UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION

Plaintiff,

vs.

10 Civ. 00457 (GLS/DRH)

MCGINN, SMITH & CO., INC.
McGINN, SMITH ADVISORS, LLC,
McGINN, SMITH CAPITAL HOLDINGS CORP.,
FIRST ADVISORY INCOME NOTES, LLC,
FIRST EXCELSIOR INCOME NOTES, LLC,
FIRST INDEPENDENT INCOME NOTES, LLC,
THIRD ALBANY INCOME NOTES, LLC,
TIMOTHY M. MCGINN, AND
DAVID L. SMITH, LYNN A. SMITH,
DAVID M. WOJESKI, Trustee of the David L.
and Lynn A. Smith Irrevocable Trust U/A 8/04/04,
GEOFFREY R. SMITH, LAUREN T. SMITH, and
NANCY MCGINN,

Defendants,

LYNN A. SMITH, and
NANCY MCGINN,

Relief Defendants, and

DAVID M. WOJESKI, Trustee of the David L.
and Lynn A. Smith Irrevocable Trust U/A 8/04/04,

Intervenor.

MEMORANDUM OF LAW IN SUPPORT OF THE OPPOSITION TO THE PLAINTIFF'S MOTION FOR CONTEMPT BY DEFENDANTS TIMOTHY M. MCGINN AND DAVID L. SMITH

TABLE OF CONTENTS

Page

PRELIMINARY STATEMENT 1

BACKGROUND 2

ARGUMENT

I. The SEC's Contempt Motion Must Be Denied Because It Does Not Meet Its Burden To Prove A Violation Of The PI Order Occurred By "Clear and Convincing" Evidence 3

a. The SEC's motion based upon Section 10(b) of the Securities Exchange Act must be denied because it fails to establish a purchase or sale of SAC notes 5

b. The SEC's motion based upon Section 17(a) of the Securities Act must be denied because it fails to establish an offer or sale of a SAC note 7

II. The SEC's Motion For An Order Of Contempt Must Be Denied Because The SEC Failed To Meet the Basic Notice Pleading Requirement That Fraud Be Pled With Particularity 11

III. The Alleged Omissions The SEC Identifies Are Not Material And Cannot Form The Basis For A Securities Law Violation 13

CONCLUSION 19

TABLE OF AUTHORITIES

Azrielli v. Cohen Law Offices
21 F.3d 512 (2d Cir. 1994)..5

Fendi Adele S.R.I. v. Burlington Coat Factory Warehouse Corp.
No. 06-Civ.- 0085(LBS), 2007 WL 2982295 (S.D.N.Y. Oct. 10, 2007).............3, 4

In re Marsh & McLennan Co., Inc. Securities Litigation
501 F. Supp. 2d 452, (S.D.N.Y. 2006) 13

In re Ressler Hardwoods and Flooring, Inc.
No. 1:08-bk-01878MDF, 2009 WL 975155 (Bkrtcy. E.D. Pa. April 1, 2009)......14

In re Time Warner Inc. Securities Litigation
9 F.3d 259 (2d Cir. 1993)...13, 14

In Re Worldcom, Inc.
263 F. Supp. 2d 745 (S.D.N.Y. 2003)...6

Lasater v. Goss
No. 90-cv-40154 (FL), 1991 WL 354886 (E.D. Mich. July 25, 1991)...................6

Levin v. Tiber Holding Corp.
277 F.3d. 243 (2d Cir. 2002)...4

Mills v. Polar Molecular Corp.
12 F.3d 1170 (2d Cir. 1993)...11

Press v. Chemical Investment Services Corp.
166 F.3d 529 (2d Cir. 1999)..5

Radiation Dynamic, Inc. v. Goldmuntz
464 F.2d 876 (2d Cir. 1972)..6

SEC v. American Berryllium & Oil Corp.
303 F. Supp. 912 (S.D.N.Y. 1969) 8

SEC v. Brown
Civ. No. 09-1423 (GK), 2010 WL 3786563 (D.D.C. Sept. 27, 2010).................7, 8

SEC v. First Jersey Securities, Inc.
101 F.3d 1450 (2d Cir. 1996)..14

SEC v. Pentagon Capital Mgmt. PLC
612 F. Supp. 2d 241 (S.D.N.Y. 2009)....11

Stevelman v. Alias Research Inc.
174 F.3d 79 (2d Cir. 1999)....12

Stringfellow v. Haines,
309 F.2d 910 (2d Cir. 1962)....3

STATUTES

15 U.S.C. § 77q(a) 7

15 U.S.C. § 78j(b)....5

17 C.F.R. §230.502(b) 14, 15, 16

17 C.F.R. § 240.10b-5....5

F.R.C.P. 9(b) 11

Defendants Timothy M. McGinn and David L. Smith ("Defendants"), by and through their undersigned attorneys, oppose the motion for contempt made by plaintiff as follows:

Preliminary Statement

The Securities & Exchange Commission's ("SEC") motion is frivolous. The allegations made do not even satisfy basic pleading requirements of either the federal securities laws or the Federal Rules of Civil Procedure. And the so-called evidence falls remarkably short of the mark established by the heightened "clear and convincing" evidence standard applicable to this motion. Were there sufficient time, the SEC would be the recipient of a Rule 11 letter and motion.

As the primary enforcers of the securities laws, the SEC cannot claim to be unfamiliar with the elements of the antifraud provisions of the securities laws. Nonetheless, in its motion the SEC asserts a violation of Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rule 10b-5 without even alleging – or presenting evidence – that there was a "purchase or sale" of securities. It is basic hornbook law that a violation of 10b-5 cannot be found in the absence of a transaction. The SEC also ventures to claim a violation of Section 17(a) of the Securities Act of 1933 (the "Securities Act") without providing any evidence that an offer to sell securities (in this case SAC notes) was made to an investor. Again, this assertion is made despite established law requiring an offer or sale. The complete absence of these basic elements suggests that the SEC has an improper motive in bringing this motion – perhaps additional negative publicity that will interfere with the Defendants' livelihood.

It is clear that the SEC has acted with malice here. The SEC has even requested that this Court find that David Smith has violated the securities laws in contempt of the preliminary injunction order despite the fact that it admits that it does not even know what role, if any, Mr.

Smith played. Moreover, the SEC fails to allege or present a scintilla of evidence that Mr. Smith participated in the offer of securities to any investor. The only allegation it can muster is that Mr. Smith was listed as an officer of the SAC for a period of time and resigned. It is incredible that the SEC would even suggest to this Court that such an allegation is sufficient to sustain a finding that Mr. Smith violated the securities laws.

Numerous fatal defects in the SEC's allegations and evidence which warrant a denial of the motion for contempt are described below. The total lack of substance in the SEC's papers also warrants sanctions to prevent the SEC from behaving similarly in the future.

Background

On November 3, 2010, SEC filed the instant motion by order to show cause to hold Defendants McGinn and Smith in contempt of the Court's Preliminary Injunction Order dated July 22, 2010 (the "PI Order"). On November 4, 2010, the Court held a hearing. During the hearing, counsel for Defendants requested that the motion proceed on notice and that discovery be permitted. The Court denied Defendants' requests, holding that on November 17, 2010 a hearing would be held to determine whether an evidentiary hearing is necessary. It also ordered Defendants McGinn and Smith to show cause why they should not be held in contempt.

It is a matter of public record that the SEC investigated this matter for several weeks, interviewed witnesses and obtained documents through subpoena before filing its ridiculously thin allegations. Defendants Smith and McGinn have not been afforded an opportunity to conduct discovery in this matter and are prejudiced in their ability present evidence in response to the allegations leveled by the SEC. Most of the pertinent witnesses reside outside the jurisdiction of this Court, are not within the control of Defendants, and have been cooperating with the SEC. If an evidentiary hearing is required, Defendants must first be permitted to take the depositions of (at a minimum) Anchor Alarm Center, Inc. ("Anchor"), Paul Zindell, Michael Latty, Bill Knox, Jeffrey Faye and Quantum National Bank ("Quantum Bank") – all of which reside more than 100 miles from the NDNY courthouse – to obtain their testimony for trial, and rebut the untrue assertions presented by the SEC in its papers. In addition, Defendants must be permitted to take the deposition of Carolyn Gracey with respect to the proposed securities offering by Security Alarm Credit, LLC ("SAC"). Finally, Defendants require time to hire an expert witness to testify as to the disclosure requirements of Regulation D in a securities offering such as the one allegedly conducted by SAC. *See*, Declaration of Martin P. Russo, dated November 12, 2010, ("Russo Decl.") ¶ 2.

For the purposes of this opposition, Defendants will address the SEC's arguments and the absence of factual "evidence" purportedly supporting them below.

<u>Argument</u>

I. THE SEC'S CONTEMPT MOTION MUST BE DENIED BECAUSE IT DOES NOT MEET ITS BURDEN TO PROVE A VIOLATION OF THE PI ORDER OCCURRED BY "CLEAR AND CONVINCING" EVIDENCE

The SEC's motion to hold Defendants in contempt of the PI Order in this case should be denied because the SEC has failed present clear and convincing evidence that a violation of the securities laws has occurred.

It is well established that to hold a party in civil contempt of a court order, the moving party must make a showing by "clear and convincing" evidence that a violation occurred. *See generally*, *Stringfellow v. Haines*, 309 F.2d 910, 912 (2d Cir. 1962) ("[I]n civil contempt, although the reasonable doubt requirement does not prevail, 'a bare preponderance of the evidence will not suffice . . . Proof of violation must be clear and convincing.'") (quoting *Coca-Cola Co. v. Feulner*, 7 F. Supp. 364, 365 (S.D. Texas 1934); *see also Fendi Adele S.R.I. v.*

Burlington Coat Factory Warehouse Corp., No. 06-Civ.- 0085(LBS), 2007 WL 2982295, *3 (S.D.N.Y. Oct. 10, 2007). The moving party must show that the alleged violator "'had knowledge of and disobeyed a clear, explicit and lawful order of the court and that the offending conduct prejudiced the right of the opposing party.'" *Levin v. Tiber Holding Corp.*, 277 F.3d. 243, 251 (2d Cir. 2002) (holding that the district court's finding that there was no showing of contempt to support a claim of aiding and abetting contempt). The "clear and convincing evidence" standard requires "a quantum of proof adequate to demonstrate a 'reasonable certainty' that a violation occurred." *Id.* One of the recognized defenses to an allegation of civil contempt is that the "… proof of non-compliance fails to meet the clear and convincing standard of proof." *Fendi Adele S.R.I.*, 2007 WL 2982295 at *3.

In the *Levin* case, the court held that the underlying claim of contempt necessary to support a claim of aiding and abetting contempt was not established by clear and convincing evidence. 277 F.3d. at 252. There, it was alleged that certain payments made by a third party to an entity subject to a consent order was done to divert assets away from the movant in violation of the order. *See id.* at 247. The court found, however, that showing that the actions of the alleged violator and aider and abettor might have been "suspect" was not sufficient to meet the clear and convincing evidence standard. *See id.* at 251.

As is set forth more fully below, the SEC has provided no evidence that the Defendants are violating the PI Order by engaging in any activities related to SAC. It has not properly alleged any conduct which could reasonably be considered a violation of the securities laws necessary to support its claim for contempt of the PI Order. Like the movant in the *Levine* case, simply asserting that the Defendants' activities on behalf of SAC is suspect is insufficient to meet the clear and convincing evidence standard.

a. The SEC's Motion based upon Section 10(b) of the Securities Exchange Act Must Be Denied Because It Fails to Establish A Purchase or Sale of SAC Notes

The SEC's motion must be denied because the SEC does not present any evidence to satisfy the "in connection with" requirement of Section 10(b) of the Exchange Act and Rule 10b-5. The Exchange Act provides, in pertinent part, that it shall be unlawful for any person:

> (b) To use or employ, *in connection with the purchase or sale of any security* registered on a national securities exchange or any security not so registered, or any securities-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act), any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j(b) (emphasis added). The rules promulgated under that section further provide, in pertinent part, that it shall be unlawful for any person:

> (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
>
> ***************************
>
> *in connection with the purchase or sale of any security.*

17 C.F.R. § 240.10b-5. (emphasis added).

Courts in the Second Circuit have interpreted the "in connection with" language to mean that "the act complained of somehow induced the purchaser to purchase the security at issue." *Press v. Chemical Investment Services Corp.*, 166 F.3d 529, 537 (2d Cir. 1999); *see generally Azrielli v. Cohen Law Offices*, 21 F.3d 512, 518 (2d Cir. 1994) ("Satisfaction of the 'in connection with' element requires only a showing that 'a defendant has committed a proscribed act in a transaction of which the pledge of a security is a part.'") (quoting *Chemical Bank v.*

Arthur Anderson & Co., 726 F.2d 930 (2d Cir. 1984)). A Section 10(b) claim can only stand where there is an allegation that an actual purchase or sale of security took place. *See generally, In Re Worldcom, Inc.*, 263 F. Supp. 2d 745, 771 (S.D.N.Y. 2003). A purchase or sale of a security for purposes of a Rule 10b-5 occurs "at the time when the parties to the transaction are committed to each other." *Radiation Dynamic, Inc. v. Goldmuntz*, 464 F.2d 876, 891 (2d Cir. 1972). Where there is no showing of the basic and necessary requirement of a purchase or sale of a security, a violation of a Section 10(b) cannot be established. *See Lasater v. Goss,* No. 90-cv-40154 (FL), 1991 WL 354886 (E.D. Mich. July 25, 1991) (holding that there was no violation of Section 10(b) of the Exchange Act of 1934 or Rule 10b-5 because there was no transaction which could have been considered a purchase or sale of securities).

In the *Lasater* case, court dismissed claims against a broker dealer alleging violations of Section 10(b) of the Exchange Act because the plaintiff was unable to allege that there was a purchase or sale of securities. *See* 1991 WL 354886 at * 3. There, the plaintiff had a non-discretionary account with a broker-dealer, but no orders or contracts for securities had occurred in that account. *See id.* In fact, the plaintiff's account was completely inactive for the entire time at issue in the case. *See id.* at 1. Since there was no purchase or sale of securities, the plaintiff's Section 10(b) and Rule 10b-5 claims could not stand.

Likewise, the SEC's claims of Section 10(b) and Rule 10b-5 violations fail because it has not even alleged and cannot prove that there was a purchase or sale of securities related to the draft SAC Confidential Private Placement Memorandum (the "SAC PPM"). That is because the SEC knows there have been no purchases or sales! Although the SEC makes a sweeping and bare bones claim that misrepresentations and material omissions in the draft SAC PPM can be attributed to the Defendants (*See* SEC brief, p. 14), its motion papers do not allege – or attempt to prove through evidence – that a purchase or sale relating to the draft SAC PPM took place. None of the documents the SEC annexes to declarations in support of its application support the proposition that an actual purchase or sale relating to the draft SAC PPM occurred. Without even alleging this threshold issue (let alone proving it by clear and convincing evidence) there can be no violation of Section 10(b) of the Exchange Act or Rule 10b-5. Therefore, the SEC's motion to hold the Defendants in contempt of the PI Order for a violation of Section 10(b) must be denied.

b. The SEC's Motion Based Upon Section 17(a) of the Securities Act Must Be Denied Because It Fails to Establish An Offer or Sale of a SAC Note

The SEC's motion to hold the Defendants in contempt must be denied because it fails to show by clear and convincing evidence that a violation of Section 17(a) of the Securities Act occurred. Section 17(a) of the Securities Act provides, in pertinent part, as follows:

> It shall be unlawful for any person in the offer or sale of any securities …
>
> (2) to obtain money or property by means of any untrue statement of a material fact or any omission 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 ….

15 U.S.C. § 77q(a). To state a claim for a violation of Section 17(a) of the Securities Act, there must be an allegation that there was an offer or sale of securities. *See generally SEC v. Brown*, --- F.Supp.2d ----, Civ. No. 09-1423 (GK), 2010 WL 3786563*11 (D.D.C. Sept. 27, 2010) (holding that the "SEC has failed to cite, and this Court has failed to identify, any precedent holding that a complaint may properly state a claim under§17 (a) when it fails to allege that an offer or sale of securities ever occurred."); *see also SEC v. American Berryllium & Oil Corp.*,

303 F. Supp. 912, 918 (S.D.N.Y. 1969) (denying summary judgment for a Section 17(a) claim with respect to defendant who allegedly made fraudulent statements to individuals and not the public at large because "[n]o showing has been made that Hesse sold or offered shares to, or for that matter, purchased from persons he misinformed.").

In the *Brown* case, the SEC brought a claim against two former employees of a publicly traded company for a violation of Section 17(a) of the Securities Act alleging that there were material omissions in the company's filings concerning one of the defendant's status as an officer and past securities law violator. *See* 2010 WL 3786563 at *1-2. The Court held that the SEC did not state a claim under Section 17(a) of the Securities Act because it only alleged that the defendants had made purportedly material omissions in company filings, but never alleged that those omissions occurred in connection with an actual offer or sale of the company's securities. *See id.* at *11. ("In the absence of any allegation that there was an offer or sale of Integral Systems's securities in the period between 1998 and 2006, during which the alleged fraud occurred, Count I fails to state a claim under §17(a).").

Like in the *Brown* case, the SEC does not make any showing here that an offer or sale of securities occurred to support a claim of a Section 17(a) violation, and therefore, the SEC's motion for contempt must be denied. The SEC's reliance on Paul Zindell's affidavit to demonstrate that an offer to sell securities was made is either misplaced or intentionally dishonest. Mr. Zindell's affidavit and the exhibits are clear that Mr. McGinn was proposing that Mr. Zindell invest money as a partner in SAC, not to purchase notes. In this respect, the SEC omits portions of critical quotes it presents to mislead the Court. For example, in the text chain which is Exhibit 1 to the Zindell Affidavit. ("Zindell Aff."), Mr. McGinn informed Mr. Zindell that there is "*[n]o narrative on the partnership*. Will email offering document and related material on Deal 1." The SEC omitted the italicized portion. It is clear that Mr. Zindell wanted a narrative on the partnership because he was being asked to invest in SAC. The draft material on Deal 1 was not for solicitation purposes; rather, it was to demonstrate to Zindell they type of business SAC would conduct.

Importantly, another document selectively quoted by the SEC to mislead the Court confirms that Mr. McGinn was seeking to have Mr. Zindell only as a partner in SAC. Specifically, Exhibit 2 to the Zindell Aff. provides, in pertinent part, the following communication from Mr. McGinn to Mr. Zindell:

> I present on the attached what the partnership proposal would mean ... I believe we can achieve this performance given my experience in the industry and knowledge of the current lending environment and capital demand needs for this asset class.
>
> ***
>
> Although DLS and I do not want numerous Partners, we would entertain you teaming with other(s) to make the investment, so long as our operating dynamics would only involve you.

This facsimile confirms that Mr. McGinn is seeking to have Mr. Zindell invest in SAC as a partner. Mr. Zindell could not invest in the "notes" with partners, and no noteholder would have operational involvement. Moreover, the attachment to the facsimile gives profitability projections on eight deals to be completed in two years by SAC. Clearly, the projected economics of SAC is being presented to Mr. Zindell to get him to invest in SAC. Noteholders would only be concerned with the rate of interest.

Finally, Mr. Zindell himself admits that he was asked to invest in SAC, not purchase notes. In paragraph 12 of the Zindell Aff., Mr. Zindell states that "[a]s I made clear in my text messages to Mr. McGinn, I had no interest in investing funds in SACC." He does not say he was solicited to purchase notes in the offering and the SEC has no reasonable basis to make such a conclusion. Put simply, the evidence presented does not establish clearly and convincingly that Zindell was solicited as an investor in the notes.[1]

The SEC also provides a sworn statement of David Stoelting purportedly support of the SEC's motion. Mr. Stoelting's declaration annexes an email from Mr. McGinn to Ms. Gracey which states that he has "been pitching." *See* Stoelting Declaration ("Stoelting Decl.") ¶ 14. Contrary to Mr. Stoetling's unsupportable interpretation, the email does not specify that Mr. McGinn's "pitching" was connected to the draft SAC PPM. In fact the email itself does not specify exactly what Mr. McGinn had been pitching, to whom, how the pitch was conducted or if it even involved the SAC PPM. Connecting the isolated statement "been pitching" to the draft SAC PPM is speculative at best, and the email does not amount to a showing by clear and convincing evidence that the SAC PPM was part of an offer of securities made by Mr. McGinn to an investor. Accordingly, the SEC has not proved an underlying violation of Section 17(a) of the Securities Act necessary to support its claim that a violation of the PI Order occurred.

With respect to David Smith, the SEC similarly fails to meet its burden of proof to establish a violation of Section 17(a) of the Securities Act. The SEC never even alleges, let alone provide a scintilla of evidence, that Mr. Smith approached one potential investor about a note offering or gave anyone the draft SAC PPM. The SEC only alleges in the most conclusory manner that Mr. Smith was at one time an officer of SAC and allowed his name to be used for "marketing" purposes. The SEC does even not specify the marketing purposes for which Mr. Smith's name allegedly was used. In other words, the SEC does not and cannot produce any evidence that Mr. Smith allowed his name to be used to market the draft SAC PPM or even to

[1] Notably, the hearsay statements of SEC Attorney David Stoelting are not admissible for the purposes of determining a violation of the securities laws. While Mr. Stoelting claims in paragraph 3 of his declaration that Mr. Zindell "told me that McGinn had solicited him to participate in a new securities offering formed by McGinn and Smith call Security Alarm Credit, LLC," Mr. Zindell apparently refused to make that statement in own his sworn affidavit. It does not appear in the Zindell Affidavit!

market the partnership interest in SAC that Mr. Zindell describes in his affidavit. It also presents no evidence that Mr. Smith actually participated in an offer or sale of securities as contemplated by Section 17(a) of the Securities Act. Since the SEC has not met its burden in establishing a Section 17(a) violation, it also does not meet its burden of establishing a violation of the PI Order by Mr. Smith. Its motion for contempt must be denied.

II. THE SEC'S MOTION FOR AN ORDER OF CONTEMPT MUST BE DENIED BECAUSE THE SEC FAILED MEET THE BASIC NOTICE PLEADING REQUIREMENT THAT FRAUD BE PLED WITH PARTICULARITY

The SEC's motion to hold Defendants in contempt for a violation of the PI Order based on violations of the federal securities laws should not even be considered because the SEC has not alleged a violation of the securities laws with the particularity required by Rule 9(b) of the Federal Rules of Civil Procedure.[2] In the absence of such particularity, Defendants do not have sufficient notice of the allegations against them to defend themselves.

FRCP 9(b) applies all averments of fraud and provides, in pertinent part, as follows:

> In alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake.

FRCP 9(b). To meet the particularity requirement of FRCP 9(b), the allegations must: "(1) specify the statements that the plaintiff contends were fraudulent, (2) identify the speaker, (3) state where and when the statements were made, and (4) explain why the statements were fraudulent." *Mills v. Polar Molecular Corp.*, 12 F.3d 1170, 1175 (2d Cir. 1993) (citing, *Cosmas v. Hassett, 886 F.2d 8, 11 (2d Cir. 1989)*; *see also SEC v. Pentagon Capital Mgmt. PLC*, 612 F. Supp. 2d at 258 (citing *Novak v. Kasaks,* 216 F. 3d 306 (2d Cir. 2000)). Rule 9(b) of the Federal

[2] Because the SEC's motion papers purport to allege violations of the securities laws which must be proven before this court may find contempt of its Preliminary Injunction Order, the moving papers and should be considered the equivalent of a complaint for the purposes of this motion. Put simply, the papers are the operative pleading giving defendants notice of the SEC allegations against them.

Rules of Civil Procedure is not met when averments of fraud are attributed to a group of defendants in a vague or conclusory manner. *See Mills*, 12 F.3d at 1175.

A complaint alleging violations of Section 10(b) of the Securities Act and Rule 10b-5 thereunder must meet the particularity requirements of FRCP 9(b). *See generally, Stevelman v. Alias Research Inc.*, 174 F.3d 79, 82 (2d Cir. 1999) (citing, *Decker v. Massey-Ferguson, Ltd.*, 681 F.2d 111, 114 (2d Cir. 1982)). Likewise, allegations of fraud under Section 17(a) of the Securities Act of 1933 (the "Securities Act") must met the particularity requirements of FRCP 9(b). *See generally SEC v. Pentagon Capital Mgmt. PLC*, 612 F. Supp. 2d 241, 257-258 (S.D.N.Y. 2009).

Here, the SEC's motion must be denied because it has failed to assert with particularity facts necessary to state a claim for securities fraud under the Exchange Act or Securities Act.

With respect to David Smith, the SEC does not assert in any way that David Smith participated in any offer, sale or purchase of any note related to the draft SAC PPM. The SEC does not allege that Mr. Smith made any material misstatement or omission, or as much as communicated with potential investors concerning SAC or the draft SAC PPM. The SEC only makes generalized and conclusory allegations that Mr. Smith somehow engaged in a fraudulent scheme because he was an officer of SAC for a period of time. Notably, the SEC does not even allege that the SAC PPM was circulated to potential investors during a time period when Mr. Smith was an officer of SAC.

