CASE NO. B172588

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

OCM Principal Opportunities Fund, L.P., Pacholder Value Opportunity Fund L.P., and Pacholder Heron Limited Partnership,

Plaintiffs, Respondents and Cross-Appellants,

v.

CIBC World Markets Corp.,

Defendant, Appellant, and Cross-Respondent;

TCW Shared Opportunity Fund II, LP, TCW Shared Opportunity Fund IIB, LLC, TCW Shared Opportunity Fund III, LP, TCW Leveraged Income Trust, LP, and TCW Leveraged Income Trust II, LP,

Plaintiffs, Respondents and Cross-Appellants,

v.

CIBC World Markets Corp.,

Defendant, Appellant, and Cross-Respondent.

Appeal from the Superior Court for Los Angeles County
Case Nos. BC 229069 and BC 250268
The Honorable Wendell Mortimer, Jr., Judge

COMBINED RESPONDENTS' AND CROSS-APPELLANTS' BRIEF

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RESPONDENTS' BRIEF

I. INTRODUCTION

Defendant CIBC World Markets Corp. induced Plaintiffs to buy Notes by misrepresenting the purported success of Renaissance Cosmetic's business strategy and growth plan and by failing to reveal its dire financial condition, its failed marketing strategies, and that it had cooked its books by failing to account for massive quantities of products that had been shipped but had not sold and would never sell through to consumers. As a result Plaintiffs invested over $50 million in worthless Renaissance (or "RCI") Notes.

Plaintiffs sued CIBC, seeking relief on theories including intentional nondisclosure, negligent misrepresentation and violations of state and federal securities laws. Following a lengthy trial and substantial deliberations, the jury found CIBC liable on each of these theories and awarded Plaintiffs $51,971,156 in damages.

CIBC's appeal raises two issues. First, CIBC contends it is entitled, not to a new trial, but to judgment in its favor. Second, CIBC contends the trial court erroneously entered judgment based on the jury's identification of "total damages." These contentions fail foundational appellate tests:

- CIBC has waived its JNOV argument because it ignores an elementary appellate rule – the substantial evidence rule. In 62 pages of briefing, CIBC never recites, nor deals with, the evidence in the light most favorable to Plaintiffs.
- That evidence is substantial and abundantly supports the jury's determinations. Because CIBC fails to acknowledge the evidence favorable to Plaintiffs, it has not even tried to satisfy its burden of demonstrating that *only* a judgment in its favor was permissible.

- As to its attack on the amount of damages, CIBC's appeal also fails. It never comes to grip with the facts: the jury expressly stated that Plaintiffs should receive $51,971,156; CIBC then consented to the trial court's method of clarifying the jury's intent, which confirmed the figure; CIBC obstructed Plaintiffs' efforts to resolve any remaining doubt; and there is neither evidentiary nor logical support for CIBC's position that the jury must have intended to award half the "total damages."

Bottom line: Except for the single issue raised in the cross-appeal, the judgment is fully supported by the record and should be affirmed.

II. STATEMENT OF FACTS[1]

A. The Plaintiffs

Plaintiffs are funds that manage investments for individuals and entities, including pension plans and charitable foundations.[2] Plaintiffs look for companies with solid operations and an effective business plan, but which carry more debt than they can bear.[3]

In such circumstances, a company's "distressed debt" securities fall in value, and Plaintiffs consider whether the decline is excessive.[4] They

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[1] In light of the governing standard of review, this Statement of Facts – unlike CIBC's – presents the evidence in the light most favorable to Plaintiffs, disregarding conflicting evidence and inferences. *Foreman & Clark Corp. v. Fallon* (1971) 3 Cal.3d 875, 881.

[2] 6RT1131:15-24, 1132:20-26; 67AA18853-54. By citing collateral sources, CIBC purports to characterize Plaintiffs' investment strategies. AOB 5-8, 13. None of this material was in evidence.

[3] 6RT1114:8-1115:13, 1116:25-1121:15; 7RT1199:15-19, 1200:13-1201:1; 13RT2605:28-2606:28.

[4] 7RT1199:15-1200:12, 1193:26-1195:5.

invest to achieve returns not from scheduled interest payments, but from exchanging the debt securities for an equity stake, or from an asset sale.[5] Plaintiffs' willingness to work with flagging but basically sound companies often saves those companies and the jobs they support.[6]

Before investing, Plaintiffs carefully analyze the available facts regarding the company and its value.[7] An important information source is the company's security offering materials, in part because those materials are produced by underwriters or "initial purchasers" such as CIBC who have supposedly worked to ensure the materials are truthful and complete.[8]

B. Renaissance Cosmetics

Tom Bonoma founded Renaissance in 1994 with a capital-intensive plan to manufacture and distribute fragrances and other products.[9] With funds raised through securities offerings, Renaissance would acquire "classic" fragrance brands (*e.g.*, "Chantilly") and apply two strategies: advertising to reinvigorate the classic brands; and launches of new, "focused flanker" products (*e.g.*, "White Chantilly") that drew from and reinforced classic brands' "strong name recognition and brand equity."[10]

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[5] 6RT1116:25-1121:15, 9RT1710:18-1711:15, 15RT2971:10-18; 10RT1835:14-1836:10, 1876:17-1877:26; 13RT2525:23-2527:20.

[6] 6RT1118:20-119:7, 1120:9-1121:15.

[7] 6RT1121:16-1124:19; 7RT1193:26-1195:5, 9RT1712:24-1714:17; 10RT1804:25-1806:15; 18RT3509:12-23.

[8] 3RA459; 5RA886; 7RT1290:22-1292:24; 6RT1126:12-1128:2; 9RT1714:18-1715:21; 14RT2824:1-25; 18RT3509:28-3510:8, 3516:16-3517:5; 7RT1339:10-1342:15; 11RT2186:5-2188:27.

[9] 48AA13517.

[10] 48AA13518-20, 13565, 13570-73.

C. CIBC's Growth "Story" For Renaissance And Its Notes

CIBC was integral to Renaissance's capital-raising efforts. CIBC peddled itself to Renaissance on its ability to create a "story" appealing to investors.[11] In exclusively marketing Renaissance's securities, CIBC told a story of a growth company bringing a "renaissance" to traditional brands and "successfully" launching flankers.[12]

CIBC's story also touted Renaissance's analytical tools, such as weekly brand data on consumer sales gathered by an expensive, subscription service from Information Resources, Inc. ("IRI").[13] With this data, Renaissance had "real time understanding of relaunch marketing effectiveness" and the ability to "gaug[e] new product success rates."[14]

Using this story, CIBC marketed a series of offerings. In mid-1996, CIBC sold $115 million of Renaissance preferred stock.[15] For its fee, CIBC received approximately $5 million, which it used to acquire Renaissance common stock and the right to attend its board meetings.[16]

To complete further acquisitions, in December 1996 Renaissance borrowed $117.5 million in a CIBC-syndicated bridge loan, with CIBC

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[11] 2RA203, 209; 7RT1313:11-26.

[12] 7RT1317:19-1320:1, 1343:9-22; 16RT3153:23-3155:6 ("investors are saying, I believe in you and your story"); 3RA351, 359, 361, 364.

[13] 48AA13576, 9RT1699:20-1700:3.

[14] *E.g.*, 48AA13517, 13563, 13571, 13576; 51AA14398, 14444, 14452, 14457; 7RT1346:5-1347:17; 9RT1621:14-1622:17.

[15] 16RT3125:17-3126:5; 12RT2208:1-2208:13; 2209:22-2212:11; 5RA812.

[16] 16RT3125:17-3126:5, 3291:27-3297:2; 11RT2188:28-2189:17; 3RA342; 64AA18067 (Bonoma: "syphilitic muggers would use a kinder club" regarding CIBC stock acquisition).

itself lending $15.5 million.[17] As a condition to the loan, CIBC required Renaissance to refinance through a CIBC-promoted note issuance.[18]

So in February 1997, CIBC created an Offering Memorandum ("OM") to market $200 million in Renaissance notes (the "Notes") in a private offering.[19] To entice investors with trading liquidity, CIBC contractually required Renaissance to take steps allowing the initial private Notes to be exchanged for identical, but publicly-tradable Notes.[20] The successful offering repaid the bridge lenders (including CIBC) and generated CIBC an additional $6 million fee.[21]

Finally, as part of the "tied together" process that included the initial sale and the follow-on exchange for publicly-tradable Notes, CIBC participated through counsel in preparing a Registration Statement.[22] The Registration Statement re-used nearly verbatim the OM's "story."[23]

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[17] 16RT3123:11-3124:10, 17RT3362:1-3363:15, 3364:19-3365:4, 3406:19-22; 8RT1394:13-18.

[18] 17RT3360:8-3361:4; 8RT1370:24-1371:24, 1389:28-1393:6.

[19] 48AA13511-13712.

[20] 3RA474-78; 7RT1328:7-1329:5, 8RT1435:28-1437:6.

[21] 4RA711, 713; 8RT1393:7-1394:18, 1395:15-20.

[22] 21RT4197:19-4200:19, 4165:25-4184:27; 66AA18567-68; 6RA1034, 1011; 3RA462, 463; 8RT1437:28-1438:7; 13RT2448:16-2449:8; 48AA13523, 13631, 51AA14406, 14475; 9RT1648:23-1649:25; 19RT3903:8-3903:17; 59AA16717.

[23] 10RT1891:14-25; 48AA13511, 13517-35, 13563-92, 13604-16; 51AA14398-400, 14404-16, 14444-87.

D. The Deceit Behind CIBC's Renaissance "Growth Story"

Two fragrance industry fundamentals illuminate CIBC's fraud. First, the industry is highly seasonal. A wholesaler, such as Renaissance, sells approximately half its annual total during the fall Christmas season.[24] A far smaller sales bump occurs ahead of Mother's Day.[25] Thus, each year the Christmas season largely determined Renaissance's success or failure.

