UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

Not For Publication

In re:	:	Chapter 11
ENRON CORP., *et al*.	:	Case No. 01 B 16034 (AJG)
	:	(Confirmed Case)
Reorganized Debtors.	:	
ENRON CORP.,	:	
Plaintiff,	:	
v.	:	Adv. Pro. No. 03-93373 A
UBS AG and UBS SECURITIES, LLC, f/k/a UBS WARBURG LLC (a/k/a UBS WARBURG)	:	
Defendants.	:	

OPINION DENYING
DEFENDANTS' MOTION FOR SUMMARY JUDGMENT

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ARTHUR J. GONZALEZ
UNITED STATES BANKRUPTCY JUDGE

The matter before the Court is defendants' motion for summary judgement seeking dismissal of all the claims in a complaint filed by the debtor in which the debtor asserts that certain transfers made by it are avoidable, pursuant to section 547 of the Bankruptcy Code, as preferential transfers and that certain of the payments are avoidable, pursuant to sections 544(b) and 548 of the Bankruptcy Code, as fraudulent conveyances.

The issue presented is whether, apart from the cause of action based upon intentional fraud, the payments at issue qualify, as a matter of law, as settlement payments that are protected from avoidance

by sections 546(e) and 546(g) of the Bankruptcy Code. In addition, with respect to the cause of action that is based upon intentional fraud, the issue is whether fraud could not be established as a matter of law.

The Court concludes that, assuming the debtor was insolvent, the transactions at issue that involved the payment by an Oregon corporation for the purchase of its own shares in violation of an Oregon statute, which prohibits distributions by an insolvent corporation on account of its stock, were not settlement payments within the context of, or protected from avoidance by, section 546(e) of the Bankruptcy Code. This is because, under Oregon law, an act in violation of the relevant Oregon distribution statute is considered void. Therefore, such action is a nullity and, as such, the underlying transaction cannot form the basis of a securities transaction that supports a settlement payment. As there would be no resulting settlement payment, the protection afforded by section 546(e) of the Bankruptcy Code would not be implicated. Nor does section 546(g) of the Bankruptcy Code protect such transfers from avoidance because if the underlying transaction involving the corporation's own shares were void, the transfer would not have been made under or in connection with a swap agreement. In this case, there remains a factual dispute requiring a trial concerning whether the debtor was insolvent at the time of the transfers in issue, as well as factual disputes concerning certain defenses asserted by the defendants.

With respect to the transfers that did not involve a payment by the debtors in exchange for the debtors common stock, further evidence must be presented on whether such agreements were similar to the types of swap agreements that were protected by section 546(g) from avoidance at the times of the relevant transactions.

In addition, the causes of action related to the debtor's alleged fraudulent intent related to certain of the transactions is pled with sufficient particularity to allow for further discovery and to preclude a grant of summary judgment. With respect to the other transactions, the Court will schedule a hearing for further argument on the sufficiency of the allegations related to fraudulent intent. The Court concludes that the defendant is not entitled to summary judgment as a matter of law.

FACTS

Commencing on December 2, 2001, and from time to time continuing thereafter, Enron Corporation ("Enron") and certain of its affiliated entities, (collectively, the "Debtors"), filed voluntary petitions for relief under chapter 11 of title 11 of the United States Code (the "Bankruptcy Code"). On July 15, 2004, the Court entered an Order confirming the Debtors' Supplemental Modified Fifth Amended Joint Plan of Affiliated Debtors (the "Plan") in these cases. The Plan became effective on November 17, 2004.

Commencing in 1996, Enron and UBS AG and its wholly-owned subsidiary UBS Securities LLC, f/k/a UBS Warburg LLC (a/k/a UBS Warburg) (collectively, "UBS") entered into a series of transactions related to Enron common stock. Initially, the transactions were subject to a Master Stock Purchase Agreement (the "MSPA"). Subsequently, they were subject to definitions and documents published by the International Swaps and Derivatives Association, Inc. (the "ISDA"), including the ISDA 1992 Master Agreement (the "ISDA Agreement"). Each transaction was documented in a confirmation (the "Confirmation") that incorporated by reference the terms of the applicable MSPA or ISDA Agreement. At or before the time UBS entered into each of the transactions at issue, UBS purchased Enron common stock in the amount designated in the transaction.

Certain of the transactions required Enron to purchase a certain number of shares of its common stock from UBS at a designated future date (the "Termination Date") and at a designated price, or required one of the parties to make a comparable cash payment reflecting the change in the market price of the stock during the term of the agreement. Certain other transactions, which did not require Enron to purchase its stock from UBS, involved the payment by one party to the other of the difference between the initial price of the stock at the time of entry into the transaction and its market price on a certain future date.

At various times, the parties entered into new agreements that adjusted the number of shares and the pricing thereof and/or otherwise modified the terms of the transactions. The new agreements superceded the previous agreements. The parties entered into several agreements in 2001 (the "2001 Agreements").

In 1999 and 2000, Enron entered into related transactions with UBS that extracted the value accrued in certain of the transactions involving Enron common stock and transferred that value to capitalize two Enron special purpose vehicles.

In March 2001, the price of Enron common stock began to decline rapidly. Within the 90-day period prior to filing its bankruptcy petition, Enron made five separate payments (the "90-Day Transfers") to or for the benefit of UBS. The total amount transferred to UBS in the 90-Day Transfers was $375,513,907.35. Enron had made seven additional payments totaling $42,798,857.63 to UBS more than 90 days, but within one year, prior to the commencement of this case (collectively, with the 90-Day Transfers, the "2001 Transfers"). Thus the total amount transferred in the 2001 Transfers was $418,312,764.98.