With respect to Mr. McGinn, the SEC's motion also fails to make the requisite averments of securities fraud and must be denied. The SEC has not alleged that Mr. McGinn consummated any transaction for securities with any person or entity. The SEC also has not alleged that Mr. McGinn offered or presented the draft SAC PPM to any particular person for purposes of investing in the notes. The strongest evidence the SEC could provide was an email between Mr. Smith and the president of SAC in which he generally states that he had "been pitching." But that evidence – even when viewed as an allegation – is anemic inasmuch as it does not identify to whom any purported pitch was made, what was pitched, how it was pitched, whether a draft SAC PPM was provided, or what statements were made.

The vague and unsupported allegations the SEC sets forth in its application for an order to show cause are not sufficient to allege violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5. As such, the SEC's papers do not give the Defendants sufficient notice of the allegations to defend themselves. Since the SEC cannot even properly allege an underlying securities violation, its motion must be denied.

III. THE ALLEGED OMMISSIONS THE SEC IDENTIFIES ARE NOT MATERIAL AND CANNOT FORM THE BASIS FOR A SECURITES LAW VIOLATION

The SEC's motion for contempt must be denied because the Defendants did not make any material misstatements or omissions in the draft SAC PPMs, and the disclosures that were made are compliant with any duty imposed by the securities laws.

A fact is material for purposes of Section 10(b) and Rule 10b-5 thereunder and Section 17(a) if there is "'a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information available.'" *In re Time Warner Inc. Securities Litigation*, 9 F.3d 259, 267-268 (2d Cir. 1993) (quoting, *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449, 96 S.Ct. 2126, 2132, 48 L.Ed.2d 757 (1976). "'When a corporation does make a disclosure-whether it be voluntary or required-there is a duty to make it complete and accurate.'" *In re Marsh & McLennan Co., Inc. Securities Litigation*, 501 F. Supp. 2d 452, 469 (2006) (quoting, *Roeder v. Alpha Indus. Inc.*, 814

F.2d 22, 26 (1st Cir. 1987)). "The materiality of an item of information is a mixed question of law and fact." *SEC v. First Jersey Securities, Inc.*, 101 F.3d 1450, 1466 (2d Cir. 1996). The SEC identifies seven alleged facts it claims should have been included in the draft SAC PPMs. Even if the SAC PPMs were not draft documents and were circulated as an offering memorandum to investors who purchased notes – which has not been proven in any respect – none of these items qualify as material omissions.[3]

First, the SEC complains that the drafts omit financial information about Anchor. This argument is misplaced. As the issuer of securities exempt from registration pursuant to Rule 506 of Regulation D, SAC was not required to make any disclosure to accredited investors. See 17 C.F.R. §230.502(b).[4] Moreover, if SAC chose to offer the notes to unaccredited investors, financial information about Anchor still would not have to be included in the offering documents because only information about the issuer must be disclosed pursuant to Rule 502(b)(2). *See* 17 C.F.R. §230.502(b)(2) . There is no statutory requirement that an issuer conducting an offering exempt from registration pursuant to Regulation D disclose financial information about entities with which it does business. *See id.* Accordingly, SAC had no obligation to make any disclosure of Anchor's financial data.

With respect to voluntary disclosure, SAC only had an obligation to ensure that any statements it elected to make about Anchor were complete and accurate (i.e., not misleading).

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[3] The SEC also has failed to prove by clear and convincing evidence that Defendants knew or should have know the information that it alleges was omitted from the draft SAC PPMs. Since the SEC has not demonstrated this fact, it has also failed to prove scienter and no violation of Section 10(b) or Section 17(a) can be found.

[4] Rule 502 provides, in pertinent part, the following requirement as to when information must be furnished in an offering exempt from Registration under Rule 506: "The issuer *is not required to furnish the specified information to purchasers* when it sells securities … to any accredited investor." 17 C.F.R. §230.502(b) (emphasis added); *See also, In re Ressler Hardwoods and Flooring, Inc.,* No. 1:08-bk-01878MDF, 2009 WL 975155 *7, (Bkrtcy. E.D. Pa. April 1, 2009) (holding that the purchaser of the securities in an exempt offering was an accredited investor, and therefore, there was no requirement to provide any information under Rule 502(b)).

The fact is that the information set forth in the draft documents does disclose sufficient information about Anchor's financial health to make the statements not misleading. The draft SAC PPM dated November 1, 2010 disclosed that SAC would be lending Anchor $425,000 (*See* Stoelting Decl., ¶14, Exhibit 7 at 4), that the loan by SAC would be subordinated to an existing loan to Anchor from Quantum Bank that would not be paid back until December 15, 2015 (*see id*) that Anchor would use up to $408,000 of the $425,000 loan – almost all of it – to extinguish other existing debt (*see id.* at 6), that there was a risk that Anchor might not adhere to the debt service payments (*see id.*), that there was a risk that Anchor might be unable to make the balloon payment (*see id.* at 8), that SAC has no other assets and will rely on Anchor's debt service payments to pay back the notes (*see id.* at 6) and that the investors would have no recourse against SAC in the event of a default (*see id.* at 8).

The draft PPM does not imply that Anchor is flush with cash or otherwise in fantastic financial condition. To the contrary, the draft SAC PPM states that Anchor needs to borrow the money to retire existing debt, and has a large additional loan it has to pay back simultaneously with the SAC loan. Such a disclosure can only lead an investor to believe is that Anchor needs the loan to help refinance its existing debt obligations and ease its cash flow obligations. The SEC recognized the cash flow issue when it analyzed the emails and late payment history provided by Quantum Bank. The conclusion it reached with respect to Anchor's financial condition, however, is not supported by the evidence. Anchor's revenues exceed its expenses (including salaries) and its unaudited income statements show net income in 2009 of $108,000 and $42,000 in the first six months of 2010. *See* Russo Decl., Exhibits A and B. These reports also indicate that the average monthly revenue generated during the last 18 months is approximately $85,000, which is more than sufficient to service the combined monthly payment of the Quantum Bank and proposed SAC loans. *See id.* As a consequence, the SEC has failed to prove by clear and convincing evidence that Anchor is in financial distress and that any disclosure regarding its financials would be considered by a reasonable investor to significantly alter the "total mix" of information available. Even taken in the best light for the SEC (which this Court should not), these issues are questions of fact which must be determined after discovery and an evidentiary hearing.

The SEC's second and third proposed omissions similarly are misplaced and relate to immaterial financial issues. It alleges that the draft SAC PPMs omit both that Anchor and Mr. Latty had trouble repaying loans in the past and were required to refinance loans and that Anchor's customers were slow to pay invoices. As discussed above, there is no requirement to provide any disclosures at all to accredited investors under Rule 502. *See,* 17 C.F.R. §230.502(b). In addition, there is no requirement to provide information about Anchor (which is not the issuer in this case) to unaccredited investors. *See,* 17 C.F.R. §230.502(b) referring to Part II of Form 1-A.

As is set forth above, the draft PPM disclosed that SAC would be lending Anchor $425,000, that Anchor would use up to $408,000 of the $425,000 loan to extinguish other existing debt, that there was a risk that Anchor might not adhere to the debt service payments, that there was a risk that Anchor might be unable to make the balloon payment, that SAC has no other assets and will rely on Anchor's debt service payments to pay back the notes and that the investors would have no recourse against SAC in the event of a default. Such disclosure is adequate to inform a potential investor that Anchor may not be able to repay the loan it receives as a result of the note offering. The SEC fails to present any evidence that disclosure of the fact that Anchor had made late payments – **but not defaulted** – or that Mr. Latty had refinanced loans would be considered by a reasonable investor to significantly alter the "total mix" of information available from the draft PPM. As a consequence, even assuming that such disclosure was required (which it was not), the SEC has failed to prove that it is material. Even taken in the best light for the SEC (which this Court should not), the issue of materiality is a question of fact which must be determined after discovery and an evidentiary hearing.

Fourth, the SEC claims that a portion of the loan proceeds will be used to repay Mr. Latty's personal debt. The SEC distorts the evidence. The schedule of payments it obtained from Carolyn Gracey clearly shows that the repayment of the loans made by Bill Knox and the Phil Petty Revocable Trust are a corporate obligation of Anchor to Mr. Latty, which is repaying them on a monthly basis. *See* Russo Decl. Exhibit C. The SEC simply has not done its homework. If given the opportunity to present evidence at a hearing (by virtue of a trial deposition of Mr. Latty), Defendants will show that those loans were taken by Mr. Latty to infuse funds into Anchor, and that the proceeds of the loans promptly were deposited with the company. *See* Russo Decl. ¶ 7. It is Anchor's ultimate obligation to repay Mr. Latty for the money he infused into the company and he, in turn, must repay Bill Knox and the Phil Petty Revocable Trust. Notably, the draft SAC PPM discloses that "up to $408,000 of the loan proceeds to extinguish existing debt." *See* SEC Brief, p. 6, Stoelting Decl. Exhibit 7 at 6. That disclosure is completely accurate and consistent with paying back the company's debt obligations to Mr. Latty. The SEC has failed to prove by clear and convincing evidence that the Bill Knox and the Phil Petty Revocable Trust loans are not obligations of Anchor, and that a reasonable investor would consider the disclosure of repayment to Mr. Latty to significantly alter the "total mix" of information available from the draft PPM. As a consequence, the SEC has not established that the alleged omission complained of is material. Even taken in the best light for the SEC (which this Court should not), the issue of materiality is a question of fact which must be determined after discovery and an evidentiary hearing.

Fifth, the SEC claims that the draft SAC PPM misstates the amount of the Quantum Bank loan as being $484,000 when it allegedly is $497,264. As an initial matter, it is highly unlikely that the approximate $13,000 difference in the amount of the Quantum Loan would be considered by a reasonable investor to significantly alter the "total mix" of information available, and the SEC has failed to present any evidence on that point. In addition, the evidence the SEC relies upon is flawed because it is a summary dated October 24, 2010. That same summary schedule indicates that payments in the range of $10,000- $12,000 are made in the last few days of each month. Since the draft SAC PPM is dated November 1, 2010, the inconsistency likely is attributed to a shortfall in the SEC's evidence and is in no way clear and convincing (that is, the SEC failed to account for the payments made at the end of October). As a consequence, the SEC has not established that the alleged omission is material. Moreover, the issues of whether the amount of the Quantum Bank loan was misrepresented and whether such discrepancy would be considered material by a reasonable investor is a question of fact to bet determined at an evidentiary hearing.

Finally, the SEC's sixth and seventh contention with respect to alleged omissions focus on disclosures made about the Defendants' litigation before this Court. The SEC claims that the draft SAC PPMs fail to disclose: (1) that the offering is similar to the deals which are subject to the SEC's allegations in the instant action, and (2) that the Defendants have been enjoined from engaging in violations of the securities laws. Again the SEC is wrong. The draft PPM contained full disclosure of the instant action by stating that the SEC filed a civil lawsuit against the Defendants on April 20, 2010, that they are defending the lawsuit, and that the full complaint can be obtained on the McGinn, Smith & Co., Inc.'s receiver's website. The draft SAC PPM even and provides the web address/link to that site. Notably, the receiver's web site (Part III) provides a current copy of the ECF docket in this case and links to every document and order ever filed in this case, including the PI Order. *See* Securities and Exchange Commission v. McGinn, Smith & Co., Inc., et al. Receiver Web Site, http://www.mcginnsmithreceiver.com, last visited November 12, 2010. It is disingenuous for the SEC to claim that certain particulars of the lawsuit have been hidden when the draft PPM provided access to every document ever filed in this case.

For the reasons set forth above, the purported omissions the SEC complains of are not material and cannot form the basis for a violation of the securities laws.

CONCLUSION

For the foregoing reasons, Defendants Timothy M. McGinn and David L. Smith respectfully request that the Court deny the Plaintiff's application for an order to show cause why Defendants should not be held in contempt for violating the preliminary injunction order dated July 22, 2010.

Dated: New York, New York
November 12, 2010

GUSRAE, KAPLAN, BRUNO & NUSBAUM PLLC

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CERTIFICATE OF SERVICE

I, Alison B. Cohen, hereby certify that on this 12th day of November 2010, I served a copy of the foregoing by CM/ECF upon the following:

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UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK

SECURITIES AND EXCHANGE COMMISSION :

Plaintiff, :

vs. :

: 10 Civ. 00457 (GLS/DRH)

MCGINN, SMITH & CO., INC. :
McGINN, SMITH ADVISORS, LLC, :
McGINN, SMITH CAPITAL HOLDINGS CORP., :
FIRST ADVISORY INCOME NOTES, LLC, :
FIRST EXCELSIOR INCOME NOTES, LLC, :
FIRST INDEPENDENT INCOME NOTES, LLC, :
THIRD ALBANY INCOME NOTES, LLC, :
TIMOTHY M. MCGINN, AND :
DAVID L. SMITH, LYNN A. SMITH, :
DAVID M. WOJESKI, Trustee of the David L. :
and Lynn A. Smith Irrevocable Trust U/A 8/04/04, :
GEOFFREY R. SMITH, LAUREN T. SMITH, and :
NANCY MCGINN, :

Defendants, :

LYNN A. SMITH, and :
NANCY MCGINN, :

Relief Defendants, and :

DAVID M. WOJESKI, Trustee of the David L. :
and Lynn A. Smith Irrevocable Trust U/A 8/04/04, :

Intervenor. :

DECLARATION OF MARTIN P. RUSSO, ESQ.

I, Martin P. Russo, Esq., declare the following:

1. I am a member of the firm of Gusrae, Kaplan, Bruno & Nusbaum PLLC, attorneys for defendants David L. Smith and Timothy M. McGinn (the "Defendants"). I am admitted to practice in the State of New York and before the United States District Court for the Northern District of New York. I have personal knowledge of the matters set forth herein, except for those matters set forth upon information and belief.

2. Defendants Smith and McGinn have not been afforded an opportunity to conduct discovery in this matter and are prejudiced in their ability present evidence in response to the allegations leveled by the SEC. We are informed and I believe that many of the necessary witnesses with information relevant to this matter reside outside the jurisdiction of this Court, are not within the control of Defendants, and have been cooperating with the SEC. If an evidentiary hearing is required, Defendants must first be permitted to take the depositions of (at a minimum) Anchor Alarm Center, Inc. ("Anchor"), Paul Zindell, Michael Latty, Bill Knox, Jeffrey Faye and Quantum National Bank ("Quantum Bank") – all of which reside more than 100 miles from the NDNY courthouse – to obtain their testimony for trial, and rebut the untrue assertions presented by the SEC in its papers. In addition, Defendants must be permitted to take the deposition of Carolyn Gracey with respect to the proposed securities offering by Security Alarm Credit, LLC ("SAC"). Finally, Defendants require time to hire an expert witness to testify as to the disclosure requirements of Regulation D in a securities offering such as the one allegedly conducted by SAC.

3. On or about November 4, 2010, I received from the Securities and Exchange Commission ("SEC") a copy of a DVD containing documents it had received in response to the October 25, 2010 subpoena served upon Anchor.

4. Among the documents contained on that DVD was Anchor's Profit & Loss statement for January through December 2009. A true and complete copy of Anchor's Profit & Loss Statement for January through December 2009 is annexed hereto as Exhibit A.

5. The DVD also contained Anchor's Income Statement for the Six Months Ended June 30, 2010. A true and complete copy of Anchor's Income Statement for the Six Months Ended June 30, 2010 is annexed hereto as Exhibit B.

6. Among the Anchor documents contained on the DVD also was a schedule of proposed repayments. A true and complete copy of the schedule of proposed repayments is annexed hereto as Exhibit C.

7. We are informed and I believe that the funds obtained from Bill Knox and the Phil Petty Revocable Trust which the SEC alleges were personal loans to Mr. Latty were obtained to infuse cash in to Anchor. We are further informed and I believe that such funds were in fact deposited with Anchor creating an existing debt to Mr. Latty. If given the chance to conduct depositions of Anchor and Mr. Latty, I believe we could make such a showing at an evidentiary hearing.

8. A true and complete copy of the opinion in the case captioned *Fendi Adele S.R.I. v. Burlington Coat Factory Warehouse Corp.*, No. 06-Civ.- 0085(LBS), 2007 WL 2982295 (S.D.N.Y. Oct. 10, 2007) is annexed hereto as Exhibit D.

9. A true and complete copy of the opinion in the case captioned *Lasater v. Goss,* No. 90-cv-40154 (FL), 1991 WL 354886 (E.D. Mich. July 25, 1991) is annexed hereto as Exhibit E.

10. A true and complete copy of the opinion in the case captioned *SEC v. Brown*, --- F.Supp.2d ----, Civ. No. 09-1423 (GK), 2010 WL 3786563 (D.D.C. Sept. 27, 2010) is annexed hereto as Exhibit F.

11. A true and complete copy of the opinion in the case captioned *In re Ressler Hardwoods and Flooring, Inc.*, No. 1:08-bk-01878MDF, 2009 WL 975155 , (Bkrtcy. E.D. Pa. April 1, 2009) is annexed hereto as Exhibit G.

12. Pursuant to 28 U.S.C. § 1746, I declare under penalty of perjury that the foregoing is true and correct.

Executed on November 12, 2010

Martin P. Russo

EXHIBIT A

11:04 AM
08/06/10
Accrual Basis

Anchor Alarm Center, Inc.
Profit & Loss
January through December 2009

	Jan - Dec 09
Ordinary Income/Expense	
Income	
Fees	25,527.76
Reimbursed Expenses	12,370.96
Services	947,207.18
Uncategorized Income	1,036.84
Total Income	986,142.74
Cost of Goods Sold	
Cost of Goods Sold	-1,328.69
Total COGS	-1,328.69
Gross Profit	987,471.43
Expense	
Advertising	449.95
Bank Service Charges	13,895.65
Contract Labor	0.00
Contributions	500.00
Dues and Subscriptions	1,003.00
Equipment Rental	33,087.53
Insurance	76,603.09
Interest Expense	129,134.25
Licenses and Permits	4,036.49
Office Supplies	7,130.86
Payroll Expenses	514,558.26
Postage and Delivery	8,197.53
Printing and Reproduction	7,446.73
Professional Development	295.00
Professional Fees	3,634.30
Rent	26,880.00
Repairs	10,782.68
Taxes	153.00
Telephone	21,791.46
Travel & Ent	10,164.75
Utilities	11,190.00
Total Expense	880,934.53
Net Ordinary Income	106,536.90
Net Income	**106,536.90**

EXHIBIT B

Anchor Alarm Center, Inc.
Income Statement
For the Six Months Ended June 30, 2010

Revenues	
Services	525,719
Total Revenue	525,719
Expenses	
Bank Fees	7,389
Contributions	500
Depreciation	18,750
Dues & Subscriptions	1,210
Equipment Rental	25,483
Insurance	30,602
Interest Expense	67,922
Licenses & Permits	3,635
Officers Compensation	80,000
Office Supplies	5,308
Payroll Expense	179,530
Postage	4,157
Printing	6,507
Professional Fees	50
Rent	13,506
Repairs & Maintenance	4,958
Taxes	346
Telephone	24,450
Travel & Entertainment	1,546
Utilities	7,142
Total Expenses	482,991
Net Income	42,728

See Accountants Liability Report

EXHIBIT C

II.	Proposed Re-Payments	Balance	% Rate	Monthly Payment	1st Funding
2	American Express Business Platinum Card	$ 11,329.82	15.24	$ 1,300.00	
3	American Express Optima	$ 3,914.34	13.24	$ 300.00	
4	Bank Card (Previously - First Equity)	$ 4,764.00	14.99	$ 300.00	
5	Bank of America Business Card - 3825	$ 16,929.54	19.99	$ 550.00	
6	Bank of America Business Card	$ 9,688.96	23.98	$ 600.00	
7	Bank of America Business Card - 3089	$ 28,995.96	19.99	$ 900.00	
8	Bank of America Business Card - 0944	$ 29,081.03	27.24	$ 1,300.00	$ 29,081.03
9	Bank of America LOC (prev MBNA /Textron) - 3190	$ 29,090.62	15.99	$ 900.00	
12	Bill Knox - Loan	$ 67,005.71	21.01	$ 4,000.00	
13	Chase - (previous - Washington Mutual Visa)	$ 12,284.39	29.24	$ 600.00	$ 12,284.39
15	Chase Business Card	$ 23,852.73	29.99	$ 950.00	$ 23,852.73
16	Chrysler Financial - Liberty	$ 17,550.00	12.10	$ 750.00	
17	Chrysler Financial - P T Cruiser	$ 11,808.54	12.10	$ 550.00	
18	Citi Advantage	$ 8,363.95	19.99	$ 400.00	$ 8,363.95
19	Citi Flex Line	$ 2,652.31	7.24	$ 700.00	$ 2,652.31
20	Dell Business Credit	$ 6,784.22	18.99	$ 350.00	
21	Discover Business Card	$ 3,328.28	29.99	$ 400.00	$ 3,328.28
22	Home Depot Credit Card	$ 2,313.74	15.00	$ 350.00	
23	Office Depot	$ 5,453.62	29.99	$ 400.00	$ 5,453.62
24	Phil Petty - Revocable Trust Loan	$ 44,022.24	12.00	$ 2,152.06	
25	Pitney Works Postage Power	$ 5,287.21	22.00	$ 300.00	$ 5,287.21
26	RBC Centura Business Card	$ 9,669.66	19.99	$ 400.00	
28	Sam's Club Business Credit	$ 1,050.60	29.99	$ 350.00	
29	SunTrust Business Card	$ 24,492.74	13.15	$ 600.00	
35	Wells Fargo Business Line of Credit	$ 13,162.18	17.25	$ 350.00	
		$ 392,876.39	19.62	$ 19,752.06	$ 90,303.52
				Send to Anchor	***$ 9,696.48***
					$ 100,000.00

EXHIBIT D

H
Only the Westlaw citation is currently available.

United States District Court,
S.D. New York.
FENDI ADELE S.R.L., Fendi S.R.L., and Fendi North America, Inc., Plaintiffs,
v.
BURLINGTON COAT FACTORY WAREHOUSE CORPORATION and Cohoes Fashions, Inc., Defendants.
Burlington Coat Factory Warehouse Corporation and Cohoes Fashions, Inc., Defendants/Third-Party Plaintiffs,
v.
546332 BC Ltd., d/b/a Colton International, Summit Resource Imports LLC, Euro Moda, Inc., Moda Oggi, Inc., and Ashley Reed Trading, Third-Party Defendants.
No. 06 Civ. 0085(LBS).

Oct. 10, 2007.

Memorandum & Order

SAND, J.

*1 Plaintiffs move for partial summary judgment pursuant to Federal Rule of Civil Procedure 56 on the grounds that there are no disputed issues of fact and plaintiffs are entitled to judgment as a matter of law for defendants' alleged violations of a Permanent Consent Injunction "So Ordered" by this Court on May 19, 1987. First, Plaintiffs seek an order pursuant to 28 U.S.C. § 2201 declaring defendants in contempt for willful violation of the May 19, 1987, Permanent Consent Injunction. Second, Plaintiffs request, pursuant to 28 U.S.C. § 2202 that the order declaring defendants in contempt also require defendants to disgorge profits on their sales of goods bearing the Fendi trademark from May 19, 1987, to the present, to be established by an accounting. Third, Plaintiffs request that the court grant them an award of their costs and reasonable attorney's fees incurred to date in connection with this action pursuant to Rule 83.9(a), *Civil Rules of the United States Courts for the Southern and Eastern Districts of New York.*

I. BACKGROUND

A. 1987 Consent Injunction

On May 19, 1987, Fendi agreed to discontinue a lawsuit against Defendants for counterfeiting in exchange for a settlement agreement that was read into the record. *Fendi S.a.S. Di Paola Fendi e Sorelle v. Burlington Coat Factory Warehouse Corporation, et al.,* 86 Civ. 571 (1987) (the "1987 Consent Injunction"). The Defendants agreed not to "purchase or sell any merchandise bearing the Fendi trademark unless permission in writing is received from Fendi." The Court approved these terms and ordered the lawsuit's dismissal without costs. Neither Burlington nor Cohoes ever received permission in writing from Fendi at any time since May 19, 1987.

B. Post-1987 Sale of Fendi Products

Defendants did not deal in Fendi goods again until 2002. At that point, Defendants admit they began purchasing and selling Fendi-branded merchandise, "taking care to make certain the goods were genuine." By way of explaining this violation of the 1987 Consent Injunction, defendants state that because they had not dealt in Fendi goods for 15 years, they had "forgotten during those 15 years as a matter of corporate memory the terms of the 1987 Consent Injunction restraining trade in the 'second sale' of authentic Fendi goods," especially because in the intervening years they had "changed the manner in which they purchased goods by hiring in-house buyers who had no personal knowledge of the 1986 litigation ." (Defs. Mem. of Law at 2.)

