

UNITED STATES BANKRUPTCY COURT  
SOUTHERN DISTRICT OF NEW YORK

Not For Publication

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In re:	:	Chapter 11
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ENRON CORP., <i>et al.</i>	:	Case No. 01 B 16034 (AJG)
	:	
Reorganized Debtors.	:	

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ENRON CORP.,	:	
	:	
Plaintiffs,	:	
	:	
v.	:	Adv. Pro. No. 03-93383 A
	:	
LEHMAN BROTHERS FINANCE S.A., <i>et al.</i> ,	:	
	:	
Defendants.	:	

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OPINION DENYING  
DEFENDANTS' MOTION TO DISMISS COMPLAINT

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The matter before the Court is a motion to dismiss a complaint filed by the debtor in which the debtor assert 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 causes of action based upon intentional fraud, the avoidance causes of action should be dismissed because 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 causes of action that are based upon intentional fraud, the issue is whether the causes of action are asserted with sufficient particularity to defeat a motion to dismiss.

The Court concludes that, assuming that the debtor was insolvent, because the transfers at issue 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, they 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 was no resulting settlement payment, the protection afforded by section 546(e) of the Bankruptcy Code was not 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.

The Court further concludes that the claims based upon intentional fraud are pled with sufficient particularity to defeat the motion to dismiss.

#### *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.

Starting in November 2000,<sup>1</sup> Enron entered into a series of transactions with Lehman Brothers Finance S.A., Lehman Brothers Inc., Lehman Brothers Holdings Inc., and Lehman Commercial Paper Inc. (collectively, “Lehman”) related to Enron common stock. Pursuant to the terms of the confirmations (the “Confirmations”) that reflect these transactions, the transactions incorporated certain definitions and documents published by the International Swaps and Derivatives Association, Inc. (the “ISDA”), including the ISDA 1992 Master Agreement.

Pursuant to the terms of certain transactions, Enron was required to purchase a certain number of shares of Enron common stock from Lehman at a designated future date (the “Termination Date”), at a specific price. Other transactions 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. At or before the date Lehman entered into each of the transactions at issue in the Complaint, Lehman purchased Enron common stock in the amount designated for the particular transaction and advised Enron of such purchase. Pursuant to the terms of the transactions as set forth in the corresponding Confirmations, it was the intent of the parties that each transaction “not give [Lehman] any of the rights that rank senior to a common shareholder of Enron Corp.”

In the Complaint, Enron alleges that on January 17, 2001, Enron was insolvent but nevertheless paid Lehman \$80,319,600 for 999,000 shares of Enron common stock.<sup>2</sup> Enron further alleges that in March 2001, the price of Enron common stock began to decrease rapidly. The parties renegotiated

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<sup>1</sup>Although Enron actually entered into these transactions commencing in November 2000, the transactions were dated as of August 2000.

<sup>2</sup>Enron also references a transfer of \$9,990.00 to Lehman on January 18, 2001 but does not indicate whether it was in exchange for Enron stock.

the terms of certain of the transactions and entered into new agreements adjusting the Termination Date and certain other terms of the transactions. Enron further alleges that certain of the transactions were subsequently consolidated into two transactions, dated September 28, 2001, the terms of which were manipulated to require an earlier payment from Enron in exchange for its stock of precisely the amount that it was determined Enron could afford on that earlier Termination Date. The remaining amount due and the corresponding shares of stock were structured as part of a second transaction with a Termination Date of January 4, 2002. Enron alleges that as a result of the consolidation, on November 5, 2001, in accordance with the terms of the first of the two consolidated transactions, Enron transferred \$150,022,449.20 to Lehman for 2,245,761 shares of Enron common stock.

Enron asserts that according to the terms of certain of the transactions, Enron originally had the option to pay Lehman any net amount owed on the transactions by giving Lehman shares of Enron common stock instead of cash. Enron alleges that in April 2001 and thereafter, Lehman negotiated with Enron for a series of European puts entered into in conjunction with certain of the transactions that gave Lehman the right to put (i.e., compel a sale) back to Enron, at a predetermined strike price, and on or about a specific expiration date, a certain number of shares of Enron common stock held by Lehman. Enron further alleges that the parties modified the European put transactions, ultimately renegotiating the transaction to the point where all of the puts were subsumed into two transactions dated as of October 1, 2001.