On November 21, 2003, Enron commenced this adversary proceeding seeking to recover the payments it made to UBS. In the Complaint, Enron seeks avoidance and recovery, pursuant to §§ 547 and 550 of the Bankruptcy Code, of the 90-Day Transfers as preferential transfers. Enron also seeks entry of a judgment declaring that, under applicable Oregon law, the 2001 Transfers and 2001 Agreements were illegal and void distributions to Enron common shareholders. As void transactions, Enron seeks rescission of the agreements and the payments made and restitution from UBS for any amounts by which UBS was unjustly enriched. In addition, pursuant to §§ 544(b), 548 and 550 of the Bankruptcy Code and applicable state law, Enron seeks avoidance and recovery of the transfers as fraudulent conveyances. In the Complaint, Enron also seeks disallowance, pursuant to § 502(d) of the Bankruptcy Code, of any claims filed by UBS until payment by UBS of any amounts for which it is liable under § 550(a) of the Bankruptcy Code. Enron also seeks subordination, pursuant to § 510 of the Bankruptcy Code, of an equity-related claim asserted by UBS and disallowance, pursuant to § 502(b) of the Bankruptcy Code, of the equity-related claim as unenforceable against Enron under applicable law.

On May 21, 2004, UBS filed a motion for summary judgment seeking dismissal of all of the claims in the adversary proceeding. UBS asserts that, as a matter of law, all of the transfers at issue were settlement payments protected by sections 546(e) and 546(g) of the Bankruptcy Code from a trustee's avoidance powers except in instances of actual fraud. UBS further contends that the fraud claim in the complaint must also be dismissed because the evidence eliminates any possibility that Enron, whose business depended on maintaining its credit rating, can prove that it complied with its contractual obligations to UBS for the purpose of defrauding creditors.

Enron opposes UBS's motion and argues that there are material factual issues in dispute precluding entry of summary judgment. Specifically, Enron contends that there is a factual issue as to whether the transfers in issue are of the types that are protected by the safe harbor provisions of the Bankruptcy Code. Enron maintains that the transfers were illegal and void and, as a result, cannot be considered "commonly used" in the securities or forward contract trade to bring them within the protection from avoidance offered by section 546(e) of the Bankruptcy Code. Enron further contends that individually traded equities are neither commodity swaps nor other similar agreements that would afford them the protection from avoidance available pursuant to section 546(g) of the Bankruptcy Code. Enron also argues that there is a factual dispute concerning the purpose for the transactions which is necessary for an understanding of the true underlying nature of the transactions. Enron maintains that this factual issue is relevant to a determination of whether the transactions were components of an illegal attempt to perpetuate a false and fraudulent financial structure to conceal the actions of certain wrongdoers. At a minimum, Enron contends that it must be afforded the opportunity for discovery prior to any ruling on UBS's motion for summary judgment.

The ISDA, the Securities Industry Association and the Bond Market Association (collectively, the "Amici") obtained permission from the Court to file and filed, as Amicus Curiae, a memorandum of law, dated July 21, 2004, in support of UBS's motion to dismiss the adversary proceeding.[1] A hearing on this matter was held before the Court on October 28, 2004.

Summary Judgment

[1]The Amicus brief was filed, generally, in support of the position taken by UBS in this adversary proceeding and by several other defendants in various other similar adversary proceedings filed by the Debtors.

Fed. R. Civ. P. 56(c) incorporated into bankruptcy practice by Fed. R. Bankr. P. 7056 provides that summary judgment shall be rendered "if the pleadings, depositions, answers to interrogatories, and admissions of file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." Rule 56(c) specifies that to preclude summary judgment, the fact in dispute must be material. Substantive law determines the facts that are material. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986). If a fact is material, it is then necessary to see if the dispute about that material fact is genuine, "that is, if the evidence is such that a reasonable jury could return a verdict for the non-moving party." *Liberty Lobby*, *Id*., at 248. If the fact may be reasonably resolved in favor of either party, then there is a genuine factual issue that may only be resolved by the trier of facts and summary judgment will be denied. *Id*. at 250. If, however, the evidence "is so one-sided that one party must prevail as a matter of law," then summary judgment will be granted. *Id*. at 252. On considering a motion for summary judgment, the evidence is viewed in the light most favorable to the non-moving party. *Adickes v. S.H. Kress & Co.*, 398 U.S. 144, 158-159, 90 S.Ct. 1598, 1609, 26 L.Ed.2d 142 (1970).

After the non-moving party to the summary judgment motion has been afforded a sufficient time for discovery, summary judgment must be entered against it where it fails to make a showing sufficient to establish the existence of an element essential to its case and on which it has the burden of proof at trial. *Celotex Corp. v. Catrett*, 477 U.S. 317,322 106 S.Ct. 2548, 2552 (1986). It is said that there is no genuine issue concerning any material fact because "a complete failure of proof concerning an essential element of the nonmoving party's case necessarily renders all other facts immaterial." *Id*., 477

U.S. at 323, 106 S.Ct. at 2552. In this manner, the summary judgment standard is similar to the directed verdict standard under Fed. R. Civ. P. 50(a). *Id*. The summary judgment standard is interpreted in a way to support its primary goal of "dispos[ing] of factually unsupported claims or defenses." *Celotex*, 477 U.S. at 323-24, 106 S.Ct. at 2553. The summary judgment movant meets its burden by "'showing' . . . that there is an absence of evidence to support the nonmoving party's case." 477 U.S. at 325, 106 S.Ct. at 2554.

Application of the summary judgment procedure is not a disfavored procedural shortcut, but an integral part of the Federal Rules where there are no triable factual issues. *Celotex*, 477 U.S. at 327, 106 S.Ct. at 2555. Pursuant to Fed. R. Civ. P. 56(d), if summary judgment is not rendered upon the whole case or for all the relief requested, the Court shall, if practicable, ascertain what material facts exist without substantial controversy and those facts that are controverted, and the Court shall then specify the facts that are not in substantial controversy and such facts shall be deemed established for trial.

