# IN THE UNITED STATES DISTRICT COURT
# FOR THE NORTHERN DISTRICT OF ILLINOIS
# EASTERN DIVISION

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|---|---|---|
| LAWRENCE E. JAFFE PENSION PLAN, On Behalf of Itself and All Others Similarly Situated, | ) | Lead Case No. 02-C-5893 (Consolidated) |
| Plaintiffs, | ) | |
| v. | ) | **Hon. Ronald A. Guzman** Magistrate Judge Nan R. Nolan |
| HOUSEHOLD INTERNATIONAL, INC., et al., | ) | |
| Defendants. | ) | |

FILED
MAR 7 2005 WH
MICHAEL W. DOBBINS
CLERK, U.S. DISTRICT COURT

## APPENDIX A

## UNREPORTED AUTHORITIES SUPPORTING DEFENDANT ARTHUR ANDERSEN LLP'S MOTION TO DISMISS IN PART PLAINTIFFS' [CORRECTED] AMENDED CONSOLIDATED COMPLAINT OR, IN THE ALTERNATIVE, FOR JUDGMENT ON THE PLEADINGS

# APPENDIX OF UNREPORTED CASES

1. Antell v. Arthur Andersen LLP, 1998 WL 245878 (N.D. Ill. May 4, 1998) (Judge Andersen)

2. Donnelli v. Peters Securities Co., 2002 U.S. Dist. LEXIS 16305, at * 12 (N. D. Ill. Aug. 29, 2002) (same)

3. Foss v. Bear, Stearns Co., Inc., No. 04-2514, 2005 U.S. App. LEXIS 406 (7th Cir. Jan. 11, 2005)

4. L-3 Communications Corp. v. Clevenger, 2004 U.S. Dist. LEXIS 17845 (E.D. Pa. Aug. 31, 2004)

5. Lieberman v. Cambridge Partners LLC, 2004 U.S. Dist. LEXIS 11553 (E.D. Pa. June 21, 2004)

6. Muhammad v. Village of Bolingbrook, 2004 U.S. Dist. LEXIS 12726, at * 4 (N.D. Ill. July 8, 2004)

7. Newby v. Enron Corp., 2004 U.S. Dist. LEXIS 8158 (S.D. Tex. Feb. 25, 2004)

8. Northwestern Human Services, Inc. v. Panaccio, 2004 U.S. Dist LEXIS 19147, at * 66 (E.D. Pa. Sept. 24, 2004)

9. Roberts v. Dean Witter Reynolds, Inc., 2003 U.S. Dist. LEXIS 5676 (M.D. Fla. Mar. 31, 2003)

10. Stauffer v. Westmoreland Obstetric and Gynecologic Associates, 2001 WL 585510, at *5 (N.D. Ill. May 25, 2001) (Judge Moran)

11. Waldock v. M.J. Select Global, Ltd., 2004 WL 2278549, at * 4 (N.D. Ill. Oct. 7, 2004) (Judge St. Eve)

12. In re Worldcom, Inc. Sec. Litig., 2004 U.S. Dist. 11696 (S.D.N.Y. June 29, 2004)

13. Zouras v. Hallman, 2004 U.S. Dist. LEXIS 19684 (D.N.H. Sept. 30, 2004)

14. Zurich Capital Markets, Inc. v. Coglianese, 2004 U.S. Dist. LEXIS 19432 (N.D. Ill. Sept. 23, 2004)

# EXHIBIT 1

**Motions, Pleadings and Filings**

Only the Westlaw citation is currently available.

United States District Court, N.D. Illinois.

**James B. ANTELL, III, Nick Pino, Anthony Dicamillo, and Ralph Corigliano Plaintiffs**
**v.**
**Arthur ANDERSEN LLP., Defendant.**

**No. 97 C 3456.**

May 4, 1998.

MEMORANDUM OPINION AND ORDER

ANDERSEN, District J.

*1 On February 20, 1998, Magistrate Judge Martin C. Ashman filed and served upon the parties his report and recommendation concerning the motion of Defendant, Arthur Andersen LLP ("Arthur Andersen"), to dismiss the instant complaint pursuant to Fed.R.Civ.P. 12(b)(6). Judge Ashman recommends that Arthur Andersen's motion be granted in part and denied in part.

After a careful consideration of the above-referenced motion, the applicable memoranda of law, other relevant pleadings, Judge Ashman's report, and the parties' objections, the Court hereby adopts in full the report and recommendation.

I. BACKGROUND

For purposes of a motion to dismiss, the allegations in the complaint are presumed true. The Discovery Zone, Inc. (the "Discovery Zone") owns, operates, and franchises children's indoor recreational centers. In June 1993, the Discovery Zone offered its stock to the public for the first time.

Each of the four named Plaintiffs purchased Discovery Zone stock in the pertinent time period. According to Plaintiffs, between March 31, 1994 and September 15, 1995, the officers and directors of the Discovery Zone inflated the price of the company's stock by using false and misleading financial statements in the company's annual Form 10-K Securities and Exchange Commission ("SEC") filings for the years ending 1993 and 1994. Plaintiffs further allege that Arthur Andersen, an independent accounting firm, audited these financial statements and issued unqualified or "clean" audit opinions. Additionally, Plaintiffs contend that the officers and directors of the Discovery Zone and Arthur Andersen engaged in various accounting improprieties which converted normal operating expenses to capital thereby masking operational loses. Accordingly, Plaintiffs allege that these accounting manipulations and other misrepresentations deceived the public into believing that the Discovery Zone was profitable and well positioned for dramatic future growth.

The Discovery Zone filed the pertinent Form 10-Ks and audit reports prepared by Arthur Andersen with the SEC on March 31, 1994 and March 31, 1995.

On November 9, 1994, the Discovery Zone reported a substantial operating loss for the third quarter of 1994. On November 28, 1994, the first putative class action was filed against the Discovery Zone and certain officers and directors alleging that these defendants improperly inflated the price of Discovery Zone stock in violation of §§ 10(b) and 20 of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) and 78t, and SEC Rule 10b-5, 17 C.F.R. § 240.10b-5.

Several other putative class actions were also filed against the Discovery Zone and certain officers and directors. All of the separate lawsuits were consolidated in front of Judge Ruben Castillo (the "Related Action"). On January 31, 1995, James B. Antell, III ("Antell") filed a consolidated putative class action complaint in the Related Action and later amended that pleading on April 25, 1995 and November 16, 1995. Antell purchased Discovery Zone stock on December 7, 1994.

***2** In the Related Action, Antell asserted a fraud-on-the-market theory on behalf of a class of shareholders who purchased Discovery Zone stock during the period that the price of the stock was purportedly inflated due to the defendants' alleged manipulations and misrepresentations.

As part of the Related Action, on September 5, 1995 Arthur Andersen was served with a subpoena seeking its work papers from its 1993 and 1994 audits of the Discovery Zone's financial statements. In December 1996 and January 1997, Arthur Andersen produced documents which allegedly demonstrated, for the first time, that Arthur Andersen acted with scienter in the alleged accounting manipulations. Based on this information, on March 28, 1997, Antell sought leave to file a third amended complaint in the Related Action asserting similar fraud-on-the-market claims against Arthur Andersen. Judge Castillo denied the motion on the grounds that the addition of Arthur Andersen would delay discovery and prejudice the defendants. Nonetheless, Judge Castillo's order did not preclude the filing of a separate lawsuit against Arthur Andersen.

On May 9, 1997, Antell filed a putative class action against Arthur Andersen. Antell seeks damages on behalf of the class of shareholders who purchased Discovery Zone stock between March 31, 1994 and September 15, 1995. Antell claims that Arthur Andersen's audit reports either intentionally or recklessly failed to disclose that the Discovery Zone's financial statements were materially misstated and not in compliance with Generally Accepted Accounting Principles and General Accepted Auditing Standards. Antell brings claims under § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and SEC Rule 10b-5, 17 C.F.R. § 240.10b-5, (Count I) and common law fraud (Count II).

On August 6, 1997, Judge Ashman granted the motion of class members Nick Pino ("Pino"), Anthony DiCamillo ("DiCamillo"), and Ralph Corigliano ("Corigliano") for appointment as lead plaintiffs. Corigliano purchased Discovery Zone stock on March 24, 1995. DiCamillo and Pino purchased the stock on September 13, 1995 and September 14, 1995, respectively.

Arthur Andersen filed a motion to dismiss Plaintiffs' claims on July 21, 1997. In its motion to dismiss, Arthur Andersen argues that Plaintiffs' federal securities claim (Count I) is barred by the applicable statutes of limitations and repose. Arthur Andersen further asserts that the Court should decline to exercise supplemental jurisdiction over Plaintiffs' state law claim for common law fraud (Count II). Plaintiffs contend that their claims are not time barred.

Judge Ashman issued his report and recommendation on February 20, 1998 recommending that Arthur Andersen's motion to dismiss based on the one-year statute of limitations be denied and that the motion be granted based on the applicable three-year statute of repose. Accordingly, Judge Ashman recommends that all claims for purchases made in reliance on the March 31, 1994 Form 10-K and the accompanying supplemental claims for common law fraud be dismissed. The Plaintiffs and Arthur Andersen each filed and briefed their objections in March 1998.

## II. DISCUSSION

***3** A motion to dismiss a complaint pursuant to Fed.R.Civ.P. 12(b)(6) does not test whether the plaintiff will prevail on the merits but instead whether the claimant has properly stated a claim. *Triad Assoc. v. Chicago Housing Auth.*, 892 F.2d 583, 586 (7th Cir.1989), *cert. denied*, 498 U.S. 845, 111 S.Ct. 129, 112 L.Ed.2d 97 (1990). The court must accept as true all well-pleaded factual allegations and draw all reasonable inferences in favor of the plaintiff. *Chaney v. Suburban Bus Div. of Reg'l Transp. Auth.*, 52 F.3d 623, 626-627 (7th Cir.1995) (citations omitted). Dismissal is proper only if it appears beyond doubt that the plaintiff cannot prove any of the facts in support of her claim that would entitle her to the requested relief. *Hughes v. Rowe*, 449 U.S.

5, 9-10, 101 S.Ct. 173, 66 L.Ed.2d 163 (1980).

With these standards in mind, we now turn to the report and recommendation. In doing so, we must "make a de novo determination upon the record, or after additional evidence, of any portion of the magistrate judge's disposition to which a specific written objection has been made." Fed.R.Civ.P. 72(b). This "de novo determination" does not require a new hearing, but simply means that we must give "fresh consideration to those issues to which specific objections have been made." *Rajaratnam v. Moyer,* 47 F.3d 922, 925 n. 8 (7th Cir.1995) (*quoting* 12 Charles A. Wright et al., *Federal Practice and Procedure* § 3076.8 (Supp.1994)).

An action claiming a violation of Section 10(b) or Rule 10b-5 must be brought "within one year after the discovery of the facts constituting the violation and within three years after such violation." *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson,* 501 U.S. 350, 364, 111 S.Ct. 2773, 115 L.Ed.2d 321 (1991); 15 U.S.C. § 78i(e). The statue of limitations is an affirmative defense. In the context of a motion to dismiss, a plaintiff is not required to negate an affirmative defense in his complaint. *Fugman v. Aprogenex, Inc.,* 961 F.Supp. 1190, 1198 (N.D.Ill.1997). Nonetheless, if the plaintiff pleads facts that establish that his suit is time barred, he pleads himself out of court. *Tregenza v. Great American Communications Co.,* 12 F.3d 717, 718 (7th Cir.1993), *cert. denied,* 511 U.S. 1085, 114 S.Ct. 1837, 128 L.Ed.2d 465 (1994).

### A. One-Year Statute of Limitations

The one-year limitations period begins to run when a plaintiff has "inquiry notice" of the alleged fraud rather than when a plaintiff actually discovers the fraud. *Id.* at 722. The test is an objective one. *Law v. Medco Research, Inc.,* 113 F.3d 781, 786 (7th Cir.1997). A person is charged with "inquiry notice" when she becomes aware of facts that would lead a reasonable person to investigate whether she has a claim under Section 10(b) or Rule 10b-5. *Marks v. CDW Computer Centers, Inc.,* 122 F.3d 363, 367 (7th Cir.1997). " 'Suspicious circumstances, coupled with ease of discovering, without the use of legal process, whether the suspicion is well grounded, may cause the statute of limitations to start to run before the plaintiffs discover the actual fraud." ' *Fujisawa Pharm. Co., Ltd. v. Kapoor,* 115 F.3d 1332, 1335 (7th Cir.1997) (citing *Law,* 113 F.3d at 786).

*4 Judge Ashman recommends that Arthur Andersen's motion to dismiss based on the one-year limitations period be denied. Arthur Andersen objects to Judge Ashman's conclusion that Plaintiffs did not have "inquiry notice" of their claim more than one year before the action was commenced. Plaintiffs offer no objection on this point. For the following reasons, we agree with Judge Ashman and overrule Arthur Andersen's objection.

Plaintiffs filed the instant action against Arthur Andersen on May 9, 1997. Arthur Andersen contends that Plaintiffs had inquiry notice of this claim on November 28, 1994, the day the original complaint in the Related Action was filed. Arthur Andersen asserts that the Related Action complaint proclaimed to the world that Discovery Zone shareholders asserted fraud based on the same type of accounting manipulations and practices that Plaintiffs claim in the instant lawsuit. Thus, Arthur Andersen concludes that Plaintiffs were sufficiently alerted that Arthur Andersen, the auditor of the purported fraudulent financial statements, may have participated in the alleged fraud.

A "reasonable investor is presumed to have information available in the public domain, and therefore [a plaintiff] is imputed with constructive knowledge of this information." *Whirlpool Fin. Corp. v. GN Holdings, Inc.,* 67 F.3d 605, 610 (7th Cir.1995). Arthur Andersen correctly states that pleadings in a lawsuit can provide inquiry notice of a claim. *See Astor Chauffeured Limousine Co. v. Runnfeld Inv. Corp.,* 910 F.2d 1540, 1544 (7th Cir.1990); *Cashman v. Coopers & Lybrand,* 877 F.Supp. 425, 436-437, n. 14 (N.D.Ill.1995). Nonetheless, Plaintiffs are not charged with inquiry notice until they knew or should have known Arthur Andersen acted with scienter. *Law*, 113 F.3d at 786.

Plaintiffs contend that they could not have known that Arthur Andersen may have joined in the alleged fraudulent accounting treatment until Arthur Andersen produced its work papers in the Related Action in late 1996 and early 1997. Specifically, in ¶ 80 of the complaint Plaintiffs allege that:

> Beginning in December 1996 and continuing in January 1997, as a result of discovery in the action against the Related Action Defendants, which discovery had previously been stayed, plaintiffs received work papers of Arthur Andersen relating to the 1993 and 1994 audits. Included in the Administration Binder produced by Arthur Andersen, contained as part of the 1993 work papers, were Audit Issue Control Documents dated February 7, 1994. These documents and related documents revealed for the first time, that Arthur Andersen knew or recklessly disregarded that the public financial statements for the years ended December 31, 1993, and December 31, 1994, issued or disseminated in the name of [the Discovery Zone], were materially false and misleading and that Arthur Andersen's audits did not conform with GAAS.

Although the pleadings filed in the Related Action and the disclosures in the Form 10-K filings may have created suspicious circumstances as to Arthur Andersen's knowledge and activities, we cannot accept Arthur Andersen's assertion that these documents conclusively provided inquiry notice of Arthur Andersen's supposed recklessness or intentional misconduct. In order to make the inference Arthur Andersen requires, the Court must ignore the equally reasonable inference that the Related Action pleadings and the SEC filings merely put Plaintiffs on notice that Arthur Andersen acted only in a negligent manner.

***5** Whether a plaintiff has inquiry notice of a claim under Section 10(b) or Rule 10b-5 is a question of fact and, as such, is often inappropriate for resolution of a motion to dismiss. *Marks*, 122 F.3d at 366. At this stage of the proceedings, we must assume the truth of Plaintiffs' allegations and draw all reasonable inferences in their favor. Thus, for purposes of the motion to dismiss we find that Plaintiff had inquiry notice of the instant claim against Arthur Andersen when it received Arthur Andersen's work papers in December 1996 or January 1997. Arthur Andersen's motion to dismiss based on the one-year statue of limitations is, therefore, denied.

B. Three-Year Statute of Repose

In *Lampf*, the Supreme Court adopted a three-year statute of repose for claims brought under Section 10(b) and Rule 10b-5. The Supreme Court, however, did not specifically define the "violation" that triggers the repose period. Plaintiffs assert that a plaintiff's purchase of a security triggers the repose period. Judge Ashman and Arthur Andersen both suggest that the alleged misrepresentation is the "violation" contemplated by the statute of repose.

Based on the statute of repose, Judge Ashman recommends that Arthur Andersen's motion to dismiss be granted for all claims for purchases made in reliance on the Discovery Zone's March 31, 1994 Form 10-K filing, namely all purchases made prior to March 31, 1995. Plaintiffs object to Judge Ashman's recommendation. Defendant offers no objection on this point. For the following reasons, we agree with Judge Ashman and overrule Plaintiffs' objection.

Whether Plaintiffs' claims are time-barred under the statute of repose depends on when the repose period began to run. Although the Seventh Circuit has not yet determined the triggering event in the Section 10(b) or Rule 10b-5 context, the court has held that a period of repose bars a suit a fixed number of years after an action by a defendant, even if this period ends before a plaintiff suffers any injury. *Beard v. J.I. Case Co.*, 823 F.2d 1095, 1097 n. 1 (7th Cir.1987). *Accord Lampf*, 501 U.S. at 363 (stating "the purpose of the 3- year [statute of repose] is clearly to serve as a cutoff...."); *Law*, 113 F.3d at 786 (noting that "the three-year statute of repose gives defendants a definite limit beyond which they needn't fear being sued"). For the following reasons, we hold that the repose period is triggered by the alleged misrepresentation rather than by a plaintiff's purchase of a security.

An examination of the language of 15 U.S.C. § 78i(e), § 9(e) of the of the 1933 Security and Exchange Act, the rule adopted by the Supreme Court in *Lampf,* is instructive. Pursuant to § 78i(e), claims must be "brought within one year after the discovery of the facts constituting the *violation* and within three years after such *violation.*" The employment of the term "violation" for purposes of both the one-year statute of limitations period and the three-year repose period demonstrates that a "violation" occurs at the time of the alleged fraudulent conduct. As discussed above, *see supra* Section A, a party must commence a Section 10(b) or Rule 10b-5 claim within one-year after discovery of the facts constituting the alleged fraudulent conduct. If we held that the repose period begins when a plaintiff purchased the Discovery Zone stock, "violation" would have two different meanings in the same sentence.

***6** Additionally, although the *Lampf* opinion did not specifically decide what constitutes a triggering event for the repose period, the Court stated:

> As there is no dispute that the earliest of plaintiffs-respondent's complaints was filed *more than three years after petitioner's alleged misrepresentations,* plaintiffs-respondent's claims were untimely.

*Lampf,* 501 U.S. at 364 (emphasis added). Furthermore, the Ninth Circuit and the SEC agree that a "violation" of Section 10(b) or Rule 10b-5 does not depend on a sale or purchase of a security. *E.g. S.E.C. v. Rana Research, Inc.,* 8 F.3d 1358, 1364 (9th Cir.1993) ; *In re Cambridge Biotech Corp.,* Exch. Act. Rel. No. 33-7358, 1996 WL 595674 (Oct. 17, 1996).

Thus, we find that the three-year repose period for Section 10(b) and Rule 10b-5 claims begins to run when a defendant makes an affirmative misrepresentation. *Accord In re Prudential Ins. Co. of America Sales Practices Litigation,* 975 F.Supp. 584, 603-604 (D.N.J.1997) (holding that the alleged misrepresentation rather than the sale or purchase of a security triggers the three-year repose period); *In re Phar-Mor, Inc. Securities Litigation,* 892 F.Supp. 676, 687-688 (W.D.Pa.1995) (same); *Continental Bank, Nat'l Assoc.,* 777 F.Supp. 92, 102 (D.Mass.1991) (same); *Greenberg v.. Boettcher & Co.,* 755 F.Supp. 776, 784-785 (N.D.Ill.1991) (same); *c.f., Otto v. Variable Annuity Life Ins. Co.,* 816 F.Supp. 458, 461 (N.D.Ill.1991) (declining to select a triggering date for affirmative misrepresentation cases and noting in *dicta* that "a violation of § 10(b) and Rule 10b-5 is comprised not only of a misrepresentation or omission of material fact, but also includes the purchase or sale of any security").

In their objection, Plaintiffs assert that Judge Ashman's conclusion that the misrepresentation triggers the repose period is contrary to law. We have already rejected this argument and agree with Judge Ashman's analysis. Furthermore, Plaintiffs' reliance on *Kleban v. S.Y.S. Restaurant Management, Inc.,* 912 F.Supp. 361 (N.D.Ill.1995), is misplaced. In *Kleban,* the court held that the sale of the security triggers the repose period. *Id.* at 367. We are not bound by this decision and for the reasons stated above we disagree with its reasoning.

Likewise, *Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723, 95 S.Ct. 1917, 44 L.Ed.2d 539 (1975), offers Plaintiffs no assistance. In *Blue Chip Stamps,* the Supreme Court held only that actual purchasers and sellers of securities have standing to pursue a claim under the anti-fraud provisions of the Security and Exchange Act of 1934. The Court did not decide when the repose period begins to run or define "violation" in the repose context. Therefore, Plaintiffs' objection is denied.

In sum, all claims for purchases made in reliance on the Discovery Zone's March 31, 1994 Form 10-K filing, namely all purchases made prior to March 31, 1995, are time bared by the statute of repose. Because Antell and Corigliano purchased the stock before March 31, 1995, their federal claims are time-barred.

Generally, when federal claims are dismissed, the court should decline to exercise jurisdiction over supplemental state law claims. *United Mine Workers of America v. Gibbus,* 383 U.S. 715, 726-727, 86 S.Ct. 1130, 16 L.Ed.2d 218 (1966). Accordingly, the Court will not exercise supplemental jurisdiction over the state law claims based on purchases made before March 31, 1995. Thus, the claims of Antell and Corigliano are dismissed.

***7** Additionally, in his report, Judge Ashman overlooked the purchase dates of Plaintiffs DiCamillo and Pino which occurred on September 13, 1995 and September 14, 1995. Because DiCamillo and Pino relied on the alleged misrepresentations contained in the March 31, 1995 Form 10-K filing, the repose period for their claims had not expired when the instant action was filed on May 9, 1997. Thus, Plaintiffs DiCamillo and Pino may pursue the federal and state law claims in Counts I and II for purchases made in reliance on the Discovery Zone's March 31, 1995 Form 10-K, namely all purchases made between March 31, 1995 and September 15, 1995.

C. Tolling Of The Three-Year Statue Of Repose

Plaintiffs also contend that the statue of repose was tolled on March 28, 1997, three days before the anniversary of the initial Form 10-K filing. On that date, Plaintiffs filed their motion to amend the complaint in the Related Action to add Arthur Andersen as a defendant. Plaintiffs, thus, argue that the repose period was tolled during the pendency of their motion. Judge Ashman rejected Plaintiffs' assertion and we agree with Judge Ashman.

In *Lampf,* the Supreme Court squarely rejected the doctrine of equitable tolling in securities fraud cases. The Court held that "it is evident that the equitable tolling doctrine is fundamentally inconsistent with the 1-and 3-year [limitations] structure." *Lampf,* 501 U.S. at 363.

Moreover, even if the clock stopped running while Judge Castillo decided Plaintiffs' motion to amend, from March 28, 1997 to May 2, 1997, the repose period would only be extend by three days. Plaintiffs, however, waited four days before filing the instant suit. Thus, we reject Plaintiffs' equitable tolling argument.

III. CONCLUSION

For the foregoing reasons, we adopt Magistrate Judge Ashman's report and recommendation. Arthur Andersen's motion to dismiss the complaint pursuant to Fed.R.Civ.P. 12(b)(6) based on the one-year statute of limitations is denied. The motion to dismiss based on the three-year statute of repose is granted in part and denied in part.

Claims for purchases made in reliance on the Discovery Zone's March 31, 1994 Form 10-K filing are time barred under the statute of repose, namely purchases made prior to March 31, 1995. The claims of Plaintiffs Antell and Corigliano are, thus, dismissed. Accordingly, we decline to exercise supplemental jurisdiction of their state law claims. Claims for purchases made in reliance on the Discovery Zone's March 31, 1995 Form 10-K filing are timely. Therefore, Arthur Andersen's motion to dismiss is denied as to Plaintiffs DiCamillo and Pino. Plaintiffs DiCamillo and Pino may pursue the federal and state law claims in Counts I and II for purchases made in reliance on the Discovery Zone's March 31, 1995 Form 10-K, namely all purchases made between March 31, 1995 and September 15, 1995.

The objections to the report and recommendation of Plaintiffs and Arthur Andersen are hereby overruled.

***8** It is so ordered.

1998 WL 245878 (N.D.Ill.)

**Motions, Pleadings and Filings (Back to top)**

. **1:97CV03456** **(Docket)** **(May. 09, 1997)**

**END OF DOCUMENT**

# EXHIBIT 2

ROBERT DONNELLI, an individual, Plaintiff, v. PETERS SECURITIES CO., L.P., a limited partnership, REUBEN PETERS, ROBERT G. PETERS, C. TIMOTHY VLAHOS, STEVE HELMS, CHRISTOPHER ROSMAN, CHRIS RANDLE, STEVE STOYCHA and JASON PERHACS, Defendants.

No. 02 C 0691

UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION

2002 U.S. Dist. LEXIS 16305

August 28, 2002, Decided
August 29, 2002, Docketed

**DISPOSITION:** [*1] Defendants' motion to dismiss was granted in part and denied in part.

**CASE SUMMARY**

**PROCEDURAL POSTURE:** Plaintiff stock trader filed a complaint seeking payment he alleged was due to him as a result of his marketing efforts performed under an alleged oral agreement with defendants, securities broker and principals, which moved to dismiss the entire case for failure to state a claim for which relief could be granted. The trader asserted the motion was untimely under *Fed. R. Civ. P. 12(g)*, (h).

**OVERVIEW:** The trader brought other entities into contact with the broker to handle the others' securities trading accounts. Although the broker verbally agreed to pay the trader ten percent of the trading profits, it began by paying him eight and one-third percent. The trader alleged he was told that his profit distribution would be raised when the broker met its projections. After the relationship collapsed and the broker ceased to follow the agreed division of profits, the trader asserted his claims for breach of contract, quantum meruit recovery, tortious interference with both the profit-splitting contract and prospective business advantage, and for an accounting. The court first held that the broker was not required to file its *Fed. R. Civ. P. 12(b)(6)* at the same time it moved to transfer venue and to dismiss for lack of subject matter jurisdiction. The court found that the trader successfully alleged a valid oral, at-will contract existed; therefore the quasi-contract, equitable, remedies, quantum meruit and an accounting, were not proper and were dismissed, as the trader had adequate remedies at law. The other claims were supported by some alleged facts.

**OUTCOME:** The motion to dismiss was granted as to the trader's equitable claims for quantum meruit and recovery and for an accounting. It was denied as to the claim for breach of contract in so far as a specific percentage was agreed upon but partially was not paid; tortious interference with both contract and a prospective business advantage.

**CORE TERMS:** motion to dismiss, breach of contract, quantum meruit, termination, prospective economic advantage, tortuous, at-will, tortious interference, oral contract, contractual, terminable, accounting, failure to pay, trading, intentional interference, duration, failure to state a claim, split, pled, reasonable expectation, expectancy, marketing, customer, scrap, partner, viable, paying, contractual relationship, modification, discovery

**LexisNexis(TM) Headnotes**

***Civil Procedure > Pleading & Practice > Defenses, Objections & Demurrers > Failure to State a Cause of Action***
[HN1]In ruling on a motion to dismiss for failure to state a claim, the court considers whether relief is possible under any set of facts that could be established consistent with the allegations. A plaintiff's complaint will generally not be dismissed unless it is beyond doubt that under no set of facts would plaintiff's allegations entitle him to relief. The purpose of a motion to dismiss is to test the sufficiency of the complaint, not to rule on its merits.

***Civil Procedure > Pleading & Practice > Defenses, Objections & Demurrers > Failure to State a Cause of Action***
[HN2]When considering a motion to dismiss for failure to state a claim, a court accepts the allegations of the complaint as true as well as reasonable inferences therefrom, and views these both in the light most favorable to the plaintiff.

***Civil Procedure > Pleading & Practice > Defenses, Objections & Demurrers > Failure to State a Cause of Action***
[HN3]See *Fed. R. Civ. P. 12(g)*.

***Civil Procedure > Pleading & Practice > Defenses, Objections & Demurrers > Waiver & Preservation***
[HN4]See *Fed. R. Civ. P. 12(h)*.

***Contracts Law > Breach > Causes of Action***
[HN5]To state a claim for breach of contract under Illinois law, a plaintiff must allege: (1) the existence of a valid contract with the defendant; (2) the defendant's breach of that contract; (3) plaintiff's performance under the contract; and, (4) damages to the plaintiff resulting from such breach. However, contracts of in-

definite duration are terminable at the will of either party.

*Civil Procedure > State & Federal Interrelationships > Application of State Law*
[HN6]When neither party raises a conflict of law issue in a diversity case, the federal court simply applies the law of the state in which the federal court sits.

*Labor & Employment Law > Employment Relationships > At-Will Employment*
[HN7]The Illinois Supreme Court applies the rule that a breach of contract claim cannot arise from the termination of an at-will contract to a sales distribution agreement. The rule that contracts of indefinite duration are terminable at will has long been followed in Illinois.

*Labor & Employment Law > Employment Relationships > At-Will Employment*
[HN8]Under the terminable at will rule, either party to the contract can terminate the agreement for any reason or no reason without committing a breach of contract.

*Contracts Law > Types of Contracts > Implied-in-Fact Contracts*
[HN9]To state a claim for quantum meruit, a plaintiff must allege: (1) he performed a service to benefit Peters Securities and the individual defendants; (2) he performed the service non-gratuitously; (3) defendants accepted this service; and, (4) no contract existed to prescribe payment of this service.

*Contracts Law > Types of Contracts > Implied-in-Fact Contracts*
[HN10]Quantum Meruit means, literally, as much as he deserves. A party seeking recovery on a quantum meruit theory must demonstrate the performance of services by the party, the conferral of the benefit of those services on the party from whom recovery is sought, and the unjustness of the latter party's retention of the benefit in the absence of any compensation. The basis for quantum meruit recovery is equitable: receipt by a defendant from a plaintiff of a benefit which is unjust for him to retain without paying for it.

*Torts > Business & Employment Torts > Interference With a Contract*
[HN11]To state a claim for tortious interference with contractual relations under Illinois law, a plaintiff must allege: (1) the existence of a valid and enforceable contract; (2) the defendants' knowledge of such contract; (3) the defendants' intentional and unjustified inducement of breach of the contract; (4) a subsequent breach by the other contracting party caused by defendant's wrongful conduct; and (5) damages resulting from such breach.

*Torts > Business & Employment Torts > Interference With Prospective Advantage*
[HN12]To state a claim for tortuous interference with prospective economic advantage a plaintiff must allege: (1) the existence of a valid business relationship or expectancy; (2) knowledge of the relationship or expectancy on the part of the interfering party; (3) an intentional and malicious interference inducing or causing a breach of termination of the relationship or expectancy; and (4) resultant damage to the party whose relationship has been disrupted.

*Torts > Business & Employment Torts > Interference With Prospective Advantage*
[HN13]In cases where parties have operated under an at-will contract for at least two years, courts have held such allegations are sufficient to meet the first element of a claim for tortuous interference with prospective economic advantage: the existence of a valid business relationship or expectancy.

*Civil Procedure > Remedies > Equitable Accounting*
[HN14]To state a claim for accounting under Illinois law, a plaintiff must allege that he has no adequate remedy at law and one or more of the following: (1) a breach of a fiduciary duty; (2) a need for discovery; (3) fraud; or (4) the existence of complex mutual accounts.

**COUNSEL:** For ROBERT DONNELLI, plaintiff: Lawrence Walner, Kristi L. Browne, Dennis Tighe Trainor, Lawrence Walner & Associates, Ltd., Chicago, IL.

For ROBERT DONNELLI, plaintiff: John Patrick Flynn, Tiffany & Bosco PA, Phoenix, AZ.

For PETERS SECURITIES CO., L.P., REUBEN PETERS, ROBERT G PETERS, C TIMOTHY VLAHOS, STEVE HELMS, CHRISTOPHER ROSMAN, CHRIS RANDLE, STEVE STOYCHA, JASON PERHACS, defendants: Lisa Colleen Sullivan, Howrey Simon Arnold & White, LLP, Ted S. Helwig, Katten Muchin Zavis Rosenman, Chicago, IL.

For PETERS SECURITIES **[*2]** CO., L.P., defendant: James Alexander Grimsley, Lawrence GD Scarborough Bryan Care LLP, Phoenix, AZ.

**JUDGES:** Robert W. Gettleman, United States District Judge.

**OPINIONBY:** Robert W. Gettleman

**OPINION: MEMORANDUM OPINION AND ORDER**

Plaintiff Robert Donnelli filed a five-count complaint against defendants Peters Securities Co., LP ("Peters Securities"), Reuben Peters, Robert G. Peters, C. Timothy Vlahos ("Vlahos"), Steve Helms ("Helms"), Christopher Rosman ("Rosman"), Chris Randle ("Randle"), Steve Stoycha ("Stoycha"), and Jason Perhacs ("Perhacs"), seeking payment allegedly due to him arising out of Donnelli's marketing efforts performed under an alleged oral agreement with Peters Securities. Donnelli asserts the following causes of action: breach of contract against Peters Securities, Reuben Peters, Robert G. Peters, Vlahos, Helms, Rosman, Randle, Stoycha and Perhacs (Count I); "quantum meruit for reasonable value of services" against Peters Securities, Reuben Peters, Robert G. Peters, Vlahos, Helms, Rosman, Randle, Stoycha and Perhacs (Count II); intentional interference with contract against Reuben Peters, Randle, Stoycha and Perhacs (Count III); intentional interference with prospective **[*3]** economic advantage against Reuben Peters, Randle, Stoycha and Perhacs (Count IV); and, an accounting against all defendants (Count V). Before the court is defendants' motion to dismiss all claims pursuant to *Federal Rules of Civil Procedure 12(b)(6)* for failure to state a claim upon which relief can be granted. Based on the following, the court grants in part and denies in part defendants' motion.

**LEGAL STANDARD**

[HN1]In ruling on a motion to dismiss for failure to state a claim, the court considers "whether relief is possible under any set of facts that could be established consistent with the allegations." *Bartholet v. Reishauer A.G., 953 F.2d 1073, 1078 (7th Cir.1992).* A plaintiff's complaint will generally not be dismissed unless it is beyond doubt that under no set of facts would plaintiff's allegations entitle him to relief. *Conley v. Gibson, 355 U.S. 41, 45-46, 2 L. Ed. 2d 80, 78 S. Ct. 99 (1957).* The purpose of a motion to dismiss is to test the sufficiency of the complaint, not to rule on its merits. *See Gibson v. City of Chicago, 910 F.2d 1510, 1520(7th Cir.1990).*

**BACKGROUND**

[HN2]When considering a motion **[*4]** to dismiss, the court accepts the allegations of the complaint as true as well as reasonable inferences therefrom, and views these both in the light most favorable to the plaintiff. *Travel All Over the World, Inc v. Kingdom of Saudi Arabia, 73 F.3d 1423, 1428 (7th Cir.1996).* Donnelli's allegations are set forth below.

Prior to August 1996, Donnelli was a market maker on the floor of the Chicago Board of Options Exchange ("CBOE"). In August 1996, Donnelli entered into an agreement with John Najarian ("Najarian"), the owner of Mercury Trading and a partner with Shamrock Investment Bank. Najarian, among other businesses, operated as a Third Market Maker ("TMM") through Mercury/ Shamrock. A TMM is a person or entity that purchases buy and sell orders from securities brokerage firms, and trades out of these newly purchased positions.

Under the agreement between Donnelli and Najarian, Donnelli was to leave market making on the CBOE and become the marketing partner for Mercury/ Shamrock. Donnelli agreed to attempt to develop order flow from large on-line brokerage firms such as E*Trade Securities, Inc. ("E*Trade") in return for a $ 5000 monthly consulting fee, all expenses, **[*5]** and 20% of the profit from the business generated from Donnelli's efforts. From September 1996 through January 1998, Donnelli continued to work for Najarian and worked on developing relationships with E*Trade and other firms.

In late 1997, as a result of Donnelli's efforts, E*Trade committed to send trades to Mercury/ Shamrock and in January 1998 began sending orders. At about this time, Najarian lost interest in the TMM business and told E*Trade that he would no longer target them for clearing. Based on Najarian's statements, E*Trade stopped its order flow and, based on the substantial sum of time and money it spent establishing its operation for clearing securities trades for Najarian's TMM operation, E*Trade threatened to sue Najarian.

In an effort to continue business between Mercury/ Shamrock and E*Trade, Donnelli searched for a broker/ dealer to replace Mercury/ Shamrock, contacted defendant Peters Securities, and spoke with defendant Randle. n1 Donnelli presented the business concept and strategy to Peters Securities, including financial information and projections. The proposed sale price of the business to Peters Securities was $ 250,000 plus a percentage of the trading **[*6]** profits on the business, and Donnelli's compensation would be $ 50,000 and a division of the prospective trading profits. When Peter's Securities indicated an interest, Donnelli put Randle, Reuben Peters and Najarian in contact to work out the financial package.

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n1 With regard to the individual defendants, Donnelli alleges that Reuben Peters controls Peters Securities in Chicago, as the managing general partner. Robert Peters, Vlahos, Helms and Christopher Rosman are "general partners and/ or employees or agents" of Peters Securities, and Randle, Stoycha and Perhacs are "employees and/ or agents" of Peters Securities.

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During these initial discussions, Peters Securities and Reuben Peters agreed that 20% of the trading profits would be split evenly between Donnelli, Stoycha and Perhacs, whom Peters Securities would employ as traders. It was also initially agreed that Donnelli would receive another 5% of the profits, 5% would be paid to Najarian, E*Trade would receive 20%, and the final 50% of profits would **[*7]** go to Peters Securities. After these initial discussions, Donnelli negotiated with E*Trade to stop its process of suing Najarian in return for which, among other things, E*Trade demanded that Najarian could not be involved with the new Mercury/ Peters TMM. In response to E*Trade's demand regarding Najarian, Peters Securities and Reuben Peters agreed Najarian would not be involved and that the 30% trading profits remaining above the 20% to E*Trade and 50% to Peters Securities, would be equally split among Donnelli, Stoycha and Perhacs.

In February 1998, Peters Securities purchased Mercury/ Shamrock's TMM business. For the next two years, between February 1998 and 2000, Donnelli worked to build Peters Securities' TMM business. Instead of paying Donnelli 10% of the trading profits, however, Peters Securities began paying Donnelli only 8 1/3% of the profits, splitting 25% between the three traders instead of 30%. Peters n2 promised Donnelli that when the firm met its projections, Donnelli's profit distribution would be raised to "the agreed upon amount (i.e., a one-third split of 30%)" or higher, depending on the level of success. Donnelli acquiesced and accepted the 8 1/3% split in reliance **[*8]** on Peter's representations.

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n2 The complaint does not specify if it was Reuben or Robert Peters.

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In the ensuing two years, Mercury/ Peters continued to experience numerous systems problems that caused E*Trade to stop sending Mercury/ Peters its business on at least two occasions. Donnelli continued to work with E*Trade to motivate them to continue sending Mercury/ Peters its business. Donnelli also performed various other services for Peters Securities, including bringing in business from other smaller brokerage firms.

During the entire two year period--February 1998 through February 2000--Peters Securities paid Donnelli 8 1/3% of the profits from Peters Securities' TMM trading business. In February 2000, Donnelli's relationship with Peters Securities was severed allegedly as a result of certain intentionally malicious acts of Reuben Peters, Randle, Stoycha and Perhacs.

**DISCUSSION**

Defendants have moved to dismiss all five counts of plaintiff's complaint for failure to state a claim. In response, **[*9]** in addition to arguments relating to the individual claims, plaintiff asserts that the court should deny defendant's entire motion as untimely pursuant to *Fed.R.Civ.P. Rule 12(g)*.

***FEDERAL RULES OF CIVIL PROCEDURE RULE 12(g)*** n3

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n3 Rule 12(g)-(h)(2) provides:[HN3](g) Consolidation of Defenses in Motion. A party who makes a motion under this rule may join with it any other motions herein provided for and then available to the party. If a party makes a motion under this rule but omits therefrom any defense or objection then available to the party which this rule permits to be raised by motion, the party shall not thereafter make a motion based on the defense or objection so omitted, except a motion as provided in subdivision (h)(2) hereof on any of the grounds there stated. [HN4](h) Waiver or Preservation of Certain Defenses.
(1) A defense of lack of jurisdiction over the person, improper venue, insufficiency of process, or insufficiency of service of process is waived (A) if omitted from a motion in the circumstances described in subdivision (g),
or (B) if it is neither made by motion under this rule nor included in a responsive pleading or an amendment thereof permitted by Rule 15(a) to be made as a matter of course.
(2) A defense of failure to state a claim upon which relief can be granted, a defense of failure to join a party indispensable under Rule 19, and an objection of failure to state a legal defense to a claim may be made in any pleading permitted or ordered under Rule 7(a), or by motion for judgment on the pleadings, or at the trial on the merits.

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**[*10]**

Plaintiff originally filed his action in an Arizona federal district court where defendants filed a motion to dismiss for lack of personal jurisdiction and improper venue pursuant to Rule 12(b)(2, 3), and a motion to transfer pursuant to *28 U.S.C. § 1406*(a). Defendants did not file a Rule 12(b)(6) motion to dismiss at that time. The Arizona court concluded that it had neither general nor specific personal jurisdiction over the defendants. Finding that personal jurisdiction existed over the defendants in the Northern District of Illinois, however, the court granted defendants' motion to transfer to this court.

Generally, courts have denied defendants' attempts to file multiple pre-answer motions to dismiss, finding such motions contravene the purpose of Rule 12(g): to prevent litigants from interposing defenses in a piecemeal fashion and eliminate unnecessary delay at the pleading stage. *See generally, Moore v. Ford Motor Co., 1994 U.S. Dist. LEXIS 652, 1994 WL 25822* at *2 (N.D.Ill. Jan. 26, 1994); *U.S. Fidelity & Guaranty Co. v. Jepsen, 1991 U.S. Dist. LEXIS 16818, 1991 WL 249706* at *2-3 (N.D.Ill. Nov. 14, 1991). Defendants respond that the current motion to dismiss was **[*11]** not intended for purposes of delay but to expedite resolution of the current matter, and that based on the merits of its jurisdictional and venue motions before the Arizona court, defendants felt that there was no reason to burden the Arizona court with the additional 12(b)(6) defenses.

In *Strandell v. Jackson County, Illinois, 648 F. Supp. 126, 129 (S.D.Ill. 1986)*, denying the plaintiff's request to deny the defendants Rule 12(b)(6) motion filed after a previously litigated Rule 12 motion, the court quoted from 2A Moore's Federal Practice P 12.22 at 12-102:

> Although the proper procedure for raising the [Rule 12(b)(6)] defenses now at issue is in a motion for judgment on the pleadings, 'since the objection [of failure to state a claim] is so basic and is not waived, the Court might properly entertain the second motion [to dismiss] if convinced that it is not interposed for delay and that the disposition of the case on the merits can be expedited by so doing.'

*See also, Kincaid v. City of Anchorage, 13 Alaska 449, 100 F. Supp. 325, 327 (D. Alaska 1951)*, in which the court addressed the merits of a Rule 12(b)(6) motion filed **[*12]** after a fully adjudicated Rule 12(b)(7) motion, recognizing that in doing so it was disregarding the literal language of Rule 12(g). The court reasoned that the 12(b)(6) motion was not interposed for delay, that the motion addressed each of the causes of action, and that if the supporting grounds for such motion were valid, adjudication of the motion would "clearly expedite the disposition of the case on the merits."

After considering the parties' briefs, the reasoning in Strandall and Kincaid appears particularly applicable to the instant case. The court finds defendants' motion was not filed for the purpose of delay and that adjudication of the instant motion will narrow the scope of this matter, greatly expediting resolution of the case. Accordingly, the court will now turn to the merits of defendants' motion to dismiss.

**BREACH OF CONTRACT**

Defendants move to dismiss Count I based on two arguments: 1) under Illinois law, no action for breach of contract can be brought for breach of an "at-will" employment contract with Peters Securities; and, 2) Donnelli does not allege that a valid contract existed between plaintiff and the individual defendants. Plaintiff in **[*13]** essence concedes the validity of defendants' second argument, asserting that a "clerical error" was made when the individual defendants were included in the "parenthetical characterization" of Count I as being filed against the individual defendants. Accordingly, the court grants defendants' motion to dismiss the individual defendants from the breach of contract claim alleged in Count I.

In response to Peters Securities' argument that no cause of action lies against it for breach of an "at-will" contract, Donnelli argues that the contract was not an "employment contract" and that Count I states all the essential elements of a breach of contract claim. Before discussing the applicable law, the court notes that as pled, there are two parts to Donnelli's breach of contract claim against Peters Securities: 1) breach of defendant's oral contract to pay Donnelli a certain percentage of trading profits during the period that plaintiff actually worked for Peters Securities, i.e., February 1998 to February 2000; and, 2) breach of the oral contract arising from the termination of the alleged oral contract with Donnelli and the resulting failure to pay Donnelli profits after the termination **[*14]** date.

[HN5]Under Illinois law, n4 to state a claim for breach of contract Donnelli must allege: 1) the existence of a valid contract with Peters Securities; 2) Peters Securities' breach of that contract; 3) Donnelli's performance under the contract; and, 4) damages to Donnelli resulting from such breach. *See, Owen Wagener & Co. v. U.S. Bank, 297 Ill. App. 3d 1045, 697 N.E.2d 902, 906, 232 Ill. Dec. 160 (Ill. App. Ct. 1998)*. It is also well-established Illinois law, however, that "contracts of indefinite duration are terminable at the will of either party." *Jespersen v. Minnesota Mining and Manufacturing Co., 183 Ill. 2d 290, 700 N.E.2d 1014, 1016, 233 Ill. Dec. 306 (Ill. 1998)*.

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n4 The parties have not raised a choice of law issue and, because both parties rely on

Illinois law in their brief, the court will apply Illinois law. *Wood v. Mid-Valley Inc., 942 F.2d 425, 426 (7th Cir. 1991)* ("The operative rule is that [HN6]when neither party raises a conflict of law issue in a diversity case, the federal court simply applies the law of the state in which the federal court sits.").

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**[*15]**

While the cases cited and discussed in defendants' brief all relate to employment contracts, [HN7]the Illinois Supreme Court in Jespersen applied the rule that a breach of contract claim cannot arise from the termination of an at-will contract to a sales distribution agreement, noting that the rule that "contracts of indefinite duration are terminable at will" has long been followed in *Illinois. 700 N.E.2d at 1017.* The court further noted that Illinois courts have applied this rule to a variety of types of contracts including employment contracts, credit card agreements, money market fund accounts and sales contracts. *Id.*

[HN8]Under this rule, either party to the contract can "terminate the agreement for any reason or no reason without committing a breach of contract." *Id.* (affirming judgment dismissing plaintiff's complaint alleging defendant breached sales distribution contract by terminating it, for failure to state a cause of action for breach of contract); *see also, O'Brien v. Omni Pro Electronics, Inc., 1996 U.S. Dist. LEXIS 11725, 1996 WL 459853* at *4 (N.D.Ill. Aug. 13, 1996) (where contract did not specify duration, court dismissed plaintiff's claim that defendant breached the contract **[*16]** by failing to pay him the remainder of his annual salary and commissions after the defendant terminated the plaintiff's employment).

Donnelli's complaint does not allege that the oral contract between Peters Securities and him provided for a specific duration of the contract. The court finds that under Illinois law, Donnelli has failed to allege a breach of contract based on Peters Securities' termination of the contract and subsequent failure to pay Donnelli any profits after February 2000. Construing the allegations in Count I most favorably in Donnelli's favor, however, the court finds Count I arguably n5 states the elements of a breach of contract claim for failure to pay Donnelli the proper amount as agreed upon under the terms of the alleged oral contract for his services during the contract's duration.

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n5 It is unclear under the allegations in plaintiff's complaint whether Peters Securities affected a valid unilateral modification of the terminable at will contract with Donnelli with regard to his remuneration, and whether Donnelli in turn acquiesced in and ratified such modification by continuing to work under the contract under Peters Securities' modified terms. *See, Bass v. Prime Cable of Chicago, Inc., 284 Ill. App. 3d 116, 674 N.E.2d 43, 50-51, 220 Ill. Dec. 772(Ill. App. Ct. 1996)* (cable operator's discontinuance of formerly free television guide unless customer paid fee was valid permissible modification of terminable at-will contract which was supported by sufficient consideration through company's continued service to customer under new terms: "[a] contract without a specified duration is terminable at will by either party [and] ... may be unilaterally modified").

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**[*17]**

Accordingly, the court grants defendants' motion to dismiss Donnelli's breach of contract claim based on termination of the contract and his request for damages based on a failure to pay Donnelli profits beyond February 2000, but denies defendants' motion to dismiss Count I against Peters Securities for failure to pay Donnelli the profits allegedly due during the period Donnelli performed services for Peters Securities, February 1998 to February 2000.

**QUANTUM MERIUT**

Defendants move to dismiss Count II because, (a) Donnelli's *quantum meruit* claim alleges a valid contract between the parties, and (b) his allegation acknowledging receipt of some compensation from Peters Securities during the years he performed marketing services is fatal to asserting a *quantum meruit* claim. [HN9]To state a claim for *quantum meruit,* Donnelli must allege: 1) he performed a service to benefit Peters Securities and the individual defendants; 2) he performed the service non-gratuitously; 3) defendants accepted this service; and, 4) "no contract existed to prescribe payment of this service." *Owen Wagener & Co. v. U.S. Bank, 297 Ill. App. 3d 1045, 697 N.E.2d 902, 908, 232 Ill. Dec. 160 (Ill. App. Ct. 1998);* **[*18]** *Canel and Hale, Ltd. v. Tobin, 304 Ill. App. 3d 906, 710 N.E.2d 861, 868, 238 Ill. Dec. 64 (Ill. App. Ct. 1999).*

In the general allegations of his complaint, Donnelli alleges that he entered into a contract with defendants and that there were specific payment terms within the contract. This contract is alleged not only in the preliminary paragraphs of his complaint, incorporated by reference in Count II, but is further alleged in P 34 of Count II, which states: "while Robert Donnelli was performing these services, Robert Donnelli and these defendants expected that Robert Donnelli would be paid the agreed upon and reasonable value for those services." Accordingly, plaintiff has failed to state a claim for *quantum meruit* because he has pled the existence of a contract for the services for which he claims *quantum meruit* damages. The court therefore grants defendants' motion to dismiss Count II of the complaint.

The court notes that there is language in Illinois Supreme and Appellate court cases that support dismissal of Count II based Donnelli's allegation that he was paid some compensation for his services, i.e., Peters Securities' payment of 8 1/3% of the **[*19]** profits over the course of the period Donnelli performed services for Peters Securities. In *First National Bank of Springfield v. Malpractice Research, Inc., 179 Ill. 2d 353, 688 N.E.2d 1179, 1185, 228 Ill. Dec. 202 (Ill. 1997),* while finding the plaintiff was not entitled to recovery under a *quantum meruit* claim because it failed to establish that its activities conferred any benefit on the defendants, the Illinois Supreme Court stated *(emphasis added):*

[HN10]*Quantum Meruit* means, literally, "as much as he deserves." ... A party seeking recovery on a *quantum meruit* theory must demonstrate the performance of services by the party, the conferral of the benefit of those services on the party from whom recovery is sought, and the unjustness of the latter party's *retention of the benefit in the absence of any compensation.*

*See also, Owen Wagener & Co., 297 N.E.2d at 1053 (citations omitted) (emphasis added)* ("The basis for *quantum meruit* recovery is equitable: '... receipt by a defendant from a plaintiff of a benefit which is unjust for him to *retain without paying for it*"').

Donnelli alleges in his complaint that **[*20]** Peters Securities did in fact pay him for his services, just arguably not as much as Donnelli was entitled to under the alleged oral agreement between the two parties. The parties did not cite, nor did the court find, a single case directly on point addressing this issue or a case in which a party was paid some form of compensation and yet was entitled to further recovery under a *quantum meruit* claim. Based on the court's finding that Donnelli's reliance on the terms of his alleged oral contract bars his *quantum meruit* claim, and the lack of controlling precedent on this issue, the court declines to reach the issue of the effect of Donnelli's payment for his services in ruling on the motion to dismiss Count II.

**TORTIOUS INTERFERENCE WITH CONTRACT**

Defendants move to dismiss Donnelli's claim for tortuous interference with contract, asserting that such a cause of action cannot be asserted based on a contract that is terminable at will. As set forth by defendants, "under Illinois law a plaintiff cannot bring an action for tortuous interference with contractual relations based on a contract that is terminable at will." 3 *Com Corp. v. Electronics Recovery Specialists, Inc., 104 F. Supp. 2d 932, 937 (N.D.Ill. 2000).* **[*21]** The case defendants cite for this proposition, *Hoskins v. Droke, 1995 U.S. Dist. LEXIS 7090, 1995 WL 318817* (N.D.Ill. May 24, 1995), addresses an employee's claim based on alleged interference with his employment contract causing the plaintiff's termination. Plaintiff argues, without authority, that such law applies only to employment contracts and that his claim is not based on an employment agreement.

In 3 Com Corp., 104 F. Supp.2d at 937, however, the court applied this rule of law to the plaintiff's claim alleging that the defendant tortiously interfered with the agreement between the plaintiff seller of scrap materials and the buyer of the scrap materials "by participating in the scheme of understating the scrap's weight and value." n6 The case cited and relied on by the 3Com Corp court for this legal proposition, *Canel and Hale, Ltd. v. Tobin, 304 Ill. App. 3d 906, 710 N.E.2d 861, 871, 238 Ill. Dec. 64 (Ill. App. Ct. 1999),* concerned a plaintiff's claim arising from the termination of a contract. In Canel, the court held that an "action for tortuous interference with contractual relations is not the proper vehicle for a discharged attorney seeking **[*22]** to recover damages," but rather the court should re-classify such claim as one for intentional interference with prospective economic advantage. Id.

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n6 The court did not dismiss the plaintiff's claim entirely, but held such claim must be classified and considered under the standard applied to tortious interference with prospective economic advantage claims. 3 Com Corp., 104 F. Supp. 2d at 937.

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Similarly, the Hoskins court, relied on the Illinois Supreme Court's decision in *Fellhauer v. City of Geneva, 142 Ill. 2d 495, 568 N.E.2d 870, 154 Ill. Dec. 649 (Ill. 1991)*. In *Fellhauer, 568 N.E.2d at 877*, the plaintiff, a former director of the Geneva City electric department, brought an action against the city's mayor for various claims including intentional interference with contractual relations, alleging "that defendant Lewis embarked on a course of conduct intended to result in the termination of plaintiff's employment with the City of Geneva." Addressing **[*23]** the viability of this claim, the court noted a split among the Illinois Appellate courts on whether a plaintiff can prevail on this type of claim under the theory of tortuous interference with contractual relations, and determined that:

an at-will employee such as plaintiff has no enforceable contractual right to employment and therefore cannot prevail under the theory of tortuous interference with contractual relations. Reasoning that an at-will employee may have a legitimate expectation of continued employment, however, the appellate court found that count III of plaintiff's amended complaint sounds in the tort of intentional interference with a prospective economic advantage.

*Fellhauer, 568 N.E.2d at 877.* Noting that the plaintiff did not challenge the appellate court's reclassification of his claim to one for tortious interference with a prospective economic advantage, the Illinois Supreme Court analyzed the court's ruling under that theory. *Id.*

In order [HN11]to state a claim for tortious interference with contractual relations under Illinois law, a party must allege: 1) the existence of a valid and enforceable contract; 2) the defendants' knowledge **[*24]** of such contract; 3) the defendants' intentional and unjustified inducement of breach of the contract; 4) a subsequent breach by the other contracting party caused by defendant's wrongful conduct; and 5) damages resulting from such breach. *See, R.J.N. Corp. v. Connelly Food Products, Inc., 175 Ill. App. 3d 655, 529 N.E.2d 1184, 1190, 125 Ill. Dec. 108 (Ill. App. Ct. 1988).*

The court finds that a reasonable interpretation of the holdings in Canel, Hoskins and Felhauer parallels the court's previous discussion separating Donnelli's ability to state a claim for breach of contract for Peters Securities' failure to pay the proper amount of profits due during the period in which Donnelli performed services for Peters Securities, from his inability to state a viable claim for breach of an at-will contract based on the termination of such contract. Applied in the context of stating a viable claim for tortious interference of contract under Illinois law, the court finds that if the allegations in Donnelli's complaint allege the elements set forth in R.J.N. Corp, Donnelli can state a viable claim for tortious interference only with Peters Securities' alleged **[*25]** breach of paying the proper amount due during the time Donnelli performed services under the alleged oral contract, between February 1998 and February 2000. Based on the precedent set forth above, however, any tortuous interference based on acts allegedly causing Peters Securities to sever or terminate the contract with Donnelli cannot state a claim for tortious interference with contract and are therefore dismissed from Count III.

In the complaint, Donnelli alleges he had a valid, enforceable oral contract with Peters Securities to provide marketing and other services, and defendants Reuben Peters', Randle's, Stoycha's and Perhacs' n7 knowledge of such contract. Donnelli further alleges that these defendants "intentionally and with malice, caused defendant Peters Securities to breach its contract with Robert Donnelli by ... causing Peters Securities to not pay Robert Donnelli the amounts due under that contract ... because these defendants wanted to eliminate Robert Donnelli's participation in the profits of Peters Securities TMM business and to increase their share of the monies received from that business."

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n7 Defendants Reuben Peters, Randle, Stoycha and Perhacs are the only defendants named in Counts III and IV.

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**[*26]**

While Donnelli does not allege specific actions performed by each defendant, the court finds that for purposes of a motion to dismiss, the allegations as set forth are sufficient to state a cause of action for tortious interference with contractual relations. Accordingly, based on the preceding analysis, the court grants in part defendants' motion to dismiss the allegations in Count III relating to claims arising from the severance of Donnelli's contract with Peters Securities and the resulting damages therefrom. The court denies, however, defendants' motion to dismiss Donnelli's claim for intentional interference with contractual relations arising from the alleged conduct of the individual defendants allegedly causing Peters Securities to pay Donnelli less than he was entitled to under the contract between February 1998 and February 2000.

**TORTIOUS INTERFERENCE WITH PROSPEC-**

TIVE ECONOMIC ADVANT...

Under Illinois law, in order [HN12]to state a claim for tortuous interference with prospective economic advantage Donnelli must allege: "1) the existence of a valid business relationship or expectancy; 2) knowledge of the relationship or expectancy on the part of the interferer; 3) **[*27]** an intentional and malicious interference inducing or causing a breach of termination of the relationship or expectancy; [and] 4) resultant damage to the party whose relationship has been disrupted." *Small v. Sussman, 306 Ill. App. 3d 639, 713 N.E.2d 1216, 1223, 239 Ill. Dec. 366 (Ill. App. Ct. 1999).* Defendants argue that Donnelli fails to adequately allege the first and third elements.

Defendants argue that under Illinois law, because of the at-will status of his contract, Donnelli fails to allege a reasonable expectancy of continuation of his contract. The cases cited by defendants are factually distinguishable and thus inapplicable. n8 [HN13]In cases where the parties have operated under an at-will contract for at least two years, courts have held such allegations are sufficient to meet the first element of a claim for tortuous interference with prospective economic advantage. *See,* 3 *Com Corp. v. Electronic Recovery Specialists, Inc., 104 F. Supp. 2d 932, 937-938 (N.D.Ill. 2000)* (holding complaint sufficiently pled a reasonable expectation of continued contractual relationship where plaintiff alleged the contractual arrangement had lasted for at **[*28]** least two years); *Speakers of Sport, Inc. v. ProServ, Inc., 1998 U.S. Dist. LEXIS 12522, 1998 WL 473469* at *3-4 (N.D. Ill. Aug 07, 1998), *affirmed, 178 F.3d 862 (7th Cir. 1999)* (denying summary judgment because genuine issue of fact remained regarding reasonable expectation based on two-and-a-half year business relationship: "Happy or not, it should be noted that Rodriguez had been with Speakers for the past two-and-a- half years despite his fickle relationship with previous agents.").

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n8 In *Byker v. Sequent Computer Systems, Inc., 1997 U.S. Dist. LEXIS 15991, 1997 WL 639045* at *12 (N.D.Ill. Oct. 1, 1997), addressing a motion for summary judgment, the court stated that an "at-will employee may possess a legitimate expectation of future economic advantage if he or she can establish there existed a presumption that his or her employment would continued indefinitely." The issue addressed in Byker, however, was plaintiff's failure to meet this element based on the fact that the plaintiff was demoted rather than terminated, and then voluntarily chose to resign following his demotion. In the other case cited by defendants, *Williams v. Weaver, 145 Ill. App. 3d 562, 495 N.E.2d 1147, 1152, 99 Ill. Dec. 412 (Ill. App. Ct. 1986),* the court held that the plaintiff could not meet the first element based on the fact that it was undisputed that there was a written employment contract between the parties under which the plaintiff's employment was for a fixed one-year academic term, and he therefore had no reasonable expectation of employment beyond the one-year term.

- - - - - - - - - - - - End Footnotes- - - - - - - - - - - - - -

**[*29]**

In *Fellhauer v. City of Geneva, 142 Ill. 2d 495, 568 N.E.2d 870, 878, 154 Ill. Dec. 649 (Ill. 1991),* the court similarly rejected the defendant's argument that the plaintiff, a city employee who was originally appointed to his position for a specific term and while not reappointed continued beyond such term as a "holdover appointee," failed to allege the element of reasonable expectation in continued relationship, reasoning:

This court ... has long recognized a legitimate expectancy in an employment relationship. "Where the contract is one of employment, it is immaterial whether it is for a fixed period or is one which is terminable by either party at will, both parties being willing and desiring to continue the employment under that contract for an indefinite period."

In the instant complaint, Donnelli alleges an ongoing contractual relationship with Peters Securities spanning two years, during which time the contracting parties continued regardless of the fact that the main customer Donnelli brought to Peters Securities, E*Trade, withdrew its business on multiple occasions. For purposes of a motion to dismiss, the court finds such allegations are sufficient **[*30]** to meet the first element of his claim for tortuous interference with prospective economic advantage.

The court also rejects defendants' argument that plaintiff has failed to allege that the individual defendants, partners and employees of Peters Securities, acted for purely personal reasons unrelated to their employer's interest. The complaint alleges that Donnelli had developed substantial business for Peters Securities' TMM business and was in the process of bringing in more customers when his contract was severed based on the intentional and malicious acts of the individual defendants. This count also incorporates the previous allegations in the complaint, including that the individuals' acts in causing Peters Securities to breach its contract with Donnelli were done in furtherance of their own personal goal to eliminate Donnelli's participation in the profits of the TMM business "and to increase their share of the monies received from that business."

While Donnelli does not enumerate the acts taken by the individual defendants that caused the termination of his contract, for purposes of the instant motion to dismiss, the court finds Donnelli has sufficiently pled the elements **[*31]** of his claim for tortuous interference with prospective economic advantage. The court, therefore, denies defendants' motion to dismiss Count IV.

**ACCOUNTING**

"In order [HN14]to state a claim for accounting under Illinois law, a plaintiff must allege that he has no adequate remedy at law and one or more of the following: 1) a breach of a fiduciary duty; 2) a need for discovery; 3) fraud; or 4) the existence of complex mutual accounts." *Firstar Bank, N.A. v. Faul, 2001 U.S. Dist. LEXIS 21294, 2001 WL 1636430* at *8 (N.D.Ill. Dec. 20, 2001); 3 *Com Corp. v. Electronic Recovery Specialists, Inc., 104 F. Supp. 2d 932, 941 (N.D.Ill. 2000)*. "Generally, the lack of an adequate legal remedy is the essential prerequisite to an accounting claim." 3 Com Corp., 104 F. Supp.2d at 941. In the instant case, the complaint in general, and Count V in particular, fails to plead an inadequate remedy at law. In fact, Donnelli has pled a viable breach of contract claim as well as tort claims arising from the same set of operative facts on which he bases his accounting claim.

In his response brief, without reference to an allegation in his complaint or authority for such argument, Donnelli **[*32]** argues that defendants "owed Donnelli fiduciary duties once an agreement was reached whereby they would jointly develop and launch the Peters Securities' TMM operation." Donnelli's complaint is devoid of any such allegation and there is no support for such an argument in Illinois law. *See generally,* 3 Com Corp., 104 F. Supp.2d at 941 (buyer who relied on seller to accurately report amount and value of scrap it removed from buyer's facilities for resale did not have fiduciary relationship with seller for purposes of establishing claim for accounting under Illinois law: "This was a contractual relationship not a fiduciary relationship"). The court further notes that dismissal of Donnelli's accounting claim "is of little negative consequence to plaintiff ... as the information [he] seeks in the accounting claim will likely be revealed during the discovery phase of this case." *104 F. Supp. 2d at 942; Firstar Bank, 2001 U.S. Dist. LEXIS 21294, 2001 WL 1636430* at *8. Accordingly, the court grants defendants' motion to dismiss Count V of the complaint.

**CONCLUSION**

For the reasons set forth above, the court: grants defendants' motion to dismiss Count I against the **[*33]** individual defendants and against Peters Securities as to any claim arising from the termination of the alleged oral contract and any claim for post-contract termination profits; denies the motion to dismiss Count I against Peters Securities as to any potential breach of the payment terms during the period between February 1998 and February 2000; grants defendants' motion to dismiss Count II against all defendants; grants in part and denies in part defendants' motion to dismiss Count III; consistent with its ruling on Count I, denies defendants' motion to dismiss Count IV; and grants defendants' motion to dismiss Count V in its entirety. To clarify, remaining before the court is plaintiff's breach of contract claim alleged in Count I against Peters Securities for failure to pay the agreed upon profits percentage between February 1998 and February 2000, plaintiff's tortuous interference with contract claim alleged in Count III arising from individual defendants' Reuben Peters, Randle, Stoycha and Perhacs alleged conduct causing Peters Securities to fail to pay the agreed upon profits percentage between February 1998 and February 2000, and Count IV against Reuben Peters, Randle, Stoycha **[*34]** and Perhacs for intentional interference with prospective economic advantage. All claims against Robert G. Peters, C. Timothy Vlahos, Steve Helms and Christopher Rosman are dismissed.

Plaintiff is directed to file an amended complaint conforming to the court's ruling herein on or before September 18, 2002. Defendants shall respond on or before October 9, 2002. The parties are directed to file a joint status report using the court's form on or before October 9, 2002. This matter is set for a status report on October 22, 2002, at 9:00 a.m., at which the court will set a definitive discovery schedule.

**ENTER: August 28, 2002**

**Robert W. Gettleman**

**United States District Judge**

# EXHIBIT 3

KENNETH FOSS, Administrator of the Estate of Vincent P. Koth, Plaintiff-Appellant, v. BEAR, STEARNS & CO., INC., and PATRICK DELAHANTY O'MEARA, Defendants-Appellees.

No. 04-2514

UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

2005 U.S. App. LEXIS 406

November 30, 2004, Argued
January 11, 2005, Decided

**PRIOR HISTORY:** **[*1]** Appeal from the United States District Court for the Northern District of Illinois, Eastern Division. No. 03 C 8338. Matthew F. Kennelly, Judge. *Foss v. Bear, Stearns & Co., 2004 U.S. Dist. LEXIS 9304 (N.D. Ill., May 17, 2004)*

**DISPOSITION:** Affirmed.

**CASE SUMMARY**

**PROCEDURAL POSTURE:** Plaintiff executor appealed a judgment of the United States District Court for the Northern District of Illinois, Eastern Division, which dismissed, with prejudice, his complaint under § 10(b) of the Securities Exchange Act of 1934, *15 U.S.C.S.* § *78j*(b), alleging that defendant account executive defrauded a decedent's estate and that defendant firm was vicariously liable for the executive's misdeeds under § 20(a) of the Act, *15 U.S.C.S.* § *78t*(a).

**OVERVIEW:** A former administrator of the estate concealed the decedent's securities; set up a corporation; and got his son-in-law, the account executive, to transfer the securities to the administrator's ownership. The subsequent executor of the estate filed an action against the account and his firm alleging securities law liability. The court affirmed the dismissal of the action. The court held that there was no liability under § 10(b) of the Securities Exchange Act of 1934, *15 U.S.C.S.* § *78j*(b), because the deceit was committed by the former administrator, not the executive, against the executor and estate and aiding and abetting primary violations did not support damages in private actions. The court held that, since the executive was not liable to the estate, his firm could not have been vicariously liable under § 20(a) of the Act, *15 U.S.C.S.* § *78t*(a). The court held that the Sarbanes-Oxley Act, codified in part at *28 U.S.C.S.* § *1658*(b), did not apply retroactively to bar the executor's claim.

**OUTCOME:** The court affirmed.

**CORE TERMS:** deceit, federal securities, heirs, aiding and abetting, vicariously liable, manipulation, retroactive, deceiving, discovery, deceived, probate, misdeeds

**LexisNexis(TM) Headnotes**

***Securities Law > Bases for Liability > Controlling Persons Liability***
[HN1]Aiding and abetting a fraud does not support damages in private actions, though it does allow relief in some actions by the Securities and Exchange Commission. § 20(e) of the Securities Exchange Act of 1934, *15 U.S.C.S.* § *78t*(e).

***Civil Procedure > Appeals > Reviewability > Preservation for Review***
[HN2]Prevailing parties may defend their judgments on all grounds preserved below.

***Civil Procedure > Pleading & Practice > Defenses, Objections & Demurrers > Affirmative Defenses***
[HN3]The period of limitations is an affirmative defense that a complaint need not address. Unless the complaint alleges facts that create an ironclad defense, a limitations argument must await factual development.

***Governments > Legislation > Effect & Operation > Prospective & Retrospective Operation***

***Securities Law > Bases for Liability***
[HN4]The Sarbanes-Oxley Act, codified in part at *28 U.S.C.S.* § *1658*(b), is not retroactive.

***Securities Law > Bases for Liability > Deceptive Devices***
[HN5]In securities law, manipulation is a kind of fraud; deceit remains essential.

***Securities Law > Bases for Liability > Controlling Persons Liability***
[HN6]Section 20(a) of the Securities Exchange Act of 1934, *15 U.S.C.S.* § *78t*(e), creates vicarious liability for a person who actually or potentially controlled the primary violator's acts. *17 C.F.R.* § *240.12b-2*.

***Securities Law > Bases for Liability > Deceptive Devices***
[HN7]Section 10(b) of the Securities Exchange Act of 1934, *15 U.S.C.S.* § *78j*(b), is not an all-purpose remedy for private misdeeds.

**COUNSEL:** For KENNETH FOSS, Administrator of the Estate of VINCENT P. KOTH, Plaintiff-Appellant:

Peter B. Shaeffer, Chicago, IL USA.

For BEAR, STEARNS & CO., INC., PATRICK DELAHANTY O'MEARA, Defendants-Appellees: Christopher L. Gallinari, Nicholas P. Ivarone, BELLOWS & BELLOWS, Chicago, IL USA.

**JUDGES:** Before BAUER, POSNER, and EASTERBROOK, Circuit Judges.

**OPINIONBY:** EASTERBROOK

**OPINION:** EASTERBROOK, *Circuit Judge*. Arthur McDonnell became administrator of Vincent P. Koth's estate in May 1998. Discovering that Koth kept some securities in safe deposit boxes, so that they did not appear in any of his brokerage statements, McDonnell concealed them from the probate court, Koth's heirs, and the tax collector. He set up a corporation and asked his son-in-law Patrick O'Meara to transfer the securities to its ownership. O'Meara, an account executive of Bear, Stearns & Co., did just that. McDonnell withdrew the money for his own use. We must assume, given the posture of the case, that O'Meara was McDonnell's accomplice and deceived Bear Stearns about what he **[*2]** was doing and why -- though this is no more than an allegation, and perhaps O'Meara did not realize what McDonnell was up to. Eventually McDonnell was caught, and a state court has ordered him to repay more than $ 3.4 million; whether the money can be recouped is doubtful. Kenneth Foss, who replaced McDonnell as executor in May 2002, filed this suit against both O'Meara and Bear Stearns under § 10(b) of the Securities Exchange Act of 1934, *15 U.S.C. § 78j(b)*, and the SEC's Rule 10b-5, *17 C.F.R. § 240.10b-5*. Foss contends that O'Meara defrauded the Koth Estate and that Bear Stearns is vicariously liable for his misdeeds under § 20(a), *15 U.S.C. § 78t(a)*.

This statement of the claim reveals its weakness, for O'Meara did not deceive McDonnell (or for that matter the estate, which "knew" whatever McDonnell knew). There is no violation of § *10(b)* without fraud and no fraud without deceit. See, e.g., *Dirks v. SEC, 463 U.S. 646, 77 L. Ed. 2d 911, 103 S. Ct. 3255 (1983)*; *Chiarella v. United States, 445 U.S. 222, 63 L. Ed. 2d 348, 100 S. Ct. 1108 (1980)*; *Ernst & Ernst v. Hochfelder, 425 U.S. 185, 47 L. Ed. 2d 668, 96 S. Ct. 1375 (1976)*. **[*3]** The deceit was committed by McDonnell against the probate court and Koth's heirs. McDonnell doubtless violated § *10(b)* and *Rule 10b-5*, even though his fraud does not concern the value of any security. See *SEC v. Zandford, 535 U.S. 813, 153 L. Ed. 2d 1, 122 S. Ct. 1899 (2002)*; *United States v. Naftalin, 441 U.S. 768, 60 L. Ed. 2d 624, 99 S. Ct. 2077 (1979)*; *SEC v. Jakubowski, 150 F.3d 675 (7th Cir. 1998)*. But McDonnell is not a defendant. Instead of deceiving McDonnell, O'Meara helped him bilk the court, heirs, and revenue officials. Yet [HN1]aiding and abetting a fraud does not support damages in private actions, see *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 128 L. Ed. 2d 119, 114 S. Ct. 1439 (1994)*, though it does allow relief in some actions by the Securities and Exchange Commission. See § 20(e), *15 U.S.C. § 78t(e)*. If O'Meara is not liable to the Koth Estate, Bear Stearns cannot be liable vicariously under § *20(a)*. So the district court dismissed the complaint for failure to state a claim on which relief may be granted. *2004 U.S. Dist. LEXIS 8694 (N.D. Ill. May 14, 2004)*, *2004 U.S. Dist. LEXIS 9304* **[*4]** *(N.D. Ill. May 17, 2004)*.

O'Meara and Bear Stearns contend that we need not consider these subjects, because the claim comes too late. Until 2002, suit had to be filed by the earlier of one year from discovery of the wrongdoing or three years from the improper transactions. See *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 501 U.S. 350, 115 L. Ed. 2d 321, 111 S. Ct. 2773 (1991)*. As part of the *Sarbanes-Oxley Act*, Congress changed the allowable time to the shorter of two years from discovery or five years from the improper transactions. See Section 804 of Pub. L. No.107-204, 116 Stat. 745, 801 (2002), codified in part at *28 U.S.C. § 1658(b)*. Defendants contend that, by the time Sarbanes-Oxley took effect on July 30, 2002, three years had passed since McDonnell's corporation got record title to the Koth securities. Only if the law retroactively revives expired claims, defendants contend, is this suit viable.

Foss insists that we lack authority to consider this argument because the district judge did not pass on it. That's wrong; [HN2]prevailing parties may defend their judgments on all grounds preserved below. See *Massachusetts Mutual Life Insurance Co. v. Ludwig, 426 U.S. 479, 48 L. Ed. 2d 784, 96 S. Ct. 2158 (1976)*; **[*5]** *Pease v. Production Workers Union, 386 F.3d 819, 821 (7th Cir.2004)*. Foss also says that, because the judge did not make a decision on this issue, the decision is not final and may not be appealed. That's odd, as Foss himself *did* appeal, from a classic final judgment: one dismissing his complaint with prejudice. A selection among reasons for the dismissal did not make it any the less final.

Having advanced ill-considered procedural responses to defendants' position, Foss then decided not to meet it on the merits. That was both daring and foolish. He could have 4 No. 04-2514 asked us to emulate the district judge; after all, [HN3]the period of limitations is an affirmative defense that a complaint need not address. Unless the complaint alleges facts that create an ironclad defense, a limitations argument must await factual development. See *United States v. Northern*

*Trust Co., 372 F.3d 886 (7th Cir. 2004)*; *Xechem, Inc. v. Bristol-Myers Squibb Co., 372 F.3d 899 (7th Cir. 2004)*; *Walker v. Thompson, 288 F.3d 1005 (7th Cir. 2002)*. Perhaps Foss could show that some of the improper transactions occurred within three years **[*6]** of suit, or at least within three years before the Sarbanes-Oxley Act tacked on two more. But he has not advanced such an argument, so the complaint is doomed unless the new statute is retroactive. *In re Enterprise Mortgage Acceptance Co. Securities Litigation, 2004 U.S. App. LEXIS 25010 (2d Cir. Dec. 6, 2004)*, the first appellate decision on the subject, holds that [HN4]it is not retroactive. We find it persuasive and have nothing to add to the second circuit's explanation.

For completeness we add that the district judge got this right on the merits. O'Meara was at worst McDonnell's henchman, and there is no securities-law liability in private litigation for aiding and abetting. If O'Meara is not liable to the estate, then Bears Stearns cannot be vicariously liable to it under § *20(a)*. Foss wants us to call the conduct "manipulation" rather than "fraud," but this is a distinction without a difference. [HN5]In securities law, manipulation is a *kind* of fraud; deceit remains essential. See *Schreiber v. Burlington Northern, Inc., 472 U.S. 1, 86 L. Ed. 2d 1, 105 S. Ct. 2458 (1985)*; *Santa Fe Industries, Inc. v. Green, 430 U.S. 462, 476-77, 51 L. Ed. 2d 480, 97 S. Ct. 1292 (1977)*. **[*7]**

This drives Foss to contend that O'Meara deceived Bear Stearns about what he was doing and about his relations to McDonnell. Such deceit might make O'Meara liable *to* Bear Stearns, even though it did not affect the value of any security. See *United States v. O'Hagan, 521 U.S. 642, 138 L. Ed. 2d 724, 117 S. Ct. 2199 (1997)*, in addition to *Zandford, supra*. But how could that help the estate? Bear Stearns is a defendant, not a plaintiff; if O'Meara is liable to Bear Stearns for deceiving it (and thus depriving it of the value of his honest services), then it rather than the estate would collect any damages.

What Foss would like to do is put O'Meara's (potential) liability to Bear Stearns together with control-person liability under § *20(a)* in the estate's favor. We don't see how that could be possible; Foss does not cite any decision holding that it is. [HN6]*Section 20(a)* creates vicarious liability for a person who actually or potentially controlled the primary violator's acts. See *17 C.F.R. § 240.12b-2*; *Harrison v. Dean Witter Reynolds, Inc., 974 F.2d 873, 880-81 (7th Cir. 1992)*; *Pommer v. Medtest Corp., 961 F.2d 620, 626-27 (7th Cir. 1992)*. **[*8]** If the primary violation is O'Meara's deceit of Bear Stearns, then McDonnell would be the control person. It makes no sense to say that Bear Stearns is the control person and victim at the same time. And if by some legerdemain Bear Stearns could be thought to control O'Meara's fraud against itself, then as the victim of the primary violation it would hold the right to collect *from* itself, a useless circle.

Unless § *10(b)* turns all transactions using the proceeds of crime into a species of "fraud," the estate lacks a claim under the federal securities laws. Yet, as the Supreme Court has held repeatedly, [HN7]§ *10(b)* is not an all-purpose remedy for private misdeeds. *Schreiber* and *Santa Fe* make the point directly, and *Zandford* distinguishes, as outside the federal laws' reach, "a case in which a thief simply invested the proceeds of a routine conversion in the stock market." *535 U.S. at 820*. Fraud differs from hawking or fencing stolen goods (the best description of the activity in which O'Meara aided McDonnell). A teller who embezzles from the bank and invests the proceeds in stock does not violate the federal securities laws. McDonnell embezzled securities, **[*9]** so he *did* violate the federal securities laws; but that primary violation is McDonnell's alone. Given *Central Bank of Denver*, which knocks out private actions for aiding 6 No. 04-2514 and abetting primary violations, there is no way that the people and firms who dealt with McDonnell and the proceeds of his crimes could themselves be liable under § *10(b)* in this private suit.

AFFIRMED

# EXHIBIT 4

L-3 COMMUNICATIONS CORPORATION, Plaintiff v. WAYNE CLEVENGER; LARRY COLANGELO; JOHN FLEURY; EDWARD GORMAN; MIDMARK CAPITAL L.P.; MIDMARK ASSOCIATES, INC.; MILAN RESANOVICH; JOSEPH ROBINSON; and PAUL TISCHLER, Defendants

03-cv-3932

UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

2004 U.S. Dist. LEXIS 17845

August 31, 2004, Decided

**DISPOSITION:** Defendants' motions to dismiss granted.

**CASE SUMMARY**

**PROCEDURAL POSTURE:** Plaintiff, a supplier of secure communications technology, sued defendants, three corporate owners of a prospective merger target, primarily asserting claims for securities fraud under § 10(b) the Securities Exchange Act of 1934 (1934 Act), *15 U.S.C.S. § 78j*(b), a derivative securities violation under § 20(a) of the 1934 Act, *15 U.S.C.S. § 78t*(a). The owners moved to dismiss under Fed. R. Civ. P. 12(b)(6), asserting the claim was time barred.

**OVERVIEW:** The supplier and the corporate owners entered into a merger agreement whereby the supplier purchased all outstanding stock of the merger target. The supplier claimed that the corporate owners and individual defendants engaged in a fraudulent scheme to make the target look more attractive and to misrepresent information. The supplier alleged that it did not learn of the fraudulent scheme until January 2002 when it received revealing information about the alleged fraud. The issue was whether to apply the Lampf rule, under which the complaint was not timely, or the recently adopted § 804(c) of the Public Company Accounting and Investor Protection Act of 2002, codified in part at *28 U.S.C.S. § 1658,* that was adopted after the supplier's claims arose. Because the latter statute read that "nothing in this section shall create a new, private right of action," the court found that Congress did not intend the claims to be revived, or the statute to apply retroactively. The statute could not overcome the presumption against applying it to previously time-barred claims. The court declined to exercise supplemental jurisdiction over the state law claims.

**OUTCOME:** The motions to dismiss were granted.

**CORE TERMS:** time-barred, statute of limitations, repose, revive, motion to dismiss, newly enacted, discovery, securities fraud, inappropriate, impermissible, deadline, retroactive application, limitations period, federal securities, facts constituting, cause of action, right of action, three year, retroactively, unambiguous, revival, state law, fraudulent scheme, statute of limitations period, negligent misrepresentation, supplemental jurisdiction, cause of action accrues, legislative history, retroactive effect, applicable statute

**LexisNexis(TM) Headnotes**

***Civil Procedure > Pleading & Practice > Defenses, Objections & Demurrers > Failure to State a Cause of Action***
[HN1]A motion to dismiss pursuant to Fed. R. Civ. P. 12(b)(6) challenges the legal sufficiency of the complaint. In ruling on such a motion to dismiss, a court must accept as true the factual allegations in the complaint and all reasonable inferences that can be drawn therefrom. Because a court must determine whether under any reasonable reading of the pleadings, the plaintiff may be entitled to relief, a claim may be dismissed only if it appears that the plaintiffs can prove no set of facts that would entitle them to relief.