Enron further alleges that Lehman recognized the possibility of an imminent bankruptcy filing by Enron and as a result, on or about November 1, 2001, Lehman used its leverage to impose upon Enron a new transaction purporting to terminate the puts and have Enron purchase the remaining 2,434,339

shares of its stock still held by Lehman in exchange for a \$5,000,000 cash payment and an “agreement” by Enron to execute an interest-bearing note in the principal sum of \$173,538,284.14 (the “November 1, 2001 Agreement”). Enron also asserts that the November 1, 2001 Agreement purports to require Enron to “account for and treat the Note for all purposes as senior unsecured indebtedness, ranking pari passu with all bank debt.”

Enron alleges that the November 1, 2001 Agreement was not a valid and legally enforceable obligation of Enron. Enron alleges that the individual who executed the November 1, 2001 Agreement on behalf of Enron was not authorized by Enron and that Enron never executed the promissory note in the principal amount of \$173,538,284.14 payable to Lehman. Enron further alleges that on November 8, 2001, Enron transferred \$5,000,000.00 to Lehman.

Enron alleges that it was insolvent on November 5, 2001 when it paid Lehman \$150,022,449.20 for the 2,245,761 shares of Enron common stock. Enron further alleges that on November 6, 2001, at a time when Enron was insolvent, Lehman transferred to Enron the remaining 2,434,339 shares of Enron common stock held by Lehman. Enron also alleges that on November 8, 2001, Enron paid Lehman \$5,000,000.

Thus, Enron alleges that in the ninety days prior to the filing of Enron’s bankruptcy petition, Enron was insolvent and transferred over \$155,000,000 to Lehman related to these stock transactions (the “90-Day Transfers”) and that such transfers are avoidable and recoverable as preferential transfers. In addition, Enron alleges that these transfers and similar payments to Lehman that occurred within one year prior to the filing of Enron’s bankruptcy petition (collectively, the “2001 Transfers”) and their related agreements (the “2001 Agreements”) are avoidable and recoverable as fraudulent transfers

because they were illegal and void distributions to a common shareholder.

On November 24, 2003, Enron commenced this adversary proceeding seeking to recover the payments it made to Lehman. 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 Lehman for any amounts by which Lehman 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 Lehman until payment by Lehman 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 Lehman and disallowance, pursuant to § 502(b) of the Bankruptcy Code, of the equity-related claim as unenforceable against Enron under applicable law.

On February 20, 2004, Lehman filed a motion to dismiss the adversary proceeding, pursuant to Federal Rule of Bankruptcy Procedure (“Fed. R. Bankr. P.”) 7012(b) and Federal Rule of Civil Procedure (“Fed. R. Civ. P.”) 12(b)(6), for failure to state a claim. Lehman contends that the “safe harbor” provisions of section 546 of the Bankruptcy Code bar the relief sought by Enron. Enron opposes the motion to dismiss, arguing that the transfer in issue is not protected by the safe harbor provisions of the Bankruptcy Code. 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 April 7, 2004, in support of Lehman’s motion to dismiss the adversary proceeding.<sup>3</sup> A hearing on this matter was held before the Court on October 28, 2004.

### *DISCUSSION*

Fed. R. Civ. P. 12(b)(6) is incorporated into bankruptcy procedure by Fed. R. Bankr. P. 7012(b). In considering a Fed. R. Civ. P. 12(b)(6) motion to dismiss for failure to state a claim for relief, the court accepts as true all material facts alleged in the complaint and draws all reasonable inferences in favor of the plaintiff. *Walker v. City of New York*, 974 F.2d 293, 298 (2d Cir. 1992). The motion to dismiss is granted only if no set of facts can be established to entitle the plaintiff to relief. *Id.*

In considering such a motion, although a court accepts all the factual allegations in the complaint as true, the court is “not bound to accept as true a legal conclusion couched as a factual allegation.” *Papasan v. Allain*, 478 U.S. 265, 286 106 S. Ct. 2932, 2944 92 L. Ed. 2d 209 (1986). Thus, where more specific allegations of the complaint contradict such legal conclusions, “[g]eneral, conclusory allegations need not be credited.” *Hirsch v. Arthur Andersen & Co.*, 72 F.3d 1085, 1092 (2d Cir. 1995). Rather, to withstand a motion to dismiss, there must be specific and detailed factual allegations to support the claim. *Friedl v. City of New York*, 210 F.3d 79, 85-86 (2d Cir. 2000).

