UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF ILLINOIS

EASTERN DIVISION

LAWRENCE E. JAFFE PENSION PLAN, ON BEHALF OF ITSELF AND ALL OTHERS SIMILARLY SITUATED,	)	Lead Case No. 02-C-5893 (Consolidated)
Plaintiffs,	)	CLASS ACTION
- *against* -	)	Judge Ronald A. Guzmán
HOUSEHOLD INTERNATIONAL, INC., ET AL.,	)	
Defendants.	)	

SUPPLEMENTAL APPENDIX OF UNREPORTED AUTHORITIES IN SUPPORT OF DEFENDANTS' MOTIONS FOR JUDGMENT AS A MATTER OF LAW PURSUANT TO RULE 50(b) OR, IN THE ALTERNATIVE, FOR A NEW TRIAL PURSUANT TO RULE 59

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September 18, 2009

UNREPORTED AUTHORITIES

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TAB 1

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IN RE ANICOM INC. SECURITIES LITIGATION

No. 00 C 4391

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

2001 U.S. Dist. LEXIS 6607*; *Fed. Sec. L. Rep. (CCH) P91,458

May 15, 2001, Decided
May 18, 2001, Docketed

DISPOSITION: [*1] Defendants motions to dismiss [64-1] and [65-1] denied.

COUNSEL: For STATE OF WISCONSIN INVESTMENT BOARD, plaintiff: Douglas M. Hagerman, Michael Anthony Glackin, John R Landis, Foley & Lardner, David H. Kistenbroker, Pamela Gregory Smith, Leah J. Domitrovic, Theresa Lynn Davis, Katten, Muchin & Zavis, Chicago, Il.

For STATE OF WISCONSIN INVESTMENT BOARD, plaintiff: Brian D Melton, Kenneth E McNeil, Susman Godfrey, Houston, TX.

For STATE OF WISCONSIN INVESTMENT BOARD, plaintiff: Lynn Lincoln Sarko, Juli E Farris, Keller Rohrback, LLP, Seattle, WA.

For CHARLES DECHTER FAMILY TRUST, plaintiff: Marvin Alan Miller, Matthew Eric Van Tine, Lori Ann Fanning, Miller Faucher and Cafferty, LLP, Chicago, IL.

For CHARLES DECHTER FAMILY TRUST, plaintiff: Marian P. Rosner, Michael A. Schwartz, Patricia I. Avery, Wolf Popper, LLP, New York, NY.

For ANICOM INC, SCOTT C ANIXTER, defendants: David H. Kistenbroker, Pamela Gregory Smith, Leah J. Domitrovic, Theresa Lynn Davis, Katten, Muchin & Zavis, Chicago, Il.

For SCOTT C ANIXTER, defendant: Vincent J. Connelly, Heather Lee O'Farrell, Paris A. Wynn, Mayer, Brown & Platt, Chicago, IL.

For CARL E PUTNAM, DONALD C WELCHKO, [*2] defendants: Donald John Veverka, Veverka, Rosen & Haugh, Chicago, IL.

For CARL E PUTNAM, defendant: James R. Streicker, Theodore Thomas Poulos, Terence H. Campbell, Cotsirilos, Stephenson, Tighe & Streicker, Chicago, IL.

For CARL E PUTNAM, defendant: Joseph F Savage, Brian E. Pastuszenski, Testa, Hurwitz & Thibeault, Boston, MA.

For DONALD C WELCHKO, defendant: Donald C Veverka, Veverka, Rosen & Haugh, Chicago, IL.

For DONALD C WELCHKO, defendant: Rodney Strickland, Kathleen Hamm, Leo P Cunningham, Wilson, Sonsini, Goodrich & Rosati, Bruce G Vanyo, Wilson, Soncini, Goodrich & Rosati, Palo Alto, CA.

For DONALD C WELCHKO, defendant: Laurie B Smilan, Timothy D Belevetz, Wilson, Sonsini, Goodrich & Rosati, PC, McLean, VA.

JUDGES: JOHN W. DARRAH, United States District Judge.

OPINION BY: JOHN W. DARRAH

OPINION

MEMORANDUM OPINION AND ORDER

The State of Wisconsin Investment Board brings this action on behalf of itself and the class that it seeks to represent against defendants Anicom Inc., Scott Anixter (Scott), Carl Putman (Putman), Donald Welchko (Welchko), and Alan Anixter (Alan), alleging securities fraud in violation of §§ 10(b) and 20(a) of the Securities Exchange [*3] Act of 1934, *15 U.S.C §§ 78j(b)* and *78t(a)*. Before this Court is defendants Scott, Putman, Welchko, and Alan's Motions to Dismiss plaintiffs' consolidated class action complaint for failure to state a claim pursuant to *Federal Rule of Civil Procedure 12(b)(6)* and failure to plead fraud with particularity pursuant to *Federal Rule of Civil Procedure 9(b)* and the Private Securities Litigation Reform Act of 1995 (PSLRA), *15 U.S.C. § 78u-4(b)(1)*.

I. FACTS

The following facts are derived from plaintiffs' Consolidated Class Action Complaint. Anicom is a publicly-traded company. Defendant Scott served as Chief Executive Officer and a director of the company from 1993 through September 1, 1999. From September 1, 1999 through May 17, 2000, Scott was Chairman of the Board of Directors of Anicom. From May 17, 2000 until December 31, 2000, at which time Scott retired from Anicom, Scott was Chairman Emeritus and Director of Strategic Planning.

Defendant Putman was a director at Anicom during the class period. Putman served as President and Chief Operating Officer of Anicom until September 1, 1999. As of September 1, 1999 until July 18, 2000, when [*4] he was placed on administrative leave, Putman was the President and Chief Executive Officer of Anicom.

Defendant Welchko was Vice President and Chief Financial Officer of Anicom from 1995 until September 1, 1999. From September 1, 1999 until his resignation on July 18, 2000, Welchko was Anicom's Senior Executive Vice President and Chief Financial Officer. He was a director of Anicom throughout the class period and a member of Anicom's Audit Committee in 1998 and 1999.

Defendant Alan was an Anicom director from its founding until his resignation on May 17, 2000. He served as Chairman of the Board of Directors until September 1999 and as Chairman of Anicom's Executive Management Committee from September 1999 until his retirement.

Anicom, which is in the business of distributing multimedia technology products, was founded in 1993. Anicom began being traded publicly in 1995. Shortly afterward, Anicom began its "growth through acquisition" strategy of acquiring independently owned wire and cable distributors in the United States and Canada. By the end of 1997, Anicom had acquired 12 companies valued at a total of approximately of $ 100 million.

Anicom's ability to issue stock and borrow [*5] money fueled its acquisition strategy. Anicom maintained a credit agreement with various lenders throughout the class period. The available borrowings under the credit agreements increased from $ 50 million at the beginning of the class period to $ 150 million at the end of the class period. The credit agreements contained certain financial covenants, including an interest coverage ratio to which Anicom was required to comply. For example, the December 17, 1999, credit agreement provided that the interest coverage ratio, a ratio of earnings before interest and taxes to interest expense, must be maintained at a 2 to 1 ratio.

Beginning in 1998, Anicom's internal revenue, earnings, and profit growth began to decline. On April 29, 1998, defendants issued a press release announcing record first quarter 1998 results, stating in pertinent part, that net income for the quarter ending March 31, 1998, had increased 200.3 percent. On or about May 15, 1998, defendants filed their First Quarter 1998 Form 10-Q reiterating the financial results disclosed in the press release.

On or about July 20, 1998, defendants issued a press release reporting the results for the second quarter and first six [*6] months of 1998. The press release stated that the net income available to common stockholders increased 194 percent. For the three months ending June 30, 1998, the reported basic and diluted earnings per share increased 100 percent. Reported net sales for the second quarter increased 116 percent. In August 1998, defendants filed a Form 10-Q reiterating these results.

In September 1998, defendants issued another press release announcing the acquisition of Texas Cables. Thereafter, Scott issued statements that the acquisition was accretive to earnings and that Anicom was able to accomplish the transaction while maintaining a strong balance sheet. Defendanst also announced that their credit facility increased from $ 100 million to $ 125 million. In November 1998, defendants issued a press release announcing record third quarter and nine-month financial results, including that fully diluted earnings per common share increased more than 44 percent and net sales increased 65 percent. That same month, defendants filed a Form 10-Q reiterating these results.

In February 1999, defendants issued a press release announcing a fifth consecutive year of record growth. The press release reported [*7] that net sales increased 85 percent in the last quarter of 1998 and 93 percent for the 1998 calendar year. In March 1999, defendants filed a Form 10-Q reiterating these results.

In May 1999, defendants issued a press release announcing "record first quarter results". The release reported that net income available to common stockholders increased 17 percent, and net sales increased 34 percent.

Later that month, defendants filed a Form 10-Q reiterating these results.

In July 1999, defendants issued a press release reporting that Anicom expected sales for the second quarter of 1999 to be less than expected due to disappointing results of an acquisition from 1997. In August 1999, defendants issued a press release reporting a 17 percent increase in net sales for the second quarter of 1999 and a 25 percent increase in net sales for the first six months of 1999. That same month, defendants filed a Form 10-Q reiterating these results.

On October 1, 1999, defendants announced an anticipated $ 12 million third-quarter charge relating to restructuring and acceleration of expenses. In November 1999, defendants issued a press release reporting a net loss of $ 12 million for the third quarter [*8] and a net loss of $ 9 million for the nine month period ending September 31, 1999. It reported that Anicom's net sales for the third quarter increased 8 percent and 19 percent for the nine-month period. Defendants filed a Form 10-Q reiterating these results.

In February 2000, Anicom released a press release reporting that Anicom had a $ 3 million increase in net sales for the last quarter of 1999 and a net sales increase of 14 percent for 1999. Anicom reported that the company had a net loss of $ 10 million for 1999. In March 2000, defendants filed a Form 10-Q reiterating these results.

In May 2000, Anicom issued a press release reporting record net sales for the first quarter of 2000. Later that month, defendants filed a Form 10-Q reiterating these results.

On July 18, 2000, Anicom issued a press release announcing that it was investigating "certain accounting matters, including possible accounting irregularities, which, if confirmed, could result in revision of previously issued financial statements."

On November 13, 2000, Anicom released unaudited financial information that showed, for the nine quarters ending with the first quarter of 2000, Anicom had overstated its gross revenue [*9] by approximately $ 39.6 million and its net income by approximately $ 34.4 million. A restatement was never issued, and Anicom filed for bankruptcy on January 5, 2001.

Plaintiffs' complaint alleges primary liability pursuant to § 10(b) against Scott, Putman, and Welchko (collectively defendants) and secondary liability pursuant to § 20(a) against Scott, Putman, Welchko, and Alan.

II. ANALYSIS

A claim may not be dismissed if there is a set of facts that, if proven, would entitle a plaintiff to relief. *Trans All Over the World, Inc. v. Kingdom of Saudi Arabia, 73 F.3d 1423, 1426* (7th Cir. 1996.) The court considers "whether relief is possible under any set of facts that could be established consistent with the allegations." *Pokuta v. Trans World Airlines, Inc., 191 F.3d 834, 839 (7th Cir. 1999).* A motion to dismiss tests the sufficiency of a complaint, not its merits. *Gibson v City of Chicago, 910 F.2d 1510, 1520 (7th Cir. 1990).* However, the court is not required to accept conclusory allegations as true. *Baxter v. Vigo County Sch. Corp., 26 F.3d 728, 730 (7th Cir. 1994).*

Federal Rule of Civil Procedure 9(b) [*10] requires plaintiffs plead the circumstances constituting fraud with particularity. "This means the who, what, when, where, and how: the first paragraph of any newspaper story." *DiLeo v. Ernst & Young, 901 F.2d 624, 627 (7th Cir. 1990)* (*DiLeo*).

The PSLRA imposes even more stringent pleading standards on private plaintiffs seeking relief pursuant to § 10(b). The PSLRA requires plaintiffs to "specify each statement alleged to have been misleading." *15 U.S.C. § 78u-4(b)(1).* In addition, plaintiffs must "state with particularity facts giving rise to a strong inference that the defendants acted with the requisite state of mind." *15 U.S.C. § 78u-4(b)(2).* If these requirements are not met, the court shall dismiss the complaint. *15 U.S.C. § 78u-4(b)(3)(A).*

To state a claim for securities fraud under § 10(b), plaintiffs must allege: (1) a misrepresentation or omission, (2) of material fact, (3) made with scienter, (4) in connection with the purchase of sale of securities, (5) upon which plaintiffs relied, and (6) that reliance proximately caused plaintiffs' injuries. *In re Healthcare Compare Corp. Sec. Litig., 75 F.3d 276, 280 (7th Cir. 1996).* [*11]

Here, plaintiffs allege that Security Exchange Commission (SEC) forms filed by Anicom and signed by defendants, and press releases relating to these filings, contained material misrepresentations because the filings and statements failed to reveal that for nine quarters the defendants artificially inflated Anicom's reported earnings and profits. Plaintiffs allege that defendants engaged in accounting fraud by issuing "prebill" invoices for goods that were not shipped and for services that were not performed, creating fictitious prebill invoices through the "Drop-Ship" department, the deferral of credits due Anicom customers, overstating vendor rebates, understating expense accruals, and understating inventory costs. Evidence of the alleged fraud includes the intention to file a restatement and Anicom's admission that it would be required to restate its income by $ 35 million because Anicom had overstated revenues and recognized revenue that should not have been recognized.

In the complaint, plaintiffs identify each statement that they believe was false and allege why each statement was false. Plaintiffs go into detail why each statement was misleading; but, in general, plaintiffs [*12] allege that the statements were misleading because they reported increased sales and increased profits when defendants knew that the company was actually in financial trouble and that the reported numbers were false because they were generated through prebilling and fictitious orders. For example, the complaint alleges that Scott, Putnam and Welchko (who) implemented a fraudulent prebilling scheme (what) using computer programs from their offices (where) at the end of each quarter (when) by having their Regional managers prebill premature invoices (how) in order to make end of quarter results (why). Such pleading is sufficient to meet the requirements of *Rule 9(b)* and the PSLRA. *See Chu v. Sabratek Corp, 100 F. Supp. 2d 827, 836 (N.D.Ill. 2000)* (*Chu II*) (plaintiffs supplied sufficient details, including the contents of the misrepresentations, date and location of misrepresentations, and how the misrepresentation furthered the alleged fraudulent scheme); *Market Street Sec. v. Racing Champions Corp., 2000 U.S. Dist. LEXIS 19103, 2000 WL 1727788* (N.D.Ill. Nov. 21, 2000) (*Market Street*) (plaintiffs identified each misleading statement, the dates the statements were made, persons [*13] responsible for the statements, and alleged each statement was misleading because they suggested that the company would continue to prosper when defendants knew the company was experiencing financial problems).

Defendants argue that plaintiffs have specifically identified only 14 transactions that may have been the result of fraud; therefore, all claims based on any unidentified transactions must be dismissed. The argument is not persuasive. Courts have found that a complaint need not describe each specific transaction in detail. *See First Merchants Acceptance Corp. Sec. Litig., 1998 U.S. Dist. LEXIS 17760, 1998 WL 781118* (N.D.Ill. Nov. 4, 1998) (*First Merchants); Cooper v. Pickett, 137 F.3d 616, 627 (9th Cir. 1997)*; *SEC v. Feminella, 947 F. Supp. 722, 733 (S.D.N.Y. 1996)*. In addition, the general averments and the 14 specific transactions give adequate notice to defendants of the claims asserted them, and the information concerning the other transactions is primarily in the hands of the defendants. Plaintiffs have met their burden at this stage of the litigation. *See Market Street*, 2000 WL 1727788 at * 3; *First Merchants*, 1998 WL 781118 [*14] at * 8.

Defendants also argue that plaintiffs failed to sufficiently plead scienter.

The PSLRA provides that a complaint must "state with particularity facts giving rise to a strong inference" that the defendants acted with scienter. 15 U.S.C. § 78u04(b)(2). Scienter is established by demonstrating that the defendants had both motive and opportunity to commit fraud or by alleging facts that constitute strong circumstantial evidence of conscious misbehavior or recklessness. *Rehm v. Eagle Finance Corp., 954 F. Supp. 1246, 1253 (N.D.Ill. 1997)* (*Rehm*), citing *Shields v. Citytrust Bancorp, Inc., 25 F.3d 1124, 1128 (2nd Cir. 1994)*; *In re Nanophase Tech. Corp. Sec. Litig., 2000 U.S. Dist. LEXIS 11744, 2000 WL 1154631* (N.D.Ill. Aug. 4, 2000) (*Nanophase*). 'Reckless conduct is, at the least, conduct which is highly unreasonable and which represents an extreme departure from the standards of ordinary care ... to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it.' *Rehm, 954 F. Supp. at 1255*, quoting *Rolf v. Blyth, Eastman Dillon & Co., 570 F.2d 38, 47 (2nd Cir. 1978)*. [*15]

General accounting practice violations and/or financial restatements, standing alone, are insufficient to raise an inference of scienter. *See Rehm, 954 F. Supp. at 1255*. However, a company's overstatement of earnings or revenues combined with other circumstantial evidence can suggest fraudulent intent sufficient to support a strong inference of scienter. *Chu v Sabratek Corp., 100 F. Supp. 2d 815, 824 (N.D.Ill. 2000)*.

In the instant case, plaintiffs allege violations of general accounting practices, and Anicom admits that a financial restatement is required; however, it has not been issued. In addition, the complaint alleges that Scott, Putman, and Welchko knew of the prebilling and fictitious invoices because they were procured at the defendants' direction. Defendants also took an active part in the dissemination of the press releases and SEC filings that misrepresented Anicom's actual quarterly and yearly finances. In addition, the complaint alleges that the defendants had the ability and did monitor orders and should have noticed the large number of orders input near the end of the quarter and that such orders significantly changed the outcome of [*16] the quarter's results. Thus, the allegations raise a strong inference that the defendants knew or recklessly disregarded that Anicom was disseminating incorrect information and that Anicom was having financial difficulties. Despite this knowledge, defendants failed to correct any press releases or SEC filings.

Defendants also argue that the complaint insufficiently pleads liability against Scott, Putman, and Welchko as individual defendants. Once again, a review of the complaint indicates otherwise.

As to defendant Scott, plaintiffs allege that he signed at least two of the SEC filings that he knew contained false information, he made numerous misleading and false press releases, he took part in the prebilling and fictitious invoice "scheme", and his position within Anicom placed him in a position to know what was happening and to carry out the scheme.

Plaintiffs allege that Putman signed at least two of the SEC filings that he knew contained false and misleading information, he took part in the prebilling and fictitious invoice scheme, and he made numerous false and misleading announcements concerning the status of Anicom when he knew that the only reason the sales and profits [*17] were what they were reported as was because of the prebilling and fictitious invoices.

Plaintiffs allege that Welchko signed every quarterly and annual financial statement issued by Anicom that contained false and misleading information, and he supervised the deferred credit plan and took part in the fictitious invoice scheme. In addition, Welchko was a member of Anicom's Audit Committee, which was responsible for Anicom's auditing program and used such position to aid in not disclosing the scheme. These allegations sufficiently plead a cause of action against the individual defendants.

Defendants also argue that plaintiffs' complaint does not sufficiently plead liability for Scott, Putnam, and Welchko because it relies on "group pleading" -- that a company's statements may be presumed to be the collective work of those individuals with direct involvement in the everyday business of the company-- which was abolished by the PSLRA.

The Seventh Circuit has not ruled on the applicability of "group pleading" following the more stringent pleading requirements of the PSLRA. The courts are split on whether it still exists. *See Danis v. USN Communications, Inc., 73 F. Supp. 2d 923, 939 n.9 (N.D.Ill. 1999)*; [*18] *In re Allied Prod. Corp. Sec. Litig., 2000 U.S. Dist. LEXIS 16781, 2000 WL 1721042* (N.D.Ill. Nov. 15, 2000); *Koehler v. Nationsbank Corp., 1997 U.S. Dist. LEXIS 1839, 1997 WL 80928* (N.D.Ill. Feb. 27, 1997); *In re Oxford Health Plans, Inc. Sec. Litig., 187 F.R.D. 133, 142 (S.D.N.Y. 1999)* (all allowing group pleading) *but see, Chu II, 100 F. Supp. 2d at 837*; *Marra v. Tel-Save Holdings, Inc., 1999 U.S. Dist. LEXIS 7303, 1999 WL 317103* (E.D. Penn. May 18, 1999) (PSLRA abolished group pleading).

Based on the above findings concerning the pleadings against the individual defendants, the Court need not determine if group pleading survives the PSLRA. The above allegations against the individual defendants demonstrate that plaintiffs rely on more than the group pleading presumption to sufficiently allege a cause of action against the individual defendants. Accordingly, defendants Scott, Putman, and Welchko's Motion to Dismiss the 10(b) claims is denied.

Alan Anixter filed a motion to dismiss the § 20(a) claim against him, alleging that the claim must be dismissed because plaintiffs failed to adequately plead primary liability under § 10(b), and the complaint fails to allege a claim for control [*19] person or secondary liability for securities fraud against him. 15 U.S.C. § 78(t).

Having concluded that plaintiffs successfully pled a § 10(b) claim against the other defendants, Alan's motion to dismiss on the basis of lack of § 10(b) liability is denied.

Plaintiffs must demonstrate that Alan, as the alleged control person, actually exercised general control over the operations of the primary violator and that he had the power or ability to control the specific transaction or activity upon which the primary violation is predicated even if that power was not exercised. *See Donohoe v. Consolidated Operating Prod. Corp., 30 F.3d 907, 911-12 (7th Cir. 1994)*. Section 20(a) does not have a scienter requirement or a heightened pleading standard. Accordingly, liberal pleading requirements apply. *Chu II, 100 F. Supp. 2d at 843*.

Plaintiffs allege that Alan was a director of Anicom for several years, Chairman of the Board of Directors until September 1999, and Chairman of the Executive Management Committee from September 1999 through May 2000 and that these positions gave Alan direct control over Anicom and the power or ability to [*20] control specific transactions to which primary liability is predicated. Such allegations are sufficient at this stage of the pleadings. *See Chu II, 100 F. Supp. 2d at 843*; *In re System Software, 2000 U.S. Dist. LEXIS 3071, 2000 WL 283099* (N.D.Ill. Mar. 8, 2000); *Nanophase*, 2000 WL 1154631 at *7.

III. CONCLUSION

For the reasons stated above, defendants' Motions to Dismiss are denied.

Dated: 5-15-01

JOHN W. DARRAH

United States District Judge

TAB 2

United States District Court, N.D. Illinois, Eastern Division.
William B. BLANCHARD, on behalf of himself and all others who sold, relinquished rights in or were deprived of ownership of shares of EdgeMark Financial Corporation common stock on or after April 1, 1993 and on or before November 1, 1993, Plaintiff,
v.
EDGEMARK FINANCIAL CORPORATION, Roger A. Anderson, and Charles A. Bruning, Doe Group I, Doe Group II and Old Kent Financial Corporation, Defendants.
No. 94 C 1890.

Feb. 3, 1999.

MEMORANDUM OPINION AND ORDER

ANDERSEN, J.

***1** This class action under the federal securities laws is before the court on the motion of the defendants EdgeMark Financial Corporation ("EdgeMark"), Roger A. Anderson, Charles H. Bruning, Old Kent Financial Corporation ("Old Kent"), and Doe Groups I and II to dismiss the Third Amended Class Action Complaint pursuant to Fed.R.Civ.P. 12(b)(6). On September 14, 1998, Magistrate Judge Martin C. Ashman filed and served upon the parties his Report and Recommendation recommending that this court deny the defendants' motion to dismiss. After a careful consideration of the Magistrate Judge's Report and Recommendation, the defendants' objections thereto, the motions and memoranda of law filed by the parties, and other relevant pleadings, this court denies the defendants' motion to dismiss the Third Amended Class Action Complaint.

BACKGROUND

The plaintiffs' well-pleaded allegations, which we presume are true and view in a light most favorable to the plaintiffs for purposes of this motion, are as follows. EdgeMark is a Delaware corporation and a multi-bank holding company with its principal place of business in Chicago, Illinois. EdgeMark is the parent company of five commercial banks located in Illinois. EdgeMark and its subsidiaries were engaged in the commercial banking and trust business.

From the formation of EdgeMark in 1988, it was the intention of the directors and major shareholders to sell EdgeMark to a larger regional or national bank-holding company, thereby providing a means for its investors to realize the full value of their investment. From EdgeMark's inception, shareholder value was depressed because of the debt and preferred shareholder obligations EdgeMark incurred at its founding. EdgeMark hoped that a merger with a large bank would remedy the historical undervaluation of its stock. This plan and its rationale were well-known to William B. Blanchard, the class representative, and other members of the class. Blanchard and the other class members were also well aware that there were attempts to sell EdgeMark in the years prior to 1993.

In early 1993, EdgeMark reinitiated its efforts to find a buyer. The defendants sought the assistance of Donaldson, Lufkin & Jenrette Securities Corporation ("DLJ") to arrange such a sale. DLJ was a nationally recognized investment banking firm regularly engaged by banks, bank holding companies, and other financial corporations to value their businesses in preparation for a sale. On May 20, 1993, EdgeMark's Board of Directors authorized defendant Charles A. Bruning ("Bruning"), EdgeMark's President, Chief Executive Officer and Director, to enter into an engagement letter with DLJ as EdgeMark's exclusive financial advisor to value EdgeMark and assist in its sale. On June 1, 1993, EdgeMark executed an agreement with DLJ pursuant to which DLJ agreed to advise EdgeMark on any sale or other business combination involving EdgeMark.

In July 1993, DLJ contacted Old Kent, an Illinois banking corporation doing business in Cook County, Illinois, and approximately ten other bank holding companies. Sometime before July 22, 1993, DLJ informed EdgeMark, Bruning, and Roger A. Anderson ("Anderson"), the Chairman of the Board of EdgeMark, that EdgeMark could be sold at a price exceeding $35 per share. At an executive session of EdgeMark's Board on August 19, 1993, DLJ advised EdgeMark that a number of regional multi-bank holding companies, including Old Kent, had expressed interest in purchasing EdgeMark, had signed confidentiality agreements, and would be reviewing financial and other information concerning EdgeMark. In September 1993, DLJ advised EdgeMark that offers to purchase EdgeMark were forthcoming. In mid-October 1993, DLJ advised EdgeMark, Bruning, and Anderson that it had received three firm written offers, each containing all of the terms essential to the purchase of EdgeMark, at prices ranging from $35 to $42.79 per share.

***2** At the EdgeMark Board of Directors meeting on October 21, 1993, the directors voted to accept the offer of Old Kent at $42.79 per share. On November 2, 1993, EdgeMark announced that Old Kent had executed an acquisition agreement with EdgeMark wherein Old Kent agreed to pay $42.79 per share for EdgeMark's common stock. On November 1, 1993, the day before the announcement, EdgeMark stock was trading at $23.75 per share.

At all relevant times, EdgeMark's shares were traded over the NASDAQ Small-Cap Market. After its inception, EdgeMark had approximately 500 shareholders and approximately 1,450,000 shares and options outstanding. Until mid-October 1993, EdgeMark stock was only sporadically traded, usually in small lots. Between March 15 and April 13, 1993, there were 7,400 shares traded, with reported trading occurring on only seven days with a closing bid price on April 13 of $17 per share. Between April 15 and May 14, 1993, 1,600 shares were traded on a total of three days with a closing bid price on May 14 of $18. Between May 15 and June 15, 1993, 8,900 shares were traded on six days with a closing bid price of $22 on June 15. From June 16 through July 31, 1993, 3,000 shares of EdgeMark were traded over six days with a closing bid price of $20 per share on July 31. Between August 1 and October 13, 1993, 22,700 shares of EdgeMark traded on a total of sixteen days, with a closing bid price of $21.50 on October 13. Between October 14 and November 1, 1993, EdgeMark was traded on two days totaling 31,900 shares with a closing bid price of $23.75.

On March 25, 1994, Joseph S. Beale filed a federal putative class action against EdgeMark and two of its directors, Anderson and Bruning (collectively referred to hereinafter as the “director defendants”), asserting claims on behalf of himself and a class of current and former common stockholders of EdgeMark “who sold shares of EdgeMark common stock during the period beginning June 1, 1993 and ending November 1, 1993.” As the purported class representative, Beale alleged that the defendants deliberately concealed from the shareholders the fact that EdgeMark would be sold to Old Kent at a price vastly in excess of the then current price of its shares. On July 15, 1994, Beale filed a two-count amended complaint against the defendants on behalf of himself and a class defined as “all persons who sold, relinquished rights in or were deprived of ownership of shares of EdgeMark common stock on or after April 1, 1993 and on or before November 1, 1993.” Beale alleged that the defendants violated the Securities and Exchange Act of 1934, 15 U.S.C. § 78j(b). Beale also alleged a claim for equitable fraud.

On August 1, 1995, this court certified this litigation as a class action when we granted Beale's motion for class certification. *Beale v. EdgeMark Fin. Corp.,* 164 F.R.D. 649 (N.D.Ill.1995). Plaintiffs then filed a second amended complaint to include additional parties, including Old Kent, and causes of action, including a claim for insider trading. Subsequently, because of a settlement with Beale, the plaintiffs substituted Blanchard as the class representative and, on October 15, 1997, filed a Third Amended Class Action Complaint. The third amended complaint names as defendants EdgeMark, Old Kent, Anderson, Bruning, and Doe Groups I and II. Doe Group I consists of any and all insiders of EdgeMark who traded on inside information for their own accounts or who tipped inside information to other individuals (Doe Group II) who then traded on that information. Anderson and Bruning are members of Doe Group I.

***3** Plaintiffs claim that the defendants schemed to defraud the class by concealing material facts and omitting to state material facts necessary to make other statements not misleading concerning the sale of EdgeMark to Old Kent. Specifically, plaintiffs allege that the defendants failed to disclose the retention of DLJ, DLJ's opinion that EdgeMark could be sold for a price in excess of $35 per share, the interest expressed by other banks in purchasing EdgeMark, and the submission of offers made by other banks. Plaintiffs maintain that the negotiations for the sale of EdgeMark constituted material information that the defendants had a duty to disclose. Plaintiffs also claim that, by failing to disclose this information, other statements made by the defendants were rendered false or misleading, including EdgeMark's statement that it was "look[ing] forward to [the new president and chief executive officer, Michael Braun's] leadership as [EdgeMark] continue[d its] profitable growth" and the quarterly reports published by EdgeMark. Blanchard allegedly sold 1,200 shares of EdgeMark on July 12, 1993 and 1,000 shares of EdgeMark on August 10, 1993. Blanchard alleges that, had he known of the impending sale of EdgeMark, he would not have sold his shares in July and August of 1993. Plaintiffs further assert claims for insider trading.

The Third Amended Class Action Complaint is broken down into seven counts. In Count I, plaintiffs allege that EdgeMark, the director defendants, and Doe Group I violated Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5 under the Exchange Act, 17 C.F.R. § 240.10b-5. In Count II, plaintiffs claim that EdgeMark, the directors defendants, and Doe Groups I and II engaged in insider trading in violation of Section 10(b) and Rule 10b-5. Plaintiffs allege in Count III that EdgeMark, the directors defendants, and Doe Groups I and II violated section 14(e) of the Exchange Act, 15 U.S.C. § 78n(e), and its attendant Rule 14e-3, 17 C.F.R. 240.14e-3. Count IV alleges that EdgeMark, the directors defendants, and Doe Groups I and II violated the Insider Trading and Securities Fraud Enforcement Act, 15 U.S.C. § 78t-1. Count V is a claim for a constructive trust against the director defendants and Doe Groups I and II. Count VI alleges a claim for common law fraud against EdgeMark and the director defendants. Finally, Count VII is a claim for tortious interference against Old Kent.

LEGAL STANDARD

A motion to dismiss 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. *See Scheuer v. Rhodes,* 416 U.S. 232, 236, 94 S.Ct. 1683, 1686, 40 L.Ed.2d 90 (1974). In deciding a motion to dismiss, the court must assume all facts in the complaint to be true, construe the allegations liberally, and view the allegations in a light most favorable to the plaintiff. *Caremark, Inc. v. Coram Healthcare Corp.,* 113 F.3d 645, 648 (7th Cir.1997). The court should not ignore any facts set forth in the complaint that undermine the plaintiff's claim or assign any weight to unsupported conclusions of law. *Scott v. O'Grady,* 975 F.2d 366, 368 (7th Cir.1992), *cert. denied,* 508 U.S. 942, 113 S.Ct. 2421, 124 L.Ed.2d 643 (1993). The court may dismiss a complaint for failure to state a claim under Rule 12(b)(6) only if "it if it is clear that no relief could be granted under any set of facts that could be proved consistent with the allegations." *Hishon v. King & Spalding,* 467 U.S. 69, 73, 104 S.Ct. 2229, 2232, 81 L.Ed.2d 59 (1984).

***4** In reviewing a magistrate judge's report and recommendation, the district court generally 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)). The district court may accept, reject, or modify the recommended decision, receive further evidence, or recommit the matter to the magistrate judge with instructions. Fed.R.Civ.P. 72(b). With these standards in mind, we now turn to the defendants' motion to dismiss.

DISCUSSION

The defendants seek to dismiss plaintiffs' Third Amended Class Action Complaint in its entirety. The defendants move to dismiss plaintiffs' claim under Section 10(b) of the Securities Exchange Act on the grounds that (1) they had no duty to disclose the information relating to the sale of EdgeMark; (2) the steps taken to sell EdgeMark were too preliminary to be considered material; and (3) the plaintiffs have not adequately alleged that the defendants acted with scienter. As to plaintiffs' insider trading claims in Counts II, III, and IV, the defendants contend that plaintiffs have failed to allege with particularly the "circumstances constituting fraud" within the meaning of Fed.R.Civ.P. 9(b). Finally, the defendants argue that, because Counts I through IV must be dismissed, this court lacks jurisdiction over the state law claims in Counts V, VI, and VII. We address each of these arguments in turn.

I. Count I Sufficiently Alleges a Claim Under Section

10(b) of the Securities Exchange Act and Rule 10b-5.

Plaintiffs allege in Count I that the defendants violated Section 10(b) of the Securities Exchange Act. This section prohibits the use "in connection with the purchase or sale of any security ... [of] any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe." 15 U.S.C. § 78j(b). Pursuant to this section, the SEC promulgated Rule 10b-5 which makes it unlawful for any person:

(a) To employ any device, scheme, or artifice to defraud, (b) [t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or (c) [t]o 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. To state a claim under Section 10(b) and Rule 10b-5, a plaintiff must allege that: (1) the defendant made an untrue statement of a material fact or omitted a fact that rendered a statement made by the defendant misleading; (2) with the intent to mislead (scienter); (3) in connection with the purchase or sale of securities; (4) upon which the plaintiff relied; and (5) that reliance proximately caused plaintiff's injuries. *Stransky v. Cummins Engine Co.,* 51 F.3d 1329, 1331 (7th Cir.1995). In a case involving alleged fraudulent omissions, the plaintiff must establish that the defendant had a duty to disclose the omitted information. *Basic, Inc. v. Levinson,* 485 U.S. 224, 239, n. 17, 108 S.Ct. 978, 987 n. 17, 99 L.Ed.2d 194 (1988).

***5** The defendants first move to dismiss Count I on the ground that plaintiffs have not alleged sufficiently that the defendants had a duty to disclose material facts relating to the sale of EdgeMark. Second, the defendants argue that, even if they had a duty to disclose, the information regarding the sale of EdgeMark was not "material." Specifically, the defendants contend that most of the plaintiffs sold their stock well before any negotiations to sell EdgeMark began. Thus, the defendants claim that the events leading up to the sale of EdgeMark were not material until after most members of the class sold their stock. Finally, the defendants claim that the plaintiffs have failed to allege sufficient facts to establish that the defendants acted with scienter. The Magistrate Judge rejected each of these arguments and the defendants have filed objections thereto. As explained below, we agree with the Magistrate Judge that the defendants' motion to dismiss Count I should be denied.

A. The Third Amended Complaint Sufficiently Alleges that the Defendants had a Duty to Disclose the Information Regarding the Sale of EdgeMark

When, as here, a Section 10(b) claim is based upon non-disclosure of a material fact, rather than from the making of a statement that is independently misleading, "there can be no fraud absent a duty to speak." *Chiarella v. United States,* 445 U.S. 222, 235, 100 S.Ct. 1108, 1118, 63 L.Ed.2d 348 (1980). The Supreme Court has explicitly held that "[s]ilence, absent a duty to disclose, is not misleading under Rule 10b-5." *Basic,* 485 U.S. at 239 n. 17. Thus, a person does not have a duty to disclose under Section 10(b) merely because he possesses nonpublic market information. *Chiarella,* 445 U.S. at 235. A duty to disclose material information exists when (1) the omission renders other statements misleading; (2) a special, fiduciary relationship or other similar relationship of trust and confidence exists between the parties; or (3) the insider trades on or tips nonpublic information to others who trade on that information. *See Chiarella,* 445 U.S. at 227-30; *Schlifke v. Seafirst Corp.,* 866 F.2d 935, 944-46 (7th Cir.1989).

Plaintiffs claim that these three situations obligated the defendants to disclose the information relating to the sale of EdgeMark. We conclude that the defendants failure to disclose did not render other statements made by EdgeMark misleading. As to the second situation, we find that the defendants owed Beale a duty to disclose based on a special relationship between Beale and the defendants. We disagree with the Magistrate Judge that the defendants also owed the plaintiff class a duty to disclose based on Beale's special relationship with the defendants. Finally, we find that defendants Anderson and Bruning had a duty to disclose because they allegedly engaged in insider trading. We agree with the Magistrate Judge that, because EdgeMark may be held primarily liable for the director defendants' insider trading, EdgeMark also had a duty to disclose.

1. The omissions did not render the defendants' other

statements misleading so as to create a duty to disclose.

***6** The Magistrate Judge concluded that EdgeMark's alleged omissions relating to the sale of EdgeMark did not render other statements made by EdgeMark misleading. In the Third Amended Class Action Complaint, plaintiffs rely on three statements that they claim were rendered misleading by the defendants' failure to disclose the pre-merger activities: (1) a statement that appeared in EdgeMark's April 15, 1993 quarterly report indicating that EdgeMark had experienced improved financial results for the quarter, but that the bank's book value per common share had decreased $1.51 from that reported a year earlier (Third Am. Compl. ¶ 27); (2) the June 3, 1993 announcement that Michael C. Braun had been named president and chief executive officer of Merchandise National Bank, an EdgeMark subsidiary, and that EdgeMark was “look[ing] forward to [Braun's] leadership as we continue our profitable growth” (*Id.* ¶ 33); and (3) the July 1993 and October 21, 1993 quarterly reports that reported EdgeMark's book value at $22.38 per share. (*Id.* ¶¶ 36, 42).

Plaintiffs contend that these statements led them to believe that EdgeMark was not pursuing its original plan to sell itself and that “EdgeMark was going nowhere when, in fact, the contrary was true.” Plaintiffs argue that the defendants' failure to disclose their efforts to sell EdgeMark made these statements misleading. As the Magistrate Judge correctly noted, the defendants would have a duty to disclose if the statements noted above could reasonably be viewed as a declaration that EdgeMark had abandoned its efforts sell EdgeMark. Although there must be some nexus between the statements and the alleged omissions, it is not necessary that each statement, on its own, must be rendered misleading by a particular omission. *KAS v. Caterpillar, Inc.,* 815 F.Supp. 1158, 1170 (C.D.Ill.1992). Rather, the pertinent inquiry is whether the statements, viewed in light of the circumstances under which they were made and in the context of all other material information, were rendered misleading by the alleged omissions. *Id.* at 1171.

Applying this standard, the Magistrate Judge concluded that the statements regarding EdgeMark's book value and earnings and the announcement of Braun's promotion were not rendered misleading by the defendants' alleged omissions because these statements had nothing to do with the sale of EdgeMark. We agree with the Magistrate Judge that these statements bear no relation to the sale of EdgeMark. None of the statements implied that the sale of EdgeMark was less likely or more likely than before. Thus, no reasonable person could have concluded from these statements that EdgeMark had abandoned its efforts to find a buyer. Plaintiffs' contrary interpretations of these statements are implausible. Because these statements do not shed light on the sale of EdgeMark, we find that the defendants did not owe plaintiffs a duty to disclose because the defendants' alleged failure to disclose material information rendered other statements made by EdgeMark misleading.

2. Plaintiffs have alleged sufficient facts to establish a special relationship between Beale and the defendants to give rise to a duty to disclose.

***7** The plaintiffs next contend that the defendants owed Beale and thereby, the class as a whole, a duty to disclose based on the existence of a special relationship between Beale and the defendants. The Supreme Court has held that a fiduciary relationship or similar relation of trust and confidence may create a duty to disclose under Section 10(b). *Chiarella,* 445 U.S. at 228. This duty arises from the common law that imposed a duty of disclosure when one party had information “that the other [party] is entitled to know because of a fiduciary or other similar relation of trust and confidence between them.” *Chiarella,* 445 U.S. at 228 (citing Restatement (Second) of Torts § 551(2)(a)(1976)). Such a relationship of trust exists between the shareholders of a corporation and those insiders who have obtained confidential information by virtue of their position in the corporation. *Id.* Thus, the courts have found violations of Section 10(b) when corporate insiders used nonpublic information for their own benefit. *See, e.g., SEC v. Texas Gulf Sulphur Co.,* 401 F.2d 833 (2d Cir.1968) (en banc), *cert. denied,* 394 U.S. 976, 89 S.Ct. 1454, 22 L.Ed.2d 756 (1969).

The Magistrate Judge found that plaintiffs have alleged sufficiently a relationship of trust and confidence between Beale and the defendants that goes beyond that normally found between a corporate shareholder and insiders. Specifically, plaintiffs allege that Beale pledged all of his 197,357 shares of

EdgeMark stock to Harris Trust and Savings Bank as security for a loan Beale obtained from Harris. Beale allegedly used the loan proceeds to purchase enough EdgeMark stock so that EdgeMark could meet the Federal Reserve capitalization requirements to become a multi-bank holding company. (Third Am. Compl. ¶ 47). These shares, with some qualifications, could be reacquired by Beale upon receipt of notice to Harris Bank and payment of $24 per share prior to July 31, 1993. (*Id.*) The purpose of qualifying EdgeMark as a national bank holding company was to facilitate the sale of EdgeMark. (*Id.* ¶ 48). Plaintiffs allege that the director defendants and Harris Bank knew that Beale planned to pay back the loan when EdgeMark was sold to another bank. (*Id.*).

Plaintiffs claim that, rather than receiving any direct compensation from EdgeMark for assisting it in meeting the capitalization requirements, Beale expected to be compensated through the sale of EdgeMark stock in the event it was sold to a large national or regional bank. (*Id.* ¶ 49). Plaintiffs also claim that the director defendants knew that Beale would lose the right to redeem his shares in July 1993 and that he would not redeem his shares absent information about the steps that had been taken to sell EdgeMark. (*Id.*). Plaintiffs claim that, because the defendants failed to disclose facts concerning the sale of EdgeMark, Beale decided not to reacquire his 197,357 shares of EdgeMark common stock by paying Harris Bank $24 per share. (*Id.* ¶ 52). Plaintiffs allege that, had Beale known that the defendants had deliberately concealed information about the sale of EdgeMark, he would have reacquired or redeemed his stock. (*Id.*).

***8** Additionally, plaintiffs allege that, by concealing their plans to sell EdgeMark, the defendants were able to maintain Harris Bank as the largest single shareholder. (*Id.* ¶ 61). Plaintiffs claim that this concealment allowed the director defendants to entrench themselves as directors and managers of EdgeMark. (*Id.*). As the Magistrate Judge correctly noted, the defendants may have benefitted by having Harris Bank, rather than Beale, as the largest single shareholder because Harris may have been more willing to acquiesce to the directors' choice of buyers. Based on these allegations, the Magistrate Judge concluded that plaintiffs have alleged sufficient facts that could give rise to a special relationship between Beale and the defendants such that the defendants owed Beale and the class a duty to disclose the events leading up to the sale of EdgeMark. The Magistrate Judge further noted that these facts were relevant and admissible despite the settlement between Beale and the defendants because this court previously ruled that Beale's release would not affect the admissibility of such evidence.

We agree with the Magistrate Judge that plaintiffs have alleged sufficient facts that could give rise to a special relationship between Beale and the defendants which, in turn, would require the defendants to disclose to Beale information concerning the sale of EdgeMark. The defendants give us no reason to conclude otherwise and, indeed, do not object to the Magistrate Judge's finding on this issue. (Obj. at p. 3). The defendants object to the Magistrate Judge's conclusion that, because of the special relationship between Beale and the defendants, a duty to disclose was also owed to the entire class. According to the defendants, "[w]ithout any citation to supporting authority, the Report holds that if there was a 'special' relationship with Beale that gave rise to a duty of disclosure, that duty was owed not just to Beale, but to the entire class." (*Id.*). The defendants claim that the "facts unique to [Beale] and his own relationship with EdgeMark do not confer a similar special standing upon every other member of the class." (*Id.* at p. 4).

Plaintiffs have not cited, nor have we discovered, any authority for the proposition that a defendant who owes a duty to disclose to a class representative based on a special relationship automatically owes a duty to disclose to the rest of the class. Indeed, such a rule would conflict with the "established doctrine that duty arises from a specific relationship between two parties." *Chiarella,* 445 U.S. at 233. Thus, absent any allegations indicating a special relationship between them a duty to disclose merely because Beale had a relationship of trust and confidence with the defendants. The plaintiffs object to this conclusion arguing that they have alleged such facts in paragraph 60 of the third amended complaint. Although paragraph 60 concludes that the defendants owed "fiduciary duties" to the plaintiff class, it does not set forth sufficient facts to support the conclusion that the plaintiff class had a special relationship with the defendants akin to that shared between the defendants and Beale.

***9** Moreover, plaintiffs claim that the defendants could have fulfilled their duty to Beale only by a public disclosure that would undoubtedly have reached the class. Implicit in this argument is that none of the other class members would have been misled if the defendants would have fulfilled their duty to Beale to disclose material information concerning the sale of EdgeMark. While this may be true, plaintiffs fail to explain how this fact obligated the defendants to disclose such information to the plaintiff class in the first instance. The Supreme Court has held that, in determining whether a duty to disclose exists based on a special relationship, the court must "identify a relationship" between the plaintiff and the party who allegedly withheld the material information. *Id.* at 232. By focusing on the harm that a nondisclosure would cause the plaintiff class, plaintiffs fail to allege any special relationship that would bring this case within the purview of *Chiarella.* Absent such allegations, the defendants did not owe the plaintiff class a duty to disclose.

In summary, we agree with the Magistrate Judge that plaintiffs have alleged sufficient facts to support a finding that the defendants owed Beale a duty to disclose based on a special relationship between Beale and the defendants. We disagree with the Magistrate Judge that the defendants automatically owed the plaintiff class a duty to disclose because of their special relationship with Beale.

3. Plaintiffs' insider trading allegations establish that the defendants had a duty to disclose based on the abstain or disclose rule.

Next, plaintiffs claim that the defendants owed them a duty to disclose because the defendants traded on inside information and tipped that information to others. A corporate insider is liable under Rule 10b-5 for insider trading if he fails to disclose material nonpublic information before trading on it and thereby makes "secret profits." *Dirks v. SEC,* 463 U.S. 646, 654, 103 S.Ct. 3255, 3261, 77 L.Ed.2d 911 (1983). This rule is commonly referred to as the abstain or disclose rule. *Id.* at 661 n. 21. A corporate insider may also be liable under Rule 10b-5 if, instead of trading on his own account, he tips material nonpublic information to another person who then trades on that information. *Id.* at 655-56. The purpose of the disclosure determines whether the insider breached his fiduciary duty to the corporation. *SEC v. Maio,* 51 F.3d 623, 632 (7th Cir.1995). A disclosure that lacks a legitimate purpose is improper if it will benefit the insider either directly or indirectly. *Id.*

We find, as did the Magistrate Judge, that the third amended complaint sufficiently alleges that defendants Anderson and Bruning had a duty to disclose because they traded on inside information and tipped that information to others. Plaintiffs allege that Anderson and Bruning are members of Doe Group I which consists of "any and all insiders of EdgeMark who traded on inside, material, nonpublic information for their own accounts or tipped material, nonpublic information ... to other others who then traded on that information." (Third Am. Compl. ¶¶ 7, 73). A corporate insider who tips nonpublic information to a third party may be liable for insider trading not only when the tipping confers a direct benefit on the insider, but also when the insider makes a gift of confidential information to a trading friend or relative. *Maio,* 51 F.3d at 632. This is so because "the tip and trade resemble trading by the insider himself followed by a gift of profits to the recipient." *Id.* Because plaintiffs have alleged that both directors traded for their own account and tipped confidential information to others, either for their own benefit or as a gift, the director defendants owed plaintiffs a duty to abstain or disclose.

***10** In their objections, the defendants do not challenge the conclusion that the allegations as to Anderson and Bruning are sufficient to establish a duty to disclose under the abstain or disclose rule. Indeed, the defendants acknowledge that "the allegation is there, and we will deal with it later." (Obj. at p. 2). Rather, the defendants claim that, while the Magistrate Judge correctly recognized that there were no allegations of insider trading by EdgeMark, he improperly found that EdgeMark could be held primarily liable for the alleged insider trading of Anderson and Bruning because they held prominent positions in EdgeMark. The defendants claim that the Magistrate Judge's ruling on this issue is erroneous because the "courts have consistently held that insider trades do not impose a duty of disclosure on the corporation, regardless of how highly placed in the corporation the individuals are." (*Id.* at 7). Thus, absent any allegations of insider trading by EdgeMark, the defendants conclude that EdgeMark cannot have a duty to disclose.

As the Magistrate Judge correctly noted, in the context of a claim under Rule 10b-5 high ranking officers in a corporation present a different situation from lower level employees. *SEC v. Tome,* 638 F.Supp. 596, 624 (S.D.N.Y.1986). "Officers are able to make policy and generally carry authority to bind the corporation. Their action on behalf of the corporation is therefore primary, and holding a corporation liable for their actions does not require respondeat superior." *Id.* at 624. We agree with the Magistrate Judge that, because Anderson was the Chairman of the Board and Bruning was the Chief Executive Officer and President, EdgeMark may be held primarily liable for their actions. Whether plaintiffs will ultimately succeed in holding EdgeMark liable for the actions of Anderson and Bruning depends on a number of factual questions including, among others, when Anderson and Bruning allegedly traded on inside information, who at EdgeMark knew that they were trading on inside information, and the precise relationship Anderson and Bruning had with EdgeMark. Moreover, if Anderson and Bruning failed to disclose to EdgeMark that they were trading on inside information, EdgeMark may have a claim against them if it is liable to the plaintiffs. These are factual questions that cannot be addressed at this stage of the proceedings.

In conclusion, we find that EdgeMark had a duty to disclose information concerning the sale of EdgeMark because it could be held primarily liable for the director defendants' alleged insider trading.

B. The Negotiations Leading to the Sale of EdgeMark were Material.

The defendants argue that, even if they had a duty to disclose, the events leading up to the sale of EdgeMark did not become material until after EdgeMark's suitors submitted offers to purchase EdgeMark. Because Blanchard and most of the other members of the class sold their stock before EdgeMark received these offers, the defendants contend that there was nothing material to disclose to the plaintiff class. After a thorough review of the third amended complaint, the Magistrate Judge concluded that the plaintiffs had alleged sufficient facts to establish a substantial likelihood that a reasonable investor would have considered each event leading up to the sale of EdgeMark important in deciding whether to invest in EdgeMark. In reaching this conclusion, the Magistrate Judge refused to conclude as a matter of law that the events preceding the sale of EdgeMark became material only after a given point in the negotiation process.

***11** "An omitted fact is material if there is a substantial likelihood that a reasonable [investor] would consider it important in [making an investment decision]." *Basic,* 485 U.S. at 231 (quoting *TSC Indus., Inc. v. Northway, Inc.,* 426 U.S. 438, 449, 96 S.Ct. 2126, 2132, 48 L.Ed.2d 757 (1976)). In determining whether a particular fact is material, the court must ask whether there is a "substantial likelihood that the disclosure of the omitted fact would have been viewed by the investor as having significantly altered the total mix of information made available." *Id.* at 231-32 (quoting *TSC Indus.,* 426 U.S. at 449). This standard does not lend itself to straightforward application in the context of preliminary merger negotiations because of the contingent and speculative nature of such negotiations. *Id.* at 232. The materiality of merger negotiations in any given case must be determined by balancing "both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity." *Id.* at 238 (quoting *Texas Gulf Sulphur Co.,* 401 F.2d at 849).

In assessing the probability that the merger will occur, the trier of fact must "look to indicia of interest in the transaction at the highest corporate levels," including board resolutions, instructions to investment bankers, and actual negotiations between principals or their intermediaries. *Id.* at 239. In assessing the magnitude of the merger to the issuer and its shareholders, the fact finder must consider facts as the size of the corporate entities and the size of the potential premiums over the market value. *Id.* Importantly, because "the determination [of materiality] requires the delicate assessment of the inferences a reasonable shareholder would draw from a given set of facts and the significance of those inferences to him," materiality is an issue for the trier of fact and ordinarily is not amendable to a motion to dismiss. *Marks v. CDW Computer Ctrs.,* 122 F.3d 363, 369 (7th Cir.1997) (quoting *TSC Indus.,* 426 U.S. at 450); *McGrath v. Zenith Radio Corp.,* 651 F.2d 458, 466 (7th Cir.) (noting that materiality is a question peculiarly for the trier of fact), *cert. denied,* 454 U.S. 835, 102 S.Ct. 136, 70 L.Ed.2d 114 (1981).

Plaintiffs claim that the following events were material and thus should have been disclosed: (1) the decision of EdgeMark's Board of Directors to seek a buyer for EdgeMark; (2) the decision to retain DLJ to assist with the sale; (3) DLJ's prediction that EdgeMark shares could be sold in excess of $35 per share; (4) DLJ's delivery to EdgeMark of the list of potential buyers; and (5) EdgeMark's decision to accept Old Kent's offer at $42.79 per share. The defendants agree that the fifth step was material but contend that the earlier events were too incipient to be material. Specifically, the defendants claim that pre-merger events that occurred prior to the commencement of formal negotiations are immaterial as a matter of law. The defendants maintain that the Magistrate Judge's decision on the materiality issue was “patently erroneous” because “where negotiations have not yet started there is nothing to disclose.” (Obj. at 12-13). Thus, as they did before the Magistrate Judge, the defendants argue for a bright line rule on when events become material in the context of a merger.

***12** In discussing the inappropriate nature of a bright-line rule in the materiality context, the Supreme Court observed:

A bright-line rule indeed is easier to follow than a standard that requires the exercise of judgment in the light of all the circumstances. But ease of application alone is not an excuse for ignoring the purposes of the Securities Acts and Congress' policy decisions. Any approach that designates a single fact or occurrence as always determinative of an inherently fact-specific finding such as materiality, must necessarily be overinclusive or underinclusive.

Basic, 485 U.S. at 236. Thus, we agree with the Magistrate Judge that it is inappropriate to conclude, as a matter of law, that merger negotiations can only be material after a given point in the negotiation process. Rather, we must apply the test articulated by the Supreme Court in *Basic* and balance the probability that the merger will go through with the magnitude of the merger to the shareholders.

Applying this standard, we cannot conclude at this stage of the litigation that the pre-merger negotiations were immaterial as a matter of law. Beginning with the magnitude of the transaction, it is clear that the merger had a dramatic impact on the value of the stock which jumped from a price of $23.75 to $42.79 per share after the merger. This fact alone demonstrates that the merger was an event of significant magnitude. Turning to the probability prong, we find that a reasonable jury could conclude, based on the defendants' resolve to find a buyer and the the attractiveness of the offers, that there was a reasonable probability that a merger would be consummated once EdgeMark received the three bids. As to the events preceding the offers to purchase EdgeMark, we agree with the Magistrate Judge that there are insufficient facts before the court to conclude that these events are immaterial as a matter of law. Because of the fact-intensive nature of the materiality question and the other facts alleged in the complaint, we believe that this issue cannot be resolved on the pleadings.

The defendants object to this conclusion arguing that the pre-merger events are not material because they did not alter the total mix of information available to EdgeMark investors. The defendants contend that the EdgeMark investors knew that (1) EdgeMark was formed for the sole purpose of being sold to a larger bank-holding company; (2) past efforts to sell EdgeMark had failed; and (3) bank acquisitions were on the rise, especially in the Chicago area. Although EdgeMark investors may have been aware of this information, we find that the fact that EdgeMark was again seeking a buyer and taking affirmative steps toward the culmination of a merger, including actual receipt of bids at prices well above the market, altered the mix of information available. This finding is especially appropriate because EdgeMark had failed in the past to find a buyer and the EdgeMark stockholders and potential investors had no reason to know or think that new efforts to sell EdgeMark were underway.

***13** In conclusion, we agree with the Magistrate Judge that the plaintiffs have alleged facts sufficient to establish a substantial likelihood that a reasonable investor would have considered each of the pre-merger events important in making the decision to invest in EdgeMark. Accordingly, the defendants' motion to dismiss Count I on the basis that the omitted information was not material as a matter of law is denied.

C. The Plaintiffs Have Alleged Adequately Scienter

The defendants next contend that plaintiffs have failed to allege scienter. To establish a claim under

Section 10(b) and Rule 10b-5, a plaintiff must plead and prove that the defendant acted with scienter. *Sundstrand Corp. v. Sun Chem. Corp.,* 553 F.2d 1033, 1045 (7th Cir.), *cert. denied,* 434 U.S. 875, 98 S.Ct. 224, 54 L.Ed.2d 155 (1977). "Scienter" refers to a mental state embracing intent to deceive, manipulate, or defraud. *Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 200, 96 S.Ct. 1384, 47 L.Ed.2d 668 (1976). The scienter factor is also satisfied if the defendant acts recklessly. *Panter v. Marshall Field & Co.,* 646 F.2d 271, 282 (7th Cir.), *cert. denied,* 454 U.S. 1092, 102 S.Ct. 658, 70 L.Ed.2d 631 (1981). Scienter "may be adequately alleged by setting forth facts establishing a motive and an opportunity to commit fraud, or by setting forth facts that constitute circumstantial evidence of either reckless or conscious behavior." *Weiner v. Quaker Oats Co.,* 129 F.3d 310, 318 n. 8 (3d Cir.1997) (citation omitted); *Renovitch v. Kaufman,* 905 F.2d 1040, 1046 (7th Cir.1990).