In April 2004, Fendi contacted Burlington by letter, alleging that a Fendi bag purchased at Burlington was counterfeit, but not referencing the 1987 Injunction. Burlington contacted its supplier, Colton, who responded to Fendi that it only sold genuine products. In September 2004, Fendi wrote to Colton, again alleging that the bag was counterfeit but still not mentioning the 1987 Consent Injunction. Colton responded that it had confirmed with Fendi-Italy that the bag was genuine, and asked Fendi for the reports Fendi was relying on as the basis for its claim that the bags were not genuine so that Colton could effectively investigate the claim.

***2** In October 2004, Fendi again alleged the bags were not genuine, did not provide the requested reports, but requested the documentation Colton said it had which showed the bags were genuine. Fendi did not reference the 1987 Injunction in this correspondence. In November, Colton provided to Fendi a copy of the letter (purportedly) from Fendi-Italy identifying the bags as genuine. Later in November 2004, Fendi wrote to Colton that the Fendi-Italy letter was a forgery. Colton wrote to Fendi, asserting that the letter was genuine.

On January 14, 2005, Fendi asked to see the original of the Fendi-Italy letter. Colton responded on February 1, 2005, and suggested Fendi telephone to make an appointment to see the letter. No mention of the 1987 Consent Injunction was made by either party in any of this correspondence. In fact, Fendi admits that its then-lawyers, Mintz Levin, were not aware of the 1987 Consent Injunction.

In a letter dated December 22, 2005, from Fendi's lawyers, Pavia & Harcourt, Fendi first made reference to the 1987 Consent Injunction. Burlington responded on December 30, 2005, asking for a week to respond. On January 5, 2006, Fendi filed this action.

After the filing of the action, on or around January 9, 2006, defendants instructed their respective stores to remove all Fendi-branded items from their shelves. At a January 20 conference, defendants raised their concerns about the legality of the provision of the Injunction requiring prior written approval before resale of authentic Fendi goods. Defendants moved on February 3, 2006, to amend *nunc pro tunc* the 1987 Consent Injunction to remove the restraint on purchasing and selling genuine Fendi products, and this Court upheld the contested provision by a bench order on March 2, 2006. The Second Circuit subsequently upheld this Court's ruling on March 14, 2007. *Fendi Adele S.R.L. v. Burlington Coat Factory Warehouse Corp.,* 222 Fed.Appx. 25 (2d Cir. March 14, 2007).

For purposes of the present motion, Fendi assumes, without admitting, that the goods sold by defendants are genuine.

C. **Fendi Brand Perfume**

After the present motion was submitted and briefed, plaintiffs learned in April 2007 that Defendant Burlington ran radio advertisements promoting the sale of "up to 50% on designer fragrances including Gucci and Fendi." Plaintiffs then hired a private investigator who made two purchases of Fendi brand fragrance products at Burlington Coat Factory Stores in New York City.

Burlington's consignor, Scents of Worth, Inc. (formerly known as Model Imperial, Inc.) has been buying and stocking Fendi perfume in Burlington Coat Factory stores for approximately eight years. Burlington ran radio advertisements through May 2007 promoting the sale of Fendi brand fragrance products at Burlington Coat Factory stores. A consumer who purchases a coat and a bottle of perfume pays for these two items at the same cash register and receives a single receipt that bears the Burlington Coat Factory name.

***3** When this fact was brought to Burlington's attention, its initial response was that Burlington "rents space to an independent perfume company in which it has no interest. These purchases and sales of perfume were not made by BCF or any company in which it has any direct or indirect interest."

(Mattiaccio Decl. Ex. 6) The Fendi brand fragrance products are unpacked by Burlington Coat Factory employees and the contents are displayed on shelves located in Burlington Coat Factory stores. Burlington receives 26 percent of total net sales of fragrance products in the Burlington stores. Burlington's general counsel and chief compliance officer explained Burlington's conduct in connection with the advertising and sale of Fendi brand fragrances by pointing out that (a) the Injunction says nothing about advertising and (b) since the fragrances are not Burlington's merchandise, it's not covered by the Injunction. Burlington thus maintains that since it never had title to the perfume it sold, it did not violate the 1987 Consent Injunction by offering the fragrances at its stores.

II. DISCUSSION

A motion for summary judgment must be granted if there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law. Fed.R.Civ.P. 56(c). In deciding a motion for summary judgment, the evidence submitted must be viewed in the light most favorable to the nonmoving party. See *Anderson v. Liberty Lobby, Inc.,* 477 U.S. 242, 255 (1986). While credibility determinations, weighing evidence, and drawing legitimate inferences from facts are functions that the Court must leave to the jury, if the nonmoving party does not present evidence from which a reasonable jury could return a favorable verdict, then summary judgment is appropriate. See, e.g., *Golden Pacific Bancorp. v. F.D.I.C.,* 375 F.3d 196, 200 (2d Cir.2004).

A. Civil Contempt

A party will be held in civil contempt of a court order only upon a showing of "clear and convincing" evidence of a violation of "a clear and unambiguous" order of the court. *New York v. Local 28, Sheet Metal Workers' Internat'l. Assoc.,* 170 F.3d 279, 282-83 (2d Cir.1999) (citation omitted). Although the violation need not be shown to have been willful, the alleged contemnor must have failed to exercise "reasonable diligence" in attempting compliance. *Id* (quoting *United States v. Local 1804-1,* 44 F.3d 1091, 1096 (2d Cir.1995); *see also Panix Promotions. Ltd. v. Lewis.* 2004 WL 421937. at *2 (S.D.N.Y. March 5, 2004), *aff'd. mem.,* 106 Fed.Appx. 757, 2004 WL 1922197 (2d Cir.2004); *O'Hearn v. Bodyonics, Ltd.,* 56 F.Supp.2d 302, 312 (E.D.N.Y.1999); *Cablevision Systems Corp. v. Muneyyirci,* 1995 WL 362541, at *1 (E.D.N.Y. June 2, 1995).

In the context of civil contempt, clear and convincing evidence is interpreted to mean "a quantum of proof adequate to demonstrate to a 'reasonable certainty' that a violation has occurred." *Levin v. Tiber Holding Corp..* 277 F.3d 243, 250 (2d Cir.2002) (citation omitted). Three defenses to civil contempt are: (1) the order allegedly violated is unclear; (2) the party charged with contempt had no knowledge of the order or (3) proof of non-compliance fails to meet the clear and convincing standard of proof. *Id* at 251.

B. Defendants' Violation of the 1987 Consent Injunction

*4 Here, the court order is clear and unambiguous. Furthermore, it is clear that the scope of the court order encompasses genuine goods as well as counterfeit goods bearing the Fendi name. Burlington agreed not to "purchase or sell any merchandise bearing the Fendi trademark unless permission in writing is received from Fendi." The point of the settlement was that Fendi did not trust Burlington to distinguish between authentic and counterfeit Fendi merchandise, so Burlington was required to present *all* Fendi-marked goods for pre-approval.

Second, there is clear and convincing proof of non-compliance. Indeed, Burlington admits that it forgot about the Consent Injunction and began selling Fendi-branded merchandise in 2002 without ever seeking Fendi's approval. Burlington claims that its action were not willful as the terms of the 1987 Consent Injunction faded from its corporate memory. Despite this purported defense, Burlington did not implement any internal control mechanisms to prevent it from dealing in Fendi-branded merchandise prior to obtaining the necessary consent of Fendi. In fact, Burlington's in-house counsel, Stacy Hagney, admitted that he was not aware of a single piece of writing concerning any steps that the company took to comply with this permanent injunc- tion.

Defendants argue that the third element necessary for a finding of contempt is lacking, namely clear and convincing proof that defendants did not attempt to comply in a reasonably diligent manner. As support, they assert, first, that "both defendants and Fendi simply and innocently forgot" the relevant provision of the Injunction after 15 years, and second, that as soon as the prohibition was brought to their attention in December 2005, they took all Fendi-branded merchandise off their shelves (with the exception of perfume). Defendants assert that these circumstances create a question of fact about whether their attempts to comply were reasonably diligent.

Diligence, at the very least, requires keeping records of the agreements to which a corporation has obligated itself. Burlington Coat Factory should have implemented reasonable control mechanisms to ensure that Fendi-branded merchandise was neither purchased nor sold without obtaining necessary permission from Fendi. Moreover, Fendi entered into the Consent Injunction so it would not have to allocate its time and resources to policing defendants' sales. It is defendants' responsibility to comply with their own contractual obligations. A lapse in corporate memory is simply not a valid defense to Burlington's failure to be reasonably diligent in carrying out the terms of the 1987 Consent Injunction.

C. **Willfulness**

Fendi also asks this Court to find that the defendants' violations were willful. A willful contempt is one where "the contemnor had actual notice of the court's order, was able to comply with it, did not seek to have it modified, and did not make a good faith effort to comply." *Bear U.S.A.. Inc. v. Kim,* 71 F.Supp.2d 237, 249 (S.D.N.Y.1999). If the court finds that defendants' violations were willful, the Court should award costs and attorney's fees unless there are "persuasive grounds" to deny them. *Weitzman v. Stein,* 98 F.3d 717, 719 (2d Cir.1996).

***5** While Burlington's actions prior to January 2006 were clearly negligent, a finding of willfulness is also appropriate here as to at least some of the sales. Once reminded of the terms of the 1987 Consent Injunction, Burlington began making efforts to comply by removing all Fendi branded items *except* perfume, reasoning that because they sold perfume through a lease department, the Consent Injunction did not apply. This Court finds that interpretation erroneous. Fendi branded perfume was stocked and handled by Burlington employees, the perfume was sold at the same registers as other Burlington products, and Burlington received 26 percent of the net sales obtained from those items. Burlington's agreement with Scents of Worth cannot defeat the clear implications of the 1987 Consent Injunction, specifically requiring Fendi's consent prior to the sale of *all* Fendi branded products. Burlington advertised and sold Fendi branded perfume even *after* being reminded of the 1987 Consent Injunction in December 2005, making their actions a willful violation of that order.

This Court hereby finds Burlington in willful contempt of the 1987 Consent Injunction.[FN1] The Court also finds Defendant Cohoes in contempt of the injunction.[FN2]

FN1. Defendant argues that the equitable doctrine of laches bars a finding of contempt. Fendi first learned of Burlington's sale of its branded products in early 2004, two years prior to filing suit against the Defendant. However, Defendants have flouted the 1987 Consent Injunction even after being reminded of its terms in December 2005 by continuing to advertise and offer for sale Fendi branded perfume. Defendants therefore come to this court with unclean hands and cannot claim the benefit of a laches defense. See *Stone v. Williams,* 891 F.2d 401, 404 (2d Cir.1989).

FN2. Based on the record before the Court, Cohoes behavior was negligent but not intentional.

D. Sanctions

It is well settled that a court may award sanctions in a civil contempt proceeding for two purposes: 1) to coerce the defendant into compliance with the court's orders; and 2) to compensate the complainant for injury caused by past noncompliance. *United States v. United Mine Workers of America,* 330 U.S. 258, 304 (1947); *Manhattan Industries. Inc. v. Sweater Bee by Banff, Ltd., et al.,* 885 F.2d 1 (2d Cir.1989). Civil contempt sanctions must be remedial and compensatory, rather than punitive. *Id.* at 5.

A contempt plaintiff need not demonstrate actual injury to receive compensatory damages, but is entitled under a theory of unjust enrichment to the profits derived by a contemnor from violation of a court order. *Manhattan Industries,* 885 F.2d at 6-7; *Stephen King v. Allied Vision. Ltd..* 155 F.R.D. 440, 452 (S.D.N.Y.1994).

Fendi seeks the following as remedies for Burlington's violation of the 1987 order: a disgorgement of profits to be established by an accounting, costs, and attorney's fees. Such awards are permissible even if the Court does not find defendant's violations willful, because a "district court has broad discretion to fashion an appropriate coercive remedy in a case of civil contempt, based on the nature of the harm and the probable effect of alternative sanctions." *N.A. Sales Co. v. Chapman Industries. Corp.,* 736 F .2d 854, 857 (2d Cir.1984). As this Court noted in its bench order of March 2, 2006, the Consent Injunction reflected Fendi's desire not to engage in ongoing litigation with Burlington, a company Fendi believed to be engaged in the sale of counterfeit Fendi products. This lawsuit is the very situation Fendi sought to avoid. As this Court finds Burlington's violation of the Consent Injunction willful with respect to perfume, an award of costs and attorney's fees is therefore appropriate in an amount to be determined on motion. See *New York State Nat'l Org. for Women v. Terry,* 952 F.Supp. 1033, 1043-44 (S.D.N.Y.1997) ("It is well settled in this Circuit that costs, including reasonable attorneys' fees, may be awarded to the party who prosecutes a contempt motion as an appropriate compensatory sanction for contumacious behavior.").

***6** Fendi's request for an accounting and disgorgement of profits is also granted. As Fendi argues, a disgorgement of profits would compensate Fendi for being deprived of the benefit of its bargain, that is, the Injunction reflects Fendi's desire not just to avoid litigation, but to have some extra measure of control over making sure its trademark is not diluted by counterfeit goods from a particular retailer. See *Manhattan Indus. Inc. v. Sweater Bee By Banff, Ltd.,* 885 F.2d 1 (2d Cir.1989) (approving the use of compensatory sanctions based on defendant's profits, without requiring proof of actual injury to the plaintiff, under the theory of unjust enrichment). Defendants argue that the Court concluded that the only purpose of the Injunction was to prevent defendants' sale of *counterfeit* goods, and to allow a disgorgement of profits would be to punish defendants for selling *authentic* goods. Defendants are off-point, however. The sanction is not for selling authentic goods, but for selling them without prior approval as they contracted to do and as the Court ordered. Moreover, a contempt proceeding is not the forum to challenge the validity of the injunction. *See N.A. Sales Co.,* 736 F.2d at 857 (citing *Maggio v. Zeitz,* 333 U.S. 56, 69 (1948) ("a contempt proceeding does not open to reconsideration the legal or factual basis of the [disobeyed] order"). Having already challenged the order in the Court of Appeals, *Fendi Adele S.R.L. v. Burlington Coat Factory Warehouse Corp.,* 222 Fed.Appx. 25 (2d Cir. March 14, 2007), and been unsuccessful, a sanction beyond costs and fees is called for in the present case.

III. CONCLUSION

Plaintiff's motion for partial summary judgment finding defendants in contempt of the 1987 Consent Injunction is GRANTED. Plaintiffs' motion seeking an accounting is also GRANTED. This Court orders the Defendants to open their financial books and statements to a consultant chosen by Plaintiffs for the purpose of determining profits from unauthorized sales of Fendi brand merchandise and the date of such sales.

As to costs and attorneys fees, plaintiffs are directed to submit to this court a summary of the costs and fees associated with prosecuting this proceeding. The parties are to advise the court in writing by November 1, 2007, of the timetable they have agreed upon for submission of the foregoing.

SO ORDERED.

S.D.N.Y.,2007.
Fendi Adele S.R.L. v. Burlington Coat Factory Warehouse Corp.
Not Reported in F.Supp.2d, 2007 WL 2982295 (S.D.N.Y.)

END OF DOCUMENT

EXHIBIT E

United States District Court, E.D. Michigan.
LASATER
v.
GOSS, et al.
Civ. A. No. 90-CV-40154-FL.

July 25, 1991.

NEWBLATT, District Judge.

***1** Before the Court is Defendant Baird, Patrick & Company's Motion to Dismiss under both Rules 12(B)(6) and 56, Fed.R.Civ.P., and for Sanctions under Rule 11 Fed.R.Civ.P.[FN1] The plaintiff has responded in opposition, and the defendant has replied to the plaintiff's brief in opposition. For the reasons that follow, the defendant's Motion to Dismiss is GRANTED. Defendant's Motion for Sanctions is GRANTED as well.

The plaintiff in this case alleges mishandling of her investments by her broker, Stephen Goss. Plaintiff claims that Goss enticed plaintiff to invest large sums of money by telling her that valuable investment opportunities would be sacrificed by delay. Goss would sell the interests shortly after the investments were made so that he could deposit the proceeds of the sale in the clients' margin account. The money in these accounts would in turn be "churned" by Goss to create commissions. The plaintiff claims that the investments made were unsuitable in light of the client's investment objectives, and that Goss misinformed Lasater about the risk involved in these investments.

On February 7, 1990, Lasater filed her five-count complaint against Stephen Douglas Goss and the securities firms for which Goss was employed at one time or another during the time that Lasater was Goss's client. Count I is a claim under § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10(b)(5) of the regulations promulgated by the SEC. Count II is a claim for common law fraud. Count III is a claim for common law negligence. Count IV and Count V allege breach of fiduciary and contractual duties, respectively.

Plaintiff seeks to recover from defendant Baird, Patrick & Co., which employed Mr. Goss for a three-month tenure, under the doctrine of respondent superior. Plaintiff also argues that by hiring Mr. Goss, Baird, Patrick & Co. held Goss out as an expert in the securities field. Baird, Patrick & Co. thereby committed common law fraud and negligence as well.

Baird, Patrick & Co. argue that there is no way that it can be liable for any of Mr. Goss's conduct, and that it did not commit any fraud itself. Simply put, the plaintiff's account stayed dormant the entire time that Mr. Goss was in Baird, Patrick's employ. The defendant provides copies of the account statements sent to the plaintiffs while her account was with Baird, Patrick & Co. The beginning balance and ending balance are exactly the same.

This is important to the defendant's argument for several reasons. Since no securities were traded, there could be no purchase or sale of securities to state a cause of action for violation of the Securities Act and its regulations. There could be no fraudulent inducement to purchase securities that were not within the best interest of the plaintiff's investment plans. There could be no churning of the account simply to produce commissions. In short, there is no unlawful conduct for which Baird, Patrick & Co. can be held vicariously liable. It also argues that, even if the firm represented Mr. Goss to be an expert, he did nothing during his tenure that would prove that representation to be false.

Federal Securities Claims

"in connection with the purchase and sale of any security"

***2** A threshold requirement of a 10b-5 cause of action is that the misrepresentation or fraud must take place in connection with the purchase or sale of securities. Defendant argues that there were no purchases or sales of securities or commodities to satisfy this threshold requirement.

There are some cases which contradict this apparent bright line requirement of a purchase or sale. An investment contract is included within the statutes' definition of security, the purchase and sale of which would meet the threshold requirement of a § 10b-5 cause of action. In addition, discretionary accounts have been held to be investment contracts. *Troyer v. Karcagi,* 476 F.Supp. 1142 (S.D.N.Y.1979) (applying the definition of "investment contract" supplied by the Supreme Court in *Securities & Exchange Comm'n v. W.J. Howey Co.,* 328 U.S. 293, 298-99, 66 S.Ct. 1100, 1103, 90 L.Ed. 1244, 1249 (1946)).

A case with facts that are very similar to those presented here held that the establishment of a discretionary account amounted to the purchase or sale of a security, and therefore met the "in connection" requirement. *In re Catanella and E.F. Hutton and Co., Securities Litigation,* 583 F.Supp. 1388 (E.D.Pa.1984). "The instant case does not involve the mere retention of securities, although it does, to an extent involve the retention of Catanella as a broker. The fraud alleged here includes activities such as churning, margin trading without disclosing the risks and the purchase of unsuitable securities." *Id.* at 1412. Ms. Lasater also alleges churning, inadequate warning about the risks of proposed investments, and the purchase and sale of securities that were ill-suited for her investment objectives. The *Catanella* court, faced with this fact pattern, concluded, "Where a broker is given control of the client's portfolio, the choice of a broker is tantamount to the choice of securities." Therefore, the opening of a discretionary account, in and of itself, is sufficient to satisfy the "in connection" requirement to state a cause of action under and § 10b-5.

Defendant denies that plaintiff ever had a discretionary account. Written consent is required for such an account to be opened with Baird, Patrick & Co.. "Here, undeniably, there was no written instruction or consent; and, thus, no discretionary account was ever set up." Defendant's Reply Brief in Support of Motion to Dismiss, at 4, n. 2. Indeed, the plaintiff states in her brief in opposition to the motion to dismiss that she "instructed Goss to seek approval prior to initiating any transaction." Plaintiff's Brief in Opposition to Motion to Dismiss, at 6.

Besides plaintiff's admission that no discretionary account existed, the facts do not indicate that such an account existed in this case. The court in *Bischoff v. G.K. Scott & Co., Inc.,* 687 F.Supp. 746 (E.D.N.Y.1986) adopted Black's Law Dictionary's definition of a discretionary account:

A "discretionary account" is an account "in which customer gives broker discretion as to purchase or sales of securities or commodities including selection, timing and price to be paid or received." Black's Law Dictionary 419 (5th ed.1979).

***3** *Id.* at 749, n. 3. The establishment of the investment relationship between Mr. Goss and Ms. Lasater can not be construed as the institution of a discretionary account. She did not give discretion at all. The broker was requested to seek approval before engaging in any transaction. Even if those instructions were not followed, as plaintiff alleges, Plaintiff's Brief in Opposition to Motion to Dismiss, at 6, there still was no agreement between the plaintiff and Mr. Goss that Goss was to use his discretion in making investments on her behalf. Without that agreement, there can be no discretionary account.

An additional argument weighs against plaintiff's attempt to label her relationship to Goss as an investment contract. In *Howey, supra,* the Supreme Court provided its own definition for "investment contract" to fit within Congress' definition of security.

In other words, an investment contract for purposes of the Securities Act, means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or nominal interests in the physical assets employed in the enterprise.

Securities & Exchange Comm'n v. Howey Co., 328 U.S. 293, 298-99, 66 S.Ct. 1100, 1103, 90 L.Ed. 1244, 1249 (1946). There is no way to fit the broker-client relationship in this case into the Supreme Court's definition of an investment contract. Although there may have been some scheme, there is no common enterprise. Plaintiff did not expect to earn profits from the efforts of a promoter; the profits were to come from the return on the investments made in various securities. Plaintiff cannot meet the "in connection" threshold requirement by characterizing her relationship with Baird, Patrick & Co., through Mr. Goss, as a discretionary account.

"[T]he time of a 'purchase or sale' of securities within the meaning of Rule 10b-5 is to be determined as the time when the parties to the transaction are committed to one another." *Radiation Dynamics, Inc. v. Goldmuntz,* 464 F.2d 876 (2nd Cir.1972) . *See also Shamrock Assoc. v. Sloane,* 738 F.Supp. 109, 117 (S.D.N.Y.1990) (quoting *Radiation Dynamics* to support the proposition that "The standard for determining when a purchase occurs under Section 10(b) is straightforward: 'the time when the parties to the transaction are committed to one another.' "). Plaintiff argues, accordingly, that a fulfilled contract for the exchange of securities is not strictly required for there to be a purchase or sale of any security. Even with no activity in his portfolio, this court could not be certain whether or not, during his tenure with Baird, Patrick & Co., Goss placed orders or entered contracts that were fulfilled only after Goss left the firm.[FN2] But plaintiff has failed to come forth with any evidence to establish such orders or contracts and thus has failed to create a factual issue. Accordingly, plaintiffs have failed to create a factual issue as to their ability to establish this threshold requirement of a 10b-5 cause of action. *The motion is thus granted.*

Other Requirements for a 10b-5 Cause of Action

***4** The essential elements of a 10b-5 claim are:

(1) damage to plaintiff, (2) caused by reliance on defendant's misrepresentations or omissions of material facts, or on a scheme by defendant to defraud, (3) made with scienter (i.e., an intent to deceive, manipulate or defraud or possibly with reckless disregard), (4) in connection with the purchase or sale of securities, and (5) furthered by defendant's use of the mails or any facility of a national securities exchange.

Royal American Managers, Inc. v. IRC Holding Corp., 885 F.2d 1011, 1015 (2nd Cir.1989), *citing Bochicchio v. Smith Barney, Harris Upham & Co.,* 647 F.Supp. 1426, 1429 (S.D.N.Y.1986) and T. Hazen, *The Law of Securities Regulation,* § 13.4, at 457-61 (1985 & Supp.1988); *see also Perez-Rubio v. Wyckoff,* 718 F.Supp. 217, 232 (S.D.N.Y.1989). In addition to the plaintiff's failure to establish any facts that would meet the fourth element, the other elements also are wholly unsupported.

Common Law Claims

The elements of common law fraud in Michigan have been established for some time, and, as demonstrated below, they bear a striking resemblance to the elements of a 10b-5 claim.

"The general rule is that to constitute actionable fraud it must appear: (1) That defendant made a material representation; (2) that it was false; (3) that when he made it he knew that it was false; (4) that he made it with the intention that it should be acted upon by plaintiff; (5) that plaintiff acted in reliance upon it; and (6) that he thereby suffered injury."