Second, wholesale sales are effectively on consignment. Retailers can return merchandise they do not themselves re-sell for a 100% refund, with wholesalers, such as Renaissance, picking up return shipping costs.[26] Accounting rules permitted Renaissance immediately to record its wholesale shipments as sales revenue so long as it established reasonable reserves based on honest estimates of anticipated returns.[27]

1. Renaissance Suffers A Financial Debacle In Its Christmas 1996 Season (Its Fiscal Third Quarter)

Before the Note offering, Renaissance already had foundered. In the decisive 1996 Christmas season, Renaissance's shipments to retailers had ruinously failed to sell through to consumers.[28] A January 27, 1997 IRI written report recapping Renaissance's Christmas-season (its fiscal third quarter) results showed the White Chantilly flanker had not been "successfully launched," but instead was failing miserably along with most

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[24] 7RT1356:24-1360:1; 5RA760; 48AA13571, 13528; 20RT3986:10-18.

[25] *Id.*

[26] 7RT1345:15-1346:4; 48AA13574; 9RT1730:17-1731:13; 17RT3416-19.

[27] 9RT1730:17-1731:13; 17RT3416:18-3419:11.

[28] 9RT1699:20-1700:3, 1731:11-1731:23; 64AA18075, 18078, 18084 (below prior year), 18097-99, 18102.

classic brands.[29] Prior to January 27, Renaissance knew the underlying data through a frequently-accessed, weekly-updated electronic IRI database and through the drafts of the January 27th report.[30] The lack of retail sales (when far greater amounts had been projected and shipped) resulted in a "stuffed" distribution channel, with substantial returns to come.[31] This meant Renaissance's fiscal year would conclude in shambles on March 31, 1997; and much of its already-booked pre-Christmas revenue would, if properly accounted for, be reversed off the books.[32]

2. CIBC Knows The Fourth Quarter Cannot Reverse The Debacle.

CIBC had access to the IRI data for the already-completed Christmas season and knew it was central to assessing financial results and projections.[33] In preparing the OM, CIBC learned about the "poor third quarter." On December 10, 1996 (in a memo CIBC omits to mention),

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[29] 12RT2327:3-9; 9RT1732:21-1734:5; 14RT2689:11-28; 11RT2145:15-2146:18; 12RT2258-2265; 64AA18075, 18078, 18084, 18097-99 (other than Chantilly, classic brands and White Chantilly in steep decline), 18102.

[30] 11RT2162:22-2168:20, 2172:3-2176:24.

[31] 16RT3238:28-3242:25, 3245:18-3253:6; 20RT3980:20-3991:23; 12RT2258:11-24; 6RA1006; 3RA432-34; 64AA18098. CIBC fails to mention or provide Exhibits 1032 and 66.

[32] 13RT2621:18-2623:26.

[33] 7RT1353-1364; 9RT1627:18-1628:7, 1657:9-1658:18, 1699:20-1700:3; 11RT2101:5-2102:13, 2193:6-12; 16RT3268:23-3270:20; 8RT1417:24-1420:21, 1423:22-1425:19; 20RT3986:10-18; 4RA708. CIBC understood that it (not Renaissance's auditors) was responsible for due diligence on the OM's projections. (7RT1291:5-1292:24; 9RT1657:9-1658:18, 1660:2-25; 11RT2103:6-2104:27, 2194:21-2195:27; 5RA886-87.)

CIBC's Mark Dalton referenced Renaissance's poor third quarter as a *fait accompli*.[34]

3. CIBC Buries the Christmas Debacle Under "Squirrelly" Fourth-Quarter Projections

The reality of industry seasonality meant that Renaissance's fourth quarter—ending March 31—could not honestly be projected at levels sufficient to overcome the Christmas debacle, and CIBC knew it. Indeed, a January 1997 Dalton memo specifically referred to Renaissance's fourth-quarter "squirrelly sales assumptions" and "padded" numbers.[35] Imbedded within the company's quarterly projections were projected March 1997 sales substantially more than the fiscal year's next highest month, and enormous projected March EBITDA.[36] Given Renaissance's heavy dependence on Christmas-season sales, these "Miracle March" projections

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[34] 3RA349-50. Dalton was CIBC's principal liaison with Renaissance. (17RT3334:15-21; 7RT1324:12-1325:2; 9RT1660:21-25.) For a possible inquiry by Bonoma as to whether he should delay the Note offering until the 3/31/97 end of the fiscal year, Dalton proposed his superior respond:

> If you believe that your fourth quarter will be great, we can sell through *the poor third quarter*. The risk is waiting for the fourth quarter, missing the numbers and being unable to finance in May, or that the market goes away.

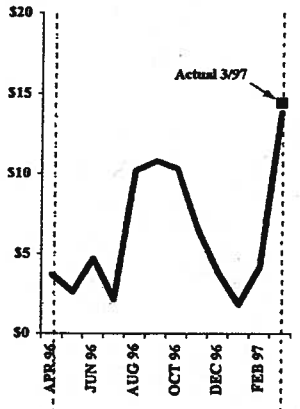
(3RA350: emphasis added.) CIBC cannot overcome the inferences properly drawn regarding its access to the IRI data merely by citing (AOB 27) testimony from one TCW witness that he did not know whether CIBC received the hard copy IRI report. *See Donahue v. United Artists Corp.* (1969) 2 Cal.App.3d 794, 807 (jury may disbelieve even uncontradicted denials of wrongdoing).

[35] 3RA458. Though this exhibit 75 was much discussed at trial, CIBC omits it. (*E.g.*, 20RT3971:9-3980:19; 8RT1408:12-1410:21, 1414:13-1416:3; 16RT3180:17-3184:28, 3279:20-3291:26.)

[36] 8RT1399:9-1400:9, 1409:10-1411:7; 66AA18564.A.

were untenable. This point was illustrated at trial by comparing Renaissance's March plan to traditional industry seasonality. The comparison (reproduced below) shows that preceding the enormous Christmas retail bump, there is a large bump in Renaissance's wholesale sales, but it was indefensibly projecting a second large bump in wholesale sales before Mother's Day's tiny retail sales blip.[37]

Renaissance Cosmetics, Inc.
Fragrance Division
Net Sales - Actual and Forecasted



Ex. 532 and Ex. 1001

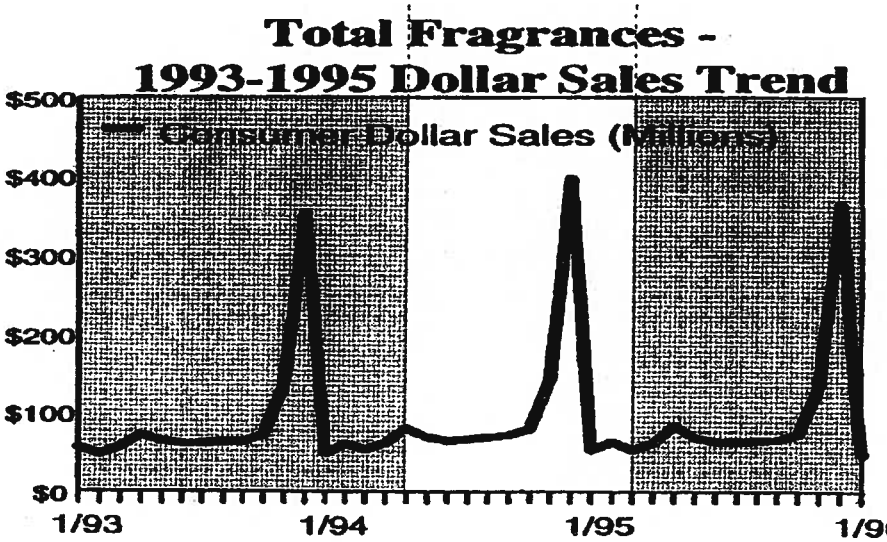


Exhibit 529

[37] 23RT 4362:24-4364:28.

Dalton initially addressed the bloated March projections by stating that he had caused Renaissance to lower them while preparing the OM.[38] The squirrelly projections, however, were imbedded in the OM's numbers.[39] Upon recognizing this, Dalton admitted his testimony had been "incorrect," and claimed Bonoma had told his superiors the padded numbers were achievable.[40] Such a discussion, however, had not occurred.[41]

4. CIBC Knows Of Renaissance's Disregard For The Truth: The "Weasel Parade"

CIBC knew it should doubt Renaissance's honesty in its offerings.[42] At a fall 1996 dinner celebrating the preferred stock offering, CIBC heard Bonoma read his graphic "Weasel Parade" in which he said the "morals involved" in such offerings gave "crooks, sophisters and Nazis something to aspire to, if one aspires to a lower circle of Hell as much as a higher."[43]

E. CIBC Prepares The Fraudulent OM

By January 1997, Renaissance was out of honest business options:

- Its classic brands were failing;[44]

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[38] 16RT3180:17-3181:16, 3184:11-3184:20, 3289:19-3290:20.

[39] *Compare* 66AA18564.A *with* 48AA13542; 19RT3971:15-3972:12, 3974:17-3975:19; 16RT3290:21-3291:26.

[40] 16RT3279:20-3291:26; 17RT3350:1-3351:7.

[41] 19RT3904:18-3906:19, 3924:23-3925:17; 9RT1660:2-1662:6.

[42] 26AA7630-31 (trial court: documents relevant "to whether CIBC conducted proper due diligence and . . . disclosed what they knew").

[43] 64AA18066; 8RT1445:13-28; 16RT3206:21-3208:4. He also lambasted CIBC for pushing for "growth for growth's sake even when that is not the best thing." 64AA18067.

