as well as our external auditor and counsel," while failing to mention Watkins' vocalized concerns. See generally Complaint at 242-43 ¶¶705-709. The complaint also charges the Administrative Committee with an ongoing conflict of interest:

In considering the use and continued use of Enron stock as an investment option in the Plan for participant contributions (deducted from participants' paychecks), and in monitoring the prudence of continuing to implement Enron's decision to match employee contributions in Company stock (the employer matching contribution), the Administrative Committee members as employees and executives of Enron, and Enron itself who oversaw the Committee members, faced a direct, ongoing conflict of interest given the manifold business reasons they had for wanting to see employees heavily invested in Company stock."

Complaint at 240, ¶694.

stock holdings.

Members of both the Administrative and the Compensation Committees, Enron, and Olson, when they spoke about plan investments, had a fiduciary obligation not to materially mislead plan participants and beneficiaries about Defendants' concealment of Enron's precarious financial condition by means of erroneous accounting and about the risk involved in investing their assets in and retaining its stock. *Varity Corp. v. Howe*, 516 U.S. at 506 ("Lying is inconsistent with the duty of loyalty owed by all fiduciaries and codified in section 404(a)(1) of ERISA"); *Schlumberger*, 338 F.3d at 424-25 ("The Supreme Court's words in *Varity* instruct that when an employer chooses, in its discretion, to communicate about future plan benefits, it does so as an ERISA fiduciary. In speaking it is exercising discretionary authority in the administration of the plan Thus it has a duty to refrain from 'knowingly and significantly' deceiving a plan's beneficiaries 'in order to save the employer money at the beneficiaries' expense'"); *Mullins v. Pfizer, Inc.*, 23 F.3d at 668 ("when a plan administrator speaks, it must speak truthfully"). Communication with plan participants about employee benefit plans is an exercise of "discretionary authority" regarding the management or administration of the plans, under 29 U.S.C. § 1001(21)(A)(i) and (iii), and is a fiduciary act. *Varity Corp. v. Howe*, 516 U.S. at 502. These Defendants allegedly breached their fiduciary duty to protect the plan participants and beneficiaries through failure to disclose to them and to other Committee Members that what they knew or should have known, through prudent investigation, was a threat to the pension plans

or to correct any material misinformation. Lay and Olson in particular are described in the complaint as explicitly encouraging plan participants to direct the Savings Plan and ESOP fiduciaries to purchase and hold Enron stock when they knew or should have known that it was an imprudent investment option. In *Varity Corp.*, 516 U.S. at 502-03, the Supreme Court found that "conveying information about the likely future of plan benefits, thereby permitting beneficiaries to make an informed choice about continued participation," was part of a plan administrator's duty "to offer beneficiaries detailed plan information" and, that misinformation about such provided in conjunction with misrepresentations about the business health of the company, constituted an act of plan administration subject to fiduciary standards. Moreover Olson allegedly failed to correct what she knew were material misstatements of fact made by Lay, i.e., statements substantially likely to mislead plan participants in making informed decisions about investing in Enron stock, in the fall of 2001 that affected the interests of the plan participants and beneficiaries and which plan participants and beneficiaries, to protect their interests, should but did not know were untruthful. Administrative Committee Member Defendants also allegedly failed not only to conduct, but even to consider conducting, a prudent investigation of Enron's financial situation and of Enron stock as an investment option for retirement assets until Enron was on the very edge of bankruptcy.

In sum Plaintiffs have stated claims against Enron, Lay, Olson, other Enron ERISA Defendants (including the Compensation

Committee and the Administrative Committees) for breaching duties of undivided loyalty to the interests of the Savings Plan and ESOP plan participants and beneficiaries and duty of care to act with the skill, prudence and diligence under the circumstances to the extent that they were authorized to perform fiduciary duties: these Defendants allegedly exercised, but in specified cases not well,¹⁴⁸ their explicit duty to select and appoint fiduciaries, but, despite knowledge of the threat to the plan participants' retirement assets, failed to investigate adequately, failed to provide material information or correct misleading information essential to prudent administration of the plans, failed to direct the trustee regarding prudent investment of plan assets in both the Savings Plan, including employer matching contributions, and the ESOP, and failed to monitor or remove their appointees for incompetence. Instead the complaint charges that they permitted, encouraged, or induced uninformed plan participants to invest in or retain Enron stock in their Savings Plan individual accounts. The fact that the Savings Plan is asserted not to be a § 404(c) plan makes the Plan fiduciaries potentially liable for all investment decisions taken by the plan participants.

Count V addresses breach of the fiduciary duty to appoint, monitor and remove. As indicated earlier, as a matter of law, because Enron (i.e., a corporation acting through employees who perform functions on behalf of the corporation) has authority and control over appointments of fiduciaries to administer the

¹⁴⁸ See, for example, Prentice's alleged admission that he was incompetent to fill his fiduciary duties on the Committee.

plan and control its investments, it also has a fiduciary duty to monitor its appointees.

The ESOP (Ex. C to #322) at § 14.10 designates Enron as the Plan administrator, which is authorized under § 14.1 to appoint a Committee for Administration of the Plan. "For purposes of [ERISA], the Committee shall be the 'named fiduciary' with respect to the general administration of the Plan (except as to the investment of the assets of the Trust Fund)." *Id.* at § 14.1. Among the duties assigned by the ESOP to the Administrative Committee is "to direct the Trustee as to the purchase and sale of Company Stock" and "to instruct the Trustee as to the management, investment and reinvestment of the Trust Fund generally." *Id.* at § 14.7 (l) and (n).

In a supplement (#619), Outside Director Defendants have argued that the Compensation Committee Defendants are not "named fiduciaries" under the 1994 amendment to the ESOP (Ex. C to #619), which superseded the 1989 version of the ESOP and deleted any express reference to the Board of Directors' having powers of appointment of investing fiduciaries and thus the ESOP ERISA claim against them should be dismissed.

Plaintiffs have responded (#623) that the Board of Directors were not "named" fiduciaries in the 1994 amendment, but "functional fiduciaries" who in exercising the duty to appoint, failed to monitor the fiduciaries of all three Plans. *Landry v. Air Line Pilots Ass'n Intern., AFL-CIO*, 901 F.2d 404, 418 5th Cir.) ("[W]e must emphasize that fiduciary status is to be determined by looking at the actual authority or power

demonstrated, as well as the formal title and duties of the party at issue), *cert. denied*, 498 U.S. 895 (1990).

The Secretary of Labor, however, has pointed out that the controlling version of the ESOP for all conduct following the date it became effective here is the January 1, 1999 document (Ex. B to #625), which was approved by the same Board of Directors now challenging the complaint under the earlier 1994 amendment to the plan. The 1999 version explicitly restated the ESOP "in its entirety . . . except as otherwise indicated herein" according to Ex. A, p. ii, to #625. Section 1.1(14) of that plan defines "Directors" as "The Board of Directors of Enron Corp." *Id.* at I-3. Section 16.1 ("The Trustee shall be appointed, removed, and replaced by and in the sole discretion of the Directors") of that document expressly states that the Directors had that authority. Moreover, argues the Secretary, that provision is consistent with Section 17.2's authorization, "The Company shall have the sole authority to appoint and remove the Trustee or members of the Committee," because, as made clear by § 16.1 and as a matter of established law, a corporation acts through its board of directors to effectuate its corporate duties. *Curtiss-Wright Corp. v. Schoonejongen*, 514 U.S. 73, 80-81 (1995) (because only natural persons can make decisions and because principles of corporate law provide ready-made rules for determining who has the authority to make decisions on behalf of a corporation, an ERISA plan need not specify individuals or bodies within the "Company" to show who has the authority to perform the action on behalf of the corporation). This Court agrees. In part for the same reason, the Court agrees

with the Secretary and disagrees with Outside Directors' reply, which contends that Sections 16.1 and 17.2 of the 1999 ESOP are inconsistent and ambiguous. Under federal common law, drawing on analogous state law, to the extent that it is consistent with congressional policy concerns, pertaining to the rules of contract construction (applicable because the ERISA plan is administered by a federal agency), one part of a writing should not be construed to nullify another; a contract should be interpreted as a whole, and its provisions should be read to give effect to and harmonize all where possible. See, e.g., *Transitional Learning Community at Galveston, Inc. v. U.S. Office of Personnel Management*, 220 F.3d 427, 431 (5th Cir. 2000); *Todd v. AIG Life Ins. Co.*, 47 F.3d 1448, 1451-52 (5th Cir. 1995). After reviewing the documents, the Court concurs with the Secretary's view that the controlling plan is clear and unambiguous. Should there be a dispute whether the Outside Directors were actually the Company officials involved in the appointments, it can be raised on summary judgment after discovery.

Similarly Outside Directors argue that the Savings Plan did not invest them with any power of appointment. As indicated in the summary of the relevant terms of the Savings Plan, Enron had and exercised the power of appointment, which, as a corporation, it necessarily did through its Board of Directors. Under the holding of *Curtiss-Wright Corp.*, 514 U.S. at 80-81, an ERISA plan need not specify individuals or bodies within the "Company" to show who has the authority to perform the action on behalf of the corporation.

The Court finds that Plaintiffs on behalf of the Savings Plan and the ESOP have stated claims in Count V for breach of fiduciary duties of loyalty and prudence under ERISA against Enron, Enron ERISA Defendants, including Members of the Compensation and Management Development Committee ("Compensation Committee" made up of Blake, Duncan, Jaedicke and LeMaistre), and Ken Lay,¹⁴⁹ because they were given the power to appoint, retain and remove plan fiduciaries (Enron to appoint members of the Administrative Committee of both plans, and all three Defendants to select, appoint and remove fiduciaries of the Savings Plan and the ESOP) and because they allegedly exercised that discretionary authority of appointment over the management or administration of a plan under § 3(21)(A) of ERISA, 29 U.S.C. § 1002(21)(A).¹⁵⁰ They were expressly charged by the plans to perform the selection, and therefore the monitoring, of the Administrative Committee with respect to its control over Plan investment and the prudence of investing in Enron stock as one of the Savings Plan's investment

¹⁴⁹ Enron may be liable not only as a fiduciary to both the Savings Plan and the ESOP under § 3(21)(A), 29 U.S.C. § 1002(21)(A), but also as a party in interest under § 3(14), 29 U.S.C. § 1002(14), because it provided services to the Plans and was an employer with some employees covered by the Plans.