“Although bald assertions and conclusions of law are insufficient, the pleading standard is nonetheless a liberal one.” *Cooper v. Parsky*, 140 F.3d 433, 440 (2d Cir. 1998). Pursuant to Fed.

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<sup>3</sup>The Amicus brief was filed, generally, in support of the position taken by Lehman in this adversary proceeding and by several other defendants in various other similar adversary proceedings filed by the Debtors.

R. Civ. P. 8(a), which is made applicable to adversary proceedings by Fed. R. Bankr. P. 7008, in asserting a claim, the pleader need only set forth a short and plain statement of the claim showing that the pleader is entitled to relief. The purpose of the statement is to provide “fair notice” of the claim and “the grounds upon which it rests.” *Conley v. Gibson*, 355 U.S. 41, 47, 78 S. Ct. 99,103, 2 L. Ed. 2d 80 (1957). The simplicity required by the rule recognizes the ample opportunity afforded for discovery and other pre-trial procedures which permit the parties to obtain more detail as to the basis of the claim and as to the disputed facts and issues. *Id.* 355 U.S. at 47-48, 78 S. Ct. at 103. Based upon the liberal pleading standard established by Fed. R. Civ. P. 8(a), even the failure to cite a statute, or to cite the correct statute, will not affect the merits of the claim. *Northrop v. Hoffman of Simsbury, Inc.*, 134 F.3d 41, 46 (2d Cir. 1997). In considering a motion to dismiss, it is not the legal theory but, rather, the factual allegations that matter. *Id.*

In reviewing a Fed. R. Civ. P. 12(b)(6) motion, a court may consider the allegations in the complaint; exhibits attached to the complaint or incorporated therein by reference; matters of which judicial notice may be taken; *Brass v. Am. Film Technologies, Inc.*, 987 F.2d 142, 150 (2d Cir. 1993); and documents of which plaintiff has notice and on which it relied in bringing its claim or that are integral to its claim. *Cortec Indus. v. Sum Holding, L.P.*, 949 F.2d 42, 48 (2d Cir. 1991). However, mere notice or possession of the document is not sufficient. *Chambers v. Time Warner, Inc.*, 282 F.3d 147, 153 (2d Cir. 2002). Rather, a necessary prerequisite for a court’s consideration of the document is that a plaintiff relied “on the terms and effect of a document in drafting the complaint.” *Id.* As such, the document relied upon in framing the complaint is considered to be merged into the pleading. *Id.* at 153 n.3 (citation omitted). In contrast, when assessing the sufficiency of the complaint,

the Court does not consider extraneous material because considering such would run counter to the liberal pleading standard which requires only a short and plain statement of the claim showing entitlement to relief. *Id.* at 154. Nevertheless, in considering a Rule 12(b)(6) motion, a court may consider facts as to which the court may properly take judicial notice under Rule 201 of the Federal Rules of Evidence (“Fed. R. Evid.”). *In re Merrill Lynch & Co., Inc.*, 273 F. Supp. 2d 351, 357 (S.D.N.Y. 2003), *citing*, *Chambers*, 282 F.3d at 153.

To survive a motion to dismiss, a plaintiff only has to allege sufficient facts, not prove them. *Koppel v. 4987 Corp.*, 167 F.3d 125, 133 (2d Cir. 1999). A court’s role in ruling on a motion to dismiss is to evaluate the legal feasibility of the complaint, not to undertake to weigh the evidence which may be offered to support it. *Cooper v. Parsky*, 140 F.3d 433, 440 (2d Cir. 1998).

Thus, for the purposes of the Motion to Dismiss, the Court accepts as true all of the material allegations in the Plaintiff’s complaint.