The defendants contend that there were innocent and compelling reasons why they did not disclose the premerger negotiations. According to the defendants, disclosure could have hurt EdgeMark's bargaining position, caused market speculation, or even doomed the deal. In light of these legitimate concerns, the defendants maintain that plaintiffs must allege some facts "which would demonstrate to a reasonable person why an evil motive is more likely than an innocent or prudent one." (Mem. Supp. at 14). We agree with the Magistrate Judge that the defendants misapprehend the nature of plaintiffs' burden in pleading scienter. Because intent may be alleged generally under Fed.R.Civ.P. 9(b), plaintiffs need not allege that an evil motive was more likely than an innocent one. Rather, at this stage of the litigation, the complaint need only set forth some factual basis to believe that plaintiffs will be able to prove scienter. *DiLeo v. Ernst & Young,* 901 F.2d 624, 629 (7th Cir.), *cert. denied,* 498 U.S. 941, 111 S.Ct. 347, 112 L.Ed.2d 312 (1990).

In the present case, plaintiffs allege that the defendants intentionally and with reckless disregard for the interests of its shareholders withheld and fraudulently concealed material information about the pending merger although they knew that such information was important to purchasers and sellers of EdgeMark stock. (Third Am. Compl. ¶ 67). Plaintiffs also claim that EdgeMark knew that the fraudulently concealed information would (and did) become known to others who would profit from having such knowledge to the detriment of the plaintiff class. (*Id.* ¶ 68). Finally, plaintiffs claim that the defendants were motivated to commit fraud because it would enable them to (1) manipulate the market price of the EdgeMark shares; (2) manipulate the offers EdgeMark received for its shares and manipulate EdgeMark's acceptance of those offers; (3) entrench themselves as directors and managers of EdgeMark; and (4) permit insiders of EdgeMark and their tipees to profit from the concealed information at the expense of the plaintiff class. These allegations sufficiently show that the defendants had a motive and an opportunity to commit fraud.

***14** Reviewing our conclusions above, we conclude that plaintiffs have alleged sufficient facts that (1) the defendants had a duty to disclose the events preceding the sale of EdgeMark; (2) the events leading up to the merger of Old Kent and EdgeMark constituted material information within the meaning of Section 10(b); and (3) the defendants acted with scienter. Therefore, the defendants' motion to dismiss Count I is denied.

II. Plaintiffs' Insider Trading Claims in Counts II, III, and IV Satisfy the Particularity Requirement of Fed.R.Civ.P. 9(b).

The defendants argue that Counts II, III, and IV are deficient under Fed.R.Civ.P. 9(b). Although a complaint is ordinarily sufficient if it contains a "short and plain statement of the claim showing that the pleader is entitled to relief," Fed.R.Civ.P. 8(a)(2), a plaintiff alleging fraud must plead with particularity the circumstances constituting fraud. This standard applies to plaintiffs' Section 10(b) and Rule 10b-5 claim in Count II because fraud is an element of such a claim. *Goldsmith v. Technology Solutions Co.,* 92 C 4374, 1994 WL 323317, at *4 (N.D. Ill. June 27, 1994). Plaintiffs' Section 14(e) claim in Count III must also satisfy the particularity requirement of Rule 9(b) because Section 14(e) and Rule 10b-5 "are coextensive in their antifraud prohibitions." *Panter,* 646 F.2d at 282. Finally, because the Insider Trading and Securities Fraud Enforcement Act claim in Count IV requires an independent predicate violation of the 1934 Act or the rules or regulations promulgated thereunder, *Hogan v. Piasecki* No. 96 C 7399, 1997 WL 260345, at *1 (N.D.Ill. May 7, 1997), we conclude that this claim is based on the same allegations of fraud therefore triggering Rule 9(b).

In order to satisfy the particularity requirement of Rule 9(b), plaintiffs must plead the "who, what, where, when and how" of the alleged fraud. *Dileo,* 901 F.2d at 627. The defendants contend that plaintiffs have failed to plead who engaged in the unlawful insider trading or tipping, when the unlawful insider trading or tipping took place, how the information was tipped, for whose benefit it was tipped, and why EdgeMark, Anderson or Bruning should be liable. Additionally, the defendants claim that dismissal is proper because the allegations are based on information and belief. The defendants argue that plaintiffs have not alleged any facts that create an inference that insider trading took place. Finally, the defendants contend that Blanchard is an inadequate class representative because he cannot satisfy the contemporaneous trading requirement because he sold his stock more than a month before the alleged increase in trading. The Magistrate Judge, after a careful and thorough review of the third amended complaint, rejected each of these arguments.

Initially, we find that plaintiffs have adequately alleged the "who, what, when, where and how" of the claimed fraud. Plaintiffs state that the "who" includes Anderson, Bruning and other insiders, as well as third parties identified in Exhibit A who allegedly traded on the basis of tipped information. (Third Amend. Compl. ¶¶ 7, 8). The "what" component is the purchase of EdgeMark stock by the EdgeMark insiders and their tipees. (*Id.* ¶ ¶ 58, 59, 73, 78, 88). The plaintiffs further allege that the fraud was committed through the issuance of incomplete or misleading releases and quarterly reports. (*Id.* ¶¶ 27, 33, 36, 42). As to the "when" component, plaintiffs allege that the trading took place between April 1 and November 1, 1993. (*Id.* ¶ 78). Plaintiffs do not allege, however, the exact dates on which the individual defendants traded even though they must establish that they traded contemporaneously with the individual defendants to sustain their insider trading claims. *Wilson v. Comtech Telecomm. Corp.,* 648 F.2d 88, 94-95 (2d Cir.1981). The defendants claim that the insider trading claims are deficient under Rule 9(b) for this reason.

***15** We conclude, as did the Magistrate Judge, that such a deficiency is not fatal because plaintiffs have not had the opportunity to conduct discovery because discovery was stayed early in this case. Although Rule 9(b) is designed to prevent fishing expeditions and to provide sufficient notice to the defendants of the claims against them, *Fugman v. Aprogenex, Inc.,* 961 F.Supp. 1190, 1194 (N.D.Ill.1997), the court "can not expect a private plaintiff in an insider trading case to plead with the specificity Rule 9(b) requires without allowing some limited opportunity for discovery." *Neubronner v. Milken,* 6 F.3d 666, 671 (9th Cir.1993). Because plaintiffs have had no opportunity to conduct discovery, we find that their allegations concerning the dates of the alleged insider trading are sufficient at this stage of the proceedings to withstand the defendants' motion to dismiss. We agree with the Magistrate Judge that the defendants may renew their objections regarding specificity and the potential lack of contemporaneous trading if, after time for discovery, plaintiffs are unable to plead the dates of the alleged insider trading with greater specificity.

As to plaintiffs' attempt to plead on information and belief, we note that "allegations based on information and belief do not satisfy the particularity requirement unless the complaint sets forth the facts on which the belief is founded." *Goldsmith,* 1994 WL 323317 at *4 (internal quotations omitted). Although many of plaintiffs' insider trading allegations are based on information and belief, plaintiffs have stated that this belief is based on the following: the marked increase in trading activity during the Class period, the fact that the stock was thinly traded, the fact that there was very little public information available about the company, the fact that EdgeMark vehemently resisted the production of the NASD responses, and the fact that the NASD responses demonstrate that there is some kind of "relationship" between some of the third parties that purchased EdgeMark stock and EdgeMark insiders. (Third Amend. Compl. ¶¶ 7, 25, 28, 31, 34, 37, 41, 44, 58, 59, 60, 74, 82). We agree with the Magistrate Judge that these facts and the reasonable inferences therefrom form an adequate basis for plaintiffs' claim that the individual defendants engaged in insider trading.

The objections the defendants have filed with this court on the insider trading claims echo many of the same arguments that were presented to and rejected by the Magistrate Judge. The remainder of the defendants' objections focus on each of the allegations noted above in an effort to show that they cannot support a claim of insider trading. We overrule these objections for the reasons stated above and because they ignore the reasonable inferences that we must draw in favor of the plaintiffs on a motion to dismiss. For all of the foregoing reasons, we conclude that the plaintiffs have adequately pled a claim for insider trading under Rule 9(b).

III. The Court Retains Jurisdiction Over the State Law Claims.

***16** The defendants argue that the state law claims in Counts V, VI, and VII should be dismissed because this court lacks an independent ground for asserting jurisdiction. Because we deny the defendants' motion to dismiss the federal claims in Counts I, II, III, and IV, this court retains supplemental jurisdiction over the plaintiffs' state law claims. Accordingly, the defendants' motion to dismiss Counts V, VI, and VII is denied.

CONCLUSION

For all of the forgoing reasons, the defendants' motion to dismiss the Third Amended Class Action Complaint is denied.

It is so ordered.

N.D.Ill.,1999.
Blanchard v. EdgeMark Financial Corporation
Not Reported in F.Supp.2d, 1999 WL 59994 (N.D.Ill.), Fed. Sec. L. Rep. P 90,439, Fed. Sec. L. Rep. P 92,000

END OF DOCUMENT

TAB 3

Not Reported in F.Supp.2d, 2007 WL 1029092 (N.D.Ill.)
(Cite as: 2007 WL 1029092 (N.D.Ill.))

Only the Westlaw citation is currently available.

United States District Court,
N.D. Illinois,
Eastern Division.
In re CAREER EDUCATION CORPORATION Securities Litigation.
No. 03 C 8884.

March 29, 2007.

Steven G. Schulman, Andrei V. Rado, Peter Seidman, Milberg Weiss Bershad & Schulman LLP, Joshua Lifshitz, Bull & Lifshitz, LLP, New York, NY, Anthony F. Fata, Marvin Alan Miller, Miller Faucher and Cafferty, LLP, Chicago, IL, for Plaintiff.

Thomas Schroder, pro se.

David H. Kistenbroker, Joni S. Jacobsen, Karl Richard Barnickol, Mary Ellen Hennessy, Katten Muchin Zavis Rosenman, LLP, Daniel E. Reidy, Alicia Marie Hawley, James Cordray Dunlop, Lee Ann Russo, Jones Day, Chicago, IL, for Defendant.

MEMORANDUM OPINION AND ORDER

JOAN HUMPHREY LEFKOW, United States District Judge.

***1** The buyers of stock in Career Education Corporation ("CEC"), including lead plaintiff Thomas Schroder and a putative class (collectively, "plaintiffs"), filed this suit alleging that defendants, CEC, John M. Larson (CEC's CEO) ("Larson"), and Patrick K. Pesch (CEC's CFO) ("Pesch") (collectively, "defendants"), committed securities fraud in violation of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78(j), and Rule 10(b)-5 promulgated thereunder, 17 C.F.R. § 240.10b-5. They also allege that defendants Larson and Pesch are liable as control persons of CEC under Section 20(a) of the 1934 Act, 15 U.S.C. § 78(t). The court has jurisdiction pursuant to 28 U.S.C. § 1331 and 15 U.S.C. § 78aa.

The case is before the court on defendants' motion to dismiss plaintiffs' third amended consolidated complaint ("the third amended complaint"). Two of plaintiffs' complaints have previously been dismissed without prejudice. *See* Mem. Op. and Order of February 11, 2005 (Dkt. No. 48); Mem. Op. and Order of March 28, 2006 (Dkt. No. 99). Last time, the court warned plaintiffs that they would have one final opportunity to state a claim for securities fraud. Mem. Op. and Order of March 28, 2006, at 20. For the reasons that follow, defendants' motion is granted. This case is dismissed with prejudice.

I. Background

CEC is a provider of private, for-profit post-secondary education with campuses worldwide and online.[FN1] Third Amended Consolidated Complaint for Violation of the Federal Securities Laws ("TAC"), at ¶ 2. During the class period, April 22, 2002 through February 15, 2005,[FN2] CEC made public statements about its performance in press releases, United States Securities and Exchange Commission ("SEC") filings, and conference calls. TAC, at ¶ 5, ¶¶ 220-328. It reported bad debt expense to revenue ratios that were comparatively positive to those of its competitors, "record" revenues and earnings, steadily increasing figures for new student "starts" and overall student population, and job placement rates for graduates in the 90th percentile and above. *Id.*

FN1. The court assumes familiarity with the background of this case as stated in its previous memorandum opinions, but restates the basic facts here for the convenience of the reader.

FN2. Plaintiffs seek to amend the alleged class period to extend it further backwards in time from January 28, 2003 to April 22, 2002. Defendants oppose this, arguing that plaintiffs are attempting to validate previously rejected witness statements made in 2002 by moving the class period instead of substantively curing their allegations. Because the court has determined that plaintiffs' claims must be dismissed in any event, the dispute need not be addressed.

On February 15, 2005, when CEC announced its results for the fourth quarter of 2004 and the year ended December 31, 2004, the news was not quite so good. TAC, at ¶ 329. The press release indicated that CEC's financial results included the following two items: first, a restatement of its revenue for the financial periods 2000-2004 due to a change in its method of revenue recognition for certain student externships. TAC, at ¶ 330-31.[FN3] Second, CEC took a fourth quarter charge of $18.9 million due to an increased estimate for doubtful student accounts.[FN4] The 2004 Form 10-K was filed a month later, on March 16, 2005. TAC, at ¶ 335. The 10-K included the news that CEC was writing off $92 million of its student account receivables ("bad debt"). TAC, at ¶ 336 (citing CEC's 2004 Form 10-K). CEC's reserve against which this charge was taken was $153.2 million. Defendants' Reply Mem., at 13; CEC's 2004 Form 10-K (Filed March 16, 2005) (available at http://www.sec.gov/). [FN5]

FN3. It explained, "The new revenue recognition method recognizes tuition revenue through the end of the student's externship period, while the prior practice recognized revenue only over the period of in-school academic instruction.... The full-year and fourth quarter 2004 restatement resulted in a non-cash reduction of $11.5 million and $3.4 million in revenue and $0.06 and $0.02 per diluted share after taxes, respectively. This revenue will be earned and recognized in subsequent periods net of student refunds." TAC, at ¶ 331. This restatement is not a focus of plaintiffs' third amended complaint. Plaintiffs address it only in three paragraphs: 107-109.

FN4. CEC said, "The company recently analyzed its receivables collection rates together with changes in financial aid funding sources and improved analytical tools, and determined it should increase its estimate for its allowance for doubtful accounts." TAC, at ¶ 332.

FN5. Although plaintiffs did not attach the 10-K to their complaint, they cite extensively from it, and the statements therein are central to their securities fraud claims, Therefore, the court can consider the 10-K on this motion to dismiss. *Albany Bank & Trust Co. v. Exxon Mobil Corp.,* 310 F.3d 969, 971 (7th Cir.2002). The court can also take judicial notice of SEC filings without converting a motion to dismiss into one for summary judgment. *Stavros v. Exelon,* 266 F.Supp.2d 833, 844 n. 8 (N.D.Ill.2003).

***2** Plaintiffs allege that defendants made materially false and misleading statements in their communications to investors throughout the class period by (1) understating and manipulating CEC's bad debt allowance and expense and its ratio of bad debt to revenue in violation of Generally Accepted Accounting Principles ("GAAP"); (2) overstating earnings in violation of GAAP; and (3) inflating reported figures for new student starts, overall student population, and job placement rates for CEC graduates. Plaintiffs' Mem. Opp. Mot. D., at 3. As noted above, the court has dismissed the same claims twice already. *See* Mem. Opp. and Order of Feb. 11, 2005, at 4; Mem. Opp. and Order of March 28, 2006, at 2-3. In both of those opinions, the court carefully examined each of the allegations and concluded that plaintiffs did not state a claim for securities fraud for various reasons: the complaint did not show that its confidential informants were reliable; the allegations were insufficiently particular in that they were vague as to when and to what extent any misconduct occurred; the allegations did not show that the misconduct had any effect on CEC's public statements or how and why those statements or omissions were rendered materially false or misleading; and the complaints did not adequately allege that the defendants acted with the requisite scienter.

In order to succeed on a claim under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5, a plaintiff must prove that "(1) the defendant made a false statement or omission (2) of material fact (3) with scienter (4) in connection with the purchase or sale of securities (5) upon which the plaintiff justifiably relied and (6) that the false statement proximately caused the plaintiff damages." *Makor Issues & Rights, Ltd. v. Tellabs, Inc.,* 437 F.3d 588, 595 (7th Cir.2006) (citing *Caremark Inc. v. Coram Healthcare Corp.,* 113 F.3d 645, 648 (7th Cir.1997)). At the outset of each case, plaintiffs must clear the high hurdles for pleading a securities fraud claim set by Federal Rule of Civil Procedure 9(b) and the Private Securities Litigation Reform Act of 1995 ("the PSLRA"), 15 U.S.C. § 78u-4(b). *Id.* at 594. "Under the PSLRA, a securities fraud complaint must (1) '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' and (2) 'state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.' " *Id.* (citing 15 U.S.C. § 78u-4(b) (1)). Because many of plaintiffs' allegations are based on information and belief acquired by counsel from confidential witnesses, plaintiffs must describe their sources "with sufficient particularity to support the probability that a person in the position occupied by the source would possess the information alleged." *Makor Issues & Rights,* 437 F.3d at 596.

***3** Although it is 128 pages and 387 paragraphs long (26 pages and 100 paragraphs longer than the second amended complaint was), employs 27 confidential witnesses instead of 22, and attaches 27 additional documents, the third amended complaint still fails to state a claim for securities fraud. Despite the court's specific findings regarding the first and second amended complaints' deficiencies, and its explicit warning that "[p]laintiff should take note ... that the quality of the allegations, rather than the quantity, is what is important in pleading a claim of securities fraud," Mem. Op. and Order of March 28, 2006, at 20 n. 14, the third amended complaint suffers from the same problems as its predecessors did.[FN6]

FN6. Unbelievably, plaintiffs have submitted some of the same paragraphs, verbatim or nearly so, as were rejected in the court's first *and* second memorandum opinions. Mem. Op. and Order of March 28, 2006, at 9 ("Despite the court's explicit counsel to plaintiff, plaintiff has resubmitted many of the same allegations without correcting their deficiencies."); *Compare* Amended Consolidated Complaint ("ACC"), at ¶ 38 with Second Amended Complaint ("SAC"), at ¶ 129 and TAC, at ¶ 193; ACC, at ¶ 39 with SAC, at ¶ 131 and TAC, at ¶ 201. Only slightly less incredible is the fact that plaintiffs have resubmitted allegations that have been rejected once before (as opposed to twice). *See, e .g.,* SAC, at ¶ ¶ 91-97; TAC, at ¶¶ 161-167; Defendants' Mem. Supp. Mot. Dismiss, at 4 n. 2 (comparing additional paragraphs).

The majority of plaintiffs' new allegations are vague or otherwise unreliable, and none raise an inference that any of CEC's public statements were false or misleading. Critically, plaintiffs do not cite any competent witness or document to show how any of the alleged improprieties affected the truth of CEC's public statements. In addition, regardless of all other problems, plaintiffs' third amended complaint must be dismissed because they have failed to plead facts supporting a strong inference that the defendants acted with scienter, a deficiency that is sufficient by itself to require dismissal of the complaint. Plaintiffs again ask the court to view their allegations as a whole, Plaintiffs' Mem. Opp. Mot. D., at 15, 37, but as previously explained, the court cannot draw any inferences from allegations that are not themselves well pleaded; zero plus zero is zero. Mem. Op. and Order of March 28, 2006, at 3-4. For these reasons and because the court has already issued two comprehensive opinions, this memorandum will only highlight the insufficiency of plaintiffs' key allegations instead of undertaking a comprehensive review of the 387 paragraph complaint.

The court will begin with the first pleading hurdle of the PSLRA, which "requires the plaintiff to support with particularity the first two elements noted above: the falsity of the statement of fact or omission, and its materiality." *Makor Issues & Rights,* 437 F.3d at 595. In Section IV the court will address the independent requirement for plaintiffs to allege scienter.

II. Allegedly False or Misleading Statements Regarding Understatement of Bad Debt Allowance, Expense, and Ratio of Bad Debt to Revenue

Plaintiffs' main focus is their theory that the defendants understated and manipulated CEC's bad debt allowance and expense and its ratio of bad debt to revenue, which ultimately led to the need to take an additional $18.9 million charge to increase its bad debt allowance and a $92 million write off of bad debt expense. "Bad debt" in this context is a past due student tuition account whose collectibility is doubtful. Plaintiffs allege, among other things, that CEC employees encouraged current and former students to make token “good faith” payments of $25 or less on their overdue debts. Based on those payments, CEC re-classified the students' loans as current, thereby decreasing its reported bad debt expense by millions of dollars. The individual allegations, however, do not support this “good faith payment” theory. For the following reasons, plaintiffs have not adequately alleged that any of CEC's public statements regarding bad debt were false or misleading.

***4** Many of plaintiffs' allegations focus on management pressure on employees to reduce bad debt. *See, e.g.,* TAC, at ¶¶ 40, 44, 56, 57, 59, 62, Exs. C, D, E, G. Nothing in these allegations, however, indicates that CEC's management told employees to engage in improper accounting practices in order achieve their goals. It is proper for a company to attempt to reduce its bad debt; if CEC had not tried to do so, plaintiffs might be in court alleging a breach of fiduciary duty. *See* Mem. Op, and Order of March 28, 2006, at 15. Plaintiffs also allege that defendants had a “template” to calculate bad debt allowances, under which the allowance would be based on a percentage of the amount of the receivables, with the percentage increasing as the age of the receivables increased and the student left school. TAC, at ¶¶ 45, 47, 54. Plaintiffs do not adequately allege that this was improper.

Plaintiffs believe that the use of “good faith” payments to make a student's account current and thereby reduce reported bad debt violated GAAP and was fraudulent. Assuming that they are right, they are vague as to when and to what extent this occurred and how it affected CEC's financial statements. *See* TAC, at ¶¶ 45, 46, 52, 64, n. 7. Additionally, many of the confidential witness statements that plaintiffs cite have still not been shown to be reliable. Plaintiffs have not shown that the witnesses have any basis for their knowledge for some of the statements, and for others, the witnesses are only relaying rumors and second-hand information. *See, e.g.,* TAC, at ¶¶ 48, 51, 52, 53, 80, 92, fn.9. The only witness allegations that are sufficiently particular and arguably well-founded concern minimal discrepancies at only a few schools. *See, e.g.,* TAC, at ¶¶ 50 (bad debt at eight schools was reportedly 5%, but should have been between 6% and 12%), 55 (one school reported $2.5 million in bad debt, but should have reported $4 million in Witness 12's “professional judgment”).

New internal CEC documents attached to the third amended complaint provide some quantification of the use of “good faith payments” at certain CEC schools. Internal audits conducted at six CEC schools during the summer of 2003 found that without the use of good faith payments and the incorrect classification of some students as in school versus out of school, CEC's bad debt expense would have been negatively impacted by a total of approximately $900,000. TAC, at Exs. H-M. Plaintiffs also cite internal CEC “Bad Debt Improvement Reports,” which reflect improvement of bad debt via good faith payments. *See* TAC, at Exs. F, N (Document entitled “Divisional Summary” stated that the effect of good faith payments on bad debt improvement was $14 million as of June 5, 2003), O, P, Q, There is no indication of who received these documents or when.

Plaintiffs implicitly ask this court to make an inference that defendants' use of good faith payments and misclassification of students ultimately led to the announcements made in 2005 that CEC had to increase its bad debt allowance by $18.9 million and write off $92 million of uncollectible accounts, but they do not explain the connection between the two. “A general allegation that the accounting practices at issue resulted in a false [financial] report is not a sufficiently particular claim of misrepresentation to satisfy Rule 9(b).” *In re Midway Games, Inc. Sec. Litig.,* 332 F.Supp.2d 1152, 1164 (N.D.Ill.2004) (Lefkow, J.) (citing *Gross v. Summa Four, Inc.,* 93 F.3d 987, 996 (1st Cir.1996)). “Rather, plaintiffs must allege the amount of the putative overstatement ... or the net effect it had on the company's earnings. *Id.* (citing, *inter alia, Roots Partnership v. Lands' End, Inc.,* 965 F.2d 1411, 1420 (7th Cir.1992) (allegation that company “failed to establish adequate reserves for its excessive and outdated inventory” does not satisfy Rule 9(b) where investor does not allege “what the company's reserves were or suggest how great the reserves should have been”).)

***5** Although it is *possible* that manipulations made by CEC employees had a material effect on CEC's overall bad debt calculations, it is also entirely possible that they had only an immaterial effect, or no effect at all, because the court does not know if or how any manipulated figures were incorporated into the final Financial statements that were reported to the market.[FN7] Plaintiffs imply that CEC should have written off more of its bad debt earlier, but fail to say when or to offer any suggestion about what CEC's numbers should have been in any particular financial statement. "For any bad loan the time comes when the debtor's failure is so plain that the loan is written down or written off. No matter when a [company] does this, someone may say that it should have acted sooner." *DiLeo v. Ernst & Young,* 901 F.2d 624, 627 (7th Cir., 1990). The court cannot make the plaintiffs' suggested but unsupported inferences in the context of the PSLRA. *Davis v. SPSS, Inc.,* 385 F.Supp.2d 697, 710 (N.D.Ill.2005) ("plaintiff forgoes providing necessary factual allegations, relying instead on the court to make connections unwarranted by the current pleadings.").[FN8][FN9]

FN7. Witness 7, new for the third amended complaint, was "a senior accounting executive at CEC Corporate in Hoffman Estates throughout the class period. Witness 7 was responsible for the Company's consolidating internal and external financial statements and financial reporting." In the entire 387 paragraph complaint, however, Witness 7 is cited only 3 times, TAC, at ¶¶ 30(g), 47, 49, n. 5, and he alleges nothing about CEC's financial statements.

FN8. The fact that CEC assigned internal auditors to investigate bad debt accounting issues does not support an inference that it intended to conceal fraudulent accounting methods. Defendants' Reply, at 17 (citing *In re Watchguard Sec. Litig.,* 2006 WL 2927663, at *8 (W.D.Wash. Oct.12, 2006) (allegation that a company assigned internal auditors to investigate an issue is "far more consistent with an attempt to remedy problems than an intent to mislead investors.").)

FN9. The court notes that CEC apparently *did* maintain a sufficient student receivable allowance for bad debts in 2004 for the $92 million that it wrote off. Defendants' Reply Mem., at 13; CEC's 2004 Form 10-K (Filed March 16, 2005) (available at http://www .sec.gov/).

Plaintiffs have not sufficiently alleged that any of defendants' statements regarding its bad debt were materially false or misleading when they were made. The court will move on to consider the next major category of allegedly fraudulent statements.

III. Allegedly False or Misleading Statements Regarding Student-Related Information

Defendants allegedly issued false and misleading statements concerning critical business metrics of the company including its new student starts, total student population, and job placement rates. Additionally, plaintiffs allege that CEC schools incorrectly reported students' enrollment status to the United States Department of Education's National Student Loan Data System ("the NSLDS") and that they inflated reported income by withholding refunds of Title IV funds that should have been returned to the government.[FN10] For the following reasons, plaintiffs have not adequately alleged that any of CEC's public statements regarding student-related information were false or misleading.

FN10. A large portion of plaintiffs' allegations in this section of their complaint are unreliable. Some are vague as to what happened, when, and whether it had any effect on the truth of CEC's public statements. *See* TAC, at ¶¶ 144, 146-47, 155, 174-75, 183, 187, 193, 196-97, 199, 200, 214-15, 218, fn.15. Many of the confidential witnesses' allegations are based on rumor or second hand information. *See* TAC, at ¶¶ 147, 156-58, 161-67, 178, 188-89, 194-95,213,219.

Plaintiffs believe that in violation of an internal CEC policy regarding who could be considered a "start," defendants included students in their start numbers who did not have proof of a high school diploma or a GED, who did not have a full package of financial aid, or who had not shown up for the first week of class. Defendants also moved start deadlines so that they could count late students as starts. The individual allegations do not support this theory.

First, the complaint again focuses on management's pressure on employees to meet their goal enrollment numbers for new student starts. TAC, at ¶¶ 140-42, 148, 169, fn.18. Pressure to meet performance goals, no matter how tough or unreasonable it might have been, is not evidence that CEC employees engaged in misconduct or fraud in order to meet those goals. Second, plaintiffs allege that many students who were counted as starts had not yet submitted proof that they had a high school diploma or a GED. TAC, at ¶¶ 143-44, 177, 179, 181, 184. The fact that some students had not submitted the necessary paperwork, however, does not show that they in fact had not graduated from high school. *But cf.* TAC, at ¶¶ 180, 185. Third, many students allegedly were not fully "packaged" when they started school; that is, they did not have financial aid and loans to cover 100% of their tuition, and were therefore likely to drop out. TAC, at ¶¶ 191-196. Packaging was not one of the criteria for a "start" according to CEC's internal guidelines, however. TAC, at ¶ 138. Furthermore, a lack of full packaging does not necessarily indicate that a student was sure to drop out, and the court must keep in mind that CEC was not representing to the market that all of its new student starts would stay in school through graduation. Fourth, plaintiffs' allegations that defendants moved their start deadlines in order to count late students are generally vague and unreliable. *See, e.g.,* TAC, at ¶¶ 199-200. The exceptions, including paragraphs 145 and 172-73, show only minimal evidence of counting late students in the previous start period at a couple of schools and therefore are insufficient to support any inference that CEC's public statements were rendered materially false or misleading.

***6** Plaintiffs also contend that defendants made false statements regarding CEC's overall student population numbers because they failed to account for students who had stopped attending class. TAC, at ¶¶ 182, 197-98, 201. In paragraph 182, Witness 5 says that in the "spring of 2002," she participated in an audit of students at Katherine Gibbs New York School, found 250 "phantom" students, and told defendant Larson at a meeting on May 13, 2002. In paragraph 197, Witness 10 says that at her school in the "end of 2003" the school's official population number was 775 but "the number of students who were active and attending classes was, in fact, closer to 650 students." TAC, at ¶ 197. In paragraph 198, Witness 17 reports that at his school, between 2002 and July 2004, 208 students were dropped "between 15 and 298 days" later than they should have been. Finally, in paragraph 201, Witness 2 says that between April 2002 and June 2003, "4-6% of the students in every quarter during her tenure should not have been counted as active students (*i.e.,* included as starts), as they were not attending classes." Even crediting all of these allegations, plaintiffs have not raised an inference that there was a problem with accurately reporting student population numbers at all of CEC's schools (or even a significant portion) that rose to the level of materially affecting CEC's public statements.

Moving on to plaintiffs' belief that CEC misrepresented its placement rate for graduates, plaintiffs allege that CEC reported a higher placement percentage than was actually achieved, in part by counting any job as related to the student's course of study. The problems with these allegations are that many of CEC's statements were made to prospective students, not to the market, and plaintiffs do not allege that they relied on those statements in purchasing or retaining their CEC stock. TAC, at ¶¶ 134, 152, 155, 158. Plaintiffs complain that CEC included placements that the student had achieved without CEC's assistance in its numbers, but do not explain why this made reported placement percentages false. TAC, at ¶¶ 133, 156-57, 160. The only credible example of counting clearly unrelated jobs as related to the student's course of study is in paragraph 157 and concerns just one school. Paragraph 153 alleges that a May 2002 report shows only a 68% placement rate at 17 schools, but plaintiffs do not allege that any contemporaneous statement to the market was thereby rendered false.[FN11]

> FN11. In CEC's Annual Report for the year ending December 31, 2002, issued on March 10, 2003, it said "94.1 percent of our graduates who were available for employment for the academic year ended June 30, 2002, had found employment relating to their fields of study within six months of graduation." TAC, at ¶ 251.

Finally, plaintiffs make allegations based on audits of CEC schools that found that the schools had incorrectly reported students' enrollment status to the Department of Education, withheld federal Title IV funds that should have been returned, or returned Title IV funds late. Plaintiffs ask the court to infer that based on this information, CEC's student population numbers in its public statements were false and its reported revenue was inflated.

***7** In audits of seven CEC schools done for the federal government by Almich & Associates ("the Almich audits"), the auditors found that the schools incorrectly reported the enrollment status or graduation date to the NSLDS for some of their students. TAC, at ¶¶ 206-11, Exs. Y-EE. For the seven schools combined, 189 total students were incorrectly reported in 2002-2003. The possible effect of this was stated in the audits: "Incorrect reporting of student status changes may result in federal interest subsidies being paid toward loans that should be in repayment and are no longer eligible for the subsidies." While this may constitute evidence of poor record keeping, the court cannot infer from the fact that seven schools incorrectly reported the status of 189 students to the NSLDS that CEC materially misrepresented the size of its overall student population (which was between approximately 40,000 and 100,000 during the class period) in its SEC filings and other public statements.

Four reports were sent to CEC regarding schools that failed to return Title IV money to the federal government, or that failed to return money on time. TAC, at ¶¶ 112-14, 204-05, 208, 216-17, Exs. S, AA, EE. The first report concerned a review of student files for the years 2000-2003 at Collins College in Tempe, Arizona. TAC, at Ex. S. The report found that Collins improperly failed to return approximately $20,000 worth of Title IV funds and that it returned other funds later than it should have based on the timing of students' changes in enrollment status. *Id.,* at 10. Additionally, it found that Collins engaged in some improper accounting techniques which affected its eligibility to receive Title IV funds under the Department of Education's "90/10 rule," under which a school must receive a portion of its revenues from non-Title IV sources in order to remain eligible. *Id.,* at 21. Similarly, for Katherine Gibbs College in Montclair, New Jersey, Katherine Gibbs College in Boston, and the Cooking and Hospitality Institute of Chicago, the auditors found that the schools failed to return Title IV funds in a timely manner. TAC, at Exs, AA, EE, FF. Katherine Gibbs College in New Jersey failed to return funds on time for only two students. TAC, at Ex. AA. At Katherine Gibbs College in Boston, $105,143.77 worth of funds were returned between 12 and 598 days late. TAC, at Ex. FF. And at the Cooking and Hospitality Institute of Chicago, funds for 23 students were returned late, amounting to at least $16,256.00. [FN12]

> FN12. In paragraph 190, Witness 28, who worked a CEC Headquarters and is one of plaintiffs' new witnesses for the third amended complaint, says that a number of schools held on to funds for much longer than they were supposed to, and that the total amount withheld on a quarterly basis was at least $10-12 million. The court cannot credit this allegation because plaintiffs have failed to show that Witness 28 would have any basis to know this. Plaintiffs' only description of Witness 28 is that he "had a variety of executive titles including Vice President of Admissions for all of CEC." TAC, at ¶ 30bb.

Although these reports indicate some sloppy accounting at a few of CEC's schools, the court cannot infer that any of CEC's statements to the market regarding its student population numbers or revenues were materially false or misleading. Plaintiffs have not identified any specific connection between the problems identified in the audits and any particular statement made by CEC. [FN13] Regardless, even if the court were to find these allegations sufficient to raise an inference that any of CEC's statements were rendered false, they must be rejected anyway because plaintiffs fail to raise a strong inference that defendants acted with the requisite scienter.

> FN13. The court notes that CEC disclosed information relating to this subject in its financial statements. In its annual report for 2003, issued on March 12, 2004, CEC disclosed, "Institutions that receive Title IV Program funds that have been found during an audit or compliance review to have made late student refunds above a minimum threshold in either of their last two fiscal years must post a letter of credit with the DOE in an amount equal to 25% of the total Title IV Program refunds paid by the institution during its prior fiscal year. Based on this standard, we currently have posted a total of $4,100,066 in letters of credit with respect to 19 of our institutions."

IV. Scienter

***8** As noted above, "with respect to each act or omission alleged" as false or misleading, a plaintiff must "state with particularity facts giving rise to a strong inference that the defendant acted with the requisite state of mind." 15 U.S.C. § 78u-4(b)(2). That state of mind, or scienter, is "the intent to deceive, manipulate, or defraud," *Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 193, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976), or "an extreme departure from the standards of ordinary care, which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it." *Makor Issues & Rights,* 437 F.3d at 600 (citations omitted). Therefore, "not only must plaintiffs meet a particularity requirement; they must also meet a substantive requirement by pleading sufficient facts to create 'a strong inference' of scienter ." *Id.* at 601.[FN14] In their third amended complaint, plaintiffs have failed to create a strong inference of scienter, and their case must be dismissed on that basis.

FN14. The third amended complaint is replete with vague and conclusional allegations that defendants or "CEC Corporate" knew or were aware of improprieties that occurred throughout the company through their access to corporate information and participation in conference calls and meetings regarding general topics such as "bad debt issues." *See, e.g.,* TAC, at ¶¶ 7, 25, 40, 42-43, 44-46, 52-54, 56, 59, 91-92, 110, 126, 144, 146-148, 175, 196, 341, fn.7, fn.8, fn.9, fn.13, fn.16, Ex. C. These allegations clearly lack the requisite particularity and cannot be credited. *See Davis v. SPSS,* 385 F.Supp.2d at 716.

Plaintiffs cite the fact that there was a restatement of financial reports and the magnitude of the alleged GAAP violations as evidence of defendants' state of mind. TAC, at ¶¶ 343-44. These allegations are insufficient by themselves to support a strong inference of scienter. *See DiLeo v. Ernst & Young,* 901 F.2d 624, 627 (7th Cir.1990); *In re Bally Total Fitness Sec. Litig.,* 2006 WL 3714708, at *7-*8 (N.D.Ill. July 12, 2006) (citing, *inter alia, DiLeo,* 901 F.2d at 627) ("The Seventh Circuit has observed that even a very large restatement [$4 billion] is not itself evidence of scienter.").[FN15] Plaintiffs also note that Larson and Pesch were high-ranking executives, and ask the court to infer that their positions support an inference of scienter. "Scienter, however, may not rest on the inference that defendants must have been aware of a misstatement based simply on their positions within the company." *Bally Total Fitness* 2006 WL 3714708, at *8 (citing *Davis v. SPSS, Inc.,* 385 F.Supp.2d at 713-14 (quoting *Johnson v. Tellabs, Inc.,* 262 F.Supp.2d 937, 957 (N.D.Ill.2003); *Abrams v. Baker Hughes Inc.,* 292 F.3d 424, 432 (5th Cir.2002)).[FN16] Furthermore, defendants' pressure on employees to meet financial and business goals does not establish an inference that defendants knew that any of their public statements were fraudulent. *See* TAC, at ¶¶ 7, 25(d), 56, 140-41, 342.

FN15. Some courts have found that a large violation of GAAP, when combined with other circumstances suggesting fraudulent intent, can bolster scienter allegations. *See, e.g., Davis v. SPSS,* 385 F.Supp.2d at 713-14 (citations omitted) ("While violations of GAAP provide some evidence of scienter, they fall far short of raising a strong inference of knowing or reckless misrepresentation."). Here, there are no other circumstances with which to combine the alleged GAAP violations. The court also notes that plaintiffs' citation of *Selbst v. McDonald's Corp.,* 2005 WL 2319936 (N.D.Ill. Sept.21, 2005), a case in which plaintiffs' lawyers here were involved, is inappropriate due to that court's later reversal of course and dismissal of their case in *Selbst v. McDonald's Corp.,* 432 F.Supp.2d 777 (N.D.Ill.2006) and *Selbst v. McDonald's Corp.,* NO. 04-C-2422, Minute Order dated December 15, 2006 (Dkt. No. 107).

FN16. Plaintiffs' citation on this point of *In re Sears, Roebuck & Co. Sec. Litig.,* 291 F.Supp.2d 722 (N.D.Ill.2003) is not persuasive because that case is distinguishable from this one. Plaintiffs in *Sears* made particularized allegations that the individual defendants, high-ranking executives of *Sears,* personally made specific statements regarding the company's credit card business, which represented over half of its operating income. *Id.* at 724. Defendants stated that its credit card customers were "low risk" while the truth was that over 50% of them were in fact high risk at the beginning of the class period. *Id.* at 725. In this situation, the court was able to conclude that "defendants in their positions would be expected to have knowledge of the facts regarding the credit card portfolio at the time they were making statements about the portfolio." *Id.* at 727. As the court has discussed in Sections II and III, plaintiffs here have not adequately alleged the existence of any internal information that contradicted CEC's public statements. Therefore, *Sears* does not support an inference of scienter in this case.

Plaintiffs' reliance on insider trading allegations to support an inference of scienter also fails, because they do not compare Larson's and Pesch's stock sales to any previous or subsequent trading activity, as they must in order to use insider trading to create an inference of scienter. *See* TAC, at ¶¶ 8, 21, 22, 345-46, 349, 351-52. "While insider trading may be sufficient circumstantial evidence of scienter, plaintiffs must show that the sale of stock is 'dramatically out of line with prior trading practices at times calculated to maximize the personal benefit from undisclosed inside information.' " *Makor Issues & Rights,* 437 F.3d at 604 (citing *In re Silicon Graphics Sec. Litig.,* 187 F.3d 970, 986 (9th Cir.1999)).

***9** Similarly, the facts that Larson and Pesch both received bonuses based on CEC's performance, and CEC was able to make some stock-based acquisitions on favorable terms based on the inflation of its stock, do not indicate that the defendants acted with scienter. This court agrees with the view of numerous others that allegations that executives were motivated to achieve higher compensation and that a company was motivated to achieve buying power cannot be evidence of scienter because these motivations are common to every executive and every corporation. Allowing them to be evidence of scienter would eviscerate the requirement. *Bally Total Fitness,* 2006 WL 3714708, at ----9-10 (citing cases).[FN17]

FN17. Plaintiffs' citations do not support them. *See, e.g., In re Spiegel, Inc. Securities Litigation,* 382 F.Supp.2d 989, 1027 (N.D.Ill.2004) (citation omitted) ("a salary and benefits incentive is arguably too general to satisfy the scienter requirement, particularly in the absence of any additional evidence of wrongdoing, such as suspicious timing. Indeed, under Plaintiffs' argument, virtually any corporate executive would have the requisite intent to defraud, since most salaries and benefit packages have some incentive-based dimension."). Plaintiffs here have not adequately alleged suspicious timing or other additional evidence of wrongdoing.

Larson's receipt of the Department of Education audits does not create an inference of scienter. In addition to the issues raised above regarding these reports, Larson received the audits long after the time periods which the audits were reviewing. TAC, Ex. S (Audit report regarding Collins College's Title IV program in 2000-2003 dated July 14, 2004); Ex. AA (Almich audit report regarding Katherine Gibbs College in New Jersey for the year 2003 dated May 5, 2005).[FN18]

FN18. Plaintiffs must allege that defendants had knowledge that their statements were false or misleading at the time that they made those statements. *Bally Total Fitness,* 2006 WL 3714708, at *7; *In re Abbott Labs. Sec. Litig.,* 813 F.Supp. 1315, 1318-19 (N.D.Ill.1992).

The remaining allegations regarding what Larson or Pesch knew do not support any inference that they made any extreme departures from the standards of ordinary care. In paragraph 143, Witness 28 states that "between 2002 and 2004, approximately 20% of the students who were counted as starts at CEC did not have proof of graduation or a GED." In paragraph 144, Witness 28 says that "Larson, Pesch, and other CEC executives knew about this" and Witness 28 attended "meetings with Larson and Pesch where this issue was discussed.... [L]ack of proof of graduation at various schools was discussed [*sic*] on numerous occasions during the class period at CEC's weekly Executive Committee meetings, the 'War Room Meetings' and on conference calls between Corporate and the Regional/Divisional Teams. These calls included Larson and/or Pesch...." Putting aside the point that a lack of *proof* of graduation or a GED does not mean that students in fact did not graduate or have a GED, this statement is generally vague about what Larson and Pesch knew and when they knew it. In paragraph 145, Witness 28 reports, "in December 2002/January 2003 two hundred students at the Gibbs School in New York were moved from one start period to another so that Pat Martin, a close associate of Larson, could make her start numbers.... Larson was definitely aware of that." As discussed above, the fact that 200 students were moved does not lead to the conclusion that any of CEC's public statements were materially misleading. Also, Witness 28 is vague about when Larson knew about this incident. Finally, in paragraph 182, Witness 5 states that "in the Spring of 2002, she participated in an audit of students at Katherine Gibbs New York School and determined that 250 of the students there were 'phantom' students who had been counted as starts by the admissions department (and that number was reported to Corporate), but were not attending school. She told Larson about this at an in-person meeting in New York on May 13, 2002." There is no indication in this allegation of what time period the audit reviewed, when the students stopped attending school, and what effect the numbers had on CEC's public statements. Larson's knowledge of it, even if assumed, does not matter.

***10** The key allegation that the court again searched for and again found missing in plaintiffs' third amended complaint is any reliable statement that the defendants had knowledge of particular facts that rendered a specific statement materially false or misleading. Plaintiffs again ask the court to consider the totality of their complaint, but the court must again point out that aggregating all of plaintiffs' insufficient allegations does not add up to more than their sum.[FN19] The third amended complaint has not created a strong inference that defendants made any false or misleading statements with scienter.

FN19. Plaintiffs suggest that even if scienter is not found on the part of the individual defendants, the court could find it on the part of CEC as a whole. The court disagrees, based on well-reasoned precedent and the fact that allowing that would eviscerate the scienter requirement. *See Bally Total Fitness,* 2006 WL 3714708, at *11 (citing *Caterpillar, Inc. v. Great Am. Ins. Co.,* 62 F.3d 955, 963 (7th Cir.1995)).

V. Order

For the foregoing reasons, plaintiffs' securities fraud claim, along with its dependent control person liability claim, must be dismissed. Because the plaintiffs have had ample opportunities to research and plead their claims and have been warned that this was their last chance to amend their complaint, defendants' motion to dismiss [# 124] is granted, and this case is dismissed with prejudice. The clerk is directed to terminate it.

N.D.Ill.,2007.
In re Career Educ. Corp.
Not Reported in F.Supp.2d, 2007 WL 1029092 (N.D.Ill.)

END OF DOCUMENT

TAB 4

Only the Westlaw citation is currently available.

United States District Court,
N.D. Illinois, Eastern Division.
CENTRAL LABORERS' PENSION FUND, Plaintiff,
v.
SIRVA, INC., Brian P. Kelley, Joan E. Ryan, James W. Rogers, Richard Schnall, Carl T. Stocker, Credit Suisse First Boston LLC, Goldman Sachs & Co., Deutsche Bank Securities, Inc., Citigroup Global Markets, Inc., J.P. Morgan Securities, Inc., Banc of America Securities LLC, Morgan Stanley & Co., Inc., Pricewaterhousecoopers LLP, and Clayton Dubilier & Rice, Inc., Defendants.
No. 04 C 7644.

Sept. 22, 2006.

Maya Susan Saxena, Saxena White, P.A., Boca Raton, FL, for Plaintiff.

Courtney Ann Rosen, Matthew Brian Kilby, Richard Bradshaw Kapnick, Tara Kocheran Charnes, Brian A. McAleenan, Tara Kocheran Charnes, Sidley Austin LLP, Howard Steven Suskin, Keith V. Porapaiboon, Jenner & Block LLP, Robert Y. Sperling, David E. Koropp, Michael Patrick Digiannantonio, Nicole E. Wrigley, Ronald Steven Betman, Winston & Strawn, John Conroy Martin, Paul Edwin Greenwalt, III, Schiff Hardin LLP, Peter M. King, William H. Jones, Canel, Davis & King, Chicago, IL, David W. Debruin, Jenner & Block, Christopher Davies, Howard M. Shapiro, Stuart F. Delery, Wilmer Cutler Pickering Hale and Dorr, LLP, Washington, DC, John H. Hall, Stephen Chahn Lee, Steven Klugman, Debevoise & Plimpton LLP, New York, NY, for Defendants.

MEMORANDUM OPINION AND ORDER

GUZMÁN, J.

***1** Plaintiff has sued SIRVA, Inc., Joan E. Ryan, Brian P. Kelley, James W. Rogers, Richard Schnall, Carl T. Stocker, Clayton Dubilier & Rice, Inc., Credit Suisse First Boston LLC, Goldman Sachs & Co., Deutsche Bank Securities, Inc., Citigroup Global Markets, Inc., J.P. Morgan Securities, Inc., Banc of America Securities LLC, Morgan Stanley & Co., Inc., and PricewaterhouseCoopers LLP pursuant to the Public Securities Litigation Reform Act ("PSLRA"), 15 U.S.C. § 78u-4, for their alleged violations of the Securities Act of 1933 and the Securities and Exchange Act of 1934. The case is before the Court on defendants' Federal Rule of Civil Procedure ("Rule") 12(b)(6) motions to dismiss. For the reasons set forth below, the motions of SIRVA, Ryan, Kelley, Rogers, Schnall, Stocker, Clayton Dubilier & Rice, Credit Suisse First Boston LLC, Goldman Sachs & Co., Deutsche Bank Securities, Inc., Citigroup Global Markets, Inc., J.P. Morgan Securities, Inc., Banc of America, Securities LLC, Morgan Stanley & Co, Inc., are granted in part and denied in part, and PricewaterhouseCoopers' motion is denied.

Facts

SIRVA is a company that provides a variety of moving and other services. (Corrected Consol. Am. Class Action Compl. ("Compl.") ¶ 13.) The company is divided into four operating units: Relocation Solutions-North America, Relocation Solutions-Europe and Asia (collectively, "Global Relocation Solutions"), Network Services and Transportation Solutions. (*Id.* ¶ 14.) Global Relocation Solutions helps SIRVA clients relocate employees by moving household goods, assisting with the sale and purchase of homes, and arranging financing for home purchases. (*Id.* ¶ 14a.) Network Services provides insurance and other services to moving and storage agents, independent owner-operators and small fleet operators. (*Id.* ¶ 14b.) Transportation Solutions provides outsourcing services for supply chain functions like freight bill auditing and inventory management. (*Id.* ¶ 14c.)

Defendant Kelley is SIRVA's CEO, a position he has held since August 2002. (*Id.* ¶ 16.) Defendant Ryan is a former member of SIRVA's Audit Committee and served as SIRVA's CFO from February 2003 until January 21, 2005. (*Id.* ¶ 17.) Defendant Rogers is Chairman of the SIRVA Board of Directors, a position he has occupied since November 1999, and is a principal of defendant Clayton, Dubilier & Rice, Inc.

("CDR"), SIRVA's majority shareholder. (*Id.* ¶¶ 18, 30.) Defendant Schnall has been a SIRVA director since March 2002 and is also principal of CDR. (*Id.* ¶¶ 19, 30.) Defendant Stocker has been a SIRVA director since March 2000 and has served as Chairman of its Audit Committee since 2003. (*Id.* ¶¶ 20, 90.)

Defendants Credit Suisse First Boston LLC, Goldman Sachs & Co., Deutsche Bank Securities, Inc., Citigroup Global Markets, Inc., J.P. Morgan Securities, Inc., Banc of America Securities LLC and Morgan Stanley & Co., Inc. (collectively, "the Underwriters") are investment banking firms that served as underwriters for SIRVA's initial and supplemental public offerings ("IPO" and "SPO"). (*Id.* ¶¶ 22-28.)

***2** Defendant PricewaterhouseCoopers ("Price") is an accounting firm that was SIRVA's auditor during the IPO and SPO. (*Id.* ¶ 29.) Price also served as SIRVA's actuary until May 2005. (*Id.* ¶ 94.)

Plaintiff is a union pension fund that purchased SIRVA common stock pursuant to the IPO and SPO. (*Id.* ¶ 12.)

On November 25, 2003, SIRVA conducted its IPO. (*Id.* ¶ 34.) In connection with that offering, SIRVA filed a prospectus and registration statement with the SEC that was signed by defendants Kelley, Ryan, Rogers, Schnall and Stocker. (*Id.*) The prospectus included audited financial statements for the years 2001 and 2002, unaudited financial statements for the nine months ending September 30, 2003 and a favorable audit opinion by Price. (*Id.* ¶¶ 41-42.)

Plaintiff says that the prospectus contains numerous misstatements concerning, among other things, the health and potential of the company's European business, the company's accounting practices and financial results, and the method by which it calculated insurance reserves. (*Id.* ¶¶ 37-40, 43-46.)

Plaintiff alleges that Kelley, Ryan and Rogers knew that there were problems with the European business long before the IPO because a former senior European finance executive told them that the unit could not meet its budget and was "experiencing declining demand, revenue shortfalls, an inability to further cut costs and an inability of acquisitions to perform up to expectations." (*Id.* ¶¶ 102-03.) Plaintiff says that defendants knew the statements about their accounting practices and their financial results were false because they did not conform to Generally Accepted Accounting Principles. (*Id.* ¶¶ 359-89.) Plaintiff also alleges that defendants knew the statements about SIRVA's reserves methodology were false because they manipulated the reserves to boost earnings and Price told them in June and December 2003 that certain insurance lines were under-reserved. (*Id.* ¶¶ 137-70.)

On June 10, 2004, SIRVA conducted its SPO. (*Id.* ¶ 54.) Again, SIRVA filed a prospectus and registration statement with the SEC that was signed by Kelley, Ryan, Rogers, Schnall and Stocker. (*Id.*) Plaintiff alleges that the misstatements defendants made in the IPO prospectus were repeated in the SPO prospectus. (*Id.* ¶¶ 56-63.)

Defendants' misstatements, plaintiff says, were not limited to the prospectuses. According to plaintiff, during the first nine months of 2004, defendants also made false statements about the European operations, SIRVA's accounting practices and financial results and its insurance reserves in press releases, conference calls with securities analysts, SEC filings and its 2003 Annual Report to shareholders. (*Id.* ¶¶ 231-303, 318-22.)

On November 9, 2004, SIRVA announced that it had to take a $15.2 million charge to increase insurance reserves, a development that Kelley attributed to an increase in losses and SIRVA's change in actuarial firms. (*Id.* ¶¶ 304-09.) SIRVA also said it was scaling back its 2004 earnings guidance by approximately thirty-two cents per share. (*Id.* ¶ 305.) The following day, SIRVA's stock price dropped from $23.78 to $17.95 per share. (*Id.* ¶ 312.)

***3** On January 21, 2005, CFO Ryan resigned from the company, effective immediately. (*Id.* ¶ 325.) According to a letter sent to Price on her behalf, Ryan was asked to leave because of her insistence on accurate financial reporting. (*Id.* ¶ 354.)

Ten days later, SIRVA announced that it might have to restate its financials and was reviewing whether its accounting had any material weaknesses. (*Id.* ¶ ¶ 327-28.) That announcement caused the price of SIRVA stock to drop from $14.40 to $8.86 per share. (*Id.* ¶ 329.)

On March 10, 2005, SIRVA announced that its financial statements for the years 2001-2003 and the first three quarters of 2004 would have to be restated because the company had to take a $22 million charge due to twelve accounting errors it had identified. (*Id.* ¶ 335.)

On June 20, 2005, SIRVA revised its estimate of the accounting errors charge from $22 million to $27 million. (*Id.* ¶ 339.)

On September 21, 2005, SIRVA filed its 2004 Form 8-K with the SEC. (*Id.* ¶ 347.) In that Form, the company admitted that it had material weaknesses in its internal control over financial reporting and identified twelve errors that lead to a $34 million overstatement of the company's pretax income for the years 2000 through the first nine months of 2004. (*Id.* ¶¶ 347-48.)

Discussion

On a Rule 12(b)(6) motion to dismiss, the Court accepts as true all well-pleaded factual allegations of the complaint, drawing all reasonable inferences in plaintiffs' favor. *Forseth v. Vill. of Sussex,* 199 F.3d 363, 368 (7th Cir.2000). No claim will be dismissed unless "it is clear that no relief could be granted under any set of facts that could be proved consistent with the allegations." *Hishon v. King & Spalding,* 467 U.S. 69, 73, 104 S.Ct. 2229, 81 L.Ed.2d 59 (1984).

I. The Underwriters' Motion

A. *Count I-Standing*

In Count I, plaintiff charges the Underwriters with violating section 11 of the Securities Act of 1933. Section 11 holds underwriters liable for damages sustained by those who purchased stock pursuant to a registration statement that "contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading." 15 U.S.C. § 77k(a). The Underwriters say these claims must be dismissed because: (1) plaintiff has no standing to pursue them; and, even if it does, (2) none of the allegedly false statements was material; and (3) it cannot satisfy the damage element of the claims related to the IPO.

It is not clear whether the Underwriters contend that plaintiff lacks Article III standing to pursue these claims or does not fall within the class of investors covered by the statute. To the extent it is the former, their motion must be denied. Plaintiff has standing under Article III if it suffered a "concrete and particularized" injury that is fairly traceable to defendants' conduct and is likely to be "redressed by a favorable decision." *Lujan v. Defenders of Wildlife,* 504 U.S. 555, 560-61, 112 S.Ct. 2130, 119 L.Ed.2d 351 (1992) (quotations omitted). Plaintiff alleges that it purchased SIRVA stock at an inflated price because of the misstatements in the offering documents, an economic injury that a lawsuit could redress. Thus, plaintiff has constitutional standing to assert its section 11 claims.

***4** Whether it falls within the class of persons entitled to sue under that section is a different, and non-jurisdictional, question. *See Steel Co. v. Citizens for a Better Env't,* 523 U.S. 83, 97 n. 2, 118 S.Ct. 1003, 140 L.Ed.2d 210 (1998) (noting that whether plaintiff has a cause of action under the statute is a "merits inquiry," and whether a plaintiff has "[a] remediable injury in fact," is a question of Article III standing). Though the Seventh Circuit has yet to address the issue, other circuit courts of appeal have interpreted section 11 as providing a cause of action to investors who purchase stock in an offering and "aftermarket purchasers who can trace their shares to an allegedly misleading registration statement." *DeMaria v. Andersen,* 318 F.3d 170, 178 (2d Cir.2003); *see Rosenzweig v. Azurix Corp.,* 332 F.3d 854, 873 (5th Cir.2003) (same); *Joseph v. Wiles,* 223 F.3d 1155, 1160 (10th Cir.2000) (same); *Hertzberg v. Dignity Partners, Inc.,* 191 F.3d 1076, 1081 (9th Cir.1999) (same). Plaintiff has alleged that it purchased SIRVA stock "issued pursuant or traceable to the November 25, 2003 IPO and/or June 10, 2004 SPO." (Compl.¶ 64.) At this stage of the proceedings, that allegation is sufficient to put plaintiff in the class of investors covered by section 11. *See Shapiro v. UJB Fin. Corp.,* 964 F.2d 272, 286 (3rd Cir.1992) (allegation that plaintiff purchased the shares "pursuant to the [offering]" held sufficient to defeat motion to dismiss section 11 claim); *Danis v. USN Comms., Inc.,* 73 F.Supp.2d 923, 931 (N.D.Ill.1999) (holding that plaintiff need only allege that his injury is traceable to challenged registration to maintain section 11 claim); *Cf. In re LILCO Sec. Litig.,* 111 F.R.D. 663, 671 (E.D.N.Y.1986) ([T]racing is a question of fact reserved for trial.").