¹⁵⁰ Although Outside Directors have argued that the Savings Plan's only express allocation of authority and control to the Compensation Committee was to review and approve plan amendments, a task which does not trigger a fiduciary duty, Plaintiffs' complaint does allege that the Compensation Committee had and exercised the authority to select, monitor and remove fiduciaries to the Plan and that the Plans do explicitly allocate fiduciary duties to Enron, a corporate entity on whose behalf its officers and directors, including the Compensation Committee members, necessarily acted. Discovery will be required to determine precisely what role the Compensation Committee members played.

options. See, e.g., *Coyne & Delany Co.*, 98 F.3d 1464-65 ("the power . . . to appoint, retain and remove plan fiduciaries constitutes 'discretionary authority' over the management or administration of a plan within the meaning of § 1002(21)(A)"); *Hickman*, 840 F.2d 564 ("Tosco is a fiduciary within the meaning of ERISA . . . because it appoints and removes the members of the administrative committee that administers the pension plan."); *Sommers Drug Stores*, 794 F.2d at 1459-60; *Leigh v. Engle*, 727 F.2d at 133-35; *Martin v. Feilen*, 965 F.2d at 668-70; *Detroit Terrazzo Contractors Ass'n v. Board of Trustees of B.A.C. Local 32 Ins. Fund*, 176 F. Supp. 2d 733, 739-40 (E.D. Mich. 2001); ERISA Interpretative Bulletin 75-8, 29 C.F.R. § 2509.75-78 (D-4) (members of a board of directors "responsible for the selection and retention of plan fiduciaries" have "'discretionary authority or discretionary control respecting the management of such plan' and are, therefore, fiduciaries with respect to the plan."). As such, they had a duty to insure that the selected fiduciaries in turn complied with their fiduciary duties. *Leigh v. Engle*, 727 F.2d at 134-35; *Mehling v. New York Life Ins. Co.*, 163 F. Supp. 2d at 509-10; *Liss v. Smith*, 991 F. Supp. at 310, 311.

The complaint has also stated a claim in Counts I and V against these Defendants for co-fiduciary liability under § 502(a)(3), 29 U.S.C. § 1132(a)(3), for knowingly participating in or concealing their knowledge of and/or failing to make reasonable efforts to remedy their co-fiduciaries' breach of fiduciary duties in violation of § 404(a), 29 U.S.C. § 1104(a). Section 405(a), 29 U.S.C. § 1105(a); *Landry*, 901 F.2d at 422-23; *American Fed. of*

Unions Local 102 Health & Welfare Fund v. Equitable Life Assurance Soc'y, 841 F.2d 658, 665 (5th Cir. 1988) (failure to monitor and remove fiduciaries for misconduct may result in § 405 liability). The complaint further asserts that Enron, Lay, and the Compensation Committee are liable as co-fiduciaries for their failure to inform the Administrative Committees about Enron's actual financial status and/or failure to monitor their appointees and to supervise the Administrative Committees of the plans regarding the prudence of their decision to invest assets of the Savings Plan and the ESOP in Enron stock. Plaintiffs also claim that the Committees failed in their duty to investigate whether the investment options were prudent¹⁵¹ and that the Committee Members were not competent, had no process in place for fulfilling their duty to make prudent investment decisions, and had corporate conflicts of interest that undermined their duties of loyalty to the plan participants and beneficiaries. *Brock*, 632 F. Supp. at 1524 (holding plan trustees that blindly follow the recommendations of another plan trustee or *de facto* fiduciaries liable for the others' breaches); *Sandoval v. Simmons*, 622 F. Supp. 1174, 1214-15 (C.D. Ill. 1985) (fiduciaries failing to perform independent investigation of plan's investment options because of conflicting loyalties to another plan fiduciary and his

¹⁵¹ Although Enron Committee members cite several cases for the proposition that Plaintiffs must show that an adequate investigation would have revealed information proving that the trustee's investment decision was objectively imprudent, all of them were decided after discovery at the summary judgment stage of the litigation. #439 at 7.

corporate interests were liable for that fiduciary's breaches under § 405).

The Court additionally finds that the complaint states a claim under Count I against Arthur Andersen as a party in interest under § 3(14), 29 U.S.C. § 1002(14), as a provider of professional services to Enron and the Savings Plan, based on Plaintiffs' allegations that Arthur Andersen knowingly participated in the Enron Defendants' fiduciary breaches under § 404(a) by actively concealing from Plan fiduciaries and Plan participants and beneficiaries the truth about Enron's financial condition and the imprudence of investing in the company's stock, a prohibited transaction violation under ERISA's § 406(a). Under § 502(a)(3) and *Great West*, 534 U.S. 204, if they prevail Plaintiffs may recover restitution in equity, disgorgement or other types of equitable relief. Plaintiffs assert that the enormous fees, over \$100 million, for aiding Enron and other Defendants to breach their fiduciary duties, are traceable to Andersen's knowing participation in such breaches and are subject to such equitable remedies.

2. Count II: Lockdowns

Defendants to Count II have argued that they are not "fiduciaries" with respect to the transition between service providers. Some Defendants have argued that under § XV.6 (relating to "Third-Party Administrator") of the Savings Plan, Enron "may, in its sole discretion, engage any service provider which is not an employee or a subsidiary of the Company to perform identified administrative services with respect to the Plan," and

that if it does engage such a "service provider," "Enron shall be fully responsible and accountable for selecting, credentialing, overseeing and monitoring such service provider, including without limitation, evaluating the quality of performance, determining whether the fees charged are reasonable, and removing or replacing such service provider as the Company deems to be necessary or appropriate in its discretion," and "[t]hereafter the Committee shall have no power, duty, or responsibility to monitor the performance of such service provider." The ESOP Plan has a parallel provision, § 14.7. Defendants argue that Northern Trust fits into this category of Third-Party Administrator and therefore the Administrative Committee has no liability relating to it. Here the Plans have specific provisions directly addressing the responsibilities of the named Trustee and the Administrative Committee, as distinguished from the general provision for an Enron-selected Third-Party Administrator.

Section XV.6 of the Savings Plan (Ex. A to #322) provides that only if Enron chooses to hire an independent service provider to perform specific services for the plan and does so, and only if it informs the Administrative Committee in writing, identifying the service provider and the services to be performed by it, is Enron subsequently fully responsible for that selection and supervision of the service provider. Otherwise it appears that under the Plan's terms, the Administrative Committee, which was given "sole responsibility for the administration of the Plan" (§§ XIII.1, XV.2), is responsible wholly or in part (along with co-fiduciary Enron) for hiring, monitoring and removing third-

party service providers under § XIII.7(d) (giving the Administrative Committee "the right, power, authority, and duty . . . [t]o employ and compensate such accountants, attorneys, investment advisors, and other agents, employees, and independent contractors as the Committee may deem necessary or advisable for the proper and efficient administration of the Plan"). Parallel ESOP provision ¶14.7(d) (but without the written notice requirement).

The consolidated complaint alleges that the two Administrative Committees' members exercised that authority to appoint with respect to Northern Trust and recordkeeper Northern Trust Retirement Consulting, LLC. Defendants have not alleged nor demonstrated with documentary attachments that Enron invoked its discretionary authority to select the trustee, and the standard of review for Rule 12(b) motions requires the Court to accept Plaintiffs' factual allegations as true. Moreover at issue in the lockdown count is not the transfer of power from Northern Trust to a new service provider, but the Administrative Committees' discretionary control over the assets of the Plan, cutting off the plan participants' access to their individual accounts when circumstances make clear that the Committees knew or should have known that a lockdown was imprudent. Investment of Plan assets was solely within the control of the Committees and the mutual Trustee.

Olson has also challenged the assertion that she functioned as a fiduciary with respect to the lockdown decision. The complaint asserts that she, not only as a Committee Member,

but also as a corporate officer for Enron, performed fiduciary functions on behalf of Enron relating to the transition in service providers and that the decision to lockdown the plans despite extraordinary circumstances that allegedly made the choice imprudent and disloyal to plan participants and beneficiaries. Lay, Enron's CEO, also is alleged to have exercised supervisory authority over the Committees and over Northern Trust and to have breached his fiduciary and co-fiduciary duty; thus he purportedly had some authority relating to the lockdowns.

According to the complaint, the lockdowns prevented both plan participants from directing the transfer and plan fiduciaries from fulfilling their duties of prudence and loyalty by disregarding, contrary ERISA provisions, and by transferring the participants' assets at a critical time. As a result, the Enron stock in the Savings Plan purportedly lost more than one-third of its value, and in the ESOP, more than two-thirds of its value.

Plaintiffs have stated a claim for breach of fiduciary and co-fiduciary duties to the ESOP and Savings Plan participants and beneficiaries against Enron, the Enron ERISA Defendants (see footnote 4 of this memorandum and order), and the named fiduciary and trustee Northern Trust, whether deemed a directed trustee or not, for proceeding with a previously scheduled lockdown of the Savings Plan and the ESOP on October 26, 2001 and October 20, 2001, respectively, in spite of the extraordinary circumstances, enumerated below,¹⁵² that obviously made the lockdowns an extreme

¹⁵² Other courts have also found a duty to disclose based on unique circumstances. See, e.g., *Glaziers and Glassworkers*, 93

threat to the participants' interests in their employee benefit plans. Plaintiffs have stated a claim that these exigent circumstances should have triggered the trustee's fiduciary duties to its plan participants and beneficiaries to postpone or at least to limit the duration of the scheduled lockdowns,¹⁵³ as Defendants had the ability to do.

First, the complaint asserts that Enron shocked Wall Street with the announcement on October 16, 2001 that it had lost \$618 million in the quarter and was writing down \$1.2 billion of its net worth. The media were filled with stories raising questions about the corporation's financial stability. Concerned employees urged Northern Trust and Enron to postpone the lockdowns. Their questions may have triggered the fiduciaries' duties to respond with truthful and complete information that would apply to the plans as a whole. Even without questions from the plan participants and beneficiaries, the fiduciaries had a duty to disclose to the participants and beneficiaries material facts affecting their interests in the plans' assets of which they were unaware and which threatened their retirement funds. With

F.3d 1171 (holding that plaintiffs, a group of benefit pension plans, stated a claim for breach of fiduciary duty against a former brokerage firm for failure to disclose that one of its brokers had been forced to resign on suspicion that he had committed fraud, after which the pension funds followed that broker to his new employer and the broker embezzled more than \$2 million from the funds).

¹⁵³ In the face of the outcry from plan participants, the Committee Members purportedly shortened the original month-long lockdown to twelve business days. Plaintiffs claim even that amount of time was a breach of fiduciary duty under the circumstances. Clearly fact questions exist that may not be resolved at this stage of the litigation.

Enron's report to Wall Street, if not before, according to the complaint, Olson should have known that Watkins' warnings in August had substance and that Lay had misled plan participants with his representations that Enron's financial picture that quarter was "great." Yet allegedly she continued to do nothing.

Second, on October 22, 2001, Enron announced that the SEC was informally investigating the company.

Third, two days later Fastow was forced to leave his position of Chief Financial Officer, which was taken over by McMahon, who had earlier voiced many of the same concerns about Enron's purportedly massive accounting improprieties as Watkins.