#### *Procedural Issues*

Enron first argues that Lehman’s motion to dismiss is procedurally flawed because it introduces extrinsic material outside of the factual allegations contained in the Complaint and, therefore, cannot form the basis to dismiss the Complaint pursuant to Fed. R. Civ. P. 12(b)(6).

In reviewing this Fed. R. Civ. P. 12(b)(6) motion, the Court may properly consider the Confirmations and the agreement entered into by the parties which reflect the terms of the transaction that is the subject of the Complaint. The Confirmation describes the terms of the transaction between the parties. Enron referenced the Confirmation in the Complaint and relied upon its terms and the terms of the agreement in drafting the Complaint.

The Court, however, does not consider the extrinsic material submitted by Lehman concerning Enron's alleged intent in entering into the transactions with Lehman. To support the contention that Enron entered into the transactions as a risk management strategy to hedge its incentive-based compensation plans, the Court's attention is directed to the 10-K report filed with the SEC by Enron in which Enron reported that it had entered into certain common stock swaps, with an aggregate notional amount of \$121,000,000.00, to hedge certain incentive-based compensation plans.<sup>4</sup> Enron disputes this contention with respect to the intent in entering into the transactions with Lehman. Inasmuch as there is no way to correlate the transactions or amount mentioned in the 10-K filing with the actual transactions with Lehman, the 10-K filing cannot form the basis, at this stage of the proceedings, to resolve this factual dispute.

*Section 546(e) of the Bankruptcy Code*

In its motion to dismiss, Lehman argues that as a matter of law, the transfers made by Enron to Lehman 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

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<sup>4</sup>See 2000 Enron Corp. 10-K at F-8, Section 3 (Price Risk Management Activities and Financial Instruments) (available at <http://www.sec.gov/Archives/edgar/data/1024401/000102440101500010/0001024401-01-500010.txt>).

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 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).<sup>5</sup> 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. S.D.N.Y. 2005).

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<sup>5</sup>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).

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,<sup>6</sup> which renders distributions<sup>7</sup> 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 reasons as set forth in this Court's *Bear Stearns* Opinion, the transfers that were made by Enron to

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<sup>6</sup>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.

<sup>7</sup>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).

Lehman in exchange for Enron's own shares of stock, if it were ultimately determined that Enron had been insolvent at the time, were not settlement payments that would qualify for protection under section 546 of the Bankruptcy Code.

Thus, accepting as true all of the material allegations in Enron's Complaint, section 546 of the Bankruptcy Code would not protect any transfer made in violation of Or. Rev. Stat. § 60.181 from avoidance. As Lehman sought dismissal based upon the application of section 546 of the Bankruptcy Code, its motion to dismiss the adversary proceeding with respect to those transfers that were made in exchange for Enron stock is denied.

*Section 546(g) of the Bankruptcy Code*

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).

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).<sup>8</sup>

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<sup>8</sup>The current version of 11 U.S.C. § 101(53B) provides that the term “swap agreement”--

(A) means--

(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



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 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 Capital Market and Investment*

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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.

*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 (9<sup>th</sup> 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.”<sup>9</sup> 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.

Lehman argues that the transfers by Enron in exchange for its stock are protected from avoidance pursuant to section 546(g) of the Bankruptcy Code as equity or 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

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<sup>9</sup>As previously set forth in footnote 5, the current version of section 101(53B) specifically references “equity swaps” and “equity forwards.”

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.<sup>10</sup>

*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 fraudulent. Specifically, Enron asserts that these transfers were made “with actual intent to hinder, delay or defraud” Enron’s creditors. Lehman contends that the causes of action based upon intentional fraud should be dismissed as they are conclusory and have not been pled with sufficient particularity.