Hi-Way v. International Harvester Co., 398 Mich. 330, 336, 247 N.W.2d 813, 816 (1976) *quoting Candler v. Heigho,* 208 Mich. 115, 121, 175 N.W. 141 (1919).[FN3] Conspicuous in its absence from these elements is the 10b-5 requirement that the misrepresentation be made in connection with the sale or purchase of securities. Nonetheless, Baird, Patrick & Co. argues that the plaintiff's "common law claim fails for the same reasons that her claim under the federal securities law fails." Baird, Patrick & Co. based its arguments for the dismissal of the 10b-5 claim, however, solely on the absence of any sale or purchase of securities during Goss's tenure with the firm. While that element simply is not required for the plaintiff to state a claim for common law fraud, plaintiff has failed to create any factual issue of fraud. Fraudulent purchase and sale of securities is not the plaintiff's only allegation of fraud, but plaintiff has failed to create a factual issue of any other fraud.

As to the plaintiff's claims for negligence, breach of fiduciary duty and breach of contract claims, there are no factual issues created by plaintiff in response to the motion.

Defendant Baird, Patrick & Co.'s Motion to Dismiss is therefore GRANTED, as is its Motion for Sanctions.[FN4]

SO ORDERED.

FN1. Movant has supported its motion by the affidavit of Stuart K. Patrick which established the central basis for the motion. According to Rule 12(b), when matters outside the pleading are presented, the motion is to be treated as motion under Rule 56. Patrick's affidavit thus makes this a motion under Rule 56. Since movant also designated the motion as being under Rule 56, plaintiff could not have been misled about his obligation to create a factual issue. Moreover, plaintiff's response asserts that his complaint is well grounded in fact.

FN2. The Court is aware that *Radiation Dynamics* is distinguishable from the facts presented in this case. In *Radiation Dynamics,* the broker obtained inside information after the contract to sell the securities had already been entered into. Since the deal had been made without benefit of the inside information, the contract could be fulfilled without violating the securities laws; even though the defendant gained inside information subsequent to the making of the contract. *Id.* at 891.

However, this Court notes that the term "in connection with purchase and sale, of any security registered on a national securities exchange," 15 U.S.C. § 78j, like other provisions within the federal securities legislation, is to be "construed ... flexibly to effectuate its remedial purposes." *Securities & Exchange Comm'n v. Capital Gains Research Bureau Inc.,* 375 U.S. 180, 195, 84 S.Ct. 275, 285, 11 L.Ed.2d 237, 248 (1963). *See also Pinter v. Dahl,* 486 U.S. 622, 653, 108 S.Ct. 2063, 2082, 100 L.Ed.2d 658, 686 (1988) ("Accordingly, the Court itself has construed securities law provisions ' "not technically and restrictively, but flexibly to effectuate [their] remedial purposes."); *Securities & Exchange Comm'n v. Coffey,* 493 F.2d 1304 (6th Cir.1974) *cert. den.* 420 U.S. 908, 95 S.Ct. 826, 42 L.Ed.2d 837 (1975). Consequently, the term "purchase or sale of any security" must include the entry into contractual obligations to sell or purchase securities, even if the terms of the contract were not ultimately fulfilled.

FN3. *Candler* has been overruled "insofar as it purports to hold that all six common-law requirements of frauds must be proven in an innocent misrepresentation case....

Michigan law has never so required." *U.S. Fidelity & Guaranty Company v. Black,* 412 Mich. 99, 116, 313 N.W.2d 77, n. 8 (1981).

FN4. Plaintiff has admitted in its filings in response to Baird, Patrick & Co.'s motion that plaintiff is suspicious of Goss's conduct while at Baird, Patrick & Co., but did not have at that time any facts to support the claims asserted. Thus, plaintiff has acknowledged violation of Rule 11, Fed.R.Civ.P. Justifiably hoping, as the plaintiffs admittedly did, to find evidence to support the claims asserted in the complaint, is not a defense to Rule 11 sanction motion. The plaintiffs did not have any facts in support of their complaint against this defendant at the time of the filing of the complaint and were unable to create a factual issue in response to the motion.

E.D.Mich.,1991.
Lasater v. Goss
Not Reported in F.Supp., 1991 WL 354886 (E.D.Mich.), Fed. Sec. L. Rep. P 96,881

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EXHIBIT F

Only the Westlaw citation is currently available.

United States District Court,
District of Columbia.
UNITED STATES SECURITIES and EXCHANGE COMMISSION, Plaintiff,
v.
Elaine M. BROWN, et al., Defendants.
Civil Action No. 09-1423 (GK).

Sept. 27, 2010.

Background: Securities and Exchange Commission (SEC) filed enforcement action against former employees of publicly traded corporation alleging violations of Securities Act of 1933, Securities Exchange Act of 1934, and rules promulgated under Exchange Act. Defendants moved to dismiss.

Holdings: The District Court, Gladys Kessler, J., held that:
(1) five-year "catch-all" statute of limitations was not tolled for civil penalties claims for lack of due diligence by SEC in trying to uncover prior alleged wrongdoing;
(2) determination of whether continuing violation doctrine applied to toll limitations period could not be resolved on motion to dismiss;
(3) SEC stated claim that corporate officer had duty, apart from Regulation S-K, to disclose adverse legal background de facto corporate officer;
(4) term, "officer," under definitions in federal securities regulations was not void for vagueness;
(5) SEC sufficiently stated what omissions had been made and time, place, and persons responsible for omissions;
(6) SEC adequately pleaded way in which alleged omissions misled SEC;
(7) claim under provision that prohibited fraudulent interstate transactions required offer or sale of securities; and
(8) SEC adequately pleaded that concealing role of person with adverse legal background as de facto officer of company was material to transactions that were subject of proxy solicitations.

Ordered accordingly.

West Headnotes

[1] Federal Civil Procedure 170A 636

170A Federal Civil Procedure
170AVII Pleadings and Motions
170AVII(A) Pleadings in General
170Ak633 Certainty, Definiteness and Particularity
170Ak636 k. Fraud, Mistake and Condition of Mind. Most Cited Cases
Circumstances that must be pleaded with particularity under the federal rules include time, place, and content of false misrepresentations, misrepresented fact, and what opponent retained or claimant lost as consequence of alleged fraud; conclusory allegations that a defendant's actions were fraudulent and deceptive are not sufficient. Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

[2] Securities Regulation 349B 134

349B Securities Regulation
349BI Federal Regulation
349BI(E) Remedies
349BI(E)1 In General
349Bk134 k. Time to Sue and Limitations. Most Cited Cases
Equitable relief which is granted upon a showing that it is necessary to prevent future harm to the public is remedial, and not punitive, and, thus, "catch-all" statute of limitations did not apply to equitable relief sought by Securities and Exchange Commission (SEC) against former employees of publicly traded corporation alleging violations of Securities Act of 1933, Securities Exchange Act of 1934, and rules promulgated under Exchange Act. Securities Act of 1933, § 1, 15 U.S.C.A. § 77a; Securities Exchange Act of 1934, § 1, 15 U.S.C.A. § 78a; 28 U.S.C.A. § 2462.

[3] Securities Regulation 349B ⚷134

349B Securities Regulation
349BI Federal Regulation
349BI(E) Remedies
349BI(E)1 In General
349Bk134 k. Time to Sue and Limitations. Most Cited Cases
Remedial relief does not constitute a "penalty" under the "catch-all" statute of limitations. 28 U.S.C.A. § 2462.

[4] Securities Regulation 349B ⚷171

349B Securities Regulation
349BI Federal Regulation
349BI(E) Remedies
349BI(E)2 Injunction
349Bk171 k. Nature and Grounds of Injunction in General. Most Cited Cases
In order to determine whether injunctive relief or an officer-and-director bar is merited in an enforcement action brought by the Securities and Exchange Commission (SEC) alleging violations of Securities Act of 1933, Securities Exchange Act of 1934, and rules promulgated under Exchange Act, a court must consider, among other consistent factors, the likelihood that misconduct will recur. Securities Act of 1933, § 1, 15 U.S.C.A. § 77a; Securities Exchange Act of 1934, § 1, 15 U.S.C.A. § 78a.

[5] Securities Regulation 349B ⚷134

349B Securities Regulation
349BI Federal Regulation
349BI(E) Remedies
349BI(E)1 In General
349Bk134 k. Time to Sue and Limitations. Most Cited Cases
Claim made by Securities and Exchange Commission (SEC) against former employees of publicly traded corporation for civil penalties alleging violations of Securities Act of 1933, Securities Exchange Act of 1934, and rules promulgated under Exchange Act was subject to "catch-all" five-year statute of limitations. Securities Act of 1933, § 1, 15 U.S.C.A. § 77a; Securities Exchange Act of 1934, § 1, 15 U.S.C.A. § 78a; 28 U.S.C.A. § 2462.

[6] Limitation of Actions 241 ⚷104.5

241 Limitation of Actions
241II Computation of Period of Limitation
241II(G) Pendency of Legal Proceedings, Injunction, Stay, or War
241k104.5 k. Suspension or Stay in General; Equitable Tolling. Most Cited Cases
The "catch-all" statute of limitations is subject to equitable tolling. 28 U.S.C.A. § 2462.

[7] Limitation of Actions 241 ⚷104(1)

241 Limitation of Actions
241II Computation of Period of Limitation
241II(F) Ignorance, Mistake, Trust, Fraud, and Concealment or Discovery of Cause of Action
241k104 Concealment of Cause of Action
241k104(1) k. In General. Most Cited Cases
To toll the limitations period for fraudulent concealment, the Securities and Exchange Commission (SEC) must demonstrate that: (1) defendants concealed the existence of the cause of action; (2) it did not discover the alleged wrongdoing until some point within five years of commencing this action; and (3) its continuing ignorance was not attributable to lack of diligence on its part. 28 U.S.C.A. § 2462.

[8] Federal Civil Procedure 170A ⚷636

170A Federal Civil Procedure
170AVII Pleadings and Motions
170AVII(A) Pleadings in General
170Ak633 Certainty, Definiteness and Particularity
170Ak636 k. Fraud, Mistake and Condition of Mind. Most Cited Cases
To toll a limitations period for fraudulent concealment, a plaintiff must plead with particularity the facts giving rise to the fraudulent concealment claim and establish that it used due diligence in try-

ing to uncover the facts. Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

[9] Limitation of Actions 241 ⚿104(1)

241 Limitation of Actions
241II Computation of Period of Limitation
241II(F) Ignorance, Mistake, Trust, Fraud, and Concealment or Discovery of Cause of Action
241k104 Concealment of Cause of Action
241k104(1) k. In General. Most Cited Cases

Five-year "catch-all" statute of limitations was not tolled under fraudulent concealment doctrine for civil penalties claims against former employees of publicly traded corporation alleging violations of Securities Act of 1933, Securities Exchange Act of 1934, and rules promulgated under Exchange Act; Securities and Exchange Commission (SEC) failed to exercise due diligence in trying to uncover prior alleged wrongdoing. 28 U.S.C.A. § 2462.

[10] Limitation of Actions 241 ⚿192(.5)

241 Limitation of Actions
241V Pleading, Evidence, Trial, and Review
241k186 Pleading in Avoidance of Defense
241k192 Matters Avoiding Bar of Statute
241k192(.5) k. In General. Most Cited Cases

Determination of whether continuing violation doctrine applied in civil enforcement action brought by Securities and Exchange Commission (SEC) against former employees of publicly traded corporation alleging violations of Securities Act of 1933, Securities Exchange Act of 1934, and rules promulgated under Exchange Act to toll limitations period could not be resolved on motion to dismiss for failure to state claim upon which relief could be granted, where there were factual disputes regarding its application. Securities Act of 1933, § 1, 15 U.S.C.A. § 77a; Securities Exchange Act of 1934, § 1, 15 U.S.C.A. § 78a; 28 U.S.C.A. § 2462; Fed.Rules Civ.Proc.Rule 12(b)(6), 28 U.S.C.A.

[11] Securities Regulation 349B ⚿60.28(13)

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(13) k. Particular Matters. Most Cited Cases

Securities and Exchange Commission (SEC) stated federal securities claim in enforcement action that corporate officer had duty, apart from Regulation S-K, to disclose adverse legal background de facto corporate officer, on allegations that omission could have affected "total mix of information" in corporation's filings, rendering them misleading. Securities Exchange Act of 1934, § 1 et seq., 15 U.S.C.A. § 78a et seq.; 17 C.F.R. § 229.401(f).

[12] Securities Regulation 349B ⚿60.28(2.1)

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(2) Duty to Disclose or Refrain from Trading
349Bk60.28(2.1) k. In General. Most Cited Cases

Under the federal securities laws, there is no general duty to disclose all material information.

[13] Securities Regulation 349B ⚿60.28(2.1)

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(2) Duty to Disclose or Refrain from Trading
349Bk60.28(2.1) k. In General. Most Cited Cases
Corporate officers do have a duty under the federal securities laws to disclose material information when required by a specific rule or regulation or when silence would make other statements misleading or false.

[14] Administrative Law and Procedure 15A ⚷390.1

15A Administrative Law and Procedure
15AIV Powers and Proceedings of Administrative Agencies, Officers and Agents
15AIV(C) Rules and Regulations
15Ak390 Validity
15Ak390.1 k. In General. Most Cited Cases
A rule is unconstitutionally vague when men of common intelligence must necessarily guess at its meaning; if the rule is an economic regulation or if it includes a scienter requirement, the Court's review is less strict.

[15] Constitutional Law 92 ⚷1133

92 Constitutional Law
92VIII Vagueness in General
92k1132 Particular Issues and Applications
92k1133 k. In General. Most Cited Cases

Securities Regulation 349B ⚷3

349B Securities Regulation
349BI Federal Regulation
349BI(A) In General
349Bk3 k. Administrative Rules and Regulations. Most Cited Cases
Term, "officer," under definitions in federal securities regulations, was not void for vagueness, in civil enforcement action brought by Securities and Exchange Commission (SEC) against former employees of publicly traded corporation alleging violations of Securities Act of 1933, Securities Exchange Act of 1934, and rules promulgated under Exchange Act, since securities laws were economic in nature and danger of imposing liability in absence of notice of what constituted "officer" was minimal given that SEC had to prove that defendant either knew or was reckless with regard to status of "officer." 17 C.F.R. § 240.3b-2; 17 C.F.R. § 240.3b-7.

[16] Corporations 101 ⚷289

101 Corporations
101X Officers and Agents
101X(A) Election or Appointment, Qualification, and Tenure
101k289 k. De Facto Officers and Agents. Most Cited Cases
While an individual's title is relevant to the question of whether he or she was an officer, courts must look to the facts of each situation and determine whether the defendant exercised the executive responsibilities traditionally associated with corporate officers. 17 C.F.R. § 240.3b-2; 17 C.F.R. § 240.3b-7.

[17] Federal Civil Procedure 170A ⚷636

170A Federal Civil Procedure
170AVII Pleadings and Motions
170AVII(A) Pleadings in General
170Ak633 Certainty, Definiteness and Particularity
170Ak636 k. Fraud, Mistake and Condition of Mind. Most Cited Cases
Securities and Exchange Commission (SEC) sufficiently stated what omissions had been made and time, place, and persons responsible for omissions, as required to plead fraud with particularity on federal securities claim in enforcement action, on allegations that corporate officer had concealed "role and involvement in the company" of de facto officer "[f]or over seven years, from approximately December 1998 through August 2006," failure to

disclose had been made in "seven annual reports" from 1999 through mid-2006 filed with SEC on Forms 10-K or 10-KSB and "seven proxy statements" each of which, with exception of 1999 10-KSB, had been reviewed and signed by officer. Securities Exchange Act of 1934, § 1 et seq., 15 U.S.C.A. § 78a et seq.; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

[18] Federal Civil Procedure 170A ⚿636

170A Federal Civil Procedure
170AVII Pleadings and Motions
170AVII(A) Pleadings in General
170Ak633 Certainty, Definiteness and Particularity
170Ak636 k. Fraud, Mistake and Condition of Mind. Most Cited Cases

A complaint alleging securities fraud pleads fraud with particularity if it sets forth (1) precisely what statements were made in what documents or oral representations or what omissions were made and (2) the time and place of each such statement and the person responsible for making (or, in the case of omissions, not making) same, and (3) the content of such statements and the manner in which they misled the plaintiff, and (4) what the defendants obtained as a consequence of the fraud. Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

[19] Federal Civil Procedure 170A ⚿636

170A Federal Civil Procedure
170AVII Pleadings and Motions
170AVII(A) Pleadings in General
170Ak633 Certainty, Definiteness and Particularity
170Ak636 k. Fraud, Mistake and Condition of Mind. Most Cited Cases

Securities and Exchange Commission (SEC) adequately pleaded way in which alleged omissions misled SEC, namely by concealing role of person with adverse legal background as de facto officer of company, as required to plead fraud with particularity on federal securities claim in enforcement action, on allegations, among other things, that such person appeared at executive vice president level on internal organizational charts and his office was located in the same area as company officers holding official titles, he regularly attended board of director meetings, and his compensation was equal to that of top officers holding official titles at corporation. Securities Exchange Act of 1934, § 1, 15 U.S.C.A. § 78a; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

[20] Federal Civil Procedure 170A ⚿636

170A Federal Civil Procedure
170AVII Pleadings and Motions
170AVII(A) Pleadings in General
170Ak633 Certainty, Definiteness and Particularity
170Ak636 k. Fraud, Mistake and Condition of Mind. Most Cited Cases

To plead fraud with particularity, a plaintiff does not need to recite the evidence or plead detailed evidentiary matters. Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

[21] Securities Regulation 349B ⚿27.14

349B Securities Regulation
349BI Federal Regulation
349BI(B) Registration and Distribution
349BI(B)6 Fraudulent Transactions
349Bk27.11 Transactions Subject to Regulation or Protection
349Bk27.14 k. Offer and Sale in General. Most Cited Cases

Claim under provision that prohibited fraudulent interstate transactions required offer or sale of securities; thus, allegations that defendant corporate officer had made material omissions in seven annual reports and seven proxy statements and that corporation was public company that had stock traded on public markets did not state claim under that provision. 15 U.S.C. § 77q(a); 17 C.F.R. § 240.13a-14.

[22] Securities Regulation 349B ⚿35.23

349B Securities Regulation

349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)1 In General
349Bk35.23 k. Periodic Reporting; Accounting and Reports. Most Cited Cases
Alleged violation of certification requirement under Exchange Act Rule, that quarterly and annual reports did not contain any untrue statement of material fact or omit to state material fact necessary in order to make statements made not misleading, supported separate cause of action. 17 C.F.R. § 240.13a-14.

[23] Securities Regulation 349B ⚿49.26(3)

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)4 Proxies
349Bk49.19 False or Fraudulent Proxies; Accuracy and Completeness
349Bk49.26 Grounds of and Defenses to Liability
349Bk49.26(3) k. Materiality of Violation; Reliance and Causation. Most Cited Cases
Securities and Exchange Commission (SEC) in enforcement action adequately pleaded that concealing role of person with adverse legal background as de facto officer of company was material to transactions that were subject of proxy solicitations, on allegations that "[f]rom 2000 through mid-2006, [corporation] filed seven proxy statements to give notice of [its] annual meetings and to solicit for the election of directors," since reasonable minds could have differed as to whether person's officer status and legal background was obviously unimportant to shareholders who had to decide whether to vote for chief executive officer (CEO) or other directors involved in decision to re-hire him. Securities Exchange Act of 1934, § 14(a), 15 U.S.C.A. § 78n(a); 17 C.F.R. § 240.14a-9.

[24] Securities Regulation 349B ⚿49.20

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)4 Proxies
349Bk49.19 False or Fraudulent Proxies; Accuracy and Completeness
349Bk49.20 k. In General. Most Cited Cases
A private plaintiff bringing a claim under provision of Securities Exchange Act governing solicitation of proxies must allege that (1) a proxy statement contained a material misrepresentation or omission which (2) caused the plaintiff injury and (3) that the proxy solicitation was an essential link in the accomplishment of the transaction. Securities Exchange Act of 1934, § 14(a), 15 U.S.C.A. § 78n(a); 17 C.F.R. § 240.14a-9.

[25] Securities Regulation 349B ⚿49.26(3)

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)4 Proxies
349Bk49.19 False or Fraudulent Proxies; Accuracy and Completeness
349Bk49.26 Grounds of and Defenses to Liability
349Bk49.26(3) k. Materiality of Violation; Reliance and Causation. Most Cited Cases
In a private action under the provision of the Securities Exchange Act governing solicitation of proxies, the essential link element requires a causal connection between the proxy solicitation and the transaction that resulted in injury to the plaintiff. Securities Exchange Act of 1934, § 14(a), 15 U.S.C.A. § 78n(a); 17 C.F.R. § 240.14a-9.

[26] Securities Regulation 349B ⚿49.26(3)

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)4 Proxies
349Bk49.19 False or Fraudulent Proxies; Accuracy and Completeness

349Bk49.26 Grounds of and Defenses to Liability
349Bk49.26(3) k. Materiality of Violation; Reliance and Causation. Most Cited Cases
On a claim under provision of Securities Exchange Act governing solicitation of proxies, a complaint may not be dismissed on the ground that the alleged omission is not material unless it is so obviously unimportant to a reasonable investor that reasonable minds could not differ on the question of its importance. Securities Exchange Act of 1934, § 14(a), 15 U.S.C.A. § 78n(a); 17 C.F.R. § 240.14a-9; Fed.Rules Civ.Proc.Rule 12(b)(6), 28 U.S.C.A.

[27] Securities Regulation 349B 🔑49.26(3)

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)4 Proxies
349Bk49.19 False or Fraudulent Proxies; Accuracy and Completeness
349Bk49.26 Grounds of and Defenses to Liability
349Bk49.26(3) k. Materiality of Violation; Reliance and Causation. Most Cited Cases
Under provision of Securities Exchange Act governing solicitation of proxies, an omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote on the proxy solicitation. Securities Exchange Act of 1934, § 14(a), 15 U.S.C.A. § 78n(a); 17 C.F.R. § 240.14a-9.

[28] Securities Regulation 349B 🔑49.26(3)

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)4 Proxies
349Bk49.19 False or Fraudulent Proxies; Accuracy and Completeness
349Bk49.26 Grounds of and Defenses to Liability
349Bk49.26(3) k. Materiality of Violation; Reliance and Causation. Most Cited Cases
Securities and Exchange Commission (SEC) in enforcement action stated claim against corporate officer for aiding and abetting violations of provision of Securities Exchange Act governing solicitation of proxies, even assuming that periodic reports had not been incorporated into proxy statements, on allegations specifying that certain information regarding de facto corporate officer with adverse legal background, including his identity, were material and therefore were required to be disclosed in proxy statements, and that corporate officer had prepared, reviewed, and approved materials for use in proxy statements with knowledge that such required information had been omitted. Securities Exchange Act of 1934, § 14(a), 15 U.S.C.A. § 78n(a); 17 C.F.R. § 240.14a-9.

[29] Securities Regulation 349B 🔑35.16

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)1 In General
349Bk35.16 k. Aiders and Abettors. Most Cited Cases
Liability for aiding and abetting a violation of the securities laws requires proof of (1) a securities violation by a primary wrongdoer; (2) knowledge of the violation by the aider and abettor; and (3) substantial assistance by the aider and abettor in the primary violation.

[30] 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
Securities and Exchange Commission (SEC) in enforcement action stated that de facto corporate of-

ficer with adverse legal background had "made" statement in violation of Rule 10b-5 under "bright-line" approach for primary liability, on allegations that such person generally had reviewed, commented on, and approved corporation's periodic filings and proxy statements but he did not correct omission of his status as officer of company and of his holdings and transactions in company's securities. Securities Exchange Act of 1934, § 10, 15 U.S.C.A. § 78j; 17 C.F.R. § 240.10b-5.

[31] Securities Regulation 349B 🔑60.41

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.39 Persons Liable
349Bk60.41 k. Aiders and Abettors. Most Cited Cases

Section 10(b) prohibits only the making of a material misstatement or omission or the commission of a manipulative act; it does not provide a cause of action against those who only aid and abet such acts. Securities Exchange Act of 1934, § 10, 15 U.S.C.A. § 78j.

[32] Securities Regulation 349B 🔑60.28(16)

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(16) k. Correction or Confirmation of Prior Statements or Rumors. Most Cited Cases

De facto corporate officer with adverse legal background had duty under Rule 10b-5 to correct omissions in corporation's periodic reports and proxy statements as to his status as officer of company and of his holdings and transactions in company's securities, where he generally had reviewed, commented on, and approved those periodic filings and proxy statements. Securities Exchange Act of 1934, § 10, 15 U.S.C.A. § 78j.

[33] Securities Regulation 349B 🔑35.23

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)1 In General
349Bk35.23 k. Periodic Reporting; Accounting and Reports. Most Cited Cases

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

Securities and Exchange Commission (SEC) in enforcement action stated claim against alleged de facto corporate officer with adverse legal background under Rule 10b-5 for scheme liability, on allegations that he did not file statements under provision that governed required filings by directors, officers, and principal stockholders; SEC otherwise adequately alleged that such person acted as officer of corporation with scienter and reasonable fact finder could conclude that his failure to file required reports had been done with purpose and effect of concealing his officer status from public. Securities Exchange Act of 1934, §§ 10, 16(a), 15 U.S.C.A. §§ 78j, 78p(a); 17 C.F.R. § 240.10b-5.