Furthermore, the complaint asserts that in the face of a swell of complaints and demands from panicked Plan participants, Enron actually did inquire about possible postponement of the lockdown and was told by Northern Trust and Hewitt Associates that a postponement was physically possible. Nevertheless, according to the complaint, although they knew or should have known the likely harm that would result for plan participants and although they had the discretion and power to delay the lockdowns, Enron decided that a postponement would be "inconvenient"; Olson, purportedly without even consulting other members of the Administrative Committee, refused the Plan participants' requests for a postponement; and Northern Trust, the named trustee and a fiduciary for the Savings Plan and the ESOP,¹⁵⁴ recommended that the lockdowns proceed even though it had the power to stop them and

¹⁵⁴ See §§ 1.24. 3.6; Articles V and VI of the Savings Plan Trust Agreement (Ex. B to #322).

despite the extreme circumstances and participants' outcry. In addition, allege Plaintiffs, the objections made to Northern Trust by the participants about their plight triggered a duty in the fiduciary to communicate all material facts in connection with the transaction that the trustee knew or should have known, a duty which it did not fulfill.

This Court emphasizes that the Fifth Circuit's approach to issues of fiduciary duties has generally been a case- and fact-specific inquiry and a rejection of bright-line rules and "easy formula[s]." See, e.g., *Schlumberger*, 338 F.3d at 427; *Ehlmann*, 198 F.3d at 556. Such an evaluation requires a record developed through discovery; thus dismissal is not appropriate based on a 12(b)(6) motion.

Plaintiffs have further complained that these Defendants had a duty to provide timely and informative notice of the lockdown to Savings Plan participants so they had an opportunity to safeguard their rights and direct Northern Trust to sell the Enron stock allocated to their individual accounts; instead Enron sent notice to participants by e-mail on October 25, 2001 at 11:44 p.m., the day before the lockdown, and employees did not receive it until they came to work on the day of the lockdown.¹⁵⁵ The

¹⁵⁵ An initial notice was sent on October 8, 2001, before any of the "extraordinary circumstances" materialized, providing ESOP participants with the routine notice that unless they filed distribution request forms with Northern Trust by October 20th, their ESOP assets would remain in Enron stock until November 20. Once Enron made its shocking announcement on October 16, plan participants sent "a slew of complaints . . . to Northern Trust urging Northern Trust to postpone the lockdowns." Complaint at 244, 246, ¶¶ 710, 718.

complaint asserts they had no reasonable time to "review [their] overall strategy and carefully weigh the potential earnings of each investment choice against its risk before making investment decisions that are aligned with [their] long-term financial plans and [their] risk tolerance," as directed by the e-mail. Consolidated complaint at 244-47, ¶¶710-25. Given the timing of the e-mail and the lack of opportunity for this kind of detailed portfolio review, the fiduciaries knew or should have known that the notice was clearly inadequate, maintain Plaintiffs.

According to Plaintiffs, the lockdowns denying Plaintiffs access to their retirement investments were an exercise of control over the assets of the plans by Northern Trust. As noted *supra*, exercise of control over the assets of a plan does not require the person exercising control to have discretionary authority to do so in order to be a fiduciary; only the exercise over the management of a plan requires discretionary authority. *First Tier*, 16 F.3d at 911; *IT Corp.*, 107 F.3d at 1421; *Wetlin*, 237 F.3d at 272-74. Thus Northern Trust was a fiduciary in imposing the lockdowns. Even if it was acting as a directed trustee with lessened discretion or control over imposing lockdowns, Northern Trust was still required to determine whether its directions complied with ERISA and thus disregard allegedly improper instructions of the Administrative Committee.

Finally, Plaintiffs have stated a claim for co-fiduciary liability against the Enron ERISA Defendants, Northern Trust, Olson, and the Administrative Committee relating to their action or inaction in knowingly participating in the lockdowns and

failing to make reasonable efforts to remedy the breaches of their co-fiduciaries.

3. Count III: Failure to diversify Savings Plan assets

Plaintiffs have also stated a claim against the Enron ERISA Defendants, including the Administrative Committee, and against Northern Trust for failure to diversify Savings Plan assets in accordance with the plan's provisions and ERISA.¹⁵⁶

Section XV.2 of the Savings Plan provides with respect to allocation of fiduciary duties:

Each fiduciary with respect to the Plan shall have only those specific powers, duties, responsibilities and obligations as are specifically given him under the Plan. Enron Corp. shall have the sole authority to appoint and remove the Trustee and members of the Committee. Except as otherwise specifically provided herein, the Committee shall have the sole responsibility for the administration of the Plan, which responsibility is specifically described herein. Except as otherwise specifically provided herein and in the Trust Agreement, the Trustee shall have the sole responsibility for the administration, investment, and management of the assets held under the Plan. However, if the Committee, as a co-fiduciary, shall exercise its power given hereunder at any time, and from time to time, by written notice to the Trustee, to direct the Trustee in the management, investment, and reinvestment of the Trust Fund, then in such event the Trustee shall be subject to all proper directions of the Committee that are made in accordance with the terms of the Plan and the Act. It is intended under the Plan that each fiduciary

¹⁵⁶ Plaintiffs indicate in their memorandum in opposition to Northern Trust's motion to dismiss, #316 at 38 n.19, that although Count III currently refers only to the Savings Plan, because the ESOP Plan has parallel language requiring the trustee to prudently diversify, it will request leave of Court to amend to add the ESOP to Count III.

shall be responsible for the proper exercise of his own powers, duties, responsibilities, and obligations hereunder and shall not be responsible for any act or failure to act of another fiduciary except to the extent provided by law or as specifically provided herein.

Section XV.1 makes clear that Article XV, titled "Fiduciary Provisions," "shall control over any contrary, inconsistent or ambiguous provisions contained in the Plan." A critical provision under Article XV for purposes of this suit, § XV.3(c) of the Savings Plan states, "Each fiduciary under the Plan, including, but not limited to, the Committee and the Trustee . . . shall discharge his duties and responsibilities with respect to the Plan" *inter alia* by "diversifying the investments of the Plan so as to minimize the risk of large losses, unless under the circumstances it is clearly not prudent to do so."¹⁵⁷ In addition, § XV.3(d) requires each fiduciary to act "[i]n accordance with the documents and instruments governing the Plan insofar as such documents and instruments are consistent with applicable law."

Moreover, while § 1.1 of the Savings Plan Trust agreement (Ex. B to #322) states that the Administrative Committee "has the responsibility . . . for monitoring the diversification of the investments of the Funds," § 6.2 mandates that, subject to its duty of loyalty and the prudent man standard, "the Trustee

¹⁵⁷ Therefore under §§ XV.1, XV.3 and XIX.5 (authorizing but not mandating investment of Plan assets in Enron stock), only if investment of Plan assets in Enron stock were prudent would nondiversification have been appropriate. Plaintiffs contend that not only was the decision to invest the assets in Enron stock imprudent, but that Defendants failed to investigate whether it was prudent.

shall diversify the investments of that portion of the Fund of which it has investment responsibility so as to minimize the risk of large losses" Furthermore § 6.3 recites that subject to its duty of loyalty and the prudent man standard, "the Trustee shall, with respect to that portion of the Fund of which it has investment responsibility, follow the investment guidelines established by the Administrative Committee and shall act in accordance with the direction of the Administrative Committee" Thus the Savings Plan mandates that the Administrative Committee and the Trustee share a fiduciary responsibility to diversify plan assets where prudent. The trustee furthermore has a duty to plan participants not to follow the Administrative Committee's directions where they are contrary to ERISA, i.e., where they would lead to an imprudent result harmful to the plan participants and beneficiaries.

An exception to the diversification requirement is established by § 404(a)(2) of ERISA, 29 U.S.C. § 1104(a): an "eligible individual account plan" may acquire and hold qualifying employer securities (as defined in § 1107(d)(4) and (5)) without regard to the diversification requirements or the diversification element of the prudent man rule. Section 3(34) of ERISA, 29 U.S.C. § 1002(34), defines an "individual account plan" as one that

provides for an individual account for each participant and for benefits based solely upon the amount contributed to the participant's account, and any income, expenses, gains, and losses, and forfeitures of accounts of other participants which may be allocated to such participant's accounts.

In re Unisys Sav. Plan Litigation, 74 F.3d 420, 425 n.1 (3d Cir.), cert. denied, 519 U.S. 810 (1996). A 401(k) plan is a type of individual account plan.

Under 29 U.S.C. § 1104(a)(1)(C), a plan fiduciary has a duty to "diversif[y] the investments of the Plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so." Since no statute or regulation has defined that duty, the Fifth Circuit has turned to the legislative history for guidance:

The degree of investment concentration that would violate this requirement to diversify cannot be stated as a fixed percentage, because a fiduciary must consider the facts and circumstances of each case. The factors to be considered include (1) the purposes of the plan; (2) the amount of the plan assets; (3) financial and industrial conditions; (4) the type of investment, whether mortgages, bonds or shares of stock or otherwise; (5) distribution as to geographical location; (6) distribution as to industries; (7) the dates of maturity.

Metzler v. Graham, 112 F.3d 207, 209 (5th Cir. 1997), citing H.R. Rep. No. 1280, 93d Cong., 2d Sess. (1974), reprinted in 1974 U.S.C.C.A.N. 5038, 5084-85 (Conference report at 304). The appellate court admonished, "It is clearly imprudent to evaluate diversification solely in hindsight--plan fiduciaries can make honest mistakes that do not detract from a conclusion that their decisions were prudent at the time the investment was made." *Id.* Thus, "[p]rudence is evaluated at the time of investment without the benefit of hindsight." *Id.* As to the question of who bears the burden of proof, to demonstrate a breach of the duty to diversify the plaintiff must show that the portfolio was not

diversified "on its face"; the burden then shifts to the defendant fiduciary to show why under the circumstances it was prudent not to diversify the investments of the plan. *Id.*

As noted, the Savings Plan states, "Each fiduciary under the Plan, including, but not limited to, the Committee and the Trustee . . . shall discharge his duties and responsibilities with respect to the Plan" by, *inter alia*, "diversifying the investments of the Plan so as to minimize the risk of large losses, unless under the circumstance it is clearly not prudent to do so." Enron Corp. Savings Plan § XV.3(c). The Plan provision's language is nearly identical to the language of § 404(a)(1)(C) of ERISA, 29 U.S.C. § 1104(a)(1)(C) ("[A] fiduciary shall discharge his duties with respect to a plan solely in the interests of participants and beneficiaries and . . . by diversifying the investment of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so. . . .").