At the time of the commencement of this adversary proceeding, section 548(a)(1)(A) of the Bankruptcy Code,<sup>11</sup> provided that

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

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<sup>10</sup>It is not clear from the Complaint whether the transfer of \$9,990.00 on January 18, 2001 to Lehman was in exchange for stock. If it were not in exchange for stock, it would not fall within the proscription of the Oregon statute prohibiting distributions to shareholders. However, as these transactions transpired prior to the 2005 amendment to sections 546(g) which specifically added equity swaps to the definition of swap agreements, *see* the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, in order for the transaction to be considered a swap agreement, it must qualify as “any other similar agreement” or as a commodity swap. Thus, as set forth in this Court’s Opinion, entered contemporaneously herewith in *Enron Corp. v. Credit Suisse (In re Enron Corp.)*, Adv. Pro. No. 03-93371, op. at 18-19 (Bankr. S.D.N.Y. July 29, 2005), it is necessary to establish if the swap market generally understands it to be a swap agreement. Thus, evidence or authority must be presented showing that, at that 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. In a motion to dismiss, however, a court is not called upon to weigh the evidence.

<sup>11</sup>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.

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.<sup>12</sup> *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. 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

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<sup>12</sup>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.

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.

Enron alleges that transfers were made "with actual intent to hinder, delay or defraud" Enron's creditors. Lehman contends that, as plead, the fraud claims are conclusory and have not been pled with the requisite particularity. Enron counters that a relaxed standard or 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 certainly 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 any event, even applying a stricter standard to the facts as alleged, the complaint is viable.

Here, Enron alleges that while Enron was insolvent and without the wherewithal to make cash payments to creditors, it made payments in violation of Oregon corporate law to Lehman. Enron further alleges that Lehman 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 Lehman depleted Enron's cash and adversely impacted its liquidity and hindered or delayed payment to Enron's other creditors. Enron references Lehman'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, Lehman maneuvered to affect this status and evade this contractual term, elevating Lehman's subordinate rights and hindering other creditors. Enron contends that Enron wrongfully transferred assets to Lehman, a powerful shareholder, to the disadvantage of creditors and there was intent to hinder or delay such creditors. Enron further alleges that Lehman and Enron subsequently entered into a new arrangement that attempted to replace Lehman's remaining shares of Enron common stock with senior unsecured debt, thereby elevating Lehman's subordinate status over that of other creditors. The Court concludes that the badges of fraud that Enron alleges are sufficient to

defeat a motion to dismiss. In addition, because it has a well-pleaded complaint, Enron is entitled to take discovery.

Finally, as a result of the Court's determination to deny the motion to dismiss the Complaint's previously discussed causes of action, the Court also denies the motion to dismiss those causes of action seeking disallowance or subordination of other claims that Lehman may have against Enron. The viability of the disallowance causes of action and certain aspects of the subordination causes of action depend on the resolution of the previously discussed causes of action. In addition, with respect to the subordination causes of action, there are disputed issues of fact that preclude dismissal of the causes of action.<sup>13</sup>

### *Conclusion*

The Court concludes that with respect to the transaction where Enron paid Lehman in exchange for its own shares of stock, if the payments to Lehman are 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, Lehman could not avail itself of the protection from avoidance provided for transfers in connection with swap agreements pursuant to section 546(g) of the

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<sup>13</sup>Further, for the reasons set forth by Enron, the Court finds that Lehman's assertion of the affirmative defense, that the transfers are not avoidable as fraudulent conveyances because Lehman received the transfers for value and in good faith, is premature. With respect to Lehman's argument that because there is no allegation that there was a transfer to either Lehman Brothers Holding, Inc. or to Lehman Commercial Paper Inc. the Court should dismiss the causes of action against them, the Court will schedule further argument on the issue.



Bankruptcy Code.

Accepting as true all of the material allegations in Enron's Complaint, section 546 of the Bankruptcy Code would not protect the transfers made in violation of Or. Rev. Stat. § 60.181 from avoidance. As Lehman sought dismissal based upon the application of section 546 of the Bankruptcy Code, its motion to dismiss the adversary proceeding in that respect is denied.

Further, Enron has sufficiently pled the Complaint to defeat Lehman's motion to dismiss for failure to plead the fraud claim with particularity.

Based upon the foregoing, Lehman's motion to dismiss the Complaint is properly denied. Counsel for the Debtors is to settle an order consistent with this Court's Memorandum Opinion.

Dated: New York, New York  
July 29, 2005

*s/ Arthur J. Gonzalez*  
UNITED STATES BANKRUPTCY JUDGE