***Governments > Legislation > Statutes of Limitations > Time Limitations***
[HN2]See *28 U.S.C.S. § 1658.*

***Securities Law > Bases for Liability > Controlling Persons Liability***

***Securities Law > Bases for Liability > Deceptive Devices***
[HN3]The language of the Public Company Accounting and Investor Protection Act of 2002 applies to claims brought under § 10(b) and § 20(a) under the Securities and Exchange Act of 1934, *15 U.S.C.S. §§ 78j*(b) and 78t(a).

***Governments > Legislation > Statutes of Limitations > Time Limitations***
[HN4]Under the Lampf statute of limitations, a plaintiff is required to file by the earlier of one year after discovery or three years after the fraud.

***Securities Law > Bases for Liability > Deceptive Devices***
[HN5]Whether a plaintiff had sufficient facts to place it on inquiry notice of a claim for securities fraud under S.E.C. Rule 10b-5 is a question of fact, and such is often inappropriate for resolution on a motion to dismiss under Fed. R. Civ. P. 12(b)(6). Though inquiry notice in some cases is decided as a matter of law, it is inappropriate to dismiss claims as time-barred where the analysis is so fact intensive.

*Governments > Legislation > Statutes of Limitations > Pleading & Proof*
[HN6]A newly enacted statute that lengthens an applicable statute of limitations may not be applied retroactively to revive a plaintiff's claim that was otherwise barred under the old statutory scheme because to do so would alter the substantive rights of a party and increase a party's liability.

*Governments > Legislation > Statutes of Limitations > Pleading & Proof*
[HN7]The United States Supreme Court has made statutes of limitations subject to the general rule that, absent clear Congressional intent, courts are to apply a presumption against retroactive application of a new law.

*Governments > Legislation > Statutes of Limitations > Pleading & Proof*
[HN8]The first step in determining whether a limitations statute has an impermissible retroactive effect is to ascertain whether Congress has directed with the requisite clarity that the law be applied retrospectively.

*Governments > Legislation > Statutes of Limitations > Pleading & Proof*
[HN9]The standard for finding an unambiguous direction to apply a limitations statute retrospectively is a demanding one. Cases where the United States Supreme Court has found a true intent to apply a statute retroactively have involved statutory language that was so clear that it could sustain only one interpretation.

*Governments > Legislation > Statutes of Limitations > Extension & Revival*
[HN10]A statute of repose is essentially different from a statute of limitations, in that a limitations statute is procedural, giving a time limit for bringing a cause of action, with the time beginning when the action has ripened or accrued; while a repose statute is a substantive statute, extinguishing any right of bringing the cause of action, regardless of whether it has accrued. Regarding statutes of repose as substantive rights suggests an even greater presumption against permitting new legislation to open the gates to claims that had already been time-barred.

*Civil Procedure > Jurisdiction > Subject Matter Jurisdiction > Supplemental Jurisdiction*
[HN11]A district court has discretion as to whether to retain supplemental jurisdiction over the state law claims upon dismissal of the federal claims brought in a case. *28 U.S.C.S.* § *1367*(c)(3). Under Third Circuit caselaw, where the claim over which the district court has original jurisdiction is dismissed before trial, the district court must decline to decide the pendent state law claims unless considerations of judicial economy, convenience, and fairness to the parties provide an affirmative justification for doing so.

**COUNSEL: [*1]** For L-3 COMMUNICATIONS CORPORATION, Plaintiff: CARL M. BUCHHOLZ, BLANK ROME COMISKY & McCAULEY LLP, PHILADELPHIA, PA. MATTHEW J. SIEMBIEDA, BLANK ROME LLP, PHILADELPHIA, PA. TIMOTHY D. KATSIFF, BLANK ROME LLP, PHILADELPHIA, PA. FRANK A. DANTE, BLANK ROME COMISKY & McCAULEY, PHILADELPHIA, PA.

For WAYNE CLEVENGER, LARRY A. COLANGELO, MIDMARK CAPITAL L.P., MIDMARK ASSOCIATES, INC., JOSEPH R. ROBINSON, Defendants: ALEXANDER KERR, MCCARTER AND ENGLISH, LLP, PHILADELPHIA, PA. GREGORY J. HINDY, MCCARTER & ENGLISH LLP, NEWARK, NJ. PETER J. BOYER, MCCARTER & ENGLISH, LLP, PHILADELPHIA, PA. SETH TAUBE, MC CARTER & ENGLISH, NEWARK, NJ.

For JOHN C. FLEURY, EDWARD GORMAN, PAUL TISCHLER, Defendants: JOHN F. SMITH, REED SMITH LLP, PHILADELPHIA, PA. MARC D. POWERS, BAKER & HOSTETLER LLP, NEW YORK, NY. ELIZABETH F. ABRAMS, REED SMITH LLP, PHILADELPHIA, PA.

For MILAN RESANOVICH, Defendant: LEWIS DONALD PRUTZMAN, TANNENBAUM HELPERN, SYRACUSE & HIRSCHTRITT, NEW YORK, NY. RALPH A. SICILIANO, TANNENBAUM HELPERN, SYRACUSE & HIRSCHTRITT, NEW YORK, NY.

**JUDGES:** ANITA B. BRODY, J.

**OPINIONBY:** ANITA B. BRODY

**OPINION: MEMORANDUM AND ORDER**

**Anita B. Brody, J.**

**I. INTRODUCTION**

On July 1, 2003, plaintiff **[*2]** L-3 Communications Corporation ("L-3") filed this action against defendants Wayne Clevenger ("Clevenger"), Larry Colangelo ("Colangelo"), John Fleury ("Fleury"), Edward Gorman ("Gorman"), Midmark Capital L.P. ("Midmark"), Midmark Associates, Inc. ("Midmark Associates"), Milan Resanovich ("Resanovich"), Joseph Robinson ("Robinson"), and Paul Tischler ("Tischler"). Plaintiff filed an amended complaint on October 7, 2003. The amended complaint includes seven claims: (1) securities fraud under § *10(b) of the 1934 Securities and Exchange Act* ("SEA"); (2) a derivative securities violation under § *20(a) of the 1934 SEA*; (3) common law fraud; (4) civil conspiracy; (5) negligent misrepresentation; (6) negligence/gross negligence; and (7) breach of fiduciary duty.

All defendants have moved to dismiss the complaint in its entirety. n1 On July 15, 2004, the parties presented oral argument. The court has subject matter jurisdiction over the case. The motions will be granted.

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n1 Defendants have actually filed three separate motions to dismiss. The motion to dismiss of defendants Clevenger, Colangelo, Robinson, Midmark and Midmark Associates is Docket # 16. The motion to dismiss of defendants Fleury, Gorman and Tischler is Docket # 22. The motion to dismiss of defendant Resanovich is Docket # 23. Because all defendants have incorporated by reference the memoranda of law submitted by their co-defendants, I will address all three motions together.

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**[*3]**

## II. BACKGROUND

### A. The Parties

Plaintiff L-3 is a leading merchant supplier of secure communications technology and other products. L-3's customers include the United States Department of Defense and United States Department of Homeland Security. (Pl. Resp. Mot. Dismiss 1.) In April 1998, SPD Technologies, Inc. ("SPD Technologies") was the parent of four separate wholly-owned subsidiaries: (1) SPD Electrical Systems, Inc. ("SPD Electrical"); (2) Henschel, Inc. ("Henschel"); (3) PacOrd, Inc. ("PacOrd"); and (4) Power Paragon, Inc. ("Power Paragon"). (Am. Compl. P 17.) SPD Electrical, the only subsidiary discussed in the complaint, manufactures circuit breakers and switchgear for the United States Navy's nuclear powered ships and submarines (the "Nuclear Powered Fleet"). (Am. Compl. P 19.)

At all relevant times, defendants Clevenger, Colangelo, Resanovich, and Robinson served on the Board of Directors of SPD Technologies. (Am. Compl. PP 2, 3, 8, 9.) Defendant Colangelo also served as President, Director and Chief Executive Officer ("CEO") of SPD Electrical and as President and CEO of SPD Technologies. (Am. Compl. P 3.) Defendant Fleury served as Chief Financial **[*4]** Officer ("CFO"), Vice President, and Secretary of SPD Electrical, as well as serving as Vice President, CFO, Treasurer and Secretary of SPD Technologies. (Am. Compl. P 4.) Defendant Gorman was an Officer and Vice President of Operations of SPD Electrical. (Am. Compl. P 5.) Defendant Tischler was the Director of Manufacturing for SPD Electrical. (Am. Compl. P 10.) Defendant Midmark was a majority shareholder of SPD Technologies and defendant Midmark Associates was the General Partner of Midmark. (Am. Compl. PP 6-7.)

### B. The Allegations n2

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n2 As required when ruling on a motion to dismiss, the facts as averred by plaintiffs are accepted as true for purposes of this motion. *Nami v. Fauver, 82 F.3d 63, 65 (3d Cir. 1996)*.

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On August 13, 1998, L-3 entered into a merger agreement with SPD Technologies and Midmark whereby L-3 purchased all outstanding stock of SPD Technologies. (Am. Compl. PP 36, 38.) L-3 alleges that, from 1996 to 2002, defendants engaged in a fraudulent scheme designed **[*5]** to: (1) make SPD Technologies attractive for acquisition; (2) induce L-3 to pay an artificially inflated price for the company; and (3) cover up the misrepresentations and omissions made in the acquisition phase from plaintiff even after the merger took place. L-3 alleges that it did not learn of the fraudulent scheme until January 2002 when the Navy provided L-3 with revealing information about the alleged fraud. (Am. Compl. P 67.)

L-3 filed this complaint on July 1, 2003. Because my decision regarding the statute of limitations is dispositive, many facts which may have been relevant to determining whether plaintiff adequately pled its claims have been omitted from this section.

## III. STANDARD OF REVIEW

[HN1]A motion to dismiss pursuant to *Federal Rule of Civil Procedure 12(b)(6)* challenges the legal sufficiency of the complaint. *Kost v. Kozakiewicz, 1 F.3d 176, 183 (3d Cir. 1993)*. In ruling on a motion to dismiss pursuant to *Federal Rule of Civil Procedure 12(b)(6)*, a court must "accept as true the factual allegations in the complaint and all reasonable inferences that can be **[*6]** drawn therefrom." *Nami v. Fauver, 82 F.3d 63, 65 (3d Cir. 1996)*. Because a court must determine whether "under any reasonable reading of the pleadings, the plaintiff may be entitled to relief," a claim may be dismissed only "if it appears that the plaintiffs [can] prove no set of facts that would entitle them to relief." Id.

## IV. DISCUSSION

Defendants move to dismiss on four grounds: (1) plaintiff's complaint is time-barred; (2) plaintiff fails to properly plead a federal securities fraud claim under § *10(b) of the SEA*; (3) plaintiff fails to properly plead an action for control person liability under § *20(a) of the SEA*; and (4) plaintiff's state common law claims of fraud and negligent misrepresentation are precluded by the economic loss doctrine. Because I find that plaintiff's federal claims are time-barred, I will not reach defendants' other arguments.

### A. Statute of Limitations

Defendants contend that plaintiff's federal securities claims are time-barred. L-3's federal securities fraud claims are brought under §§ *10(b)* and *20(a)* of the SEA. The SEA does not set forth an applicable statute of limitations. Instead, the statute **[*7]** of limitations for these claims was traditionally governed by the Supreme Court's ruling in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 501 U.S. 350, 115 L. Ed. 2d 321, 111 S. Ct. 2773 (1991)*. In that case, the Supreme Court held that the statute of limitations period governing such a claim is one year from the date of discovery of facts constituting the violation or three years after the violation, whichever is earlier. *Lampf, 501 U.S. at 364*. In addition, the Lampf court found the three year period to be a "statute of repose." *Id. at 362*. Finally, the Court held that equitable tolling principles do not apply to the one year/three year structure, reasoning that the one year period makes tolling "unnecessary" because it begins after discovery of the facts constituting the violation, and the three year period of repose is "inconsistent" with tolling because the three year period was "clearly" intended to "serve as a cutoff." *Id. at 363*.

On July 30, 2002, President George W. Bush signed into law the Public Company Accounting and Investor Protection Act of 2002 (popularly known as the "Sarbanes-Oxley Act of 2002"), Pub. **[*8]** L. 107-204, Title VIII, § 804, 116 Stat. 745, 801, codified in part at *28 U.S.C. § 1658(b)* [hereinafter "The Act"]. Among other things, the Act amended *28 U.S.C. § 1658* to read:[HN2]**Time limitations on the commencement of civil actions arising under Acts of Congress**

**(a)** Except as otherwise provided by law, a civil action arising under an Act of Congress enacted after the date of the enactment of this section may not be commenced later than 4 years after the cause of action accrues. Notwithstanding subsection (a), a private right of action that involves a claim of fraud, deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning the securities laws, as defined in section 3(a)(47) of the Securities Exchange Act of 1934 (*15 U.S.C. 78c(a)(47)*), may be brought not later than the earlier of -

(1) 2 years after the discovery of the facts constituting the

violation; or

(2) 5 years after such violation.

**(b)** Effective Date - The limitations period provided by *Section 1658(b) of title 28, United States Code*, as added by this section, shall **[*9]** apply to all proceedings addressed by this section that are commenced on or after the date of enactment of this Act.

**(c)** Nothing in this section shall create a new, private right of action.

[HN3]The language of the Act applies to § *10(b)* claims as well as § *20(a)* claims for control person liability based on a primary violation of § *10(b)*.

Defendants argue that the Lampf limitations periods apply to the claims of securities fraud brought by L-3. The relevant dates are: (1) the fraud occurred on August 13, 1998 when the merger took place; (2) the fraud was discovered in January 2002 n3; and (3) plaintiff filed its complaint on July 1, 2003.[HN4]Under the Lampf statute of limitations, plaintiff was required to file by the earlier of one year after discovery or three years after the fraud. One year after discovery was January 2003 and three years after the violation was August 13, 2001. Applying this rule, by filing on July 1, 2003, defendants argue that plaintiff had to file by August 13, 2001 and that plaintiff missed the deadline.

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n3 Defendants argue that two earlier incidents should have alerted L-3 to the alleged fraudulent scheme and that one of these incidents should therefore be considered the day on which the clock began to run for statute of limitations purposes. The face of plaintiff's complaint indicates that: "It was not until new management personnel at SPD Electrical Systems met with the United States Navy in January 2002, that L-3 first realized it may have been defrauded." (Am. Compl. P 67.) Taking plaintiff's allegation as true, as required on a motion to dismiss, I find the fact-intensive inquiry requested by defendants to be inappropriate at this juncture, and accept plaintiff's proposed date of January 2002 as the alleged date of discovery. See *Marks v. CDW Comp. Centers, Inc., 122 F.3d 363, 367 (7th Cir. 1997)* [HN5]("Whether a plaintiff had sufficient facts to place him on inquiry notice of a claim for securities fraud under *S.E.C. Rule 10b-5* is a question of fact, and such is often inappropriate for resolution on a motion to dismiss under *Rule 12(b)(6)*") (citations omitted); *In re Lucent Techs., Inc. Sec. Litig., 217 F. Supp. 2d 529, 542 (D.N.J. 2002)* ("Though inquiry notice in some cases is decided as a matter of law, it is inappropriate to dismiss claims as time-barred where the analysis is so fact intensive.") (internal quotations and citations omitted.)

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**[*10]**

Plaintiff argues for application of the Sarbanes-Oxley Act statute of limitations, which allows plaintiffs to file within the earlier of two years after discovery or five years after the fraud. Applying Sarbanes-Oxley to the present facts sets a deadline of August 13, 2003. By filing on July 1, 2003, plaintiff contends that it met its deadline.

The question is whether to apply the Lampf statute of limitations, under which plaintiff's claim is time-barred, or the expansive Sarbanes-Oxley statute of limitations, under which plaintiff met the deadline. To date, several district courts, but no appellate court, have addressed the issue. Although the majority have held that under these circumstances a plaintiff cannot avail itself of the newly enacted Sarbanes-Oxley statute of limitations, a number of district courts have ruled otherwise. See, in the Eastern District of Pennsylvania, *Lieberman v. Cambridge Partners, L.L.C., No. Civ. A. 03-2317, 2004 WL 1396750, 2004 U.S. Dist. LEXIS 11553 (E.D.Pa. June 21, 2004)* (Judge Cynthia Rufe), appeal docketed, No. 04-3079 (3d Cir. July 27, 2004) (Sarbanes-Oxley does not revive stale claims); see also *In re WorldCom, Inc. Sec. Litig., No. Civ. A. 02-3288, 2004 WL 1435356, 2004 U.S. Dist. LEXIS 11696 (S.D.N.Y. June 28, 2004)* **[*11]** (same); *Glaser v. Enzo Biochem, Inc., 303 F. Supp. 2d 724 (E.D.Va. 2003)* (same); *In re Heritage Bond Litig., 289 F. Supp. 2d 1132 (C.D. Cal. 2003)* (same); *Great S. Life Ins. Co. v. Enter. Mortg. Acceptance Co., LLC (In re Enter. Mortg. Acceptance Co., LLC, Sec. Litig.) ["EMAC"], 295 F. Supp. 2d 307 (S.D.N.Y. 2003)* (same); *Newby v. Enron Corp. (In re Enron Corp. Sec., Derivative & "ERISA" Litig.), No. Civ. A. H-01-3624, 2004 WL 405886, 2004 U.S. Dist. LEXIS 8158 (S.D.Tex. Feb. 25, 2004)* (same); *ATO RAM II, Ltd. v. SMC Multimedia Corp., No. Civ. A. 03-5569, 2004 WL 744792, 2004 U.S. Dist. LEXIS 5810 (S.D.N.Y. Apr. 7, 2004)* (applying the amended statute of limitations because plaintiff's claims were not time-barred when Sarbanes-Oxley was passed); *Friedman v. Rayovac Corp., 295 F. Supp. 2d 957 (W.D. Wis. 2003)* (applying the Act's longer limitations period to securities fraud claims against a defendant added to the complaint after July 30, 2002, although original complaint was filed before Sarbanes-Oxley); *Roberts v. Dean Witter Reynolds, Inc., No. Civ. A. 8:02-CV-2115-T-26EAJ, 2003 WL 1936116, 2003 U.S. Dist. LEXIS 5676 (M.D.Fla. Mar. 31, 2003)* **[*12]** (relying on legislative history to find Congressional intent to revive stale claims).

For many years Supreme Court jurisprudence counseled that statutes of limitations "strictly affect the remedy, and not the merits." *Campbell v. Holt, 115 U.S. 620, 626, 29 L. Ed. 483, 6 S. Ct. 209 (1885)* (quoting *Townsend v. Jemison, 50 U.S. 407, 413, 13 L. Ed. 194 (1850))*; see *Chase Secs. Litig. v. Donaldson, 325 U.S. 304, 314, 316, 89 L. Ed. 1628, 65 S. Ct. 1137 (1945)* (finding that statutes of limitations are "by definition arbitrary" and that "lifting a bar of a statute of limitations so as to restore a remedy lost through mere lapse of time" does not offend the *Fourteenth Amendment* even if it affects a party's expectation interests); see also *Int'l Union Electrical, Radio & Machine Workers, AFL-CIO, Local 790 v. Robbins & Myers, Inc., 429 U.S. 229, 244, 50 L. Ed. 2d 427, 97 S. Ct. 441 (1976)* (applying Chase to find that "Congress might constitutionally provide for retroactive application" of an extended statute of limitations period.) This could suggest that statutes of limitations are procedural and that the statute in effect at the time the **[*13]** action was commenced would be the limitation that controlled.

Although statutes of limitations are not traditionally viewed as conferring substantive rights, in Hughes Aircraft Co. v. United States the Supreme Court noted in dicta that "extending a statute of limitations after the pre-existing period of limitations has expired impermissibly revives a moribund cause of action." n4 *520 U.S. 939, 950, 138 L. Ed. 2d 135, 117 S. Ct. 1871 (1997)*. In Hughes the Supreme Court refused to apply an amendment to the *False Claims Act* retroactively because it would revive a previously foreclosed *qui tam* action. *Id. at 949*. The Court compared the application of the foreclosed *qui tam* action to the impermissible revival of time-barred claims by newly lengthened statutes of limitations, citing with approval the Ninth Circuit's decision in *Chenault v. United States Postal Serv., 37 F.3d 535 (9th Cir. 1994)*. In Chenault, the Ninth Circuit considered whether the newly lengthened statute of limitations provided in the *Civil Rights Act* *of 1991* could revive previously time-barred claims. First, the Chenault court found that Congress did not express a clear intent with **[*14]** respect to retroactivity of any portion of the Civil Rights Act. *37 F.3d at 537.* The court then went on to hold that[HN6]"a newly enacted statute that lengthens the applicable statute of limitations may not be applied retroactively to revive a plaintiff's claim that was otherwise barred under the old statutory scheme because to do so would alter the substantive rights of a party and increase a party's liability." *37 F.3d at 539.* By approving of *Chenault* and specifically holding that the revival of time-barred claims is "impermissible," [HN7]the Supreme Court has made statutes of limitations subject to the general rule that, absent clear Congressional intent, courts are to apply a presumption against retroactive application of a new law. See *Landgraf v. USI Film Products, 511 U.S. 244, 280, 128 L. Ed. 2d 229, 114 S. Ct. 1483 (1994).*

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n4 Prior to Hughes, the circuit courts were nearly unanimous in finding that previously time-barred claims could not be revived by newly enacted statutes of limitations. *Chenault v. United States Postal Serv., 37 F.3d 535, 539 (9th Cir. 1994)*; *FDIC v. Belli, 981 F.2d 838, 842-43 (5th Cir. 1993)* (without a clearly expressed legislative intent to the contrary, a newly enacted statute of limitations will not revive time-barred claims); *Bellwood v. Dwivedi, 895 F.2d 1521, 1527 (7th Cir. 1990)* (finding a presumption against using a newly enacted statute of limitations to revive a time-barred claim); *Million v. Frank, 47 F.3d 385, 390 (10th Cir. 1995)* (same); *Resolution Trust Corp. v. Artley, 28 F.3d 1099, 1103 n.6 (11th Cir. 1994)* (same); but see *Vernon v. Cassadaga Valley Cent. Sch. Dist., 49 F.3d 886, 889-91 (2d Cir. 1995)* (applying a new statute of limitations to conduct occurring before the claim was filed because statutes of limitations affect the conduct of plaintiffs filing complaints and not the substantive rights of defendants).

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**[*15]**

Under Landgraf, Congressional intent may operate to override the presumption against retroactive application of the new limitations period. *Landgraf, 511 U.S. at 280.* [HN8]The first step in determining whether a statute has an impermissible retroactive effect is to ascertain whether Congress has directed with the requisite clarity that the law be applied retrospectively." *INS v. St. Cyr, 533 U.S. 289, 316, 150 L. Ed. 2d 347, 121 S. Ct. 2271 (2001)* (declining to extend provisions of the Illegal Immigration Reform and Immigrant Responsibility Act [IIRIRA] to aliens whose plea agreements were entered into before IIRIRA's enactment). n5 The Supreme Court has instructed that [HN9]the "standard for finding such unambiguous direction is a demanding one." Id. In fact, cases where the Supreme Court has found a true intent to apply a statute retroactively "have involved statutory language that was so clear that it could sustain only one interpretation." Id. (quoting *Lindh v. Murphy, 521 U.S. 320, 328 n.4, 138 L. Ed. 2d 481, 117 S. Ct. 2059 (1997)* (holding that new provisions of the Antiterrorism and Effective Death Penalty Act of 1996 [AEDPA] do not apply to pending **[*16]** noncapital petitions for habeas corpus)).

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n5 INS v. St. Cyr directs that the "second step" in determining whether a statute has an impermissible retroactive effect is to determine whether the statute actually produces the effect. *533 U.S. at 320.* Because Hughes directly answered this question I need not conduct this inquiry. *520 U.S. at 950.*

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Plaintiff argues that the plain language of § 804(b) necessitates a reading that it apply to *any* complaint filed on or after July 30, 2002, regardless of when the underlying conduct occurred. Plaintiff's reading of the statute is that, by stating that the new time limits "*shall* apply to all proceedings . . . that are commenced on or after the date of enactment of this Act" (emphasis added), Congress intended for all complaints filed on or after July 30, 2002 to be considered under the Sarbanes-Oxley period, irrespective of the date of the underlying conduct.

This is not an unreasonable literal interpretation of § 804(b), but it **[*17]** is simply one such interpretation. For example, it is also reasonable to read the statute as applying to all proceedings commenced on or after July 30, 2002 alleging conduct not previously time-barred. This latter interpretation forecloses any potential defendant's argument that Sarbanes-Oxley should apply only to *conduct* occurring on or after the statute's enactment date. Such an argument would forbid plaintiffs alleging, for example, conduct that occurred in the months immediately preceding Sarbanes-Oxley from bringing claims within the Sarbanes-Oxley time limitations. Section 804(b) clearly forecloses this potential argument, but does not necessarily open the door for L-3's claim.

The language of § 804(c) further bolsters a finding that § 804(b) is ambiguous. Section 804(c) states that, "Nothing in this section shall create a new, private right of action." Pub. L. 107-204, Title VIII, § 804(c). Allowing a claim to proceed when it had previously been time-barred is arguably comparable to creating a new right of action.

Furthermore, Congress has expressed its unambiguous intention to apply statutes of limitations to time-barred claims. See e.g. Riegle-Neal Interstate **[*18]** Banking and Branching Efficiency Act of 1994, *12 U.S.C. § 1821(d)(14)(C)(i) (1994)* (amending the Act to provide that "the Corporation may bring an action. . . on such claim without regard to the expiration of the statute of limitation applicable under State law"); and the Higher Education Technical Amendments of 1991, *20 U.S.C. § 1091a(a)(2)* (eliminating statute of limitations with regard to recovering on defaulted student loans by stating "no limitation shall terminate the period within which suit may be filed.") The fact that a statute of repose is at play here, rather than a statute of limitations as in the above cases, makes the need for Congressional clarity even greater. n6

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n6 Several courts have found that rights of repose are substantive and not procedural. See *Kaplan v. Shure Bros., Inc., 153 F.3d 413, 422 (7th Cir. 1998)* [HN10]("A statute of repose is essentially different from a statute of limitations, in that a limitations statute is procedural, giving a time limit for bringing a cause of action, with the time beginning when the action has ripened or accrued; while a repose statute is a substantive statute, extinguishing any right of bringing the cause of action, regardless of whether it has accrued.") (internal citation omitted); *Stuart v. American Cyanamid Co., 158 F.3d 622, 627 (2d Cir. 1998)* ("a statute of repose may bar commencement of an action even before the cause of action accrues"); *Christ v. Prater Indus., Inc., 67 F. Supp. 2d 491, 492 (E.D. Pa. 1991)* (same); *Crouch v. General Electric Co., 699 F. Supp. 585, 592 n.5 (S.D.Miss. 1988)* ("Statutes of repose acquire a substantive character since they operate to extinguish not only the right to enforce a remedy but the substantive right itself."); *Moore v. Liberty Nat'l Ins. Co., 108 F. Supp. 2d 1266, 1275 (N.D.Ala. 2000)* (same). Regarding statutes of repose as substantive rights suggests an even greater presumption against permitting new legislation to open the gates to claims that had already been time-barred.

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**[*19]**

Plaintiff urges me to study Sarbanes-Oxley's legislative history for insight into Congress's intent. Such an inquiry would be inappropriate in light of the requirement that the statute be unambiguous. It is not impossible that Congress did in fact intend claims like L-3's to be revived, but the statute is not "so clear that it could sustain only one interpretation." *Lindh, 521 U.S. at 328 n.4.* n7 Therefore, the statute cannot overcome the presumption against applying it to previously time-barred claims.

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n7 Also finding ambiguity in the Sarbanes-Oxley context are: *EMAC, 295 F. Supp. 2d at 312*; *Roberts, 2003 U.S. Dist. LEXIS 5676, 2003 WL 1936116, at *3*; *Glaser, 303 F. Supp. 2d at 734*; *Heritage Bond, 289 F. Supp. 2d at 1148*; *Worldcom, 2004 U.S. Dist. LEXIS 11696, 2004 WL 1435356, at *7*; and *Lieberman, 2004 U.S. Dist. LEXIS 11553, 2004 WL 1396750, at *3.*

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Because the language of § 804 is ambiguous, I am bound to apply the *Landgraf-Hughes* presumption against revival of time-barred **[*20]** claims. Under the *Lampf* statute of limitations, plaintiff's claims were time-barred after August 13, 2001 - nearly a year before Sarbanes-Oxley was passed. I will therefore dismiss plaintiff's *10(b)* and *20(a)* claims.

**B. Jurisdiction over State Law Claims**

[HN11]I have discretion as to whether to retain supplemental jurisdiction over the state law claims in light of my dismissal of the federal claims. *28 U.S.C. § 1367(c)(3)*. The Third Circuit has instructed that, "where the claim over which the district court has original jurisdiction is dismissed before trial, the district court must decline to decide the pendent state law claims unless considerations of judicial economy, convenience, and fairness to the parties provide an affirmative justification for doing so." *Hedges v. Musco, 204 F.3d 109, 123 (3d Cir. 2000)*. No scheduling order has been entered in this case, thus alleviating any concerns about judicial economy and fairness to the parties. I find no affirmative justification for deciding these pendent state law claims, and decline to exercise supplemental jurisdiction over them. Under *28 U.S.C. 1367(d)*, **[*21]** plaintiff has thirty days to file its surviving claims in state court.

**ORDER**

**AND NOW**, this day of 2004, defendants' motions to dismiss (Docket # 16, Docket # 22 and Docket # 23) are **GRANTED**. This matter is **DISMISSED**. The Clerk's Office shall mark this case closed for statistical purposes.

ANITA B. BRODY, J.

# EXHIBIT 5

IRVIN S. LIEBERMAN, and others similarly situated, Plaintiffs v. CAMBRIDGE PARTNERS, L.L.C. and J.B. HANAUER & COMPANY, Defendants

CIVIL ACTION NO. 03-2317

UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

2004 U.S. Dist. LEXIS 11553; Fed. Sec. L. Rep. (CCH) P92,850

June 21, 2004, Decided

**PRIOR HISTORY:** *Lieberman v. Cambridge Partners, LLC, 2003 U.S. Dist. LEXIS 23732 (E.D. Pa., Dec. 16, 2003)*

**DISPOSITION:** Defendant's motion to dismiss amended class action complaint granted. All claims against Defendant J.B. Hanauer & Company dismissed with prejudice.

**CASE SUMMARY**

**PROCEDURAL POSTURE:** In an amended class action complaint, plaintiff investor sued defendant underwriters, alleging violations of §§ 12(a)(2) and 15 *(15 U.S.C.S. §§ 77l*(a)(2), 77o) of the Securities Act of 1933, §§ 10(b) and 20(a) *(15 U.S.C.S. §§ 78j*(b), 78t(a)) of the Securities Exchange Act of 1934, and Rule 10b-5, 17 C.F.R. § 240.10b-5. One underwriter moved to dismiss.

**OVERVIEW:** The investor purchased bonds on April 21, 1998 and filed the initial complaint on April 14, 2003. The investor contended that because he commenced the matter after the July 30, 2002 enactment of the Sarbanes-Oxley Act of 2002 (SOA), Pub. L. No. 107-204, 116 Stat. 745 (codified in part at *28 U.S.C.S.* § *1658*(b)), the SOA's longer limitations and repose periods applied. The investor's § 10(b) and Rule 10b-5 claims were already time-barred when Congress enacted the SOA. The court determined that the § 10(b) and Rule 10b-5 claims were time-barred because it was impermissible to utilize SOA § 804 to revive claims that were time-barred when the SOA took effect on July 30, 2002, regardless of whether the case was filed before or after July 30, 2002. The court determined that the investor's claims under § 12(a)(2) of the Securities Act of 1933 were also untimely and the SOA's longer statute of limitations and repose periods did not apply to the claims. Finally, the claims under § 15 of the Securities Act of 1933 and § 20(a) of the Securities Exchange Act of 1934 were barred because they were derivative of the untimely claims.

**OUTCOME:** The court granted the underwriter's motion to dismiss and dismissed with prejudice the claims against that underwriter. The court ordered the investor to show cause why all claims against the other underwriter should not be dismissed without prejudice.

**CORE TERMS:** time-barred, repose, statute of limitations, revive, limitations period, three-year, fails to state, one-year, accrued, Exchange Act, misleading statement, right of action, actions filed, equal force, filing date, retroactively, retroactive, derivative, deficient, discovery, untimely, analyses, expired, stale, prior opinion, reconsideration, contradict

**LexisNexis(TM) Headnotes**

*Securities Law > Bases for Liability > Deceptive Devices*

*Governments > Legislation > Statutes of Limitations > Time Limitations*
[HN1]Actions under § 10(b) *(15 U.S.C.S.* § *78j*(b)) of the Securities Exchange Act of 1934 and Rule 10b-5, 17 C.F.R. § 240.10b-5, are governed by the statute of limitations and repose contained in § 9(e) *(15 U.S.C.S.* § *78i*(e)) of the Securities Exchange Act of 1934, which requires that such actions be brought within one year after discovery of the facts constituting the violation and within three years after such violation.

*Securities Law > Bases for Liability > Deceptive Devices*

*Governments > Legislation > Statutes of Limitations > Time Limitations*
[HN2]With enactment of the Sarbanes-Oxley Act of 2002 (SOA), Pub. L. No. 107-204, 116 Stat. 745 (codified in part at *28 U.S.C.S.* § *1658*(b)), Congress has extended the limitations/repose periods for § 10(b) *(15 U.S.C.S.* § *78j*(b)) of the Securities Exchange Act of 1934 and Rule 10b-5, 17 C.F.R. § 240.10b-5, claims from the one-year/three-year period to a two-year/five-year period. SOA § 804(a). In addition, Congress has directed that the new, longer limitations period shall apply to all proceedings addressed by this section that commenced on or after the date of enactment, July 30, 2002, of this Act. SOA § 804(b). Congress has also provided that nothing in this section shall create a new, private right of action. SOA § 804(c).

*Securities Law > Bases for Liability > Deceptive Devices*

*Governments > Legislation > Effect & Operation > Prospective & Retrospective Operation*

*Governments > Legislation > St...es of Limitations > Extension & Revival*

[HN3]It is impermissible to utilize § 804 of the Sarbanes-Oxley Act of 2002 (SOA), Pub. L. No. 107-204, 116 Stat. 745 (codified in part at *28 U.S.C.S. § 1658*(b)), to revive claims that were time-barred when the SOA took effect on July 30, 2002, regardless of whether the case pursuing those claims was filed before or after July 30, 2002.

*Securities Law > Bases for Liability > Civil Liability*

*Governments > Legislation > Statutes of Limitations > Time Limitations*

[HN4]To be timely, a claim under § 12(a)(2) *(15 U.S.C.S. § 77l*(a)(2)) of the Securities Act of 1933 must be brought within one year of discovery of an alleged misleading statement (or within one year of when due diligence would have uncovered an alleged misleading statement), or, under the three-year statute of repose, within three years after the plaintiff purchased the security. *15 U.S.C.S. § 77m.*

*Securities Law > Bases for Liability > Civil Liability*

*Governments > Legislation > Statutes of Limitations > Time Limitations*

[HN5]The Sarbanes-Oxley Act of 2002's, Pub. L. No. 107-204, 116 Stat. 745 (codified in part at *28 U.S.C.S. § 1658*(b)), longer statute of limitations and repose periods do not apply to § 12(a)(2) *(15 U.S.C.S. § 77l*(a)(2)) of the Securities Act of 1933 claims.

*Securities Law > Bases for Liability > Controlling Persons Liability*

[HN6]Section 20(a) *(15 U.S.C.S. § 78t*(a)) of the Securities Exchange Act of 1934 plainly requires the plaintiff to prove that the "controlled person" is liable under the Securities Exchange Act of 1934. If no controlled person is liable, there can be no controlling person liability.

**COUNSEL: [*1]** For IRVIN S. LIEBERMAN, AND ALL OTHERS SIMILARLY SITUATED, Plaintiff: JOHN F. INNELLI, INNELLI ROBERTSON, PHILADELPHIA, PA. MICHAEL J. MOLDER, LAW OFFICES OF MICHAEL J. MOLDER, WYNNEWOOD, PA.

For J.B. HANAUER & CO., Defendant: JACQUELYN J. AGER, CONRAD O'BRIEN GELLMAN & ROHN PC, PHILADELPHIA, PA. LAWRENCE M. ROLNICK, LOWENSTEIN SANDLER PC, ROSELAND, NJ. ROBERT N. FELTOON, CONRAD O'BRIEN GELLMAN & ROHN PC, PHILADELPHIA, PA. THOMAS E. REDBURN, JR., LOWENSTEIN SANDLER PC, ROSELAND, NJ.

**JUDGES:** CYNTHIA M. RUFE, J.

**OPINIONBY:** CYNTHIA M. RUFE

**OPINION: MEMORANDUM OPINION AND ORDER**

**RUFE, J.**

In this putative securities class action, Plaintiff Irvin S. Lieberman proceeds against Defendants Cambridge Partners, L.L.C. ("Cambridge") and J.B. Hanauer & Company ("Hanauer"), two underwriters of debt securities issued by the Allegheny County Industrial Development Authority ("ACIDA"). Plaintiff filed his initial Complaint on April 14, 2003, advancing claims under *sections 12(a)(2)* and *15 of the Securities Act of 1933* ("Securities Act"), *15 U.S.C. §§ 77l, 77o.* On August 25, 2003, after more than 120 days had passed without filing of proof of service on either **[*2]** defendant, the Court issued an Order to Show Cause why the matter should not be dismissed without prejudice under *Federal Rule of Civil Procedure 4(m).* Plaintiff responded by explaining that his efforts to locate Cambridge had been unsuccessful. As to Hanauer, however, Plaintiff enclosed proof of timely service and a stipulation of counsel permitting Hanauer approximately thirty days to respond to the Complaint, which the Court approved.

Thereafter, Hanauer moved to dismiss the Complaint on three grounds: (1) improper service; (2) Plaintiff's *section 12(a)(2)* claim is time-barred and fails to state a claim upon which relief can be granted; and (3) Plaintiff's *section 15* claim fails to state a claim because it is predicated on Plaintiff's deficient *section 12(a)(2)* claim. On December 16, 2003, the Court dismissed without prejudice Plaintiff's claims against Cambridge for failure to effect timely service. The Court also dismissed Plaintiff's claims against Hanauer for failure to state a claim, concluding that as tax-exempt industrial development bonds, the ACIDA bonds are expressly exempt from the liability provisions of *section 12(a)(2).* Lastly, **[*3]** the Court dismissed Plaintiff's claim under *section 15 of the Securities Act* because a successful *section 12* claim is a precondition to a successful *section 15* claim. The Court dismissed all claims against Hanauer with prejudice without reaching any of Hanauer's alternative arguments. n1

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n1 See *Lieberman v. Cambridge Partners, LLC, 2003 WL 22999217, 2003 U.S. Dist. LEXIS 23732.*

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Plaintiff filed a Motion for Reconsideration and represented therein that "since the issuance of the Court's opinion, individuals with first hand knowledge of the workings of . . . entities involved in the events giving rise to this action have provided information which would enable the filing of an amended complaint to address all of the issues raised by Hanauer." n2 Accepting this representation as true and to ensure that Plaintiff received a full opportunity to present his claims, the Court granted leave to amend the Complaint but specifically denied the Motion "insofar as it challenges, contradicts or seeks reconsideration of any of the legal conclusions" **[*4]** in the Court's December 16, 2003 Memorandum Opinion and Order. n3

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n2 Pl.'s Mot. for Recons. at 5.

n3 Order of Jan. 30, 2004.

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On February 19, 2004, Plaintiff filed an Amended Class Action Complaint against Cambridge and Hanauer. In addition to reasserting claims under *sections 12(a)(2)* and *15 of the Securities Act*, Plaintiff added new claims under Securities and Exchange Commission Rule 10b-5 ("Rule 10b-5"), *17 C.F.R. § 240.10b-5*, and *sections 10(b)* and *20(a) of the Securities Exchange Act of 1934* ("Exchange Act"), *15 U.S.C. §§ 78j(b), 78t(a)*.

Presently before the Court is Hanauer's Motion to Dismiss the Amended Class Action Complaint, which seeks dismissal for the following reasons: (1) Plaintiff's claims under *section 12(a)(2) of the Securities Act*, *section 10(b) of the Exchange Act* and *Rule 10b-5* are time-barred by applicable statutes of limitations and repose; (2) Plaintiff's claim under *section 12(a)(2) of the Securities Act* fails to state a valid **[*5]** legal claim for substantially the same reasons outlined in the Court's December 16, 2003 Memorandum Opinion and Order; (3) Plaintiff fails to plead the element of scienter with the requisite particularity for his claims under *section 10(b) of the Exchange Act* and *Rule 10b-5*; (4) Plaintiff's claims under *section 15 of the Securities Act* and *section 20(a) of the Exchange Act* fail because there are no underlying violations by a person allegedly being controlled; and (5) Plaintiff has not properly served Hanauer.

Today the Court holds that the applicable statutes of limitations and repose bar Plaintiff's claims. The Court will not restate the factual background of this matter as it is already set forth in the Court's prior opinion. Only the bare adjudicative facts are discussed below. n4

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n4 The familiar *Rule 12(b)(6)* standard governs. See *Brody v. Hankin, 299 F. Supp. 2d 454, 457-58 (E.D. Pa. 2004)* (outlining standard of review for motion to dismiss pursuant to *Rule 12(b)(6)*). The Court assumes for purposes of today's decision that service upon Hanauer was proper.

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**[*6]**

Plaintiff purchased the ACIDA bonds on April 21, 1998. It was not until almost five years later, however, that Plaintiff filed the initial Complaint on April 14, 2003. Taking the allegations in the light most favorable to Plaintiff, the subsequent Amended Class Action Complaint arises out of the same conduct and transactions set forth in the initial Complaint. Therefore, it relates back to the filing date of the initial Complaint pursuant to *Federal Rule of Civil Procedure 15(c)(2)*. Hanauer concedes this point for purposes of its Motion. n5

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n5 See Mem. of Law in Supp. of Mot. to Dismiss at 6 n.1.

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Prior to July 30, 2002, when Congress enacted the Sarbanes-Oxley Act of 2002 ("SOA"), n6 claims under *section 10(b) of the Exchange Act* and *Rule 10b-5* were governed by the Supreme Court's ruling in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 501 U.S. 350, 115 L. Ed. 2d 321, 111 S. Ct. 2773 (1991)*. There, the Court held that [HN1]actions under *section 10(b)* and *Rule 10b-5* **[*7]** are governed by the statute of limitations and repose contained in *section 9(e) of the Exchange Act*, which requires that such actions be brought "within one year after discovery of the facts constituting the violation and within three years after such violation." n7

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n6 Pub. L. No. 107-204, 116 Stat. 745 (codified in part at *28 U.S.C.A. § 1658(b) (West Supp. 2004)*).

n7 *501 U.S. at 364 & n.9*; see also section 9(e) of the Exchange Act, *15 U.S.C.*

§ *78i(e)*.

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[HN2]With enactment of the SOA, Congress extended the limitations/repose periods for *section 10(b)* and *Rule 10b-5* claims from the one-year/three-year period outlined in Lampf to a two-year/five-year period. n8 In addition, Congress directed that the new, longer limitations period "shall apply to all proceedings addressed by this section that commenced on or after the date of enactment [July 30, 2002] of this Act." n9 Congress also provided that "nothing in this section shall create a new, **[*8]** private right of action." n10 Plaintiff contends that because he commenced this matter on April 14, 2003 -- after the July 30, 2002 enactment of the SOA -- the SOA's longer limitations/repose periods apply. If that is the case, this action was timely-filed on April 14, 2003, which is within five years of the alleged April 21, 1998 violation, when Hanauer commenced the sale of the ACIDA bonds.

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n8 SOA § 804(a).

n9 Id. § 804(b).

n10 Id. § 804(c).

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Hanauer responds by noting that Plaintiff's *section 10(b)* and *Rule 10b-5* claims were already time-barred when Congress enacted the SOA. That is, under pre-SOA law, Plaintiff's claims were governed by Lampf's one-year/three-year limitations/repose period. Having alleged that the violation occurred on April 21, 1998 when Hanauer brought the ACIDA bonds to market, the three-year statute of repose expired on April 22, 2001 -- well before the SOA took effect on July 30, 2002 and long before Plaintiff filed suit on April 14, 2003. Therefore, argues Hanauer, **[*9]** applying the SOA's longer limitations period to Plaintiff's *section 10(b)* and *Rule 10b-5* claims would revive stale claims and thus be contrary to SOA § 804(c)'s prohibition against creating a "new, private right of action." In addition, it argues, because the SOA lacks a clear statement directing courts to apply the longer limitations period retroactively to revive time-barred claims, the Court must adhere to the firmly-rooted presumption against retroactive legislation and can only apply the longer limitations period to claims that had accrued but had not become time-barred before enactment of the SOA. n11

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n11 See *Landgraf v. USI Film Prods., 511 U.S. 244, 265, 128 L. Ed. 2d 229, 114 S. Ct. 1483 (1994)* ("the presumption against retroactive legislation is deeply rooted in our jurisprudence, and embodies a legal doctrine centuries older than our Republic"); see also *Hughes Aircraft Co. v. United States ex rel. Schumer, 520 U.S. 939, 950, 138 L. Ed. 2d 135, 117 S. Ct. 1871 (1997)* ("extending a statute of limitations after the pre-existing period of limitations has expired impermissibly revives a moribund cause of action . . . a newly enacted statute of limitations may not be applied retroactively to revive a plaintiff's claim that was otherwise barred under the old statutory scheme").

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**[*10]**

Several courts have adopted these arguments. Those courts set forth thorough and persuasive analyses demonstrating that [HN3]it is impermissible to utilize SOA § 804 to revive claims that were time-barred when the SOA took effect on July 30, 2002, regardless of whether the case pursuing those claims was filed before or after July 30, 2002. The Court agrees with those decisions and adopts their rationales as though restated herein. n12 Accordingly, Plaintiff's *section 10(b)* and *Rule 10b-5* claims are time-barred and must be dismissed.

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n12 *Newby v. Enron Corp. (In re Enron Corp. Sec. Derivative & "ERISA" Litig.), 2004 U.S. Dist. LEXIS 8158, No. MDL-1446, Civ.A.H-01-3624, 2004 WL 405886, at *12-17 (S.D. Tex. Feb. 25, 2004)* (concluding that SOA's longer limitations periods apply to actions filed after July 30, 2002 "based on underlying conduct that occurred before the enactment of the [SOA] as long as such claims were not time-barred by the Lampf statute of limitations and/or repose controlling before July 30, 2002"); *Great S. Life Ins. Co. v. Enter. Mortg. Acceptance Co., LLC (In re Enter. Mortg. Acceptance Co., LLC, Sec. Litig.), 295 F. Supp. 2d 307, 312-17*

*(S.D.N.Y. 2003)* (concluding that Congress did not intend the SOA to revive previously time-barred claims, and that reviving time-barred claims would contradict SOA § 804(c)'s proscription against creating new private rights of action); *Glaser v. Enzo Biochem, Inc., 303 F. Supp. 2d 724, 732-34 (E.D. Va. 2003)* ("Congress's provision that the statute of limitations would apply to all proceedings commenced on or after July 30, 2002, applies only to actions that may have accrued but that were not time-barred under the previous one-year limitations period."); *In re Heritage Bond Litig., 289 F. Supp. 2d 1132, 1147-48 (C.D. Cal. 2003)* ("While the amended statute of limitations may apply to proceedings filed after passage of the [SOA], it cannot apply to claims already barred at the time of its enactment, regardless of the filing date."); cf. *ATO RAM II, Ltd. v. SMC Multimedia Corp., No. 03 Civ. 5569 (HB), 2004 U.S. Dist. LEXIS 5810, at *17-19 (S.D.N.Y. Apr. 7, 2004)* (noting that "many courts have interpreted [SOA § 804] to mean[] that the extended statute of limitations applies to private securities fraud claims that had accrued at the time of enactment, but were not already time-barred," but finding the plaintiffs' claims were timely because those claims were not yet barred when the SOA was enacted). Although some of these cases deal with actions filed before enactment of the SOA and thus by the terms of § 804(b) are not governed by the SOA's longer limitations periods, their analyses as to whether Congress intended the SOA to revive stale claims -- regardless of when an action is commenced -- apply with equal force to the case at bar.

*Roberts v. Dean Witter Reynolds, Inc., 2003 U.S. Dist. LEXIS 5676, No. 8:02-CV-2115-T-26EAJ, 2003 WL 1936116 (M.D. Fla. Mar. 31, 2003)* reached the opposite conclusion, but its reasoning rests on unpersuasive citations to the SOA's legislative history. The Court agrees with those courts that have concluded that *Roberts* should be rejected. See *Newby, 2004 U.S. Dist. LEXIS 8158, 2004 WL 405886, at *12 n.39*; *Great S. Life, 295 F. Supp. 2d at 316-17.*

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[*11]

Plaintiff's claims under *section 12(a)(2) of the Securities Act* are also untimely. [HN4]To be timely, such a claim must be brought within one year of discovery of an alleged misleading statement (or within one year of when due diligence would have uncovered an alleged misleading statement), or, under the three-year statute of repose, within three years after the plaintiff purchased the security. n13 Applying the three-year statute of repose, Plaintiff's *section 12(a)(2)* claim became time-barred three years after the April 21, 1998 purchase date, or on April 22, 2001. Because Plaintiff did not file suit until April 14, 2003, Plaintiff's *section 12(a)(2)* claim is time-barred.

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n13 *15 U.S.C. § 77m.*

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As with his *section 10(b)* and *Rule 10b-5* claims, Plaintiff seeks to revive his *section 12(a)(2)* claim via SOA § 804. However, this Court agrees with the several courts that have held that [HN5]the SOA's longer statute of limitations and repose periods do not apply to *section 12(a)(2)* claims. n14 Even if **[*12]** the SOA did apply, for the same reasons set forth above with respect to Plaintiff's *section 10(b)* and *Rule 10b-5* claims, the SOA cannot permissibly rescue Plaintiff's otherwise time-barred *section 12(a)(2)* claim.

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n14 E.g., *In re FirstEnergy Corp. Sec. Litig., 316 F. Supp. 2d 581, 2004 U.S. Dist. LEXIS 7604, No. 5:03-CV-1684, -- F. Supp. 2d --, 2004 WL 938440, at *12 (N.D. Ohio May 3, 2004)*; *ATO RAM II, 2004 U.S. Dist. LEXIS 5810, at *15*; *Lawrence E. Jaffe Pension Plan v. Household Int'l, Inc., No. 02 C 5893, 2004 U.S. Dist. LEXIS 4659, at *38-39 (N.D. Ill. Mar. 22, 2004)* (noting that every court to consider the question has concluded that *section 12(a)(2)* claims are not covered by the SOA).

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Finally, as noted in the Court's prior opinion, Plaintiff's claim under *section 15 of the Securities Act* is derivative of his claim under *section 12.* n15 Accordingly, the failure of Plaintiff's claim under *section 12(a)(2) of the Securities Act* sounds the death knell for his claim under *section 15* as well. Similarly, **[*13]** Plaintiff's claim under *section 20(a) of the Exchange Act* is derivative of his claims under *section 10(b)* and *Rule 10b-5*, so the untimely filing of these claims also bars recovery under *section 20(a)*. n16

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n15 *2003 U.S. Dist. LEXIS 23732, 2003 WL 22999217, at *4; 2003 U.S. Dist. LEXIS 23732, at *15-16.*

n16 *Shapiro v. UJB Fin. Corp., 964 F.2d 272, 279 (3d Cir. 1992)* [HN6]("*[Section 20(a)*] plainly requires the plaintiff to prove . . . that the "controlled person" is liable under the [Exchange] Act. If no controlled person is liable, there can be no controlling person liability."); see also *Dalicandro v. Legalgard, Inc., Civ. A. No. 99-3778, 2004 U.S. Dist. LEXIS 2253, at *16 (E.D. Pa. Jan. 21, 2004)* (holding that statute of limitations for claims brought pursuant to *section 10(b)* applies with equal force to claims brought pursuant to *section 20(a) of the Exchange Act*); *In re Heritage Bond Litig., 289 F. Supp. 2d at 1148* (concluding claims under *section 10(b)* and *section 20(a)* are "likely" governed by same statute of limitations).

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**[*14]**

Although Plaintiff's claims against Cambridge appear to be identical to its deficient claims against Hanauer, Cambridge has not entered an appearance in this case, nor has Plaintiff had an opportunity to argue the merits or viability of its claims against Cambridge. Accordingly, the Court will not address sua sponte the merits of Plaintiff's claims against Cambridge. However, as of today, more than 120 days have passed since the filing of the Amended Class Action Complaint, and the docket does not reflect service thereof on Cambridge. Therefore, today the Court issues an Order to Show Cause why the remaining claims against Cambridge should not be dismissed without prejudice pursuant to *Federal Rule of Civil Procedure 4(m)*.

An appropriate Order follows.

**ORDER**

**AND NOW**, this 21st day of June, 2004, upon consideration of Defendant J.B. Hanauer & Company's Motion to Dismiss the Amended Class Action Complaint [Doc. # 21], Plaintiff's Opposition thereto [Doc. # 25], Defendant's Reply [Doc. # 29], Plaintiff's Sur-Reply [attached to Doc. # 30], and for the reasons set forth in the attached Memorandum Opinion, it is hereby **[*15] ORDERED** that Defendant's Motion is **GRANTED**. All claims against Defendant J.B. Hanauer & Company are **DISMISSED WITH PREJUDICE**.

It is further **ORDERED** that Plaintiff shall, within seven (7) days of the date of this Order, show cause why all claims against Defendant Cambridge Partners, L.L.C. should not be dismissed without prejudice pursuant to *Federal Rule of Civil Procedure 4(m)*.

It is so **ORDERED**.

**BY THE COURT:**

**CYNTHIA M. RUFE, J.**

# EXHIBIT 6

MARIA A. MUHAMMA., .aintiff, v. VILLAGE OF BOLINGBROOK, .OLINGBROOK POLICE DEPARTMENT, CHIEF KENNETH EACH, COMMANDER KEITH GEORGE, SERGEANT MICHAEL JOHNSTONE, Defendants

No. 02 C 3770

UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION

2004 U.S. Dist. LEXIS 12726

July 6, 2004, Decided
July 8, 2004, Docketed

**DISPOSITION:** **[*1]** Defendants' motion to dismiss granted in part and denied in part. Plaintiff's ADEA claim against defendant Bolingbrook Police Department dismissed. Defendants' motion to dismiss Muhammad's Section 1983 claim against her superior officers denied.

**CASE SUMMARY**

**PROCEDURAL POSTURE:** Plaintiff employee sued defendants, a police department, a village, and superior officers, alleging that she was discriminated against in violation of Title VII of the Civil Rights Act of 1964 (Title VII), *42 U.S.C.S. § 2000e* et seq., the Age Discrimination in Employment Act (ADEA), *29 U.S.C.S. § 621,* and *42 U.S.C.S. § 1983.* Defendants moved to dismiss the ADEA claim against the department and the *42 U.S.C.S. § 1983* claim against the officers.

**OVERVIEW:** The department argued that the employee's ADEA claim must have been dismissed because it was not a proper defendant for such a claim. Although caselaw on ADEA claims against law enforcement agencies was sparse, defendants analogized to Title VII, pointing out that, under that statute, police departments were neither an employer, nor a proper defendant. The court found that the same logic applied to the employee's ADEA claim. The village was the proper defendant for the employee's ADEA claim and naming the department as a defendant in that claim added nothing to the complaint. As to the *42 U.S.C.S. § 1983* claim, although the employee had not made specific factual allegations against each defendant by name, the gravamen of her complaint was clear. She claimed that defendants denied her several promotions due to her age and gender despite her excellent qualifications. The employee described her claim in great detail, identifying each of the promotions she was denied, naming the officers who received the promotion, and describing the age and education of the promoted officers. The employee provided enough information to place her superior officers on notice of the claims against them.

**OUTCOME:** Defendants' motion to dismiss was granted as to the ADEA claim and was denied as to the civil rights claim. The employee's ADEA claim against the police department was dismissed.

**CORE TERMS:** motion to dismiss, renewed motion, promotion, notice, police departments, national origin, legal existence, reasons stated, discriminated, municipality, religion, naming, gender

**LexisNexis(TM) Headnotes**

***Civil Procedure > Pleading & Practice > Defenses, Objections & Demurrers > Failure to State a Cause of Action***
[HN1]When ruling on a motion to dismiss pursuant to Fed. R. Civ. P. 12(b)(6), the court accepts the factual allegations made in a plaintiff's complaint as true. The court will then consider whether any set of facts, consistent with the allegations, could support the plaintiff's claim for relief.

***Civil Procedure > Pleading & Practice > Pleadings > Interpretation***
[HN2]A complaint need only contain enough facts to put a defendant on notice of the claim so that an answer can be filed.

***Civil Procedure > Pleading & Practice > Defenses, Objections & Demurrers > Failure to State a Cause of Action***

***Civil Procedure > Joinder of Claims & Parties > Self-Representing Parties***
[HN3]Dismissal should be granted only if it is "beyond doubt" that a plaintiff cannot prove any facts to support a claim entitling the plaintiff to relief. In that inquiry, complaints prepared pro se are given greater latitude.

***Civil Procedure > Pleading & Practice > Defenses, Objections & Demurrers > Failure to State a Cause of Action***
[HN4]Fed. R. Civ. P. 12(g) provides that any issues or objections that a defendant fails to raise in the initial motion to dismiss are waived. Fed. R. Civ. P. 12(b)(6).

***Civil Procedure > Pleading & Practice > Defenses, Objections & Demurrers > Failure to State a Cause of Action***

[HN5]The purpose of Fed. R. Civ. P. 12(g) is to prevent litigants from unnecessarily delaying proceedings at the pleading stage by interposing their defenses piecemeal. However, a court might properly entertain a second motion to dismiss if convinced that it is not interposed for delay and that the disposition of the case on the merits can be expedited by doing so.

***Governments > Local Governments > Claims By & Against***

***Constitutional Law > Civil Rights Enforcement > Civil Rights Act of 1964***

***Labor & Employment Law > Discrimination > Title VII***

[HN6]Under Title VII of the Civil Rights Act of 1964 (Title VII), *42 U.S.C.S. § 2000e* et seq., police departments are neither an employer, nor a proper defendant. This is so because municipal police departments have no legal existence independent from the municipality that they serve. Rather, the municipality is responsible for the unlawful acts of its police department and, therefore, is the proper defendant to a Title VII claim alleging discrimination by that department.

***Labor & Employment Law > Discrimination > Age Discrimination > Coverage & Definitions***

***Labor & Employment Law > Discrimination > Title VII***

[HN7]Courts often apply arguments of liability to Title VII of the Civil Rights Act of 1964, *42 U.S.C.S. § 2000e* et seq., and the Age Discrimination in Employment Act interchangeably.

**COUNSEL:** For MARIA A MUHAMMAD, plaintiff: Rex Lisle Sessions, Kevin M Cloutier, Winston & Strawn LLP, Chicago, IL.

MARIA A MUHAMMAD, plaintiff, Pro se, Aurora, Il.

For VILLAGE OF BOLINGBROOK, defendant: Daniel C. Shapiro, Moss & Bloomberg, Ltd., Bolingbrook, IL. James P. DeNardo, Kristin Dvorsky Tauras, McKenna, Storer, Rowe, White & Farrug, Chicago, IL.

For BOLINGBROOK POLICE DEPARTMENT, KENNETH EACH, Chief, KEITH GEORGE, Commander, MICHAEL JOHNSTONE, Sergeant, defendants: James P. DeNardo, Kristin Dvorsky Tauras, McKenna, Storer, Rowe, White & Farrug, Chicago, IL.

**JUDGES:** JOAN B. GOTTSCHALL, United States District Judge.

**OPINIONBY:** JOAN B. GOTTSCHALL

**OPINION: ORDER AND MEMORANDUM OPINION**

Maria A. Muhammad ("Muhammad"), a police officer with the Bolingbrook Police Department ("Bolingbrook PD"), has sued Bolingbrook PD, the Village of Bolingbrook (the "Village"), and several of her superior officers alleging that she was discriminated **[*2]** against on the basis of age, race, national origin, religion and gender in violation of Title VII of the Civil Rights Act of 1964 ("Title VII"), *42 U.S.C. § 2000e, et seq.*, the Age Discrimination in Employment Act ("ADEA"), *29 U.S.C. § 621*, and *42 U.S.C. § 1983*. On November 4, 2002, defendants moved to dismiss some of Muhammad's claims. This court granted defendants' motion in part and denied it in part, dismissing (a) Muhammad's *Title VII* claim against Bolingbrook PD because Bolingbrook PD is not an "employer" within the meaning of that act, (b) her *Section 1983* claim against Bolingbrook PD because the department has no legal existence separate from the Village and, therefore, is not a "person" against whom a suit can be brought under that section, and (c) her *Title VII* and *ADEA* claims against her superior officers because there is no individual liability under those statutes.

In their initial motion, defendants did not move to dismiss Muhammad's ADEA claim against Bolingbrook PD or her *Section 1983* claim against her superior officers. In the "renewed motion" before the court, defendants now seek dismissal **[*3]** of those claims pursuant to *Federal Rule of Civil Procedure 12(b)(6)*. For the reasons stated below, defendants' renewed motion to dismiss is granted in part and denied in part. Muhammad's ADEA claim against defendant Bolingbrook PD is dismissed. Defendants' motion to dismiss Muhammad's *Section 1983* claim against her superior officers is denied.

**ANALYSIS**

[HN1]When ruling on a motion to dismiss pursuant to *Fed. R. Civ. P. 12(b)(6)*, the court accepts the factual allegations made in the plaintiff's complaint as true. *Leatherman v. Tarrant County Narcotics Intelligence and Coordination Unit, 507 U.S. 163, 164, 122 L. Ed. 2d 517, 113 S. Ct. 1160 (1993)*. The court will then consider whether any set of facts, consistent with the allegations could support plaintiff's claim for relief. *Bartholet v. Reishauer A.G., 953 F.2d 1073, 1078 (7th Cir. 1992)*. [HN2]A complaint need only contain enough facts to put the defendant on notice of the claim so that an answer can be filed. *Flannery v. Recording Indus. Assoc. of America, 354 F.3d 632, 639 (7th Cir. 2004)*. [HN3]Dismissal should be granted **[*4]** only if it is "beyond doubt" that the plaintiff cannot prove any facts to support a claim entitling plaintiff to relief. *Haines v. Kerner, 404 U.S. 519, 520-521, 30 L. Ed. 2d 652, 92 S. Ct. 594 (1972)*. In that inquiry, complaints prepared *pro se,* such as Muhammad's, are given greater latitude. *Id.*

Ordinarily, defendants' renewed motion to dismiss would be barred by *Fed. R. Civ. P. 12(g)*, which [HN4]provides that any issues or objections that the defendant fails to raise in the initial motion to dismiss are waived. *Fed. R. Civ. P. 12(b)(6)*. [HN5]The purpose of *Rule 12(g)* is to prevent litigants from unnecessarily delaying proceedings at the pleading stage by interposing their defenses piecemeal. *Donnelli v. Peters Secs. Co., 2002 U.S. Dist. LEXIS 16305, 2002 WL 2003217, *3 (N.D. Ill. Aug. 29, 2002)*. However, "a court might properly entertain [a] second motion to dismiss if convinced that it is not interposed for delay and that the disposition of the case on the merits can be expedited by doing so." *Id.* The court finds that defendants' renewed motion meets that standard: the motion does not appear **[*5]** to have been filed to delay proceedings and adjudication of this motion will narrow the issues before the court, allowing it to resolve this matter more quickly. Failure to rule would result only in unnecessary delay, expense and inconvenience for all parties. Therefore, the court will address the merits of defendants' motion.

**I. Muhammad's ADEA Claim Against Bolingbrook PD**

Bolingbrook PD argues that Muhammad's ADEA claim must be dismissed because it is not a proper defendant for such a claim. Although caselaw on ADEA claims against law enforcement agencies is sparse, defendants analogize to Title VII, pointing out that, [HN6]under that statute, police departments are neither an employer, nor a proper defendant. *E.g., McCraven v. City of Chicago, 18 F. Supp. 2d 877, 881 (N.D. Ill. 1998)*. This is so because, as this court held in dismissing Muhammad's *Section 1983* and *Title VII* claims against Bolingbrook PD, municipal police departments have no legal existence independent from the municipality that they serve. *See Chan v. City of Chicago, 777 F. Supp. 1437, 1442 (N.D. Ill. 1991)*; *Collins v. Village of Woodridge, 1995 U.S. Dist. LEXIS 15814, 1995 WL 632260,*1 (N.D. Ill. 1995)* **[*6]** . Rather, the municipality is responsible for the unlawful acts of its police department and, therefore, is the proper defendant to a Title VII claim alleging discrimination by that department. *McCraven 18 F. Supp.2d at 881*. The court finds that the same logic applies to Muhammad's ADEA claim. *See, e.g., EEOC v. AIC Sec. Investigations, Ltd., 55 F.3d 1276, 1280 (7th Cir. 1995)* (noting that [HN7]courts often apply arguments of liability to Title VII and the ADEA interchangeably). The court concludes that the Village of Bolingbrook, which is already a party to this action, is the proper defendant for Muhammad's ADEA claim and that naming Bolingbrook PD as a defendant in that claim adds nothing to Muhammad's complaint. The court, therefore, dismisses Muhammad's ADEA claim as to Bolingbrook PD.

**II. Muhammad's *Section 1983* Claims Against Her Supervisors**

Defendants also argue that Muhammad's complaint as to the individual officers should be dismissed because it "does not contain allegations against [them] in their individual capacity." However, that is not the case. Although Muhammad has not made specific factual allegations against **[*7]** each defendant by name, the gravamen of her complaint is clear. She claims that defendants denied her several promotions due to her age and gender despite her "excellent qualifications." n1 She describes her claim in great detail, identifying each of the promotions she was denied, naming the officers who received the promotion and describing the age and education of the promoted officers. While she has not specified each individual officer's role in the promotions process, she has provided enough information to place her superior officers on notice of the claims against them. The court finds that Muhammad's *Section 1983* claim meets the liberal notice pleading standard of *Fed. R. Civ. P. 8* and, therefore, defendants' motion to dismiss that claim is denied.

- - - - - - - - - - - - - - Footnotes - - - - - - - - - - - - - - -

n1 Muhammad's Title VII claims that she was discriminated against on the basis of religion, color, national origin and race have been dismissed because those claims were not raised in her complaint before the Equal Employment Opportunity Commission.

- - - - - - - - - - - - End Footnotes- - - - - - - - - - - - - -

**[*8]**

**CONCLUSION**

For the reasons stated above, defendants' motion to dismiss is granted in part and denied in part. Plaintiff's ADEA claim against defendant Bolingbrook Police Department is dismissed. Defendants' motion to dismiss Muhammad's *Section 1983* claim against her superior officers is denied.

JOAN B. GOTTSCHALL

United States District Judge

DATE: July 6, 2004

# EXHIBIT 7

In Re Enron Corporation Secur. Derivative & "ERISA" Litigation; MARK NEWBY, ET AL., Plaintiffs VS. ENRON CORPORATION, ET AL., Defendants; THE REGENTS OF THE UNIVERSITY OF CALIFORNIA, et al., Individually and On Behalf of All Others Similarly Situated, Plaintiffs, VS. KENNETH L. LAY, et al., Defendants.

MDL-1446, CIVIL ACTION NO. H-01-3624 CONSOLIDATED CASES

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

2004 U.S. Dist. LEXIS 8158

February 24, 2004, Decided
February 25, 2004, Entered

**SUBSEQUENT HISTORY:** Motion granted by, Motion denied by, Motion granted by, in part, Motion denied by, in part, Dismissed by, in part *Newby v. Enron Corp. (In re Enron Corp. Secs.), 310 F. Supp. 2d 819, 2004 U.S. Dist. LEXIS 8157* (S.D. Tex., Mar. 29, 2004)

**PRIOR HISTORY:** *Newby v. Enron Corp. (In re Enron Corp. Sec., Derivative & "ERISA" Litig.), 2003 U.S. Dist. LEXIS 25038* (S.D. Tex., Dec. 10, 2003)

**DISPOSITION:** **[*1]** ICERS' motion to intervene as a named plaintiff granted, but, at this time ICERS' motion to intervene as a class representative denied as premature.

**CASE SUMMARY**

**PROCEDURAL POSTURE:** In a securities fraud class action, movant county employee retirement system sought to intervene as a named plaintiff and as an additional class representative for purchasers in nine offerings of foreign debt securities during the relevant class period, under Fed. R. Civ. P. 23(d)(2) and 24(b)(2).

**OVERVIEW:** The foreign debt securities claims were not time-barred because they were clearly filed within the three-year statute of repose and neither the stock-issuing company's bankruptcy nor a congressional investigation into that company's collapse triggered a duty of reasonable investigation by the lead plaintiff. Moreover, the lead plaintiff had timely investigated and asserted the claims within one year of a published Private Securities Litigation Reform Act notice. The retirement system was allowed to intervene as a named plaintiff because standing was not required for permissive intervention. However, a ruling on the motion to intervene as a class representative was deferred as the court had to first address pending motions to determine which parties and claims remained in the litigation. Because of the statutory privity/seller restriction, while the retirement system was allowed to intervene as a named plaintiff, under § 12(a)(2), *15 U.S.C.S. § 77l*(a)(2), the system could only sue and serve as a class representative for other purchasers for claims against the entities that successfully sold to it or successfully solicited its purchase of notes in a particular offering.

**OUTCOME:** The motion to intervene as a named plaintiff was granted, but the motion to intervene as a class representative was denied without prejudice as premature.

**CORE TERMS:** statute of limitations, investor, purchaser, intervenor, class action, seller, time-barred, class representative, inquiry notice, intervene, limitations period, omission, motion to intervene, class certification, underwriter, juridical, entity, revive, permissive, discovery, offering, misrepresentation, one-year, typicality, motions to dismiss, subclass, timeliness, cause of action, retroactive application, retroactively

**LexisNexis(TM) Headnotes**

***Civil Procedure > Class Actions > Judicial Discretion***

[HN1]The language of Fed. R. Civ. P. 23(d)(2) empowers the court in any type of class action to encourage members of the class to intervene and present claims or defenses, or otherwise to come into the action. Pursuant to this Rule, the court has great discretion to allow intervention for two purposes: for the protection of the members of the class or otherwise for the fair conduct of the action. These two purposes mirror the two types of intervention which Fed. R. Civ. P. 24 allows intervention as of right and permissive intervention.

***Civil Procedure > Joinder of Claims & Parties > Intervention***

[HN2]See Fed. R. Civ. P. 24(b)(2).

***Securities Law > Bases for Liability > Civil Liability***

[HN3]See *15 U.S.C.S. § 77l*(a).

***Securities Law > Bases for Liability > Private Securities Litigation***

[HN4]Courts in the Second Circuit repeatedly reject as undermining the purpose of the Private Securities

Litigation Reform Act the view . a court must cobble together a lead plaintiff group that has standing to sue on all possible causes of action.

*Securities Law > Bases for Liability > Deceptive Devices*
[HN5]Only purchasers or sellers of the securities in dispute have standing to bring claims under § 10(b), *15 U.S.C.S.* § *78j*(b).

*Civil Procedure > Jurisdiction > Subject Matter Jurisdiction > Jurisdiction Over Action*
[HN6]The United States Court of Appeals for the Third Circuit holds, and whose rule is now accepted by most courts, that even though intervention contemplates an existing suit in a court of competent jurisdiction, if the original claims have been dismissed for lack of jurisdiction, a court has the discretion to treat a pleading for intervention, where the intervenor has a separate and independent basis for jurisdiction and where the failure to adjudicate the claim will only result unnecessary delay, as a separate action that may continue the suit. Furthermore if a named class representative has standing at the time a class action suit is initiated, the class action may proceed even if the class representative's claim becomes moot where the issues were capable of repetition, yet evading review.

*Securities Law > Bases for Liability > Deceptive Devices*

*Governments > Legislation > Statutes of Limitations > Time Limitations*
[HN7]A private right to bring claims under § 10(b), *15 U.S.C.S.* § *78j*(b) of the Securities Exchange Act is not explicit, but judicially implied, and there is no express statute of limitations directed to such a claim. Prior to the passage of the Public Company Accounting and Investor Protection Act of 2002 (popularly known as the Sarbanes Oxley Act of 2002), Pub. L. No. 107-204, 116 Stat. 745 (2002), regarding a private right of action under § 10(b) and Rule 10b-5, 17 C.F.R. § 240.10b-5, no action could be maintained to enforce any liability created under the statute unless brought within one year after the discovery of the facts constituting the violation and within three years after such violation. *15 U.S.C.S.* § *78i*(e).

*Securities Law > Bases for Liability*

*Governments > Legislation > Statutes of Limitations > Time Limitations*
[HN8]See *15 U.S.C.S.* § *78i*(e).

*Securities Law > Bases for Liability*

*Governments > Legislation > Statutes of Limitations > Time Limitations*
[HN9]To determine when the limitations period begins to run under *15 U.S.C.S.* § *78i*(e), most of the Circuit Courts of Appeals apply some version of the doctrine of constructive or inquiry notice. Under this doctrine, the statute begins to run when the plaintiff has actual knowledge of the facts giving rise to his claims or has notice of facts that in the exercise of reasonable diligence should have led to such knowledge.

*Securities Law > Bases for Liability*

*Governments > Legislation > Statutes of Limitations > Time Limitations*
[HN10]Some courts apply the term "storm warnings" for circumstances which would suggest to an investor of ordinary intelligence that he had been defrauded and should trigger the duty of inquiry under *15 U.S.C.S.* § *78i*(e), although they do not agree on precisely what constitutes such storm warnings. Whether the plaintiff was aware of sufficient facts to put him on inquiry notice is frequently inappropriate for resolution on a motion to dismiss under Fed. R. Civ. P. 12(b)(6).

*Securities Law > Bases for Liability*

*Governments > Legislation > Statutes of Limitations > Time Limitations*
[HN11]To the question whether the limitations period of *15 U.S.C.S.* § *78i*(e)begins to accrue on the date that sufficient storm warnings first appear or the later date on which an investor, alerted by storm warnings and thereafter exercising reasonable diligence, would have discovered the fraud, the United States Court of Appeals for the First Circuit holds that the later date controls because the purpose of a discovery rule is to protect plaintiffs who do exercise reasonable diligence regarding available information and because such a rule is fair to both plaintiffs and defendants since it prevents premature suits while still requiring that a suit be filed timely after the facts should have been discovered. This inquiry-notice or storm-warning rule (as opposed to actual notice) is the majority view.

*Securities Law > Bases for Liability*

*Governments > Legislation > Statutes of Limitations > Time Limitations*
[HN12]Deciding when a claimant is on inquiry notice for purposes of *15 U.S.C.S.* § *78i*(e) requires a fact-specific examination, and even then courts weigh those facts differently. Among the circumstances found by some courts to constitute sufficient notice to be a storm warning are disclosures in the media, a sudden drop in stock price, filing for bankruptcy, an investigation, or even warning in a prospectus.

*Securities Law > Bases for Liability > Civil Liability*

*Governments > Legislation > Statutes of Limitations > Time Limitations*
[HN13]See *15 U.S.C.S.* § *77m*.

*Securities Law > Bases for Liability > Deceptive De-*

*vices*

*Governments > Legislation > Statutes of Limitations > Time Limitations*
[HN14]See Public Company Accounting and Investor Protection Act of 2002, Pub. L. No. 107-204, Title VIII, § 804, 116 Stat. 745, 801, codified in part at *28 U.S.C.S.* § *1658*(b).

*Securities Law > Bases for Liability > Deceptive Devices*
[HN15]See *15 U.S.C.S.* § *78*(c)(47).

*Governments > Legislation > Interpretation*
[HN16]In construing a statute, a court should first address the plain language of the provision, although plain does not always mean indisputable or pellucid. The court must examine not only the text of the disputed provision, but also its relationship to the structure and the design of the statute as a whole to effect a harmonious construction. Only if the statutory language is opaque or ambiguous should the court address the legislative history for guidance in construing a provision. Indeed, legislative history should be consulted gingerly, if at all, in the aid of statutory construction. Policy considerations cannot change the interpretation of Congress's language, but they can contribute to an understanding of that language. Employing these principles, a court should adopt the most reasonable interpretation of a provision.

*Securities Law > Bases for Liability > Civil Liability*

*Governments > Legislation > Statutes of Limitations > Time Limitations*
[HN17]Court decisions addressing the question regarding claims under § 11, *15 U.S.C.S.* § *77k*, and § 12(a)(2), *15 U.S.C.S.* § *77l*(a)(2), hold that based on the text of § 804, *28 U.S.C.S.* § *1658*(b), (extending limitations period for claims involving fraud, deceit, manipulation or contrivance in language mirroring that of § 10(b), *15 U.S.C.S.* § *78j*(b), and Rule 10b-5, 17 C.F.R. § 240.10b-5), where § 11, *15 U.S.C.S.* § *77k*, and § 12(a)(2), *15 U.S.C.S.* § *77l*(a)(2), claims do not require a showing of fraudulent intent, but are based on negligence or strict liability, § 804's, *28 U.S.C.S.* § *1658*(b)'s, enlarged statute of limitations does not apply, but § 13, *15 U.S.C.S.* § *77m*, governs.

*Securities Law > Bases for Liability*

*Governments > Legislation > Statutes of Limitations > Time Limitations*
[HN18]The new statutory provision in § 804(b), *28 U.S.C.S.* § *1658*(b), clearly and unambiguously states that the two-year/five-year limitations period shall apply to all proceedings addressed by this section that are commenced on or after the date of enactment of the Public Company Accounting and Investor Protection Act of 2002 (popularly known as the Sarbanes Oxley Act of 2002), Pub. L. No. 107-204, 116 Stat. 745 (2002), i.e., July 30, 2002. The express language of the statute does not include actions already pending on the date of enactment.

*Securities Law > Bases for Liability*

*Governments > Legislation > Statutes of Limitations > Time Limitations*
[HN19]The United States District Court for the Southern District of Texas, Houston Division, finds that the unambiguous text of § 804(b), *28 U.S.C.S.* § *1658*(b), does not extend the new statute of limitations to claims in suits pending at the date of enactment. It does apply to subsequently filed actions based on underlying conduct that occurred before the enactment of the Public Company Accounting and Investor Protection Act of 2002 (popularly known as the Sarbanes Oxley Act of 2002), Pub. L. No. 107-204, 116 Stat. 745 (2002), as long as such claims were not time-barred by the Lampf statute of limitations and/or repose controlling before July 30, 2001.

*Civil Procedure > Pleading & Practice > Pleadings > Amended Pleadings*

*Civil Procedure > Pleading & Practice > Pleadings > Supplemental Pleadings*
[HN20]Supplementation of a pleading under Fed. R. Civ. P. 15(d) is used to set forth transactions or occurrences or events which have happened since the date of the pleading sought to be supplemented, relating to events that have transpired since the date of the party's most recent pleading. In contrast, amendment under Fed. R. Civ. P. 15(a) is used to modify the previous pleading's allegations about events that occurred before the pleading was filed.

*Governments > Legislation > Effect & Operation > Prospective & Retrospective Operation*
[HN21]Deciding whether a statute should be applied retroactively is not always a ministerial matter because a statute does not have a retroactive effect merely because it is applied to conduct occurring prior to its enactment; rather it has a retroactive effect if it takes away or impairs vested rights acquired under existing laws, or creates a new obligation, imposes a new duty, or attaches a new disability, in respect to transactions or considerations already past. The court must make a commonsense, functional judgment whether the new statutory provision attaches new legal consequences to events completed before its enactment and be informed and guided by considerations of fair notice, reasonable reliance, and settled expectations. Elementary considerations of fairness dictate that individuals should have an opportunity to know what the law is and conform their conduct accordingly; settled expectations should not lightly be disrupted.

***Governments > Legislation > Eff.ct & Operation > Prospective & Retrospective Operation***

[HN22]There is a three-step analysis for determining whether a new statute should apply to conduct occurring before the statute's enactment. First, the court asks whether Congress expressly proscribed the statute's proper reach. If so, that directive controls and the inquiry stops. If not, the court examines whether application of the statute has an impermissible retroactive effect, i.e., whether it impairs the rights a party possessed when he acted, increases a party's liability for past conduct, or imposes new duties with respect to transactions. If so, a traditional judicial presumption against retroactive application of the new statute to acts occurring prior to the statute's enactment applies. Although courts originally distinguished between procedural and substantive statutes, applying a lower standard to the former, such categorization is not definitive. Finally, if the court determines that Congress has not expressly indicated the statute's proper temporal reach and finds that the retroactive application of the statute impairs the rights of the party, the statute will not apply to events occurring prior to its enactment unless Congress expresses a clear intention that the statute have retroactive application or revives stale claims. If the court finds that Congress clearly intended to apply the statute retrospectively, that intent overcomes the judicial default rule.

***Governments > Legislation > Effect & Operation > Prospective & Retrospective Operation***

***Governments > Legislation > Statutes of Limitations > Extension & Revival***

[HN23]Several federal Circuits Courts of Appeals, including the United States Court of Appeals for the Fifth Circuit, in determining whether a statute that enlarges a period of limitations will be deemed to revive a claim that was time-barred before the new statute was enacted, follow the doctrine of clear statement, i.e., the new federal statute must expressly state that the legislative intent was to apply a newly enlarged limitations period retroactively and thus to revive otherwise time-barred claims.

***Securities Law > Bases for Liability***

***Governments > Legislation > Statutes of Limitations > Extension & Revival***

[HN24]The United States District Court for the Southern District of Texas, Houston Division, holds that in what the court finds is an absence of any expression of specific intent that the Public Company Accounting and Investor Protection Act of 2002 (popularly known as the Sarbanes Oxley Act of 2002), Pub. L. No. 107-204, 116 Stat. 745 (2002), should apply retroactively, either in the Act or the legislative history, the Sarbanes-Oxley Act's extended limitations period cannot revive stale claims.

***Governments > Legislation > Extension & Revival***

[HN25]While Congress may enlarge a limitations period, Congress's acts do not revive a cause of action that has become time-barred unless Congress specifically provides for retroactive application.

***Securities Law > Bases for Liability > Deceptive Devices***

***Governments > Legislation > Statutes of Limitations > Time Limitations***

[HN26]Where the limitations period of § 804, *28 U.S.C.S. § 1658,* are applicable, courts also apply the inquiry notice rule to trigger the running of the statute of limitations for § 10(b), *15 U.S.C.S. § 78j*(b), claims.

***Securities Law > Bases for Liability > Civil Liability***

***Governments > Legislation > Statutes of Limitations > Tolling***

[HN27]Lower courts, swayed by Congress's enactment of § 13, *15 U.S.C.S. § 77m,* of the Securities Act of 1933 with its express standard of inquiry, hold that the running of the one-year statute of limitations may be stayed if, and as long as, the plaintiff exercises reasonable care and diligence in investigating the facts what would disclose fraud, while concluding that the doctrine of equitable tolling does not apply to the three-year period of repose in securities fraud cases.

***Securities Law > Bases for Liability > Civil Liability***

***Securities Law > Bases for Liability > Deceptive Devices***

***Governments > Legislation > Statutes of Limitations > Tolling***

[HN28]Courts hold that equitable tolling not only does not apply to the three-year period of repose for claims under § 10(b), *15 U.S.C.S. § 78j*(b), in § 9(e), *15 U.S.C.S. § 78i*(e) of the Securities Exchanged Act of 1934, but also to the three-year statute of repose in § 13, *15 U.S.C.S. § 77m,* for claims under § 11, *15 U.S.C.S. § 77k,* and § 12(a)(2), *15 U.S.C.S. § 77l*(a)(2), of the Securities Act of 1933. Indeed , § 13, *15 U.S.C.S. § 77m,* is not only a statute of limitations but also operates as a statute or repose. There is an absolute maximum of three years to prevent stale claims. Actions brought under § 12(a)(2), *15 U.S.C.S. § 77l*(a)(2), must be brought within three years of the sale forming the basis for the alleged violation. To compute the three-year repose period, the courts construe limitations as running from the date of sale, which is generally from the last of three occurrences; the date the security was offered for sale, the date it was sold, or the date it was delivered.