[44] 64AA18084, 18098-99, 18102; 10RT1810:16-1811:2.

- The flanker strategy had failed, with White Chantilly plummeting;[45]
- Renaissance's distribution channels were overloaded because retail customers had failed to purchase the products;[46]
- March 1997 would be its death-knell because management planned to further overload its distribution channels;[47] and
- Renaissance's management had demonstrated a lack of integrity by committing to fraudulent sales projections to market the Notes.[48]

In preparing the OM,[49] CIBC, with a $15 million loan and a $6 million fee at stake in completing the offering, had a significant incentive to withhold this information from investors, and it did so.

The OM retained the "squirrelly" March projection imbedded in its projection for the nearly-completed fiscal 1996.[50] The OM also touted Renaissance's management's competence and the successful execution of its reinvigorated-classic/flanker-brand strategy.[51] Each of these points was specifically noted in the Road Show presentation in which CIBC

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[45] *Id.*

[46] 9RT1728:7-1730:11.

[47] 20RT3976:6-3978:15; 8RT1432:12-1434:23; 14RT2689:11-2691:2; 13RT2619:15-2620:19; 9RT1728:7-1730:11.

[48] 9RT1728:7-1730:11.

[49] 16RT3136:7-3137:21; 17RT3336:13-15.

[50] *Supra* n.39. For the fall 1996 bridge loan, the projected net sales and EBITDA for the 6 months beginning October 1, 1996 were $117.5 million and $12.7 million. (5RA854.) After the Christmas disaster, the OM had higher projections: $121.1 million and $12.6 million. (48AA13542.)

[51] 48AA13518-19, 13526-27, 13565, 13570-73, 13583-85. The OM provided narrowly-selected IRI data through November 3, 1996, but not the Christmas data. (48AA13517, 13571.)

highlighted the major investment points.[52] With this false picture, the Notes offering succeeded, with CIBC collecting its fees and recouping its loan.

F. Renaissance's Situation Worsens

1. The Fatal Blow: Stuffing the Channel

The padded projections demonstrated a fatal "channel stuffing" plan. By massively shipping into an already-overloaded distribution channel, a company hurts future sales, guarantees the eventual need to change accounts receivable into accounts payable and disastrously devalues its brands.[53]

In March 1997 Renaissance implemented its plan to stuff the already-overflowing channel and pad its financials. Reported March "sales" to retailers exceeded even the padded projections.[54] The inflated sales revenue carried over into Renaissance's June 1997 10-K financials.[55]

Its channel-stuffing eventually resulted, by July 1998, in "millions of pounds of unopened boxes or returned merchandise sitting at the warehouse," with Renaissance having "no idea what its receivables were."[56]

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[52] 2RA311, 332, 341.

[53] 20RT3975:20-3980:19 (CIBC Vice-Chairman Heyer); 8RT1423:22-1425:19, 1432:12-1434:23; 23RT4425:1-2; 14RT2689:11-2691:2; 13RT2619:15-2620:19; 18RT3627:24-3628:7.

[54] *Compare* 5RA791 *with* 66AA18564.A.

[55] The OM's padded $198 million in projected net sales was carried over into a padded $174 million in "actual" net sales in the 10-K. (54AA15228 (upper-right corner); 48AA13542.) The difference was explained as largely due to the OM's inadvertent, unrelated double-counting of October and November 1996 revenue, not because actual results were less than the OM's projections. (6RA951; 20RT4023:21-4025:27.)

[56] 17RT3465:28-3467:7; 9RT1739:2-1740:15; 13RT2622:27-2623:26.

2. "Improved Lying and Cheating"

Bonoma presented a further "Weasel Parade" at an April 1997 dinner celebrating the Notes offering,[57] shortly before the May Registration Statement. Bonoma said he had been "off to confound investor companies" with "whatever prospectuses are called before registration," and that his "song and dance" to sell the Notes had been "***Improved Lying and Cheating***" when compared to his prior promotion of RCI securities.[58]

G. CIBC's Subsequent Analyst Reports Maintain The Illusion of Renaissance As A Substantial Company

Throughout 1997, CIBC endorsed RCI through positive analyst reports – recommending purchase even with the Notes were trading above their initial price.[59] The reports, particularly the 25-page September 18 report, echoed the OM's positive statements.[60] The reports failed to

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[57] 16RT3210:19-3211:1, 3224:4-20.

[58] 64AA18072 (emphasis in original).

[59] 64AA18172, 18174, 18145.

[60] 64AA18172-73 ("company continues to demonstrate its ability to reinvigorate established brand names"; "Financially RCI remains on track to deliver strong fourth quarter and full-year results for the periods ended March 30, 1997"); 64AA18174-75 ("the story remains on track"; EBITDA substantially exceeds interest payments; "[w]hile . . . the overall domestic fragrance market is under performing, we believe that Renaissance is poised to combat the trend through new product introductions and revitalized promotional campaigns."); 64AA18145, 18148-49, 18151 ("at current trading levels [100.8], [the opportunity] to benefit from a compelling growth story leads us to recommend purchase," "Management's impressive track record in reinvigorating several mass market fragrance brands . . . bodes well"; "The ability to turn around tired brands . . . should amplify Renaissance's potential value to [an acquirer]"; "Demonstrated Expertise in Reinvigorating Tired Fragrance Brands Supports Top-Line Growth and Improved Profitability: The company has proven that its strategy works – each of the three [original] classic fragrance brands . . . has

disclose Renaissance's systemic brand failure, its falsified financial results and its corrupt management.[61]

H. Some Bad Financial News Sends The Notes Down In Price And Catches Plaintiffs' Interest

On February 3, 1998, Renaissance began selectively releasing some of the bad news. It announced:

- Fiscal 1998 results would be "significantly below" analyst's expectations;
- A third-quarter operating loss;
- Two successive "underperforming" Christmas seasons *for the industry* had caused Renaissance's management to conclude that its "business environment ha[d] changed fundamentally," and that it should reconsider and change its business; and
- It might be unable to make the Notes' scheduled interest payments.[62]

The press release, however, attributed Renaissance's problems to fragrance "industry" changes and stated a continued belief that its "long term strategy" "will be successful," with change necessary only in the "execut[ion of] that strategy."[63]

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exhibited strong growth . . . . Given this successful formula, the growth opportunity is attractive for the recently-acquired brands . . . ."), 18148-49 ("'Brand Equity' Concept Augments Valuation: . . . The attractiveness of [RCI] to a potential suitor is based on the value of its brand names and shelf space" and values that could be achieved if brands were sold), 18156 (RCI has successfully introduced three flankers including White Chantilly).

[61] 64AA18172-73, 18174-75, 18145-71.

[62] 64AA18020-21.

[63] 64AA18021.

This news caused the Notes to decline to approximately half their initial price.[64] This drop, coupled with the affirmation that Renaissance's basic strategy was sound, caused the Plaintiffs to focus on the Notes as a possible investment.[65]

I. Plaintiffs' Analyze and Purchase of the Notes

In considering their purchases, Plaintiffs carefully evaluated the available information and the extent to which the latest news affected prior information. In this process: Plaintiffs used the OM as a baseline for understanding Renaissance's business, as it was the most recent description ostensibly tested by an outside third party's due diligence; and used the June 1997 10-K, which reported fiscal 1996 financial results, in assessing the quantitative implications of the February 1998 disclosures.[66] Plaintiffs also relied on the content of CIBC's analyst reports.[67]

Plaintiffs relied on several false aspects of CIBC's ongoing "story":

- That Renaissance's financial statements as modified by subsequent revisions reflected actual financial results;[68]

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[64] 13RT2500:10-2501:18.

[65] 10RT1817:24-1818:8, 1834:17-1838:4; 12RT2248:23-2250:9; 15RT2948:14-26; 18RT3517:6-3518:22; 6RT1117:10-1122:22;.

[66] 9RT1714:18-1715:21, 1736:13-1737:16; 6RT1126:15-1128:2, 14RT2824:1-25; 10RT1893:22-1894:5; 13RT2530:22-2531:8; 18RT3517:24-3518:22, 3521:12-3522:15; 65AA18470-71. This methodology was sound because Plaintiffs' experience indicated that companies usually disclosed "bad news" all at once and completely. (12RT2266:19-2269:7.)

[67] 10RT1846:5-16, 1909:18-26; 9RT1717:3-1719:9; 12RT2250:13-2257:1, 2269:28-2272:16; 18RT3515:1-7, 3516:6-11, 3518:23-3520:18.

[68] 65AA18465, 18470-71; 13RT2517:27-2518:10, 2530:22-2531:8; 10RT1893:22-1894:5; 64AA18229-30, 18242; 19RT3736:12-3741:26.

- That it had viable, "reinvigorated" classic brands with substantial "brand equity" evidenced in its reported EBITDA;[69]
- That the flanker brands had "successfully launched" and were successfully generating cash flow;[70] and
- That its business was strong enough, and had generated sufficient cash, that the company could revise its plan and take advantage of its supposedly valuable brands as the industry changed.[71]

Plaintiffs concluded that Renaissance was worth more than half the Notes obligation.[72] Thus, with a restructuring, Noteholders would expect to recover more than the newly-discounted market price.[73]

The reasonableness of Plaintiffs' analysis was confirmed by CIBC's parallel analyst reports on February 3, 6 and 20 which also analyzed Renaissance by deducting the February 1998 disclosures from the June

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[69] "EBITDA" or "earnings before interest taxes depreciation and amortization" is a measure of cash flow. 48AA13518 (RCI "continu[ing] to selectively acquire and . . . reinvigorate underperforming and/or undermarketed established brands"), 13565, 13573; 64AA18151 ("Demonstrated Expertise in Reinvigorating Tired Fragrance Brands . . . : [RCI] has proven that its strategy works – each of the three classic fragrance brands originally purchased . . . has exhibited strong growth since its acquisition . . . . Given this successful formula, the growth opportunity is attractive for the recently-acquired brands . . . ."); 18RT3517:24-3518:22, 3522:22-3523:6; 10RT1893:6-1896:21; 13RT2529:3-13; 64AA18236-18239 (Oaktree's favorable analysis of brands, including: Navy, Chantilly, White Chantilly and Tabu).