[34] 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

An individual's participation in a scheme to defraud may result in Section 10(b) primary liability even in the absence of a misstatement or manipulative act if the individual engaged in conduct that had the principal purpose and effect of creating a false appearance of fact in furtherance of the scheme. Securities Exchange Act of 1934, § 10, 15 U.S.C.A. § 78j; 17 C.F.R. § 240.10b-5.

[35] 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

Primary liability under Rule 10b-5 may arise out of the same set of facts under all three subsections where the plaintiffs allege both that the defendants made misrepresentations in violations of Rule 10b-5(b), as well as that the defendants undertook a deceptive scheme or course of conduct that went beyond the misrepresentations. 17 C.F.R. § 240.10b-5.

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Sarah Alyssa Altschuller, Foley Hoag, LLP, Stephen J. Crimmins, K & L GATES LLP, Washington, DC, for Interested Party.

MEMORANDUM OPINION

GLADYS KESSLER, District Judge.

*1 Plaintiff United States Securities and Exchange Commission ("SEC") brings this action against Defendants [FN1] Elaine M. Brown and Gary A. Prince alleging violations of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. § 77a *et seq,* the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78a *et seq,* and Rules promulgated under the Exchange Act. This matter is before the Court on Defendants' Motions to Dismiss the Complaint pursuant to Fed.R.Civ.P. 12(b)(6) and 9(b). [Dkt. Nos. 13, 14]. Upon consideration of the Motions, Opposition, Replies, and the entire record herein, and for the reasons stated below, Defendant Brown's Motion to Dismiss is **granted in part, and denied in part,** and Defendant Prince's Motion to Dismiss is **denied.**

I. Background[FN2]

Defendants Brown and Prince are former employees of Integral Systems, Inc. ("Integral"), a publicly traded Maryland corporation that manufactures ground-based controls for satellite systems. Defendant Brown was the Chief Financial Officer and Principal Accounting Officer of Integral from 1997 until May of 2007, and the Vice President of Administration from 2007 until she resigned from that position in July 2008. Defendant Prince was hired as Integral's Chief Executive Officer in 1982, but then resigned in 1995 shortly before pleading guilty in the Central District of California to a conspiracy to commit securities fraud and to making false statements in connection with his conduct as an officer of another corporation. *United States v. Prince,* No. 95-cr-00771 (C.D.Cal. Sept. 5, 1995).

In 1994, the United States District Court for the District of Columbia enjoined Prince from violating the antifraud and lying-to-auditors provisions of the Exchange Act based on the conduct underlying his guilty plea in the Central District of California. *SEC v. Bolen,* No. 93-cv-01331 (D.D.C. Aug. 18, 1994). In 1997, the SEC issued an Order ("1997

Order") permanently barring Prince from appearing before the Commission as an accountant. *In re Gary A. Prince,* Release No. 38,765, 64 S.E.C. Docket 2074, 1997 WL 343054 (June 24, 1997).

In 1998, Prince was re-hired by Integral. Until his termination from Integral on March 30, 2007, Prince held various titles, including Director of Mergers and Acquisitions, Director of Strategic and Financial Planning, and Managing Director of Operations. The SEC alleges that Prince had "substantial authority and responsibilities" during this nine-year period that made him a *de facto* officer of Integral in violation of its 1997 Order. The "substantial authority and responsibilities" included Prince's authority to approve major contracts, attendance at Integral's Board of Director meetings, and evaluation of potential mergers. Prince was also allegedly a member of a policy-making group of senior executive officers, and he was compensated at levels equal to Integral's top-ranking officers. Compl. ¶¶ 21-29.

***2** In the period between 1998 and August 2006, when Integral Systems named Prince as an officer, Prince's alleged status as a de facto officer of the company was never disclosed in periodic filings with the SEC or in proxy statements. The SEC claims this was a material omission in violation of provisions of the Securities Act, the Exchange Act, and related Rules. Specifically, the SEC alleges that both Defendants (1) violated § 17(a) of the Securities Act, (2) violated § 10(b) of the Exchange Act and Rule 10b-5, (3) aided and abetted Integral Systems's violations of Exchange Act § 13(a) and Rules 12b-20 and 13a-1, (4) violated Exchange Act Rule 13a-14, and (5) aided and abetted violations of Exchange Act § 14(a) and Rule 14a-9 by Steven Chamberlain, Integral Systems's former Chief Executive Officer. Defendant Prince is also charged with violations of Exchange Act § 16(a), Rule 16a-3, and the 1997 Order.

On September 28, 2009, Defendants Brown and Prince filed Motions to Dismiss [Dkt. Nos. 13 and 14], relying upon the statute of limitations contained in 28 U.S.C. § 2462, Fed.R.Civ.P. 9(b), and Fed.R.Civ.P. 12(b)(6). Defendant Brown also argues that the entire Complaint is void because the term "officer" is impermissibly vague.

II. Standard of Review

[1] Under Rule 9(b), "the circumstances that the claimant must plead with particularity include matters such as the time, place and content of the false misrepresentations, the misrepresented fact, and what the opponent retained or the claimant lost as a consequence of the alleged fraud." *United States ex rel. Totten v. Bombardier Corp.,* 286 F.3d 542, 551-52 (D.C.Cir.2002)). "Conclusory allegations that a defendant's actions were fraudulent and deceptive are not sufficient to satisfy 9(b)." *Shekoyan v. Sibley Int'l Corp.,* 217 F.Supp.2d 59, 73 (D.D.C.2002).

The purpose of the heightened pleading standard in Rule 9(b) is two-fold. First, it ensures that the defendant is put on notice of the claims brought against him or her. Second, Rule 9(b)'s particularity requirement "prevents attacks on [the defendant's] reputation where the claim for fraud is unsubstantiated, and protects against a strike suit brought solely for its settlement value." *In re U.S. Office Prod. Sec. Litig.,* 326 F.Supp.2d 68, 73 (D.D.C.2004). Rule 9(b) does not abrogate the "short and plain statement of the claim" standard in Rule 8(a); instead, the two rules function in harmony. *In re U.S. Office Products Sec. Litig.,* 326 F.Supp.2d 68, 74 (D.D.C.2004) (citing *Kowal v. MCI Comms. Corp.,* 16 F.3d 1271, 1278 (D.C.Cir.1994)).

Under Rule 12(b)(6), a plaintiff need only plead "enough facts to state a claim to relief that is plausible on its face" and to "nudge[ ] [his or her] claims across the line from conceivable to plausible." *Bell Atl. Corp. v. Twombly,* 550 U.S. 544, 570, 127 S.Ct. 1955, 167 L.Ed.2d 929 (2007). "[A] complaint [does not] suffice if it tenders naked assertions devoid of further factual enhancement." *Ashcroft v.*

Iqbal, --- U.S. ----, ----, 129 S.Ct. 1937, 1949, 173 L.Ed.2d 868 (2009) (internal quotations omitted) (citing *Twombly,* 550 U.S. at 557). Instead, the complaint must plead facts that are more than "merely consistent with" a defendant's liability; "the pleaded factual content [must] allow[ ] the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Id.* at 1940.

***3** "[O]nce a claim has been stated adequately, it may be supported by showing any set of facts consistent with the allegations in the complaint." *Twombly,* 550 U.S. at 563. Under the standard set forth in *Twombly,* a "court deciding a motion to dismiss must ... assume all the allegations in the complaint are true (even if doubtful in fact) ... [and] must give the plaintiff the benefit of all reasonable inferences derived from the facts alleged." *Aktieselskabet AF 21. November 2001 v. Fame Jeans Inc.,* 525 F.3d 8, 18 (D.C.Cir.2008) (internal quotations marks and citations omitted); *see also Tooley v. Napolitano,* 586 F.3d 1006, 1007 (D.C.Cir.2009) (declining to reject or address the government's argument that *Iqbal* invalidated *Aktieselskabet*).

III. Analysis

[2] Defendants make several arguments in support of their Motions to Dismiss. First, Defendant Brown seeks to narrow the scope of the Complaint by arguing: (1)that the statute of limitations in 28 U.S.C. § 2462 bars all claims based on conduct occurring before July 30, 2005; and (2) that Defendants had no obligation to disclose Prince's conviction after 2002, so all claims based on their failure to do so from 2002-2006 should be dismissed. Second, Brown argues that all claims should be dismissed because the term "officer," the definition/ interpretation of which is central to the SEC's allegation that Prince acted as a de facto officer at Integral, is void for vagueness. Third, Brown argues that Counts I and II fail to plead fraud with the particularity required by Rule 9(b).

Finally, Defendants Brown and Prince both argue that certain counts in the Complaint fail to state a claim under Rule 12(b)(6). Brown argues that Counts I, II, IV, and V fail as against her. Prince challenges Counts I and II on the basis that the SEC has failed to allege facts sufficient to hold him liable as a primary actor under §§ 17(a) and 10(b) or to establish that he has a duty to disclose information under these provisions.

A. Statute of Limitations

As neither the Exchange Act nor the Securities Act includes a statute of limitations, Brown argues that the "catch-all" statute of limitations in 28 U.S.C. § 2462 applies to bar all claims based on conduct that occurred more than five years before the filing of the Complaint. Def. Brown's Mot. at 14. Section 2462 states that:

> Except as otherwise provided by Act of Congress, an action, suit, or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued if, within the same period, the offender or the property is found within the United States in order that proper service may be made thereon.

28 U.S.C. § 2462. Specifically, Brown argues that § 2462 bars the SEC from seeking equitable relief and civil penalties against her on the basis of conduct that occurred before July 30, 2004, or more than five years before the SEC filed its Complaint on July 30, 2009 [Dkt. No. 1].

1. Equitable Relief

***4** [3] In response to Brown's argument, the SEC contends that equitable relief-which includes the injunctions and officer-and-director bar sought against Defendant Brown-are "remedial" in nature. Remedial relief does not constitute a "penalty" under § 2462, and so is not subject to its statute of limitations. *See SEC v. Tandem Mgmt., Inc.,* No. 95-cv-8411, 2001 WL 1488218, at *6 (S.D.N.Y. Nov.21, 2001) ("Courts have found that SEC suits for equitable and remedial relief, including requests for permanent injunctions and disgorgement, are not governed by § 2462 because they are not actions or proceedings for a "penalty" within the meaning of the statute.") (collecting cases).

Brown disagrees. Relying on *Johnson v. SEC,* 87 F.3d 484 (D.C.Cir.1996), she argues that the equitable relief sought in this case is actually penal in nature. In *Johnson,* our Court of Appeals held that a broker's censure and six-month suspension following an administrative SEC proceeding were punitive in nature, and thus subject to § 2462's statute of limitations. In reaching this conclusion, the Court explained that "a 'penalty,' as the term is used in § 2462, is a form of punishment imposed by the government for unlawful or proscribed conduct, which goes beyond remedying the damage caused to the harmed parties by the defendant's action." *Id.* at 488.

In addition, the Court of Appeals was careful to emphasize that the administrative judge in the SEC proceeding had focused on Johnson's wrongful conduct under the Exchange Act, and not the likelihood of future harm. *Id.* at 489-90. As the Court explained, "[t]his sanction would less resemble punishment if the SEC had focused on Johnson's current competence or the degree of risk she posed to the public." *Id.* at 489; *see also McCurdy v. SEC,* 396 F.3d 1258, 1265 (D.C.Cir.2005) (where SEC's suspension of plaintiff was not punishment because it was meant to protect public); *Meadows v. SEC,* 119 F.3d 1219, 1228 n. 20 (5th Cir.1997) (distinguishing *Johnson,* and concluding that the SEC's temporary bar from association following an administrative proceeding was not penal in nature because the Administrative Law Judge made findings regarding the risk of future harm).

[4] This Court must therefore consider whether the equitable relief sought against Brown would be justified, if granted, on the basis of Defendant's wrongful conduct-in which case it is penal in nature-or on the risk of future harm. "To obtain equitable remedies, the government must demonstrate a 'reasonable likelihood of further violation[s] in the future.' " *United States v. Philip Morris USA, Inc.,* 566 F.3d 1095, 1132, (D.C.Cir.2009) (quoting *SEC v. Savoy Indus., Inc.,* 587 F.2d 1149, 1168 (D.C.Cir.1978)); *see also SEC v. First City Fin. Corp., Ltd.,* 890 F.2d 1215, 1228 (D.C.Cir.1989) (applying *Savoy Indus.* test to SEC action); *SEC v. Bolla,* 401 F.Supp.2d 43, 73-74 (D.D.C.2005) (same). The courts in this Circuit therefore must consider "the likelihood that misconduct will recur," among other consistent factors, in order to determine whether injunctive relief or an officer-and-director bar is merited. *SEC v. Johnson,* 595 F.Supp.2d 40, 45 (D.D.C.2009). The Second Circuit has similarly made clear that the likelihood of Defendants' future misconduct is an "essential" component in imposing a lifetime bar. *SEC v. Patel,* 61 F.3d 137, 141, 142 (2d Cir.1995); *accord SEC v. Levine,* 517 F.Supp.2d 121, 145 (D.D.C.2007).

***5** Thus, the equitable relief sought by the SEC should only be granted under this Circuit's law upon a showing of future risk of harm. Given this requirement, *Johnson's* reasoning-that the sanctions were punitive in nature because they focused exclusively on the individual's past conduct-is inapplicable to this case. Equitable relief which is granted upon a showing that it is necessary to prevent future harm to the public is remedial, and not punitive. Thus, the statute of limitations in § 2462 does not apply to the equitable relief sought by the SEC. Defendant Brown's Motion to Dismiss the claims for injunctive relief and an officer-and-director bar under § 2462 is therefore **denied.**

2. Civil Penalties

[5] The parties do not dispute that the SEC's claim for civil penalties, in contrast, is subject to the five-year statute of limitations in § 2462. Defendants argue that § 2462 therefore should apply to bar any such claims based on conduct occurring before July

30, 2004. The SEC counters, however, that these claims are saved because the statute of limitations in § 2462 is tolled by the fraudulent concealment doctrine and the continuing violation doctrine.

a. The Fraudulent Concealment Doctrine

[6] It is well established that, like all federal statutes of limitation, § 2462 is subject to equitable tolling. *Holmberg v. Armbrecht,* 327 U.S. 392, 397, 66 S.Ct. 582, 585, 90 L.Ed. 743 (1946) (equitable tolling "is read into every federal statute of limitation"); *3M Co. v. Browner,* 17 F.3d 1453, 1461 n. 15 (D.C.Cir.1994) (suggesting that doctrine of fraudulent concealment would apply to § 2462); *Fed. Election Comm'n v. Williams,* 104 F.3d 237, 240 (9th Cir.1996) (applying doctrine of fraudulent concealment to § 2462); *SEC v. Gabelli,* No. 08-cv-3868, 2010 WL 1253603, at *6-7 (S.D.N.Y. March 17, 2010) (same).

[7][8] "To toll the limitations period for fraudulent concealment, the Commission must demonstrate: (1) that Defendants concealed the existence of the cause of action; (2) that it did not discover the alleged wrongdoing until some point within five years of commencing this action; and (3) that its continuing ignorance was not attributable to lack of diligence on its part." *SEC v. Jones,* 476 F.Supp.2d 374, 382 (S.D.N.Y.2007). Fed.R.Civ.P. 9(b) requires that a plaintiff "plead with particularity the facts giving rise to the fraudulent concealment claim and [ ] establish that [it] used due diligence in trying to uncover the facts." *Larson v. Northrop Corp.,* 21 F.3d 1164, 1173 (D.C.Cir.1994) (internal quotation and citation omitted).

[9] The Complaint fails to allege any facts that would establish that the SEC used due diligence in trying to uncover Defendants' wrongdoing from 1998 to 2005. More problematically, the Complaint fails to allege when the SEC discovered the claims; there are no allegations that the SEC remained ignorant of Prince's role at Integral up until five years or less before filing its Complaint. For these reasons, the Court concludes that the SEC has failed to adequately plead Defendants' fraudulent concealment, and the five-year statute of limitations in § 2462 is not tolled for the civil penalties claims. *See Gabelli,* 2010 WL 1253603, at *7 (rejecting fraudulent concealment doctrine when plaintiff SEC failed to allege due diligence).

b. The Continuing Violation Doctrine

***6** [10] In the alternative, the SEC argues that the claims barred by § 2462 are part of a "continuing, integrated fraudulent scheme" which ended within the limitations period. Pl.'s Opp'n at 25. In other words, the five-year statute of limitations did not begin to accrue until the scheme ended with the disclosure of Prince's role at Integral on August 8, 2006. *Id.*

Our Court of Appeals has not considered whether the "continuing violation doctrine," which originated in the federal employment discrimination context, applies to claims brought in the securities fraud context. District courts in the Second and Third Circuits have indicated great skepticism that it does. *In re Comverse Tech ., Inc. Sec. Litig.,* 543 F.Supp.2d 134, 155 (E.D.N.Y.2008) (noting that "[t]he weight of authority in [the Second Circuit] is skeptical of the application of the continuing violations doctrine in securities fraud cases"); *In re DVI, Inc. Sec. Litigation,* No. 03-cv-5336, 2005 WL 1307959, at *11 (E.D.Pa. May 31, 2005) (declining to extend continuing violation doctrine to case brought under securities laws) (unreported opinion); *but see SEC v. Kelly,* 663 F.Supp.2d 276, 287-88 (S.D.N.Y.2009) (applying continuing violation doctrine in case brought by SEC).

However, even if the doctrine does apply in the securities fraud context, there are factual disputes which would determine its application. For example, the parties disagree as to when the alleged scheme to conceal Prince's officer status began, when Defendant Brown's obligation to disclose his status arose, and if she had such an obligation.[FN3]

Discovery has not yet even been concluded. The Court therefore defers consideration of this issue until it has the benefit of a more fully developed factual record. *Cf. In re Converse,* 543 F.Supp.2d at 155 (concluding "it would be prudent to defer consideration of [the continuing violation doctrine] issue until the factual record [ ] is more fully developed"); *SEC v. Schiffer,* No. 97-cv-5853, 1998 WL 226101, at *3 (S.D.N.Y. May 5, 1998) (concluding that decision on continuing violation doctrine issue was premature, given undetermined fact issues). The Motion to Dismiss the SEC's claims for civil penalties based on conduct occurring before 2005 is therefore **denied without prejudice** at this time.

B. Regulation S-K's Look-Back Provision

[11] Until December 23, 2009,FN4 Item 401(f) of Regulation S-K required disclosure of injunctions and/or criminal proceedings or convictions "that occurred during the past five years and that are material to an evaluation of the ability of any director ... or executive officer." 17 C.F.R. § 229.401(f) (2009). Defendant Brown argues that any claims included in Counts I-V which allege her failure to disclose Prince's conviction and injunction after June 23, 2002-five years after the Commission permanently enjoined Prince from appearing or practicing before it as an accountant-must be dismissed because there was no duty to disclose under Regulation S-K after that date.

*7 The SEC responds that the five-year limitation in Regulation S-K is irrelevant because the sole test for determining whether information must be disclosed is whether it is material, i.e. whether there is "a substantial likelihood that a reasonable investor would consider it important." *Basic, Inc. v. Levinson,* 485 U.S. 224, 231-232, 108 S.Ct. 978, 99 L.Ed.2d 194 (1988). Under the SEC's view, if an officer's legal history remains material to investors after five years, it must be disclosed regardless of Regulation S-K's five-year limitation.

"[N]o authority suggests that Regulation S-K is preemptive of the materiality requirement." *Degulis v. LXR Biotechnology, Inc.,* 928 F.Supp. 1301, 1314 (S.D.N.Y.1996). The SEC is therefore correct that the fact that Regulation S-K does not require disclosure of particular information does not answer whether the information is material to investors under the securities laws. *See SEC v. Pace,* 173 F.Supp.2d 30, 32-33 (D.D.C.2001) (illegal transfer of $36,659.28 to defendant's personal account "was material-and had to be disclosed-even if Item 404 [of Regulation SK] did not require it"); *In re WorldCom, Inc. Sec. Litig.,* 346 F.Supp.2d 628, 689 (S.D.N.Y.2004) ("[N]on-disclosure of an underwriter or issuer's conflicts of interest can constitute material omissions, even where no regulation expressly compels the disclosure of such conflicts.").

[12] However, the SEC's argument does not answer the issue raised by Brown. Putting aside materiality, there is no general duty to disclose all material information under the securities laws. *Basic, Inc. v. Levinson,* 485 U.S. at 239 ("Silence, absent a duty to disclose, is not misleading...."); *Chiarella v. United States,* 445 U.S. 222, 235, 100 S.Ct. 1108, 1118, 63 L.Ed.2d 348 (1980).

[13] However, corporate officers such as Defendant Brown do have a duty to disclose material information when required by a specific rule or regulation or "when silence would make other statements misleading or false." *In re XM Satellite Radio Holdings Sec. Litig.,* 479 F.Supp.2d 165, 178 (D.D.C.2007) (citation and internal quotations omitted). In the latter case, "[t]he touchstone of the inquiry is ... whether defendants' representations or omissions, considered together and in context, would affect the total mix of information and thereby mislead a reasonable investor.... " *Id.* (citation and internal quotations omitted).

Although Item 401 of Regulation S-K did not impose a duty on Defendant Brown to disclose Prince's legal background after June 23, 2002, it is certainly possible that the omission could have affected the "total mix of information" in Integral's filings, rendering them misleading and giving rise to a duty to disclose.[FN5] In fact, the SEC's Complaint alleges just this, and for purposes of a Motion to Dismiss, these allegations must be deemed true. Compl. ¶¶ 40-57. Defendant Brown did not address this issue, but instead assumed that Regulation S-K was the only potential source of a duty to disclose Prince's legal background. Consequently, the Motion to Dismiss on the basis of Item 401 of Regulation S-K is **denied.**

C. Void for Vagueness

***8** [14][15] Defendant Brown next argues that the Complaint should be dismissed in its entirety because the definition of "officer," which lies at the heart of the SEC's allegations that Defendants concealed Prince's officer status, is an unconstitutionally vague term. A rule is unconstitutionally vague when "men [sic] of common intelligence must necessarily guess at its meaning." *Broadrick v. Oklahoma,* 413 U.S. 601, 607, 93 S.Ct. 2908, 2913, 37 L.Ed.2d 830 (1973). If the rule is an economic regulation or if it includes a scienter requirement, the Court's review is less strict. *Village of Hoffman Estates v. Flipside, Hoffman Estates, Inc.,* 455 U.S. 489, 498, 102 S.Ct. 1186, 1193, 71 L.Ed.2d 362 (1982).

As the SEC points out, the terms "officer" and "executive officer" are defined in Exchange Act Rules 3b-2 and 3b-7. "Officer" means "a president, vice president, secretary, treasurer or principal financial officer, comptroller, or principal accounting officer, and any person routinely performing corresponding functions with respect to any organization ...." 17 C.F.R. § 240.3b-2. "Executive Officer" means a registrant's "president, any vice president ... in charge of a principal business unit, division, or function (such as sales, administration, or finance), and any other officer who performs a policy making function or any other person who performs similar policy making functions for the registrant." 17 C.F.R. § 240.3b-7.

[16] Courts regularly rely on these definitions to determine whether an individual acted as a de facto officer of a company. *See, e.g., C.R.A. Realty Corp. v. Crotty,* 878 F.2d 562, 565 (2d. Cir.1989); *SEC v. Solucorp,* 274 F.Supp.2d 379, 420 (S.D.N.Y.2003). While an individual's title is relevant to the question of whether he or she was an officer, courts must look to the facts of each situation and determine whether the defendant "exercise[d] the executive responsibilities traditionally associated with corporate officers." *United States v. Jensen,* 537 F.Supp.2d 1069, 1081 (N.D.Cal.2008), *vacated on other grounds, United States v. Reyes,* 577 F.3d 1069 (9th Cir.2009).

Given this case-by-case approach, it is not surprising that the SEC, as Defendant Brown points out, has refused to clarify whether certain corporate positions such as general counsel categorically fall within the definition of "officer." *See* Def. Brown's Mot. to Dismiss at 12. However, this refusal does not mean that the term lacks any standard at all. *Village of Hoffman Estates,* 455 U.S. at 495 n. 7 (vagueness challenges not raising First Amendment issues must prove that no standard of conduct is specified at all). Given the expansive definitions set forth in Rules 3b-2 and 3b-7, the Court is not persuaded that corporate officers like Defendant Brown must guess at the meaning of the term "officer."