***Securities Law > Bases for Liability > Civil Liability***

***Governments > Legislation > Statutes of Limitations >***

*Time Limitations*
[HN29]The three-year period for claims under § 12(a)(2), *15 U.S.C.S.* § 77*l*(a)(2), begins to run at the time of the sale, when the investor executes a subscription agreement and tenders his payment.

***Securities Law > Bases for Liability > Civil Liability***

***Governments > Legislation > Statutes of Limitations > Time Limitations***
[HN30]The United States District Court for the Southern District of Texas, Houston Division, finds that the one-year/three-year limitations structure identified in caselaw applies to claims under the Securities Exchange Act of 1934, and that § 13, *15 U.S.C.S.* § *77m*, applies to the negligence-based claims under § 12(a)(2), *15 U.S.C.S.* § 77*l*(a)(2), of the Securities Act of 1933.

***Civil Procedure > Pleading & Practice > Pleadings > Amended Pleadings***

***Governments > Legislation > Statutes of Limitations > Time Limitations***
[HN31]When a plaintiff moves to amend to add a new defendant to a pending suit, the date of the filing of the motion for leave to amend constitutes the date the action was commenced for purposes of the statute of limitations.

***Constitutional Law > The Judiciary > Case or Controversy***
[HN32]Under U.S. Const. art. III, § 2, federal court jurisdiction is restricted to resolving cases and controversies. U.S. Const. art. III, § 2, cl. 1. This judicially developed doctrine ensures the presence of the concrete adverseness which sharpens the presentation of issues upon which the court so largely depends for illumination of difficult constitutional questions. Moreover the case or controversy requirement relates to the properly limited role of the unelected, unrepresentative judiciary in a democratic society based on a separation of powers doctrine.

***Constitutional Law > The Judiciary > Case or Controversy > Standing***
[HN33]To satisfy the constitutional requirements of standing under U.S. Const. art. III, the party invoking federal jurisdiction has the burden at minimum to demonstrate three elements. First, he must have suffered an injury in fact, an invasion of a legally protected interest that is (1) concrete and particularized, and (2) actual or imminent, not conjectural or hypothetical. Second, there must be a causal connection between the injury and the conduct complained of. Third, it must be likely, as opposed to merely speculative, that the injury will be redressed by a favorable decision. To show causation, a plaintiff must demonstrate that his injury is fairly traceable to the challenged action of the defendant, and not the result of the independent action of some third party. The district court must examine standing and class certification on a claim-by-claim basis.

***Civil Procedure > Justiciability > Standing***
[HN34]The jurisdictional issue of standing may be raised sua sponte despite the parties' failure to raise it. The burden of establishing standing, which rests on the party invoking federal court jurisdiction, varies depending upon the stage at which standing becomes an issue. At the pleading stage, the court looks only to the sufficiency of the allegations. In response to a summary judgment, however, the plaintiff can no longer rest on such mere allegations, but must adduce evidence in support of the elements of standing. At the final stage of the litigation, standing must be supported adequately by the evidence offered at trial.

***Civil Procedure > Justiciability > Standing***
[HN35]In addition to constitutional limitations, there are judge-crafted prudential limitations to the standing doctrine and the court's exercise of jurisdiction, such as the general prohibition on raising a third party's legal rights, preclusion of the adjudication of generalized grievances or abstract issues of substantial public significance that should more appropriately be addressed by the legislative branch, and the rule that a plaintiff's claims fall within the zone of interests protected by the law the plaintiff invokes.

***Civil Procedure > Justiciability > Standing***

***Securities Law > Bases for Liability > Private Securities Litigation***
[HN36]A modification of the general rule of standing is necessary where a lead plaintiff in a class action securities case, preferably an institution with the largest financial interest in the action selected pursuant to the criteria of the Private securities Litigation Reform Act of 1995, is authorized by statute to bring suit on behalf of the whole class even though it may not have purchased every type of security that others in the class hold, as long as a representative plaintiff with standing to sue on each class or subclass can be designated at class certification time.

***Constitutional Law > The Judiciary > Case or Controversy > Standing***
[HN37]The United States Court of Appeals for the Fifth Circuit expressly rejects the view that intervenors who lack standing destroy a court's jurisdiction over a case and the view that intervenors must have standing because they seek to be on equal footing with the original litigants in a case. Instead, it concludes that the better reasoning is to be found in cases which hold that U.S. Const. art. III does not require intervenors to possess standing because they recognize that Article III standing serves primarily to guarantee the existence

of a case or controversy approp. for judicial determination and that Article III does not require each and every party in the case to have such standing. Rather, once a valid Article III case-or-controversy is present, the court's jurisdiction vests. The presence of additional parties, although they alone could independently not satisfy Article III's requirements, does not of itself destroy jurisdiction already established.

***Civil Procedure > Justiciability > Standing***

***Civil Procedure > Class Actions***

***Constitutional Law > The Judiciary > Case or Controversy > Standing***
[HN38]Where statutory standing is at issue, class certification issues are logically antecedent to U.S. Const. art. III concerns, and themselves pertain to statutory standing, which may properly be treated before Article III standing. In cases in which statutory standing is involved, the court may address statutory standing before Article III standing.

***Civil Procedure > Class Actions > Prerequisites***
[HN39]Under Fed. R. Civ. P. 23(a), the prerequisites for class certification are (1) numerosity (a class so large that joinder of all members is impracticable), (2) commonality (questions of law or fact common to the class), (3) typicality (named parties' claims or defenses are typical of the class), and (4) adequacy of representation (representative will fairly and adequately protect the interests of the class). Plaintiffs must also demonstrate that the class action may proceed under one of the categories of Fed. R. Civ. P. 23(b).

***Civil Procedure > Class Actions > Prerequisites***
[HN40]The commonality, typicality, and adequacy-of-representation requirements of Fed. R. Civ. P. 23(a) tend to overlap and to merge because they serve as guideposts for determining whether the named claimant and the class claims are so inter-related that the interests of the class members will be fairly and adequately protected in their absence.

***Civil Procedure > Class Actions > Prerequisites***
[HN41]In the context of a motion for class certification, the standard for commonality is not high, but merely requires that the resolution of common questions affect all or a substantial number of the class members. Indeed, all that is required for each class is that there is one common question of law or fact: The interests and claims of the various plaintiffs need not be identical. Rather the commonality test is met when there is at least one issue whose resolution will affect all or a significant number of all putative class members. Therefore, the fact that some of the plaintiffs may have different claims or claims that may require some individualized analysis, is not fatal to commonality.

***Civil Procedure > Class Actions > Prerequisites***
[HN42]A class rep...ntative must be a member of the class, possess the same interest, and suffer the same injury as class members. The typicality test is not demanding. It focuses on the similarity between the named plaintiffs' legal and remedial theories and the theories of those whom they purport to represent. Typicality does not require a complete identity of claims. Rather the critical inquiry is whether the class representative's claims have the same essential characteristics of those of the putative class. If the claims arise from the same course of conduct and share the same legal theory, factual differences will not defeat typicality.

***Civil Procedure > Class Actions > Prerequisites***
[HN43]Typicality involves the individual plaintiff's U.S. Const. art. III standing to pursue his own personal claim and to raise the legal claims of the class. Typicality focuses less on the relative strengths of the named and unnamed plaintiffs' cases than on the similarity of the legal and remedial theories behind their claims. The typicality inquiry is intended to assess whether the action can be efficiently maintained as a class and whether the named plaintiffs have incentives that align with those of absent class members so as to assure that the absentees' interests will be fairly represented. Neither commonality nor typicality requires that all putative class members share identical claims.

***Civil Procedure > Class Actions > Prerequisites***
[HN44]As for adequacy of representation under Fed. R. Civ. P. 23(a), differences between named plaintiffs and class members render the named plaintiffs inadequate representatives only if those differences create conflicts between the named plaintiffs' interests and the class members' interests.

***Civil Procedure > Class Actions > Prerequisites***
[HN45]Where there is a prominent thread through all plaintiffs' claims, e.g., a scheme to defraud where the plaintiffs have suffered the same generic type of harm as a result of the same common, wrongful conduct (material misrepresentations and omissions) and have suffered economic damage, some courts find that the scheme may demonstrate that the claims of the named plaintiffs are typical of the class as a whole. The various forms which the injuries may take do not negate a finding of typicality, provided the cause of those injuries is some common wrong.

***Civil Procedure > Class Actions > Prerequisites***
[HN46]There is an exception to the requirement that representative plaintiffs must have individual standing to assert colorable claims against all members of the defendant class where the defendant members are related by a concerted scheme, conspiracy, or juridical link, that is some legal relationship which relates all

defendants in a way such single resolution of the dispute is preferred to a multiplicity of similar actions. A juridical link sufficient to confer standing generally must stem from an independent legal relationship. It must be some form of activity or association on the part of the defendants that warrants imposition of joint liability against the group even though the plaintiff may have dealt primarily with a single member. This link may be a conspiracy, partnership, joint enterprise, agreement, contract, or aiding and abetting, which acts to standardize the factual underpinnings of the claims and to insure the assertion of defenses common to the class.

***Civil Procedure > Justiciability > Standing***

***Civil Procedure > Class Actions > Prerequisites***
[HN47]The fundamental requirement is that each plaintiff have standing to sue each defendant. A predicate to a plaintiff's right to represent a class is his eligibility to sue in his own right. What he may not achieve himself, he may not accomplish as a representative of a class. The procedural expedient of plaintiff class certification should not be mistaken for the sort of legal relationship that confers standing on representative to litigate the claims of individual members. A plaintiff may not use the procedural device of a class action to boot strap himself into standing he lacks under the express terms of the substantive law. The plaintiff's standing to bring an action against each defendant named in the complaint must be established independently of Fed. R. Civ. P. 23. Only then is a plaintiff in a position to represent others having similar claims against those same defendants.

***Civil Procedure > Class Actions > Prerequisites***

***Securities Law > Bases for Liability > Civil Liability***
[HN48]Unlike plaintiffs suing under § 10(b), *15 U.S.C.S.* § *78j*(b), which does not require privity, despite allegations of a concerted scheme or wrongful course of conduct, the express substantive statutory requirement of § 12(a)(2), *15 U.S.C.S.* § *77l*(a)(2), that the defendant must be a seller, even under the judicial expansion of the definition of that word, to the plaintiff who sues that defendant, restricts the class of defendants whom or which a particular plaintiff has standing to sue individually and therefore also as a representative for a putative class of investors. A plaintiff bringing suit under either § 11, *15 U.S.C.S.* § *77k*, or § 12, *15 U.S.C.S.* § *77l*, of the Securities Act of 1933 at least must allege that he or she purchased or acquired the security at issue. Furthermore, for a claim under § 12(a)(2), *15 U.S.C.S.* § *77l*(a)(2), which provides for liability against sellers or against parties that actively, directly and successfully solicited the purchase of the security in dispute, pursuant to a prospectus, absent an allegation of direct contact between defendants and plaintiff-purchasers, as a matter of law the defendants are not statutory sellers.

***Securities Law > Bases for Liability > Civil Liability***
[HN49]There is no support in the statutory language or legislative history for expansion of § 12(1), *15 U.S.C.S.* § *77l*(1), liability beyond those who pass title and persons who offer, including those who solicit offers. Indeed, § 12's, *15 U.S.C.S.* § *77l*'s, failure to impose express liability for mere participation in unlawful sales transactions suggests that Congress did not intend that the section impose liability on a participant's collateral to the offer or sale.

***Securities Law > Bases for Liability > Civil Liability***
[HN50]The "offers or sells" and the "purchasing such security from him" language that governs § 12(1), *15 U.S.C.S.* § *77l*(1) also governs § 12(2), *15 U.S.C.S.* § *77l*(2), which provides a securities purchaser with a similar rescissionary cause of action for misrepresentation. *15 U.S.C.S.* § *77l*.

***Securities Law > Bases for Liability > Civil Liability***
[HN51]The United States District Court for the Southern District of Texas, Houston Division, finds relevant to requiring a plaintiff to restrict its claims to its substantive "seller" defendants is the fact that § 12(a)(2), *15 U.S.C.S.* § *77l*(a)(2), unlike § 10(b), *15 U.S.C.S.* § *78j*(b), does not provide for joint and several liability. Moreover, recovery under the statute is in the nature of rescission, a remedy arising from common law, suggesting it is limited to parties to a transaction/contract or the seller's direct agent.

***Securities Law > Bases for Liability > Deceptive Devices***
[HN52]The United States District Court for the Southern District of Texas, Houston Division, believes that a common-course-of-conduct rule is properly applied in claims under § 10(b), *15 U.S.C.S* § *78j*(b), for which Rule 10b-5, 17 C.F.R. § 240.10b-5, makes it unlawful for any person, directly or indirectly, to employ any scheme to defraud or to engage in any practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security, but not to claims under § 12(a)(2), *15 U.S.C.S.* § *77l*(a)(2).

***Civil Procedure > Justiciability > Standing***

***Civil Procedure > Class Actions > Prerequisites***
[HN53]A named plaintiff must have standing to serve as a class representative.

***Civil Procedure > Joinder of Claims & Parties > Intervention***
[HN54]See Fed. R. Civ. P. 24(b)(2).

***Civil Procedure > Joinder of Claims & Parties > Intervention***
[HN55]The principal consideration in a court's exer-

cise of discretion under Fed. R. Civ. P. 24(b) is whether the intervention will unduly delay or prejudice the adjudication of the rights of the original parties.

*Civil Procedure > Joinder of Claims & Parties > Intervention*
[HN56]The United States Court of Appeals for the Fifth Circuit concludes that a motion for leave to intervene under Fed. R. Civ. P. 24(a) (intervention by right) or 24(b) (permissive intervention) must be timely, a determination committed to the court's discretion. Timeliness is not limited to chronological considerations, but is to be determined from all the circumstances. The court must consider four factors in reviewing the timeliness of a motion for leave to intervene under Fed. R. Civ. P. 24: (1) the length of time during which the would-be intervenors actually knew or should have known of their interest in the case before they filed their motion to intervene; (2) the degree of prejudice that existing parties would suffer as a result of the would-be intervenors' failure to intervene as soon as they actually knew or reasonably should have known of their interest in the case; (3) the degree of prejudice that the applicant-intervenors would suffer if their motion to intervene were denied; and (4) any unusual circumstances that would weigh for or against a determination that the motion was timely, i.e., a convincing justification for tardiness.

*Civil Procedure > Joinder of Claims & Parties > Intervention*
[HN57]For purposes of Fed. R. Civ. P. 24, knowledge of the pendency of the litigation is not sufficient by itself to require immediate motion to intervene; scarce judicial resources would be squandered, and the litigation costs of the parties would be increased if such were the rule, causing premature filing, while many individuals who excusably failed to appreciate the significance of a suit at the time it was filed would be barred from intervening to protect their interests when its importance became apparent to them later on. Rather than the date when the would-be intervenor became aware of the litigation, the relevant circumstance would be when it became aware that its interest would no longer be adequately protected by the parties.

*Civil Procedure > Joinder of Claims & Parties > Intervention*
[HN58]A two-step analysis is applied to determine whether permissive intervention under Fed. R. Civ. P. 24(b)(2) should be granted: (1) the court must determine whether the applicant's claim or defense and the main action have a question of law or fact in common; (2) if they do have a question of law or fact in common, the court must decide in its discretion whether the intervention should be allowed.

*Civil Procedure > Joinder of Claims & Parties > Intervention*
[HN59]Generally courts appear to be particularly amenable to permissive intervention when no additional issues are presented to the case, when the intervenor's claims are virtually identical to class claims, and when intervention would strengthen the adequacy of class representation. Indeed, unlike Fed. R. Civ. P. 24(a), intervention as of right, which allows a party to intervene only where its interests are not adequately represented by current parties, Fed. R. Civ. P. 24(b) contains no such restriction.

*Civil Procedure > Joinder of Claims & Parties > Intervention*

*Civil Procedure > Class Actions > Prerequisites*
[HN60]The United States Court of Appeals for the Fifth Circuit approves the addition of plaintiffs to better represent potential subclasses where the named plaintiffs are not inadequate representatives. It states that this principle should be applied to allow permissive intervention to make the class representation even stronger and to protect the class members most completely.

*Civil Procedure > Pleading & Practice > Pleadings > Amended Pleadings*
[HN61]Under Fed. R. Civ. P. 15(a), once a response to a complaint has been filed, amendment of a pleading must be by leave of court. The rule limits the court's discretion by directing that leave to amend shall be given freely when justice so requires, reflecting a bias in favor of granting leave to amend. The policy of the Federal Rules of Civil Procedure is to permit liberal amendment to facilitate determination of claims on the merits and to prevent litigation from becoming a technical exercise in the fine points of pleading. Reasons substantial enough to justify denial of leave to amend include undue delay, bad faith or dilatory motive on the part of the movant, repeated failure to cure deficiencies by amendments previously allowed, and undue prejudice to the opposing party. If such reasons exist, the court may also consider any prejudice that might arise because of a denial of leave to amend. It may also consider judicial economy and the most efficient means to resolve the merits of the suit.

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**JUDGES:** MELINDA HARMON, UNITED STATES DISTRICT JUDGE.

**OPINIONBY:** MELINDA HARMON

**OPINION: MEMORANDUM AND ORDER**

**RE IMPERIAL COUNTY EMPLOYEES RETIREMENT SYSTEM'S MOTION TO INTERVENE**

Pending before the Court is Imperial County Employees Retirement System's ("ICERS'") motion to intervene as plaintiff and as additional class representative for purchasers in nine offerings of Foreign Debt Securities n1 during the *Newby* Class Period, under Federal Rules of Civil Procedure 23(d)(2) and 24(b)(2) n2 (instrument # 1630).

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n1 The Foreign Debt Securities were issued from September 1999 through July 2001, were sold in a series of offerings in Europe during 2000 and 2001, and were listed and traded upon the Luxembourg stock exchange. *See* First Amended Consolidated Complaint (# 1388) at PP 641.1-641.2. They are described in detail in the controlling complaint from pages 409-49, PP 641.1-641.44.

**[*3]**

n2 [HN1]Rule 23(d)(2) "empowers the court in any type of class action to encourage members of the class 'to intervene and present claims or defenses, or otherwise to come into the action ....'" *Vuyanich v. Republic Nat'l Bank of Dallas, 82 F.R.D. 420, 436 (N.D. Tex. 1979)*, quoting Rule 23(d)(2). Pursuant to this Rule, the court has great discretion to allow intervention for two purposes: "'for the protection of the members of the class or otherwise for the fair conduct of the action ....'" *Id. at 437.* "These two purposes mirror the two types of intervention which Rule 24 allows intervention as of right and permissive intervention." *Id.*

Rule 24(b)(2), relating to permissive intervention, provides in relevant part, [HN2]"Upon timely application any one may be permitted to intervene in an action ... when an applicant's claim or defense and the main action have a question of law or fact in common ... In exercising its discretion the court shall consider whether the intervention will unduly delay or prejudice the adjudication of the rights of the original parties."

As will be discussed, while ICERS requests intervention as both a named plaintiff and a class representative, the requirements for intervening as a plaintiff are distinct from those for intervening as a class representative.

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**[*4]**

The motion to intervene was initially filed with co-Movant IHC Health Plans, Inc. ("HPI") and joined by Deseret Mutual Benefit Administrators ("Deseret") (# 1680) in order to represent more broadly the interests of the class, but they have both since withdrawn (# 1724). Opposition to the motion has been filed by Conseco Annuity Assurance Company n3 ("Conseco") (# 1653, relating to its class action suit, H-03-2240, and # 1592, relating to H-03-860 and H-03-2240 n4 ), Outside Directors (# 1681) n5, Bank Defendants n6 (# 1719), and Vinson & Elkins L.L.P. (simply adopting the former two) (# 1729).

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n3 As will be explained, Conseco's claims against Citigroup and Citigroup subsidiaries are based on losses arising from the purchase of "Credit Linked Notes" ("CLNs") issued by, in the name of, and for the benefit of Citigroup.

In # 1592 at 2 n.2, Conseco explains that the CLNs were issued by trusts created by Citigroup. They included the following securities:(a) Yosemite Securities Trust I 8.25% Series 1999-A Linked Enron Obligations maturing November 15, 2003, issued in the aggregate amount of $ 750,000,000 on or about November 4, 1999 ("Yosemite I Notes"); (b) Yosemite Securities Trust II 8.75% Series 2000 Linked Enron Obligations maturing February 2007, issued in the aggregate amount of 200,000,000 [English pounds] on or about February 23, 2000 ("Yosemite II Notes"); (c) Credit Linked Notes Trust 8% Notes maturing August 15, 2005, issued in the aggregate amount of 200,000,000 [English pounds] on or about August 25, 2000 ("ECLN Notes"); (d) Credit Linked Notes Trust II 7 3/8% Notes maturing May 15, 20006, issued in the aggregate amount of $ 500,000,000 on or about May 24, 2001 ("ECLN II Notes"); (e) Enron Sterling Credit Linked Notes Trust 7 1/4% Notes maturing May 24, 2006, issued in the aggregate amount of 125,000,000 [English pounds] on or about May 24, 2001 ("Sterling CLN Notes"); and (f) Enron Euro Credit Linked Notes Trust 6 1/2% Notes maturing May 24, 2006, issued in the aggregate amount of 200,000,000 Euro on or about May 24, 2001 ("Euro CLN Notes").

Together the Yosemite I Notes, the Yosemite II Notes, the Yosemite III Notes, the ECLN Notes, the ECLN II Notes, Sterling CLN Notes and the Euro CLN may be collectively referred to herein as "Citigroup CLNs."

Conseco's opposition to ICERS' motion to intervene is directed at HPI, and not ICERS, which did not purchase CLNs. Both would-be intervenors sought to represent the interests of such purchasers in a larger class of all Foreign Debt Securities investors. As noted, HPI has withdrawn its request to intervene. Because ICERS and *Newby* Lead Plaintiff contend that ICERS would have standing to sue for violations relating to all Foreign Debt Securities offerings, the Court addresses Conseco's objections as if they were directed to ICERS as a potential representative of a subclass for Foreign Debt Securities.

**[*5]**

n4 Hudson Soft Company, on July 22, 2002, filed a class action suit grounded in the Racketeer Influenced and Corrupt Organizations Act ("RICO"), *18 U.S.C. §§ 1961, et seq.*, against Credit Suisse First Boston Corporation, Credit Suisse First Boston International, CSFB Europe Ltd., Donaldson, Lufkin & Jenrette Securities Corporation, Citibank N.A., Salomon Smith Barney, Inc., Schroder Salomon Smith Barney, Salomon Brothers International Ltd., Arthur Andersen L.L.P., Vinson & Elkins L.L.P., and a number of bank employees and Enron Corporation officials in the Southern District of New York. In an amended complaint filed on September 29, 2002, Hudson Soft added, as alternative causes of action, securities fraud claims under § 10(b); that same day it published notice on the *PR Newswire* as required by the PSLRA. Subsequently it filed a motion for appointment as lead plaintiff. A month later it and Conseco jointly filed a motion to be appointed lead plaintiff. On February 28, 2003, Hudson Soft and Conseco moved to sever the claims based on CSFB's Enron-linked notes from claims based on the Citigroup CLNs, with Hudson Soft indicating that it was no longer pursuing class claims but only individual claims and withdrawing from seeking lead plaintiff status. That motion to sever was granted.

On March 5, 2003, Conseco then filed a class action complaint against Citigroup and its subsidiaries and employees for violations of § 10(b), § 20A, and 20(a) of the 1934 Act and § 12 (a) and § 15 of the 1933 Act.

Both cases were transferred to this Court by the Judicial Panel for Multidistrict Litigation to be included in MDL 1446. Hudson Soft's suit was designated as H-03-860, while Conseco's class action against Citigroup entities and employees was designated as H-03-2240. The parties have recently filed a stipulation and order dismissing H-03-860 with prejudice pursuant to a Settlement and Release Agreement. H-03-2240 remains pending.

**[*6]**

n5 Outside Directors object to the intervention on limited grounds: "Though Movants do not specifically claim to do so, the Outside Directors object to the proposed intervention to the extent, if any, it purports to reassert § 10(b), Rule 10b-5, or any other claims [against Outside Directors] previously dismissed by this Court." They quote this Court's order of July 11, 2003 at 4 ("IN ALL AMENDED PLEADINGS COUNSEL SHALL NOT REITERATE ALLEGATIONS OR ARGUMENTS PREVIOUSLY REJECTED BY THIS COURT IN RULINGS ON MOTIONS TO DISMISS THE CONSOLIDATED COMPLAINTS.")

The would-be Intervenors have not responded to this objection or claimed that they are attempting to reinstate § 10(b) claims against Outside Directors. Moreover, the Court finds that the amended complaint does not assert such claims against the Outside Directors. Thus the objection is moot.

n6 Bank Defendants are composed of Bank of America Corporation, Banc of America Securities LLC, Barclays PLC, Barclays Bank PLC, Barclays Capital, Inc., Canadian Imperial Bank of Commerce, CIBC World Markets, Corp (f/k/a CIBC Oppenheimer Corp.), CIBC World Markets plc, Credit Suisse First Boston LLC (f/k/a Credit Suisse First Boston Corporation), Credit Suisse First Boston (USA), Inc., Pershing LLC, J.P. Morgan Chase & Co., J.P. Morgan Securities Inc., J.P. Morgan Chase Bank, Lehman Brothers, Inc., Lehman Brothers Holdings Inc., Merrill Lynch & Co., Inc., and Merrill, Lynch, Pierce Fenner & Smith Incorporated.

The Court notes that pursuant to an unopposed motion, it recently dismissed Lead Plaintiff's § 10(b) and § 20(a) claims against the Lehman Brothers entities. # 1969.

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**[*7]**

**WOULD-BE INTERVENOR ICERS' CONTENTIONS**

ICERS claims that it purchased certain Foreign Debt Securities n7 at artificially inflated prices within the *Newby* Class Period, i.e., October 19, 1998-November 27, 2001 according to the First Amended Consolidated Complaint (# 1388) although ICERS, like the *Newby* Lead Plaintiff, asserts claims under § 10(b) of the Securities Exchange Act of 1934, ICERS explains that if the Court grants its motion, the intervention would cure any perceived defects relating to Lead Plaintiff's standing to assert the First Amended Consolidated Complaint's § 12(a)(2) claims n8 under the Securities Act of 1933 on behalf of all purchasers of all Foreign Debt Securities during the Class Period.

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n7 According to schedule A, attached to ICERS and HPI's motion to intervene, ICERS purchased Marlin Water Trust II notes at two different offerings: the first, an investment of $ 345,000 on July 12, 2001, and then another, also for $ 345,000 on December 10, 2001. Thus it purchased in only one of the nine Foreign Debt Securities Offerings listed in the complaint (# 1388 at 409, P 641.2). There were a number of underwriters for the Marlin Water Trust II notes: Credit Suisse First Boston, Deutsche Bank Securities, Inc. f/k/a Deutsche Bank Alex. Brown, Banc of America Securities LLc, CIBC World Markets plc, and J.P. Morgan. # 1388 at 410, P 641.2. ICERS does not identify the underwriter from which it purchased its notes.

Although Defendants, in briefing related to their motions to dismiss, argue in detail that § 12(a)(2) does not govern the offering of the Marlin Water Trust II notes because the statute applies only to public offerings made pursuant to a prospectus under *Gustafson v. Alloyd Co., 513 U.S. 561, 577, 131 L. Ed. 2d 1, 115 S. Ct. 1061 (1995)*, the question is only conclusorily mentioned in the briefing related to the motion to intervene. The Court therefore defers ruling on the question until it addresses the Bank Defendants' motions to dismiss.

**[*8]**

n8 Section 12(a)(2), *15 U.S.C.* § *77l*(a)(2), which prior to recodification in 1995, was designated § 12(2), *15 U.S.C.* § *77l*(2), provides, "[HN3]Any person ... who offers or sells ... shall be liable ... to the person purchasing such security from him ..." for false and misleading statements or omissions in or from prospectuses or other selling communications. *15 U.S.C.*

*136 F.R.D. 466, 474 (N.D. Ill. 1991)*; *In re Prudential Sec. Inc. Ltd. Partnership Litig., 163 F.R.D. 200, 208 (S.D.N.Y. 1995)* (and other cases cited therein). *See also In re American Continental Corp./Lincoln Sav. & Loan Sec. Litig., 794 F. Supp. 1424, 1461 (D. Ariz. 1992)* (in response to a challenge that plaintiff class "has no standing under Sections 10(b), 11 and 12 because there is not a named plaintiff representing each of the different securities at issue," the court concluded, "Plaintiffs need not name a representative for each subgroup of securities where common issues predominate as to all securities.").

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n9 This Court notes that the claims in *Trief* were based on § 10(b) and § 20(a) of the 1934 Act and Rule 10b-5 and on common law fraud and negligent misrepresentation. Those in *Bromley* were based on the First and Fourteenth Amendments and *42 U.S.C. § 1983*. Thus neither dealt with § 12(2) of the 1933 Act.

n10 The claims in *Longden* arose under § 10(b), RICO, and common law fraud, but not § 12(2).

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**[*14]**

As additional authority for granting ICERS' request to intervene, ICERS cites decisions in two complex, federal securities class actions granting motions of lead plaintiffs to add named plaintiffs with standing to assert particular claims under the 1933 Act where the lead plaintiff's standing regarding such claims was challenged: *In re Initial Pub. Offering Sec. Litig., 214 F.R.D. 117, 122-23 (S.D.N.Y. 2002)* ("In order for a claim to be asserted on behalf of a putative class, only the named plaintiffs--but not necessarily the lead plaintiff--must have standing"; "It stands to reason that in many cases ... the plaintiff with the largest financial interest [lead plaintiff under PSLRA n11 requirements] may not have standing to sue on all causes of action. There is nothing to suggest that, in those cases, Congress intended that plaintiffs must file an entirely separate class action suit, when in any other context, a subclass would suffice.") n12; *In re Northwestern Corp. Sec. Litig., 299 F. Supp. 2d 997*, Order at 1006, 1008(noting that a lead plaintiff is selected by means of "the largest financial stake inquiry," the court stated, while it may be favorable, it is not a requirement **[*15]** that a lead plaintiff under the PSLRA suffer losses on each type of security that may be at issue in the class action. "'The purpose of the lead plaintiff section of the PSLRA was never to do away with the notion of class representatives or named plaintiffs in securities class actions. Rather, the purpose was to ensure that the securities litigation was investor-driven, as opposed to lawyer driven.'" (*quoting In re Initial Public Offering, 214 F.R.D. at 123*, which held that a "'named plaintiff' survives in securities class actions distinct from the PSLRA-defined 'lead plaintiff.'") (D.S.D. Oct. 15. 2003) (Ex. 2 to # 1804) and *In re WorldCom Inc. Sec. Litig., 294 F. Supp. 2d 392, 2003 WL 21219049*, at *405 (S.D.N.Y. May 19, 2003) ("The Underwriter Defendants have not shown there is any legal bar to a lead plaintiff asking other plaintiffs to join a lawsuit as named plaintiffs in order to represent more broadly the interests of the class at the time of the filing of the consolidated class complaint. Long before passage of the PSLRA, it was well established that named plaintiffs may jointly represent the class and it is their claims that determine whether **[*16]** there is standing to bring the claims alleged on behalf of the class. n13 "). Thus if the lead plaintiff is not required to have standing, i.e., to have invested in and suffered a loss, for each type of security involved in the suit, it makes no sense to deny him the right to join named plaintiffs and class representatives who can fulfill that requirement, argues ICERS.

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n11 Private Securities Litigation Reform Act of 1995, which amended both the Securities Act of 1933 and the Securities Exchange Act of 1934. *15 U.S.C. § 78u-4*.

n12 Distinguishing a lead plaintiff under the PSLRA from a Class Representative under Federal Rule of Civil Procedure 23, United States District Court Judge Scheindlin noted that [HN4]courts in the Second Circuit have repeatedly rejected as undermining the purpose of the PSLRA the view that a court must cobble together a lead plaintiff group that has standing to sue on all possible causes of action." *214 F.R.D. 117* at *123, *citing In re Razorfish, Inc. Sec. Litig., 143 F. Supp.2d 304, 308 (S.D.N.Y. 2001)* ("To allow an aggregation of unrelated plaintiffs to serve as lead plaintiffs defeats the purpose of choosing a lead plaintiff."); *In re Crayfish Co. Sec. Litig., 2002 U.S. Dist. LEXIS 10134*, No. 00 CIV. 6766, 2002 WL 1268013, *5 (S.D.N.Y. June 6, 2002) (and cases cited therein).

**[*17]**

n13 *Citing In re Initial Pub. Offering*

§ *77l*(a). *Maher v. Durango Metals, Inc., 144 F.3d 1302, 1303 n.1 (10th Cir. 1998)* (noting recodification of § 12(2) as § 12(a)(2) following the addition of another subsection under PSLRA). As will be discussed later in greater depth, a § 12(a)(2) "seller" includes either the person who actually passes title to the buyer or "the person who successfully solicits the purchase, motivated in part by a desire to serve his own financial interests or those of the securities owner." *Pinter v. Dahl, 486 U.S. 622, 647, 100 L. Ed. 2d 658, 108 S. Ct. 2063 (1988).*

------------ End Footnotes- - - - - - - - - - - - -

Objections have been raised that ICERS lacks standing to assert claims on behalf of any class members **[*9]** who invested in Foreign Debt Securities other than the type and offering in which ICERS purchased, i.e., Marlin Water Trust II offered on 7/12/01. In its reply memorandum (# 1804 at 2), ICERS disagrees and cites *Sanders v. Robinson Humphrey/American Express, 634 F. Supp. 1048, 1057, on reconsideration on other grounds, 1986 U.S. Dist. LEXIS 23066, 1986 WL 10096 (N.D. Ga. 1986), aff'd in part and rev'd in part on other grounds sub nom. Kirkpatrick v. J.C. Bradford & Co., 827 F.2d 718 (11th Cir. 1987), cert. denied, 485 U.S. 959, 99 L. Ed. 2d 421, 108 S. Ct. 1220 (1988)* (where claims were raised under § 10(b) of the 1934 Act and §§ 11 and 12(a)(2) of the 1934 Act), in which the district court stated,

Even though class members purchased different Petro-Lewis limited partnership interests, the plaintiffs allege that Defendants engaged in a uniformly fraudulent course of conduct, disseminated virtually identical false prospectuses, false financial statements and other financial information, and failed to disclose material information regarding operations of Petro-Lewis to purchasers during the class period. When plaintiffs have alleged such a common course of conduct, courts **[*10]** have consistently found no bar to class certification even though members of a class may have purchased different types of securities.

Moreover, "a class of plaintiffs who purchased different types of securities may properly be certified with a representative party who purchased only one type of security." *Endo v. Albertine, 147 F.R.D. 164, 167 (N.D. Ill. 1993)* (in accord with "better-reasoned" view that where a proposed class representative's claims arise from same event or practice or course of conduct giving rise to other class members' claims, are based on same legal theory, and arise from issuance of prospectuses equally applicable to different types of securities purchased by different class members, proposed class representative may represent all such purchasers).

Contending that the objection to its standing to represent a Foreign Debt Securities class is premature, ICERS also points to and emphasizes this Court's order of August 7, 2002 at 6, stating that the Court would deal with issues regarding standing and the creation of classes or subclasses at class certification time. # 1804 at 1. Nevertheless, in response to Defendants' challenge that no **[*11]** currently named *Newby* plaintiff had bought Foreign Debt Securities, ICERS explains that "out of an abundance of caution, and in an effort to properly meet its mandate to control and direct the litigation, Lead Plaintiff has sought to intervene ICERS. Once intervention is approved, ICERS can properly serve as a representative for all purchasers of Foreign Debt Securities." # 1804 at 2. *See Trief v. Dun & Bradstreet, 144 F.R.D. 193, 203 (S.D.N.Y. 1992)* (in a securities fraud class action where plaintiffs sought to intervene a later purchaser of shares, the court concluded that "important policy considerations support [intervenor's] inclusion because [his] presence will ensure that all interested plaintiffs are represented"); *Bromley v. Michigan Educ. Ass'n, 178 F.R.D. 148, 158-60 (E.D. Mich. 1998)* (relying on *Trief*). n9 ICERS underlines the fact that every Enron security investor "was defrauded by the very same scheme. And the statements at issue in the offering memoranda for the Foreign Debt Securities are the same as those in claims the Court has already upheld." # 1804 at 3 (listing examples of statements regarding which this Court has **[*12]** previously upheld claims). ICERS further contends that "because the § 12(a)(2) claims arise from the same illegal scheme, the purchaser of any one of the Foreign Debt Securities can represent the § 12(a)(2) claims of all classes of foreign debt securities." *Id., citing Longden v. Sunderman, 123 F.R.D. 547, 550, 553 (N.D. Tex. 1988)* (investors in seven partnerships were certified to represent a class of investors in 121 separate partnership transactions over five-year period because complaint alleged a common course of fraudulent conduct by defendants employing the identical or similar misrepresentations) n10; *In re WorldCom, Inc. Sec. Litig.,219 F.R.D. 267,* Order at 280-281 (S.D.N.Y. Oct. 24, 2003) (Ex. 1 to # 1804) (noting that lead plaintiff, which did not purchase in either of the two offerings forming the basis of the § 12(a)(2) claims, "has claims based on the same Registration Statements and will have an incentive to pursue and prove many of the facts that underlie the Sections 11 and 12(a)(2) claims."). *In accord Collins v. International Dairy Queen, Inc., 168 F.R.D. 668, 674 (M.D. Ga. 1996), modified on other grounds, 169 F.R.D. 690 (M.D. Ga. 1997)*; **[*13]** *In re VMS Sec. Litig.,*

*Litig., 214 F.R.D. at 123* &.

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Furthermore, ICERS insists that its motion to intervene was timely. It was filed on August 27, 2003, a little more than three months after the First Amended Consolidated Complaint (# 1388) was filed on May 14, 2003. ICERS argues that its intervention will conserve judicial and litigant resources rather than create prejudice or delay. In support of the motion's timeliness, would-be Intervenor urges that discovery is only beginning, limiting any threat of duplication. Moreover, because would-be Intervenor has adopted the *Newby* complaint, and because it is represented by the same counsel as Newby's Lead Plaintiff, no delay or prejudice to the original parties will be caused by having to bring new counsel into the suit. *Davis v. Smith, 431 F. Supp. 1206, 1209 (S.D.N.Y. 1977)* (No prejudice results from permitting interventions where the intervenor is represented by the same attorney as plaintiffs already in the action and counsel's participation facilitates efficient adjudication of the legal **[*18]** issues), *aff'd, 607 F.2d 535 (2d Cir. 1987)*; *Demeulanaere v. Rockwell Mfg. Co., 23 F.R.D. 689, 690 (S.D.N.Y. 1957)*. ICERS further urges that because it seeks to intervene as an additional class representative, its claims clearly satisfy the Rule 23(b) requirement of common questions of law or fact for permissive intervention, even though the particular securities that ICERS purchased differ from those bought by other potential class members and *Newby* named plaintiffs, and it seeks the same relief as the *Newby* Plaintiffs. Thus intervention by ICERS as a class representative would permit the rights of the class to be more broadly represented without delaying or prejudicing the orderly process of the litigation or the rights of the existing parties. *See, e.g., Moe v. Dinkins, 533 F. Supp. 623 (S.D.N.Y. 1981), aff'd, 669 F.2d 67 (2d Cir. 1982)*.

**OBJECTIONS TO INTERVENTION**

There are two substantive challenges raised to ICERS' requested intervention, one by Conseco and one by the Bank Defendants. These objections raise two overlapping issues that require resolution before a decision can be made on ICERS' **[*19]** request for permissive intervention: (1) whether the addition of new Bank Defendants and new claims based on securities issued by Enron-related entities in the First Amended Consolidated Complaint, filed on May 14, 2003, is time-barred; (2) whether ICERS has standing to serve as a class representative for purchasers of securities in all nine Foreign Debt Securities offerings with respect to their claims under § 12(a)(2).

**A. Conseco's Objections**

The original complaint (# 1) in *Newby v. Enron* was filed on October 20, 2001 on behalf of "publicly traded debt and equity holders of Enron Corporation" who acquired their Enron securities from October 19, 1998 through November 27, 2001. n14 On April 8, 2002, the Consolidated Complaint for Violation of the Securities Laws was filed, on behalf of "purchasers of Enron Corporation's ... publicly traded equity and debt securities" during the same period. # 441 at 2, P 1. On May 14, 2003 Lead Plaintiff filed the First Amended Consolidated Complaint for Violation of the Securities Laws (# 1388), with the same class definition in the text, but with a footnote that stated, "Enron's publicly-traded securities *include the publicly-traded* **[*20]** *securities of entities related to Enron,* the repayment of which was dependent upon Enron's credit, financial condition and ability to pay [emphasis added by the court]." 1388 at 3, P 1 n. 1.

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n14 Citigroup conclusorily argues that the CLNs were not "publicly traded equity or debt securities of Enron." This issue will be fully addressed with respect to the Bank Defendants' motions to dismiss.

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Conseco argues that this "surreptitiously" revised class definition, which would embrace investors previously outside the proposed class' perimeters, in particular the purchasers of Foreign Debt Securities, constitutes an "attempt[] to artificially broaden the definition ... [to] obtain standing through the 'back door' of this class action."

Furthermore Conseco is the named plaintiff in an independent class action grounded in § 10(b) of the 1934 Act, *Conseco Annuity Assurance Co. v. Citigroup, Inc. et al.*, transferred from the Southern District of New York by the Judicial Panel for Multidistrict Litigation to **[*21]** this Court on June 26, 2003, when it was designated H-03-2240, consolidated with *Newby*, and made a part of MDL 1446. *See* footnote 3 of this memorandum and order. Conseco brought the suit on behalf of purchasers of "Credit Linked Notes" ("CLNs") issued by, in the name of, and for the benefit of Citigroup, directly against Citigroup, Citigroup subsidiaries, and Citigroup employees (*Conseco Annuity Assurance Co. v. Citigroup et al.*). n15 Purportedly the CLNs were issued to enable Citigroup to shift from Citigroup to the CLN investors the financial risk of loss associated with Citigroup's fraudulent transactions with Enron without disclosing Enron's actual financial condition; the investors claim they were fraudulently induced by Citigroup into purchasing the CLNs at artificially inflated prices between November 4, 1999 and December 3, 2001, at a loss to them of more than $ 2.4 billion. Conseco emphasizes that, unlike Lead Plaintiff in *Newby,* it has not sued Citigroup for its participation in the fraudulent Ponzi scheme alleged in *Newby,* nor for aiding and abetting Enron in that alleged misconduct, nor did it sue any Enron defendants. Instead it asserts "a 'direct' **[*22]** claim against Citigroup, who manufactures its own fraudulent scheme by which it defrauded purchasers of the Citigroup CLNs." n16

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n15 Specifically the named Defendants in H-03-2240 are Citigroup, Inc., Citibank NA, Citigroup Global Markets, Inc., Schroder Salomon Smith Barney, Salomon Brothers International Ltd., and employees Rick Caplan, James Reilly, William J. Fox, and Maureen Hendricks.

n16 The Court finds unpersuasive and spurious Conseco's tactical endeavor to distinguish the two suits by partitioning one part of the larger scheme asserted in *Newby* from the rest. The Court emphasizes that Conseco's "independent" action was transferred to this Court after careful consideration by the Multidistrict Litigation Panel for pre-trial consolidation with *Newby,* which was effected on June 26, 2003 by an order (# 6 in H-03-2240; # 1538 in *Newby*) that also sent it to the mediation before Judge William Connor. Indeed, as Lead Plaintiff has contended in its Reply Memorandum in Response to Conseco Annuity Assurance Company's Opposition to Class Certification, # 1853 at 2,Conseco's counsel is attempting to Balkanize this case by objecting to a unitary class seeking to carve out a "niche" class of purchasers, just one of the several types of debt securities that were sold by Enron and its bankers to investors during the Class Period. There is nothing unique about the legal and factual bases of the claims of the purchasers of any of the foreign debt securities that differentiates them from claims already asserted in this class action, not only for purchasers of those notes, but for purchasers of other of Enron's publicly traded debt securities. These [CLNs] were sold via offering circulars that contained the same misrepresentations and falsifications that permeated Enron's SEC filings and financial statements. The same investment banks sued by Conseco ... are already defendants in [*Newby*] and stand accused of participation in the scheme to defraud Enron's equity and debtor investors, in *inter alia,* selling these credit linked notes ...

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**[*23]**

Conseco complains that more that ten months after Conseco filed its class action, *Newby* Lead Plaintiff filed on May 14, 2003 its First Amended Consolidated Complaint, which Conseco charges "for the first time, buried in a footnote, purported to assert claims on behalf of purchasers of Citigroup CLNs." *See* First Amended Consolidated Complaint, # 1388 at 3, n.1 ("Enron's publicly-traded securities include the publicly-traded securities of entities related to Enron, the repayment of which was dependent upon Enron's credit, financial condition and ability to pay").and at 625 ("the Class includes purchasers of all securities identified herein issued by Enron-related entities during the Class Period, the value or repayment of which was dependent on the credit, financial condition or ability to pay of Enron") and n.20 (specifically identifying the Foreign Debt Securities, including Citigroup CLNs). Conseco emphasizes that "no plaintiff listed in the First Amended Consolidated Complaint was identified as ever having purchased Citigroup CLNs." Thus, maintains Conseco, the *Newby* plaintiffs lack standing to pursue these claims. Furthermore, because Conseco timely filed suit under **[*24]** the PSLRA, and is the only purchaser of the CLNs that has timely and fully complied with requirements of the PSLRA, it has moved to dismiss the CLN claims that are now merely footnoted in the *Newby* amended complaint on the grounds that the *Newby* plaintiffs lack standing to assert them and because the claims are time-barred; neither defense can be asserted by Citigroup against Conseco in Conseco's independent class action, H-03-2240, because Conseco did purchase CLNs, has standing, and timely asserted its claims. Conseco charges that with ICERS' and HPI's motion to intervene, *Newby* Lead Plaintiff seeks "to improperly gain control of a completely separate and distinct class action ... and to collect any fees that might flow from such a recovery."

In sum Conseco argues that intervention should be denied for several reasons. First, it maintains that HPI/ICERS n17 cannot satisfy the requirements for permissive intervention under Rule 24(b)(2) to represent a class of purchasers of the CLNs. Second, as noted, Conseco has timely asserted claims on behalf of the CLN investors in its separate and earlier class action suit, as a CLN purchaser Conseco has standing to pursue these [*25] claims, and Conseco is represented by qualified counsel that have vigorously been pursuing such claims, so any intervention by ICERS is unnecessary. Moreover, it maintains, intervention by HPI [ICERS] would cause extreme prejudice to the CLN plaintiff class because its claims in *Newby* would be time-barred by limitations. Furthermore, the proposed Intervenor, unlike Conseco, has never complied with the particularized pleading and Lead-Plaintiff requirements of the PSLRA and appears to be attempting to circumvent them. Moreover, Conseco has suffered damages in nearly twice the amount as those incurred by HPI, and thus Conseco has the largest financial interest in representing the class of Citigroup CLN purchasers. n18

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n17 Even though HPI has withdrawn, because ICERS argues that any purchaser of any type of the Foreign Debt Securities can represent the interests of a class or purchasers of all types of the Foreign Debt Securities, the Court summarizes the arguments directed toward HPI.

n18 Presumably this argument relates to appointment of Lead Plaintiff, which is a separate issue from that of permissive intervention or of appointment as a class representative. This Court has chosen a single Lead Plaintiff for the entire *Newby* class action, into which ICERS seeks to intervene, and it will address particularized standing and class representation issues when class certification is ripe. There is no requirement that every named plaintiff, no less putative class member, must satisfy the PSLRA requirements for pleading and must move for appointment as Lead Plaintiff with appointment of Lead Counsel.

Meanwhile, Conseco may choose to participate in *Newby*, pursue a role as a class or subclass representative in *Newby* to represent the purchasers of the CLNs, or it can choose to opt out of *Newby*, pursue its separate action (especially if it is convinced that the Foreign Securities Debt investors' claims in *Newby* are time-barred), and move for appointment as Lead Plaintiff in its independent class action. The Court finds there is no prejudice to Conseco's substantive rights from allowing intervention of ICERS as a named plaintiff to pursue its substantive rights under § 12 (a) (2) and those of any class or subclass it is qualified to represent.

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[*26]

Specifically with respect to timeliness, Conseco contends that HPI's [ICERS'] motion to intervene is untimely because HPI [or ICERS] knew or reasonably should have known (i.e., had inquiry notice) of HPI's interest in pursuing a case against Citigroup based on the CLNs by December 2, 2001, n19 when Enron declared bankruptcy, an occurrence expressly defined in the Indenture Agreements for the CLNs as an "event of default." Furthermore, the bankruptcy caused a sharp drop in the CLN price, which put the Foreign Debt Securities purchasers on actual notice of their injury. Conseco further contends that additional inquiry notice was given on July 23, 2002, the day after Conseco filed its independent class action complaint, when the United States Senate's Permanent Subcommittee on Investigations started investigating the role of financial institutions, including Citigroup, in Enron's collapse. Finally, it emphasizes that the investors again received notice of their potential claims on September 29, 2002 when Conseco published notice, pursuant to the PSLRA requirement, announcing that litigation had commenced on behalf of CLN purchasers. Yet it only moved to intervene in *Newby* on [*27] August 27, 2003, nearly twenty-four months after Enron filed for bankruptcy and long after HPI had all these reasons to know of the existence of its claims against Citigroup. n20

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n19 In their motions to dismiss Bank Defendants have urged that plaintiffs were at the very least put on inquiry notice as early as October 16, 2001 with Enron's earnings release (including $ 1 billion in charges and $ 1.2 billion reduction of shareholder's equity), followed by Enron's announcement on November 8, 2001 that it was restating its financial reports from 1997-2000, that "shocked the markets." Also that fall the SEC announced it was investigating Enron. The original *Newby* complaint was filed on October 22, 2001, followed by many more lawsuits alleging fraud against Enron and its co-Defendants. These statute-of-limitations arguments will be addressed in more detail by this Court when it reaches the Bank Defendants' motions to dismiss.

n20 As noted, these arguments relating to HPI's failure to investigate need to be modified as applied to ICERS, which did not purchase CLNs and therefore could not have intervened, no less applied to be appointed as Lead Plaintiff, in Conseco's suit. Nevertheless, the factors identified by Conseco as providing "inquiry notice" to investors in Foreign Debt Securities need to be addressed as they relate to the timeliness of the claims in Lead Plaintiff's First Amended Consolidated Complaint with its class definition specifically including these investors, and ultimately, ICERS' motion to intervene.

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**[*28]**

In contrast to the prejudice to Conseco if intervention were permitted, insists Conseco, HPI would not be prejudiced if the intervention were denied because its interests are already being vigorously represented by Conseco in its class action suit. Once again, this argument does not address non-CLN Foreign Debt Securities investors like ICERS, which could not be a member of the class in Conseco's suit.

Last, Conseco urges, "unusual circumstances," based on the same facts described earlier, n21 militate against finding the motion to intervene timely. Furthermore, Conseco notes, in the Court's June 26, 2003 order (# 6 in H-03-2240; # 1538 in *Newby*), consolidating Conseco's action with *Newby* following transfer by the Judicial Panel on Multidistrict Litigation, this Court ordered the parties in Conseco's action to participate in the mediation before Judge Connor. Conseco reports that during a hearing on July 10, 2003, Conseco's counsel raised the question of Lead Plaintiff's lack of standing in view of the revised *Newby* class definition, and counsel for Lead Plaintiff stated that CLN holders were covered under "foreign debt" and did not need a separate representative. Conseco **[*29]** charges that with the motion to intervene, filed August 27, 2003, Lead Plaintiff now seems to have changed its stance. n22

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n21 Specifically, (1) Lead Plaintiff filed the original *Newby* complaint on October 20, 2001, and the First Consolidated and Amended Complaint on April 8, 2002; (2) Conseco filed its independent class action suit on July 22, 2002; (3) ten months after Conseco had filed its complaint, Lead Plaintiff filed its First Amended Consolidated Complaint on May 14, 2003; (4) and according to Conseco, in that new pleading Lead Plaintiff "surreptitiously" redefined, or arguably clarified, the class to include the CLN purchasers, even though it did not have a plaintiff with standing to represent that class.

n22 The Court observes that this issue is a grey area of the law and Lead Plaintiff's position is supported by authority, cited previously.

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**B. Bank Defendants' Objections**

Bank Defendants also complain that Lead Plaintiff seeks "to sweep into this case nine so-called 'Foreign Debt **[*30]** Securities Offerings' that were not the basis of any claims in the prior Consolidated Complaint, filed on April 8, 2002," and that were not issued by Enron but by other entities, but that were purportedly dependent in other ways on Enron's credit rating, financial condition, and/or ability to pay.

Bank Defendants are sued under § 10(b), n23 and derivatively § 20(a), of the 1934 Act and under § 12(a)(2), and derivatively § 15, of the Securities Act of 1933. Like Conseco, they have moved to dismiss the latest Amended Consolidated Complaint for lack of standing because no currently named *Newby* plaintiff is alleged to have purchased any of the Foreign Debt Securities. Bank Defendants contend that the motions to intervene cannot be used to cure such a jurisdictional defect. n24 Second, they argue that the proposed intervention should be denied as futile because the claims are time-barred by the one-year statute of limitations. Finally, even if the Court should grant the intervention, Bank Defendants request the dismissal of all claims relating to all Foreign Debt Securities Offerings in which the proposed intervenor ICERS did not purchase based on ICERS' lack of standing.

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N23 [HN5]Only purchasers or sellers of the securities in dispute have standing to bring claims under Section 10(b). *Blue Chip Stamps v. Manor Drug Stores, 421*

*U.S. 723, 735, 44 L. Ed. ___ 539, 95 S. Ct. 1917 (1975).*

[*31]

n24 Bank Defendants cite, *inter alia, McClune v. Shamah, 593 F.2d 482, 486 (3d Cir. 1979)* (A "motion for intervention under Rule 24 is not an appropriate device to cure a situation in which plaintiffs may have stated causes of action that they have no standing to litigate."); *Ruiz v. Estelle, 161 F.3d 814, 830 (5th Cir. 1998)* (intervention is only permissible where it "is into a subsisting and continuing Article III case or controversy and the ultimate relief sought by the intervenors is also being sought by at least one subsisting party with standing to do so."), *cert. denied sub nom. Ruiz v. Culberson, 526 U.S. 1158, 144 L. Ed. 2d 213, 119 S. Ct. 2046 (1999)*; *Fleming v. Lind-Waldock & Co., 922 F.2d 20, 26 (1st Cir. 1990)* (intervention is not available to "cure" standing deficiency); *In re Elscint Ltd. Sec. Litig., 674 F. Supp. 374, 382 (D. Mass. 1987)* (denying intervention of actual purchasers of stock where nominal plaintiffs lacked standing to represent class); *Lidie v. State of Cal., 478 F.2d 552, 555* (9th Cir, 1973) (intervention, when used where the original plaintiffs lacked standing to represent a class, as a "back-door attempt to begin the action anew," should be denied where original plaintiffs were unsuited to litigate the claims on behalf of the class).

The Court finds that these cases are distinguishable from the action before this Court or that Defendants' reading of these cases requires clarification and supplementation.

First, *McClune* was not a class action, a significant factor, as will be discussed. *Warden v. Crown American Realty Trust, 1998 U.S. Dist. LEXIS 16194,* No. CIV. A. 96-25J, 1998 WL 725946, *5 (W.D. Pa. 1998) (*McClune* rule applies "outside the class action context"), *aff'd, 229 F.3d 1140 (3d Cir. 2000)*; *Bromley, 178 F.R.D. at 157* ("*McClune* does not hold that plaintiffs cannot intervene prior to class certification as party representatives in a class action to cure a deficiency.").

Furthermore, generally the lawsuits cited by Defendants deal with situations where all the initiating plaintiffs' claims had been dismissed prior to class certification, so there was no existing cause of action into which a party might intervene. *See, e.g., McClune, 593 F.2d 482*; *Warden v. Crown American Realty Trust, 1998 U.S. Dist. LEXIS 16194,* No. CIV. A. 96-25J, 1998 WL 725946, *7 (W.D. Pa. 1998) (because original plaintiffs lacked standing and court had granted motion to dismiss the Securities Act claims, court denied motion for permissive intervention into "an otherwise defunct claim" because there were no longer any common questions of law or fact between plaintiffs and intervenor), *aff'd, 229 F.3d 1140 (3d Cir. 2000)*; *Lidie, 478 F.2d at 555*; *Kendrick v. Kendrick, 16 F.2d 744, 745 (5th Cir. 1926)* ("An existing suit within the court's jurisdiction is a prerequisite of intervention.").

Indeed, this Court observes that the existing suit requirement has been modified in certain kinds of permissive intervention. [HN6]The Third Circuit had previously held, in a case cited in *McClune* and whose rule is now accepted by most courts, that even though intervention "contemplates an existing suit in a court of competent jurisdiction," if the original claims have been dismissed for lack of jurisdiction, a court has the discretion to treat a pleading for intervention, where the intervenor has a separate and independent basis for jurisdiction and where the failure to adjudicate the claim will only result unnecessary delay, as a separate action that may continue the suit. *Fuller v. Volk, 351 F.2d 323, 328-29 (3d Cir. 1965)* ("By allowing the suit to continue with respect to the intervening party, the court can avoid the senseless 'delay and expense of a new suit, which at long last will merely bring the parties to the point where they now are.'"), *citing Hacker v. Guaranty Trust Co., 117 F.2d 95, 98 (2d Cir. 1941), cert. denied, 313 U.S. 559, 85 L. Ed. 1520, 61 S. Ct. 835 (1941)*. Furthermore the United States Supreme Court has even held that if a named class representative has standing at the time a class action suit is initiated, the class action may proceed even if the class representative's claim becomes moot where the issues were "capable of repetition, yet evading review". *Sosna v. Iowa, 419 U.S. 393, 402, 42 L. Ed. 2d 532, 95 S. Ct. 553 (1975)* (holding that a "case or controversy" may still exist "between a named defendant and a member of the class represented by the named plaintiff, even though the claim of the named plaintiff has become moot."); *Franks v. Bowman Transp. Co., 424 U.S. 747, 47 L. Ed. 2d 444, 96 S. Ct. 1251 (1976).*

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**[*32]**

**APPLICABLE LAW AND ITS APPLICATION HERE**

At issue here are several interrelated, complex issues which the Court addresses in what appears to it to be the logical order: (A) whether ICERS' and Lead Plaintiff's Foreign Debt Securities claims are timely asserted or time-barred; (B) whether ICERS has or needs to have standing for permissive intervention; (C) whether ICERS has standing and is qualified to serve as a representative plaintiff in this action on behalf of all purchasers of all Foreign Debt Securities during the Class Period; and (D) whether ICERS should be granted permissive intervention.

**A. Statute of Limitations**

The threshold question here is whether Lead Plaintiff has timely asserted claims relating to the Foreign Debt Securities investors. Because issues relating to the statute of limitations are raised in most of the *Newby* Defendants' motions to dismiss as well as here, to insure consistency and fairness the Court has reviewed all briefing relating to the limitations periods. It sets out its conclusions about the law applicable to the limitations issues here. n25

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n25 The Court emphasizes that the concept of timeliness for purposes of a statute of limitations defense is distinct from the issue of timeliness for purposes of a motion for leave to intervene.

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**[*33]**

[HN7]A private right to bring claims under Section 10(b) of the Exchange Act is not explicit, but judicially implied, and there is no express statute of limitations directed to such a claim. *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 501 U.S. 350, 358, 115 L. Ed. 2d 321, 111 S. Ct. 2773 (1991).* Prior to the passage of the Sarbanes-Oxley Act of 2002, n26 discussed *infra*, regarding a private right of action under Section 10(b) of the Exchange Act and Rule 10b-5, the Supreme Court has held that "no action shall be maintained to enforce any liability created under this statute unless brought within one year after the discovery of the facts constituting the violation and within three years after such violation." Section 9(e) of the 1934 Act, *15 U.S.C.* § *78i*(e); *Lampf, 501 U.S. at 364* (analogizing to express statutes of limitations with a one year/three year structure elsewhere in the 1933 and 1934 Acts and holding that claims under § 10(b) are subject to the statute of limitations in § 9(e) of the Exchange Act of 1934).

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n26 Public Company Accounting and Investor Protection Act of 2002 (popularly known as the "Sarbanes Oxley Act of 2002"), Pub. L. 107-204, Title VIII, § 804, 116 Stat. 745, 801, codified in part at *28 U.S.C.* § *1658*(b), was signed into law by President Bush on July 30, 2002.

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**[*34]**

The language of section 9(e), [HN8]"No action shall be maintained to enforce any liability created under this section, unless brought within one year after the discovery of the facts constituting the violation and within three years after such violation," suggests that the one-year period requires actual discovery to trigger limitations. Compared with section 13 (suit must be "brought within one year after the discovery of the untrue statement or the omission, **or after such discovery should have been made by the exercise of reasonable diligence** ... [emphasis added]"), which provides the limitations periods for claims under § 11 and § 12 of the 1933 Act, section 9 does not appear to trigger limitations when the plaintiff "should have" discovered the wrongdoing.

Nevertheless, [HN9]to determine when the limitations period begins to run, most of the Circuit Courts of Appeals have applied some version of the doctrine of constructive or inquiry notice. n27 Under this doctrine, the statute begins to run when the plaintiff has actual knowledge of the facts giving rise to his claims or has notice of facts **that in the exercise of reasonable diligence should have led to such knowledge. [*35]** *See e.g., LC Capital Partners, LP v. Frontier Ins. Group, Inc., 318 F.3d 148, 154 (2d Cir. 2003)*; *In re NAHC, Inc. Sec. Litig., 306 F.3d 1314, 1325-27 (3d Cir. 2002)*; *Young v. Lepone, 305 F.3d 1, 8 (1st Cir.*

2002); *Franze v. Equitable Assurance, 296 F.3d 1250, 1254 (11th Cir. 2002)* ("Inquiry notice is triggered by evidence of the possibility of fraud, not full exposition of the scam itself."); *Ritchey v. Horner, 244 F.3d 635, 638-39 (8th Cir. 2001)*; *Sterlin v. Biomune Sys., 154 F.3d 1191, 1201 (10th Cir. 1998)* ("Inquiry notice ... triggers an investor's duty to exercise reasonable diligence, and ... the one-year statute of limitations period begins to run once the investor, in the exercise of reasonable diligence, should have discovered the facts underlying the alleged fraud."); *Marks v. CDW Computer Centers, Inc., 122 F.3d 363, 367 (7th Cir. 1997)* ("Not only must the investor be on notice of the need to conduct further inquiry, but the investor also must be able to learn the facts underlying the claim with the exercise of reasonable diligence."); *Ockerman v. May Zima & Co., 27 F.3d 1151, 1155 (6th Cir. 1994)*. **[*36]** n28

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n27 *See generally* Lewis D. Lowenfels and Alan R. Bromberg, *SEC Rule 10b-5 and its Statute of Limitations: The Circuits Defy the Supreme Court*, 51 Bus. Law. 309 (February 1996).

n28 In *Berry v. Valence Technology, Inc., 175 F.3d 699, 704 (9th Cir. 1999), cert. denied, 528 U.S. 1019, 145 L. Ed. 2d 409, 120 S. Ct. 528 (1999)*, the Ninth Circuit, which has not formally ruled on the question, stated,

If we were to adopt inquiry notice, we would agree with the Tenth Circuit's formulation of that standard. In *Sterlin*, the Tenth Circuit surveyed case law from other circuits and found that most circuits "generally apply an inquiry notice standard coupled with some form of reasonable diligence requirement [citation omitted]."

The Fifth Circuit has only conclusorily referred to and appeared to accept the inquiry notice/storm warning rule in securities cases, but has not addressed it in detail. *Jensen v. Snellings, 841 F.2d 600, 607 (5th Cir. 1988)* ("Investors are not free to ignore 'storm warnings,' which would alert a reasonable investor to the possibility of fraudulent statements or omissions in his securities transactions ... Our emphasis on the duty of due diligence comports with the policy underlying statutes of limitations. They are intended to ensure fairness to defendants against 'claims that have been allowed to slumber ... the right to be free of stale claims in time comes to prevail over the right to prosecute them."); *Topalian v. Ehrman, 954 F.2d 1125, 1134-35 (5th Cir. 1992)*.

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**[*37]**

[HN10]Some courts have applied the term "storm warnings" for circumstances which would suggest to an investor of ordinary intelligence that he had been defrauded and should trigger the duty of inquiry, although they do not agree on precisely what constitutes such storm warnings. See, *e.g.*, *LC Capital, 318 F.3d at 154*; *NAHC, 306 F.3d at 1325*; *Ritchey, 244 F.3d at 639*. Whether the plaintiff was aware of sufficient facts to put him on inquiry notice is frequently inappropriate for resolution on a motion to dismiss under Rule 12(b)(6). *LC Capital, 318 F.3d at 156*; *NAHC, 306 F.3d at 1325* ("Whether the plaintiffs, in the exercise of reasonable diligence, should have known of the basis for their claims depends on whether they had 'sufficient information of possible wrongdoing to place them on 'inquiry notice' or to excite 'storm warnings of culpable activity.' ... The test for 'storm warnings' is an objective one, based on whether a 'reasonable investor of ordinary intelligence would have discovered the information and recognize it as a storm warning.'" [citations omitted); *Young v. Lepone, 305 F.3d at 8-9*; **[*38]** *Ritchey, 244 F.3d at 640-41* ("But the facts relied upon to support inquiry notice must rise to the level of more than mere suspicion; they must instead be 'sufficiently confirmed or substantiated' to a point at which the victims are incited to investigate." [citations omitted]).

Moreover, [HN11]to the question whether "limitations begins to accrue on the date that sufficient storm warnings first appear or the later date on which an investor, alerted by storm warnings and thereafter exercising reasonable diligence, would have discovered the fraud," the First Circuit has held that the later date controls because the purpose of a discovery rule is to protect plaintiffs who do exercise reasonable diligence regarding available information and because such a rule is fair to both plaintiffs and defendants since it prevents premature suits while still requiring that a suit be filed timely after the facts should have been discovered. *Young v. Lepone, 305 F.3d at 9-10*. *See also LC Capital, 318 F.3d at 154* ("If the investor makes no inquiry once the duty arises, knowledge will be imputed as of the date the duty arose ... However, if the investor **[*39]** makes some inquiry once the duty arises, we will impute knowledge of what an investor 'in the exercise of reasonable diligence, should have discovered' concerning the fraud, ... in such cases the limitations period begins to run from the date such inquiry should have revealed the fraud." [citations omitted]); *NAHC, 306 F.3d at 1326* ("the period begins to run from 'the time at which the plaintiff should have discovered the general fraudulent scheme.'" [citations omitted]); *Fujisawa Pharmaceutical Co. v. Kapoor, 115 F.3d 1332 (7th Cir. 1997)* (The statute of limitations "begins to run not when the fraud occurs, and not when the fraud is discovered, but when (often between the date of occurrence and the date of the discovery of the fraud) the plaintiff learns, or should have learned through the exercise of ordinary diligence in the protection of one's legal rights, enough facts to enable him by such further investigation as the facts would induce in a reasonable person to sue within a year."). This inquiry-notice or storm-warning rule (as opposed to actual notice) has become the majority view, *Young v. Lepone, 305 F.3d at 10.* **[*40]**

[HN12]Deciding when a claimant is on inquiry notice requires a fact-specific examination, and even then courts have weighed those facts differently. Among the circumstances found by some courts to constitute sufficient notice to be a storm warning are disclosures in the media, n29 a sudden drop in stock price, n30 filing for bankruptcy, n31 an investigation, or even warning in a prospectus. n32

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n29 *See, e.g., In re USEC Sec. Litig., 190 F. Supp. 2d 808, 820-21 (D. Md. 2002)*; *In re Merrill Lynch & Co. Research Reports Sec. Litig., 289 F. Supp.2d 416 (S.D.N.Y. 2003)* (finding that extensive media coverage of alleged conflicts of interest of research analysts and brokers at Merrill Lynch put plaintiffs on inquiry notice more than two years before they filed suit); *but see In re WorldCom, Inc. Sec. Litig.*, 2003 LW 22790943 (press reports did not constitute storm warnings sufficient to put plaintiffs on inquiry notice where reports failed to discuss the particular corporation and were vague about the illegal relationship tainting the corporation's financial reports).

**[*41]**

n30 *Cooperative de Ahorro y Credito Aguada v. Kidder, Peabody & Co., 129 F.3d 222, 224 (1st Cir. 1997).*

n31 *See, e.g., Theoharous v. Fong, 256 F.3d 1219, 1228 (11th Cir. 2001).*

n32 *See, e.g., Harner v. Prudential-Bache Sec. Inc., 35 F.3d 565* (Table), Nos. 92-1353, 92-1910, 1994 WL 494871, *5-6 (6th Cir. 1994) (warning of risks in prospectus coupled with letters from partnership reporting substantially lower returns than expected should have put plaintiffs on notice of potential fraud).

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Until passage of the Sarbanes-Oxley Act, it was established law that Section 11 and Section 12(a)(2) claims, as well as a derivative claim under § 15, of the 1933 Act were governed by the express statute of limitations in § 13, *15 U.S.C. § 77m*, which states,[HN13]No action shall be maintained to enforce any liability created under section 77k or 77l(a)(2) of this title unless brought within one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the **[*42]** exercise of reasonable diligence, or, if the action is to enforce a liability created under section 77l(a)(1) of this title, unless brought within one year after the violation upon which it is based. In no event shall any such action be brought to enforce a liability created under section 77k or 77l(a)(1) of this title more than three years after the security was bona fide offered to the public, or under section 77l(a)(2) of this title more than three years after the sale.

Section 804 (entitled, "Statute of Limitations for Securities Fraud") of the Sarbanes-Oxley Act of 2002 amended *28 U.S.C. § 1658* of Title 28 of the United States Code by lengthening the statute of limitations for private causes of action alleging fraud. n33 Pub. L. 107-204, Title VIII, § 804(a), 116 Stat. 745, 801 (July 30, 2002), amending § 1658 by adding a susubsection (b). The statute now states in relevant part,

([HN14]a) [] ... [A] private right of action that involves a claim of fraud, deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning the securities laws, as defined in section 3(a)(47) of the [Exchange Act, *15 U.S.C. §§ 98c* **[*43]** (47)], may be brought not later than the earlier of --

(1) 2 years after the discovery of the facts constituting the violation; or
(2) 5 years after such violation.

(b) EFFECTIVE DATE.--The limitations period provided by section 1658(b) to title 28, United State Code, as added by this section, shall apply to all proceedings addressed by this section that are commenced on or after the date of enactment of this Act.

(c) NO CREATION OF ACTIONS.-Nothing in this section shall create a new, private right of action. Public Company Accounting and Investor Protection Act of 2002, Pub. L. 107-204, Title VIII, § 804, 116 Stat. 745, 801, codified in part at *28 U.S.C. § 1658*(b). Furthermore, Section 3(a)(47), *15 U.S.C. § 78c*(a)(47), provides a pertinent definition: [HN15]"The term 'securities laws' means the Securities Act of 1933, the Securities Exchange Act of 1934 ... [and others]."

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n33 Before the amendment, Section 1658 set a four-year statute of limitations for civil causes of action arising under any Act of Congress enacted after December 1, 1990 that lacked an express statute of limitations.

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**[*44]**

ICERS' response to objections that intervention would be futile because ICERS's claims are time-barred n34 insists that even if the Court should find its § 12(a)(2) claims would be barred by a one-year limitations period, they are saved by the lengthened statute of limitations in the Sarbanes-Oxley Act or the relation-back doctrine. n35 ICERS contends that the "operative" pleading is Lead Plaintiff's First Amended Consolidated Complaint, filed on May 14, 2003, which added the subsidiaries to the original Bank Defendants as new defendants approximately eight months after the enactment of the Sarbanes-Oxley Act, July 30, 2002. In ICERS' view, the First Amended Consolidated Complaint is a "new proceeding commenced after the effective date" of the Act (July 30, 2002) and the Sarbanes-Oxley Act therefore applies; thus ICERS' claims are not time-barred by the shorter one-year statute of limitations.

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n34 Objectors argue that would-be intervenors were put on "notice inquiry" as early as December 2002, when Enron filed for bankruptcy and the prices of Enron and Enron-related securities plunged. They contend that the "operative" complaint was the original *Newby* complaint, filed on October 20, 2001. The Court finds this argument lacks merit, as the first complaint was filed before Enron made most of its public disclosures prior to filing for bankruptcy and the nature of the alleged fraud is so complex and the banks' purported involvement initially less obvious than that of Enron officers and directors, that experts to this day have difficulty unraveling the intricacies.

**[*45]**

n35 The briefing on the application of the relation-back defense to the statute of limitations was filed with respect to the Bank Defendants' motions to dismiss and will be dealt with in greater detail as it affects those entities when the Court addresses those motions.

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The objectors maintain that Sarbanes-Oxley does not apply to Lead Plaintiff's claims (1) because they were pending at the time the Act was passed and (2) because the Sarbanes-Oxley Act does not extend limitations for § 11 and § 12(a)(2) claims under the 1933 Securities Act.

[HN16]In construing a statute, a court should first address the plain language of the provision, although "'plain' does not always mean 'indisputable' or 'pellucid.'" *Aviall Services, Inc. v. Cooper Industries, Inc., 312 F.3d 677, 680 (5th Cir. 2002), cert. granted on other grounds, 124 S. Ct. 981, 157 L. Ed. 2d 811 (2004)*. The court must examine not only the text of the disputed provision, but also its relationship to the structure and the design of the statute as a whole to effect a harmonious construction. *Id.* & n.3. Only if the statutory **[*46]** language is opaque or ambiguous should the court address the legislative history for guidance in construing a provision. *Id.* Indeed, "legislative history should be consulted gingerly, if at all, in the aid of statutory construction." *Id.* at 684. "Policy considerations cannot change the interpretation of Congress's language, but they can contribute to an understanding of that language." *Id.* at 691. Employing these principles, a court should adopt the most reasonable interpretation of a provision. *Id.* at 681.

A number of issues regarding the application of § 804 have arisen since its enactment that are relevant to the instant action. As a threshold matter, this Court observes that § 804 has been criticized as hastily passed and "poorly drafted," as reflected, as one example, in its inconsistency with the express limitations periods in the federal securities statutes that is "likely to create significant interpretational difficulties for courts." Bruce Vanyo, Stuart Kagan, and John Classen, *The*

*Sarbanes-Oxley Act of 2002: A Securities Litigation Perspective,* 1332 PLI/Corp 89, 119-20 (September-October 2002); *see also* Michael A. Perino, *Statute of Limitations [*47] Under the Newly Passed Sarbanes-Oxley Act, N.Y.L.J. at 4 (Aug. 2, 2002)* **[*47]** (Section 804 is "poorly drafted," "inconsistent with express statutes of limitation already contained in the federal securities laws and is likely to create significant interpretational difficulties for the courts"); Michael A. Perino, *Enron's Legislative Aftermath: Some Reflections on the Deterrence Aspects of the Sarbanes-Oxley Act of 2002, 76 St. John's L. Rev. 671, 672 (Fall 2002)* ("The SOA moved with lightening speed through the legislature and only seemed to pickup momentum with the revelation of each new accounting restatement. Unfortunately, the Act reflects that speed ... The result was, at a minimum, a disorganized law."); John C. Coffee, Jr., *A Brief Tour of the Major Reforms in the Sarbanes-Oxley Act,* SH097 ALI-ABA 151, 171-72 (2002) ("Passed quickly and containing important provisions that were added by floor amendments and without hearings, it was predictable that the Act would contain some ambiguities and yield some unintended consequences. Controversy appears to be developing around the following issues ... [including Statute of Limitations]").

For examples of uncertainties **[*48]** created by the new statute of limitations in § 804(b), unlike § 10(b) of the 1934 Act, Sections 11 and 12(a)(2) [and derivatively, § 15] of the 1933 Act cover claims of material nondisclosures that do not necessarily sound in fraud, but may sound in negligence or strict liability. Since Section 804(b) explicitly applies only to "a private right of action that involves a claim of fraud, deceit, manipulation or contrivance," application of the longer statute of limitations in § 804 to a claim under either Section 11 or Section 12(a)(2) appears to depend upon whether the particular claim involves "fraud, deceit, manipulation, or contrivance."

Another issue that has arisen is whether Section 804(b) applies to statutes that have express limitations periods, n36 which includes Sections 11 and 12(a)(2), which have been subject to time limitations imposed by Section 13. Significantly, when Congress passed the Sarbanes-Oxley Act, Congress did not repeal the express one-year/three-year statute of limitations in Section 13, *15 U.S.C. § 77m.*

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n36 As discussed earlier in this memorandum and order, a private cause of action under § 10(b) is not express, but judicially implied; the limitations period was established in *Lampf* by analogy to other express limitations provisions elsewhere in the securities statutes. Thus technically such a claim does not arise from an "Act of Congress," as was required for the application of the general statute of limitations for causes of action without express statutes of limitations, *28 U.S.C. § 1658,* amended by Sarbanes-Oxley Act. The new § 804(b) does not appear to rely on a distinction between express and implied causes of action but addresses only the former, perhaps another reflection of the haste and poor drafting characterizing the new legislation.

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**[*49]**

Furthermore, Section 804(b)'s statute of limitations (which begins to run "(1) 2 years after the discovery of the facts constituting the violation; or (2) 5 years after such violation") omits certain language found in § 13 (expressly providing that limitations begins to run "after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence"), raising the question whether actual notice, as opposed to inquiry notice, is required to trigger limitations for §§ 11 and 12(a)(2) claims. Nevertheless, that same language omission is found in *Lampf,* and, as discussed, all the Circuit Courts of Appeals that have addressed the issue have applied the inquiry notice rule, i.e., that limitations for § 10(b) claims begins to run on the date that a plaintiff acquires either actual or sufficient inquiry notice of the facts giving rise to the claim. *See, e.g., Topalian v. Ehrman, 954 F.2d 1125, 1134-35 (5th Cir. 1992); Tregenza v. Great American Communications Co., 12 F.3d 717 (7th Cir. 1993), cert. denied, 511 U.S. 1085, 128 L. Ed. 2d 465, 114 S. Ct. 1837 (1994); Howard v. Haddad, 962 F.2d 328.* **[*50]** 329-30 (4th Cir. 1992); *Dodds v. Cigna Sec., Inc., 12 F.3d 346 (2d Cir. 1993); Great Rivers Co-op of SE Iowa v. Farmland Indus., Inc., 120 F.3d 893, 896-97 (8th Cir. 1997); Sterlin v. Biomune Sys., 154 F.3d 1191, 1202 (10th Cir. 1998); New England Health Care Employees Pension Fund v. Ernst & Young, L.L.P., 336 F.3d 495, 500 (6th Cir. 2003), petition for cert. filed* (Dec. 29, 2003) (No. 03-937). A few courts have applied the principle of inquiry notice to the extended statute of limitations in the Sarbanes-Oxley Act. *See, e.g., In re WorldCom, Inc. Sec. Litig.,* 2003 WL 227909942, at *265; *In re Enterprise Mortgage Acceptance Co., L.L.C. Sec. Litig., 295 F. Supp. 2d 307, 2003 WL 22955925,* *309 (S.D.N.Y. 2003); *Taylor v. Prudential Ins. Co. of America, 2003 U.S. Dist. LEXIS 9437,* No. 1:02-

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[*53]

ICERS has stated that it has adopted the *Newby* First Amended Consolidated Complaint which expressly disclaims that its allegations under § 11 and § 15 were grounded in fraud or intentional or reckless misconduct, but instead are based on strict liability and/or negligence. # 1388 at 631, P 1005. The complaint also asserts that its § 12(a)(2) claims, including those relating to the Foreign Debt Securities, and related § 15 claims are "negligence claims." *Id.* at 637, P 1016.3. Thus the longer statute of limitations in § 804 does not apply to ICERS' § 12(a)(2) claims.

Perhaps the least difficult issue regarding the new statute is whether Section 804(b) extends the limitations period for claims that were pending at the time of its enactment. [HN18]The new statutory provision clearly and unambiguously states that the two-year/five-year limitations period "shall apply to all proceedings addressed by this section that are *commenced on or after the date of Enactment of this Act* [emphasis added by this Court]," i.e., July 30, 2002. The express language of the statute does not include actions already pending on the date of enactment. Senator Patrick Leahy, the sponsor of Title **[*54]** VIII, stated, "The section, by its plain terms, applies to any and all cases *filed after* the effective date of the Act, regardless of when the underlying conduct occurred [emphasis added by this Court]." 148 Cong. Rec. S7418 (July 26, 2002). n39 [HN19]This Court finds that the unambiguous text does not extend the new statute of limitations to claims in suits pending at the date of enactment. n40 It does apply to subsequently filed actions based on underlying conduct that occurred before the enactment of the Sarbanes-Oxley Act as long as such claims were not time-barred by the *Lampf* statute of limitations and/or repose controlling before July 30, 2001.

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n39 In *Roberts v. Dean Witter Reynolds, Inc., 2003 U.S. Dist. LEXIS 5676,* No. 8:02-CV-2115-T-26EAJ, 2003 WL 1936116, *3-4 (M.D. Fla. Mar. 31, 2003), which relied on the legislative history to find Congressional intent to apply the new statute of limitations retroactively, the court quoted several comments by Senator Leahy "referring to victims of Enron recovering damages." For example,

> When I look at places such as Washington State alone where the pension funds of firefighters and police lost $ 50 million because of the fraud of the leaders of Enron, I don't feel too sympathetic. We already have a very short statute of limitations in here anyway. *We ought to at least have that so people might be able to recover some of the money they have lost,* if it is at all possible, instead of just a few executives going up and building their $ 50 million mansions and hiding there. There ought to be some way for people who lost their pensions, lost their life savings, to get it ...
> *These are people who would like, in these kinds of situations, at least to have a statute of limitations such that we can go after them.*

*Id.* at *3, *citing* 148 Cong. Rec. S6524-02, * S6534-35 (emphasis added by *Roberts* court). This Court agrees with the rejection of the *Roberts* court's conclusions by the court in the Southern District of New York in *In re Enterprise Mortgage Acceptance Co., 295 F. Supp. 2d 307, 2003 WL 22955925* at *310:

> None of Senator Leahy's statements refers to reviving time-barred claims nor did he make statements that clearly show the Act was intended for resurrection of time-barred claims. In fact, Mr. Leahy actually made one statement that indicated the Act was not intended to revive time-barred claims. During a hearing he stated: "[In the Act] we extend the statute of limitations in security fraud cases--something that would have helped so many people who were defrauded by Enron and others." Conference Report on Corporate Responsibility Legislation: Hearing on H.R. 3763 before Conference Comm. 107th Cong. at 12 (2002) (statement of Senator Leahy). Additionally Senator Gramm made statements indicating that the Act does not revive time-barred claims. In response to Senator Durbin's assertion that the one-year/three-year statute of limitations permitted some corporate officers to "get off the hook," Mr Gramm said:
>
> When the Senator was talking about letting people off the hook, surely everybody understands that our system has no ex post facto laws. So if the provision raising the statute of limitations to 5 years became law, it would have no effect on anybody who has committed one of these violations

about which we are talking.
148 Cong. Rec. S6537 (July 10, 2002).