Section 546(e) of the Bankruptcy Code

In its motion for summary judgment, UBS argues that as a matter of law, the transfers made by Enron to UBS are settlement payments protected from avoidance pursuant to section 546 of the Bankruptcy Code. Section 546(e) of the Bankruptcy Code provides that

> Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title, the trustee may not avoid a transfer that is a margin payment, as defined in section 101, 741, or 761 of this title, or settlement payment, as defined in section 101 or 741 of this title, made by or to a commodity broker, forward contract merchant, stockbroker, financial institution, or securities clearing agency, that is made before the commencement of the case, except under section 548(a)(1)(A) of this title.

11 U.S.C. § 546(e). Section 546 of the Bankruptcy Code provides a "safe harbor" for certain types of transactions as its purpose is "to protect the nation's financial markets from the instability caused by the reversal of settled securities transactions." *Kaiser Steel Corp. v. Charles Schwab & Co., Inc. (In re Kaiser Steel Corp.)*, 913 F.2d 846, 848 (10th Cir. 1990) (hereinafter, "*Kaiser I*"). When first enacted, 11 U.S.C. § 546 only applied to the commodities market, however, in 1982, its scope was expanded to protect the securities market. *Kaiser I*, 913 F.2d at 848-49. In connection with the securities trade, "settlement payment" is defined in section 741(8) of the Bankruptcy Code which provides that:

> "settlement payment" means a preliminary settlement payment, a partial settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment, or any other similar payment commonly used in the securities trade.

11 U.S.C. § 741(8).[2] As section 741(8) merely lists various types of settlement payments without specifying the required elements, its reference to "or any other similar payment commonly used in the securities trade" provides a basis upon which to get around the circularity of the definition and discern the meaning of the term "settlement payment." *See Kipperman v. Circle Trust F.B.O. (In re Grafton Partners, L.P.)*, 321 B.R. 527, 538 (B.A.P. 9th Cir. 2005). Thus, to qualify as a settlement payment that is protected by the safe harbors, the settlement payment must be "commonly used" within the industry. *Enron Corp. v. Bear Stearns Int'l Ltd (In re Enron Corp.)*, 323 B.R. 857, 870 (Bankr.

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[2]In the context of the forward contract market, a "settlement payment" is similarly defined in section 101(51A) of the Bankruptcy Code as follows:

> "settlement payment" means, for purposes of the forward contract provisions of this title, a preliminary settlement payment, a partial settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment, a net settlement payment, or any other similar payment commonly used in the forward contract trade.

11 U.S.C. § 101(51A).

S.D.N.Y. 2005).

In *Bear Stearns Int'l*, 323 B.R. at 876, this Court held that, pursuant to Oregon law, transfers made by an Oregon corporation to acquire its own shares in violation of an Oregon statute,[3] which renders distributions[4] by a corporation on account of its stock illegal, were not settlement payments protected from avoidance by section 546 of the Bankruptcy Code. The Court's holding was based on the fact that under Oregon state law, if Enron was insolvent, Enron's repurchase of its own shares in violation of the Oregon statute would be void and therefore a nullity. *Field v. Haupert*, 647 P.2d 952, 953-54 (Or. Ct. App. 1982); *see also Minnelusa Co. v. Andrikopoulos*, 929 P.2d 1321, 1324 (Colo. 1997) (en banc) (comparing various state court interpretations regarding whether corporate stock repurchases by an insolvent corporation are void or voidable and noting that Oregon concludes that such transactions are void). If the underlying transaction were void, there would be no securities transaction to complete from which a settlement payment to be protected could result. For the same

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[3]Or. Rev. Stat. § 60.181, entitled Distributions to Shareholders provides, in relevant part, that

> (1) A board of directors may authorize and the corporation may make distributions to its shareholders subject to restriction by the articles of incorporation and the limitation in subsection (3) of this section. . . . .
>
> (3) A distribution may be made only if, after giving it effect, in the judgment of the board of directors:
>
> > (a) The corporation would be able to pay its debts as they become due in the usual course of business; and
> >
> > (b) The corporation's total assets would at least equal the sum of its total liabilities plus, unless the articles of incorporation permit otherwise, the amount that would be needed if the corporation were to be dissolved at the time of the distribution, to satisfy the preferential rights upon dissolution of shareholders whose preferential rights are superior to those receiving the distribution.

OR. REV. STAT. § 60.181.

[4]Pursuant to Oregon Revised Statutes, a "distribution" is defined as

> a direct or indirect transfer of money or other property, except of a corporation's own shares, or incurrence of indebtedness by a corporation to or for the benefit of its shareholders in respect of any of its shares. A distribution may be in the form of a declaration or payment of a dividend, a purchase, redemption or other acquisition of shares, a distribution of indebtedness, or otherwise.

OR. REV. STAT. § 60.001 (7) (Oregon Laws Ch. 107 (S.B. 398) 2005).

reasons as set forth in this Court's *Bear Stearns* Opinion, the transfers that were made by Enron to UBS in exchange for Enron's own shares of stock, if it were ultimately determined that Enron had been insolvent at the time,[5] were not settlement payments that would qualify for protection under section 546 of the Bankruptcy Code.

Thus, section 546 of the Bankruptcy Code would not protect any transfer made in violation of Or. Rev. Stat. § 60.181 from avoidance. As UBS sought summary judgment based upon the application of section 546 of the Bankruptcy Code, its motion for summary judgment with respect to those transfers that were made in exchange for Enron stock is denied. A trial is required on the factual dispute concerning whether Enron was insolvent at the time of the transfers and as to the factual issues in dispute concerning the various defenses asserted by UBS to the state law claims.