[70] 48AA13565, 13571 ("proven flanker strategy"), 13573; 11RT2141:16-26; 12RT2272:4-16; 10RT1932:18-1933:9.

[71] 12RT2273:28-2274:25.

[72] 65AA18465-71; 18RT3517:24-3518:22; 64AA18227; 19RT3734:1-17.

[73] 65AA18465, 18470-71; 13RT2517:27-2518:10; 15RT2953:15-2954:9, 2984:28-2985:5; 64AA18229-30, 18242; 19RT3734:5-17; 18RT3517-18.

1997 10-K financial reports.[74] While these reports reduced CIBC's recommendation from "Buy" to "Hold," they did not say "Sell," and they did not disclose that Renaissance's brands and strategy had failed, its financial statements were deliberately falsified, and its management had intentionally stuffed the channel. CIBC's "Hold" assessment, while the Notes were trading at a price near 50,[75] was a false representation that Renaissance could reasonably be valued as Plaintiffs had done, and that this method could support a value above 50.[76]

Plaintiffs began buying Notes in February 1998.[77] Through July 1998, with further purchases at declining prices, Plaintiffs invested more than $50 million.[78]

J. The Real Bad News Is Revealed Only After Plaintiffs' Purchases

On August 10, 1998, Plaintiffs were unexpectedly informed that Renaissance had run out of cash and that, without an emergency infusion, it would have to close its doors.[79] Such a shut-down would have necessitated a "fire sale" in which Plaintiffs would have lost their investment.[80]

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[74] 65AA18475-80; 66AA18655-7; 65AA18481-82.

[75] 66AA18655 (price 58); 12RT2269:28-2272:16.

[76] 65AA18475 (standalone restructuring value – 38.3 to 55.8; sale value – 67.5 to 85), 18477-78 (valuation method parallel to plaintiffs'); 66AA18655, 18657 (slightly lower sale value); 65AA18481-82.

[77] 66AA18562-64, 18565-66.

[78] *Id.*; 66AA18561.

[79] 17RT3484:18-3487:18; 9RT1736:22-1737:2.

[80] 17RT3488:14-3490:22.

Plaintiffs tried to mitigate such losses by loaning Renaissance $2 million in cash, after getting its senior lender's agreement that this "Mitigation Loan" would have bankruptcy priority equal to the senior loan.[81]

In conjunction with the Mitigation Loan, Plaintiffs gained access to further information about Renaissance.[82] Only then did Plaintiffs discover its true condition: it had warehouses full of returns from multiple, prior Christmas seasons; many ostensible accounts receivable were probably accounts payable because Renaissance owed the customer for returned merchandise and shipping; and its accounting system was in such shambles that it could not reconcile accounts with its customers.[83] These facts were unknown to Plaintiffs until after completing their purchases.[84]

Plaintiffs purchased no further Notes. They kept Renaissance afloat for several months, looking to achieve a better solution by selling the company or its brands, but the senior lender (GECC) ended the futile process in June 1999 and liquidated the company.[85] That liquidation generated insufficient proceeds to fully repay even the senior loan and the Mitigation Loan, leaving nothing for the Notes.[86]

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[81] 17RT3475:27-3479:18, 3488:14-3490:22.

[82] 17RT3492:20-3493:26, 3462:18-3463:11, 3495:10-3496:3.

[83] 9RT1738:17-1740:15; 13RT2622:27-2623:26; 17RT3465:28-3467:7; 18RT3625:18-28.

[84] 17RT3465:28-3467:7, 3485:22-3487:8, 3526:14-3527:16; 9RT1736:13-1737:2, 1739:2-1740:15; 13RT2622:27-2623:26; 12RT2278:16-2279:10; 18RT3523:18-3524:4, 3625:18-28, 3627:24-3628:7.

[85] 15RT2973:27-2974:24; 17RT3480:7-3481:5.

[86] 9RT1740:16-21; 10RT1813:13-23; 66AA18561-64, 18565; 68AA18935-54; 6RA1000, 1001.

III. STATEMENT OF THE CASE

A. The Lawsuit And The Jury Trial

Plaintiffs sued CIBC, asserting claims for intentional non-disclosure, intentional misrepresentation and negligent misrepresentation, and violation of Corporations Code Section 25500 and federal Securities Act Section 11.

The jury heard evidence over a four-week period. Plaintiffs asked the jury to award total damages of $51,971,156, with $26,178,337 to TCW, $21,889,633 to Oaktree and $3,903,186 to Pacholder.[87] These figures represented the amounts Plaintiffs invested in the worthless Notes plus the amounts lost on the Mitigation Loan.[88]

CIBC disputed that the Notes had always been worthless and presented alternative calculations based upon the supposed value of the Notes when Plaintiffs made their purchases. According to CIBC, Plaintiffs could not have collectively suffered more than $18.3 million in damages.[89]

B. The Jury's Verdict

After four weeks of deliberations, the jury's Verdict No. 1 found CIBC liable for intentional nondisclosure, negligent misrepresentation, and

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[87] 23RT4380:18-4382:19; 25RT4677:3-7, 4687:14-4688:2; 66AA18561-64, 18565-66; 6RA945, 1000, 1001. Mitigation losses were not recoverable on the statutory claims, so Plaintiffs sought slightly lower amounts on those claims. 23RT4382:8; 32AA9073-74, 9089-90, 9149-50.

[88] 13RT2618:10-2620:19, 2561:9-17, 2466:6-20; 14RT2689:11-2690:28; 15RT2944:24-2945:24, 2965:20-2966:16, 2973-2977; 66AA18561-64, 18565; 6RA998-1001; 9RT1736:13-1738:2, 1740:16-21; 10RT1800-1804; 12RT2277-79, 2301:14-20; 18RT3520:19-25, 3524:15-23.

[89] 20RT 4086:22-4089:19, 4103:14-4106:7; 23 RT4464:19-4465:4.

violations of state and federal securities laws.[90] In its Verdict No. 2, the jury determined Plaintiffs' "total damages" were exactly the amounts each Plaintiff had requested.[91]

In its Verdict No. 1, the jury also purported to allocate portions of the "total damages" among Plaintiffs' various claims.[92] To avoid the possibility that this allocation would become a bone of contention, Plaintiffs sought further deliberations.[93] CIBC opposed further jury inquiry.[94] The trial court proposed a clarifying inquiry to the jury foreman in the presence of the full jury.[95] CIBC agreed that if any inquiry was to be had, this manner of inquiry was appropriate.[96] The trial court asked its question, and the foreman confirmed the jury's intent to award the "total damages" in its Verdict No. 2.[97] CIBC did not request any further proceedings, and the jury was discharged.[98]

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[90] The jury found CIBC not liable for intentional misrepresentation. (32AA9205.) TCW did not assert statutory claims.

[91] 32AA9206. Though it complains now, CIBC did not object at trial to use of the word "total." Instead, CIBC had proposed 21 pages of verdict forms that would have required the jury to record more than 300 findings. (31AA8741-8764.) CIBC does not appeal the trial court's decision that such forms were needlessly "cumbersome," (22RT4298:20-23) raising instead new concerns that it did not raise below. (22RT4298:28-4301:8.)

[92] 33AA9205.

[93] 25RT4673:2-4673:28; 1RA005, 009.

[94] 25RT4673:27-4675:21, 4684:25-4685:1. 32AA9221, 9224-25 & n.1.

[95] 25RT4695:8-17, 4701:2-5.

[96] 25RT4702:5-4703:9.

[97] 25RT4704:1-4704:13, 4705:5-17.

[98] 25RT4705:18-26.

C. The Judgment And Post-Judgment Proceedings

The trial court entered judgment based on the Verdict No. 2 amounts, less offsets for prior settlements.[99]

The court denied CIBC's JNOV motions and Plaintiffs' motion for statutory prejudgment interest under Corporations Code section 25500.[100]

D. The Appeal And Cross-Appeal.

CIBC appeals the judgment amount and the order denying its nonsuit and JNOV motions. Plaintiffs cross-appeal from the denial of statutory prejudgment interest.[101]

ARGUMENT

IV. CIBC'S JNOV APPEAL SHOULD BE SUMMARILY REJECTED: CIBC WAIVED ITS ARGUMENT BY NOT RECITING THE EVIDENCE IN THE LIGHT MOST FAVORABLE TO THE VERDICT

A. The Standard Of Review: Affirm If Any Substantial Evidence Supports The Verdict

CIBC does not seek a new trial, nor has it made any effort to show prejudicial error warranting a new trial.[102] Instead, CIBC's appeal is

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[99] 47AA13392-94.

[100] 47AA13387; 1RA086.

[101] 47AA13404-405, 13423-24, 13426-27.

[102] *In re Marriage of McLaughlin* (2000) 82 Cal.App.4th 327, 337 (affirmative showing that error is prejudicial required).

narrowly focused: it seeks entry of judgment in CIBC's favor or a modified judgment with lower damages based on a reinterpretation of the verdict.[103]

The trial court's orders denying nonsuit and JNOV are reviewed to determine whether substantial evidence supported the judgment. *Wright v. Beverly Fabrics, Inc.* (2002) 95 Cal.App.4th 346, 351. In this review:

- An appellate court's power begins and ends with the determination of whether there is any substantial evidence, contradicted or uncontradicted, that supported the judgment. *Primm v. Primm* (1956) 46 Cal.2d 690, 693.