*In re Enterprise Mortgage, 295 F. Supp. 2d 307, 2003 WL 22955925* at *310. This Court agrees that it is unclear whether a number of Senator Leahy's remarks are directed toward alleged securities fraud generally, of which he makes Enron a notable example, or whether they were directed toward the charges of purported Enron victims regardless of how old their claims were.

**[*55]**

n40 In *dicta* one court has assumed that the lengthened Sarbanes-Oxley statute of limitations does not apply to claims pending on July 30, 2002. *See De La Fuente v. DCI Telecommunications, Inc., 259 F. Supp. 2d 250, 2003 WL 832009 (S.D.N.Y. 2003)* (amendment does not apply to claims pending at the time it was enacted).

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Moreover, in the suit *sub judice,* there is an additional factor: ICERS has emphasized that it has adopted the *Newby* complaint. There is an important technical distinction relevant here between amendment of a pleading under Fed. R. of Civ. P. 15(a) and supplementation of a pleading under Fed. Rule of Civ. P. 15(d). [HN20]Supplementation is used to "set[] forth 'transactions or occurrences or events which have happened since the date of the pleading sought to be supplemented,'" relating to events that "'have transpired since the date of the party's most recent pleading.'" *United States v. Hicks, 350 U.S. App. D.C. 279, 283 F.3d 380, 385 (D.C. Cir. 2002).* **[*56]** In contrast, amendment under Rule 15(a) is used to modify the previous pleading's allegations about events that occurred before the pleading was filed. The factual occurrences and transactions from which ICERS' claims arose did not happen after the filing of the First Consolidated Complaint. Rule 15(a) allows the party to amend "to assert matters that were overlooked or were unknown at the time" he filed his earlier pleading, as was the case here. *See* 6A Charles Alan Wright, Arthur R. Miller, and Mary Kay Kane, *Federal Practice and Procedure: Civil 2D* § 1504 at 185-86 and Vol. 6, § 1473 at 520 (2d ed. 1990) ("Amended pleadings "relate to matters that occurred prior to the filing of the original pleading and entirely replace the earlier pleading; [supplemental pleadings] deal with events subsequent to the pleading to be altered and merely represent additions or continuations of earlier pleadings.").

*Newby* Lead Plaintiff moved for leave to "amend" (# 1351) and filed its First *Amended* Consolidated Complaint (# 1388). The claims alleged are based on wrongdoing that occurred prior to the filing of the First Consolidated Complaint, which, in accordance with ICERS' own **[*57]** arguments, encompassed the same wrongdoing, material misrepresentations and omissions, asserted against defendants that were substantially the same as the original defendants and their subsidiaries based on substantially the same facts, all pending months before the Sarbanes-Oxley Act was enacted. While the amended pleading first identified investors in the Foreign Debt Securities issued by Enron-related entities as putative class members, the creation and exploitation of these Enron-related entities by Defendants in the alleged Ponzi scheme were described in the First Consolidated Complaint, but not their concurrent role as issuers of securities that were sold based on the same alleged material misrepresentations and omissions and Enron-issued securities regarding Enron's financial condition. Therefore, because the latest complaint is technically an amendment of the previous consolidated complaint, relating to matters that occurred prior to the filing of the previous consolidated pleading, this Court does not construe the newly defined related-Enron entity claims in the last *Newby* complaint as a "new proceeding" and concludes that its claims are not governed by the lengthened **[*58]** statute of limitations also on these grounds.

Another related area of contention is whether, and/or to what extent, the longer limitations period of § 804(b) applies retroactively and revives claims that would have been time-barred under *Lampf* at the time § 804(b) was enacted, but which were not filed until after July 30, 2002. The problematic language of § 804(b) states that the "limitations period ... shall apply to all proceedings ... commenced on or after" the date of the Act's enactment. Because the text focuses on the date that litigation is commenced rather than the date the statute was violated by wrongful conduct, it appears to apply to suits that allege misconduct that occurred before July 30, 2002, but that were not filed until after that date. As mentioned, Senator Leahy, whose comments comprise much of the minimal legislative history of the Sarbanes-Oxley Act, stated, "This provision is intended to lengthen any statute of limitations under federal securities law, and to shorten none. The section, by its plain terms, applies to any and all cases filed after the effective date of the Act, regardless of when the underlying conduct occurred." 148 Cong. Rec. S7418 (July 26, 2002). **[*59]** Such a principle of limitations based on when suit was filed rather than the underlying misconduct would reward those plaintiffs who delayed filing their suits, clearly not the purpose of a limitations period. Moreover § 804(c), "Nothing in this section shall create a new, private right of action," undermines the argument that § 804 revives time-barred claims. *Hughes Aircraft Co. v. United States, 520 U.S. 939, 950, 138 L. Ed. 2d 135, 117 S. Ct. 1871 (1997)* (retroactive application of the 1986 amendment to False Claims Act in essence impermissibly creates a new cause of action just as "extending a statute of limitations after a preexisting period of limitations has expired impermissibly revives a moribund cause of action"). While clearly a response to widespread corporate scandals like WorldCom and Enron, the language of the new provision is unclear as to whether the Act's extended limitations constituted Congress' attempt to remedy future problems or whether it was intended to reach Enron victims with expired claims. No court has found that in § 804 Congress was not ambiguous or that it expressly prescribed the temporal reach of the statute. n41 Furthermore, as noted *supra*, **[*60]** several commentators have remarked that the Sarbanes-Oxley Act was passed in such haste that inconsistencies and ambiguities are the result. Thus because language of the Act is not clear and certain and because permitting the tardy plaintiff an extended statute of limitations if it waits to sue after July 30, 2000, while denying an extended period to the diligent plaintiffs who filed suit quickly, but before that date, makes little sense, the Court finds that it is appropriate to turn for guidance to the general law regarding retroactive application of new statutes of limitations.

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n41 For example, the district court of the Southern District of New York *In re Enterprise Mortgage, 295 F. Supp. 2d 307, 2003 WL 22955925*, at *311, has observed,

There is no clear language of revival in either of these two sentences ... The first sentence may be read to mean that Congress only applied the Act's extended statute of limitations to existing claims not already time-barred. The second sentence may be interpreted to state that even if a claim is brought after the Act is effective, the expanded statute of limitations can reach conduct that happened not only after the enactment, but also before its enactment. The language and the legislative history of the Sarbanes-Oxley Act [do] not show Congress clearly intended to apply the lengthened statute of limitations in Section 804 to already time-barred claims ...

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**[*61]**

[HN21]Deciding whether a statute should be applied retroactively is not always a ministerial matter because a statute does not have a retroactive effect merely because it is applied to conduct occurring prior to its enactment; rather it has a retroactive effect if it "takes away or impairs vested rights acquired under existing laws, or creates a new obligation, imposes a new duty, or attaches a new disability, in respect to transactions or considerations already past." *Landgraf v. USI Film Products, 511 U.S. 244, 269, 128 L. Ed. 2d 229, 114 S. Ct. 1483 (1994)*. The court must make a commonsense, functional judgment whether the new statutory provision "attaches new legal consequences to events completed before its enactment" and be informed and guided by "considerations of fair notice, reasonable reliance, and settled expectations." *Id. at 269*; *Martin v. Hadix, 527 U.S. 343, 357-58, 144 L. Ed. 2d 347, 119 S. Ct. 1998 (1999)*. "Elementary considerations of fairness dictate that individuals should have an opportunity to know what the law is and conform their conduct accordingly; settled expectations should not lightly be disrupted." *Landgraf, 511 U.S. at 265.* **[*62]**

[HN22]In *Landgraf*, the United States Supreme Court set out a three-step analysis for determining whether a new statute should apply to conduct occurring before the statute's enactment. First, the court should ask whether Congress "expressly proscribed the statute's proper reach." *Id. at 264, 280.* If so, that directive regarding the statute's temporal reach controls and the inquiry stops. If not, the court must examine whether application of the statute would have an impermissible retroactive effect, i.e., whether it would "impair the rights a party possessed when he acted, increase a party's liability for past conduct, or impose new duties with respect to transactions." Id. If so, a traditional judicial presumption against retroactive application of the new statute to acts occurring prior to the statute's enactment applies. *Id. at 265.* Although courts originally distinguished between procedural and substantive statutes, applying a lower standard to the former, the Supreme Court has since indicated that such categorization is not definitive. *Martin, 527 U.S. at 358.* Finally, if the court determines that Congress has not expressly indicated the **[*63]** statute's proper temporal reach and finds that the retroactive application of the statute impairs the rights of the party, the statute will not apply to events occurring prior to its enactment unless Congress expresses a clear intention that the statute have retroactive application or revives stale claims. *Landgraf, 511 U.S. at 280.* If the court finds that Congress clearly intended to apply the statute retrospectively, that intent overcomes the judicial default rule.

cv-1462-LJM-VSS, 2003 WL 2..14254, *4-6 (S.D. Ind. May 7, 2003); *In re Merrill Lynch & Co., Inc. Research Reports Sec. Litig., 272 F. Supp. 2d 243, 265 (S.D.N.Y. 2003).* In light of the treatment of that language in *Lampf,* this **[*51]** Court agrees that the majority rule that inquiry notice applies to and triggers the limitations period of § 804 for those § 11 and § 12(a)(2) claims that fall within its reach. *See generally* Eric Landau and Shaw Harpen, *The Discovery Rule Under Sarbanes-Oxley: Just How Much Does an Investor Really Need to Know to Trigger the New Two-Year Statute of Limitations,* 1386 PLI/Corp 113 (Sept.-Oct. 2003).

[HN17]Nevertheless in the court decisions uncovered by this Court addressing the question regarding claims under § 11 and § 12(a)(2), all have held that based on the text of section 804 (extending limitations period for claims involving "fraud, deceit, manipulation or contrivance" in language mirroring that of § 10(b) and Rule 10b-5), where Section 11 and Section 12(a)(2) claims do not require a showing of fraudulent intent, but are based on negligence or strict liability, section 804's enlarged statute of limitations does not apply, but Section 13 governs. n37 *See, e.g., In re Merrill Lynch & Co., Inc. Research Reports Sec. Litig., 289 F. Supp. 2d 416, 423, 2003 WL 21518833 (S.D.N.Y. 2003)* (holding that the one-year/three-year limitations period of Section 13, **[*52]** not the two-year/five-year limitations period of Section 804, applied to claims under Section 11 and 12(a)(2)); *In re Global Crossing Ltd. Sec. Litig., 313 F. Supp. 2d 189, 2003 U.S. Dist. LEXIS 22930,* No. 02 CIV. 910 (GEL), 2003 WL 22999478, *3 (S.D.N.Y. Dec. 22, 2003); *In re WorldCom, Inc. Sec. Litig., 294 F. Supp. 2d 431, 2003 WL 22738546,* *435-437 (S.D.N.Y. 2003) n38; *Friedman v. Rayovac Corp., 295 F. Supp. 2d 957, 2003 U.S. Dist. LEXIS 13135,* *974-975 (W.D. Wis. May 29, 2003); *Taylor v. Prudential Ins. Co. of America, 2003 U.S. Dist. LEXIS 9437,* No. 1:02-cv-1462-LJM-VSS, 2003 WL 21314254, *4-6 (S.D. Ind. May 7, 2003).

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n37 As noted, the language of § 804 in extending the statute of limitations for "a claim of fraud, deceit, manipulation, or contrivance" in contravention of a regulatory requirement, reiterates the language of § 10(b). Thus the language reflects Congress' intent not to reach claims grounded in negligence or strict liability.

n38 Judge Cote in *WorldCom* also concluded that the legislative history of the debate regarding Section 804's lengthened limitations period reflected Congressional concern with fraud. She quotes the sponsor of that portion, Vermont Senator Patrick Leahy, the Chairman of the Senate Judiciary Committee, remarking that the provision was a response to "such enormous fraud." *294 F. Supp. 2d 431, 2003 WL 22738546* at *436, *citing* 148 Cong. Rec. S6524, 6535 (July 10, 1002. She further quotes Representative Edward J. Markey's statement that "we should extend from 3 years to 5 years the time that people have to go in and do something about fraud ...." *Id., citing* 148 Cong. Rec. H4838, 4836 (July 17, 2002). She also quotes Senator Leahy's lengthy comment directly under the caption, "Section 804--Statute of Limitations" relating to "securities fraud cases," not strict liability and negligence claims:

This section would set the statute of limitations in private securities fraud cases to the earlier of two years after the discovery of the facts constituting the violation or five years after such violation. The current statute of limitations for most private securities fraud cases is the earlier of three years from the date of the fraud or one year from the date of discovery. This provision states that it is not meant to create any new private cause of action, but only to govern all the already existing private causes of action under the various federal securities laws that have been held to support private causes of action.

294 F. Supp. 2d at *436-437. Judge Cote concluded,

If Congress had intended to extend the statute of limitations for every private securities law claim, it could have done so. Section 804 does not, however, state that it extends the statute of limitations for all claims under the securities claims under the securities laws. Instead it includes limiting language that extends the time for private securities laws only for claims that involve "fraud, deceit, manipulation or contrivance." This language does not encompass Sections 11 and 12(a)(2) claims.

294 F. Supp. 2d at *437.

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In *Hughes Aircraft Co. v. United States ex rel. Schumer, 520 U.S. 939, 948-50, 138 L. Ed. 2d 135, 117 S. Ct. 1871 (1997)*, the Supreme Court held that a 1986 amendment to the False Claims Act that allowed private *qui tam* suits to proceed could not be applied retroactively to revive previously barred claims because it increased the number of potential plaintiffs and thus the likelihood that a defendant would be subject to suit regarding past transactions, undermining basic notions of fair notice, reasonable reliance, and settled expectations.

[HN23]Several federal Circuits Courts of Appeals, including the Fifth Circuit, in determining whether a statute that enlarges a period of limitations will be deemed **[*64]** to revive a claim that was time-barred before the new statute was enacted, have followed this doctrine of clear statement, i.e., the new federal statute must expressly state that the legislative intent was to apply a newly enlarged limitations period retroactively and thus to revive otherwise time-barred claims. *See, e.g., Resolution Trust Corp. v. Seale, 13 F.3d 850 (5th Cir. 1994)* (addressing the Financial Institutions Reform, Recovery and Enforcement Act ("FIRREA") and holding that claims time-barred by the Texas state two-year statute of limitations were not revived by FIRREA's new three-year limitations for the United States to bring a tort action when the RTC was appointed as conservator because there was no clear statement of congressional intent to do so); *FDIC v. Belli, 981 F.2d 838, 842 (5th Cir. 1993)* (holding that FIRREA's statute of limitations providing that a contractual claim held by the FDIC runs from the later date on which the FDIC was appointed conservator or receiver, or the date on which the cause of action accrued, does not apply retroactively to revive claims that expired before FIRREA's effective date). The panel in *Seals* **[*65]** paid lip service to the competing policies in interpreting statutes of limitations with respect to FIRREA: "promoting the value of repose by protecting citizens from stale and vexatious government claims" and "protecting governmental claims by keeping the courthouse doors open." *13 F.3d at 852.* The panel "following the plain language of the FIRREA limitations provision understood in light of congressional intent," announced,

Put simply, we need not look to general policy considerations where particular policy decisions, found in the text of the statute and the history of its enactment, dispose of the case. *Belli* accommodates the competing policies by invoking the doctrine of clear statement--Congress can revive stale claims but must do so clearly.

*13 F.3d at 853.* Other Circuit Courts of Appeals have also held that for retroactive application of a new, enlarged statute of limitations and revival of otherwise stale claims, there must be clear expression of Congressional intent to do so or the retroactive application is impermissible. *See, e.g., Million v. Frank, 47 F.3d 385, 390 (10th Cir. 1995)* (Without clear expression **[*66]** of Congressional intent for retroactive application, "applying the new time limit would alter the substantive rights of both the plaintiff and the defendant. Plaintiff would be afforded relief where previously there was none to be gained. The defendant would be stripped of his right to raise a valid defense and would be forced to defend an action previously time-barred: defendant's liability would be substantially increased."); *Chenault v. United States Postal Serv., 37 F.3d 535, 539 (9th Cir. 1994)* ("[A] newly enacted statute that lengthens the applicable statute of limitations may not be applied retroactively to revive a plaintiff's claim that was otherwise barred under the old statutory scheme because to do so would 'alter the substantive rights' of a party and 'increase a party's liability.' In this case the rights of the defendant would be altered and its liability increased because it would be forced to defend an action that was previously time-barred."); *Brown v. Hot, Sexy and Safer Productions, Inc., 68 F.3d 525, 538 (1st Cir. 1995)* (holding that the Religious Freedom Restoration Act did not create a retroactive cause of action for monetary **[*67]** damages because of absence of "clear, strong and imperative" language showing Congressional intent to do so), *cert. denied, 516 U.S. 1159, 134 L. Ed. 2d 191, 116 S. Ct. 1044 (1996). See also Hughes Aircraft, 520 U.S. at 950* ("extending a statute of limitations after the pre-existing period of limitation has expired impermissibly revives a moribund cause of action.").

A few district courts have addressed the new, enlarged statute of limitations under § 804 to determine whether it applies retroactively and revives claims that would have been time-barred under the *Lampf* limitations period. *See, e.g., Roberts v. Dean Witter Reynolds, Inc., 2003 U.S. Dist. LEXIS 5676,* No. 8:02-CV-2115-T-26EAJ, 2003 WL 1936116 (M.D. Fla. Mar. 31, 2003) (finding that although Congress did not expressly use the term, "retroactive application," or prescribe the temporal reach of the statute, "Congress intended to lengthen the statute of limitations to enable people who lost their life-savings to companies like Enron to recover some of their investments. To do so, the amendment must be given retroactive application"; and holding that the amendment revives expired claims) n42; *Glaser v. Enzo Biochem,* **[*68]** *Inc. 303 F. Supp. 2d 724, 2003 WL 21960613,* *730 (E.D. Va. 2003) (concluding that (1) "Congress did not unambiguously provide" that § 804(b)'s two-year limitations period applies retroactively, (2) the court previously concluded the claims were time-barred under *Lampf's* one-year limitations period, (3) the presumption against retroactive application of the new provision favored Defendants, (4) the provision that § 804(b) "applies to all proceedings commenced on or after July 30, 3003" applies only to actions that may have accrued but that were not time-barred under the previous one-year limitations period," and (5) "Congress did not specifically intend ... to revive moribund actions" with the Sarbanes-Oxley Act); *In re Heritage Bond Litigation, 289 F. Supp. 2d 1132, 1148 (C.D. Cal. 2003)* (finding the Sarbanes-Oxley Act unclear, relying on *Chenault v. United States Postal Service, 37 F.3d 535, 539 (9th Cir. 1994)* ("a newly enacted statute that lengthens the applicable statute of limitations may not be applied retroactively to revive a plaintiff's claim that was otherwise barred under the old statutory scheme because to do **[*69]** so would 'alter the substantive rights' of a party and 'increase a party's liability.'"), and holding that the Sarbanes-Oxley Act does not apply to any claim time-barred at the time of its enactment regardless of when the suit was filed); *In re Enterprise Mortgage Acceptance Co., L.L.C. Sec. Litig., 295 F. Supp. 2d 307, 2003 WL 22955925*, *309-311 (S.D.N.Y. Nov. 14, 2003) (holding that the language and the legislative history of § 804 do not show clearly that Congress intended to apply the new statute of limitations to time-barred claims, regardless of the filing date, and dismissing the claims before it as untimely). Commentators demonstrate similar uncertainty about the propriety and/or extent of refractivity. *See, e.g.*, Harold S. Bloomenthal, *Sarbanes-Oxley in Perspective*, Part X, § 74 (2002) ([Section 804] has retroactive applications, at least for a period of time, in that for actions filed after the date of the Act it permits an action to be brought within a period of time that at the date of the Act would have been barred under the statute of limitations as it existed prior to the adoption of the Act. **[*70]** ").

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n42 Objectors point to an unpublished opinion, *Friedman v. Rayovac Corp.,295 F. Supp. 2d 957*, Order at 23 (W.D. Wis.2003) (attached as exhibit 2 to # 1575), which held that the Sarbanes-Oxley limitations period applies to all proceedings commenced after July 31, 2002, that an amended complaint that adds new parties commences a "new proceeding" even if the claim was part of the previously filed lawsuit, and that the date of the amended complaint, not the date that the initial complaint was filed, determines whether the Sarbanes-Oxley longer limitations period applies. The judge also opined that since the plaintiffs could have simply filed a separate new suit to be governed by the new statute of limitations, it made no sense and would create judicial inefficiency to create a rule requiring plaintiffs to file separate actions for claims against different defendants arising out of the same conduct. *Id.*

This Court disagrees with the *Friedman* court's reasoning and finds its conclusions contrary to established law, as will be discussed. To permit a plaintiff to file a new second suit or a new claim or add a new party in order to circumvent a statute of limitations and expand his legal rights, especially where the clear language of the statute reflects Congress' intent not to permit such expansion, as here, would create legal chaos.

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**[*71]**

Defendants have contended, and the Court finds the argument persuasive, that the Second Circuit's reasoning regarding application of § 108 of the PSLRA, defining its temporal reach by the effective date of the Act in similar language to that of the Sarbanes Oxley Act (the Act does not apply "to any private action ... commenced before and pending on" the date of enactment of the statute), can serve as an analogous guide here. *Gerber v. MTC Electronic Technologies Co., Ltd., 329 F.3d 297, 309-10 (2d Cir. 2003), cert. denied sub nom. Daiwa Securities America Inc. v. Kayne, 157 L. Ed. 2d 311, 124 S. Ct. 432 (2003)*. The Second Circuit affirmed the district court's holding that where the action was filed before the date of the enactment of the PSLRA, because the statute refers to "actions," not to "parties" or "claims," the Act did not apply to parties and claims added after the enactment to a pre-existing suit. *Id.* The *Gerber* panel observed, "In the absence of any indication to the contrary, we doubt that Congress intended that courts would apply different sets of substantive and procedural rules to groups of plaintiffs asserting identical claims **[*72]** in a single action, depending on when those plaintiffs were added to the complaint." *Id. at 310*. In the case of the Sarbanes-Oxley Act, the extended limitations provision refers to "proceedings," not to claims or parties.

With regard to claims that were time-barred by the shorter one-year statute of limitations under *Lampf* prior to the enactment of the Sarbanes-Oxley Act, [HN24]this Court agrees with *Glaser* that in what this Court finds is an absence of any expression of specific intent that Sarbanes-Oxley should apply retroactively, either in the Act or the legislative history of the Sarbanes-Oxley Act's extended limitations period cannot revive stale claims. Where plaintiffs file a second complaint after the enactment of the Sarbanes-Oxley Act in order to revive otherwise time-barred claims, the *Glaser* court observed,

[HN25]While Congress may enlarge a limitations period, Congress' acts do not revive a cause of action that has become time-barred unless Congress specifically provides for retroactive application. *See Hughes Aircraft Co. v. United States, 520 U.S. 939, 950, 138 L. Ed. 2d 135, 117 S. Ct. 1871* ... (1997) ("extending a statute of limitations after **[*73]** the pre-existing period of limitations has expired impermissibly revives a moribund cause of action ... a newly enacted statute of limitations that lengthens the applicable statute of limitations may not be applied retroactively to revive a plaintiff's claim that was otherwise barred under the old statutory scheme"); *INS v. St. Cyr, 533 U.S. 289, 317, 316, 150 L. Ed. 2d 347, 121 S. Ct. 2271* ... (2001) ("a statement that a statute will become effective on a certain date does not even arguably support that it has any application to conduct that occurred at an earlier date") (stating that while Congress has the power to enact laws with retroactive effects, it must clearly and unambiguously state that the law applies retroactively).

*303 F. Supp. 2d 724, 2003 WL 21960613* at *730.

[HN26]Where the limitations period of Section 804 has been found applicable, courts have also applied the inquiry notice rule to trigger the running of the statute of limitations for Section 10(b) claims. *See, e.g., Taylor v. Prudential Ins. Co. of America. 2003 U.S. Dist. LEXIS 9437*, No. 1:02-cv-1462-LJM-VSS, 2003 WL 21314254, *4-6 (S.D. Ind. May 7, 2003); *In re Merrill Lynch & Co., Inc. Research Reports Sec. Litig., 289 F. Supp. 2d 416, 423 (S.D.N.Y. 2003)* **[*74]** ("Even if the Court assumes that the actions filed after July 30, 2002 are subject to a two year statute of limitations under the Sarbanes-Oxley Act, there was clearly enough publicly available information to put the plaintiffs on inquiry notice of their claims more than two years before the commencement of these actions.").

The parties have raised the issue of the equitable tolling doctrine to stop the running of the statute of limitations. As discussed supra, in *Lampf, 501 U.S. 350, 115 L. Ed. 2d 321, 111 S. Ct. 2773 (1991)*, the Supreme Court applied as a statute of limitations to an implied private right of action under § 10(b) and Rule 10b-5 a uniform federal statute of limitations by turning to other limitations periods in express provisions in the 1933 and 1934 Acts, especially section 9(e) of the Exchange Act ("must be commenced within one year after the discovery of the facts constituting the purchase or sale of securities and within three years after such violation"). The Supreme Court's language in *Lampf* appears to require actual notice rather than inquiry notice to trigger the one-year period. Nevertheless, as noted previously, the [HN27]lower courts, n43 swayed by Congress' **[*75]** enactment around the same time of section 13 of the 1933 Act with its express standard of inquiry, have applied the latter approach and held that the running of the one-year statute of limitations may be stayed if, and as long as, the plaintiff exercises reasonable care and diligence in investigating the facts what would disclose fraud, while concluding that the doctrine of equitable tolling does not apply to the three-year period of repose in securities fraud cases. *Lampf, 501 U.S. at 363-64* ("The equitable tolling doctrine is fundamentally inconsistent with the 1- and 3-year structure [of the statute of limitations] ... The 3-year limit is a period of repose inconsistent with tolling ... Because the purpose of the 3-year limitation is clearly to serve as a cutoff, we hold that tolling principles do not apply to that period."); *Rothman v. Gregor, 220 F.3d 81 (2d Cir. 2000)*; In re *Merrill Lynch & Co., Inc. Research Reports Sec. Litig., 289 F. Supp. 2d 416, 426 (S.D.N.Y. 2003)* ("Equitable tolling is inconsistent with the discovery period because if a defendant actively conceals a fraud, then plaintiff will not discover the facts **[*76]** suggesting the violation and the statute will not begin to run, making tolling unnecessary ... Equitable tolling is also fundamentally inconsistent with the repose period because that limit is 'clearly to serve as a cutoff' and it would have no significance as an outside limit if it could be tolled.'"); *In re Heritage, 289 F. Supp. 2d at 1149-50* (class action tolling doctrine established in *American Pipe & Construction Co. v. Utah, 414 U.S. 538, 554, 38 L. Ed. 2d 713, 94 S. Ct. 756 (1974)* (filing of a class action tolls statute of limitations for all potential class members who subsequently seek to intervene after denial of class certification to avoid multiplicity and judicial inefficiency); and *Crown, Cork & Seal Co., Inc. v. Parker, 462 U.S. 345, 350, 76 L. Ed. 2d 628, 103 S. Ct. 2392 (1983)* (extending tolling doctrine to all putative class members who file individual actions after denial of class certification does not apply).

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n43 *See, e.g., Topalian v. Ehrman, 954 F.2d 1125, 1134-35 (5th Cir. 1992)*; *Tregenza v. Great American Communications Co., 12 F.3d 717 (7th Cir. 1993), cert. denied, 511 U.S. 1085, 128 L. Ed. 2d 465, 114 S. Ct. 1837 (1994)*; *Howard v. Haddad, 962 F.2d 328.* 329-30 (4th Cir. 1992); *Dodds v. Cigna Sec., Inc., 12 F.3d 346 (2d Cir. 1993)*; *Great Rivers Co-op* *of SE Iowa v. Farmland Ind., Inc., 120 F.3d 893, 896-97 (8th Cir. 1997); Sterlin v. Biomune Sys., 154 F.3d 1191, 1202 (10th Cir. 1998)*; New *England Health Care Employees Pension Fund v. Ernst & Young, L.L.P., 336 F.3d 495, 500 (6th Cir. 2003), petition for cert, filed* (Dec. 29, 2003) (No. 03-937). See generally Lewis D. Lowenfels and Alan R. Bromberg, *SEC Rule 10b-5 and its Statute of Limitations: The Circuits Defy the Supreme Court*, 51 Bus. Law. 309 (February 1996).

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**[*77]**

[HN28]Courts have also held that equitable tolling not only does not apply to the three-year period of repose for claims under § 10(b) in § 9(e) of the 1934 Act, but also to the three-year statute of repose in § 13 for claims under §§ 11 and 12(a)(2) n44 of the 1933 Act. See Thomas Lee Hazen, 1 *Law of Securities Regulation* § 7.10[2] (2d ed. 2004 Supp.) ("The courts have almost uniformly agreed that the three year statute of repose in sections 11 and 12 is absolute and thus equitable tolling principles will not be invoked to extend the period further.") (and cases cited therein). Indeed Hazen clearly states,Section 13 is not only a statute of limitations but also operates as a statute or repose. There is an absolute maximum of three years to prevent stale claims. Actions brought under section 12(a)(2) must be brought within three years of the sale forming the basis for the alleged violation.Id. at § 7.10[4]. To compute the three-year repose period, the courts construe limitations as running from the date of sale, which is generally from the last of three occurrences; the date the security was offered for sale, the date it was sold, or the date it was delivered. **[*78]** *Id.* at § 7.10[1]. § 7.10[4].

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n44 [HN29]The three-year period for claims under § 12(a)(2) begins to run at the time of the sale, when the investor executes a subscription agreement and tenders his payment.

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[HN30]Thus the Court finds that the one-year/three-year limitations structure identified in *Lampf* applies to claims under the 1934 Act, and that § 13 applies to the negligence-based claims under § 12 (a) (2) of the 1933 Act here. The claims were clearly filed within the three-year period of repose, so the issue is when Lead Plaintiff had actual or inquiry notice that should have triggered a reasonable person to discover its claims for purposes of the one-year period.

[HN31]When a plaintiff moves to amend to add a new defendant to a pending suit, the date of the filing of the motion for leave to amend, here instrument # 1351 on April 15, 2003, constitutes the date the action was commenced for purposes of the statute of limitations. *Northwestern National Ins. Co. v. Alberts, 769 F. Supp. 498, 510 (S.D.N.Y. 1991)*; **[*79]** J. William Hicks, 17 Civil Liabilities: Enforcement and Litigation under the 1933 Act § 6:152, *Statute of Limitation--Determining When Diligence is Needed--Stating the Problem* (2001, updated Oct. 2003).

Defendants have argued that a number of facts should have alerted Lead Plaintiff to assert its § 12(a)(2) claims on behalf of the CLN investors, and, by extension, all Foreign Debt Securities investors, much earlier. For example, Conseco first emphasizes that Enron filed for bankruptcy in December 2001, an occurrence expressly defined in the Indenture Agreements for the CLNs as an "event of default." Moreover, argues Conseco, the bankruptcy caused a sharp drop in the CLN price, which put the Foreign Debt Securities purchasers on actual notice of their injury and interest in bringing suit. This Court disagrees. A bankruptcy, a default in payment, and a related drop in price of a security do not necessarily or even probably indicate that the selling communications regarding the securities at issue contained material misrepresentations and omissions to give rise to a claim under § 12(a)(2).

Furthermore, the § 12(a)(2) claims asserted here are not against Enron and its officers, **[*80]** but against the more attenuated Bank entities whose alleged involvement and fraudulent acts in the concerted scheme made them far less obvious wrongdoers at the start of the investigation of Enron's collapse. In addition the fact that the claims arise out of securities issued not by Enron, but by the SPEs and other Enron-related entities made early discovery even less likely. For instance, in *Levitt v. Bear Stearns & Co., 340 F.3d 94 (2d Cir. 2003)*, in which the Second Circuit reversed the district court's dismissal on limitations grounds of complaint of securities fraud under § 10(b) against Bear Stearns, the clearing brokerage firm for the corporation, ML Direct, whose securities were at the heart of the alleged fraud. *Id. at 103*. The *Levitt* panel noted that the complaint at issue contained allegations not in another complaint filed earlier by other plaintiffs, and that the district court had failed to examine the new assertions to see if they were necessary to state a claim. More significantly, Judge Miner, writing for the panel emphasized,

This is not a typical storm warnings case, as it was not brought against ML Direct or its officers **[*81]** or directors but instead against ML Direct's clearing agent. This is, therefore, not a case where Plaintiffs could allege a prima facie case against Bear Stearns simply by examining ML Direct's financial statements and media coverage of the company ... Instead, this is a case involving the liability of a secondary wrongdoer-the clearing agent.

*Id. at 103.*

In sum, the Court is not persuaded that the Enron bankruptcy was sufficient to trigger a duty of reasonable investigation by these investors.

As a second storm warning, Conseco maintains that additional notice was given on July 23, 2002, the day after Conseco filed its independent class action complaint, when the United States Senate's Permanent Subcommittee on Investigations started investigating the role of financial institutions, including Citigroup, in Enron's collapse. Conseco argues that the testimony at the hearings showed that Citigroup issued the notes "(i) with full knowledge of the false and misleading nature of Enron's reported financial results, and (ii) in order to fraudulently transfer $ 2.4 billion worth of its Enron credit risk from itself to third-party investors, such as HPI." Nevertheless **[*82]** the Court does not find the initiation of an investigation sufficient to constitute inquiry notice because the information uncovered by that investigation was not disseminated on the day the investigation *began;* instead the ultimate report of the Senate Subcommittee, the issuance date of which Conseco does not provide, might constitute inquiry notice.

Finally, according to Conseco, the investors again received notice of their potential claims on September 29, 2002 when Conseco published notice, pursuant to the PSLRA requirement, announcing that litigation had commenced on behalf of CLN purchasers. The Court agrees that September 29, 2002 publication notice might suffice to trigger inquiry notice to at least CLN investors, but not necessarily **the other** Enron-related-entity investors, including ICERS, that they had an interest in pursuing litigation against the sellers. By the time of that publication, media were reporting alleged fraudulent misconduct by more than Enron officials, employees, outside directors. Like a rock thrown into the water, increasing disclosure of the involvement of numerous parties expanded ever outward to embrace accountants, law firms, and banks. **[*83]** The notable complexity of the schemes involving Enron-related entities in which ICERS, HPI, Deseret and others invested, were only gradually unraveled and their alleged connections to each other and the Ponzi scheme exposed. Under all of the circumstances, even if it accepts the publication date of the litigation based on the CLNs as the time the one-year period began to run for all Foreign Debt Securities purchases, the Court finds that Lead Plaintiff did timely investigate and assert, within one year of that notice by publication of the litigation on behalf of CLN purchasers, the claims of the Foreign Debt Securities Investors.

**B. Standing and Rule 24 Intervention in a Class Action**

[HN32]Article III, Section 2 of the United States Constitution restricts federal court jurisdiction to resolving "cases" and controversies." U.S. Const. art. III, § 2, cl. 1. This "judicially developed doctrine" "'ensures the presence of the 'concrete adverseness which sharpens the presentation of issues upon which the court so largely depends for illumination of difficult constitutional questions.''" *Ruiz, 161 F.3d at 829, citing Diamond v. Charles, 476 U.S. 54, 90 L. Ed. 2d 48, 106 S. Ct. 1697 (1986).* **[*84]** Moreover the "case or controversy requirement" relates to the properly limited role of the unelected, unrepresentative judiciary in a democratic society based on a separation of powers doctrine. *Allen v. Wright, 468 U.S. 737, 750, 82 L. Ed. 2d 556, 104 S. Ct. 3315 (1984).*

[HN33]To satisfy the constitutional requirements of standing under Article III, the party invoking federal jurisdiction has the burden at minimum to demonstrate three elements. First, he must have "suffered an 'injury in fact,'--an invasion of a legally protected interest that is (a) concrete and particularized, and (b) actual or imminent, not conjectural or hypothetical. Second there must be a causal connection between the injury and the conduct complained of ... Third, it must be likely, as opposed to merely speculative, that the injury will be redressed by a favorable decision." *James v. City of Dallas, Tex., 254 F.3d 551, 563 (5th Cir. 2001) (quoting United States v. Hays, 515 U.S. 737, 742-43, 132 L. Ed. 2d 635, 115 S. Ct. 2431 (1995) (in turn quoting Lujan v. Defenders of Wildlife, 504 U.S. 555, 560-61, 119 L. Ed. 2d 351, 112 S. Ct. 2130 (1992)), cert. denied, 534 U.S. 1113, 151 L. Ed. 2d 884, 122 S. Ct. 919 (2002).* **[*85]** To show causation, a plaintiff must demonstrate that his injury is "'fairly traceable to the challenged action of the defendant, and not the result of the independent action of some third party.'" *Id. at 564.* The district court must examine standing and class certification on a claim-by-claim basis. *James, 254 F.3d at 563.* n45

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n45 As described by Judge Benavides in

*Ford v. NYLCare Health Plans of the Gulf Coast, Inc., 301 F.3d 329 334 (5th Cir. 2002)* (concurring), *cert. denied sub nom. Ford v. Aetna U.S. Healthcare, Inc., 538 U.S. 923, 155 L. Ed. 2d 313, 123 S. Ct. 1574 (2003)*,

... [HN34]The jurisdictional issue of standing may be raised *sua sponte* despite the parties' failure to raise it. *Henderson v. Stalder, 287 F.3d 374, 379 n.5 (5th Cir. 2002)*. The burden of establishing standing, which rests on the party invoking federal court jurisdiction, varies depending upon the stage at which standing becomes an issue. *Lujuan, 504 U.S. at 561* . At the pleading stage, we look only to the sufficiency of the allegations. *Id.* "In response to a summary judgment, however, the plaintiff can no longer rest on such 'mere allegations,'" but must adduce evidence in support of the elements of standing. *Id.* (quoting Fed. R. Civ. P. 56(e)). At the final stage of the litigation, standing must be supported adequately by the evidence offered at trial. *Id.*

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**[*86]**

[HN35]In addition to constitutional limitations, there are judge-crafted prudential limitations to the standing doctrine and the court's exercise of jurisdiction, such as the general prohibition on raising a third party's legal rights, preclusion of the adjudication of generalized grievances or abstract issues of substantial public significance that should more appropriately be addressed by the legislative branch, and the rule that a plaintiff's claims fall within the zone of interests protected by the law the plaintiff invokes. *Allen v. Wright, 468 U.S. at 751*; *Warth v. Seldin, 422 U.S. 490, 500, 45 L. Ed. 2d 343, 95 S. Ct. 2197 (1975)*.

As has been pointed out by Conseco, [HN36]a modification of the general rule is necessary where a Lead Plaintiff, preferably an institution with the largest financial interest in the action selected pursuant to the criteria of the PSLRA of 1995, is authorized by statute to bring suit on behalf of the whole class even though it may not have purchased every type of security that others in the class hold, as long as a representative plaintiff with standing to sue on each class or subclass can be designated at class certification time. *In re Initial Pub. Offering Sec. Litig., 214 F.R.D. at 122-23* **[*87]** ("In order for a claim to be asserted on behalf of a putative class, only the named plaintiffs--but not necessarily the lead plaintiff--must have standing"; "It stands to reason that in many cases ... the plaintiff with the largest financial interest [lead plaintiff under PSLRA requirements] may not have standing to sue on all causes of action. There is nothing to suggest that, in those cases, Congress intended that plaintiffs must file an entirely separate class action suit, when in any other context, a subclass would suffice."); and *In re WorldCom Inc. Sec. Litig., 294 F. Supp. 2d 392, 2003 WL 21219049*, at *405 ("The Underwriter Defendants have not shown there is any legal bar to a lead plaintiff asking other plaintiffs to join a lawsuit as named plaintiffs in order to represent more broadly the interests of the class at the time of the filing of the consolidated class complaint. Long before passage of the PSLRA, it was well established that named plaintiffs may jointly represent the class and it is their claims that determine whether there is standing to bring the claims alleged on behalf of the class."). *See also* footnote 12 of the memorandum and order.

Furthermore, there is **[*88]** a split among the Circuits regarding the relationship of the Article III standing requirement and permissive intervention into a class action under Fed. R. Civ. P. 24(b). n46 *See generally* Amy M. Gardner, *An Attempt to Intervene in the Confusion: Standing Requirements For Rule 24 Intervenors, 69 U. Chi. L. Rev. 681 (Spring 2002)* n47; Tyler R. Stradling and Doyle S. Byers, *Intervening in the Case (Or Controversy): Article III Standing, Rule 24 Intervention, and the Conflict in the Federal Courts, 2003 B.Y.U.L. Rev. 419 (2003)*. n48 Traditionally only the party initiating a suit was required to have standing, which in turn gave the court jurisdiction over that party's claims/suit. *Ruiz v. Estelle, 161 F.3d at 829, quoting Valley Forge Christian College v. Americans United for Separation of Church & State, 454 U.S. 464, 70 L. Ed. 2d 700, 102 S. Ct. 752 (1982)* ("At an irreducible minimum Art. III requires the party who invokes the court's authority to [show standing]"). The majority of federal appellate courts, including the Fifth Circuit, have concluded that once a court has jurisdiction over subsisting **[*89]** claims and parties, an intervenor without standing may intervene in that suit. For example, the Fifth Circuit in *Ruiz, 161 F.3d at 830*, held that "Article III does not require intervenors to independently possess standing where the intervention is into a subsisting and continuing Article III case or controversy and the ultimate relief sought by the intervenors is also being sought by at least one subsisting party with standing to do so."). Similarly, in *Chiles v. Thornburgh, 865 F.2d 1197, 1213 (11th Cir. 1989)*, the Eleventh Circuit Court of Appeals concluded that "a party seeking to intervene need not demonstrate that he has standing in addition to meeting the requirements of Rule 24 as long as there exists a justiciable case and controversy between the parties already in the lawsuit."

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n46 Because intervention as of right under Rule 24(a) is not at issue here, the Court does not discuss the distinction under that provision except where necessary to explain the law relating to permissive intervention.

n47 Gardner concludes that the federal courts have taken three different approaches to the question whether a permissive intervenor need have standing:

(1) a separate showing of Article III standing is not required for intervention under Rule 24; (2) a separate showing of Article III standing requirements must be made; or (3) an Article III inquiry is not necessary because the Rule 24 requirements actually require a higher threshold than does Article III.

*Id.* at 684. She places the Fifth ( *Ruiz v. Estelle, 161 F.3d 814*), Eleventh ( *Chiles v. Thornburgh, 865 F.2d 1197, 1213 (11th Cir. 1989)*), and Second Circuit Courts of Appeals ( *United States Postal Serv. v. Brennan, 579 F.2d 188, 190 (2d Cir. 1978)*), in the first group; the Eighth ( *Mausolf v, Babbitt, 85 F.3d 1295 (8th Cir. 1996)* (divided panel)), in the second category; and the Seventh ( *United States v. 36.96 Acres of Land, 754 F.2d 855, 859 (7th Cir. 1985)*) in the third classification. *Id.* at 693-97.

**[*90]**

n48 Stradling and Byers divide court decisions into two groups: (1) those "that do not require intervenors to have Article III standing view standing as a requirement imposed on all federal courts, that is, that **at least one party** must have standing before the court can maintain jurisdiction [emphasis added]"; and (2) those "that do require intervenors to have Article III standing view standing as a requirement imposed **on all parties** that come before a federal court [emphasis added]." *Id.* at 420. In the first category they place five of the eight federal circuits that have addressed the issue: the Fifth in *Ruiz;* the Second in *United States Postal Serv. v. Brennan, 579 F.2d at 190* ("The existence of a case or controversy having been established between the Postal Service and the [couple that ran the mail business], there was no need to impose the standing requirement upon the proposed intervenor."); the Sixth Circuit based on dicta in *Associated Builders & Contractors v. Perry, 16 F.3d 688, 689 (6th Cir. 1994)* ("An intervenor need not have the same standing necessary to initiate a lawsuit in order to intervene in an existing district court where the plaintiff has standing," but the intervenor must have standing to appeal); the Ninth Circuit in *Yniguez v. Arizona, 939 F.2d 727, 731 (9th Cir. 1991)* (intervenor need only satisfy the four criteria (timeliness, interest in subject matter of suit, practical impairment of intervenor's interest absent intervention, and inadequate representation of intervenor's interest by other parties) for intervention as of right under Rule 24(a)); *Chiles v. Thornburgh, 865 F.2d 1214* (party seeking to intervene permissively need only show a timely application and that his claim or defense has a question of law or fact in common with the main action). Only three Circuits have concluded that all parties must meet the Article III standing requirement: *Rio Grande Pipeline Co. v. Federal Energy Regulatory Commission, 336 U.S. App. D.C. 229, 178 F.3d 533, 538 (D.C. Cir. 1999)* ("Because a Rule 24 intervenor seeks to participate on an equal footing with the original parties to the suit he must satisfy the standing requirements imposed on those parties."); *Mausolf v. Babbitt, 85 F.3d at 1300* (8th Cir.) ("An Article III case or controversy, once joined by intervenors who lack standing, is--put bluntly--no longer an Article III case or controversy. An Article III case or controversy is one where all parties have standing and a would-be intervenor, because he seeks to participate as a party, must have standing as well"); and *United States v. 36.96 Acres of Land, 754 F.2d at 859 (7th Cir. 1985)* ("the interest of a proposed intervenor must be greater than the interest sufficient to satisfy the standing requirement").

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**[*91]**

[HN37]The Fifth Circuit has expressly rejected the Eighth Circuit's view in *Mausolf* that intervenors who lack standing destroy a court's jurisdiction over a case and the Seventh Circuit's view that intervenors must have standing because they seek to be on "equal footing" with the original litigants in a case. *Ruiz, 161 F.3d at 831-32.* Instead it concluded that "the better reasoning" is to be found in cases like *Yniguez, Chiles, and United States Postal Service v. Brennan,* which held that Article III does not require intervenors to possess standing because they "recognize that Article III standing serves primarily to guarantee the existence of a 'case' or 'controversy' appropriate for judicial determination" and that Article III does not require each and every party in the case to have such standing." *Id. at 832.* Rather, "once a valid Article III case-or-controversy is present, the court's jurisdiction vests. The presence of additional parties, although they alone could independently not satisfy Article III's requirements, does not of itself destroy jurisdiction already established." *Id.* Moreover, relevant to the arguments before this Court, **[*92]** in *Ruiz* it was argued that "even if standing is not required of all intervenors, it should be required in this case because [the intervenors] advance arguments not raised by either party ... [and thus] "'seek to invoke' the district court's jurisdiction in order to decide the merits of their claims." *Id. at 833.* The Fifth Circuit's response rejected the argument: "This use of the term 'invoke' is misplaced. The court's jurisdiction in this case has already been invoked by the original parties. At the very least, there has been a case or controversy since [the plaintiff] filed its motion to terminate and defendants their opposition, and there continues to be a case or controversy ... Instead [the intervenors] seek only to ask the district court to consider other possible grounds for granting the relief [plaintiff] has already requested." *Id.* n49

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n49 One commentator has observed,In addition, these circuits [following the majority rule that standing is not required of intervenors] support the view that Rule 24 represents a policy choice--how to streamline related issues into a single lawsuit without it becoming unwieldy--rather than a deep constitutional question. In fact, courts often fail to reach the standing-interest conundrum because pragmatic concerns--like the timeliness and inadequacy of representation--are embodied in other prongs of Rule 24 and provide an easier basis for decision-making.Juliet Johnson Karastelev, Note, *On the Outside Seeking In: Must Intervenors Demonstrate Standing to Join a Lawsuit, 52 Duke L.J. 455 (2002).* Disagreeing with the minority view that all parties to a suit must have standing, she argues that under such a rule not only intervenors under Rule 24(a), but also "necessary parties joined under the identically phrased Rule 19 must also prove standing, or the case implodes, a consequence thus far ignored by both courts and legal commentators." *Id. at 469.*

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**[*93]**

Nevertheless the Fifth Circuit, in concluding that "Article III does not require intervenors to have standing as a matter of constitutional law," nevertheless noted, "Whether intervention under Rule 24(a)(2) requires such a showing we do not today consider." *Ruiz, 161 F.3d at 832 n.26.*

In the instant case ICERS, like the *Newby* plaintiffs, seeks recissionary money damages under § 12(a)(2) for investment losses caused by material misrepresentations and omissions about Enron's financial condition, on the grounds that the material misrepresentations and omissions made in the selling documents of the Enron-related entities' Foreign Debt Securities during the *Newby* Class Period were the same as those made in Enron-issued securities by many of the same underwriters involved in the *Newby* Ponzi scheme. This Court is bound by the Fifth Circuit's determination that standing is not required for permissive intervention and thus ICERS may intervene as a named plaintiff, if not as a class representative to assert § 12(a)(2) claims on behalf of all Foreign Debt Securities investors, as long as it meets the requirements of Rule 24(b).

**C. Standing and Class Representation [*94]**

The parties have argued, and cite an old Fifth Circuit case holding, *inter alia,* that if a plaintiff initiating a class action has no standing individually to sue on his personal claims, no "case or controversy" arises; therefore the constitutional requirements for standing must be met before the court considers the procedural requirements for class certification, including typicality of claims or commonality of issues, under Fed. R. Civ. P. 23. *Brown v. Sibley, 650 F.2d 760, 771 (5th Cir. 1981). See also Bertulli v. Independent Ass'n of Continental Pilots, 242 F.3d 290, 294 (5th Cir. 2001)* (standing implicates the constitutional power of this Court to entertain this action and is an "inherent prerequisite to the class representation inquiry," including typicality of claims, commonality of issues, and adequacy of representation of a proposed class representative). Once the court determines that a class action presents a constitutional "case or controversy" and the class representative has shown he has threshold individual standing, there is no further constitutional class standing requirement and the plaintiff **[*95]** must merely show compliance with the procedural rule. *Krell v. Prudential Ins. Co. of Am. (In re Prudential Ins. Co. Am. Sales Practice Litig. Agent Actions), 148 F.3d 283, 306-07 (3d Cir. 1998), cert. denied, 525 U.S. 1114, 142 L. Ed. 2d 789, 119 S. Ct. 890 (1999), citing Newberg on Class Actions* § 2.05 at 2-29 (3d ed. 1992).

The Supreme Court, however, has indicated in several class action cases, *Ortiz v. Fibreboard Corp., 527 U.S. 815, 144 L. Ed. 2d 715, 119 S. Ct. 2295 (1999), Steel Co. v. Citizens for a Better Env't, 523 U.S. 83, 92, 140 L. Ed. 2d 210, 118 S. Ct. 1003 (1998)*, and *Amchem Products, Inc. v. Windsor, 521 U.S. 591, 612, 138 L. Ed. 2d 689, 117 S. Ct. 2231 (1997)* (where class certification issues are dispositive, it is logical to reach them before Article III issues), that [HN38]where statutory standing is at issue, as with claims under the federal securities statutes, "class certification issues are ... logically antecedent to Article III concerns, and themselves pertain to statutory standing, which may properly be treated before Article III standing." *Ortiz, 527 U.S. at 831. See also James, 254 F.3d at 562 n.9* "In cases in which statutory standing is involved, we may address **[*96]** statutory standing before Article III standing. To the extent that ICERS may not be qualified to serve as class representative for investors of those Foreign Debt Securities other than the Marlin Water Trust II notes in an initial public offering from a statutory "seller" under § 12(a)(2), the issue may be viewed as antecedent to and dealt with prior to the constitutional standing issues. n50

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n50 There is no dispute, however, that ICERS has constitutional standing to sue those entities qualifying as its statutory sellers under § 12(a)(2) relating to its purchases of Marlin Water Trust II notes and, for reasons indicated *supra*, may intervene in the existing class action regardless of whether it has standing to sue underwriters of other Foreign Debt Securities.

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Since class certification issues are premature in *Newby* because the Court must first address pending motions to dismiss and the motions to remand to determine which parties and claims remain in the litigation, and because a hearing and a proper **[*97]** record will be necessary to decide certification issues, the Court defers ruling on part of ICERS's motion, i.e., to intervene as a class representative. Nevertheless, to prepare for future resolution of class certification and standing and because ICERS' ability to serve as a class representative directly relates to part of its motion to intervene, the Court sets out relevant law, some of which has not been directly addressed by the parties, and weighs ICERS's potential to serve in such a role. Defendants have challenged ICERS' standing to represent absent investors in other types of Foreign Debt Securities than the Marlin Water Trust II securities that ICERS purchased. After careful review, this Court concludes that under § 12(a)(2), ICERS has standing to and may serve as a class or subclass representative only for Marlin Water Trust II investors.

[HN39]Under Fed. R. Civ. P. 23(a), the prerequisites for class certification are "(1) numerosity (a class so large that joinder of all members is impracticable), (2) commonality (questions of law or fact common to the class), (3) typicality (named parties' claims or defenses are typical of the class), **[*98]** and (4) adequacy of representation (representative will fairly and adequately protect the interests of the class)." *Mullen v. Treasure Chest Casino, L.L.C., 186 F.3d 620, 623 (5th Cir. 1999)*. Plaintiffs must also demonstrate that the class action may proceed under one of the categories of Rule 23(b), in this instance 23(b)(3) (class action is "superior to other available methods for fair and efficient adjudication of the controversy" and predominance of issues of law and fact common to all members of the class over issues affecting only individual members).

Particularly at issue with respect to ICERS' intervention here are the commonality and typicality elements. [HN40]The commonality, typicality, and adequacy-of-representation requirements tend to overlap and to merge because they "serve as guideposts for determining whether ... the named clamant and the class claims are so inter-related that the interests of the class members will be fairly and adequately protected in their absence." *General Tel. Co. v. Falcon, 457 U.S. 147, 157 n.13, 72 L. Ed. 2d 740, 102 S. Ct. 2364 (1982); AmchemProds. v. Windsor, 521 U.S. 591, 626 n.20, 138 L. Ed. 2d 689, 117 S. Ct. 2231 (1997).* **[*99]**

[HN41]The standard for commonality is not "high," but merely requires that "the resolution of common questions affect all or a substantial number of the class members." *Jenkins v. Raymark Indus., 782 F.2d 468, 472 (5th Cir. 1986); Mullen, 186 F.3d at 625* ("To demonstrate commonality, Plaintiffs must allege that there exist 'questions of law or fact common to the class.'"). Indeed,

All that is required for each class is that there is one common question of law or fact. The interests and claims of the various plaintiffs need not be identical. Rather the commonality test is met when there is 'at least one issue whose resolution will affect all or a significant number of all putative class members.'" [ *Forbush v. J.C. Penney Co., Inc., 994 F.2d 1101, 1106 (5th Cir. 1993)]* (quoting *Stewart v. Winter, 669 F.2d 328, 335 (5th Cir. 1982)*.)) Therefore the fact that some of the Plaintiffs may have different claims or claims that may require some individualized analysis, is not fatal to commonality.

*James, 254 F.3d at 570; see also In re Prudential Ins. Co. of America Sales Practices Litig., 148 F.3d at 310.* **[*100]**

[HN42]A class representative must be a member of the class, possess the same interest, and suffer the same injury as class members. *Schlesinger v. Reservists Comm. To Stop The War, 418 U.S. 208, 216, 41 L. Ed. 2d 706, 94 S. Ct. 2925 (1974).* The typicality test also "'is not demanding. It focuses on the similarity between the named plaintiffs' legal and remedial theories and the theories of those whom they purport to represent." *James, 254 F.3d at 571.* Most important here, "Typicality does not require a complete identity of claims. Rather the critical inquiry is whether the class representative's claims have the same essential characteristics of those of the putative class. If the claims arise from the same course of conduct and share the same legal theory, factual differences will not defeat typicality."

*Id., quoting* 5 James Wm. Moore et al., *Moore's Federal Practice* P 23.24[4] (3d ed. 2000). *See also Wilmington Firefighters Local 1590 v. City of Wilmington, 109 F.R.D. 89, 93 (D. Del. 1985)* ("A representative's claim is typical if it arises from the same event, practice, or conduct that gives rise to the claim of the other class members, **[*101]** and it is based on the same legal theory."); *see also Baby Neal for and by Kanter v. Casey, 43 F.3d 48, 58 (3d Cir. 1994)* ("'Factual differences will not render a claim atypical if the claim arises from the same event or practice or course of conduct that gives rise to the claims of the class members, and if it is based on the same legal theory [citations omitted].'"); 1 *Newberg on Class Actions* § 3.15, p. 3-78. [HN43]Typicality thus involves the individual plaintiff's Article III standing to pursue his own personal claim and to raise the legal claims of the class. *Rector v. City and County of Denver, 348 F.3d 935, 949-50 (10th Cir. 2003)*, citing *Wooden v. Bd of Regents of Univ. Sys. of Ga., 247 F.3d 1262, 1287 (11th Cir. 2001)*, and *Sample v. Aldi, Inc., 61 F.3d 544, 551 (7th Cir. 1995)*. Typicality "focuses less on the relative strengths of the named and unnamed plaintiffs' cases than on the similarity of the legal and remedial theories behind their claims." *Jenkins v. Raymark Indus., 782 F.2d ,468, 472.* "The typicality inquiry is intended to assess whether the action can be efficiently maintained as a class and whether **[*102]** the named plaintiffs have incentives that align with those of absent class members so as to assure that the absentees' interests will be fairly represented." *Baby Neal, 43 F.3d at 57.* Neither commonality nor typicality requires that all putative class members share identical claims. *Id. at 56.*

[HN44]As for adequacy of representation under Rule 23(a), "'differences between named plaintiffs and class members render the named plaintiffs inadequate representatives only if those differences create conflicts between the named plaintiffs' interests and the class members' interests.'" *James, 254 F.3d at 571, quoting Mullen, 186 F.3d at 625-26.*

In the *Newby* securities fraud class action, some of the questions of law or fact that may be common to the proposed class include whether the class members allege that (1) Defendants violated the same statute(s), (2) Defendants made the same kinds of material misrepresentations or omissions of fact regarding the financial condition of Enron or accounting fraud, (3) Defendants acted knowingly, with severe recklessness, recklessly or negligently in or are strictly liable for (depending **[*103]** on the relevant statute) making such material misrepresentations or omissions or in concealing Defendants' wrong doing, and (4) the market price of Enron securities and the Enron-related entities' Foreign Debt Securities was artificially inflated due to Defendants' wrongdoing. In addition to Lead Plaintiff's alleging a common scheme to defraud, minimizing the differences in the types of securities purchased by the Foreign Debt investors, ICERS focuses on material misrepresentations and omissions in the Foreign Debt Securities' offering memoranda and selling communications virtually identical to those already upheld as the bases for the Enron-securities investors' claims under the same legal theories by this Court: for example, the Osprey I offering memorandum incorporates Enron's 1998 10-K, Forms 10-Q for quarters ended March 31 and July 30, 2000 and included Enron's consolidated financial information for years ended 1997 and 1998; and the Marlin Water Trust offering memorandum incorporates Enron's 2000 10-K, Form 10-Q for the quarter ended March 31, 2000, Form 8-Ks filed January 31 and February 28, 2001, and includes Enron's consolidated financial information for years ended 1998-2000. # **[*104]** 1804 at 3.

[HN45]Where there is a prominent thread through all plaintiffs' claims, e.g., a scheme to defraud where the plaintiffs have suffered the same generic type of harm as a result of the same common, wrongful conduct (material misrepresentations and omissions) and have suffered economic damage, some courts have found that the scheme may demonstrate that the claims of the named plaintiffs are typical of the class as a whole. *In re Prudential Ins. Co. of America Sales Practices Litig., 148 F.3d at 310-12, citing Gen. Tel. Co. of the Southwest v. Falcon, 457 U.S. 147, 159, 72 L. Ed. 2d 740, 102 S. Ct. 2364 (1982).* "The various forms which the injuries may take do not negate a finding of typicality, provided the cause of those injuries is some common wrong." *Id.* at 312, *citing Baby Neal, 43 F.3d at 58*, and *Falcon, 457 U.S. at 157-59* ("Where an action challenges a policy or practice, the named plaintiffs suffering one specific injury from the practice can represent a class suffering other injuries, so long as all injuries are shown to result from the practice."). *In re Prudential Ins. Co. of America Sales Practices Litig., 148 F.3d at 312,* **[*105]** a class action brought on behalf of more than eight million policy holders alleging that the life insurer employed a common and extensive scheme involving a variety of false and misleading sales and marketing materials to defraud them, the Third Circuit found, "Since all members of the class would need to demonstrate the existence of this scheme, their interests are sufficiently aligned that the class representatives can be expected to adequately pursue the interests of the absentee class members." *Id., citing Amchem, 117 S. Ct. at 2248* ("Rule 23 asks 'whether a proposed class has sufficient unity so that absent class members can fairly be bound by decisions of class representatives.'"). *See also Longden, 123 F.R.D. 547* (holding that purported common course of conduct through a uniform distribution of substantially similar private placement memoranda to market real estate limited partnerships met the commonality requirement for class certification despite the fact that the private placement memoranda involved over 100 separate limited partnership transactions over a five-year period).

There is, of course, contrary authority. For example, in *In re Taxable Municipal Bonds Litig., 1993 U.S. Dist. LEXIS 10997,* No. Civ. A. No. MDL 863, 1993 WL 302619 **[*106]** (E.D. La. Aug. 5, 1993), the court pronounced, "It is settled law that a single plaintiff lacks standing to assert class claims against defendants with whom the plaintiff has not dealt, even though unnamed individuals that the plaintiff seeks to represent may have direct claims against those defendants." *Id. 1993 U.S. Dist. LEXIS 10997* at *3. In *Taxable,* a class action brought by multiple plaintiffs involving eight separate bond issues, the court concluded that a class has standing against multiple defendants as long as every defendant was charged with a claim by at least one named class representative. *Id. 1993 U.S. Dist. LEXIS 10997* at *4. The court noted,Plaintiffs contend that there is an "alleged common scheme,"... that ties the eight master complaints together. Nevertheless, it does not appear from the record that plaintiffs are alleging that *all* named defendants, disregarding in which master complaint they are named, acted in concert such that every plaintiff has a direct claim against every defendant ... Rather, plaintiffs are alleging that the "same misrepresentations and omissions taint each of the bond issues," i.e., that the alleged schemes in the master complaints and the claims arising therefrom are **[*107]** very similar.

*Id. at 1993 U.S. Dist. LEXIS 10997* * n. 17.

Where a representative plaintiff in a class action suit has itself been injured by one or more, but not by all, of named multiple defendants, some courts have recognized an exception to the general rule that each class representative must have a plausible claim against each named defendant in a class or subclass. This exception is frequently designated the "juridical links" doctrine:[HN46]There is an exception to [the requirement that representative plaintiffs must have individual standing to assert colorable claims against all members of the defendant class] where the defendant members are related by a concerted scheme, conspiracy, or juridical link, that is some legal relationship which relates all defendants in a way such single resolution of the dispute is preferred to a multiplicity of similar actions. A juridical link sufficient to confer standing generally must stem from an independent legal relationship. It must be some form of activity or association on the part of the defendants that warrants imposition of joint liability against the group even though the plaintiff may have dealt primarily with a single member. This link may **[*108]** be a conspiracy, partnership, joint enterprise, agreement, contract, or aiding and abetting, which acts to standardize the factual underpinnings of the claims and to insure the assertion of defenses common to the class. [footnotes omitted]6A *Federal Procedure,* Lawyers Ed. § 12:44 (Database updated Oct. 2003). The doctrine is a powerful tool that can allow a plaintiff's lawyer to force many defendants (and what might otherwise be numerous class actions) into a single lawsuit at a substantially reduced cost. William D. Henderson, *Reconciling the Juridical Links Doctrine with the Federal Rules of Civil Procedure and Article III, 67 U. Chi. L. Rev. 1347, 1348 (Fall 2000).* Originally developed by the Ninth Circuit and initially applied only to governmental-entity defendant classes in bilateral class actions, the doctrine was gradually extended to reach private sector defendants involving individually named defendants joined by a common agreement, uniform practice, or common course of conduct (in securities cases, as alleged here, a common course of misrepresentations and omissions), for purposes of judicial efficiency. *Id. at 1355-56, 1359.* **[*109]** See, *e.g., La Mar v. H&B Novelty & Loan Co., 489 F.2d 461, 466 (9th Cir. 1973)* (although a plaintiff may only recover on § 12(2) claims from the defendants that played a substantial role in selling the plaintiff the disputed securities, the panel recognized in dicta an exception where plaintiffs alleged they have been injured as a group by the same course of conduct by defendants in a conspiracy or concerted scheme or "juridically related in a manner that suggests a single resolution of the dispute would be expeditious."); *In re Computer Memories Sec. Litig., 111 F.R.D. 675 (N.D. Cal. 1986)* (applying juridical link exception where representative plaintiff did not have standing to sue all named defendant underwriters under § 12(2) of 1933 Act n51 because of limitation of liability to parties who were a substantial factor in causing the securities sale, but also where defendant underwriters had an agreement about the relevant underwriting and were bound to a common course of conduct relating to purposes of common stock offering); *In re Activision Sec. Litig., 621 F. Supp. 415, 432 (N.D. Cal. 1985)* (finding that a juridical link in **[*110]** underwriters' Agreement); *Fallick v. Nationwide Mut. Ins. Co., 162 F.3d 410, 423-24 (6th Cir. 1998)* ("Where, as here, the crux of an ERISA plaintiff's complaint concerns the methodology used to determine benefits, courts have recognized that the standing-related provisions of ERISA were not intended to limit a claimant's right to proceed under Rule 23 on behalf of all individuals affected by the challenged conduct regardless fo the representative's lack of participation in all the ERISA-governed plans involved ... Onee a potential ERISA class representative establishes his individual standing to sue his own ERISA-governed plan, there is no additional constitutional requirement related to his suitability to represent putative class members of other plans to which he does not belong."), *citing Forbush v. J.C. Penney Co., Inc., 994 F.2d 1101, 1106 (5th Cir. 1993)* (not employing juridical link terminology, but viewing the issue through Rule 23's commonality and typicality requirements for class certification, the majority of the panel reversed the district court's denial of class certification where plaintiff sought to represent members of four separate **[*111]** ERISA plans administered by same employer and challenged employer's general practice of over-estimating social security benefits in violation of ERISA's nonforfeiture provisions) n52; *In re Itel Sec. Litig., 89 F.R.D. 104, 119 (N.D. Cal. 1981)* ("In summary then, unless the proponent of the class action can allege a conspiracy or concerted action among the defendants, or unless juridical links exist that make class resolution of a dispute expeditious, class treatment is not proper unless each plaintiff class representative has a cause of action against each defendant, even though the plaintiffs were all injured by a method of dealing common to all defendants.").

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n51 As expressed in *In re Itel Sec. Litig., 89 F.R.D. 104, 121, 119 (N.D. Cal. 1981)*, which defined a "juridical link" or "juridical relationship" as "some type of legal relationship which relates all defendants in a way that would make single resolution of a dispute preferable to a multiplicity of similar actions,"

Liability under § 12(2) is ordinarily restricted to the immediate seller of the defrauded purchaser. If none of the exceptions to this § 12(2) privity requirement are applicable, i.e., control, agency, aiding and abetting or conspiracy, each plaintiff member would have a cause of action only against his or her immediate seller ... Unless an exception to § 12(2) is alleged or unless an exception recognized by the La Mar court is alleged, i.e., conspiracy or juridical relationship which suggests that class treatment of the underwriters would be expeditious, class certification as to the § 12(2) action would have to be denied pursuant to La Mar because each plaintiff class representative does not have a § 12(2) cause of action against each defendant underwriter.

*89 F.R.D. at 119*. The *Itel* court found sufficient juridical links or legal relationships to permit a § 12(2) class of underwriters because these underwriters already comprised a class for § 11 claims based on the same registration statements and prospectuses ("with the same untruths or omissions which are materially misleading") and because class treatment "is clearly the most expedient way in which to try the claims." *Id. at 121*. "otherwise the district courts could conceivably be faced with having to determine this issue over one hundred separate times if the plaintiffs decide to pursue § 12(2) remedies against each "immediate seller" underwriter." *Id. at 121-22*.

**[*112]**

n52 *See also Alves v. Harvard Pilgrim Health Care, Inc., 204 F. Supp. 2d 198 (D. Mass. 2002), aff'd, 316 F.3d 290* (1st Cir.), addressing a class action brought by former beneficiaries of ERISA health care plans against sponsors and medical services provider alleging that these defendants violated terms of plans and breached fiduciary duties by deciding to increase co-payments in excess of prescription drug costs and by failing to disclose material information and providing misleading information about these costs. The district court held that under *Fallick, Forbush,* and *La Mar,* the plaintiffs' claims could not be dismissed for lack of standing because the defendants were wholly owned affiliate plans of the defendant sponsors in one of which each plaintiffs was a participant and which had substantially the same co-payment provisions and for which a single resolution of the dispute would be expeditious. *Id. at 205.*

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A number of courts have warily admonished that "broad construction of the juridical link exception to *La Mar* obscures the **[*113]** confines of that doctrine." *Angel Music, Inc. v. ABC Sports, Inc., 112 F.R.D. 70, 75 (S.D.N.Y. 1986)* (concluding that the juridical link exception is only applicable where defendants' conduct "is standardized by a common link to an agreement, contract or enforced system which acts to standardize the factual underpinnings of the claims and to insure the assertion of defenses common to the class."); *Leer v. Washington Educ. Assoc., 172 F.R.D. 439, 448-49 (W.D. Wash. 1997)* (following *Angel Music's* restrictive definition, finding no juridical link among two subclasses of defendants); *Akerman v. Oryx Communications, Inc., 609 F. Supp. 363, 376 (S.D.N.Y. 1984).*

Lead Plaintiff argues strenuously that it, through the intervention of ICERS, must have standing to sue for all investors, including the Foreign Debt Securities investors claims under § 12(a)(2), for pragmatic reasons:

If each of these claimants were separately certified [as a class representative] with its own class action and with lead plaintiff and counsel, this litigation would disintegrate into chaos, resulting in hugely wasteful duplicative activities and increased **[*114]** fees and expenses. It would also greatly increase the burden on the Court to administer and oversee the case and inevitably would delay the recovery ultimately obtained by the victims of this fraud.

# 1853 at 3. In *Ackerman,* the district court, disagreeing with Itel's conclusion that class certification of defendant class for § 11 claims was a sufficient juridical link to support class treatment of Section 12(2) claims, and insisting that "a juridical link sufficient to confer standing generally must stem from an independent legal relationship," *609 F. Supp. at 375,* made some incisive comments about bilateral classes and the dangers of the juridical link doctrine:

A defendant class may not be certified simply on the ground that underwriters distributed identical printed matter to securities purchasers. Nor does justice demand a lowering of the justiciability threshold in order to permit vindication of constitutional claims ... Finally as noted with respect to the section 11(e) damages issue, courts must be careful of expanding substantive rights conferred by the securities acts. Certification of a defendant class of underwriters for purposes of section **[*115]** 12(2) claims would effectively eliminate the privity requirement and subject any underwriter to suit by any purchaser.

... [HN47]The fundamental requirement [is] that each plaintiff have standing to sue each defendant ... "[A] predicate to a plaintiff's] right to represent a class is his eligibility to sue in his own right. What he may not achieve himself, he may not accomplish as a representative of a class." ... The procedural expedient of plaintiff class certification should not be mistaken for the sort of legal relationship that confers standing on representative to litigate the claims of individual members ... [A] plaintiff "may not use the procedural device of a class action to boot strap himself into standing he lacks under the express terms of the substantive law ... The plaintiff's standing to bring an action against each defendant named in the Complaint must be established independently of Federal Rule of Civil Procedure 23. Only then is a plaintiff in a position to represent others having similar claims against those same defendants." [citations omitted]

*609 F. Supp. at 376-77.* n53

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n53 Indeed not only the juridical links doctrine or the "concerted scheme" approach have eroded the express privity requirement of § 12(a)(2), but also the lower courts' judicial expansion of the term "seller" beyond the plaintiff's immediate seller to include others actively soliciting and collaborating in the sale (including brokers, agents of the principal seller) and their application of secondary theories of liability like aiding and abetting and conspiracy. *See, e.g.,* Patricia A. O'Hara, *Erosion of the Privity Requirement in Section 12(2) of the Securities Act of 1933: The Expanded Meaning of Seller,* 31 U.C.L.A. 921, 931-33 (June 1984). See discussion *infra.*

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[*116]

Henderson also critically comments that the case law on juridical links "contains a complex and often incoherent merger of procedural and jurisdictional issues," perhaps because "courts have uncritically relied on stare decisis to justify the doctrine and have incrementally extended it in cases where it might promote judicial economy." *67 U. Chi. L. Rev. at 1366*. For instance it has been identified as an exception to both or either the Rule 23(a)(3) requirement of typicality for class certification and/or to Article III standing. *Id. at 1361*.

In the instant suit, there is no question that, if not barred by limitations, ICERS individually has standing to sue the underwriter that sold ICERS its debt securities under § 12(a)(2) for rescissory damages n54 arising from its personal investment in the Marlin Water Trust II debt securities during the Class Period.

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n54 Section 12(a)(2) allows the prevailing plaintiff-purchaser "to recover the consideration paid [i.e., purchase price] for such security with interest thereon, less the amount of any income received thereon, upon tender of such security [i.e., to rescind his purchase] or for equivalent monetary damages if he no longer owns the security," unless the seller proves that it did not know, and in the exercise of reasonable care could not have known, of the alleged misstatement or omission in the written or oral communications used to sell the securities. *15 U.S.C. § 77l*(a)(2).

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[*117]

Lead Plaintiff has alleged an actual monetary loss by investors arising from their purchase of Foreign Debt Securities fairly traceable to and caused by the purported material misrepresentations and omissions of their various underwriter(s) Defendants in concealing Enron's actual financial condition that can be redressed by an award of damages in this action. The alleged injuries arise from the same purportedly fraudulent practice or course of conduct of identical material misrepresentations and omissions deceiving the *Newby* plaintiffs. According to ICERS, the offering memoranda of all nine types of Foreign Debt Securities incorporated the same misleading financial documents relied upon by investors in other securities at issue in *Newby*. The Foreign Debt Securities claims are based on the same legal theories and statutory, i.e., § 12(a)(2) violations.

Nevertheless, although *Newby* Lead Plaintiff has alleged a concerted scheme for purposes of its § 10(b) claims, unlike in the ERISA cases or in the cases involving securities issued by a single corporation cited above, there are more than Article III and Rule 23 criteria involved in establishing standing for class representation **[*118]** under § 12(a)(2). In some ways establishing a claim under § 12(a) is substantially easier for a disgruntled, defrauded plaintiff-investor than establishing one under § 10(b) and Rule 10b-5. Section 12(a) does not require a showing of reliance, in deciding to make his purchase, on the alleged misstatements or omissions the plaintiff targets, but only a demonstration that he lacked actual knowledge of them, nor does he have to show scienter. Nevertheless, the statute's privity requirement, not part of § 10(b), limits its imposition of liability.

With respect to the juridical links doctrine, other than the privity between each investor and his immediate seller expressly set out in § 12(a)(2), in this litigation there was no allegation of an agreement, such as one to share expenses or workload or a collective bargaining agreement or a partnership or joint venture among the various Bank Defendant underwriters here that would support a "legal relationship" beyond a plaintiff's privity with an underwriter in his individual purchase of securities. *See, e.g., Endo, 147 F.R.D. at 172-73*.

More significantly, [HN48]unlike plaintiffs suing under § 10(b), which does not require **[*119]** privity, despite allegations of a concerted scheme or wrongful course of conduct, the express substantive statutory requirement of § 12(a)(2), that the defendant must be a "seller," n55 even under the judicial expansion of the definition of that word, to the plaintiff who sues that defendant, restricts the class of defendants whom or which a particular plaintiff has standing to sue individually and therefore also as a representative for a putative class of Foreign Debt Securities investors. "[A] plaintiff bringing suit under either Section 11 or Section 12 of the Securities Act at least must allege that he or she purchased or acquired the security at issue." *In re Paracelsus Corp. Sec. Litig., 6 F. Supp. 2d 626, 631 (S.D. Tex. 1998)*. Furthermore, for a claim under § 12(a)(2), which provides for liability against sellers or against parties that actively, directly and "successfully solicited the purchase" of the security in dispute, pursuant to a prospectus, absent an "allegation of direct contact between defendants and plaintiff-purchasers, as a matter of law the defendants are not statutory sellers." *Pinter v. Dahl, 486 U.S.*

*622, 647, 100 L. Ed. 2d 658, 10~~. Ct. 2063 (1988)*; **[*120]** *In re Azurix Corp. Sec. Litig., 198 F. Supp. 2d 862, 892 (S.D. Tex. 2002), aff'd sub nom. Rosenzweig v. Azurix Corp., 332 F.3d 854, 871 (5th Cir. 2003)*.

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n55 Title *15 U.S.C. § 77l* defines the class of defendants subject to liability in part as "Any person ... who offers or sells ... shall be liable ... to the person purchasing such security from him ..." Section 2(3) defines "sale" or "sell" as including "every contract of sale or disposition of a security or interest in a security, for value." *15 U.S.C. § 77b*(3). The phrases "offer to sell," "offer for sale," or "offer," refer to "every attempt or offer to dispose of, or solicitation of an offer to buy a security or interest in a security, for value." *Id.* Thus even though a party is not an owner who passes title, he may be liable as a statutory "seller" if he successfully solicits a purchase involving the transfer of securities not gratuitously, but to serve his own financial interests or those of the securities' owner. *Pinter, 486 U.S. at 647*.

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**[*121]**

As noted previously, the lower courts developed a variety of theories to expand the definition of "seller" for increased liability under § 12 of the 1933 Act. For a time, the Fifth Circuit, using a proximate causation analysis, took a middle road between strict privity's limitation of liability to the immediate party/owner/vendor in the transaction and the overly liberal approach that all who "participated in" the acts leading up to the sale transaction may be sued. Drawing on the "cause and effect" approach of *Lennerth v. Mendenhall, 234 F. Supp. 59 (N.D. Ohio 1964)*, derived from the law of negligence, for claims under §§ 12(a)(1) and 12(a)(2), the Fifth Circuit utilized a "substantial factor" test from torts. *Pharo v. Smith, 621 F.2d 656, 665-68* & nn. 6-8 (a "seller" is one "whose participation in the buy-sell transaction is a substantial factor in causing the transaction to take place."), *on rehearing in part on other grounds, 625 F.2d 1226 (5th Cir. 1980). See generally* O'Hara, *Erosion of the Privity Requirement*, 31 U.C.L.A. at 961-74.

Nevertheless in *Pinter v. Dahl, 486 U.S. 622, 630, 654, 100 L. Ed. 2d 658, 108 S. Ct. 2063 (1988)*, **[*122]** the United States Supreme Court, although addressing only § 12(1), n56 rejected this standard as well as other current theories of primary seller liability as too broad and held, "Being merely a "substantial factor" in causing a sale of unregistered securities is not sufficient in itself to render a defendant liable" as a "seller" under the statute. In "refinement" of that collateral participation test, *486 U.S. at 648*, the Supreme Court concluded,

[HN49]There is no support in the statutory language or legislative history for expansion of § 12(1) liability beyond those who pass title and persons who "offer," including those who "solicit" offers. Indeed, § 12's failure to impose express liability for mere participation in unlawful sales transactions suggests that Congress did not intend that the section impose liability on participants' [sic] collateral to the offer or sale. When Congress wished to create such liability, it had little trouble doing so.

*Id. at 650*. n57 The high court sanctioned the inclusion of successful solicitation for value as "selling" under the statute; "Had Congress intended liability to be restricted to those who pass **[*123]** title, it could have effectuated its intent by not adding the phrase 'offers or' when it split the definition of 'sell' in § 2(3). *Id. at 646*. Therefore it recognized the established view that a broker acting as an agent of one of the principals to the transaction who successfully solicits a purchase is a "seller" with primary liability who may be sued by the plaintiff purchaser. *486 U.S. at 646-47* ("solicitation of a buyer is perhaps the most critical stage of the selling transaction" and "brokers and other solicitors are well positioned to control the flow of information to the purchaser").

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n56 With respect to seller liability under § 12(2), the Supreme Court in *Pinter v. Dahl, 486 U.S. at 622 n.20*, noted,

[HN50]The "offers or sells" and the "purchasing such security from him" language that governs § 12(1) also governs § 12(2), which provides a securities purchaser with a similar rescissionary cause of action for misrepresentation. *15 U.S.C. § 77l*. Most courts and commentators have not defined the defendant class differently for purposes of the two provisions. *See, e.g., Pharo v. Smith, 621 F.2d 656, 665-68* and nn. 6-8 (CA5 1980) ... The question whether anyone beyond the transferor of the title, or immediate vendor, may be deemed a seller for purposes of § 12(1) and § 12(2). Decisions under § 12(2) addressing the "seller" question are thus relevant to the issue presented to us in this case, and, to that extent, we discuss them here. Nevertheless, this case does not present, nor do we take the position on, the scope of a statutory seller for purposes of 12(2).

Since *Pinter* was issued, other Courts of Appeals have held that Pinter's interpretation of "seller," i.e., persons who pass title or who "offer" securities, including those who successfully "solicit," applies to § 12(2) liability, too. *See, e.g., Ryder International Corporation v. First American National Bank, 943 F.2d 1521, 1526-27 (11th Cir. 1991).*

**[*124]**

n57 In examining the role of § 12 in the statutory scheme, the Supreme Court observed,

Section 11 of the Securities Act, *15 U.S.C. § 77k*, lends support to the conclusion that Congress did not intend to extend § 12 primary liability to collateral participants in the unlawful securities sales transaction. That section provides an express cause of action for damages to a person acquiring securities pursuant to a registration statement that misstates or omits a material fact. Section 11(a) explicitly enumerates the various categories of persons involved in the registration process who are subject to suit under that section, including many who are participant in the activities leading up to the sale. There are no similar provisions in § 12, and therefore we may conclude that Congress did not intend such persons to be defendants in § 12 actions.

*486 U.S. 650 n.26.* The Court also admonished that the substantial participation test

would extend § 12(1) liability to participants only remotely related to the relevant aspects of the sales transaction. Indeed it might expose securities professionals, such as accountants and lawyers, whose involvement is only the performance of their professional services, to § 12(1) strict liability for rescission. The buyer does not, in any meaningful sense, "purchase the security" from such a person."

*Id. at 651.* The Supreme Court further emphasized that in light of the strict liability imposed on defendants by the statute, the substantial participation test

affords no guidelines for distinguishing between the defendant whose conduct rises to a level of significance sufficient to trigger seller status and the defendant whose conduct is not sufficiently integral to the sale ... None of the courts employing the approach has articulated what measure of participation qualifies a person for seller status, and logically sound limitations would be difficult to develop. As a result decisions are made on an ad hoc basis, offering little predictive value to participants in securities transactions."

*Id. at 652.*

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**[*125]**

[HN51]This Court also finds relevant to requiring a plaintiff to restrict its claims to its substantive "seller" defendants is the fact that § 12(a)(2), unlike § 10(b), does not provide for joint and several liability. *Endo, 147 F.R.D. at 172.* Moreover, recovery under the statute is in the nature of rescission, a remedy arising from common law, suggesting it is limited to parties to a transaction/contract or the seller's direct agent. *See* O'Hara, *Erosion of the Privity Requirement,* 31 U.C.L.A. at 938-44

There is clearly dissension in the case law regarding class representation of § 12(a)(2) claims. As discussed, a few courts as a general rule recognize class representation in a securities suit where the class members have asserted a common course of conduct or the same illegal scheme by defendants and purportedly relied on the same material misrepresentation and omissions, including for claims under § 12(a)(2), even though the class representative and the class members have purchased different types of securities. [HN52]This Court believes that such a common-course-of-conduct rule is properly applied in claims under § 10(b), n58 for which Rule 10b-5 makes it "unlawful **[*126]** for any person, directly or indirectly, ... to employ any ... scheme ... to defraud ... or to engage in any ... practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security," but not to claims under § 12(a)(2). 17 C.F.R.