Section 546(g) of the Bankruptcy Code

There are, however, other transfers from Enron to UBS that were not made in exchange for Enron stock and which would not fall within the proscription of the Oregon statute prohibiting distributions to shareholders. As previously noted, certain payments were not made in exchange for stock. Rather, they were allegedly components of cash-settled equity swaps.

Section 546(g) provides

> Notwithstanding sections 544, 545, 547, 548(a)(1)(B) and 548 (b) of this title, the trustee may not avoid a transfer under a swap agreement, made by or to a swap participant, in connection with a swap agreement and that is made before the commencement of the case, except under section 548(a)(2)(A) of this title.

11 U.S.C. § 546(g).

[5]There are also facts in dispute concerning the defenses asserted by UBS to the state law claims.

Pursuant to the legislative history of section 546, the sections concerning swap agreements were added to the Bankruptcy Code for the purpose of extending the same protections to swap agreements that were afforded to forward and securities transactions. The legislative history of section 546(g) indicates that the purpose of the section is to ensure that the swap financial market remains stabilized and protected from "uncertainties regarding the treatment of [its] financial instruments under the Bankruptcy Code." H.R. REP. NO. 101-484, P.L. 101-311, *reprinted in*, 1990 U.S.C.C.A.N. 223, 1990 WL 92539 (May 14, 1990). This section was intended to extend to swap agreements the same type of protection from avoidance powers that was afforded to similar types of financial agreements, including forward, commodity and securities contracts. *Id*. Similar to the subsection concerning forward and securities contracts, section 546(g) provides, with respect to swap agreements, that a trustee may not avoid a transfer entered into pre-petition except where the swap agreement is entered into with the actual intent to hinder, delay, or defraud creditors. *Id*. at 223.

At the time of the transactions at issue, section 101(53B) of the Bankruptcy Code defined a swap agreement as:

> (A) an agreement (including terms and conditions incorporated by reference therein) which is a rate swap agreement, basis swap, forward rate agreement, commodity swap, interest rate option, forward foreign exchange agreement, spot foreign exchange agreement, rate cap agreement, rate floor agreement, rate collar agreement, currency swap agreement, cross-currency rate swap agreement, currency option, any other similar agreement (including any option to enter into any of the foregoing);
> (B) any combination of the foregoing; or
> (C) a master agreement for any of the foregoing together with all supplements.

11 U.S.C. § 101(53B).[6]

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[6]The current version of 11 U.S.C. § 101(53B)provides that the term "swap agreement"--
(A) means--

In *Interbulk v. Louis Dreyfus Corp. (In re Interbulk, Ltd.)*, 240 B.R. 195, 201 (Bankr. S.D.N.Y. 1999), the court described a swap agreement as

> a bilateral agreement, frequently between a commercial entity involved with commodities or subject to interest rate, currency or equity price fluctuations and a

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(i) any agreement, including the terms and conditions incorporated by reference in such agreement, which is--

(I) an interest rate swap, option, future, or forward agreement, including a rate floor, rate cap, rate collar, cross-currency rate swap, and basis swap;

(II) a spot, same day-tomorrow, tomorrow-next, forward, or other foreign exchange or precious metals agreement;

(III) a currency swap, option, future, or forward agreement;

(IV) an equity index or equity swap, option, future, or forward agreement;

(V) a debt index or debt swap, option, future, or forward agreement;

(VI) a total return, credit spread or credit swap, option, future, or forward agreement;

(VII) a commodity index or a commodity swap, option, future, or forward agreement; or

(VIII) a weather swap, weather derivative, or weather option;

(ii) any agreement or transaction that is similar to any other agreement or transaction referred to in this paragraph and that--

(I) is of a type that has been, is presently, or in the future becomes, the subject of recurrent dealings in the swap markets (including terms and conditions incorporated by reference therein); and

(II) is a forward, swap, future, or option on one or more rates, currencies, commodities, equity securities, or other equity instruments, debt securities or other debt instruments, quantitative measures associated with an occurrence, extent of an occurrence, or contingency associated with a financial, commercial, or economic consequence, or economic or financial indices or measures of economic or financial risk or value;

(iii) any combination of agreements or transactions referred to in this subparagraph;

(iv) any option to enter into an agreement or transaction referred to in this subparagraph;

(v) a master agreement that provides for an agreement or transaction referred to in clause (i), (ii), (iii), or (iv), together with all supplements to any such master agreement, and without regard to whether the master agreement contains an agreement or transaction that is not a swap agreement under this paragraph, except that the master agreement shall be considered to be a swap agreement under this paragraph only with respect to each agreement or transaction under the master agreement that is referred to in clause (i), (ii), (iii), or (iv); or

(vi) any security agreement or arrangement or other credit enhancement related to any agreements or transactions referred to in clause (i) through (v), including any guarantee or reimbursement obligation by or to a swap participant or financial participant in connection with any agreement or transaction referred to in any such clause, but not to exceed the damages in connection with any such agreement or transaction, measured in accordance with section 562; and

(B) is applicable for purposes of this title only, and shall not be construed or applied so as to challenge or affect the characterization, definition, or treatment of any swap agreement under any other statute, regulation, or rule, including the Securities Act of 1933, the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935, the Trust Indenture Act of 1939, the Investment Company Act of 1940, the Investment Advisers Act of 1940, the Securities Investor Protection Act of 1970, the Commodity Exchange Act, the Gramm-Leach-Bliley Act, and the Legal Certainty for Bank Products Act of 2000.

> financial intermediary, whereby cash payments are exchanged periodically (or a lump sum at termination between the parties based upon changes in the price of the underlying asset or index as determined by an agreed-upon benchmark.