Plaintiffs concede in their complaint at ¶696 that ERISA explicitly exempts defined contribution plans (a/k/a "individual account plans") from the diversification requirement to the extent that the employee benefit plan invests in the employer's own stock. Section 404(a)(2), 29 U.S.C. § 1104(a)(2), provides, "In the case of an eligible individual account plan (as defined in section 407(d)(3) of this title), the diversification requirement of (1)(C) and the prudence requirement (only to the extent that it requires diversification) of paragraph (1)(B) is [sic] not

violated by¹⁵⁸ acquisition or holding of qualifying employer real property or qualifying employer securities (as defined in section 407(d)(4) and (5))." Section 407(d)(5)(A) defines "qualifying employer security" as "an employer security which is . . . stock." 29 U.S.C. § 1107(d)(5)(A). Plaintiffs also admit that the Savings Plan at issue here was an eligible individual account plan within the meaning of § 407 of ERISA, 29 U.S.C. § 1107. Complaint at ¶158. Nevertheless, since an employer may establish the conditions and terms of its plan as long as these conditions and terms do not violate ERISA, and because neither the statute nor the plan mandates non-diversification in the individual account plan, Plaintiffs argue that § XV.3 of the Savings Plan, charging the Administrative Committee and Northern Trust with the duty of "diversifying the investments of the Plan so as to minimize the risk of large losses," controls over § 404(a)(2), 29 U.S.C. § 1104(a)(2).

Urging that Plaintiffs cannot state a claim for failure of the fiduciaries to diversify the Savings Plan, Defendants highlight a different provision in the Plan, which they claim is contrary to § XV.3, i.e., § XIX.5, which provides, "The Plan is specifically authorized to acquire and hold up to 100% of its assets in 'qualifying employer securities' as such term is defined in Section 407(d) of [ERISA]." Moreover, Section V.16 of the Savings Plan (Joint Appendix In Support of Defendants' Motions to Dismiss Amended and Consolidated Complaint, #271, at Ex. A)

¹⁵⁸ Note the statute does not mandate that the plan utilize the exception and not diversify.

provides that Enron's 50% match of employees' contributions would be made "primarily" in Enron stock and remain in such stock until participants reach the age of 50. Complaint at ¶¶ 677, 161.

After examining the text of the Savings Plan, the Court concludes the provisions are not in conflict and that Plaintiffs can state a claim under the key "clearly prudent under the circumstances" standard established in § XV.3(c): "[e]ach fiduciary . . . **shall discharge his duties and responsibilities** with respect to the Plan *by inter alia* **"diversifying the investments of the Plan** so as to minimize the risk of large losses, **unless under the circumstances it is clearly not prudent to do so** [emphasis added]." While the plan authorizes the trustee to hold "up to 100% of its assets" in Enron stock, it does not mandate that the trustee hold 100%, or even 30% or 20%, of its assets in Enron stock, and, in fact, seemingly allows complete discretion in how much may be invested in Enron stock where the circumstances make such investment imprudent. There also is substantial discretion permitted in § V.16's requirement that employer matching contributions be "primarily," but not wholly, in Enron stock. The language and grammatical structure of the Savings Plan's § XV.3 indicate that diversification is the general rule, not the exception, and where diversification is not effected, there is a burden to justify that the absence of diversification was clearly prudent under the circumstances. As most investment advisors inform their clients, putting all of one's eggs in a single basket is clearly a risky investment strategy; it is the rare case where diversification "is clearly

not prudent." According to the parallel provision to § XV.3(c) in ERISA (§ 404(a)(1)(C)) and, as noted earlier, to case law construing it, if the fiduciary trustee decides not to diversify and is subsequently sued for breach of fiduciary duty, once a plaintiff meets the minimal burden of showing that the portfolio is not diversified on its face, the trustee then bears the much heavier burden to show that the choice was **clearly** prudent under the circumstances. *Metzler*, 112 F.3d at 209.

The complaint meets its light burden by alleging as facts that immediately before the lockdown, and in light of the red lights and rapidly deteriorating circumstances described in the pleadings, the Plan assets were dangerously overweighted in Enron stock, which constituted 60% of its investments, as Olson conceded during her testimony before Congress. It charges that Defendants breached their responsibility to protect the investments and to diversify.

The complaint states a claim specifically against the Administrative Committee [and its members], which, despite the express Savings Plan provision mandating diversification where prudent, allegedly did not question or investigate the prudence of investing Plan assets in Enron stock and did nothing to direct Trustee Northern Trust to diversify, nor did it supervise to insure that Northern Trust did diversify, the Savings Plan's assets.¹⁵⁹ As further factual support for breach of their

¹⁵⁹ The complaint at 241, ¶699, states, "Olson agreed with Senator Lieberman that the Savings Plan, which had 60% or more of its total assets invested in Enron stock as of last year, was not in fact 'diversified.'"

fiduciary duty, Plaintiffs have asserted that the Administrative Committee had no process for monitoring the prudence of Enron stock as an investment option nor for discontinuing that option for the Plan if it became imprudent, as evidenced by the Congressional testimony of Prentice and Olson, both members of the Administrative Committee. The complaint asserts that Prentice and Olson admitted that only in November 2001, just prior to Enron's bankruptcy, did the Committee seek legal and investment advice about the prudence of using Enron stock as an investment option. The Court has previously noted allegations in the complaint regarding prior warnings to Olson about Enron's financial condition. The complaint also asserts that Olson missed most of the Committee meetings in breach of her fiduciary duties. The Court finds that the complaint has stated a claim that Olson failed to act solely in the interest of the Savings Plan participants and beneficiaries with the care skill, prudence and diligence under the circumstances that a prudent person in similar circumstances would use.

Furthermore, although Enron's matching contributions under § V.16 of the Savings Plan were to be made "primarily in Enron stock," Plaintiffs have stated a claim in alleging that the Administrative Committee had an overriding fiduciary duty to monitor the prudence of allowing Enron to continue to match employee contributions with Enron stock if the stock became an imprudent investment, as they assert it had. ERISA § 404(a)(1)(D), 29 U.S.C. § 1004(a)(1)(D) (a fiduciary "shall discharge his duties with respect to a plan solely in the interest

of the participants and beneficiaries and . . . in accordance with the documents and instruments governing the plan insofar as such documents are consistent with the provisions of this title and title IV."). Plaintiffs have further pointed out that "primarily" means "for the most part," not "all," and that the leeway provides the plan fiduciaries with considerable discretion, which they allegedly did not exercise prudently or loyally. Moreover, an investment fiduciary must disregard plan documents if following their terms would be imprudent. *Laborers National Pension Fund*, 173 F.3d at 322; *Cunningham*, 716 F.2d at 1467 (ESOP fiduciaries breached duty of prudent in purchasing company stock); *Eaves*, 587 F.2d at 1459 (ERISA "requires that in making investment decision whether to invest in company stock, an ESOP fiduciary, like a fiduciary from other ERISA plans, is subject to the "solely in the interest" and "prudence" tests of § 404).

Because the complaint states a claim that the Administrative Committee and the Trustee were fiduciaries that breach their duties, Plaintiffs also state a claim against each for co-fiduciary liability relating to the failure to diversify under 29 U.S.C. § 1105(a)(2).

4. Count IV (Plaintiffs on behalf of certain retirement plan participants and beneficiaries sue Enron and the Enron ERISA Defendants for breach of fiduciary duties to the Cash Balance Plan

participants and beneficiaries from 1998-2000¹⁶⁰ relating to offsets based on the inflated value of Enron stock)

Section XVII.1 of the Cash Balance Plan provides in part,

The general administration of the Plan shall be vested in the Committee, which shall be appointed by the Company and shall consist of one or more persons. . . . For purposes of the Act, the Committee shall be the Plan "administrator" and shall be the "named fiduciary" with respect to the general administration of the Plan (except as to the investment of the assets of the Trust Fund).

Ex. A.3 to #271. The "Company" denotes Enron Corp. *Id.* at (i). The Committee's duties are set out in § XVII.7. Section XVIII.1, dealing with the Trustee, states that "[t]he Trustee shall be appointed, removed and replaced by and in the sole discretion of the Company. The Trustee shall be the 'named fiduciary' with respect to investment of the Trust Fund's assets." Moreover, under Section XVIII.5, "The Committee shall issue directions to the Trustee concerning all benefits which are to be paid from the Trust Fund pursuant to the provisions of the Plan." Section XVIII.7, entitled "No Benefits to the Employer," states, "No part of the corpus or income of the Trust Fund shall be used for any purpose other than the exclusive purpose of providing benefits for

¹⁶⁰ Cindy Olson, whom the complaint identifies as one of the ERISA Defendants, insists, and points to ¶679 of the complaint to demonstrate that she did not join the Administrative Committee, which is charged with making the offset calculations, until January 2001 and thus this claim as to her should be dismissed. Because Plaintiffs have asserted that Olson is liable as a fiduciary in her capacity both as a Committee Member and as a corporate officer for Enron, with a duty to monitor, the fact that she did not become a Committee Member until January 2001 will not relieve her of potential responsibility.

the Members and their beneficiaries and of defraying reasonable expenses of administering the Plan." The Cash Balance **Plan expressly limits** "[t]he power to appoint or otherwise affect the Committee or the Trustee and **the power to amend the Plan and Trust Agreement**" to the **"Company, alone [emphasis added]."** § XX.3, Ex. A-3 to #271. Section XXI.1 provides . . . "the Company may from time to time amend, in whole or in part, any or all provisions of the Plan" Nevertheless, § XXI.2 makes clear, "No amendment of the Plan may be made that would vest in the Employer, directly or indirectly any interest in or control of the Trust Fund."

With respect to the amendment of the Cash Balance Plan, effective in 1996, and its computation of the offset to a plan participant's average pay for retirement benefits under § 5.2(g) of the amended Cash Balance Plan, Plaintiffs have asserted that Enron and the ERISA Defendants, because they knew or should have known that the market price of Enron stock did not reflect its actual value, breached their fiduciary duty by (1) failing to use the true value of Enron stock, which Defendants knew or should have known, rather than the artificially inflated market price, to compute the offset; (2) failing to fix permanently the market value component of the offset because it did not reflect the stock's real value at the close of the market on the first day of each year from 1996 to 2000; and/or (3) failing to disclose to participants and beneficiaries that the value of the stock used for the offset was artificially inflated or not the actual value of the stock on the relevant dates.

In opposition, Defendants have argued that the offset is part of the design of a plan, for which Enron was wearing its settlor hat and not its fiduciary hat, and thus they are not subject to fiduciary duties.¹⁶¹

Plaintiffs, in turn, insist that their claim is based not on the design of Enron's plan, but on implementation of the plan because Enron undermined the plan when it artificially and fraudulently manipulated the plan's components, specifically the market price of Enron stock. Plaintiffs also contend that Defendants had a fiduciary duty to provide plan participants with the information that the value of the stock was inflated. #315 at 72.