§ 240.10b-5. The Court observes that with respect to § 12(a)(2), other courts have focused on the specific statutory restriction of § 12(a)(2), limiting a plaintiff's standing to sue to only the party from which the plaintiff purchased the securities at issue or which successfully solicited the plaintiff's purchase, and they have found it to be a substantial obstacle to suit and class representation. *Azurix, 198 F. Supp. 2d at 892* ("For potential § 12(a)(2) liability to exist, defendants must have passed title to plaintiffs as a 'direct seller' (such as an underwriter) or solicited the transaction in which title passed to them ... Absent any allegation of direct contact of any kind between defendants and plaintiff purchasers, as a matter of law the defendants are not statutory sellers."), *aff'd, 332 F.3d at 871* **[*127]** ("Liability does not extend to ... 'collateral participants.'") The Court agrees with this construction.

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n58 As well as for derivative claims under § 20 and § 20A.

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[HN53]A named plaintiff must have standing to serve as a class representative. *In re Taxable Munic. Bond Sec. Litig., 51 F.3d 518, 522 (5th Cir. 1995)* ("It is well-established that to have standing to sue as a class representative it is essential that a plaintiff must be part of that class ...."); *In re Initial Pub. Offering Sec. Litig., 214 F.R.D. at 122*. It is undisputed that ICERS, personally, has standing under § 12(a)(2) to assert claims against its own statutory seller(s) for its purchases of the Marlin Water Trust II securities. It would also have standing to represent purchasers of the same notes in the same offering from the same broker.

Thus because of the statutory privity/seller restriction, this Court concludes that as a matter of law while ICERS may intervene as a named plaintiff, under § 12(a)(2), ICERS **[*128]** individually, can only sue, and therefore can only serve as a class representative for other purchasers for claims against, the entities that successfully sold to ICERS, or successfully solicited ICERS' purchase of, the Marlin Water Trust II notes in the July 12, 2001 offering. ICERS is not qualified to serve as a class representative for purchasers of the other eight types of Foreign Debt Securities in other offerings from other statutory sellers for claims under § 12(a)(2). Judicial economy and pragmatic concerns, underlying the juridical links doctrine and the concerted scheme theory, cannot manufacture standing for a class representative where the statutory language and the provision's role in the statute's structure expressly and impliedly mandate satisfaction of the substantive seller requirement.

Whether a class or subclass relating to § 12(a)(2) claims by purchasers in the other eight offerings of Foreign Debt Securities may be certified in this litigation will depend upon whether any eligible and willing class members, who have purchased any of each of the other eight types of securities, move to intervene and to be named a class representative.

**D. Permissive intervention [*129] under Fed. R. Civ. P. 24(b)(2)**

As noted previously, Rule 24(b)(2), relating to permissive intervention, provides in relevant part, [HN54]"Upon timely application any one may be permitted to intervene in an action ... when an applicant's claim or defense and the main action have a question of law or fact in common ... In exercising its discretion the court shall consider whether the intervention will unduly delay or prejudice the adjudication of the rights of the original parties." *See also League of United Latin American Citizens, Council No. 4434 v Clements, 884 F.2d 185, 189 (5th Cir. 1989)* (the court has discretion to grant a motion for permissive intervention where (1) timely application is made by the intervenor, (2) the intervenor's claim or defense and the main action have a question of law or fact in common, and (3) intervention will not unduly delay or prejudice adjudication of the rights of the existing parties.). [HN55]The "principal consideration" in a court's exercise of discretion under Rule 24(b) is "'whether the intervention will unduly delay or prejudice the adjudication of the rights of the original parties.'" C Wright, **[*130]** Miller & Kane, *Federal Practice and Procedure: Civil 2d* § 1913, at 379 (West 1986). n59

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n59 This Court points out that the issue of timeliness of the filing of the motion to intervene is distinct from, and must be analyzed separately from, the question of timeliness relating to assertion of claims within the statute of limitations.

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In *Stallworth v. Monsanto Co., 558 F.2d 257, 263 (5th Cir. 1977)*, [HN56]the Fifth Circuit concluded that a motion for leave to intervene under Rule 24(a) (intervention by right) or (b) (permissive intervention) must be timely, n60 a determination committed to the Court's discretion. "Timeliness is not limited to chronological considerations, but 'is to be determined from all the circumstances.'" *Id., citing United States v. United States Steel Corp., 548 F.2d 1232, 1235 (5th Cir. 1977)*. The court must consider four factors in reviewing the timeliness of a motion for leave to intervene under Rule 23: (1) the length of time during which the would-be intervenors **[*131]** actually knew or should have known of their interest in the case before they filed their motion to intervene n61; (2) the degree of prejudice that existing parties would suffer as a result of the would-be intervenors' failure to intervene as soon as they actually knew or reasonably should have known of their interest in the case n62; (3) the degree of prejudice that the applicant-intervenors would suffer if their motion to intervene were denied; and (4) any unusual circumstances that would weigh for or against a determination that the motion was timely, i.e., a convincing justification for tardiness. *Id.* at 264-66.

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n60 The Fifth Circuit earlier stated,

"Timeliness" is not a word of exactitude or of precisely measurable dimensions. The requirement of timeliness must have accommodating flexibility toward both the court and the litigants if it is to be successfully employed to regulate intervention in the interest of justice.

*McDonald v. E.J. Lavino Co., 430 F.2d 1065, 1074 (5th Cir. 1970)*.

n61 [HN57]Knowledge of the pendency of the litigation is not sufficient by itself to require immediate motion to intervene; "scarce judicial resources would be squandered, and the litigation costs of the parties would be increased" if such were the rule, causing premature filing, while "many individuals who excusably failed to appreciate the significance of a suit at the time it was filed would be barred from intervening to protect their interests when its importance became apparent to them later on." *Stallworth, 558 F.2d at 265*. Rather than the date when the would-be intervenor became aware of the litigation, the relevant circumstance would be when it became aware that its interest would no longer be adequately protected by the parties. *Legal Aid Soc. of Alameda Co. v. Dunlop, 618 F.2d 48, 50 (9th Cir. 1980)*.

**[*132]**

n62 The Fifth Circuit observed, "The relevant issue is not how much prejudice would result from allowing intervention, but rather how much prejudice would result from the would-be intervenor's failure to request intervention as soon as he knew or should have known of his interest in the case." *Stallworth, 558 F.2d at 267*.

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Furthermore [HN58]a two-step analysis is applied to determine whether permissive intervention under Rule 24(b)(2) should be granted: (1) the court must determine whether "the applicant's claim or defense and the main action have a question of law or fact in common"; (2) if they do have a question of law or fact in common, the court must decide in its discretion whether the intervention should be allowed. *Id. at 269*.

[HN59]Generally courts "appear to be particularly amenable to permissive intervention when no additional issues are presented to the case, when the intervenor's claims are 'virtually identical' to class claims, and when intervention would strengthen the adequacy of class representation." 3 Herbert Newberg & Alba Conta, *Newberg on Class Actions* **[*133]** §§ 16.08-.09 (3d ed. 1992). Indeed, unlike Rule 24(a), intervention as of right, which allows a party to intervene only where its interests are not adequately represented by current parties, Rule 24(b) contains no such restriction. *In re Lutheran Bhd.. Variable Ins. Prods.Co. Sales Practices Litig., 2002 U.S. Dist. LEXIS 20163*, No. 99-MD-1309 (PAM), 2002 WL 31371945, *4 (D.Minn. Oct. 7, 2002) ("intervention under Rule 24(b) is allowable in the context of class action to enhance or strengthen the representation of the class").

[HN60]The Fifth Circuit Court of Appeals has approved the addition of plaintiffs to better represent potential subclasses where the named plaintiffs were not inadequate representatives. *Vuyanich, 82 F.R.D. at 437, citing Oatis v. Crown Zellerbach, 398 F.2d 496 (5th Cir. 1968)*. It stated that this principle should be applied to allow permissive intervention to make the class "representation even stronger and to protect the class members most completely." *Id.* The Fifth Circuit also pointed out that it has "extended the Oatis rule, which technically applied only to co-plaintiffs, to intervenors in Title VII cases." *Id., citing Wheeler v. American Home Products Corp., 563 F.2d 1233 (5th Cir. 1977)*; **[*134]** *Olivares v. Martin, 555 F.2d 1192 (5th Cir. 1977)*.

With respect to the issue of timeliness of the motion to intervene, specifically the length of time during which ICERS actually knew or should have know of its interest in the case prior to filing its motion to intervene, as has been noted, there have been three *Newby* complaints filed: (1) the original on October 20, 2001; (2) the First Consolidated Complaint, filed on April 8, 2002,; and (3) the First Amended Consolidated Complaint on May 14, 2003. In the Court's eyes, the "operative" *Newby* complaint is the second, i.e., the First Consolidated Complaint, which was filed after the appointment of Lead Plaintiff and Lead Counsel and was the first intended to represent the entire class. Only in the subsequent, First Amended Consolidated Complaint, did Lead Plaintiff define the class specifically to include securities issued by Enron-related entities as well as by Enron, but securities that plaintiff-investors purchased, like investors in Enron-issued securities, based on the same allegedly false and misleading representations and omissions by Defendants about Enron's financial condition. Moreover the role of these **[*135]** Enron-related-entity issuers in the alleged *Ponzi* scheme was discussed in the First Consolidated Complaint.

Moreover, a major reason for any "delay" between the two consolidated complaints rests with the Court, which had numerous complex motions to dismiss to resolve and which ordered Lead Plaintiff not to amend piecemeal, but to wait until the Court had ruled on all parties' motions to file the amended pleading. With respect to the third, now superseding, *Newby* complaint, after ruling on the first round of all Defendants' motions to dismiss the second complaint, not until an order (# 1347) entered on April 24, 2003 did the Court order Lead Plaintiff within twenty days to amend or supplement to cure pleading deficiencies identified by the Court in various memoranda and orders. On April 25, 2003 Lead Plaintiff filed a motion for leave to file its first consolidated amended complaint, enlarging the time until June 16, 2003 (# 1351); in that motion Lead Plaintiff indicated that it was considering adding new parties. Given the volume of the second complaint and the implied request for an extension of time to draft the next, the Court did not expect a copy of the proposed amended **[*136]** pleading to be attached, as required by the Local Rules. Nevertheless, to give the parties enough information to be able to contest the motion for leave to amend, in an order entered on May 2, 2003 the Court ordered Lead Plaintiff to file "a **brief but adequately informative summary** of the parties Lead Plaintiff wished to add and the claims it wished to assert against them." # 1364 at 2. Instead, however, Lead Plaintiff submitted its amended complaint (# 1388) by the original due date, May 14, 2003, without technically obtaining leave, as was required because numerous answers had been filed by Defendants, n63 to add *inter alia* the Foreign Debt Securities claims and plaintiffs, which were beyond the scope of the Court's order. Nevertheless, the addition of these Foreign Debt Securities plaintiffs and defendants was effected before the docket control schedule's deadline for adding parties. Furthermore, the Court subsequently granted the motion for leave to amend on June 5, 2003 (# 1469), thus retroactively approving the filing. Moreover, the only objection to the motion for leave to amend was submitted by Deutsche Bank AG and its affiliates and subsidiaries (# 1436), in essence **[*137]** complaining that it had been renamed in the third complaint after being dismissed by the Court for claims against it in the second. Deutsche Bank AG also stated its intentions to file a motion to dismiss that would brief the objections that it had to the new pleading, as it has subsequently done. The Court will give that motion due consideration. Thus there was no substantial showing of prejudice by Defendants with respect to the filing of the 2003 amendment.

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n63 [HN61]Under Fed. R. Civ. P. 15(a), once a response to a complaint has been filed, amendment of a pleading must be by leave of court. *Dussouy v. Gulf Coast Inv. Corp., 660 F.2d 594, 597 (5th Cir. 1981).* The rule limits the court's discretion by "directing that leave to amend 'shall be given freely when justice so requires,'" reflecting "a bias in favor of granting leave to amend." *Id.* "The policy of federal rules is to permit liberal amendment to facilitate determination of claims on the merits and to prevent litigation from becoming a technical exercise in the fine points of pleading." *Id. at 598.* Reasons substantial enough to justify denial of leave to amend "include undue delay, bad faith or dilatory motive on the part of the movant, repeated failure to cure deficiencies by amendments previously allowed, and undue prejudice to the opposing party." *Id.* If such reasons exist, the court may also consider any prejudice that might arise because of a denial of leave to amend. *Id.* It may also consider judicial economy and the most efficient means to resolve the merits of the suit. *Id.*

Here there was no undue delay by or dilatory motive by Lead Plaintiff; the substantial time required by the Court to resolve numerous complex motions to dismiss was largely responsible for time between the First Consolidated Complaint and the First Amended Consolidated complaint. "Mere passage of time need not result in refusal of leave to amend; on the contrary it is only un... delay that forecloses amendment." *Id.* Nor has there been anything but an indirect and conclusory allegation of bad faith, i.e., that Lead Plaintiff seeks "to improperly gain control of a completely separate and distinct class action ... and to collect any fees that might flow from such a recovery." Instead the Court finds Lead Plaintiff's aim is to serve judicial economy by adding additional factual allegations closely related to those made previously, as exposing an added facet of the alleged Ponzi scheme, and to cure pleading deficiencies cited by the Court. The Court finds no substantial prejudice from allowing the amendment because Defendants have had adequate notice of the challenged occurrences, which are part and parcel of the *Newby* scheme involving the identical conduct, the other parties have raised their objections to contents of the new pleading in responses to the motion to intervene and motions to dismiss the latest complaint, the Court will give full consideration to such objections as statute of limitations and futility. Thus in the event there is any question, the Court reaffirms its decision granting the motion for leave to amend.

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**[*138]**

Furthermore, the Court also granted the motion for leave to amend because the factual bases of the claims of this new group of investors are very similar to and have much in common those of the *Newby* Enron securities investors, minimizing any surprise or prejudice to Defendants. Moreover, the Enron-related entities that issued the Foreign Debt Securities were described in some detail in the earlier pleadings as the means by which Defendants effected the fraudulent Ponzi scheme. Thus Defendants were not totally without notice. Furthermore, as noted with respect to limitations issues, discovery of the alleged wrongdoing outside of Enron was more difficult and less obvious to a reasonable investor. *Levitt v. Bear Stearns, 340 F.3d at 103-04.* Recognizing the greater difficulty in discovering facts relating to secondary actors' roles, *inter alia* the Circuit Court found that not only had the district court failed to determine whether the factual allegations were sufficient to state a claim against secondary actor Bear Stearns for primary liability under § 10(b), but also whether "a reasonable investor of ordinary intelligence exercising reasonable diligence should **[*139]** have discover sufficient facts to support filing a securities fraud claim against Bear Stearns ... at least one year prior to the filing of the Plaintiff's complaint." *Id. at 104.* Therefore, "discovery should have been permitted on the question of what information was realistically available to Plaintiffs and when it was available." *Id.* Nor should Plaintiff be penalized or prejudiced for following the Court's orders to wait until it resolved all motions to dismiss before filing an amended pleading. In view of the fact that in the instant case Lead Plaintiff was following court orders to defer amendment until the Court had resolved all the motions to dismiss and ultimately to file an amended complaint by May 14, 2003 (# 1347), the Court finds that there was no undue delay or dilatory motive here.

Moreover, it was merely a matter of three months between the filing of the First Amended Consolidated Complaint and the motion to intervene, and only a few weeks between the hearing at which counsel conferred about the standing issue and ICERS' motion. For these reasons also the Court finds that the motion was not untimely and that Defendants have not suffered substantial **[*140]** prejudice.

In addition, the Court concurs with Movant that participation by ICERS would serve to protect the class better by bolstering class representation. No class has yet been certified, there is an existing suit into which the intervenor can be admitted, and there is legal authority supporting this Court's discretionary right to permit such intervention.

Furthermore, the Court agrees with Movant that key legal issues in the two suits are virtually identical or significantly related and that there is clearly overlap on factual matters, although the particular securities purchased by investor/plaintiffs differ. Indeed, as noted, although investors in the Enron-related entities that issued the Foreign Debt Securities were not expressly included in the class in the original *Newby* complaint, those entities themselves were identified and described in the previous complaints as SPEs and partnerships illicitly created and exploited in transactions as part of the Ponzi scheme to provide Defendants with notice of their inclusion in the alleged fraud.

In addition, as ICERS has highlighted, at the time the motion to intervene was filed, discovery in *Newby* had barely begun, and **[*141]** Movant's attorney was already involved in the litigation as counsel for *Newby* Lead Plaintiff. Movant has also adopted the *Newby* complaint, further demonstrating a lack of prejudice to existing parties because the parties have all had notice of the nature of the claims.

Conseco has not made any convincing arguments that it is unduly prejudiced by the intervention or that the intervention would substantially delay this litigation.

This Court can certify two class actions, and Conseco's independent class action can still go forward if it properly states a claim and if putative class members choose to join it. The purchasers of the Foreign Debt Securities are within the controlling *Newby* complaint's definition of the alleged victims of the same pattern of misconduct, the same fraudulent scheme charged in *Newby*, even though Conseco chose to limit its independent class action claims to those against Citigroup and its subsidiaries. Indeed, the purchasers of the Foreign Debt Securities may have viable claims against the Enron Defendants, Arthur Andersen, etc. for material misrepresentations and omissions under the same statutes and should be be offered the opportunity to pursue **[*142]** them as members of the *Newby* class. Putative class members should have the right to determine which suit and class they will join if their claims in both actions survive and classes are certified. Lead Plaintiff has not "improperly gained control of a completely separate and distinct class action." Surely the question of Conseco's attorney's fees should not be the determinative factor regarding which claims class members may bring.

The Court has carefully considered all the circumstances of the requested intervention and finds that ICERS' motion to intervene is timely, made within a reasonable time of discovery of the underwriters alleged statutory violations and within a reasonable period after Movant learned of possible problems in standing for a potential subclasses of Foreign Debt Securities investors that ICERS seeks to represent.

Accordingly, for the reasons stated above, the Court

ORDERS that ICERS' motion to intervene as a named plaintiff is GRANTED, but, at this time ICERS' motion to intervene as a class representative is DENIED as premature, but without prejudice to its being reurged at the appropriate time since it would require the Court to define a potential class **[*143]** or subclass of Marlin Water Trust II investors. That decision will be made when the Court addresses class certification and determines what classes and/or subclasses shall go forward. The Court further

ORDERS that Conseco is granted leave to refile its motion for appointment as Lead Plaintiff in H-03-2240, since it was filed timely in H-03-860 (# 51). n64

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n64 H-03-2240 was severed from H-03-860, and H-03-860 was subsequently settled. See footnote 4 of this memorandum and order.

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**SIGNED** at Houston, Texas, this 24th day of February, 2004.

MELINDA HARMON

UNITED STATES DISTRICT JUDGE

# EXHIBIT 8

NORTHWESTERN H[illegible]N SERVICES, INC., NORTHWESTERN [illegible]RASYSTEMS, INC., NORTHWESTERN INTRASYSTEMS, INC. TRUST Dated April 1, 1994, Plaintiffs v. ROBERT C. PANACCIO, MARTA PANACCIO, JOHN L. McKEEVER, III, McKEEVER, BURKE & GRANT, PROVIDENT MUTUAL LIFE INSURANCE COMPANY, PROVIDENT MUTUAL INSURANCE AND FINANCIAL SERVICES COMPANY, 1717 CAPITAL MANAGEMENT COMPANY, SHIRLEY BARR, JOSEPH J. PATRICK, THOMAS X. FLAHERTY, BARRY N. BOWERS, JOHN DOES 1-6, JANE DOES 1-6, and DOE CORPORATIONS 1-6, Defendants

CIVIL ACTION NO. 03-157

UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

2004 U.S. Dist. LEXIS 19147

September 24, 2004, Decided

**DISPOSITION:** Defendants' motions to dismiss granted in part and denied in part.

**CASE SUMMARY**

**PROCEDURAL POSTURE:** Plaintiff nonprofit agency filed an action against defendant officers, which alleged violations of the Racketeer Influenced and Corrupt Organizations Act (RICO). The agency also alleged that defendant financial advisors violated the Securities and Exchange Act of 1934. The complaint also stated several state law claims. The officers and the financial advisors filed a motion to dismiss under *Fed. R. Civ. P. 12(b)(6)*.

**OVERVIEW:** The agency provided mental health services to indigent persons. It contended that the officers engaged in a series of frauds designed to fleece the Medicare and Medicaid programs. It filed an action against the officers and the advisors, who then filed a motion to dismiss. In granting the motion in part, the court determined that the agency did not have standing to bring the RICO action with relation to Medicare/Medicaid fraud under *18 U.S.C.S. § 1964*(c) because its injuries were sufficiently remote from the RICO conduct. It was not a direct victim of the fraud, and it was not the best party to vindicate the goals underlying RICO. Further, the allegations concerning fraud as it related to the establishment of two other non-profit entities was dismissed because they failed to meet the specificity requirements of *Fed. R. Civ. P. 9(b)*. The agency was able to show that there was a "pattern" of RICO activity under *18 U.S.C.S. § 1962*(c) based on the fact that the officers engaged in transactions over a period of 14 months. The complaint also stated a RICO conspiracy claim. Finally, the court found that all of the securities claims were barred by the statute of limitations.

**OUTCOME:** The court dismissed all of the claims against the financial advisors. The court dismissed the RICO claim relating to Medicare/Medicaid fraud and the claim relating to the organization of other non-profit entities. The rest of the motion to dismiss was denied. The court declined to exercise supplemental jurisdiction over some of the state law claims.

**CORE TERMS:** mailing, predicate, looting, misrepresentation, mail, target, continuity, racketeering, state law, repose, fraudulent, stadium, proximate cause, salary, secret, pattern of racketeering activity, racketeering activity, fraudulent scheme, discovery, omission, motion to dismiss, mail fraud, statute of limitations, constituting, three-year, united states, continuation, annuity, fine, supplemental jurisdiction

**LexisNexis(TM) Headnotes**

***Civil Procedure > Pleading & Practice > Defenses, Objections & Demurrers > Failure to State a Cause of Action***

[HN1]In considering a motion to dismiss pursuant to *Fed. R. Civ. P. 12(b)(6)*, a court must accept as true the factual allegations in the complaint and all reasonable inferences that can be drawn therefrom. A motion to dismiss may only be granted where the allegations fail to state any claim upon which relief may be granted. The court primarily considers the allegations of the complaint, but it may also consider a document integral to, attached to, or explicitly relied upon in the complaint. Dismissal is warranted if it is certain that no relief can be granted under any set of facts which could be proved.

***Criminal Law & Procedure > Criminal Offenses > Racketeering > Racketeer Influenced & Corrupt Organizations***

[HN2]See *18 U.S.C.S. § 1964*(c).

***Civil Procedure > Justiciability > Standing***

***Criminal Law & Procedure > Criminal Offenses > Racketeering > Racketeer Influenced & Corrupt Organizations***

[HN3]Racketeer Influenced and Corrupt Organizations Act (RICO) "standing" is not to be confused with the constitutional or prudential standing doctrines. Despite the somewhat confusing moniker, the statutory requirement of *18 U.S.C.S.* § .-.(c) is said to be RICO's "standing" provision. A plaintiff is injured "by reason of" of a RICO violation and thus has RICO standing if the violation was the proximate cause of the plaintiff's injury.

***Civil Procedure > Justiciability > Standing***

***Criminal Law & Procedure > Criminal Offenses > Racketeering > Racketeer Influenced & Corrupt Organizations***
[HN4]For purposes of standing, the Third Circuit Court of Appeals has identified three formal factors of proximate cause in the Racketeer Influenced and Corrupt Organizations Act (RICO): (1) the directness of the injury -- the more indirect the injury, the more difficult it becomes to ascertain the amount of a plaintiff's damages attributable to defendant's wrongdoing, as distinct from other, independent, factors; (2) the difficulty of apportioning damages among potential plaintiffs allowing recovery by indirectly injured parties would require complicated rules for apportioning damages; and (3) the possibility of other plaintiffs vindicating the goals of RICO direct victims could generally be counted on to vindicate the policies underlying RICO in a better manner than indirect victims.

***Civil Procedure > Justiciability > Standing***

***Criminal Law & Procedure > Criminal Offenses > Racketeering > Racketeer Influenced & Corrupt Organizations***
[HN5]For purposes of standing, proximate cause under the Racketeer Influenced and Corrupt Organizations Act (RICO) requires more than "but for" causation: there must be a direct relation between the injury asserted and the injurious conduct alleged. Proximate cause is more likely extant if the RICO plaintiff's interests are the direct target of the alleged scheme.

***Civil Procedure > Justiciability > Standing***

***Criminal Law & Procedure > Criminal Offenses > Racketeering > Racketeer Influenced & Corrupt Organizations***
[HN6]The Third Circuit Court of Appeals has rejected the notion that proximate cause exists for purposes of standing in a Racketeer Influenced and Corrupt Organizations Act case where a defendant targets a third party in order to further a scheme against the plaintiff's interests.

***Civil Procedure > Justiciability > Standing***

***Criminal Law & Procedure > Criminal Offenses > Racketeering > Racketeer Influenced & Corrupt Organizations***
[HN7]Several federal courts have endorsed the "target" standing requirement. The Second Circuit Court of Appeals is perhaps the most frequent adherent to this concept. It has consistently held that plaintiffs lack Racketeer Influenced and Corrupt Organization Act standing where they were neither the target of the racketeering enterprise nor the competitors nor the customers of the racketeer.

***Criminal Law & Procedure > Criminal Offenses > Fraud > Mail Fraud***

***Criminal Law & Procedure > Criminal Offenses > Fraud > Wire Fraud***

***Criminal Law & Procedure > Criminal Offenses > Racketeering > Racketeer Influenced & Corrupt Organizations***
[HN8]To plead a violation of the Racketeer Influenced and Corrupt Organizations Act, a plaintiff must allege (1) conduct (2) of an enterprise (3) through a pattern (4) of racketeering activity. An exhaustive list of "racketeering activities" appears in *18 U.S.C.S. § 1961*(1) and includes any act which is indictable under *18 U.S.C.S. § 1341* (relating to mail fraud) and *18 U.S.C.S. § 1343* (relating to wire fraud).

***Civil Procedure > Pleading & Practice > Pleadings > Heightened Pleading Requirements***
[HN9]To satisfy *Fed. R. Civ. P. 9(b)*, a plaintiff must plead with particularity the circumstances of the alleged fraud in order to place the defendants on notice of the precise misconduct with which they are charged, and to safeguard defendants against spurious charges of immoral and fraudulent behavior. The plaintiff may satisfy this burden by pleading the "date, place or time" of the fraud, or through alternative means of injecting precision and some measure of substantiation into their allegations of fraud. The plaintiff must also allege who made a misrepresentation to whom and the general content of the misrepresentation. However, the Third Circuit Court of Appeals has suggested that a somewhat more lenient standard applies to allegations of frauds conducted in secret. In applying Rule 9(b), courts should be "sensitive" to situations in which "sophisticated defrauders" may successfully conceal the details of their fraud. Where it can be shown that the requisite factual information is peculiarly within the defendant's knowledge or control, the rigid requirements of Rule 9(b) may be relaxed. Nevertheless, even when the defendant retains control over the flow of information, boilerplate and conclusory allegations will not suffice. Plaintiffs must accompany their legal theory with factual allegations that make their theoretically viable claim plausible.

***Civil Procedure > Pleading & Practice > Pleadings > Heightened Pleading Requirements***
[HN10]The purpose of *Fed. R. Civ. P. 9(b)* is to provide notice, not to test the factual allegations of the claim.

***Criminal Law & Procedure > Criminal Offenses >***

*Fraud > Mail Fraud*

*Criminal Law & Procedure > Criminal Offenses > Racketeering > Racketeer Influenced & Corrupt Organizations*

[HN11]For purposes of the mail fraud statute, the mailing need not contain any misrepresentations. Rather, innocent mailings -- ones that contain no false information -- may supply the mailing element of a Racketeer Influenced and Corrupt Organizations Act claim.

*Civil Procedure > Pleading & Practice > Pleadings > Heightened Pleading Requirements*

[HN12]Under *Fed. R. Civ. P. 9(b)*, a complaint must allege who made a misrepresentation to whom and the general content of the misrepresentation.

*Civil Procedure > Pleading & Practice > Pleadings > Heightened Pleading Requirements*

[HN13]The purpose of *Fed. R. Civ. P. 9(b)* is to provide notice of the "precise misconduct" charged.

*Criminal Law & Procedure > Criminal Offenses > Racketeering > Racketeer Influenced & Corrupt Organizations*

[HN14]To advance a Racketeer Influenced and Corrupt Organizations Act claim under *18 U.S.C.S. § 1962*(c), a plaintiff must plead a "pattern of racketeering activity," defined at *18 U.S.C.S. § 1961*(5) as at least two acts of racketeering activity within a 10 year period. To prove a pattern of racketeering activity a plaintiff must show that the racketeering predicates are related and that they amount to or pose a threat of continued activity. Predicate acts are "related" if they have the same or similar purposes, results, participants, victims, or methods of commission, or otherwise are interrelated by distinguishing characteristics and are not isolated events.

*Criminal Law & Procedure > Criminal Offenses > Racketeering > Racketeer Influenced & Corrupt Organizations*

[HN15]As for the second, or "continuity," prong of the pattern analysis under the Racketeer Influenced and Corrupt Organizations Act, the United States Supreme Court has urged a "flexible approach," permitting plaintiffs to proceed on a theory of closed-end continuity or open-ended continuity. Open-ended continuity refers to past conduct that by its nature projects into the future with a threat of repetition. Closed-ended continuity refers to a closed period of repeated conduct, proved by "a series of related predicates extending over a substantial period of time. Continuity is centrally a temporal concept. Although the United States Supreme Court couched the continuity test in terms of whether the racketeering predicates pose a threat of continued activity, the court must do more than merely count and calendar the alleged acts of mail and wire fraud. The Third Circuit Court of Appeals has instructed that the continuity test requ[illegible] a court to look beyond the mailings and examine the underlying scheme or artifice. Although the mailing is the actual criminal act, the instances of deceit constituting the underlying fraudulent schemes are more relevant to the continuity analysis.

*Criminal Law & Procedure > Criminal Offenses > Racketeering > Racketeer Influenced & Corrupt Organizations*

[HN16]To state a Racketeer Influenced and Corrupt Organizations Act (RICO) conspiracy claim, a plaintiff must allege (1) agreement to commit the predicate acts of fraud, and (2) knowledge that those acts were part of a pattern of racketeering activity conducted in such a way as to violate *18 U.S.C.S. § 1962*. A claim of RICO conspiracy must also allege that the plaintiff was injured by a predicate act of racketeering, rather than an overt act of the conspiracy that is not otherwise wrongful under RICO.

*Securities Law > Additional Offerings, Disclosure & the Securities Exchange Act of 1934 > Scope & Jurisdiction > Limitations on Remedies*

[HN17]Section 10(b) of the Securities Exchange Act of 1934 contains no express statute of limitations, which is not surprising because private causes of action under section 10(b) are a judicial creation. The Supreme Court of the United States has determined the applicable limitations period for such claims, holding that litigation instituted pursuant to § 10(b) must be commenced within one year after the discovery of the facts constituting the violation and within three years after such violation. Claims under section 20(a) of the Act are governed by the same one-year/three-year limitations/repose period. Neither the one-year limitations period nor the three-year repose period are subject to equitable tolling; the three year period is an absolute "cutoff."

*Securities Law > Additional Offerings, Disclosure & the Securities Exchange Act of 1934*

[HN18]A "violation" of section 10(b) of the Securities Exchange Act of 1934 occurs not at the time the securities are purchased but on the date that the alleged fraudulent misrepresentation is made or, in the case of an omission, on the date a duty to disclose the withheld information arises.

*Civil Procedure > Pleading & Practice > Defenses, Objections & Demurrers > Failure to State a Cause of Action*

*Governments > Legislation > Statutes of Limitations > Pleading & Proof*

[HN19]Under the so-called "Third Circuit Rule," defendants may raise a limitations defense on a *Fed. R. Civ. P. 12(b)(6)* motion to dismiss, but only if the time alleged in the statement of a claim shows that the cause of action has not been brought within the statute of limitations. If the bar is not apparent on the face of the complaint, then it may not afford the basis for a dismissal of the complaint.

*Civil Procedure > Jurisdiction > Subject Matter Jurisdiction > Supplemental Jurisdiction*
[HN20]The Third Circuit Court of Appeals has instructed that where the claim over which the district court has original jurisdiction is dismissed before trial, the district court must decline to decide the pendent state law claims unless considerations of judicial economy, convenience, and fairness to the parties provide an affirmative justification for doing so.

**COUNSEL:** **[*1]** For NORTHWESTERN HUMAN SERVICES, INC., Plaintiffs: GEORGE BOCHETTO, BOCHETTO & LENTZ PC, PHILADELPHIA, PA; JOSEPH T. KELLEY, JR., KELLEY & MURPHY, BLUE BELL, PA.

For NORTHWESTERN INTRASYSTEMS, INC., NORTHWESTERN INTRASYSTEMS, INC. TRUST Dated April 1, 1994, Plaintiffs: GEORGE BOCHETTO, BOCHETTO & LENTZ PC, PHILADELPHIA, PA.

For ROBERT C. PANACCIO, MARTA PANACCIO, SHIRLEY BARR, JOSEPH J. PATRICK, Defendants: THOMAS E. GROSHENS, DILWORTH PAXSON, LLP, PHILADELPHIA, PA.

For JOHN L. McKEEVER, III, McKEEVER, BURKE & GRANT, Defendants: JOHN J. SOROKO, DUANE MORRIS LLP, PHILADELPHIA, PA.

For PROVIDENT MUTUAL LIFE INSURANCE COMPANY, PROVIDENT MUTUAL INSURANCE AND FINANCIAL SERVICES COMPANY, 1717 CAPITAL MANAGEMENT COMPANY, Defendants: MICHAEL E. DASH, JR., MORGAN LEWIS & BOCKIUS LLP, PHILADELPHIA, PA.

For THOMAS X. FLAHERTY, Defendant: DAVID B. SMITH, TIMOTHY J. HOLMAN, SMITH, GIACOMETTI & CHIKOWSKI, LLC, PHILADELPHIA, PA.

For BARRY N. BOWERS, Defendant: JOHN A. GALLAGHER, HIGH SWARTZ ROBERTS & SEIDEL, NORRISTOWN, PA.

**JUDGES:** CYNTHIA M. RUFE, J.

**OPINIONBY:** CYNTHIA M. RUFE

**OPINION: MEMORANDUM OPINION AND ORDER**

**RUFE, J.**

Plaintiff Northwestern Human Services, Inc. ("Northwestern") **[*2]** and its subsidiaries are non-profit entities whose principal mission is to provide community-based mental health and mental retardation services to indigent individuals. According to the Amended Complaint, the nobility of Northwestern's mission is matched conversely by the avarice and greed of its former President and Chief Executive Officer, Defendant Robert C. Panaccio. Northwestern alleges that Panaccio and others engaged in a complex and intertwined series of frauds designed to fleece the Medicare and Medicaid programs for Northwestern's pecuniary benefit so that Panaccio could then loot Northwestern's unlawfully fattened coffers for the pecuniary benefit of himself and others. In sweeping fashion, the Amended Complaint alleges that Panaccio duped Northwestern into funding his princely lifestyle of slush funds and exorbitant retirement packages, as well as kick-backs and secret loans to Panaccio's cronies and business associates.

These allegations, if true, are deeply troubling, but their veracity is a question for another day. Presently before the Court are various motions to dismiss the Amended Complaint. For the reasons below, the motions are granted in part and denied part. **[*3]**

**I. BACKGROUND**

Plaintiffs are Northwestern, its wholly-owned subsidiary, Northwestern Intrasystems, Inc., and Northwestern Intrasystems, Inc. Trust Dated April 1, 1994 (collectively, "NHS"). Defendant Robert C. Panaccio is a former NHS President and Chief Executive Officer. His wife, Marta, is also a named defendant. Defendant Shirley Barr is NHS's former Director of Insurance. Defendant Thomas X. Flaherty is NHS's former Chief Financial Officer and a former member of NHS's Board of Directors or Trustees. Defendant Barry N. Bowers was a personal accountant to Panaccio. Defendant John L. McKeever, III, and his employer, McKeever, Burke & Grant ("MBG"), were financial advisors to both Panaccio and NHS. Finally, Defendants Provident Mutual Life Insurance Company, Provident Mutual Insurance and Financial Services Company, and 1717 Capital Management Company (collectively, "Provident"), are financial and insurance service providers who issued various insurance products to NHS through its licensed agents, McKeever and MBG. n1

- - - - - - - - - - - - - - Footnotes - - - - - - - - - - - - - - -

n1 The Amended Complaint also names Joseph J. Patrick as a defendant, but the Court understands that Plaintiffs and Mr. Patrick have reached a settlement.

- - - - - - - - - - - - End Fo[illegible]es- - - - - - - - - - - - - -

[*4]

The allegations of the Amended Complaint, which the Court must accept as true on a motion to dismiss, describe four interrelated schemes, all controlled by Panaccio, whereby he stripped the assets of NHS by various fraudulent acts, breaches of fiduciary duty and self-dealing.

First, Panaccio caused an NHS affiliate, Northwestern Center, Inc., to commit Medicare and Medicaid fraud. This fraud (hereinafter, "Medicare/Medicaid fraud") ultimately resulted in a criminal investigation by the United States Department of Justice ("DOJ") and the filing of a criminal information. In addition, the Medicare/Medicaid fraud was the subject of a related qui tam action in which the United States Attorney intervened. The civil and criminal cases were settled jointly, with NHS paying a combined criminal fine and civil penalty of $ 7.78 million. n2

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n2 See United States v. Northwest Center, Inc., Crim. A. No. 02-316 (E.D. Pa.); United States ex rel. Hendricks v. Northwestern Human Serv., Inc., Civ. A. No. 97-4203 (E.D. Pa.). Copies of the criminal guilty plea and the civil settlement agreement are attached to the Amended Complaint at Exs. E and F, respectively.

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[*5]

Second, Panaccio used the proceeds of the Medicare/Medicaid fraud to purchase various insurance policies and annuities for himself from McKeever and MBG, thereby providing himself with millions of dollars worth of benefits to which he was not entitled, and enriching McKeever and MBG in the process, all at NHS's expense. NHS alleges that Provident ignored irregularities and conflicts of interest in these insurance-funded transactions, thereby aiding Panaccio and McKeever's fraudulent conduct. This fraud (hereinafter, the "Excessive Compensation" fraud) also involved Panaccio allegedly providing himself with excessive salaries, perquisites, expense accounts and other payments to which he was not entitled.

Third, Panaccio created a for-profit automobile leasing company, Amica Leasing, allegedly to overcharge NHS hundreds of thousands of dollars annually in connection with a fleet of 400 vehicles. Although NHS owned Amica, Panaccio used Amica revenues as a slush fund fo[illegible]nself and others, gave cars to friends and family members at NHS's expense, and put his son (who did no work) on Amica's payroll. Panaccio also allegedly established a similar arrangement through another company, **[*6]** United Staffing, which was to provide temporary labor to NHS. Panaccio's outside accountant, Bowers, allegedly assisted in siphoning cash from these businesses to Panaccio and Patrick's personal accounts (hereinafter, the "Amica/Bowers" fraud).

Finally, Panaccio and Flaherty allegedly cheated NHS out of millions of dollars for a purported investment in a minor league baseball stadium, Lehigh Valley Stadium, and related real estate through a series of misrepresentations to the NHS Board of Trustees and through additional fraudulent transactions (hereinafter, the "Stadium Looting" fraud). Each of these alleged frauds is discussed in greater detail infra at Part II.

NHS claims that these four schemes resulted in: (a) a $ 780,000 criminal fine and a related $ 7 million civil settlement; (b) hundreds of thousands of dollars in attorneys' fees arising from the DOJ investigation; (c) millions of dollars funneled from NHS to Defendants in the form of unearned salaries, fees, and other benefits; and (d) more than $ 1 million in administrative and legal costs incurred undoing the wrongs caused by Defendants. The twenty-two counts of the Amended Complaint allege violations of the Racketeer **[*7]** Influenced and Corrupt Organizations Act ("RICO"), *18 U.S.C. §§ 1961-1968*, sections 10(b) and 20(a) of the Securities Exchange Act of 1934, *15 U.S.C. §§ 78j(b), 78t(a)*, and various common law doctrines. Defendants' motions to dismiss test the sufficiency of the Amended Complaint under *Federal Rule of Civil Procedure 12(b)(6)*. The familiar standard of review governs. n3

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n3 [HN1]In considering a motion to dismiss pursuant to *Federal Rule of Civil Procedure 12(b)(6)*, the Court must accept as true the factual allegations in the complaint and all reasonable inferences that can be drawn therefrom. A motion to dismiss may only be granted where the allegations fail to state any claim upon which relief may be granted. The Court primarily considers the allegations of the complaint, but it may also consider a document integral to, attached to, or explicitly relied upon in the complaint. Dismissal is warranted if it is certain that no relief can be granted under any set of facts which could be proved. See *Brody v. Hankin, 299 F. Supp. 2d*

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n6 RICO[HN3]"standing" is not to be confused with the constitutional or prudential standing doctrines. Despite the somewhat confusing moniker, the statutory requirement of § *1964(c)* is said to be RICO's "standing" provision. See, e.g., *Maio v. Aetna, Inc., 221 F.3d 472, 482-83 (3d Cir. 2000)*.

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Borrowing from the causation requirements of the antitrust laws, the Supreme Court of the United States held in *Holmes v. Securities Investor Protection Corp., 503 U.S. 258, 268, 117 L. Ed. 2d 532, 112 S. Ct. 1311 (1992)* **[*12]** that a plaintiff is injured "by reason of" of a RICO violation and thus has RICO standing if the violation was the proximate cause of the plaintiff's injury. Panaccio and Flaherty concede that NHS suffered injury to its business or property when it paid a fine, a civil penalty and attorneys' fees and costs in connection with the Medicare/Medicaid fraud investigation. The issue presented by their motions to dismiss is whether the alleged RICO violation was the proximate cause of these injuries.

Panaccio and Flaherty argue that NHS's injuries are too remote from the alleged racketeering activity to support RICO standing. They argue that the direct target and victim of the fraud was the Government's Medicare and Medicaid programs, not NHS. To the contrary, they contend, NHS was the intended ***beneficiary*** of the Medicare/Medicaid fraud, not a victim. They argue that the Government's discovery of the fraudulent scheme -- not the Medicare/Medicaid fraud scheme itself -- was the proximate cause of NHS's injuries (i.e., the civil fine, penalty and legal fees). Therefore, they contend, RICO standing is lacking.

In response, NHS urges the Court to view the four fraudulent schemes **[*13]** as an inseparable whole. The Medicare/Medicaid fraud cannot be isolated from the other frauds, it contends, because the Medicare/Medicaid fraud provided the revenues for Defendants' overall scheme to enrich themselves by looting NHS. Taken in this light, it contends, RICO standing exists because the Medicare/Medicaid fraud was "a substantial factor in the sequence of responsible causation, and . . . the injury [was] reasonably foreseeable or anticipated as a natural consequence." n7

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n7 *Brittingham v. Mobil Corp., 943 F.2d 297, 304 (3d Cir. 1991)* (quoting *Hecht v. Commerce Clearing House, Inc., 897 F.2d 21, 23-24 (2d Cir. 1990)*), overruled on other grounds by *Jaguar Cars, Inc. v. Royal Oaks Motor Car Co., Inc., 46 F.3d 258 (3d Cir. 1995)*.

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Drawing directly from the reasoning in Holmes, [HN4]the Third Circuit has identified three "formal factors of proximate cause in RICO":(1) the directness of the injury -- "the more indirect the injury, 'the more difficult **[*14]** it becomes to ascertain the amount of a plaintiff's damages attributable to [defendant's wrongdoing], as distinct from other, independent, factors;'"

(2) the difficulty of apportioning damages among potential plaintiffs "allowing recovery by indirectly injured parties would require complicated rules for apportioning damages;" and,

(3) the possibility of other plaintiffs vindicating the goals of RICO "direct victims could generally be counted on to vindicate the policies underlying" RICO in a better manner than indirect victims. n8As outlined below, application of these factors to the case at bar and examination of analogous case law lead to the conclusion that NHS lacks standing to pursue RICO claims arising from the Medicare/Medicaid fraud.

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n8 *Allegheny Gen. Hosp. v. Philip Morris, Inc., 228 F.3d 429, 443 (3d Cir. 2000)* (brackets in original) (quoting *Steamfitters Local Union No. 420 Welfare Fund v. Philip Morris, Inc., 171 F.3d 912, 932 (3d Cir. 1999)* (quoting *Holmes, 503 U.S. at 268-69*)).

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**[*15]**

The first factor to consider is the directness of the injury. As a starting point, the actual, immediate and direct result of the Medicare/Medicaid fraud was the collection of excessive reimbursements. Thus, there is a direct relationship between Panaccio's conduct and a ***benefit*** to NHS, not an injury. By contrast, the damages claimed by NHS -- the civil penalty, fine and attorneys' fees -- are the immediate, direct result of the DOJ investigation and the ensuing guilty plea agreement. It is true that the Medicare/Medicaid fraud was the "but for" cause of these injuries, but [HN5]proximate cause under RICO requires more than "but for" causation: there must be a "***direct relation*** between the injury asserted and the injurious conduct alleged." n9

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n9 *Holmes, 503 U.S. at 268* (emphasis added); see also *Allegheny Gen. Hosp., 228 F.3d at 443* (directness factor "addresses the difficulty of ascertaining damages traceable to [Panaccio and Flaherty's] conduct," as opposed to "other, independent factors" that are not predicate acts under RICO).

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**[*16]**

Proximate cause is more likely extant if the RICO plaintiff's interests are the "direct target of the alleged scheme." n10 For example, in Brokerage Concepts, the plaintiff (BCI) was the former administrator of a pharmacy's self-funded employee health insurance plan. When the pharmacy (Gary's) opened a new branch, it wanted the new branch to be a member of defendant U.S. Healthcare's network. U.S. Healthcare essentially forced Gary's to use a U.S. Healthcare affiliate as the plan administrator and to terminate its relationship with BCI. The court noted that although the alleged RICO predicate acts of extortion were allegedly committed by U.S. Healthcare against Gary's, BCI's injury was direct and not merely indirect or incidental:

The injury proved by BCI, the loss of its TPA [third party administrator] contract with Gary's, was not *derivative* of any losses suffered by Gary's. . . . BCI's injury was not contingent upon any injury to Gary's, nor is it more appropriately attributable to an intervening cause that was not a predicate act under RICO. Here, BCI's TPA relationship with Gary's was a direct target of the alleged scheme -- indeed, interference with that relationship **[*17]** may well be deemed the linchpin of the scheme's success. n11

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n10 *Brokerage Concepts, Inc. v. U.S. Healthcare, Inc., 140 F.3d 494, 521 (3d Cir. 1998)*.

n11 Id.

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By contrast, in *Callahan v. A.E.V., Inc., 182 F.3d 237 (3d Cir. 1999)*, the Third Circuit identified an instance where the plaintiff was ***not*** the "direct target of the alleged scheme." There, smaller beer distributors brought anantitrust and RICO action against a larger beer distributor. They alleged that the defendant had engaged in several anti-competitive practices in violation of antitrust laws. In their RICO counts, the plaintiffs alleged the defendant had engaged in racketeering activity when it made fraudulent license applications to the Pennsylvania Liquor Control Board ("LCB"). The plaintiffs alleged that because of the fraud on the LCB, the defendant was able to continue its anti-competitive practices and obtain volume discounts unavailable to the plaintiffs. The plaintiffs were then harmed **[*18]** by the defendant's ability to sell beer at lower prices. n12 The Callahan court distinguished Brokerage Concepts and found the plaintiffs lacked RICO standing:

Here, although the ultimate goal of [the defendant] was presumably to woo customers away from the plaintiffs, the direct target of its alleged fraudulent scheme was the LCB, not customers. Unlike *Brokerage Concepts*, this case involves *two* third parties, one that was the target of the defendants' racketeering and another that had a relationship with the plaintiffs with which the defendants interfered. n13

Although it involved a different factual scenario, in *Callahan* the Third Circuit essentially rejected the theoretical structure proposed by NHS in support of its standing argument. That is, [HN6]the Third Circuit rejected the notion that proximate cause exists where a defendant (in Callahan, the large beer distributors; here, Panaccio) targets a third party (in Callahan, the LCB; here, the Medicare and Medicaid programs) in order to further a scheme against the plaintiff's interests (in Callahan, the smaller beer distributors and/or their relationship with beer customers; here, **[*19]** NHS). In such circumstances, the plaintiff is not the "direct target" of the RICO scheme and the plaintiff lacks RICO standing.

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n12 *Callahan, 182 F.3d at 245*.

n13 *Id. at 262 n.16*.

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As noted by one leading treatise, [HN7]several federal courts have endorsed the "target" standing requirement. n14 The Second Circuit is perhaps the most frequent adherent to this concept. It has consistently held that plaintiffs lack RICO standing where they "were neither the target of the racketeering enterprise nor the competitors nor the customers of the racketeer." n15 One such case from the Second Circuit involves RICO standing considerations similar to those in the case at bar.

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n14 David B. Smith & Terrance G. Reed, Civil RICO P 6.04[a][iii], at 6-95 & n.151 (March 2002) (citing and discussing cases from the Second and Eleventh Circuits, and the district courts for the Southern District of New York and the District of Columbia). **[*20]**

n15 *Sperber v. Boesky, 849 F.2d 60, 65 (2d Cir. 1988)*; see also *Lerner v. Fleet Bank, N.A., 318 F.3d 113, 124 (2d Cir. 2003)* ("We have repeatedly emphasized that the reasonably foreseeable victims of a RICO violation are the targets, competitors and intended victims of the racketeering enterprise.").

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*In re American Express Co. Shareholder Litigation, 39 F.3d 395 (2d Cir. 1994)* (hereinafter, "In re AmEx"), was a shareholder derivative action against present and former top-level officers of American Express. The plaintiffs alleged that the American Express officers conspired with "shady overseas operatives, greedy journalists, and corrupt foreign politicians in a scheme to defame a rival by falsely linking him to organized crime, Columbian drug trafficking, and the Iran-Contra affair." n16 The scheme was eventually exposed, and the shareholders claimed the following injuries to American Express as a result: lost sales, exposure to potential liability, damages to business reputation, and past and future expenditure of "large sums of costs, **[*21]** expenses and legal fees in connection with defendants' unlawful acts." n17 The Second Circuit concluded that the shareholders "were certainly not the intended targets of the RICO violations," and thus lacked RICO standing:

Any fair reading of the complaint in the instant case discloses that the RICO defendants' "preconceived purpose" was most assuredly not to cause some $ 10 million in losses to American Express. Instead, the complaint consistently alleges that the RICO defendants' actions, however misguided and injurious to American Express in the end, were undertaken to further American Express's competitive interests. . . . The injuries alleged thus were neither the "preconceived purpose" nor the "specifically-intended-consequence" of the RICO defendants' acts. Moreover, any losses to American Express were caused only because the scheme itself was exposed and thus failed. n18

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n16 *In re AmEx, 39 F.3d at 396.*

n17 *Id. at 398.*

n18 *Id. at 400.*

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**[*22]**

In reaching this conclusion, the Second Circuit discussed a similar district court decision, *In re Crazy Eddie Securities Litigation, 714 F. Supp. 1285, 1290-91 (E.D.N.Y. 1989)*, in which Crazy Eddie, Inc. ("Crazy Eddie") asserted RICO claims against former employees for artificially inflating the company's share price. Crazy Eddie claimed it was injured when the scheme was exposed, causing its share price to drop and opening Crazy Eddie to potential liability. The district court concluded that the RICO acts were "directed not at Crazy Eddie, but at the shareholders and the investing public." n19 The scheme was actually intended to benefit Crazy Eddie and only caused harm because it was publicly exposed. Therefore, the district court concluded, Crazy Eddie's injuries were not proximately caused by the alleged RICO violations.

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n19 *714 F. Supp. at 1291.*

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The reasoning of *In re AmEx* and *In re Crazy Eddie* applies with equal force here. The Medicare and Medicaid programs were **[*23]** unquestionably the "direct target" of the Medicare/Medicaid fraud. Defrauding the Medicare and Medicaid programs was intended to benefit NHS ***in the first instance***, regardless of Panaccio's ultimate objective of looting those illegal revenues. Although NHS argues that the proceeds of the Medicare/Medicaid fraud were essential to Panaccio's looting scheme, the pertinent standing inquiry is not the relationship between one RICO scheme and another, or even between separate components of a single scheme. Rather, the critical issue is the relationship between the injury and the conduct constituting the scheme. It cannot be said that the injuries alleged by NHS -- legal fees and civil penalties, etc. -- were an essential part of Panaccio's looting scheme. To the contrary, such harm was to be avoided if the scheme was to succeed. It defies reason to suggest that Panaccio intended to fatten NHS's coffers with the illegal proceeds of the Medicare/Medicaid fraud but simultaneously intended the scheme to come crashing down on NHS in the form of a DOJ investigation and all its attendant fallout and costs.

Moreover, like the losses claimed in In re AmEx and In re Crazy Eddie, **[*24]** the losses to NHS were caused by exposure of the Medicare/Medicaid fraud and not by commission of the fraud itself. In other words, NHS suffered the losses "by reason of" the DOJ's investigation, threatened prosecution and guilty plea agreement, not "by reason of" the alleged RICO conduct. n20 NHS asks the Court to ignore that this intervening, independent cause is directly responsible for its harm. n21

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n20 *18 U.S.C. § 1964(c).*

n21 Cf. *Brokerage Concepts, 140 F.3d at 521* ("nor is [plaintiff's injury] more appropriately attributable to an intervening cause that was not a predicate act under RICO"); *Anderson v. Ayling, 297 F. Supp. 2d 805, 810 (E.D. Pa. 2003)* ("whether the plaintiff's injury was caused by the RICO offense itself or merely by public disclosure of the offense" is an appropriate consideration in the proximate cause analysis) (quoting Gregory P. Joseph, Civil Rico 37 (2d ed. 2000)); see also *Callahan, 182 F.3d at 263 n.18* ("additional step" in the chain of causation "bars the inference of proximate causation").

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**[*25]**

The second proximate cause factor requires examination of the difficulty of apportioning damages among potential plaintiffs. This factor weighs in favor of finding that NHS has standing to pursue its RICO claims against Panaccio for the alleged Medicare/Medicaid fraud. There is little or no difficulty in apportioning the damages attributable to the scheme because there is only one plaintiff, and its injuries are an ascertainable sum of the civil penalties, fines and legal costs arising from the investigation and its aftermath. Courts routinely make such calculations. n22

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n22 To the extent that NHS attempts to draw a connection between the injuries attributable to the looting schemes and the conduct constituting the Medicare/Medicaid fraud, any such purported connection does not confer RICO standing on NHS to pursue the Medicare/Medicaid fraud. As noted, NHS contends that the Medicare/Medicaid fraud was an essential component of the looting frauds (i.e., the Excessive Compensation, Amica/Bowers, and Stadium Looting frauds), and thus contends there is a relationship between the Medicare/Medicaid fraud and the looting injuries. Yet, there is no reliable method by which the Court could attribute or apportion the looting injuries to the success of the Medicare/Medicaid fraud as opposed to, for example, the success of the Excessive Compensation fraud. To do so would be an exercise in pure speculation. In other words, there is no "direct relation" between the looting fraud injuries and the conduct constituting the Medicare/Medicaid fraud.

Moreover, attributing these injuries to the Medicare/Medicaid fraud would be duplicative because these injuries can be readily attributed to other RICO conduct. Defendants do not challenge NHS's standing to pursue RICO claims for the alleged Excessive Compensation, Amica/Bowers and Stadium Looting frauds. It is undisputed that there exists a direct relation between these frauds, allegedly committed in violation of RICO, and the looting injuries. Accordingly, even if the Medicare/Medicaid fraud played some role in the success of the looting schemes, for purposes of RICO standing the injuries flowing from the looting frauds are attributable to the looting frauds only.

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**[*26]**

Regarding the third proximate cause factor, NHS is not the appropriate plaintiff to vindicate the goals of RICO. Here, the "direct victim" of the Medicare/Medicaid fraud was the Government. Even though it did not proceed under the RICO statute, the Government's plea agreement with NHS was an appropriate and successful vindication of the policies underlying RICO: inter alia, to protect against use of the mails in furthering a fraudulent scheme constituting a pattern of racketeering. Although NHS was an "indirect victim" of the Medicare/Medicaid fraud, it was a "direct victim" of an alleged civil conspiracy by its officers involving egregious breaches of fiduciary duty and other wrongs. Of course, it may vindicate these wrongs under state law, but its indirect injuries -- no matter how grievous or deserving of recompense -- do not confer RICO standing.

In conclusion, while problems of apportionment may be not significant, NHS's injuries are sufficiently remote from the RICO conduct. It is not the direct victim of the Medicare/Medicaid fraud, and it is not the best plaintiff to vindicate the goals underlying RICO. Accordingly, proximate cause is lacking. n23

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n23 See *Allegheny Gen. Hosp., 228 F.3d at 444* ("While the Hospitals may be the best party to vindicate RICO claims and problems of apportionment may not be significant, the remoteness of the Hospitals' alleged RICO injuries from any wrongdoing on the part of the Tobacco Companies leads us to conclude that proximate cause is lacking.") (citation, internal quotes and brackets omitted).

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[*27]

**B. Failure to State RICO Claims Against Panaccio and Flaherty**

Panaccio and Flaherty argue that the RICO counts of the Amended Complaint fail to state a legally cognizable claim. NHS alleges violations of RICO, *18 U.S.C. § 1962(c)*, as well as a conspiracy to violate RICO, *18 U.S.C. § 1962(d)*. Because NHS's RICO counts are based on alleged predicate acts of mail and wire fraud, their allegations must satisfy the heightened pleading requirements of *Federal Rule of Civil Procedure 9(b)*. n24

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n24 *Lum v. Bank of Am., 361 F.3d 217, 220 (3d Cir. 2004)*, petition for cert. filed, 2004 WL 1553529 (U.S. July 7, 2004).

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[HN8]To plead a violation of RICO, NHS must allege (1) conduct (2) of an enterprise (3) through a pattern (4) of racketeering activity. n25 An exhaustive list of "racketeering activities" appears in *18 U.S.C. § 1961(1)* and includes any act which is indictable under *18 U.S.C. § 1341* **[*28]** (relating to mail fraud) and *18 U.S.C. § 1343* (relating to wire fraud). Here, Panaccio and Flaherty contend that the Amended Complaint contains boilerplate allegations of mail and wire fraud that lack the requisite particularity, thus failing to allege adequately any predicate racketeering activity. In addition, they argue that NHS fails to allege a "pattern" of racketeering activity.

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n25 *Id. at 223*.

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**1. Pleading "Predicates" with Particularity Under *Rule 9(b)***

[HN9]To satisfy *Rule 9(b)*, NHS must plead with particularity "the circumstances of the alleged fraud in order to place the defendants on notice of the precise misconduct with which they are charged, and to safeguard defendants against spurious charges of immoral and fraudulent behavior." n26 NHS may satisfy this burden by pleading the "date, place or time" of the fraud, or through "alternative means of injecting precision and some measure of substantiation into their allegations of fraud." n27 NHS must also allege **[*29]** "who made a misrepresentation to whom and the general content of the misrepresentation." n28 However, the Third Circuit has suggested that a somewhat more lenient standard applies to allegations of frauds conducted in secret:

In applying *Rule 9(b)*, courts should be 'sensitive' to situations in which 'sophisticated defrauders' may 'successfully conceal the details of their fraud. Where it can be shown that the requisite factual information is peculiarly within the defendant's knowledge or control, the rigid requirements of *Rule 9(b)* may be relaxed. Nevertheless, even when the defendant retains control over the flow of information, 'boilerplate and conclusory allegations will not suffice. Plaintiffs must accompany their legal theory with factual allegations that make their theoretically viable claim plausible.'" n29

[HN10]The purpose of *Rule 9(b)* is to provide notice, not to test the factual allegations of the claim. n30

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n26 *Id. at 223-24* (quoting *Seville Indus. Mach. Corp. v. Southmost Mach. Corp., 742 F.2d 786, 791 (3d Cir. 1984)*).

n27 *Seville Indus. Mach. Corp. v. Southmost Mach. Corp., 742 F.2d 786, 791 (3d Cir. 1984)*.

**[*30]**

n28 *Lum, 361 F.3d at 224*; see also *Warden v. McLelland, 288 F.3d 105, 114 (3d Cir. 2002)* (complaint must "state clearly how . . . [the] communications were false or misleading, or how they contributed to the alleged fraudulent scheme").

n29 *In re Rockefeller Ctr. Props., Inc. Sec. Litig., 311 F.3d 198, 216 (3d Cir. 2002)* (internal citations omitted).

n30 *Morganroth & Morganroth v. Noriss, McLaughlin & Marcus, P.C., 331 F.3d 406, 414 n.2 (3d Cir. 2003)*.

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Panaccio and Flaherty argue that the Amended Complaint is deficient under *Rule 9(b)* because it fails to explain either how any mailings or wires were false or misleading, or how they contributed to the alleged frauds. Excluding the Medicare/Medicaid fraud for the reasons stated supra at Part II.A., each fraud and the attendant mailings or wires are discussed below.

Excessive Compensation Fraud

NHS describes this fraud accordingly: From 1986 through his departure from NHS in 2000, Panaccio looted NHS by increasing his annual compensation and benefits to "excessive **[*31]** and abusive" levels. Am. Compl. PP 55, 74. Panaccio accomplished this end by manipulating and deceiving the Board of Trustees and the Compensation Committee. He "disseminated reports to the then sitting NHS Board of Trustees containing false, doctored, and incomplete information, and was himself directly responsible for the Board's failure to be fully or properly informed of NHS' business matters." Id. P 61.

At Panaccio's direction, NHS retained McKeever and MBG to act as insurance and financial consultants to NHS, paying them hourly consulting fees. McKeever also served on NHS's Compensation Committee (a subcommittee of the Board of Trustees). Id. PP 64, 66. At the same time, McKeever and MBG were personal advisors to Panaccio, but this conflict of interest was never disclosed to NHS or the Board. Id. P 70. Panaccio, McKeever and MBG undertook to enrich themselves at NHS's expense at a time when NHS was experiencing financial difficulty. Id. P 71.

At Panaccio's direction and with McKeever and MBG's assistance, NHS created Plaintiff Northwestern Intrasystems, Inc. ("NI") to act as the employer of NHS executives and to create the Northwestern Intrasystems, Inc. Trust **[*32]** Dated April 1, 1994 (the "Trust") for those executives' benefit. Id. PP 72-73. The Trust created a "salary continuation" plan, which provided key executives with "excessive and abusive" payments following their departure from NHS. Id. P 74. In creating the Trust, Panaccio authorized the appointment of McKeever as one of only two trustees. Id. P 75.

Panaccio, McKeever and MBG funded the Trust by arranging for NHS, NI and the Trust to purchase several insurance policies from Provident. See id. P 79 (listing policy numbers, account values, surrender values and death benefits). "No effort was made to solicit competitive bids for these products." Id. P 80. NHS alleges that Panaccio, McKeever and MBG failed to disclose material information in creating and structuring the salary continuation plans, including McKeever and MBG's sales commissions and numerous provisions of the salary continuation agreements, which were highly unfavorable to NHS. Id. PP 82, 84. In establishing these arrangements, Panaccio, McKeever and MBG "had irreconcilable conflicts of interest and violated even the most minimal standard of duty owed by fiduciaries." Id. P 86. Panaccio, McKeever **[*33]** and MBG were able to accomplish this fraud because the individuals serving on the Board and the Compensation Committee "were either not fully informed, not informed at all, or, in the case of the Compensation Committee, peopled by individuals with conflicts of interest or over whom Panaccio had controlling influence." Id. P 60.

NHS identifies eighteen separate mailings that contributed to this fraud, all of which relate to routine administration of the Trust or the insurance policies (including checks sent to Panaccio, see id. P 162), and none of which are alleged to contain any false or misleading representation. That is, they are "innocent mailings," but their innocence does not defeat NHS's RICO claim. n31

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n31 [HN11]For purposes o. ..e mail fraud statute, "the mailing need not contain any misrepresentations. Rather, 'innocent mailings -- ones that contain no false information -- may supply the mailing element" of a RICO claim. *Kehr Packages, Inc. v. Fidelcor, Inc., 926 F.2d 1406, 1413-14 (3d Cir. 1991)* (quoting *Schmuck v. United States, 489 U.S. 705, 715, 103 L. Ed. 2d 734, 109 S. Ct. 1443 (1989)*).

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**[*34]**

Defendants' primary argument is that NHS fails to explain how the mailings were used to defraud NHS. n32 NHS responds that "there can be absolutely no question" how the mailings related to Panaccio's scheme to obtain excessive compensation benefits: without the mailings, "transmission of deferred compensation monies would not have occurred." n33 Obtaining regular, ongoing salary continuation payments -- payments which were fraudulently obtained -- was the object of the alleged fraud, and use of the mails was incident to the fraud. n34

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n32 See *Warden, 288 F.3d at 114* (complaint must "state clearly how . . . [the] communications contributed to the alleged fraudulent scheme").

n33 Pls.' Consol. Mem. at 27.

n34 See *Schmuck v. United States, 489 U.S. 705, 710-11, 103 L. Ed. 2d 734, 109 S. Ct. 1443 (1989)* (mailing that is "incident to an essential part of the scheme" or a "step in [the] plot" satisfies federal mail fraud statute) (citation omitted); *Spitzer v. Abdelhak, 1999 U.S. Dist. LEXIS 19110, No. Civ. A. 98-6475, 1999 WL 1204352, at *5 (E.D. Pa. Dec. 15, 1999)* ("The law of this Circuit suggests that if Plaintiffs received any mail or interstate wires which are remotely connected to a concurrent scheme to defraud, the predicate acts of mail and wire fraud are met.") (Buckwalter, J.).

Although Panaccio and Flaherty clearly attack the allegations of mail fraud as inadequate under *Rule 9(b)*, they do not argue that the "mailing" allegations are deficient as a matter of substantive law under RICO. See *18 U.S.C. § 1341* (mailing must be for the purpose of executing" a scheme to defraud); *United States v. Brown, 583 F.2d 659, 664-69 (3d Cir. 1978)* and *United States v. Tarnopol, 561 F.2d 466, 471-72 (3d Cir. 1977)* ("mailings taking place after the object of the scheme has been accomplished . . . are not sufficiently closely related to the scheme to support a mail fraud prosecution"), both overruled on other grounds by *Griffin v. United States, 502 U.S. 46, 116 L. Ed. 2d 371, 112 S. Ct. 466 (1991)*.

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**[*35]**

These allegations satisfy *Rule 9(b)* by providing Panaccio with adequately detailed notice of the claims against him. The Amended Complaint explains the machinations of the fraud in some detail. It identifies specific information improperly concealed from the Board and Compensation Committee, as well as who failed to make the required disclosures to whom. n35 It also provides adequate identifying information for the insurance policies funding the Trust. n36

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n35 See *Lum, 361 F.3d at 224* [HN12](complaint must allege "who made a misrepresentation to whom and the general content of the misrepresentation").

n36 See *Seville, 742 F.2d 786* (finding *Rule 9(b)* satisfied where plaintiffs pleaded which machines were the subject of alleged fraudulent transactions and the nature and subject of alleged misrepresentations).

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The Amended Complaint also accounts for any lack of detail: it avers that Panaccio and those under his control, as part of their fraudulent scheme, are responsible for "a **[*36]** wholesale absence of documents and information remaining at NHS." Am. Compl. P 63; see also id. PP 66-67 (alleging "incomplete" and "unavailable" records). These allegations of concealment, taken together with "factual allegations that make [NHS's] theoretically viable claim plausible," n37 persuades the Court to relax somewhat the rigorous requirements of *Rule 9(b)*. Taken in this light, with respect to the Excessive Compensation fraud, any failure to identify additional mailings or fraudulent statements is not an adequate basis for dismissal at this early stage of the litigation. In short, NHS's allegations are adequate to place Panaccio on notice of the precise misconduct with which he is charged, making NHS's allegations of racketeering activity sufficient for purposes of *Rule 9(b)*.

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n37 *In re Rockefeller, 311 F.3d at 216.*

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One additional issue warrants brief discussion. Panaccio contends that NHS's present Chairman and CEO, M. Joseph Rocks, ratified Panaccio's compensation package when **[*37]** Mr. Rocks executed the 2000 Revised Compensation Agreement. Therefore, argues Panaccio, NHS cannot contend now that the compensation package was fraudulently obtained. NHS responds that (1) this argument is improper on a *Rule 12(b)(6)* motion because it relies on a document that is not explicitly relied upon or integral to the Amended Complaint, and (2) even if the Court considers the Revised Compensation Agreement, this merely presents a disputed issue of fact that cannot impact a *Rule 12(b)(6)* motion. Given the procedural posture of this case, that the Court must accept the allegations as true and draw any inferences in favor of NHS, and that Panaccio improperly relies on an extraneous document, the Court agrees with NHS and rejects Panaccio's argument.

Amica/Bowers Fraud

NHS alleges that Panaccio established two separate for-profit entities, Amica Leasing (a vehicle leasing company) and United Staffing (a temporary staffing company), to facilitate his looting of NHS. Am. Compl. P 91. The Amended Complaint focuses on Amica, which Panaccio formed as a subsidiary of NHS, installing himself and Flaherty on its five-member Board of Directors.

At Panaccio's direction, NHS leased **[*38]** from Amica a fleet of 400 vehicles, including numerous luxury automobiles, many of which were unnecessary. Id. PP 94-95. Most leases were structured to force NHS to pay far in excess of market value (e.g., $ 1,179 monthly for a Ford Explorer) "so as to (1) allow Amica to develop extraordinary cash surpluses which Panaccio, Patrick and Flaherty could then siphon off; and (2) to create a cash buyout option to Panaccio and his colleagues far below the lease-end market value of such vehicles." Id. P 96.

By enriching Amica and looting NHS in this manner, Panaccio funded other self-serving schemes. For example, he put his son on Amica's payroll without requiring him to work. (Panaccio's son was in veterinary school at the time.) Id. P 99. He also caused Amica to enter into a number of transactions with another vehicle leasing company, Fleetway, which made money for Fleetway at NHS's expense. Examples include Amica purchasing vehicles from Fleetway in excess of Fleetway's cost, and payment of a $ 5,000 monthly "consulting fee" to Fleetway. Id. P 100. n38

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n38 Panaccio's relationship with Fleetway is not explained in the Amended Complaint, so his motive for enriching Fleetway remains unclear. The cogent allegation, however, is that Panaccio sought to enrich Fleetway at NHS's expense.

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**[*39]**

Relatedly, NHS alleges that Panaccio and Patrick siphoned cash directly from Amica, United and other sources of NHS funds. They hired accountant Barry Bowers to create a "secret bank account over which NHS' regular accountants were excluded. Each month for many years, Bowers would make out checks for thousands of dollars to Panaccio, Patrick and others." Id. P 102. Bowers allegedly paid Panaccio and others' "personal, non-reimbursable expenses" with NHS funds, transferred money from NHS to Panaccio that Bowers knew Panaccio was not entitled to, and paid his own consulting fees from these secret accounts. Id. PP 103-107.

With respect to predicate acts of mail fraud, NHS alleges that "Bowers made regular use of the United States mails to administer the secret accounts, to receive instructions from Panaccio on when and how to make unlawful transfers of NHS funds, and to make such transfers." Id. P 159. Attached to the Amended Complaint at Exhibit U are numerous documents allegedly transmitted through the mails, some of which suggest that other related mailings followed. n39

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n39 See, e.g., Doc. # BB0684 (Letter from Panaccio to Bowers of 4/30/97 (sent via Federal Express, transmitting $ 15,000 "toward the special account which you will open and manage on my behalf," stating, "I will be sending you monthly invoices for you to pay from this account," and instructing Bowers to pay enclosed bills from American Express and the Academy of Music "post haste")); Doc. # BB0886 & BB0505 (invoice from and check payable to Panaccio's dentist).

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[*40]

NHS's allegations surrounding the Amica/Bowers fraud are lacking insufficient detail for purposes of *Rule 9(b)*. First, the Amended Complaint fails to go beyond ambiguous allegations of a connection between the Amica fraud and the secret accounts. Its best effort is this: "Panaccio and Patrick also siphoned cash directly from Amica and United Staffing and/or other sources of NHS funds. In doing so, they hired an outside accountant by the name of Barry Bowers . . . ." Am. Compl. P 102. There is no specific explanation of how use or administration of the secret account is connected with the allegedly fraudulent operation of Amica by, for example, explaining how Amica or NHS's funds were allegedly deposited in the secret account. Morever, there are no details whatsoever regarding any fraudulent operation of United, other than to allege an "arrangement similar to the Amica fraud." Am. Compl. P 4.

NHS alleges that Amica cheated NHS out of profits and served as Panaccio's slush fund for luxury automobiles and nepotism, but there is no allegation that Panaccio used the mails to accomplish such fraud. The mailings it does identify, and which serve as the alleged RICO predicate acts, all [*41] relate to the secret account. Without any detailed allegations of a connection between the Amica fraud and use of the mails, the Amended Complaint fails to explain how use of the mails contributed to the alleged fraud.

Furthermore, even accepting that the documents were all sent via mail or via interstate facsimile, n40 the Amended Complaint does not explain how the documents contributed to any fraud. The documents are innocent on their face, dealing with legal activities such as paying bills, cancelling checks, generating statements of account, and reporting expenses. The Amended Complaint lacks an explanation of how these payments were part of a fraudulent scheme. For instance, while the Amended Complaint alleges that Bowers used the secret account to pay for Panaccio's "personal, non-reimbursable expenses," Am. Compl. P 104, it fails to identify any particular expenses of a non-reimbursable nature. *Rule 9(b)* requires that NHS explain how mere administration of the account furthered the overall fraud scheme. n41

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n40 Intrastate facsimiles are beyond the scope of the wire fraud statute, *18 U.S.C. § 1343*. *Annulli v. Panikkar, 200 F.3d 189, 200 n.9 (3d Cir. 1999)*, overruled on other grounds by *Rotella v. Wood, 528 U.S. 549, 145 L. Ed. 2d 1047, 120 S. Ct. 1075 (2000)*.

[*42]

n41 See *Lum, 361 F.3d at 224* (finding allegations insufficient "because they do not identify particular fraudulent transactions"); *Kehr, 926 F.2d at 1413-14* (although "innocent mailings" can support a predicate act of mail fraud, "the mailing must relate to the underlying fraudulent scheme").

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Accordingly, the allegations associated with the Amica/Bowers fraud are insufficient under *Rule 9(b)*. Those relevant aspects of the Amended Complaint are dismissed without prejudice to NHS's right to amend its allegations consistent with this opinion and to conform to the requirement of *Rule 9(b)*.

Stadium Looting Fraud

The Amended Complaint sets forth in significant detail the series of transactions constituting this fraud, although it alleges only generally that Panaccio and Flaherty used the mails in furtherance of the scheme. The fraud was allegedly carried out as follows.

Since approximately June 1998, Panaccio recommended to the Board of Trustees that it acquire a minor league baseball and soccer stadium to be constructed by Flaherty on property owned by NHS [*43] in Northampton County. Am. Compl. P 112. However, Panaccio and Flaherty failed to disclose that Flaherty had no independent ability to pay for the construction. The Trustees approved a plan for NHS to acquire the stadium, but only as a gift after Flaherty built it. Panaccio and Flaherty then set out to finance the stadium construction secretly using NHS funds, even though they repeatedly represented to the Board that no NHS funds were being used for that purpose. Id. PP 113-18.

On August 15, 1998, Flaherty and Panaccio entered into agreements for NHS to buy a building owned by Flaherty and located at 201 Larry Holmes Drive in Easton, Pennsylvania. NHS paid an allegedly inflated price of $ 1,750,000 for the property. Having paid only $ 874,000 for the property four years earlier, Flaherty reaped nearly $ 900,000 in profit. Id. PP 125-26. The proceeds of the sale were then used to finance stadium construction. In addition, Panaccio arranged for NHS to act as guarantor of all construction costs and the long-term debt for the stadium. Id. PP 121-22. None of these transactions were disclosed to NHS's Board. Id. P 127.

The August 15, 1998 agreement of sale contained a provision **[*44]** making the agreement contingent upon the Board's approval, and it further provided that if Board approval did not occur, any monies paid by NHS as deposit funds would be repaid by Flaherty to NHS. Id. P 129. On December 23, 1998, Flaherty and Panaccio revised the agreement retroactively to December 15, 1998, retaining the Board approval contingency but eliminating Flaherty's obligation to return any deposited funds if Board approval was never obtained. Id. P 130. Panaccio did not seek approval of these revisions by NHS's legal counsel. Id. P 132. By falsely representing to an NHS executive that the Board had approved the sale, Panaccio arranged for NHS to pay $ 800,000 in deposits to Flaherty. Ultimately, because the NHS Board did not know about the transaction, let alone approve it, NHS forfeited those deposits to Flaherty. Id. PP 131; 134-37, 140.

In another transaction, on May 29, 1998, without authority from or disclosure to the Board, Panaccio entered into a "Bridge Loan Agreement" with Flaherty. Pursuant to the terms of the loan, on June 2, 1998, NHS transferred more than $ 400,000 to Federal Development Co., the stadium development company owned by Flaherty. **[*45]** Repayment of the full amount was due on or before September 15, 1998, but it was never repaid. Id. P 124.

In yet another transaction, on May 15, 1998, without informing the Board, Panaccio signed a Land Development Agreement, providing that NHS would guarantee improvement work at the stadium construction site in Williams Township. To meets NHS's obligation under the Land Development Agreement, on December 4, 1998, Panaccio executed a Surety Bond to Williams Township, placing $ 463,272.10 of NHS's funds in escrow with an insurance company for the Township. Panaccio signed a second Surety Agreement on the property, this time committing $ 339,514 in NHS funds to guarantee ongoing work at the site. These transactions were never disclosed to NHS's Board. PP 123, 138-39.Id.

Finally, in yet another undisclosed transaction, Panaccio ordered the execution of documents, purportedly on behalf of NHS, asserting that a Flaherty-owned corporation had deposited $ 200,000 in stock certificates into an escrow account controlled by NHS. Such a deposit was a prerequisite for Flaherty's continued ownership of his minor league baseball team franchise and the team's eligibility to participate **[*46]** in the Atlantic League. The documents made NHS an escrow agent on behalf of Flaherty, thereby obligating NHS to pay $ 200,000 on demand to the Atlantic League. No members of NHS's Board knew of or approved these documents or their effect. The documents were completely false; no funds or stock were ever placed in escrow. NHS contends that creation of these documents has soiled NHS's credibility in the eyes of its funders, licensors and creditors, and has subjected it to legal action by the Atlantic League. Id. PP 141-46.

By July 1999, construction at the stadium site stopped because Flaherty failed to pay his bills. At that point, an outside financier stepped forward and agreed to pay the contractors by purchasing their accounts receivable. It would do so, however, only if NHS acknowledged that Flaherty had acted in all respects as NHS's agent and that, in fact, payments due from Flaherty were actually debts owed by NHS. At a combined Finance and Executive Committee meeting on July 2, 1999, Panaccio presented the financier's proposal but failed to relate that the proposal required NHS to assume Flaherty's debts. The Committees approved the deal, and Panaccio signed an agreement **[*47]** accepting responsibility to pay the financier $ 2,759,024. NHS is now a defendant in legal proceedings to collect those monies. Id. PP 147-48.

Panaccio and Flaherty attack these allegations as insufficient under *Rule 9(b)* because NHS fails to identify any specific mailings or interstate wires used in furtherance of this fraud. As the lengthy recitation above makes clear, the Amended Complaint provides great detail and specificity in outlining the Stadium Looting fraud. [HN13]The purpose of *Rule 9(b)* is to provide notice of the "precise misconduct" charged; here, NHS has "injected precision and some measure of substantiation into their allegations of fraud." n42 It has identified numerous transactions, the sums and parties involved, the dates, and the purpose and effect of these transactions. Accordingly, Defendants have more than adequate notice of the charges against them, and the requirements of *Rule 9(b)* are satisfied.

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n42 *Seville, 742 F.2d at 791*; see also *Morganroth & Morganroth, 331 F.3d at 414 n.2* (purpose of *Rule 9(b)* is to provide notice, not to test the factual allegations of the claim); *Crown Cork & Seal Co. v. Ascah, 1994 U.S. Dist. LEXIS 1965, Civ. No. 93-2933, 1994 WL 57217, at *5 (E.D. Pa. Feb. 18, 1994)* (Pollak, J.) (denying motion to dismiss RICO claims) ("It is true that the specific details of what exact pieces of paper were mailed or what communications were wired are lacking. Yet it is not necessary for a plaintiff to allege such details in the complaint, before sufficient discovery to discover those details has occurred.").

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**[*48]**

At this early stage in the litigation, NHS's failure to identify any specific mailings is not fatal to its claim. This is especially so because there can be little doubt that Panaccio and Flaherty used the mails in accomplishing the various transactions constituting the fraud. n43 Moreover, permitting dismissal at this early stage would run counter to the Third Circuit's admonition to "be sensitive to the fact that . . . application of [*Rule 9(b)*], prior to discovery, may permit sophisticated defrauders to successfully conceal the details of their fraud." n44 The Amended Complaint contains factual allegations "that make their theoretically viable claim plausible," n45 so NHS is entitled to pursue the claim as presently alleged.

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n43 Viewing the circumstances of this fraud as they are alleged in the Amended Complaint, an objective observer would undoubtedly conclude "that a mailing (or other covered delivery by an interstate carrier) would have been reasonably foreseeable." *United States v. Tiller, 302 F.3d 98, 103 (3d Cir. 2002).*

n44 *Christidis v. First Pa. Mortgage Trust, 717 F.2d 96, 99-100 (3d Cir. 1991).*

**[*49]**

n45 *In re Rockefeller, 311 F.3d at 216.*

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**2. Pleading a RICO "Pattern"**

[HN14]To advance a RICO claim under *18 U.S.C. § 1962(c)*, NHS must plead a "pattern of racketeering activity," defined at *18 U.S.C. § 1961(5)* as "at least two acts of racketeering activity" within a ten year period. Having concluded supra that NHS may not pursue claims of alleged racketeering activity associated with the Medicare/Medicaid fraud, and having concluded that the Amica/Bowers fraud allegations are deficient under *Rule 9(b)*, the Court will only consider the Excessive Compensation and Stadium Looting frauds in examining whether NHS has sufficiently alleged a pattern of racketeering activity.

"To prove a pattern of racketeering activity a plaintiff must show that the racketeering predicates are related ***and*** that they amount to or pose a threat of continued activity." n46 Predicate acts are "related" if they "have the same or similar purposes, results, participants, victims, or methods of commission, or otherwise are interrelated by distinguishing **[*50]** characteristics and are not isolated events." n47 NHS proceeds on the theory that all of the above-described frauds are related by virtue of identical leadership (Panaccio), methods (fraudulent looting), purposes (benefitting and enriching Panaccio), and victim (NHS).

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n46 *H.J., Inc. v. Northwestern Bell Tel. Co., 492 U.S. 229, 239, 106 L. Ed. 2d 195, 109 S. Ct. 2893 (1989).*

n47 *Id. at 240.*

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Panaccio and Flaherty do not challenge NHS's theory of relatedness. Instead, they contend that NHS failed in the first instance to properly allege any predicate acts. Therefore, they argue, NHS has failed to allege a "pattern" of predicate acts. However, as set forth supra at Part II.B.1., NHS has adequately alleged predicate acts relating to the Excessive Compensation and Stadium Looting frauds. Accordingly, this simplistic argument of a lack of pattern is rejected.