Moreover, with the exception of Count I, all of the claims in the Complaint include a scienter requirement. *Aaron v. SEC,* 446 U.S. 680, 691, 100 S.Ct. 1945, 1953, 64 L.Ed.2d 611 (1980) (scienter required for § 10b and Rule 10b-5 claims); *SEC v. Treadway,* 430 F.Supp.2d 293, 323 (S.D.N.Y.2006) (knowledge required in aiding and abetting claims); 15 U.S.C. § 7241(a)(1), (2), (3) (requiring certification from officers that, based on their knowledge, no material omissions were made in annual reports). Because the SEC must prove that Brown either knew or was reckless with regard to Prince's officer status, the danger of imposing liability in the absence of notice of what constitutes an "officer" is minimal. Finally, the securities laws are economic in nature, which means they are subject to a less strict vagueness test because the "subject matter is [ ] more narrow, and because businesses, which face economic demands to plan behavior carefully, can be expected to consult relevant legislation in advance of action." *Village of Hoffman Estates,* 455 U.S. at 498. For these reasons, Defendant Brown's Motion to Dismiss the Complaint on the ground that "officer" is void for vagueness is **denied.**

D. Failure to Plead Fraud with Particularity Under Rule 9(b)

***9** [17] Defendant Brown argues that the Complaint fails to satisfy Rule 9(b)'s heightened pleading requirement because it: (1) does not allege Prince's role as an executive officer by demonstrating that he performed a policy making function similar to those performed by Integral's president or vice president in charge of a principal business unit, division, or function; (2) does not state when Prince became an executive officer at Integral, beyond stating that it was after 1998; and (3) does not specify which of Prince's alleged job responsibilities "caused him to cross the threshold from non-officer to executive officer." Def. Brown's Mot. at 7-11.

[18] As noted earlier, a complaint alleging fraud must "state the time, place, and content of the false representations, the fact misrepresented and what was retained or given up as a consequence of the fraud[,] ... and identify individuals allegedly involved in the fraud." See *U.S. ex rel. Williams v. Martin-Baker Aircraft Co.,* 389 F.3d 1251, 1256 (D.C.Cir.2004) (citing *Kowal v. MCI Comms. Corp.,* 16 F.3d 1271, 1278 (D.C.Cir.1994)). Specifically,

> [a] complaint alleging securities fraud complies with Rule 9(b) if it sets forth (1) precisely what statements were made in what documents or oral representations or what omissions were made and (2) the time and place of each such statement and the person responsible for making (or, in the case of omissions, not making) same, and (3) the content of such statements and the manner in which they misled the plaintiff, and (4) what the defendants obtained as a consequence of the fraud.

Burman v. Phoenix Worldwide Industries, Inc., 384 F.Supp.2d 316, 328 (D.D.C.2005) (citation omitted).

The Complaint alleges that Defendant Brown concealed Prince's "role and involvement in the company" "[f]or over seven years, from approximately December 1998 through August 2006." Compl. ¶ 1. The alleged false representations-the failure to disclose Prince's officer status-were made in "seven annual reports" from 1999 through mid-2006 filed with the SEC on Forms 10-K or 10-KSB and "seven proxy statements" filed by Integral Systems from 2000 through mid-2006. Each of these filings, with the exception of the 1999 10-KSB, were allegedly reviewed and signed by Defendant Brown. *Id.* ¶¶ 32-35; *see also Howard v. Everex Sys., Inc.,* 228 F.3d 1057, 1061-62 (9th Cir.2000) (allegation that corporate officer signed periodic filing containing misstatements with scienter suffices to plead liability as a primary violator of § 10(b)). Thus, the Complaint sufficiently alleges what omissions were made and the time, place, and persons responsible for the omissions.

[19] Next, the Complaint adequately pleads the way in which the alleged omissions misled the SEC, namely by concealing Prince's role as a de facto officer of the company from 1998 through 2006. The SEC alleges that, after being re-hired in 1998, Prince "became one of Chamberlain's closest advisors, preparing recommendations concerning annual salary increases and bonuses for all senior managers," as well as a member of a policy-setting group "of the most senior executive officers at Integral Systems, known at various times as the 'Group of Six' ('G-6') and 'Group of Seven' (or 'G-7')." *Id.* ¶ 23. He reported directly to the Chief Executive Officer of Integral Systems, appeared at the Executive Vice President level on internal organizational charts, and his office was located in

the same area as company officers holding official titles. *Id.* ¶ 24.

***10** In addition, the Complaint alleges that Prince was put in charge of Integral System's mergers and acquisitions program after being rehired. That position involved operational decision-making and a role as Director of Integral Systems's acquisition vehicle, ISI Merger Corporation, and a role as Chairman of the Board of Newpoint Technologies, Inc., an Integral Systems subsidiary. The Complaint further alleges that Prince regularly attended board of director meetings from 2000 to 2006, and that he became head of the Contracts Department in 2005. *Id.* ¶¶ 26-27. Finally, the Complaint alleges that Prince's compensation was equal to that of the top officers holding official titles at Integral Systems from 1999 through 2005. *Id.* ¶ 28.

[20] Given these allegations, the Court concludes that the Complaint adequately pleads sufficient facts to put Defendants on notice of the SEC's claims. While Defendant Brown may question whether the SEC will ultimately carry its burden to prove that Prince acted as an officer of Integral Systems throughout the period from 1998 until 2006, that will be for a jury to decide. "To comply with the requirements of Rule 9(b), a plaintiff does not need to recite the evidence or plead detailed evidentiary matters." *McQueen v. Woodstream Corp.,* 248 F.R.D. 73, 78 (D.D.C.2008) (internal quotation and citation omitted). Defendant Brown's Motion to Dismiss Counts I and II under Rule 9(b) is therefore **denied.**

E. Failure to State a Claim for Relief Under Rule 12(b)(6)

[21] Defendant Brown makes three arguments under Rule 12(b)(6). First, she argues that Count I fails to state a claim for violations of § 17(a) of the Securities Act, 15 U.S.C. § 77q(a), because it fails to allege that an offer or sale of securities ever occurred. Second, Brown argues that Count IV, which alleges violations of Exchange Act Rule 13a-14, 17 C.F.R. § 240.13a-14, fails to state a claim because the Rule does not set forth an independent cause of action. Finally, Brown argues that Count V, alleging violations of Exchange Act § 14(a) and Rule 14a-9, fails to allege essential elements of these claims.

In his Motion to Dismiss, Defendant Prince argues that Counts I and II should be dismissed because the SEC has failed to allege sufficient facts to establish his primary liability.

1. Count I, Alleging Violations of Section 17(a)

Defendant Brown argues that Count I fails to state a claim for violations of § 17(a) of the Securities Act, 15 U.S.C. § 77q(a), because it fails to allege that an offer or sale of securities ever occurred. Section 17(a) provides that:

> It shall be unlawful for any person *in the offer or sale of any securities* ... by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly
>
> (1) to employ any device, scheme, or artifice to defraud, or
>
> (2) to obtain money or property by means of any untrue statement of a material fact or any omission 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
>
> ***11** (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

15 U.S.C. § 77q(a) (emphasis added).

The Supreme Court has instructed that the "offer or sale" requirement should be construed broadly so as to encompass fraud in any part of the selling process. *See United States v. Naftalin,* 441 U.S. 768, 772-73, 99 S.Ct. 2077, 2081, 60 L.Ed.2d 624 (1979). As a result, "Section 17(a) has been broadly construed to encompass a wide range of conduct." *SEC v. Softpoint, Inc.,* 958 F.Supp. 846, 861 (S.D.N.Y.1997) (collecting cases). Such conduct typically involves omissions and misstatements made in securities registration statements. *See, e.g., SEC v. Leffers,* 289 Fed.Appx. 449, 451 (2d Cir.2008). However, at least one district court has ruled that misstatements made in periodic filings, such as those underlying the SEC's claims in this case, suffice to state a claim under § 17(a) "where the company's securities are sold and purchased throughout the period at issue." *SEC v. Goldsworthy,* No. 06-cv-10012, Slip Op. at 19 (D. Mass. June 11, 2008).FN6

The SEC has failed to cite, and this Court has failed to identify, any precedent holding that a complaint may properly state a claim under § 17(a) when it fails to allege that an offer or sale of securities ever occurred. *See Naftalin,* 441 U.S. at 772-73 (determining first that an offer or sale had occurred before considering whether defendant's fraud was "in" the offer or sale). The Complaint alleges only that Defendants made material omissions in seven annual reports and seven proxy statements, and that Integral Systems is a public company whose stock is traded on the public markets. Compl. ¶ 17. In the absence of any allegation that there was an offer or sale of Integral Systems's securities in the period between 1998 and 2006, during which the alleged fraud occurred, Count I fails to state a claim under § 17(a). Defendant Brown's Motion to Dismiss Count I is therefore **granted.**

2. Count IV, Alleging Violations of Exchange Act Rule 13a-14, 17 C.F.R. § 240.13a-14

[22] Defendant Brown next argues that Count IV, which alleges violations of Exchange Act Rule 13a-14, 17 C.F.R. § 240.13a-14, fails to state a claim for relief because Rule 13a-14 does not set forth an independent cause of action. Brown relies first upon the language of Rule 13a-14, which states that "[e]ach report. filed on ... Form 10-K ... must include certifications in the form specified in the applicable exhibit filing requirements of such report ... [and][e]ach principal executive and principal financial officer of the issuer ... must sign a certification." FN7 This language, Brown argues, does not prohibit or otherwise regulate individual conduct, and so it cannot be interpreted as establishing a separate cause of action. However, the Rule requires certain executives and officers to sign a certification, which quite clearly imposes a requirement on those individuals.

***12** Second, Brown relies on an unreported opinion, *SEC v. Black,* No. 04-cv-7377, 2008 WL 4394891, at *16-17 (N.D.Ill. Sept.24, 2008), which held that Rule 13a-14 does not establish a separate cause of action in an SEC enforcement proceeding. No courts appear to have followed *Black's* logic or holding; indeed, SEC claims brought under Rule 13a-14 are routinely permitted. *See, e.g., SEC v. Stanard,* No. 06-cv-7736, 2009 WL 196023, at *28 (S.D.N.Y. Jan.27, 2009) (unreported opinion); *SEC v. Brady,* No. 05-cv-1416, 2006 WL 1310320, at *5 (N.D.Tex. May 12, 2006) (unreported opinion); *SEC v. Sandifur,* No. 05-cv-1631C, 2006 WL 538210, at *8 (W.D.Wash. Mar.2, 2006) (unreported opinion); *but see SEC v. Retail Pro, Inc.,* 673 F.Supp.2d 1108, 1143 n. 8 (S.D.Cal.2009) (citing *Black* as evidence of a "conflict among courts at to whether a violation of the certification requirement of Rule 13a-14 supports a separate cause of action," which it declined to address).

In its discussion of Rule 13a-14, the *Black* court appears to have viewed the issue of whether the SEC may bring a claim under the Rule as analytically identical to the issue of whether a private plaintiff has an independent cause of action. The only caselaw relied on as authority for the court's holding consisted of two rulings that there was no right of action under Rule 13a-14 for claims brought by private investors.FN8 *See Black,* 2008 WL 4394891, at *16 (relying upon *In re Intelligroup Sec. Litig.,* 468 F.Supp.2d 670, 706-07

(D.N.J.2006), and *In re Silicon Storage Tech., Inc., Sec. Litig.,* No. C-05-0295, 2007 WL 760535 (N.D.Cal. Mar. 9, 2007) (unreported opinion)). However, the securities laws raise "distinct" statutory interpretation questions in private actions. *See, e.g., SEC v. Kelly,* 545 F.Supp.2d 808, 813 (N.D.Ill.2008).

Black does not address whether § 21(d)(1) of the Exchange Act, 15 U.S.C. § 78u(d)(1), enables the SEC to bring a claim under Rule 13a-14. Section 21(d)(1) authorizes the Commission to bring an action in a United States District Court "to enjoin" any "acts or practices constituting a violation of any provision of this title [or] the rules or regulations thereunder." 15 U.S.C. § 78u(d)(1); *see also SEC v. Johnson,* 595 F.Supp.2d at 43 (discussing authority to enjoin violations of securities laws under 15 U.S.C. § 78u(d)(1)). In light of this specific statutory authority, the Court concludes that the SEC's claim to enforce Rule 13a-14 states a valid cause of action. Defendant Brown's Motion to Dismiss Count IV under Rule 12(b)(6) is therefore **denied.**

3. Count V, Alleging Violations of Exchange Act § 14(a) and Rule 14a-9

[23] Defendant Brown next contends that Count V, which alleges that she aided and abetted violations of Exchange Act § 14(a) and Rule 14a-9, should be dismissed under Rule 12(b)(6) for failure to allege necessary elements of the claims. Section 14(a) makes it unlawful "for any person ... 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, to solicit or to permit the use of his name to solicit any proxy...." 15 U.S.C. § 78n(a). Rule 14a-9 states that "no solicitation subject to this regulation shall be made by means of any proxy statement ... containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading." 17 C.F.R. § 240.14a-9. Count V alleges that Brown and Prince aided and abetted violations of § 14(a) and Rule 14a-9 when they prepared, reviewed, and approved materials in seven proxy statements filed by Integral Systems between March 2000 and March 2006 which failed to disclose Prince as an executive officer.

***13** First, Brown argues that the SEC has failed to allege (1) an essential link between the purpose of the proxy statements and the alleged omission and (2) that the omission was material.FN9 Second, Brown argues that the SEC has failed to allege which material information concerning Prince was omitted from the proxy statements, as well as which materials Brown prepared, reviewed, and approved. Def. Brown's Mot. to Dismiss at 31-32; Compl. ¶ 35.

[24] It is well settled that a private plaintiff bringing a claim under § 14(a) or Rule 14a-9 must allege that "(1) a proxy statement contained a material misrepresentation or omission which (2) caused the plaintiff injury and (3) that the proxy solicitation ... was an essential link in the accomplishment of the transaction." FN10 *Bender v. Jordan,* 439 F.Supp.2d 139, 163 (D.D.C.2006). Brown argues that the facts pled do not allege an "essential link" between the alleged misrepresentation or omission and "the subject of the proxy solicitation." Def. Chamberlain's Reply at 8; *see also* Def. Chamberlain's Mot. to Dismiss at 14-15 ("There must be a clear connection, that is-an 'essential link' between the alleged fraud in the proxy statement and the corporate transaction authorized by the proxy solicitation."); Def. Brown's Mot. to Dismiss at 32 (describing argument as concerning "the lack of an essential link between the purpose of a proxy and the alleged omission").

[25] As the Supreme Court has explained, "[s]o long as the misstatement or omission was material, the causal relation between violation and injury is sufficiently established ... if 'the proxy solicitation itself ... was an essential link in the accomplishment of the transaction.' " *TSC Industries, Inc. v. North-*

way, Inc., 426 U.S. 438, 444, 96 S.Ct. 2126, 2130, 48 L.Ed.2d 757 (1976) (quoting *Mills v. Electric Auto-Lite Co.,* 396 U.S. 375, 385, 90 S.Ct. 616, 622, 24 L.Ed.2d 593 (1970)). Thus, in a private action, the essential link element requires a causal connection between the proxy solicitation and the transaction that resulted in injury to the plaintiff. However, Defendant Brown does not argue that the Complaint fails to allege this causal connection. Instead, Brown incorrectly characterizes the connection between the alleged fraud and the subject of the proxy solicitation, which is the focus of her argument, as a required showing under the essential link element. In reality, the connection between the alleged omission and the subject or purpose of the proxy solicitation is essentially a question of materiality.

[26][27] Brown's first argument is therefore reduced to the single question of whether the SEC has pled sufficient facts that the omission was material to the transactions which were the subject of the proxy solicitations. Under § 14(a), "[a]n omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote" on the proxy solicitation. *Id.* at 449. Under Rule 12(b)(6), a complaint may not be dismissed on the ground that the alleged omission is not material "unless [it is] so obviously unimportant to a reasonable investor that reasonable minds could not differ on the question of [its] importance." *Ganino v. Citizens Utility Co.* ., 228 F.3d 154, 162 (2d Cir.2000) (citation omitted).

***14** The Complaint alleges that "[f]rom 2000 through mid-2006, Integral Systems filed seven proxy statements to give notice of Integral Systems's annual meetings and to solicit for the election of directors." Compl. ¶ 35. Certainly, reasonable minds could differ as to whether Prince's officer status and legal background is "obviously unimportant" to shareholders who must decide whether or not to vote for Chamberlain or other directors involved in the decision to re-hire him.[FN11]

Ganino, 228 F.3d at 162. The Court is therefore satisfied that Count V alleges a material omission under § 14(a) and Rule 14a-9.

[28] Next, Brown argues that the SEC fails to allege specific facts in Count V regarding her role in aiding and abetting the alleged violations of § 14(a) and Rule 14a-9. The Complaint states that "Defendant[ ] Brown [ ] prepared, reviewed, and approved materials in the proxy statements, including the incorporated periodic reports, knowing that they did not identify Prince or disclose any of the required information concerning him," thereby providing "substantial assistance to ... Integral Systems's and Chamberlain's violations of Section 14 and Exchange Act Rule 14a9." Compl. ¶ 57. Brown's argument is that this allegation (1) fails to specify which information concerning Prince was required; (2) fails to specify which materials were prepared, reviewed, and approved by Brown; and (3) erroneously states that the periodic reports were incorporated into the proxy statements, when in fact they were merely included with them.

[29] Liability for aiding and abetting a violation of the securities laws requires proof of "(1) a securities violation by a primary wrongdoer; (2) knowledge of the violation by the aider and abettor; and (3) substantial assistance by the aider and abettor in the primary violation." *Treadway,* 430 F.Supp.2d at 323; *see also SEC v. DiBella,* 587 F.3d 553, 565 (2d. Cir.2009). Even assuming that the periodic reports were not incorporated into the proxy statements, the allegations in Count V specify that certain information regarding Prince, including his identity, were material and therefore were required to be disclosed in the proxy statements, and that Defendant Brown prepared, reviewed, and approved materials for use in the proxy statements with the knowledge that this required information was omitted. This suffices to state a claim for aiding and abetting violations of § 14(a) and Rule 14a-9. Defendant Brown's Motion to Dismiss Count V is therefore **denied.**

4. Failure to State a Claim for Primary Liability

[30] Finally, Defendant Prince moves to dismiss Counts I and II against him on the basis that the SEC has failed to allege his primary liability for violations of the securities laws. Because Count I, alleging violations of § 17(a), is dismissed in its entirety for failure to allege that an offer or sale of Integral Systems's securities ever occurred, the Court will only consider Defendant Prince's arguments as they relate to Count II, alleging violations of § 10(b) and Rule 10b-5.

***15** [31] Section 10(b) "prohibits only the making of a material misstatement (or omission) or the commission of a manipulative act"; it does not provide a cause of action against those who only aid and abet such acts. FN12 *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.,* 511 U.S. 164, 177, 114 S.Ct. 1439, 1448, 128 L.Ed.2d 119 (1994). Primary liability under § 10(b) may be found for any person who:

> directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange ... use[s] or employ[s], in connection with the purchase or sale of any security ... 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. On the basis of this statute, the SEC promulgated Rule 10b-5, which makes it unlawful for:

> any person, directly or indirectly, ... (a) [t]o 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 the 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.

First, Prince argues that any claim under Rule 10b-5(b) must fail because the Complaint fails to allege that he "made" any material misstatement or omission or, alternatively, that he had a duty to disclose or clarify any alleged material omission made by Integral Systems. Second, Prince argues that the Complaint fails to state a claim for "scheme liability" under Rule 10b-5(a) and (c) because there are no allegations that Prince committed any manipulative or deceptive acts.

a. Rule 10b-5 (b)

The Complaint alleges that Prince was responsible for drafting and preparing the Management Discussion and Analysis section of Integral Systems's periodic reports filed with the SEC, addressing the company's financial results for that period. Compl. ¶ 39. Prince is also alleged to have created and prepared internal quarterly financial results and forecasts which were incorporated into the periodic reports. *Id.* Finally, Prince allegedly reviewed, commented on, and approved Integral Systems's draft annual reports and proxy statements. *Id.* ¶ 35. Prince argues that these allegations fail to state a claim for primary liability under Rule 10b-5 (b) because they do not show (1) that he made any material misstatement or omission or (2) that he had a duty to disclose or clarify any material omission by Integral.

Three tests for primary liability have emerged in different circuits. The "bright-line approach" is the most demanding of the three approaches. *See SEC v. May,* 648 F.Supp.2d 70, 77 (D.D.C.2009) (discussing approaches to primary liability under securities laws). Under the bright-line approach, a defendant in a private action may be held primarily liable under § 10b and Rule 10b-5 only if he or she actually makes a false or misleading statement and the statement is attributed to the defendant at the time of its dissemination. *Id.* The least demanding approach is called the "substantial participation" approach, which requires a showing that a defendant substantially participated or was intricately involved in making a material misstatement or omission. *See Howard v. Everex Sys., Inc.,* 228 F.3d 1057, 1061 n. 5 (9th Cir.2000). The middle approach-called the "creation" test-requires a secondary actor to have "created" the misrepresentation or omission. *SEC v. Wolfson,* 539 F.3d 1249, 1259 n. 16 (10th Cir.2008). This Circuit has not yet adopted one of the three approaches to primary liability for the securities laws.

***16** Prince urges this Court to adopt the "bright-line" approach to determining primary liability, which, as noted, is the strictest of the three approaches. *See Wright v. Ernst & Young, LLP,* 152 F.3d 169, 175 (2d Cir.1998). Prince argues that, under the "bright-line" approach, the SEC must plead that Prince made a statement or omission, and that the statement or omission was attributed to him at the time of its dissemination to the public.

Attribution is required under the "bright-line" approach in private actions because a private plaintiff, unlike the SEC, must prove that he or she relied on the defendant's statements in order to state a claim. *See id.* at 175; *May,* 648 F.Supp.2d at 77. The Second Circuit, which introduced the attribution requirement, has not directly addressed whether it should apply in actions brought by the SEC. However, other Circuits have rejected the attribution requirement in SEC actions as irrelevant because reliance need not be proven. *See, e.g., SEC v. Tambone,* 597 F.3d 436, 447 n. 9 (1st Cir.2010); *Wolfson,* 539 F.3d at 1260.

In addition, as the SEC points out, even the Second Circuit has not consistently required in suits by a private plaintiff that misstatements be attributed to the defendant for primary liability to attach. *See, e.g., In re Scholastic Corp. Sec. Litig.,* 252 F.3d 63, 75-76 (2d Cir.2001) (finding primary liability for corporate insider who was "involved in drafting, producing, reviewing and/or disseminating of the false and misleading statements," even though statements not specifically attributed to him).

However, district courts in the Second Circuit have directly addressed the issue, and have rejected the attribution requirement in actions brought by the SEC. In one such case, the court explained that "in an SEC enforcement action, there appears to be no reason to impose a requirement that a misstatement have been publicly attributed to a defendant for liability to attach, at least so long as the SEC is able to show that the defendant was sufficiently responsible for the statement-in effect, caused the statement to be made-and knew or had reason to know that the statement would be disseminated to investors." *SEC v. KPMG, LLP,* 412 F.Supp.2d 349, 375 (S.D.N.Y.2006); *see also SEC v. Richitelli,* No. 3:09-cv-361, 2010 WL 2802911, at *5 (D.Conn. July 12, 2010); *SEC v. Collins & Aikman Corp.,* 524 F.Supp.2d 477, 490 (S.D.N.Y.2007); *SEC v. Forman,* No. 07-cv-11151, 2008 WL 2704554, at *2 n. 3 (D.Mass. July 7, 2008) (unreported opinion); *SEC v. Hopper,* No. Civ.A. H-04-1054, 2006 WL 778640, at *9 (S.D.Tex. March 24, 2006) (unreported opinion).

Thus, the majority of courts which have directly addressed the issue have concluded that attribution is not required under the "bright-line" approach in actions brought by the SEC.[FN13] Even assuming the application of the strictest approach is proper, the SEC, as plaintiff, need only show that Prince was sufficiently responsible for the statement and knew or had reason to know the statement would be disseminated to investors. *KPMG, LLP,* 412 F.Supp.2d at 375.

***17** As discussed above, the Complaint alleges that Prince was responsible for drafting and preparing portions of Integral Systems's periodic reports dealing with the company's financial results and forecasts, and that he also reviewed, commented on, and approved the company's draft annual reports and proxy statements. Compl. ¶¶ 35, 39. Prince correctly argues that the allegations that he prepared or drafted Integral Systems's internal financial results and forecasts fail to state a claim for primary liability, even if those forecasts were later incorporated into the company's periodic filings, because the SEC does not allege that there were any misstatements concerning the company's finances. Prince's Mot. to Dismiss at 11.

However, the Complaint also alleges that Prince generally reviewed, commented on, and approved Integral Systems's periodic filings and proxy statements but failed to correct the omission of his status as an officer of the company and of his holdings and transactions in the company's securities. This allegation, if proven, would establish that Prince was sufficiently responsible for the omission FN14 under the "bright-line" approach. Because the allegations state a claim under the "bright-line" approach, which requires a showing that the defendant actually made a statement or omission, they also state a claim under the less strict "substantial participation" or "creation" approaches. Prince's Motion to Dismiss therefore fails under all three approaches. Consequently, the Court need not decide which standard applies in this Circuit.