B. Materiality

The Underwriters also argue that plaintiff cannot satisfy the material misstatement element of their section 11 claims. A misstatement or omission is material if "under all the circumstances, the omitted fact or the prediction without a reasonable basis is one that a reasonable investor would consider significant in making the decision to invest, such that it alters the total mix of information available about the proposed investment." *Harden v. Raffensperger, Hughes & Co., Inc.,* 65 F.3d 1392, 1404 & 1405 n. 11 (7th Cir.1995) (quotation omitted). Plaintiff alleges that the IPO and SPO prospectuses misstated or failed to disclose material information about SIRVA's European business, its insurance reserves, and its accounting practices and financial results. The Court will address each category in turn.

1. European Business

According to plaintiff, defendants failed to disclose various problems SIRVA was having with its European business, including: its failure to meet internal budget projections, the decline in demand for its services, its inability to cut costs further, and the poor performance of the companies it had acquired. (*See* Compl. ¶¶ 37, 63.) In addition, plaintiff says the prospectuses contained the following misstatements:

***5** We intend to increase our market share internationally as we continue to develop our global relocation solutions platform. We believe that the European and Asian market opportunities are considerable, as the markets are large and the corporate outsourcing trend is at an earlier stage of development. We are approaching this international opportunity from a position of strength, with a leading market share position in Europe, Australia and Asia.

and

Historically, a majority of our operating revenues and income from operations was derived from our moving services businesses. A significant element of our growth model, however, is our new and unproven strategy of offering a global comprehensive relocation solution to customers by combining our higher margin relocation services with our proprietary moving services network. We embarked on this strategy less than two years ago with the acquisition of the business of Cooperative Resources Services, Ltd., and have not yet proven that it will succeed in the long-term, especially in Europe and Asia.

(*Id.* ¶¶ 38-39, 63.)

Boiled down, the Underwriters say, the first omissions claim is just a complaint that defendants did not disclose SIRVA's internal profit projections for 2004 for its European operations. Because there is no duty to disclose such projections, *see, e.g., In re VeriFone Sec. Litig.,* 11 F.3d 865, 869 (9th Cir.1993), the Underwriters say this claim must be dismissed.

The Court disagrees. Plaintiff does not contend that defendants should have disclosed SIRVA's internal projections about the future profits of its European operations. Rather, it says that defendants should have revealed that SIRVA's European operations had fallen short of internal profit projections in both 2002 and 2003. (Compl.¶¶ 102-03.) Those are facts about past performance, not projections about future performance. As a result, that information is not exempt from disclosure. *Verifone,* 11 F.3d at 869 (stating that "financial data or other existing facts from which forecasts are typically derived" are not exempt).

The next question is whether that information is material; that is, whether "a reasonable investor would consider [it] significant in making the decision to invest." *Harden,* 65 F.3d at 1404. At least one court has said no, because: (1) internal estimates are generally prepared using more aggressive assumptions than estimates intended for the public; (2) "internal estimates ... necessarily change over time" and are "invariably wrong"; and (3) "a comparison of actual and internally[-]predicted results does not [bear on] the truthfulness of the actual results." *Saddle Rock Partners, Ltd. v. Hiatt,* No. 95-2326 GA, 1996 WL 859986, at *9-11 (W.D.Tenn. Mar.26, 1996).

That may be true, but in this case, the budget shortfalls are only half of the story. The other half is that the shortfall was trending upward. In 2002, the European operations fell $3.5 million short of budget. By

2003, that number had climbed to $7 million. (Compl.¶¶ 102-03.) That trend could suggest any number of things-that demand was falling, costs were increasing, the European operations were poorly managed or SIRVA management set unrealistic budgets-any of which a reasonable investor could arguably consider significant. Given the possible implications of the budgetary shortfalls in this case, the Court cannot say as a matter of law that they are immaterial.

***6** The same is true for the other information plaintiff says SIRVA withheld, that demand for its services in Europe was declining, it could not cut costs in those operations any further and the European businesses it had acquired were underperforming. The financial statements in the IPO prospectus indicate that SIRVA increasingly relied on its European operations for its total operating revenues and income. By the end of 2003, those operations accounted for more than twenty percent of SIRVA's total operating revenues and more than a quarter of its income. (*See* Exs. SIRVA Defs.' Mem. Law Supp. Mot. Dismiss, Ex. 1, IPO Prospectus at 2, 31; *id.,* Ex. 8, SPO Prospectus at 2, 23.) [FN1] Moreover, SIRVA specifically identified cutting costs and acquiring other companies as two of its strategies for increasing its revenues. (*Id.,* Ex. 1, IPO Prospectus at 5; *id.,* Ex. 8, SPO Prospectus at 5.) Given the importance of the European operations to SIRVA's bottom line and its stated strategies for increasing revenues from them, the Court cannot say, as a matter of law, that no reasonable investor would consider the alleged omissions immaterial to an investment decision.

> FN1. "[I]n securities actions, the court may ... rely on public disclosure documents required by law to be, and that have been, filed with the SEC, and documents that the plaintiffs either possessed or knew about and upon which they relied in bringing the suit without, pursuant to Rule 12(b), converting the motion into one for summary judgment." *Fin. Acquisition Partners LP v. Blackwell,* 440 F.3d 278, 286 (5th Cir.2006) (quotation and citation omitted).

Plaintiff also contends that defendants made the following affirmative misstatements about SIRVA's European operations: "We intend to increase our market share internationally"; "We believe that the European and Asian market opportunities are considerable, as the markets are large and the corporate outsourcing trend is at an earlier stage of development"; and "We are approaching this international opportunity from a position of strength, with a leading market share position in Europe, Australia and Asia." (Compl. ¶ 38; *see* Exs. SIRVA Defs.' Mem. Law Supp. Mot. Dismiss, Ex. 1, IPO Prospectus at 4; *id.,* Ex. 8, SPO Prospectus at 4-5.) Plaintiff does not allege that those statements are literally false, *i.e.,* that SIRVA did not intend to increase its international market share, did not believe the international opportunities were considerable and did not have a leading market share in Europe. But it says they are actionable because they are misleading in light of the material facts defendants did not disclose about the European operations: declining demand, revenue shortfall, an inability to cut costs, and the failure of acquisitions to perform up to expectations. (Compl.¶ 37.)

The Underwriters say those statements are not actionable under any circumstances because they are simply puffery. *See Searls v. Glasser,* 64 F.3d 1061, 1066 (7th Cir.1995) (stating, in the context of section 10(b), that "promotional phrase[s] ... devoid of any substantive information," "indefinite predictions of 'growth,'" and optimistic statements that "lack [ ] ... specificity" are immaterial as a matter of law). The Court agrees. The contested statements about the European operations are just the kind of vague, optimistic statements held not to be actionable in *Searls. See Lasker v. N.Y. State Elec. & Gas Corp.,* 85 F.3d 55, 59 (2d Cir.1996) (per curiam) (statements that company "would not compromise its financial integrity," was "commit[ed] to creat[ing] earnings opportunities" and was using "business strategies [that] would lead to continued prosperity" held to be non-actionable puffery); *Simon v. Am. Power Conversion Corp.,* 945 F.Supp. 416, 428-29 (D.R.I.1996) ("[W]e are gaining market share, we are gaining momentum, and our revenues are strong," and the company has "good opportunities to expand its products offerings" held to be puffery).

***7** Finally, plaintiff alleges that defendants misled investors about the company's prospects, by saying that its "growth model" was largely based on its "new and unproven strategy of offering a global comprehensive relocation solution to customers," a strategy that was less than two years old and might not "succeed in the long-term, especially in Europe and Asia." (Compl. ¶ 39; Exs. SIRVA Defs.' Mem. Law Supp. Mot. Dismiss, Ex. 1, IPO Prospectus at 14; *id.,* Ex. 8, SPO Prospectus at 11.) Defendants contend that this statement cannot be actionable because it cautions investors about investing rather than enticing them to do so. Plaintiff says this is a caveat in appearance only because defendants knew at the time of the IPO that its strategy was a failure in Europe. Whether that is true depends on a number of facts that cannot be determined on a motion to dismiss, among them: the length of time a strategy has to be in place before it can be deemed a success or a failure, whether defendants believed the European business would improve over time or thought it was in a downward spiral, and whether defendants were aware of any characteristics of or constraints on the European market that would negatively impact its strategy. Until those facts, are resolved, this claim cannot be dismissed.

2. Insurance Reserves

Plaintiff also alleges that defendants manipulated SIRVA's insurance reserves to inflate its earnings. (*See* Compl. ¶¶ 137-70.) That conduct, plaintiff says, rendered the following prospectus statements untrue, that: (1) SIRVA's reserve rates are "based on a percentage of earned premium[, which, in turn,] is based on historical data, run rates and actuarial methods"; (2) reserves for cargo claims are analyzed quarterly and changes to them are made "as appropriate"; and (3) reserves are "based upon past claims experience, knowledge of claims staff regarding the nature and potential cost of each claim and trends and estimates of future claims trends." (*Id.* ¶¶ 44-45, 137; Exs. SIRVA Defs.' Mem. Law Supp. Mot. Dismiss, Ex. 1, IPO Prospectus at 37, 77; *id.,* Ex. 8, SPO Prospectus at 28, 67.)

The Underwriters say that all of these statements relate to reserves for cargo claims, which are not addressed in plaintiff's reserve manipulation allegations. The Court disagrees. Only the second statement is specifically limited to cargo claims. The others are statements about SIRVA's reserve methodology, generally.

The Underwriters are correct, however, that plaintiff does not allege that defendants manipulated reserves for cargo claims. Rather, plaintiff alleges that defendants manipulated reserves for claims made on National Association of Independent Truckers ("NAIT") policies and workers' compensation policies. (*See* Compl. ¶¶ 153-55, 162-63, 166-68.) Because plaintiff has not alleged that defendants manipulated reserves for cargo claims, it cannot base a section 11 claim on prospectus statements about those reserves.

***8** The remaining reserves manipulation claims are based on information from: (1) a "Former TransGuard Finance Executive," a "Former NAIT Claims Manager," and a "Former NAIT Claims Supervisor," who reported that: (a) Dan Briody, Vice President of NAIT, would "actively push reserves downward" during large loss meetings; and (b) Price, which was serving as the company's actuary, concluded in June 2003 that SIRVA's workers' compensation line was under-reserved by up to $2 million (*id.* ¶¶ 145, 153, 162); (2) a "Former TransGuard Supervisor of Insurance Accounting" who said that "they would adjust reserves here and there" in order to "make the numbers" (*id.* ¶ 166); (3) a "Former TransGuard General Accounting Manager" who said Gary Jinx, then-head of accounting for TransGuard reserves, told him in March 2004 that the workers' compensation line was under-reserved by $4 to $5 million (*id.* ¶ 167); and (4) a "Former SIRVA Executive of Pricing" who said that "[i]t was widely known that we were going to take a big hit to reserves" (*id.* ¶ 170).

Those allegations are insufficient under the PSLRA. Though the statute permits plaintiff to rely on confidential sources to defeat a motion to dismiss, it must describe those sources "with sufficient particularity to support the probability that a person in the position occupied by the source would possess the information alleged ..., or in the alternative provide other evidence to support [its] allegations." *Makor Issue & Rights, Ltd. v. Tellabs,* 437 F.3d 588, 596 (7th Cir.2006) (citation and quotation omitted). Plaintiff has offered no other evidence in support of the reserve manipulation claim. Thus, it must allege sufficient detail about the sources to suggest that they would have the information they report.

Plaintiff has not satisfied that standard with respect to any of its confidential sources. Plaintiff does not generally allege any of the sources' job duties or the dates of their employment. Moreover, with the exception of the Former TransGuard General Accounting Manager, plaintiff has not alleged how the sources obtained the information they report. Plaintiff does not explain whether the sources have personal knowledge of the alleged reserves manipulation or if they know that Kelley and Ryan actually received and read the documents that disclosed the manipulation and, if so, how. Nor does plaintiff explain how the Former TransGuard Supervisor of Insurance Accounting knew reserves were being adjusted "here and there," when such adjustments occurred, in which lines of insurance the adjustments were made or who was doing the adjusting. Similarly, plaintiff does not explain the basis for the assertion by the Former SIRVA Executive of Pricing that "[i]t was widely known that we were going to take a big hit to reserves." Without further support, plaintiff's reserves manipulation claims do not pass muster under the PSLRA. *See Calif. Pub. Employees' Retirement Sys. v. Chubb Corp.,* 394 F.3d 126, 148 (3rd Cir.2004) (dismissing section 10(b) claim premised on information from confidential sources because plaintiffs did not allege when the sources were employed by defendant, the dates the sources obtained the alleged information, or how they had access to such information).

3. Accounting Practices

***9** The last category of statements plaintiff challenges are those pertaining to SIRVA's accounting practices. Specifically, plaintiff alleges that the financial results defendants' reported in the prospectuses were false because the company: (1) failed to take a timely charge to accrue additional liabilities related to its multiple-line property and commercial liability insurance; (2) improperly overstated premium revenue and commission income; (3) improperly accounted for accrued expenses; (4) improperly accelerated revenue related to corporate and referral fees; (5) improperly accounted for home inventory valuation reserve; and (6) failed to establish and maintain adequate internal accounting controls. (Compl.¶¶ 40, 47.)

The Underwriters contend that these errors, to which SIRVA admitted in the Form 8-K it filed in September 2005, did not materially impact the financial information in the prospectuses. In fact, the Underwriters say, but for the accounting errors, SIRVA's cumulative net income for the years 2000 through the first three quarters of 2003, would have been higher than what was reported in the prospectuses. Because the actual numbers were higher than the numbers reported in the prospectuses, the Underwriters say the errors were immaterial as a matter of law.

The Underwriters' argument assumes that cumulative net income is the only figure an investor would find important in making the decision to invest. Whether that is true is a factual question that cannot be resolved on a motion to dismiss.

Moreover, the increase in cumulative net income notwithstanding, the impact of the restatement on SIRVA's financials was not wholly positive. Though the restatement effected a $11.7 million increase in SIRVA's net income for 2002, it effected a $5.8 million increase in the net loss SIRVA sustained in 2001. (*Compare* Exs. SIRVA Defs.' Mem. Law Supp. Mot. Dismiss, Ex. 7, 9/21/05 10-K at 34 *with id.,* Ex. 1, IPO Prospectus at 8 & Ex. 8, SPO Prospectus at 7.) In addition, in the restatement SIRVA admitted that there were "material weaknesses in [its financial reporting] control environment, organizational structure and in [its] consistent application of GAAP [Generally Accepted Accounting Principles]." (*Id.,* Ex. 7, 9/21/05 Form 10-K at 41.) A material weakness, SIRVA explained, "is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected." (*Id.* at 185.) Because it is arguable that a reasonable investor would find such information relevant to his investment decision, the section 11 accounting practices claim cannot be dismissed.

C. Damage Related to the Offerings

Next, the Underwriters argue that plaintiff cannot state a section 11 claim in connection with either the IPO or the SPO because it did not suffer any damage that is traceable to those offerings. According to the statute, plaintiff was damaged if the price of the stock was higher on the date plaintiff purchased it than on the date plaintiff filed suit. *See* 15 U.S.C. § 77k(e) ("[D]amages represent the difference between the amount paid for the security ... and the value thereof as of the time [the] suit was brought"). There is no dispute that plaintiff paid less for its SIRVA stock than it was fetching on November 24, 2004, the date plaintiff filed this suit. (*Compare* Initial Compl., Certification Proposed Lead Pl., Schedule A, *with http://*

online.wsj.com/public/us (enter "SIR" in "Quotes & Research"; then enter 11/24/04 in "Historical Quotes" date).) [FN2] Plaintiff did not, however, assert a section 11 claim in its initial complaint.

FN2. The Court "may take judicial notice of well-publicized stock prices without converting the motion to dismiss into a motion for summary judgment." *Ganino v. Citizens Util. Co.,* 228 F.3d 154, 167 n. 8 (2d Cir.2000).

***10** That fact, the Underwriters say, is irrelevant. In their view, plaintiff's section 11 claims relate back to the initial complaint because they arise from the same "conduct, transaction, or occurrence" as the claims set forth in it. *See* FED. R. CIV. P. 15(c)(2); (Compl. ¶¶ 5-7, 33-38, 53-58 (asserting violations of section 10(b) of the Exchange Act and Rule 10b-5 based on, among other things, the alleged misrepresentations in the offering documents); *id.* ¶¶ 37-41, 56-63 (alleging section 11 claims grounded in the same conduct).) Thus, the Underwriters contend that the Court should deem the section 11 claims to have been filed on November 24, 2004, the date plaintiff filed suit.

In support of their argument, the Underwriters cite *Alpern v. UtiliCorp United, Inc.,* 84 F.3d 1525 (8th Cir.1996). As in this case, the plaintiff in *Alpern* filed an initial complaint asserting claims under section 10(b) and later amended the complaint to assert a section 11 claim. *Id.* at 1543. Because the stock price was higher on the date Alpern filed the section 11 claim than it was when he purchased it, the district court entered summary judgment for the defendant on the section 11 claims. *Id.* at 1541-43. Alpern appealed, arguing that the section 11 claims related back to the original filing date. *Id.* at 1542.

The Eighth Circuit agreed:

> Alpern's § 11 claim was based on the same misappropriations alleged in the original complaint.... Both his [section 10(b) and section 11] claims asserted that he was unaware of the misappropriations and that UtiliCorp artificially inflated its stock prices by disseminating materially misleading statements and/or omitting to state material facts necessary to make its statements not misleading.
>
> Other considerations also favor the relation back of the amended complaint.... Nothing suggests that Alpern sought to capitalize on a further drop in stock prices by waiting for a more favorable date to file his § 11 claim. Rather, he amended his claim less than two months after filing his initial complaint based on additional information discovered about the same underlying occurrences. Since Alpern was a DRIP plan purchaser, Utilicorp also should not have been surprised that Alpern sought to hold it accountable for its statements related to the DRIP prospectus. Finally, it is unlikely that UtiliCorp's defense on the merits will be unfairly prejudiced, and it may also assert reasonable inquiry and good faith belief defenses against a § 11 claim. Under the circumstances Alpern's amended complaint relates back to the filing date of the original complaint under Rule 15(c)(2).

Id. at 1543-44.

The Underwriters ask this Court to follow *Alpern* and apply Rule 15(c) to plaintiff's section 11 claims. But there is an important difference between *Alpern* and this case. In *Alpern,* the plaintiff asked the court to apply the relation-back doctrine to save his section 11 claim. In this case, defendants ask the Court to use the doctrine to *defeat* plaintiff's claims. Defendants have not cited, and the Court has not found, any case in which the relation-back doctrine was used to bar claims. Moreover, applying the doctrine in that manner would defeat its purpose, which is to allow plaintiffs to assert time-barred claims as long as defendants have sufficient notice of their exposure. *See Kansa Reins. Co., Ltd. v. Congressional Mortgage Corp. of Tex.,* 20 F.3d 1362, 1366 (5th Cir.1994) (stating that the purpose of Rule 15(c) is "to allow a party to amend an operative pleading despite an applicable statute of limitations in situations where the parties to litigation have been sufficiently put on notice of facts and claims which may give rise to future, related claims"). Applying the doctrine as the Underwriters urge would, in effect, shorten the statute of limitations on plaintiff's section 11 claims, not lengthen it, as Rule 15 contemplates.

***11** Even if it might be appropriate to apply the doctrine in this manner in some cases, the facts of this case show that this is not one of them. Though SIRVA announced in November 2004 that it needed to take a $15.2 million charge to reserves, Kelley attributed that development to increased losses and a change in actuaries. (Compl.¶¶ 304-09.) It was not until the end of January 2005 that the company announced it might have to restate its financials and was reviewing whether its accounting had any material weaknesses. (*Id.* ¶¶ 327-28.) Moreover, the final decision to restate was not announced until March 2005, and SIRVA did not identify the actual accounting errors it had discovered until September 2005, nearly a year after plaintiff filed its initial complaint. (*Id.* ¶¶ 335, 347-48.) As a result, relating the section 10(b) claims back to the original filing date, would divest plaintiff of claims about which it could not reasonably have known when it filed the suit.

In short, given the dearth of authority supporting the Underwriters' request and its tension with the purpose of the Rule and the facts of this case, the Court declines to relate plaintiff's section 11 claims back to the date the initial complaint was filed.

Plaintiff first asserted its section 11 claims in the amended complaint filed October 11, 2005. On that day, SIRVA stock was selling for $6.57 per share. (*See http://online.wsj.com/public/us* (enter “SIR” in “Quotes & Research”; then enter 10/11/05 in “Historical Quotes” date).) Plaintiff paid $22.11 and $24.47 per share, respectively, for the shares it bought after the IPO. (*See* Initial Compl., Certification Proposed Lead Pl., Schedule A.) Because plaintiff paid more for its IPO shares than they were worth on the day it filed its section 11 claims, plaintiff satisfies the damage element of those claims.

The Underwriters also say that plaintiff cannot trace its post-SPO stock purchases to that offering. Plaintiff's PSLRA certification shows that it purchased 25,820 shares in the aftermarket on nine separate occasions between June 15, 2004 and August 27, 2004. (*See* Initial Compl., Certification Proposed Lead Pl., Schedule A.) On the last eight of those dates, the Underwriters say, SPO stock mingled in the market with IPO stock and the stock of corporate insiders. Thus, they conclude, “[p]laintiff cannot possibly prove that the securities it bought after the SPO are directly traceable to an allegedly false registration statement.” (Underwriters' Mem. Law. Supp. Mot. Dismiss at 10.)

That may be true, but at this stage of the litigation, plaintiff does not have to *prove* anything. It simply has to allege that it purchased stock that is traceable to the offerings. *See In re Suprema Specialties, Inc. Sec. Litig.,* 438 F.3d 256, 274 n. 7 (3rd Cir.2006) (stating that “plaintiffs need not prove their shares are traceable to a false or misleading registration statement” to defeat a motion to dismiss and holding that allegations that plaintiffs purchased stock “ ‘in’ and ‘traceable to’ the ... stock offerings were sufficient”). Plaintiff has made the requisite allegations. (*See* Compl. ¶ 74.)

Count II

***12** In Count II, plaintiff alleges that defendants violated section 12(2) of the 1933 Act, which imposes liability on any person who offers or sells stock in interstate commerce pursuant to a prospectus or oral communication that “includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements ... not misleading.” 15 U.S.C. § 77l. However, standing under this section is limited to those who purchase stock pursuant to public offerings, which plaintiff admits it did not do. *See Gustafson v. Alloyd Co., Inc.,* 513 U.S. 561, 566, 115 S.Ct. 1061, 131 L.Ed.2d 1 (1995); (Compl. ¶¶ 34, 54 (alleging that IPO and SPO were November 25, 2003 and June 10, 2004, respectively); Initial Compl., Certification Proposed Lead Pl., Schedule A (showing that plaintiff made no purchases on those dates).)

Plaintiff says that is irrelevant because, as lead plaintiff in this PSLRA suit, it is not required to have standing as to every claim in the suit. While that is true, *see, e.g., Hevesi v. Citigroup, Inc.,* 366 F.3d 70, 82 (2d Cir.2004) (“Nothing in the PSLRA indicates that district courts must choose a lead plaintiff with standing to sue on every available cause of action.”), there must be least one named plaintiff who does have standing to sue as to every claim. *See id.* at 83 (stating that additional named plaintiffs who have standing lead plaintiff lacks can be appointed to assist lead plaintiff in representing the class); *Payton v. County of Kane,* 308 F.3d 673, 682 (7th Cir.2002) (“[I]t bears repeating that a person cannot predicate standing on injury which he does not share. Standing cannot be acquired through the back door of a class action.”); *Ong ex rel. Ong IRA v. Sears, Roebuck & Co.,* 388 F.Supp.2d 871, 891-92 (N.D.Ill.2004) (dismissing certain section 12(2) claims because none of the named plaintiffs had purchased securities in those offerings). Because plaintiff is the only named plaintiff in this suit, Count II must be dismissed for lack of standing.

II. The SIRVA Defendants' Motions

Count I

In Count I, plaintiff seeks to hold SIRVA, Kelley, Ryan, Rogers, Schnall and Stocker liable for violating section 11 of the 1933 Act. The arguments advanced by these defendants for the dismissal of the Count I claims are the same as those advanced by the Underwriters. Thus, for the reasons discussed above, the SIRVA defendants' motions to dismiss the Count I claims is granted in part and denied in part.

Count II

In Count II, plaintiff alleges that SIRVA is liable for violating section 12(2). Because the Court has determined that this count must be dismissed for lack of standing, we need not address the SIRVA defendants' arguments with respect to it.

Count IV FN3

> FN3. Because each defendant's liability on Count III depends on their liability on Count I's section 11 claims, the Court addresses Count IV first.

In Count IV, plaintiff contends that SIRVA, Kelley, Ryan, Rogers, Schnall, Stocker and CDR ("the SIRVA defendants") violated section 10(b) of the 1934 Act and Rule 10b-5 (collectively, "section 10(b)") by making false statements or failing to disclose material facts about: (1) the health of SIRVA Europe; (2) the calculation of SIRVA's insurance reserves and (3) SIRVA's accounting practices and earnings projections. In addition, plaintiff alleges that CDR violated section 10(b) by trading on inside information. Section 10(b) prohibits the use of "any device, scheme, or artifice to defraud" or the making of "any untrue statement of a material fact" or omission of a material fact by "the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange." 17 C.F.R. § 240.10b-5; *see* 15 U.S.C. § 78j (prohibiting the "use ... in connection with the purchase or sale of any security registered on a national securities exchange ... [of] any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe"). To state a section 10(b) claim, plaintiff must allege that: each defendant made a false statement of, or failed to disclose, a material fact; they did so with scienter and in connection with the purchase or sale of securities; plaintiff relied on the statement or the omission or the integrity of the market, and was damaged as a result. *Basic Inc. v. Levinson,* 485 U.S. 224, 250, 108 S.Ct. 978, 99 L.Ed.2d 194 (1988); *Tellabs,* 437 F.3d at 595. Such claims are also subject to the pleading requirements of the PSLRA:

> ***13** Under the PSLRA, a securities fraud complaint must (1) 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 and (2) state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind. In other words, plaintiffs must not only plead a violation with particularity; they must also marshal sufficient facts to convince a court at the outset that the defendants likely intended to deceive, manipulate, or defraud.

Tellabs, 437 F.3d at 594-95 (quotations and citations omitted).

A. European Operations

1. Materiality

The first category of misrepresentations plaintiff says defendants made concern SIRVA's European operations. Plaintiff alleges that, like the Underwriters, the SIRVA defendants misstated material facts in, or deliberately withheld such facts from the prospectuses, including that:

(1) SIRVA intended to increase its European market share, believed the opportunities there were considerable and was approaching them from a position of strength;

(2) the European business had failed to meet internal

budget projections; and

(3) demand was declining, no further cost cutting was feasible, and the European businesses SIRVA had acquired were underperforming. (Compl. ¶ 38; *see* Exs. SIRVA Defs.' Mem. Law Supp. Mot. Dismiss, Ex. 1, IPO Prospectus at 4; *id.,* Ex. 8, SPO Prospectus at 4-5.)

In addition, plaintiff alleges that the SIRVA defendants made the following misrepresentations of material facts:

(4) in a February 10, 2004 conference call with securities analysts, Ryan said: "[W]ith our capabilities in place in Europe, we are now in a position to drive real, organic growth in 2004." (Compl.¶ 233);

(5) in an April 27, 2004 press release regarding the company's results for the first quarter of 2004, Kelley said: "[W]e made significant progress in broadening our services offering and expanding our presence throughout the European continent." (*Id.* ¶ 252);

(6) in an April 27, 2004 conference call with securities analysts, Kelley said that SIRVA Europe was "generating organic growth through [cross] selling relocation and moving services to our corporate clients. We're quickly integrating and growing acquisitions and as always, we're sharply focused on costs, productivity and quality." (*Id.* ¶ 255);

(7) in the same conference call, when an analyst asked Kelley, "[W]hat are you guys doing exactly in Europe that is allowing you to get these margins up so quickly. Is it Scanvan? Did they come in with a better margin than anticipated or is this just blocking and tackling?"

Kelley responded: "It is blocking and ... tackling, Chris. It is looking at all of the operations we have across the UK and the continent. It's looking at how do we continue to wring costs out of this and wring efficiency [and] productivity out of it and do it in a way that is better and do it on an ongoing basis. This effort has been going on for 12 months, 18 months, and we anticipate that we will continue to be able to do this. If we look at this, we talked a little bit about Europe, we want to be able to continue to take the cost out, rip the cost out, make sure that we've got an efficient model so that we can invest in the front end. Invest in selling and marketing so we can grow the business. And that is basically what we have done. We have invested a significant amount on sales and marketing there. We had to have the cost reduction in order to do that and get the productivity to do that. So, that is what you're seeing in Europe." (*Id.* ¶ 258);

***14** (8) in an August 4, 2004 press release Kelley said: "We continue to invest in our European and Asia Pacific operations with the goal of developing a powerful selling and marketing capability across the rest of the world like we have in the U.S." and "We are building the infrastructure for future growth." (*Id.* ¶ 287).

As discussed above, the statements in the second category are material, but the statements in the first category are not. Consequently, the latter statements cannot be the basis for a section 10(b) claim.

Nor can the alleged misstatements in the fourth, fifth and eighth categories. Ryan's statement that SIRVA was "in a position [in Europe] to drive real, organic growth in 2004" is an "indefinite prediction[ ] of 'growth,' ' and Kelley's statements that SIRVA "made significant progress in broadening [its] services offering and ... presence" in Europe, "continue[d] to invest in [the] European ... operations" and was "building the infrastructure for future growth" are vague statements of optimism, both of which are immaterial puffery. *See Searls,* 64 F.3d at 1066.

The situation is different for the third category, which concerns defendants' failure to disclose in the prospectuses that there were demand, cost reduction and acquisition problems in Europe. With respect to these problems, plaintiff alleges that a "Former Senior European Finance Executive" personally told Kelley and Ryan in a meeting that occurred in October 2003 at SIRVA's "Centre of Excellence" in the United Kingdom and in another that occurred on December 12, 2003 at the Chelsea Royal Hospital that demand was falling in Europe, no further cost reductions could be made and the European companies SIRVA had acquired were performing poorly. (Compl.¶¶ 98, 100-03, 106-07.) Plaintiff also alleges, through a "Former SIRVA Relocation Business Development Executive," that at a February 2004 "Summit Meeting" in Florida, Kelley said "the European operations were losing money" and "Europe was bringing the Company down." (*Id.* ¶¶ 109-10, 113.) Moreover, plaintiff says this information was material because: (1) the financials in the prospectuses demonstrated that the company's bottom line had become increasingly dependent on the European operations which, by the end of 2003, accounted for more than a quarter of its income (*see id.* ¶ 37; Exs. SIRVA Defs.' Mem. Law Supp. Mot. Dismiss, Ex. 1, IPO Prospectus at 2, 31; *id.,* Ex. 8, SPO Prospectus at 2, 23); and (2) SIRVA specifically identified cost cutting and corporate acquisitions as strategies for increasing its revenues (*id.,* Ex. 1, IPO Prospectus at 5; *id.,* Ex. 8, SPO Prospectus at 5). Those allegations are sufficient to satisfy the materiality element as modified by the PSLRA.

The materiality element is also satisfied with respect to the sixth and seventh categories of alleged misrepresentations. In the April 27, 2004 conference call, Kelley is alleged to have said that SIRVA Europe was "quickly integrating and growing acquisitions" and owed its profitability, both current and anticipated, to "wring[ing] costs ... efficiency [and] productivity" out of the operation. Given the company's alleged reliance on its European operations, the Court cannot say as a matter of law that these statements are immaterial.

2. Scienter

***15** The next question is whether plaintiff has sufficiently alleged the scienter element as to each defendant. *See Tellabs,* 437 F.3d at 603 ("[P]laintiffs must create th[e] inference [of scienter] with respect to each individual defendant in multiple defendant cases."). Defendants say scienter is lacking because plaintiff has not alleged that any of them had a motive to mislead investors. Motive is not, however, a prerequisite to scienter:

> Currently three different approaches toward the way to demonstrate the required "strong inference [of scienter]" exist among the courts of appeals. The Second and Third Circuits take the position that ... plaintiffs may ... state a claim by pleading either motive and opportunity or strong circumstantial evidence of recklessness or conscious misbehavior. The Ninth and Eleventh Circuits disagree, believing that Congress opted instead for a more onerous burden. The remaining six circuits that have considered this issue take a middle ground, reasoning that Congress chose neither to adopt nor reject particular methods of pleading scienter-such as alleging facts showing motive and opportunity-but instead only required plaintiffs to plead facts that together establish a strong inference of scienter.... [W]e conclude that the best approach is for courts to examine all of the allegations in the complaint and then to decide whether collectively they establish such an inference. Motive and opportunity may be useful indicators, but nowhere in the statute does it say that they are either necessary or sufficient.

Id. at 601 (citations, quotations and alterations omitted).

The *Tellabs* court also rejected defendants' argument that the scienter element is satisfied only if the most reasonable inference from the alleged facts is that defendants acted with fraudulent intent:

> The Sixth Circuit has said that the strong inference requirement creates a situation in which plaintiffs are entitled only to the most plausible of competing inferences, but that it does not mandate that the inference be irrefutable. As the Sixth Circuit itself has hinted, however, this standard could potentially infringe upon plaintiffs' Seventh Amendment rights.

> While we express no view on whether the Sixth Circuit's approach is in fact unconstitutional, we think it wiser to adopt an approach that cannot be misunderstood as a usurpation of the jury's role. Instead of accepting only the most plausible of competing inferences as sufficient at the pleading stage, we will allow the complaint to survive if it alleges facts from which, if true, a reasonable person could infer that the defendant acted with the required intent.

Id. at 601-02 (citation and quotation omitted). With these standards in mind, we will examine plaintiff's allegations.

Plaintiff argues that Kelley's scienter can be inferred from the alleged fact that he knew about the problems with the European operations and the company's increasing dependence on them, before he misrepresented or withheld material facts. In other words, plaintiff alleges that Kelley made public statements or disseminated information about the European business that he knew were untrue or materially incomplete. Those allegations are sufficient to support a reasonable inference that Kelley acted with scienter when he failed to disclose the problems with the European operations in the prospectuses and gave purportedly inaccurate information about them in the April 27, 2004 conference call.

***16** We turn now to Ryan. Having determined that her alleged statement in the February 10, 2004 conference call with the analysts is puffery, the section 10(b) claim against Ryan with respect to Europe rests only on the alleged omissions from the prospectuses. According to plaintiff, Ryan's scienter can be inferred from her alleged knowledge about the problems in Europe before the prospectuses were issued. The Court agrees. At this stage, Ryan's alleged knowledge that the prospectuses were materially incomplete is sufficient to satisfy the scienter element.

The claim against Rogers with respect to the European operations is also based solely on the alleged prospectus omissions. Plaintiff does not allege, however, that Rogers participated in the 2003 meetings in which the Former Senior European Finance Executive told Kelley and Ryan about the problems with Europe. But plaintiff does allege that during a conference call with Rogers, Kelley and Ryan that took place shortly after Kelley and Ryan's first meeting with the Former Executive, Rogers told the Former Executive that he had lowered the 2004 profit projection for Europe by fifteen percent. (*See* Compl. ¶¶ 99-105.) Plaintiff also alleges that Rogers attended the February 2004 summit meeting and that he, along with Kelley, said that Europe was "losing money" and "was bringing the Company down." (*Id.* ¶¶ 110, 113.) Taken together, those allegations are sufficient to enable a reasonable person to infer that Rogers acted with the requisite intent with respect to the alleged omissions about Europe in the prospectuses.

The situation is different for Schnall. Plaintiff does not allege any facts from which a reasonable person could infer that he knew the prospectus information about Europe was materially incomplete. But plaintiff says that his scienter can be inferred from the fact that he is one of the "principals" of and has a "financial and controlling interest[ ]" in CDR and, thus, had a financial motive to inflate the offering price. (Compl.¶¶ 30, 175, 179, 181.)

The Court disagrees. Every shareholder in a company that decides to go public has a financial interest in obtaining a high offering price. Equating that interest with an intent to defraud would make all such shareholders targets of securities fraud claims. Consequently, the Court holds that Schnall's alleged financial interest in the offerings does not, by itself, give rise to a strong inference of scienter. *See Nathenson v. Zonagen Inc.,* 267 F.3d 400, 420 (5th Cir.2001) (allegations that officers and directors would benefit from higher public offering price held "insufficient to support a strong inference of scienter"); *Sloane Overseas Fund, Ltd. v. Sapiens Int'l. Corp., N.V.,* 941 F.Supp. 1369, 1377 (S.D.N.Y.1996) (allegations that defendant bank "was a founder, a substantial creditor, and a shareholder" of company whose notes were sold in the offering and, therefore, "had ample motive to inflate [the company's] financial soundness to ensure a successful and profitable offering" held inadequate to allege scienter). Accordingly, the Court dismisses the section 10(b) claim asserted against Schnall for misstatements about SIRVA Europe.

***17** We turn now to the last individual defendant, Stocker. Plaintiff has not alleged any facts that suggest Stocker knew the prospectus information about Europe was materially incomplete, had any motive to defraud, or otherwise acted with the requisite intent with respect to the alleged omissions about Europe in the prospectuses. Therefore, the section 10(b) claim plaintiff asserts against him for those alleged omissions must be dismissed.

That leaves the two corporate defendants, SIRVA and CDR. The individual defendants' knowledge can be imputed to those entities but only if they obtained the knowledge when they were acting within the scope of their employment. *United States v. One Parcel of Land Located at 7326 Highway 45 N., Three Lakes, Oneida County, Wis.,* 965 F.2d 311, 316 (7th Cir.1992). Plaintiff alleges that Kelley and Ryan learned about the problems in Europe in the course of their duties as SIRVA's CEO and CFO, respectively, and that Rogers learned about them while acting in his capacity as a principal of CDR. Accordingly, their knowledge can be imputed to SIRVA and CDR.

B. Insurance Reserves

Plaintiff alleges that the SIRVA defendants made the following misrepresentations and omissions about insurance reserves in the prospectuses: (1) that SIRVA manipulated insurance reserves to boost earnings; (2) SIRVA's reserve rates are "based on a percentage of earned premium[, which, in turn,] is based on historical data, run rates and actuarial methods"; (3) reserves for cargo claims are analyzed quarterly and changes to them are made "as appropriate"; (4) reserves are "based upon past claims experience, knowledge of claims staff regarding the nature and potential cost of each claim and trends and estimates of future claims trends"; and (5) SIRVA improperly failed to take a timely charge to accrue additional liabilities to its multiple-line property and commercial liability insurance (Compl. ¶¶ 40, 44-45, 137, 153-70; Exs. SIRVA Defs.' Mem. Law Supp. Mot. Dismiss, Ex. 1, IPO Prospectus at 37, 77; *id.,* Ex. 8, SPO Prospectus at 28, 67.) In addition, plaintiff alleges that defendants made the following misrepresentations elsewhere:

(6) in a February 10, 2004 conference call, Kelley said that SIRVA's insurance business was growing in an "intelligent and low-risk manner" and operated on "very careful risk models" (Compl.¶¶ 232, 235);

(7) in the 2003 Form 10-K, defendants said that SIRVA was "cautious in choosing which customers to insure and what kinds of insurance to write" and reported that SIRVA had reserves of $48.7 million and $53.7 million at the end of 2002 and 2003, respectively (*id.* ¶¶ 240, 243-44);

(8) in the Form 10-Q for the first quarter of 2004, defendants said that SIRVA had insurance reserves of $51.7 million and claims reserves of $19.6 million at the end of March 2004 (*id.* ¶ 262);

(9) in an April 27, 2004 conference call, Kelley said that more than two-thirds of the insurance unit's growth "came organically" (*id.* ¶ 254); and

***18** (10) In an August 5, 2004 conference call, Kelley said that SIRVA was "growing th[e] [insurance] business without compromising [its] risk standards" (*id.* ¶ 292).

As noted above, the third alleged misrepresentation concerning reserves for cargo claims is not actionable because plaintiff alleges that SIRVA manipulated reserves for NAIT and workers' compensation claims only. (*See* Compl. ¶¶ 153-55, 162-63, 166-68.) Consequently, plaintiff cannot base a section 10(b) claim on prospectus statements about cargo claims reserves.

Plaintiff fares no better with its claim that defendants concealed alleged reserves manipulation. As discussed above, the manipulation claims are based on information from confidential informants whose identities and personal knowledge are not described with the detail demanded by the PSLRA.

Plaintiff's remaining reserves claims-(1) that defendants falsely described SIRVA's reserves methodology in the prospectuses; (2) that defendants improperly failed to take a timely charge to accrue additional liabilities related to certain lines of insurance; (3) that Kelley falsely characterized SIRVA's insurance business and its growth in the February 10, April 27 and August 5, 2004 conference calls; and (4) that defendants falsely characterized SIRVA's insurance business and the amount of its reserves in its 2003 Form 10-K and its Form 10-Q for the first quarter of 2004-depend on the inadequately pleaded manipulation allegations. Thus, these claims must also be dismissed.

C. Accounting Practices & Projections

That last group of misstatements that plaintiff attributes to the SIRVA defendants concerns the company's accounting practices and financial projections. With respect to SIRVA's accounting practices, plaintiff alleges that defendants:

(1) put false financial information for the years 2001-2003 and the first three quarters of 2004 in the prospectuses, the February 10, 2004 press release, SIRVA's 2003 Form 10-K, the April 27, 2004 press release and conference call, SIRVA's Form 10-Qs for the first, second and third quarters of 2004, SIRVA's 2003 Annual Report, and the August 5, 2004 press release and conference call (Compl.¶¶ 40-41, 43, 48-52, 57, 59, 63, 231, 236, 251, 256, 259, 273-74, 279, 286, 289, 291, 293, 318, 374, 376-80, 384, 386, 388);

(2) gave false assurances that the financial statements

fairly presented the company's financial results in the prospectuses, in SIRVA's 2003 Form 10-K, in SIRVA's Form 10-Qs for the first, second and third quarters of 2004 and in its 2003 Annual Report and Proxy (*id.* ¶¶ 41, 59, 63, 237-38, 259-60, 274, 277, 293-94, 318-19);

(3) falsely stated the company's policy regarding revenue recognition in the prospectuses, SIRVA's 2003 Form 10-K, SIRVA's Form 10-Qs for the first, second and third quarters of 2004, the 2003 Annual Report and Proxy and the January 31, 2005 conference call (*id.* ¶¶ 46, 62-63, 241-42, 261, 276, 295, 320, 333);

***19** (4) falsely stated that the company had adequate internal accounting controls in the prospectuses, SIRVA's 2003 Form 10-K, SIRVA's Form 10-Qs for the first, second and third quarters of 2004 and its 2003 Annual Report and Proxy (*id.* ¶¶ 40, 52, 56, 63, 222, 237, 239, 263, 275, 296, 322, 398-99);

(5) failed to disclose in the prospectuses changes defendants made in certain accounting methodologies (*id.* ¶¶ 52-53, 63); and

(6) falsely stated that SIRVA's financial statements had been prepared in accordance with GAAP in the 2003 Annual Report and Proxy, the 2003 Form 10-K and the Form 10-Qs for the second and third quarters of 2004 (*id.* ¶¶ 237, 260, 274-75, 294, 319, 263).

Defendants do not argue that these statements were true or immaterial, but they say plaintiff's allegations do not support the inference that any of them knew the statements were false.

With respect to the individual defendants' knowledge, plaintiff alleges, in essence, that they must have known about the accounting improprieties because they were actively involved in the company's management and/or their positions gave them access to all of SIRVA's financial information. (*See id.* ¶¶ 194-205, 219-27.) The fact that defendants were active managers does not, however, support the inference that they knew of the alleged accounting manipulations. *Fin. Acquisition,* 440 F.3d at 287 ("[O]fficers are *not* liable for acts solely because they are officers, even where their day-to-day involvement in the corporation is pleaded."). Nor does the fact that defendants, by virtue of their positions, had access to the accounting information. *City of Phila. v. Fleming Cos., Inc.,* 264 F.3d 1245, 1264 (10th Cir.2001) ("[A]llegations that a securities fraud defendant, because of his position within the company, 'must have known' a statement was false or misleading are precisely the types of inferences which [courts], on numerous occasions, have determined to be inadequate ...." (quotation omitted)). Rather, plaintiff must allege facts that support the inference that each defendant was actually aware, or had a duty to be aware, of the alleged improprieties.

Plaintiff has made the requisite allegations only as to Stocker and Ryan. Though plaintiff does not allege Ryan's responsibilities as SIRVA's CFO, it is reasonable to infer that one of them was to ensure that the company's financial statements were accurate. Moreover, plaintiff specifically alleges that Stocker and Ryan were members of the Audit Committee during the class period, a committee that was charged with:

review[ing] the quality and integrity of SIRVA's financial reporting and other internal control processes, the quality and integrity of its financial statements, its compliance with legal and regulatory requirements and its code of conduct, the qualifications and independence of its auditors, the performance of its internal audit function and independent auditors and other significant financial matters.

***20** (Compl.¶¶ 219-20, 222, 226.) Further, because Ryan and Stocker are alleged to have learned of the accounting issues while acting in the scope of their employment with SIRVA, their knowledge can be imputed to the company. *One Parcel of Land,* 965 F.2d at 316. In sum, plaintiff's knowledge allegations are sufficient with respect to Ryan, Stocker and SIRVA but not with respect to Kelley, Schnall, Rogers or CDR.

Plaintiff also alleges that defendants made false earnings projections in the February 10, 2004 conference call, the April 27, 2004 press release and conference call and the August 5, 2004 press release and conference call. (Compl.¶¶ 234, 253, 257, 288, 290-91.) Defendants contend that these projections are protected by the PSLRA's "safe harbor" for forward-looking statements. Forward-looking statements include "projection[s] of revenues, income (including income loss), earnings (including earnings loss) per share, capital expenditures, dividends, capital structure, or other financial items" and "statement[s] of future economic performance." 15 U.S.C. § 78u-5(i). Defendants are shielded from liability for such statements if they are "accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement[s]" or "plaintiff fails to prove that the forward-looking statement[s] ... w[ere] made with actual knowledge ... that [they] w[ere] false or misleading." *Id.* § 78u-5(c)(1).

Defendants told investors both during the conference calls and in the press releases that the projections were forward-looking statements and directed them to the cautionary language in SIRVA's SEC filings, including the IPO prospectus and SIRVA's 2003 Form 10-K. (*See* Exs. SIRVA Defs.' Mem. Law Supp. Mot. Dismiss, Ex. 2, Tr. 2/10/04 Conference Call at 1; *id.,* Ex. 4, Tr. 4/27/04 Conference Call at 1; *id.,* Ex. 13, Tr. 8/5/04 Conference Call at 1; *id.,* Ex. 14, 2/10/94 Press Release at 3; *id.,* Ex. 15, 4/27/04 Press Release at 2-3; *id.,* Ex. 16, 8/5/04 Press Release at 2-3.) The IPO prospectus sets forth twenty-three risk factors associated with SIRVA's business:

(1) If we do not successfully compete within the highly competitive industries in which we operate, our operating revenues and profitability could be adversely affected.

(2) Competition may force us to lower our prices thereby adversely affecting our operating revenues and profitability.

(3) Our business and financial condition could continue to be adversely affected by the present economic downturn and could also be affected by future economic downturns and other external events.

(4) Until recently, we had a history of net losses, and may not be profitable in the future.

(5) Our success depends in part on our relatively new and unproven strategy of offering a global comprehensive relocation solution to customers.

***21** (6) Our global relocation solutions business exposes us to some of the risks of the real estate industry, including risks relating to the purchase, ownership and resale of transferred employees' homes at a loss.

(7) Our network services business exposes us to some of the risks of the insurance industry.

(8) We may not be able to recruit and retain a sufficient number of agents, representatives or owner/operators to carry out our growth plans.

(9) Actions taken by our agents may harm our brands or reputation, or result in legal action against us.

(10) Potential liability associated with accidents in the trucking industry is severe and occurrences are unpredictable. In addition, an increase in liability, property or casualty insurance premiums could cause us to incur significant costs.

(11) If we lost one or more of our government licenses or permits or became subject to more onerous government regulations, including the new federal safety rules on truck driver work hours, we could be adversely affected.

(12) We are subject to litigation or governmental investigations as a result of our operations.

(13) Contingent or future environmental liabilities could cause us to incur significant costs and adversely affect our operations.

(14) Our business is highly seasonal, which leads to fluctuations in our operating results and working capital needs.

(15) Our owner/operators are currently not considered to be employees by taxing and other regulatory authorities. Should these authorities change their position and consider our owner/operators to be our employees, our costs related to our tax, unemployment compensation and workers' compensation payments could increase significantly.

(16) The international scope of our business may adversely affect our business.

(17) We are exposed to currency fluctuations, which may have an adverse effect on us.

(18) Fuel is a significant cost element in the trucking transportation industry. Fuel prices are currently high and may continue to rise and they, and the availability of fuel, have been subject to volatility in the past.

(19) We are a holding company with no significant independent operations and therefore rely on our subsidiaries to make funds available to us.

(20) We have had substantial existing debt and may incur substantial debt in the future, and the agreements governing our debt contain restrictions that could significantly restrict our ability to operate our business.

(21) Any difficulties with our information systems or our information systems providers could delay or disrupt our ability to service our customers and impair our competitiveness.

(22) We are dependent on our highly trained executive officers and employees. Any difficulty in maintaining our current employees or in hiring similar employees would adversely affect our ability to operate our business.

(23) If we acquire any companies or technologies in the future, they could prove difficult to integrate, disrupt our business, dilute stockholder value or have an adverse effect on our results of operations.

***22** (*Id.,* Ex. 1, IPO Prospectus at 13-19.) The cautionary language in the 2003 Form 10-K, which was filed nearly six months later, is virtually identical. (*See id.,* Ex. 9, 2003 Form 10-K at 12-20.) Plaintiff contends that those warnings are too general to be meaningful, as the PSLRA safe harbor requires.

Our court of appeals discussed the parameters of the safe harbor provision in *Asher v. Baxter International, Inc.,* 377 F.3d 727 (7th Cir.2004). In that case, a group of investors sued Baxter under section 10(b) claiming that the earnings projections Baxter made for 2002 were false. *Id.* at 728. Baxter argued that the projections fell within the safe harbor because they were accompanied by the following cautionary language:

Many factors could affect the company's actual results, causing results to differ materially, from those expressed in any such forward-looking statements. These factors include, but are not limited to, interest rates; technological advances in the medical field; economic conditions; demand and market acceptance risks for new and existing products, technologies and health care services; the impact of competitive products and pricing; manufacturing capacity; new plant start-ups; global regulatory, trade and tax policies; regulatory, legal or other developments relating to the company's Series A, AF, and AX dialyzers; continued price competition; product development risks, including technological difficulties; ability to enforce patents; actions of regulatory bodies and other government authorities; reimbursement policies of government agencies; commercialization factors; results of product testing; and other factors described elsewhere in this report or in the company's other filings with the Securities and Exchange Commission. Additionally, as discussed in Item 3-"Legal Proceedings," upon the resolution of certain legal matters, the company may incur charges in excess of presently established reserves. Any such change could have a material adverse effect on the company's results of operations or cash flows in the period in which it is recorded.

Currency fluctuations are also a significant variable for global companies, especially fluctuations in local currencies where hedging opportunities are unreasonably expensive or unavailable. If the United States dollar strengthens significantly against most foreign currencies, the company's ability to realize projected growth rates in its sales and net earnings outside the United States could be negatively impacted.

The company believes that its expectations with respect to forward-looking statements are based upon reasonable assumptions within the bounds of its knowledge of its business operations, but there can be no assurance that the actual results or performance of the company will conform to any future results or performance expressed or implied by such forward-looking statements.

Id. at 730. The district court agreed and granted Baxter's motion to dismiss. *Id.*

***23** The investors appealed, arguing that Baxter could not take advantage of the safe harbor because the cautionary language was not meaningful. *Id.* In the Seventh Circuit's view, the word “meaningful” prohibits “boilerplate” warnings, such as “all businesses are risky.” *Id.* at 732-33. Rather, a caution “must be tailored to the risks that accompany the particular projections.” *Id.* at 732. Ultimately, the court concluded that a caution falls within the safe harbor “only if it includes those sources of variance that (at the time of the projection) were the principal or important risks.” *Id.* at 734.

The court did not, however, make a determination on the meaningfulness of Baxter's cautionary language because such a decision was premature:

There is no reason to think-at least, no reason that a court can accept at the pleading stage, before plaintiffs have access to discovery-that the items mentioned in Baxter's cautionary language were those that at the time were the (or any of the) “important” sources of variance. The problem is not that what actually happened went unmentioned; issuers need not anticipate all sources of deviations from expectations. Rather, the problem is that there is no reason (on this record) to conclude that Baxter mentioned those sources of variance that (at the time of the projection) were the principal or important risks. For all we can tell, the major risks Baxter objectively faced when it made its forecasts were exactly those that, according to the complaint, came to pass, yet the cautionary statement mentioned none of them.

Id.

As in *Asher,* the cautionary language in this case lists a host of factors and events that might impact SIRVA's projections but not the ones plaintiff contends were most important. As the *Asher* court explained, that omission is not necessarily fatal to defendants' quest for the safe harbor. But, given plaintiff's allegation that the missing information pertained to the “principal or important” risks at the time the projections were made, we cannot say, as a matter of law, that the cautionary language was meaningful.

All is not lost for defendants, however. Plaintiff must also allege that they had actual knowledge of the falsity of the projections, to defeat defendants' motion. As discussed above, plaintiff's allegations support the inference that Kelley, Ryan and Rogers knew the projections were false because of the problems in Europe. Moreover, because they obtained that information in the course of their duties for SIRVA and CDR, respectively, that knowledge can be imputed to the corporate defendants. *One Parcel of Land,* 965 F.2d at 316. Further, Rogers' alleged possession of material information about SIRVA Europe and his alleged ownership and control of CDR are sufficient to support the inference that CDR engaged in insider trading. Finally, as noted above, plaintiff's allegations support the inference that Ryan and Stocker, and therefore, SIRVA, knew the projections were false because of the accounting improprieties.

***24** They do not, however, support the inference that: (1) Schnall or Stocker knew the projections were false because of the problems with Europe; (2) any of the defendants knew the projections were false because of manipulation of the insurance reserves; or (3) Kelley, Schnall, Rogers or CDR knew the projections were false because of improper accounting practices. Thus, the projections claim survives but only as to Kelley, Ryan, Rogers, SIRVA and CDR with respect to the problems in Europe and as to Ryan, Stocker and SIRVA with respect to the improper accounting practices.

Counts III & V

In Count III, plaintiff asserts a claim under section 15 of the 1933 Act against Kelley, Ryan, Schnall, Stocker and CDR. In Count V, plaintiff asserts a claim under section 20(a) of the 1934 Act against the same defendants. Section 15 provides:

Every person who, by or through stock ownership, agency, or otherwise, or who, pursuant to or in connection with an agreement or understanding with one or more other persons by or through stock ownership, agency, or otherwise, controls any person liable under [section 11 of the 1933 Act], shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist.

15 U.S.C. § 77o. Section 20(a) provides:

Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder [*i.e.,* section 10(b)] shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

15 U.S.C. § 78t(a). Though the two sections are not identical, the analysis applied to them is the same. *See Donohoe v. Consol. Operating & Prod. Corp.,* 30 F.3d 907, 911-13 (7th Cir.1994) (analyzing section 15 and section 20(a) claims together); *Barker v. Henderson, Franklin, Starnes & Holt,* 797 F.2d 490, 494 (7th Cir.1986) (noting that the two sections are "parallel").

Defendants contend that these counts must be dismissed because they cannot be held liable both as primary violators, as charged in Counts I and IV, and as control persons. The statutory language suggests that control person liability is an alternative to liability for a primary violation, and some courts have interpreted it that way. *See, e.g., In re Scholastic Corp. Sec. Litig.,* 252 F.3d 63, 77 (2d Cir.2001) (stating that control person liability "is a separate inquiry from that of primary liability and provides an alternative basis of culpability"). Only a few courts have addressed the issue, however, and the Seventh Circuit is not one of them. Thus, whether control person liability is an alternative or a supplement to primary liability is an open question in this circuit.

***25** At some point, the Court may have to decide that question, but we need not do it now. Because plaintiff is permitted to plead alternatively, the Court would not dismiss Counts III and V even if liability cannot be imposed on defendants under both theories.

Defendants also say that these counts must be dismissed because plaintiff has not pleaded enough facts to demonstrate that they are control persons within the meaning of the statutes. Control person claims are not, however, subject to a heightened pleading standard. *See* FED. R. CIV. P. 9(b); *Lawrence E. Jaffe Pension Plan v. Household Int'l, Inc.,* No. 02 C 5893, 2004 WL 574665, at *16 (N.D.Ill. Mar.22, 2004). Consequently, plaintiff's allegation that each defendant "had direct involvement in the day to day operations of [SIRVA] and/or control over major corporate decision and policy making, and, therefore, is presumed to have had the power to control or influence the particular transactions giving rise to the securities violations as alleged herein, and exercised the same" (Compl.¶ 461), is sufficient to satisfy the control element of the section 15 and 20(a) claims. *See Harrison v. Dean Witter Reynolds, Inc.,* 974 F.2d 873, 881 (7th Cir.1992) (stating that a control person is one who "actually participated in, that is, exercised control over, the operations of the person in general and ... 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.").