Id. at 201.

A swap agreement has also been defined as "an agreement between two parties whereby the parties agree to exchange one or more future payments measured by different prices of a commodity, with payments calculated by reference to a notional amount." *Id*. at 201, *citing*, *Nuts and bolts of Financial Products 1999: Understanding the Evolving World of Captial Market and Investment Management Products*, 1099 PLI Corp 315, 323 1999. In swap agreements, the "'notional' amount provides the basis for calculating payment obligations but does not change hands." *Thrifty Oil Co. v. Bank of Am. Nat'l Trust*, 322 F.3d 1039, 1042 (9th Cir. 2003) (defining swap agreement as "a contract between two parties . . . to exchange . . . cash flows at specified intervals, calculated by reference to an index . . . [and basing the payments] on a number of indices including interest rates, currency rates and security or commodity prices").

Although the definition of "swap agreement" in section 101(53B) of the Bankruptcy Code at the time of these transactions did not refer explicitly to equity swaps or equity forwards, it did include by its plain language "any other similar agreement."[7] This extension to similar agreement was a recognition that the nature of swap agreements "evolve over time" and to encompass within the statute's protection any such evolution. *See* S.Rep.No. 101-285, 8 (1990). As a result, equity swaps and credit derivatives should include what the swap market understands to be a swap agreement.

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[7] As previously set forth in footnote 5, the current version of section 101(53B) specifically references "equity swaps" and "equity forwards."

Here, UBS argues that a certain transfer did not complete the delivery of any Enron stock. Rather, it simply provided for a payment calculated on the basis of a notional amount of Enron common stock. The Enron stock never moved as it was merely the item used to make the calculations. It was also argued that the incorporation of the ISDA Master Agreements and ISDA definitions in the confirmations at issue evidences that the participants in the equity derivatives market consider equity swaps to be swap agreements. The Court's attention was also directed to another enactment in 2000[8] which specifically included equity swaps in its definition of swap agreements as further evidence that equity swaps were then in general use and regarded as swap agreements. For its part, Enron contends that the financial community's continuing efforts to amend the Bankruptcy Code to specifically include equity swaps within the definition of swap agreements evidences that, at the time of these transactions, the status of an equity swap as qualifying as a section 546(g) swap agreement was not as certain as argued by UBS.[9] Enron also references what it considers characteristics of the transactions at issue that would not make them similar to the types of equity swap agreements covered by the definition in the Bankruptcy Code, including the fact that the shares at issue were one of the trading parties' own shares which potentially allowed for manipulation and influence over the share price and the fact that,

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[8]When the Commodity Exchange Act was updated in 2000, the definition of swap agreement specifically listed equity swaps. The Commodity Futures Modernization Act of 2000, Pub.L. 106-554, Dec. 21, 2000.

[9]Enron concedes that the fact that the legislation was not amended earlier specifically to include equity swaps within the definition of swap agreements is not dispositive of whether they qualified as such prior to the 2005 amendment. Rather, Enron merely cites to the trade associations' prior continuing efforts to have the definition amended and their testimony in support of those efforts as evidence that there was not consensus in the financial community concerning whether equity swaps came within the definition of swap agreements prior to the amendment. In addition, Enron contends that the trade associations' efforts also contradict UBS's contention that equity swaps were clearly identified as "commodity contracts."

with respect to certain regulations, the IRS afforded disparate treatment to equity swaps involving a corporation's own shares.

Thus, UBS and Enron both present evidence to the Court to support their position concerning the similarity between the transactions at issue and the types of transactions delineated in section 546(g) of the Bankruptcy Code. To determine whether a transaction that is not specifically included in section 546(g) qualifies as "any other similar agreement," it is necessary to establish if the swap market generally understands it to be a swap agreement. As these transactions transpired prior to the 2005 amendment to sections 546(g), evidence or authority must be presented showing that, at that time, the market considered equity swaps to be swap agreements. Thus, with respect to the equity swap transactions in which the transfers by Enron to UBS were not made in exchange for stock, there is a factual issue requiring expert testimony as to whether, at the time of the transactions, equity swaps involving a corporation's own stock were in general use and generally understood in the swap market to be swap agreements.[10]

Section 548(a)(1)(A) of the Bankruptcy Code

In the Complaint, Enron seeks, pursuant to section 548(a)(1)(A) and relevant state fraudulent transfer law, to avoid the 90-Day Transfers and their related 2001 agreements as intentionally

[10]With respect to the previously discussed transfers by Enron in exchange for its stock, UBS also argued that the transfers were protected from avoidance as a matter of law pursuant to section 546(g) of the Bankruptcy Code as commodity swaps. The Court, however, does not agree. Where a transaction is rendered void by state law, it is a nullity. Thus, the purpose of subsection 546(g) is not implicated. The transaction is void and there is no recognized financial instrument to protect from the "uncertainties regarding [its treatment] under the Bankruptcy Code." Rather, the treatment of the financial instrument is the result of state law voiding the entire transaction. If it is determined that the transaction violated Oregon law, the agreement would be a nullity and have no legal effect. As a consequence, the transfer would not have been made under or in connection with a swap agreement and it would not be protected from avoidance under section 546(g) of the Bankruptcy Code.

fraudulent. Specifically, Enron asserts that these transfers were made "with actual intent to hinder, delay or defraud" Enron's creditors.

UBS contends that summary judgment should be granted in its favor dismissing the causes of action based upon intentional fraud because it maintains that no evidence has been offered to establish that Enron made the transfers with intent to hinder, delay, or defraud its creditors. Rather, UBS argues that Enron made the transfers for a legitimate business purpose in that it sought to preserve its own credit. UBS argues that this supervening purpose defeats any inferences suggested by the badges of fraud that Enron has pled. UBS also contends that the badges of fraud alleged are conclusory and have not been pled with sufficient particularity.