[HN15]As for the second, or "continuity," prong of the pattern analysis, the Supreme Court has urged a "flexible approach," permitting plaintiffs **[*51]** to proceed on a theory of closed-end continuity or open-ended continuity. n48 Open-ended continuity refers to "past conduct that by its nature projects into the future with a threat of repetition." n49 Closed-ended continuity refers to "a closed period of repeated conduct," proved by "a series of related predicates extending over a substantial period of time." n50 In the case at bar, NHS advances its RICO claims on a closed-ended continuity theory.

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n48 *Id. at 241.*

n49 Id.

n50 *Id. at 242.*

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Continuity is "centrally a temporal concept." n51 Although the Supreme Court couched the continuity test in terms of whether the "racketeering predicates . . . pose a threat of continued activity," n52 in the case at bar the Court must do more than merely count and calendar the alleged acts of mail and wire fraud. The Third Circuit has instructed that "the continuity test requires us to look beyond the mailings and examine the underlying scheme or artifice. Although the mailing **[*52]** is the actual criminal act, the ***instances of deceit*** constituting the underlying fraudulent schemes are more relevant to the continuity analysis." n53

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n51 Id.

n52 *Id. at 239.*

n53 *Tabas v. Tabas, 47 F.3d 1280, 1294 (3d Cir. 1995)* (en banc) (emphasis added) (quoting *Kehr, 926 F.2d at 1414*).

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As with his argument on the relatedness prong, Panaccio relies heavily on the contention that there are no "well-pleaded predicate acts," thereby creating an absence of a pattern of racketeering activity. The Court disagrees. Taking the Amended Complaint in the light most favorable to NHS, the alleged "instances of deceit" reveal underlying schemes of substantial duration. n54

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n54 Id.

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With respect to the Excessive Compensation fraud, NHS alleges that Panaccio orchestrated **[*53]** his receipt of princely salary and benefits since at least 1986, when he received the first compensation insurance policy, and through his retirement in June 2000. n55 With respect to the Stadium Looting fraud, NHS alleges fraudulent conduct by Panaccio and Flaherty beginning with an April 30, 1998 Board meeting and continuing through July 1999, a period of approximately fourteen months. n56

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n55 See Am. Compl. PP 56, 165, 173; id. Ex. T at 4 (listing NHS deferred compensation plan policies and annuities). The Amended Complaint further alleges fraudulent manipulation of the Board of Trustees and the Compensation Committee in creating the Trust in April 1994, id. PP 72-75 & Ex. I, in providing salary continuation plans for Patrick in May 1997, id. P 76 & Ex. L, and for Panaccio in June 1998, id. P 76 & Ex. J.

n56 Id. PP 114-147.

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In sum, the Amended Complaint alleges Panaccio's overall scheme to defraud and loot NHS consumed a period of approximately fourteen years, with a particular **[*54]** concentration of activity consuming approximately five years, from 1994 to 1999. Therefore, Panaccio's scheme to defraud NHS lasted a "substantial period of time" and is more than adequate under Third Circuit precedent. n57

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n57 *Tabas, 47 F.3d at 1294* (implementing scheme to defraud over three and a half year period satisfies closed-ended continuity); *United States v. Pelullo, 964 F.2d 193, 209 (3d Cir. 1992)* (nineteen months satisfies continuity); *Swistock v. Jones, 884 F.2d 755, 759 (3d Cir. 1989)* (fourteen months satisfies closed-ended continuity).

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Finally, Flaherty argues that NHS has failed to allege a pattern of racketeering with respect to him. The Amended Complaint does not include any specific allegations concerning Flaherty's involvement in the Excessive Compensation fraud. At best it avers on "information and belief" that Flaherty "participated in, and was aware of" other frauds, or was their intended beneficiary. Am. Compl. PP 94, 168. However, such **[*55]** conclusory allegations are plainly lacking the requisite detail for purposes of *Rule 9(b)*.

Although NHS argues that it nee[illegible]t particularize its allegations against Flaherty due to his "insider" status, the Amended Complaint is lacking specific details or factual allegations explaining "why the charges against [Flaherty] are not baseless and why additional information lies exclusively within [Flaherty's] control." n58 Unlike its allegations regarding the Excessive Compensation fraud, where it explained an absence of documentary evidence, e.g., Am. Compl. P 63 ("deliberate management decisions" resulted in "wholesale absence of documents and information remaining at NHS . . . ."), NHS fails to allege and explain why the necessary information lies with Flaherty alone. Accordingly, any alleged predicate acts associated with the Excessive Compensation fraud cannot be considered by the Court in determining whether Flaherty has engaged in a "pattern of racketeering activity" under *18 U.S.C. § 1962(c)*. n59 Therefore, the Court must determine whether NHS's allegations in the Stadium Looting fraud sufficiently allege that Flaherty engaged in a pattern of racketeering. **[*56]**

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n58 *In re Craftmatic Sec. Litig., 890 F.2d 628, 646 (3d Cir. 1989)*.

n59 Cf. *Banks v. Wolk, 918 F.2d 418, 421 (3d Cir. 1990)* ("We note that no defendant can be liable under RICO unless he participated in two or more predicate offenses sufficient to constitute a pattern."); *Rowe v. Metabolife Int'l, Inc., 2004 U.S. Dist. LEXIS 2453, No. Civ.A.03-4346, 2004 WL 292475, at *2 (E.D. Pa. Jan. 20, 2004)* ("When the acts of multiple defendants are alleged to constitute fraud, plaintiffs must separately plead the allegedly fraudulent acts of each defendant to comply with *Rule 9(b)*.") (citation omitted).

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Even focusing narrowly on Flaherty's participation in the Stadium Looting fraud, the Amended Complaint adequately alleges that Flaherty engaged in a pattern of racketeering activity. NHS alleges that he and Panaccio, over a period of approximately fourteen months, orchestrated a series of transactions designed to enrich Flaherty at NHS's expense. The Amended Complaint details at least five separate **[*57]** instances during that fourteen-month period where Flaherty misrepresented or failed to disclose material information to the Board concerning the stadium project. n60 In light of Third Circuit precedent, the Court cannot conclude that NHS 's RICO claim against Flaherty is deficient. n61 This is a close question, [illegible] at this early stage of the litigation it does not appear "beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." n62 NHS will have the opportunity to develop its theory through discovery, and the Court may revisit this issue on a developed record. n63

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n60 See Am. Compl. PP 115-118 (failing to disclose Flaherty's inability to pay for the stadium construction; failing to disclose that NHS must purchase the stadium property; misrepresenting that no NHS funds were being used to finance stadium construction); P 127 (failing to disclose the Larry Holmes Drive transaction and Flaherty's large profit therefrom); PP 143-145 (ordering creation of false escrow documents and failing to disclose or seek approval of the Board regarding execution thereof).

**[*58]**

n61 See *Swistock, 884 F.2d at 759* (fourteen months satisfies closed-ended continuity).

n62 *Conley v. Gibson, 355 U.S. 41, 45, 2 L. Ed. 2d 80, 78 S. Ct. 99 (1957)*.

n63 See *Banks, 918 F.2d at 419-20* ("We note that in RICO actions, 'in many cases plaintiffs will be able to withstand a facial attack on the complaint and have the opportunity to have their pattern allegations threshed out in discovery.'") (quoting *Swistock, 884 F.2d at 758*).

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### 3. RICO Conspiracy

[HN16]To state a RICO conspiracy claim, the plaintiff "must allege (1) agreement to commit the predicate acts of fraud, and (2) knowledge that those acts were part of a pattern of racketeering activity conducted in such a way as to violate [*§ 1962*]." n64 A claim of RICO conspiracy must also allege that the plaintiff was injured by a predicate act of racketeering, rather than an overt act of the conspiracy that is not otherwise wrongful under RICO. n65

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n64 *Rose v. Bartle, 871 F.2d 331, 366 (3d Cir. 1989)* (citation omitted).

**[*59]**

n65 *Beck v. Prupis, 529 U.S. 494, 505-06, 146 L. Ed. 2d 561, 120 S. Ct. 1608 (2000)*.

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Defendants' arguments concerning the RICO conspiracy claim are rather terse, comprising only a few sentences. They allege that the Amended Complaint fails to satisfy the above requirements because: (1) NHS cannot allege an agreement to commit predicate acts when the Amended Complaint fails to allege predicate acts in the first place; (2) NHS cannot allege awareness of a pattern of racketeering activity because the Amended Complaint fails to describe such a pattern; and (3) the Amended Complaint attributes NHS's injuries to a conspiracy generally and not to predicate acts of racketeering as required by the Supreme Court's decision in Beck v. Prupis. n66

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n66 See Panaccio Mem. of Law at 25; Flaherty Mem. of Law at 16-17.

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The first two arguments depend on premises already rejected supra and thus cannot prevail. As to the last **[*60]** argument, the rule announced in *Beck v. Prupis* is inapposite to the case at bar. As correctly noted by NHS, Beck involved a corporate officer who discovered racketeering activity by other corporate officers and directors, reported it to regulators, and lost his job in retaliation. Because the claimed injury -- termination -- was not caused by a predicate act under RICO, the claimed injury did not give rise to a cause of action under § *1964(c)* for a violation of § *1962(d)*. n67 Unlike the case in Beck, NHS alleges injuries by reason of the predicate acts of racketeering underlying the Excessive Compensation and Stadium Looting frauds. Accordingly, the Beck rule does not defeat NHS's conspiracy claim. n68

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n67 See *Beck, 529 U.S. at 505*.

n68 Cf. *Smith v. Berg, 247 F.3d 532, 539 (3d Cir. 2001)* ("As the District Court correctly concluded, the Plaintiffs' claims in this case stem from injury directly attributable to Berg's racketeering; they are the direct victims of substantive RICO violations. . . . Thus the Appellants remain subject to liability under the reasoning enunciated by the Supreme Court in Beck.") (internal footnote omitted).

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**[*61]**

### C. Conclusion

NHS lacks standing to pursue its RICO claims insofar as those claims are premised on the alleged Medicare/Medicaid fraud. In addition, the allegations concerning the Amica/Bowers fraud fail to meet the specificity requirements of *Rule 9(b)* and thus are dismissed. The Court will permit NHS to file a Second Amended Complaint if it can cure the deficiencies outlined in this Memorandum Opinion. In all other respects, however, the Amended Complaint is sufficient and withstands Defendants' motions to dismiss.

Defendants do not challenge the merits of NHS's state law claims against Panaccio, Flaherty, Mrs. Panaccio, and Barr. Having determined that some of NHS's federal claims against these defendants survive the motions to dismiss, the Court will retain supplemental jurisdiction over NHS's state law claims.

## III. THE SECURITIES FRAUD CLAIMS

Plaintiffs pursue federal securities fraud claims against Defendants McKeever, MBG and Provident. These Defendants move to dismiss the Amended Complaint for a host of reasons, but their arguments boil down to this: The federal securities claims are barred by the statute of limitations, or in the alternative, they fail **[*62]** to meet the heightened pleading requirements of *Rule 9(b)*, and they fail to state a claim under *Rule 12(b)(6)*. Accordingly, the federal claims should be dismissed, and the Court should decline to exercise subject matter jurisdiction over the state common law claims. Alternatively, even if the Court wants to retain jurisdiction over the common law claims, they all fail on their substantive merits.

Because the Court concludes that the federal securities claims are barred by the applicable statute of limitations, it need not reach Defendants' alternative arguments. The Court declines to exercise supplemental jurisdiction over the state law claims.

### A NHS's Securities Claims

In Count 13 of the Amended Co... ..nt (mislabeled as the second "Count 12"), NHS alleges that McKeever and MBG violated Section 10(b) of the Securities Exchange Act of 1934, *15 U.S.C. § 78j(b)*. It contends that "Defendant McKeever sold certain annuities, life insurance policies and other insurance products to NHS through the Trust. Specifically, beginning in or around 1986, and continuing at least through 1998, McKeever sold to NHS the insurance policies set forth and attached hereto as **[*63]** Exhibit [T]." Am. Compl. P 268. n69 In connection with the sale of such securities, McKeever and MBG allegedly misrepresented material facts and omitted material facts, including whether the insurance products were "suitable for NHS," and that McKeever "would earn substantial commissions and other fees on the sale of the insurance products." Id. P 270. In setting out the facts common to all counts of the Amended Complaint, NHS also alleges that McKeever and MBG failed to disclose: (a) McKeever's conflict of interest in that he served both as a consultant to NHS and as a personal advisor to Panaccio, id. PP 68, 70, and (b) that the salary continuation agreements contained provisions highly unfavorable to NHS, id. PP 84-85.

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n69 Paragraph 268 of the Amended Complaint actually refers to Exhibit "X," but as noted by the parties in their memoranda, this appears to be a typographical error because the list of annuities, life insurance policies and other insurance products appears in Exhibit T.

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In Count **[*64]** 14 (mislabeled as Count 13), NHS alleges controlling person liability against MBG and Provident in violation of Section 20(a) of the Securities Exchange Act, *15 U.S.C. § 78t(a)*. In short, it alleges that MBG and Provident directly or indirectly controlled McKeever and thus are jointly and severally liable for McKeever's violation of *Section 10(b)*. The viability of NHS's claim for controlling person liability is contingent upon the success of its *section 10(b)* claim against McKeever and MBG. n70

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n70 See *In re Alpharma Inc. Sec. Litig., 372 F.3d 137, 153 (3d Cir. 2004)* ("If no controlled person is liable, there can be no controlling person liability.") (quoting *Shapiro v. UJB Fin. Corp., 964 F.2d 272, 279 (3d Cir. ..2))*.

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**B. Statutes of Limitations and Repose**

*Section 10(b) of the Securities Exchange Act* [HN17]contains no express statute of limitations, which is not surprising because private causes of action under *section 10(b)* are a judicial creation. **[*65]** n71 In *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 501 U.S. 350, 364, 115 L. Ed. 2d 321, 111 S. Ct. 2773 (1991)*, the Supreme Court of the United States determined the applicable limitations period for such claims, holding that "litigation instituted pursuant to § *10(b)* . . . must be commenced within one year after the discovery of the facts constituting the violation and within three years after such violation." n72 Claims under *section 20(a)* are governed by the same one-year/three-year limitations/repose period. n73 Neither the one-year limitations period nor the three-year repose period are subject to equitable tolling; the three year period is an absolute "cutoff." n74

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n71 See *Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 13 n.9, 30 L. Ed. 2d 128, 92 S. Ct. 165 (1971)* (recognizing an implied private right of action under *section 10(b)*).

n72 Section 804 of the Sarbanes-Oxley Act of extended *section 10(b)*'s statute of limitations and repose from the one-year/three-year period outlined in Lampf to a two-year/five-year period. See Pub. L. No. 107-204, 116 Stat. 745, § 804 (codified in part at *28 U.S.C.A. § 1658(b) (West Supp. 2004)*). Whether the Sarbanes-Oxley Act revives claims that expired under Lampf's shorter limitations/repose periods is a matter of some debate, although almost all courts (including this Court) have determined it does not. See *Lieberman v. Cambridge Partners, L.L.C., 2004 U.S. Dist. LEXIS 11553, No. Civ.A.03-2317, 2004 WL 1396750, at *3 & n.12 (E.D. Pa. June 21, 2004)* (Rufe, J.) (collecting cases). In a July 12, 2004 letter to the Court, counsel for NHS states explicitly that NHS does not rely on Sarbanes-Oxley's longer limitations/repose periods in pursuing its claims.

**[*66]**

n73 *Dalicandro v. Legalgard, Inc., 2004 U.S. Dist. LEXIS 2253, No. Civ.A.99-3778, 2004 WL 250546, at *4 n.9 (E.D. Pa. Jan. 21, 2004).*

n74 *Lampf, 501 U.S. at 363* ("The 1-year period, by its terms, begins after discovery of the facts constituting the violation, making tolling unnecessary. The 3-year limit is a period of repose inconsistent with tolling. . . . Because the purpose of the 3-year limitation is clearly to serve as a cutoff, we hold that tolling principles do not apply to that period.").

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[HN18]A "violation" of *section 10(b)* occurs not at the time the securities are purchased but on the date that the alleged fraudulent misrepresentation is made or, in the case of an omission, on the date a duty to disclose the withheld information arises. n75 Here, the Amended Complaint contains no specific dates on which McKeever made any misrepresentation or omission. Rather, NHS alleges that McKeever sold the relevant securities, which are listed in Exhibit T, "beginning in or around 1986, and continuing at least through 1998." Am. Compl. P 268. Turning to Exhibit T, the earliest effective date **[*67]** for any policy issued to Panaccio is December 16, 1998 ( # 7100577), and the latest effective date is November 10, 1998 ( # 9076395).

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n75 *In re Prudential Ins. Co. of Am. Sales Practices Litig., 975 F. Supp. 584, 602-05 (D.N.J. 1996)* (hereinafter, "In re Prudential"); *In re Phar-Mor, Inc. Sec. Litig., 892 F. Supp. 676, 686-88 (W.D. Pa. 1995).*

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As a matter of simple logic, any misrepresentation or omission must have occurred on or before the date of sale. Accordingly, taking the allegations in the light most favorable to NHS, the last possible date on which McKeever violated *section 10(b)* was November 10, 1998. Applying Lampf's three-year statute of repose, NHS's claims expired in November 2001. Because NHS did not commence the instant action until January 2003, its *section 10(b)* and *20(a)* claims are untimely.

NHS offers three arguments in opposition to this conclusion. First, it contends that the discovery rule should be applied and the statutes of limitations and **[*68]** repose should be tolled. This argument lacks merit and requires no discussion, the Supreme Court having concluded unequivocally in Lampf that tolling principles do not apply to the one-year statute of limitations or the three-year statute of repose. n76

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n76 See *Lampf, 501 U.S. at 363.*

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Second, NHS argues that Defendants' statute of limitations argument is premature on a motion to dismiss. [HN19]Under the so-called "Third Circuit Rule," defendants may raise a limitations defense on a *Rule 12(b)(6)* motion to dismiss, but only if "the time alleged in the statement of a claim shows that the cause of action has not been brought within the statute of limitations. . . . If the bar is not apparent on the face of the complaint, then it may not afford the basis for a dismissal of the complaint." n77

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n77 *Robinson v. Johnson, 313 F.3d 128, 135 (3d Cir. 2002)* (citations omitted).

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**[*69]**

NHS contends that the limitations bar is not apparent on the face of the Amended Complaint because it "contains no independent averment of when the last annuity was purchased," and that Defendants' argument is premised "on an assumption that the last policy was obtained in 1998." n78 These arguments are unavailing. NHS's argument implies that there were sales of securities after November 1998, but neither the Amended Complaint nor its memoranda of law allege such sales. In any event, as noted above, the relevant date for accrual of a *section 10(b)* claim is the date of a misrepresentation or omission, not the date of sale. NHS's failure to allege any such dates does not preclude Defendants or the Court from determining, with adequate specificity for purposes of the instant motion, when these omissions could have occurred. The unavoidable inference flowing from NHS's claim that McKeever misrepresented or omitted material facts in connection with the sale of securities is that he did so ***before*** NHS purchased those securities. NHS identifies the securities at issue as those set forth in Exhibit T, and the latest effective date of any security identified in Exhibit T is November 10, 1998. n79 **[*70]** Therefore, a plain reading of the Amended Complaint reveals a time frame during which McKeever allegedly violated *section 10(b)*, i.e., sometime on or before November 10, 1998. NHS is simply incorrect that the untimeliness of its securities claims is not apparent from the face of the Amended Complaint. n80

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n78 Pls.' Opp. at 45.

n79 See *Oatway v. Am. Int'l Group, Inc., 325 F.3d 184, 185 n.1 (3d Cir. 2003)* (when considering a *Rule 12(b)(6)* motion, a district court may consider a document integral to or explicitly relied upon in the complaint).

n80 Some courts within the Third Circuit hold that a plaintiff bears the burden of pleading compliance with Lampf because the statute of limitations Lampf sets forth is a substantive requirement rather than a procedural one. See *In re Prudential, 975 F. Supp. at 598* (noting courts in the District of New Jersey "have consistently" so held) (citing *Rolo v. City Investing Co. Liquidating Trust, 845 F. Supp. 182, 243 n.38 (D.N.J. 1994)* and *Kress v. Hall-Houston Oil Co., 1993 U.S. Dist. LEXIS 6350, No. Civ.A.92-543, 1993 WL 166274, at *2 (D.N.J. May 12, 1993)*); see also *Davidson v. Wilson, 973 F.2d 1391, 1402 (8th Cir. 1992)*. Judge Posner of the Seventh Circuit argues forcefully in *Tregenza v. Great American Communications Co., 12 F.3d 717, 718-19 (7th Cir. 1993)* that the rule is dubious and should be discarded. If the rule applies here, NHS has utterly failed to satisfy it. In any event, the Court need not resolve this issue because the limitations bar is apparent on the face of NHS's Amended Complaint. See *id. at 718* ("Of course if [the plaintiff] pleads facts showing that his suit is time-barred or otherwise without merit, he has pleaded himself out of court.").

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**[*71]**

Finally, NHS notes that it is making continuing premium payments on annuities it purchased from McKeever. Each of these annuities are terminable at its option; therefore, it argues, each contribution it makes constitutes an independent investment decision "for which [it] is entitled to full disclosure and freedom from any scheme to defraud." n81 It contends that as long as NHS makes continuing premium payments, its securities claims continue to accrue. This argument ignores that NHS's *section 10(b)* claims accrue on the date McKeever allegedly made a misrepresentation or omission, not on the date of sale. n82 Accordingly, absent allegations that NHS's continuing payments are tied to a misrepresentation or omission by McKeever that occurred within the three-year period of repose, NHS's *section 10(b)* claims are time-barred. n83

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n81 Pls.' Opp. at 45-46 (citing *Helman v. Murry's Steaks, Inc., 742 F. Supp. 860, 870 (D. Del. 1990)* ("If the parties enter into an agreement to purchase securities into the future and the parties possess the power to terminate the agreement, any additional investment of money may be seen as a new investment decision and thus a new purchase or sale.")).

**[*72]**

n82 *In re Prudential, 975 F. Supp. at 602-05*; *In re Phar-Mor, Inc. Sec. Litig., 892 F. Supp. at 686-88*.

n83 See *In re Prudential, 975 F. Supp. at 604 n.15* ("Although the continuing investment doctrine remains valid after Lampf, and plaintiffs may accordingly allege securities fraud based upon payments they made within the three-year period, we hold that plaintiffs must also tie such payments to a misrepresentation or omission occurring within that period.").

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**C. Conclusion**

Accordingly, NHS's securities fraud claims are barred by the applicable statute of limitations, and those claims are dismissed. Because NHS cannot cure the deficiencies of its time-barred claims, it may not amend these claims.

Having dismissed the federal claims against Provident, McKeever and MBG, retaining jurisdiction over the state law claims against these defendants is within the Court's discretion. [HN20]The Third Circuit has instructed, "where the claim over w...n the district court has original jurisdiction is dismissed before trial, the district court must [*73] decline to decide the pendent state law claims unless considerations of judicial economy, convenience, and fairness to the parties provide an affirmative justification for doing so." n84

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n84 *Borough of W. Mifflin v. Lancaster, 45 F.3d 780, 788 (3d Cir. 1995).*

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The Court believes there is no affirmative justification for retaining the state law claims against these defendants. Although considerable time has passed since NHS filed this action, discovery in this matter has been stayed. Thus, despite the passage of time, this matter is essentially in an early stage. Furthermore, although discovery has proceeded in the related matter of Panaccio v. Northwestern Human Services, Inc., Civ. A. No. 02-7767, and although the issues in that case overlap somewhat with the case at bar, Provident, n85 McKeever and MBG are not parties to that litigation.

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N85 The Court entered summary judgment in favor of Provident on May 12, 2004. Panaccio consented to such disposition, and NHS did not object at the time. See Panaccio v. Northwestern Human Services, Inc., Civ. A. No. 02-7767, Doc. # 74 (E.D. Pa.).

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[*74]

NHS has offered no persuasive justification for retaining jurisdiction. Accordingly, the Court declines to exercise jurisdiction over the state law claims against these defendants, and they are dismissed from this action.

An appropriate Order follows.

**ORDER**

**AND NOW**, this 24th day of September, 2004, upon consideration of Provident's Motion to Dismiss [Doc. # 42], Thomas X. Flaherty's Motion to Dismiss [Doc. # 44], McKeever and MBG's Motion to Dismiss [Doc. # 45], Panaccio's Motion to Dismiss [Doc. # 46], NHS's Consolidated Response thereto [Doc. # 55], Defendants' Reply memoranda [Docs. # # 57-59], NHS's Sur-Reply [Doc. # 60], and for the reasons set forth in the attached Memorandum Opinion, it is hereby **ORDERED** that Defendants' Motions are **GRANTED IN PART** and **DENIED IN PART**. It is specifically **ORDERED** that:

**1.** Those aspects of the Amended Complaint asserting a RICO claim premised on the alleged Medicare/Medicaid fraud, including but not limited to the factual allegations (PP 45-54) and Count 1 (PP 166-179), are hereby **DISMISSED WITH PREJUDICE**;

**2.** Those aspects of the Amended Complaint asserting [*75] a RICO claim premised on the alleged Amica/Bowers fraud, including but not limited to the factual allegations (PP 91-109), are hereby **DISMISSED WITHOUT PREJUDICE**. Plaintiffs are granted leave to amend those allegations consistent with this Memorandum Opinion within twenty (20) days of the date of this Order;

**3.** The Court retains supplemental jurisdiction over the state law claims asserted against Defendants Robert C. Panaccio, Marta Panaccio, Barry N. Bowers and Thomas X. Flaherty;

**4.** Plaintiffs' federal securities fraud claims (Counts 13 and 14) n1 are hereby **DISMISSED WITH PREJUDICE** as barred by the applicable statute of limitations and repose;

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n1 Citations to the counts of the Amended Complaint are sequential and ignore the misnumbering that begins after Count 12.

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**5.** The Court declines to exercise supplemental jurisdiction over the state law claims against Defendants Provident Mutual Life Insurance Company, Provident Mutual Insurance and Financial Services Company, and 1717 [*76] Capital Management Company (Counts 8-10,15-16, 19-21). Accordingly, those claims are hereby **DISMISSED WITHOUT PREJUDICE**;

**6.** The Court declines to exercise supplemental jurisdiction over the state law claims against Defendants John L. McKeever, III and McKeever, Burke & Grant (Counts 6, 8-9, 12, 15-16, 19-22). Accordingly, those claims are hereby **DISMISSED WITHOUT PREJUDICE**.

It is so **ORDERED**.

**BY THE COURT:**

**CYNTHIA M. RUFE, J.**

# EXHIBIT 9

E. PAUL ROBERTS on behalf of himself and all others similarly situated, Plaintiffs, v. DEAN WITTER REYNOLDS, INC., n/k/a MORGAN STANLEY DW, INC., MARK RODGERS and PAUL GRANDE, Defendants.

CASE NO: 8:02-cv-2115-T-26EAJ

UNITED STATES DISTRICT COURT FOR THE MIDDLE DISTRICT OF FLORIDA, TAMPA DIVISION

2003 U.S. Dist. LEXIS 5676

March 14, 2003, Decided
March 14, 2003, Filed

**DISPOSITION:** [*1] Defendants' Motions to Dismiss denied.

**CASE SUMMARY**

**PROCEDURAL POSTURE:** Plaintiff investors sued various defendants, alleging that various unsuitable and unauthorized trades occurred between January 1998 and August 19, 1998. Defendants moved to dismiss.

**OVERVIEW:** Defendants asserted that the Public Company Accounting Reform and Investor Protection Act of 2002 did not apply to claims that extinguished or expired before the Act was passed on July 30, 2002. Defendants further asserted that plaintiffs' causes of action expired on August 19, 2001, which was three years after the end of the limitations period. Defendants relied on several cases for the proposition that a statute extending a limitations period would not revive claims that expired before the enactment of the statute unless Congress clearly manifested an intent to do so. To apply the Act to this case, defendants argued, would essentially create a new, private right of action, which was prohibited by the Act. The court held that the legislative history indicated that Congress intended for the extended statute of limitations found in the amended version of *28 U.S.C.S. § 1658* to apply retroactively. Regarding the timeliness of plaintiffs' claims under the Sarbanes-Oxley Act, the arguments raised under this premise required looking at matters outside the four corners of the complaint. As such, the argument was inappropriate material for a motion to dismiss.

**OUTCOME:** Defendants' motions to dismiss were denied.

**CORE TERMS:** statute of limitations, legislative history, right of action, expired, revive, discovery, limitations period, effective date, causes of action, retroactively, fined, facts constituting, pension, Securities Exchange Act, retroactive application, difference of opinion, congressional intent, interlocutory appeal, immediate appeal, question of law, plain language, claim of fraud, retroactivity, contravention, manipulation, contrivance, life-savings, time-barred, termination, materially

**LexisNexis(TM) Headnotes**

***Securities Law > Bases for Liability > Liability for Fraud***

***Securities Law > Bases for Liability > Deceptive Devices***

***Governments > Legislation > Statutes of Limitations > Time Limitations***
[HN1]See Pub. L. 107-204.

***Securities Law > Bases for Liability > Liability for Fraud***

***Securities Law > Bases for Liability > Deceptive Devices***

***Governments > Legislation > Statutes of Limitations > Time Limitations***
[HN2]See *28 U.S.C.S. § 1658.*

***Governments > Legislation > Interpretation***
[HN3]Interpreting a statute requires looking to its plain language first and resorting to the legislative history to discern congressional intent only when the language of the statute is unclear.

***Securities Law > Bases for Liability > Liability for Fraud***

***Securities Law > Bases for Liability > Deceptive Devices***

***Governments > Legislation > Statutes of Limitations > Time Limitations***
[HN4]The Supreme Court has previously held that the prior three-year statute of limitations of *28 U.S.C.S. § 1658,* now a five-year limit, is a period of repose.

***Governments > Legislation > Statutes of Limitations > Extension & Revival***
[HN5]There is no question that Congress holds the power to extend a previously applicable limitation period that has already commenced running and to enact a new limitation rule so as to revive claims already barred under a prior rule. Absent a clear expression of legislative intent, an extension of a limitations period, however, will not revive barred claims.

***Governments > Legislation > Interpretation***

***Governments > Legislation > Effect & Operation > Prospective & Retrospective Operation***
[HN6]Courts must effectuate congressional intent regarding retroactivity absent explicit statutory language mandating retroactivity.

***Securities Law > Bases for Liability > Liability for Fraud***

***Securities Law > Bases for Liability > Deceptive Devices***

***Governments > Legislation > Statutes of Limitations > Time Limitations***
[HN7]The phrase "regardless of when the underlying conduct occurred" as used in 148 Cong. Rec. S7418-01, demonstrates that Congress intended for the extended statute of limitations in the amended portion of *28 U.S.C.S. § 1658* to apply retroactively.

**COUNSEL:** For E. PAUL ROBERTS, plaintiff: Burton H. Finkelstein, Conor R. Crowley, Shannon P. Keniry, Finkelstein, Thompson & Loughran, Washington, DC. Jonathan L. Alpert, The Alpert Law Firm, Tampa, FL. Sonia C. Lawson, Sonia C. Lawson, PA, Tampa, FL.

For DEAN WITTER REYNOLDS, INC. nka Morgan Stanley DW Inc., defendant: John Eamon Johnson, Marvin E. Barkin, Trenam, Kemker, Scharf, Barkin, Frye, O'Neill & Mullis, P.A., Tampa, FL, Thomas John Roehn, Carlton Fields, P.A., Tampa, FL. Eric F. Leon, William H. Pratt, Kirkland & Ellis, New York, NY.

For MARK RODGERS, defendant: Stanley T. Padgett, Colleen Fitzgerald Nestor, Morgan, Padgett & Associates, P.A., Tampa, FL.

For PAUL GRANDE, defendant: Katherine C. Lake, Fowler White Boggs Banker, P.A., Tampa, FL. A. Inge Selden, Luther M. Dorr, Jr., Maynard, Cooper & Gale, Birmingham, AL.

For MARK TELLO, plaintiff: Burton H. Finkelstein, Conor R. Crowley, Shannon P. Keniry, Finkelstein, Thompson & Loughran, Washington, DC. Jonathan L. Alpert, The Alpert Law Firm, Tampa, FL.

**JUDGES:** RICHARD A. LAZZARA, UNITED STATES DISTRICT JUDGE.

**OPINIONBY:** RICHARD A. LAZZARA

**OPINION: AMENDED ORDER**

Before the Court is Defendant Morgan Stanley DW, Inc.'s Motion to Dismiss and supporting memorandum (Dkts. 16 and 17), Defendant Paul Grande's Motion to Dismiss **[*2]** (Dkt. 18), Defendant Mark Rodger's Motion to Dismiss (Dkt. 23), n1 and Plaintiffs' Memorandum in Opposition (Dkt. 24). After careful consideration of the allegations of the Complaint and the arguments made, the Court concludes that the motions should be denied.

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n1 Defendants Grande and Rodgers adopt and incorporate by reference the memorandum of law submitted by Defendant Morgan Stanley.

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**Applicability of the *Sarbanes-Oxley Act***

*Extended Statute of Limitations Period*

Congress passed the *Public Company Accounting Reform and Investor Protection Act of 2002* (popularly referred to as the *Sarbanes-Oxley Act*) (Act) on July 26, 2002, and President Bush signed the law on July 30, 2002. n2 *The Act* amended title *28, United States Code § 1658* as follows:[HN1]Sec. 804. STATUTE OF LIMITATIONS FOR SECURITIES FRAUD.

(a) IN GENERAL.-*Section 1658* of title 28, United States Code, is amended--[1) by inserting "(a)" before "Except"; and

(2) by adding at the end the following:

"(b) **[*3]** Notwithstanding subsection (a), a private right of action that involves a claim of fraud, deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning the securities laws, as defined in section 3(a)(47) of the Securities Exchange Act of 1934 (*15 U.S.C. 78c(a)(47)*), may be brought not later than the earlier of--

(1) 2 years after the discovery of the facts constituting the violation; or

(2) 5 years after such violation.

(b) EFFECTIVE DATE.-The limitations period provided by *section 1658(b)* of title 28, United States Code, as added by this section, shall apply to all proceedings addressed by this section that are commenced on or after the date of enactment of this Act.

(c) NO CREATION OF ACTIONS.-Nothing in this section shall create a new, private right of action.Pub. L. 107-204, Title VIII, § 804(a)(b) and (c). n3 For particular securities violations, the amendment extended the statute of limitations from one year from the discovery of facts constituting the violation to two years, and from three years from the violation to five years. The amendment retained the language denominating that the earlier of **[*4]** the time from the discovery of the facts or the time from the violation prevails.

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n2 "By mid-July, the Sarbanes-Oxley bill was moving so quickly in Congress that the conference report consisted only of the legislation and did not have the typical commentary that accompanies a bill." John J. Huber, Thomas J. Kim, Latham & Watkins, *The Response to Enron: The Sarbanes-Oxtey Act of 2002 and Commission Rulemaking*, 1348 Practising Law Inst./Corp. Law and Practice Course Handbook Series, PLI Order No. B0-01VY, 641, 647 (Dec. 2002).

n3 *Section 1658* [HN2]now provides in pertinent part:

§ *1658*. Time limitations on the commencement of civil actions arising under Acts of Congress

(a)...

(b) Notwithstanding subsection (a), a private right of action that involves a claim of fraud, deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning the securities laws, as defined in section 3(a)(47) of the Securities Exchange Act of 1934 (*15 U.S.C. 78c(a)(47)*), may be brought not later than the earlier of---

(1) 2 years after the discovery of the facts constituting the violation; or

(2) 5 years after such violation.

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**[*5]**

*The Complaint*

The Complaint, viewed in the light most favorable to the Plaintiffs, alleges that the unsuitable and unauthorized trades at issue occurred between January 1998 and August 19, 1998. (Dkt. 1 at para. 13). According to the Complaint, on October 1, 2002, the Securities and Exchange Commission (SEC) issued on Order Instituting Public Administrative and Cease-and-Desist Proceedings Pursuant to *Sections 15(b) and 21(C)* of the *Securities Exchange Act of 1934*, Making Findings and Imposing Remedial Sanctions (SEC Order). (Dkt. 1 at para. 3, Exh. A). "The SEC Order censured and fined Defendant Dean Witter, suspended and fined Defendant Grande and fined and barred Defendant Rodgers from association with any broker or dealer." Id. Plaintiffs filed the Complaint on November 15, 2002. (Dkt. 1).

*Arguments*

Defendants assert that the Act does not apply to claims, such as the Plaintiffs', that have extinguished or expired before the Act was passed on July 30, 2002. Defendants assert that the Plaintiffs' causes of action expired on August 19, 2001, which was three years after the end of the period at issue and long before this action was filed. Defendants **[*6]** rely on several cases from other federal circuits for the proposition that a statute extending a limitations period will not revive claims that expired before the enactment of the statute unless Congress clearly manifested an intent to do so. See, e.g.,*Kansas Pub. Employees Ret. Sys. v. Reimer & Koger Assocs., Inc., 61 F.3d 608, 615 (8th Cir. 1995)*; *Chenault v. United States Postal Serv., 37 F.3d 535, 539 (9th Cir. 1994)*; *Resolution Trust Corp. v. Seale, 13 F.3d 850, 853 (5th Cir. 1994)*. n4 To apply the Act to this case, Defendants argue, would essentially create a new, private right of action, which is prohibited by the Act. Finally, Defendants contend that Congress did not expressly intend for the Act to revive stale claims. See *Resolution Trust Corp. v. Artley, 28 F.3d 1099, 1102 n. 6 (11th Cir. 1994)*.

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n4 In a footnote, Defendant cites two Eleventh Circuit cases in support of this principle. See *McKissick v. Busby, 936 F.2d 520, 521 (11th Cir. 1991)*; *Spellissy v. United Techs. Corp., 823 F.2d 438 (11th Cir. 1988)*.

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**[*7]**

Plaintiffs respond that the text of the Act is clear and unambiguous and does not create a new, private right of action, nor does the Court need to consider legislative history. See *United States v. Gonzales, 520 U.S. 1, 137 L. Ed. 2d 132, 117 S. Ct. 1032 (1997)*; *Harris v. Garner, 216 F.3d 970, 976 (11th Cir. 2000)*; *Bryant v. Avado Brands, Inc., 187 F.3d 1271, 1283 (11th Cir. 1999)* [HN3](interpreting statute requires looking to its plain language first and resorting to legislative history to discern congressional intent only when language of statute is unclear). Even if this Court considers the legislative history, Plaintiffs argue, the history supports their contention that Congress intended the Act to apply retroactively.

*Retroactive application*

The issue in this case is whether the Act applies to revive Plaintiffs' claims, which would have expired under the former three-year statute of limitations on August 18, 2001. n5 If the Act applies to Plaintiffs' claims, which were filed after July 30, 2002, the claims would not be barred by the new five-year limit. n6

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n5 [HN4]The Supreme Court has previously held that the prior 3-year, now 5-year, limit is a period of repose. See *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 501 U.S. 350, 363, 115 L. Ed. 2d 321, 111 S. Ct. 2773 (1991).*

**[*8]**

n6 As to the new 3-year limit from the discovery of facts, Plaintiffs take the position that this period had not expired on the date of the filing of the Complaint, November 15, 2002.

- - - - - - - - - - - - - End Footnotes- - - - - - - - - - - - - -

[HN5]There is no question that Congress holds the power to extend a "previously applicable limitation period that has already commenced running and to enact a new limitation rule so as to revive claims already barred under a prior rule." See *United States v. Hunter, 700 F. Supp. 26, 27 (M.D. Fla. 1988)* (citing *Chase Sec. Corp. v. Donaldson, 325 U.S. 304, 311-12, 89 L. Ed. 1628, 65 S. Ct. 1137 (1945))*. Absent a clear expression of legislative intent, an extension of a limitations period, however, will not revive barred claims. See *Resolution Trust Corp. v. Seale, 13 F.3d 850, 853 (5th Cir. 1994)*.

The plain language of the amendment provides that the extended limitations period "shall apply to all proceedings addressed by this Section that are commenced on or after the enactment of this Act." Pub. L. 107-204, Title VIII, § 804 (b). The effective date, which is July 30, 2002, hinges **[*9]** on the date that "proceedings" commence or commenced rather than on the date the violation occurred. This language, standing alone, seems to presume that the Act affords redress for violations that had already occurred before July 30, 2002.

Having just set forth what the language provides, the Court notes that Congress did not use the phrase "retroactive application" in the statute itself. Thus, the Court turns to the legislative history, which shows that various members of Congress discussed and debated the extension of the statute of limitations. See *USA v. Olin Corp., 107 F.3d 1506, 1512-14 (11th Cir. 1997)* [HN6](courts must effectuate congressional intent regarding retroactivity absent explicit statutory language mandating retroactivity). As a whole, the history reveals that Congress intended to lengthen the statute of limitations to enable people who lost their life-savings to companies like Enron to recover some of their investments. To do so, the amendment must be given retroactive application.

Evidence of the intent of Congress may be discerned from the words of Senator Leahy of Vermont on July 10, 2002, when he stated the following:When I look at places **[*10]** such as Washington State alone where the pension funds of firefighters and police lost $ 50 million because of the fraud of the leaders of Enron, I don't feel too sympathetic. We already have a very short statute of limitations in here anyway. *We ought to at least have that so people might be able to recover some of the money they have lost,* if it is at all possible, instead of just a few executives going up and building their $ 50 million mansions and hiding it there. There ought to be some way for the people who lost their pensions, lost their life savings, to get it back.

. . . .

Florida lost $ 335 million because of Enron; the University of California, $ 144 million-all the way down to Vermont; we lost millions of dollars. *These are people who would like, in these kinds of cases, at least to have a statute of limitations such that we can go after them.*

. . . .

I am here to try to protect people and give them an opportunity-when there has been such enormous fraud and all the pension funds have been lost, and all the people who have lost their life-savings----*give them at least some chance to recover something,* especially as the executives **[*11]** of these companies walk off with tens of millions of dollars. We go two-five instead of one-three. That was negotiated and voted on in the Judiciary Committee, and the final bill was passed unanimously.148 Cong. Rec. S6524-02, * S6534-35 (emphasis added). The language referring to victims of Enron recovering damages indicates the intent to retroactively apply the statute of limitations. Most telling is the requested section-by-section analysis of Title VIII, which was made a part of the record, "in order to provide guidance in the legal interpretation of these provisions of Title VIII of H.R. 2673 before that volume is issued." 148 Cong. Rec. S7418-01, * S7418. The section-by-section analysis provides in pertinent part:This provision [section 804.-Statute of limitations] states that it is not meant to create any new private cause of action, but only to govern all the already existing private causes of action under the various federal securities laws that have been held to support private causes of action. This provision is intended to lengthen any statute of limitations under federal securities law, and to shorten none. The section, by its plain terms, applies **[*12]** to any and all cases filed after the effective date of the Act, *regardless of when the underlying conduct occurred.* 148 Cong. Rec. S7418-01, *7418 (emphasis added). [HN7]The phrase "regardless of when the underlying conduct occurred" demonstrates that Congress intended for the extended statute of limitations to apply retroactively.

**Timeliness of Plaintiff's Claims under the *Sarbanes-Oxley Act***

The Court finds that the arguments raised under this premise require looking at matters outside the four corners of the Complaint. As such, this argument is inappropriate material for a motion to dismiss. See *Milburn v. United States, 734 F.2d 762, 765 (11th Cir. 1984)*.

**Interlocutory Review Pursuant to *28 U.S.C. § 1292(b)***

Defendant Morgan Stanley has requested this Court to certify an interlocutory appeal of this order pursuant to *28 U.S.C. § 1292(b)*. (Dkt. 29). In accordance with *28 U.S.C. § 1292(b)*, this Court finds that this order "involves a controlling question of law as to which there is substantial ground for difference of opinion **[*13]** and that an immediate appeal from the order may materially advance the ultimate termination of the litigation." The controlling question of law is whether time-barred claims are revived by the Sarbanes-Oxley Act. Arguably, a difference of opinion may exist as to the interpretation of the Act and its legislative history. An immediate appeal may materially advance the ultimate termination of the litigation, because if this order is reversed, the Plaintiffs' claims will be time-barred.

It is therefore **ORDERED AND ADJUDGED** as follows:1. Defendants' Motions to Dismiss (Dkts. 16, 18 and 23) are **DENIED.**

2. Defendants are permitted to seek a timely interlocutory appeal of this order to the Eleventh Circuit pursuant to *28 U.S.C. § 1292(b)*, if they so choose.

**DONE AND ORDERED** at Tampa, Florida, on March 31, 2003.

**RICHARD A LAZZARA**

**UNITED STATES DISTRICT JUDGE**

# EXHIBIT 10

Motions, Pleadings and Filings

United States District Court, N.D. Illinois, Eastern Division.

Christine F. STAUFFER f/n/a Christine F. Skorberg, Plaintiff,
v.
WESTMORELAND OBSTETRIC AND GYNECOLOGIC ASSOCIATES, S.C., Hugh Falls, William Gardner, Scott Logan, Chuhak & Tecson, P.C., Albert L. Grasso, Esq., Leaf, Dahl and Company, Ltd., Benjamin Robert Leaf, Defendants.

No. 00 C 1242.

May 25, 2001.

*MEMORANDUM OPINION AND ORDER*

MORAN, Senior J.

*1 Plaintiff Christine F. Stauffer ("Stauffer") is a physician and former member of Westmoreland Obstetric and Gynecologic Associates, S.C. ("Westmoreland"). Stauffer claims that when she left Westmoreland in February 1999, she was owed more than $800,000 in stock and deferred compensation. Westmoreland has not paid Stauffer what she claims she is owed, and therefore she has filed a nine-count complaint against Westmoreland, its physician members, its attorneys and its accountants. All defendants now move to dismiss the complaint. For the reasons set forth below, their motions are granted in part and denied in part.

*BACKGROUND*

Stauffer entered into an employment agreement with Westmoreland on March 3, 1990 ("1990 Employment Agreement"). This agreement set the terms of Stauffer's employment and also provided Stauffer an option to purchase an ownership interest in Westmoreland after three years at the practice (cplt.exh.1). Stauffer claims that, [FN1] in addition to the 1990 Employment Agreement, two other documents were relevant to her relationship with Westmoreland from the start: the 1989 Stock Purchase Agreement and the 1989 Unfunded Deferred Compensation Agreement (cplt.exhs.2, 5). These two contracts governed the rights of shareholders in the practice. Stauffer owned no stake in Westmoreland when she began working there and thus was not a party to these agreements. As part of the 1990 Employment Agreement, however, Stauffer was told that if she were to become a shareholder, the 1989 agreements obligated Westmoreland to buy back her shares plus interest in the event of her departure from the practice.

FN1. On a motion to dismiss, we take as true all facts alleged in the complaint and construe all reasonable inferences in plaintiff's favor. *See Dawson v. General Motors Corp.*, 977 F.2d 369, 372 (7 th Cir.1992).

Sometime prior to August 1993, Stauffer and Westmoreland decided to renegotiate their relationship. On August 1, 1993, Stauffer and the three physician shareholders of the practice, defendants Hugh Falls, William Gardner, and Scott Logan (the "doctors" or "doctor defendants"), reached an oral understanding modifying some of the terms of the 1990 Employment Agreement. Specifically, the parties orally agreed that Stauffer would become an equal shareholder in the practice as of August 1, 1993. They also agreed that Westmoreland would buy back Stauffer's shares for the amount she paid for them plus 6 per cent annual interest if she were ever to leave the practice. Although the terms of this 1993 Employment Agreement were not reduced to writing, Stauffer says that the doctor defendants personally guaranteed the arrangement. Subsequent to August 1, 1993, Stauffer purchased 250 shares in Westmoreland for $258,327 and thereby became an equal partner in the practice.

Stauffer continued to practice medicine at Westmoreland for the ensuing several years. In late 1998, Stauffer informed her colleagues that she had decided to leave the practice and move to Colorado. In the subsequent negotiations regarding her departure, Stauffer learned of two contracts formed the previous year: the 1997 Stock Redemption Agreement and 1997 Deferred Compensation Agreement. The doctor defendants informed Stauffer that these two agreements modified the 1989 Stock Purchase Agreement and 1989 Unfunded Deferred Compensation Agreement, respectively. [FN2] Stauffer had not signed the two 1997 agreements. [FN3] Upon learning of their existence in December 1998, however, Stauffer assumed that the 1997 agreements did not alter the valuation of her stock and deferred compensation. Stauffer soon discovered she was wrong. On February 1, 1999, Westmoreland sent Stauffer a letter suggesting that it would not be calculating her stock value as equivalent to her original contribution plus 6 per cent interest (cplt.exh.3). Stauffer's resignation from Westmoreland became official on February 28, 1999. On March 15, 1999, Westmoreland's accountant, defendant Benjamin Robert Leaf of Leaf, Dahl and Company, Ltd. (collectively "Leaf"), informed Stauffer that she would receive $29,753 for her shares under the 1997 Stock Redemption Agreement and $128,864 in benefits under the 1997 Deferred Compensation Agreement, for a total of $158,617 (cplt.exh.6). Stauffer was surprised and upset by these numbers. She had contributed $258,327 to purchase her stock in 1993 and believed that she was owed at least that much plus interest for her 250 shares. She also believed that Westmoreland owed her substantially more than $128,864 in deferred compensation.

FN2. Staffer had become an official party to the 1989 Stock Purchase Agreement when she executed an amendment to that contract on May 1, 1996 (cplt.exh. 9).

FN3. Indeed, Stauffer claims that she did not even receive copies of the 1997 agreements until early 1999.

***2** Stauffer protested, but Westmoreland stood by its figures. Stauffer says that the defendants subsequently led her to believe that if she transferred her 250 shares back to Westmoreland, she would receive the $158,617 (in 12 installments) while maintaining the right to contest the matter. On April 1, 1999, Westmoreland sent Stauffer one payment of $10,739. On April 14, 1999, Stauffer wrote a letter to Westmoreland stating that she had lost her original stock certificate but that she owned 250 shares in the practice and was transferring those shares to Westmoreland while reserving "the right to contest the consideration paid" by Westmoreland (cplt.exh.4). Stauffer expected that Westmoreland would respond by continuing to pay her the $158,617 it claimed was owed. Instead, on April 19, 1999, Westmoreland's attorney, Albert J. Grasso of Chuhak & Tecson, P.C. (collectively "Grasso"), wrote Stauffer back to inform her that Westmoreland would cease making any further stock or deferred compensation payments pending resolution of the dispute (cplt.exh.10). To date, Stauffer has received only $10,739 in connection with her departure from Westmoreland.

Stauffer initiated this lawsuit, *pro se*, on February 28, 2000. On July 27, 2000, we granted defendants' motion to strike the original complaint under Rule 8(a) but provided Stauffer with some time to cure the defects in her pleading. She has since retained counsel and filed a nine-count amended complaint. Stauffer alleges that all of the defendants (Westmoreland, the doctors, Leaf and Grasso) are liable for violations of the Securities Exchange Act of 1934, 15 U.S.C. § 78j (count III), the Illinois Securities Law of 1953, 815 ILCS 5/12 (count VIII), and for common law fraud (count IV). Against Westmoreland and the doctor defendants, Stauffer also alleges breach of contract (count I), conversion (counts II and IX), intentional infliction of emotional distress (count V), and violation of the Illinois Business Corporation Act, 805 ILCS 5/7.75 (count VI). Finally, Stauffer seeks to hold the doctor defendants personally liable for the conduct of Westmoreland (count VII).

Defendants now seek to dismiss Stauffer's amended complaint. In their motion

Westmoreland, Grasso, and the doctor defendants argue that Stauffer's lawsuit, at bottom, is a breach of contract case and therefore counts II-VI and VIII-IX should be dismissed under Rule 12(b)(6). They further assert that late service dooms Stauffer's claims against Grasso under Rule 12(b)(5), and that Rule 8(a) pleading deficiencies continue to plague counts I and VII. Leaf has filed a separate motion to dismiss, arguing that the three counts raised against it-- counts III, IV and VIII--fail to state a claim under Rule 12(b)(6). Defendants concede that there may be enough merit behind at least some of Stauffer's claims to survive the motion to dismiss stage. And we agree that the story as told by Stauffer clearly constitutes a foundation on which to build a case. The complaint nevertheless contains much clutter, and for this and other reasons, defendants' motions to dismiss are granted in part and denied in part.

## *DISCUSSION*

### I. *Conversion*

***3** In count II of the complaint Stauffer alleges that Westmoreland and the doctor defendants wrongfully converted the value of her 250 shares of stock. Admitting that the allegations contained in her complaint are not very clear, Stauffer elaborates on this cause of action in her brief. Stauffer explains that count II is based on two somewhat distinct theories regarding defendants' alleged conversion of her stock. First, Stauffer claims that Westmoreland and the doctor defendants accepted her 250 shares of stock on April 14, 1999, but have not paid her the $29,753 they claim those shares are worth or the $158,617 they had promised in exchange for the shares, despite her demands on them to do so. Second, Stauffer asserts that she contributed $258,327 for the 250 shares in 1993 and was told that Westmoreland would maintain that money in a separate account. Stauffer claims that Westmoreland and the doctor defendants have converted those funds by failing to return the $258,327 plus 6 per cent interest as the parties had agreed.

In order to state a cause of action for conversion under Illinois law, a plaintiff must allege: "(1) an unauthorized and wrongful assumption of control, dominion, or ownership by a defendant over plaintiff's personalty; (2) plaintiff's right in the property; (3) plaintiff's right to the immediate possession of the property, absolutely and unconditionally; and (4) a demand for possession of the property." *Colonial Funding, L.L.C. v. American Empire Surplus Lines Ins. Co.,* 719 N.E.2d 1098, 1100 (Ill.App. 1 st Dist.1999). Here, Stauffer claims that Westmoreland and the doctor defendants have wrongfully converted the value of her stock. As we recently explained:

> Illinois law limits the circumstances under which money can be the subject of a conversion claim. Generally "conversion will not lie for money represented by a general debt or obligation." If the money at issue is "capable of being described as a specific chattel," however, then it may serve as the basis of a conversion claim. In order to state a claim of conversion based on money, plaintiff must allege that it has a right to a specific, identifiable amount of money; a claim of right to an indeterminate sum of money sounds in debt rather than in conversion.

*3Com Corp. v. Electronic Recovery Specialists, Inc.,* 104 F.Supp.2d 932, 939-40 (N.D.Ill.2000) (citations omitted).

The allegations as described in Stauffer's brief would satisfy the pleading requirements for a conversion claim under Illinois law. Under her first theory, Stauffer claims that Westmoreland and the doctor defendants took her 250 shares of stock and have not returned the shares or what they claim is their cash value ($29,753 or $158,617) to Stauffer even though she has made a demand on them. Stauffer's second theory is that Westmoreland and the doctor defendants are wrongfully withholding her original contribution of $258,327 plus interest. Both theories designate a specific chattel or sum of money as being converted. *See 3Com,* 104 F.Supp.2d at 940 ("Courts allow claims of conversion to go forward where the allegations indicate that the sum of money at issue was segregated from other funds, received in a lump sum, earmarked, or otherwise identifiably distinct.") (citations omitted)). Thus, the elements of a conversion claim are met. Westmoreland and the doctor defendants counter that there can be no conversion because Stauffer voluntarily relinquished the 250 shares to Westmoreland in her April 14, 1999 letter. [FN4] Defendants miss the point. Stauffer did not give her shares away. Rather, she transferred her stock for a specific (albeit disputed) amount of money (while reserving the right to contest the matter). In short, Stauffer claims that Westmoreland and the doctors have taken her stock without paying for it and/or have deposited her $258,327 contribution into an account and are refusing to return it. This is enough to allege conversion under Illinois law. Accordingly, we dismiss count II without prejudice and allow Stauffer to resuscitate that count with the factual allegations set out in her brief.

FN4. Defendants also contend that since Stauffer lost her original stock certificate, there was no valuable property to convert in the first place. But Westmoreland accepted Stauffer's April 14, 1999 statement in lieu of the actual stock certificate, and executed a document on that date officially redeeming Stauffer's 250 shares (cplt.exh16). Thus, the lost stock certificate is not important.

*4 Count IX also alleges conversion. The subject of that claim is Stauffer's individual retirement account (IRA). Westmoreland had maintained Stauffer's IRA while she worked at the practice. Stauffer claims that on August 29, 2000, she asked Westmoreland to transfer her IRA funds to an account she had established with Charles Schwab & Co. Westmoreland did so the next day. Soon after, Stauffer learned that Westmoreland had transferred only $187,573.21 to her new account. Stauffer believed that she had much more than that in her IRA and inquired into the discrepancy. She learned that because she had withdrawn the funds prior to the end of the calendar year (*i.e* ., before December 31, 2000), she had forfeited the year-to-date profits on her IRA. Thus, she received the balance of her IRA as of December 31, 1999, rather than the value of her account on August 29, 2000.

As presently alleged, count IX claims that Westmoreland and the doctor defendants unlawfully converted the profits that had accrued on Stauffer's IRA from January 1, 2000 to August 29, 2000. In her brief, Stauffer admits that ERISA, and not state law conversion, is the appropriate legal vehicle through which to allege this issue. She therefore asks us to dismiss count IX without prejudice so that she may raise the claim in its proper legal context. Westmoreland and the doctor defendants have no real objection, other than to voice their frustrations with Stauffer's mispleading. Without passing on the validity of the purported ERISA claim, we dismiss count IX without prejudice.

II. *Fraud Related Claims*

In counts III, IV and VIII, Stauffer accuses all of the defendants of making a number of false statements regarding the value of her shares. Specifically, Stauffer cites the following categories of alleged misrepresentations: (1) on March 3, 1990, Westmoreland and the doctor defendants orally informed Stauffer that the 1989 agreements would govern her employment relationship and that those agreements provided that if she became a partner in Westmoreland she would receive her original contribution plus interest in the event of her departure from the practice; (2) on August 1, 1993, Westmoreland and the doctor defendants orally confirmed that the 1989 agreements governed, and further stated that under those agreements Stauffer would receive her $258,327 contribution plus 6 per cent annual interest if she were to leave the practice; and (3) between December 1998 and April 1999, by both oral and written statements, defendants informed Stauffer that the 1997 agreements trumped the 1989 agreements, that under the 1997 agreements her stock value and deferred compensation amounted to $158,617, and that if she transferred her 250 shares to Westmoreland she would receive $158,617. Stauffer contends that she joined the practice in 1990, bought into the partnership in 1993, and sold her 250 shares in 1999, all in reliance on these alleged misrepresentations. We find it useful to keep the different categories of statements in mind as we discuss the three counts that are based on them.

A. *Securities Exchange Act*

*5 Count III alleges that defendants violated Section 10(b) of the Securities Exchange Act and related SEC Rule 10b-5 by making the statements described above. Among other challenges, defendants argue that count III fails on statute of limitations grounds. We agree. [FN5] A claim brought under Section 10(b) or Rule 10b-5 must be brought "within one year after the discovery of the facts constituting the violation and within three years after such violation." *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson,* 501 U.S. 350, 364 (1991). The first two categories of alleged misrepresentations occurred in 1990 and 1993, respectively, and therefore clearly fall outside of the three-year statute of repose. Thus, they are not actionable representations under the federal securities laws.

FN5. Stauffer's cause under the Securities Exchange Act in count III, as well as her claim under the Illinois Securities Law in count VIII, are also subject to attack on the grounds that her 250 shares in Westmoreland do not constitute "securities" as that term is defined under the federal and state securities laws. *See S.E.C. v. W.J. Howey Co.,* 328 U.S. 293, 298-99 (1946) (federal securities laws apply only to passive investments by which the investor receives profits from the efforts of others); *Doherty v. Kahn,* 682 N.E.2d 163, 169-70 (Ill.App. 1 Dist.1997) (same under Illinois Securities Law). Defendants claim that Stauffer's shares were not "securities" because Stauffer was more than just a passive investor in Westmoreland. They point out that Stauffer's efforts contributed to the practice's profitability. Defendants are correct in that general partners typically do not own "security" interests in the partnership. *See Giuffre Organization, Ltd. v. Euromotorsport Racing, Inc.,* 141 F.3d 1216, 1219 (7 th Cir.1998); *Cogniplex, Inc. v. Ross,* 2001 WL 436210, at *8-10 (N.D.Ill. Apr. 27, 2001). Questions remain, however, regarding whether and to what extent Stauffer exercised a degree of control over the practice. *See Williamson v. Tucker,* 645 F.2d 404, 424 (5 th Cir.) (holding that a partner without meaningful managerial power may be covered by the securities laws), *cert. denied,* 454 U.S. 897 (1981); *Cogniplex,* 2001 WL 436210, at *8-10. According to the pleadings, Stauffer was not an officer of Westmoreland, did not participate in management decisions, and did not sign or even have access to important partnership documents. Thus, it is too early to decide whether Stauffer's shares qualify as protectable "securities."

The viability of the third category of statements depends on whether Stauffer had "inquiry notice" of the alleged fraud more than one year prior to filing her lawsuit. [FN6] Under the inquiry notice doctrine, the "one-year statute of limitations ... begins to run not when the fraud occurs, and not when the fraud is discovered, but when ... the plaintiff learns, or should have learned through the exercise of ordinary diligence in the protection of one's legal rights, enough facts to enable him by such further investigation as the facts would induce in a reasonable person to sue within a year." *Fujisawa Pharmaceutical Co., Ltd. v. Kapoor,* 115 F.3d 1332, 1334 (7 th Cir.1997). "Suspicious circumstances, coupled with ease of discovering, without the use of legal process, whether the suspicion is well-grounded, may cause the statute of limitations to start to run before the plaintiffs discover the actual fraud...." *Law v. Medco Research, Inc.,* 113 F.3d 781, 786 (7 th Cir.1997).

FN6. This third category of alleged misrepresentations fails to support Stauffer's federal securities fraud claim for the additional reasons stated in part II.C below.

Stauffer filed her lawsuit on February 28, 2000. Thus, the question is whether she had inquiry notice of the alleged misrepresentations by February 28, 1999. The facts show that she did. In December 1998, Stauffer discovered that the 1997 Stock Redemption Agreement and 1997 Deferred Compensation Agreement may have modified the 1989 Stock Purchase Agreement and 1989 Unfunded Deferred Compensation Agreement. Although she states that she did not know at the time that the 1997 agreements had altered her share value, Stauffer did know that the 1997 agreements were critical in that they established the method by which Westmoreland would calculate the value of her shares. Indeed, Stauffer admits in her complaint that she began to suspect foul play when she learned of the existence of the 1997 agreements. She alleges in paragraph 109 that "in December of 1998" she was first put on notice "of facts that previous Defendants' statements and representations in connection with the two sales of her securities were possibly untrue" (cplt.¶ 109). Stauffer has made similar concessions in previous motions filed with this court. [FN7] Thus, the alarms regarding defendants' statements were first set off in December 1998.

FN7. On September 13, 2000, Stauffer submitted a motion for leave to file an amended complaint, which stated that "Stauffer first had notice of facts which in the exercise of reasonable diligence would lead to actual knowledge of the alleged violation of [the Illinois Securities Law] around the middle of December 1998. This is the first time she was told by anyone that she was not going to receive back from the Corporation exactly the same amount of money she had paid for her stock shares, with interest, as she had always been told by all the other doctors/shareholders" (def.reply exh. 1).

***6** Less than two months later, Stauffer received a letter from Westmoreland which further suggested to her that something may be awry. In that letter, dated February 1, 1999, Westmoreland informed Stauffer that Grasso and Leaf would be preparing the documents and calculations necessary for the transfer of Stauffer's 250 shares to the practice (cplt.exh.3). Attached to the letter was an outline of the terms upon which Westmoreland planned to purchase the shares. The attachment stated that "the agreed value of your shares shall be $2000" and went on to state that an "additional amount to be agreed upon by counsel for both parties after their appropriate review of the financial records of the Corporation will be payable to you ... at such times as may be mutually agreed by counsel." Stauffer's understanding had been that she would receive at least her $258,327 contribution plus 6 per cent annual interest for the 250 shares. The representations contained in the February 1, 1999 letter were at odds with this understanding. This should have raised another red flag for Stauffer. In short, the 1997 agreements and the February 1, 1999 letter constituted the sort of "suspicious circumstances" that would put a reasonable person on notice of potential fraud.

Stauffer argues that she was not on inquiry notice until March 15, 1999, because that was the date on which she learned that Westmoreland planned to pay her only $29,753 for the 250 shares and $158,617 in total compensation. Stauffer may not have been aware of the precise amount Westmoreland proposed to pay until March 15, 1999, but she had enough facts in December 1998 and February 1999 to put her on inquiry notice of the alleged misrepresentations regarding her stock value. Thus, count III is dismissed as time-barred.

B. *Illinois Securities Law*

Count VIII alleges fraud under Section 12 of the Illinois Securities Law of 1953, 815 ILCS 5/12. Rescission is the only remedy available for a violation of Section 12. *Kleban v. S.Y.S. Restaurant Management, Inc.*, 912 F.Supp. 361, 368 (N.D.Ill.1995). In order to take advantage of this remedy a plaintiff must satisfy the six-month notice provision contained in Section 13(B) of the statute: "Notice of any election [to rescind] shall be given by the purchaser within 6 months after the purchaser shall have knowledge that the sale of the securities to him or her is voidable...." 815 ILCS 5/13(B). Stauffer admits that she has not filed such a rescission notice (cplt.¶ 113). Usually, failure to plead compliance with the six-month notice rule is fatal to a Section 12 claim. *See Reshal Associates, Inc. v. Long Grove Trading Co.*, 754 F.Supp. 1226, 1236 (N.D.Ill.1990); *Wislow v. Wong*, 713 F.Supp. 1103, 1107 (N.D.Ill.1989). Some courts have allowed plaintiffs to substitute their complaint in lieu of a rescission notice, *Ashenden v. Lloyd's of London*, 1996 WL 717464, at *4 (N.D.Ill.Dec. 9, 1996) (citing cases), but Stauffer does not pursue this route either. Having neither filed a rescission notice nor included remedial allegations in her complaint, Stauffer's prospects with regard to her Illinois Securities Law claim are dim.

***7** Stauffer presses forward, nevertheless, asking us to excuse her failure to file a rescission notice because, she says, defendants have wrongfully refused to produce certain documents and thereby have obstructed her ability to determine whether the securities transactions at issue in this case are voidable (cplt.¶¶ 106-113). The pleadings indicate, however, that Stauffer knew of her state securities law claim more than six months ago. In December 1998, Stauffer had notice of facts indicating that defendants' "statements and representations in connection with the two sales of her securities were possibly untrue" (cplt.¶ 109). By February 1999, Stauffer knew that defendants had changed the way they would be calculating her stock value (cplt.exh.3). On March 15, 1999, Stauffer learned that Westmoreland planned to pay her only $158,617 when she left the practice, much less than what she had expected (cplt.exh.6). Sometime after April 19, 1999, Stauffer's attorney wrote to defendants, stating that "[i]t is clear that Dr. Stauffer's rights as a shareholder of Westmoreland ... are not being honored" and "it appears that the [doctor defendants], in breach of their fiduciary obligations and personal guarantees, have conspired to use Westmoreland as an engine of fraud to personally benefit themselves at the expense of Dr. Stauffer and in derogation of the duties owed to her" (cplt.exh.15). And, finally, as of February 2000, Stauffer had enough knowledge to file this lawsuit against defendants. These facts establish that Stauffer had sufficient knowledge of her Illinois securities fraud claim more than six months ago. *See Denten v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 887 F.Supp. 176, 180 n.8 (N.D.Ill.1995) ( "plaintiff's allegation that she became aware of violations of the securities laws is equivalent to her awareness of the legal consequences [*i.e.*, voidability] of [defendant]'s actions."); *Kleban*, 912 F.Supp. at 369 (holding that date of attorney's letter describing allegations of future complaint represented the date on which plaintiff had requisite knowledge under Section 13(B)'s notice provision). Stauffer has not yet filed a notice of rescission despite this prior knowledge. Therefore, count VIII is dismissed.

C. *Common Law Fraud*

Count IV alleges common law fraud against all defendants. In Illinois, the elements of a common law fraud claim are: "(1) a false statement of material fact; (2) defendant's knowledge that the statement was false; (3) defendant's intent that the statement induce the plaintiff to act; (4) plaintiff's reliance upon the truth of the statement; and (5) plaintiff's damages resulting from reliance on the statement." *Connick v. Suzuki Motor Co., Ltd.*, 675 N.E.2d 584, 591 (Ill.1996). Stauffer's common law fraud claim does not suffer from the same timeliness issues that doomed her securities fraud claims. This does not mean, however, that all is well with count IV.

***8** As we described above, the first two categories of alleged misrepresentations include statements made in 1990 and 1993 regarding how Stauffer's stock value would be calculated in the event of her departure from the practice. In both March 1990 and August 1993, Stauffer was told that the 1989 agreements provided that she would receive her original contribution ($258,327) plus interest (6 per cent) if she left Westmoreland. The 1989 agreements do not contain such a method of calculating stock value (cplt.exhs.2, 5). Stauffer argues that Westmoreland and the doctor defendants intentionally lied about her stock valuation in order to induce her to join the practice in 1990 and contribute into the partnership in 1993 (cplt.¶¶ 67-69). Stauffer also claims detrimental reliance (cplt.¶¶ 70-72). Generally, promissory statements of this sort cannot be woven into a common law fraud cause of action (*see infra* pp. 15-16). But, according to Stauffer, the doctors not only promised her certain payout benefits, but also informed her that those benefits were codified in the 1989 agreements (cplt.¶¶ 14, 20). Stauffer also claims that she did not receive copies of the 1989 agreements until early 1999. Thus, with respect to the first two categories of alleged misrepresentations, Stauffer's allegations state a cause of action for common law fraud. We underscore the narrow nature of this claim--it can proceed only insofar as it is based on the theory that Stauffer was informed that the 1989 agreements contained certain provisions when in fact those contracts did not include such clauses. As a further limitation, the claim can be brought only against Westmoreland and the doctor defendants, since Stauffer had no contact with either Leaf or Grasso until 1999 and did not rely on any of their statements prior to the time. [FN8]

FN8. Stauffer claims that Leaf and Grasso were involved in drafting the 1989 agreements and the 1997 agreements, but she also admits that she did not receive copies of those agreements until 1999 and therefore she could not have relied upon them when deciding to join the practice or the partnership.

In the third category of statements, Stauffer claims that defendants informed her that the 1997 agreements trumped the 1989 agreements, that under the 1997 agreements her stock value and deferred compensation amounted to $158,617, and that if she transferred her 250 shares to Westmoreland she would receive $158,617. These alleged misrepresentations cannot serve as the bases for a common law fraud claim. Defendants' position in this lawsuit is that the 1997 agreements govern their relationship with Stauffer. Stauffer disagrees, claiming that other contracts control. Defendants' position regarding which contracts govern is legal argument and not actionable fraud. Similarly, defendants' position regarding how much Stauffer is owed under the controlling agreements is part of the underlying contractual dispute, not a false statement of material fact. Finally, insofar as defendants promised to pay Stauffer $158,617 upon transfer of her 250 shares, and have reneged on that promise by remitting to date only one payment of $10,739, that alleged misconduct sounds in breach of contract and not in fraud. *See Zankle v. Queen Anne Landscaping,* 724 N.E.2d 988, 992-93 (Ill App. 2 Dist.2000); *Murphy v. Murphy,* 59 N.E. 796, 797 (1901) ("A false representation, within the meaning of the law, must be a representation as to an existing or past fact, and not merely a promise to do an act in the future."); *see also Mills v. Polar Molecular Corp.,* 12 F.3d 1170, 1176 (7 th Cir.1993) ("Contractual breach, in and of itself, does not bespeak fraud, and generally does not give rise to tort damages.").

***9** Accordingly, with respect to Leaf and Grasso, count IV is dismissed in its entirety. With respect to Westmoreland and the doctor defendants, count IV is dismissed only to the extent that it is based on the third category of alleged misrepresentations.

III. *Intentional Infliction of Emotional Distress*

In count V, Stauffer alleges intentional infliction of emotional distress against Westmoreland and the doctor defendants. In order to sustain this cause of action, Stauffer must establish that defendants' conduct was extreme and outrageous, that defendants either knew or were substantially certain that their conduct would cause severe emotional distress, and that the conduct in fact caused severe emotional distress. *See Doe v. Calumet City,* 641 N.E.2d 498, 506 (Ill.1994). Stauffer claims that Westmoreland and the doctor defendants have intentionally refused to honor their commitments to Stauffer and have paid her only a fraction of what she is owed, all while knowing that their conduct would make it difficult for her to provide for her child and impossible for her to afford an attorney (cplt.¶ ¶ 75-78).

We understand that Stauffer has had to endure financial hardship as a result of this dispute. But her allegations do not bring her within this narrow tort. Even assuming that everything Stauffer says about her injuries and defendants' conduct is true, there is not enough here to support an intentional infliction of emotional distress claim. Stauffer's complaint simply does not contain allegations of conduct that is "so outrageous in character, and so extreme in degree, as to go beyond all possible bounds of decency." *Public Finance Corp. v. Davis,* 360 N.E.2d 765, 767 (Ill.1976). Nor does it describe distress that "is so severe that no reasonable man could be expected to endure it." *Id.; see McNamara v. Guinn,* 2000 WL 1222128, at *5-6 (N.D.Ill. Aug. 23, 2000) (describing Illinois cases). Therefore, we must dismiss count V.

IV. *Illinois Business Corporation Act*

Section 7.75 of the Illinois Business Corporation Act (IBCA) provides that "a shareholder of record shall have the right to examine ... the corporation's books and records" upon making an appropriate written request for inspection. 805 ILCS 5/7.75. In count VI, Stauffer claims that Westmoreland and the doctor defendants did not comply with her request to review its corporate records and therefore are liable for the 10 per cent penalty fee provided under Section 7.75. 805 ILCS 5/7.75(d) (establishing "a penalty of up to ten per cent of the value of the shares owned" for failure to allow examination of corporate records).

Defendants point to many potential flaws with this claim. Not the least of which is that no federal court in this circuit has upheld an action seeking to recover the 10 per cent statutory penalty available under Section 7.75. [FN9] In any event, Stauffer cannot succeed with her IBCA claim because she did not timely file an appropriate demand for inspection on Westmoreland. Section 7.75(b) provides that "a shareholder of record" has a right to inspect business records if she makes a "written demand upon the corporation, stating with particularity the records sought to be examined and the purpose therefor." Stauffer alleges that she made a number of oral requests for corporate records, but only written demands count under Section 7.75(b). Stauffer cites to a letter sent by her attorney requesting documents from Westmoreland as evidence of a written demand (cplt.exh.15). Stauffer admits, however, that the letter was sent after she had already relinquished her shares in Westmoreland. Since she was not "a shareholder of record" at the time she made that written demand, she does not fall under the auspices of Section 7.75. Therefore, the IBCA claim contained in count VI is dismissed.

FN9. Indeed, there is some doubt as to whether such an action would fall within the jurisdiction of a federal court. *See Schaefer v. H.B. Green Transportation Line, Inc.*, 232 F.2d 415, 417-18 (7 th Cir.1956) (holding "that the demand for the penalty imposed by the Illinois statute for refusal to permit inspection was not enforcible [sic] in the [federal] district court."); *Tasner v.. U.S. Industries, Inc.*, 379 F.Supp. 803, 807-08 (N.D.Ill.1974) (same). The statute itself provides that an aggrieved shareholder should seek recourse in state court, not federal court: "If the corporation refuses examination, the shareholder may file suit in the circuit court of the county in which either the registered agent or principal office of the corporation is located to compel by mandamus or otherwise such examination as may be proper." 805 ILCS 5/7.75(c). Whether a Section 7.75 action should be brought in federal court or state court, we agree with defendants that that provision of the IBCA was not designed for lawsuits such as this one.

V. *Service of Process and Pleading Deficiencies*

*10 Finally, we address two additional grounds for dismissal advanced by some of the defendants. First, defendants Albert J. Grasso and Chuhak & Tecson, P.C. argue that they should be dismissed from the lawsuit because Stauffer failed to serve process on them within 120 days of filing her complaint, as required by Rule 4(m). These two defendants are correct in that Stauffer filed her initial complaint on February 28, 2000, but did not serve process on them until 123 days later, on June 30, 2000. In addition to establishing the 120-day rule, however, Rule 4(m) provides that "if the plaintiff shows good cause ... the court shall extend the time for service for an appropriate period." Stauffer points out that she was proceeding *pro se* at the time and also notes that the process server attempted to serve Grasso and Chuhak on an earlier date but was unable to do so. Stauffer has established good cause for an extension of time with regard to service of process. Accordingly, we deny defendants' Rule 12(b)(5) motion to dismiss.

Second, defendants claim that counts I and VII do not comply with the pleading requirements of Rule 8(a). Specifically, defendants complain that it is unclear whether count VII is a claim seeking to hold the doctor defendants individually liable for the obligations of Westmoreland or, instead, a claim alleging corporate waste and mismanagement (def.br.at 27-28). In her response brief Stauffer clarifies that count VII is a traditional "piercing the corporate veil" claim in which she seeks to hold the doctor defendants personally liable for the debts and obligations of Westmoreland (plf .br.at 32-33). Thus, this issue is now resolved to the satisfaction of defendants. We, too, find counts I and VII acceptable. Defendants' motion to dismiss on Rule 8(a) grounds is denied.

*CONCLUSION*

For the reasons set forth above, defendants' motions to dismiss are granted in part and denied in part as follows: Counts III, V, VI, and VIII are dismissed; Count IV is dismissed in its entirety with respect to Leaf and Grasso and dismissed in part as discussed above with respect to Westmoreland and the doctor defendants; Counts II and IX are dismissed without prejudice and Stauffer has leave to re-file those claims consistent with this opinion; defendants' motions are denied in all other respects.

2001 WL 585510 (N.D.Ill.), 145 Lab.Cas. P 59,509

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# EXHIBIT 11

*454, 457-58 (E.D. Pa.* [illegible] (outlining standard of review for motion to dismiss pursuant to *Rule 12(b)(6)*).

- - - - - - - - - - - - End Footnotes- - - - - - - - - - - - - -

**[*8]**

**II. THE RICO CLAIMS**

NHS brings two substantive RICO counts and one RICO conspiracy count against Panaccio, Flaherty and Bowers arising from the four schemes described briefly above. Perhaps anticipating insurmountable barriers to a RICO claim based on the Medicare/Medicaid fraud, the second RICO count is pleaded in the alternative and excludes the allegations surrounding the Medicare/Medicaid fraud.

Panaccio and Flaherty filed separate motions to dismiss, but the arguments raised in both motions are nearly identical. n4 They argue that: (1) NHS lacks standing to bring a RICO claim arising from the Medicare/Medicaid fraud; (2) NHS's RICO allegations are insufficient under *Rule 9(b)*'s particularity requirement; (3) NHS's RICO allegations fail to state a claim because they do not adequately allege the requisite "pattern of racketeering activity"; and (4) the Court should decline to exercise supplemental jurisdiction over the state law claims against Panaccio, Flaherty, Mrs. Panaccio, and Barr. The Court addresses these arguments seriatim.

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n4 Despite having received a Court-approved extension of time to file a motion to dismiss, see Doc. # 54, Bowers never responded in any fashion to the Amended Complaint.

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**[*9]**

**A. RICO Standing for Medicare/Medicaid Fraud**

NHS contends that Panaccio directed the Medicare/Medicaid fraud, which required Northwest Center, Inc. to make repeated misrepresentations to state and federal agencies in order to qualify for increased Medicare and Medicaid payments. NHS outlines a host of improper billing practices, such as billing for services in excess of those actually provided, for services of a recreational nature, and for treatment services rendered to patients who were so impaired that they were unable to participate in and benefit from those services.

The DOJ investigated this unlawful conduct and prepared an information against Northwest Center, Inc., alleging multiple violations of the mail fraud statute and sustained practices of fraud and misrepresentation. On May 20, 2002, NHS entered into a criminal plea agreement and a civil settlement agreement with the United States Government, agreeing to pay a penalty and civil fine totaling $ 7.8 million, to be paid in three installments. The final installment is contingent on NHS's recovery of "insurance assets that Panaccio and other Defendants wrongfully purchased for themselves with NHS revenues," Am. **[*10]** Compl. P 54, i.e., the proceeds of the Excessive Compensation fraud. n5

- - - - - - - - - - - - - - Footnotes - - - - - - - - - - - - - - -

n5 As noted supra and described in greater detail infra at Part II.B., Panaccio allegedly arranged for NHS to purchase certain insurance products to fund his and other NHS executives' "salary continuation plans" or retirement packages. Panaccio and other NHS executives have filed a separate action asserting legal entitlement to those assets, Panaccio v. Northwesten Human Services, Inc., Civ. A. No. 02-7767 (E.D. Pa.). That matter is currently pending before the undersigned.

- - - - - - - - - - - - End Footnotes- - - - - - - - - - - - - -

NHS alleges that the DOJ identified Panaccio as a "target" of its investigation, and that "throughout the investigation [Panaccio] was understood to be the mastermind" of the fraud. Id. P 50. It contends that Panaccio undertook this fraudulent scheme to ensure adequate financial resources to fund his Excessive Compensation fraud, and to provide sufficient revenue to loot NHS through the Amica/Bowers fraud and the Stadium Looting fraud. See id. **[*11]** P 52.

*Section 1964(c) of Title 18* creates a civil cause of action for RICO violations: [HN2]"Any person injured in his business or property by reason of a violation of *section 1962* of this chapter may sue therefor in any appropriate United States district court." Panaccio and Flaherty argue that NHS cannot demonstrate injuries sustained "by reason of" alleged RICO violations associated with the Medicare/Medicaid fraud. In other words, they argue that NHS lacks standing to pursue RICO claims based on the Medicare/Medicaid fraud. n6

**Motions, Pleadings and Filings**

United States District Court,
N.D. Illinois, Eastern Division.

**John H. WALDOCK, solely as Trustee of the John H. Waldock Trust, et al., Plaintiffs,
v.
M.J. SELECT GLOBAL, LTD., a Bahamian investment company now in Liquidation, et al., Defendants.**

**No. 03 C 5293.**

Oct. 7, 2004.

Constantine John Gekas, Gekas & Associates, Ltd., Chicago, IL, for Plaintiffs.

*MEMORANDUM OPINION AND ORDER*

ST. EVE, J.

*1 Plaintiffs have filed a First Amended Complaint ("FAC") against multiple Defendants alleging a fraudulent investment scheme in connection with the purchase of shares in M.J. Select Global, Ltd. ("M.J.Select"), a Bahamian mutual fund. Plaintiffs have sued Defendants Oceanic Bank and Trust, Ltd., Kenneth Clowes, Terah Rahming and others for losses resulting from their investments in the fund. Defendants Oceanic, Clowes and Rahming have moved to dismiss the FAC. The Oceanic Defendants seek to dismiss the FAC for lack of personal jurisdiction, lack of standing and failure to state a claim. The Court grants their motion in part and denies it in part.

BACKGROUND

This case is related to *Zurich Capital Markets Inc. v. Coglianese, et al.*, No. 03 C 7960, (the "ZCM Case"), also pending before this Court. The Court recently addressed similar motions in that case. *See Zurich Capital Markets Inc. v. Coglianese, et al.*, No. 03 C 7960, 2004 WL 2191596 (N.D.Ill. Sept.22, 2004) (the "September 22, 2004 Opinion") and *Zurich Capital Markets Inc. v. Coglianese, et al.*, No. 03 C 7960, 2004 WL 1881782 (N.D.Ill. Aug.2, 2004) (the "August 2, 2004 Opinion"). Although the ZCM Case involves different plaintiffs and a different complaint, because many of the allegations are similar to the ones in this case and because both cases are based on investments in the same allegedly fraudulent scheme, the Court's reasoning in its September 22, 2004 and August 2, 2004 Opinions applies equally to many of the issues in this case.