However, a control person is liable under sections 15 and 20(a), only if the person or entity that it controls is liable for violating sections 11 and 10(b), respectively. As discussed above, plaintiff has adequately alleged that SIRVA violated both sections 11 and 10(b). Therefore, defendants' motions to dismiss Counts III and V are denied.

Count VI

In Count VI, plaintiff asserts a claim under section 20A of the 1934 Act against CDR for insider trading. Defendants say this claim must be dismissed because liability under section 10(b) is a predicate to liability under this section. *See, e.g., Jackson Nat'l Life Ins. Co. v. Merrill Lynch & Co., Inc.,* 32 F.3d 697, 703 (2d Cir.1994) ("[T]he language of the statute is ... quite plain that to state a claim under § 20A, a plaintiff must plead a predicate violation of the [19]34 Act or its rules and regulations.") Even if that is true, an issue we do not decide, Count VI survives. As discussed above, plaintiff has successfully pleaded section 10(b) claims against CDR.

III. Price

Counts I and IV

Plaintiff alleges that Price violated sections 11 and 10(b) by falsely stating in its audit opinions [FN4] for SIRVA's 2000-2003 financial statements, which were included in SIRVA's 2003 Annual Report, 2003 Form 10-K, 2004 Form 10-K and both prospectuses, that: (1) the financial statements were prepared in accordance with GAAP; and (2) Price had audited those statements in accordance with Generally Accepted Auditing Standards ("GAAS"). (Compl.¶¶ 95, 274, 280.)

FN4. It is not clear whether plaintiff asserts a 10(b) claim against Price for its actuarial work. To the extent that it does, the claim must be dismissed because plaintiff does not allege that Price made any false statements in connection with that work.

***26** Price says the section 11 claim must be dismissed because plaintiff has not alleged it with the particularity required by Rule 9(b). Plaintiff contends that such claims are not subject to that Rule, and both parties offer authority in support of their positions. We need not, however, decide whether the Rule applies because, even if it does, plaintiff's allegations pass muster.

Rule 9(b) requires plaintiff to allege the "who, what, when, where and how" of the alleged fraud. *DiLeo v. Ernst & Young,* 901 F.2d 624, 627 (7th Cir.1990). Plaintiff alleges that Price falsely stated in specifically identified documents that its audits conformed to GAAS and SIRVA's financials conformed to GAAP, and that Price knew or should have known, for the reasons discussed below, that those statements were false. Those allegations are sufficient to satisfy Rule 9(b). Accordingly, Price's motion to dismiss the section 11 claim asserted against it is denied.[FN5]

FN5. In its reply brief, Price argues, for the first time, that plaintiff has no standing to pursue a section 11 claim with respect to the SPO and that even if it does, it has failed to allege damages that are traceable to that offering. (*See* Price Reply at 9-10.) To the extent that Price is arguing plaintiff lacks non-jurisdictional standing, Price has waived the argument by failing to raise it in its opening brief. *United States v. Turner,* 203 F.3d 1010, 1019 (7th Cir.2000). To the extent that Price argues that plaintiff lacks Article III standing, that argument fails for the reasons discussed above.

With respect to the section 10(b) claim, Price argues that plaintiff has not adequately alleged that it acted with scienter. "The mere publication of inaccurate accounting figures, or a failure to follow GAAP, without more, does not establish scienter." *In re Worlds of Wonder Sec. Litig.,* 35 F.3d 1407, 1426 (9th Cir.1994) (quotation omitted). Rather, plaintiff must allege that "the accounting practices were so deficient that the audit amounted to no audit at all, or an egregious refusal to see the obvious, or to investigate the doubtful, or that the accounting judgments which were made were such that no reasonable accountant would have made the same decisions if confronted with the same facts." *Id.* (quotation omitted). Moreover, as discussed above, to satisfy the PSLRA, plaintiff must allege "sufficient facts to convince a court at the outset that the defendants likely intended to deceive, manipulate, or defraud." *Tellabs,* 437 F.3d. at 594-95 (quotations and citations omitted).

Plaintiff says that Price's intent can be inferred from its disregard of numerous "red flags," of fraud, including: (1) the pervasive and obvious deficiencies in SIRVA's internal controls; (2) SIRVA's use of, and lack of control over, manual entries; (3) SIRVA's unusual growth or profitability compared to other companies in the industry; (4) management's failure to follow up on issues, provide oversight and display an appropriate attitude toward control; (5) the lack of properly trained personnel responsible for ensuring accurate financial reporting; (6) management's domination by a single person or small group and its undue emphasis on aggressive earnings targets; (7) earnings increases that were due solely to changes in methodology; (8) SIRVA's flawed inter-company reconciliation process; (9) SIRVA's use of subjective or unsupported estimates about assumptions affecting the amount of assets, liabilities, revenues and expenses reported; and (10) SIRVA's understatement of its insurance reserves (Compl.¶¶ 408-10, 413-14, 416-17, 419, 420-26, 428).

***27** Plaintiff also alleges facts from which we can infer that Price actually knew, or should have known, about most of these issues. Plaintiff says that it is standard auditing practice to examine a company's internal controls before issuing an audit report, to question a company's unusual growth or profitability relative to its competitors and to scrutinize closely the use of manual journal entries and assumptions based on estimates. (*Id.* ¶¶ 413-14, 416, 427.) Plaintiff also says that Price should have realized that the statements did not accurately reflect insurance reserves because it served as the actuary for those reserves.[FN6] (*Id.* ¶¶ 162-63, 428.) Moreover, it is reasonable to infer, given the extent of the alleged problems, that a competent auditor would have discovered, in the course of investigating the sufficiency of SIRVA's internal controls, that the company lacked the personnel necessary to ensure accurate financial reporting, certain earnings increases were due solely to methodology changes and SIRVA's inter-company reconciliation process was flawed. Taken together, these allegations are sufficient to suggest that Price made the false GAAP and GAAS representations with the intent to defraud or with reckless disregard as to their accuracy. *See In re WorldCom, Inc. Sec. Litig.,* No. 02 Civ. 3288(DLC), 2003 WL 21488087, at *7 (S.D.N.Y.2003) (holding that scienter element was satisfied by allegations that auditor "had unlimited access to WorldCom's books and records ... [and] an obligation to review and evaluate those records in order to form an opinion regarding WorldCom's financial statements[,] .... [and that] WorldCom's books and records contained no support for or documentation of the accounting treatment of significant merger reserves and line costs"); *In re First Merchs. Acceptance Corp. Sec. Litig.,* No. 97 C 2715, 1998 WL 781118, at *11 (N.D.Ill. Nov.4, 1998) ("Plaintiffs allege not only violations of GAAP and GAAS, but that Deloitte deliberately ignored several red flags in the financial statements which would have exposed the fraud.... Thus, the allegations in the complaint, including the magnitude of the misstatements, the specific GAAP and GAAS violations and the 'red flags' together support an inference that Deloitte's audit amounted to no audit at all or an egregious refusal to see the obvious or investigate the doubtful." (quotation omitted)).[FN7] Price's motion to dismiss is, therefore, denied.

FN6. Price argues that plaintiff's assertion of this argument is an impermissible attempt to amend its complaint through a brief. The Court disagrees. That Price should have suspected accounting irregularities when it discovered SIRVA was under-reserved is a reasonable inference from the allegations in the complaint.

FN7. Price also argues that plaintiff's section 10(b) allegations do not satisfy Rule 9(b). For the reasons discussed above, the Court rejects this argument.

Conclusion

For all of the reasons stated above:

(1) the Underwriters' motion to dismiss [doc. no. 83] is granted in part and denied in part. The motion is granted as to: (1) the Count I claims based on insurance reserves manipulation, which are dismissed without prejudice; (2) the Count I claims based on the prospectus statements that "We intend to increase our market share internationally"; "We believe that the European and Asian market opportunities are considerable, as the markets are large and the corporate outsourcing trend is at an earlier stage of development"; and "We are approaching this international opportunity from a position of strength, with a leading market share position in Europe, Australia and Asia," which are dismissed with prejudice; and (3) the claims in Count II, which are dismissed without prejudice. In all other respects, the Underwriters' motion is denied.

***28** (2) the SIRVA defendants' motions [doc. nos. 87 & 89] are granted in part and denied in part. The motion is granted as to: (1) the Count I claims based on insurance reserves manipulation, which are dismissed without prejudice; (2) the Count I claims based on the prospectus statements that "We intend to increase our market share internationally"; "We believe that the European and Asian market opportunities are considerable, as the markets are large and the corporate outsourcing trend is at an earlier stage of development"; and "We are approaching this international opportunity from a position of strength, with a leading market share position in Europe, Australia and Asia," which are dismissed with prejudice; (3) the claims in Count II, which are dismissed without prejudice; (4) the Count IV claims premised on: (a) the prospectus statements that SIRVA intended to increase its European market share, believed the opportunities there were considerable and was approaching them from a position of strength, which are dismissed with prejudice; (b) Ryan's statement in the February 10, 2004 conference call, which is dismissed with prejudice; (c) Kelley's statement in the April 27, 2004 press release that "[SIRVA] made significant progress in broadening [its] services offering and expanding [its] presence throughout the European continent," which is dismissed with prejudice;

and (d) Kelley's statements in the August 4, 2004 press release that "We continue to invest in our European and Asia Pacific operations with the goal of developing a powerful selling and marketing capability across the rest of the world like we have in the U.S." and "We are building the infrastructure for future growth," which are dismissed with prejudice; (5) the Count IV claims asserted against defendants Schnall and Stocker that are premised on omissions from the prospectuses about SIRVA Europe, which are dismissed without prejudice; (6) all of the Count IV claims premised on alleged misstatements about the insurance reserves, which are dismissed without prejudice; (7) the Count IV claims premised on SIRVA's accounting practices that are asserted against Kelley, Rogers, Schnall and CDR, which are dismissed without prejudice; and (8) the Count IV claims premised on the alleged falsity of the financial projections; (a) due to undisclosed information about SIRVA Europe that are asserted against Schnall and Stocker; (b) due to undisclosed information about insurance reserves asserted against all of the SIRVA defendants; (c) due to undisclosed problems with SIRVA's accounting practices asserted against Kelley, Schnall, Rogers and CDR, all of which are dismissed without prejudice. In all other respects, the motions are denied.

(3) Price's motion to dismiss [doc. no. 86] is denied.

Plaintiff has thirty days from the date of this Memorandum Opinion and Order to amend its complaint in accordance with this Order. If no amendment is timely filed, the Court will dismiss the deficient claims with prejudice.

***29** SO ORDERED.

N.D.Ill.,2006.
Central Laborers' Pension Fund v. SIRVA, Inc.
Not Reported in F.Supp.2d, 2006 WL 2787520 (N.D.Ill.)

END OF DOCUMENT

TAB 5

Only the Westlaw citation is currently available.

United States Court of Appeals,
Fifth Circuit.
Todd FENER, on Behalf of Himself and All Others Similarly Situated, et al., Plaintiffs,
Belo Corporation; Robert W. Decherd, Barry Peckham; James M. Moroney, III, Defendants-Appellees,
v.
OPERATING ENGINEERS CONSTRUCTION INDUSTRY AND MISCELLANEOUS PENSION FUND (LOCAL 66), Appellant.
No. 08-10576.

Aug. 12, 2009.

Background: Shareholders brought securities fraud action against media company and five of its senior officers and directors, alleging that plaintiffs had bought company stock when its price was artificially and fraudulently inflated as a result of the manipulation of newspaper's reported circulation and were injured when company revealed the fraud and its stock price fell. Shareholders moved for class certification. The United States District Court for the Northern District of Texas, Sidney A. Fitzwater, J., 560 F.Supp.2d 502, denied motion, and shareholders appealed.

Holdings: The Court of Appeals, Jerry E. Smith, Circuit Judge, held that:
(1) the Supreme Court's general discussion of fraud-on-the-market theory in *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta*, 552 U.S. 148, 128 S.Ct. 761, 169 L.Ed.2d 627,, did not affect the Fifth Circuit's fraud-on-the-market rules;
(2) shareholders' original motion for class certification did not demonstrate loss causation required to establish securities fraud under fraud-on-the-market theory at the class certification stage; and
(3) shareholders' original motion for class certification, coupled with their expert's testimony and event study, still fell short of demonstrating loss causation.

Affirmed.

West Headnotes

[1] Federal Courts 170B ⚷817

170B Federal Courts
170BVIII Courts of Appeals
170BVIII(K) Scope, Standards, and Extent
170BVIII(K)4 Discretion of Lower Court
170Bk817 k. Parties; Pleading. Most Cited Cases
Court of Appeals reviews class certification decisions for abuse of discretion in recognition of the essentially factual basis of the certification inquiry and of the district court's inherent power to manage and control pending litigation. Fed.Rules Civ.Proc.Rule 23, 28 U.S.C.A.

[2] Federal Courts 170B ⚷776

170B Federal Courts
170BVIII Courts of Appeals
170BVIII(K) Scope, Standards, and Extent
170BVIII(K)1 In General
170Bk776 k. Trial De Novo. Most Cited Cases
Whether the district court applied the correct legal standard in granting or denying a motion for class certification is a legal question that the Court of Appeals reviews de novo. Fed.Rules Civ.Proc.Rule 23, 28 U.S.C.A.

[3] Federal Courts 170B ⚷812

170B Federal Courts
170BVIII Courts of Appeals
170BVIII(K) Scope, Standards, and Extent
170BVIII(K)4 Discretion of Lower Court
170Bk812 k. Abuse of Discretion. Most Cited Cases
Where a district court premises its legal analysis on an erroneous understanding of governing law, it has abused its discretion.

[4] Federal Civil Procedure 170A ⚷171

170A Federal Civil Procedure
170AII Parties

170AII(D) Class Actions
170AII(D)2 Proceedings
170Ak171 k. In General; Certification in General. Most Cited Cases
District court must conduct a rigorous analysis of the prerequisites of numerosity, commonality, typicality, and adequacy of representation before certifying a class. Fed.Rules Civ.Proc.Rule 23, 28 U.S.C.A.

[5] Federal Civil Procedure 170A ⚷172

170A Federal Civil Procedure
170AII Parties
170AII(D) Class Actions
170AII(D)2 Proceedings
170Ak172 k. Evidence; Pleadings and Supplementary Material. Most Cited Cases
Party seeking class certification bears the burden of proof. Fed.Rules Civ.Proc.Rule 23, 28 U.S.C.A.

[6] Securities Regulation 349B ⚷60.18

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.17 Manipulative, Deceptive or Fraudulent Conduct
349Bk60.18 k. In General. Most Cited Cases
In securities fraud cases, plaintiff must prove: (1) a material misrepresentation or omission, (2) “scienter,” that is, a wrongful state of mind, (3) a connection with the purchase or sale of a security, (4) reliance, often referred to in cases involving public securities markets or fraud-on-the-market cases as “transaction causation,” (5) economic loss, and (6) “loss causation,” that is, a causal connection between the material misrepresentation and the loss. Securities Exchange Act of 1934, § 1 et seq., 15 U.S.C.A. § 78a et seq.

[7] Securities Regulation 349B ⚷60.47

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.43 Grounds of and Defenses to Liability
349Bk60.47 k. Causation; Existence of Injury. Most Cited Cases
Plaintiff seeking to recover under the securities fraud theory of fraud-on-the-market must prove more than a material misstatement; proof that the misstatement actually moved the market is required. Securities Exchange Act of 1934, § 1 et seq., 15 U.S.C.A. § 78a et seq.

[8] Securities Regulation 349B ⚷60.48(3)

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.43 Grounds of and Defenses to Liability
349Bk60.48 Reliance
349Bk60.48(3) k. Fraud on the Market. Most Cited Cases
Under the securities fraud theory of fraud-on-the-market, plaintiffs can create a rebuttable presumption of reliance if they can show: (1) defendant made public material misrepresentations, (2) defendant's shares were traded in an efficient market, and (3) plaintiffs traded shares between the time the misrepresentations were made and the time the truth was revealed. Securities Exchange Act of 1934, § 1 et seq., 15 U.S.C.A. § 78a et seq.

[9] Securities Regulation 349B ⚷60.47

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.43 Grounds of and Defenses to Liability
349Bk60.47 k. Causation; Existence of Injury. Most Cited Cases

Securities Regulation 349B ⚷60.48(3)

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.43 Grounds of and Defenses to Liability
349Bk60.48 Reliance

349Bk60.48(3) k. Fraud on the Market. Most Cited Cases
When proving reliance under the securities fraud theory of fraud-on-the-market, plaintiffs cannot trigger a presumption of reliance by simply offering evidence of any decrease in price following the release of negative information; they instead must show “loss causation,” that is, that the false statement causing the increase was related to the statement causing the decrease. Securities Exchange Act of 1934, § 1 et seq., 15 U.S.C.A. § 78a et seq.

[10] Securities Regulation 349B 60.48(3)

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.43 Grounds of and Defenses to Liability
349Bk60.48 Reliance
349Bk60.48(3) k. Fraud on the Market. Most Cited Cases
Proving loss causation, in order to establish reliance under the securities fraud theory of fraud-on-the-market, requires a plaintiff to prove that defendant's non-disclosure materially affected the market price of the security, which requires plaintiff to show that: (1) the negative truthful information causing the decrease in price is related to an allegedly false, non-confirmatory positive statement made earlier, and (2) it was more probable than not that it was this negative statement, and not other unrelated negative statements, that caused a significant amount of the decline. Securities Exchange Act of 1934, § 1 et seq., 15 U.S.C.A. § 78a et seq.

[11] Federal Civil Procedure 170A 187

170A Federal Civil Procedure
170AII Parties
170AII(D) Class Actions
170AII(D)3 Particular Classes Represented
170Ak187 k. Stockholders, Investors, and Depositors. Most Cited Cases

Securities Regulation 349B 60.63(1)

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.60 Evidence
349Bk60.63 Weight and Sufficiency
349Bk60.63(1) k. In General. Most Cited Cases
Loss causation as an issue of predominance must be established at the class certification stage of a securities fraud action by a preponderance of all admissible evidence. Securities Exchange Act of 1934, § 1 et seq., 15 U.S.C.A. § 78a et seq.; Fed.Rules Civ.Proc.Rule 23, 28 U.S.C.A.

[12] Federal Civil Procedure 170A 187

170A Federal Civil Procedure
170AII Parties
170AII(D) Class Actions
170AII(D)3 Particular Classes Represented
170Ak187 k. Stockholders, Investors, and Depositors. Most Cited Cases

Federal Civil Procedure 170A 1809

170A Federal Civil Procedure
170AXI Dismissal
170AXI(B) Involuntary Dismissal
170AXI(B)4 Particular Actions, Insufficiency of Pleadings in
170Ak1809 k. Stockholders', Investors, and Other Class Actions. Most Cited Cases

Federal Civil Procedure 170A 2511

170A Federal Civil Procedure
170AXVII Judgment
170AXVII(C) Summary Judgment
170AXVII(C)2 Particular Cases
170Ak2511 k. Securities Cases in General. Most Cited Cases

Securities Regulation 349B 60.51(1)

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.50 Pleading
349Bk60.51 In General
349Bk60.51(1) k. In General.

Most Cited Cases
In a securities fraud action, a court can examine loss causation at the pleadings stage, the class certification stage, on summary judgment, or at trial. Securities Exchange Act of 1934, § 1 et seq., 15 U.S.C.A. § 78a et seq.

[13] Federal Civil Procedure 170A 187

170A Federal Civil Procedure
170AII Parties
170AII(D) Class Actions
170AII(D)3 Particular Classes Represented
170Ak187 k. Stockholders, Investors, and Depositors. Most Cited Cases
In a securities fraud action, the proof needed for loss causation at the pleadings stage should not be conflated with the requirements needed at the class certification stage. Securities Exchange Act of 1934, § 1 et seq., 15 U.S.C.A. § 78a et seq.; Fed.Rules Civ.Proc.Rule 23, 28 U.S.C.A.

[14] Securities Regulation 349B 60.48(3)

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.43 Grounds of and Defenses to Liability
349Bk60.48 Reliance
349Bk60.48(3) k. Fraud on the Market. Most Cited Cases
Supreme Court's general discussion of fraud-on-the-market theory in *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta* did not affect the Fifth Circuit's fraud-on-the-market rules; the Supreme Court did not mention either of the Fifth Circuit's cases in question, nor did it discuss the Fifth Circuit's fraud-on-the-market theory, the Supreme Court did not, simply by discussing a general legal standard and citing its earlier caselaw on point, overrule intervening decisions of lower courts, and earlier decision of the Supreme Court allowed each of the circuits room to develop its own fraud-on-the-market rules. Securities Exchange Act of 1934, § 1 et seq., 15 U.S.C.A. § 78a et seq.

[15] Courts 106 96(3)

106 Courts
106II Establishment, Organization, and Procedure
106II(G) Rules of Decision
106k88 Previous Decisions as Controlling or as Precedents
106k96 Decisions of United States Courts as Authority in Other United States Courts
106k96(3) k. Supreme Court Decisions. Most Cited Cases
When the Supreme Court discusses a general legal standard and cites its earlier caselaw on point, it does not necessarily overrule intervening decisions of the lower courts.

[16] Securities Regulation 349B 60.47

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.43 Grounds of and Defenses to Liability
349Bk60.47 k. Causation; Existence of Injury. Most Cited Cases
To prove loss causation in securities fraud cases in which multiple items of negative information were released together with the corrective disclosure, plaintiff must show that it is more probable than not that it was the corrective disclosure, and not other unrelated negative statements, that caused a significant amount of the decline. Securities Exchange Act of 1934, § 1 et seq., 15 U.S.C.A. § 78a et seq.

[17] Securities Regulation 349B 60.48(3)

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.43 Grounds of and Defenses to Liability
349Bk60.48 Reliance
349Bk60.48(3) k. Fraud on the Market. Most Cited Cases
Shareholders failed to demonstrate loss causation necessary to establish that media company violated federal securities laws under fraud-on-the-market theory by artificially and fraudulently inflating newspaper's circulation where, together with their motion for class certification, shareholders submitted only Securities and Exchange Commission (SEC) reports, stock-price charts, analyst reports, and other similar

information, and they did not include the testimony of an expert or any kind of analytical research or event study. Securities Exchange Act of 1934, § 1 et seq., 15 U.S.C.A. § 78a et seq.

[18] Securities Regulation 349B 60.63(2)

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.60 Evidence
349Bk60.63 Weight and Sufficiency
349Bk60.63(2) k. Misrepresentation, Nondisclosure, and Insider Trading. Most Cited Cases

Shareholders failed to demonstrate, on their motion for class certification, the loss causation necessary to establish that media company violated federal securities laws under fraud-on-the-market theory by artificially and fraudulently inflating newspaper's circulation; testimony of shareholders' expert was fatally flawed, as he based his event study on incorrect assumption that company's press release, which contained two items of negative information in addition to a corrective disclosure concerning discovery that newspaper's circulation had been overstated, was only one piece of news, expert's event study thus could not be used to support a finding of loss causation, and, without the study, the rest of expert's testimony related to analyst opinions about company's stock decline, which, together with other materials submitted by shareholders, amounted to nothing more than “well-informed speculation” insufficient to support a finding of loss causation. Securities Exchange Act of 1934, § 1 et seq., 15 U.S.C.A. § 78a et seq.

[19] Securities Regulation 349B 60.47

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.43 Grounds of and Defenses to Liability
349Bk60.47 k. Causation; Existence of Injury. Most Cited Cases

To prove loss causation in securities fraud case in which only one negative disclosure is at issue, plaintiffs must go through the same rigorous process articulated by the Fifth Circuit in *Oscar Private Equity Investments v. Allegiance Telecom, Inc.* for cases involving multiple items of negative information that were released together with the corrective disclosure; regardless of the number of disclosures, plaintiffs must establish the connection between the disclosure and the decline in price. Securities Exchange Act of 1934, § 1 et seq., 15 U.S.C.A. § 78a et seq.

[20] Securities Regulation 349B 60.48(3)

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.43 Grounds of and Defenses to Liability
349Bk60.48 Reliance
349Bk60.48(3) k. Fraud on the Market. Most Cited Cases

Securities fraud class action based on a fraud-on-the-market theory may not proceed against a defendant whose only fault is releasing a disclosure on a volatile trading day. Securities Exchange Act of 1934, § 1 et seq., 15 U.S.C.A. § 78a et seq.

[21] Securities Regulation 349B 60.25

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.17 Manipulative, Deceptive or Fraudulent Conduct
349Bk60.25 k. Fraud on the Market; Price Manipulation. Most Cited Cases

Securities Regulation 349B 60.47

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.43 Grounds of and Defenses to Liability
349Bk60.47 k. Causation; Existence of Injury. Most Cited Cases

Securities fraud litigation is not a scheme of investor's insurance but, instead, is designed to protect those who buy stock at fraudulently inflated prices; if the fraud did not cause the price of the stock to in-

crease, and its disclosure does not cause the price to go down, no injury has occurred. Securities Exchange Act of 1934, § 1 et seq., 15 U.S.C.A. § 78a et seq.
Martin B. McNamara (argued), Sarah Viola Toraason, Lawrence J.C. VanDyke, M. Byron Wilder, Gibson, Dunn & Crutcher, L.L.P., Dallas, TX, for Belo Corp., Decherd and Moroney.

Roger Evans, Mathis & Donheiser, Dallas, TX, for all Defendants-Appellees.

Mark M. Donheiser, Randal Gilbert Mathis, Mathis & Donheiser, Dallas, TX, for Peckham.

Alexandra S. Bernay, Eric Alan Isaacson (argued), Henry Rosen, Julie Anna Wilber, Coughlin, Stoia, Geller, Rudman & Robbins, L.L.P., San Diego, CA, for Appellant.

Appeals from the United States District Court for the Northern District of Texas.

Before SMITH, GARZA and CLEMENT, Circuit Judges.

JERRY E. SMITH, Circuit Judge:

***1** Todd Fener and other plaintiffs filed a class action against Belo Corporation and some of its officers (collectively "Belo") alleging violations under the Securities Exchange Act of 1934. Fener moved for class certification, which the district court denied. He appeals, and we affirm.

I.

Belo is a media company that owns television stations, websites, and newspapers, including the *Dallas Morning News* ("DMN"). Revenue from the DMN makes up about 60% of Belo's publishing revenue and 30% of its total revenue; 90% of the DMN's revenue comes from advertising sales, which are priced based on circulation.

The plaintiffs allege that Belo engaged in a fraudulent scheme designed to inflate DMN's circulation artificially in the face of a nationwide downward trend in newspaper circulation. Belo allegedly paid bonuses for achieving circulation targets, rigged audits of DMN's circulation, and implemented a no-return policy that eliminated any incentive for distributors to return unsold newspapers. Those actions, the plaintiffs claim, allegedly artificially increased recorded circulation, which led to higher advertising revenues for DMN and larger profits for Belo.

On March 9, 2004, Belo announced that DMN's future circulation would be down 2.5% on daily papers and 3.5% on the Sunday paper. On August 5, after the New York Stock Exchange ("NYSE") closed, Belo issued a press release ("the press release") that admitted that an internal investigation had revealed questionable circulation practices.

According to the press release, the allegedly fraudulent practices resulted in a 1.5% daily paper circulation decline and a 5% Sunday decline. The press release noted that the declines were "coupled with" the circulation declines announced in March and with lower anticipated circulation for the next six months; the total circulation decline from all of these announcements was predicted to be 5% for the daily paper and 11.5% for Sunday. The press release also stated that Belo would begin exercising more stringent control over possible improper manipulation of circulation.

When the NYSE opened the next day, Belo's stock, which had closed the previous day at $23.21, dropped to as low as $18.00. It finished the day at $21.55, down $1.66 from the previous day's close. Several securities analysts lowered their earning estimates for Belo and downgraded its stock.

On August 16, Belo announced that it would compensate advertisers by approximately $23 million, with an additional $3 million to cover costs related to an ongoing internal investigation. On September 29, Belo revised its initial circulation figures, projecting a decrease of 5.1% in daily circulation and 11.9% for Sunday. It said that most of the declines were related to the overstatements.

***2** Plaintiffs[FN1] sued on behalf of those who held Belo's common stock between May 12, 2003, and August 6, 2004, alleging that Belo and five of its senior officers and directors had violated § 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. They claimed the class members had bought Belo stock when its price was artificially (and fraudulently) inflated as a result of the manipulation of DMN's reported circulation and were injured when Belo revealed the fraud and its stock price fell. Plaintiffs eventually[FN2] moved for class certification under Federal Rule of Civil Procedure 23.

Belo opposed class certification and presented expert Dr. Paul Gompers, who testified that class certification was inappropriate because plaintiffs could not show that the fraudulent disclosure in the press release was the primary cause of the stock price decline. Plaintiffs responded with a declaration from expert Dr. Scott Hakala, who rejected Gompers's testimony and stated that the decline was "entirely or almost entirely attributable to the revelation of the relevant truth in this case."[FN3] After hearing from the experts and examining the other evidence, the district court denied class certification.

II.

[1][2][3][4][5] "We review class certification decisions for abuse of discretion in recognition of the essentially factual basis of the certification inquiry and of the district court's inherent power to manage and control pending litigation. Whether the district court applied the correct legal standard ..., however, is a legal question that we review de novo." *Regents of the Univ. of Cal. v. Credit Suisse First Boston (USA), Inc.,* 482 F.3d 372, 380 (5th Cir.2007) (citation, internal quotation marks, and ellipses omitted). "Where a district court premises its legal analysis on an erroneous understanding of governing law, it has abused its discretion." *Id.* (*citing Unger v. Amedisys Inc.,* 401 F.3d 316, 320 (5th Cir.2005)). "A district court must conduct a rigorous analysis of the rule 23 prerequisites before certifying a class .... The party seeking certification bears the burden of proof." *Castano v. Am. Tobacco Co.,* 84 F.3d 734, 740 (5th Cir.1996).

"[C]lass certification creates insurmountable pressure on defendants to settle, whereas individual trials would not." *Id.* at 746 (citation omitted). "The risk of facing an all-or-nothing verdict presents too high a risk, even when the probability of an adverse judgment is low." *Id.* (citation omitted). This risk is particularly high in securities-fraud class actions, in which the current "class-based compensatory damages regime in theory imposes remedies that are so catastrophically large that defendants are unwilling to go to trial even if they believe the chance of being found liable is small." Janet Cooper Alexander, *Rethinking Damages in Securities Class Actions,* 48 STAN. L.REV. 1487, 1511 (1996). Some have observed that seeking class certification to force favorable settlements does not benefit small investors[FN4] but instead resembles a shakedown[FN5] or "judicial blackmail."[FN6]

III.

***3** [6][7][8][9] In securities fraud cases, the plaintiff must prove

(1) a material misrepresentation (or omission); (2) scienter, i.e., a wrongful state of mind; (3) a connection with the purchase or sale of a security; (4) reliance, often referred to in cases involving public securities markets (fraud-on-the-market cases) as "transaction causation"; (5) economic loss; and (6) "loss causation," i.e., a causal connection between the material misrepresentation and the loss.

Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 341-42, 125 S.Ct. 1627, 161 L.Ed.2d 577 (2005) (citations omitted). In *Basic v. Levinson,* 485 U.S. 224, 108 S.Ct. 978, 99 L.Ed.2d 194 (1988), the Court held that requiring proof of "actual reliance" was unduly burdensome to plaintiffs, and instead it "recognized the securities fraud theory of fraud-on-the-market." *Greenberg v. Crossroads Sys., Inc.,* 364 F.3d 657, 661 (5th Cir.2004) (citation omitted). Under that theory, plaintiffs can create a rebuttable presumption of reliance if they can show "(1) the defendant made public material misrepresentations, (2) the defendant's shares were traded in an efficient market, and (3) the plaintiffs traded shares between the time the misrepresentations were made and the time the truth was revealed." *Id.* (citation omitted). When proving reliance, "plaintiffs cannot trigger the presumption ... by simply offering evidence of any decrease in price following the release of negative information .... [They instead] must show that the false statement causing the increase was related to the statement causing the decrease." *Id.* at 665. This last requirement for fraud-on-the-market reliance is known as loss causation, a concept that is at the heart of the instant case.[FN7]

[10][11] Proving loss causation "require[s] a plaintiff additionally to 'prove that the defendant's non-

disclosure materially affected the market price of the security.' " *Alaska Elec. Pension Fund v. Flowserve Corp.,* 572 F.3d 221, 227 (5th Cir.2009) (per curiam) (citing *Nathenson v. Zonagen Inc.,* 267 F.3d 400, 414 (5th Cir.2001)). A plaintiff must show "(1) that the negative truthful information causing the decrease in price is related to an allegedly false, non-confirmatory positive statement made earlier and (2) that it was more probable than not that it was this negative statement, and not other unrelated negative statements, that caused a significant amount of the decline." 572 F.3d at 227 (internal quotation marks and brackets omitted) (citing *Greenberg,* 364 F.3d at 666). "[L]oss causation as an issue of predominance must be established at the class certification stage by a preponderance of all admissible evidence." 572 F.3d at 228 (citations omitted).

[12][13] A court can examine loss causation at the pleadings stage, [FN8] the class certification stage,[FN9] on summary judgment, [FN10] or at trial. The proof needed for loss causation at the pleadings stage should not be conflated with the requirements needed at the class certification stage.[FN11] We must examine whether these plaintiffs have presented enough information to show loss causation under rule 23.

IV.

A.

***4** [14] As a threshold issue, we address plaintiffs' argument that *Stoneridge Investment Partners, LLC v. Scientific-Atlanta,* 552 U.S. 148, 128 S.Ct. 761, 169 L.Ed.2d 627 (2008), overruled some of our earlier opinions, specifically *Greenberg* and *Oscar Private Equity Investments v. Allegiance Telecom, Inc.,* 487 F.3d 261 (5th Cir.2007). Plaintiffs cannot direct us to any mention of either case in *Stoneridge* or to any discussion of this circuit's fraud-on-the-market theory. They point only to *Stoneridge*'s general summary of the fraud-on-the-market theory, urging that that discussion somehow indicates that the Supreme Court meant to strike down our recent securities fraud caselaw.

[15] Plaintiffs are mistaken. First, when the Supreme Court discusses a general legal standard and cites its earlier caselaw on point, it does not necessarily overrule intervening decisions of the lower courts. Moreover, *Basic* "allows each of the circuits room to develop its own fraud-on-the-market rules." *Oscar,* 487 F.3d at 264 (quoting *Abell v. Potomac Ins. Co.,* 858 F.2d 1104, 1117-18 (5th Cir.1988), *vacated on other grounds,* 492 U.S. 914, 109 S.Ct. 3236, 106 L.Ed.2d 584 (1989)). In *Greenberg* and *Oscar,* we used this "room" to develop specific rules. *Stoneridge* and its general discussion of the fraud-on-the-market theory do not affect those rules.

B.

Recognizing that *Stoneridge* does not change our fraud-on-the-market analysis, we turn to whether plaintiffs met our requirements for proving loss causation at the class certification stage. Plaintiffs filed their certification motion with about one hundred pages of support.[FN12] The relevant information consisted of excerpts from Belo's SEC Form 10-K for two years, Belo's historical stock prices, Belo's SEC S-3 forms from 1996 to 2006, financial data from Yahoo! finance, and a chart of Belo's daily share price. Plaintiffs submitted no expert testimony.

In response, Belo presented Gompers's testimony and an event study that he had conducted. Gompers argued that the press release contained not one piece of information but three separate items of news: DMN's circulation decrease resulted from (1) fraudulent overstatements;[FN13] (2) changes in DMN's methodology; and (3) industry-wide decline in newspaper circulation.[FN14] Gompers's event study examined 132 analyst reports and found that the stock price decline was primarily related to the non-fraudulent disclosures instead of the fraudulent one.

Plaintiffs responded with Hakala's testimony and event study. That study concluded that Belo's stock was efficiently traded during the class period, that revenue at DMN was closely tied to circulation, that Belo's stock moved in close connection with the industry's other stocks, and that its share price had moved significantly when it issued the press release. More importantly, he disputed Gompers's conclusion that the press release could be separated into three parts, claiming instead that the fraudulent and non-fraudulent parts of the press release had to be examined together as one disclosure. Finally, he alleged that the market had already absorbed the non-fraudulent disclosures' information, and thus only the fraudulent disclosure affected Belo's stock price.[FN15]

***5** [16] Whether we view the press release as one complete disclosure or three separate ones is important. In *Oscar,* 487 F.3d at 266, we specified how parties must prove loss causation in cases in which "multiple items of negative information were released together with the corrective disclosure." "In such multi-layered loss-causation inquiries," we require that the plaintiff shows that "it is more probable than not that it was this negative statement, and not other unrelated negative statements, that caused a significant amount of the decline."FN16 *Id.* (citing *Greenberg,* 364 F.3d at 666). Thus, if we view the press release as multiple pieces of information, plaintiffs must prove that the fraudulent disclosure caused a significant amount of the decline.

By its plain language, the press release consists of three separate pieces of information, and-contrary to plaintiffs and Hakala's belief-Gompers did not invent that three-part classification.FN17 The press release first discusses the fraudulent "overstatement" and the estimated "decline in circulation related to this matter." It then recognizes that the disclosure is "coupled with" the earlier reduction announcement and the "anticipated lower circulation" over a six-month period. Thus, the release divides the news into fraudulent and non-fraudulent information related to possible future circulation declines.

[17] Plaintiffs assert, however, that even if the news can be divided into three parts, they still meet *Oscar*'s requirement of showing that the fraudulent disclosure caused a significant reduction in Belo's stock price. As an initial point, plaintiffs' original motion for certification does not meet our standards for proving loss causation. They submitted only SEC reports, stock-price charts, analyst reports, and other similar information; they did not include expert testimony.

As we stated in *Oscar,* these items contain "little more than well-informed speculation." *Id.* at 271. Although analyst reports and stock prices are helpful in any inquiry, the testimony of an expert-along with some kind of analytical research or event study-is required to show loss causation. *See id.* For all of the reasons stated in *Greenberg* and *Oscar,* stock prices and analyst reports, without more, are insufficient at the class certification stage.

[18] Even considering the plaintiffs' analyst commentary and stock price information together with Hakala's testimony and event study, the motion for class certification still falls short. As the district court correctly held, Hakala's testimony was fatally flawed; he wedded himself to the idea that the press release was only one piece of news and conducted his event study based on that belief. We reject any event study that shows only how a "stock reacted to the *entire bundle* of negative information," rather than examining the "evidence linking the *culpable* disclosure to the stock-price movement." *Id.* Because Hakala based his study on that incorrect assumption, it cannot be used to support a finding of loss causation.

***6** Without the event study, the rest of Hakala's testimony relates to analyst opinions about Belo's stock decline. Again, this "well-informed speculation" cannot support a finding of loss causation "without reference to any post-mortem data [the analysts] have reviewed or conducted." *Id.* Thus, once we disregard Hakala's flawed event study, the rest of his testimony is insufficient to prove loss causation.

Plaintiffs' other arguments are also flawed. First, they argue that the press release recognizes that the fraudulent disclosure would result in a 1.5% total daily paper decline and a 5% Sunday decline. This, they claim, is nearly one-third of the total daily decline and over 40% of the total Sunday decline from all three disclosures. Assuming *arguendo* that one-third of a given stock decline is a "significant amount" of the total, we do not need to answer that question,FN18 because plaintiffs fail to understand which decline we are examining. A court should examine the decline in the *stock price* related to the disclosure, not the decline in the circulation.

Conceivably, DMN's fraudulent practices could have resulted in 90% of the circulation decline, but if the stock price fell because the market was concerned *only* with the reason for the other 10%, loss causation could not be proven. Belo's fraud regarding DMN was significant, but for long-term investors, news about the substantial and continuing decline in nationwide newspaper circulation could be much more disconcerting than were the fraudulent practices. If investors sold Belo's stock because of that long-term trend, and not because of the fraud, there is no loss causation.

[19] Plaintiffs' only remaining argument is premised on Hakala's allegation that the market already knew

about and had absorbed the impact of the non-fraudulent disclosures. If that is so, the plaintiffs argue, *Oscar* does not apply, the stock drop after the press release is related to only the one fraudulent disclosure, and the drop in stock price alone proves loss causation. We disagree. "There is no reason why the concerns stated in *Oscar* do not equally apply to cases in which only one negative disclosure is at issue." *Luskin v. Intervoice-Brite Inc.,* 261 Fed.Appx. 697, 702 (5th Cir.2008). Plaintiffs still must prove loss causation through the same rigorous process that we established in *Oscar,* even if there is only one negative disclosure. "[P]laintiffs cannot trigger the presumption of reliance by simply offering evidence of any decrease in price following the release of negative information." *Greenberg,* 364 F.3d at 665.

[20] Under an alternative system, were a defendant to release a corrective disclosure on a particularly volatile market day, its stock could plummet regardless of whether the market cared about the disclosure. Such a drop, even coupled with the disclosure, is insufficient, however, unless there is a showing that the disclosure actually caused the decline. A class action may not proceed against a defendant whose only fault is releasing a disclosure on a volatile trading day.

***7** [21] Securities fraud litigation is not "a scheme of investor's insurance"[FN19] but instead is designed to protect those who buy stock at fraudulently inflated prices. If the fraud did not cause the price of the stock to increase, and its disclosure does not cause the price to go down, no injury has occurred. Thus, regardless of the number of disclosures, plaintiffs must establish the connection between the disclosure and the decline in price. [FN20]

V.

In summary, the district court did not abuse its discretion in denying class certification. Plaintiffs' failure to present an expert witness with an event study or other analytical evidence of loss causation runs afoul of *Oscar.* The order denying class certification is AFFIRMED.

FN1. The district court designated Operating Engineers Construction Industry and Miscellaneous Pension Fund as the lead plaintiff.

FN2. Other developments, including the district court's dismissal of some claims against the individual defendants, are described in district court opinions on this dispute. *See Fener v. Belo Corp.,* 425 F.Supp.2d 788 (N.D.Tex.2006) (*Fener I*); *Fener v. Belo Corp.,* 513 F.Supp.2d 733 (N.D.Tex.2007) (*Fener II*); *Fener v. Belo Corp.,* Nos. 3:04-CV-1836-D, 3:04-CV-1869-D, 3:04-CV-2156-D, 2007 WL 4165709 (N.D.Tex. Nov. 26, 2007) (*Fener III*).

FN3. We discuss Gompers's and Hakala's testimony more thoroughly *infra.*

FN4. *See* Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions,* 43 STAN. L.REV. 497, 501 (1991) ("[T]he actual distribution of the settlement funds suggests that the present system does not really benefit the small investors who are presumed to be the beneficiaries of class actions, and it may actually foreclose more efficient client-controlled litigation by large investors.").

FN5. Vincent E. O'Brien, *The Class-Action Shakedown Racket,* WALL ST. J. , Sept. 10, 1991, at A20.

FN6. *Castano,* 84 F.3d at 746.

FN7. In *Oscar Private Equity Investments v. Allegiance Telecom, Inc.,* 487 F.3d 261 (5th Cir.2007), we further detailed our requirements for loss causation:

> We now require more than proof of a material misstatement; we require proof that the misstatement *actually moved* the market. That is, the plaintiff may recover under the fraud on the market theory if he can prove that the defendant's non-disclosure materially affected the market price of the security. Essentially, we require plaintiffs to establish loss causation in order to trigger the fraud-on-the-market presumption. Our most recent statement of this rule was in *Greenberg,* which held that to trigger the presumption of reliance plaintiffs must demonstrate that the cause of the decline in price is due to the revela-

tion of the truth and not the release of the unrelated negative information.

Id. at 265 (footnotes, internal quotation marks, ellipses, and brackets omitted).

FN8. *See Lormand v. U.S. Unwired, Inc.,* 565 F.3d 228, 255-58 (5th Cir.2009) (discussing pleading standards for loss causation).

FN9. *See Oscar,* 487 F.3d at 266-70 (establishing that this examination is appropriate as part of the class certification inquiry).

FN10. *See id.* at 269 n. 40 ("This is not to say that loss causation, as an element of a 10b-5 claim, cannot be reexamined at summary judgment.").

FN11. The parties submitted extensive letters regarding the impact of *Lormand,* which, however, examines what is required under Federal Rule of Civil Procedure 8 to survive the pleadings stage. To the degree those standards are easier to meet than are our requirements for class certification, *Lormand* does not inform our decision.

FN12. Of those hundred pages, eighty were the resumes of the lawyers at Fener's law firm. That information is not helpful for the class certification motion.

FN13. We refer to this part of the press release as "the fraudulent disclosure."

FN14. We refer to parts 2 and 3 of the press release collectively as "the non-fraudulent disclosures."

FN15. Gompers submitted a response to Hakala's study challenging his conclusions and analysis. Ultimately, however, we do not need to examine Gompers's reply, because his initial study-rather than Hakala's-discusses the proper way in which to examine Belo's disclosures.

FN16. We also clarified that this inquiry is appropriate at the class certification stage. *See Oscar,* 487 F.3d at 266-70.

FN17. The relevant part of the press release reads as follows:

Belo Corp. announced today that [DMN], a wholly-owned subsidiary, will report a greater than expected decline in its September 2004 circulation. An internal investigation, which is ongoing, has disclosed practices and procedures that led to an overstatement in circulation, primarily in single copy sales. Belo estimates the decline in circulation related to this matter to be approximately 1.5 percent daily and five percent Sunday. This decline, coupled with a reduction in state circulation that was first communicated publicly on March 9, 2004, of approximately 2.5 percent daily and 2.5 percent Sunday, and anticipated lower circulation volumes for the six month period ending September 30, 2004, will result in a total decline in circulation of approximately five percent daily and 11.5 percent Sunday ....

FN18. Like the court in *Oscar,* "[w]e will not attempt to quantify what fraction of a decline is 'significant.' " *Oscar,* 487 F.3d at 270.

FN19. *Basic,* 485 U.S. at 252, 108 S.Ct. 978 (White, J., concurring in part and dissenting in part) (citation omitted).

FN20. Hakala also failed to submit enough evidence to prove that the stock market absorbed the other pieces of information. He admitted that his analysis was incomplete, and the conclusions he did reach lack analytical support.

C.A.5 (Tex.),2009.
Fener v. Operating Engineers Const. Industry and Miscellaneous Pension Fund (LOCAL 66)
--- F.3d ----, 2009 WL 2450674 (C.A.5 (Tex.)), Fed. Sec. L. Rep. P 95,315

END OF DOCUMENT

TAB 6

Only the Westlaw citation is currently available.

United States District Court,
N.D. Illinois,
Eastern Division.
Kevin FOX & Melissa Fox, Plaintiffs,
v.
Edward HAYES, Michael Guilfoyle Scott Swearengen, Brad Wachtl and Will county, Defendants.
No. 04 C 7309.

Sept. 25, 2008.

Kathleen T. Zellner, Anne E. Zellner, Douglas Henry Johnson, Kathleen T. Zellner & Associates, P.C., for Plaintiffs.

Joan Marie G. Kubalanza, Michelle Katherine Wendlinger, Gerald Haberkorn, Julie Z. Wulf, Mark John Smith, Robert H. Smith, Lowis & Gellen, Paul Louis Jacobs, Kralovec, Jambois & Schwartz, Chicago, IL, for Defendants.

MEMORANDUM OPINION AND ORDER

JOHN W. DARRAH, District Judge.

***1** Before the Court are Defendants' Rule 50(b) Motion for New Trial or Judgment as a Matter of Law, Defendants' Rule 59(e) Motion to Alter or Amend Judgment and Defendants' Rule 59(a) Motion for New Trial.

BACKGROUND

Following a seven-week trial, a jury found in favor of Plaintiff Kevin Fox on his claims for Violation of Due Process, False Arrest, Malicious Prosecution and Intentional Infliction of Emotional Distress. The jury awarded Kevin Fox compensatory damages for these claims of $1.7 million, $1.7 million, $600,000 and $ 1.6 million, respectively. The jury also found in favor of Plaintiff Melissa Fox, Kevin Fox's wife, on her claims for Loss of Consortium and Intentional infliction of Emotional Distress and awarded her $2.7 million and $1 million, respectively. The jury also awarded punitive damages in the amount of $3.7 million to Kevin Fox and $2.5 million to Melissa Fox. The jury found in favor of Defendants on Kevin Fox's claims of False Imprisonment and Conspiracy and Melissa Fox's Conspiracy claim.

Rule 50(b) Motion for new Trial or Judgment as a Matter of Law

In ruling on a Rule 50(b) motion, the Court does not re-weigh the evidence or make credibility determinations. *Caletz ex rel. Estate of Colon v. Blackmon,* 476 F.Supp.2d 946, 951 (N.D.Ill., 2007) (citing *Reeves v. Sanderson Plumbing Prods., Inc.,* 530 U.S. 133, 150, 120 S.Ct. 2097, 147 L.Ed.2d 105 (2000)). Rather, the question is "whether the evidence presented, combined with all reasonable inferences permissibly drawn therefrom, is sufficient to support the verdict when viewed in the light most favorable to the party against whom the motion is directed." *Erickson v. Wisconsin Dept. of Corrections,* 469 F.3d 600, 601 (7th Cir.2006) (*Erickson*) (quoting *Mack v. Great Dane Trailers,* 308 F.3d 776, 780 (7th Cir.2002)). The verdict should be overturned only if no reasonable jury could have found in favor of the prevailing party. *See Erickson,* 469 F.3d at 601.

Defendants argue that they are entitled to qualified immunity on Plaintiff Kevin Fox's § 1983 claims and that Plaintiff Melissa Fox failed to prove all the elements in her claim against Defendant Hayes for Intentional Infliction of Emotional Distress. Plaintiffs respond that Defendants waived the issues now raised in their Rule 50(b) motion because those arguments were not made with sufficient specificity in Defendants' Rule 50(a) motions to put Plaintiffs on notice. Plaintiffs also argue that Defendants' renewed motions for judgment fall short on the merits.

Plaintiffs' waiver argument is based oh two grounds. First, Plaintiffs argue that although Defendants made earlier 50(a) motions during trial, they are required to renew their motions for judgment as a matter of law at the close of all the evidence. However, a motion for a directed verdict at the close of all the evidence in no longer required under Rule 50(b). *See Wright & Miller,* 9B Fed. Prac. & Proc. Civ.2d § 2537 (the 2006 amendments to the Federal Rules of Civil Procedure revised Rule 50(b) to permit renewal after verdict of any Rule 50(a) motion for judgment as a matter of law even if not made at the close of all evidence).

***2** Second, Plaintiffs argue that Defendants' Rule 50(a) motions were not made with sufficient specificity to put Plaintiffs on notice. "[I]ssues that were not adequately preserved in a Rule 50(a) motion ... may not be included in a Rule 50(b) motion." *Petit v. City of Chicago,* 239 F.Supp.2d 761, 767 (N.D.Ill.2002). Defendants assert several grounds for judgment as a matter of law in their Rule 50(b) motion. To the extent that those arguments were not raised in Rule 50(a) motions, they are deemed waived. Defendants claim to have made eleven motions for judgment as a matter of law under Rule 50(a)-"six times orally and five times in writing." Under Rule 50(a)(2), the motion "must specify the judgment sought and the law and facts that entitle the movant to the judgment." Defendants' oral motions for judgment did not meet this standard. Defendants simply stated that they were moving for a directed verdict without, in any way, specifying on which of Plaintiffs' claims they were moving or their legal or factual grounds for the motions. Thus, only the following arguments made in Defendants' five written motions will be considered preserved regarding Defendants' Rule 50(b) motion.

Defendants first claim that they were entitled to qualified immunity on Plaintiff Kevin Fox's § 1983 claims. Defendants' remaining arguments concern Plaintiff Melissa Fox's claim for Intentional Infliction of Emotional Distress against Defendant Hayes.

Qualified Immunity

Defendants first argue that they are entitled to qualified immunity on both Kevin Fox's Due Process claim and his claim for False Arrest. Government officials performing discretionary functions are entitled to qualified immunity "insofar as their conduct does not violate clearly established statutory or constitutional rights of which a reasonable person would have known." *Harlow v. Fitzgerald,* 457 U.S. 800, 818, 102 S.Ct. 2727, 73 L.Ed.2d 396 (1982). In determining whether the official's conduct is unlawful, it is not necessary that the specific violation in question to have previously been held unlawful; rather, "a clearly established constitutional right exists in the absence of precedent, 'where the contours of the right [are] sufficiently clear that a reasonable official would understand that what he is doing violates that right.' " *Board v. Farnham,* 394 F.3d 469, 477 (7th Cir.2005) (quoting *Anderson v. Creighton,* 483 U.S. 635, 640, 107 S.Ct. 3034, 97 L.Ed.2d 523 (1987)).

This Court has previously considered and rejected Defendants' contention that they are entitled to qualified immunity on the Due Process claims. *Fox v. Tomczak,* 2006 WL 1157466 at *2 (N.D.Ill.2006). Defendants have not raised any additional arguments not considered by the Court in its previous decision. Therefore, Defendants' claim to qualified immunity on the Due Process claims is again denied.

Defendants next argue that they are entitled to qualified immunity for Kevin Fox's claim of False Arrest. An officer is entitled to qualified immunity in a § 1983 claim for unlawful arrest when there was probable cause for the arrest or when a reasonable officer could have mistakenly believed that probable cause existed. *Wollin v. Gondert,* 192 F.3d 616, 621 7th Cir.1999) (*Wollin*). This latter case, known as arguable probable cause, exists when "a reasonable police officer in the same circumstances and with the same knowledge and possessing the same knowledge as the officer in question *could have* reasonably believed that probable cause existed in light of well-established law." *Wollin,* 192 F.3d at 621.

***3** Defendants cite numerous parts of trial testimony that purportedly show the existence of probable cause, or at least arguable probable cause, to arrest. However, most of the "evidence" listed by Defendants was either disputed at trial or occurred after the earliest point at which the jury could reasonably have found that Kevin Fox was under arrest.[FN1] In the former category is the statement allegedly made by Kevin Fox's son that he saw his father leave the house on the night of the abduction, Plaintiffs offered evidence at trial that this statement was never made. In the latter category are Kevin Fox's statements that he placed his daughter in the water and that he may have been responsible for her murder. These statements occurred after the earliest point that the jury could have determined that the arrest had taken place. Thus, viewing the evidence in the light most favorable to Plaintiffs, those statements occurred post-arrest and are not relevant to the issue of probable cause. This evidence, taken together with the remainder of the evidence cited by Defendants, does not support a determination of arguable probable cause.

FN1. Some of Defendants' characterization of this testimony is not supported by the trial transcript. For example, Defendants claim that trial testimony established that, before his arrest, Kevin Fox was reluctant to give a buccal swab for DNA testing. However, the testimony Defendants cite, the cross-examination of Defendant Detective Swearengen, contradicts that assertion. The cited testimony establishes (1) that while Swearengen claimed in his *deposition* that Fox was reluctant to give the buccal swab, Swearengen did not include that statement in his police report and (2) the individual who actually took the buccal swab specifically noted that Fox had given the swab voluntarily. (Trial Tr. at p. 1003.)

Intentional Infliction of Emotional Distress

Defendants argue that they are entitled to a judgment as a matter of law on Plaintiff Melissa Fox's claim for Intentional Infliction of Emotional Distress against Defendant Hayes, Evidence regarding this issue showed, *inter alia,* that while Kevin Fox was being questioned at the Will County Police Station, Defendant Hayes yelled at Melissa Fox, "Your husband's a fucking liar, and he's a fucking murderer. He never loved you or your fucking daughter, and he killed her, and you need to learn to fucking get over it." Defendants first argue that this statement was not sufficiently outrageous to support liability. To support a claim for intentional infliction of emotional distress, the conduct must be "so outrageous in character and so extreme in degree, as to go beyond all possible bounds of decency." This statement, contrary to what Defendants may argue, is more than merely "insulting, offensive and somewhat abusive." Considering this statement, in the context of the evidence regarding Melissa Fox's situation at this time-her three-year-old daughter had recently been murdered, and her husband had just then been accused of committing the murder-it is difficult to see within what "possible bounds of decency" Defendant Hayes' conduct would fall.

Defendants' argument that Plaintiffs did not show that Defendant Hayes intended that his conduct inflict severe emotional distress and did not know that there was a high probability that it would cause severe emotional distress also falls short. The jury was instructed on this requirement. Evidence introduced at trial, including the statement itself and the circumstances in which it was made, could support such a finding. Thus, Defendants have failed to show that no reasonable jury could have found in favor of Plaintiff Melissa Fox on this claim. Defendants also argue that Melissa Fox failed to prove injury as a result of the statement. Melissa Fox's testimony regarding the above-cited statement by Defendant Hayes to Melissa was sufficient for a reasonable jury to find in her favor.

***4** For the foregoing reasons, Defendants' Motion for a New Trial or Judgment as a Matter of Law is denied.

Rule 59(e) Motion to Alter or Amend Judgment

"Rule 59(e) allows a party to direct the district court's attention to newly discovered material evidence or a manifest error of law or fact, and enables the court to correct its own errors and thus avoid unnecessary appellate procedures," *Mora v. Shell Oil Co.,* 91 F.3d 872, 876 (7th Cir.1996) (*Moro*). However, the rule "does not provide a vehicle for a party to undo its own procedural failures" or to "advance arguments that could and should have been presented to the district court prior to the judgment." *Moro,* 91 F.3d at 876. "[A]n argument raised for the first time in a Rule 59(e) motion is waived." *Estramera v. United States,* 442 F.3d 580, 587 (7th Cir.2004).

Defendants first challenge the punitive damages award of $2.5 million to Plaintiff Melissa Fox. Defendants argue that punitive damages are not available under Illinois law for either intentional infliction of emotional distress or loss of consortium, the only two claims on which Melissa Fox prevailed. Plaintiffs counter that Defendants waived this argument by failing to make their objection before the jury was discharged.[FN2]

FN2. Plaintiffs also argue that the award of punitive damages indicates that the jury intended to find for Plaintiff Melissa Fox on her Conspiracy Claim. This argument has been rejected by the Court in a previously issued opinion denying Plaintiff's motion to alter or amend judgment. Minute Order, March 12, 2008, Docket No. 661.