Plaintiffs have not argued that Enron did not have the right as settlor to amend its earlier plan to create the Cash Balance Plan without triggering fiduciary duties. Nor have Plaintiffs alleged that the Cash Balance Plan was not amended in accordance with the procedures laid out in the plan document nor that use of a stock price on a fixed date (January 1st for five years) is, on its face, an impermissible offset of accrued pension

¹⁶¹ Plaintiffs have not challenged the amendment of the plan that put the new computation formula into effect. Even if they had, it is black letter law that ERISA's fiduciary standards do not apply when an employer amends an ERISA benefit plan; the amendment relates to "the composition or design of the plan itself and does not implicate the employer's fiduciary duties ERISA's fiduciary duty requirement simply is not implicated where [the employer], acting as the Plan's settlor, makes a decision regarding the form or structure of the Plan, such as who is entitled to receive Plan benefits and in what amounts, or how such benefits are calculated." *Hughes Aircraft Co.*, 525 U.S. at 444. See also *Izzarelli v. Rexene Products Co.*, 24 F.3d 1506, 1522-25 (5th Cir. 1994).

benefits. Nor is their challenge to a decrease in accrued benefits, based on § 204(g), 29 U.S.C. § 1054(g). They also do not challenge the use of the amended formula during at least its first couple of years, since "[b]etween 1993 and 1997, Enron's stock did not appreciate significantly," prior to the Class Period. Complaint at ¶196.

According to the complaint, beginning in 1998, the company diversified, acquired more and new businesses, and the price of Enron stock increased substantially through 2000; at some point, not clearly pinpointed, the price became fraudulently inflated. While the amount of the offset under the Cash Balance Plan also increased, thereby reducing the participants' and beneficiaries' accrued pension benefits, had that rise in value of Enron reflected Enron's actual worth, the larger offset amount would not have injured Plaintiffs because their ESOP account holdings would also have increased substantially. Thus in essence the target of Plaintiffs' claim is not the new pension benefit plan formula established by the amendment. The cause of the injury is not the structure of the plan itself, but the purported fraud that allegedly began to occur a couple of years after the 1995 amendment became effective and which caused the market value of the stock to rise when the actual financial condition of the company was deteriorating, thereby making the application of the plan's formula injurious to plan participants and beneficiaries.

Plaintiffs have characterized their claim as a breach of fiduciary duty on the grounds that once Defendants knew or should have known that Enron's precarious financial condition and

fraudulent accounting made evident that Enron stock was overpriced (identified by the complaint at 53, ¶189, as "the three-year period 1998-2000"), the plan fiduciaries should have disregarded the terms of the plan for those three years, determined what the true value of the stock should have been, and computed each component of the offset with that true value, or refused to fix the component permanently at the artificially inflated closing price as the plan mandated, or disclosed to plan participants and beneficiaries that the values of the stock were artificially inflated. Instead Defendants proceeded according to the plan amendment's formula even though they knew that the new formula would unfairly reduce the plan participants' pension benefits. Moreover, in the context of the larger scheme to defraud, Plaintiffs have also charged Defendants with a conflict of interest because at least some of the savings to Enron in paying Plaintiffs with, and reducing the amount of their benefits by use of, artificially inflated stock in their ESOP accounts allegedly went into higher bonuses and salaries for Defendants' personal gain, another breach of fiduciary duty because Defendants had the authority to amend the pension benefits and the discretion to exercise it.

According to Plaintiffs, Defendants had a fiduciary duty during the last three years of the phase-out "to effectively **disregard** the formula (or at a minimum, not to use the publicly traded share price on the days in question to calculate the offset) in order to avoid an imprudent, disloyal result." *Id.* at 74. Plaintiffs cite § 404(a)(1)(D) (A trustee must act prudently

and "in accordance with the documents and instruments governing the plan *insofar as such documents are consistent with ERISA* [emphasis added])", 29 U.S.C. § 1104(a)(1)(D), and, in support of their arguemnt, two cases, *Central States*, 472 U.S. at 569 ("[T]rust documents cannot excuse trustees from their duties under ERISA, and . . . trust documents must generally be construed in light of ERISA's policies."); *NationsBank*, 126 F.3d at 1369 (ESOP trustees are required to follow plan documents only to the extent they are consistent with ERISA; if the mirror voting provision was imprudent, NationsBank must ignore the provision and vote the unallocated shares prudently).¹⁶²

¹⁶² The facts, focus, and the contexts in these cases are easily distinguishable from those in *Tittle*. More importantly, while the cases in *dicta* support "disregarding" provisions in a plan that would require a trustee to breach its fiduciary duties of loyalty to the participants and prudence, the cases do not stand for the kind of specific affirmative duty to rewrite or amend the plan with the kind of particular plan provisions advocated here by Plaintiffs, i.e., to determine for themselves the real value of Enron stock for each of the last three years and/or not fix the price of the artificially inflated stock as a permanent component of the offset. Instead trustees, not the court, must examine available prudent options, described by the Eleventh Circuit in *NationsBank* as a "fact-laden issue" which is not appropriate for determination before discovery. 126 F.3d at 1369.

Central States, 472 U.S. 559, dealt with two ERISA-governed multiemployer welfare and pension benefit plans for employees performing work covered by collective bargaining agreements between a labor union and sixteen trucking companies. Under the collective bargaining agreements, each trucking company employer was required to make weekly contributions to the plans for each covered employee and, because of the size of the plans, to self-report the amount of its contribution liability and relate fluctuations in the employment status (e.g., terminations, new hires) of employees covered by the collective bargaining agreement so that the funds could adjust the weekly invoice. The funds would check on this self-reporting process by conducting random audits of the participating trucking company employers' records. Furthermore, the trust agreements of the plans contained a number of provisions to protect the trust, including one giving the trustees the power to demand and review relevant employer records,

which the trustees construed as authorizing the audits. The trucking company employers refused to permit the funds to audit their payroll, tax, and personnel records, including records of employees that the employers maintained were not plan participants. The funds filed suit seeking an order to permit them to do the audits.

The case does not address a plan provision that would cause conflict with a trustee's fiduciary obligations to the participants. The Supreme Court concluded that the trustees' interpretations of the trust agreements as authorizing the audits, including those of non-covered employees to verify the accuracy of the employer's determination of the class of covered employees, was consistent with ERISA and entirely reasonable in light of ERISA's policies. The Supreme Court drew on the traditional common law of trusts to fill in the powers of the trustees not specifically enumerated in ERISA. At common law trustees had all the powers necessary or appropriate for effectuating the purposes of the trusts, which would include the goals of the audit, i.e., to inform plan participants fully of their rights and to check the financial integrity of the plans by determining the group of potential benefit claimants, while simultaneously insuring that the employers made full and prompt contributions. Significantly, as noted, in *Central States* the Supreme Court concluded that there was no inconsistency between the trustees' interpretation of the plan and ERISA. The high court observed that typically an employer is motivated to under-report the number of covered employees to reduce its own liability to the plans. Unlike the *Tittle* Plaintiffs, the court in *Central States* did not impose an affirmative duty on the trustees not merely to ignore the trust agreement, but to create new terms in order to fulfill duties of loyalty and prudence to plan participants and beneficiaries. Instead it determined that the right to monitor the employers' records to insure the financial stability and continuance of the plans was entirely reasonable and consistent with the policies behind the statute to preserve the funds' financial soundness to ensure that workers would receive vested benefits.

The Eleventh Circuit's opinion in *NationsBank* concerned an ESOP, not a Cash Balance Plan, and focused largely on ESOP shares allocated to the participants' individual accounts, regarding which the appellate court determined the trustee was a directed trustee and was relieved of liability in part because it was protected by § 404(c) when informed participants directed the management of those assets. This Court questions whether and how an ESOP would qualify as a § 404(c) plan. The trustee was held to be a fiduciary, however, with respect to ESOP shares not allocated to the participants individual accounts, not at issue here, which required the trustee to satisfy fiduciary standards under § 404(a)(1)(D).

In *NationsBank*, in 1988 Polaroid created an ESOP in part to thwart the threat of a hostile takeover by Shamrock Acquisitions, III, Inc. It allocated some common stock to

participants' individual accounts in proportion to that participant's compensation and held other, unallocated stock in a separate account. The ESOP provided for "pass-through voting," which permitted participants to vote their allocated shares as if they were shareholders. The plan also stated that in the event of a tender offer, the plan participants may direct the trustee, which was NationsBank, to tender or not tender their allocated shares. In addition the ESOP had a mirror voting provision, instructing the trustee to tender the unallocated shares in the same proportion as it tendered the allocated shares. Pass-through voting and mirror voting provisions are common in ERISA-governed ESOPs. The focus of NationsBank, unlike the issues before this Court, was on the trustee's responsibilities with respect to these two types of provisions and on evaluating the Department of Labor's stance regarding them.

When Shamrock made its tender offer, followed by one from Polaroid, NationsBank mailed the plan participants a description of the tender offers and informed them that by a specified date they had to direct NationsBank to tender or not tender their allocated shares to Polaroid or Shamrock, and that if they did not return the direction form, NationsBank would consider them to have chosen not to tender their shares. Significantly, the letter did not inform the participants that the unallocated shares would be voted in the same proportions as the allocated shares. Thus NationsBank was a directed trustee under §403(a) for the plan participants with shares allocated to their individual ESOP.

After considering the prudence of the three options (directing tender to Polaroid, directing tender to Shamrock, and not tendering the ESOP shares in the individual accounts), the bank's Committee decided each was prudent because the post-tender price of Polaroid stock was uncertain; it chose to follow the plan provision for "pass-through voting" and the mirror voting provision.

The Secretary of the Department of Labor sued NationsBank on two causes of action, only one of which is relevant here: that the trustee violated § 404(a)(1)(A) and (B) because it failed to tender all of the unallocated shares and the allocated non-voted shares to Polaroid.

Both parties filed motions for summary judgment. The district court held that NationsBank could not rely on the plan's pass-through and mirror voting provisions, but had to exercise its independent judgment and follow the plan provisions only if they led to a prudent result. It also held that NationsBank had the exclusive responsibility for deciding whether to tender allocated non-voted shares and that ERISA precluded it from construing plan participants' failures to respond to its notice as directions not to tender. It further found that genuine issues of material fact existed regarding whether NationsBank acted prudently in withholding the shares it did and whether NationsBank acted solely in the interest of plan participants. The district court pursuant to a request from NationsBank certified the decision on Count One

for interlocutory appeal.

The Eleventh Circuit, whose opinion is not binding on this Court, focused on the directed trustee exception (29 U.S.C. § 1103(a)(1)) to the general rule that trustees have exclusive authority and control over plan assets. It pronounced, "[I]nsofar as a trustee acts at the direction of a named fiduciary in accordance with the terms of the plan and ERISA's requirements, he is not subject to the fiduciary requirement in § 1104(a) to act prudently [emphasis added]." *NationsBank*, 126 F.3d at 1361, citing *Maniace*, 40 F.3d at 267 (holding that a directed trustee is not acting as a fiduciary when he follows a named fiduciary's directions). This Court has previously discussed its disagreement with such a general rule. Thus the issue in *NationsBank* became whether the ESOP participants were "named fiduciaries" who can direct *NationsBank's* decisions regarding specific plan assets, i.e., unallocated and the allocated but non-voted shares.