Enron argues that it has alleged sufficient facts as a matter of law to present a claim for fraudulent transfer or, alternatively, it should be afforded an opportunity for discovery to further investigate the allegations. Enron maintains that, contrary to its prior dealings and to the contractual terms of its agreements, it made substantial payments to UBS while it was insolvent. Enron further alleges that UBS had leverage and sophisticated knowledge that was not available to smaller creditors. Enron maintaints that the payments adversely impacted Enron's liquidity and hindered and delayed payments to other creditors of Enron.

At the time of the commencement of this adversary proceeding, section 548(a)(1)(A) of the Bankruptcy Code,[11] provided that

The trustee may avoid any transfer of an interest of the debtor in property, or any

[11]Section 548 of the Bankruptcy Code was amended by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 and pursuant to its express provision, the amendments do not apply to this adversary proceeding which was commenced prior to its enactment.

> obligation incurred by the debtor that was made or incurred on or within one year before the date of the filing of the petition, if the debtor voluntarily or involuntarily –
>
> > (A) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted.

11 U.S.C. 548(a)(1)(A).

Fed. R. Civ. P. 9(b), which is entitled Fraud, Mistake, Condition of the Mind and which is incorporated into bankruptcy practice by Fed. R. Bankr. P. 7009, provides that

> In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other condition of mind of a person may be averred generally.

FED. R. CIV. P. 9(b).

The Fed. R. Civ. P. 9(b) requirements of pleading fraud with particularity apply to claims of intentional fraud. *Pereira v. Equitable Life Ins. Society (In re Trace Int'l Holdings, Inc.)*, 289 B.R. 548, 557 (Bankr. S.D.N.Y. 2003). The particularity required by Fed. R. Civ. P. 9(b), however, must be viewed in the context of "the liberal notice-pleading requirement" of Fed. R. Civ. P. 8.[12] *In re Olympia Brewing Co. Securities Litigation*, 674 F.Supp. 597, 619 (N.D. Ill. 1987).

Pursuant to the express terms of Fed. R. Civ. P. 9(b), a party's requisite mental state, or scienter, may be pleaded generally. Fed. R. Civ. P. 9(b). Nevertheless, as the purposes of Fed. R.

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[12]Fed. R. Civ. P. 8, incorporated into bankruptcy practice by Fed. R. Bankr. P. 7008 provides, in relevant part, as follows:

> (a) Claims for Relief. A pleading which sets forth a claim for relief . . . shall contain . . . (2) a short and plain statement of the claim showing that the pleader is entitled to relief . . . .
>
> . . .
>
> (e) Pleading to be Concise and Direct; Consistency.
>
> > (1) Each averment of a pleading shall be simple, concise, and direct. No technical forms of pleading or motions are required.

Civ. P. 9(b) are to give fair notice to a defendant of the claim to enable it to prepare its defense, to protect the defendant's reputation and good will from ill-considered charges of misconduct, and to protect the defendant from strike suits, the relaxation of the specificity requirement for scienter is not to be viewed as permission to base fraud claims "on speculation and conclusory allegations." *Shields v. Citytrust BanCorp, Inc.*, 25 F.3d 1124, 1128 (2d Cir. 1994) (citations omitted). Rather, to further the purposes of Fed. R. Civ. P. 9(b), despite the reduced pleading standard for scienter, plaintiffs are required "to allege facts that give rise to a strong inference of fraudulent intent." *Id*.

As previously noted, one of the major functions of Fed. R. Civ. P. 9(b) is to give adequate notice of the claim to the adverse party to allow it to prepare its defense. As a result, fraud allegations cannot be based upon "information and belief" except in instances where the opposing party is in control of the facts or the facts are peculiarly within the knowledge of the opposing party. *In re Manhattan Investment Fund Ltd.*, 310 B.R. 500, 505 (Bankr. S.D.N.Y. 2002). And when based upon information and belief, the complainant must set forth the facts upon which the belief is based. *DiVittorio v. Equidyne Extractive Indus., Inc.*, 822 F.2d 1242, 1247 (2d Cir. 1987).

Courts take a liberal approach when reviewing allegations of fraud pled by a trustee because, as an outside party to the transactions in issue, the trustee must plead the claim of fraud for the benefit of the estate and its creditors based upon second-hand knowledge. *Manhattan Investment*, 310 B.R. at 505.

Further, because establishing a transferor's actual intent is ordinarily not susceptible to direct proof, courts look to the totality of the circumstances and certain "badges of fraud." *Manhattan Investment*, 310 B.R. at 505. "Badges of fraud are circumstances that . . . commonly accompany

fraudulent transfers [and] their presence [leads to] and inference of intent to defraud." *Manhattan Investment*, 310 B.R. at 505 n.3. Certain examples of badges of fraud that courts have relied upon to infer the requisite intent include

> 1) a close relationship among parties to the transaction;
> 2) a secret or hasty transfer not in the usual course of business;
> 3) the inadequacy of the consideration;
> 4) the transferor's knowledge of other creditor's claims and the debtor's inability to pay them;
> 5) use of dummies or fictitious parties; and
> 6) retention of control or reservation of rights in the transferred property by the transferor after the conveyance.

Id. A court may infer the requisite intent based upon a confluence of these factors. Thus, circumstantial evidence is utilized to prove actual fraudulent intent. Further, as section 548(a)(1)(A) refers to "hinder, delay, or defraud" in the disjunctive, intending any of these results is sufficient to render a transfer fraudulent.