- "Substantial evidence" means any credible evidence or inference. *Tognazzini v. San Luis Coastal Unified Sch. Dist.* (2001) 86 Cal.App.4th 1053, 1058; *Wickoff v. James* (1958) 159 Cal.App.2d 664, 667-68.

- All evidence is considered, regardless of whether it was erroneously admitted.[104] This is because prevailing parties are not required to put on redundant evidence once the court has admitted evidence in their favor. *Donahue v. Ziv Television Programs, Inc.* (1966) 245 Cal.App.2d 593, 609-610; *Estate of Callahan* (1967) 67 Cal.2d 609, 617; *Cullen v.*

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[103] AOB 3-5, 30-32, 62-65. If CIBC wanted to raise other issues, it was required to say so. Rule of Court 14(a)(1)(B) ("brief must . . . state each point under a separate heading or subheading summarizing the point, and support each point by argument"); *Santa Teresa Citizen Action Group v. State Energy Resources Conservation & Dev. Comm'n.* (2003) 105 Cal.App.4th 1441, 1451 (point suggested only by footnote, waived).

[104] The one case CIBC cited in the trial court to refute this established principle was inapplicable as it did not involve a jury trial. *Kimble v. Board of Ed.* (1987) 192 Cal.App.3d 1423, 1429-30 (writ of mandate regarding public employment administrative proceeding).

Spremo (1956) 142 Cal.App.2d 225, 230; *Keen v. Prisinzano* (1972) 23 Cal.App.3d 275, 283.

- The evidence must be viewed in the light most favorable to the prevailing parties, disregarding conflicting evidence and inferences. *Foreman & Clark Corp. v. Fallon* (1971) 3 Cal.3d 875, 881.

- In applying these familiar rules, the judgment is presumed correct, and the record is presumed to contain evidence to sustain every finding of fact. It is the appellant's burden to show it does not. *Id.*

B. CIBC Waived Its Substantial Evidence Argument By Failing To Recite The Evidence In The Light Most Favorable To Plaintiffs.

To mount a proper substantial-evidence challenge, *an appellant is required* to fairly summarize the facts in the light most favorable to the verdict, giving the prevailing parties the benefit of every reasonable inference, and resolving any conflicts in their favor. *Id.*; *Green v. Green* (1963) 215 Cal.App.2d 31, 35; *Crawford v. Southern Pacific Co.* (1935) 3 Cal.2d 427, 429. When an appellant fails to meet this obligation, its sufficiency-of-the-evidence argument *is waived*. *Nwosu v. Uba* (2004) 122 Cal.App.4th 1229, 1247; *Foreman & Clark Corp. v. Fallon, supra*, 3 Cal.3d at 881; *Green v. Green, supra*, 215 Cal.App.2d at 35.

Notwithstanding its obligation, CIBC's factual statement focuses on evidence supporting its defense theories, and generally ignores and otherwise mischaracterizes key testimony and exhibits supporting Plaintiffs' theories of liability. CIBC's factual presentation is barely recognizable as a retelling of the trial.

Having ignored the evidence it finds uncomfortable, CIBC has waived its substantial evidence argument. *Baxter Healthcare Corp. v. Denton* (2004) 120 Cal.App.4th 333, 368 ("If the appellant fails to set forth

all of the material evidence, its claim of insufficiency of the evidence is waived"). This Court need read no further and should summarily affirm for this reason alone. *Niederer v. Ferreira* (1987) 189 Cal.App.3d 1485, 1510.

V. IN ANY EVENT, THE COURT SHOULD REJECT CIBC'S JNOV CLAIM BECAUSE SUBSTANTIAL EVIDENCE SUPPORTS THE JUDGMENT

Even if the Court does not find a waiver, the full judgment amount should be upheld if substantial evidence supports the verdict on either of the claims attacked by CIBC. Because these claims had common proof and measure of damages, the full Verdict No. 2 amounts were effectively awarded on each one.[105] *All-West Design, Inc. v. Boozer* (1986) 183 Cal.App.3d 1212, 1219-25; *see Weddle v. Loges* (1942) 52 Cal.App.2d 115, 119-20 (same rule when jury allocates damages between jointly-liable defendants – such incorrect verdict forms are "not incomprehensible" and "reasonable inferences may be drawn which will support rather than defeat a judgment"); *Sparks v. Berntsen* (1942) 19 Cal.2d 308, 310-12; *Dauenhauer v. Sullivan* (1963) 215 Cal.App.2d 231, 233-35; *Mixon v. Riverview Hospital* (1967) 254 Cal.App.2d 364, 372, 374 (rule applies unless "verdict on its face does not fix a total"). The jury's attempt to allocate was mere surplusage (*Id.*), which "it is almost a commonplace" to reject. *Mixon v. Riverview Hospital, supra*, 254 Cal.App.2d at 374. Consequently, to alter the judgment amount, CIBC must overturn both claims' liability verdicts.

Here, substantial evidence supports the judgment not merely on one theory, but on both. Plaintiffs will now demonstrate why each of CIBC's eight substantial evidence arguments fails. Rather than address the

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[105] 32AA9073-74.

arguments in the order in which CIBC raises them, we will address them in the traditional, logical sequence that highlights the relationship between the elements of Plaintiffs' claims.

A. Substantial Evidence Established That CIBC Made Actionable Misrepresentations

CIBC first contends Plaintiffs' negligent misrepresentation claim failed for want of evidence of a single affirmative misrepresentation.[106] *Oakes v. McCarthy Co.* (1968) 267 Cal.App.2d 231, 261 (single false statement sufficient). Remarkably, CIBC wholly disregards the evidence of affirmative misrepresentations and half-truths that Plaintiffs identified in successfully opposing the JNOV motion.[107]

1. CIBC Falsely Claimed Business Strategy Successes

CIBC's OM[108] stated Renaissance had "successfully launched White Chantilly," and touted "growth" through reinvigorated classic brands.[109] CIBC accompanied its padded sales projections with statements that "significant opportunity for growth" existed through reinvigoration of recently-acquired brands and the "proven" flanker strategy.[110] As detailed above in Part II.D, these statements were false.

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[106] AOB 33.

[107] 45AA12754-59.

[108] 16RT3136:7-3137:21; 17RT3336:13-15.

[109] 48AA13518-19, 13565, 13570-71, 13573. The Registration Statement repeated these falsehoods. (51AA14399-400, 14446, 14451-52, 14454.)

[110] 48AA13570-71; 51AA14451-52.

CIBC issued analyst reports confirming and compounding these misrepresentations.[111] CIBC insisted that "[t]he company has proven that its strategy works – each of the three classic fragrance brands originally purchased by the company has exhibited strong growth since its acquisition," and continued to tout White Chantilly's successful launch and Renaissance's "compelling growth story."[112]

2. CIBC Falsely Described Operating Performance

In its OM and analyst reports, CIBC praised the benefits of IRI data to Renaissance's decision-making and stated that the OM and the reports contained financial data based on IRI information.[113] The affirmative statements about IRI benefits and about Renaissance's performance incorrectly indicated that the IRI data supported CIBC's descriptions of Renaissance's performance.[114]

The facts were otherwise. The then-current IRI data flatly contradicted CIBC's representations about Renaissance's "successful launch" of flanker brands and reinvigoration of classic brands, and demonstrated the impropriety of its projections.[115]

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[111] *See* Part II.G.

[112] 64AA18145, 18151, 18156.

[113] *E.g.*, 48AA13517, 13563, 13571, 13576; 51AA14398, 14444, 14452, 14457; 64AA18156, 18159-60, 62.

[114] *Supra* nn.13-14 & accompanying text & Parts II.D-E.

[115] *See* Part II.D.

In the OM, CIBC also made affirmative statements in the form of projections that it knew were "squirrelly" and "padded."[116] As detailed above in Parts II.E, F & I, these false projections misled investors regarding Renaissance's existing and planned channel stuffing.

3. CIBC Falsely Described Management

The OM and the Registration Statement stressed management's capabilities and background.[117] These were half-truths. CIBC did not tell investors that Renaissance's highly-touted management was creating and distributing phony sales projections, intentionally stuffing the channel and had indicated that it viewed its securities-offering process as immoral.[118] Telling half the truth while endorsing a person's merits is actionable as negligent misrepresentation. *Randi W. v. Muroc Joint Unified Sch. Dist.* (1997) 14 Cal.4th 1066, 1081-85.

Thus, ample evidence supported the jury's finding of actionable misrepresentations by CIBC.

4. A Half-Truth Can Be As Misleading As An Outright Falsehood.

Negligent misrepresentation may be accomplished not only by an affirmative misrepresentation, but also by a misleading half-truth. *Whiteley v. Philip Morris, Inc.* (2004) 117 Cal.App.4th 635, 674-75 ("[H]alf-truths may constitute 'affirmative representations' which are 'false and misleading in light of defendants' . . . knowledge.'"); *Randi W. v. Muroc*

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[116] 3RA458; 19RT3971:15-3972:12, 3974:17-3975:19; 16RT3290:21-3291:2.

[117] 48AA13526-27, 13564, 13583; 51AA14410, 14445, 14464.

[118] *See* Part II.D.

Joint Unified Sch. Dist., supra, 14 Cal.4th 1066, 1082-3. *See also Prosser & Keeton on Torts* (5th ed. 1984) § 106, p. 738 ("half of the truth may obviously amount to a lie, if it is understood to be the whole"); *Roberts v. Ball, Hunt, Hart, Brown & Baerwitz* (1976) 57 Cal.App.3d 104, 111 (describing partnership as "general partnership" was actionable given defendant's undisclosed doubt about status).