The Secretary of Labor argued *inter alia* that plan participants cannot ever be named fiduciaries for the purpose of directing the trustee under 29 U.S.C. § 1103(a)(1)) with respect to unallocated shares or allocated non-voted shares and therefore the trustee's decisions regarding those kinds of shares are subject to fiduciary duties, including the prudent man standard of 29 U.S.C. § 1104(a)(1). She insisted that the trustee always has the fiduciary responsibility for managing such unallocated shares, as well as allocated non-voted shares; thus the trustee may choose to follow plan participants' directions regarding those unallocated shares only to the extent that the participants' directions are prudent, consistent with the plan, and not contrary to ERISA. She also argued more narrowly that even if the plan participants were fiduciaries with respect to unallocated shares in some circumstances, because the tender notice sent to the participants did not explain to them the effect on the unallocated shares of their action or inaction in responding to the trustee's notice, they were not properly informed of their power and control over these unallocated shares. In addition, the Secretary maintained that the only prudent course for *NationsBank* would have been to tender all of the ESOP's shares to Polaroid.

The Eleventh Circuit, noting that under ERISA to be a fiduciary a party must have "discretion to decide the disposition of plan assets or must exercise authority or control over plan assets," reasoned that "[a] person cannot exercise the power of choice or individual judgment unless he is aware of his ability to do so." 126 F.3d at 1366. Because the participants did not receive notice that their action or inaction in voting their allocated shares would also control the disposition of the unallocated shares, they were not fiduciaries. Furthermore, "if ERISA did not limit the definition of fiduciaries to those with knowledge of their authority and discretion, then person or entities could become subject to fiduciary liability without notice. Such a result would not only be unfair, but it would also disserve a core purpose of ERISA, which is to create a system

As was the case in *Central States*, this Court finds that the Cash Balance Plan amendment, itself, is consistent with ERISA. In fact, the use of the closing market price on the designated day of each of five years is consistent with ERISA's own provision, § 3(1), 29 U.S.C. § 1002(18), that "adequate consideration" for purposes "of a security for which there is a generally recognized market" is "the price of the security prevailing on a national securities exchange which is registered under section 6 of the Securities Exchange Act of 1934." Moreover, although the inflated value of Enron stock had the effect of severely reducing the plan participants and beneficiaries' pension benefits, "[t]he Internal

whereby accountable fiduciaries are motivated by their accountability to protect the interests of participants in ERISA plans." *Id.* The Eleventh Circuit emphasized that § 404(c)(1) of ERISA allows individual account plans to give participants control over the assets allocated to their own individual accounts and thus relieve the trustee from being deemed fiduciaries and free the trustee from liability, while simultaneously not saddling the participants with fiduciary responsibilities and liability for what happens when they exercise control over their own accounts. But ERISA does not address unallocated shares nor participant control over unallocated assets, especially where participants are not adequately informed of the power and effect of their decisions. Imprudent decisions by plan participants would then affect not only their own assets, but the interests of other participants, and the participant decision-makers would be subject to suit by co-participants. Moreover, plan participants do not lose control over the assets allocated to their individual accounts merely because they fail to respond with directions for a tender offer after they have been informed that a failure to respond will be treated as a direction not to tender because that failure to respond with directions is an exercise of control or discretion. Thus the plan participants can be named fiduciaries with respect to the allocated, non-voted shares also. The appellate court remanded the case for determinations of fact issues.

Revenue Code does not require that the defined benefit be fixed, but only that it be determinable according to criteria specified in advance that do not permit the plan to play favorites." *Brengettsy v. LTV Steel (Republic) Hourly Pension Plan*, 241 F.3d 609, 612 (7th Cir. 2001), citing 26 U.S.C. § 401(a)(25); 26 C.F.R. § 1.401-1(b)(1)(i). There are no allegations here of discrimination in the administration of the plan in order to interfere with benefits under § 510 of ERISA. Furthermore, an offset is a permissible method of controlling employer costs; "[b]enefits provided by one plan may be offset by benefits received under other plans provided by the same employer." *Lunn v. Montgomery Ward & Co.*, No. 97 C 3026, 1998 WL 102751, *6 (N.D. Ill. Feb. 26, 1998) (citing *Pritchard v. Rainfair*, 945 F.2d 185, 189-90 (7th Cir. 1991), and *Holliday v. Xerox Corp.*, 732 F.2d 548, 550-52 (6th Cir. 1984)), *aff'd*, 166 F.3d 880 (7th Cir. 1999). In sum Plaintiffs have failed to point out any specific provisions showing that the plan is inconsistent with the provisions of ERISA or of the Internal Revenue Code.

What Plaintiffs have alleged is that various Defendants' purported fraud made the implementation of the plan, even though it was facially consistent with and permissible under the statute, imprudent for the last three years of a five-year phase-out period and that those circumstances made continued implementation of the plan a violation of their fiduciary duty of loyalty and prudence. It is necessary here to distinguish the breach of fiduciary duty alleged by Plaintiffs and the remedies they claim the trustee should have followed rather than breach his fiduciary duty. The

Court agrees that Plaintiffs have stated a claim for breach of fiduciary duty; it is two of their particular remedies with which this Court takes issue because they offend policies behind ERISA. It addresses the Plaintiffs' proposed remedies first.

Plaintiffs plead that the plan administrators should have not only "disregarded" terms of the amended plan established by the employer in his settlor capacity, even though they facially complied with the statute, but also that the administrators should affirmatively have determined for themselves the real value of Enron stock for each of the last three years and used that amount and/or not fixed the price of the artificially inflated stock as a permanent component of the offset. Plaintiffs cannot mandate to the plan administrators what they should have done; and a court can only determine after the fact whether the path the administrators took was prudent in light of the circumstances and available options. A fiduciary must independently investigate and examine the prudence of possible options and determine which to follow, with an eye to the policies underlying ERISA. There is a substantial difference between "disregarding" a plan term and mandating a specific new one that offends the employer/settlor's authority.

The two proposed remedies appear not merely to restrict the administrators' options, but are contrary to ERISA's policies. These proposed remedial actions in essence would constitute a plan amendment without reference to plan procedures.¹⁶³ The Court finds

¹⁶³ The Court points out that § 402(a) of ERISA, 29 U.S.C. § 1102(a) requires, "Every employee benefit plan shall be

no authority for and is not willing to impose as a fiduciary duty on the trustee or plan administrators, as a matter of law, writing such specific terms into the plan; plan amendment is a settlor function, and in the case *sub judicia*, is reserved by the Cash Balance Plan's express terms solely to the Company. *McCall v. Burlington Northern/Santa Fe Co.*, 237 F.3d 506, 511 (5th Cir. 2000) ("An employer who adopts, amends or terminates an employee benefit plan is not acting as a fiduciary.") (citing *Lockheed Corp. v. Spink*, 517 U.S. 882, 889-90 (1996).), *cert. denied*, 534 U.S. 822 (2001). The settlor function protection was created to encourage employers to establish plans. There are other options open to the trustee to "disregard" the plan's terms under the circumstances.

Second, the proposed task (of determining the true worth of Enron stock) would have been complex, costly, and unlikely to yield certain or verifiable figures in light of the alleged fraud. ERISA was enacted not only to provide plan participants and beneficiaries with a vested right to receive benefits when they reach normal retirement age, but also, as a balance, to hold down the impact of cost increases and burdens on employers, again to induce them to create such plans.

established and maintained pursuant to a written instrument." Thus the statute "mandates that [a] plan itself and any changes made to it are to be in writing." *Degan v. Ford Motor Co.*, 869 F.2d 889, 895 (5th Cir. 1989). Indeed, "a written employee benefit plan may not be modified or superceded by oral undertakings on the part of the employer." *Musto v. American General Corp.*, 861 F.2d 897, 910 (6th Cir. 1988), *cert. denied*, 490 U.S. 1020 (1989).

Alternatively Plaintiffs assert that Defendants had a fiduciary duty to disclose the artificially inflated price of the stock to protect the plan participants and beneficiaries. Here Plaintiffs have stated a more appropriate option under the circumstances: affirmative disclosure of the artificially high price of the stock, which, as noted previously, would, because of the securities laws' insider trading provisions, also necessitate a duty to find a means to disclose to all investors and the public at large the fraudulent acts and concealment that inflated the value of Enron stock. As indicated *supra*, the Fifth Circuit has recognized that "Section 404(a) imposes on a fiduciary the duty of undivided loyalty to plan participants and beneficiaries, as well as a duty to exercise care, skill, prudence and diligence. An obvious component of those responsibilities is the duty to disclose material information" to protect plan participants and beneficiaries where the impact of undisclosed information could cause plan participants and beneficiaries substantial injury. In *McDonald v. Provident Indem. Life Ins. Co.*, 60 F.3d at 237; *Ehlmann v. Kaiser Foundation Health Plan of Texas*, 198 F.3d at 556 (describing the imposition of a duty to disclose in *McDonald* as based on the "extreme impact" that the change in rate schedules would have on small employers, including the plaintiffs). Plaintiffs have alleged circumstances supporting the extreme impact that implementation of the new formula would have on plan participants and beneficiaries from 1998-2000.

Some Defendants have argued that rather than a cause of action for breach of fiduciary duty, Count IV is actually an

improperly framed challenge of and claim for plan benefits that can only be brought under § 502(a)(1)(B), 29 U.S.C. § 1132,¹⁶⁴ authorizing a participant civil suit "to recover benefits due . . . under the terms of [the] plan, to enforce . . . rights under the terms of the plan, or to clarify . . . rights to future benefits under the terms of the plan" and with remedies limited to "accrued benefits due, a declaratory judgment on entitlement to benefits, or an injunction against a plan administrator's improper refusal to pay benefits".¹⁶⁵ "When a beneficiary wants what was supposed to have been distributed under a plan, the appropriate remedy is a claim for denial of benefits under § 502(a)(1)(B) of ERISA rather than a fiduciary duty claim brought pursuant to § 502(a)(3)." *McCall v. Burlington Northern/Santa Fe Co.*, 237 F.3d 506, 512 (5th Cir. 2000), cert. denied, 534 U.S. 822 (2001).¹⁶⁶ Moreover, as noted earlier, a § 502(a)(1) claim can

¹⁶⁴ See discussion in this memorandum and order addressing Standing and Remedies under ERISA.

¹⁶⁵ *Pilot Life*, 481 U.S. at 53. Furthermore, the Fifth Circuit has held that "an ERISA plaintiff may bring a private action for breach of fiduciary duty only when no other remedy is available under [§ 501(a)(3)], 29 U.S.C. § 1132." *Rhorer v. Raytheon Eng'rs and Constructors, Inc.*, 181 F.3d 634, 639 (5th Cir. 1999), citing *Varity Corp.*, 516 U.S. at 510-16.