Under Illinois law, "punitive damages may not be assessed as an additional recovery where the conduct arises from intentional infliction of emotional distress." *Gragg v. Calandra,* 297 Ill.App.3d 639, 650, 231 Ill.Dec. 711, 696 N.E.2d 1282 (2d Dist.1998). *See also, Littlefield v. McGuffey,* 954 F.2d 1337, 1345 n. 3 (7th Cir.1992) (citing *Knierim v. Inzo,* 22 Ill.2d 73, 88, 174 N.E.2d 157 (1961)). Punitive damages are also not available under Illinois law for loss of consortium claims. *Hammond v. North American Asbestos Corp.,* 97 Ill.2d 195, 211, 73 Ill.Dec. 350, 454 N.E.2d 210 (1983). Therefore, consistent with Illinois law, the judgment is amended to strike the punitive damage award against Defendant Hayes in favor of Plaintiff Melissa Fox.

Defendants next argue that the punitive damage awards against Defendant Brad Wachtl should be stricken because Plaintiffs waived their claims for punitive damages against Wachtl by stating during closing arguments that they were not seeking such damages. Plaintiffs respond that Defendants waived their objections to the punitive damage awards by failing to object to the verdict form.

Reviewing the transcript of Plaintiffs' closing argument, it is clear that Plaintiffs waived their claims for punitive damages against Wachtl. During closing arguments, Plaintiffs' attorney stated "for ... Wachtl, we are not seeking punitive damages." This statement is binding on Plaintiffs. *See McCaskill v. SCI Management Corp.,* 298 F.3d 677, 680 (7th Cir.2002) (counsel's "verbal admission ... at oral argument is a binding judicial admission, the same as any other formal concession made during the course of proceedings"). Plaintiffs draw an analogy to *Super Group Packaging & Distribution Corp. v. Smurfit Stone Container Corp. .,* 2006 WL 274779 (W.D.Wis.), in which the court held that a plaintiff's attorney's damages request in closing arguments does not act as a cap on the award. The case is not analogous. Here, Plaintiffs completely withdrew their claims for punitive damages against Defendant Wachtl. Therefore, Plaintiffs waived their claims for punitive damages against Defendant Wachtl. The judgment is amended to strike the punitive damage award against Defendant Wachtl.

***5** Defendants next make several arguments to the effect that Plaintiff Kevin Fox should not have been able to recover on both his constitutional and state-law claims. Defendants allege that the awards amount to double and triple recovery for the Plaintiff. The verdict form in this case allowed the jury to award Plaintiffs separate damages for each claim. For each claim against each Defendant, the jury could either mark a space under "For Defendant" or write in a dollar amount under "For Plaintiff, Kevin Fox and award damages in the Following amount(s)." It was, thus, foreseeable that if the jury found for Kevin Fox on multiple claims, that they would award separate damages for each claim. Despite this possibility, Defendants did not object to the format of the verdict form. Defendants have therefore waived this objection.

Defendants claim that they did make a relevant objection at the jury instruction conference; Defendants argue that their proposed instruction number 51, which would have instructed the jury on double recovery, was refused by the Court. The Court ruled that the proposed instruction could confuse and would not aid the jury. Defendants made no objection to this statement, gave no further argument on the subject and cited no case law or other authority in support of their position. Therefore, Defendants'objections to Plaintiff Kevin Fox's recovery of separate amounts for his multiple claims have been waived.

Finally, Defendants argue this Court should exercise its discretion to set aside the award of punitive damages to Kevin Fox. Defendants argue that the punitive damages are excessive and without basis in the record. Defendants further argue that the format of the verdict form makes it impossible to determine on which claims the jury awarded punitive damages and that the jury was likely motivated by "improper reasons such as caprice and prejudice" in awarding punitive damages. With respect to the first objection, the Court previously ruled on this issue that Plaintiffs were entitled to argue for punitive damages. Defendants have not offered any basis to reverse this ruling, With respect to the format of the verdict form, Defendants failed to object to that format before the case went to the jury. The objection is therefore waived. Finally, Defendants' argument that Plaintiffs' closing argument confused the jury was heard and rejected at the time. Therefore, the Court declines to set aside the remaining punitive damages against Defendants.

For the reasons stated above, Defendants' motion to alter or amend judgment is granted in part and denied in part. The judgment is amended as follows: The punitive damage awards against Defendant Brad Wachtl in favor of Plaintiff Kevin Fox are stricken. All punitive damage awards in favor of Plaintiff Melissa Fox are stricken, and the judgment in her favor is so amended.

Rule 59(a) Motion for New Trial

A motion for a new trial should be granted when the verdict is against the weight of the evidence, the damages were excessive or, for other reasons, the trial was not fair to the moving party. *Taylor v. National R.R. Passenger Corp.,* 920 F.2d 1372, 1377 (7th Cir.1990). In ruling on such a motion, the Court must review the facts in the light most favorable to the prevailing party. *Schobert v. Illinois Dept. of Transp.,* 304 F.3d 725, 728 (7th Cir.2002) (citing *EEOC v. Bd. of Regents of Univ. of Wis. Sys.,* 288 F.3d 296, 301 (7th Cir.2002)).

***6** Defendants base their motion for a new trial on multiple grounds, including: purported evidentiary errors, misconduct on the part of the Court and Plaintiffs' attorneys, improper jury instructions, and various other grounds.

Exclusion of Fox's Video-Recorded Confession

Defendants first argue that the Court erred by excluding the video-recorded confession of Kevin Fox. This issue was the subject of extensive argument before the Court ruled it inadmissible. The Court's reasoning and application of the Federal Rules of Evidence is more fully set out in the transcript of the proceedings.

Defendants first argue that the video recording was relevant to the issue of Defendants' probable cause to arrest Kevin Fox. However, there is no basis to argue that the jury could reasonably have found that Kevin Fox was not already under arrest by Defendants when Defendants began video recording the statement. The evidence established that Kevin Fox made a purported oral confession to Defendants before the video-recorded purported confession. (Defendants chose not to record this earlier statement, although the video recorder was then available.) The jury was fully informed regarding this first, non-video-recorded statement. As Defendants admit, Fox's video-recorded statement is a restatement of incriminating statements he had previously made to Defendants in the non-recorded statement. Kevin Fox was not free to leave after making the first statement and before the recording of the second statement began. Therefore, it is indisputable that Fox was already under arrest when the video recording was made, Fox's recorded statements are of no consequence to the determination of Defendants' probable cause to arrest. *See Sherrod v. Berry,* 856 F.2d 802, 804 (7th Cir.1988) (*Sherrod*).

Defendants later argued that the video-recorded statement is relevant to the issue of whether Kevin Fox's first statement was voluntary, and not coerced as argued by Plaintiffs, in that the subsequent recorded statement shows Kevin Fox's demeanor immediately after the claimed coerced first statement. Specifically, Defendants argue that the tape would rebut Plaintiffs' contention that Kevin Fox was emotionally, mentally and physically impaired at the time he made the first statement. However, Defendants have not pointed to any evidence in the record that the circumstances surrounding the first, non-recorded statement, including Kevin Fox's demeanor and appearance, as well as the demeanor and conduct of his interrogators then, were the same as those appearing on the video recording of the subsequent statement.

Even assuming that the video recording was probative of Kevin Fox's demeanor during the earlier statement, and thus had some relevance under FRE 401, the tape was properly excluded under FRE 403 as the slight probative value on this issue was substantially outweighed by the danger of unfair prejudice, confusion of the issues, or misleading the jury as to what evidence is properly considered as to probable cause to arrest Kevin Fox. *See Sherrod,* 856 F.2d at 813 (Flaum, J., dissenting). As explained above, probable cause must have been based on facts that occurred prior to the recorded statement. Therefore, the tape was properly excluded.

Interrogation Recreation Photographs

***7** Defendants object to the admission of photographs introduced by Plaintiffs that portray Plaintiffs' version of the interrogation of Kevin Fox, claiming that the photographs were unfairly prejudicial. Plaintiffs argue that Defendants waived this objection by failing to object to the introduction to the photographs.

Defendants reply that they filed a motion *in limine.* However, the Court clearly instructed both sides before trial that an objection contained in a motion *in limine* would be deemed waived if it was not renewed at the time the evidence was offered.[FN3] Defendants did not object to the admission of the photographs during the trial. Therefore, the objection was waived.

> FN3. "THE COURT: If I take a motion *in limine* under advisement, that motion will have to be renewed at the time of trial, or it will be deemed to be waived. So if you object to something here and it's not resolved today, I charge you with objecting when it's raised in the courtroom.
>
> ...
>
> Likewise, our proposed pretrial order form requires you to set out exhibits to which you object and the like. I'm not going to follow that, I'm going to use that as an aid [as to] what might be at issue and what might not be. But the fact that you may have interposed an objection in the pretrial order does not preserve your objection during the trial. So you have to object again.
>
> And if you have objected to something in the pretrial order and don't object at the time of trial, I will deem that to be your intention to withdraw the objection."
>
> (Pre-trial Conf. Tr. at 5:6-24.)

Improper Judicial Conduct

Defendants next accuse the Court of improper judicial conduct, specifically favoring the Plaintiffs during the trial. The Court has already denied Defendants' motion for recusal in a written opinion and, for the same reasons, rejects Defendants' 59(a) motion, to the extent it is based on the same grounds.[FN4] Defendants' evidence of bias does not rise to the level needed to prevail on their motion. "[J]udicial remarks during the course of a trial that are critical or disapproving of, or even hostile to counsel, the parties or their cases, ordinarily do not support a bias or partiality challenge." *Grove Fresh Distributors, Inc. v. John Labatt, Ltd.,* 299 F.3d 635, 640 (7th Cir.2002) (quoting *Liteky v. United States,* 510 U.S. 540, 555, 114 S.Ct. 1147, 127 L.Ed.2d 474 (1994)). There is a difference between being biased against a party and being annoyed with the party's counsel. *See Gomez v. St. Jude Medical Daig Div. Inc.,* 442 F.3d 919, 938 (5th Cir.2006). Moreover, the alleged instances of bias of which Defendants complain essentially all occurred at sidebar, outside the presence of the jury and, thus, could not have prejudiced the jury against Defendants.[FN5] The examples of supposed bias cited by Defendants that happened within hearing of the jury-instructing a witness to answer yes or no or asking an attorney to move along from repetitive and irrelevant questioning-were merely instances of courtroom management and do not show bias on the part of the Court.

> FN4. *Fox v. Tomczak,* 2007 WL 4365355 (N.D.Ill.2007).

> FN5. Furthermore, Defendants cite the record out of context in an attempt to paint some of the Court's comments as unreasonable. For example, Defendants cite the Court's statement to Defendants' counsel, regarding one of the Defendants, Mary Jane Pluth, "What kind of representation has she been given here?" The Court made the statement after Defense counsel began a line of questioning that illuminated a clear issue of conflict of interest as to Defense counsels' representation of both Pluth and the other Defendants and reflected the Court's concern that Defense counsel could be sacrificing Pluth's interest to benefit the other Defendants. (Trial Tr. at 2182-84.) This was a concern throughout the trial.

Failure to Rule on Motions in Limine/Exclusion of Probable Cause Factors

Defendants argue that the Court improperly delayed ruling on motions *in limine* and that the delay prejudiced Defendants in that they were unable to present a number of factors that could have provided probable cause for the arrest. The Court reserved its ruling on the motions to get the full context of the predicate evidence to determine admissibility of the proffered evidence. Furthermore, the delay was not prejudicial to Defendants because the evidence they sought to introduce, that Kevin Fox watched an adult video and masturbated into a condom on the night of the murder, had scant relevance to the question of probable cause.[FN6] Defendants' theory of relevance, centered on Fox's supposed need to "come clean" about the video and his state of sexual arousal that night, is beyond far-fetched.[FN7] Furthermore, the evidence would have been highly unfairly prejudicial to Plaintiffs. Thus, the evidence was properly excluded; and Defendants were not prejudiced by any delay in the Court's rulings.

FN6. Defendants were permitted to introduce evidence that Fox watched an adult video.

FN7. Defendants' argument that Fox's failure to disclose his sexual activities to Defendants could result in probable cause to arrest for obstruction of justice is frivolous. Defendants raise this argument for the first time in their Rule 59(a) motion.

Admission of DNA from Duct Tape

***8** Defendants argue that the Court erred in admitting testimony regarding duct tape found at the crime scene because it had no probative value and unfairly prejudiced Defendants. Plaintiffs respond that the testimony regarding the duct tape established that Kevin Fox was not guilty of the murder of his daughter and that the admission of that fact into evidence was necessary to keep the jury focused on the issues actually before them. Plaintiffs cite *Newsome v. McCabe,* 2002 WL 548725 (N.D.Ill.2002) (*Newsome*), in support of their position. The court in *Newsome,* facing a similar issue, stated:

"The issue in this case was not, as defendants point out, whether [plaintiff] was guilty or innocent of the crime. But that is what it would have become if the fact of [plaintiff's] innocence ... had been kept from the jury. Excluding that evidence would have been highly prejudicial to [plaintiff]. It would have invited the jurors to draw the impermissible inference that he was actually guilty, and, thus, absolve defendants of any misconduct."

Newsome, 2002 WL 548725 at 6. Furthermore, Defendants fail to show how the admission of this evidence, even if not relevant, was prejudicial to their case.

Undisclosed Expert Testimony

Defendants argue that Plaintiffs' experts, Dr. Raskin and Dr. Burgess, testified to matters that had not been disclosed in their expert reports, in violation of Rules 37 and 26 of the Federal

Rules of Civil Procedure. However, Defendants fail to disclose that the Court sustained Defendants' objection regarding Dr. Raskin and instructed the jury to disregard the testimony to which Defendants objected.[FN8] With respect to Dr. Burgess, after hearing arguments from both parties at sidebar, the Court determined that Plaintiffs had disclosed the relevant information.

FN8. "[DEFENSE COUNSEL]: Same objection as earlier, your honor.

THE COURT: Sustained."

(Trial Tr. at 1539.)

"[DEFENSE COUNSEL]: Objection, your Honor. May I be heard?

THE COURT: Yes

(Sidebar proceedings outside the hearing of the jury:)

...

THE COURT: The objection is sustained.

[PLAINTIFFS' COUNSEL]: Okay.

THE COURT: Avoid that

[PLAINTIFFS' COUNSEL]: Yes.

(Further proceedings within the hearing of the jury:)

THE COURT: The objection is sustained. Ladies and gentlemen, disregard that last answer. Do you all understand?

(Jurors nodding.)”

(Trial Tr. at 1566-68.)

Plaintiff Counsel's Comments During Trial

Defendants object to several comments made by Plaintiffs' counsel during the trial in which counsel expressed opinions regarding the credibility of witnesses. Specifically, Defendants assert that Plaintiffs' counsel implied that Defendant Swearengen and Guilfoyle lied on the witness stand and vouched for the honesty of her own client, Kevin Fox. The instances cited by Defendants do not merit a new trial. First, a party may draw reasonable inferences from the evidence adduced at trial, even in questioning a witness's truthfulness if supported by the record. *See United States v. Goodapple,* 958 F.2d 1402, 1409-10 (7th Cir.1992). Here, Defendant Swearengen's testimony regarding conversations with Dr. Denton was directly contradicted by Denton's testimony. Thus, some of Plaintiffs' aggressive questioning of Swearengen cited by Defendants was not improper. Second, many of Plaintiffs' counsel's comments of which Defendants complain were either not objected to by Defendants or were immediately followed by an admonishment from the Court and an instruction to the jury to disregard the comments.[FN9] Thus, to the extent that any of Plaintiffs' counsels' questions were improper, the jury was appropriately instructed to disregard those comments.

FN9. “Q: It's also important not to lie to a jury, wouldn't you agree, when you're under oath?

[DEFENSE COUNSEL]: Objection. Move to strike. I have a motion relative-

THE COURT: Sustained. Ladies and gentlemen, disregard the question,”

(Trial Tr. at 2215-16.)

Special Interrogatories and Jury Instructions

***9** Defendants argue that it was error for the Court to refuse several of Defendants' proposed jury instructions and to give several jury instructions proposed by Plaintiffs. Additionally, Defendants argue that two special interrogatories should have been given to the jury: the first would have asked whether Defendants had probable cause to arrest Kevin Fox; the second asked whether Defendants reasonably but mistakenly believed probable cause was present. At the jury instruction conference, the Court rejected both proposed special interrogatories. The interrogatories were ambiguous with respect to *when* the Defendants had either probable cause or arguable probable cause. Considering that a central issue in the case was when the arrest occurred, asking only whether Defendants had probable cause, without specifying a time-frame would be confusing and counterproductive. Defendants did not propose amended instructions that would have remedied this deficiency.

With respect to the jury instructions, Defendants argue that Plaintiffs' due-process claim should not have gone to the jury because the validity of those claims was pending before the Court of Appeals. However, this Court had previously certified Defendants' appeal as frivolous. *See Apostal v. Gallion,* 870 F.2d 1335, 1339 (7th Cir.1989) (“a district court may certify to the court of appeals that the appeal is frivolous and get on with the trial”). Thus, it was not improper to proceed with the due-process claim.

Defendants next argue that the jury should have been instructed that Defendants needed only probable cause to arrest Kevin Fox for some criminal offense, not necessarily the offense with which he was eventually charged. Defendants' proposed instruction was not warranted based on the evidence.

The Court's reasoning in denying Defendants' other proposed jury instructions is set out in the transcript of the proceedings.

Excessive Damages

Defendants complain that the damages awarded to Plaintiffs are excessive. The damages awarded by the jury were not outside the range of damages to which a reasonable jury could find Plaintiffs entitled. Both sides were permitted to argue their theories on the issue of damages. The jury awarded an amount far less than Plaintiffs asked. The amount is not shocking to the judicial conscience and, therefore, will not be reduced.

Miscellaneous Objections

Defendants raise a number of other issues that they claim entitle them to a new trial. Defendants argue that the Court erred in excluding evidence of drug use by Kevin Fox, excluding the testimony of Defendants' expert Ken Lanning, excluding testimony regarding water usage at the Fox home, excluding Defendants' conversations with the Federal Bureau of Investigations, excluding the deposition testimony of former Defendant John Moss, permitting overly broad cross-examination of former Defendant Nick Ficarello, and allowing improper rebuttal testimony from Plaintiffs' witness, Dr. Denton. Defendants' arguments on these points were considered and ruled upon during the trial. Defendants have offered nothing beyond the reasons offered at trial, Therefore, Defendants' Motion for a New Trial on these grounds is denied.

Inconsistent Verdict

***10** Defendants argue that the verdict in their favor on Kevin Fox's false imprisonment claim is inconsistent with the verdict in favor of Kevin Fox on his claims of false arrest, due-process and malicious prosecution claims. Plaintiffs argue that Defendants waived this issue by failing to object before the jury was discharged.

The Seventh Circuit has not definitively ruled on whether a contemporaneous objection to inconsistent verdicts constitutes a waiver. *See Carter v. Chicago Police Officers,* 165 F.3d 1071, 1080 (7th Cir.1998); *Black and Decker, Inc. v. Robert Bosch Tool Corp.,* 2007 WL 108412 (N.D.Ill.2007). However, other circuits have held that failure to make such an objection does constitute waiver. *See e.g., Kosmynka v. Polaris Industries, Inc.,* 462 F.3d 74, 83 (2d Cir.2006) ("It is well established that a party waives its objection to any inconsistency in a jury verdict if it fails to object to the verdict prior to the excusing of the jury."); *Home Indem. Co. v. Lane Powell Moss and Miller,* 43 F.3d 1322, 1331 (9th Cir.1995); *see also Strauss v. Stratojac Corp.,* 810 F.2d 679, 683 (7th Cir.1987) (*Strauss*) (noting that requiring an objection to an inconsistent verdict before the jury is discharged promotes the efficient use of judicial resources). The Court finds the opinions on this issue of the Circuits and the reasoning of *Strauss* persuasive, especially considering the extended length of the trial in this case and the judicial resources expended. Therefore, Defendants' failure to raise this objection before the jury was discharged constitutes a waiver of the issue.

CONCLUSION

Defendants' Rule 50(b) Motion for a New Trial or Judgment as a Matter of Law and Defendants' Rule 59(a) Motion for New Trial are denied. Defendants' Rule 59(e) Motion to Alter or Amend Judgment is granted in part and denied in part. The judgment is amended to strike the punitive damage award against Defendant Brad Wachtl in favor of Plaintiff Kevin Fox and the punitive damage award against Defendant Edward Hayes in favor of Plaintiff Melissa Fox.

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Not Reported in F.Supp.2d, 2008 WL 4411574 (N.D.Ill.)

END OF DOCUMENT

TAB 7

This case was not selected for publication in the Federal Reporter.

Not for Publication in West's Federal Reporter See Fed. Rule of Appellate Procedure 32.1 generally governing citation of judicial decisions issued on or after Jan. 1, 2007. See also Third Circuit LAR, App. I, IOP 5.7. (Find CTA3 App. I, IOP 5.7)

United States Court of Appeals,
Third Circuit.
GLOBIS CAPITAL PARTNERS, L.P., On Behalf of Itself and All Others Similarly Situated; Judi Friedman; Antonio Sottle; Robert Enger; Jeff Farr
v.
STONEPATH GROUP, INC.; Dennis L. Pelino; Bohn H. Crain; Thomas L. Scully.
Globis Capital Partners, L.P., Appellant.
No. 06-2560.

Submitted Pursuant to Third Circuit LAR 34.1(a)
June 4, 2007.
Filed: July 10, 2007.

Background: Investor filed a putative class action complaint against corporation and its executives for securities fraud. The United States District Court for the Eastern District of Pennsylvania, Stewart Dalzell, J., granted defendants' motion to dismiss. Investor appealed.

Holdings: The Court of Appeals, Cowen, Circuit Judge, held that:
(1) fact that one subsidiary failed to eliminate certain inter-company transactions from its ledger provided parent company and its executives no warning that a different subsidiary would improperly fail to alter its estimated transportation costs to capture actual costs, such that parent corporation and executives acted with the required state of mind for a securities fraud action;
(2) financial interest of subsidiary's chief executive officer (CEO) in subsidiary's earnings did not demonstrate that parent corporation and its executives were reckless in depending upon subsidiary's accounting reports; and
(3) failure of parent corporation and its executives to investigate relatively small understatement by subsidiary of its transportation costs was not recklessness.

Judgment affirmed.

West Headnotes

[1] Securities Regulation 349B 60.45(1)

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.43 Grounds of and Defenses to Liability
349Bk60.45 Scienter, Intent, Knowledge, Negligence or Recklessness
349Bk60.45(1) k. In General. Most Cited Cases

Fact that one subsidiary failed to eliminate certain inter-company transactions from its ledger provided parent company and its executives no warning that a different subsidiary would improperly fail to alter its estimated transportation costs to capture actual costs, such that parent corporation and executives acted with the required state of mind for a securities fraud action. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5.

[2] Securities Regulation 349B 60.45(1)

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.43 Grounds of and Defenses to Liability
349Bk60.45 Scienter, Intent, Knowledge, Negligence or Recklessness
349Bk60.45(1) k. In General. Most Cited Cases

Financial interest of subsidiary's chief executive officer (CEO) in subsidiary's earnings did not demonstrate that parent corporation and its executives were reckless in depending upon subsidiary's accounting reports, as was required for scienter element of securities fraud action. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5.

[3] Securities Regulation 349B 60.45(1)

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.43 Grounds of and Defenses to Liability
349Bk60.45 Scienter, Intent, Knowledge, Negligence or Recklessness
349Bk60.45(1) k. In General. Most Cited Cases

Failure of parent corporation and its executives to investigate relatively small understatement by subsidiary of its transportation costs was not recklessness, as was required for securities fraud claim, even though faulty report concerned parent corporation's core financial metric, where earnings reported by subsidiary were entirely in line with expectations. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5.

***833** On Appeal from the United States District Court for the Eastern District of Pennsylvania, (D.C. Civil No. 04-cv-04515), District Judge: Hon. Stewart Dalzell.Deborah R. Gross, Law Offices of Bernard M. Gross Juniper & Market Streets, Philadelphia, PA, U. Seth Ottensoser, Bernstein, Liebhard & Lifshitz, New York, NY, for Globis Capital Partners, L.P.

***834** Steven E. Bizar, Thomas P. Manning, Buchanan Ingersoll, Philadelphia, PA, for Stonepath Group, Inc.; Dennis L. Pelino; Bohn H. Crain; Thomas L. Scully.

BEFORE: SMITH and COWEN, and SILER [FN*], Circuit Judges.

FN* Honorable Eugene E. Siler, Jr., Senior United States Circuit Judge, U.S. Court of Appeals for the Sixth Circuit, sitting by designation.

OPINION

COWEN, Circuit Judge.

****1** Globis Capital Partners, LP ("Globis") appeals an order of the United States District Court for the Eastern District of Pennsylvania granting a motion to dismiss filed by Stonepath Group, Inc. ("Stonepath") and Stonepath executives Dennis L. Pelino, Bohn H. Crain, and Thomas L. Scully. For the reasons discussed below, we will affirm.

I.

Stonepath is a non-asset based third-party logistics services company. In 2001, Stonepath commenced a series of acquisitions through its two primary subsidiaries: Domestic Services and International Services. Among the companies acquired through Domestic Services was Air Plus. As part of this acquisition, Stonepath agreed to make a series of earn-out payments to Air Plus's shareholders if Air Plus met certain earning targets in subsequent years. Stonepath named the co-founder and majority shareholder of Air Plus, Gary A. Koch, CEO of Domestic Services. Domestic Services also had its own CFO and controller, and continued to use Air Plus's legacy information system. International Services-Stonepath's other major subsidiary-had separate officers and used a different legacy information system.

During the class period, Stonepath restated its financial results three times. The first restatement, which was announced in August 2003, related to allocating more value to the customer relationship intangible assets for the company's acquisitions and revising the amortization method and life used for such assets. Second, in January 2004, Stonepath announced that it would restate its results for the last three quarters of fiscal year 2002 and the first three quarters of fiscal year 2003, because of an error in International Services' accounting process. Most simply, International Services' accounting figures mistakenly included transfers between International Services and one of its subsidiaries, which resulted in corresponding overstatements of revenues and costs. After this occurred, Stonepath executives stated that they were working with their internal and external auditors to ensure that such an error did not recur. However, in September 2004, Stonepath announced the need for a third restatement because Domestic Services had overstated its earnings by failing to adjust its transportation cost estimates to reflect its actual costs. This resulted in Domestic Services' overstating its income by a total of $16.3 million for 2001, 2002, 2003, and the first six months of 2004. On the day of this announcement, Stonepath's stock dropped from $1.59 per share to $0.86 per share.

Four days after the announcement, Globis filed a putative class action complaint seeking recovery under section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5, and section 20(a) of the Exchange Act, 15 U.S.C. § 78t(a). Globis alleged that press releases and SEC filings discussing Stonepath's financial results ***835** were false and misleading, and sought relief on behalf of itself and all others who purchased Stonepath common stock from March 29, 2002, through September 20, 2004. After permitting Globis to file a second amended complaint, the District Court granted appellees' motion to dismiss under Fed.R.Civ.P. 12(b)(6). Globis then appealed.

II.

****2** We have jurisdiction over this appeal by virtue of 28 U.S.C. § 1291. Our review of a district court's dismissal of a complaint under Fed.R.Civ.P. 12(b)(6) is plenary. *Lum v. Bank of Am.,* 361 F.3d 217, 223 (3d Cir.2004). A motion to dismiss pursuant to Rule 12(b)(6) should be granted only if, accepting as true the facts alleged and all reasonable inferences that can be drawn therefrom, there is no reasonable reading upon which the plaintiff may be entitled to relief. *Id.*

III.

Globis argues that the District Court erred in dismissing its securities fraud complaint. The gravamen of the complaint is the section 10(b) claim, which is enforced through Rule 10b-5. *See In re Advanta Corp. Sec. Litig.,* 180 F.3d 525, 535 (3d Cir.1999). In order to state a claim under section 10(b) and Rule 10b-5, a plaintiff must plead that the defendant "(1) made a misstatement or an omission of a material fact (2) with scienter (3) in connection with the purchase or the sale of a security (4) upon which the plaintiff reasonably relied and (5) that the plaintiff's reliance was the proximate cause of his or her injury." *In re Ikon Office Solutions, Inc.,* 277 F.3d 658, 666 (3d Cir.2002).

The District Court dismissed Globis's complaint because it concluded that the complaint failed adequately to plead scienter. The Private Securities Litigation Reform Act (PSLRA) requires the complaint to "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 complaint may present a "strong inference" of scienter, as relevant here, "by alleging facts that constitute strong circumstantial evidence of ... recklessness." *In re Alpharma Inc. Sec. Litig.,* 372 F.3d 137, 148 (3d Cir.2004). Recklessness involves "not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it." *Advanta,* 180 F.3d at 539 (internal quotation marks omitted). We employ a demanding standard of recklessness to ensure that "the culpability attaching to such reckless conduct closely approaches that which attaches to conscious deception." *In re Digital Island Sec. Litig.,* 357 F.3d 322, 332 (3d Cir.2004) (internal quotation marks omitted).

[1] Globis argues that it was reckless of Stonepath to rely on Domestic Services' accounting reports. Generally, we will not "presume recklessness or intentional misconduct from a parent corporation's reliance on its subsidiary's internal controls." *In re Comshare Inc. Sec. Litig.,* 183 F.3d 542, 554 (6th Cir.1999); *see also Chill v. Gen. Elec. Co.,* 101 F.3d 263, 271 (2d Cir.1996) (same). Globis argues that this case departs from that norm for three reasons. First, it argues that appellees were aware that Domestic Services' internal controls were deficient because Stonepath had previously been forced to restate its financial results. This argument, however, misses the mark. Globis does not, and could not, argue that the first restatement notified ***836** appellees of widespread internal-control problems. The second restatement-which Globis does rely on-concerned accounting problems at International Services, which used an entirely different accounting system than Domestic Services. The fact that one subsidiary failed to eliminate certain inter-company transactions from its ledger provided appellees no warning that a

different subsidiary would improperly fail to alter its estimated transportation costs to capture actual costs.

****3** [2] Second, Globis contends that appellees were reckless in relying on Domestic Services' accounting because the CEO of Domestic Services, Koch, would be rewarded under the earn-out arrangement if Air Plus (an important component of Domestic Services) reached earning targets. According to Globis, Koch's interest imposed a heightened duty on appellees to monitor Domestic Services. However, Globis presents no caselaw recognizing this heightened duty, and it is inconsistent with the fact that executives commonly have financial interests in their companies. As we have explained in a similar context: "In every corporate transaction, the corporation and its officers have a desire to complete the transaction, and officers will usually reap financial benefits from a successful transaction. Such allegations alone cannot give rise to a 'strong inference' of fraudulent intent." *GSC Partners CDO Fund v. Washington,* 368 F.3d 228, 237 (3d Cir.2004). Further, as the District Court recognized, Domestic Services had its own CFO and controller, and Stonepath was entitled to rely on those disinterested individuals to participate in managing the internal controls of Domestic Controls. Thus, the fact that Koch was interested in the earnings of Domestic Services does not demonstrate that appellees were reckless in depending upon Domestic Services' accounting reports.

[3] Finally, Globis argues that the scope of the error and the fact that it concerned Stonepath's most important source of earnings means that appellees were reckless in failing to catch it. However, the error in this case was relatively small: as the District Court determined, in a generous calculation, Domestic Services understated its transportation costs by only 5.7% in 2003 and less than 3.8% in 2002. Moreover, the earnings reported by Domestic Services were entirely in line with expectations. While there may be cases where the figures presented by a subsidiary are so startling that it would be reckless for the parent company to fail to investigate, this is not such a case. *Cf. Alpharma,* 372 F.3d 137, 151 (3d Cir.2004) (explaining that spike in small subsidiary's revenue did not put company on notice that subsidiary engaged in fraud). Nor does the fact that the faulty report concerned Stonepath's core financial metric change this conclusion. As we stated above, recklessness requires "an extreme departure from the standards of ordinary care." *Advanta,* 180 F.3d at 539 (internal quotation marks omitted); *see also Chill,* 101 F.3d at 269 (explaining that "showing of recklessness must be such that it gives rise to a strong inference of fraudulent intent" (internal quotation marks omitted)). Globis does not claim that Stonepath's internal or external auditors alerted appellees to this accounting error, nor does Globis assert that appellees should have otherwise been aware that Domestic Services' internal controls were deficient. *See Kushner v. Beverly Enters., Inc.,* 317 F.3d 820, 829 (8th Cir.2003) (finding it "telling" that company's "outside auditors did not question its accounting practices"). Thus, while viewed in retrospect it may have been a poor decision for Stonepath to rely ***837** on Domestic Services' accounting, "[r]ecklessness is not intended to encompass 'claims essentially grounded on corporate mismanagement.' " *Digital Island,* 357 F.3d at 332 (quoting *Advanta,* 180 F.3d at 540). Accordingly, we agree with the District Court that Globis has failed to allege facts that constitute strong evidence of recklessness.[FN1]

> FN1. In *Tellabs, Inc. v. Makor Issues & Rights, Ltd.,* the Supreme Court held that, under the PSLRA, "an inference of scienter must be more than merely plausible or reasonable-it must be cogent and at least as compelling as any opposing inference of nonfraudulent intent." 551 U.S. 308, 127 S.Ct. 2499, 2504-05, 168 L.Ed.2d 179 (2007). The Court's *Tellabs* decision removes any doubt that the PSLRA's scienter pleading requirement is a significant bar to litigation that Globis has failed to meet.

****4** Our conclusion is fortified by the fact that the three individual appellees were acquiring substantial amounts of Stonepath stock throughout the period that they were allegedly acting recklessly. As we explained in *Digital Island,* because appellees' interests "were at all times tied to the value of their shares, we have no basis to infer the sort of conscious disregard and deliberate ignorance required to plead scienter." 357 F.3d at 332.

For the foregoing reasons,[FN2] the judgment of the District Court entered on April 4, 2006, will be affirmed.

FN2. Globis also brought a claim under section 20(a) of the Exchange Act, 15 U.S.C. § 78t(a). However, because Globis failed to plead a predicate violation of section 10(b) and Rule 10b-5, its section 20(a) claim must also be dismissed. *See In re Rockefeller Ctr. Props., Inc. Sec. Litig.,* 311 F.3d 198, 211 (3d Cir.2002)

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TAB 8

LEXSEE 2009 U.S. DIST. LEXIS 53739

LAURA HARDNICK, as Special Administrator of the Estate of Britteny George, deceased, Plaintiff, v. UNITED STATES OF AMERICA, Defendant.

No. 07 C 1330

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

2009 U.S. Dist. LEXIS 53739

June 25, 2009, Decided
June 25, 2009, Filed

COUNSEL: [*1] For Laura Hardnick, estate of Britteny George, Plaintiff: Donald T. Bertucci, LEAD ATTORNEY, Law Offices of Donald T. Bertucci, Chicago, IL.

For United States of America, Defendant: Daniel M Tardiff, Linda A. Wawzenski, LEAD ATTORNEYS, AUSA, United States Attorney's Office (NDIL), Chicago, IL.

JUDGES: Robert M. Dow, Jr., United States District Judge.

OPINION BY: Robert M. Dow, Jr.

OPINION

MEMORANDUM OPINION AND ORDER

Plaintiff Laura Hardnick, as Special Administrator of the Estate of Britteny George, brought this action under the Federal Tort Claims Act ("FTCA") following the death of her 13-year old daughter, Britteny George. The complaint alleges that Britteny's death was caused by the negligence of a doctor practicing at the Lawndale Christian Health Center. The United States is the Defendant in this action because the doctor whose treatment is at issue, Dr. Ann Dominguez, worked at a health care facility operated by the United States, and thus, pursuant to the Federally Supported Health Centers Assistance Act, *42 U.S.C. § 233(g)-(n)*, Dr. Dominguez is deemed to be an employee of the United States Public Health Service for purposes of this lawsuit.

This case came before the Court for a three-day bench trial in December [*2] 2008. At trial, the Court heard the testimony of several witnesses, including Ms. Hardnick, Dr. Dominguez, and other Lawndale personnel. The Court also heard the testimony of four expert witnesses -- two per side -- on issues relating to the applicable standard of care and whether the alleged negligence proximately caused Britteny's death. The Court sets forth below its findings of fact and conclusions of law, as required under *Federal Rule of Civil Procedure 52(a)*. The facts are drawn from the documentary record in the case and the evidence and testimony presented at trial.

I. Background

A. Events leading up to Britteny's October 26 visit to Mt. Sinai Hospital

Britteny George was born on September 19, 1990. The events leading to her death at the age of thirteen took place in late October and early November 2003.

On October 23, 2003, Britteny complained of a headache, took a pain reliever, and went to bed. Tr. 209. The next day, a Friday, Britteny felt well enough to go to school. *Id.* The following day, the headache returned, along with a runny nose. Tr. 210.

On Sunday, October 26, 2003, Britteny complained that she had a bad headache and that the light was hurting her eyes. Tr. 210-11. [*3] Britteny's mother, Laura Hardnick, drove Britteny to the emergency room at Mt. Sinai Hospital, where Britteny was examined by Naveed Hyderi, a physician's assistant. Tr. 160-62; PX 1. The notes taken during the examination at Mt. Sinai Hospital indicate that Britteny complained of a constant, throbbing, "frontal" headache of three days duration causing a pain level of 7 on a scale of 1-10. PX 1. The records from Mt. Sinai also reflect that the headache was worse when Britteny bent down, that she had a stuffy nose with yellow mucus, and that she had vomited once the prior night. *Id.* The physician's assistant diagnosed Britteny with a migraine headache and an upper respiratory infection, prescribed ibuprofen and Sudafed, advised Britteny and her mother to follow up with her primary care doctor in three days, and instructed them to return to the emergency room if Britteny developed a fever. *Id.;* see also Tr. 211-12.

B. Britteny's October 27 visit to Lawndale

After returning home from Mt. Sinai, Britteny took three doses of the pain medication without relief. Tr. 164-66, 170-71. The next morning, October 27, 2003, Ms. Hardnick took Britteny to the Lawndale Christian Health Center hoping [*4] to see Britteny's regular pediatrician, Dr. Jerome Umanos. Tr. 166, 168.

Because Dr. Umanos was not working that day, Britteny was examined by Dr. Ann Dominguez, a board certified family practice physician who was the obstetrical service line director at Lawndale. Tr. 168-72; PX 4. The "Walk-In Triage/History/Physical" chart of Britteny's October 27 visit to Lawndale -- completed in part by a registered nurse, Elizabeth Stipp, and in part by Dr. Dominguez -- noted that Britteny came to Lawndale as a follow-up to her visit to Mt. Sinai the night before and that Britteny was given ibuprofen and Sudafed without much relief. PX 4; see also Tr. 89-90. Britteny's chief complaints were rhinorrea, congestion, cough, headache, and sore throat for five days. PX 4; Tr. 50. It was noted on the chart that Britteny had a "sinus headache" and that she had "+ yellow PND" (PX 4), which Dr. Dominguez testified is a thick yellow mucus draining from the sinuses into the pharynx (Tr. 60-61). Dr. Dominguez observed during the examination that Britteny was tired and crying, but that she was otherwise alert and cooperative. PX 4; Tr. 53. Dr. Dominguez also noted that Britteny had full range of motion in her [*5] neck and that although her sinuses were boggy, there was no sinus tenderness. PX 4. During the examination, Ms. Hardnick told Dr. Dominguez that Britteny's headache had persisted for five days and that Britteny had not felt any relief from the pain even though she had taken several doses of pain reliever. Tr. 171-73. Although Dr. Dominguez understood that Britteny had an intense headache, Dr. Dominguez did not specifically ask Britteny to rate the severity of the headache pain on the 10-point pain scale provided on the chart. Tr. 106-07. Nor did Dr. Dominguez attempt to access any records from Britteny's visit the previous afternoon to Mt. Sinai Hospital (Tr. 63), despite the fact that Dr. Dominguez had privileges at Mt. Sinai and acknowledged that she likely would have received any such records as were available had she requested them (Tr. 66, 110).

After completing the examination, Dr. Dominguez diagnosed Britteny with an upper respiratory infection and prescribed an increased dosage of Motrin and a nasal spray called Flonase. PX 4. She further advised Britteny to drink a mix of fluids, including soup and juice, and to return if she felt worse or did not improve within ten to fourteen [*6] days. *Id.*

C. Events following the visit to Lawndale

No change in Britteny's condition was detected for the rest of the day on October 27 or during the next day. Tr. 354. However, on October 29, Ms. Hardnick received a call at work informing her that Britteny's eye was swelling. *Id.* at 355. When Ms. Hardnick returned home, Britteny was complaining of double vision. *Id.*

That afternoon, Ms. Hardnick took Britteny back to the emergency room at Mt. Sinai. Tr. 186. At that time, Britteny was suffering from facial swelling, protosis of the eye, and had difficulty walking. *Id.* at 185-88; PX 2, at 6, 10. Britteny was admitted to the hospital's pediatric intensive care unit and administered empiric antibiotics. DX B, at 30. A CT scan of her head revealed complete opacification of the ethnoid and sphenoid sinuses bilaterally, and an MRI was suspicious for meningitis and possible bilateral retro-orbital fluid on the right side. *Id.* at 9-10. A lumbar puncture showed a white cell count 1300 with predominantly polymorphonuclear leukocytes consistent with a diagnosis of bacterial meningitis. *Id.* at 18, 30.

On October 30, the surgeons at Mt. Sinai determined that Britteny needed a surgical drainage of [*7] her retrobulbar or retro-orbital spaces and arranged for Britteny to be transferred to University of Illinois at Chicago Hospital ("UIC"), where the surgery could be performed. PX 2, at 15-16, 23. At UIC Hospital, Britteny was diagnosed with acute sphenoid sinusitis, ethmoid sinusitis, meningitis, and bilateral orbital cellulitis and treated with intravenous antibiotics. PX 5, at 35-38; Tr. 193, 274. At approximately midnight on October 30, Britteny underwent surgery for bilateral ethmoidectomy and bilateral endoscopic sphenoid sinusotomy. *Id.* On November 1, Britteny underwent a second surgery at UIC Hospital for sinus debridement. PX 5, at 39-41; Tr. 193.

Despite the surgeries and the administration of large quantities of antibiotics, an EEG performed on Britteny on November 3 showed that she had no brain activity. PX 5, at 11-12, 244; Tr. 194. Accordingly, Britteny was removed from life support and pronounced dead on November 3, 2003. DX C, at 327-28. She was survived by her mother, Laura Hardnick, her father, Henry George, Jr., and her brother, Brandon George, who was nine years old at the time of his sister's death. An autopsy performed on Britteny identified the cause of her death [*8] as acute and chronic sinusitis, retro orbital and parasellar abscess formation, meningitis and cerebritis consistent with ascending infections process, brain edema, and changes consistent with non-perfused brain. PX 5, at 200-03; DX C, at 320-23.

D. Expert testimony

1. Plaintiff's experts

a. Dr. Correa

At trial, Plaintiff presented the expert testimony of Dr. Armando Correa, an Assistant Professor of Pediatrics at Baylor College of Medicine who is board-certified in Pediatrics and Pediatric Infectious Diseases and has published widely in those fields. PX 19, at 1 & Ex. 1; Tr. 221-309. In his expert report, Dr. Correa opined that the constellation of symptoms that Britteny reported -- namely, severe "frontal" headache pain that worsened as she bent down, pain lasting for five days without relief from medication, nasal congestion, boggy nasal passages, yellow discharge, yellow post-nasal drip -- required further evaluation beyond the prescription of additional pain medication, but that no further evaluation was undertaken at the time of Britteny's examination at Lawndale. PX 19, at 1-3. In addition to his analysis of the records of Britteny's October 26 and 27 examinations, Dr. Correa's [*9] opinions rest on his assertions that (i) intracranial complications of sinusitis are more common in teenagers than in younger children because of the more advanced anatomy and increased surface area of the frontal and sphenoid sinuses by age 13 (*id.* at 4-6; see also Tr. 281-82) and (ii) the increased pain that Britteny reported when she bent forward was associated with inflammation and increased pressure in the sinuses associated with sinusitis (*id.* at 4-5; see also Tr. 253-54).

Dr. Correa opined that the headache pain that Britteny reported on October 26 and 27 was not consistent with a diagnosis of a migraine or an upper respiratory infection, but rather was the result of sinusitis. PX 19, at 3. Among other things, Dr. Correa stated his view that the severity and persistence of the headache, despite the administration of ibuprofen, is not what a doctor would expect to see with an upper respiratory infection. Tr. 259. He believes that Britteny had sinusitis when she was examined at Lawndale on October 27, but that she did not develop bacterial meningitis until later. PX 19, at 4. Dr. Correa explained at trial that when he uses the term "sinusitis," he is talking about bacterial sinusitis, [*10] not viral sinusitis. Tr. 233.

Dr. Correa opined that Dr. Dominguez's treatment of Britteny was not in conformity with the applicable standard of care in several respects:

> . Dr. Dominguez did not evaluate the etiology of Britteny's very severe headache pain which persisted for five days (PX 19, at 3);
>
> . Dr. Dominguez did not access the chart of Britteny's visit to Mt. Sinai on October 26, despite the fact that Dr. Dominguez had privileges at Mt. Sinai (*id.* at 4);
>
> . Dr. Dominguez did not give consideration to a consultation with a pediatrician, a pediatric infectious diseases physician, or an ENT specialist to ascertain whether antibiotics should have been prescribed on the basis of Britteny's presentation (*id.* at 5-6);
>
> . Dr. Dominguez did not give consideration to whether a CT scan of the brain should have been undertaken given Britteny's severe headache of five days duration that was refractory to pain medication and the fact that intracranial complications of sinusitis are more common in teenagers (*id.* at 6);
>
> . Dr. Dominguez did not make a clinical diagnosis of Britteny's condition as sinusitis -- or, at a minimum, arrive at a differential diagnosis inclusive of sinusitis -- at the time [*11] of Britteny's October 27 visit to Lawndale (*id.* at 5);
>
> . Dr. Dominguez did not prescribe antibiotics for Britteny (*id.* at 6-7).

Dr. Correa stated his view that Britteny's condition was significantly complicated (Tr. 305), but that the administration of a routine dosage of antibiotics (Amoxicillin), to which Britteny was not allergic, would have adequately treated her sinusitis (PX 19, at 6-7). Put differently, Dr. Correa concluded that in all medical likelihood, if Britteny had been prescribed oral antibiotics by Dr. Dominguez on October 27, Britteny would not have developed bacterial meningitis and that her death on November 3, 2003 could have been prevented. *Id.;* see also Tr. 236, 278.

b. Dr. Leavy

Plaintiff also provided expert opinion testimony from Dr. Phillip Leavy, an Associate Professor of Emergency Medicine at Eastern Virginia Medical School who is board-certified in Emergency Medicine. PX 21, at 1; Tr. 312-343. The opinions offered in Dr. Leavy's report track Dr. Correa's in most respects. *Id.* at 2-8. He stressed that the medical record from Mt. Sinai and Lawndale indicated that Britteny's headache had gotten worse between October 26 and October 27 (Tr. 324-28) and the fact that [*12] the headache had gotten worse, not better, despite the administration of prescribed pain medication cast doubt on the diagnosis of URI and should have led Dr. Dominguez "to go one step or two steps further in her treatment of this patient to consider other etiologies" (Tr. 334). Like Dr. Correa, Dr. Leavy opined that Britteny had sinusitis at the time that she saw Dr. Dominguez. *Id.* at 333. And like Dr. Correa, Dr. Leavy explained that the term "sinusitis" means "bacterial sinusitis." *Id.* at 342-43.

Dr. Leavy offered at least one opinion in an area that Dr. Correa did not address, relating to Dr. Dominguez's prescription of Flonase. PX 21, at 7-8. In Dr. Leavy's view, Flonase should not have been prescribed without the administration of antibiotics, because Flonase is an immunosuppressant, which can diminish a patient's antibodies that are used to fight off infection. *Id.* at 7. In this instance, Dr. Leavy opined that the prescription of Flonase without simultaneously giving antibiotics in all likelihood increased the extension of the bacterial disease in Britteny's sinuses. *Id.* at 8.

2. Defendant's experts

a. Dr. Bielanski

Defendant offered at trial the expert testimony of Dr. Thomas Bielanski, [*13] who is board certified in Family Medicine and both practices and teaches family medicine in the Chicago area. DX E, at 1; Tr. 369-462. Dr. Bielanski worked with Dr. Dominguez during her medical residency, and in fact was her direct supervisor for a period of time. Tr, 373-74, 408.

Dr. Bielanski offered an opinion within a reasonable degree of medical certainty that Britteny more likely than not had a viral upper respiratory infection at the time that she was examined by Dr. Dominguez on October 27, 2003, and that there was no need for Britteny to have been treated with antibiotics at that time. DX E, at 3-4. He also opined that Dr. Dominguez did not deviate from the standard of care in her treatment of Britteny on that date. *Id.* at 4. In elaborating on his opinion, Dr. Bielanski stressed that the symptoms of URI, viral infection, and acute bacterial sinusitis are all the same, and that apart from a sinus culture, which rarely is done, there is no test that a doctor can give a patient to diagnose bacterial sinusitis. Tr. 384. He also testified that, in his view, Dr. Dominguez did know the etiology of Britteny's headache at the time that she provider her diagnosis on October 27. *Id.* at 426.

On [*14] cross-examination, Dr. Bielanski acknowledged that the intensity of a headache may be significant in evaluating whether a patient has acute bacterial sinusitis, and that a physician also must "take other history, examine the patient and determine what the source of the headache is." Tr. 386. He also agreed that, in view of the autopsy's findings that Britteny had chronic sinusitis at the time of her death, it is more likely than not that Britteny had sinusitis on October 27 -- although he draws a distinction between sinusitis and acute bacterial sinusitis. Tr. 415.

b. Dr. Segreti

Defendant also offered at trial the expert testimony of Dr. John Segreti, a Professor in the Department of Internal Medicine at Rush University Medical Center who is board-certified in Internal Medicine and Infectious Diseases. DX D, at 2; Tr. 465-508. Dr. Segreti opined that the care and treatment rendered by Dr. Dominguez on October 27, 2003 complied with the standard of care. *Id.* at 5. According to Dr. Segreti, Britteny's clinical presentation at the time that she was examined by Dr. Dominguez was most consistent with a diagnosis of upper respiratory infection and Britteny did not have the clinical picture [*15] of a patient with acute bacterial sinusitis or meningitis. *Id.*

In support of that opinion, Dr. Segreti referenced the AAP Guidelines for pediatric sinusitis. DX D, at 5. As Dr. Segreti noted, the diagnosis of acute bacterial sinusitis is based on clinical criteria in children who present with upper respiratory symptoms that are either persistent (those lasting longer than 10 to 14 days) or severe (temperature of at least 102 degrees and purulent nasal discharge for 3 to 4 consecutive days in a child who seems ill). *Id.* at 5-6. Dr. Segreti opined that although Britteny may have had sinusitis at the time that she was examined by Dr. Dominguez, "[b]ased on this guideline, Britteny George did not meet the clinical criteria for acute bacterial sinusitis." *Id.* at 6. He also stressed that the severity of a headache does not differentiate viral from bacterial sinusitis. *Id.* at 5. Dr. Segreti believes that Britteny developed acute bacterial sinusitis some time after leaving Lawndale on October 27, and that she later developed acute bacterial ethmoid sinusitis, which was then complicated by bacterial meningitis and ultimately led to her death. *Id.* at 6.

Dr. Segreti testified that he is not aware [*16] of data that adolescents are more susceptible to complications of viral sinusitis. DX D, at 6. He opined that a consultation with an infectious disease specialist was not indicated as of October 27, nor were radiographs, CT scans, or an MRI required as of that time under the applicable standard of care. *Id.* He also stated his view that the records from Britteny's October 26 visit to Mt. Sinai simply would have confirmed Dr. Dominguez's diagnosis of viral URI. *Id.* Finally, he opined that any use by Britteny of Flonase could not have contributed to the development of acute bacterial sinusitis or meningitis in Britteny. *Id.* at 6-7.

In response to questions from Plaintiff's counsel, Dr. Segreti acknowledged that he is not board certified in pediatric infectious diseases, that he has no formal training in pediatric infectious diseases or in family practice, and no primary care experience with pediatric patients with either upper respiratory infection or acute bacterial sinusitis. Tr. 481-83. As a result of an absence of specific experience with pediatric patients, Dr. Segreti did not know at the time of his deposition, for example, the age at which a pediatric patient's sphenoid sinuses [*17] are pneumatized. *Id.* at 486.

II. Analysis

A. Applicable legal standards

The Federal Tort Claims Act provides a remedy for personal injuries caused by the negligent or wrongful act or omission of a governmental employee while acting within the scope of her employment. *Kasongo v. United States, 523 F. Supp. 2d 759, 791 (N.D. Ill. 2007)*; see also *28 U.S.C. §§ 1346(b)(1)*, *2671*, *2674*. In FTCA cases, the government is liable in the same manner and to the same extent as a private individual, and the law of the state in which the cause of action arose governs the scope of that liability. See *United States v. Olson, 546 U.S. 43, 45-46, 126 S. Ct. 510, 163 L. Ed. 2d 306 (2005)*; *Midwest Knitting Mills, Inc. v. United States, 950 F.2d 1295, 1297 (7th Cir. 1991)*. Here, it is undisputed that the substantive law of Illinois applies in this medical negligence case under the FTCA.

Under Illinois law, to establish negligence, the Plaintiff must show that (i) Defendant owed a duty of care to Plaintiff; (ii) Defendant breached that duty of care; and (iii) Defendant's breach proximately caused an injury to Plaintiff. *Curatola v. Village of Niles, 154 Ill. 2d 201, 207, 608 N.E.2d 882, 181 Ill. Dec. 631 (1993)*. In determining whether a duty exists, the court must "consider not [*18] only the (1) reasonable foreseeability and (2) likelihood of injury, but also (3) the magnitude of the burden on defendant in guarding against injury and (4) the consequences of placing that burden on defendant." *Staples v. Krack Corp., 186 F.3d 977, 979 (7th Cir. 1999)* (applying Illinois law).

Here, as in any negligence action predicated on alleged medical malpractice, the "central issue * * * is the standard of care against which a doctor's negligence is judged." *Curi v. Murphy, 366 Ill. App. 3d 1188, 1199, 852 N.E.2d 401, 304 Ill. Dec. 151 (4th Dist. 2006)*. If the plaintiff fails to prove that the doctor deviated from the standard of care, she cannot prevail. *Burrow v. Widder, 52 Ill. App. 3d 1017, 1023, 368 N.E.2d 443, 10 Ill. Dec. 848 (1st Dist. 1977)*. To prevail, a medical malpractice plaintiff must show that the doctor failed to do something that a reasonably careful physician would do, or did something that a reasonably careful physician would not have done, under circumstances similar to those shown by the evidence in the case. See, *e.g., Kwak v. St. Anthony DePadua Hosp., 54 Ill. App. 3d 719, 726, 369 N.E.2d 1346, 12 Ill. Dec. 332 (1st Dist. 1977)*; see also *Bryant v. LaGrange Mem. Hosp., 345 Ill. App. 3d 565, 575, 803 N.E.2d 76, 280 Ill. Dec. 846 (1st Dist. 2003)* ("the standard of care required of a defendant [*19] medical professional is to act as would an 'ordinarily careful professional'"). To be sure, the standard of care is not the highest degree of skill that one learned in the profession may acquire; rather, it reflects "reasonable skill such as physicians in good practice ordinarily use and would bring to a similar case in that locality." *Taber v. Riordan, 83 Ill. App. 3d 900, 904, 403 N.E.2d 1349, 38 Ill. Dec. 745 (2d Dist. 1980)*; see also *Kasongo, 523 F. Supp. 2d at 792* ("the standard of care against which a defendant's conduct is measured is not the highest degree of skill possible, but the reasonable skill that a physician in good standing in the community would use in a similar situation") (applying Illinois law).

As both parties have acknowledged, to determine what the standard of care required in a particular set of circumstances, the trier of fact ordinarily must rely on the testimony of qualified expert witnesses. See, *e.g., Purtill v. Hess, 111 Ill. 2d 229, 242, 489 N.E.2d 867, 95 Ill. Dec. 305 (1986)*; *Dolan v. Galluzzo, 77 Ill. 2d 279, 282, 396 N.E.2d 13, 32 Ill. Dec. 900 (1979)*; see also I.P.I. Civil Jury Instr. 105.01. In addition, to satisfy the element of proximate cause, expert testimony must establish within a reasonable degree of medical certainty that the defendant's [*20] acts (or omissions) caused the plaintiff's injury. See *Wintz v. Northrop Corp., 110 F.3d 508, 515 (7th Cir. 1997)*. "The weight given to medical expert testimony is for the trier of fact to determine." *Kasongo, 523 F. Supp. 2d at 793*. [1]

1 During trial, Defendant raised a number of objections to the scope of the testimony offered by Plaintiff's expert witnesses. Defendant insisted that those witnesses presented testimony that went beyond the opinions stated in their pre-trial disclosures and *Rule 26* expert reports and requested that any such testimony be excluded.

> Plaintiff made similar objections during the testimony of Defendant's experts. The Court has carefully examined the expert reports and the trial transcript to ensure that it has relied only on opinions that were fairly encompassed within the expert reports tendered in this case. While the expert reports are not as comprehensive as they might have been -- a comment that applies equally to Plaintiff's and Defendant's experts -- the reports contain sufficient detail as to both the opinions offered and the basis for those opinions to satisfy any foundational, relevance, and reliability concerns that have been raised by either side. [*21] Accordingly, the Court rejects Defendant's position that Plaintiff "failed to disclose or produce any expert opinion establishing that Dr. Dominguez's treatment of Britteny on October 27, 2003 deviated from the acceptable standard of care." To be sure, as noted elsewhere in this opinion, some of the experts have more relevant experience than others, a factor that the Court properly may consider in determining how much weight to accord the experts' opinions.