In the Complaint, Enron alleges that the transfers were made "with actual intent to hinder, delay or defraud" Enron's creditors. UBS contends that the fraud claims are conclusory and have not been pled with the requisite particularity. Enron counters that a relaxed standard of pleading applies because Enron does not have access to the parties that have first-hand knowledge and, therefore, is in the same position as a trustee.

Ordinarily, a debtor in possession is presumed to have first-hand knowledge of the facts. However, in the instant case, the personnel with first-hand knowledge of the relevant facts left the company early on and senior management left during that period as well. Moreover, various investigations by governmental and quasi-governmental agencies have made many of the relevant decision-makers unavailable to Enron resulting in Enron being in the same position as a trustee with

second-hand information. Furthermore, early in the case, a restructuring officer took on the role of interim CEO. In that role, he performed certain functions based on second-hand information, as would a trustee. As previously noted, the basis for taking a more liberal approach in reviewing a trustee's pleadings of actual fraud is predicated on the trustee's second-hand knowledge. Therefore, if a debtor in possession operates under the same disadvantage, a similar standard should apply. In this case, the debtor in possession's deficiencies with respect to first-hand knowledge are sufficient to justify a relaxed pleading requirement.

In its motion for summary judgment, UBS contends that Enron entered into the transactions as a hedge for its employee stock-option plan and that the purpose of making the 90-Day Transfers was for the legitimate business purpose of preserving, among other things, Enron's credit rating. As such, UBS maintains that the intervening legitimate business purpose precludes any inference of fraud.

Enron contends that there are factual issues in dispute concerning the purpose of the transactions and purpose of making the transfers. Enron argues that there is evidence that the transactions were not used primarily to hedge the employee stock-option plan. Rather, Enron points to the channeling of the accrued value from some transactions to capitalize certain special purpose vehicles. Enron alleges that discovery will establish that certain Enron personnel structured a financial scheme that required the support of financiers like UBS to manipulate the market by having stock-trading activity on certain days, to prop up Enron's stock prices or to keep liabilities off Enron's financial books. It is Enron's contention that the wrongdoers perpetuated the scheme by illegally paying on the agreements to ensure that certain liabilities were kept off Enron's financial books, thereby protecting those individuals from the consequences of having Enron's true liabilities disclosed.

Therefore, Enron contends that it illegally paid UBS to continue defrauding other creditors concerning the existence of the liabilities. Further, Enron maintains that the parties intended to attempt to use the safe harbor provisions of the Bankruptcy Code for the benefit of UBS - not as a shield - but as a mechanism to affirm or enforce a fraud.

UBS contends that the structure of the transactions can be discerned from the Confirmations which it claims sets forth the terms of the agreements. Enron, however, contends that the very nature of the fraud may be that the transactions were not structured as set forth on the Confirmations. Rather, Enron maintains that the transactions were structured to manipulate Enron's financial statements and that there may have been a separate "understanding" by the parties as to the actual terms of their agreement. In support of this alleged "understanding," Enron references the parties course of conduct after a new accounting requirement went into effect that would only permit Enron to classify its obligations under the Confirmations as equity, and not as a liability, if the net-amount due was made in unregistered shares of stock. As originally drafted, the Confirmations allowed Enron to elect to settle the transaction in registered shares of its stock. However, as settlement with registered shares would not comply with the new accounting regulation, Enron would then be required to disclose those liabilities on its balance sheet. Enron further argues that this would also have drawn attention to the use of the special purpose vehicles to conceal Enron's liabilities and alerted Enron's creditors to its true financial condition. Enron contends that as a result, the parties revised the Confirmations concerning the terms for the net-share settlement to limit its use to unregistered shares. Yet, Enron always settled with UBS by paying cash, without obtaining Board of Director approval, and never availed itself of the less-costly option of net-share settlement. Enron maintains that this indicates that the revision of the

Confirmations was merely illusory to allow Enron to continue its off balance-sheet accounting for liabilities. Enron argues that it needs discovery to investigate whether the parties to the Confirmations had a side agreement pursuant to which they recognized that the term concerning the use of "unregistered" shares was only included in the Confirmations to evade the new regulation concerning disclosure of liabilities and pursuant to which there was an "understanding" to the effect that the Confirmations would always be settled in cash. Enron alleges that there was a large-scale balance sheet fraud and that the Confirmations may have been at the center of it. Enron maintains that it needs discovery to uncover the true nature of the underlying transaction.[13]

For its part, UBS argues that Enron had a valid independent business purpose in always paying in cash as it wanted to maintain its lines of credit to continue its equity forward business. UBS further contends that Enron waived its right to discovery as it had ample opportunity to take discovery concerning the transactions.[14] Enron counters that its first order of business upon the filing of the bankruptcy case was to stabilize the debtor before it focused on any potential litigation. Enron further references the stay of discovery that was instituted in this and similar adversary proceedings. Enron also maintains that it could not specify the type of discovery it required until after reviewing the motion

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[13]Enron also contends that there is conflicting evidence concerning whether Enron was initially the source of the shares that UBS used in these transactions. As Enron argues that the Confirmations were inconsistent with the actual intent of the parties and the true terms of their agreement, Enron maintains that discovery may show that the transactions were actually off balance-sheet loans with the hedge shares used as collateral.

[14]UBS also maintains that the examiner (the "ENA Examiner"), appointed by the Court in the Enron North America Corp. bankruptcy case and whose role was later expanded to investigate the role of certain entities related to the Enron special purpose vehicles, extensively examined UBS's involvement with Enron and found no wrongdoing by UBS. However, as noted by Enron, the ENA Examiner specifically indicated that he was not considering UBS's liability on preference or avoidance claims as those issues were being evaluated by Enron's special litigation counsel.

for summary judgment filed by UBS.