¹⁶⁶ *McCall*, 237 F.3d at 512, sets out the Fifth Circuit's two-step analysis for determining if a plan administrator abused its discretion in denying a participant benefits under the plan. First, the Court must decide whether the administrator's interpretation of the plan's terms was the legally correct interpretation. If it was, the inquiry ends. If the court determines the administrator's decision was not legally sound, it must then decide if the administrator's decision constituted an abuse of discretion. *Id.* "A decision is not an abuse of discretion if a reasonable person could have reached a similar decision given the evidence before him." *Id.* Elsewhere the Fifth Circuit has elaborated to explain that in deciding if the

only be brought on behalf of the plan, and not by "certain" plan participants and beneficiaries.

On the other hand, Section 502(a)(3) permits a plan participant to bring a suit "to enjoin any act or practice which violates any provision of [ERISA] or the terms of the plan, or . . . to obtain other such appropriate equitable relief . . . to redress such violations or . . . to enforce any provisions of [ERISA] or the terms of the plan."

Plaintiffs insist they do not assert a § 502(a)(1) claim for denied plan benefits, which would require the Court to determine (1) whether the plan administrator made the correct legal interpretation of the plan and (2) whether the administrator interpreted the plan uniformly. *Tolson v. Avondale Industries, Inc.*, 141 F.3d 604, 608 (5th Cir. 1998). Plaintiffs emphasize that their claim does not fall under § 502(a)(1) because they agree that the plan is clear and unambiguous, they are not contending that Defendants did not interpret it properly, and they are not seeking to recover benefits under the terms of the plan. The Court agrees. They seek not to recover benefits, enforce rights, or clarify rights to future benefits under the plan; they seek to nullify the provision in dispute as it applies to certain plan participants from 1998-2000. *See, e.g., Ross v. Rail Car America Group Disability Income Plan*, 285 F.3d 735, 740, 741 (8th Cir.

administrator's interpretation was an abuse of discretion, the court should examine whether the administrator gave the plan a uniform construction, made a fair reading of the plan, and any other unanticipated costs resulting from different interpretations of the plan. *Tolson v. Avondale Industries, Inc.*, 141 F.3d 604, 608 (5th Cir. 1998).

2001) (section 502(a)(1)(B) does not authorize a claim to reform a plan by obtaining a declaration that certain amendments are void; suits "which seek to invalidate [plan provisions] can only be characterized as arising under 29 U.S.C. § 1132(a)(3), section 502(a)(3) of ERISA.") (and cases cited therein)), *cert. denied*, 537 U.S. 885 (2002). Normally the defendant in a suit for payable benefits under the terms of a plan is the plan. *Ross*, 285 F.3d at 740, *citing Jass v. Prudential Health Care Plan, Inc.*, 88 F.3d 1482, 1490 (7th Cir. 1996) ("The appropriate defendant for a denial of benefits claim would be the Plan"), and *Gelardi v. Pertec Computer Corp.*, 761 F.2d 1323, 1324 (9th Cir 1985) ("ERISA permits suits to recover benefits only against the Plan as an entity. . . ."). Here Plaintiffs have dismissed the Cash Balance Plan. Because Plaintiffs have consciously framed their claim under § 502(a)(3) as a breach of fiduciary duty, they therefore must meet the burdens of proving a claim for which relief is provided under that statute.

In their complaint, Plaintiffs are vague about the equitable remedy prayer with respect to the Cash Balance Plan. According to the complaint they seek to enjoin Defendants "from computing the value of each component of the ESOP offset according to the market value of the Enron shares on each January 1st of the three-year period 1998-2000 and order those defendants to redress all damages flowing from prior Cash Balance payments made pursuant to the offset arrangement." Complaint at 295. In their memorandum in opposition (#315 at 76), they assert that they seek "injunctive and declaratory relief from those now in charge of the

plan" and from each Committee Member "monetary make-whole relief that was 'typically available in equity.'" They cite as authority *Great-West*, 122 S.Ct. at 712, which ironically may be their undoing.

"In determining the propriety of a remedy, we must look to the real nature of the relief sought, not its label." *Gerosa v. Savasta & Co., Inc.*, 329 F.3d 317, 321 (2d Cir. 2003), petition for cert. filed (Aug. 14, 2003, No. 03-263), citing *Great-West*, 534 U.S. at 210.

The remedy of an injunction to maintain the status quo in *Tittle* would be to enjoin a three-year practice of offsetting pension benefits with the inflated value of Enron stock; that practice ended in 2000 and thus injunctive relief "to preserve the status quo" is a moot issue. Moreover it would not be an injunction under the language of § 502(a)(3) "to enjoin any act or practice which violates the terms of the plan," since implementation of that offset was in compliance with the terms of the plan.

Moreover declaratory relief is not necessarily equitable relief. *Bauhaus USA, Inc. v. Copeland*, 292 F.3d 439 (5th Cir. 2002) (Section 502(a)(3) of ERISA does not authorize Bauhaus' suit, because Defendants were not in possession or control of the funds). As noted by Judge Weiner in his dissent to *Bauhaus*, the Declaratory Judgment Act is a procedural statute and does not provide an independent basis for federal jurisdiction. *Id.* at 447. Instead "although declaratory judgment, in and of itself, is neither legal nor equitable, it takes on the character of the

underlying right or relation it declares." *Id.* at 448 and nn.17, 19.

Under § 503(a) a prayer for equitable relief such as disgorgement or restitution to redress violations such as breaches of fiduciary duty must refer to "those categories of relief that were typically available in equity" under *Great-West*. Remedies of equitable restitution and disgorgement would have to meet the standard set out in *Great-West*, i.e., remedies that were typically available in a court of equity and that are not compensatory damages punishing Defendants for Plaintiffs' loss, but restoration of property subject to imposition of a constructive trust or equitable lien in which money belonging in good conscience to Plaintiffs can clearly be traced to particular funds in the Defendants' possession.

Plaintiffs' complaint alleges that they are seeking "monetary make-whole relief" from Committee Members' personal assets, in essence a claim for the difference in value between what their pensions would have been if calculated by a formula using the true worth of Enron stock and what they were allocated under the inflated value calculation from 1998-2000. As discussed earlier, under *Great-West* such monetary relief is actually compensatory relief for their loss, the imposition of personal liability on these Defendants' individual resources, unless Plaintiffs can trace some or all of the sum of money to which they claim entitlement, but which was never received by them or by the plan, through Enron's enormous business into the bonuses and increased salaries that went into these particular Defendants'

personal pockets and which remains within their possession and control. Plaintiffs have set themselves a daunting task. At this stage of the litigation the Court cannot state that there is no possibility that Plaintiffs can satisfy their burden of proof, but their relief is limited to that defined as typical equitable restitution in *Great-West*.

D. Texas Common Law Causes of Action

1. Count IX: Civil Conspiracy

Plaintiffs' civil conspiracy claim (Count IX, complaint at 292-95, brought against Andersen, Enron Insiders, Attorney Defendants, and Investment Banking Defendants, asserts that "non-Enron Defendants . . . conspired with Enron and Enron Insider Defendants for the unlawful purpose of masking the true financial condition of Enron, thereby deceiving Enron employees into (i) accepting over-valued Enron stock and "phantom stock" as compensation; (ii) keeping their retirement assets in artificially inflated Enron stock; and (iii) continuing to work a[t] Enron based on their false belief that it was a strong company." *Id.* at 293, ¶823. It also states that the Defendants knew that "the falsified financial picture generated by the conspiracy" would *inter alia* cause the plan participants to "accept an offset to their Cash Balance Plan payments based on the artificially inflated price of Enron stock held by the ESOP," "continue to direct that their retirement plans be heavily concentrated in Enron stock which provided further benefits to Enron and, indirectly, to its co-conspirators," and "continue to offer Enron securities to the market." *Id.*, ¶ 827.

The Court finds that Plaintiffs have stated a claim for civil conspiracy to defraud under Texas common law. The issue becomes whether it is preempted by ERISA.

In a preemption analysis, the Court finds that some factors weigh against preemption of the civil conspiracy claim by ERISA. Texas common-law fraud or fraudulent misrepresentation as the cause of action underlying Plaintiffs' conspiracy claim does not "relate to" ERISA in the sense that it does not refer to ERISA or ERISA plans generally; indeed it is a law of general applicability. Moreover the states have traditionally regulated the area of common law fraud. Nevertheless these factors alone are not sufficient to determine the preemptive effect of the statute. *See Christopher*, 950 F.2d at 1218-19 (where a state law fraud claim "relates to the operations of an ERISA plan," "preempted state law includes any state law cause of action as it relates to an employee benefit plan, even if it arises under general law which in and of itself has no connection to employee benefits plans").

To determine whether there is a forbidden "connection" between the alleged wrongful fraudulent conduct and the plans at issue here, that would directly impact the administration and operation of those plans, rather than have merely a tenuous, remote or peripheral connection with the plans, this Court starts with the presumption that Congress does not intend to supplant state law. *Travelers*, 514 U.S. at 654. It looks to the objectives of ERISA to determine the scope of the state law that Congress intended would survive and finds a number of them

relevant here: protecting the interests of participants and their beneficiaries by requiring the disclosure and reporting of financial and other information, establishing standards of conduct, responsibility, and obligation for fiduciaries of employee benefit plans, and providing appropriate and uniform remedies.

The specific nature of the allegations of fraud here shows that the employee benefit plans at issue were an essential part of Defendants' alleged conspiracy for personal gain. According to the complaint, by paying compensation to plan participants in the form of highly inflated Enron stock rather than cash, Enron was able to save substantial money which it then used for enormous bonuses and fees that purportedly went to the conspiring Defendants. The complaint also states that the block of shares owned by the Savings Plan was "likely to be voted in accordance with Enron management's wishes" and that the participants' purchases of the stock "created extra demand for Enron stock and thus helped increase the market price for Enron stock which was another objective of the Enron Insider Defendants." Complaint at 70, ¶241. Furthermore, with the participants' shares tied up in the plans where they could not easily be traded, fewer shares of Enron stock could be sold by worried investors, allowing defendants to sell theirs at higher prices.

The complaint asserts that the conspirators simultaneously engaged in self-dealing and knowingly, fraudulently, and substantially diminished at the outset of the

conspiracy (not by decline over the years) the value of the assets contributed by Enron to the plan that would fund benefits to the plan participants and beneficiaries, thus immediately and directly impacting an area of exclusive federal concern, i.e., the plan participants' and beneficiaries' right to receive benefits. The alleged fraudulent conduct falls within the sphere of a "pension-defeating motive" and was central to the conspiracy claim. *Bullock*, 259 F.3d at 400. Moreover, denial of plan benefits "is an area of core ERISA concern." *Egelhoff*, 532 U.S. at 147. Plaintiffs' alleged wrongful conduct in the civil conspiracy/fraud claim directly impacted the administration of the ERISA plans and interfered with the responsibilities of the plans' administrators and fiduciaries with the authority and the duty to invest prudently in appropriate securities to protect participants and beneficiaries' retirement funds. The conspiracy allegedly directly and substantially looted the assets that should have been placed in trust in the plans to be available as future benefits to the participants and beneficiaries.