The cases CIBC cites are not to the contrary. One predated the Supreme Court's 1997 *Randi W.* decision which endorsed the half-truth principle. Moreover, both cases dealt with alleged "implied representations" where, unlike our case, there was no misleading half-truth *on the subject. Wilson v. Century 21 Great W. Realty* (1993) 15 Cal.App.4th 298, 306 (house buyers relied on three statements as to foundation's condition – court found two statements did not impliedly indicate, or did not directly relate to, foundation's condition and third was not misleading); *Residential Capital v. Cal-W. Reconveyance Corp.* (2003) 108 Cal.App.4th 807, 827-29 (holding foreclosure sale is insufficient affirmative representation by "conduct" of sale's validity, particularly given conflicting regulatory scheme and complicated reasons for invalidity).[119]

B. Substantial Evidence Established CIBC's Duty To Disclose Material Facts To Plaintiffs.

Four separate bases in the record belie CIBC's argument[120] (as to the intentional nondisclosure claim) that Plaintiffs presented no evidence of a duty to disclose the truth.

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[119] Neither a conflicting regulatory scheme nor "misrepresentation-by-conduct" is involved here.

[120] AOB 36-37.

1. CIBC Acknowledged Its Duty To Disclose

CIBC essentially conceded its duty to disclose the full facts in the OM. Former CIBC employee Jeremy Back, who worked on the Renaissance deal, described at length CIBC's obligation to conduct a thorough due diligence review and to disclose all material facts of which it was aware.[121] He acknowledged that CIBC's extensive involvement in preparing the OM was due to its "expertise" and "experience," and that, before presenting an investment to investors, CIBC was obliged to do everything it could to make sure that the investment was "exactly" as represented, and that nothing material was omitted.[122]

While CIBC wants this duty to disclose to end with the first person whom it defrauds AOB 36-37, that is not California law. Common law fraud does not require privity. *Shapiro v. Sutherland* (1998) 64 Cal.App.4th 1534, 1548; *Lingsch v. Savage, supra,* 213 Cal.App.2d at 736; *see Small v. Fritz Cos.* (2003) 30 Cal.4th 167, 175 ("Fraud can be perpetrated by any means of communication intended to reach and influence the recipient.").

Under the doctrine of indirectly-communicated fraud, CIBC's duty to disclose extended to subsequent purchasers (such as Plaintiffs), because CIBC misrepresented facts in, and omitted facts from, its statements to its initial buyers intending or having reason to expect its deceit would be

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[121] 7RT1340:12-1342:15.

[122] 7RT1340:12-17, 1340:24-1342:15. To the extent that Back's testimony involved a legal conclusion as to "duty," his testimony was correct. CIBC had a "transactional relationship" with, and thus an admitted corresponding duty to, its immediate purchasers to reveal all material facts. *LiMandri v. Judkins* (1997) 52 Cal.App.4th 326, 226-37.

repeated to and acted upon by a class of others (here, secondary-market purchasers), including Plaintiffs.[123] *Shapiro v. Sutherland, supra*, 64 Cal.App.4th at 1548, 1550; *Geernaert v. Mitchell* (1995) 31 Cal.App.4th 601, 608; *Varwig v. Anderson-Behel Porsche/Audi, Inc.* (1977) 74 Cal.App.3d 578, 580-81; Restatement (2d) Torts § 533 & cmt. g.

This principle applies to nondisclosures, as well as to misrepresentations, since a fact intentionally kept from one buyer will almost certainly remain undisclosed to a future buyer, until an eventual owner suffers damage: "While an affirmative misrepresentation might not be repeated, a nondisclosure must necessarily be passed on." *Barnhouse v. City of Pinole* (1982) 133 Cal.App.3d 171, 192. In such cases, "it is the *subsequent* purchaser who is directly damaged by the initial nondisclosure," since the intermediate purchaser "neither suffers damage nor has knowledge to disclose." *Id.* (emphasis added). This rule does not extend the potential liability of vendors, it simply preserves it. *Id.* at 193.

Here, substantial evidence showed the connection between CIBC as the Notes' initial seller and Plaintiffs as later purchasers. Among other things, as part of its offering, CIBC *required* an immediate follow-on registration so that "substantially identical" Notes could be sold in the public aftermarket.[124] CIBC did so to enhance its own ability to sell the Notes in the first place.[125] Indeed, CIBC understood that secondary market

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[123] The jury was properly instructed on these matters (32AA9069-72), and CIBC has not appealed from those instructions.

[124] 48AA13631; 3RA472-475; 7RT1328:7-1329:5

[125] 8RT1435:28-1437:6.

support was an important part of its services.[126] These facts transfer CIBC's duty to its direct buyers (with their buyer/seller "relationship") further on to Plaintiffs, who were the ones ultimately damaged by the deceit.

2. Other Circumstances Imposed A Duty To Disclose

Neither a confidential nor fiduciary relationship is required to establish an affirmative duty to disclose material information in a commercial transaction. *Lingsch v. Savage, supra,* 213 Cal.App.2d at 735, 738. Other circumstances may suffice, including the elements with which the jury was instructed here:[127] where the defendant knows a material fact, knows that the plaintiff does not or cannot learn the facts, fails to disclose the fact and intends to induce reliance on the non-disclosure.[128] *Id.*

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[126] 9RT1753:21-1758:7 (CIBC understood that as "underwriter" with regard to Renaissance, it was expected to publish analyst reports on company), 1616:26-1617:1, 1652:5-1653:20 (continuing analyst reports important to investors and sometimes to issuers); 2RA241 (capital for after-market support), 242 (investor research), 203 (strong after-market performance).

[127] 23RT4503:23-4504:12. While not raising it as grounds for reversal, CIBC complains the trial court did not identify "duty to disclose" as a separate element in these instructions. AOB 37. This was not error. The instruction given was correct since its elements *define* circumstances in which a duty to disclose exists in non-fiduciary circumstances. *Lingsch v. Savage* (1963) 213 Cal.App.2d 729, 738. An additional "duty to disclose" element would have been redundant and confusing.

[128] *Wilkins v. Nat'l Broadcasting Co.* (1999) 71 Cal.App.4th 1066, relied on by CIBC, has special facts and is not to the contrary. The *Wilkins* plaintiffs *perpetrated* an investment scam. They sued journalists who secretly filmed the bogus sales pitch. On these facts, the court held there was no duty for the journalists to tell the plaintiffs that they were journalists with cameras. After all, these con artists willingly presented their sales pitch to "anyone who was interested." *Id.* at 1083. In finding no duty on these unusual facts, the *Wilkins* court recognized that other circumstances, such as those here, would give rise to a duty to disclose, including when a defendant has knowledge of material facts not known to plaintiff and when a defendant makes partial, incomplete representations. *Id.* at 1082.

3. CIBC Had A Duty To Speak Fully And Truthfully When It Chose To Speak At All

CIBC's duty of disclosure also arose as a matter of law when it made partial disclosures. When one chooses to speak, one must not only speak the truth, but must also *not withhold* facts that materially affect a proper understanding of the statements made. *Vega v. Jones, Day, Reavis & Pogue* (2004) 121 Cal.App.4th 282, 294 & n.9; *Randi W. v. Muroc Joint Unified School Dist.* (1997) 14 Cal.4th 1066, 1082-83; *Marketing West, Inc. v. Sanyo Fisher (USA) Corp.* (1992) 6 Cal.App.4th 603, 613; *Cicone v. URS Corp.* (1986) 183 Cal.App.3d 194, 201.

CIBC's duty to speak fully about the material facts (and its breach of that duty) was proven by evidence that it made misleadingly incomplete statements in a disclosure document (the OM), and then continued to make such statements in its analyst reports.[129]

CIBC's contrary contention was expressly rejected last year in *Vega, supra*, 121 Cal.App.4th at 292-294, a case in which the defendant had provided a "disclosure schedule" for a merger but failed to disclose knowledge of the deal's "toxic" nature. The court found that the defendant's incomplete "speaking" in the disclosure schedule allowed a fraud claim; no direct transactional relationship or other "independent duty to disclose" was required. *Id.* at 294. Here, CIBC did far more than omit a potential hazard from a disclosure schedule.

4. As An Underwriter, CIBC Had A Duty to Disclose

Because an underwriter occupies a special position in a security issuance and with the issuer, it has a duty to disclose the results of its due

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[129] *See* Parts II.D, E & G.

diligence investigation. *In re Donaldson, Lufkin & Jenrette Sec. Corp.* (Sept. 22, 1992) 1992 SEC Lexis 2422 at *20-21, *26; *Dannenberg v. PaineWebber Inc.* (9th Cir. 1995) 50 F.3d 615, 621, 625-26 & n.2 (underwriter's due diligence obligation and duty to disclose); *Chris-Craft Indus., Inc. v. Piper Aircraft Corp.* (2d Cir. 1973) 480 F.2d 341, 370 ("Prospective investors look to the underwriter – a fact well known to all concerned and especially to the underwriter – to pass on the soundness of the security and the correctness of the registration statement and prospectus."); *Sanders v. John Nuveen & Co., Inc.* (7th Cir. 1980) 619 F.2d 1222, 1227-8; *Escott v. BarChris Constr. Corp.* (S.D.N.Y. 1968) 283 F.Supp. 643, 696-97.

This duty extends to secondary market purchasers. *Lee v. Ernst & Young, LLP* (8th Cir. 2002) 294 F.3d 969, 976-77; *Joseph v. Wiles* (10th Cir. 2000) 223 F.3d 1155, 1159; *Hertzberg v. Dignity Partners, Inc.* (9th Cir. 1999) 191 F.3d 1076, 1079-80.