I. The Plaintiffs

The Plaintiffs in this case all invested in M.J. Select, and lost all or substantial portions of their investments. Plaintiffs include: John H. Waldock, solely as Trustee of the John H. Waldock Trust; Mary Jane S. Hill and John E. Rosino, solely as Trustees of the Andrew W. Waldock Trust, John H. Waldock, Jr. Trust, Julia Wright Waldock Trust, Cameron Douglas Waldock Trust, Gary Phillip Liebenthal, II Trust, Samuel Louis Waldock Trust, Benjamin Nicholas Waldock Trust, Dustin J. Houck Trust, Daniel R. Houck Trust, Erik J. VanDootingh Trust, Ian A. VanDootingh Trust, John H. Waldock, II Trust, Andrew W. Waldock, Jr. Trust, Christopher J. Waldock Trust; 766347 Ontario Ltd., a Canadian corporation; The James F. Boughner Foundation, a Canadian corporation; Ed Pettegrew, Sr., a citizen of Florida; David Miller a citizen of California, John A. Copeland, as Trustee under a trust agreement dated April 18, 1988; Jack C. Kenning and Barbara Straka-Kenning, citizens of Ohio; Robert M. Warner, Sr. individually and as beneficiary of Independent Trust Corporation Trust, for Adam Scott Warner and for Robert Warner, Account No. 263 in the name of Adam S. Warner and Account No. 264 in the name of Andrew Robert Warner; and George Lukas, a citizen of New Jersey. Collectively, Plaintiffs are referred to as the "Waldock Plaintiffs" or "Plaintiffs."

II. The Oceanic Defendants

Plaintiffs have sued multiple Defendants, including Oceanic Bank and Trust Limited ("Oceanic"), Terah Rahming and Kenneth Clowes. Defendants Oceanic, Clowes, and Rahming are collectively referred to as the "Oceanic Defendants." Oceanic is a bank and trust company with its principal offices located in Nassau, Bahamas. It acquired New World Trustees Limited, effective May 1, 1998. Effective December 31, 1999, Oceanic and New World merged under the name of Oceanic Bank and Trust Limited.

***2** Rahming was an officer and employee of Oceanic. In 1997, Oceanic appointed Rahming as its Manager of Fund Services. She also served as a director of M.J. Select, and administered its affairs. She is a graduate of Florida Memorial Collect and licensed as a certified public accountant by the Board of Accountancy of the State of Colorado.

Clowes was the Chief Operating Officer of Oceanic. In addition, he served as a director of M.J. Select, and administered its affairs.

III. The Alleged Scheme [FN1]

FN1. For a more detailed discussion of the alleged scheme, *see* the Court's September 22, 2004 and August 2, 2004 Opinions.

The Waldock Plaintiffs allege that Defendants participated in a complex scheme to defraud M.J. Select's investors. They contend that Defendants used false and misleading offering materials to induce Plaintiffs to invest in M.J. Select. Plaintiffs allege that Defendants falsely represented that M.J. Select followed a "market neutral" trading approach and that its investors could redeem their investments on fifteen days notice. Plaintiffs further allege that Defendants funneled their investments through a series of foreign entities, and then illegally placed them into illiquid investments. In total, Plaintiffs assert that they lost approximately $9.8 million through the allegedly fraudulent scheme.

Plaintiffs allege that Defendants violated Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78j(b), Rule 10b-5 promulgated thereunder, Section 20(a) of the Exchange Act, the Investment Company Act of 1940, 15 U.S.C. §§ 80a-7, 80a-46 and 80a-47, and various state law claims. The Oceanic Defendants seek to dismiss each of the claims stated against them.

ANALYSIS

I. Legal Standards

The Oceanic Defendants bring this motion pursuant to Rules 12(b)(2) and 12(b)(6). A Rule 12(b)(2) motion to dismiss for lack of personal jurisdiction tests whether a federal court has personal jurisdiction over a defendant. *See* Fed.R.Civ.P. 12(b)(2). A plaintiff has the burden of demonstrating the existence of personal jurisdiction over a defendant. *Jennings v. AC Hydraulic A/S,* No. 03-2157, 2004 WL 1965661, at *1 (7th Cir. Sept.2, 2004); *RAR, Inc. v. Turner Diesel, Ltd.,* 107 F.3d 1272, 1276 (7th Cir.1997). A plaintiff need only make a prima facie case that jurisdiction over a defendant is proper. *Hyatt Int'l Corp. v. Coco,* 302 F.3d 707, 713 (7th Cir.2002). In determining whether a plaintiff has met this burden, a court may consider affidavits from both parties. *Turnock v. Cope,* 816 F.2d 332, 333 (7th Cir.1987).

A Rule 12(b)(6) "test[s] the sufficiency of the complaint." *Triad Assocs., Inc. v. Chicago Housing Auth.,* 892 F.2d 583, 586 (7th Cir.1989). When deciding a motion to dismiss pursuant to Rule 12(b)(6), the Court views "the complaint in the light most favorable to the plaintiff, taking as true all well-pleaded factual allegations and making all possible inferences from those allegations in his or her favor." *Lee v. City of Chicago,* 330 F.3d 456, 459 (7th Cir.2003). Dismissal is appropriate only where it appears beyond doubt that under no set of facts would plaintiff's allegations entitle him or her to relief. *See Henderson v. Sheahan,* 196 F.3d 839, 846 (7th Cir.1999).

II. Personal Jurisdiction

***3** The Court addressed the issue of personal jurisdiction in its September 22, 2004 Opinion. Each of the Oceanic Defendants has sufficient contacts with the United States to satisfy the due process clause and to establish this Court's personal jurisdiction over Plaintiffs' securities fraud claims. *See Zurich Capital Markets, Inc. v. Coglianese,* No. 03 C 7960, 2004 WL 2191596, at ----5-7 (N.D.Ill. Sept.22, 2004). As noted in that Opinion, the Court also will assert personal jurisdiction over the state law claims under the doctrine of "supplemental" or "pendent" personal jurisdiction. *Id. See also Robinson Eng'g. Co., Ltd. Pension Plan & Trust v. George,* 223 F.3d 445, 449- 50 (7th Cir.2000). Finally, Rahming's and Clowes's claims for protection under the fiduciary shield doctrine fail. *Id.* at ----7-8.

III. Standing

The Court addressed the standing issue in its September 22, 2004 Opinion and its August 2, 2004 Opinion. Defendants' motion to dismiss for lack of standing is denied.

IV. Federal Securities Fraud Claims

In Court I, Plaintiffs have included both Section 10(b) primary liability and Section 20(a) control person allegations against the Oceanic Defendants.

A. Section 10(b) Liability

In order to state a claim for securities fraud under Section 10b, Plaintiffs must allege that Defendants made (1) a false statement or omission; (2) of a material fact; (3) with scienter; (4) in connection with the purchase or sale of securities; (5) upon which Plaintiffs justifiably relied; and (6) the reliance proximately caused Plaintiffs' damages. *In re HealthCare Compare Corp. Sec. Litig.,* 75 F.3d 276, 280 (7th Cir.1996). The Section 10(b) liability in Court I is premised on allegedly false statements in M.J. Select's offering memorandum. The Oceanic Defendants correctly note that Plaintiffs have failed to attribute any of these allegedly false statements to the Oceanic Defendants. Plaintiffs' allegations that Oceanic distributed the false offering memorandum, participated in the distribution of the false offering documents, and had involvement in the promotion and sale of M.J. Select's shares do not suffice to attribute any misrepresentations to Oceanic, Rahming or Clowes. *See Central Bank of Denver, N.A. v. First Interstate Bank,* 511 U.S. 164, 114 S.Ct. 1439, 128 L.Ed.2d 119 (1994) (no aiding and abetting liability exists under Section 10(b)). Plaintiffs Section 10(b) claim in Count I against the Oceanic Defendants is dismissed without prejudice.

B. Section 20(a)

In Count I, Plaintiffs also allege that the Oceanic Defendants were control persons of M.J. Select pursuant to Section 20(a) of the Exchange Act. In order to allege a Section 20(a) claim, Plaintiffs must allege (1) a primary securities violation; (2) each of the individual defendants exercised general control over the operations of M.J. Select; and (3) each of the individual defendants "possessed the power or ability to control the specific transaction or activity upon which the primary violation was predicated, whether or not that power was exercised." *Harrison v. Dean Witter Reynolds, Inc.,* 974 F.2d 873, 881 (7th Cir.1992). Plaintiffs' allegations must comply with Rule 9(b)'s particularity mandates. Defendants challenge each element of Plaintiffs' Section 20(a) claim.

*4 The primary securities violation is premised on false and misleading statements made in the M.J. Select Offering Memorandum and in connection with the purchase of M.J. Select shares. Although Plaintiffs have not alleged a Section 10(b) violation against the Oceanic Defendants, they have stated with sufficient particularity a primary violation against co-defendant Michael Coglianese.

Plaintiffs' specific and general control allegations are equivalent to those in the Amended Complaint in the ZCM Case. For the reasons set forth in the Court's September 22, 2004 Opinion, Plaintiffs have adequately alleged general and specific control on behalf of each of the Oceanic Defendants.

C. Statute of Repose

15 U.S.C. § 80a-46(b)(1). It further provides that to the extent that such a contract has been performed "a court may not deny rescission at the insistence of any party unless such court finds that under the circumstances denial of rescission would produce a more equitable result than its grant and would be inconsistent with the purposes of this subchapter." 15 U.S.C. § 80a-46(b)(2).

Oceanic argues that it was not an "issuer" under the ICA. The ICA defines "issuer" as "every person who issues or proposes to issue any security, or has outstanding any security which it has issued." 15 U.S.C. § 80a-2(22). Plaintiffs do not allege that the Oceanic Defendants issued or proposed to issue the shares of the securities at issue in this case. Even though Plaintiffs allege that the Oceanic Defendants were part of an organized group of persons--including some "persons" who issued the securities in question-- such allegations do not make the Oceanic Defendants the issuers of the securities. Accordingly, Count II fails.

V. Illinois Securities Act (Count III)

Count III alleges that the Oceanic Defendants violated the Illinois Securities Law of 1953 (the "Act"), 815 ILCS 5/12 & 5/13 (2002). Under the Act, "[e]very sale of a security made in violation of the provisions of this Act shall be voidable at the election of the purchaser ... and the issuer, controlling person, underwriter, dealer or other person by or on behalf of whom said sale was made, and each underwriter, dealer, or salesperson who shall have participated or aided in any way in making the sale ... shall be jointly and severally liable to the purchaser." 815 ILCS 5/13A. Because Plaintiffs allege that Oceanic, Rahming and Clowes "owned beneficially such number of outstanding securities that enabled them to elect a majority to the board of directors of M.J. Select," Plaintiffs have alleged that each of the Oceanic Defendants is a "controlling person" as defined by the Act. [FN2] *See* 815 ILCS 5/2.4 (defining controlling person as "any person offering or selling a security, or group of persons acting in concert in the offer or sale of a security, owning ... such number of outstanding securities of the issuer of such security as would enable such person, or group of persons, to elect a majority of the board of directors or other managing body of such issuer"). Defendants' allegations that they did not own any shares of M.J. Select raise an issue of fact that is not appropriate for the Court to determine at this stage.

FN2. These allegations are in contrast to the allegations in the ZCM Case where ZCM only alleged that Oceanic selected the directors for M.J. Select. ZCM did not allege anything regarding ownership of M.J. Select shares.

*6 Oceanic also contends that Plaintiffs failed to provide timely notice as required under the Act. The Act requires Plaintiffs to give notice of election to void and rescind their purchase or sale of securities "to each person from whom recovery will be sought" within six months after they have knowledge that the purchase or sale is voidable. 815 ILCS 5/13(B). "The six month rule regarding notice is not a statute of limitations, but rather, an equitable feature built into the statute to protect against stale claims." *Martin v. Orvis Bros. & Co.*, 25 Ill.App.3d 238, 246, 323 N.E.2d 73, 79 (1974). A complaint containing sufficiently specific allegations may serve as notice of an election to void and rescind the purchase or sale of securities. *Norville v. Alton Bigtop Restaurant, Inc.*, 22 Ill.App.3d 273, 384, 317 N.E.2d 391 (5th Dist.1974).

Defendants correctly note that the allegations in the FAC establish that Plaintiff Miller failed to provide timely notice. David Miller admits that he knew the sales were voidable as of December 20, 2001, yet he did not provide notice to the Oceanic Defendants until July 30, 2003. Accordingly, Count III is dismissed regarding Miller. Furthermore, Plaintiffs 766347 Ontario Ltd., James Boughner Foundation, John H. Waldock, Mary Jane S. Hill and John E. Rosino had knowledge of their right to rescind on April 5, 2000, but they failed to give Defendant Clowes notice until July 30, 2003. Accordingly, these Plaintiffs' claims in Count III are dismissed as to Defendant Clowes.

Based on the allegations in the FAC, Plaintiffs Ed Pettegrew, Sr., Jack C. Kenning and Barbara Straka-Kenning, Robert M. Warner, Sr. and George Lukas provided timely notice to each Defendant of their right to rescind. Thus, Count III stands as to these Plaintiffs.

Finally, both parties agree that the limitations period for rescission under the Act is five years. Any purchases made before July 30, 1998 are therefore time-barred.

VI. Unjust Enrichment (Count VII)

For the reasons set forth in the Court's September 22, 2004 Opinion, the Oceanic Defendants' motion to dismiss on this count is denied.

VII. Equitable Accounting (Count VIII)

In Count VIII, Plaintiffs seek the equitable remedy of an equitable accounting. To state a claim for equitable accounting, Plaintiffs "must allege the absence of an adequate remedy at law and one of the following: (1) a breach of fiduciary relationship between the parties; (2) a need for discovery; (3) fraud; or (4) the existence of mutual accounts which are of a complex nature." *Hartigan v. Candy Club,* 149 Ill.App.3d 498, 501, 501 N.E.2d 188, 190, 103 Ill.Dec. 167 (1st Dist.1986). Defendants argue that Plaintiffs have alleged an adequate remedy at law and have failed to allege a fiduciary duty.

Courts have broad discretion to determine whether an equitable accounting is warranted. *First Commodity Traders, Inc. v. Heinold Commodities, Inc.,* 766 F.2d 1007, 1011 (7th Cir.1985). A court may order an equitable accounting when "the computation of damages involves complexities that would baffle a jury." *Williams Elecs. Games, Inc. v. Garrity,* 366 F.3d 569, 577 (7th Cir.2004) (citing *Kirby v. Lake Shore & Mich. S. R.R.,* 120 U.S. 130, 134, 7 S.Ct. 430, 30 L.Ed. 569 (1887)). Even if Plaintiffs had alleged an adequate remedy at law, a plaintiff may plead in the alternative. *See* Fed.R.Civ.P. 8(e)(2); *Pickrel v. City of Springfield, Ill.,* 45 F.3d 1115, 1119 (7th Cir.1995). *See also Enter. Warehousing Solutions, Inc. v. Capital One Servs.,* No. 01 C 7725, 2002 WL 406976, at *4 (N.D.Ill. Mar.15, 2002).

*7 Finally, as discussed below, Plaintiffs have alleged a fiduciary duty. Count VIII stands.

VIII. Breach of Contract (Counts IX and X)

Oceanic seeks to dismiss Counts IX and X, alleging breach of contract. Count IX is premised on Plaintiffs' Subscription Agreement with Oceanic, and Count X is based on a third-party beneficiary theory under the Administration, Registrar & Transfer Agency Agreement between Oceanic and M.J. Select.

To state a breach of contract claim, Plaintiffs must allege that: (1) a valid and enforceable contract existed; (2) the plaintiff performed according to the contract; (3) the defendant breached the contract; and (4) the breach resulted in damages. *D.S.A. Fin. Corp. v. County of Cook,* 345 Ill.App.3d 554, 559 134 801 N.E.2d 1075, 1079 280 Ill.Dec. 130, (1st Dist.2003) (citations omitted). In Count IX, Plaintiffs allege that Oceanic entered into subscription agreements with Plaintiffs pursuant to M.J. Select's offering documents, and that Oceanic breached its obligations under the subscription agreements. This allegation, however, is contradictory to the content of the subscription agreements, which the Court can review on a motion to dismiss. *See Albany Bank & Trust Co., v. Exxon Mobil Corp.,* 310 F.3d 969, 971 (7th Cir.2002) (courts can consider both facts alleged in complaint and documents attached to or incorporated into a complaint when considering motion to dismiss). Where a plaintiff "relies upon the documents to form the basis for a claim or part of a claim, dismissal is appropriate if the document negates the claim." *Thompson v. Illinois Dep't. of Prof'l Regulation,* 300 F.3d 750, 754 (7th Cir.2002). Oceanic is not a party to the subscription agreements, and Plaintiffs have not alleged any other basis to support their breach of contract claim in Count IX. Accordingly, Count IX is dismissed without prejudice.

The third-party beneficiary contract claim in Count X stands for the reasons set forth in the Court's August 2, 2004 Opinion.

IX. Fiduciary Duty (Count XI)

For the reasons set forth in the Court's September 22, 2004 Opinion and August 2, 2004 Opinion regarding Defendant Coglianese, Count XI stands.

X. Conspiracy to Defraud (Count XII)

In order to state a claim for conspiracy to defraud in Illinois, Plaintiffs must allege "(1) a conspiracy; (2) an overt act of fraud in furtherance of the conspiracy; and (3) damages to the plaintiff as a result of the fraud." *Bosak v. McDonough,* 192 Ill.App.3d 799, 803, 549 N.E.2d 643, 646 139 Ill.Dec. 917, 920 (1989). Count XII pleads a conspiracy to defraud case against Defendant Oceanic, but not against Defendants Rahming and Clowes. Accordingly, Count XII is dismissed without prejudice against Rahming and Clowes.

XI. Bahamian Law Claims (Counts XVII and XVIII)

As set forth in the Court's September 22, 2004 Opinion, these counts stand.

CONCLUSION

The Oceanic Defendants' motion to dismiss is granted in part and denied in part. Plaintiffs have until 30 days after the Court rules on all Defendants' outstanding motions to dismiss in this case to file a Second Amended Complaint addressing the deficiencies identified in this memorandum. The Oceanic Defendants do not have to answer the First Amended Complaint.

2004 WL 2278549 (N.D.Ill.), Fed. Sec. L. Rep. P 93,010

**Motions, Pleadings and Filings (Back to top)**

**. 2004 WL 2173927 (Trial Motion, Memorandum and Affidavit) Landmark Defendants' Memorandum of Law in Support of Their Consolidated Motion for Reconsideration and Clarification of This Court's Memorandum Opinion and Order Dated August 2, 2004 (Aug. 13, 2004)**

**. 2004 WL 2173924 (Trial Motion, Memorandum and Affidavit) Oceanic, Kenneth Clowes, and Terah Rahming's Reply in Support of Their Motion to Dismiss ZCM's Amended Complaint for Lack of Personal Jurisdiction (Jun. 28, 2004)**

**. 2004 WL 2173919 (Trial Motion, Memorandum and Affidavit) Oceanic, Kenneth Clowes, and Terah Rahming's Reply in Support of Their Motion to Dismiss (May. 20, 2004)**

**. 2004 WL 2173911 (Trial Motion, Memorandum and Affidavit) Vorisek Defendants' Reply Memorandum in Support of Their Rule 12(B)(6) Motion to Dismiss the ZCM Investors' Amended Complaint (May. 18, 2004)**

**. 2004 WL 2175882 (Trial Motion, Memorandum and Affidavit) The Zurich Plaintiffs' Reply Brief in Support of Their Motion to Compel Answers to Interrogatories, and for Costs (May. 13, 2004)**

**. 2004 WL 2175871 (Trial Motion, Memorandum and Affidavit) Memorandum of Law in Opposition to Landmark Defendants' Consolidated Motion to Dismiss Zurich Plaintiffs' Amended Complaint (Apr. 29, 2004)**

**. 2004 WL 2175876 (Trial Motion, Memorandum and Affidavit) Memorandum of Law in Opposition to the Coglianese Defendants' Motion to Dismiss the Zurich Plaintiffs' Amended Complaint (Apr. 29, 2004)**

**. 2004 WL 2175867 (Trial Motion, Memorandum and Affidavit) Memorandum of Law in Opposition to Oceanic's Motion to Dismiss Zurich's Amended Complaint Pursuant to Fed. R. Civ. P. 12(B)(6) (Apr. 15, 2004)**

. 2004 WL 2175839 (Trial Motion, Memorandum and Affidavit) Coglianese Defendants' Amended Memorandum of Law in Support of Motion to Dismiss ZCM Plaintiffs' Amended Complaint (Mar. 03, 2004)

. 2004 WL 2173906 (Trial Motion, Memorandum and Affidavit) Coglianese Defendants Memorandum of Law in Support of Motion to Dismiss ZCM Plaintiffs' Amended Complaint (Feb. 27, 2004)

. 2004 WL 2175826 (Trial Motion, Memorandum and Affidavit) Plaintiffs' Reply on Their Motion to Conduct Discovery on Jurisdictional and Valuation Issues (Feb. 12, 2004)

. 2004 WL 2173901 (Trial Motion, Memorandum and Affidavit) Oceanic Bank and Trust Limited, Kenneth Clowes, and Terah Rahming's Motion to Dismiss (Feb. 11, 2004)

. 2004 WL 2175820 (Trial Motion, Memorandum and Affidavit) Oceanic's Response to Waldock's Motion for Discovery (Feb. 10, 2004)

. 2004 WL 2175808 (Trial Motion, Memorandum and Affidavit) Coglianese Defendants' Memorandum of Law in Support of Motion to Dismiss Waldock Plaintiffs' Complaint (Jan. 21, 2004)

. 2004 WL 2175811 (Trial Motion, Memorandum and Affidavit) Vorisek Defendants' Rules 12(b)(1) & 12(b)(6) Memorandum in Support of Their Motion to Dismiss the Waldock Plaintiffs' Complaint (Jan. 21, 2004)

. 2004 WL 2175814 (Trial Motion, Memorandum and Affidavit) Memorandum of Law in Support of the Motion to Dismiss of Defendants Southridge Capital Management, LLC, Stephen M. Hicks and Daniel S. Pickett (Jan. 21, 2004)

. 2004 WL 2175817 (Trial Motion, Memorandum and Affidavit) Oceanic, Kenneth Clowes, and Terah Rahming's Memorandum in Support of Their Motion to Dismiss (Jan. 21, 2004)

. 2003 WL 23801705 (Trial Motion, Memorandum and Affidavit) Memorandum in Support of Motion for Consolidation of Cases for Scheduling and Briefing Purposes (Nov. 03, 2003)

. 1:03CV05293 (Docket) (Jul. 30, 2003)

END OF DOCUMENT

# EXHIBIT 12

# EXHIBIT 13

James B. Zouras, Individually and on behalf of All Others Similarly Situated, Plaintiff v. Robert W. Hallman, Neil Rossen, and Presstek, Inc., Defendants

Civil No. 03-240-SM

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF NEW HAMPSHIRE

2004 DNH 144; 2004 U.S. Dist. LEXIS 19684; Fed. Sec. L. Rep. (CCH) P92,923

September 30, 2004, Decided

**NOTICE:**
**PUB-STATUS:** [**1] NOT FOR PUBLICATION

**DISPOSITION:** Defendants' motions to dismiss was granted. Judgment was entered.

**CASE SUMMARY**

**PROCEDURAL POSTURE:** Plaintiff brought a class action suit against defendants, a corporation and two of its former officers, alleging violations of §§ 10(b) and 20(a) *(15 U.S.C.S.* §§ *78j*(b) and 78t(a)) of the Securities Exchange Act of 1934 and *17 C.F.R.* § *240.10b-5*. Defendants moved to dismiss.

**OVERVIEW:** Plaintiff alleged that defendants failed to adequately disclose problems with a major customer, misled investors concerning the commercial viability of a new product line, projected inflated sales forecasts, and failed to disclose quality control problems and production issues experienced by a subsidiary. The court found that none of the alleged statements--which appeared in press releases, on Internet web sites, in earnings reports, and in other documents--were actionable. One of the statements could not be attributed to defendants. With respect to other statements, plaintiff failed to allege factual knowledge on the part of defendants that would have made the statements false or misleading. A Securities and Exchange Commission cease and desist order issued to the corporation did not establish scienter because the instant allegations bore scant resemblance to the prior violations. The claims concerning the subsidiary were untimely; the two-year statute of limitations under the Sarbanes-Oxley Act was inapplicable, as the prior one-year limitations period had run by the time the Act became effective. Absent a viable § 10(b) claim, the § 20(a) claim failed.

**OUTCOME:** Defendants' motion to dismiss was granted.

**CORE TERMS:** misleading, false and misleading, com, scienter, particularity, entanglement, actionable, technology, customer, falsity, product line, seybold, platesetter, flaws, statute of limitations, dimension-related, reporting, following statement, attributed, announced, imaging, projections, website, analyst, announcement, generalized, time-barred, third-party, disclose, shipment

**LexisNexis(TM) Headnotes**

***Civil Procedure > Pleading & Practice > Defenses, Objections & Demurrers > Failure to State a Cause of Action***
[HN1]A motion to dismiss for failure to state a claim upon which relief can be granted, *Fed. R. Civ. P. 12(b)(6)*, requires the court to conduct a limited inquiry, focusing not on whether a plaintiff will ultimately prevail but whether the claimant is entitled to offer evidence to support the claims. When considering a motion to dismiss under *Fed. R. Civ. P. 12(b)(6)*, the court must accept as true all well-pleaded allegations and give the plaintiffs the benefit of all reasonable inferences. However, while a court deciding a motion to dismiss under Rule 12(b)(6) must take all well-pleaded facts as true it need not credit a complaint's "bald assertions" or legal conclusions. Finally, dismissal under *Fed. R. Civ. P. 12(b)(6)* is only appropriate if the complaint, so viewed, presents no set of facts justifying recovery.

***Securities Law > Bases for Liability > Deceptive Devices***
[HN2]See *15 U.S.C.S.* § *78j*.

***Securities Law > Bases for Liability > Deceptive Devices***
[HN3]See *17 C.F.R.* § *240.10b-5*.

***Securities Law > Bases for Liability > Deceptive Devices***
[HN4]For securities fraud purposes, a statement is false or misleading if the person making it has actual factual knowledge, at the time of the statement, that makes the statement false or misleading.

***Securities Law > Bases for Liability > Deceptive Devices***
[HN5]In a securities fraud case, general averments of the defendants' knowledge of material falsity do not suffice. A *17 C.F.R.* § *240.10b-5* plaintiff must allege details of the defendants' alleged fraudulent involvement, including specifics as to what the defendants had knowledge of and when. To satisfy this requirement, complaints typically identify internal reports, memoranda, or the like, and allege both the contents of those documents and the defendants' possession of them at the relevant time. Plaintiffs' citing to reports and documents presented to the defendants at relevant times

that are inconsistent with the defendants' public statements satisfies the necessary pleading requirements. Moreover, such citation must be "specifically" made. Merely alleging the existence of a highly efficient reporting system--even one that would logically lead to internal reports on the relevant subject matter--is not enough. Such allegations may speak to the question of how the defendants might have known what they allegedly knew, but they are insufficient absent some indication of the specific factual content of any single report generated by the alleged reporting system.

***Securities Law > Bases for Liability > Deceptive Devices***
[HN6]Liability under § 10(b) *(15 U.S.C.S. § 78j*(b)) of the Securities Exchange Act of 1934 and *17 C.F.R. § 240.10b-5* requires scienter, a mental state embracing intent to deceive, manipulate, or defraud. In addition, the United States Court of Appeals for the First Circuit has rejected any rigid formula for pleading scienter, preferring to rely on a "fact-specific approach" that proceeds case by case.

***Civil Procedure > Pleading & Practice > Pleadings > Heightened Pleading Requirements***

***Securities Law > Bases for Liability > Deceptive Devices***
[HN7]Complaints brought under § 10(b) *(15 U.S.C.S. § 78j*(b)) of the Securities Exchange Act of 1934 are subject to a heightened pleading standard, set out in rule and statute.

***Civil Procedure > Pleading & Practice > Pleadings > Heightened Pleading Requirements***
[HN8]See *Fed. R. Civ. P. 9(b)*.

***Civil Procedure > Pleading & Practice > Pleadings > Heightened Pleading Requirements***

***Securities Law > Bases for Liability > Deceptive Devices***
[HN9]The particularity requirement for a complaint under *15 U.S.C.S. § 78j*(b) is regarded as being of fundamental importance. Substantively, the particularity requirement entails specifying in the pleader's complaint the time, place, and content of the alleged false or fraudulent representations. In addition, the complaint must set forth specific facts that make it reasonable to believe that the defendant knew that a statement was materially false or misleading. The rule requires that the particular times, dates, places, or other details of the alleged fraudulent involvement of the actors be alleged.

***Securities Law > Bases for Liability > Private Securities Litigation***
[HN10]See *15 U.S.C.S. § 78u-4*(b)(1).

***Securities Law > Bases for Liability > Private Securities Litigation***
[HN11]See *15 U.S.C.S. § 78u-4*(b)(2).

***Civil Procedure > Pleading & Practice > Pleadings > Heightened Pleading Requirements***

***Securities Law > Bases for Liability > Private Securities Litigation***
[HN12]The Private Securities Litigation Reform Act of 1995 (PSLRA) imposes requirements for pleading with particularity that are consistent with the First Circuit's prior rigorous requirements for pleading fraud with particularity under *Fed. R. Civ. P. 9(b)*. Moreover, under the PSLRA, the complaint must state with particularity facts that give rise to a "strong inference" of scienter, rather than merely a reasonable inference. That is, it is clear that scienter allegations now must be judged under the "strong inference" standard at the motion to dismiss stage.

***Securities Law > Bases for Liability > Deceptive Devices***
[HN13]It is not the law that a *17 C.F.R. § 240.10b-5* complaint is to be judged on the basis of the general flavor derived from an issuer's collective statements over a long period of time. Rather, § 240.10b-5 allegations must be organized into discrete units that are, standing alone, each capable of evaluation.

***Securities Law > Bases for Liability > Deceptive Devices***
[HN14]The United States Court of Appeals for the First Circuit has expressly adopted the United States Court of Appeals for the Second Circuit's "entanglement" test for determining whether the statements of a third party may be attributed to a defendant for purposes of establishing liability under § 10(b) *(15 U.S.C.S. § 78j*(b)) of the Securities Exchange Act of 1934 and *17 C.F.R. § 240.10b-5*. This test requires the plaintiff to demonstrate the defendants' involvement with third-party statements: Liability may attach to an analyst's statements where the defendants have expressly or impliedly adopted the statements, placed their imprimatur on the statements, or have otherwise entangled themselves with the analysts to a significant degree. The court will determine whether the complaint contains allegations which, favorably construed and viewed in the context of the entire pleading, could establish a significant and specific, not merely a casual or speculative, entanglement between the defendants and the analysts with respect to the statements at issue. Entanglement also includes situations where company officials intentionally foster a mistaken belief concerning a material fact. However, an entanglement claim will be rejected if it merely suggests or assumes that company insiders provided the information on which analysts or other outsiders based their reports.

***Securities Law > Bases for Liability > Deceptive De-***

*vices*
[HN15]Section 10(b) *(15 U.S.C.S.* § *78j*(b)) of the Securities Exchange Act of 1934 cases are properly decided by a statement-by-statement analysis in which the inquiry made is restricted to the immediate context of each statement--namely, the balance of what was said on the particular occasion, and the immediate circumstances in which the particular statement was made.

***Civil Procedure > Pleading & Practice > Pleadings > Heightened Pleading Requirements***

***Securities Law > Bases for Liability > Deceptive Devices***

***Securities Law > Bases for Liability > Private Securities Litigation***
[HN16]*Fed. R. Civ. P. 9(b)* and the Private Securities Litigation Reform Act of 1995 require a *17 C.F.R.* § *240.10b-5* claim to be pled with specificity.

***Torts > Business & Employment Torts > Deceit & Fraud***
[HN17]"Fraud by hindsight" is a liability theory long disfavored in the First Circuit.

***Securities Law > Bases for Liability > Deceptive Devices***
[HN18]For securities fraud purposes, the fact that a new product might face problems in the market is obvious to a reasonable investor, and therefore omission of it is not culpable.

***Securities Law > Bases for Liability > Deceptive Devices***
[HN19]For securities fraud purposes, accurate reports of past results or events are not actionable.

***Torts > Business & Employment Torts > Deceit & Fraud***
[HN20]The fact that the defendants published statements when they knew facts suggesting the statements were inaccurate or misleadingly incomplete is classic evidence of scienter. Conversely, however, where a plaintiff fails to adequately allege a defendant's knowledge of facts that would make his or her statement false or misleading, it is difficult to argue that the plaintiff has adequately alleged that the defendant acted with the intent to defraud.

***Securities Law > Bases for Liability > Deceptive Devices***
[HN21]Where a plaintiff has failed to state with particularity facts giving rise to a strong inference, *15 U.S.C.S.* § *78u-4*(b)(2), that the defendants made statements with an intent to deceive, manipulate, or defraud, or that they made false or misleading statements with a degree of extreme recklessness that is closer to a lesser form of intent, the plaintiff's complaint does not contain an adequate allegation of the defendants' scienter, which is an essential element of a successful *17 C.F.R.* § *240.10b-5* claim.

***Governments > Legislation > Statutes of Limitations > Time Limitations***

***Securities Law > Bases for Liability***
[HN22]Until the enactment of the Sarbanes-Oxley Act on July 30, 2002, the statute of limitations applicable to federal securities claims barred all actions if they were filed more than one year after the discovery of the facts constituting the violation. However, the Sarbanes-Oxley Act established a new, more generous statute of limitations, providing, in part, that a private right of action that involves a claim of fraud, deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning the securities laws may be brought not later than the earlier of (1) two years after the discovery of the facts constituting the violation, or (2) five years after such violation. *28 U.S.C.S.* § *1658*(b).

***Governments > Legislation > Effect & Operation > Prospective & Retrospective Operation***

***Governments > Legislation > Statutes of Limitations > Time Limitations***
[HN23]The limitations period under the Sarbanes-Oxley Act shall apply to all proceedings addressed by the section that are commenced on or after the date of enactment of the Act (July 30, 2002). Pub. L. No. 107-204, § 804(b), 116 Stat. 801 (2002).

***Governments > Legislation > Statutes of Limitations > Extension & Revival***

***Securities Law > Bases for Liability***
[HN24]The Sarbanes-Oxley Act's enlargement of the statute of limitations for securities fraud claims does not revive claims already time-barred by the date of its enactment.

***Governments > Legislation > Effect & Operation > Prospective & Retrospective Operation***

***Governments > Legislation > Statutes of Limitations > Time Limitations***
[HN25]While Congress may enlarge a limitations period, Congress's acts do not revive a cause of action that has become time-barred unless Congress specifically provides for retroactive application.

***Securities Law > Bases for Liability > Controlling Persons Liability***

***Securities Law > Bases for Liability > Deceptive Devices***
[HN26]There must be a primary violation of § 10(b) *(15 U.S.C.S.* § *78j*(b)) of the Securities Exchange Act of 1934 for liability under § 20(a) *(15 U.S.C.S.* § *78t*(a)) of the Exchange Act.

**COUNSEL:** For James B. Zouras, Plaintiff: Avi N. Wagner, LEAD ATTORNEY, Glancy Binkow & Goldberg, LLP, Los Angeles, CA.

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For Robert W. Hallman, Defendant: Peter G. Callaghan, LEAD ATTORNEY, Preti Flaherty Beliveau Pachios & Haley, Concord, NH.

For Neil Rossen, Presstek, Inc., Defendants: Alexander J. Walker, LEAD ATTORNEY, Devine Millimet & Branch PA, Manchester, NH.

For Presstek, Inc., Defendant: Brian E. Pastuszenski, LEAD ATTORNEY, Testa Hurwitz & Thibeault LLP, Boston, MA.

**JUDGES:** Steven J. McAuliffe, United States District Judge.

**OPINIONBY:** Steven J. McAuliffe

**OPINION: ORDER**

James B. Zouras, representing a class of plaintiffs who purchased Presstek common stock between December 10, 1999, and August 7, 2001, brings suit alleging violations of section 10(b) of the Securities Exchange Act of 1934 (*15 U.S.C. § 78j (b)*), and Rule 10b-5 (*17 C.F.R. § 240.10b-5* **[**2]** ), against all defendants (Count I) and violations of section 20(a) of the Act (*15 U.S.C. § 78t(a)*) against defendants Hallman and Rossen (Count II). Before the court is defendants' motions to dismiss. *FED. R. CIV. P. 9(b)* and *12(b)(6)*. Plaintiff objects. For the reasons given below, defendants' motion to dismiss is granted.

**The Legal Standard**

[HN1]A motion to dismiss for "failure to state a claim upon which relief can be granted," *FED. R. CIV. P. 12(b)(6)*, requires the court to conduct a limited inquiry, focusing not on "whether a plaintiff will ultimately prevail but whether the claimant is entitled to offer evidence to support the claims." *Scheuer v. Rhodes, 416 U.S. 232, 236, 40 L. Ed. 2d 90, 94 S. Ct. 1683 (1974)*. When considering a motion to dismiss under *FED. R. CIV. P. 12(b)(6)*, the court must "accept as true all well-pleaded allegations and give plaintiffs the benefit of all reasonable inferences." *Cooperman v. Individual Inc., 171 F.3d 43, 46 (1st Cir. 1999)* (citing *Gross v. Summa Four, Inc., 93 F.3d 987, 991 (1st Cir. 1996)*). [**3] However, while a court "deciding a motion to dismiss under *Rule 12(b)(6)* ... must take all well-pleaded facts as true ... it need not credit a complaint's 'bald assertions' or legal conclusions." *Shaw v. Digital Equip. Corp., 82 F.3d 1194, 1216 (1st Cir. 1996)* (quoting *Wash. Legal Found. v. Mass. Bar Found., 993 F.2d 962, 971 (1st Cir. 1993)*). Finally, "dismissal under *Fed.R.Civ.P. 12(b)(6)* is only appropriate if the complaint, so viewed, presents no set of facts justifying recovery." *Cooperman, 171 F.3d at 46* (citing *Dartmouth Review v. Dartmouth Coll., 889 F.2d 13, 16 (1st Cir. 1989)*).

**Background**

Defendant, Presstek, Inc., has developed and commercialized proprietary direct imaging ("DI") technology for use in color offset printing. That technology employs laser diodes to transmit digital data directly onto plates, while they are in the press. Historically, a significant portion of Presstek's sales have been to Heidelberger Druckmaschinen AG ("Heidelberg"), a manufacturer of color offset printing presses. Heidelberg used Presstek's DI technology in its Quickmaster DI **[**4]** printing press, but subsequently turned to Creo, a Presstek competitor, to supply DI technology for its new Speedmaster 74DI printing press. On December 10, 1999, the commencement date of the class period, Presstek announced that it was entering into arbitration proceedings with Heidelberg. Subsequently, Presstek announced its intention to: (1) develop and market a new product, the Dimension 400, a thermal computer-to-plate ("CTP") device; (2) pursue a joint venture with Xerox to market a line of direct imaging presses; and (3) operate a subsidiary, Lasertel, to produce high-quality laser diodes.

The price of one share of Presstek common stock on December 10, 1999, the first day of the class period, was $ 13.75. During the class period, that price rose to a high of $ 28.75 and fell to a low of $ 7.20 on August 7, 2001, the last day of the class period.

Plaintiff has sued Presstek, its former Chief Executive Officer and President (Hallman), and its former Chief Financial Officer (Rossen), both of whom were Presstek officers during the class period. Plaintiff says defendants are liable for: (1) failing to adequately disclose problems with the Heidelberg relationship; (2) recklessly **[**5]** misleading investors concerning the commercial viability of the Dimension product line in 2000 and 2001; (3) knowingly projecting inflated sales forecasts for Xerox DocuColor units in 2001; and (4) failing to disclose severe quality control problems and production issues at Presstek's Lasertel subsidiary.

**Discussion**

*Section 10(b) of the Securities Exchange Act of 1934* provides:

[HN2]It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange-...
**(b)** To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement (as defined in *section 206B of the Gramm-Leach-Bliley Act*), any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.
*15 U.S.C. § 78j*. *Rule 10b-5*, promulgated by the Securities and Exchange Commission, **[**6]** provides:

[HN3]It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statement made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security. *17 C.F.R. § 240.10b-5*.

[HN4]A statement is false or misleading if the person making it has actual factual knowledge, at the time of the statement, that makes the statement false or misleading. See, e.g., *Mesko v. Cabletron Sys., Inc. (In re Cabletron Sys., Inc.), 311 F.3d 11, 36 (1st Cir. 2002)*; *Aldridge v. A.T. Cross Corp., 284 F.3d 72, 79 (1st Cir. 2002)*.

In the First Circuit, [HN5]"general averments of defendants' knowledge of material falsity [do] not suffice." *Gross, 93 F.3d at 991*. **[**7]** A 10b-5 plaintiff must allege "details of [defendants'] alleged fraudulent involvement," including specifics as to what defendants had knowledge of and when. Id. To satisfy this requirement, complaints typically identify internal reports, memoranda, or the like, and allege both the contents of those documents and defendants' possession of them at the relevant time. See, e.g., *Serabian [v. Amoskeag Bank Shares, Inc.], 24 F.3d [357,] 368 [(1st Cir. 1994)]* (plaintiffs, "citing to reports and documents presented to defendants at relevant times that were inconsistent with the defendants' public statements ... satisfies the necessary pleading requirements.") Moreover, such citation must be "specifically" made. Id. Recently, in Shaw, the Court ruled that merely alleging the existence of a highly efficient reporting system - even one that would logically lead to internal reports on the relevant subject matter - was not enough. The Court wrote that such allegations "may speak to the question of how defendants might have known what they allegedly knew, but [they are insufficient] absent some indication of the specific factual content of any single **[**8]** report generated by the alleged reporting system." *82 F.3d 1224* & n. 38 (emphasis in original).

*In re Boston Tech., Inc. Sec. Litig., 8 F. Supp. 2d 43, 57-58 (D. Mass. 1998)* (footnote omitted).

[HN6]"Liability under *section 10(b)* and *Rule 10b-5* also requires scienter, 'a mental state embracing intent to deceive, manipulate, or defraud.'" *Cabletron, 311 F.3d at 38* (quoting *Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12, 47 L. Ed. 2d 668, 96 S. Ct. 1375 (1976)*). In addition, "this circuit has rejected any rigid formula for pleading scienter, preferring to rely on a 'fact-specific approach' that proceeds case by case." *Cabletron, 311 F.3d at 38* (citing *Aldridge, 284 F.3d at 82*; *Greebel v. FTP Software, Inc., 194 F.3d 185, 196 (1st Cir. 1999)*).

[HN7]Complaints brought under *section 10(b)* are subject to a heightened pleading standard, set out in rule and statute. [HN8]"In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity." *FED. R. CIV. P. 9(b)*. [HN9]"The particularity requirement is regarded **[**9]** by the Court of Appeals for this Circuit as being of fundamental importance." *Boston Tech., 8 F. Supp. 2d at 52*. Substantively, the particularity "requirement 'entails specifying in the pleader's complaint the time, place, and content of the alleged false or fraudulent representations.'" *Arruda v. Sears, Roebuck & Co., 310 F.3d 13, 19 (1st Cir. 2002)* (quoting *Powers v. Boston Cooper Corp., 926 F.2d 109, 111 (1st Cir. 1991)*). In addition, "the complaint must set forth specific facts that make it reasonable to believe that the defendant knew that a statement was materially false or misleading. The rule requires that the particular times, dates, places, or other details of the alleged fraudulent involvement of the actors be alleged." *Boston Tech., 8 F. Supp. 2d at 53* (quoting *Gross, 93 F.3d at 991* (emphasis added)).

Under the provisions of the *Private Securities Litigation Reform Act* ("PSLRA") of 1995:

[HN10]In any private action arising under this chapter in which the plaintiff alleges that the defendant-

**(A)** made an untrue statement of material fact; or

**(B)** omitted to state a **[**10]** material fact necessary in order to make the statements made, in light of the circumstances in which they were made, not misleading; the complaint shall specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed.

*15 U.S.C. § 78u-4(b)(1)*. Furthermore:

[HN11]In any private action arising under this chapter in which the plaintiff may recover money damages only on proof that the defendant acted with a particular state of mind, the complaint shall, with respect to each act or omission alleged to violate this chapter, state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.

*15 U.S.C. § 78u-4(b)(2)*.

The First Circuit has held that [HN12]"the PSLRA imposes requirements for pleading with particularity that are consistent with [the] circuit's prior rigorous requirements for pleading fraud with particularity under *Fed.R.Civ.P. 9(b)* **[**11]** ." *Greebel, 194 F.3d at 188*. Moreover, "under the PSLRA, the complaint must state with particularity facts that give rise to a 'strong inference' of scienter, rather than merely a reasonable inference." *Cabletron, 311 F.3d at 38* (citing *15 U.S.C. § 78u-4 (b)(2)*; *Greebel, 194 F.3d at 195-96*). That is, "it is clear that scienter allegations now must be judged under the 'strong inference' standard at the motion to dismiss stage." *Greebel, 194 F.3d at 197*.

Finally, [HN13]"it is not the law that a 10b-5 complaint is to be judged on the basis of the general flavor derived from an issuer's collective statements over a long period of time." *Boston Tech., 8 F. Supp. 2d at 56*. Rather, "[10b-5] allegations [must be organized] into discrete units that are, standing alone, each capable of evaluation." *Id. at 55-56* (quoting *Shapiro v. UJB Fin. Corp., 964 F.2d 272, 284 (3d Cir. 1992)*).

A. The Heidelberg Arbitration

According to plaintiff, defendants failed to adequately disclose problems developing in the relationship between Presstek and Heidelberg. **[**12]** Specifically, plaintiff alleges that Presstek's actionable false and/or misleading statement is composed of: (1) a December 10, 1999, Presstek press release that stated, in pertinent part: "Presstek ... and Heidelberger Druckmaschinen, A.G ... today announced they have entered into an arbitration to resolve certain conflicts concerning on-press imaging;" and (2) a December 17, 1999, report on seybold.com that stated: "Presstek said the dispute doesn't involve the Quickmaster." Plaintiff does not contend that the first statement, standing alone, was either false or materially misleading. Rather, plaintiff's claim depends upon both statements, read together. Plaintiff's claim necessarily fails, however, because the second statement cannot be attributed to Presstek.

In Cabletron, [HN14]the First Circuit expressly adopted the Second Circuit's "entanglement" test for determining whether the statements of a third party may be attributed to a defendant for purposes of establishing liability under *section 10(b)* and *Rule 10b-5*.

This test requires the plaintiff to demonstrate the defendants' involvement with third-party statements:

Liability may attach to an analyst's statements **[**13]** where the defendants have expressly or impliedly adopted the statements, placed their imprimatur on the statements, or have otherwise entangled themselves with the analysts to a significant degree ... The court will determine whether the complaint contains allegations which, favorably construed and viewed in the context of the entire pleading, could establish a significant and specific, not merely a casual or speculative, entanglement between the defendants and the analysts with respect to the statements at issue.

*Schaffer [v. Timberland Co.], 924 F. Supp. [1298,] 1310 [(D.N.H. 1996)]*. Entanglement also includes situations where company officials "intentionally foster a mistaken belief concerning a material fact." *Elkind [v. Liggett & Myers, Inc.], 635 F.2d [156,] 163-64 [2d Cir. 1980)]*.

*311 F.3d at 37-38* (footnote omitted). However, "an entanglement claim will be rejected if it merely suggests or assumes that company insiders provided the information on which analysts or other outsiders based their reports." *Id. at 38* (citing *Suna v. Bailey Corp., 107 F.3d 64, 73-74 (1st Cir. 1997)*; **[**14]** *In re Number Nine Visual Tech. Corp. Secs. Litig. 51 F. Supp. 2d 1, 31 (D. Mass. 1999)*).

Here, plaintiff has not alleged that defendants expressly or impliedly adopted the statement reported on seybold.com, or that they placed their imprimatur on that statement. The quotation from seybold.com plainly does not identify any specific Presstek source for the statement. Thus, plaintiff has failed to allege any facts which, if proven, would demonstrate significant and specific entanglement between Presstek and seybold.com. See *Cabletron, 311 F.3d at 38* (holding that two analyst statements reporting information provided by named Cabletron executives were attributable to Cabletron under the entanglement test); *Walsingham v. Biocontrol Tech., Inc., 66 F. Supp. 2d 669, 677 (W.D. Pa. 1998)* (rejecting defendant's argument that certain media reports were non-actionable because "the majority of the [third-party] statements identified by the defendants [as non-actionable third-party statements] contain what purports to be a direct quote of a specifically named BICO official.").

Moreover, Aldridge does not support plaintiff's position. In [**15] that case, two of the three company statements reported in the Providence Journal were directly attributed to a named company official, *284 F.3d at 79-80*, while the third was "obviously" attributable to company officials, *id. at 80*. Here, by contrast, as pled in plaintiff's complaint, the statement reported by seybold.com is not obviously attributable to Presstek. It does not directly quote either a named or an unnamed Presstek official. It is but a paraphrase of a statement attributed to "Presstek," rather than to any specific individual. Thus, the seybold.com statement is plausibly read as the website's own interpretation of Presstek's December 10 press release. Finally, the mere fact that Robert Hallman has written for seybold.com at some time or another is not enough to demonstrate "entanglement between the defendants and the analysts with respect to the statements at issue." *Cabletron, 311 F.3d at 38* (quoting *Schaffer, 924 F. Supp. at 1310*) (emphasis added).

Because plaintiff has failed to allege facts adequate to meet the entanglement test as adopted in this circuit, the seybold.com statement is not attributable [**16] to Presstek for purposes of establishing liability under *section 10 (b)* and *Rule 10b-5*. And, because plaintiff's claim of fraud surrounding the Heidelberg arbitration depends upon the seybold.com statement (Pl.'s Mem. of Law (document no. 27) at 27 n.51), plaintiff has failed to state a claim on which relief can be granted with respect to the Heidelberg arbitration.

B. The Dimension Product Line

According to plaintiff, defendants recklessly misled investors regarding the commercial viability of the Dimension product line. Specifically, he points to statements contained in four Presstek press releases (three reporting quarterly earnings, one commenting on "recent market conditions"), two third-party reports posted on industry websites, and one quarterly 10-Q filing. In the words of plaintiff's amended complaint, "the statements set forth in PP 37(a) - (g) were materially false and misleading in that they failed to disclose serious critical flaws, both with the Dimension products and their production." n1 (Am. Compl. P 38.) In plaintiff's view, when Presstek made the statements detailed in paragraphs 37(a)-(g) of his amended complaint, it was obligated to disclose that: (1) [**17] the laser diodes supplied by Lasertel for use in the Dimension product performed poorly; (2) the electrical boards in the Dimension product were faulty; and (3) Dimension products suffered from malfunctions caused by dust generated during the production process.

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n1 More specifically, plaintiff contends that those statements are actionable because defendants: (1) initially mislabeled production delays as shipping or scheduling delays; and (2) ultimately, but belatedly, admitted to production delays, but never disclosed critical flaws in the Dimension products and in the production process that caused the delays.

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Defendants move to dismiss the Dimension-related claims on grounds that: (1) plaintiff does not allege any actionable misstatements or any statements that were so incomplete as to be misleading; (2) the forward-looking statements they made are protected by the PSLRA's "safe harbor;" (3) most of the statements plaintiff challenges consist of non-actionable puffery; and (4) plaintiff alleges no facts to [**18] support an inference that any defendant made a statement known to be materially false when it was made. For the rules governing the duty to disclose in *section 10(b)* cases, defendants cite *Backman v. Polaroid Corp., 910 F.2d 10 (1st Cir. 1990)* (en banc), and *Boston Technology, 8 F. Supp. 2d 43*.

Without addressing either Backman or Boston Technology, plaintiff counters that: (1) the amended complaint identifies defendants' misrepresentations concerning the Dimension product; (2) the amended complaint pleads why those statements were false when made; and (3) defendants' misrepresentations were more than mere puffery. Plaintiff does not, however, address defendants' invocation of the PSLRA safe harbor, although he does clarify his theory of liability on the Dimension-related claim:Defendants misapprehend the thrust of the Dimension allegations: Plaintiffs do not claim that Presstek failed to meet predictions as to future prospects after falsely claiming that there was strong market demand for Dimension. Rather, the positive statements made in connection with the introduction of Dimension, e.g., encouraging response to commercial [**19] release in Q3 2000, sales expected to climb steeply in Q4 2000, conceal that Dimension was released before it was commercially viable and that purchasers of early units would have to obtain numerous repairs/upgrades.(Pl.'s Mem. (document no. 27) 21 n.43 (emphasis added).)

In other words, plaintiff asserts that it was misleading for Presstek to issue positive statements about customer response to the introduction of the Dimension product line without also disclosing some combination of production and/or performance problems with its Dimension platesetters. More specifically, plaintiff asserts that Presstek intentionally attempted to mislead the market by: (1) saying that the company was experiencing shipping or scheduling delays, when it was actually dealing with production delays; (2) saying that the company was experiencing production delays, when it was actually dealing with production issues; and (3) saying that the company was experiencing production issues, when it was actually dealing with product performance issues; and (4) only belatedly disclosing that the Dimension platesetter was experiencing performance issues.

As noted above, *section 10b-5* [HN15]cases are properly **[**20]** "decided by a statement-by-statement analysis in which the inquiry made is restricted to the immediate context of each statement - namely, the balance of what was said on the particular occasion, and the immediate circumstances in which the particular statement was made." *Boston Tech., 8 F. Supp. 2d at 55.* Before analyzing each of the seven Dimension-related statements that plaintiff identifies as false and misleading, one issue common to all seven statements must be considered.

*Rule 9(b)* and the PSLRA [HN16]require a 10b-5 claim to be pled with specificity. That requirement is especially important given plaintiff's theory of the case. He claims Presstek is liable not for saying that market interest in Dimension was high when it was actually low, or for saying that Dimension was a good platesetter when it was actually a poor one, but for saying that market interest in Dimension was high without also saying that Dimension was not a very good platesetter. n2 Plaintiff's theory of liability requires not only that defendants knew about Dimension's alleged production/performance issues, but, also, that defendants understood the effect those issues would have on Presstek's bottom **[**21]** line. See *Cabletron, 311 F.3d at 36* (explaining that plaintiff had not shown why any of defendant's statements were materially misleading when made, in part because "the supply delays might or might not have been visible to defendants [when they made their statements], but in any event it may also have been reasonable to believe they would soon be resolved").

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n2 In Boston Technology, the court held that a statement about the deployment of a new product and the importance of one particular customer "neither inherently concerned, nor implicitly referred to the quality or condition of the product line." *8 F. Supp. 2d at 59.*

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Thus, under plaintiff's theory of the case, specific allegations about what Hallman and Rossen knew, when they knew it, and what they likely would have inferred from their actual knowledge, are all vital to a claim that what they said about market acceptance was in conflict with what they knew to be true about product production and performance. See *Cabletron, 311 F.3d at 36* **[**22]** (holding that plaintiff failed to adequately allege that a statement was misleading when made because "the complaint failed to demonstrate that the problems which later plagued the SmartSwitch were known to the individual defendants by mid-March when the first two statements were made").

Plaintiff's complaint falls short in alleging factual knowledge on the part of Hallman or Rossen that would have made any of the statements attributed to them false or misleading. Only one of plaintiff's confidential witnesses, CW 1, n3 says that he or she spoke to Hallman and none claims to have spoken to Rossen. n4 No dates are given for the meeting or meetings between CW 1 and Hallman, and the contents of CW 1's communication(s) to Hallman are vague, at best. n5 Plaintiff also fails to allege any concrete knowledge, or a basis for inferring knowledge, on Hallman's part concerning the link between production/performance issues and revenue. Without a more specific indication of precisely what CW 1 said to Hallman, and when, plaintiff's complaint fails to "specify ... the reason or reasons why [any] statement [attributed to Hallman] is misleading." *15 U.S.C. § 78u-4(b)(1).* **[**23]** Not only does the complaint's lack of specificity preclude analysis of discrete units subject to individual evaluation, see *Boston Tech., 8 F. Supp. 2d at 55-56*, but the complaint also comes very close to alleging [HN17]"fraud by hindsight," a liability theory long disfavored in this circuit. See *Cabletron, 311 F.3d at 36-37* (citing *Gross, 93 F.3d at 991*; *Greenstone v. Cambex Corp., 975 F.2d 22, 25 (1st Cir. 1992)*).

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n3 According to plaintiff, "CW 1 is a former Presstek employee who, throughout the Class Period, supervised engineers who made product repairs and trained customers to use Dimension products." (Am. Compl. P 38(a).)

n4 Plaintiff's only allegations that Hallman had knowledge making his statements false and misleading are: (1) "CW 1 attended meetings where Hallman was present and CW 1 candidly gave assessments of Dimension's failures to Hallman." (Am. Compl. P 38(a)); and (2) "CW 1 personally informed Hallman and Vice President Lieber of the known problems with the Dimension product. Whereas this occurred at various meetings, defendants were aware that serious problems existed and were not being remedied." (Am. Compl. P 39(a)).

[**24]

n5 The facts alleged by plaintiff in this case contrast sharply with those alleged in Cabletron.

In Cabletron, which also involved the roll-out of a new product, the SmartSwitch, "virtually every SmartSwitch manufactured from April to at least September 1997 was subject to individualized re-wiring by hand." *311 F.3d at 26-27.* Moreover:

Information about the [SmartSwitch] problems was widely known within the company and was addressed extensively at weekly quality control meetings. The problems were also described in two internal Cabletron databases that were routinely circulated in hard copy to managers, including to defendants Levine, Benson, and Oliver. According to a former employee alleged to have personal knowledge, Benson directed that these reports should not be provided to salespersons "in order to insulate them (and the Company's customers) from knowledge of problems relating to SmartSwitches."

*Id. at 27.*

Here, plaintiff has alleged that CW 1, at unspecified times and places, provided unspecified information to Hallman, and that certain other individuals were aware of several problems with the Dimension products. Notably missing from plaintiff's complaint are allegations of either the kind of systematic, institutional data reporting alleged in Cabletron, or the kind of deliberate concealment of systematically reported data alleged in that case.

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**[**25]**

Having identified the complaint's general deficiency regarding specificity, the court now turns to each of the seven Dimension-related statements plaintiff claims to have been false and misleading.

Statement 1

In paragraph 37(a) of his amended complaint, plaintiff identifies as false and misleading the following statement, contained in Presstek's October 26, 2000, third-quarter 2000 earnings announcement:[CEO Robert] Hallman continued, "Drupa2000 and GraphExpo2000 demonstrated the widespread adoption of direct imaging on-press technology, which was further confirmed by the recent announcements of our partnerships with Ryobi and Xerox Corporation. The entry of Xerox into the ink-on-paper arena with the internal cylinder designed DocuColor DI series of presses is expected to expand the short run color market to which DI contributes a high level of value."

"We are encouraged by the response to the recent commercial releases of our new Dimension platesetter series and Anthem plate," said Hallman. "These new products represent an area of exciting revenue potential. The Dimension, using the same ProFire DI technology used in our DI presses, in combination with **[**26]** the chemistry-free, highly consistent Anthem plate provide a unique opportunity in the expanding computer-to-plate market. Initial shipments of Dimension and Anthem commenced in the third quarter of 2000, and we expect volume increases in the fourth quarter and beyond."

Looking forward to the fourth quarter of 2000, the company anticipates continued sequential revenue and earnings growth, subject to the risks set forth below. The company is presently focused on meeting the production challenges that come with these projected additional revenues. In addition, due to the increased industry acceptance of Presstek's technology, there is potential for accelerated revenue growth in the fourth quarter of 2000.(emphasis added by plaintiff). Plaintiff asserts that the foregoing statement was false and misleading because "defendants continued to tout Dimension's acceptance" (Am. Compl. P 37(a)) and because of Presstek's alleged "failure to disclose serious critical flaws, both with the Dimension products and their production" (Am. Compl. P 38).

As with most of the dimension-related statements plaintiff identifies as false and misleading, statement 1 is not a single statement **[**27]** subject to evaluation. It is, instead, an extensive commentary that includes any number of statements. In other words, here, as in much of the complaint, plaintiff has offered "general flavor" pleading, see *Boston Tech., 8 F. Supp. 2d at 56*, rather than making "allegations [in] discrete units that are, standing alone, each capable of evaluation," *id. at 56*.

More importantly, plaintiff's claim is insufficient as a matter of law because the complaint does not adequately allege knowledge on Hallman's part that made statement 1 false or misleading. To be sure, plaintiff alleges that CW 1 attended meetings with Hallman and offered negative assessments of the Dimension product. But absent allegations detailing when those meetings occurred and precisely what CW 1 told Hallman, plaintiff has failed to allege that Hallman made a false or misleading statement.

Moreover, plaintiff does not indicate how Presstek's failure to simultaneously disclose production problems with Dimension made it misleading to report on initial customer response to the introduction of that product line. Presstek's ability to produce the product has, at best, an attenuated relationship **[**28]** to customer interest in its introduction. It is overreaching, on the facts alleged, to argue that Presstek "touted the Dimension line as immediately successful." (Pl.'s Mem. at 18.) In short, "it would not be reasonable to conclude from such an announcement [as Presstek made] that no [production] problems were being met." *Boston Tech., 8 F. Supp. 2d at 59* (rejecting plaintiff's claim that defendant was "obligated ... to disclose their alleged knowledge of 'technological problems with the ... new products'"). Plaintiff's suggestion that Presstek's "statement was misleading because it failed to explain that unresolved bugs in the new product would prevent its commercial acceptance," *id. at 62*, also falls short because [HN18]"the fact that a new product might face problems in the market is obvious to a reasonable investor, and therefore omission of it is not culpable," *id. at 63* (citing *In re Donald J. Trump Casino Sec. Litig., 7 F.3d 357, 377 (3d Cir. 1993)*).

Because the complaint fails to adequately allege knowledge on the part of Hallman sufficient to make statement 1 false and misleading, and because Hallman's optimistic **[**29]** appraisal of customer interest did not reasonably imply that Dimension was without flaws, statement 1 is not actionable.

Statement 2

In paragraph 37(b) of his amended complaint, plaintiff identifies as false and misleading the following statement, found in dotprint.com's October 30, 2000, report on a conference call held by Hallman: "Shipments of the Dimension, worth $ 800,000 in Q3, are also expected to climb steeply." Plaintiff offers only a generalized assertion of falsity, based upon Presstek's alleged "failure to disclose serious critical flaws, both with the Dimension products and their production." (Am. Compl. P 38.)

As a preliminary matter, the statement plaintiff identifies as false and misleading appeared on a third-party website rather than in a press release or other publication attributable to Presstek. However, even assuming the statement is attributable to Hallman rather than dotprint.com, n6 the complaint does not adequately allege any knowledge on Hallman's part that would make statement 2 false or misleading. Moreover, even assuming Hallman had knowledge of the problems identified by plaintiff, mere knowledge of those problems would not make the statement misleading **[**30]** for failure to mention them. See *Boston Tech., 8 F. Supp. 2d at 53*. As with statement 1, "it would not be reasonable to conclude from [defendant's statement] that no [production] problems were being met." *Id. at 59*. Accordingly, statement 2 is not actionable.

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n6 While a direct quote from a company official appearing in the news media is properly attributed to the company, see *Cabletron, 311 F.3d at 35*, the allegedly false and misleading statement identified in paragraph 37(b) is plainly a statement by dotprint.com rather than by Hallman.

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Statement 3

In paragraph 37(c) of his amended complaint, plaintiff identifies as false and misleading the following statement, drawn from a November 1, 2000, report found on the PFFC-online.com website:Presstek has named VIP Offset & Graphic Arts Supplies & Equipment Inc. a distributor for its new computer-to-plate (CTP) prepress products. According to Presstek, the distributor will service customers located **[**31]** primarily in New York, New Jersey, and Connecticut. Among the Presstek products VIP will distribute: the Dimension Series CTP systems with Anthem thermal plates, both of which were showcased for the first time at September's Graph Expo in Chicago, IL. Says Carl Bruchner, Presstek's eastern regional sales manager, "The quality of [these products] combined with the expert guidance VIP provides to its customers surely will result in higher productivity."(brackets and emphasis supplied by plaintiff). As with statement 2, plaintiff offers only a generalized assertion of falsity based upon Presstek's alleged "failure to disclose serious critical flaws, both with the Dimension products and their production." (Am. Compl. P 38.)

Statement 3 was published by an industry website, but, because PFFC-online.com directly quoted a named Presstek employee, the entanglement test appears to be met. See *Cabletron, 311 F.3d at 35* ("This court has previously attributed direct quotes of company officials in the news media to the company ... and does so again here.") (citing *Aldridge, 284 F.3d at 79-80*). Plaintiff makes no allegation, however, that the **[**32]** quoted employee, Presstek's eastern regional sales manager, was aware of the alleged production and performance issues that, in plaintiff's view, rendered optimistic sales projections false or misleading, much less that the quoted employee had such knowledge at the time he made the statement reported on PFFC-online.com.

In addition, the only portion of statement 3 that is remotely susceptible of an interpretation that might make it actionable is that portion added by plaintiff, in brackets. Without a copy of the actual report, which plaintiff has not provided, or specific allegations detailing the precise statements made, it is not possible to determine what the adjective "quality" modified. Thus, plaintiff has failed adequately to "specify[] ... the ... content of the alleged false or fraudulent representation[]." *Arruda, 310 F.3d at 19* (citation omitted).

Because plaintiff has not alleged knowledge on the part of the speaker, and because the complaint lacks the necessary specificity, plaintiff has not adequately stated a claim with respect to statement 3.

Statement 4

In paragraph 37(d) of his amended complaint, plaintiff identifies as false and misleading **[**33]** the following statement, taken from a December 22, 2000, Presstek press release titled "Presstek Comments on Recent Market Conditions":Presstek, Inc. (Nasdaq: PRST) a leading provider of direct digital imaging technologies to the printing and publishing industry, commenting on recent market conditions, stated today that management believes that the recent downturn in the company's stock price is not reflective of the strength of the company's ongoing operations and future business outlook.

The company also stated it is pleased with the demand for its new Dimension CTP product.(emphasis added by plaintiff). In addition to offering a generalized assertion of falsity, plaintiff asserts that this statement is false and misleading because it "emphasized the success of Dimension." (Am. Compl. P 37(d).)

Presstek did not "emphasize the success of Dimension" at all. It merely communicated that the company was "pleased with the demand for its new Dimension CTP product." But, again, because plaintiff has not adequately alleged contemporaneous knowledge that would make statement 4 false or misleading, and because nothing in statement 4 fairly implies a representation **[**34]** that Dimension was free from flaws, that statement is not actionable.

Statement 5

In paragraph 37(e) of his amended complaint, plaintiff identifies as false and misleading the following statement in Presstek's February 21, 2001, fourth-quarter 2000 earnings announcement:Presstek, Inc. (Nasdaq: PRST), a leading provider of direct digital imaging technology, today announced financial results for the fourth quarter and fiscal year ended December 30, 2000.

Commenting on the fourth quarter, Presstek's Chief Financial Officer Neil Rossen said, "While we are pleased with the double-digit growth in revenues over the third quarter of 2000, we believe it could have been an even stronger quarter based on the momentum our products are generating in the marketplace." "As we previously announced, we were facing some uncertainty entering the fourth quarter about the outlook for shipment levels and schedules for our new DocuColor and Dimension products. And we did, in fact, experience some shipping delays in the fourth quarter that kept our revenues below the upper range of what we had projected. Demand, however, continues to be strong and our partnerships continue **[**35]** to be active." President and Chief Executive Officer Robert Hallman said, "Over the course of the past few years, Presstek established and implemented several strategic initiatives to improve the company's performance. These initiatives included exploiting Presstek's technology leadership position to grow the DI press market, establishing a strong foothold in segments of the off-press computer-to-plate (CTP) markets, making chemistry-free imaging media the industry standard, and creating a strong brand identity. The solid results for fiscal year 2000 demonstrate the progress we are making with these initiatives." These include:
-- Presstek's successful launch of new products at Drupa 2000.

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-- Technological innovation, that has redefined the industry in terms of off-press applications; Dimension/Anthem's platesetter/plate system is the next generation, chemistry-free CTP.
(emphasis and ellipsis supplied by plaintiff). In addition to a generalized assertion of falsity, plaintiff asserts that this statement is false and misleading because in it, "defendants continued to tout the Dimension product line." (Am. Compl. P 37(e).)

Assuming defendants "touted" the Dimension [**36] product line, n7 statement 5 is not actionable for substantially the same reasons that the previously discussed Dimension-related statements are not actionable. Plaintiff has not adequately alleged knowledge that would make that statement false or misleading, and the statement does not fairly imply the absence of production or performance issues with the Dimension line.

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n7 The statement reported in paragraph 37(e) is decidedly more measured than plaintiff suggests.

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Statement 6

In paragraph 37 (f) of his amended complaint, plaintiff identifies as false and misleading the following statement in Presstek's April 21, 2001, first-quarter 2001 earnings announcement:Our core graphics business continues to gather momentum with revenues growing to $ 25.8 million from $ 23.5 million in the fourth quarter of 2000. Demand for product in our core business remains strong despite the general economic slowdown. In particular, our Dimension/Anthem computer-to-plate (CTP) offering appears to be gaining widespread [**37] interest across our industry. In addition, during the first quarter we addressed many of the production delays we experienced late last year.(emphasis added by plaintiff). As with all the Dimension-related statements, plaintiff makes a general assertion of falsity based upon Presstek's alleged "failure to disclose serious critical flaws, both with the Dimension products and their production." (Am. Compl. P 38.) Plaintiff seems to attempt to make another claim of falsity, but it is difficult to determine the precise contours of that claim. In addition to incorrectly stating that Presstek claimed to have resolved the Dimension production delays when, in fact, Presstek only claimed to have addressed those delays, plaintiff calls attention to Presstek's statement that "during the first quarter [it] addressed many of the production delays we experienced late last year." However, plaintiff alleges no facts tending to show that Presstek did not address those delays, and does not appear even to argue that point. Thus, plaintiff is left with a generalized assertion of falsity, which fails, as a matter of law, due to the failure to allege knowledge on Presstek's part that would [**38] make any portion of statement 6 false or misleading.

Statement 7

In paragraph 37(g) of his amended complaint, plaintiff identifies as false and misleading the following statement in Presstek's May 14, 2001 first-quarter 2001 10-Q: "The Company also experienced volume increases in sales of its CTP Dimension platesetter products." In addition to offering a generalized assertion of falsity, plaintiff asserts that this statement is false and misleading because in it, "defendants reaffirmed the growing success of the Dimension line." (Am. Compl. P 37(g).) Defendants may well have reaffirmed the growing success of the Dimension product line, but because they did so by reporting past results, the accuracy of which plaintiff does not challenge, and because [HN19]"accurate reports of past results or events are not actionable," *Boston Tech., 8 F. Supp. 2d at 59* (citing *Serabian, 24 F.3d at 361*), the complaint fails to state an actionable claim with regard to statement 7.

Scienter

In Aldridge, the court of appeals explained that [HN20]"the fact that the defendants published statements when they knew facts suggesting the statements were inaccurate or misleadingly [**39] incomplete is classic evidence of scienter." *284 F.3d at 83* (citing *Fla. State Bd. of Admin. v. Green Tree Fin. Corp., 270 F.3d 645, 665 (8th Cir. 2001)*). In Cabletron, the court held that a strong inference of scienter supported by several other factors was reinforced by an allegation that "many people within the company ... received regular information about ... problems which they should have realized contradicted the company's public statements about the rollout of the product." *311 F.3d at 39*. Conversely, however, where a plaintiff fails to adequately allege a defendant's knowledge of facts that would make his or her statement false or misleading, it is difficult to argue that the plaintiff has adequately alleged that the defendant acted with the intent to defraud.

Here, [HN21]plaintiff has failed to "state with particularity facts giving rise to a strong inference," *15 U.S.C. § 78u-4(b)(2)*, that defendants made statements with an "intent to deceive, manipulate, or defraud," *Cabletron, 311 F.3d at 38*, or that they made false or misleading statements with a degree of "extreme recklessness that is [**40] 'closer to a lesser form of intent,'" id. (quoting *Greebel, 194 F.3d at 198-99*). Thus, in addition to its other shortcomings, plaintiff's complaint does not contain an adequate allegation of defendants' scienter, which is an essential element of a successful *section 10b-5* claim. See *Cabletron, 311 F.3d at 38*.

Regarding scienter, plaintiff makes much of a December 22, 1997, cease and desist order issued by the Securities and Exchange Commission ("SEC") as a result of an administrative proceeding brought against

Presstek. The following excerpts from that order, SEC Release No. 39472, demonstrate that plaintiff's allegations in this case bear only a scant resemblance to the violations for which Presstek was found liable by the SEC:Presstek violated the antifraud provisions by falsely stating in its November 7 release that Heidelberg "has sold over 500" Quickmasters, when in fact Heidelberg had merely received that many orders. (SEC Release No. 39472, at 7.)

Presstek's management directly participated in preparing a report that it knew, or was reckless in not knowing, included forecasts that were far more optimistic than Presstek's **[**41]** contemporaneous internal projections. (SEC Release No. 39472, at 9.)

Presstek also violated the antifraud provisions by disseminating various Cabot Market Letters ... that contained earnings projections that management knew, or was reckless in not knowing, greatly exceeded Presstek's own forecasts and lacked a reasonable basis ... (SEC Release No. 39472, at 10.)

Presstek violated *Section 13(a) of the Exchange Act* and *Rules 13a-1* and *12b-20* thereunder, as well as the antifraud provisions, by providing an incomplete and materially misleading disclosure in its 1995 Form 10-K concerning Heidelberg's delayed shipments of Quickmaster presses and Presstek's reduced production schedule ... [which] referred merely to a "schedule change requested by Heidelberg ..." [while] fail[ing] to describe the "schedule change" as a reduction [in Heidelberg's order from Presstek] ... [that reduced] Presstek's production rate ... by twenty-five percent. (SEC Release No. 39472, at 10.)(Pl.'s Mem. (document no. 27) Ex. F (emphasis in the original.)

While some superficial associations might be made between the violations found by the SEC and the allegations plaintiff makes **[**42]** in this case, those associations fade under even mild scrutiny. For example, in the 1997 SEC action, Presstek's disclosure of a "schedule change" was actionable fraud because Heidelberg did not merely ask Presstek to reschedule its shipments; Heidelberg substantially reduced its order - by twenty-five percent. Here, by contrast, there is no allegation that Presstek attempted to disguise a reduction in orders as a shipping or scheduling delay. Nor is there an adequate allegation that when Presstek announced shipping delays, those who made that announcement knew that the delays were the result of production issues, or could reasonably predict that there would be performance issues with the Dimension product. n8 In short, Presstek's SEC proceeding cannot bear the weight that plaintiff asks it to. If anything, comparison of the prior SEC order and plaintiff's allegations in this case suggests, rather than scienter, that Presstek may have learned a lesson and attempted to do better.

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n8 Similarly, while the SEC found that Presstek had violated the antifraud provisions by adopting and/or issuing revenue forecasts that were far more optimistic than its own internal forecasts, plaintiff in this case seeks to hold Presstek liable for making revenue projections for its entire product line that were different from the internal projections made by Xerox for two products that Presstek and Xerox planned to produce as a joint venture.

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**[**43]**

C. The Strategic Alliance with Xerox

According to plaintiff, defendants gave sales projections for 2001 that were knowingly false when made. Specifically, plaintiff points to the following report on Presstek's third-quarter 2000 financial-results conference call, which appeared on October 30, 2000, on dotprint.com:The third quarter results set the platform for what should be a bonanza year for Presstek. The company predicts sales for 2001 running 50% above this year. This will come from increasing consumables sales and from sales of the Xerox DocuColor 400, built by Adast, and the DocuColor 233, the OEM version of the Ryobi Direct Image press. Shipments of the Dimension 400 platesetter, worth $ 800,000 in Q3, are also expected to climb steeply.(Am. Compl. P 51 (emphasis added by plaintiff).) Defendants are entitled to dismissal of the Xerox-related claim because the statement at issue is a third-party statement that, like the Heidelberg statements, fails to meet the First Circuit's entanglement test.

D. The Lasertel Subsidiary

According to plaintiff, defendants materially misled investors by failing to disclose production problems experienced **[**44]** by its Lasertel subsidiary. Specifically, he points to statements published on Lasertel's website and five Presstek press releases (three reporting quarterly earnings, one commenting on "recent market conditions," and one announcing a repositioning of the Lasertel subsidiary). Plaintiff asserts that the six identified statements were materially false and misleading because they recklessly failed to disclose known problems at Lasertel. In plaintiff's view, when

Presstek made the statements a...d to be false and misleading, it was obligated to disclose that Lasertel had no consistent procedures for growing laser wafers, for acid-etching the wafers, or for reactive ion etching (due to a lack of automation). According to plaintiff, these defects in the production process caused Lasertel to produce low-quality laser diodes that lacked durability.

Defendants move to dismiss the Lasertel-related claims on grounds that: (1) they are time-barred; (2) plaintiff has not alleged any false statement concerning Lasertel; (3) the Lasertel-related statements were not misleadingly incomplete; (4) the Lasertel allegations do not adequately allege materiality; and (5) plaintiff has failed to plead **[**45]** scienter regarding the Lasertel allegations. Plaintiff counters that: (1) defendants made false and misleading statements regarding Lasertel; (2) the amended complaint pleads with particularity why those statements were false when made; (3) defendants' false statements and omissions were material; (4) defendants' misrepresentations cannot be immunized by unspecific "cautionary language;" (5) defendants' misrepresentations concerning Lasertel were not puffery; (6) Lasertel's misrepresentations and omissions were made with scienter; and (7) the Lasertel allegations are timely.

Defendant is entitled to dismissal of the Lasertel allegations because they are untimely.

According to plaintiff's amended complaint, the market realized, no later than July 26, 2001, that defendants had previously made false and misleading statements about Lasertel's viability and market-readiness. (Am. Compl. P 80.) n9 Plaintiff's original complaint was dated May 30, 2003, and was filed on June 2, 2003, while his amended complaint was dated and filed December 15, 2003.

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n9 Plaintiff now argues that the first "storm warnings" he received came in Presstek's March 29, 2002, Form 10-K for 2001, which announced the reversal of a sale due to a customer return that was related to product quality. (Pl.'s Sur-Reply (document no. 36) at 3.) Plaintiff's argument is not persuasive, given the plain affirmation, in paragraph 80 of his complaint, that the market realized, as a result of Presstek's July 26, 2001, statement, that previous Presstek statements had been false and misleading.

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**[**46]**

[HN22]Until the enactment of the *Sarbanes-Oxley Act* on July 30, 2002, "the statute of limitations applicable to ... federal securities claims barred all actions if they were filed more than one year after the discovery of the facts constituting the violation." *Glaser v. Enzo Biochem, Inc., 303 F. Supp. 2d 724, 732 (E.D. Va. 2003)* (citing *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 501 U.S. 350, 364, 115 L. Ed. 2d 321, 111 S. Ct. 2773 (1991)*). However, the Sarbanes-Oxley Act established a new, more generous statute of limitations, providing, in pertinent part:

a private right of action that involves a claim of fraud, deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning the securities laws ... may be brought not later than the earlier of (1) 2 years after the discovery [of] the facts constituting the violation, or (2) 5 years after such violation.

*Glaser, 303 F. Supp. 2d at 733* (quoting *28 U.S.C. § 1658(b)*).

Not surprisingly, plaintiff argues that this case is governed by the new, two-year statute of limitations while defendants argue that the old, one-year statute **[**47]** applies, or, in the alternative, that even if the two-year statute applies, the Lasertel allegations are still time-barred because they were first raised in the amended complaint and do not relate back to the initial complaint. Because plaintiff's claims are subject to the one-year statute of limitations, there is no need to address the question of relation back.

"The Historical and Statutory Notes [to the Sarbanes-Oxley Act] provide that [HN23]this 'limitations period ... shall apply to all proceedings addressed by this section that are commenced on or after the date of enactment of this Act [July 30, 2002].'" *Glaser, 303 F. Supp. 2d at 733* (quoting Pub. L. 107-204 § 804(b), 116 Stat. 745 (2002)). In plaintiff's view, the fact that he filed his original complaint after July 30, 2002, requires a conclusion that the two-year Sarbanes-Oxley statute of limitations applies.

However, by the time the Sarbanes-Oxley Act became effective, the applicable one-year statute of limitations had already run on plaintiff's claim. As has been widely held, [HN24]the Sarbanes-Oxley Act's enlargement of the statute of limitations for securities fraud claims did not revive claims already time-barred **[**48]** by the date of its enactment. See, e.g., *In re World-com, Inc. Sec. Litig., 2004 U.S. Dist. LEXIS 11696, No. 02 Civ.3288(DLC), 2004 WL 1435356, at *7 (S.D.N.Y. June 28, 2004)* ("Sarbanes-Oxley does not revive previously time-barred private securities fraud claims."); *Lieberman v. Cambridge Partners, L.L.C., 2004 U.S. Dist. LEXIS 11553, No. Civ.A. 03-2317, 2004 WL 1396750, at *3 (E.D. Pa. June 21, 2004)*; *Newby v. Enron, (In re Enron Corp. Sec., Derivative & "ERISA" Litig.), 2004 U.S. Dist. LEXIS 7495, No. Civ.A. H-01-3624, 2004 WL 405886, at *17 (S.D. Tex. Feb. 25, 2004); Glaser, 303 F. Supp. 2d at 734*; *Great S. Life Ins Co. v. Enter. Mortg. Acceptance Co. (In re Enter. Mortg. Acceptance Co. Sec. Litig.), 295 F. Supp. 2d 307, 317 (S.D.N.Y. 2003)*; *In re Heritage Bond Litig., 289 F. Supp. 2d 1132, 1148 (C.D. Cal. 2003).* n10 Those decisions hinge on the principle that [HN25]"while Congress may enlarge a limitations period, Congress' acts do not revive a cause of action that has become time-barred unless Congress specifically provides for retroactive application." *Glaser, 303 F. Supp. 2d at 733* (citing *Hughes Aircraft Co. v. United States ex rel. Schumer, 520 U.S. 939, 950, 138 L. Ed. 2d 135, 117 S. Ct. 1871 (1997)* **[**49]** ).

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n10 The one opinion that goes the other way, *Roberts v. Dean Witter Reynolds, Inc., 2003 U.S. Dist. LEXIS 5676, No. 8:01-CV-2115-T-26 (EAJ), 2003 WL 1936116, at *2-*4 (M.D. Fla. Mar. 31, 2003)*, relies largely on legislative history, and has been widely criticized. See, e.g., *Lieberman, 2004 U.S. Dist. LEXIS 11553, 2004 WL 1396750, at *3 n.12* ("Roberts ... reached the opposite conclusion, but its reasoning rests on unpersuasive citations to the [Sarbanes-Oxley Act]'s legislative history. The Court agrees with those courts that have concluded that Roberts should be rejected.") (citing *Enron, 2004 U.S. Dist. LEXIS 7495, 2004 WL 405886, at *12 n.39*; *Enter. Mortgage, 295 F. Supp. 2d at 316-17*).

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Here, the Sarbanes-Oxley Act does not provide for retroactive application and, as a consequence, plaintiff's claim is governed by the one-year statute of limitations, under which he had until June 25, 2002, to file suit based upon the Lasertel allegations. He did not do so. By the time he did file his initial complaint, in 2003, any **[**50]** claim based upon the Lasertel allegations was time-barred. Accordingly, defendants are entitled to dismissal of the Lasertel allegations.

**Conclusion**

Plaintiff has failed to state a claim under *section 10(b) of the Securities Exchange Act, and*, because he has no *section 10(b)* claim, his claim under *section 20(a)* must necessarily fail. See *Aldridge, 284 F.3d at 84* [HN26]("there must be a primary violation [of *section 10(b)*] for liability under *section 20(a)*"); *Greebel, 194 F.3d at 207* (citing *Suna, 107 F.3d at 72*). Accordingly, defendants' motions to dismiss (document nos. 23 and 25) are granted. The Clerk of the Court shall enter judgment in accordance with this order and close the case.