[32] Prince argues that Count II still fails to state a claim, however, because the SEC has failed to allege that he had a duty to disclose the omitted information. As discussed, the facts alleged in the Complaint establish that Prince "made" a statement under Rule 10b-5 when he reviewed, commented on, and approved Integral Systems's periodic filings. Under Rule 10b-5, an individual who "makes" a statement has a duty to correct "any omission 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." 17 C.F.R. § 240.10b-5. Thus, Prince had a duty to correct the omissions in the periodic reports and proxy statements which he was substantially involved in preparing. *See also SEC v. Druffner,* 353 F.Supp.2d 141, 148 (D.Mass.2005) ("[T]he securities laws give rise to a duty to disclose any information necessary to make an individual's voluntary statements not misleading.").FN15

In summary, the Complaint alleges sufficient facts to establish that Prince made a statement and, therefore, that he had a duty to correct any misleading omissions in that statement. Prince's Motion to Dismiss the SEC's Rule 10b-5(b) claim is therefore **denied.**

b. Rule 10b-5(a) and (c)

[33] In addition to the Rule 10b-5(b) claim for Prince's alleged omissions, the SEC argues that Prince is liable under Rule 10b-5(a) and (c) for, respectively, employing a "device, scheme or artifice to defraud," and engaging in an "act, practice, or course of business which operates or would operate as a fraud or deceit upon any person." 17 C.F.R. § 240.10b-5. Prince argues that the SEC has failed to state a claim for such "scheme liability" under Rule 10b-5(a) and (c) because (1) it has not alleged that he engaged in a manipulative device or contrivance; and (2) the scheme allegations merely reiterate the omissions underlying the Rule 10b-5(b) claim. Prince's Mot. to Dismiss at 14-15.

***18** [34] It is certainly true, as Prince argues, that Section 10(b) "prohibits only the making of a material misstatement (or omission) or the commission of a manipulative act." *Central Bank,* 511 U.S. at 177. However, an individual's participation in a scheme to defraud may result in primary liability even in the absence of a misstatement or manipulative act if the individual "engaged in conduct that had the principal purpose and effect of creating a false appearance of fact in furtherance of the scheme." *Simpson v. AOL Time Warner Inc.,* 452 F.3d 1040, 1048 (9th Cir.2006), *vacated on other grounds, Avis Budget Group, Inc. v. Cal. State Teachers' Ret. Sys.,* 552 U.S. 1162, 128 S.Ct. 1119, 169 L.Ed.2d 945 (2008).

[35] However, to establish primary liability under Rule 10b-5 (a) or (c), the alleged conduct must be more than a reiteration of the misrepresentations

underlying the Rule 10b-5(b) misstatement claims. *Lucent Techs.,* 610 F.Supp.2d at 361. Primary liability may arise out of the same set of facts under all three subsections "where the plaintiffs allege both that the defendants made misrepresentations in violations of Rule 10b-5(b), as well as that the defendants undertook a deceptive scheme or course of conduct that went beyond the misrepresentations." *In re Alstom SA,* 406 F.Supp.2d 433, 475 (S.D.N.Y.2005).

The Complaint's sole allegation that Prince engaged in deceptive conduct, apart from his alleged involvement in the filing of fraudulent and misleading annual reports and proxy statements, is that he violated § 16(a) of the Exchange Act, 15 U.S.C. § 78p(a), by failing to file the statements required under that section. Section 16(a) requires anyone "who is a director or an officer of the issuer of [any equity] security" to file a statement concerning any holdings and transactions of the issuer's securities. 15 U.S.C. § 78p (a).

As Prince points out, in order to prove this claim, the SEC must first establish that he was, in fact, an officer of Integral Systems. Assuming as we must in a Motion to Dismiss that the SEC does establish that Prince did act as an officer of Integral Systems with scienter, a reasonable fact finder could conclude that his failure to file the reports required under § 16(a) was done with the purpose and effect of concealing his officer status from the public. *See In re Alstom SA,* 406 F.Supp.2d at 474 ("[S]ubsections (a) and (c) of Rule 10b-5 encompass a wide range of activities and are not limited to the prohibition of market manipulation."). The SEC's allegations therefore state a claim under Rule 10b-5(a) and (c) for scheme liability, and Prince's Motion to Dismiss is **denied.**

CONCLUSION

For the reasons set forth above, Defendant Brown's Motion to Dismiss Count I is **granted,** and the remainder of her Motion to Dismiss is **denied** in all other respects. Brown's Motion to Dismiss under the statute of limitations in 28 U.S.C. § 2462 is **denied without prejudice.** Defendant Prince's Motion to Dismiss is **denied** in its entirety. An Order will accompany this Memorandum Opinion.

FN1. The Complaint was originally brought against a third Defendant, Steven R. Chamberlain. On February 18, 2010, after receiving notice of Defendant Chamberlain's death, the Court granted the Consent Motion for Order Dismissing Defendant Steven R. Chamberlain as a Party pursuant to Fed.R.Civ.P. 21.

FN2. For purposes of ruling on a motion to dismiss, the factual allegations of the complaint must be presumed to be true and liberally construed in favor of the plaintiff. *Aktieselskabet AF 21. November 2001 v. Fame Jeans Inc.,* 525 F.3d 8, 15 (D.C.Cir.2008); *Shear v. Nat'l Rifle Ass'n of Am.,* 606 F.2d 1251, 1253 (D.C.Cir.1979). Therefore, the facts set forth herein are taken from the Complaint unless otherwise noted.

FN3. This of course would be a material fact in dispute for the jury to resolve.

FN4. 17 C.F.R. § 229.401(f) was amended on December 23, 2009 to require disclosure of injunctions and/or criminal proceedings or convictions that occurred during the past ten, as opposed to five, years. *See* 17 C.F.R. § 229.401(f) (2010).

FN5. For this reason, *United States v. Yeaman,* 987 F.Supp. 373 (E.D.Pa.1993), relied upon by the Defendant, is distinguishable. In *Yeaman,* the court concluded that the defendant had no duty to disclose his legal background in filings with the SEC because Item 401 of Regulation S-K did not require it. *Id.* at 384-85. However, the Court did not consider whether the omission rendered the defendant's filings misleading. In addition, because *Yeaman* involved a criminal prosecution, the Court rested its conclusion in part on the need for notice to the defendant of a duty to disclose in order to satisfy due process.

FN6. The SEC relies on *SEC v. Power,* 525 F.Supp.2d 415, 419-20 (S.D.N.Y.2007), which states that "[a] public company and its management may violate [§ 17(a)] by making a material misstatement in, or omitting material information from, a periodic report, registration statement, or other filing with the Commission." This statement simply does not address the precise issue here, which is whether the mere filing of a required document with the SEC suffices to state a claim under § 17(a) absent a showing that securities were offered and sold in the same period. This omission is understandable, given that the issue was not raised in that case: the defendant in *Power* challenged the SEC's § 17(a) claim on the basis that the government had failed to allege scienter or his personal involvement in the fraud, and not on the ground that no offer or sale was alleged. Moreover, *Power's* sole citation in support of this statement is *Softpoint,* 958 F.Supp. at 823-24, but *Softpoint* only discusses misstatements in registration statements, not periodic filings.

FN7. The certification must state that "[b]ased on [the certifying individual's] knowledge, the report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by the report." 15 U.S.C. § 7241(a)(1), (2), (3).

FN8. The *Black* court also relied on the SEC's press release accompanying the final rule, which stated that "[a]n officer providing a false certification potentially could be subject to Commission action for violating Section 13(a) or 15(d) of the Exchange Act and to both Commission and private actions for violating Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5," but not under Rule 13a-14 itself. *See Black,* 2008 WL 4394891, at *16; SEC Release No. 34-46427, 2002 WL 3170215, at *9 (Aug. 28, 2002). The Court is not persuaded that this one sentence in a press release forecloses the possibility of an independent cause of action under Rule 13a-14.

FN9. Brown relies on the arguments advanced in Defendant Chamberlain's Motion to Dismiss. As noted earlier, Defendant Chamberlain was dismissed as a party in this case on February 18, 2010. Although Chamberlain's Motion to Dismiss was denied as moot by minute order dated August 11, 2010, the Court will consider the arguments concerning Count V in deciding Brown's Motion to Dismiss. *See* Def. Chamberlain's Mot. to Dismiss at 13-20 [Dkt. No. 11].

FN10. No court appears to have addressed the specific issue of whether the SEC, as opposed to a private plaintiff, must prove injury when bringing a § 14(a) claim. The SEC argues that it is not required to do so because its enforcement actions are meant to protect the public interest in enforcing the securities laws, and so a showing of reliance or injury to private individuals is "legally irrelevant." *Berko v. SEC,* 316 F.2d 137, 143 (2d Cir.1963) (finding reliance and injury to private shareholders "legally irrelevant" to Commission's Section 10(b) claim); see *also United States v. Haddy,* 143 F.3d 542 (3d Cir.1998) (concluding that securities laws did not require proof of reliance in § 10b action brought by government); *SEC v. Lucent Techs., Inc.,* 610 F.Supp.2d 349, 349 (D.N.J.2009) ("Unlike a private litigant, the SEC need not prove either reliance or damages" in a § 10b and Rule 10b-5 ac- tion).

In response, Defendant Brown relies on two cases in which courts applied the test for private actions brought under § 14(a) and Rule 14a-9 to actions brought by the Commission. Def. Chamberlain's Reply at 9 (citing *SEC v. Mercury Interactive LLC,* No. C 07-2822, 2009 WL 2984769 (N.D.Cal. Sept. 15, 2009), and *Black,* 2008 WL 4394891, at *13). However, both *Mercury* and *Black* assumed without question that the elements for proxy violations applied in private actions would apply equally in actions brought by the SEC. As discussed, the question whether the SEC must prove injury in a § 14(a) action is not actually raised by Brown, and so it is not considered.

FN11. Brown relies on *In re Browning-Ferris Industries Shareholder Derivative Litigation,* 830 F.Supp. 361, 370 (S.D.Tex.1993), which held that the prior criminal investigation of a corporate officer was not material to a proxy soliciting an election for the board of directors because there was no indictment or criminal conviction. In this case, Prince was convicted in a criminal proceeding. Brown's reliance on a separate portion of the opinion holding that pending civil lawsuits against directors facing re-election were not material because the lawsuits were not brought against those specific directors is distinguishable from the facts of this case. Moreover, the *Browning-Ferris* court also ruled that plaintiffs failed to allege any relationship between the pending civil lawsuits and the directors elected to the board during the relevant period of time. *Id.* at 367.

FN12. The SEC could have brought an action against Prince as a secondary actor for aiding and abetting violations of § 10b and Rule 10b-5 under 15 U.S.C. § 78t(e). *See Stoneridge Inv. Partners, LLC v. Scientific-Atlanta,* 552 U.S. 148, 166, 128 S.Ct. 761, 773-74, 169 L.Ed.2d 627 (2008) (discussing SEC's power to enforce securities laws against secondary actors). However, it failed to do so; Count II only alleges primary violations of § 10b and Rule 10b5. Compl. ¶¶ 43-45.

FN13. The only exception cited by Prince is *Lucent Technologies,* 610 F.Supp.2d 342 . However, the court in *Lucent Technologies* was tasked with determining whether it should depart from the law of the case by rejecting the attribution requirement, which it had previously applied in the case at bar. The court ultimately refused to impose primary liability for violations of the securities laws on the basis that the defendants did not draft or sign the filings, and so could not be said to have "made" the misstatements allegedly contained within them. *Lucent Techs.,* 610 F.Supp.2d at 355-58.

FN14. In *SEC v. Berry,* 580 F.Supp.2d 911, 922 (N.D.Cal.2008), the district court found similar conclusory pleadings that the defendant corporate officer "reviewed," "discussed," and "finalized" various filings insufficient to plead primary liability for the defendant's role in the misstatement made in the filings. In this case, however, the SEC alleges that Prince "approved" Integral Systems's periodic filings despite the omissions contained therein, in addition to merely reviewing and commenting on them. This additional allegation indicates more substantial responsibility for preparing the filings. *See id.* (recognizing that substantial involvement in preparing a fraudulent statement supports a claim for securities fraud); *cf. Howard v. Everex Systems, Inc.,* 228 F.3d 1057, 1061 (9th Cir.2000) (fact that defendant signed document containing fraudulent statement is sufficient to conclude that defendant "made" misstatement, even if he was not involved in drafting the document).

FN15. Prince relies on *SEC v. Tambone,* 417 F.Supp.2d 127, 135 (D.Mass.2006), a case decided under the "bright-line" approach for primary liability, as authority for the principle that an individual only owes a duty to correct an omission if the statement containing the omission is attributed to the individual. However, the court in *Tambone* concluded that the defendants had no duty to correct the omission because the statement-prospectuses which were prepared by a separate entity-had not been made by them, and not because the statement was made by them but not publicly attributed to them.

D.D.C.,2010.
U.S. S.E.C. v. Brown
--- F.Supp.2d ----, 2010 WL 3786563 (D.D.C.)

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EXHIBIT G

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Only the Westlaw citation is currently available.

United States Bankruptcy Court,
M.D. Pennsylvania.
In re RESSLER HARDWOODS AND FLOORING, INC., Debtor
James Little, Plaintiff
v.
Ressler Hardwoods and Flooring, Inc.; Keith Ressler; Kenneth L. Ressler; Karen R. Ressler, Defendants.
Bankruptcy No. 1:08-bk-01878MDF.
Adversary No. 1:08-ap-00109.

April 1, 2009.

West KeySummary
Bankruptcy 51 2164.1

51 Bankruptcy
51II Courts; Proceedings in General
51II(B) Actions and Proceedings in General
51k2164 Judgment or Order
51k2164.1 k. In General. Most Cited Cases
Genuine issues of material fact existed as to whether Chapter 11 debtor committed fraud in selling its stock to a buyer. Therefore, summary judgment was precluded in the buyer's action against the debtor for fraud under the Maryland securities fraud statute. The buyer contended that the debtor committed fraud by failing to inform him that the $400,000 he had transferred to the debtor would be used for "unauthorized purposes," including the purchase of only 17% of the debtor's shares. However, the debtor contended that the $400,000 was used for its intended purposes, including that it serve as a deposit for the purchase of the debtor's stock. Fed.Rules Civ.Proc.Rule 56(c), 28 U.S.C.A.; Fed.Rules Bankr.Proc.Rule 7056, 11 U.S.C.A.; Md.Code Ann., Corps. & Ass'ns § 11-301.

Margaret M. Manning, Whiteford Taylor Preston LLP, Wilmington, DE, Ranak Kanti Jasani, Richard J. Magid, Whiteford Taylor Preston LLP, Baltimore, MD, for Plaintiff.

Jacques H. Geisenberger, Jr., Jacques H. Geisenberger, Jr., P.C., Lancaster, PA, for Ressler Hardwoods and Flooring Inc.

Kenneth J. Rollins, Michael W. Winfield, Rhoads and Sinon LLP, Timothy J. Nieman, Harrisburg, PA, for Ressler Hardwoods and Flooring Inc, Keith Ressler, Kenneth L. Ressler, Karen R. Ressler.

Deborah A. Hughes, Harrisburg, PA, for Keith Ressler.

OPINION

MARY D. FRANCE, Bankruptcy Judge.

Background

*1 Ressler Hardwoods and Flooring, Inc. ("Debtor") is a Lebanon, Pennsylvania business that manufactures hardwood flooring. Defendants Keith Ressler, Kenneth Ressler and Karen Ressler (collectively "the Resslers") are, respectively, Debtor's President, Vice President and Secretary. Together they hold one hundred percent of Debtor's stock.

On January 15, 2008, James Little ("Little") filed a lawsuit against Debtor and the Resslers in the United States District Court for the District of Maryland to recover funds he paid to Debtor that he alleges were unlawfully retained and to seek damages for violation of the Maryland Securities Act ("MSA"), Md.Code Ann., Corps. & Assns. § 11-501 et seq. On May 27, 2008, Debtor filed the instant bankruptcy case. By order dated July 14, 2008, the Maryland district court transferred Little's lawsuit to the Bankruptcy Court for the Middle District of Pennsylvania.[FN1] Before me now is the motion for summary judgment filed by Debtor and the Resslers requesting dismissal of two counts of the complaint, which allege violations of the MSA.

Jurisdiction

a. Claims against the Debtor

Section 1334 of title 28 provides that a district court has "original and exclusive jurisdiction of all cases under title 11" and "original and not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11." 28 U.S.C. § 1334(a) and (b). District courts are authorized to refer bankruptcy cases and related proceedings to the bankruptcy courts in their district under 28 U.S.C. § 157(a). Because the District Court for the Middle District of Pennsylvania has referred all bankruptcy cases to the bankruptcy courts in this district, bankruptcy courts have jurisdiction to hear: (1) cases under title 11; (2) other proceedings under title 11; (3) proceedings arising in a case under title 11; and (4) proceedings related to a case under title 11. *In re Exide Technologies,* 544 F.3d 196, 205 (3d Cir.2008).

The first three categories of matters heard by the bankruptcy court are "core" proceedings. In core proceedings, a bankruptcy court not only can hear a matter, it also can enter a final order and judgment. 28 U.S.C. § 157(b)(1). Proceedings "related to" a title 11 case, however, are "non-core." "A '[n]on-core' proceeding belongs to 'the broader universe of all proceedings that are not core proceedings but are nevertheless related to a bankruptcy case.' " *Halper v. Halper,* 164 F.3d 830, 837 (3d Cir .1999) (internal citations omitted) *cited in Exide Technologies,* 544 F.3d at 206. A bankruptcy court can hear the matter, but the district court must issue the final order and judgment after conducting a *de novo* review of the bankruptcy court's proposed findings of fact and conclusions of law. However, the bankruptcy court may issue the final order in the matter upon concurrence of the parties. *Halper,* 164 F.3d at 836.

***2** Because the complaint was filed in the Maryland federal court before Debtor filed its bankruptcy case, neither party had an opportunity to address whether the issues raised in Little's complaint are core matters or whether they are otherwise related to the bankruptcy case. The jurisdictional issue must be addressed, however, because a bankruptcy court is compelled by statute to determine whether a matter is properly before it.[FN2]

The first two counts of Little's complaint are premised on alleged violations of the MSA. The third count is titled "Assumpsit for Moneys Had and Received." None of these causes of action appear to be core because they are not proceedings under title 11 or arising in a case under title 11. Little commenced his action before Debtor's bankruptcy was filed based upon state law claims. However, after the bankruptcy case was filed, he filed a proof of claim for $400,000.00. When a creditor files a proof of claim in a bankruptcy case, he becomes subject to the claims allowance process, which is a core proceeding. *See Langenkamp v. Culp,* 498 U.S. 42, 44, 111 S.Ct. 330, 112 L.Ed.2d 343 (1990) (when party submits proof of claim, it "trigger[s] the process of allowance and disallowance of claims," thereby consenting to bankruptcy court jurisdiction to make final decision affecting claim) (citing *Granfinanciera v. Nordberg,* 492 U.S. 33, 109 S.Ct. 2782, 106 L.Ed.2d 26 (1989)). *See also Katchen v. Landy,* 382 U.S. 323, 330, 86 S.Ct. 467, 473, 15 L.Ed.2d 391 (1966); *Exide,* 544 F.3d at 207. Accordingly, Little's causes of action against Debtor have become core and subject entry of a final order and judgment by this Court.

b. Claims against the Resslers

The Resslers have not filed for bankruptcy relief. Therefore, the filing of a proof of claim in Debtor's case does not affect my determination of whether the counts in Little's complaint directed at the

Resslers are subject to this Court's jurisdiction. "[T]here is no authority that a party with a contingent claim for indemnification can bootstrap its claim onto the Bankruptcy Court's core jurisdiction." *In re Amanat,* 338 B.R. 574, 581 (Bankr.S.D.N.Y.2005) *quoted in In re Exide Technologies,* 544 F.3d at 215 (pre-petition state law cause of action against related non-debtor entity is not transformed into a "core" proceeding by filing proof of claim). Therefore Little's causes of action against Resslers are, at best, "related to" Debtor's bankruptcy case.

"The test for determining whether a civil proceeding is *related to* bankruptcy is whether the outcome of that proceeding could conceivably have any effect on the estate being administered in bankruptcy." *Pacor, Inc. v. Higgins,* 743 F.2d 984, 994 (3d Cir.1984). "For a federal court to have 'related to' jurisdiction over an action, the proceeding need not necessarily be against the debtor or against the debtor's property." *In re WorldCom, Inc. Securities Litigation,* 293 B.R. 308, 317 (S.D.N.Y.2003). Applying the *Pacor* test, the bankruptcy court in *In re Frascella Enterprises, Inc.,* 349 B.R. 421 (Bankr.E.D.Pa.2006) found that it had "related to" jurisdiction over state law causes of action against the principals of a small corporate debtor for violations of Pennsylvania consumer protection laws. The principals enjoyed a statutory right of indemnification from the corporation in the event they were found liable under the statute. Based upon the principals' contingent indemnification claim against the debtor corporation, the court assumed jurisdiction over the claims against the debtor's principals. In the case before me, the Resslers are Debtor's directors, and Little's complaint asserts that they may share liability with Debtor for violations of the MSA. The officers of Pennsylvania corporations may be held jointly and severally liable for the alleged misconduct of the corporation if they personally took part in the misconduct, or if they specifically directed other officers, agents or employees of the corporation to commit the act of misconduct. *Donner v. TamsWitmark Music Library, Inc.* 480 F.Supp. 1229, 1233 (D.C.Pa.1979)(citing *Donsco, Inc. v. Casper Corp.,* 587 F.2d 602, 606 (3d Cir.1978)); *Zubik v. Zubik,* 384 F.2d 267, 275 (3d Cir.1967), *cert. denied,* 390 U.S. 988, 88 S.Ct. 1183, 19 L.Ed.2d 1291 (1968). If the Resslers are found to be jointly and severally liable with Debtor for damages to Little under the MSA, then any payment made by the Resslers in satisfaction of the claim will reduce the amount of Little's claim against Debtor's bankruptcy estate. Because of this joint and several liability, this Court has "related to" jurisdiction over Little's claim against the Resslers.

***3** At this point in the proceeding, I have no basis upon which to determine whether the Resslers and Little would consent to the entry of a final order by this Court. "A court should not lightly infer from a litigant's conduct consent to have private state-created rights adjudicated by a non-Article III bankruptcy judge." *In re Sheridan,* 362 F.3d 96, 104 (1st Cir.2004). *But see Galaxy Computer Services, Inc. v. Baker,* 325 B.R. 544 (E.D.Va.2005) (party impliedly consented to bankruptcy court's power to issue partial summary judgment on non-dispositive matter by failing to raise core/non-core issue with bankruptcy court or appealing ruling in a timely fashion).[FN3] Accordingly, the record will remain open for ten (10) days after the date of issuance of this Opinion and accompanying Order to allow the parties to file such a consent, if they desire. If consent is not filed, the findings and conclusions contained in this Opinion pertaining to the Resslers will be proposed findings and conclusions subject to de novo review by the district court under 28 U.S.C. § 157(c)(1).

Factual Findings

Debtor was incorporated under the laws of Pennsylvania in February 1994 and has a registered office address at 233 Landis Valley Road, Lititz, Pennsylvania. Little is a natural person employed as an investment advisor and commodity trader, who resides in Maryland. In 2005 and 2006, Little's individual income exceeded $200,000.00. His net worth exceeded $1 million at the time Little and the Resslers entered into negotiations for the stock purchase.

Little was introduced to the Resslers in the spring of 2007 by his daughter, Nicole Little. Shortly thereafter, Little and Keith Ressler commenced negotiations whereby Little would purchase 51 percent of Debtor's outstanding stock for $1.2 million. In a letter dated July 6, 2007, Little informed Debtor of his "intent to complete the investment transaction" and enclosed a check for $200,000.00 as a "down-payment toward the purchase price." On July 24, 2007, he transferred another $200,000.00 in the form of a personal check made out to Debtor. On the memo line of the check Little wrote "for purchase of 51% of Ressler."

While a written agreement for the purchase was being drafted by an attorney, the parties held several meetings to work out the details of an operating agreement. Negotiations regarding the specific terms of the agreement continued through the summer and early fall of 2007. The parties are in dispute regarding the reasons why negotiations broke down, but they generally agree that no negotiations took place after November 19, 2007.

On December 11, 2007, the Resslers caused Debtor to issue 26,021 shares (17% of the outstanding common stock) (the "Ressler shares") to Little. The shares were represented by a single certificate that was mailed to Little on or about the date of issuance. The shares were issued without being registered with the Maryland Office of Attorney General, Division of Securities.[FN4] On December 19, 2007, counsel for Little sent a letter to Debtor's counsel demanding that Debtor return the $400,000.00 paid by Little, plus interest at the Maryland statutory rate. Debtor, through its principals, refused to return the funds.