"Underwriter" includes anyone who "participates or has a direct or indirect participation in any [distribution of any security by an issuer], or participates or has a participation in the direct or indirect underwriting of any such undertaking." 15 U.S.C. § 77b(11); *S.E.C. v. Van Horn* (7th Cir. 1966) 371 F.2d 181, 188 ("participation" covers everyone who participates in distribution). Substantial evidence supported the jury's implied finding that CIBC was an underwriter.[130] As part of a "tied together" process, CIBC sold the private Notes in February 1997 and contractually obligated Renaissance to promptly arrange for their exchange for "substantially identical" public Notes through the filing of a Registration Statement that

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[130] 32AA 9118, 9120, 9134, 9136, 9205.

incorporated false information verbatim from the CIBC-prepared OM.[131] Unlike the banks in the cases it relies upon, CIBC participated in the Registration Statement's preparation.[132]

Moreover, in Exhibit 88 (another document CIBC omits from its brief and appendix), CIBC acknowledged to Renaissance's auditors that the OM might be "utilized by [investors] as a basis for their investment decisions" and represented that CIBC had undertaken a review of Renaissance "substantially consistent with the due diligence review process that [CIBC] would perform if this placement of securities were [a direct public offering] being registered pursuant to the Securities Act of 1933."[133]

To escape its duty to disclose, CIBC asserts that it was not an underwriter because "the initial private placement and later exchange offering" were not an integrated transaction. AOB 8 n.1. None of the cases CIBC cites suggests that an "initial purchaser" should have different common law disclosure duties than an "underwriter."[134] Moreover, unlike

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[131] *Supra* nn.20, 22 & 23. Neither Renaissance nor CIBC received additional proceeds from the registration (51AA14395), indicating it merely completed the initial offering.

[132] *Supra* n.22.

[133] 3RA459; 5RA886; 7RT1290:22-1292:25.

[134] *See* 3RA459; 13RT2448:16-2449:8. Indeed, two cases do not even involve registrations following private sales and therefore, ordinarily, no public security to "underwrite." *In re Enron Corp. Sec., Derivative & "ERISA" Litig.* (S.D. Tex. 2004) 310 F.Supp.2d 819, 863, 866 (whether offering memorandum was "prospectus" still fact question); *In re Hayes Lemmerz Int'l Inc. Equity Sec. Litig.* (E.D. Mich. 2003) 271 F.Supp.2d 1007 (contemplated exchange offering never occurred).

the present facts, these cases involved initial purchasers who were not involved in preparing a registration statement.[135]

In short, for several independently-sufficient reasons, substantial evidence supported CIBC's duty to disclose.

C. Substantial Evidence Established That CIBC's Misrepresentations And Omissions Were Material

CIBC asserts that its misrepresentations and nondisclosures were not material. In contesting this classic jury issue, CIBC fails to carry its heavy burden. *West Shield Investigations & Sec. Consultants v. Superior Court* (2000) 82 Cal.App.4th 935, 957; *Charpentier v. L.A. Rams Football Co.* (1999) 75 Cal.App.4th 301, 313 ("'court may [only] withdraw the case from the jury if the fact misrepresented is so obviously unimportant that the jury could not reasonably find that a reasonable man would have been influenced by it'").

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[135] *Am. High-Income Trust v. AlliedSignal* (S.D.N.Y. 2004) 329 F.Supp.2d 534, 542; *In re Safety-Kleen Corp. Bondholders Litig.*, (D.S.C., March 27, 2002) 2002 WL 32349819, *1 (following S.E.C. advice) and 27AA7864 (S.E.C. letter relying on lack of participation in registration); *In re Livent, Inc. Noteholders Sec. Litig.* (S.D.N.Y. 2001) 151 F.Supp.2d 371, 432.

Moreover, while *In re Livent decision* ("*Livent I*") prompted the other opinions CIBC relies upon (*Am. High-Income Trust*, 329 F.Supp.2d at 541-42; 27AA7864 (SEC letter)), CIBC fails to cite the follow-on *Livent II* ruling against CIBC itself. *In re Livent, Inc. Noteholders Sec. Litig.* (S.D.N.Y. 2001) 174 F.Supp. 2d 144, 157-58. As Livent's banker, CIBC acted as "initial purchaser" in a two-stage note offering with promised follow-on registration. The court denied a motion to dismiss Section 11 claims because it found it was "entirely possible" that CIBC participated in preparing or reviewing the registration statement based on plaintiffs' allegations of CIBC's sales of the registered notes to plaintiffs and other public investors, its "participation in Livent's fraud arising from its close, longstanding relationship with Livent, as well as its unique personal interest in the Note transactions." Here, Plaintiffs not only alleged CIBC's participation in the Registration Statement, they proved it. *Supra* n.22.

The jury could properly have determined that a reasonable investor would have cared about each of the following misrepresentations and omissions in assessing whether to invest in the Notes:

- The misrepresentation that Renaissance had viable, "reinvigorated" classic brands, or the omission that the classic brands were failing and that the IRI data revealed this;[136]
- The misrepresentation that Renaissance had "successfully launched" flanker brands, or the omission that the flanker strategy failed at its outset and that the IRI data revealed this;[137]
- The misrepresentation that Renaissance's financial statements reflected its results as it honestly understood them, or the omission that it was padding its projections and cooking its books;[138]
- The misrepresentation in the OM's projections, or the omission of Renaissance's channel-stuffing by the end of December 1996 and further planned channel-stuffing in March 1997;[139] and

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[136] 2RA332 (CIBC's roadshow highlights importance of representation regarding successful classic brands); 9RT1730:17-1731:23, 1732:21-1734:5; 10RT1810:16-1811:2; 12RT2258:11-2265:2; 2275:8- 2276:23, 2327:3-9; 14RT2689:11-28; 11RT2145:15-2147:7; 16RT3270:7-3271:4; 18RT3527:19-3528:15; 64AA18075, 18078, 18084 (almost every week lower than prior year), 18097-99 (brands declining), 18102.

[137] *Id.*; 12RT2272:4-23.

[138] 18RT3528:16-3529:17; 13RT2621:1-2622:23; 7RT1306:1-1307:16; 9RT1728:7-1730:1; 14RT2690:1-2691:2; 65AA18475-80; 66AA18655-7; 65AA18481-82. *See Marx v. Computer Sciences Corp.* (9th Cir. 1974) 507 F.2d 485, 492 (materiality of projection and related omissions is a jury question: "An earnings forecast is a shorthand description of the general financial well-being of a company; it creates an influential impression of the condition of the company . . . . [Under federal law], when an earnings forecast is made, such facts should be disclosed as are necessary to allay any misleading impression thereby created.").

- The misrepresentation that Renaissance's management was "highly experienced" with a "proven track record," or the omission of their lack of integrity and their shocking behavior.[140]

CIBC argues that its deceit could not have been material because the true facts were known when Plaintiffs purchased the Notes. In substance, this is an argument about justifiable reliance, not about materiality. These contentions are dealt with below in Part V.F, where Plaintiffs show substantial evidence of justifiable reliance.

CIBC makes only limited "materiality" contentions that are not of this sort. First, in its attempt to render the "Miracle March" fraud immaterial, CIBC makes much of the fact that offering memoranda often do not provide monthly results. AOB 27, 50-51. This assertion does not make it less material that the OM presented an inflated six-month projection with an imbedded month that CIBC knew was "squirrelly," and which represented a plan to stuff further the already clogged channel.[141]

CIBC also asserts that the IRI data was immaterial because, if Plaintiffs truly thought it was material, they would have asked for it.

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[139] *See* Parts II.D & II.F.1.

[140] 2RA341; 48AA13526-27, 13564, 13583; 51AA14410, 14445, 14464; 6RT1132:27-1133:20; 12RT2212:12-2213:18; 14RT2691:3-21; 13RT2468:15-2469:28; 9RT1734:6-1735:16; 10RT1809:13-1810:15; 18RT3529:18-3530:5.

[141] 3RA458; 13RT2445:1-13; 8RT1415:19-1416:3. Despite CIBC's assertion, Plaintiffs did not contend March's projections exceeded the entire Christmas season's sales, but that, as Dalton recognized in Exhibit 75, the projected March sales and EBITDA were not credible, particularly because they exceeded any Christmas-season *month*. (*Id.*) Although Deloitte & Touche audited the 10-K, it missed the fraud and settled Plaintiffs' resulting claim with a payment of $8.25 million. (6RT1135:9-11; 1RA002.)

AOB 47. The evidence, however, demonstrated that the subscription IRI data cost Renaissance $2 million, and that Plaintiffs did not think it was reasonable to pay that high a price to obtain information that was already described in CIBC's OM and analyst reports and that should have been described further in the OM and analyst reports if the IRI data was materially inconsistent with those documents' other representations.[142]

CIBC also contends that its deceit regarding the "squirrelly," "padded" projections became immaterial when Renaissance released actual results for the same period. AOB 49. These subsequent financial statements, however, were consistent with the OM's phony projections.[143] The updates never corrected the projections' basic dishonesty: that the goods Renaissance shipped (and booked as sales) had not sold (and could never have reasonably been expected to sell) at retail and inevitably would be returned in vast quantities, leading to massive returns that eventually would come back to fill the company's warehouses to the bursting point.[144]

Finally, CIBC seeks to dodge the larger implications of Bonoma's Weasel documents, arguing here, as it unsuccessfully did to the jury, that "the long-dead CEO's offensive sense of humor" was immaterial in 1998.[145] But CIBC's "parodies" gloss on the Weasel documents is not the only

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[142] 9RT1731:24-1732:20; 8RT1419:11-27; 12RT2325:24-25; 19RT3768:23-3770:13.

[143] *Supra* n.55.

[144] *See* Part II.D.3 & n.83.