Here, as in most medical malpractice cases, the parties have presented the trier of fact with a "battle of the experts." Each side has offered the testimony of two licensed and well credentialed physicians. Plaintiff's experts, not surprisingly, contend that Dr. Dominguez breached the standard of care owed to Britteny in several respects, and that those breaches proximately caused Britteny's death. Defendant's experts, equally predictably, opined that Dr. Dominguez acted in conformity with the standard of care and that other factors caused Britteny's death.

As the parties recognize, the mere fact that qualified and credentialed experts disagree on the appropriate course of treatment in a given factual scenario neither condemns nor [*22] exonerates the doctor's course of treatment. Because medicine "is not an exact science," but instead "involves the exercise of individual judgment within the framework of established procedures," a diagnosis that results in a difference of opinion nevertheless can be consistent with the exercise of due care. *Walski v. Tiesenga, 72 Ill. 2d 249, 261, 381 N.E.2d 279, 21 Ill. Dec. 201 (1978)*; see also *Campbell v. United States, 904 F.2d 1188, 1192 (7th Cir. 1990).*

All four of the experts offered coherent explanations for their views on the standard of care and proximate cause. The Court found Dr. Correa to be a particularly persuasive witness in view of his specialization in pediatric infectious diseases and his concise testimony that was consistent with his expert report. And, in comparison to the other experts, the Court found Dr. Segreti's background and experience less pertinent to the matters in dispute concerning the standard of care. As noted above, among other things, Dr. Segreti is not trained in or board certified in pediatric infectious diseases and has not acted as a primary care physician for pediatric patients suspected of having either a URI or acute bacterial sinusitis. Tr. 381-83. The Court nevertheless [*23] found Dr. Segreti's testimony somewhat helpful; it simply was not as helpful as the testimony of the other opinion witnesses. The Court also found all of the opinion witnesses, as well as the other key witness, Dr. Dominguez, to be forthright and credible. At the end of the day, the resolution of this case does not turn on credibility of the witnesses, but rather on the Court's assessment, as the trier of fact, of the experts' opinions on whether the medical care and treatment provided by Dr. Dominguez on October 27, 2003 deviated from the standard of care and, if so, whether the errors or omissions in the treatment of Britteny George proximately caused her death.

B. Breach of the standard of care

As set forth in detail above, the evidence in this case shows that when Britteny appeared at Lawndale for a medical examination on the morning of October 27, 2003, she had a severe headache. In fact, the records of Britteny's visits to Mt. Sinai (PX 1) and Lawndale (PX 4) over an 18-hour period on October 26-27, 2003 described a "constant," "throbbing," "frontal" headache and establish that the headache pain was worse when Britteny bent down. Although the physician's assistant who had examined [*24] Britteny the night before at the Mt. Sinai emergency room had diagnosed the headache as a migraine, Dr. Dominguez's notes and testimony reflect her view that Britteny had a "sinus headache." Experts for both Plaintiff and Defendant opined that Britteny probably had sinusitis at the time of her examination at Lawndale, although they agree that the record does not support the conclusion that she had acute bacterial sinusitis at that time. It is undisputed that the headache had lasted for several days and persisted despite the administration of three prescribed doses of pain medication. It also is clear from the testimony and documentary record that the severity of the headache pain caused Britteny to cry throughout the October 27 examination. Finally, in addition to head pain, the examination notes from the morning of October 27 state that Britteny had boggy nasal passages and thick yellow mucus draining from her sinuses into her pharynx.

Presented with that constellation of symptoms, some of which Dr. Dominguez observed and others of which could have been known to her if she had accessed the records of Britteny's visit to Mt. Sinai Hospital the previous afternoon, Dr. Dominguez agreed [*25] with diagnosis made at Mt. Sinai the prior afternoon that Britteny was suffering from a URI and prescribed additional pain medication. Dr. Dominguez also prescribed a nasal spray called Flonase, advised Britteny to drink a mix of fluids, including soup and juice, and directed her return to the clinic if she felt worse or did not improve within ten to fourteen days.

In opening statements and through the testimony of its expert witnesses, Defendant suggested that Dr. Dominguez's diagnosis and prescribed course of treatment were consistent with the approach set forth in the AAP Guidelines. The AAP Guidelines formulate recommendations for health care providers concerning the diagnosis, evaluation, and treatment of children with "uncomplicated acute, subacute, and recurrent acute bacterial sinusitis." DX E, Tab 2, at 1 (Bielanski 0017). According to the Guidelines, a diagnosis of acute bacterial sinusitis is based on clinical criteria in children who present with upper respiratory symptoms that are either "persistent" (defined as those that last longer than 10 to 14, but less than 30, days) or "severe" (defined as including a temperature of at least 102 degrees and purulent nasal discharge [*26] present concurrently for at least 3 to 4 consecutive days in a child who seems ill). *Id.* at 3 (Bielanski 0019). Also of note, the Guidelines state that complications of acute bacterial sinusitis usually involve the orbit, the central nervous system, or both. *Id.* at 8 (Bielanski 0024). The AAP Guidelines recommend that signs of increased intracranial pressure (headache and vomiting) or nuchal rigidity require immediate CT scanning (with contrast) of the brain, orbits, and sinuses to exclude intracranial complications. *Id.* at 9 (Bielanski 0025). And while the Guidelines "promote the judicious use of antibiotics" and discourage the overuse of antibiotics (*id.* at 5 (Bielanski 0021)), they do recommend that doctors promptly and aggressively prescribe antibiotics to treat children with complications or suspected complications of acute bacterial sinusitis (*id.* at 5-6, 8-9 (Bielanski 0021-22, 0024-25)).

The Court has reviewed the testimony concerning the AAP Guidelines, as well as the Guidelines themselves. Even if the Court were to agree that Dr. Dominguez evaluated and diagnosed in a manner consistent with the recommendations set forth in the Guidelines, the Guidelines expressly state -- [*27] as the experts confirmed -- that they apply only to "uncomplicated" cases. The Guidelines further stress that they are "not intended as a sole source of guidance in the diagnosis and management of acute bacterial sinusitis in children" or "to replace clinical judgment or establish a protocol for all patients with this condition." DX E, Tab 2, at 1 (Bielanski 0017). In addition, as Dr. Bielanski confirmed, the Guidelines themselves do not establish a medical standard of care and do not specifically address children who present with an intense or very severe headache that has been refractory to pain mediation. Tr. 449-50.

On the basis of the evidence at trial and Dr. Correa's and Dr. Leavy's expert testimony, the Court concludes Britteny did not present an "uncomplicated" case on the morning of October 27. Instead, the information available to Dr. Dominguez from (i) her own observation and interaction with Britteny and her mother, (ii) the notes recorded on Britteny's chart that morning by Nurse Stipp at Lawndale, and (iii) the Mt. Sinai records from the previous evening -- which Dr. Dominguez acknowledges she probably could have accessed had she attempted to do so (Tr. 66, 110) -- reveals [*28] a number of complicating factors. Most significantly, Britteny's condition was significantly complicated by the very severe, unrelenting headache pain that had lingered for several days, had proven refractory to pain medication, and was worse when Britteny leaned forward. While Dr. Dominguez's diagnosis and course of treatment may have been appropriate for an "uncomplicated" case involving nasal drainage, the Court concludes that the standard of care required a "reasonably careful physician" to undertake a more careful assessment given the particular circumstances of Britteny's condition at the time of the October 27 examination at Lawndale. See, *e.g., Arpin v. United States, 521 F.3d 769, 774 (7th Cir. 2008)* (holding in wrongful death action under FTCA arising from alleged medical malpractice that standard of care had been breached where physicians had "a duty to conduct a competent search for the cause of a patient's symptoms, which they failed to do").

The Court concludes that, in particular, Dr. Dominguez deviated from the standard of care in failing to attempt to access the Mt. Sinai chart and in omitting to ask Britteny (or even her mother) to rate her pain on the pain scale. [*29] In so doing, Dr. Dominguez deprived herself of important clinical data that likely would have compelled a different course for Britteny's diagnosis and treatment. Most significantly, the Mt. Sinai records show that Britteny's headache pain worsened when she bent over, which Dr. Dominguez acknowledged could be significant as an indication of fluid in the sinuses. Tr. 109. The failure to gather all of the significant information that was available at the time -- which, in turn, likely contributed to Dr. Dominguez's willingness to rest on the diagnosis of URI instead of undertaking a more rigorous analysis of the etiology of Britteny's severe headache, including, at a minimum, a differential diagnosis that included sinusitis -- fell below the standard of care. See *Kasongo, 523 F. Supp. 2d at 796*. In that regard, the Court notes that not only did Dr. Correa and Dr. Leavy opine that a differential diagnosis inclusive of sinusitis was indicated by Britteny's presentation on October 27, but even Dr. Bielanski stated that after a physician learns the intensity of the patient's headache, "it's up to the physician to take other history, examine the patient and determine what the source of the [*30] headache is." Tr. 386. In addition, the expert testimony that intracranial complications of sinusitis are more common in teenagers further supports the conclusion that a "reasonably careful physician" should have at least included sinusitis on a differential diagnosis of Britteny's condition. In sum, in view of Dr. Correa's persuasive testimony that the duration and intensity of Britteny's headache pain and the presence of boggy nasal passages and yellow discharge were not consistent with a diagnosis of upper respiratory infection, and in fact reflected warning signs of sinusitis in a thirteen year old patient, the Court is persuaded that Dr. Dominguez breached the standard of care in this case.

The Court further is persuaded by the testimony of Plaintiff's experts that, given the presentation of a patient with a "frontal" "sinus" headache of several days duration that was refractory to pain medication and the other symptoms noted above, it was a breach of the standard of care not to prescribe antibiotics. The Court acknowledges the testimony and the concerns noted in the AAP Guidelines regarding the risks of overprescribing antibiotics. However, both the experts and the Guidelines [*31] agree that children with complications or even suspected complications of acute bacterial sinusitis should be treated promptly and aggressively, including with antibiotics. Although Plaintiff's experts are not willing to say that Britteny had acute bacterial sinusitis on the morning of October 27, they have shown convincingly that, at a minimum, the standard of care required (i) the inclusion of sinusitis in a differential diagnosis, (ii) further analysis of the etiology of Britteny's headaches, and (iii) the prescription of antibiotics given the warning signs of sinusitis that were present at that time.

C. Causation

The next question is whether the breaches of the standard of care proximately caused the injuries for which Plaintiff seeks damages. Proximate cause is defined as "'that cause which, in natural and continuous sequence, unbroken by any efficient intervening cause, produces the result complained of and without which the results would not have occurred." *FDIC v. Bierman, 2 F.3d 1424, 1434 (7th Cir. 1993)*. Proximate cause is not established where the causal connection between the allegedly negligent act or omission and the injury is contingent or speculative or if the injury [*32] would have occurred even in the absence of that act of omission. *Campbell v. United States, 904 F.2d 1188, 1193-94 (7th Cir. 1990)*. Rather, Plaintiff must show by a preponderance of the evidence that Defendant's failure to comply with the applicable standard of care caused or contributed to the injury giving rise to Plaintiff's cause of action. *Wise v. St. Mary's Hosp., 64 Ill. App. 3d 587, 589, 381 N.E.2d 809, 21 Ill. Dec. 482 (1st Dist. 1978)*; see also *Kasongo, 523 F. Supp. 2d at 802* (defining causation inquiry as whether "the defendant's breach of the applicable standard of care more probably than not caused [the plaintiff's] injury"). The breach of the standard of care need not be the only cause of the injury, for there can be more than one proximate cause of an injury. See *Durbin v. St. Louis Slag Prods. Co., 206 Ill. App. 3d 340, 357, 564 N.E.2d 242, 151 Ill. Dec. 265 (4th Dist. 1990)*; see also I.P.I. Civil Jury Instruction 15.01.

It appears that the experts are in agreement that an antibiotic such as Amoxicillin is very effective in treating acute bacterial sinusitis. The Court is persuaded by Dr. Correa's opinion, offered with a reasonable degree of medical certainty, that if Britteny had been prescribed an antibiotic like Amoxicillin, she would [*33] not have developed bacterial meningitis and her death on November 3 probably would have been prevented. According to Dr. Correa, the timely administration of antibiotics would have prevented the sinusitis that Britteny likely had on the morning of October 27 from developing into bacterial meningitis through the ascending infectious process noted in the autopsy results.

While Dr. Bielanski opined that antibiotics were not indicated at the time that Dr. Dominguez examined Britteny, both he and Dr. Dominguez concurred in the view that antibiotics ordinarily are appropriate in treating and effective in combating acute bacterial sinusitis. Tr. 62, 453. Dr. Bielanski, in fact, testified that none of the hundreds or thousands of patients with sinusitis whom he has treated with antibiotics has died. *Id.* at 409-10, 449. And the medical record does not support a finding that it was too late to administer antibiotics on October 27. To the contrary, as of that date, Britteny was not febrile, nor did she have any neurologic findings of bacterial meningitis.

In sum, the Court concludes that Plaintiff has sufficiently established that the breaches of the standard of care described above proximately [*34] caused Britteny's death. Therefore, the Court finds Defendant liable on Plaintiff's claim for medical negligence and wrongful death. *Kasongo, 523 F. Supp. 2d at 802* (imposing liability on the government where the Court held that "the defendant's breach of the applicable standard of care more probably than not caused [the plaintiff's] injury").

D. Damages

Damages in FTCA actions may not exceed the amount of the Plaintiff's administrative claim. See *Erxleben v. United States, 668 F.2d 268, 273 (7th Cir. 1981)*; *28 U.S.C. § 2675(b)*. In this case, the administrative claim sought $ 5,500,000.00 in damages. Plaintiff has not requested an award in excess of her administrative claim. Rather, Plaintiff seeks a total award of $ 3,500,000 under the Illinois Wrongful Death Act and an award of $ 250,000 under the Illinois Survival Act for the conscious pain and suffering endured by Britteny during her hospitalization. [2] Plaintiff requests that the total award under the Wrongful Death Act be divided among Britteny's three surviving family members -- her mother, Laura Hardnick, her father, Henry George, and her brother, Brandon George.

2 In 2005, the Illinois General Assembly enacted legislation capping [*35] noneconomic damages in malpractice cases at $ 1 million for hospitals and hospital affiliates and $ 500,000 for physicians and other health care professionals. See *Arpin, 521 F.3d at 775*; *Kasongo, 523 F. Supp. 2d at 803 n.38*. However, that law does not apply to causes of action that accrued before the effective date of the legislation -- August 25, 2005 -- and thus has no bearing on this case. In addition, a state trial court judge has invalidated the law, and the Illinois Supreme Court has heard oral argument in the appeal of the trial court's ruling. See *Lebron v. Gottlieb Mem. Hosp.,* Nos. 105741 & 105747 (consol.) (argued Nov. 13, 2008).

1. Wrongful Death Act

The purpose of the Illinois Wrongful Death Act is to compensate the parents and siblings of the deceased family member for pecuniary losses resulting from her death. See, *e.g., Elliott v. Willis, 92 Ill. 2d 530, 540, 442 N.E.2d 163, 65 Ill. Dec. 852 (1982)*. Compensable losses include loss or deprivation of support (such as money, benefits, goods, and services) and loss of society (such as companionship, guidance, advice, love, and affection). See *Bullard v. Barnes, 102 Ill. 2d 505, 514, 468 N.E.2d 1228, 82 Ill. Dec. 448 (1984)*. While the law presumes that a parent suffers a substantial pecuniary [*36] loss from the loss of a child's society (*Ballweg v. City of Springfield, 114 Ill. 2d 107, 120, 499 N.E.2d 1373, 102 Ill. Dec. 360 (1986))*, that presumption does not apply to siblings (*In re Estate of Finley, 151 Ill. 2d 95, 103, 601 N.E.2d 699, 176 Ill. Dec. 1 (1992))*.

In assessing the appropriate measure of damages, Plaintiff contends that the Court should not consider the amounts awarded in comparable cases. Instead, Plaintiff insists that under Illinois law, the Court should be guided only by the rule that a damages award cannot be so excessive as to "shock the judicial conscience." However, as a backup position, Plaintiff describes several cases in which the plaintiffs were awarded substantial damages in what she believes are factually analogous circumstances.

Defendant counters with two arguments. First, Defendant submits that controlling Seventh Circuit law clearly permits -- and even encourages -- the use of comparables in determining an award of non-economic damages. Second, Defendant contends in the alternative that the Court could award a "single-digit multiple" of the amount of compensatory damages -- which in this case essentially consist principally of the medical bills for Britteny's treatment in the week prior to her death. [3] Under either [*37] approach, Defendant contends that the sum sought by Plaintiff cannot be sustained.

3 The Court agrees with Plaintiff that the multiplier alternative suggested by Defendant does not make sense in a case involving a thirteen year old child and that any award calculated in such a fashion would undercompensate Britteny's family.

For a number of reasons, the Court concludes that Defendant has the better of the argument on the use of comparables, but that at the end of the day the most closely analogous verdicts support an award of damages closer to what Plaintiff has requested than to what Defendant contends is reasonable. To begin with, unlike in a jury trial, after a bench trial the trier of fact (the judge) "is required to explain the grounds of his decision" to comply with the dictates of *Federal Rule of Civil Procedure 52(a)*, which imposes a "duty of reasoned, articulate adjudication." *Arpin, 521 F.3d at 776*. "'This means, when the issue is the amount of damages, that the judge must indicate the reasoning process that connects the evidence to the conclusion.'" *Id.* (quoting *Jutzi-Johnson v. United States, 263 F.3d 753, 758 (7th Cir. 2001))*. When faced in *Arpin* with an instance in which [*38] the district judge did not comply with *Rule 52(a)* in explaining the basis for a damage award, the Seventh Circuit flatly stated that "[t]he judge should have considered awards in similar cases, both in Illinois and elsewhere." *Id.* In providing that guidance, the Seventh Circuit acknowledged that Illinois law "does not require or even encourage such comparisons" and that in suits under the FTCA, "the damages rules of the state whose law governs the substantive issues in the case bind the federal court." *Id.* However, the court of appeals went on to explain that "whether or not to permit comparison evidence in determining the amount of damages to award in a particular case is a matter of procedure rather than of substance, as it has no inherent tendency * * * either to increase or decrease the average damages award." *Id.* Instead, examination of "comparables" only serves "to reduce variance." *Id.* The bottom line, therefore, is that the most recent pronouncement of the Seventh Circuit strongly encourages district courts in cases like this one -- wrongful death actions under the FTCA involving alleged medical negligence -- to consider damages awards in comparable cases. See, *e.g., Kasongo, 523 F. Supp. 2d at 804, 807-12* [*39] (citing *Jutzi-Johnson* and examining comparable verdicts in determining damages in FTCA case under Illinois Wrongful Death and Illinois Survival Acts). [4]

4 The Court draws no distinction between bench and jury trials in regard to its consideration of comparable verdicts. See *Zurba v. U.S., 247 F. Supp. 2d 951, 962 (N.D. Ill. 2001)* (rejecting the government's argument that "jury verdicts should be used with great caution" in determining comparable damage awards on the grounds that (a) "the government's waiver of sovereign immunity provided by the FTCA allows only for bench trials," (b) "[t]he government has cited no authority for this proposition, nor is the Court aware of any," (c) "in *Jutzi-Johnson,* the Seventh Circuit cited several jury awards as comparable to the claim in that case," and (d) "there is no hard-and-fast rule that juries make higher awards than judges").

Both parties have submitted a number of "comparables" for the Court's consideration. Plaintiff has provided nine comparable verdicts, three of which she acknowledges involved decedents who either were significantly older (22 and 19) or younger (16 days) than Britteny. Of the six cases involving medical negligence death [*40] claims of children between the ages of 9 and 14, the average award was $ 6.0 million. If the Court were to look only at the comparables in the cases cited by Plaintiff in which damages for loss of society were awarded to parents and one sibling, the average verdict again was $ 6.0 million.

Defendant takes issue with Plaintiff's comparables, suggesting that Plaintiff has cherry-picked "record verdicts" that are not a representative cross section of damage amounts in similar cases. Defendant has submitted four "bacterial meningitis" cases, but all four ended in settlements rather than verdicts. As Plaintiff argues, and other courts have observed, settlements are "less useful than consideration of verdicts" because "[p]arties settle claims to avoid the uncertainty and expense of trial; and the amount settled for may bear little relation to the amount a jury might award upon finding a defendant liable." *Kasongo, 523 F. Supp. 2d at 804 n.39*; see also *Jutzi-Johnson, 263 F.3d at 759* (urging that the trier of fact be informed of the amounts of damages awarded in similar cases). Defendant submitted six additional wrongful death comparables, four of which ended in verdicts with awards ranging [*41] from $ 1 million to $ 4.125 million. However, as Plaintiff points out, only two of the verdicts were rendered in medical negligence cases and one of those two verdicts was subject to a statutory cap on damages of $ 1.5 million. Thus, only one of the comparables cited by Defendant involved a non-capped damages award after a verdict in a medical negligence action, and in that case the award was $ 4.125 million, of which $ 3.5 million was for loss of society.

Excluding the settlements cited in Defendant's brief, the comparable verdicts cited in the parties' briefs range from $ 1.0 million to $ 11.0 million, with the most comparable cases (example 5 in Defendant's brief and examples 8 and 9 in Plaintiff's brief) ranging from $ 3.5 to $ 6.0 million. In view of the wide range of comparables and the absence of any case directly on point -- that is, a verdict involving acute bacterial sinusitis in a teenager -- the Court concludes that Plaintiff's request for an award of $ 3.5 million in damages for loss of society is fair and reasonable, and certainly not excessive. The Court also concludes that the individual awards of $ 2.0 million for Ms. Hardnick, $ 1.0 million for Mr. George, and $ 500,000 [*42] for Brandon George likewise are fair and reasonable. In regard to Ms. Hardnick and Mr. George, the testimony showed the especially close relationship that Britteny shared with her mother and, as noted above, there is a presumption that parents suffer a substantial pecuniary loss from the loss of a child's society. See *Ballweg, 114 Ill. 2d at 120*; *In re Estate of Finley, 151 Ill. 2d at 103*. As to Brandon, notwithstanding the absence of a presumption as to siblings, it is clear from the testimony that Brandon was very close to his sister, that her death caused a great void in his life, and that he therefore is entitled to a substantial award as well.

2. Survival Act

Under the Illinois Survival Act, damages may be recovered for the decedent's conscious pain and suffering sustained until the time of her death. See *Murphy v. Martin Oil Co., 56 Ill. 2d 423, 432, 308 N.E.2d 583 (1974)*; *Kasongo, 523 F. Supp. 2d at 810*. The fact that the decedent suffered for only a short period of time before her death is not a bar to a claim under the Survival Act. See *Glover v. City of Chicago, 106 Ill. App. 3d 1066, 1072, 436 N.E.2d 623, 62 Ill. Dec. 597 (1st Dist. 1982)*; *Kasongo, 523 F. Supp. 2d at 810*. In reviewing a number of survival awards in comparable [*43] cases, the court in *Kasongo* observed "a significant variance in survival damages for pain and suffering" and a general trend "suggest[ing] that the award increases with the length of time that pain is suffered." *Id. at 812*. Plaintiff points to four cases that she contends are comparable. In those cases, the average survival award was $ 2.18 million and even excluding the largest such award, the average award was $ 1.5 million. The Court also considers the $ 1 million award of survival damages in *Kasongo, 523 F. Supp. 2d at 811-12*, a medical negligence case under the FTCA in which the plaintiff experienced pain and suffering over a twenty-four day period between the date on which her care providers first breached the standard of care and the date of her death.

Plaintiff has requested an award of $ 250,000 for Britteny's survival claim. Plaintiff stresses that she seeks compensation for Britteny's pain, suffering, and emotional distress only during the time that she was "conscious, alert and cognizant of her impending death." In consideration of the comparable survival verdicts and the specific facts of this case, the Court finds that the award requested by Plaintiff is fair and reasonable. [*44] Although Britteny's illness was relatively short and she lost consciousness a day and a half before her death, she endured repeated operations and undoubtedly did suffer considerable pain and distress from the headaches, swelling, and other physical difficulties detailed in the medical records and autopsy report. For these reasons, the Court awards Plaintiff $ 250,000 on the survival claim brought on Britteny's behalf.

III. Conclusion

As Judge Pallmeyer wrote in similar circumstances, FTCA claims involving alleged medical negligence can be "exceedingly challenging" (*Kasongo, 523 F. Supp. 2d at 812*), particularly because medicine "is not exact science" and qualified expert witnesses have presented the Court with differing views on the adequacy of the medical treatment at issue in this case. In addition, having observed Dr. Dominguez on the witness stand and listened to her testimony, the Court has no doubt that she is a dedicated professional who desires to give her patients the best possible care. However, on the basis of the evidence and the expert testimony presented at trial, the Court is persuaded that, in this instance, Dr. Dominguez's treatment of Britteny George on October 27, [*45] 2003 did not comport with the standard of care and was a proximate cause of the tragic events culminating in Britteny's death on November 3, 2003. Accordingly, the Court enters judgment for Plaintiff and against Defendant on Plaintiff's Wrongful Death and Survival Act claims and awards a total of $ 3,500,000 on the Wrongful Death claim (divided as $ 2,000,000 to Laura Hardnick, $ 1,000,000 to Henry George, Jr., and $ 500,000 to Brandon George) and further awards $ 250,000 to the Estate of Britteny George on the Survival Act claim.

Dated: June 25, 2009

/s/ Robert M. Dow, Jr.

Robert M. Dow, Jr.

United States District Judge

TAB 9

Only the Westlaw citation is currently available.

United States District Court,
C.D. California.
In re INTERNATIONAL RECTIFIER CORPORATION SECURITIES LITIGATION.
No. CV 07-02544-JFW (VBKx).

May 23, 2008.

Jacob I. Kiani, John P. Stigi, III, Kevin M. Rivera, Sheppard Mullin Richter and Hampton LLP, Los Angeles, CA, Christina Lucen Costley, Sheppard Mullin Richter and Hampton LLP, Santa Barbara, CA, for International Rectifier Corporation.

PROCEEDINGS (IN CHAMBERS): ORDER GRANTING DEFENDANT MICHAEL P. McGEE'S MOTION TO DISMISS CONSOLIDATED CLASS ACTION COMPLAINT [filed 3/6/3008; Docket No. 64];

ORDER GRANTING DEFENDANT ERIC P. LIDOW'S MOTION TO DISMISS PLAINTIFFS' CONSOLIDATED CLASS ACTION COMPLAINT [filed 3/6/3008; Docket No. 65];

ORDER GRANTING DEFENDANT ROBERT GRANT'S MOTION TO DISMISS CONSOLIDATED CLASS ACTION COMPLAINT [filed 3/6/3008; Docket No. 67];

ORDER GRANTING DEFENDANT ALEXANDER LIDOW'S MOTION TO DISMISS THE CONSOLIDATED CLASS ACTION COMPLAINT FOR VIOLATIONS OF THE FEDERAL SECURITIES LAWS [filed 3/6/2008; Docket No. 71];

ORDER GRANTING DEFENDANT INTERNATIONAL RECTIFIER CORPORATION'S MOTION TO DISMISS PLAINTIFFS' CONSOLIDATED CLASS ACTION COMPLAINT [filed 3/6/2208; Docket No. 74];

ORDER DISMISSING CONSOLIDATED CLASS ACTION COMPLAINT AGAINST DEFENDANTS IVO JUREK AND FUMIHIDE ("HUMI") ESAKA

Honorable JOHN F. WALTER, District Judge.

***1** Shannon Reilly, Courtroom Deputy.

On March 6, 2008, Defendant Michael P. McGee ("McGee") filed a Motion to Dismiss Consolidated Class Action Complaint. On March 6, 2008, Defendant Eric P. Lidow ("Eric Lidow") filed a Motion to Dismiss Plaintiffs' Consolidated Class Action Complaint. On March 6, 2008, Defendant Robert Grant ("Grant") filed a Motion to Dismiss Consolidated Class Action Complaint. On March 6, 2008, Defendant Alexander Lidow ("Alex Lidow") filed a Motion to Dismiss the Consolidated Class Action Complaint for Violations of the Federal Securities Laws. On March 6, 2008, Defendant International Rectifier Corporation ("International Rectifier") filed a Motion to Dismiss Plaintiffs' Consolidated Class Action Complaint and then an amended Motion to Dismiss Plaintiffs' Consolidated Class Action Complaint. On April 11, 2008, Lead Plaintiffs, the General Retirement System of the City of Detroit and the Massachusetts Laborers' Pension Fund filed their Opposition to Defendants' Five Motions to Dismiss Plaintiffs' Consolidated Class Action Complaint. On April 30, 2008, McGee, Grant, Alex Lidow, and International Rectifier and Eric Lidow filed Replies. Pursuant to Rule 78 of the Federal Rules of Civil Procedure and Local Rule 7-15, the Court found the matter appropriate for submission on the papers without oral argument. The matter was, therefore, removed from the Court's May 5, 2008 hearing calendar and the parties were given advance notice. After considering the moving, opposing, and reply papers, and the arguments therein, the Court rules as follows:

I. Factual and Procedural Background[FN1]

FN1. Defendants request judicial notice of (1) certain documents that defendants filed with the SEC including Form 10-Ks, DEF 14As, Form 10-Qs, Form 4s and Form 5s, (2) press releases issued by International

Rectifier, (3) historical stock price data from Yahoo! Finance; and (4) Statement of Financial Accounting Standards No. 154. Plaintiffs "generally do not oppose having the Court take judicial notice of the existence of such documents" but object to defendants' requests to the extent that defendants seek to have the Court take "judicial notice of irrelevant information or seek to have the Court take judicial notice of the truth of disputed facts so as to draw improper factual inferences in Defendants' favor." The court does not read defendants' requests as asking the court to take judicial notice of irrelevant facts or the truth of disputed facts. Rather, Plaintiffs' dispute appears to be with the arguments defendants make in reliance on certain of the submitted documents. The Court grants defendants' requests for judicial notice, and has only considered relevant information.

Plaintiff Edward R. Koller Jr. filed a class action complaint against International Rectifier and certain of its current and former officers and directors on April 17, 2007. Subsequently, plaintiff Manuel Levine filed a separate action. On May 17, 2007, the Court consolidated the two actions, and on July 23, 2007, appointed the General Retirement System of the City of Detroit and the Massachusetts Laborers' Pension Fund (collectively, "Plaintiffs") as lead plaintiffs, and appointed lead counsel. On January 14, 2008, Plaintiffs filed their Consolidated Class Action Complaint for Violations of the Federal Securities Laws ("Complaint").

Plaintiffs' Complaint alleges that International Rectifier and certain of its current and former officers and directors committed securities fraud by violating the Securities Exchange Act of 1934 ("Exchange Act"). Specifically, the Complaint alleges one claim for relief for violation of Section 10(b) and Rule 10b-5 against all defendants except Eric Lidow, and another claim for relief for violation of Section 20(a) against all defendants. The plaintiff class encompasses investors who purchased the publicly traded securities of International Rectifier between July 31, 2003 and August 29, 2007 (the "Class Period").

Plaintiffs' Complaint is primarily based on a series of disclosures by International Rectifier, acknowledging fraudulent practices at its Japan subsidiary and various accounting errors that were discovered by an independent investigation conducted at the request of the Audit Committee. As a result of these disclosures, Plaintiffs allege that, throughout the Class Period, International Rectifier issued financial statements that were materially misstated and not presented in accordance with Generally Accepted Accounting Principles ("GAAP"). They allege several different theories of fraudulent financial reporting including: (1) recognizing revenue based on fictitious purchase orders and bogus shipments of product; (2) recognizing revenue based on the sale of fictitious accounts receivables; (3) categorizing ordinary operating expenses as one-time restructuring costs; (4) transferring income from higher tax jurisdictions to lower tax jurisdictions; and (5) incorrectly recording tax benefits from the exercise of stock options as cash flow from operations rather than cash flow from financing.

A. Defendants

1. International Rectifier

***2** International Rectifier is a designer, manufacturer, and marketer of power management product devices that use power semiconductors. Complaint ¶ 1. International Rectifier has its World Headquarters in El Segundo, California, and has a number of subsidiaries located throughout the world, including North America, Europe, and Asia. Complaint ¶¶ 303-304. Its consolidated financial statements include results from the company and all of its subsidiaries. Complaint ¶ 304.

2. Alex Lidow

Defendant Alex Lidow was the Chief Executive Officer and a director of International Rectifier. Complaint ¶ 29. Plaintiffs allege that Alex Lidow signed certain of International Rectifier's alleged false and misleading SEC filings, participated in drafting and/or approved International Rectifier's alleged false and misleading press releases, met with analysts and the media, and participated in International Rectifier's conference calls with analysts and investors. Complaint ¶ 29. On August 30, 2007, Alex Lidow took a leave of absence pending resolution of the investigation into International Rectifier's accounting practices. Complaint ¶ 279. On October 2, 2007, Alex Lidow resigned "[a]t the Company's request." Complaint ¶ 286. During the Class Period, pursuant to stock trading plans, Alex Lidow sold 490,000 shares of International Rectifier stock, resulting in gross proceeds of approximately $21 million. Complaint ¶ 291.

3. McGee

Defendant McGee was the Chief Financial Officer and an Executive Vice President of International Rectifier. Complaint ¶ 30. Plaintiffs allege that McGee signed certain of International Rectifier's alleged false and misleading SEC filings, participated in drafting and/or approved International Rectifier's alleged false and misleading press releases, met with analysts and the media, and participated in International Rectifier's conference calls with analysts and investors. Complaint ¶ 30. On July 1, 2007, International Rectifier's Board of Directors terminated McGee. Complaint ¶ 275. McGee sold International Rectifier stock twice during the four year Class Period, on November 12, 2004 and August 10, 2005, resulting in gross proceeds of approximately $7.6 million. Complaint ¶¶ 291-292.

4. Grant

Defendant Grant was Executive Vice President, Global Sales and Marketing, and was "considered by [International Rectifier] to be one of its Executive Officers." Complaint ¶ 31. Grant is not alleged to have signed or made a material misrepresentation. On July 1, 2007, Grant resigned. Complaint ¶ 275. During the Class Period, pursuant to stock trading plans, Grant sold 158,636 shares of International Rectifier stock, resulting in gross proceeds of approximately $7.1 million. Complaint ¶ 291.

5. Eric Lidow

Defendant Eric Lidow is the founder of the Company, and was Chairman of the Board. Complaint ¶ 28. Eric Lidow is alleged to have signed four 10-Ks during the Class Period that contained false and misleading statements. Complaint ¶ 28. Eric Lidow is not alleged to have participated in the "fraudulent scheme" but is named only in the second claim for relief, for violation of section 20(a) of the Exchange Act. Complaint ¶ 28. During the Class Period, pursuant to stock trading plans, Eric Lidow sold 682,000 shares of International Rectifier stock, resulting in gross proceeds of approximately $28.1 million. Complaint ¶ 291.

6. Ivo Jurek

***3** Defendant Ivo Jurek ("Jurek") was Vice President, International Rectifier Automotive Products. Complaint ¶ 32. Jurek was responsible for meeting sales and margins forecasts for International Rectifier's automotive division. Complaint ¶ 32. Jurek is not alleged to have signed or made a material misrepresentation. Plaintiffs have not yet served the Complaint on Jurek who resides overseas.

7. Fumihide Esaka

Defendant Fumihide "Humi" Esaka ("Esaka") was Vice President of International Rectifier's Japan subsidiary. Complaint ¶ 33. Esaka is not alleged to have signed or made a material misrepresentation. Plaintiffs have not yet served the Complaint on Esaka who resides overseas.

B. International Rectifier's Disclosures

Plaintiffs' Complaint is based primarily on a series of disclosures by International Rectifier acknowledging fraudulent practices at its Japan subsidiary, resulting in the improper recognition of revenue, including: (1) recognizing revenue based on fictitious purchase orders and bogus shipments of product; and (2) recognizing revenue based on the sale of fictitious accounts receivables. In addition, Plaintiffs' Complaint includes allegations based on disclosures by International Rectifier acknowledging various accounting errors, apparently unrelated to the fraudulent practices at the Japan subsidiary: (1) categorizing ordinary operating expenses as one-time restructuring costs; (2) incorrectly allocating taxable income between its business units in different jurisdictions; and (3) incorrectly recording tax benefits from the exercise of stock options as cash flow from operations rather than cash flow from financing.

In its first disclosure, on May 15, 2006, International Rectifier announced that it had incorrectly recorded excess tax benefits from the exercise of stock options as operating cash flows instead of financing cash flows, and that it would restate its financial results for the first and second quarters of fiscal 2006. Complaint ¶ 102. On May 17, 2006, International Rectifier filed amended Form 10-Qs to reflect the correct classification of the excess tax benefits from stock options. Complaint ¶ 103.

Nearly a year later, beginning with an April 9, 2007 press release, International Rectifier announced that an "ongoing" independent investigation conducted at the request of the Audit Committee (the "Investigation") had found "accounting irregularities" at a foreign subsidiary, including premature revenue recognition of product sales. Complaint ¶ 266. International Rectifier announced that certain of its financial statements should not be relied upon based on the Investigation to date. Complaint ¶ 266.

About a month later, on May 11, 2007, International Rectifier filed a Form 12b-25 with the SEC, which further described the "accounting irregularities" at its foreign subsidiary, and stated:

As of the date of this filing, the investigation has found, among other things, a practice at that foreign subsidiary where from time to time certain unsubstantiated orders were entered. These orders resulted in the shipment of products and the recording of sales with no obligation by customers to receive and pay for the products. The practice included routing certain product shipments to warehouses not on the Company's logistical systems.

***4** Complaint ¶ 272. International Rectifier identified additional financial statements that should not be relied upon based on the Investigation to date. Complaint ¶ 272.

On August 31, 2007, in its most extensive description of the fraudulent practices at the foreign subsidiary (for the first time identified as the Japan subsidiary), International Rectifier filed a Form 12b-25 with the SEC stating:

The Company's Japan subsidiary circumvented established controls and processes to record false or premature sales by creating fictitious customer purchase orders in the existing control system. These orders were diverted by the customer service function when the shipments arrived in Japan at the Company's freight forwarder and then redirected to multiple third party warehouses that were not reflected on the Company's books ("off-books warehouses"). This inventory was stored in the off-books warehouses until the Japan subsidiary could either re-sell the product to another customer or when the customer, in whose name the order had been entered, placed a bona fide order for such products.... In addition, sales management entered into a number of arrangements at quarter ends with certain distributors to take excess product on verbal terms that included extended payment terms and/or an understanding that product would be taken back at the distributor's request.

Complaint ¶ 281. International Rectifier also stated that it had put "certain key Japanese management team members on administrative leave." Complaint ¶ 281.

In addition, International Rectifier's SEC filing on August 31, 2007 advised investors of two other accounting issues: (1) International Rectifier determined that certain charges associated with its restructuring initiatives should be reclassified in other line items of the income statement for fiscal 2003 to fiscal 2007; and (2) while preparing for adoption of FASB No. 48 ("Accounting for Uncertainty in Income Taxes") for the quarter ended September 30, 2007, International Rectifier "identified issues associated with its transfer pricing methodology and other tax issues for its fiscal years 2002-2007." [FN2] Complaint ¶ 281.

FN2. "Transfer pricing" refers to the method by which companies allocate taxable income among individual business units. Complaint ¶ 92.

In a November 13, 2007 SEC filing, which is the last disclosure relied on by Plaintiffs' Complaint, International Rectifier explained that it had retained an independent accounting firm to assist in the reconstruction of the Japan subsidiary's records, and that the effort was "complex". Complaint ¶ 288. International Rectifier reported that during the reconstruction of the Japan subsidiary's financial statements, it had "found that certain fictitious customer invoices were sold as part of the Japan subsidiary's accounts receivable financing facilities .... The Company plans to reflect these sales as advances against the Company's accounts receivable financing facilities and as short-term debt for the relevant periods." Complaint ¶ 288. The November 13, 2007 filing also updated investors on the restructuring and tax accounting matters. International Rectifier had determined to reclassify certain expenses from restructuring impairment to other income statement line items (i.e. $31 million of costs from consolidation of facilities would be reclassified as "cost of goods sold" and another $20 million would be reclassified in other line items). Complaint ¶ 288. In addition, International Rectifier reported that, based on analysis of its transfer pricing methodology (with the help of an independent accounting firm), International Rectifier had filed qualified amended tax returns, and paid $74 million in additional U.S. federal and state taxes. Complaint ¶ 288. It also announced that it believed it might be entitled to refunds from tax authorities in certain foreign jurisdictions and owe additional taxes in other jurisdictions. Complaint ¶ 288.

***5** On February 11, 2008, after the Plaintiffs filed their Complaint, in an SEC filing (Form NT 10-Q), International Rectifier disclosed practices within its Aerospace & Defense segment that had resulted in the early recognition of revenue including: (1) shipping product to distributors in an earlier quarter than that in which product was needed by those distributors or International Rectifier's direct customers, (2) shipping product to distributors prior to quarter-ends with a promise to accept returns of the product in a subsequent quarter, and (3) providing product originally ordered by direct customers to distributors prior to quarter-ends and subsequently reacquiring these products with the payment of fees to the distributors. Plaintiffs request judicial notice of this document. As the allegations in the Complaint neither refers to such a document or necessarily relies on it, the Court has only considered the Form NT 10-Q in determining if leave to amend is warranted. *See In re Calpine Corp. Sec. Litig.,* 288 F.Supp.2d 1054, 1076 (N.D.Cal.2003) ("The Court is aware of no authority that allows a plaintiff to request judicial notice of a document filed after the filing of the complaint to which the document allegedly pertains, at least where no set of allegations in the complaint either refers to such a document or necessarily relies on it.").

C. Defendants' Alleged Misrepresentations and Omissions

Based on International Rectifier's public disclosures, Plaintiffs allege that throughout the Class Period defendants made actionable misleading statements regarding (1) the accuracy of International Rectifier's financial results including its revenues, earnings, cash levels, gross margins, and income; (2) International Rectifier's compliance with GAAP; (3) the quality of International Rectifier's internal controls; and (4) International Rectifier's tax liabilities. The alleged misrepresentations and omissions (spanning nearly 100 pages of the Complaint) are contained in International Rectifier's SEC filings (10-Ks, 10-Qs, 8-Ks), press releases, and conference calls with investors and analysts. *See* Complaint ¶¶ 110-265.

D. Defendants' Alleged Knowledge of the Fraudulent Practices and Accounting Errors Based on the Accounts of Confidential Witnesses

Plaintiffs, relying on Confidential Witnesses ("CWs") [FN3], allege that defendants knew, or were deliberately reckless in not knowing, of the fraudulent practices at the Japan subsidiary and the various accounting errors.

> FN3. Plaintiffs' Complaint relies on 16 Confidential Witnesses, and defendants argue that the Court should disregard or discount their allegations. For the most part, Plaintiffs have described the witnesses "with sufficient particularity to support the probability that a person in the position occupied by the source would possess the information alleged and the complaint contains adequate corroborating details." *In re Daou Sys., Inc.,* 411 F.3d 1006, 1015 (9th Cir.2005) (internal quotations and citations omitted). As in *Daou,* Plaintiffs have numbered each witness, described his or her job description and responsibilities, and in most instances provided the witness's exact title and to which International Rectifier executive the witness reported. *Id.* at 1016. Except where noted in the Discussion section *infra,* the Court will consider the allegations of those Confidential Witnesses relevant to the disposition of the Motions to Dismiss.

1. Fraudulent Practices at the Japan Subsidiary (Creating Fictitious Purchase Orders, Bogus Shipments of Product, and the Sale of Fictitious Accounts Receivable)

a. Allegations with respect to Alex Lidow and

McGee

Plaintiffs allege that Alex Lidow and McGee knew, or were deliberately reckless in not knowing, of the fraudulent practices at the Japan subsidiary, based on their review of revenue information on International Rectifier's internal database system called Vision. Complaint ¶ 53. Vision provided a detailed analysis of International Rectifier's customer orders including: (1) a global sales forecast; (2) sales forecasts for each subsidiary; (3) production forecasts; (4) actual production data; (5) inventory levels, (6) shipments; (7) early shipments; and (8) customer orders. Complaint ¶ 52. Relying on CW1 and CW3, Plaintiffs allege that shipments made either prematurely or without a purchase order would appear on the Vision system as shipments without a corresponding customer order, and that Alex Lidow and McGee utilized the Vision system to review revenue information on, at least, a daily basis and more often at the end of quarters. Complaint ¶ 52-53. Alex Lidow and McGee also "received daily reports with revenue information from the current day." Complaint ¶ 53.

***6** In addition, Plaintiffs allege that Mark Larson, one of International Rectifier's internal auditors, was laid off "shortly" after he started investigating suspicious activities in Japan and the activities of McGee. Complaint ¶ 109. During an audit of International Rectifier's Japan subsidiary, "certain activities came to light that Larson wanted to investigate." Complaint ¶ 109. However, Larson was instructed to discontinue his investigation and was not allowed to go to Japan. Complaint ¶ 109. These allegations with respect to Larson rely entirely on the account of CW8, a senior accountant who worked in the fixed assets unit of International Rectifier for two years before being laid off in 2006. Complaint ¶ 109.

b. Allegations with respect to Jurek, Grant, and Esaka

Plaintiff allege that Jurek, Grant, and Esaka knew, or were deliberately reckless in not knowing, of the fraudulent practices at the Japan subsidiary. Jurek allegedly told CW1 that Jurek, Grant, and Esaka authorized the bogus shipments of product, in order to meet sales forecasts and profit margins. Complaint ¶ 49. At the end of fiscal quarters pursuant to Jurek, Grant, and Esaka's authorization, product was loaded on to tractor trailers as if it was being shipped to a customer when, in fact, Jurek, Grant, and Esaka knew that product would remain on the trailers in International Rectifier's parking lot or would be sent to a warehouse to be stored until a real customer placed a real order for the product. Complaint ¶ 49.

In addition, relying on the account of CW4, Plaintiffs allege that Esaka and the Japan subsidiary had a close relationship with the management of Kaga and Maruben, distributors of International Rectifier. Complaint ¶ 56. At the end of quarters, Kaga and Maruben would regularly agree to accept product that they had no intention of keeping and would later return to International Rectifier. Complaint ¶ 56. Then, at the beginning of the next quarter, International Rectifier would create a return materials authorization that allowed Kaga and Maruben to return the previously shipped product. Complaint ¶ 56.

In addition, Plaintiffs allege that International Rectifier's Japan subsidiary was always behind its forecasted numbers, an issue which CW4 constantly raised in emails to Grant and Esaka. Complaint ¶ 55. However, at the end of quarters, the Japan subsidiary would regularly make its forecasts. Complaint ¶ 55. Plaintiffs further allege, relying on CW5, that Esaka informed Grant in several conference calls that the Japan subsidiary was not going to make its earning forecasts. Complaint ¶ 59. CW5 recalls that in these instances Grant told Esaka to go to his customers and ask them for permission to ship product earmarked for the next quarter early, and that Esaka informed Grant that he had already made such requests. Complaint ¶ 59. In such instances, Grant would tell Esaka that he had to meet forecasts, and would basically state "you have to figure out a way to do it but I do not want to know how you do it." Complaint ¶ 59.

***7** Plaintiffs also allege, relying on CW5, that pulling in orders from future quarters to meet current quarter financial forecasts was not limited to the Japan subsidiary, and oftentimes, sales representatives extended payment terms for customers willing to accept such payment terms. Complaint ¶ 60. This practice was allegedly well known to Grant because it was discussed during internal conference calls in which he was a participant. Complaint ¶ 60.

c. Allegations not specific to any defendant

Relying on CW6 and CW7, Plaintiffs allege that the

Japan subsidiary often booked very large and unexpected orders at the end of quarters that enabled it to make its forecasted numbers. Complaint ¶¶ 61-62. The Japan subsidiary, according to CW6, extended letters of credit to its customers to fund purchases of International Rectifier product. The Japan subsidiary thus could record sales in one quarter, but defer the customer's obligation to pay for the product for 3-4 months. Complaint ¶ 63.

In addition, relying on CW1, Plaintiffs allege that it was a poorly kept secret within the company that International Rectifier made false shipments, and that it was a company-wide practice not limited to the Japan subsidiary. Complaint ¶ 51. According to CW1, this practice occurred at International Rectifier's Tijuana facility and that employees joked that, when International Rectifier met financial forecasts at the end of financial quarters, it was because the "parking lot was full of trailers." Complaint ¶ 51.

Based on CW4's account, Plaintiffs also allege that International Rectifier, not just the Japan subsidiary, would "ship like crazy" at the end of quarters to meet public forecasts by pulling in orders from future quarters (commonly referred to as "channel stuffing"). Complaint ¶ 57. International Rectifier would send these shipments to locations in Mexico or China that would hold the order for a few days so that it would not hit the customer's stock until the first or second day of the next quarter. Complaint ¶ 57. Francisco Dubuitron, former Vice President of Logistics was in charge of these logistics. Complaint ¶ 57.

2. Categorizing Ordinary Operating Expenses as One-Time Restructuring Costs

Plaintiffs allege, relying solely on CW1, that Jurek regularly "scrutinized" and "manipulated" the numbers for the automotive division by reclassifying operating expenses as restructuring costs. Complaint ¶ 88. Jurek did this to decrease the operating expense line item for the automotive division in order to increase profit margins for the division. Complaint ¶ 88. Jurek received bonuses based upon the revenues and profit margins of the automotive division. Complaint ¶ 89. Aside from Jurek, the Complaint makes no specific allegations regarding other defendants' knowledge of this alleged practice.

3. Transferring Income from Higher Tax Jurisdictions to Lower Tax Jurisdictions

***8** Based on the account of CW3, Plaintiffs allege that International Rectifier pays taxes in various jurisdictions/countries based upon the amount of profit allocated to the International Rectifier manufacturing entity versus the International Rectifier selling entity. Complaint ¶ 99. International Rectifier's headquarters provided a matrix to International Rectifier's various business units that allocated profits between International Rectifier's various manufacturing and selling entities for International Rectifier's different products. Complaint ¶ 100. The matrix was compiled by McGee and the Vice President of Tax, Chip Morgan, and determining the proper allocation of profit was their responsibility. Complaint ¶ 100. Aside from McGee, the Complaint makes no specific allegations regarding other defendants' knowledge of the incorrect allocation of taxable income between International Rectifier's business entities.

4. Incorrectly Recording Tax Benefits from the Exercise of Stock Options as Cash Flow from Operations Rather than Cash Flow from Financing

The Complaint makes no specific allegations regarding any individual defendants' knowledge of this alleged practice or error.

E. Defendants' Motions to Dismiss

In the five Motions to Dismiss,[FN4] defendants argue in relevant part that Plaintiffs' Section 10(b) claim should be dismissed because: (1) Grant did not make a material misrepresentation or omission; (2) Plaintiffs have not adequately pled scienter; and (3) Plaintiffs have not adequately pled loss causation. Defendants argue that Plaintiffs' Section 20(a) claim should be dismissed because: (1) Plaintiffs have not pled a primary violation under Section 10(b); and (2) Plaintiffs have not adequately pled that the defendants exercised the requisite control.

FN4. Defendants Jurek and Esaka have not been served, and have not filed Motions to Dismiss.

Defendant International Rectifier also argues that Plaintiffs' Complaint should be dismissed because Plaintiffs "lack authority to assert claims based upon the expanded class period." [FN5]

FN5. The initial complaint filed with this Court, and the notice published to investors to select the lead plaintiff, specified that the relevant class period encompassed investors who purchased International Rectifier's publicly traded securities between October 27, 2005 through April 9, 2007. The Complaint filed on January 14, 2008 extended that original class period by approximately 32 months, to encompass investors who purchased International Rectifier's publicly traded securities between July 31, 2003 and August 29, 2007.

II. Legal Standard

Federal Rule of Civil Procedure 9(b) and the Private Securities Litigation Reform Act ("PSLRA") govern the pleading requirements for claims under 15 U.S.C. § 78j(b) and 17 C.F.R. § 240.10b-5. *See Yourish v. California Amplifier,* 191 F.3d 983, 993 (9th Cir.1999); *Cooper v. Pickett,* 137 F.3d 616, 628 n. 2 (9th Cir.1997); *see also* William W. Schwarzer, A. Wallace Tashima, & James M. Wagstaffe, California Practice Guide, *Federal Civil Procedure Before Trial* § 8:45.10.

Rule 9(b) provides: "In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity." Fed.R.Civ.P. 9(b). The heightened pleading requirements of Rule 9(b) are designed "to give defendants notice of the particular misconduct which is alleged to constitute the fraud charged so that they can defend against the charge and not just deny that they have done anything wrong." *Neubronner v. Milken,* 6 F.3d 666, 671 (9th Cir.1993). In order to provide this required notice, "the complaint must specify such facts as the times, dates, places, benefits received, and other details of the alleged fraudulent activity." *Id.* at 672. Further, "a pleader must identify the individual who made the alleged representation and the content of the alleged representation." *Glen Holly Entertainment, Inc. v. Tektronix, Inc.,* 100 F.Supp.2d 1086, 1094 (C.D.Cal.1999).

***9** The PSLRA requires a heightened pleading standard for allegations regarding misleading statements and omissions that is similar to the heightened pleading standard required by Rule 9(b). "The purpose of this heightened pleading requirement was ... to put an end to the practice of pleading 'fraud by hindsight.' " *In re Vantive Corp. Sec. Litig.,* 283 F.3d 1079, 1084-85 (9th Cir.2002) (quoting *In re Silicon Graphics Inc. Sec. Litig.,* 183 F.3d 970, 988 (9th Cir.1999)). The PSLRA specifically provides:

> [T]he 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).

In addition, the PSLRA requires a heightened pleading standard for 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); *see also Silicon Graphics,* 183 F.3d at 974 ("We hold that a private securities plaintiff proceeding under the PSLRA must plead, in great detail, facts that constitute strong circumstantial evidence of deliberately reckless or conscious misconduct"). "To allege a 'strong inference of deliberate recklessness,' [Plaintiffs] 'must state facts that come closer to demonstrating intent, as opposed to mere motive and opportunity.' " *DSAM Global Value Fund v. Altris Software, Inc.,* 288 F.3d 385, 389 (9th Cir.2002) (quoting *Silicon Graphics,* 183 F.3d at 974). "[R]ecklessness only satisfies scienter under § 10(b) to the extent it reflects some degree of intentional or knowing misconduct." *Silicon Graphics,* 183 F.3d at 976-77.

III. Discussion

A. Violation of Section 10(b) and Rule 10b-5

Section 10(b) makes it unlawful:

> [t]o 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 ... 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(b). Rule 10b-5 makes it unlawful for any person to use interstate commerce:

(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 statements 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.

***10** 17 C.F.R. § 240.10b-5. In a typical section 10(b) or Rule 10b-5 private action, a plaintiff must prove: (1) a material misrepresentation or omission, (2) scienter, (3) a connection with the purchase or sale of a security, (4) reliance, (5) economic loss, and (6) loss causation. *Dura Pharmaceuticals, Inc. v. Broudo,* 544 U.S. 336, 125 S.Ct. 1627, 161 L.Ed.2d 577 (2005); *Stoneridge Investment Partners, LLC. v. Scientific-Atlanta, Inc.,* --- U.S. ----, ----, 128 S.Ct. 761, 768, 169 L.Ed.2d 627 (2008).

1. Plaintiffs fail to plead that Grant, Esaka, or Jurek have made a material misrepresentation or omission.

Generally, only those defendants who actually make a false or misleading statement will be liable under section 10(b) or Rule 10b-5. *See In re Hansen Natural Corp. Sec. Litig.,* 527 F.Supp.2d 1142, 1153 n. 3 (C.D.Cal.2007). “The Ninth Circuit has interpreted this limitation to mean that an individual may become a primary violator through ‘substantial participation or intricate involvement in the preparation of fraudulent statements' even if he did not actually make the statements.” *Communications Workers of America Plan for Employees' Pensions and Death Benefits v. CSK Auto Corp.,* 2007 WL 951968, at *3 (D.Ariz. Mar.28, 2007) (quoting *Howard v. Everex Sys., Inc.,* 228 F.3d 1057, 1061 n. 5 (9th Cir.2000)). Thus, courts have dismissed defendants who did not actually make a false or misleading statement or who did not substantially participate or who were not intricately involved in the preparation of the fraudulent statements. *See, e.g., Communications Workers of America Plan for Employees' Pensions and Death Benefits,* 2007 WL 951968 at *3 (dismissing President and Chief Operating Officer because the allegations were not sufficient to show he substantially participated or was intricately involved in preparing the misrepresentations); *In re Cylink Sec. Litig.,* 178 F.Supp.2d 1077, 1081 (N.D.Cal.2001) (dismissing the former Vice President of Sales and Marketing, because he did not sign the financial statements, and he was not alleged to have substantially participated or been intricately involved in preparing the statements); *accord In re Metawave Communications Corp. Sec. Litig. .,* 298 F.Supp.2d 1056, 1088 (W.D.Wash.2003) (sales executive who allegedly authorized the return of product despite knowing that the transactions were being improperly booked as actual sales liable only for the single alleged misstatement he actually made and not other alleged misstatements).

Recently, in *Stoneridge Investment Partners, LLC v. Scientific-Atlantic, Inc.,* the Supreme Court cautioned that conduct itself can be deceptive, and that a specific oral or written statement is not necessarily required to be liable under section 10(b) or Rule 10b-5. --- U.S. ----, ----, 128 S.Ct. 761, 769, 169 L.Ed.2d 627 (2008). The Supreme Court did not elaborate on the type of deceptive conduct required, but found that the deceptive conduct at issue did not have the requisite proximate relation to the investors' harm to satisfy the reliance requirement, stating:

> ***11** In effect petitioner contends that in an efficient market investors rely not only upon the public statements relating to a security but also upon the transactions those statements reflect. Were this concept of reliance to be adopted, the implied cause of action would reach the whole marketplace in which the issuing company does business; and there is no authority for this rule.

Id. at 770. The Supreme Court also admonished that “the § 10(b) private right should not be extended beyond its present boundaries.” *Id.* at 773.