**SO ORDERED.**

Steven J. McAuliffe

United States District Judge

September 30, 2004

# EXHIBIT 14

ZURICH CAPITAL MARKETS INC., et al., Plaintiffs, v. MICHAEL COGLIANESE, et al., Defendants.

No. 03 C 7960

UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION

2004 U.S. Dist. LEXIS 19432; Fed. Sec. L. Rep. (CCH) P92,926

September 22, 2004, Decided
September 23, 2004, Docketed

**SUBSEQUENT HISTORY:** Related proceeding at *Waldock v. M.J. Select Global, Ltd., 2004 U.S. Dist. LEXIS 23844 (N.D. Ill., Oct. 6, 2004)*

**PRIOR HISTORY:** *Zurich Capital Mkts., Inc. v. Coglianese, 332 F. Supp. 2d 1087, 2004 U.S. Dist. LEXIS 14908 (N.D. Ill., 2004)*

**DISPOSITION:** Oceanic Defendants' motion to dismiss granted in part and denied in part.

**CASE SUMMARY**

**PROCEDURAL POSTURE:** Plaintiffs, a Delaware corporation and related entities, sued defendants, including three movants, i.e., a bank that was the administrator of a Bahamian mutual fund, and two of the fund's directors, one of whom is referred to hereafter as "R." The case alleged violations of federal securities law, Illinois law, and Bahamian law. Movants sought dismissal of plaintiffs' amended complaint pursuant to *Fed. R. Civ. P. 12(b)(1)*, *12(b)(2)*, and *12(b)(6)*.

**OVERVIEW:** Movants claimed that the court lacked subject matter jurisdiction and personal jurisdiction. They also argued lack of standing, and that the amended complaint was untimely, and failed to state a claim. Referencing the "conduct" and "effects" approaches, the court found that the allegations were sufficient to confer subject matter jurisdiction over Count II, brought under § 10(b) of the Securities Exchange Act of 1934 (SEA), and III, a control person liability claim brought under § 20(a) of the SEA. Regarding personal jurisdiction, because Count III remained against movants, the jurisdictional provisions of the SEA applied, and the court ultimately exercised personal jurisdiction over movants. It also exercised supplemental jurisdiction. With respect to the bank, Count II was dismissed as untimely, but Count III survived. Defendants' standing argument was rejected. The court next found that the allegations in Count II against movant "R" were sufficient to survive dismissal, but scienter was not adequately alleged. Thus, as to "R," Count II was dismissed without prejudice. Count III survived. The court subsequently addressed the Illinois and Bahamian law claims.

**OUTCOME:** Movants' motion to dismiss was granted in part and denied in part. It was granted with respect to Count II. Count II was dismissed with prejudice as to the bank, and without prejudice as to defendant "R." It was also granted without prejudice as to Counts VII, IX and XI. It was denied as to Counts III, VIII, X, XII through XV, XVII and XVIII.

**CORE TERMS:** redemption, statute of limitations, personal jurisdiction, securities fraud, motion to dismiss, plead, subject matter jurisdiction, misrepresentation, inquiry notice, particularity, time-barred, website, resident, partnership, conversion, omission, offering, fraudulent, scienter, sole owner, continuous, tolling, issuer, dealer, shield, systematic, fraudulent scheme, cause of action, underwriter, limitations period

**LexisNexis(TM) Headnotes**

***Civil Procedure > Pleading & Practice > Defenses, Objections & Demurrers > Motions to Dismiss***
[HN1]A *Fed. R. Civ. P. 12(b)(1)* motion to dismiss tests the federal jurisdiction of a complaint. *Fed. R. Civ. P. 12(b)(1)*. Plaintiffs bear the burden of proving the existence of subject matter jurisdiction. In analyzing a Rule 12(b)(1) motion, the court may look beyond the pleadings. The court must accept all well-pleaded factual allegations as true and draw all reasonable inferences in favor of the plaintiff.

***Civil Procedure > Pleading & Practice > Defenses, Objections & Demurrers > Motions to Dismiss***
[HN2]A *Fed. R. Civ. P. 12(b)(2)* motion to dismiss for lack of personal jurisdiction tests whether a federal court has personal jurisdiction over a defendant. *Fed. R. Civ. P. 12(b)(2)*. Similar to subject matter jurisdiction, a plaintiff has the burden of demonstrating the existence of personal jurisdiction over a defendant. A plaintiff need only make a prima facie case that jurisdiction over a defendant is proper. In determining whether a plaintiff has met this burden, a court may consider affidavits from both parties. The court must accept as true all allegations in the complaint which are not challenged by a defendant's affidavit; any conflicts in the affidavits must be resolved in favor of the plaintiff.

***Civil Procedure > Pleading & Practice > Defenses, Objections & Demurrers > Failure to State a Cause***

***of Action***

[HN3]The purpose of a motion to dismiss under *Fed. R. Civ. P. 12(b)(6)* is to test the sufficiency of the complaint, not to decide the merits of the case. When deciding a motion to dismiss pursuant to Rule 12(b)(6), the court views the complaint in the light most favorable to the plaintiff, taking as true all well-pleaded factual allegations and making all possible inferences from those allegations in his or her favor. Dismissal is appropriate only where it appears beyond doubt that under no set of facts would plaintiff's allegations entitle him or her to relief.

***Securities Law > Additional Offerings, Disclosure & the Securities Exchange Act of 1934 > Scope & Jurisdiction > Federal Jurisdiction***

[HN4]A securities fraud claim involving foreign transactions must comply with either the "conduct" or the "effects" approach in order to confer subject matter jurisdiction on a federal court. These two approaches focus on whether the activity in question has had a sufficient impact on or relation to the United States, its markets or its citizens to justify American regulation of the situation. Specifically, one approach focuses on the domestic conduct in question, and the other focuses on the domestic effects resulting from the transaction at issue. Under the effects approach, courts have looked to whether conduct occurring in foreign countries had caused foreseeable and substantial harm to interests in the United States. As for the conduct approach, federal courts have jurisdiction over an alleged violation of the antifraud provisions of the securities laws when the conduct occurring in the United States directly causes the plaintiff's alleged loss in that the conduct forms a substantial part of the alleged fraud and is material to its success. This conduct must be more than merely preparatory in nature; however, it is not required that the conduct occurring domestically must itself satisfy the elements of a securities violation.

***Securities Law > Additional Offerings, Disclosure & the Securities Exchange Act of 1934 > Scope & Jurisdiction > Federal Jurisdiction***

[HN5]See *15 U.S.C.S. § 78aa.*

***Civil Procedure > Jurisdiction > Personal Jurisdiction & In Rem Actions > Constitutional Limits***

***Civil Procedure > Jurisdiction > Personal Jurisdiction & In Rem Actions > Personal Jurisdiction***

***Securities Law > Additional Offerings, Disclosure & the Securities Exchange Act of 1934 > Scope & Jurisdiction > Federal Jurisdiction***

[HN6]Service of process is how a court gets jurisdiction over the person. Because the Securities Exchange Act of 1934 provides for nationwide service of process, it confers personal jurisdiction in federal court over defendants with minimum contacts with the United States, as long as the mandates of constitutional due process are met. *Fed. R. Civ. P. 4(k)(2)* states that if the exercise of jurisdiction is consistent with the Constitution and laws of the United States, serving a summons is also effective, with respect to claims arising under federal law, to establish personal jurisdiction over the person of any defendant who is not subject to the jurisdiction of the courts of general jurisdiction of any state.

***Civil Procedure > Jurisdiction > Personal Jurisdiction & In Rem Actions > Constitutional Limits***

[HN7]Federal due process requires that each defendant have certain minimum contacts with the United States such that the maintenance of the suit does not offend traditional notions of fair play and substantial justice. The defendants' contacts with the United States must be such that they should reasonably anticipate being haled into court there. Each defendant must have purposefully availed himself or herself of the privilege of conducting activities in the forum state, invoking the benefits and protections of its laws. The minimum contacts standard varies depending on whether the plaintiff asserts general or specific jurisdiction.

***Civil Procedure > Jurisdiction > Personal Jurisdiction & In Rem Actions > Personal Jurisdiction***

[HN8]General jurisdiction is proper when the defendant has continuous and systematic general business contacts with the forum. Specific jurisdiction exists if the claims arise out of or relate to the defendant's contacts with the forum.

***Civil Procedure > Jurisdiction > Personal Jurisdiction & In Rem Actions > Constitutional Limits***

[HN9]A party's assertion of jurisdiction must be reasonable in light of the burden on the defendant, the plaintiff's interest in obtaining relief, the interests of State, the judicial system's interest in efficiently resolving controversies, and the shared interest of the several States in furthering fundamental substantive social policies. The court must determine whether a case is one of these rare cases in which minimum requirements inherent in the concept of fair play and substantial justice defeat the reasonableness of jurisdiction.

***Civil Procedure > Jurisdiction > Personal Jurisdiction & In Rem Actions > Constitutional Limits***

***Securities Law > Additional Offerings, Disclosure & the Securities Exchange Act of 1934 > Scope & Jurisdiction > Federal Jurisdiction***

[HN10]The United States has a substantial interest in the enforcement of its securities laws and the protection of investors in the United States securities markets. Illinois also has an interest in enforcing its securities laws.

*Civil Procedure > State & Federal Interrelationships > Application of State Law*

*Securities Law > Bases for Liability > Misleading Statements*
[HN11]The fiduciary shield doctrine is a matter of state law only, not federal law. Accordingly, it does not apply to federal securities fraud claims.

*Civil Procedure > Jurisdiction > Personal Jurisdiction & In Rem Actions > Personal Jurisdiction*
[HN12]It is clear that the fiduciary shield doctrine is discretionary or equitable, rather than an absolute entitlement. There are two exceptions to the doctrine: (1) the shield is removed if the individual's personal interests motivated his actions, and (2) the shield generally does not apply when the individual's actions are discretionary.

*Civil Procedure > Jurisdiction > Subject Matter Jurisdiction > Supplemental Jurisdiction*
[HN13]Where a court has personal jurisdiction over the defendants, it also can assert personal jurisdiction over state law claims under the doctrine of "supplemental" or "pendent" personal jurisdiction.

*Civil Procedure > Pleading & Practice > Defenses, Objections & Demurrers > Failure to State a Cause of Action*

*Governments > Legislation > Statutes of Limitations > Statutes of Limitations Generally*
[HN14]If a plaintiff pleads facts that show its suit is barred by a statute of limitations, it may plead itself out of court under a *Fed. R. Civ. P. 12(b)(6)* analysis. Because the question of whether a plaintiff had sufficient facts to place it on inquiry notice of a claim for securities fraud is one of fact, it may be inappropriate for resolution on a motion to dismiss under Rule 12(b)(6).

*Governments > Legislation > Statutes of Limitations > Time Limitations*

*Securities Law > Bases for Liability > Misleading Statements*
[HN15]Prior to July 30, 2002, a plaintiff had to file an action pursuant to § 10(b) of the Securities Exchange Act of 1934 within one year after the discovery of the facts constituting the violation and within three years after such violation. On July 30, 2002, Congress enacted the Sarbanes-Oxley Act and expanded the limitations period for such claims involving fraud, deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning the securities laws to two years after the discovery of the facts constituting the violation and within five years after such violation. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 804, 116 Stat. 745, 801 (2002) *(28 U.S.C.S. 1658*(b)). Section 804(b) of the Sarbanes-Oxley Act specifically provides that the expanded limitations period shall apply to all proceedings addressed by this section that are commenced on or after the date of enactment of the Act.

*Governments > Legislation > Statutes of Limitations > Statutes of Limitations Generally*

*Securities Law > Bases for Liability > Misleading Statements*
[HN16]The U.S. Court of Appeals for the Seventh Circuit has embraced the concept that courts may not apply a statute that lengthens an applicable statute of limitations to revive claims that are otherwise time-barred under the old statute of limitations because to do so would alter the substantive rights' of a party and increase a party's liability. Numerous courts have applied this concept to the extension of the statute of limitations in securities fraud cases of the Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745, and held that the extended limitations period does not apply to claims that were time-barred when Congress enacted Sarbanes-Oxley. The U.S. District Court for the Northern District of Illinois, Eastern Division, agrees with the reasoning of these decisions. The plain language of the statute does not clearly reflect a Congressional intention to apply the extended limitations period retroactively to revive time-barred claims.

*Governments > Legislation > Statutes of Limitations > Time Limitations*

*Securities Law > Bases for Liability > Misleading Statements*
[HN17]Because it is often difficult for a plaintiff to know that he or she has been the victim of securities fraud until years after the commission of the fraud, the statute of limitations for federal securities fraud claims commences under the doctrine of "inquiry notice." Under inquiry notice, the statute of limitations applicable to suits under S.E.C. Rule 10b-5 begins to run not when the fraud occurs, and not when the fraud is discovered, but when (often between the date of occurrence and the date of the discovery of the fraud) the plaintiff learns, or should have learned through the exercise of ordinary diligence in the protection of one's legal rights, enough facts to enable him by such further investigation as the facts would induce in a reasonable person to sue within a year. For inquiry notice, more than merely suspicious circumstances must exist. The facts constituting such notice must be sufficiently probative of fraud--sufficiently advanced beyond the stage of a mere suspicion, sufficiently confirmed or substantiated--not only to incite the victim to investigate but also to enable him to tie up any loose ends and complete the investigation in time to file a timely suit.

*Governments > Legislation > Statutes of Limitations > Time Limitations*

*Securities Law > Bases for Liability > Misleading Statements*

[HN18]In the context of federal securities law, one important factor courts consider in determining when the statute of limitations begins is a party's ease of access to evidence that would trigger an appropriate inquiry. Additionally, there must also be a suspicious circumstance to trigger a duty to exploit the access; an open door is not by itself a reason to enter a room. How suspicious the circumstance need be to set the statute of limitations running will depend on how easy it is to obtain the necessary proof by a diligent investigation aimed at confirming or dispelling the suspicion.

*Governments > Legislation > Statutes of Limitations > Tolling*

*Securities Law > Bases for Liability > Misleading Statements*

[HN19]When knowledge or notice is required to start the statute of limitations running, there is no room for equitable tolling. Equitable tolling does not apply to the statute of limitations in a securities fraud case.

*Civil Procedure > Pleading & Practice > Pleadings > Heightened Pleading Requirements*

*Securities Law > Bases for Liability > Misleading Statements*

*Securities Law > Bases for Liability > Private Securities Litigation*

[HN20]Regarding a securities fraud under § 10(b) of the Securities Exchange Act of 1934 and S.E.C. Rule 10b-5, plaintiffs must allege that the defendant (1) made a false statement or omission; (2) of a material fact; (3) with scienter; (4) in connection with the purchase or sale of securities; (5) upon which plaintiffs justifiably relied; and (6) the reliance proximately caused the plaintiffs' damages. Both *Fed. R. Civ. P. 9(b)* and the Private Securities Litigation Reform Act of 1995 (PSLRA) apply to these allegations and impose heightened pleading requirements on plaintiffs. *Fed. R. Civ. P. 9(b)* requires that plaintiffs plead fraud allegations with particularity. In addition to Rule 9(b), the strict pleading mandates of the PSLRA apply to plaintiffs' complaint. In order to meet the PSLRA's dictates for a securities fraud claim, the complaint shall specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed. *15 U.S.C.S.* § *78u-4*(b)(1).

*Securities Law > Bases for Liability > Misleading Statements*

[HN21]A duty to disclose arises if a defendant makes a statement that would be misleading without disclosing certain other information. If one speaks, he must speak the whole truth.

*Securities Law > Bases for Liability > Private Securities Litigation*

[HN22]See *15 U.S.C.S.* § *78u-4*(b)(2).

*Securities Law > Bases for Liability > Private Securities Litigation*

[HN23]Plaintiffs may use "motive and opportunity" or circumstantial evidence to establish scienter under the Private Securities Litigation Reform Act of 1995, as long as the allegations support a strong inference that the defendants acted recklessly or knowingly when they made the alleged misrepresentations.

*Civil Procedure > Pleading & Practice > Pleadings > Heightened Pleading Requirements*

*Securities Law > Bases for Liability > Controlling Persons Liability*

[HN24]In order to allege a claim pursuant to § 20(a) of the Securities Exchange Act of 1934, plaintiffs must allege (1) a primary securities violation; (2) each of the individual defendants exercised general control over the operations of the mutual fund, and (3) each of the individual defendants possessed the power or ability to control the specific transaction or activity upon which the primary violation was predicated, whether or not that power was exercised. *Fed. R. Civ. P. 9(b)*'s particularity requirements apply.

*Securities Law > Bases for Liability > Controlling Persons Liability*

[HN25]In the context of § 20(a) of the Securities Exchange Act of 1934, general control requires the plaintiff to allege that the defendants actually participated in, that is, exercised control over, the operations of the mutual fund in general.

*Securities Law > Blue Sky Laws > Civil Liability*

[HN26]See 815 Ill. Comp. Stat. 5/13A.

*Securities Law > Blue Sky Laws > Civil Liability*

[HN27]See *815 Ill. Comp. Stat. 5/2.4*.

*Securities Law > Blue Sky Laws > Civil Liability*

[HN28]Unlike the Securities Exchange Act of 1934, where "controlling persons" may be read broadly to reach many parties, the Illinois Securities Law of 1953, *815 Ill. Comp. Stat. 5/1* et seq., has been applied only to persons playing central and specialized roles. Moreover, while overt action by a member of a controlling group would not always be required, there must be some showing of assent, approval or concurrence, albeit tacit approval, in the action of the group in selling securities, before an individual will be held liable for the actions of the controlling group. A person is not liable merely because one cannot add his shareholding onto the holdings of a controlling group and they still remain a controlling group. Some connection with the sale, or decision to sell, securities is required under the statute.

***Torts > Business & Employment Torts > Deceit & Fraud***

[HN29]The elements of a claim for fraud in Illinois are: (1) a false statement of material fact; (2) knowledge or belief of the falsity by the party making the statement; (3) intention to induce the other party to act; (4) action by the other party in reliance on the truth of the statements; and (5) damage to the other party resulting from such reliance.

***Torts > Business & Employment Torts > Deceit & Fraud***

***Torts > Multiple Defendants > Conspiracy***

[HN30]In order to state a claim for conspiracy to defraud in Illinois, a plaintiff must allege (1) a conspiracy; (2) an overt act of fraud in furtherance of the conspiracy; and (3) damages to the plaintiff as a result of the fraud.

***Civil Procedure > Pleading & Practice > Pleadings > Interpretation***

[HN31]A plaintiff may plead in the alternative. *Fed. R. Civ. P. 8(e)(2).*

***Torts > Intentional Torts > Conversion***

[HN32]A conversion is any unauthorized act that deprives a person of his or her or its property permanently or for an indefinite time. In order to state a claim for conversion in Illinois, a plaintiff must allege that (1) it has a right to the property at issue; (2) it has an absolute and unconditional right to the immediate possession of that property; (3) it made a demand on the defendant for possession of the property; and (4) the defendant wrongfully and without authorization assumed control, dominion, or ownership over the property. An asserted right to money normally will not support a claim for conversion. Only if the money at issue can be described as specific chattel, in other words, a specific fund or specific money in coin or bills, will conversion lie. Moreover, the plaintiff's right to the money must be absolute. It must be shown that the money claimed, or its equivalent, at all times belonged to the plaintiff and that the defendant converted it to his own use.

***Torts > Business & Employment Torts > Interference With a Contract***

[HN33]In order to state a claim in Illinois for tortious interference with a contract, a plaintiff must allege the following elements: (1) the existence of a valid and enforceable contract between plaintiffs and another, (2) the defendant's awareness of the contract; (3) an intentional interference by the defendant inducing breach of contract; (4) a breach of contract caused by the defendant's acts; and (5) damages to the plaintiff.

***International Law > Dispute Resolution > Comity Doctrine***

***International Law > Dispute Resolution > Conflicts of Laws***

[HN34]Although under international law, a state may not exercise authority to enforce law that it has no jurisdiction to prescribe, *Restatement (Third) of Foreign Relations Law § 431* cmt. (a) (1987), for the purposes of this § 431, a judgment of a court awarding or denying damages in a civil action would generally not be seen as enforcement. *Restatement (Third) of Foreign Relations Law § 431*, cmt. b.

***International Law > Dispute Resolution > Conflicts of Laws***

[HN35]A party may raise, and the court is authorized to determine, an issue concerning the law of a foreign country. *Fed. R. Civ. P. 44.1.* Indeed, Rule 44.1 provides that a party who intends to raise an issue concerning the law of a foreign country shall give notice by pleadings or other reasonable written notice. This rule contemplates that federal courts can entertain questions of foreign law.

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**JUDGES:** AMY J. ST. EVE, District Court Judge.

**OPINIONBY:** Amy J. *St Eve

**OPINION: MEMORANDUM OPINION AND ORDER**

This is a securities fraud action against multiple defendants in connection with Plaintiffs' investment in an allegedly fraudulent scheme executed by Defendants through M.J. Select Global Fund, Ltd. ("M.J. Select"), a Bahamian mutual fund. The Court previously addressed the motions to dismiss filed by multiple Defendants. *See Zurich Capital Markets Inc. v. Coglianese, et al., 332 F. Supp. 2d 1087, 2004 U.S. Dist. LEXIS 14908, No. 03 C 7960, 2004 WL 1881782 (N.D. Ill. Aug. 2, 2004)* (the "August 2, 2004 Opinion"). In this opinion, the Court rules on the issues raised by Defendants Oceanic Bank and Trust Limited, Kenneth Clowes, and Terah Rahming (collectively, the "Oceanic Defendants") in their motion to dismiss.

The Oceanic Defendants have moved to dismiss ZCM's Amended Complaint pursuant to *Federal Rules of Civil Procedure 12(b)(1)*, *12(b)(2)* and *12(b)(6)*. Defendants claim that **[*6]** the Court lacks subject matter jurisdiction over the Amended Complaint and personal jurisdiction over each of the Oceanic Defendants. They also argue that ZCM lacks standing to assert the claims, and that the Amended Complaint is untimely and fails to state a claim upon which relief can be granted. As discussed in detail below, Defendants' motion is granted in part and denied in part.

**BACKGROUND**

Plaintiffs allege that the Oceanic Defendants and their co-Defendants engaged in a complex scheme to defraud Plaintiffs out of over $ 24 million. The details of the alleged fraud are set forth in the Court's August 2, 2004 Opinion and will not be repeated here.

**I. Factual Allegations**

Plaintiff Zurich Capital Markets Inc. ("ZCM Inc.") is a Delaware corporation and was one of the world's largest custodians of hedge funds. Plaintiff ZCM Matched Funding Corp., a Delaware corporation, ("ZCM MFC") is a wholly owned subsidiary of ZCM Inc., and specializes in the offering and sale of derivative instruments. ZCM Bermuda is a Bermuda corporation and an affiliate of ZCM Inc. that operates as a holding company for offshore investments. Plaintiff ZCM Asset Holding Company LLC ("ZCM Asset") **[*7]** is a Delaware corporation and a wholly owned subsidiary of ZCM Inc. that operates as a holding company for offshore investments. Collectively, Plaintiffs are referred to as "ZCM."

Defendant Oceanic is the administrator, registrar, and transfer agent of M.J. Select, with its principal place of business in the Bahamas. ZCM alleges that Oceanic transacted business through its agents in Illinois, and had systematic and continuous contacts with Illinois. (*Id.*)

Defendant Terah Rahming, a citizen of the Bahamas, was a director of M.J. Select and was employed by Oceanic as the Manager of the Funds Department. ZCM alleges that Rahming transacted business through her agents in Illinois and had systematic and continuous contacts with Illinois.

Defendant Kenneth Clowes, also a citizen of the Bahamas, was a director of M.J. Select and the Chief Operating Officer of Oceanic. ZCM alleges that he transacted business through his agents in Illinois, and had systematic and continuous contacts with Illinois, in his role as M.J. Select Director and Oceanic's Chief Operating Officer.

**A. Oceanic's Role in the Scheme**

ZCM alleges that the Oceanic Defendants were integral to the fraudulent scheme **[*8]** carried out by all of the defendants in connection with the investment scheme in M.J. Select. Plaintiffs allege that Oceanic became administrator, registrar and transfer agent of M.J. Select in 1998. In that role, Oceanic was responsible for the day-to-day administration of M.J. Select, including the transfer of assets into and out of M.J. Select and the processing of redemption requests.

Asset Allocation Fund, L.P. ("Asset Allocation") was M.J. Select's first and largest investor. Martin James Capital Management, Inc. ("Martin James") served as the general partner of Asset Allocation, and Martin Allamian was the sole owner and principal of Martin James. Martin James also invested two other partnerships under its control -- M.J. Diversified Fund, L.P. ("MJD") and M.J. Financial Arbitrage, L.P. ("MJFA") -- in M.J. Select.

ZCM alleges that Oceanic appointed M.J. Select's board of directors in 1999. It named its employees -- Defendants Rahming and Clowes - as the sole directors. In this capacity, Rahming and Clowes assumed control over M.J. Select.

**B. The Assignment Recognition Letter**

As discussed in detail in the August 2, 2004 Opinion, in May 2000, ZCM MFC entered into a call **[*9]** option transaction with Asset Allocation which was a derivative instrument. Under the terms of the call option, ZCM MFC agreed to accept an assignment of Asset Allocations' interests in various investments, including M.J. Select, MJD and MJFA, as an initial premium payment to acquire the option transaction. Before ZCM MFC would accept this assignment, however, it required, among other things, a written confirmation from Oceanic that it would recognize the assignments and ZCM MFC as the sole owner of 100% of the interests in these entities formerly held by Asset Allocation. In response, Coglianese arranged for Rahming to sign the confirmation on behalf of M.J. Select and Oceanic.

The confirmation -- referred to as an "assignment recognition letter" -- allegedly fraudulently induced ZCM into investing millions of dollars into M.J. Select. ZCM alleges that the May 31, 2000 "assignment recognition letter" falsely represented that Oceanic would recognize ZCM MFC as the sole owner of 100% of the shares in M.J. Select that had previously been invested under the name of Asset Allocation. They further allege that Oceanic and Rahming falsely represented that ZCM MFC "as sole owner . . . will **[*10]** have all of the rights and privileges that normally accompany such ownership." In addition, ZCM alleges that Rahming and Oceanic fraudulently omitted that M.J. Select had a discriminatory redemption policy and that ZCM's share interests were not effectively redeemable consistent with the offering documents.

Based, in part, on the assignment confirmation letter, ZCM MFC accepted an assignment of Asset Allocations interests in M.J. Select, MJD and MJFA. In 2001, ZCM instructed Oceanic to redeem its interests in M.J. Select. Contrary to its representations, Oceanic did not redeem ZCM's shares. Instead, Oceanic honored subsequently submitted redemption requests made on behalf of co-defendants Coglianese's and Martin James' friends, family and business associates. ZCM still has not received its redemptions.

**II. The 2001 ZCM Action**

On August 14, 2001, ZCM Bermuda filed a securities fraud action against Oceanic and various other defendants (the "2001 Action"). The 2001 Action was based on the defendants' "fraudulent offering, conversion, and transfer of limited partnership interests" in MJD, MJFA and M.J. Select. ZCM Bermuda alleged that Oceanic "affirmatively represented in the **[*11]** offering documents that the partnership interests and shares would be readily redeemable on short notice, and Plaintiff relied upon those representations of liquidity in making its investments."

Count I of the 2001 Action alleged that Oceanic and other defendants misrepresented that the plaintiff's shares in M.J. Select were redeemable within 30 days written notice. They alleged that defendants, including Oceanic, instead intended to control, convert, and transfer the plaintiff's interests regardless of Plaintiff's redemption demands.

On October 10, 2001, ZCM Bermuda filed an amended complaint adding ZCM, Inc., ZCM Matched Funding Corp. and ZCM Asset Holding Company LLC as plaintiffs to the 2001 Action and numerous defendants to that case. In addition, plaintiffs alleged in the amended complaint that Oceanic, with two of its co-defendants, controlled M.J. Select. On January 1, 2002, ZCM filed a second amended complaint in the 2001 Action.

On March 25, 2002, Judge Lindberg granted Oceanic's motion to dismiss the second amended complaint in the 2001 ZCM Action. The court dismissed the case with respect to Oceanic with prejudice on the ground that ZCM had failed to plead the *Rule 10b-5* **[*12]** claim against Oceanic with particularity pursuant to *Rule 9(b)* and had failed to plead scienter under the Private Securities Litigation Reform Act of 1995, *15 U.S.C. § 78u-4(b)* (the "PSLRA"). The court further found that ZCM had failed to plead that Oceanic had a duty to disclose.

On August 30, 2002, the 2001 Action was transferred to this Court. *See 766347 Ontario Ltd. v. Zurich Capital Markets, Inc., 249 F. Supp.2d 974 (N.D. Ill. 2003)* for a discussion of the case.

**ANALYSIS**

**I. Legal Standards**

The Oceanic Defendants bring this motion pursuant to *Rules 12(b)(1), 12(b)(2)* and *12(b)(6)*. [HN1]A *Rule 12(b)(1)* motion to dismiss tests the federal jurisdiction of a complaint. *See Fed. R. Civ. P. 12(b)(1)*. Plaintiffs bear the burden of proving the existence of subject matter jurisdiction. *Int'l Harvester Co. v. Deere & Co., 623 F.2d 1207, 1210 (7th Cir. 1980)*. In analyzing a *Rule 12(b)(1)* motion, the Court may look beyond the pleadings. *See Long v. Shorebank Dev. Corp., 182 F.3d 548, 554 (7th Cir. 1999)*; *Int'l Harvester, 623 F.2d at 1210*. The Court **[*13]** must accept all well-pleaded factual allegations as true and draw all reasonable inferences in favor of the plaintiff. *Long, 182 F.3d at 554*.

[HN2]A *Rule 12(b)(2)* motion to dismiss for lack of personal jurisdiction tests whether a federal court has personal jurisdiction over a defendant. *See Fed. R. Civ. P. 12(b)(2)*. Similar to subject matter jurisdiction, a plaintiff has the burden of demonstrating the existence of personal jurisdiction over a defendant. *Jennings v. AC Hydraulic A/S, 383 F.3d 546, 2004 U.S. App. LEXIS 18683, No. 03-2157, 2004 WL 1965661, at * 1 (7th Cir. Sept. 2, 2004)*; *RAR, Inc. v. Turner Diesel, Ltd., 107 F.3d 1272, 1276 (7th Cir. 1997)*. A plaintiff need only make a prima facie case that jurisdiction over a defendant is proper. *Hyatt Int'l Corp. v. Coco, 302 F.3d 707, 713 (7th Cir. 2002)*. In determining whether a plaintiff has met this burden, a court may consider affidavits from both parties. *Turnock v. Cope, 816 F.2d 332, 333 (7th Cir. 1987)*. The court must accept as true all allegations in the complaint which are not challenged by a defendant's affidavit; any conflicts in the affidavits **[*14]** must be resolved in favor of the plaintiff. *Id.*

[HN3]The purpose of a motion to dismiss under *Rule 12(b)(6)* is to "test the sufficiency of the complaint, not to decide the merits" of the case. *Triad Assocs., Inc. v. Chicago Housing Auth., 892 F.2d 583, 586 (7th Cir. 1989)*. When deciding a motion to dismiss pursuant to *Rule 12(b)(6)*, the Court views "the complaint in the light most favorable to the plaintiff, taking as true all well-pleaded factual allegations and making all possible inferences from those allegations in his or her favor." *Lee v. City of Chicago, 330 F.3d 456, 459 (7th Cir. 2003)*. Dismissal is appropriate only where it appears beyond doubt that under no set of facts would plaintiff's allegations entitle him or her to relief. *See Henderson v. Sheahan, 196 F.3d 839, 846 (7th Cir. 1999)*.

**II. Subject Matter Jurisdiction**

The Court will first address the issue of subject matter jurisdiction. The Oceanic Defendants argue that the Court lacks subject matter jurisdiction over ZCM's federal securities fraud claims because the dispute exists between ZCM Bermuda, a Bermuda corporation, and Oceanic, a Bahamian corporation. **[*15]** As addressed in the Court's August 2, 2004 Opinion, [HN4]a securities fraud claim involving foreign transactions must comply with either the "conduct" or the "effects" approach in order to confer subject matter jurisdiction on a federal court. *See Kauthar SDN BHD v. Sternberg, 149 F.3d 659, 665 (7th Cir. 1998)*. "These two approaches . . . focus on whether the activity in question has had a sufficient impact on or relation to the United States, its markets or its citizens to justify American regulation of the situation. Specifically, one approach focuses on the domestic conduct in question, and the other focuses on the domestic effects resulting from the transaction at issue." *Id.*

Under the effects approach, "courts have looked to whether conduct occurring in foreign countries had caused foreseeable and substantial harm to interests in the United States." *Tamari v. Bache & Co. (Lebanon) S.A.L., 730 F.2d 1103, 1108 (7th Cir. 1984)*. As for the conduct approach, "federal courts have jurisdiction over an alleged violation of the antifraud provisions of the securities laws when the conduct occurring in the United States directly causes the plaintiff's alleged **[*16]** loss in that the conduct forms a substantial part of the alleged fraud and is material to its success. This conduct must be more than merely preparatory in nature; however, we do not go so far as to require that the conduct occurring domestically must itself satisfy the elements of a securities violation." n1 *Kauthar, 149 F.3d at 667*.

- - - - - - - - - - - - - - Footnotes - - - - - - - - - - - - - - -

n1 *See* August 2, 2004 Opinion for a comparison of the different approaches the Courts of Appeals have established regarding the extent of conduct in the United States that will trigger subject matter jurisdiction over foreign securities fraud claims. *Zurich Capital Markets Inc. v. Coglianese, 2004 U.S. Dist. LEXIS 14908, No. 03 C 7960, 2004 WL 1881782, at *29 n.10 (N.D. Ill. Aug. 2, 2004)*.

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ZCM alleges in Count II that Rahming and Oceanic made false and misleading statements and omissions on or about May 31, 2000 in connection with the purchase and sale of securities issued by M.J. Select. ZCM alleges that M.J. Select's shares were offered and sold in the United States to **[*17]** United States' investors as a premium payment from Asset Allocation, an Illinois limited partnership. ZCM alleges that Coglianese and/or Martin James prepared the fraudulent assignment recognition agreement in Illinois, and that Martin James faxed a copy of the blank assignment confirmation to Coglianese, an Illinois resident, who arranged for Rahming to sign it. The Court draws the reasonable inference that one of these Illinois residents contacted Rahming for the purpose of signing it. ZCM further alleges that Oceanic and Rahming mailed the May 31, 2000 letter to ZCM in New York in order to induce them to invest in M.J. Select. They allege that Oceanic and Rahming had frequent communications with Coglianese, an Illinois resident, and the Coglianese Accounting Entities, one of which is an Illinois professional corporation and one is an Illinois corporation, regarding the promotion of M.J. Select securities and the daily operations of M.J. Select. Plaintiffs allege that Oceanic and Rahming conspired with Martin James in Illinois to treat Martin James and Asset Allocation, Illinois entities, as the owners of ZCM's shares and to improperly convert ZCM's redemption proceeds to insiders **[*18]** in the United States. These allegations are sufficient to confer subject matter jurisdiction over Count II.

Regarding ZCM's control person claim in Count III, ZCM has alleged both that Defendants caused foreseeable harm to United States' interests and that conduct within the United States was material to Defendants' successful completion of the allegedly fraudulent scheme. ZCM alleges that the Oceanic Defendants were control persons of M.J. Select. They allege that defendants in Illinois prepared and circulated the false misrepresentations in the M.J. Select offering materials, and that various co-defendants who are Illinois residents offered and sold M.J. Select's shares in the United States. ZCM alleges that Illinois accountants and auditors sent fraudulent M.J. Select financial statements to the Ocean efendants, who in turn sent them to United States' investors. ZCM further alleges that ZCM MFC, a Delaware corporation, accepted shares in M.J. Select as a premium payment from Asset Allocation, an Illinois limited partnership, in exchange for carrying out the call option transaction. Defendants, according to Plaintiffs, funneled substantial sums from the fraudulent scheme to the **[*19]** Coglianese Defendants in Illinois. Based on these allegations, this Court has subject matter jurisdiction over Count III.

**III. Personal Jurisdiction**

The Oceanic Defendants also seek to dismiss the complaint for lack of personal jurisdiction. They argue that they did not have continuous and systematic business contacts that would provide this Court with personal jurisdiction over them.

**A. Federal Claims**

Because Count III remains against Oceanic, Clowes, and Rahming n2, the jurisdictional provisions of the *Securities Exchange Act* apply. Specifically, *Section 27 of the Act* provides, in relevant part:

[HN5]Any suit or action to enforce any liability or duty created by this chapter or rules and regulations thereunder, or to enjoin any violation of such chapter or rules and regulations, may be brought in any ... district [wherein any act or transaction constituting the violation occurred] or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found.

*15 U.S.C. § 78aa* **[*20]** *(2000)*. [HN6]"Service of process is how a court gets jurisdiction over the person." *Lisak v. Mercantile Bancorp, Inc., 834 F.2d 668, 671 (7th Cir. 1987)*. Because the Act provides for nationwide service of process, it confers personal jurisdiction in federal court over defendants with minimum contacts with the *United States*, as long as the mandates of constitutional due process are met. *Id.* (emphasis added); *Fitzsimmons v. Barton, 589 F.2d 330, 332 (7th Cir. 1979)*. *See also Kundrat v. Chicago Bd. Options Exch., 2002 U.S. Dist. LEXIS 16908, No. 01 C 7456, 2002 WL 31017808, at *3 (N.D. Ill. Sept. 6, 2002)*. *See also Fed. R. Civ. P. 4(k)(2)* ("If the exercise of jurisdiction is consistent with the Constitution and laws of the United States, serving a summons ... is also effective, with respect to claims arising under federal law, to establish personal jurisdiction over the person of any defendant who is not subject to the jurisdiction of the courts of general jurisdiction of any state"); *Action Embroidery Corp. v. Atlantic Embroidery, Inc., 368 F.3d 1174, 1180 (9th Cir. 2004)*. Thus, the Court will analyze **[*21]** the limitations of federal constitutional due process to determine if personal jurisdiction exists over each of the Oceanic Defendants. *United Rope Distribs., Inc. v. Seatriumph Marine Corp., 930 F.2d 532, 534 (7th Cir. 1991)*.

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n2 As discussed below, the Court is dismissing Count II against Oceanic with prejudice as untimely. The Court is dismissing Count II against Rahming without prejudice for failure to state a claim.

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[HN7]Federal due process requires that each Defendant have "certain minimum contacts with [the United States] such that the maintenance of the suit does not offend 'traditional notions of fair play and substantial justice.'" *RAR, 107 F.3d at 1277* (quoting *Int'l Shoe Co. v. Washington, 326 U.S. 310, 316, 66 S. Ct. 154, 158, 90 L. Ed. 95 (1945))*. The Oceanic Defendants' contacts with the United States must be such that they "should reasonably anticipate being haled into court there." *Burger King Corp. v. Rudzewicz, 471 U.S. 462, 474, 85 L. Ed. 2d 528, 105 S. Ct. 2174, 2183 (1985)* **[*22]** *(citations omitted)*. *Each Defendant must have* purposefully availed himself or herself of the privilege of conducting activities in the forum state, invoking the benefits and protections of its laws. *Id. at 475, 105 S. Ct. at 2183*. Given *Section 78aa*, the Court will focus its due process analysis on whether the Oceanic Defendants have minimum contacts with the United States. The minimum contacts standard varies depending on whether the plaintiff asserts general or specific jurisdiction. Here, Plaintiffs argue that the Court has both general and specific jurisdiction.

[HN8]General jurisdiction is proper when the defendant has "continuous and systematic general business contacts" with the forum. *RAR, 107 F.3d at 1277* (quoting *Helicopteros Nacionales de Colombia, S.A. v. Hall, 466 U.S. 408, 416, 104 S. Ct. 1868, 1875, 80 L. Ed. 2d 404 (1984))*. Specific jurisdiction exists if the claims "arise out of or relate to the defendant's contacts with the forum." *Helicopteros Nacionales de Colombia, S.A., 466 U.S. at 414 n.8, 104 S. Ct. at 1872 n.8*.

ZCM argues that Oceanic's minimum contacts with the United States are met through **[*23]** the following: 1) Oceanic communicates with investment managers and related personnel in the United States regarding the funds at issue in this case; 2) Oceanic administers investment funds totaling approximately $ 5 billion in assets in the United States, including M.J. Select and two funds in New York; 3) Oceanic advertises through a Client Information Package that "Oceanic works with domestic advisors to preserve wealth and minimize estate taxes for U.S. residents;" 4) Oceanic derives approximately 20-25% of its overall income from administering funds with U.S. investment managers; 5) many of the trusts administered by Oceanic have United States beneficiaries; 6) Oceanic deals with major banks, money managers' dealers in the United States; 7) Oceanic advertisers that it "works with domestic advisors to preserve wealth and minimize estate taxes for United States residents; 8) Clowes testified that "senior management [of Oceanic] are constantly making client relationship management trips to the USA;" 9) Oceanic maintains accounts at eight brokerage firms in the United States with monthly balances in each account exceeding $ 10,000; 10) many wire transfers to and from Oceanic were **[*24]** routed through a correspondent bank account in New York; and 11) Oceanic has an interactive website located at www.oceanic.bs on which it actively advertises and promotes its services to residents of the United States. n3 These contacts with the United States justify the Court's exercise of personal jurisdiction over Oceanic. *See Cromer Fin. Ltd. v. Berger, 137 F. Supp.2d 452, 474-79 (S.D.N.Y. 2001)*; *Samuel H. Esterkyn, M.D., Inc. Pension Sharing and Profit Sharing Plan v. Van Hedge Fund Advisors, Inc., 108 F. Supp.2d 876, 890 (M.D. Tenn. 1999).*

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n3 This is not inconsistent with the Seventh Circuit's recent decision in *Jennings v. A C Hydraulic A/S, 2004 U.S. App. LEXIS 18683, No. 03-2157, 2004 WL 1965661, at * 2 (7th Cir. Sept. 2, 2004)* where the court concluded that "a defendant's maintenance of a passive website does not support the exercise of personal jurisdiction over that defendant in a particular forum just because the website can be accessed there." Here, Oceanic has an "interactive" website, not a passive one. Although the Seventh Circuit has not decided "what level of 'interactivity' is sufficient to establish personal jurisdiction based on the operation of an interactive website," *Id.*, Oceanic's interactive website, in combination with its numerous other contacts with the United States, gives this Court jurisdiction over it.

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**[*25]**

ZCM also has identified Rahming and Clowes' contacts with the United States. ZCM has established that Rahming has attended various conferences in the United States for business purposes. Rahming sent electronic mail to United States residents soliciting them to visit Oceanic's website; frequently communicated via telephone, e-mail, facsimile and mail with the Coglianese co-defendants in Illinois; is licensed by the Colorado Board of Accountancy as a Certified Public Accountant, sat for her Certified Public Accountant exam in California, attended Florida Memorial College in Florida, regularly visited the State of Florida; transmitted or caused to be transmitted information on redemption requests to the Coglianese defendants in Illinois for clearance and approval; contacted the Coglianese defendants and Martin James in Illinois to obtain contact information for the other M.J. Select shareholders; sent or caused to be sent performance evaluation and monthly and annual account statements and financial statements to M.J. Select shareholders residing in the United States; issued the fraudulent assignment recognition agreement to ZCM in New York; and communicated with ZCM in New York via faxes, **[*26]** phone calls and e-mails to falsely confirm that M.J. Select would honor ZCM's redemption requests.

ZCM argues that Clowes made seven trips to the United States from 1999 to the present, including one to Illinois. They also contend that Clowes sent e-mail to United States residents to advertise Oceanic's website and solicit them to visit the website; directed wire transfers through Oceanic's and M.J. Select's correspondent bank account at Barclays Bank in New York, including funds at issue in this case that originated and ended in Illinois; communicated with the Coglianese Defendants in Illinois regarding the daily operations of M.J. Select, the termination of M.J. Select's trading advisor and the liquidation of M.J. Select; communicated with the Coglianese Defendants in Illinois regarding numerous other funds administered by Oceanic for which Clowes served as Director; and filed numerous declarations in the 2001 Action to conceal the true facts of this case. Clowes' actions were purposely directed toward the United States.

These contacts with the United States satisfy the *due process clause* and establish personal jurisdiction over the securities fraud claims with respect to Rahming **[*27]** and Clowes. *See San Mateo County Transit Dist. v. Dearman, Fitzgerald and Roberts, Inc., 979 F.2d 1356, 1358 (9th Cir. 1992)*; *United Phosphorous, Ltd. v. Angus Chem. Co., 43 F. Supp.2d 904, 912 (N.D. Ill. 1999).*

**B. Fair Play and Substantial Justice**

The Court must next determine whether its exercise of personal jurisdiction over the Oceanic Defendants comports with "traditional notions of fair play and substantial justice." *Asahi Metal Indus. Co., Ltd. v. Superior Court of California, 480 U.S. 102, 113, 107 S. Ct. 1026, 1033, 94 L. Ed. 2d 92 (1987)* (quoting *Int'l Shoe Co., 326 U.S. at 316*). *See also Jennings, 2004 U.S. App. LEXIS 18683, 2004 WL 1965661, at* *2. [HN9]A party's assertion of jurisdiction must be reasonable in light of the burden on the defendant, the plaintiff's interest in obtaining relief, the interests of Illinois, the judicial system's interest inefficiently resolving controversies, and the "shared interest of the several States in furthering fundamental substantive social policies." *Asahi, 480 U.S. at 113* (citations omitted). The Court must determine whether this is "one of these rare cases **[*28]** in which minimum requirements inherent in the concept of fair play and substantial justice ... defeat the reasonableness of jurisdiction." *Id. at 116, 107 S. Ct. at 1034* (Brennan, J., concurring) (citations omitted).

Exercise of the Court's jurisdiction in this case is fair and just. [HN10]"The United States has a substantial interest in the enforcement of its securities laws and the protection of investors in the United States securities markets." *Cromer Fin, Ltd., 137 F. Supp.2d at 479.* Illinois also has an interest in enforcing its securities laws. Further, the burden on Oceanic is small given that it has continuous business in the United States. Given the Defendants' substantial contacts with the forum and their systematic and continuous business in the United States, the Court will exercise its jurisdiction over them.

**C. Fiduciary Shield Doctrine**

Defendants Clowes and Rahming argue that they are protected under the fiduciary shield doctrine because their only connection to this case is through their work as Oceanic's employees. In Illinois, the "fiduciary shield doctrine" precludes courts from exercising jurisdiction over a non-resident corporate **[*29]** official when the only contacts that individual has with Illinois are made in his or her corporate capacity. *See Rice v. Nova Biomedical Corp., 38 F.3d 909, 912 (7th Cir. 1994)* ("This doctrine . . . denies personal jurisdiction over an individual whose presence and activity in the state in which the suit is brought were solely on behalf of his employer or other principal.") (internal citations omitted). Where an individual defendant's conduct in Illinois "was a product of, and was motivated by, his employment situation and not his personal interests, ... it would be unfair to use this conduct to assert personal jurisdiction over him as an individual." *Rollins v. Ellwood, 141 Ill. 2d 244, 280, 152 Ill. Dec. 384, 400, 565 N.E.2d 1302, 1318 (1990).* [HN11]The fiduciary shield doctrine, however, "is a matter of state law only," not federal law. *Hardin Roller Corp. v. Universal Printing Mach., Inc., 236 F.3d 839, 842 (7th Cir. 2001).* Accordingly, it does not apply to ZCM's federal securities fraud claims.

Even if the doctrine applies, Clowes and Rahming are not protected by it based on the allegations in the Amended Complaint. [HN12]It is clear that **[*30]** the fiduciary shield doctrine is discretionary or equitable, rather than an absolute entitlement. *See Burnhope v. National Mortgage Equity Corp., 208 Ill. App.3d 426, 439-40, 153 Ill. Dec. 398, 405-06, 567 N.E. 2d 356, 363-64 (1st Dist 1990).* There are two exceptions to the doctrine: "(1) the shield is removed if the individual's personal interests motivated his actions, and (2) the shield generally does not apply when the individual's actions are discretionary." *Jones v. Sabis Educ. Sys., Inc., 52 F. Supp.2d 868, 883 (N.D. Ill. 1999)* (internal citations omitted). *But see Robinson v. Sabis Educ. Sys., Inc., 1999 U.S. Dist. LEXIS 9091, No 98 C 4251, 1999 WL 412642, at *3 (N.D. Ill. May 28, 1999)* (questioning whether these exceptions exist without the corporation also being a sham entity).

ZCM alleges that both Clowes and Rahming served as the two most senior persons in Oceanic's fund administration department. Rahming served as the Manager of the Fund, and Clowes served as the Chief Operating Officer of Oceanic. The allegations in the Amended Complaint are sufficient to infer that Rahming and Clowes had significant discretion at Oceanic, including discretion in determining **[*31]** whether to conduct business in the United States. Accordingly, the doctrine does not apply to them. *See Minkus v. Los Alamos Technical Assoc. Inc., 2004 U.S. Dist. LEXIS 11833, No. 03 C 4216, 2004 WL 1459499, at *3 (N.D. Ill. June 28, 2004); Brujis v. Shaw, 876 F. Supp. 975, 978-80 (N.D. Ill. 1995).*

**D. Pendent Personal Jurisdiction**

[HN13]Because the Court has personal jurisdiction over the Oceanic Defendants, it also can assert personal jurisdiction over the state law claims under the doctrine of "supplemental" or "pendent" personal jurisdiction. *Robinson Eng'g. Co., Ltd. Pension Plan & Trust v. George, 223 F.3d 445, 449-50 (7th Cir. 2000).* Oceanic's motion to dismiss for lack of personal jurisdiction is therefore denied.

**IV. Statute of Limitations**

In its August 2, 2004 Opinion, the Court set forth in detail the law governing statute of limitations in federal securities fraud actions. As the Court noted,[HN14]if a "plaintiff pleads facts that show its suit [is] barred by a statute of limitations, it may plead itself out of court under a *Rule 12(b)(6)* analysis." *Whirlpool Fin.*

*Corp. v. GN Holdings, Inc., b—r.3d 605, 608 (7th Cir. 1995).* **[*32]** "Because the question of whether a plaintiff had sufficient facts to place it on inquiry notice of a claim for securities fraud is one of fact, it may be 'inappropriate for resolution on a motion to dismiss under *Rule 12(b)(6)*.'" *Kauthar SDN BHD v. Sternberg, 149 F.3d 659, 669-70,* (citing *Marks v. CDW Computer Ctrs., Inc., 122 F.3d 363, 367 (7th Cir. 1997)).*

The Oceanic Defendants argue that Plaintiffs' federal securities law claims are barred by the statute of limitations because they are reasserting the same claims they filed against Defendant Oceanic in the 2001 action. Because ZCM filed the 2001 Action on November 7, 2003 -- more than two years before they filed this case -- the Oceanic Defendants argue that this case is time barred.

**A. The Applicable Limitations Period**

The Court must first determine the applicable statute of limitations period. [HN15]Prior to July 30, 2002, a plaintiff had to file a *Section 10(b)* action "within one year after the discovery of the facts constituting the violation and within three years after such violation." *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 501 U.S. 350, 364, 111 S. Ct. 2773, 2782, 115 L. Ed. 2d 321 (1991).* **[*33]** On July 30, 2002, Congress enacted the *Sarbanes-Oxley Act* and expanded the limitations period for such claims involving "fraud, deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning the securities laws" to two years after the discovery of the facts constituting the violation and within five years after such violation. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 804, 116 Stat. 745, 801 (2002) (to be codified at *28 U.S.C. 1658(b)*). *Section 804(b) of the Sarbanes-Oxley Act* specifically provides that the expanded limitations period "shall apply to all proceedings addressed by this section that are commenced on or after the date of enactment of this Act." *Id.*

[HN16]The Seventh Circuit has embraced the concept that courts may not apply a statute that lengthens an applicable statute of limitations to revive claims that are otherwise time-barred under the old statute of limitations because "to do so would 'alter the substantive rights' of a party and 'increase a party's liability'" *Stone v. Hamilton, 308 F.3d 751, 757 (7th Cir. 2002)* (quoting *Chenault v. United States Postal Serv., 37 F.3d 535, 539 (7th Cir. 1994)).* **[*34]** Numerous courts have applied this concept to the Sarbanes-Oxley extension of the statute of limitations in securities fraud cases, and held that the extended limitations period does not apply to claims that were time-barred when Congress enacted Sarbanes-Oxley. *See e.g., In re ADC Telecomm., Inc., Sec. Litig., 331 F. Supp. 2d 799, 2004 U.S. Dist. LEXIS 17294, No. CIV. 03-1194, 2004 WL 1890609, at ** 3-5 (D. Minn. May 17, 2004)* (Sarbanes-Oxley does not apply retroactively to revive time-barred claims); *ATO RAM, II, Ltd. v. SMC Multimedia Corp., 2004 U.S. Dist. LEXIS 5810, No. 03 Civ. 5569, 2004 WL 744792, at *5 (S.D.N.Y. Apr. 7, 2004)* ("Plaintiff's claims were not yet barred when Sarbanes-Oxley was enacted and, accordingly, the amended statute of limitations applied"); *In re Enron Corp. Sec., Derivative & Erisa Litig., 2004 U.S. Dist. LEXIS 8158, No. MDL-1446, Civ.A. H-01-3624, 2004 WL 405886, at *12 (S.D. Tex. Feb. 25, 2004)* (same); *Glaser v. Enzo Biochem, Inc., 303 F. Supp. 2d 724, No. CIV.A. 02-1242-A, 2003 WL 21960613, at *5 (E.D. Va. 2003); In re Heritage Bond Litig., 289 F. Supp. 2d 1132, 1148 (C.D. Cal. Jan. 6, 2003); but see Roberts v. Dean Witter Reynolds, Inc., 2003 U.S. Dist. LEXIS 5676, No. 8:02-CV-2115-T-26, 2003 WL 1936116,* **[*35]** *at *3 (M.D. Fla. Mar. 14, 2003)* (applying Sarbanes-Oxley retroactively to all claims, including time-barred claims because "Congress intended to lengthen the statute of limitations to enable people who lost their life-savings to companies like Enron to recover some of their investments"). The Court agrees with the reasoning of these decisions. The plain language of the statute does not clearly reflect a Congressional intention to apply the extended limitations period retroactively to revive time-barred claims. *See INS v. St. Cyr, 533 U.S. 289, 316, 121 S. Ct. 2271, 2288, 150 L. Ed 2d 347 (2001)* ("A statute may not be applied retroactively [] absent a clear indication from Congress that it intended such a result").

As discussed in the next section of this opinion, the Court cannot conclude at this stage that Plaintiffs' claims were barred as a matter on law on July 31, 2002 when Congress passed Sarbanes-Oxley. Plaintiffs' *Section 10b-5* claim accrued by August 14, 2001 when Plaintiffs filed the August 2001 Action. Under the one year statute of limitations, the period would not have expired until August 14, 2002 *after* Congress passed the Sarbannes-Oxley Act. Because **[*36]** it was not time-barred as a matter of law at that time, the amended statute of limitations - and its two year time period - applies to Plaintiffs' securities fraud claims in this case.

Defendants' heavy reliance on *In re Enterprise Mortgage Acceptance Co. L.L.C. Sec. Litg., 295 F. Supp.2d 307, 312-17 (S.D.N.Y. 2003)*, is misplaced. In *Enterprise,* the court held that the two years statute of limitations under Sarbanes-Oxley did not apply to the plaintiff's securities fraud claims because such claims were already time-barred prior to the effective date of Sarbanes-Oxley. Here, ZCM's claims were not time-barred as a matter of law when Sarbanes-Oxley became effective. The *Enterprise* reasoning, therefore, does not apply to this case.

**B. Accrual**

[HN17]Because it is often difficult for a plaintiff to know that he or she has been the victim of securities fraud until years after the commission of the fraud, the statute of limitations for federal securities fraud claims commences under the doctrine of "inquiry notice." *Fujisawa Pharm. Co., Ltd., v. Kapoor, 115 F.3d 1332, 1334 (7th Cir. 1997)*. Under inquiry notice, the "statute of limitations applicable **[*37]** to suits under *Rule 10b-5* begins to run not when the fraud occurs, and not when the fraud is discovered, but when (often between the date of occurrence and the date of the discovery of the fraud) the plaintiff learns, or should have learned through the exercise of ordinary diligence in the protection of one's legal rights, enough facts to enable him by such further investigation as the facts would induce in a reasonable person to sue within a year." *Id.*, citing *Law v. Medco Research, Inc., 113 F.3d 781, 785 (7th Cir. 1997)*. For inquiry notice, more than "merely suspicious circumstances" must exist. *Fujisawa, 115 F.3d at 1337*. "The facts constituting such notice must be sufficiently probative of fraud -- sufficiently advanced beyond the stage of a mere suspicion, sufficiently confirmed or substantiated -- not only to incite the victim to investigate but also to enable him to tie up any loose ends and complete the investigation in time to file a timely suit." *Id. at 1335*.

[HN18]One important factor courts consider in determining when the statute of limitations begins is a party's ease of access to evidence that would trigger an appropriate **[*38]** inquiry. *See Marks v. CDW Computer Ctrs., Inc., 122 F.3d 363, 368 (7th Cir. 1997)*. Additionally, "there must also be a suspicious circumstance to trigger a duty to exploit the access; an open door is not by itself a reason to enter a room . . . . *How* suspicious the circumstance need be to set the statute of limitations running . . . will depend on how easy it is to obtain the necessary proof by a diligent investigation aimed at confirming or dispelling the suspicion." *Fujisawa, 45 F.3d at 1335*.

**1. Claims Against Oceanic**

ZCM Bermuda sued Oceanic and others in the 2001 Action for securities fraud on August 14, 2001. The Oceanic Defendants argue that the 2001 Action clearly demonstrates that Plaintiffs had actual notice of the alleged violations as of August 14, 2001.

**a. *Section 10(b)* Claim**

Both the 2001 Action and this case are based on a complex fraudulent investment scheme involving M.J. Select. Both actions involve ZCM's injury arising from their investment in M.J. Select. ZCM alleges in both cases that it reasonably relied on alleged misrepresentations regarding redemption of interest in M.J. Select when it purchased the partnership **[*39]** interests. Similarly, ZCM alleges in both actions that it suffered its losses as a result of the defendants' failure to redeem ZCM's partnership interests and shares, and because the defendants fraudulently converted and transferred ZCM's interests.

The 2001 Action alleged that Oceanic had made false and material misrepresentations in M.J. Select's Private Placement Memorandum ("PPM"). Although ZCM bases the case before the Court on a May 31, 2000 "assignment recognition agreement," Plaintiffs had that agreement as early as September 2001. (2001 Action, 01 C 6250, R. 134-1, Ex.B3 at 568-69, Tr. Of 9/24/01 Martin Allamian Dep.). In the 2001 Action and this case, Plaintiffs allege that Oceanic was the administrator, registrar, and transfer agent of M.J. Select. In both cases, Plaintiffs allege they demanded that Oceanic pay ZCM the proceeds from the redemption of its limited partnership interests, and that Oceanic failed to recognize ZCM Bermuda as the owner of certain shares because it failed to process ZCM Bermuda's redemption request.

Even though in 2001 ZCM did not have all of the details of the alleged fraud committed by Oceanic, the allegations in the 2001 Action demonstrate **[*40]** that it knew enough facts to enable it to further investigate when it filed the 2001 Action. ZCM was on inquiry notice of its *Section 10(b)* claim when it filed the 2001 Action. The allegations against Oceanic are based on the same fraudulent scheme, the same injury, the same theories, the same cause of action, and the same omissions. The Court holds that as a matter of law Plaintiffs were on inquiry notice of their *Section 10(b)* claim when they filed the 2001 Action.

Although Plaintiff claims that Oceanic fraudulently concealed some crucial facts in this case,[HN19]"when knowledge or notice is required to start the statute of limitations running, there is no room for equitable tolling." *Tregenza v. Great Am. Communications Co., 12 F.3d 717, 721 (7th Cir. 1993)* (emphasis omitted). Equitable tolling does not apply to the statute of limitations in the securities fraud case. *Whirlpool, 67 F.3d at 610. See Lampf, 501 U.S. at 363-64* ("The equitable tolling doctrine is fundamentally inconsistent with the 1- and 3-year structure [of the statute of limitations] . . . . The 3-year limit is a period of repose inconsistent with tolling. . . . Because **[*41]** the purpose of the 3-year limitation is clearly to serve as a cutoff, we hold that tolling principles do not apply to that period."); *In re Merrill Lynch & Co., Inc. Research Reports Sec. Litig., 289 F. Supp.2d 416, 426 (S.D.N.Y. 2003)* ("Equitable tolling is inconsistent with the discovery period because if a defendant actively conceals a fraud, then plaintiff will not discover the facts suggesting the violation and the statute will not begin to run, making tolling unnecessary . . . . Equitable tolling is also fundamentally inconsistent with the repose period because that limit is 'clearly to serve as a cutoff' and it would have no significance as an outside limit if it could be tolled'").

**b. *Section 20(a)* Claim**

A *Section 20(a)* claim includes different elements than a *Section 10(b)* claim. In the amended complaint to the 2001 Action, ZCM alleged that Oceanic controlled M.J. Select. Although this allegation suggests ZCM was on inquiry notice regarding the general control element of a *Section 20(a)* claim, the Court cannot conclude as a matter of law that ZCM was on inquiry notice two years in advance of November 7, 2003 when it filed this suit of the specific control **[*42]** element of its *Section 20(a)* claim against ZCM. The Court admits that this issue is a close one, but at this stage, the Court cannot conclude "definitively" that ZCM has pled itself out of court as to the *Section 20(a)* claim against Oceanic. *See Barry Aviation Inc. v. Land O'Lakes Municipal Airport Com'n, 377 F.3d 682, 688 (7th Cir. 2004)*. Accordingly, that claim remains.

**2. Claims Against Rahming and Clowes**

In contrast to Oceanic, the 2001 Action does not demonstrate that ZCM was on inquiry notice regarding Rahming and Clowes. The 2001 Action does not mention either individual nor detail their roles in the alleged fraud. At this stage of the litigation, the Court cannot conclude that the statute of limitations accrued as to Rahming and Clowes when ZCM filed the 2001 Action.

**C. Statute of Repose**

The Sarbanes-Oxley five year statute of repose applies at this stage of the litigation for the same reasons the two year statute of limitations applies. ZCM's securities fraud claims involve alleged misrepresentations on May 31, 2000 and April 1, 2000. Because ZCM filed this action on November 7, 2003, these dates comfortably fall within the five year statute **[*43]** of repose.

**V. Standing**

The Court addressed the standing issue in its August 2, 2004 Opinion. Defendants' motion to dismiss for lack of standing is denied for the reasons set forth in that Opinion.

**VI. Plaintiffs Sufficiently Allege Federal Securities Fraud Violations**

**A. Count II - *Section 10(b)***

Although the Court is dismissing Count II against Oceanic as time-barred, Plaintiffs' Count II claim for [HN20]securities fraud under *Section 10(b)* and *Rule 10b-5* remains against Rahming. Plaintiffs must allege that Defendant Rahming (1) made a false statement or omission; (2) of a material fact; (3) with scienter; (4) in connection with the purchase or sale of securities; (5) upon which Plaintiffs justifiably relied; and (6) the reliance proximately caused Plaintiffs' damages. *In re HealthCare Compare Corp. Sec. Litig., 75 F.3d 276, 280 (7th Cir. 1996)*.

Both *Federal Rule of Civil Procedure 9(b)* and the PSLRA apply to these allegations and impose heightened pleading requirements on Plaintiffs. *Rule 9(b)* requires that Plaintiffs plead fraud allegations with particularity. *Fed. R. Civ. P. 9(b)* **[*44]** . In addition to *Rule 9(b)*, the strict pleading mandates of the PSLRA apply to Plaintiffs' complaint. In order to meet the PSLRA's dictates for a securities fraud claim, "the complaint shall specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed." *15 U.S.C. § 78u-4(b)(1) (2000)*.

**1. Alleged Misrepresentations and Omissions**

Count II against Rahming is premised on the May 31, 2000 "assignment recognition agreement," signed by Rahming. Plaintiffs allege that Rahming made false and misleading statements in this May 31 letter in connection with the purchase and sale of securities issued by M.J. Select. Plaintiffs allege that the assignment recognition agreement is false and misleading because 1) it falsely represented that Oceanic would recognize ZCM MFC as the sole owner of 100% of M.J. Select's shares assigned to ZCM MFC and subsequently ZCM Bermuda; 2) it falsely represented that ZCM MFC, and subsequently ZCM Bermuda, would **[*45]** have all the rights and privileges that normally accompany sole ownership; 3) it failed to disclose the existence of a discriminatory redemption policy; and 4) it failed to disclose that ZCM's share interest were not redeemable in accordance with the Offering Memoranda because Oceanic and Rahming intended to retain control over them. They further allege that ZCM MFC and ZCM Bermuda would not have accepted the assignment of, or purchased, the M.J Select securities if they had known the true facts or the existence of the omitted facts. These allegations sufficiently state a misrepresentation in Count II. Although Rahming, characterizes this letter as "a perfunctory two-sentence form letter" that does not contain any misrepresentations, that issue is not properly decided at this stage of the litigation.

Rahming, relying on *Chiarella v. United States, 445 U.S. 222, 228, 100 S. Ct. 1108, 63 L. Ed. 2d 348 (1980)*, argues that she did not have a duty to disclose the allegedly omitted information in the assignment recognition letter. [HN21]Such a duty arises if a defendant makes a statement that would be misleading without disclosing certain other information. "If one speaks, he must **[*46]** speak the whole truth." *Stransky v. Cummins Engine Co., Inc., 51 F.3d 1329, 1331 (7th Cir. 1995)* (citations omitted). ZCM alleges that Rahming made certain representations in the assignment agreement, and therefore had a duty to disclose the omitted information because such information was necessary to make Rahming's statements not misleading. At this stage, these allegations are sufficient to survive a motion to dismiss.

**2. Scienter**

Rahming also argues that Plaintiffs have failed to adequately plead scienter in Count II. Plaintiffs must [HN22]"state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." *15 U.S.C. § 78u-4(b)(2) (2000)*. [HN23]Plaintiffs may use "motive and opportunity" or "circumstantial evidence" to establish scienter under the PSLRA, as long as the allegations support a strong inference that the defendants acted recklessly or knowingly when they made the alleged misrepresentations. *766347 Ontario Ltd. v. Zurich Capital Mkts., Inc., 249 F. Supp.2d 974, 987 (N.D. Ill. 2003). See also Chu v. Sabratek Corp., 100 F. Supp.2d 815, 823 (N.D. Ill. 2000).* **[*47]**

ZCM alleges that Rahming knew or recklessly disregarded the falsity of the misrepresentations because she knew that Defendant Michael Coglianese and representatives of Martin James controlled the redemptions of share interests, she had followed each and every direction of Coglianese and Martin James regarding redemption payments without questioning whether such redemptions complied with M.J. Select's Offering Memorandum, and she had authorized payments from M.J. Select's account at Coglianese's direction without approval from Oceanic or Martin James. ZCM also alleges that Rahming had a motive to make the alleged misrepresentations and omissions because she "had the opportunity to realize monetary gains from these investments."

These scienter allegations focus primarily on the alleged omissions in the assignment recognition letter. They fail to give rise to a strong inference that Rahming knew or recklessly disregarded the alleged misrepresentations regarding recognizing ZCM MFC as the sole owner of the shares with all of the rights and privileges that normally accompany such ownership. Plaintiffs do not allege with any particularity how Rahming knew in May 2000 that statements about **[*48]** ZCM Bermuda's ownership rights were false. Furthermore, as Rahming points out, ZCM has not alleged with any particularity how increasing the investments of M.J. Select would motivate Rahming when, Oceanic received a flat $ 5,000 fee per year for its administrative services. n4

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n4 The flat fee of $ 5,000 per year for administrative services is set forth in the Administration Agreement. On this motion to dismiss, the Court can consider this document because it is referred to in the Amended Complaint and central to ZCM's claims. *Davis v. Potter, 301 F. Supp. 2d 850, 856 (N.D. Ill. 2004).*

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With regard to the omission regarding the alleged discriminatory redemption policy, ZCM also has not alleged facts that satisfy the scienter requirements regarding Rahming. Accordingly, Count II is dismissed without prejudice.

**B. Control Person Liability (Count III)**

In Count III, ZCM alleges that Oceanic, Rahming and Clowes were control persons pursuant to *Section 20(a) of the Exchange Act*. n5 [HN24]In order to allege **[*49]** a *Section 20(a)* claim, Plaintiffs must allege (1) a primary securities violation; (2) each of the individual defendants exercised general control over the operations of M.J. Select; and (3) each of the individual defendants "possessed the power or ability to control the specific transaction or activity upon which the primary violation was predicated, whether or not that power was exercised." *Harrison v. Dean Witter Reynolds, Inc., 974 F.2d 873, 881 (7th Cir. 1992). Rule 9(b)*'s particularity requirements apply to Count III.

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n5 ZCM also named Coglianese in this count. The Court addressed Coglianese in its August 2, 2004 Opinion.

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**1. General Control**

The Oceanic Defendants challenge Plaintiffs' allegations of general and specific control. [HN25]General control requires ZCM to allege that the Oceanic Defendants "actually participated in, that is, exercised control over, the operations of [M.J. Select] in general." *Harrison v. Dean Witter Reynolds, Inc., 79 F.3d 609, 614 (7th Cir. 1996).* **[*50]** Defendants correctly point out that alleging mere titles does not suffice to establish control person liability. ZCM's allegations, however, go beyond mere titles. ZCM alleges that Oceanic had the power to appoint and did appoint M.J. Select's entire Board of Directors. They contend that Oceanic issued account and financial statements for M.J. Select. ZCM also alleges that Oceanic had the responsibility for processing all subscriptions, redemptions, transfers and assignments of M.J. Select's shares and issuing monthly financial statements, had the authority to request checks drawn on M.J. Select's bank accounts and direct wire transfers from such accounts to redeem shares, had the authority to refuse to comply with redemption requests, and had the power to place (and in fact placed) M.J. Select into liquidation. These allegations satisfy ZCM's burden regarding Oceanic's general control over M.J. Select.

Regarding Rahming and Clowes, ZCM alleges that they served as directors of M.J. Select from 1999 forward. Rahming requested legal opinions for M.J. Select, issued account and financial statements, and issued audited financial statements confirming fraudulent results. ZCM alleges that **[*51]** Rahming had the authority to place M.J. Select into liquidation and to delegate M.J. Select's business affairs. These allegations particularize Rahming's general control over the operations of M.J. Select.

In addition to being an M.J Select director, ZCM alleges that Clowes was the Chief Operating Officer of Oceanic. ZCM alleges that Clowes maintained a correspondent bank account on behalf of M.J. Select in the United States and directed the wire transfer of funds through this bank account. Plaintiffs contend that Clowes communicated frequently with Michael Coglianese regarding the daily operations of M.J. Select, issued account and financial statements to M.J. Select's shareholders, and issued audited financial statements confirming fraudulent results. ZCM has alleged Clowes' general control over M.J. Select's operations.

The Oceanic Defendants ask the Court to consider a declaration from Defendant Clowes regarding Oceanic's role as administrator. At the motion to dismiss stage, the Court cannot consider this information.

**2. Specific Control**

ZCM alleges that the Oceanic Defendants had specific control over M.J. Select's offering documents that are the focus of the alleged **[*52]** primary violation in Count II. ZCM does not allege that any of the Oceanic Defendants drafted M.J. Select's Offering Memoranda. Instead, ZCM contends that the Oceanic Defendants had the power and ability to suspend the operations of M.J. Select unless it corrected the false statements in M.J. Select's Offering Memoranda or discontinued their use in soliciting new investors. They allege that Rahming and Clowes, as sole directors of M.J. Select, had this control. ZCM alleges that each of the Oceanic Defendants had the power to control the day-to-day operations of M.J. Select which gave them control over the Offering Memoranda. ZCM also contends that Oceanic, Rahming, and Clowes had the statutory and common law duty under Bahamian law to require the issuance of corrected offering documents. The Oceanic Defendants argue that the Administration Agreement did not give them the authority to do so. This contention, however, raises an issue of fact that is not appropriate for the Court to resolve at this stage. ZCM has met its pleading burden.

**VII. Illinois Securities Law (Count VII)**

Count VII alleges that Oceanic violated the Illinois Securities Law of 1953 (the "Act"). *815 ILCS 5/1-5/19* **[*53]** (2002). The Act provides that [HN26]"every sale of a security made in violation of the provisions of this Act shall be voidable at the election of the purchaser . . . and the issuer, controlling person, underwriter, dealer or other person by or on behalf of whom said sale was made, and each underwriter, dealer, or salesperson who shall have participated or aided in any way in making the sale . . . shall be jointly and severally liable to the purchaser." *815 ILCS 5/13(A).* Oceanic must fall within the definition of an "issuer, controlling person, underwriter, dealer or other person by or on behalf of whom said sale was made" or that of an "underwriter, dealer or salesperson" who participated in the sale. ZCM alleges that Oceanic is a "controlling person" or a "primary violator." Oceanic argues that because it merely served as the administrator of M.J. Select, it cannot be held liable as either a principal violator or a control person under the Act.

The Act defines a [HN27]"controlling person" as "any person offering or selling a security, or group of persons acting in concert in the offer or sale of a security, owning beneficially . . . either (i) 25% or more of the outstanding **[*54]** voting securities of the issuer of such security" or (ii) "such number of outstanding securities of the issuer of such security as would enable such person, or group of persons, to elect a majority of the board of directors or other managing body of such issuer." *815 ILCS 5/2.4.* [HN28]"Unlike the *1934 Exchange Act*, where 'controlling persons' may be read broadly to reach many parties, the Illinois Act has been applied only to persons playing 'central and specialized roles.'" *Carlson v. Bear, Stearns & Co. Inc., 906 F.2d 315, 318 (7th Cir. 1990)* (citation omitted). Moreover, "while overt action by a member of a controlling group would not always be required, there must be some showing of assent, approval or concurrence, albeit tacit approval, in the action of the group in selling securities, before an individual will be held liable for the actions of the controlling group. A person is not liable merely because one can add his shareholding onto the holdings of a controlling group and they still remain a controlling group. Some connection with the sale, or decision to sell, securities is required under the statute . . . ." *Froehlich v. Matz, 93 Ill. App. 3d 398, 406, 48 Ill. Dec. 781, 788, 417 N.E.2d 183, 190 (1981).* **[*55]**

ZCM does not allege that Oceanic owned any shares in M.J. Select. Instead, they argue that because Oceanic selected the directors for M.J. Select, the Court can infer that it owned sufficient shares in M.J. Select to do so. Based on the allegations in the Amended Complaint, the Court will not make this jump in logic. *See Purnal v. Supreme Ct. of Ill., 2004 U.S. Dist. LEXIS 2866, No. 03 C 6061, 2004 WL 542528 at *1 (N.D. Ill. Feb. 26, 2004).* Count VII is dismissed without prejudice.

Oceanic correctly points out that the term "primary violator" does not appear in the statute. ZCM does not allege that Oceanic was an underwriter, issuer, dealer or salesperson. They have not satisfied the pleading requirements.

**VIII. Fraud and Conspiracy to Defraud (Counts VIII and IX)**

Count VIII alleges common law fraud and Count XI alleges a conspiracy to defraud. The Oceanic Defendants seek to dismiss Counts VIII and IX for failure to plead fraud with the requisite particularity required under *Rule 9(b)*.

[HN29]The elements of a claim for fraud in Illinois are: (1) a false statement of material fact; (2) knowledge or belief of the falsity by the party making the statement; (3) intention to induce the other **[*56]** party to act; (4) action by the other party in reliance on the truth of the statements; and (5) damage to the other party resulting from such reliance. *WTM, Inc. v. Hennek, 125 F. Supp.2d 864, 869 (N.D. Ill. 2000).* Plaintiffs have satisfied the mandates of *Rule 9(b)* with respect to each of the Oceanic Defendants in Count VIII.

Regarding Count IX, [HN30]in order to state a claim for conspiracy to defraud in Illinois, ZCM must allege "(1) a conspiracy; (2) an overt act of fraud in furtherance of the conspiracy; and (3) damages to the plaintiff as a result of the fraud." *Bosak v. McDonough, 192 Ill. App. 3d 799, 803, 139 Ill. Dec. 917, 920, 549 N.E. 2d 643, 646 (1989).* The Court agrees that the allegations in Count IX regarding Defendants Oceanic, Rahming and Clowes do not meet *Rule 9(b)*'s particularity requirements. Count IX is dismissed without prejudice.

**VIII. Unjust Enrichment (Count X)**

The Oceanic Defendants argue that the Court should dismiss Count X because Plaintiffs have failed to allege that they retained a benefit to Plaintiffs' detriment. The Court addressed this issue in its August 2, 2004 Opinion, and denies the motion on this basis. **[*57]**

In addition, the Oceanic Defendants argue that the Court should dismiss the unjust enrichment count because Plaintiffs allege that an express contract governs their relationship, and thus unjust enrichment does not apply. Even if the the Oceanic Defendants' premise is accurate, [HN31]a plaintiff may plead in the alternative. *See Fed. R. Civ. P. 8(e)(2)*; *Pickrel v. City of Springfield, Ill., 45 F.3d 1115, 1119 (7th Cir. 1995).* If a contract did not exist between the parties, then, assuming Defendants are correct, Plaintiffs could proceed on this count.

**IX. Conversion (Count XI)**

Plaintiffs allege conversion against Defendant Oceanic in Count XI. [HN32]"A conversion is any unauthorized act that deprives a person of his or her or its property permanently or for an indefinite time." *Turner Investors v. Pirkl, 338 Ill. App. 3d 676, 681, 273 Ill. Dec. 423, 427, 789 N.E. 2d 323, 327 (2003)* (citations omitted). In order to state a claim for conversion in Illinois, Plaintiff must allege that (1) it has a right to the property at issue; (2) it has an absolute and unconditional right to the immediate possession of that property; **[*58]** (3) it made a demand on the defendant for possession of the property; and (4) the defendant wrongfully and without authorization assumed control, dominion, or ownership over the property. *Cirrincione v. Johnson, 184 Ill. 2d 109, 114, 234 Ill. Dec. 455, 458, 703 N.E.2d 67, 70 (1998).* As explained by the Seventh Circuit, "an asserted right to money normally will not support a claim for conversion. Only if the money at issue can be described as 'specific chattel,' . . . in other words, 'a specific fund or specific money in coin or bills,' . . . will conversion lie. Moreover, the plaintiff's right to the money must be absolute. It must be shown that the money claimed, or its equivalent, at all times belonged to the plaintiff and that the defendant converted it to his own use." *Horbach v. Kaczmarek, 288 F.3d 969, 978 (7th Cir. 2002)* (citations and quotations and emphasis omitted).

Here, the money at issue was used to purchase share interests in M.J. Select. Plaintiffs' interests did not represent the only purchased shares of M.J. Select.

Further, ZCM has not alleged that its interests were separated in a specific fund from other interests in M.J. Select. **[*59]** Its interests, therefore cannot be deemed specific for conversion purposes. *See Fogel v. Gordon & Glickson, P.C., 2003 U.S. Dist. LEXIS 15585, No. 03 C 1617, 2003 WL 22057194, at * 3 (N.D. Ill. Sept. 3, 2003)*. Count XI is dismissed.

**X. Breach of Contract (Count XII)**

For the reasons set forth in the Court's August 2, 2004 Opinion, Count XII stands.

**XI. Intentional Interference with Contract (Count XIII)**

[HN33]In order to state a claim in Illinois for tortious interference with a contract, a plaintiff must allege the following elements: (1) the existence of a valid and enforceable contract between plaintiffs and another, (2) the defendant's awareness of the contract; (3) an intentional interference by the defendant inducing breach of contract; (4) a breach of contract caused by the defendant's acts; and (5) damages to the plaintiff. *Smock v. Nolan, 361 F.3d 367, 372 (7th Cir. 2004)*. *See also Fieldcrest Builders, Inc. v. Antonucci, 311 Ill. App. 3d 597, 611, 243 Ill. Dec. 740, 752, 724 N.E.2d 49, 61 (1999)*. Plaintiffs have alleged each of these elements. Count XIII stands.

**XII. Breach of Fiduciary Duty (Count XIV)**

For the reasons set forth in the **[*60]** Court's August 2, 2004 Opinion regarding Defendant Coglianese, Count XIV stands.

**XIII. Breach of Contract (Count XVI)**

Plaintiffs allege that Defendant Oceanic entered into a written contract with ZCM MFC on May 31, 2000 in which it promised to recognize ZCM MFC as the sole owner of 100% of the shares that Martin James had invested with them, and confirmed that ZCM MFC would have all the rights and privileges that accompany such ownership. ZCM MFC thereafter transferred its rights under this contract to ZCM Bermuda, and Oceanic expressly recognized these assignments to ZCM Bermuda. Plaintiffs allege that Oceanic breached this contract with ZCM Bermuda by refusing to honor its valid redemption requests and converting ZCM Bermuda's interests in M.J. Select at the request of Martin James. Plaintiffs sufficiently allege a breach of contract claim based on the May 31, 2000 assignment recognition agreement.

**XIV. Bahamian Law**

ZCM premises Counts XVII and XVIII on violations of Bahamian law. In Count XVII, ZCM Bermuda alleges that the Oceanic Defendants violated the Bahamian Mutual Funds Act, 1995, and regulations thereunder. In Count XVIII, ZCM alleges that the Oceanic Defendants **[*61]** breached their common law duty of care under Bahamian law. The Oceanic Defendants argue that ZCM's Bahamian law claims do not apply outside the Bahamas.

Regarding Count XVII, the Oceanic Defendants argue that no legislation is presumed to operate outside the territorial jurisdiction of the country enacting it. [HN34]Although "under international law, a state may not exercise authority to enforce law that it has no jurisdiction to prescribe," *Restatement (Third) of Foreign Relations Law § 431* (1987) (comment a), for the purposes of this § *431*, a "judgment of a court awarding or denying damages in a civil action would generally not be seen as enforcement." *Restatement (Third) of Foreign Relations Law § 431* (comment b). Further, [HN35]ZCM may raise, and this Court is authorized to determine, an issue concerning the law of a foreign country. *Fed. R. Civ. P. 44.1*; *See, e.g., Spinozzi v. ITT Sheraton Corp., 174 F.3d 842 (7th Cir. 1999)* (Mexican law governed substantive issues); *Cummings v. Club Mediterranee, S.A., 2003 U.S. Dist. LEXIS 19459, No. 01 C 6455, 2003 WL 22462625* **[*62]** *(N.D. Ill. Oct. 29, 2003)* (court applied Bahamian law on all substantive issues). Indeed, *Federal Rule of Civil Procedure 44.1* provides that "a party who intends to raise an issue concerning the law of a foreign country shall give notice by pleadings or other reasonable written notice." This rule contemplates that federal courts can entertain questions of foreign law. Accordingly, ZCM may plead this cause of action.

Count XVIII alleges that Oceanic breached its common law duty of care. This cause of action is not based in statute, but the common law. Thus, Oceanic's argument regarding statutory effect does not apply to this cause of action. Additionally, as discussed in the previous paragraph, this Court is authorized to determine issues of foreign law. Accordingly, ZCM may plead this cause of action.

**CONCLUSION**

The Oceanic Defendants' motion to dismiss is granted in part and denied in part. It is granted with respect to Count II. Count II is dismissed with prejudice as to Oceanic, and without prejudice as to Rahming. It is also granted without prejudice as to Counts VII, IX and XI. It is denied as to Counts III, VIII, X, XII through **[*63]** XV, XVII and XVIII. Plaintiffs have until October 22, 2004 to file a Second Amended Complaint consistent with this opinion and the Court's August 2, 2004 Opinion.

ENTERED:

AMY J. ST. EVE
United States District Court Judge

Dated: September 2 , 2004