***4** On January 15, 2008, Little filed the instant lawsuit in the United States District Court for the District of Maryland. Debtor's directors convened a board meeting on January 29, 2008, at which time Keith Ressler produced a letter addressed to "Jim" [Little], signed by Keith Ressler, and bearing a date of July 24, 2007. The letter is comprised of two sentences, reading as follows:

> This letter is to serve as an acknowledgment that the two advances of funds by Jim Little to Ressler Hardwoods & Flooring, Inc. in the aggregate amount of $400,000 is (sic) a loan to the company. The loan amount will be rolled into the equity purchase transaction upon the completion and execution of the Purchase Agreement by both parties.

Little avers that he never received this letter. At his deposition, Keith Ressler testified that he did not recall writing the letter, but that he found it while reviewing his computer files in preparation for a meeting of Debtor's board. Little disputes the authenticity of the letter. He also denies that he agreed that the $400,000.00 transferred for the purchase of stock could be recharacterized as a loan to Debtor.

Except for meeting Little during one of his visits to Debtor's facilities, Karen Ressler was not involved in the negotiations for the transfer of stock. She did, however, sign the December 10, 2007 minutes of the meeting of Debtor's directors at which they voted to issue the Ressler shares to Little.

On May 27, 2008, Debtor filed its chapter 11 bankruptcy petition. In its schedules Debtor reported that Little held an unsecured claim based upon a "loan" of $400,000.00.

Discussion

The first two counts of the complaint assert violations of Maryland securities law. Defendants request summary judgment on both of these counts. Defendants do not request summary judgment on the third count of the complaint, which alleges a common law cause of action under Maryland law.

Summary judgment is appropriate "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." Fed.R.Civ.P. 56(c) (Fed. R. Bank. P. 7056). The party moving for summary judgment has the initial burden of showing that there is no genuine issue of material fact and that it is entitled to judgment as a matter of the applicable law. *Celotex Corp. v. Catrett,* 477 U.S. 317, 323, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986). If the movant is successful, the burden shifts to the nonmoving party to go beyond the mere pleadings and present evidence through affidavits, depositions, or admissions on file to show that there is a genuine issue for trial. *Id.* 477 U.S. at 324. When analyzing the pleadings and evidence on a motion for summary judgment, a court must draw all reasonable inferences in the light most favorable to the non-movant. *Big Apple BMW, Inc. v. BMW of N. Am., Inc.,* 974 F.2d 1358, 1363 (3d Cir.1992). Further, a court may not consider the credibility or weight of the evidence in deciding a motion for summary judgment even if the quantity of the moving party's evidence far outweighs that of its opponent. *Id.* Thus, in the within proceeding, Defendants have the initial burden of showing that there is no genuine issue of material fact regarding Little's claim under the MSA [FN5] and that each Defendant is entitled to judgment as a matter of law.

I. Count One-Violation of the MSA for failure to register securities

***5** In relevant part, the MSA requires an issuer to register certain types of securities with the Division of Securities before they may be sold or offered for sale to a Maryland resident. This requirement is couched in terms of a prohibition.

A person may not offer or sell any security in this State unless:

(1) The security is registered under this title;

(2) The security or transaction is exempted under Subtitle 6 of this title; or

(3) The security is a federal covered security.

Md.Code Ann., Corps. & Ass'ns. § 11-501.[FN6]

The parties in the within case agree that the Ressler shares are securities and that they were not registered under the MSA. Their dispute centers on two issues-whether the Ressler shares were exempt from registration under Subtitle 6 of the MSA and whether the Ressler shares qualify as "federal covered securities."

a. Federal preemption of covered securities

The Securities Act of 1933, c. 38, Title I, 48 Stat. 84, (the "Act"), as amended by the National Securities Market Improvement Act of 1996, Pub.L. No. 104-290, § 102, 110 Stat. 3416, 15 U.S.C. § 77 ("NSMIA"), regulates national securities offerings. [FN7] NSMIA amended Section 18 of the Securities Act of 1933, creating a category of securities-termed "covered securities"-which are exempt from state registration requirements. *See Brown v. Earthboard Sports USA, Inc.,* 481 F.3d 901, 909 (6th Cir.2007); *Odor v. Rose,* 2008 WL 2557607, *1 (W.D.Okla.) (The NSMIA "expressly preempts state laws that concern the registration or qualification of 'covered securities.' "). The Securities and Exchange Commission ("SEC") has promulgated Regulation D to enable issuers to sell securities without registering them with the SEC as otherwise required under the Act. Issuers that sell securities in reliance on Regulation D are required to file Form D with the SEC. In the within case, Defendants admit that they did not file Form D in connection with the transfer of the Ressler shares to Little. Although they did not make the required filing, Defendants argue that this failure does not negate their entitlement to treat the transferred shares as covered securities.

When Regulation D was originally promulgated in 1982, Rules 504, 505, and 506 required compliance with Rules 501-503 to qualify for the exemptions.... The S.E.C. amended Regulation D in 1989 to remove the requirement of compliance with Rule 503 as a condition for obtaining the exemptions in Rules 504-506.... The S.E.C.'s summary of the rule change states, "While the filing of Form D has been retained, it will no longer be a condition to any exemption under Regulation D. New Rule 507 will disqualify any issuer found to have violated the Form D filing requirement from future use of Regulation D." Failure to file a Form D may result in disqualification from future use of the exemptions in Rules 504-506; and it could constitute a felony under 15 U.S.C. § 77x if the failure was willful; but the S.E.C. has explicitly stated that filing a Form D is not a condition to obtaining an exemption under Rules 504-506.

***6** *Hamby v. Clearwater Consulting Concepts, LLLP,* 428 F.Supp.2d 915, 920 (E.D.Ark.2006) (citing *Larry D. Soderquist,* " Securities Act Registration Exemptions," 1490 PLI/Corp 265, 270 (2005)) (benefit of the exemption obtained without filing Form D). Accordingly, if the shares Defendants transferred to Little otherwise were required to be registered in Maryland, the issue on summary judgment is whether the shares were a "covered security" under federal law and, thus, exempt from the state registration requirement. Federal preemption of state securities law is an affirmative defense and the burden of proof rests on the party asserting the preemption. Brown, 481 F.3d at 912 (citing *Fifth Third Bank v. CSX Corp.,* 415 F.3d 741, 745 (7th Cir.2005), *Caterpillar, Inc. v. Williams,* 482 U.S. 386, 392, 107 S.Ct. 2425, 96 L.Ed.2d 318 (1987)). Thus, Defendants bear the burden of proof on this issue. Defendants must prove that "no genuine issue of material fact exists contradicting their claim that the offering was actually a 'covered security.' " *Brown,* 481 F.3d at 913.

b. What is a "covered security" under NSMIA?

At 15 U.S.C. § 77r(b), NSMIA defines four general categories of "covered" securities. Only one of those provisions is relevant in this case.[FN8] In pertinent part, that provision states:

A security is a covered security with respect to a transaction that is exempt from registration under this subchapter pursuant to ... [SEC] rules or regulations issued under Section 77d(2) of this title....

15 U.S.C. § 77r(b)(4)(D).

In turn, § 77d(2) states that "transactions by an issuer not involving any public offering" are exempt from federal registration. Regulation D, which was issued by the SEC pursuant to its authority under § 77d(2), provides as follows:

(a) Exemption. Offers and sales of securities by an issuer that satisfy the conditions in paragraph (b) of this section shall be deemed to be transactions not involving any public offering within the meaning of section 4(2) of the Act.

(b) Conditions to be met-

(1) General conditions. To qualify for an exemption under this section, offers and sales must satisfy all the terms and conditions of §§ 230.501 and 230.502.

(2) Specific Conditions-(i) Limitation on number of purchasers. There are no more than or the issuer reasonably believes that there are no more than 35 purchasers of securities from the issuer in any offering under this section. (ii) Nature of purchasers. Each purchaser who is not an accredited investor either alone or with his purchaser representative(s) has such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment, or the issuer reasonably believes immediately prior to making any sale that such purchaser comes within this description.

17 C.F.R. § 230.506 ("Rule 506").

Section 230.501 of 17 C.F.R. ("Rule 501") defines eight (8) terms used in Regulation D-"accredited investor," "affiliate," "aggregate offering price," "business combination," "calculation of number of purchasers," "executive officer," "issuer," and "purchaser representative." It is not necessary to analyze any of the definitions as they pertain to the case before me because there are no disputes between the parties pertaining to these definitions.

*7 Section 230.502 of 17 C.F.R.("Rule 502") provides three (3) "general conditions" that must be met in order for a securities transaction to qualify for the non-public offering exemption provided for in 17 C.F.R. § 230.506 and NSMIA § 77d(2). The first condition, Rule 502(a), "provides an integration safe harbor to prevent other offerings from being integrated into the initial offering and thereby destroying the exemption (e.g., by exceeding the offering price ceiling)." Thomas Lee Hazen, *Federal Securities Law* 47 (2d ed.2003). In the instant case, there was only one offering-the initial offering-so Rule 502(a) is inapplicable. The second condition, Rule 502(b), sets forth informational requirements that must be met when a security is sold to someone other than an "accredited investor." An "accredited investor" refers to "[a]ny natural person whose individual net worth ... at the time of his purchase exceeds $1,000,000." 17 C.F.R. § 230.501(a)(5). The parties do not dispute that Little's individual net worth in December 2007 exceeded $1 million. Therefore, at the time Debtor transferred the Ressler shares, Little was an accredited investor. Accordingly, Defendants were not required to comply with the informational requirements in Rule 502(b) in order for the Ressler shares to be covered securities. The third and final condition, Rule 502(c), prohibits a "covered security" from being offered through "general solicitation or general advertising." The Ressler shares transferred to Little were not offered through a general solicitation or general advertising, but were offered directly to him alone. Thus, the general conditions of the non-public offering exemption are satisfied in this case. The specific conditions set forth in Rule 506(b)(2)(i) and (ii) are also satisfied. Little was an accredited investor and the sole purchaser.

Because all prerequisites of Rules 501, 502 and 506 were met the Ressler shares are "federal covered securities" and their transfer to Little was exempt from registration under § 77d(2). Therefore, Defendants did not violate the MSA by failing to register the Ressler shares.

Anticipating a finding that the Ressler shares were exempt from registration under federal law, Little argues that 15 U.S.C. § 77r(b)(4)(D) preserves the right of a state to require that issuers make certain notice filings for exempt securities. A state may impose a notice filing requirement if it is "substantially similar to those required by rule or regulation under section 77d(2)...." FN9 Maryland has a notice filing requirement, which is set forth at Md. Regs.Code tit. 02 § 02.04.15(D) ("Md.Reg.15(D)"). Md. Reg. 15(D) provides that:

> Not later than 15 days after the first sale of securities under this regulation, the issuer shall file with the Commissioner:
>
> (1) A manually signed notice on a completed SEC Form D (Notice of Sale of Securities Pursuant to Regulation D, Section 4(6), and/or Uniform Limited Offering Exemption), as filed with the SEC and as that form may be amended from time to time, which filing or filings shall:
>
> > *8 (a) Constitute the issuer's representation and affirmation to the Commissioner that it has complied with 17 CFR § 230.505 (SEC Rule 505, Exemption for Limited Offers and Sales of Securities Not Exceeding $5,000,000) or 17 CFR § 230.506 (SEC Rule 506, Exemption for Limited Offers and Sales Without Regard to Dollar Amount of Offering), and
> >
> > (b) Include in the Appendix, the information requested in the fifth column with respect to Maryland;
>
> (2) A statement by the issuer or issuer's counsel of the first date of a sale of securities in Maryland

made under this regulation; and

(3) The fee required by the Maryland Securities Act, Corporations and Associations Article, § 11-506, Annotated Code of Maryland.

Md. Regs.Code tit. 02 § 02.04.15(D)

Little argues that Maryland's notice filing requirements are permissible under 15 U.S.C. § 77r(b)(4)(D). Accordingly, Defendants remain liable for violations of the MSA even though the transferred Ressler shares are a "federal covered security" under state law. Stated differently, Little asserts that although the shares he purchased were exempt from registration by federal law as a "covered security," federal law carves out a narrow exception from preemption when it permits a state to impose notice filing requirements. Although a state cannot require an issuer to register "covered securities," it can require an issuer to make a notice filing with the state and to suffer penalties if the issuer fails to comply.

Section 77r(b)(4)(D) authorizes a state to impose notice requirements if they are "substantially similar" to the regulations promulgated under 15 U.S.C. § 77d(2). Therefore, state regulations may be no more restrictive than federal regulations on the same subject. SEC Regulation D, codified at 17 CFR 230.501-506, was promulgated, in part, under 15 U.S.C. § 77d(2). [FN10] The first numbered paragraph of Md. Reg. 15(D) specifically requires the filing of SEC Form D. Therefore, it is clear that the notice filing requirements of Md. Reg. 15(D) are not preempted by federal law and that Debtor was required to make a notice filing with the state, which it failed to do. This finding, however, does not require that I conclude *a fortiori* that Debtor is liable to Little for failing to comply with the notice filing requirement.

Federal law requires an issuer selling securities in reliance on Regulation D to file Form D with the SEC. 17 C.F.R. § 230.503(a). SEC Rule 507 provides that the exemption under Rule 506 is not available if the issuer is subject to an order enjoining the issuer for failing to comply with SEC Rule 503. 17 C.F.R. § 230.507. The regulations are notably silent, however, regarding any penalty for simply failing to file Form D. Thus, absent an injunction for prior noncompliance, an issuer's failure to file Form D does not bar reliance on the Rule 506 safe harbor. Accordingly, state law registration requirements are preempted because the security is a "federal covered security" even though an issuer has failed to comply with SEC Regulation D. *Hamby v. Clearwater Consulting Concepts, LLLP,* 428 F.Supp.2d 915, 920 (E.D.Ark.2006); *Chanana's Corp. v. Gilmore,* 539 F.Supp.2d 1299,1303-04 (W.D.Wash.2003).[FN11]

*9 Little asserts, however, that while the Ressler shares may be a "federal covered security," the exclusion from preemption found in SEC 506 opens the door for Little to maintain a private cause of action against Defendants for failing to comply with the Maryland notice filing requirements. In *Chanana's Corp.,* the District Court for the Western District of Washington addressed a similar argument regarding the application of Washington securities laws. The District Court noted that "[t]he primary purpose of NSMIA was to preempt state 'Blue Sky' laws, which required issuers to register many securities with state authorities prior to marketing in the state. *Zuri-Invest AG v. Natwest Finance Inc.,* 177 F.Supp.2d 189, 192 (S.D.N.Y.2001)." *Chanana's Corp.,* 539 F.Supp.2d at 1304. The Court observed that NSMIA was passed in 1996 to eliminate this cumbersome regulatory scheme. *Id.* (citations omitted). Seeking to soften the impact of these changes on state treasuries, Congress permitted states to continue to collect fees from issuers for notice filings. It also explicitly authorized states to suspend offers or sales if the issuers failed to file or pay a fee. *See* 15 U.S.C. § 77r(c)(3). Thus, a state can require that a security preempted from state registration requirements as a "covered security" file a Form D and pay filing and other fees. *Id.* at 1305

Maryland securities regulations require that an issuer file a notice on SEC Form D within 15 days of a sale. Md. Regs.Code tit. 02 § 02.04.15(D). If an issuer fails to comply with this requirement, Md. Stat. Ann., Corps. & Ass'ns § 11-701.1 and 11-702 (b) authorizes the Securities Commissioner to take a variety of enforcement actions against the issuer. It is undisputed that Debtor did not file a Form D within the 15-day period, or at any other time. The issue at bar is what penalties may be imposed for Debtor's failure to comply with this requirement, and, specifically, whether there is a private right of action available to Little.

In support of his allegation that the Ressler shares were required to be registered under the MSA, Little invokes § 11-703(a), which provides that, "a person is civilly liable to the person buying a security from him if he offers or sells a security in violation of § 11-304(b), § 11-401(a), § 11-402(a), or § 11-501 of [the MSA] or of any rule or order under § 11-205 of this title which requires the affirmative approval of sales literature before it is used...." Md.Code Ann., Corps. & Ass'ns § 11-703(a)(i). Sections 11-304(b), 11-401(a), and 11-402(a), clearly are inapplicable to the stipulated facts in the within case. These provisions address prohibited representations by an issuer and transactions by unregistered broker-dealers and advisors or their agents. Section 11-501 prohibits the sale of unregistered securities in Maryland unless such securities are federal covered securities. There is no provision in § 11-703(a)(i) that empowers a purchaser to seek civil damages for the failure of an issuer to to comply with the notice filing requirements of Md Reg. 15(D), and Little does not cite to any other provision of the MSA to support his claim.

***10** Little's interpretation of the state notice filing requirement would convert a covered security for which no Form D had been filed into an "uncovered" security subject to the state's registration requirement. The effect of this broad interpretation of the notice filing requirement imposed by Maryland law would negate the purpose of NSMIA. A "federal covered security" would be forced to register under Maryland law, with a penalty for failing to register, although no comparable penalty exists under federal law. This interpretation may conflict with NSMIA's prohibition in 15 U.S.C. § 77r(a), which provides that state laws requiring registration may not apply "directly or indirectly" to a federal covered security.

Therefore, I conclude that Defendants have demonstrated that they are entitled to judgment as a matter of law on Little's cause of action for damages based upon Defendants' failure to register the Ressler shares or to comply with the Maryland notice filing requirement. Because I find that the Ressler shares are federal covered securities, I find it unnecessary to determine whether the shares are exempt under state law. Count one of the Complaint will be dismissed.

II. Count Two-Violation of the MSA for Securities Fraud

Count Two of the complaint is based on Md.Code Ann., Corps. & Ass'ns § 11-301. Under that section,

> [i]t is unlawful for any person, in connection with the offer, sale or purchase of any security, directly or indirectly to: (1) employ any device, scheme, or artifice to defraud; (2) make any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they are made, not misleading; or (3) engage in any act, practice, or course of business which operates or would operate as a fraud or deceit on any person.

Md.Code Ann., Corps. & Ass'ns § 11-301. Little's complaint avers that Defendants violated § 11-301 by failing to inform him that the $400,000.00 he had transferred to Defendants would be used for "unauthorized purposes," including the purchase of only 17% of Debtor's shares. Defendant's actions, Little argues, "constituted a sale of a security by means of an untrue statement of material fact or an omission of a material fact." (Complaint at para.

32.)

Defendants' motion for summary judgment argues that Count Two should be dismissed because there is no evidence that Defendants committed securities fraud. In support of this position, Defendants' assert that Little knew that Debtor needed a substantial cash infusion to continue its operations, that Little agreed to provide the funds, and that the funds were used for the agreed upon purposes. In the Statement of Undisputed Facts, Little admits that he "understood that Ressler Inc. had a temporary lack of cash available to pay for raw materials to fill orders and to make lease payments," but he does not concede that the $400,000.00 was advanced for this purpose. (Plaintiff's Response to Defendants' Statement of Undisputed Facts, para. 12.) Defendants acknowledge that the $400,000.00 was also intended to serve as a deposit for purchase of Debtor's stock. They admit that Little received certain shares for the funds advanced, although the transfer was later rescinded. No fraud was committed, they argue because Little's money was used for the purposes that Little himself intended.

***11** While Defendants' argument is generally accurate, it fails to acknowledge that the checks provided by Little clearly state that the money was intended as a deposit toward the purchase of a controlling interest in Debtor. Little clearly did not receive a controlling interest when Defendants transferred 17% of Debtor's outstanding stock in consideration for the $400,000.00 deposit. Further, Little ultimately did not receive any shares after the stock transfer was rescinded. There is no evidence in the record that the parties agreed that the deposit was to be forfeited if the sale was not consummated. Because the parties dispute the relevant facts, I cannot conclude that Defendants have proven that there is no genuine issue of material fact. Accordingly, summary judgment must be denied as to Count Two.

III. Liability of Keith, Kenneth and Karen Ressler as Debtor's Directors.

In their motion for summary judgment, Defendants assert that there is no legal or factual basis to hold Defendants Keith Ressler, Kenneth Ressler and/or Karen Ressler liable as control persons under the [MSA]." (Motion for Summary Judgment, para. 3.) Defendants Brief contains a single paragraph consisting of three sentences baldly asserting that Kenneth and Karen Ressler had "minimal involvement" in the transaction because Kenneth had recently undergone knee surgery and because Karen did not understand the transaction. These assertions are insufficient for me to find that there is no genuine issue of material fact regarding the Resslers' individual liability and that they are each entitled to judgment as a matter of law. Accordingly, the motion for summary judgment will be denied as to the Resslers.

An appropriate order will be entered.

FN1. The order was entered pursuant to Debtor's unopposed motion to transfer venue.

FN2. 28 U.S.C. § 157(c) states that a "bankruptcy judge shall determine, on the judge's own motion or on timely motion of a party, whether a proceeding is a core proceeding under this subsection or is a proceeding that is otherwise related to a case under title 11."

FN3. At least one appellate court has indicated that in cases involving both core and non-core matters, a bankruptcy court may choose to enter bifurcated orders-a final order in the core matter and a proposed order in the non-core matter. *In re BN1 Telecommunications, Inc.*, 246 B.R. 845, 849 (B.A.P. 6th Cir.2000). At this point in these proceedings, judicial economy would not be served by bifurcating the core and non-core causes of action within this proceeding. The claims against the non-debtor Defendants are identical to those against Debtor and, undoubtedly, will involve the same witnesses and evidence.

FN4. The certificate sent to Little bore a notation printed or typed vertically along the left hand margin stating that "[t]hese securities have not been registered under the Securities Act of 1933 or the Pennsylvania Securities Act of 1972...."

FN5. There appears to be no dispute that Maryland law applies to the transaction at issue.

FN6. Civil liability for a violation of § 11-501 of the MSA arises under Md.Code Ann., Corps. and Ass'ns. § 11-703(a)(1)(I), which provides that "a person is civilly liable to the person buying a security from him if he ... offers or sells the security in violation of ... § 11-501 of this title, or of any rule or order under § 11-205 of this title which requires the affirmative approval of sales literature before it is used." Md.Code Ann., Corps. & Ass'ns § 11-703 (a)(1)(I).

FN7. The Securities Act of 1933, c. 38, Title I, 48 Stat. 84, 15 U.S .C. § 77 consists of eighty (80) subsections published within a single section (§ 77) of Title 15 of the United States Code. 15 U.S.C. § 77a-bbbb. NSMIA amended the 1933 Act in certain respects, but did not repeal or replace it. For simplicity and uniformity of reference in this Opinion, I will hereafter refer to the federal statute as "NSMIA," and I will use the U.S.Code references rather than the numbering of the Act. Thus, for example, section 18 of the Act as amended by NSMIA will be referred to as § 77r.

FN8. "Covered securities" include (1) those listed on the New York Stock Exchange, American Stock Exchange, or NASDAQ, (2) those issued by a federally registered investment company, (3) those sold to a qualified purchaser as defined by rules of the Securities Exchange Commission ("SEC") and (4) those exempt from federal registration pursuant to SEC regulations. The Ressler shares do not fall within the first two kinds of covered securities-Debtor's stock is not listed on any stock exchange and it was not sold by a federally registered investment company. While the parties have stipulated to facts showing that Little qualifies as an "accredited investor," their statements of undisputed facts do not specifically address whether or not Little is a "qualified purchaser" as defined by the SEC.

FN9. In his brief, Little further points out that 15 U.S.C. § 77r(c) specifically provides for "the securities commission ... of any State [to] retain jurisdiction ... to investigate and bring enforcement actions with respect to fraud or deceit, or unlawful conduct by a broker or dealer, in connection with securities...." 15 U.S.C. § 77 (r)(c). The relevance of this section is not clear in this case since it a private action against a securities issuer and not an enforcement action by the Maryland Securities Commissioner.

FN10. SEC Rule 506 (Exemption for Limited Offers and Sales Without Regard to Dollar Amount of Offering), which is part of Regulation D, is promulgated under 15 U.S.C. § 77d(2). Debtor claims a exemption from registration under Rule 506.

FN11. Between the adoption of Regulation D in 1982 and its amendment in 1989, "an otherwise valid offering was destroyed by a delinquently filed Form D." J. William Hicks, 7A *Exempted Trans. Under Securities Act 1933* § 7:231 (2003) (quoted in *Chanana's Corp.*, 539 F.Supp.2d at 1303). In response to criticism of this practice, the

SEC " 'eliminated the Form D filing requirement of Rule 503 as a condition to these exemptions.' *Id.; see also* Securities and Exchange Commission Summary, *Regulation D; Accredited Investor and Filing Requirements,* 54 Fed.Reg. 11369 (March 20, 1989) ('While the filing of Form D has been retained, it will no longer be a condition to any exemption under Regulation D.'). Rather than removing the exemption, the consequence of failing to file a Form D is disqualification from making *future offerings* under the rules. 17 C.F.R. § 230.507." *Chanana's Corp.* 539 F.Supp.2d at 1304.

Bkrtcy.M.D.Pa.,2009.
In re Ressler Hardwoods and Flooring, Inc.
Not Reported in B.R., 2009 WL 975155 (Bkrtcy.M.D.Pa.)

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