The Court concludes that in the context of the overall conduct alleged in this bankruptcy case including allegations of massive fraud and undocumented side deals, Enron should be afforded the opportunity to further investigate its allegations of fraud.

Here, in addition to alleging that the parties' true intent was inconsistent with the terms of the Confirmations, Enron alleges that while it was insolvent and without the wherewithal to make cash payments to creditors, it made payments in violation of Oregon corporate law to UBS. Enron further alleges that UBS had leverage and was a sophisticated lender with knowledge of Enron's precarious financial position that was not available to smaller creditors of Enron. Enron alleges the lack of fair consideration for the 90-Day Transfers. Enron further alleges that the payments to UBS depleted Enron's cash and adversely impacted its liquidity and hindered or delayed payment to Enron's other creditors. Enron references UBS's agreement, as set forth in the Confirmations, to be treated with the status of a shareholder in the event of Enron's bankruptcy. However, Enron asserts that as bankruptcy approached, UBS maneuvered to affect this status and evade this contractual term, elevating UBS's subordinate rights and hindering other creditors. Enron contends that Enron wrongfully transferred assets to UBS, a powerful shareholder, to the disadvantage of creditors and there was intent to hinder or delay such creditors. The Court concludes that the badges of fraud that Enron alleges are sufficient, especially at this pre-discovery stage, to defeat the motion for summary judgment. Thus, Enron should be afforded an opportunity for discovery.

Finally, with respect to those transactions that relate to notional amounts that do not involve the transfer of stock, UBS argues that Enron's allegations concerning the fraudulent conduct of the Enron

personnel and the putative illegal nature of the transfers have no bearing on the "notional" transactions because those transactions involved no exchange of stock. The Court concludes that a hearing should be scheduled for further argument on that aspect of the summary judgment motion seeking dismissal of the causes of action alleging fraudulent intent related to the transfers based upon notional amounts.

Additional Matters

As a result of the Court's determination to deny the motion for summary judgment seeking to dismiss the Complaint with respect to the previously discussed causes of action, the Court also denies the motion for summary judgment concerning dismissal of the causes of action seeking disallowance or subordination of other claims that UBS may have against Enron. The analysis with respect to disallowance depends upon the resolution of the previously discussed causes of action. With respect to the subordination causes of action, there are disputed issues of fact precluding summary judgment.

Finally, UBS submitted the declaration of an associate director in the legal department of UBS AG in which she declared that UBS Securities LLC is a registered broker-dealer, a member of the New York Stock Exchange and the National Association of Securities Dealers ("NASD"), and a participant in the Depository Trust Company. Enron asserts that it cannot concede or dispute that UBS Securites LLC is a broker dealer or a member of these organizations because it lacks sufficient information and, therefore, for the purposes of the motion for summary judgment disputes these facts. Enron does not refer to any evidence on the matter. Moreover, UBS Securities LLC is listed on the websites of various quasi -public and self-regulatory organizations as a member or participant of these

agencies.[15] Pursuant to Fed. R. Civ. P. 56(d), the Court determines that the fact that UBS is a broker dealer is without substantial controversy and is deemed established for trial.

Conclusion

The Court concludes that with respect to any transaction where Enron paid UBS in exchange for its own shares of stock, if the payment to UBS is determined to be a violation of Or. Rev. Stat. § 60.181, the transaction by Enron to acquire its own shares was void under Oregon state law. If rendered void and a nullity, there was no securities transaction to complete and no settlement payment could result. Therefore, the payment could not be considered a settlement payment that qualifies for protection from avoidance under section 546(e) of the Bankruptcy Code. Further, as a null and void transaction, UBS could not avail itself of the protection from avoidance provided for transfers in connection with swap agreements pursuant to section 546(g) of the Bankruptcy Code. Thus, a trial is required to determine if Enron was insolvent at the time of the transfers in issue and to resolve the disputed factual issues concerning the various defenses asserted to the state law claims.

With respect to the transfers that did not complete the delivery of any Enron shares but simply provided for a payment calculated on the basis of a notional amount of Enron common stock, expert testimony is required to determine whether at the time of these transactions, the swap market considered these equity swaps in a company's own stock to be swap agreements similar to the types of

[15]UBS Securities LLC is listed on the NASD website as a broker dealer in the various states. *See* http://pdpi4.nasdr.com/pdpi/master_report_frame.asp?Subject=7654&Subject_Name=UBS+SECURITIES+LLC&SubjectType=F (last visited on August 9, 2005). UBS is also listed on the website of the Securities Investor Protection Corporation. *See* http://www.sipc.org/members/process.cfm (last visited on August 9, 2005). UBS is listed as a member on the National Securities Clearing Agency. *See* http://www.nscc.com/directory/directory.pdf at p. 74 (last visited on August 9, 2005).

swap agreements set forth in section 546 of the Bankruptcy Code.

As UBS's motion for summary judgment sought dismissal of the Complaint based upon the application of section 546 of the Bankruptcy Code, its motion for summary judgment in that respect is denied. Further, the causes of action related to the debtor's alleged fraudulent intent with respect to the transactions that involved transfers of stock is pled with sufficient particularity to allow for further discovery and to preclude a grant of summary judgment. The Court, however, will schedule a hearing for further argument on that aspect of the summary judgment motion seeking dismissal of the causes of action alleging fraudulent intent related to the transfers based upon notional amounts. Apart from the sufficiency of the fraudulent intent allegations related to the "notional" transactions, which the Court will address at a subsequent hearing, the Court concludes that UBS is not entitled to summary judgment as a matter of law.

Counsel for Enron is to settle an order consistent with this Court's Opinion.

Dated: New York, New York
August 10, 2005

s/ Arthur J. Gonzalez
UNITED STATES BANKRUPTCY JUDGE