Accordingly, courts since *Stoneridge* have continued to dismiss actors (including insiders) who have not made any misleading statements, either explicitly or implicitly because plaintiffs could not prove reliance on their actions. *See, e.g., In re Dura Pharmaceuticals, Inc. Sec. Litig.,* 2008 WL 483613, at *11 (S.D.Cal. Feb.20, 2008) (dismissing the Senior Vice President of Sales & Marketing in part because he did not make any materially false statements); *Katz v. Image Innovations Holdings, Inc.,* 2008 WL 762105, at *2-3 (S.D.N.Y. Mar.24, 2008) (dismissing claims against certain insider defendants, where the Amended Complaint failed to particularize any material misstatements or omissions by these defendants, and failed to explain how the alleged actions of these defendants were relied upon by purchasers of the company's stock).

In the almost 100 pages of the Complaint specifying the misrepresentations and omissions at issue, not a single misrepresentation or omission is attributed to Grant, Esaka, or Jurek. There are also no allegations that Grant, Esaka, or Jurek substantially participated or were intricately involved in the preparation of the fraudulent statements. More importantly, Plaintiffs do not explain how the alleged actions of these defendants were relied upon by the purchasers of the company's stock but instead rely on the "fraud-on-the-market" theory of reliance. This presumption of reliance is unavailable where Grant, Esaka, and Jurek's alleged deceptive acts were not communicated to the public, even if the statements that International Rectifier released to the public were "a natural and expected consequence" of defendants' alleged deceptive acts. *See Stoneridge,* 128 S.Ct. at 769-70.

Plaintiffs argue, based upon a Fifth Circuit opinion, that Grant (and Esaka, and Jurek) can be held liable under 10(b) and 10b-5 because they "furnished" information causing International Rectifier to issue false or misleading statements. *See Southland Sec. Corp. v. Inspire Insurance Solutions Inc.,* 365 F.3d 353 (5th Cir.2004). Besides the fact that this alleged test has not been adopted by the Ninth Circuit, Plaintiffs misstate the holding of *Southland.* The Fifth Circuit held that a corporation's *scienter* can be established by the scienter of an employee who furnishes information upon which the false or misleading statement relies.[FN6] *Id.* at 366. However, in determining if a misrepresentation could be attributed to an individual employee under Section 10(b), the Fifth Circuit stated:

> FN6. Moreover, district courts within the Ninth Circuit have rejected this form of collective scienter for the corporation. See discussion *infra.*

> ***12** [C]orporate documents that have no stated author or statements not attributed to any individual may be charged to one or more corporate officers provided specific factual allegations link the individual to the statement at issue. Such specific facts tying a corporate officer to a statement would include a signature on the document or particular factual allegations explaining the individual's involvement in the formulation of either the entire document, or that specific portion of the document, containing the statement.

Id. at 365.

Plaintiffs also attempt to rely on a single unpublished order from the Southern District of California, that declined to dismiss a Section 10(b) claim against two individuals who allegedly participated in a fraudulent scheme but did not make public misstatements. *See In re Petco Animal Supplies, Inc. Sec. Litig.,* No. 05-CV-0823-H (RBB), Order at 23 (S.D.Cal. July 31, 2006). Not only does the order fail to cite to any authority for its position, it conflicts with multiple cases within the Ninth Circuit.

As a last resort, Plaintiffs try to avail themselves of the group pleading doctrine,[FN7] but as this Court previously held, the group pleading doctrine did not survive the PSLRA. *In re Hansen Natural Corporation Sec. Litig.,* 527 F.Supp.2d 1142, 1153-1165 (C.D.Cal.2007).

> FN7. The group pleading doctrine allowed a presumption that false and misleading information disseminated through documents were made by the collective action of the corporation's officers. *In re GlenFed, Inc.,* 60 F.3d 591, 593 (9th Cir.1995).

Accordingly, Grant's Motion to Dismiss the Section 10(a) and Rule 10b-5 claim alleged against him is **GRANTED.**[FN8] Although Esaka and Jurek have not moved to dismiss the claims for relief against them, the Court "may properly on its own motion dismiss an action as to defendants who have not moved to dismiss where such defendants are in a position similar to that of moving defendants or where claims against such defendants are integrally related."

Silverton v. Department of Treasury, 644 F.2d 1341, 1345 (9th Cir.1981). *See also Finley v. Hartford Life & Acc. Ins. Co.,* 2008 WL 753911, at *1 (N.D.Cal. Mar.19, 2008). As discussed, like moving defendant Grant, neither Esaka nor Jurek are alleged to have made a material misrepresentation or omission, nor are they alleged to have substantially participated or been intricately involved in the preparation of the fraudulent statements. Accordingly, the Court **DISMISSES without prejudice** the 10(b) and 10b-5 claims alleged against Esaka and Jurek.

FN8. In a single footnote, Plaintiffs summarily argue that even if Grant did not make any of the misleading statements, Grant is liable for illegally selling $7.1 million of International Rectifier stock, while in possession of material, non-public information about International Rectifier. Plaintiffs' Complaint is clearly not based on a claim for insider trading under Section 10(b), and even disavows reliance on insider trading to establish scienter. Complaint ¶ 292.

2. Plaintiffs fail to plead scienter adequately against Alex Lidow and McGee.

Plaintiffs allege, and defendants do not dispute that, the vast majority of the alleged misleading representations or omissions were made by Alex Lidow and McGee. However, to survive a motion to dismiss, Plaintiffs must also "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 "required state of mind" is "scienter," i.e., "a mental state embracing intent to deceive, manipulate, or defraud." *Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 193 n. 12, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976); *In re Silicon Graphics Inc. Sec. Litig.,* 183 F.3d 970, 975 (9th Cir.1999). Plaintiffs must plead "at a minimum, particular facts giving rise to a strong inference of deliberate or conscious recklessness." *Silicon Graphics,* 183 F.3d at 979. To satisfy this pleading requirement, "the complaint must contain allegations of specific contemporaneous statements or conditions that demonstrate the defendants knew or were deliberately reckless of the false or misleading nature of the statements when made." *Ronconi v. Larkin,* 253 F.3d 423, 432 (9th Cir.2001). In addition, the Supreme Court recently described the appropriate method for determining if the "strong inference" requirement for alleging scienter had been met:

> ***13** It does not suffice that a reasonable factfinder plausibly could infer from the complaint's allegations the requisite state of mind. Rather, to determine whether a complaint's scienter allegations can survive threshold inspection for sufficiency, a court governed by § 21 D(b)(2) must engage in a comparative evaluation; it must consider, not only inferences urged by the plaintiff, ... but also competing inferences rationally drawn from the facts alleged. An inference of fraudulent intent may be plausible, yet less cogent than other, nonculpable explanations for the defendant's conduct. To qualify as "strong" within the intendment of § 21 D(b)(2), we hold, an inference of scienter must be more than merely plausible or reasonable-it must be cogent and at least as compelling as any opposing inference of nonfraudulent intent.

Tellabs, Inc. v. Makor Issues & Rights, Ltd., --- U.S. ----, ---- - ----, 127 S.Ct. 2499, 2504-2505, 168 L.Ed.2d 179 (2007). In deciding if scienter has been adequately pled, "[t]he inquiry ... is whether all of the facts alleged, taken collectively, give rise to a strong inference of scienter, not whether any individual allegation, scrutinized in isolation, meets that standard." *Id.* at 2509.

Plaintiffs allege that they have met the heightened pleading requirement under the PSLRA for scienter for Alex Lidow and McGee based on in relevant part: [FN9] (1) the number, extent, and nature of the GAAP violations and the magnitude of the impending restatement; (2) alleged knowledge of contrary facts obtained from internal reports; (3) the dismissal of an employee who sought to investigate the wrongdoing at the Japan subsidiary; (4) the resignation of Alex Lidow and the termination of McGee; (5) corroboration of the fraud by confidential witnesses; (6) SOX certifications; and (7) insider stock sales and the receipt of incentive bonuses.

FN9. In arguing that they have met the heightened pleading standard for scienter, Plaintiffs lump all of the defendants and all of the alleged fraudulent practices and accounting errors together. The Court has sifted through the allegations, and addresses only those that apply to Alex Lidow and

McGee. In addition, Plaintiffs appear to concede that they cannot establish McGee's scienter as to "transferring income from higher tax jurisdictions to lower tax jurisdictions," as Plaintiffs' Opposition makes no specific argument regarding McGee's scienter as to this accounting error (aside from the nature and magnitude of the GAAP violation, which by itself is an insufficient basis to infer scienter). Their Complaint alleges, according to CW3, that McGee (and Vice President of Tax, Chip Morgan) compiled the matrix that allocated profits between International Rectifier's various manufacturing and selling entities for International Rectifier's different products. Complaint ¶ 100. Nothing in CW3's account suggests, however, that McGee possessed any contemporaneous information that the matrix was flawed in any way, or that McGee knew of any errors in International Rectifier's tax accounting or reporting. Besides this single allegation, the Complaint provides no other allegations of scienter regarding this particular accounting error.

a. The number, extent, and nature of the GAAP violations and the magnitude of the impending restatement do not give rise to a strong inference of scienter.

GAAP violations, by themselves, are an insufficient basis to infer scienter. *See, e.g., In re Cornerstone Propane Partners, L.P. Sec. Litig.,* 355 F.Supp.2d 1069, 1091 (N.D.Cal.2005) ("The majority of circuits have clearly held that standing alone, allegations of violations of GAAP or SEC regulations do not establish scienter."); *DSAM Global Value Fund v. Altris Software, Inc.,* 288 F.3d 385, 390 (9th Cir.2002) ("[T]he mere publication of inaccurate accounting figures, or a failure to follow GAAP, without more, does not establish scienter.").

Such violations, even significant ones or ones requiring large or multiple restatements,[FN10] must be augmented by other specific allegations that defendants possessed the requisite mental state. *See In re U.S. Aggregates, Inc. Sec. Litig.,* 235 F.Supp.2d 1063, 1073 (N.D.Cal.2002) ("[T]hese cases found an inference of scienter not only from the magnitude of the restatement but also from additional, specific allegations that the defendants had actual knowledge of relevant facts from which scienter could be inferred."); *In re Cornerstone Propane Partners, L.P. Sec. Litig.,* 355 F.Supp.2d at 1091 ("Allegations of GAAP violations thus provide some measure of support for the present plaintiffs' ultimate allegation of scienter, but they must be underpinned by other particularized allegations that defendants possessed the requisite mental state."); *Wojtunik v. Kealy,* 394 F.Supp.2d 1149, 1167 (D.Ariz.2005) (in considering GAAP violations, finding allegations of scienter sufficient against defendants who "personally directed" company officials to fraudulently book a bogus sale, but finding them insufficient against certain defendants "given the lack of specific allegations about those defendants' personal involvement"). *Cf. In re Daou Systems, Inc.,* 411 F.3d 1006, 1023 (9th Cir.2005) (partially relying on specific allegations that defendant executives actually directed the improper revenue recognition in violation of GAAP as evidence of scienter).

FN10. Although International Rectifier has yet to restate, Plaintiffs argue that it is clear from International Rectifier's admissions to date that the GAAP violations are significant and pervasive, and will require large restatements.

***14** Plaintiffs also argue that the nature of the GAAP violations "strongly suggests" scienter on the part of the defendants. Plaintiffs' argument appears to be based on two grounds: (1) the admission of misconduct at the Japan subsidiary supports an inference of scienter; or (2) the accounting was so basic and simple that defendants could not have made an innocent mistake. While the admission of misconduct at the Japan subsidiary suggests wrongdoing or scienter on the part of *somebody,* without specific allegations connecting such misconduct to Alex Lidow or McGee, it cannot support any inference of scienter as to Alex Lidow or McGee. As to the other alleged accounting errors, Plaintiffs have provided no reasonable basis for the Court to conclude that the accounting was so simple or basic that defendants could not have made an innocent mistake. *See In re Hypercom Corp. Sec. Litig.,* 2006 WL 726791, at *5 (D.Ariz. Mar.9, 2006) ("[E]ven assuming that establishing the obviousness of a GAAP error could in fact establish a strong inference of scienter, Plaintiffs have not alleged sufficient facts to make such a showing.”).

Accordingly, Plaintiffs must provide “additional, specific allegations that the defendants had actual knowledge of relevant facts from which scienter could be inferred.” *In re U.S. Aggregates, Inc. Sec. Litig.* 235 F.Supp.2d at 1073.

b. Alex Lidow's and McGee's review of internal reports and data does not give rise to a strong inference of scienter.

Plaintiffs attempt to establish scienter by demonstrating that Alex Lidow and McGee possessed specific contemporaneous reports or data, which contradict their challenged statements. *See Nursing Home Pension Fund, Local 144 v. Oracle Corp.,* 380 F.3d 1226, 1230-31 (9th Cir.2004). In order to rely on such reports or data, Plaintiffs must include adequate corroborating details such as an adequate description of their contents, the sources of their information with respect to the reports or data, how they learned of the reports or data, who drafted them, or which officers received them. *See In re Silicon Graphics Inc. Sec. Litig.,* 183 F.3d 970, 985 (9th Cir.1999); *In re Vantive Corp. Sec. Litig.,* 283 F.3d 1079, 1087-88 (9th Cir.2002).

Here, Plaintiffs' allegations with respect to internal reports primarily rest on Alex Lidow's and McGee's daily review of revenue information on the Vision system.[FN11] According to CW1, shipments made either prematurely or without a purchase order would appear on the Vision system as shipments without a corresponding customer order. Complaint ¶ 52.

FN11. Plaintiffs also allege that Alex Lidow and McGee “received daily reports with revenue information from the current day.” Complaint ¶ 53. As Plaintiff do not provide any other details regarding these daily reports, they have not provided adequate corroborating details, e.g., an adequate description of their contents. *In re Vantive Corp. Sec. Litig.,* 283 F.3d 1079, 1087-88 (9th Cir.2002).

However, according to Plaintiffs' allegations, the Vision system was a repository of detailed global information regarding International Rectifier's customer orders including: (1) a global sales forecast; (2) sales forecasts for each subsidiary; (3) production forecasts; (4) actual production data; (5) inventory levels, (6) shipments; (7) early shipments; and (8) customer orders. Complaint ¶¶ 52. Plaintiffs simply allege that Alex Lidow and McGee reviewed “revenue information” on the Vision system, but do not identify specific reports or data that Alex Lidow and McGee reviewed, and do not allege any basis for the Court to conclude that Alex Lidow as CEO or McGee as CFO reviewed line item purchase order and shipping data. *See Lipton v. Pathogenesis Corp.,* 284 F.3d 1027, 1036 (9th Cir.2002) (“Plaintiffs do not mention a specific IMS document relied on by defendants such as a particular IMS report, graph or chart.”). “[M]ere access to data is insufficient to support a securities claim under the PSLRA.” *In re Apple Computer, Inc., Sec. Litig.,* 243 F.Supp.2d 1012, 1023 (N.D.Cal.2002).[FN12]

FN12. The Ninth Circuit decision in *Nursing Home Pension Fund, Local 144 v. Oracle Corp.,* 380 F.3d 1226 (9th Cir.2004) is inapposite. The Ninth Circuit found support for a strong inference of scienter where top executives admitted to monitoring sales data in a global database, *and* Plaintiffs had hard numbers and made specific allegations regarding “large” portions of Oracle's sales data. *Id.* at 1231. There, it is more likely that the top executive defendants reviewed the alleged data (and were aware of the significance of such data).

***15** More importantly, even if Alex Lidow and McGee had reviewed reports with line item purchase order and shipping data, it does not give rise to a strong inference of scienter. There is no basis for presuming that Alex Lidow and McGee should have noticed an intermittent data entry omission for a single subsidiary, or that if they did, they should have been aware of the significance of such a data entry omission. At most, this gives rise to an inference of negligence.

c. The dismissal of an employee who sought to investigate the wrongdoing at the Japan subsidiary does not give rise to a strong inference of scienter.

Plaintiffs contend in their Opposition that defendants' scienter is further evidenced by “the fact that the

Company terminated the employment of an internal auditor ... who sought to investigate suspicious activities at the Japan subsidiary and Defendant McGee's role therein."

Plaintiffs rely solely on the alleged comments of CW8, a senior accountant who was laid off after brief employment with International Rectifier. Complaint ¶ 107. According to CW8, Mark Larson, one of International Rectifier's internal auditors, was laid off "shortly" after he started investigating suspicious "activities" in Japan and the "activities" of McGee. During an audit of International Rectifier's Japan subsidiary, "certain activities came to light that Larson wanted to investigate." Larson was instructed to discontinue his investigation and was not allowed to go to Japan. Complaint ¶ 109. The Complaint does not specify when this investigation took place, what "activities" came to light, who instructed Larson to discontinue his investigation, who prevented Larson from traveling to Japan, who laid Larson off, or the proximity of Larson's lay off to the commencement of his investigation.

Although Plaintiffs claim that these vague allegations demonstrate scienter of "defendants," Plaintiffs make no attempt to connect these allegations to anyone other than McGee. Moreover, the connection to McGee is tenuous at best. Plaintiffs do not allege that McGee was aware of Larson's investigation or that he had any role whatsoever in his departure. Plaintiffs' Opposition itself highlights the weakness of these allegations: "McGee's *possible* role in [halting the investigation] is further evidence of scienter." Opposition at 32:8 (emphasis added).

This sheer speculation based on a vague allegation by a confidential witness provides minimal support for an inference of scienter as to Alex Lidow or McGee, given the stringent pleading requirements of the PSLRA.

d. The resignation of Alex Lidow and the termination of McGee do not give rise to a strong inference of scienter.

Plaintiffs argue that Alex Lidow's leave of absence "at the Company's request" and his subsequent resignation support a strong inference of scienter. Likewise, Plaintiffs argue that McGee's termination supports a strong inference of scienter. However, when International Rectifier announced Alex Lidow's resignation and McGee's termination, it did not state any reasons for the resignation or termination.

***16** Resignations or terminations by themselves do not support a strong inference of scienter. *See, e.g., In re Cornerstone Propane Partners, L.P. Sec. Litig.,* 355 F.Supp.2d 1069, 1093 (N.D.Cal.2005) ("The court finds that whether they were terminated or resigned, these notable departures are not in and of themselves evidence of scienter. Most major stock losses are often accompanied by management departures, and it would be unwise for courts to penalize directors for these decisions."); *In re U.S. Aggregates, Inc. Sec. Litig.,* 235 F.Supp.2d 1063, 1074 (N.D.Cal.2002) ("[A]fter a restatement of earnings and a subsequent loan default, it is unremarkable that the Company would seek to change its management team. Plaintiff can point to no particularized allegation refuting the reasonable assumption that Defendant [ ] was fired simply because the errors that lead to the restatement occurred on his watch or because he failed to adequately supervise his department."); *Communications Workers of America Plan for Employees' Pensions and Death Benefits v. CSK Auto Corp.,* 2007 WL 951968, at * 6 (D.Ariz. Mar.28, 2007) ("[O]fficers and employees can be terminated for negligence or incompetence as well as fraud.").

A resignation or termination provides evidence of scienter only when it is accompanied by additional evidence of the defendant's wrongdoing. *See, e.g., In re McKesson HBOC, Inc. Sec. Litig.,* 126 F.Supp.2d 1248, 1273-74 (N.D.Cal.2000) (finding strong circumstantial evidence of fraud from multiple public statements by the new chairman and CEO stating that the terminated executives were fired for cause because they knew or should have known of the fraudulent accounting practices); *Middlesex Ret. Sys. v. Quest Software Inc.,* 527 F.Supp.2d 1164, 1188 (C.D.Cal.2007) (finding support for scienter where officer resigned specifically to avoid cooperating with internal investigation); *In re Impax Laboratories, Inc. Sec. Litig.,* 2007 U.S. Dist. LEXIS 52356, at *9 (N.D.Cal. Jul. 18, 2007) (finding "minimal, non-dispositive supporting evidence of scienter" where defendant interfered with an ongoing investigation and his retirement was announced in close proximity to the news of the company's restatement).

In this case, both the resignation and termination of

Alex Lidow and McGee, although close in time to the announcement of the fraudulent practices at the Japan subsidiary, were not accompanied by any public statement by International Rectifier that they participated or were involved in the fraud. After International Rectifier announced that investors could no longer rely on multiple financial statements, it is unremarkable that International Rectifier would seek to change its management team to reassure investors. Therefore, the Court finds minimal evidence of scienter from these allegations.

e. Alex Lidow's and McGee's corporate positions do not give rise to a strong inference of scienter.

In their Opposition, interspersed in different sections, lacking any specific allegations tying Alex Lidow and McGee to the fraud, Plaintiffs appear to argue that Alex Lidow and McGee by virtue of their positions as CEO and CFO, must have known (or were deliberately reckless in not knowing) of the fraud because: (1) the Japan subsidiary was credited for much of International Rectifier's success; (2) the Japan subsidiary consistently had trouble meeting its earnings and sales forecasts but miraculously met or exceeded those forecasts at the end of each quarter; and (3) the fraud was not limited to the Japan subsidiary (as "corroborated" by certain confidential witnesses). [FN13]

FN13. Plaintiffs devote a whole section in their Opposition to "corroboration of the fraud by confidential witnesses," in attempting to establish scienter of the defendants. However, this section largely relates to defendants other than Alex Lidow and McGee. To the extent, that such "corroboration" is relevant to Alex Lidow and McGee, Plaintiffs appear to rely on the allegations that the fraud was not limited to the Japan subsidiary.

***17** By itself, the position of Alex Lidow and McGee within International Rectifier is insufficient to infer a strong inference of scienter. *See, e.g., In re Hansen Natural Corp. Sec. Litig.,* 527 F.Supp.2d 1142, 1158 (C.D.Cal.2007) ("[T]he high rank of various Individual Defendants within Hansen is insufficient, without more, to infer a strong inference of scienter."); *In re Oak Tech. Sec. Litig.,* 1997 WL 448168, at *11 (N.D.Cal. Aug.1, 1997) (allegations of knowledge based on positions within a company are "insufficient to establish [defendants'] liability for alleged misstatements"); *In re Suprema Specialties, Inc. Sec. Litig.,* 438 F.3d 256, 282 (3d Cir.2006) ("[g]eneralized imputations of knowledge do not suffice, regardless of the defendants' positions within the company") (citation omitted). Likewise, without more specific allegations, the fact that Alex Lidow and McGee credited the Japan subsidiary for International Rectifier's success, is insufficient by itself to infer knowledge on the part of Alex Lidow and McGee. *See In re Read-Rite Corp. Sec. Litig.,* 335 F.3d 843, 848 (9th Cir.2003) (rejecting contention that "facts critical to a business's core operations or an important transaction are so apparent that their knowledge may be attributed to ... key officers."); *accord In re Business Objects S.A. Sec. Litig.,* 2005 WL 1787860, at *8 n. 3 (N.D.Cal. Jul.27, 2005).

In addition, Plaintiffs claim that Alex Lidow and McGee, as CEO and CFO, were aware or should have been aware of the fraud because the Japan subsidiary consistently had trouble meeting its earnings and sales forecasts but "miraculously" met or exceeded those forecasts at the end of each quarter. This argument is based on allegations attributed to CW4, CW5, CW6, and CW7. However, there are many legitimate business reasons for an increase in sales before the end of quarters. *See Greebel v. FTP Software, Inc.,* 194 F.3d 185, 202 (1st Cir.1999) ("There is nothing inherently improper in pressing for sales to be made earlier than in the normal course."); *Broudo v. Dura Pharm., Inc.,* 339 F.3d 933, 940 (9th Cir.2003) (*rev'd* on other grounds) ("[T]here may also be other legitimate reasons for attempting to achieve sales earlier."); *In re Ashworth, Inc. Sec. Litig.,* 2000 WL 33176041, at *7 (S.D.Cal. Jul.18, 2000) (quotations and citations omitted) ("Because there may be a number of legitimate reasons for attempting to achieve sales earlier, 'channel stuffing' claims do not support a strong inference of scienter."). Thus, an increase in sales at the end of quarters does not strongly suggest that Alex Lidow or McGee had contemporaneous knowledge that these sales at the Japan subsidiary were fraudulent.

Finally, Plaintffs argue that Alex Lidow and McGee, as CEO and CFO, must have known about the wrongdoing (or were deliberately reckless in not knowing) because three confidential witnesses corroborate that the "fraud" was not limited to the Japan subsidiary. However, these three confidential witnesses do not claim that Alex Lidow or McGee themselves were aware of any fraudulent sales at International Rectifier or elsewhere. More importantly, the allegations of these three confidential witnesses are lacking in specificity, and in some cases, appear to be based on rumor or speculation. *See In re Hypercom Corp. Sec. Litig.,* 2006 WL 1836181, at * 5 (D.Ariz. Jul.5, 2006) ("[C]onfidential witnesses' unreliable or conclusory allegations will not be considered ....); *Metawave Communications Corp. Sec. Litig.,* 298 F.Supp.2d 1056, 1070 (W.D.Wash.2003) ("[A] shared opinion among confidential witnesses does not necessarily indicate either falsity or a strong inference of scienter if the allegations themselves are not specific enough."); *Zucco Partners, LLC v. Digimarc Corp.,* 445 F.Supp.2d 1201, 1208 (D.Or.2006) ("[A] shared opinion does not necessarily indicate either the falsity of or a strong inference of scienter if the allegations themselves are based on hearsay, rumor, or speculation.").

***18** For example, the Complaint alleges that according to CW1, it was a poorly kept secret within the company that International Rectifier made false shipments, and that it was a company-wide practice not limited to the Japan subsidiary. Complaint ¶ 51. CW1's opinion seems to be entirely based on the Complaint's next sentence, stating that, according to CW1, this practice occurred at International Rectifier's Tijuana facility and that employees joked that, when International Rectifier met financial forecasts at the end of financial quarters, it was because the "parking lot was full of trailers." Complaint ¶ 51. The Complaint does not indicate how CW1, who worked at International Rectifier's El Segundo, CA headquarters, and not at the Tijuana facility, was privy to these jokes. Nor does the Complaint explain when these jokes were made (or overheard), or the frequency of such jokes. Moreover, the Complaint makes no attempt to show that Alex Lidow or McGee should have been aware of jokes at a single facility. This limited gossip, not clearly based on CW1's personal knowledge, provides minimal evidence of Alex Lidow's or McGee's scienter.

CW4's and CW5's allegations similarly lack the requisite specificity. According to CW4, International Rectifier, not just the Japan subsidiary, would "ship like crazy" at the end of quarters to meet public forecasts by pulling in orders from future quarters (commonly referred to as "channel stuffing"). Complaint ¶ 57. According to CW4, International Rectifier would send "these" shipments to locations in Mexico or China that would hold the order for a few days so that it would not hit the customer's stock until the first or second day of the next quarter. Complaint ¶ 57. According to CW5, "pulling in orders from future quarters to meet current financial forecasts was not limited to the Japan subsidiary," and "[o]ftentimes, sales representatives extended payment terms for customers willing to accept such payments." However, the Complaint fails to identify overall volume, specific transactions, specific shipments, specific customers, specific times, or specific dollar amounts. *See In re Connetics Corp. Sec. Litig.,* 2008 WL 269467, at *12-13 (N.D.Cal. Jan.29, 2008) (citing *In re ICN Pharms., Inc. Sec. Litig.,* 299 F.Supp.2d 1055, 1062 (C.D.Cal.2004) (internal quotations omitted) ("Recent authority suggests that for an allegation of channel stuffing to be pled with sufficient particularity, it must allege specific transactions, specific shipments, specific customers, specific times, or specific dollar amounts."). The Court cannot even speculate whether the fraud was widespread or limited or miniscule based on these conclusory allegations. Furthermore, even if these allegations were considered, they are only weak evidence of scienter, given that there are no allegations that either Alex Lidow or McGee were aware of the fraudulent nature of the transactions. *See In re Ashworth, Inc. Sec. Litig.,* 2000 WL 33176041, at *7 (S.D.Cal. Jul.18, 2000) (quotations and citations omitted) ("Because there may be a number of legitimate reasons for attempting to achieve sales earlier, 'channel stuffing' claims do not support a strong inference of scienter."); *In re Ramp Networks, Inc. Sec. Litig.,* 201 F.Supp.2d 1051, 1077 (N.D.Cal.2002) (citations omitted) ("A number of courts have held that 'channel stuffing' gives rise to a 'very weak' inference of scienter-if any at all ... because there are 'a number of legitimate reasons for attempting to achieve sales earlier.' ").

f. Alex Lidow's and McGee's SOX certifications do not give rise to a strong inference of scienter.

***19** Plaintiffs attempt to argue that Alex Lidow's and McGee's Sarbanes Oxley ("SOX") certifications support a strong inference of scienter. However, if that were true, "scienter would be established in every case where there was an accounting error or auditing mistake made by a publicly traded company, thereby eviscerating the pleading requirements for scienter set forth in the PSLRA." *Central Laborers' Pension Fund v. Integrated Electrical Services, Inc.,* 497 F.3d 546, 555 (5th Cir.2007) (quoting *Garfield v. NDC Health Corp.,* 466 F.3d 1255, 1266 (11th Cir.2006)). *See also Communications Workers of America Plan for Employees' Pensions and Death Benefits v. CSK Auto Corp.,* 2007 WL 951968, at *8 (D.Ariz. Mar.28, 2007) ("Sarbanes-Oxley certifications, by themselves, do not support a strong inference of scienter."); *In re Loudeye Corp. Sec. Litig.,* 2007 WL 2404626, at *7 (W.D.Wash. Aug.17, 2007) ("Even if Defendants' SarbanesOxley certifications later proved to be incorrect, that does not create a strong inference that Defendants knew such certifications were false or misleading at the time they were made."). Without more specific allegations that Alex Lidow and McGee knew that the public filings contained misstatements, their certifications alone do not give rise to a strong inference of scienter.

g. The insider stock sales and the receipt of incentive bonuses do not give rise to a strong inference of scienter.

"Insider stock sales are not inherently suspicious ....“ *In re Vantive Corp. Sec. Litig.,* 283 F.3d 1079, 1092 (9th Cir.2002). Sales of stock by an insider becomes "suspicious only when it is dramatically out of line with prior trading practices at times calculated to maximize the personal benefit from undisclosed inside information." *Ronconi v. Larkin,* 253 F.3d 423, 435 (9th Cir.2001) (internal citation omitted). To determine if a stock sale by an insider is suspicious, the Ninth Circuit has held that the relevant factors to be examined include: (1) the amount and percentage of shares sold by insiders; (2) the timing of the sales; and (3) whether the sales were consistent with the insider's prior trading history. *In re Vantive Corp. Sec. Litig.,* 283 F.3d at 1092.

In their Complaint, Plaintiffs concede that they "do not rely upon allegations of insider trading to establish scienter," but that the insider stock sales during the Class Period "are consistent with and augment an already strong inference of scienter pleaded herein." Complaint ¶ 292. The allegations of insider trading in the Complaint with respect to Alex Lidow and McGee do not establish, support, or augment an inference of scienter.

As to Alex Lidow, Plaintiffs allege that he sold 490,000 shares of International Rectifier stock during the Class Period, resulting in gross proceeds of approximately $21 million. Complaint ¶ 291. The Complaint does not allege any facts that allow the Court to infer that these stock sales were unusual in timing or amount, nor do Plaintiffs provide his prior trading history. As to the amount, the sales represented 23% of Alex Lidow's holdings at the beginning of the Class Period. This amount is not terribly unusual or suspicious, given the Complaint's failure to connect Lidow's sales with any particular misleading statements. *See In re Vantive Corp. Sec. Litig.,* 283 F.3d at 1093 (finding nothing terribly unusual or suspicious about the selling of 26% of executive's stock and vested options, given the complaint's failure to connect his sales with any particular allegedly misleading statements). In addition, the sales were made pursuant to a non-discretionary 10b5-1 trading plan. *See Wietschner v. Monterey Pasta Co.,* 294 F.Supp.2d 1102, 1117 (N.D.Cal.2003) (noting that shares sold under individual SEC Rule 10b5-1 trading plans "could raise an inference that the sales were pre-scheduled and not suspicious"). Although the 10b5-1 trading plan was entered into during the class period, given the four year class period, the Court is unable to find anything unusual or suspicious about this fact.[FN14]

FN14. Plaintiffs request the Court to take judicial notice of a speech made by Linda Chatman Thomsen, Director of the Security and Exchange Commission's Division of Enforcement at the 2007 Corporate Counsel Institute on March 8, 2007, available on the SEC's website. Because there were no objections to the Plaintiffs' request to take judicial notice of this document, the Court will consider it. However, the fact that the SEC has reported that 10b5-1 trading plans *may* be abused, does not allow the Court to conclude that Alex Lidow and McGee's sales under such plans were suspicious or unusual in order to infer scienter. There are no allegations that Alex Lidow actively amended, modified, or manipulated his 10b-5 trading plans. *See In re Countrywide Financial Corp. Derivative Litig.,* --- F.Supp. ----, 2008 WL 2064977, at *19 (C.D.Cal. May 14, 2008) (finding defendant's amendments to his 10b-5 trading plan at the height of the market probative of scienter).

***20** As to McGee, Plaintiffs only allege that he sold International Rectifier stock twice during the four year Class Period, on November 12, 2004 and August 10, 2005, resulting in gross proceeds of $7,626,597 (or as McGee points out aggregate net proceeds of $4,978,697). Complaint ¶ 292. The Plaintiffs have not shown that either of these sales were in any way suspicious. As to the size, Plaintiffs simply claim that the sales were "large," but give the Court no frame of reference to ascertain their relative size-they do not provide the Court with either the percentage these stock sales represented of McGee's holdings, nor do they provide McGee's prior trading history. *See In re Vantive Corp. Sec. Litig.,* 283 F.3d at 1093 ("[B]y themselves, large numbers [of stock sales] do not necessarily create a strong inference of fraud."). In addition, the timing of the sales are not suspicious. Both sales took place shortly after dates on which International Rectifier released earnings to the public, well over a year before International Rectifier announced its discovery of any accounting errors, and almost two years before it announced the fraudulent activities at the Japan subsidiary. *See Lipton v. Pathogenesis Corp.,* 284 F.3d 1027 (9th Cir.2002) (finding that timing of stock transactions not suspicious as "[o]fficers of publicly traded companies commonly make stock transactions following the public release of quarterly earnings and related financial disclosures); *In re Vantive Corp. Sec. Litig.,* 283 F.3d at 1093 (finding timing of stock sales not suspicious in part because they took place more than a year before the press release on which plaintiffs based their action); *Communications Workers of America Plan for Employees' Pensions and Death Benefits,* 2007 WL 951968, at *7 (D.Ariz. Mar.28, 2007) (noting that sales occurring more than one year before public disclosures are "inconsistent with a strong inference of scienter").

Plaintiffs also allege that Alex Lidow and McGee were "motivated to perpetrate the fraud to achieve large bonus payments." Complaint ¶ 293. However, such bonuses have little probative value as to scienter. *See In re Syncor Intern. Corp. Sec. Litig.,* 239 Fed. Appx. 318, 321 (9th Cir.2007) ("Stock-based bonuses are common and have limited probative value as to scienter."); *Lipton v. Pathogenesis Corp.,* 284 F.3d 1027, 1038 (9th Cir.2002) (internal quotations and citations omitted) ("If scienter could be pleaded merely by alleging that officers and directors possess motive and opportunity to enhance a company's business prospects, virtually every company in the United States that experiences a downturn in stock price could be forced to defend securities fraud actions."). Furthermore, Plaintiffs do not allege any specific performance-based bonuses during the Class Period.

The Court concludes that Alex Lidow's and McGee's stock sales and receipt of incentive bonuses do not support a strong inference scienter.

h. Totality of Plaintiffs' Allegations of Scienter

***21** Plaintiffs' alleged facts, taken collectively, do not give rise to a strong inference of scienter as to Alex Lidow and McGee. The allegations are simply insufficient to link Alex Lidow and McGee to the fraudulent practices at the Japan subsidiary or other accounting errors. Moreover, the allegations fail to demonstrate that the fraud was sufficiently widespread to infer Alex Lidow's and McGee's scienter. An inference of fraudulent intent is plausible, yet less cogent than other, nonculpable explanations for Alex Lidow's and McGee's conduct. At most, the alleged facts give rise to a strong inference of negligence. Accordingly, Alex Lidow's and McGee's Motions to Dismiss the Section 10(b) and Rule 10b-5 claims alleged against them are **GRANTED.**

3. Plaintiffs fail to plead a Section 10(b) or Rule 10b-5 claim against International Rectifier.

For scienter to be attributed to International Rectifier, Plaintiffs must sufficiently plead that at least one of International Rectifier's officers had the requisite scienter at the time they made the allegedly misleading statements.[FN15] *See In re Apple Computer, Inc., Sec. Litig.,* 243 F.Supp.2d 1012, 1023 (N.D.Cal.2002) (citing *Nordstrom, Inc. v. Chubb & Son, Inc.,* 54 F.3d 1424, 1435-36 (9th Cir.1995)) ("A defendant corporation is deemed to have the requisite scienter for fraud only if the individual corporate officer making the statement has the requisite level of scienter, i.e., knows that the statement is false, or is at least deliberately reckless as to its falsity, at the time that he or she makes the statement.); *accord McGuire v. Dendreon Corp.,* 2008 WL 1791381, at * 9 (W.D.Wash. Apr.18, 2008); *Weiss v. Amkor Technology,* 527 F.Supp.2d 938, 952 (D.Ariz.2007); *In re Infineon Technologies AG Sec. Litig.,* 2006 WL

2925680, at * 3 (N.D.Cal. Sep.11, 2006) "The Ninth Circuit has rejected the concept of 'collective scienter' in attributing scienter to a corporation." *In re Apple Computer, Inc., Sec. Litig.,* 243 F.Supp.2d at 1023.

FN15. Plaintiffs agree that International Rectifier cannot be held vicariously liable for the securities fraud of its subsidiary, and instead relies on the allegations of scienter with respect to Alex Lidow, McGee, Grant, Jurek, and Esaka to establish International Rectifier's own scienter.

As discussed above, Plaintiffs have failed to plead facts that support a strong inference of scienter against Alex Lidow and McGee, the only defendants that allegedly made misleading statements in violation of Section 10(b) or Rule10b-5. Accordingly, Plaintiffs fail to plead scienter with respect to International Rectifier.

Accordingly, International Rectifier's Motion to Dismiss the Section 10(b) and Rule 10b-5 claim alleged against it is **GRANTED.**

B. Violation of Section 20(a)

To state a claim under Section 20(a), a plaintiff must allege (1) a primary violation of federal securities laws; and (2) that the defendant exercised actual power or control over the primary violator. *Howard v. Everex Systems, Inc.,* 228 F.3d 1057, 1065 (9th Cir.2000).

Plaintiffs have failed to allege a primary violation of the federal securities laws against any of the defendants. Accordingly, Alex Lidow's, McGee's, Grant's, Eric Lidow's, and International Rectifier's [FN16] Motions to Dismiss the Section 20(a) claims alleged against them are **GRANTED.** As Jurek and Esaka are in the same position as that of the moving defendants, the Section 20(a) claims against them are also **DISMISSED without prejudice.**

FN16. Plaintiffs argue that International Rectifier can be liable under Section 20(a) because it exercised the requisite control over the Japan subsidiary. Given the heightened pleading requirements of the PSLRA, the Court concludes that International Rectifier cannot be liable under Section 20(a) where Plaintiffs have not attempted to allege a primary violation committed by the Japan subsidiary. *Cf. Atlas v. Accredited Home Lenders Holding Co.,* 2008 WL 80949, at *11 (S.D.Cal. Jan.4, 2008) ("The only entity controlled by Accredited is its subsidiary the REIT, and Plaintiff's Complaint does not state a claim for a primary violation by the REIT.").

***22** Alex Lidow, McGee, Eric Lidow, and Grant also argue that Plaintiffs have failed to allege the requisite control or power over a primary violator. Determining who is a controlling person is usually "an intensely factual question, involving scrutiny of the defendant's participation in the day-to-day affairs of the corporation and the defendant's power to control corporate actions." *Howard v. Everex Systems, Inc.,* 228 F.3d 1057, 1065 (9th Cir.2000) (internal quotations and citations omitted). However, Plaintiffs cannot simply base their claims on boilerplate allegations; they must provide some factual support that defendants were in a position to control a primary violator. *See In re Hansen Natural Corp. Sec. Litig.,* 527 F.Supp.2d 1142, 1163 (C.D.Cal.2007) ("[T]his boilerplate allegation is insufficient to state a claim for control person liability."); *In re Middlesex Retirement System v. Quest Software Inc.,* 527 F.Supp.2d 1164, 1194 (C.D.Cal.2007) ("[F]or Plaintiff to establish Garn's control person liability, Plaintiff must provide factual support that Garn was in a position to control a primary violator."). At the motion to dismiss stage, allegations concerning an individual defendant's title and responsibilities are usually sufficient to establish control. *See In re Metawave Communications Corp. Sec. Litig.,* 298 F.Supp.2d 1056, 1091 (W.D.Wash.2003); *In re Adaptive Broadband Sec. Litig.,* 2002 WL 989478, at *19 (N.D.Cal. Apr.2, 2002).

Assuming Plaintiffs can allege a primary violation, Plaintiffs have adequately alleged the requisite control as to Alex Lidow, McGee, and Eric Lidow. Their positions as CEO, CFO, and Chairman of the Board and their signatures on the alleged misleading SEC filings are sufficient at the motion to dismiss stage. *See Howard v. Everex Systems, Inc.,* 228 F.3d 1057, 1066 (9th Cir.2000) (citing *Paracor Fin., Inc. v. General Elec. Capital Corp.,* 96 F.3d 1151, 1161-64

(9th Cir.1996)) (noting that under section 20(a), "we found that the company's president was not entitled to summary judgment where he signed a purportedly false statement"); *In re Adaptive Broadband Sec. Litig.,* 2002 U.S. Dist. LEXIS 5887, at *58-59 (N.D.Cal. Apr. 2, 2002) (finding allegations that "the Individual Defendants held the highest offices in the corporation, spoke frequently on its behalf, and made key decisions in how to present its financial results" are sufficient to allege control person liability).

However, as to Grant, Plaintiffs have not sufficiently alleged that he possessed the requisite control over a primary violator. His position as Executive Vice President, Global Sales and Marketing does not establish that he had control. *See In re Metawave Communications Corp. Sec. Litig.,* 298 F.Supp.2d 1056, 1091 (W.D.Wash.2003) ("Liang's titles of President of World Trade and Vice President for Worldwide operations do not establish that Liang had control."); *Middlesex Retirement System v. Quest Software, Inc.,* 527 F.Supp.2d 1164, 1194 (C.D.Cal.2007) ("[I]t is difficult for the Court to determine how, as a Vice President, Garn was able to exercise control over the other 10b-5 Defendants when the other 10b-5 Defendants held positions of Vice President or higher."). Furthermore, aside from a boilerplate allegation, Plaintiffs have not alleged that Grant had authority over the preparation of the financial statements or press releases or conference calls containing the misleading statements-just that he had authority or control over global sales and marketing. *See id.* ("The [Complaint] does not allege that Liang was involved in the day-to-day affairs of Metawave, or that Liang's position involved revenue recognition, inventory accounting, or the issuance of Metawave's financial statements-just that Liang tried to expand international sales.") Thus, Plaintiffs' Section 20(a) claim against Grant fails.

C. The Extended Class Period

***23** Defendant International Rectifier argues that the Court should take the unusual step of dismissing Plaintiff's Complaint (or all claims based on the extended class period), because Plaintiffs' Complaint extended the original 17-month class period (as represented in the notice to class members) by approximately 32 months after the appointment of the lead plaintiffs. In its Reply, International Rectifier retreats slightly, and requests the Court, alternatively, to require Plaintiffs to publish a new notice to class members. However, "courts have generally disfavored republication of notice when a complaint is amended, even where the amendment alters the class period." *Teamsters Local 445 Freight Div. Pension Fund v. Bombardier, Inc.,* 2005 WL 1322721, at * 2 (S.D.N.Y. Jun.1, 2005). *See also Thomas v. Metropolitan Life Ins. Co.,* 2007 WL 2909352, at *2 (W.D.Okla. Oct.5, 2007) ("[C]ourts have not generally required new notice where [the extension of the class period] is the only change in the claims."); *Cheney v. Cyberguard Corp.,* 213 F.R.D. 484, 503 (S.D.Fla.2003) (finding additional notice not required where the original complaint extended the class period by eleven months); *In re Synovis Life Technologies, Inc. Sec. Litig.,* 2005 WL 2063870, at *1 n. 3 (D.Minn. Aug.25, 2005) (noting "the weight of the case law" suggests no new notice is required upon extension of the class period).[FN17]

FN17. In *In re Leapfrog Enterprises, Inc. Securities Litigation,* the Northern District of California required the republication of notice where the consolidated complaint included new allegations and expanded the class period by nine months. 2005 WL 5327775, at *3 (N.D.Cal. Jul.5, 2005). However, in that case, the original lead plaintiff alleged losses of only $36,000, and an institutional investor with losses over $10 million (who was the lead plaintiff in a subsequent related action) sought to be the lead plaintiff. Here, the lead plaintiffs are two institutional investors, and there are no other individuals or entities expressing an interest in serving as a lead plaintiff at this time.

Accordingly, the Court will not require Plaintiffs to republish notice to class members (nor does it dismiss Plaintiffs' Complaint on this basis).

D. Leave to Amend is Granted.

Leave to amend is to be granted with extreme liberality in securities fraud cases, because the heightened pleading requirements imposed by the PSLRA are so difficult to meet. *Eminence Capital, LLC v. Aspeon, Inc.,* 316 F.3d 1048, 1052 (9th Cir.2003). The Supreme Court has articulated the applicable standard as follows:

> In the absence of any apparent or declared reason-such as undue delay, bad faith or dilatory motive on the part of the movant, repeated failure to cure deficiencies by amendments previously allowed, undue prejudice to the opposing party by virtue of allowance of the amendment, futility of amendment, etc.-the leave sought should, as the rules require, be 'freely given.'

Foman v. Davis, 371 U.S. 178, 182, 83 S.Ct. 227, 9 L.Ed.2d 222 (1962). *See also Eminence Capital, LLC,* 316 F.3d at 1052 ("Adherence to these principles is especially important in the context of the PSLRA.").

In this case, Plaintiffs request leave to amend (in a footnote), solely based on additional facts that may come to light as a result of International Rectifier's ongoing investigation and its most recent disclosure about improprieties at its Aerospace & Defense segment, post-dating the Complaint. In their Request for Judicial Notice, Plaintiffs claim that this recent disclosure "provides Plaintiffs with new leads that will enable Plaintiffs to uncover additional information to include in an amended consolidated complaint, if necessary."

***24** While these new leads or the ongoing investigation could potentially provide additional facts to establish Alex Lidow's or McGee's scienter or a claim against International Rectifier, it is likely futile to allow Plaintiffs to amend the Complaint as to Grant who has not made any public misrepresentations.[FN18] Plaintiffs have had approximately one year since the filing of the initial complaint, and three months since the February 11, 2008 disclosure to pursue leads to develop additional facts in order to assert a valid claim against Grant. Yet, they have failed to submit any such facts to the Court. Such a failure is a strong indication that the plaintiffs have no additional facts to plead. *See, Silicon Graphics,* 183 F.3d at 991 (denying leave to amend where plaintiff failed to offer additional facts which might cure defects in complaint); *In re VeriFone Sec. Litig.,* 11 F.3d 865, 872 (9th Cir.1993) (same).

> FN18. The Court declines to address International Rectifier's loss causation argument at this time. As Plaintiffs claim "additional revelations of accounting improprieties continue to come to light," an amended Complaint may further extend the Class Period and contain new allegations of when the fraud has been fully disclosed to the public. In addition, until Plaintiffs can assert that Grant made a material misrepresentation, or that he substantially participated or was intricately involved in the preparation of the fraudulent statements, the Court will not address whether Plaintiffs have adequately pled scienter as to Grant.

Ordinarily, the Court would not grant leave to amend under these circumstances, especially as to Grant. However, given the extreme liberality with which leave to amend is granted in securities fraud cases, the Court grants leave to amend as to all defendants.

IV. Conclusion

For the foregoing reasons, Defendant Michael P. McGee's Motion to Dismiss Consolidated Class Action Complaint is **GRANTED.** Defendant Eric P. Lidow's Motion to Dismiss Plaintiffs' Consolidated Class Action Complaint is **GRANTED.** Defendant Robert Grant's Motion to Dismiss Consolidated Class Action Complaint is **GRANTED.** Defendant Alexander Lidow's Motion to Dismiss the Consolidated Class Action Complaint for Violations of the Federal Securities Laws is **GRANTED.** Defendant International Rectifier Corporation's Motion to Dismiss Plaintiffs' Consolidated Class Action Complaint is **GRANTED.** In addition, the claims against Defendants Ivo Jurek and Fumihide Esaka are **DISMISSED without prejudice.** Accordingly, Plaintiffs' Consolidated Class Action Complaint is **DISMISSED without prejudice.**

If Plaintiffs decide to file an Amended Consolidated Class Action Complaint, it shall be filed by June 12, 2008. Plaintiffs shall deliver to Chambers two redlined versions of it, indicating all additions and/or deletions of material. If Plaintiffs fail to file the Amended Consolidated Class Action Complaint by June 12, 2008, this action will be dismissed with prejudice.

IT IS SO ORDERED.

The Clerk shall serve a copy of this Minute Order on all parties to this action.

C.D.Cal.,2008.
In re Intern. Rectifier Corp. Securities Litigation
Not Reported in F.Supp.2d, 2008 WL 4555794 (C.D.Cal.)

END OF DOCUMENT

TAB 10

152 Fed.Appx. 674, 2005 WL 2980628 (C.A.9 (Cal.)), Fed. Sec. L. Rep. P 93,554
(Not Selected for publication in the Federal Reporter)
(Cite as: 152 Fed.Appx. 674, 2005 WL 2980628 (C.A.9 (Cal.)))

This case was not selected for publication in the Federal Reporter.

Not for Publication in West's Federal Reporter See Fed. Rule of Appellate Procedure 32.1 generally governing citation of judicial decisions issued on or after Jan. 1, 2007. See also Ninth Circuit Rule 36-3. (Find CTA9 Rule 36-3)

United States Court of Appeals,
Ninth Circuit.
Robert G. KNOLLENBERG, et al., Plaintiffs-Appellants,
v.
HARMONIC, INC., et al., Defendants-Appellees.
No. 03-16238.

Argued and Submitted Feb. 17, 2005.
Decided Nov. 8, 2005.

Background: Shareholders filed putative class action against acquired corporation, acquiring corporation, and several of their top executives for violations of securities laws in connection with decline in stock price of both corporations around the time merger. The United States District Court for the Northern District of California, 2002 WL 31974384,Phyllis J. Hamilton, J., granted defendants' motion to dismiss, and plaintiffs appealed.

Holdings: The Court of Appeals held that:
(1) allegations that corporations and their executives failed to disclose key customer's demand for acquiring corporation's products had declined and would continue to do so were insufficient to state claim of securities fraud;
(2) allegations that statements favorable to acquired corporation or merger were misleading were insufficient to claim of securities fraud;
(3) allegations that acquired corporation's sales weakness had become “common knowledge” among acquiring corporation's management and employees were insufficient to support strong inference of scienter required for securities fraud claim;
(4) insider trading allegations were insufficient to raise strong inference of scienter;
(5) shareholders failed to state a proxy solicitation violation claim;
(6) shareholders stated claim for liability for material misstatements or omissions in registration statement;
(7) shareholders adequately pleaded liability for sale of securities by means of misleading prospectus; and
(8) shareholders' allegations were sufficient to state a secondary claim for “control person” liability claim against acquiring corporation's president, but not corporation.

Affirmed in part, reversed in part, and remanded.

West Headnotes

[1] Securities Regulation 349B 60.51(2)

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.50 Pleading
349Bk60.51 In General
349Bk60.51(2) k. Scienter. Most Cited Cases
(Formerly 349Bk60.51)

Shareholders' allegations, that acquired and acquiring corporations and their executives failed to disclose key customer's demand for acquiring corporation's products had declined and would continue to do so, were insufficient to state claim of securities fraud, absent facts establishing corporations or executives knew statements were false or acted with deliberate recklessness as to whether statements were false; shareholders failed to make precise allegations explaining how alleged statement that acquiring corporation was experiencing “strong demand” for its products was misleading or untrue, and failed to explain how allegedly omitted facts would have been viewed by reasonable investor as having significantly altered total mix of information made available. Securities Exchange Act of 1934, §§ 10(b), 21D(b)(2), 15 U.S.C.A. §§ 78j(b), 78u-4(b)(2); 17 C.F.R. § 240.10b-5.

[2] Securities Regulation 349B 60.51(2)

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.50 Pleading
349Bk60.51 In General
349Bk60.51(2) k. Scienter. Most Cited Cases
(Formerly 349Bk60.51)

Shareholders' allegations that acquiring corporation knew that key customer's management of its inventory would result in a slowing of its purchases from corporation until inventory was deployed by customer were insufficient to raise a “strong inference” of scienter, so as to satisfy requirements of Private Securities Litigation Reform Act (PSLRA) for securities fraud claim under § 10(b) and Rule 10b-5; shareholders failed to allege basic facts regarding either customer's “weekly forecasts” or corporation's internal reports, and failed to show corporation or its executives were aware that customer had been canceling orders. Securities Exchange Act of 1934, §§ 10(b), 21D(b)(2), 15 U.S.C.A. §§ 78j(b), 78u-4(b)(2); 17 C.F.R. § 240.10b-5.

[3] Securities Regulation 349B 60.28(15)

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.17 Manipulative, Deceptive or Fraudulent Conduct
349Bk60.28 Nondisclosure; Insider Trading
349Bk60.28(10) Matters to Be Disclosed
349Bk60.28(15) k. Mergers, Acquisitions, Reorganizations or Tender Offers. Most Cited Cases

Shareholders' allegations that statements favorable to acquired corporation or merger were misleading, insofar as such statements failed to disclose that several of acquired corporation's largest customers withdrew their orders shortly after merger announcement, were insufficient to claim of securities fraud. Securities Exchange Act of 1934, §§ 10(b), 21D(b)(2), 15 U.S.C.A. §§ 78j(b), 78u-4(b)(2); 17 C.F.R. § 240.10b-5.

[4] Securities Regulation 349B 60.51(2)

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.50 Pleading
349Bk60.51 In General
349Bk60.51(2) k. Scienter. Most Cited Cases
(Formerly 349Bk60.54)

Shareholders' allegations that acquired corporation's sales weakness had become “common knowledge” among acquiring corporation's management and employees “well before the merger” and that corporations and executives had obligation to disclose such information to the market were insufficient to support “strong inference” of scienter, so as to satisfy requirements of Private Securities Litigation Reform Act (PSLRA) for securities fraud claim under § 10(b) and Rule 10b-5; allegation of “common knowledge” did not comport with PSLRA's requirement that shareholders allege the required state of mind as to each defendant who made an allegedly misleading statement. Securities Exchange Act of 1934, §§ 10(b), 21D(b)(2), 15 U.S.C.A. §§ 78j(b), 78u-4(b)(2); 17 C.F.R. § 240.10b-5.

[5] Securities Regulation 349B 60.51(2)

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.50 Pleading
349Bk60.51 In General
349Bk60.51(2) k. Scienter. Most Cited Cases
(Formerly 349Bk60.51)

Shareholders' allegations that “insider selling” on part of certain executives of acquired corporation demonstrated merged corporations and their executives had motive and opportunity to mislead investors were insufficient to raise a “strong inference” of scienter, so as to satisfy requirements of Private Securities Litigation Reform Act (PSLRA) for securities fraud claim under § 10(b) and Rule 10b-5; under terms of merger agreement, acquired corporation and its executives were required to exercise their stock options.

Securities Exchange Act of 1934, §§ 10(b), 21D(b)(2), 15 U.S.C.A. §§ 78j(b), 78u-4(b)(2); 17 C.F.R. § 240.10b-5.

[6] Securities Regulation 349B 49.28

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)4 Proxies
349Bk49.28 k. Pleading. Most Cited Cases
Shareholders failed to state a proxy solicitation violation claim, under the Securities Exchange Act, where shareholders failed to present facts demonstrating corporate directors did not believe that merger was in the "best interests" at time they made recommendation or facts that would lead investor to conclude corporations or their executives knew either customer would not be buying as much product in the future as it had in the past or that acquired corporation's performance was down from its previous comparable levels. Securities Exchange Act of 1934, § 14, 15 U.S.C.A. § 78n(a); 17 C.F.R. § 240.14a-9.

[7] Securities Regulation 349B 25.18

349B Securities Regulation
349BI Federal Regulation
349BI(B) Registration and Distribution
349BI(B)4 Registration Statements
349Bk25.17 False Statements or Omissions; Accuracy
349Bk25.18 k. In General. Most Cited Cases
Shareholders' allegations, that acquiring corporation and its executives omitted from registration statement facts that key customer's orders had declined, that acquired corporation's sales had slowed after announcement of merger, and that acquiring corporation's stock declined 47% that day after press release disclosed that corporation expected its second quarter revenue to be approximately half the amount previously represented, were sufficient to state a claim for liability for material misstatements or omissions in registration statement. Securities Act of 1933, § 11, 15 U.S.C.A. § 77k.

[8] Securities Regulation 349B 25.57

349B Securities Regulation
349BI Federal Regulation
349BI(B) Registration and Distribution
349BI(B)5 Prospectuses and Communications
349Bk25.55 False Statements or Omissions; Accuracy
349Bk25.57 k. Particular Prospectuses or Communications. Most Cited Cases
Shareholders' allegations, that acquiring corporations and its executives omitted from prospectus the facts that key customer's orders had declined, that acquired corporation's sales had slowed after announcement of merger, and that corporations and executives were negligent in omitting to state these facts from their prospectus, adequately pleaded liability for sale of securities by means of misleading prospectus. Securities Act of 1933, § 12(a)(2), 15 U.S.C.A. § 77l(a)(2).