Which of the alleged conspirators might qualify as a plan fiduciary is a factual issue not appropriate for resolution on a 12(b)(6) motion; nevertheless that issue in turn also specifically implicates core ERISA issues of fiduciary, co-fiduciary, and interested-party breach of duties. The conspiracy claim also involves and materially affects the relationships among the traditional ERISA entities--the plans' employer, the plans' administrators and fiduciaries, the plans themselves, and the

plans' participants and beneficiaries. ERISA was intended to deter mismanagement of ERISA plan benefits:

In enacting ERISA, Congress' primary concern was the mismanagement of funds accumulated to finance employee benefits and the failure to pay employees benefits from accumulated funds. To that end, it established extensive reporting, disclosure, and fiduciary duty requirements to insure against the possibility that the employee's expectation of the benefit would be defeated through poor management by the plan administrator.

California Division of Labor, 519 U.S. at 326-27, quoting *Massachusetts v. Morash*, 490 U.S. 107, 115 (1989).

Moreover the conspiracy to defraud claim triggers both conflict preemption and complete preemption. First it interferes with the rights guaranteed to plan participants by the plans and by ERISA's fiduciary duty standards. Second, the carefully crafted, exclusive enforcement provisions in 29 U.S.C. § 1132(a) demonstrate that Congress did not intend to authorize other remedies. The compensatory and punitive damages that would be available under the Texas common-law tort constitute an alternative enforcement mechanism to that relief available in § 502(a) of ERISA. Against any Enron fiduciary compensatory and punitive monetary damages would not constitute "other appropriate equitable relief" within the meaning of § 1132(a)(3). While ERISA does not permit a civil action by plan participants for money damages against a nonfiduciary, it does permit a claim for "appropriate equitable relief" under section 502(a)(3), 29 U.S.C. § 1132(a)(3), by plan participants against a nonfiduciary "party in interest," which would include a provider of services under 29

U.S.C. § 1002(14)(B), such as Arthur Andersen, Vinson & Elkins, and the investment Bank Defendants, who purportedly knowingly participated with plan fiduciaries in a breach of fiduciary duties, i.e., violations of § 406(a) (including payment for furnishing services) and § 404. See, e.g., *Harris Trust*, 530 U.S. 238; *Diduck*, 974 F.2d at 281; *Whitfield*, 853 F.2d at 1303; *Rudowski*, 113 F. Supp. 2d at 1180. Thus the conspiracy claim falls within the scope of ERISA preemption and is preempted by ERISA.¹⁶⁷

In sum, in so far as the civil conspiracy allegations relate to Plaintiffs' ERISA claims, they were directed against ERISA plan assets and affect the relationship of the plan fiduciaries and the employer to the Tittle Plaintiffs in ERISA-covered retirement plans. They accordingly are completely preempted by ERISA. See *McDonald*, 60 F.3d at 238 (civil conspiracy claim that ERISA fiduciary failed to disclose material information about health insurance premiums preempted by ERISA); *Christopher*, 950 F.3d at 1219 (ERISA preempted civil conspiracy claim relating to alleged misrepresentations regarding tax

¹⁶⁷ In arguing against preemption, Plaintiffs rely heavily on *Corporate Health Ins., Inc. v. Texas Dept. of Ins.*, 215 F.3d 526 (5th Cir. 2000), but seem unaware that judgment was vacated *sub nom.* *Montemayor v. Corp. Health Ins.*, 536 U.S. 935 (2002), and remanded for the Fifth Circuit to reconsider in light of *Rush Prudential HMO, Inc. v. Moran*, 536 U.S. 355, 122 S. Ct. 2151 (2002) (holding *inter alia* that an Illinois statute requiring HMOs to provide independent reviews of disputes between the HMO and the primary care physician and to cover services found to be "medically necessary" by the independent reviewer did not conflict with ERISA by supplementing or supplanting ERISA's civil enforcement scheme, but was within the ultimate relief authorized by ERISA). The issues in *Rush Prudential* are not on point with those in *Tittle*, which deal with retirement plan assets.

consequences of an ERISA plan amendment affecting early retirement benefit). The relief available for civil conspiracy claims would also comprise the kind of alternative enforcement mechanism that is precluded by ERISA's civil enforcement provisions. *Pilot Life*, 481 U.S. at 54; *Arizona Carpenters*, 125 F.3d at 723.

The sole exception to dismissal of the conspiracy claim here might be as it relates to the phantom stock recipients. See footnote 2 of the Memorandum and Order. The phantom stock recipients' claims do not fall under ERISA and thus a conspiracy claim relating to them is not preempted by that statute.¹⁶⁸ Nevertheless, the Court finds that the phantom stock claims are so vaguely pled by the *Tittle* complaint that they fail to give sufficient notice to Defendants of the conspiracy claim against them; as noted in footnote 2 of this memorandum and order, the particular stock involved is not even identified. Therefore the Court finds that the conspiracy claim relating to the phantom stock recipients, too, should be dismissed, but grants leave to Plaintiffs to amend their pleading to reassert it, if they obtain sufficient information to replead their claim adequately.

2. Count VIII: Negligent Misrepresentation

As indicated previously, pursuant to black letter law, Plaintiffs' negligent misrepresentation claim against Arthur

¹⁶⁸ Indeed, the Court observes that the phantom stock claims are part of the conduct charged in the alleged Ponzi scheme actionable under the securities laws and thus not are cognizable under RICO either. Moreover phantom stock does not qualify as a "security" and thus the recipients cannot sue under the federal securities statutes. Even if they could, their conspiracy claim would be barred by SLUSA.

Andersen under Texas common law, which in essence is a professional malpractice claim, is not preempted by ERISA.

Pursuant to reasons indicated throughout this memorandum and order, the Court

ORDERS the following:

(1) As requested by Plaintiff, all claims against the Cash Balance Plan are DISMISSED without prejudice; all claims under Counts I-IV against Barnhart and Causey are DISMISSED without prejudice; all claims under Counts I and II against Skilling are DISMISSED without prejudice (See #314 at 10-11); the claim against Lay under Count I for fraudulent promotion of Enron stock, but not for breach of fiduciary duty to monitor appointment and conduct of the savings Plan and ESOP Committee Members [which actually belongs under Count V], is DISMISSED without prejudice;

OTHERWISE IN ALL RESPECTS, OR IN ACCORDANCE WITH THE ABOVE,

(2) Kopper's motion to dismiss (#207) the RICO and common-law conspiracy claims against him is GRANTED;

(3) Arthur Andersen LLP and Andersen Individual Defendants' motion to dismiss (#208) is DENIED as to Count I (ERISA) and

Count VIII (negligence), but otherwise GRANTED.

(4) Mark-Jusbasche's motion to dismiss (#209) the RICO and common-law conspiracy claims against her is GRANTED;

(5) Odom's motion to dismiss (#210) is GRANTED as to the RICO claims, but DENIED as the Texas common-law negligent misrepresentation claim;

(6) Harrison's motion to dismiss (#216) the RICO and common-law conspiracy claims against him is GRANTED;

(7) Pai's motion to dismiss (#222) the RICO and common-law conspiracy claims against him is GRANTED;

(8) Citigroup, Inc. and Salomon Smith Barney, Inc.'s motion to dismiss (#227) the RICO and common-law conspiracy claims against them is GRANTED;

(9) J.P. Morgan Chase & Co.'s motion and corrected motion to dismiss (#229, #351) the RICO and common-law conspiracy claims against it are GRANTED;

(10) Enron Corporation Savings Plan Administrative Committee's and the Administrative Committee of the ESOP's motion to dismiss (#231) is DENIED;

(11) Vinson & Elkins Defendants' motion to dismiss (#232) the RICO and common-law conspiracy claims against them is GRANTED;

(12) Derrick, Jr.'s motion to dismiss (#233) the RICO and common-law conspiracy claims against him is GRANTED;

(12) Olson's motion to dismiss (#234) ERISA claims against her is DENIED;

(13) Causey's motion to dismiss (#235) all claims against him is GRANTED;

(14) Credit Suisse First Boston Corporation's motion to dismiss (#236) the RICO and common-law conspiracy claims against it is GRANTED;

(15) Merrill Lynch & Co.'s motion to dismiss (#238) the RICO and common-law conspiracy claims against it is GRANTED;

(16) Outside Director Defendants' motion to dismiss (#240) is DENIED as to the ERISA Counts IV and V against the Compensation Committee members (i.e., Blake, Duncan, Jaedicke and LeMaistre) and is GRANTED in all other respects;

(17) Northern Trust Company's motion to dismiss (#241) is DENIED;

(18) Fastow's motion to dismiss (#244) the RICO and conspiracy claims against him is GRANTED;

(19) Sutton's motion to dismiss (#251) the RICO and conspiracy claims against him is GRANTED;

(20) Skilling's motion to dismiss (#262) is GRANTED¹⁶⁹;

(21) Lay's motion to dismiss (#264) is DENIED as to the ERISA claim of breach of fiduciary and co-fiduciary duty to appoint, monitor, and remove and to make material disclosures necessary to protect the plan and its participants and beneficiaries, but it is GRANTED as to the RICO and common-law conspiracy claims against him;

(22) Certain Officer Defendants' motion to dismiss (#265) the RICO and common law conspiracy claims against them is GRANTED

(23) Certain Administrative Committee Members' motion to dismiss (#269) is DENIED;

(24) Enron Corp.'s motion to dismiss (#370) ERISA claims against it is DENIED.

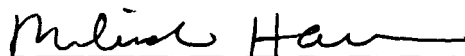
As a housekeeping matter, Plaintiffs' motion for leave to file notice of supplemental authority regarding *In re Worldcom*

¹⁶⁹ Although Count III, asserting failure to diversify the assets of the Savings Plan against the Administrative Committee and its members, conclusorily names Skilling, it does not state that he was a member of the Administrative Committee. Moreover the complaint provides no details to support Skilling's liability, and Plaintiffs do not address Skilling's role in their opposition brief.

ERISA Litigation (#598), the Secretary of Labor's request for leave to file response to supplement Outside Directors' motion to dismiss *ERISA* claims (#624), and Plaintiffs' motion for leave to file notice of supplemental authority regarding *Kmart ERISA Litigation* (#628) are GRANTED.

As a final matter, in light of this ruling, should the Tittle Plaintiffs wish to amend their motion for class certification, they shall notify the Court as soon as possible, with an indication of how much time they will need to file a superseding motion.

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



MELINDA HARMON
UNITED STATES DISTRICT JUDGE