[9] Securities Regulation 349B 25.20(1)

349B Securities Regulation
349BI Federal Regulation
349BI(B) Registration and Distribution
349BI(B)4 Registration Statements
349Bk25.17 False Statements or Omissions; Accuracy
349Bk25.20 Persons Liable
349Bk25.20(1) k. In General. Most Cited Cases

Securities Regulation 349B 25.61(4)

349B Securities Regulation
349BI Federal Regulation
349BI(B) Registration and Distribution
349BI(B)5 Prospectuses and Communications
349Bk25.55 False Statements or Omissions; Accuracy
349Bk25.61 Persons Liable
349Bk25.61(4) k. Controlling Persons. Most Cited Cases

Securities Regulation 349B 60.40

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation

349Bk60.39 Persons Liable
349Bk60.40 k. In General; Control Persons. Most Cited Cases
Shareholders' allegations were sufficient to state a secondary claim for "control person" liability claim against acquiring corporation's president; shareholders alleged that president signed registration statement for merger, and jointly with acquired and acquiring corporations, actively caused the prospectus to be drafted, revised, and approved. Securities Act of 1933, § 15, 15 U.S.C.A. § 77o; Securities Exchange Act of 1934, § 20, as amended, 15 U.S.C.A. § 78t(a).

[10] Securities Regulation 349B 25.20(1)

349B Securities Regulation
349BI Federal Regulation
349BI(B) Registration and Distribution
349BI(B)4 Registration Statements
349Bk25.17 False Statements or Omissions; Accuracy
349Bk25.20 Persons Liable
349Bk25.20(1) k. In General. Most Cited Cases

Securities Regulation 349B 25.61(4)

349B Securities Regulation
349BI Federal Regulation
349BI(B) Registration and Distribution
349BI(B)5 Prospectuses and Communications
349Bk25.55 False Statements or Omissions; Accuracy
349Bk25.61 Persons Liable
349Bk25.61(4) k. Controlling Persons. Most Cited Cases

Securities Regulation 349B 60.40

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.39 Persons Liable
349Bk60.40 k. In General; Control Persons. Most Cited Cases
Shareholders' allegations that acquiring corporation exerted control over itself failed to state secondary claim for "control person" liability claim against corporation. Securities Act of 1933, § 15, 15 U.S.C.A. § 77o; Securities Exchange Act of 1934, § 20, as amended, 15 U.S.C.A. § 78t(a).

[11] Securities Regulation 349B 60.51(1)

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.50 Pleading
349Bk60.51 In General
349Bk60.51(1) k. In General. Most Cited Cases
(Formerly 349Bk60.51)
Shareholders failed properly to allege loss causation, as was required under Private Securities Litigation Reform Act (PSLRA) to state securities fraud claim under § 10(b) and Rule 10b-5; although they alleged that the named representatives for the putative class purchased stock during the class period and that the stock price then fell, shareholders did not allege that any of these same plaintiffs sold stock at a loss caused by alleged fraud or misrepresentation by merged corporations or their executives. Securities Exchange Act of 1934, §§ 10(b), 21D(b)(2), 15 U.S.C.A. §§ 78j(b), 78u-4(b)(2); 17 C.F.R. § 240.10b-5.
***677** David Kessler, Andrew L. Barroway, Schiffrin & Barroway, Bala Cynwyd, PA, Edward M. Gergosian, Esq., Benjamin Galdston, Barrack, Rodos & Bacine, William S. Lerach, Esq., Christopher Lometti, Jay P. Saltzman, Samuel P. Sporn, Esq., Schoengold & Sporn, P.C., New York, NY, for Plaintiffs-Appellants.

Terry T. Johnson, Esq., Cheryl W. Foung, Jerone F. Birn, Wilson Sonsini Goodrich & Rosati, Palo Alto, CA, Melvin R. Goldman, Esq., Morrison & Foerster LLP, San Francisco, CA, for Defendants-Appellees.

Sanford Svetcov, Esq., Reed R. Kathrein, Esq., Patrick J. Coughlin, Esq., Susan K. Alexander, Esq., Shawn A. Williams, Esq., Stan S. Mallison, Lerach Coughlin Stoia Geller Rudman & Robbins, LLP, San Francisco, CA, William S. Lerach, Esq., Eric A. Isaacson, Esq., Lerach Coughlin Stoia Geller Rudman & Robbins, LLP, San Diego, CA.

Appeal from the United States District Court for the

Northern District of California, Phyllis J. Hamilton, District Judge, Presiding. D.C. No. CV-00-2287-PJH.

Before: ALARCÓN, SILVERMAN, and BEA, Circuit Judges.

MEMORANDUM [FN*]

FN* This disposition is not appropriate for publication and may not be cited to or by the courts of this circuit except as provided by Ninth Circuit Rule 36-3.

****1** In this securities fraud class action, Plaintiffs-Appellants Robert G. Knollenberg ("Knollenberg") *et al.* brought this putative class action against Defendants-Appellees Harmonic Inc. ("Harmonic") and C-Cube Microsystems, Inc. ("Old C-Cube") and several of their top executives for violations of securities laws in connection with the decline in stock price of both companies around the time of the May 3, 2000 merger between Harmonic and Old C-Cube.[FN1]

FN1. Plaintiff Knollenberg seeks to represent a putative class of persons who purchased or otherwise acquired (1) shares of Harmonic between January 19, 2000 and June 26, 2000 (the "Class Period") and (2) shares of Old C-Cube prior to the merger (between January 19, 2000 and May 3, 2000).

Because the parties are familiar with the facts and procedural history of the case, we do not recite them here in detail except as necessary to our decision.

I. BACKGROUND

On October 27, 1999, Harmonic and C-Cube announced that Harmonic would acquire DiviCom, Inc. ("DiviCom", a division of C-Cube). They filed Form 8-K with the Securities and Exchange Commission ("SEC"), which contained their proposed merger agreement. On April 24, 2000, the shareholders of both companies voted to approve the merger. On May 3, 2000, the merger was completed. Pursuant to the merger, Harmonic acquired DiviCom and Old C-Cube ceased to exist.[FN2]

FN2. C-Cube Microsystems was renamed C-Cube Semiconductor, Inc. (later renamed C-Cube Microsystems, Inc.) ("New C-Cube").

On June 28, 2000, Plaintiffs filed a securities class action complaint in the district court alleging Defendants and several of their executives made a series of misleading statements for the purpose of obtaining shareholder approval of Harmonic's acquisition of C-Cube's DiviCom division ***678** while they engaged in insider selling and thereby violated Sections 10b, 14(a), and 20(a) of the Securities Exchange Act of 1934 (the "1934 Act"); Rules 10b-5 and 14a-9 promulgated under the 1934 Act; and Sections 11, 12 and 15 of the Securities Act of 1933 (the "1933 Act").

II. LEGAL STANDARDS

We review *de novo* the district court's order dismissing Plaintiffs' Second Amended Complaint with prejudice for repeated failure adequately to state a claim for violations of the securities laws under the Private Securities Litigation Reform Act of 1995 ("PSLRA"), 15 U.S.C. § 78u-4(b), and Federal Rule of Civil Procedure 9(b). *See* 28 U.S.C. § 1291; *In re Silicon Graphics, Inc. Sec. Litig.,* 183 F.3d 970, 983 (9th Cir.1999). We review the district court's denial of leave to amend for abuse of discretion. *See Gompper v. VISX, Inc.,* 298 F.3d 893, 895 (9th Cir.2002).

III. DISCUSSION

A. *Claims Under Section 10(b) of the 1934 Act and Rule 10b-5*

To plead securities fraud under Section 10(b) of the 1934 Act or Rule 10b-5, Plaintiffs must allege: "(1) a misstatement or omission (2) of material fact (3) made with scienter (4) on which [plaintiffs] relied (5) which proximately caused [the plaintiffs'] injury." *DSAM Global Value Fund v. Altris Software, Inc.* 288 F.3d 385, 388 (9th Cir.2002).

Under the PSLRA, Plaintiffs must "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind" with respect to each act or omission. *See* 15 U.S.C. § 78u-4(b)(2); *In re Vantive Corp. Sec. Litig.,* 283 F.3d 1079, 1084 (9th Cir.2002). By requiring particularized, detailed allegations showing a strong inference of scienter, the PSLRA was intended to "eliminate abusive and opportunistic securities litigation." *Gompper,* 298 F.3d at 897.

****2** As to *forward looking statements* made by the Defendants, Plaintiffs must allege facts demonstrating a strong inference defendants made those statements with *actual knowledge that they were false.* 15 U.S.C. § 78u-5(c)(1)(B)(I); *In re Vantive Corp. Sec. Litig.,* 283 F.3d 1079, 1085 (9th Cir.2002). A forward looking statement is any statement regarding "(1) financial projections, (2) plans and objectives of management for future operations, (3) future economic performance, or (4) the assumptions 'underlying or related to' any of these issues." *See No. 84 Employer-Teamster Joint Council Pension Trust Fund v. America West Holding Corp.,* 320 F.3d 920, 936 (9th Cir.2003). A forecast is actionably false if " 'there is no reasonable basis for the belief' " or " 'the speaker is aware of undisclosed facts tending seriously to undermine the statements' accuracy.' " *Provenz v. Miller,* 102 F.3d 1478, 1487 (9th Cir.1996) (citation omitted).

As to *non-forward looking statements* made by the Defendants, Plaintiffs must allege facts demonstrating a strong inference defendants made those statements with *intentional falsity or with deliberate recklessness as to the statements' falsity. Id.*

Claims that a defendant "could have" or "should have" known that the statements were false are insufficient to satisfy the standard for either forward looking or non-forward looking statements. "Negligence, even gross negligence, does not rise to the level of the nefarious mental state necessary to constitute securities fraud under the PSLRA." *DSAM,* 288 F.3d at 391.

Plaintiffs allege that Defendants Harmonic and several of its executives (Ley, Dickson, Yost, Flatow, Nazarathy, Kvamme,***679** Lane, Lemieux, Vaillaud), and New C-Cube and several of its executives (Balkanski, Lookabaugh, Brown, Foreman, McKinney, Padval, Valentine, Walcykowski, Futa and Reyes) made false or misleading statements in violation of Section 10(b) and Rule 10b-5.

Analysis of the Second Amended Complaint, however, demonstrates that there are no materially misleading statements or omissions, nor are there allegations raising a "strong inference of scienter."

1. *Misstatements or Omissions of Material Fact*

Plaintiffs allege Defendants sought to inflate the value of the stock of both companies to convince shareholders to approve the merger and to allow the C-Cube Defendants to sell their personal shares.

Plaintiffs allege Defendants published several false financial statements [FN3] and press releases during the class period that were materially misleading insofar as the financial documents failed to disclose: (1) AT & T's demand for Harmonic products in the fiscal year for 2000 had declined and would continue to do so; and (2) DiviCom's business had slowed following the October 1999 announcement of the pending merger causing lower revenues in the fourth fiscal quarter of 2000.

FN3. As discussed below, Plaintiffs allege misleading statements were made in the following documents: (1) eight joint C-Cube and Harmonic press releases; (2) Harmonic's 1999 Form 10-K and first quarter for 2000 Form 10-Q; (3) the March 23, 2000 Form S-4 Registration Statement; and (4) seven analyst reports.

A. *AT & T's Demand for Harmonic Products*

****3** [1] Plaintiffs allege Defendants made several statements that Harmonic was experiencing "strong demand" for its products from traditional operators such as AT & T, and these statements were misleading because Defendants knew AT & T had been cancelling orders for 2000 and the record sales for the fourth quarter of 1999 were the result of the fact that AT & T was obligated to pay for large quantities of previously ordered custom-built product. As a result, Plaintiffs allege, Defendants knew that AT & T would place few new orders in the first quarter of 2000 and failed to disclose this information.

Plaintiffs fail to make precise allegations explaining how the alleged statement that Harmonic was experiencing "strong demand" for its products was misleading or untrue. According to Plaintiffs' allegations, Harmonic did not make a concrete prediction about future sales, only a statement about current sales. Further, Plaintiffs fail to allege exactly who at Harmonic knew about the alleged decline in sales from AT & T, when they knew it, how it was communicated to them, or how many sales orders AT & T had cancelled. Nor do Plaintiffs explain how the allegedly omitted facts would have been viewed by a reasonable investor as having significantly altered the total mix of information made available. *See In re Stac Electronics Sec. Litig.,* 89 F.3d 1399, 1408-09 (9th Cir.1996).

Without more, the statements that there was “strong demand” are insufficient to meet the heightened pleading standard under the PSLRA. *See Ronconi v. Larkin,* 253 F.3d 423, 431 (9th Cir.2001) (statement that “sales growth was accelerating” does not adequately allege facts giving rise to claim under 10(b); rather “[p]laintiffs do not specify facts or evidence that show why the statement was false at the time it was made nor that defendants knew or with deliberate recklessness disregarded that it was false”).

***680** Accordingly, Plaintiffs' allegations are insufficient to state a claim of fraud under Section 10(b) or Rule 10b-5 because Plaintiffs fail adequately to state facts establishing that the defendants knew the statements were false or acted with deliberate recklessness as to whether the statements were false.

B. *Scienter Regarding AT & T Statements*

Not only did Plaintiffs fail to plead material misstatements or omissions with regard to Harmonics' sales to AT & T, Plaintiffs also failed adequately to plead specific facts which give rise to a “strong inference” of scienter that Defendants either knew their statements were false or made the statements with deliberate recklessness as to the statements' veracity. *See, e.g., Karacand v. Edwards,* 53 F.Supp.2d 1236, 1252 (D.Utah 1999) (“Where, as here, plaintiffs have not adequately pleaded falsity, it is unnecessary to determine whether they have adequately pleaded scienter.”). Even assuming, *arguendo,* that Plaintiffs here have adequately pleaded violations under 10(b), they nonetheless still fail to plead facts that give rise to a “strong inference” of deliberate recklessness or actual knowledge.

****4** [2] Plaintiffs allege that the Harmonic Defendants “monitored inventory” through AT & T's weekly order forecasts and prepared internal reports based on information contained in such reports. From the knowledge obtained from monitoring the inventory, the Harmonic defendants “w[ere] aware that AT & T had been canceling and pushing out the scheduling of orders all throughout 1999” and that “AT & T had an excessive inventory and backlog from its late-1999 purchases of Harmonic products.” Therefore, Plaintiffs allege, the Harmonic Defendants “knew [in early 2000] that AT & T's management of this inventory would result in a slowing of its purchases from Harmonic until this inventory was deployed by AT & T.”

These allegations are insufficient to raise a “strong inference” of scienter. While courts have held that internal reports may support a strong inference of scienter, a complaint relying on the existence of such reports must contain “at least some specifics from those reports as well as such facts as may indicate their reliability.” *Nursing Home Pension Fund, Local 144 v. Oracle Corp.,* 380 F.3d 1226, 1230-31 (9th Cir.2004). Here, Plaintiffs fail to allege basic facts (such as author, date prepared, contents) regarding either AT & T's “weekly forecasts” or Harmonic's internal reports. *See In re Silicon Graphics, Inc. Sec. Litig.,* 183 F.3d 970, 977 (9th Cir.1999) (dismissing claim where plaintiffs failed to state the source of information regarding the reports, how she learned of them, who drafted them, or which officers received them); *see also Lipton v. Pathogenesis Corp.,* 284 F.3d 1027, 1231 (9th Cir.2002) (same).

Nor do Plaintiffs allege facts to show that any particular Harmonic Defendant was aware that AT & T had been cancelling orders. Plaintiffs fail to allege that the same person who read these internal reports was the person who released the alleged misleading statements. Plaintiffs' allegation the Harmonic Defendants therefore knew AT & T would be slowing its purchases of Harmonic inventory is unsupported by factual allegations. Finally, Plaintiffs' allegations with respect to the information allegedly provided by unnamed management sources is insufficient. *See Haft v. Eastland Fin. Corp.,* 772 F.Supp. 1315 (D.R.I.1991) (holding that recounting of analysts' opinions did not prove ‘underlying factual support’ necessary to create a “strong inference of scienter.”).

***681** C. *DiviCom Sales*

[3] Plaintiffs also allege that shortly after the announcement of the Harmonic-C-Cube (DiviCom) merger, several of DiviCom's largest customers withdrew their orders from DiviCom because such customers were concerned that DiviCom's acquisition by a cable company would “draw the company's focus and development efforts” from its satellite products to cable products.

Accordingly, Plaintiffs allege Defendants' statements favorable to DiviCom or the Harmonic-C-Cube (DiviCom) merger were misleading insofar as such statements presented DiviCom in a more positive light than was warranted given that DiviCom's largest customers had withdrawn orders. Thus, Plaintiffs allege that the Harmonic defendants:

> ****5** failed ... to disclose DiviCom's poor performance to the market, despite the fact that ... DiviCom's sales weakness had become ‘common knowledge’ among Harmonic management and employees well before the merger.

Plaintiffs' allegations are insufficient for several reasons. First, Plaintiffs fail to specify the *amount* by which DiviCom's sales declined. *See In re Vantive Sec. Litig.,* 283 F.3d 1079, 1088 (9th Cir.2002) (affirming district court's dismissal of plaintiff's claim under Section 10(b) where plaintiffs alleged misstatements regarding inferior product features that resulted in “slow sales” of such products).

Second, Plaintiffs fail to allege facts establishing Defendants had knowledge the merger announcement would precipitate a decline in orders. Here, Plaintiffs allege the *announcement* of the merger itself caused DiviCom's customer's to “back away.” However, Plaintiffs do not allege facts demonstrating Defendants knew such would be the market reaction.

Third, Plaintiffs fail to plead the *source* of the information about DiviCom's future after announcement of merger plans with sufficient particularity. Rather, plaintiffs state that “former employees” are the source of this information that the lagging DiviCom sales were “common knowledge” among “Harmonic management.” Significantly, however, Plaintiffs fail to allege facts demonstrating that the “former employees” consulted were in a position to know what management knew. *See In re Splash Tech. Holdings, Inc., Sec. Litig.,* 160 F.Supp.2d 1059, 1080 n. 15 (N.D.Cal.2001) (reliance on “confidential informants” was not sufficient in the absence of “any information that the Court might use to evaluate the confidential informants' bases for alleging that the defendants had access to adverse information.”).

Fourth, the allegation that Defendants misled investors by failing to publish DiviCom's financial results for 1999 and the first quarter of 2000 *before* the scheduled date of the merger is insufficient because Plaintiffs fail to allege facts demonstrating that any Harmonic defendant had a duty to publish these results prior to the merger. Silence, absent a duty to disclose, is not actionable. *See, e.g., Brody v. Transitional Hosps. Corp.,* 280 F.3d 997, 1006 (9th Cir.2002) (10b-5 prohibits misleading statements, not ones that are merely “incomplete.”).

D. *Scienter Regarding DiviCom*

[4] Plaintiffs allege “DiviCom's sales weakness had become “common knowledge” among Harmonic management and employees “well before the merger” and defendants had an obligation to disclose such information to the market.

This allegation is insufficient to support a “strong inference” of scienter. The allegation that it was “common knowledge” that sales had declined does not comport ***682** with the PSLRA's requirement that plaintiffs allege the required state of mind as to each Defendant who made an allegedly misleading statement and is therefore insufficient. *See* 15 U.S.C. § 78u-4(b)(2).

2. *Allegations of Insider Sales do not Raise a “Strong Inference” of Scienter*

****6** [5] Plaintiffs next allege that “insider selling” on the part of certain executives of C-Cube [FN4] demonstrates Defendants had “motive and opportunity” to mislead investors and such insider sales give rise to a strong inference of scienter.

FN4. Plaintiffs alleged insider trading on the part of Harmonic's executives as well. However, Plaintiffs concede on appeal that they are no longer asserting claims against Flatow and Yost. Accordingly, there are no remaining claims as to "insider sales" by Harmonic's executives.

In general, to determine whether a particular insider sale is "suspicious," courts consider the following factors: "(1) percentage of shares sold by the insiders; (2) timing of the sales; and (3) whether the sales were consistent with the trader's previous history." *See In re Silicon Graphics,* 183 F.3d at 986 (quoting *In re Apple Computer Sec. Litig.,* 886 F.2d 1109, 1117 (9th Cir.1989)).

Plaintiffs' allegations are insufficient here because, under the terms of the merger agreement, the C-Cube Defendants were *required* to exercise their options. Defendants sold some of their stock to raise the money necessary to exercise their vested options and purchase the underlying shares. Accordingly, Plaintiffs fail to allege facts from which this court can conclude that insider selling gives rise to a "strong inference" of scienter.

B. *Claims Under Section 14(a) of the 1934 Act and Rule 14a-9 Promulgated Thereunder*

[6] Plaintiffs also bring claims under Section 14(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78n(a), and SEC Rule 14a-9 promulgated thereunder. 17 C.F.R. § 240.14a-9. Plaintiffs allege Defendant Harmonic, and certain of its executives (Ley, Nazarathy, Kvamme, Lane, Lemieux, and Vaillaud) and Defendant New C-Cube and certain of its executives (Balkanski, McKinney, Padval, Valentine, Futa and Reyes) made false or misleading statements in proxy solicitations that were distributed to certain putative class members for the purpose of inducing them to approve the proposed merger between Harmonic and C-Cube (DiviCom) in violation of Section 14(a) and Rule 14a-9.

To state a claim under Section 14(a), a plaintiff must establish that "(1) a proxy statement contained a material misrepresentation or omission which (2) caused the plaintiff injury and (3) that the proxy solicitation, [rather than the particular defect in the solicitation materials], was an 'essential link in the accomplishment of the transaction.' " *Atlantic Coast Airlines Holdings v. Mesa Air Group, Inc.,* 295 F.Supp.2d 75, 81-82 (D.D.C.2003) (quoting *General Elec. Co. v. Cathcart,* 980 F.2d 927, 932 (3d Cir.1992)) (quoting *Mills v. Elec. Auto-Lite Co.,* 396 U.S. 375, 385, 90 S.Ct. 616, 24 L.Ed.2d 593 (1970)).

Moreover, the PSLRA pleading requirements apply to claims brought under Section 14(a) and Rule 14a-9. *See In re McKesson HBOC, Inc. Sec. Litig.,* 126 F.Supp.2d 1248, 1267 (N.D.Cal.2000). However, unlike Section 10(b), Section 14(a) "lacks any reference to a 'manipulative device or contrivance ... to indicate a requirement of scienter." *Id.* at 1263. Accordingly, negligence is sufficient to support a claim for a violation of Section ***683** 14(a) for both forward looking and non-forward looking statements. *Id.* at 1267 ("a Section 14(a) plaintiff must plead with particularity facts that give rise to a strong inference of negligence").

****7** None of Plaintiffs' allegations state a claim under Section 14(a). First, statements that the merger was "in the best interests of the shareholders" were expressions of opinion. *See In re McKesson,* 126 F.Supp.2d 1248 at 1265. To state a claim upon which relief can be granted, plaintiff must allege "particularized facts showing that the opinion was both subjectively and objectively false." *See Virginia Bankshares, Inc. v. Sandberg,* 501 U.S. 1083, 1095-96, 111 S.Ct. 2749, 115 L.Ed.2d 929 (1991). Here, Plaintiffs do not allege such particularized facts. Nor can they show that the merger was not "in the best interests of the shareholders." Even if they could, Plaintiffs' Second Amended Complaint is bereft of facts alleged which demonstrate the directors did not believe that the merger was in the "best interests" at the time they made the recommendation, let alone a "strong inference" of negligence.

Second, Plaintiffs do not allege any facts that would lead an investor to the conclusion Defendants knew AT & T would not be buying as much Harmonic product in the future as it had in the past or that DiviCom's performance was down from its previous comparable levels.

Accordingly, Plaintiffs fail to state a claim for relief under Section 14(a) and Rule 14a-9.

C. *Claims Under Sections 11 and 12 of the 1933 Act*

Next, Plaintiffs bring claims under Sections 11 and 12 of the Securities Act of 1933. 15 U.S.C. §§ 77k, 771(a)(2).

Claims brought under Sections 11 and 12 of the 1933 Act are *not* subject to the heightened pleading requirements of the PSLRA. *See In re Stac Electronics Sec. Litig.,* 89 F.3d at 1404. Rather, only those allegations of violations of Sections 11 and 12 which "sound in fraud" must be pleaded with particularity under Fed.R.Civ.P. 9(b). *See In re Stac,* 89 F.3d at 1404.

2. *Section 11(a) of the 1933 Act*

[7] Defendants may be liable for violations of Section 11 for innocent or negligent misstatements or omissions. *See Herman & MacLean v. Huddleston,* 459 U.S. 375, 382, 103 S.Ct. 683, 74 L.Ed.2d 548 (1983). Plaintiffs allege Defendant Harmonic and certain Harmonic executives (Ley, Dickson, Nazarathy, Kvamme, Lane, Lemieux and Vaillard) made material misstatements or omissions of material fact in Harmonic's Registration Statement. To state a claim under Section 11(a), a plaintiff must allege that: (1) the registration statement contained an omission or misrepresentation; and (2) the omission or misrepresentation was material. *See In re Stac Electronic Sec. Litig.,* 89 F.3d at 1403-04.

Plaintiffs allege Harmonic omitted the following material facts from its Registration Statement on Form S-4 filed with the SEC on March 23, 2000:(1) AT & T's orders from Harmonic had declined and (2) DiviCom's sales had slowed after the October 1999 announcement of the merger between Harmonic and C-Cube (DiviCom).

Plaintiffs allege that in its June 26, 2000 press release, Harmonic disclosed that it expected second quarter revenue of $74 million to $82 million, approximately *half* the amount previously represented by Defendants and expected by the market. The press release also stated that its reduction in earnings was due, in large part, ***684** to the reduction in orders from AT & T. The next day, June 27, 2000, Harmonic's stock declined 47% from over $40 per share to just over $23 per share.

****8** These claims are not "grounded in fraud" because Plaintiffs allege a basis for Section 11 liability other than fraud; i.e., the omission of a material fact from the Registration statement. Notably, plaintiffs do not rely on a unified course of fraudulent conduct or on the "wholesale adoption" of their securities fraud allegations. *See In re Daou Systems, Inc.,* 411 F.3d 1006, 1027-28 (9th Cir.2005). Plaintiffs also disclaim any allegations of fraud. While a disclaimer alone is insufficient to re-characterize a complaint whose gravamen is plainly fraud, here plaintiffs have made an effort to plead a non-fraudulent basis for Section 11 liability. *See In re Stac Electronics Sec. Litig.,* 89 F.3d at 1405 n. 2. Accordingly, Plaintiffs' claims under Section 11 are not subject to Fed.R.Civ.P. 9(b)'s particularity requirements. *See In re Exodus Communications, Inc., Sec. Litig.,* No. C-01-2661-MMC, 2005 WL 2206693, at *1 (N.D.Cal. Sept.12, 2005).

In sum, Plaintiffs' allegations are sufficient to state a claim under Section 11. Plaintiffs allege the Registration Statement contained omissions and allege that the omissions were material. Since the complaint is not "grounded in fraud," that is all that Section 11 requires. *See In re Stac Electronic Sec. Litig.,* 89 F.3d at 1403-04 (citing *Kaplan v. Rose,* 49 F.3d 1363, 1371 (9th Cir.1994)).

2. *Section 12(a)(2) of the 1933 Act*

[8] Plaintiffs also bring claims under Section 12(a)(2) of the 1933 Securities Act against Defendants Harmonic and Ley.

To state a claim under Section 12(a)(2), Plaintiffs must allege: (1) that the prospectus contained an omission or misrepresentation; and (2) that the omission or misrepresentation was material. *See In re Stratosphere Corp. Sec. Litig.,* 1 F.Supp.2d 1096, 1120 (D.Nev.1998) (citing *Pinter v. Dahl,* 486 U.S. 622, 646-48, 108 S.Ct. 2063, 100 L.Ed.2d 658 (1988)).

Here, Plaintiffs reiterate the allegations that the Harmonic Defendants omitted from their prospectus filed with the SEC on March 23, 2000 ("Prospectus") the facts that: (1) AT & T's orders of Harmonic had declined and (2) DiviCom's sales had slowed after the October 1999 announcement of the merger between Harmonic and C-Cube (DiviCom). Plaintiffs also allege Defendants were negligent in omitting to state these facts from their prospectus.

Plaintiffs have adequately pleaded a violation of Section 12(a)(2) by alleging that Defendants negligently omitted material facts from the prospectus. *See In re Stratosphere Corp. Sec. Litig.,* 1 F.Supp.2d at 1120. For the reasons discussed above regarding Plaintiffs' Section 11 claims, Plaintiffs' claims under Section 12(a)(2) are not “grounded in fraud” and, therefore, are not subject to Fed.R.Civ.P. 9(b).

D. *Secondary Claims of Control Person Liability Under § 15 of the 1933 Act and § 20(a) of the 1934 Act*

Finally, Plaintiffs allege secondary claims for “control person” liability against Defendants Harmonic and Ley under Section 15 of the Securities Act of 1933, 15 U.S.C. § 77o, and against Defendants Harmonic, New C-Cube, Ley and Balkanski under Section 20(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78t(a).

****9** As to Plaintiffs' claims under Section 20(a) of the 1934 Act, Plaintiffs have not met the threshold requirement of adequately pleading a primary violation of the ***685** federal securities laws. *See, e.g., Paracor Finance, Inc. v. General Elec. Capital Corp.,* 96 F.3d 1151, 1161 (9th Cir.1996).

To state a claim for control person liability under Section 15 of the 1933 Act, this circuit requires the Plaintiff to plead: (1) the defendant had the power to influence or control the primary violator and (2) the defendant actively used this influence or control so as to be a “culpable participant” in the primary violation. *See Durham v. Kelly,* 810 F.2d 1500, 1503-04 (9th Cir.1987).

[9] Here, as to Defendant Ley, Plaintiffs plead the first prong adequately by alleging Ley's position as President, CEO and Chairman of the Board of Harmonic. *See In re Immune Response Sec. Litig.,* 375 F.Supp.2d 983 (S.D.Cal.2005) (allegations of control by virtue of board position or stock ownership sufficient to meet first prong). Plaintiffs plead the second prong adequately by alleging that Ley signed the Registration statement, and jointly with his co-defendants, actively caused the prospectus to be drafted, revised and approved. *Cf. In re Calpine Corp. Sec. Litig.,* 288 F.Supp.2d 1054, 1081 (N.D.Cal.2003) (Plaintiffs failed to state a Section 15 claim when they did not allege defendants either signed or were involved in the preparation of the prospectus that contained material misstatements or omissions).

[10] Plaintiffs' theory of control person liability against Defendant Harmonic is unclear, since it rests on allegations that Harmonic exerted control over itself. While Plaintiffs thus fail to state a claim against Harmonic under Section 15, they might be able to cure this defect by amending the complaint to identify a primary violator over whom Harmonic exercised control.

IV. Loss Causation

[11] Finally, a private securities fraud action must include allegations of facts establishing economic loss to the plaintiffs caused by the defendants' fraud or misrepresentation. *Dura Pharmaceuticals, Inc. v. Broudo,* 544U.S. 336, ----, 125 S.Ct. 1627, 1629, 161 L.Ed.2d 577 (2005). Here, Plaintiffs failed properly to allege loss causation. Although they allege that the named representatives for the putative class purchased stock during the class period and that the stock price then fell, they do not allege that any of these same Plaintiffs sold stock at a loss caused by the Defendants' fraud or misrepresentation.

Accordingly, Plaintiffs have failed to allege a necessary element to their cause of action for securities fraud under Section 10(b) of the 1934 Act.

V. CONCLUSION

For the foregoing reasons, Plaintiffs have failed adequately to plead violations of Sections 10(b) and 14(a) of the 1934 Act under the heightened pleading standards of the PSLRA. After three attempts, Plaintiffs have failed to plead proper causes of action under the PSLRA. Furthermore, the defects in Plaintiffs' Second Amended Complaint cannot be remedied by further amendment. *See Desaigoudar v. Meyercord,* 223 F.3d 1020, 1026 (9th Cir.2000). Plaintiffs' claim under Section 20(a) of the 1934 Act likewise must also fail. Accordingly, we affirm the district court's dismissal with prejudice of Plaintiffs' 1934 Act claims.

****10** Plaintiffs have, however, pleaded violations of Sections 11 and 12 of the 1933 Act adequately. Accordingly, we reverse the dismissal Plaintiffs' claims under Sections 11 and 12 of the 1933 Act.

Further, Plaintiffs' allegations are sufficient to state a claim against Ley under ***686** Section 15 of the 1933 Act. Thus, we reverse the district court's dismissal of the Section 15 claim against Ley. We affirm dismissal of Plaintiff's Section 15 claim against Harmonic, but grant leave to amend. Each party shall bear its own costs on appeal.

AFFIRMED IN PART, REVERSED IN PART and REMANDED.

C.A.9 (Cal.),2005.
Knollenberg v. Harmonic, Inc.
152 Fed.Appx. 674, 2005 WL 2980628 (C.A.9 (Cal.)), Fed. Sec. L. Rep. P 93,554

END OF DOCUMENT

TAB 11

Only the Westlaw citation is currently available.

United States District Court, N.D. Illinois, Eastern Division.
SEARS, ROEBUCK AND CO., Plaintiff,
v.
SAVOY REINSURANCE CO., LTD., a foreign insurance company, and Corex Corporation, a foreign corporation, Defendants.
No. 90 C 1202.

Nov. 8, 1991.

MEMORANDUM OPINION AND ORDER

HART, District Judge.

***1** Presently pending is plaintiff Sears, Roebuck and Co.'s second motion for summary judgment against defendant Corex Corporation.[FN1] Also pending are Corex's, third-party defendant Cory & Associates, Inc.'s, and third-party defendant Avreco Inc.'s motions for summary judgment on the issue of reformation of the insurance contract issued by defendant Savoy Reinsurance Co., Ltd.[FN2] Sears has moved to strike the motions of Cory and Avreco. Prior to the filing of these motions, counsel for Savoy was permitted to withdraw because the client would not cooperate with counsel. Appropriate officials at Savoy were properly notified of counsel being permitted to withdraw and of the need to hire new counsel. Nevertheless, no one representing Savoy has appeared at status hearings nor filed any court documents since counsel withdrew and it may be that Savoy is no longer a viable and functioning organization. *See National Cycle, Inc. v. Savoy Reinsurance Co.,* 938 F.2d 61, 64 (7th Cir.1991). Thus, Savoy has not filed a response to any of the pending motions and also failed to respond to Cory's request for admissions, the response to which was due after Savoy's counsel withdrew.

On a motion for summary judgment, the entire record is considered with all reasonable inferences drawn in favor of the nonmovant and all genuine factual disputes resolved in favor of the nonmovant. *Oxman v. WLS-TV,* 846 F.2d 448, 452 (7th Cir.1988); *Jakubiec v. Cities Service Co.,* 844 F.2d 470, 471 (7th Cir.1988). The burden of establishing a lack of any genuine issue of material fact rests on the movant. *Id.* at 473. The nonmovant, however, must make a showing sufficient to establish an essential element for which it will bear the burden of proof at trial. *Celotex Corp. v. Catrett,* 477 U.S. 317, 332 (1986). In such instances, the movant need not provide affidavits or deposition testimony showing the nonexistence of these essential elements. *Id.* at 324. Also, it is not sufficient to show evidence of purportedly disputed facts if those facts are not plausible in light of the entire record. *Collins v. Associated Pathologists, Ltd.,* 844 F.2d 473, 476-77 (7th Cir.), *cert. denied,* 488 U.S. 852 (1988).

This case is before the court on diversity jurisdiction, complete diversity of citizenship being present. Because the parties have assumed that Illinois law applies to the claims in this case, the substantive law of Illinois will be applied. *See Wood v. Mid-Valley Inc.,* No. 90-3586, slip op. at 1-3 (7th Cir. Aug. 14, 1991); *Shore v. Dandurand,* 875 F.2d 656, 659 (7th Cir.1989); February Order at 2.

In September 1986, Sears contracted to purchase bicycles from Corex for resale in Sears retail outlets. The contract between Corex and Sears has the following two provisions that are relevant to the present dispute:

INDEMNITY-Seller agrees to protect, defend, hold harmless and indemnify Purchaser and Purchaser's agents and distributors from and against any and all claims, actions, liabilities, losses, costs and expenses (1) arising out of any actual or alleged infringement of any patent, trademark or copyright by any merchandise sold to Purchaser hereunder, or any unfair competition involving such merchandise, or (2) arising out of any actual or alleged death of or injury to any person, damage to any property, or any other damage or loss, by whomsoever suffered, resulting or claimed to result in whole or in part from any actual or alleged defect in such merchandise, whether latent or patent, including actual or alleged improper construction or design of such merchandise or the failure of such merchandise to comply with specifications or with any express or implied warranties of Seller, or

(3) arising out of any actual or alleged violation by such merchandise, or its manufacture, possession, use or sale, of any law, statute or ordinance or any governmental administrative order, rule or regulation of either the country of origin or the country of destination, or (4) arising out of Seller's assembly or installation of merchandise covered by this Contract.

***2** These agreements and obligations of Seller shall not be affected or limited in any way by Purchaser's extension of express or implied warranties to its customers, except to the extent that any such Purchaser's warranties expressly extend beyond the scope of Seller's warranties, express or implied, to Purchaser.

INSURANCE-Seller agrees to obtain and maintain, at its expense, during the term of this Contract, a policy or policies of Product Liability Insurance, with Vendor's Endorsement naming Purchaser, in such amounts and in such companies and containing such other provisions which shall be satisfactory to Purchaser, covering purchases of merchandise made hereunder. All such policies shall provide that the coverage thereunder shall not be terminated without at least thirty (30) days prior written notice to Purchaser. The Insurance Carrier must have adequate claim handling representation in the United States. A copy of the Policy in the English language indicating the foregoing coverage must be furnished to Sears Buying Services unit at the address shown on the reverse side.

The purchase agreement is a form contract written by Sears.

On September 30, 1987, Yaeno Lopez, as guardian ad litem for Toshinori Tamari Lopez (“Lopez”), a minor, brought suit against Sears and numerous Doe defendants, including Doe corporations and partnerships. The suit was filed in the Circuit Court of the Third Circuit in Hawaii. In the complaint, it is alleged that Lopez's father purchased a bicycle from Sears on May 8, 1987. It is alleged the bicycle came in a sealed carton and that employees of Sears assembled the bicycle. Lopez allegedly was severely injured on May 10, 1987 when the brakes on the bicycle malfunctioned. The complaint contains numerous alternative allegations. Although all acts are alleged to have been committed by Sears, including the manufacture of the bicycle, it is alternatively alleged that Does were responsible for some of the alleged conduct. There are specific allegations as to improper assembly of the bicycle by Sears employees, but it is also alleged that “Defendant ‘SEARS' is negligently responsible and/or strictly liable for the sale and/or manufacture of the defective ‘BICYCLE’ which was negligently and/or defectively designed, manufactured, assembled, marketed, delivered, distributed and/or sold to Plaintiff.”

Lopez's claim was tried to a jury which reached a verdict on April 12, 1990. [FN3] The special verdict form contained nine questions. The jury specifically found that the bicycle was in a defective condition and that the brakes on the bicycle were in the same condition both at the time the bicycle was sold and at the time of the accident. The defective condition was found to be a legal cause of the injuries to Lopez. Sears was also found to be negligent and Sears's negligence was found to be a legal cause of Lopez's injuries. Lopez's negligence was also found to be a legal cause of his injuries. The jury found that Lopez suffered $500,000 in general damages, but the verdict was only for $450,000 because the combined negligence of the two parties was found to be 90% for Sears and 10% for Lopez. With costs and post-judgment interest, Sears paid Lopez $463,768.[FN4]

***3** The following facts are also undisputed. Lopez's bicycle was one supplied to Sears by Corex. Corex hired third-party defendant Cory as its broker to procure the products liability insurance required by the contract with Sears. Corex requested that Cory include a broad form vendors endorsement in the policy. Cory obtained insurance from Savoy, the defendant in Count I of Sears's complaint and also a defendant and plaintiff in various third-party actions joined in the present suit. In April 1987, Cory sent Sears a certificate of insurance indicating the Savoy policy included vendor coverage for Sears. However, Savoy issued a products liability policy form that did not provide such coverage.

Consistent with the February Order at 8 n. 4, the parties (other than Savoy) all agree that the policy of insurance that was required to be procured would have provided coverage for the costs of Sears's defense of the *Lopez* suit, though disputes remain as to whether the damages paid to Lopez would have been covered. Thus the parties agree that either Savoy is liable to Sears for these amounts or Corex is liable for failure to procure a proper policy. The parties agree that, as written, the policy issued by Savoy provides no coverage for Sears. In the February Order at 7-8, it was held that no sufficient evidence was presented by Corex to support a finding that Corex procured adequate insurance. However, Sears was not granted summary judgment on the failure to procure claim against Corex because there was no indication that Sears was willing to drop its claim against Savoy that Sears was entitled to coverage under the policy issued by Savoy. While parties are permitted to plead in the alternative, Sears was not going to be permitted to be granted summary judgment on liability against one defendant while continuing to pursue an inconsistent position against another defendant. Presently, Sears represents that it is willing to dismiss the claim against Savoy if summary judgment is granted against Corex. Sears only refers to dismissal without prejudice. Corex, Cory, and Avreco,[FN5] argue that the evidence presently before the court shows that the Savoy policy should be reformed to provide coverage for Sears.[FN6] Since new evidence is before the court, that issue must be revisited.

In the February Order at 8-11, it was also held that factual disputes existed on the question of whether Sears was entitled to indemnity from Corex under the indemnity provision of their purchase agreement. Sears, as well as Corex, point to additional evidence on that issue so that it also must be revisited.

Whether the Savoy policy provides coverage for Sears is a central issue in resolving the failure to procure claim. Also, if the failure to procure claim is unsuccessful, the Cory parties agree that the various third-party and cross claims that they have brought would be rendered moot. Finding Savoy directly liable to Sears might not moot Savoy's third-party and cross claims, but Savoy's failure to oppose the summary judgment motions of the Cory parties would justify dismissing Savoy's claims against them.[FN7]

***4** The Cory parties contend that the policy issued by Savoy, which omits vendor coverage, was issued by mistake and therefore this contract of insurance should be reformed to include vendor coverage for Sears. Corex also argues that Savoy is estopped from disputing any claim by Sears or that Savoy ratified the vendor endorsement issued by Cory by not raising any objections when it first learned of the issuance of such a policy.

The Cory parties contend that Imperial Management, Inc. was the underwriting manager for Savoy during the relevant time period. They further contend that, acting as Savoy's agent, Imperial quoted a price of $55,000 as the premium on the Corex policy. Most importantly, they contend that this price included broad form vendors coverage, which was consistent with the application for coverage filed on Corex's behalf.[FN8] The quotation is claimed to have been made orally with no written confirmation being issued. In support of these facts, the Cory parties point to Cory's request to admit to which Savoy failed to respond, the responses having come due after Savoy's counsel withdrew from the case.[FN9] Sears contends it is “inequitable” to use the failure to respond to the request for admissions since Savoy was unrepresented at the time and Savoy's pleadings are to the contrary.

At trial, responses or nonresponses to requests for admissions can only be used against the party to whom they were issued. C.A. Wright & A. Miller, *Federal Practice & Procedure* § 2264 at 741 (1970). This is consistent with Fed.R.Evid. 801(d)(2) (admission by party-opponent). Thus, it is clear that the requests for admissions could not be used against Sears at trial even though they could be used against Savoy unless Savoy is able to have the admissions withdrawn prior to the time of trial. On summary judgment, though the document used must contain admissible evidence, the document itself need not be admissible at trial. *See* Wright & Miller, § 2264 at 308 n. 76 (1991 Supp.). For example, ordinarily an affidavit used for summary judgment is not itself admissible at trial. Instead, the requirement is that the affidavit contain statements which the affiant could testify to on personal knowledge if called at trial. Therefore, if the requests for admission are indicative of testimony which Savoy could provide at trial as against Sears, then the requests for admission are appropriate to consider as to the summary judgment motion of Sears. The Cory parties, however, point to no one at Cory, Savoy, or Imperial Management who could testify in support of the admitted facts. The defaulted admissions of Savoy will not be considered as against Sears. [FN10]

Absent the admissions, there is no evidence to support that Savoy provided a quote for coverage that included a vendors endorsement. There is, however, undisputed evidence that an application for vendors coverage was submitted. From this it could be inferred that Savoy would have intended to issue a policy containing vendors coverage. On the other hand, that Savoy issued a policy lacking the vendors endorsement is evidence that Savoy did not intend to provide vendors coverage. Absent other additional evidence,[FN11] the inference that can be drawn from the application is insufficient to create a factual dispute. *National Cycle, Inc. v. Savoy Reinsurance Co.,* No. 89 C 7751 at 7-9 (N.D.Ill. July 27, 1990), *aff'd,* 938 F.2d 61 (7th Cir.1991). Given that the policy as issued does not contain the vendors endorsement, the burden of proof should be placed on the Cory parties to show that the policy as issued was the result of a mistake and that it should be reformed to provide coverage for Sears. *Cf. Virginia First Savings & Loan Association v. Wells,* 224 Va. 691, 299 S.E.2d 370 (1983) (burden on defendant to prove plaintiff would not have qualified for insurance that defendant failed to attempt to procure); *Colonial Savings Association v. Taylor,* 544 S.W.2d 116 (Tex.1976) (burden on defendant to show plaintiff negligent in not examining policy and discovering that defendant procured inadequate insurance). Since Corex has not satisfied this burden, it must be concluded, for the purpose of deciding Sears's summary judgment motion, that a policy was purchased by Corex which did not provide vendors coverage. There is no sufficient basis in the present record for denying Sears's motion as to Count II on the ground that the insurance policy issued is subject to reformation.

***5** Corex also contends that adequate insurance was obtained because Savoy ratified the policy that Cory had issued indicating there was a vendors endorsement. Corex relies on Savoy learning on June 24, 1988 that Cory had previously issued a policy indicating there was a vendors endorsement. Corex contends that Savoy thereafter failed to disclaim coverage and thereby ratified the policy as issued by Cory. Corex's contention, however, lacks factual support. Sears tendered defense of Lopez's claim and the subsequent lawsuit to Savoy in 1987. At that time, Savoy declined to provide coverage. Thus, Savoy protected its rights in a timely manner. Also, Corex contends that "after learning of the issuance of the certificate of insurance and the vendors endorsement by CORY, SAVOY was silent with respect to their effect." This is a mischaracterization of the deposition testimony of Billie Bruner, a claims manager for Imperial Adjusters, Savoy's claims adjuster. Bruner did testify that he did not write or call Sears or the other parties after learning of the vendors endorsement issued by Cory, but this is said to be because he had already made clear to the other parties Savoy's position that it had issued a policy without any vendors endorsement, a fact that Corex chooses to ignore. Viewing this evidence in the light most favorable to Corex, it is still insufficient to support a finding that Savoy ratified the Cory-issued policy with the vendors endorsement.

Corex also contends that Savoy is estopped from denying coverage for Sears because Savoy breached its duty to defend Sears. Savoy, however, is only estopped from denying coverage if it is shown that it breached a contractual duty to defend. *See Maneikis v. St. Paul Insurance Co. of Illinois,* 655 F.2d 818, 821-22 (7th Cir.1981); *National Cycle,* 938 F.2d at 63. There is no dispute, however, that the policy issued by Savoy did not provide any coverage for Sears. Therefore, Savoy breached no duty by declining to defend Sears.

There being no factual dispute as to the question of whether Corex breached its obligation to procure insurance for Sears, Sears is entitled to summary judgment against Corex on Count II of Sears's complaint. Count I against Savoy will be dismissed with prejudice. Although Sears apparently can obtain the same relief on either Count II or III, it will not be possible to issue a final judgment until both counts are resolved. *Cf. Indiana Harbor Belt R.R. v. American Cyanamid Co.,* 860 F.2d 1441 (7th Cir.1988). Therefore, summary judgment as to Count III, the indemnity claim, will also be considered.

In the February Order at 8-9, summary judgment on Count III was denied on the ground that it was not indisputably shown that Lopez's injuries were caused in whole or in part by a design or manufacturing defect of Corex nor that Lopez's claim to that effect was substantial throughout the litigation. While Sears has now supplied some of the trial testimony of Lopez's expert, that testimony does not clarify the basis for holding Sears liable in the *Lopez* case. The expert testified there was a defect in the brakes, principally a failure to debur the ferrule. In an affidavit prepared for the present case, the expert states that it is his opinion that the defect resulted from negligent assembly of the bicycle by Sears's employees, which is consistent with the report the expert prepared for the *Lopez* trial. There is, however, nothing before this court as to what supporting evidence was introduced at the *Lopez* trial regarding manufacture and assembly of the bicycle. An expert's opinion carries no weight unless the facts he relies on to reach his conclusions are also proven.

***6** On the present record, summary judgment on Count III in favor of Sears would certainly be inappropriate because, to the extent any conclusions can be reached, the evidence before the court indicates it may have been Sears's negligent assembly, not a design or manufacturing defect of Corex, that caused the brakes to fail so that Lopez was injured. Summary judgment for Corex on Count III is also inappropriate because Corex has not so moved and, in any event, the record is insufficient to conclusively determine there is no dispute as to the cause of the brake failure.[FN12]

Corex is liable to Sears for failing to procure insurance as it had agreed to do in the purchase agreement with Sears. Corex, therefore, stands in the shoes of the insurer and must reimburse Sears for whatever expenses an insurer would have been obliged to reimburse Sears. *Gothberg v. Nemerovski,* 58 Ill.App.2d 372, 208 N.E.2d 12, 19 (1st Dist.1965); *Connor v. Thompson Construction & Development Co.,* 166 N.W.2d 109, 112 (Iowa 1969) (followed in *Zettel v. Paschen Contractors, Inc.,* 100 Ill.App.3d 614, 427 N.E.2d 189, 191 (1st Dist.1981)); *Midwest Lumber Co. v. Dwight E. Nelson Construction Co.,* 188 Neb. 308, 196 N.W.2d 377, 379-80 (1972) (same). Having violated its duty to defend Sears,[FN13] Corex cannot now contest whether the damages awarded would have been covered by the policy.[FN14] *See National Cycle,* 938 F.2d at 63.

Even if Corex is not to be treated the same as an insurer violating the duty to defend so that the underlying facts can be examined, it is clear that the policy that Corex should have procured would have covered Sears's liability in the *Lopez* case. It can be presumed that “the parties contemplated such form of policy containing such conditions and limitations as are usual in such cases or have been used before between the parties.” *Scarsdale Villas Associates, Ltd. v. Korman Associates Insurance Agency, Inc.,* 178 Ill.App.3d 261, 533 N.E.2d 81, 83 (1st Dist.1988). Therefore, it is assumed that, under the purchase agreement, the “Vendor's Endorsement” required to be procured was the standard broad form vendors endorsement, which is what was attached to the Cory-issued policy. That endorsement provides in ¶ 1: “The insurance with respect to the vendor does not apply to: ... (b) bodily injury ... arising out of ... installation, ... except such operations performed at the vendor's premises in connection with the sale of the product.” Thus, even if the cause of Lopez's injuries was, in whole or in part, negligent assembly of the bicycle, injury caused by such negligence would be covered by a properly procured policy containing the broad form vendors endorsement.

On Count II, Sears is entitled to be reimbursed for the full judgment paid to Lopez as well as its reasonable litigation expenses defending the *Lopez* case. Also, Sears is entitled to prejudgment interest on both the *Lopez* judgment amount and Sears's litigation expenses. *See Ervin v. Sears, Roebuck & Co.,* 127 Ill.App.3d 982, 469 N.E.2d 243, 250 (5th Dist.1984). Interest at the rate of five percent per annum on the claim should be calculated from the time there was a “sum certain,” which would be the date the damages were paid to Lopez. In accordance with *Ervin,* interest on the litigation expenses may be computed from the date the expenses were incurred.

***7** Sears also seeks attorney's fees for the present lawsuit. The Illinois appellate courts are split on the issue of whether an insured is entitled to its attorney's fees for bringing a declaratory judgment action against an insurer. For the time being, the Seventh Circuit has resolved the split in favor of holding that fees are appropriate where “a breach of the duty to defend ‘forced’ the insured to bring a declaratory judgment [action] against the insurer.” *National Cycle,* 938 F.2d at 64 (quoting *A. Kush & Associates, Ltd. v. American States Insurance Co.,* 927 F.2d 929, 935 n. 8 (7th Cir.1991)). Recognizing that this is the minority view of the Illinois appellate courts and that the support for such a holding is questionable, the Seventh Circuit has held that this rule should be narrowly applied. Even though Corex has stepped into the shoes of the insurer, it is not actually an insurer. *See Zettel,* 427 N.E.2d at 191. Therefore, the rule set forth in *National Cycle* does not apply in this case. Sears is not entitled to recover its fees expended in the present lawsuit.

Having resolved Sears's motion, the summary judgment motions of the other parties still remain to be resolved. Given Savoy's present posture in this case, defaulting Savoy on both its own claims and the claims against it is appropriate. Judgment, however, will not be entered at this time since other claims in this case still remain to be resolved. The default order will be subject to being vacated if Savoy makes an appropriate motion prior to the resolution of the entire case.

Counts I and II of Sears's complaint have been resolved, though the issue of the precise amount of the liability still remains, in particular the amount of attorney's fees.[FN15] But even if the amount of the judgment were to be resolved and Sears withdrew Count III, this would not be an appropriate case for entering a Rule 54(b) judgment given the interrelatedness of the various claims in this case. Still to be resolved are the cross-claims and counterclaims between Corex, Cory, and Avreco. On December 17, 1991 at 9:15 a.m., the parties shall file a proposed pretrial order addressing the remaining issues in this case. To the extent Sears and Corex can stipulate as to some or all of the amounts of relief and/or appropriate declaratory relief if any, such stipulations shall be included with the pretrial order. To the extent disputes remain on those issues, the issues should be addressed in the pretrial order. Assuming Savoy does not cure its defaults, issues as to appropriate relief against Savoy should also be addressed.

IT IS THEREFORE ORDERED that:

(1) Sears's motion for summary judgment against Corex is granted in part and denied in part. Sears's motion to strike Cory's summary judgment motion is denied. The summary judgment motion of Cory against Savoy that is also joined in by Corex and Avreco is granted in part and denied in part.

(2) Summary judgment on liability is granted in favor of Sears and against Corex on Count II of Sears's complaint. Count I of Sears's complaint is dismissed with prejudice.

***8** (3) Savoy is found to be in default on its claims and counterclaims and is also found to be in default on the third-party, cross, and counterclaims against it.

(4) A status hearing to report on the possibility of settlement set for November 15, 1991 at 9:15 a.m.

(5) The parties shall submit an original and copy of a proposed pretrial order in open court on December 17, 1991 at 9:15 a.m.

FN1. A motion for summary judgment previously brought by Sears against Corex was denied. *See* Order dated Feb. 14, 1991 (hereinafter “February Order”).

FN2. Cory's motion is for summary judgment on its reformation counterclaim against Savoy. Corex and Avreco have joined in that motion without specifying on which claims they are seeking summary judgment. Corex has a reformation cross-claim against Savoy and Avreco has a negligence counterclaim against Savoy. Corex and Cory also raise reformation-like defenses to the claims Savoy has made against each of them and reformation is also an issue related to Sears claim against Corex.

FN3. The complaint in the present case was filed on March 2, 1990 and was brought as a declaratory action. A verdict was subsequently reached in the *Lopez* action. Sears presently requests damages in amounts already expended and a declaratory judgment as to further relief in that an appeal is pending.

FN4. While there is no dispute as to what Lopez alleged in his complaint nor as to the language of the special verdict, this does not mean that the parties are in agreement as to the facts proven by Lopez at his trial.

FN5. Corex, Cory, and Avreco will be referred to jointly as the “Cory parties.”

FN6. Sears argues that Cory and Avreco lack standing to raise the issue of reformation because they are not parties to the insurance contract. That argument is moot because Corex also joined in the motion and Corex is a party to the insurance contract. In any event, certain of the third-party and cross claims contend that Cory and Avreco are liable for any failure by Corex to procure an adequate policy. It is a defense to such claims that adequate insurance was procured. Therefore, it is appropriate for Cory and Avreco to raise such an issue. Also, in its counterclaim against Savoy, Avreco characterizes its claim against Savoy as one for negligence, not as one for reformation of the contract.

FN7. Although any motion involving Savoy could be unfavorably determined against Savoy based on Savoy's default, Sears makes the argument that Savoy's policy does not provide coverage to Sears, it apparently being preferable to Sears to obtain a judgment against Corex rather than Savoy, Corex appearing to be the more substantial creditor. Therefore, the issue of Savoy's liability under the insurance policy will be addressed on its merits, not merely decided on Savoy's default.

FN8. Sears does not dispute that the application requested a broad form vendors endorsement.

FN9. The Cory parties do not explain why no person associated with Cory can testify as to the oral communication. They do contend that the person at Imperial Management who allegedly communicated the quote is now deceased.

FN10. As against Savoy, however, the unanswered requests for admissions may be considered. *See Donovan v. Porter,* 584 F.Supp. 202, 207-08 (D.Md.1984). As in the February Order, however, the dispute between the Cory parties and Savoy will not be ruled upon inconsistently with any ruling as to the dispute between Sears and Corex or inconsistently with any disputes between Corex and the other parties.

FN11. For example, the deposition testimony or affidavits of the Cory employee involved in the transaction would likely be relevant. (Some excerpts from the deposition of a person named McKinney is provided by Corex. He may have been the Cory employee communicating with Savoy, but the excerpts provided do not make clear McKinney's role nor does he refer to any statements on this issue from a Savoy employee.) Also, evidence as to the appropriate price for coverage with and without the vendors endorsement would be indirect evidence of Savoy's understanding as to what type of coverage was intended.

FN12. Having already succeeded on Count II, Sears may no longer be interested in pursuing Count III. That, however, is a decision for Sears, not the court. If Sears does move to voluntarily dismiss Count III, it may do so without prejudice.

FN13. Corex initially defended Sears based on the retained limitation of the policy with Savoy. The limit, however, was soon reached and Corex stopped providing a defense.

FN14. As was discussed in the February Order at 8-9, under the indemnity provision of the purchase agreement, Corex would be able to contest whether the *Lopez* judgment was covered by the indemnity agreement even if Corex failed to defend the case. That, however, is a holding as to Count III. For Count II liability, Corex becomes the insurer and the rules applicable to insurers will be applied.

FN15. Corex claims it has not been given access to the attorney's fees records, but no motion as to discovery on that issue is pending. In any event, it is hoped that this issue can be resolved by the parties.

N.D.Ill.,1991.
Sears, Roebuck & Co. v. Savoy Reinsurance Co., Ltd.
Not Reported in F.Supp., 1991 WL 247583 (N.D.Ill.)

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