[145] AOB 3, 24; 8RT1449:1-25; 16RT3224:4-3230:27.

inference that could be drawn.[146] Plaintiffs properly used the documents to show that CIBC was on notice of Bonoma's state of mind as well as his disturbing comments about Renaissance's growth story and financials—prior to the OM and prior to the Registration Statement and analyst reports. Whether or not they represented a tasteless attempt at humor, the Weasel Parades indicated a cavalier attitude toward the process of truthfully describing a business to potential investors, which should have made (and did make) CIBC suspicious of Renaissance's financial presentations.[147] Moreover, management integrity and stability is material, and the Weasel Parades indicated a lack of these characteristics.[148] Although Bonoma died prior to Plaintiffs' purchases, Renaissance's "squirrelly" numbers were the company's product, not his alone.[149] Indeed, as Dalton himself recognized

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[146] The trial court circumscribed the usage of the "Weasel" documents. (26AA7630 ("admissible for non-hearsay purposes to give context to CIBC's alleged failure to reveal or explain Mr. Bonoma's writings to future investors"; "jury can decide whether the documents are pure parody and satire or whether they should have raised questions that CIBC did not address"); 32AA9019-9022 (jury instruction).) Plaintiffs did *not*, as CIBC contends, use the documents to prove the truth of the matters therein (*e.g.*, that CIBC's representatives were "drooling idiot savants" or that CIBC was the "Canadian Mafioso"). The second Weasel Parade contained a number of derogatory comments about women and certain ethnicities, but these statements were redacted from the exhibit shown to the jury. 64AA18068.

[147] 26AA7630 (trial court: "It is a jury issue as to whether or not CIBC conducted proper due diligence, and whether they properly disclosed what they knew, and these documents should be seen by the jury on that issue"); 3RA458 (Dalton suspects "padded" projections after first Weasel Parade).

[148] 9RT1734:6-1735:16; 10RT1809:13-1810:15; 12RT2212:12-2213:18; 18RT3529:18-3530:5. *See* Parts V.A.3-4.

[149] Indeed, upon Bonoma's death, CIBC issued an analyst report explaining that Renaissance's management would continue to "achieve [his] standard" and "carry on [his] legacy." (64AA18172-73.)

in Exhibit 75, the "padded" data originated with other members of Renaissance's management.[150]

Again, substantial evidence supports the jury's finding that CIBC's misrepresentations and omissions were material.

D. Substantial Evidence Established That CIBC Had The Requisite Mental State

CIBC contends it did not know the contents of the January 27, 1997 IRI report before distributing the OM on or after February 4, 1997. Based on this assertion, CIBC apparently further contends that it did not have the mental state necessary for Plaintiffs' common law claims. AOB 51-52. Neither contention is correct.

Plaintiffs' intentional nondisclosure claim required that CIBC "knew of the [undisclosed] fact and knew that it was unknown to or beyond the reach of plaintiff."[151] Plaintiffs' negligent misrepresentation claim required a somewhat lesser mental state: "defendant made the representation without any reasonable ground for believing it to be true."[152] The jury implicitly found these requirements were satisfied.[153]

Having failed to identify or acknowledge the proven omissions and misrepresentations, CIBC contests these findings in a conclusory manner. Specifically, CIBC only contests its knowledge of the IRI data. It does not contest its mental state with regard to any other misrepresentations or omissions. This failure should dispose of the argument.

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[150] 3RA458.

[151] 32AA09050.

[152] 32AA09054.

[153] 32AA09205 (finding liability on both claims).

Moreover, CIBC's argument fails because substantial evidence supported its knowledge of the IRI data, and, even without such knowledge, substantial evidence satisfied both claims' mental-state requirements. First, substantial evidence showed that CIBC knew the IRI data's content.[154] That is how Dalton knew, before the OM's distribution, that Renaissance had suffered a "poor third quarter."[155] In any event, the jury could properly have inferred that CIBC had reviewed the IRI data from its ready availability, from CIBC's knowledge of its importance and from Dalton's knowledge that Renaissance was resorting to "padded" projections to produce tolerable year-end numbers in promoting the Notes.[156]

More broadly, substantial evidence showed that CIBC did not have reasonable grounds for believing its misrepresentations about Renaissance to be true and that CIBC knew of undisclosed, material facts.[157] *See Hart v. Browne* (1980) 103 Cal.App.3d 947, 958 (falsity of misrepresentation creates triable issue of knowledge of falsity). Accordingly, the jury properly found that both claims' mental-state requirements were satisfied.

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[154] *See* Part II.D.2.

[155] *Id.*.

[156] *See* Part II.D.1-3; 9RT1621:6-1623:17 (IRI data helps detect channel-stuffing: "You can produce good numbers at the company by stuffing the shelves, but at the end of the day, the IRI data is what will tell you what's actually being sold out the door.").

[157] See Part II.D.2-4, II.E, II.F.2., II.G, V.A, V.C.

E. Substantial Evidence Established That CIBC Intended To Induce Reliance By Secondary-Market Investors

CIBC contends its falsehoods were not intended to influence secondary-market investors who purchased the Notes after they became publicly tradable. AOB 34.

Intent, however, is a factual issue for the jury. *Miller v. Fairchild Industries, Inc.* (9th Cir. 1989) 885 F.2d 498, 510 ("fraud is a question of fact involving determinations of intent and evaluations of credibility properly resolved by the jury"). In fraud cases, intent "denotes not only those results the actor desires, but also those consequences which he knows are substantially certain to result from his conduct."[158] *Schroeder v. Auto Driveaway Co.* (1974) 11 Cal.3d 908, 922; *People ex rel. Lockyer v. R.J. Reynolds Tobacco Co.* (2004) 116 Cal.App.4th 1253, 1264.

1. The Substantial Evidence Of Intent

Substantial evidence established CIBC's intent to induce reliance on its omissions and misrepresentations. Notwithstanding its knowledge that the OM painted a false picture of Renaissance,[159] CIBC directed investors to rely on the OM and only on the OM.[160] Thus, CIBC cannot contest that it intended to induce reliance by the initial investors -- investors who, themselves ignorant of the truth, could only be expected to sell the Notes to Plaintiffs and other secondary market investors without revealing the truth.

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[158] Intent is determined by the jury based on inferences drawn from the circumstances surrounding transactions or events, as well as the relationships and interests of the parties. *Hart v. Browne* (1980) 103 Cal.App.3d 947, 957.

[159] *Supra* Part V.D.

[160] 48AA13515 ("Each person receiving this [OM] represents that such person's investment decision is based solely on this [OM] . . . .").

Moreover, to aid its initial sale, CIBC intended that there would be a secondary market for publicly-tradable Notes, and therefore obtained Renaissance's commitment that it would make the necessary SEC filing.[161] Once the private Notes converted to identical, publicly-tradable notes,[162] CIBC had to expect that secondary-market investors would rely, as they routinely do, on the OM that gave birth to the Notes.[163]

Indeed, long after the initial offering, CIBC provided copies of the OM to prospective investors (including Plaintiff TCW) to induce them to invest in the secondary market.[164]

Even if this OM-related evidence were insufficient, CIBC's analyst reports, as well as the Registration Statement which CIBC participated in preparing (and which reiterated the OM's misrepresentations and omissions[165]), were plainly targeted at secondary market purchasers in the public market that began after the May 1997 registration.[166]

These facts permitted the jury to conclude that CIBC intended secondary-market purchasers to rely on the information it was circulating. *See, e.g., Vega v. Jones, Day, Reavis & Pogue, supra,* 121 Cal.App.4th at 295 (acquiring company's law firm that provided "sanitized" disclosures to

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[161] *Supra* n.20.

[162] *Id.*

[163] 48AA13511; 13523; 13631-32; 12RT2388:11-2391:26; 13RT2448:19-2449:5.

[164] 13RT2567:13-2568:15 (CIBC sent TCW a copy of the OM in March 1998).

[165] *Supra* n.23.

[166] 12RT2250:13-2251:11, 2270:6-11; 4RA701, 709; 65AA18479.

acquired company in connection with merger could be liable to stockholder who allegedly relied on nondisclosures when exchanging his stock).

2. CIBC's Authorities Are Not To The Contrary.

CIBC's reliance on *Bily v. Arthur Young & Co.* (1992) 3 Cal.4th 370, is misplaced. *Bily* merely held that an auditor is exposed to third-party liability for *negligent misrepresentation* only where the auditor "intends to supply the information for the benefit of one or more third parties in a specific transaction or type of transaction identified to [it]." *Id.* at 392. This aspect of *Bily*, however, expressly does not apply to intentional deceit claims. *Id.* at 415. So, CIBC's argument immediately fails with regard to the intentional nondisclosure verdict.

Even as to Plaintiffs' negligent misrepresentation claim, *Bily* is inapplicable. The decision was expressly based on public policy grounds regarding limits on the liability of public auditors. No case has extended *Bily* to limit an investment bank's liability to investors who rely on an offering document or analyst report, nor has any case interpreted *Bily* as requiring that after-market purchases be treated as a different "transaction."

Indeed, *Bily*'s logic does not work for an investment bank. A transaction-intent requirement makes sense where the supplier of information is an auditor working for a company that needs to confirm its own books. Such an auditor generally undertakes no duty to third parties, except where it knows its report will be used by third parties in a specific transaction, like where the auditor's client specifically requests the report for the purpose of obtaining a bank loan. Unlike an auditor, however, an investment bank prepares offering documents and reports precisely so that they can be relied on by investors, not by the issuer. For this reason, an investment bank owes a duty to investors to exercise reasonable care and to

conduct a reasonable investigation. (*See* Part V.B.4.) This duty is wholly inconsistent with CIBC's contention that it should be treated like an auditor that only owed duties to its client.

Even if *Bily* somehow applied beyond the auditor context, it still would not apply here. CIBC prepared and used deceptive information to sell the Notes in an integrated transaction deliberately structured to create a public market shortly after their issuance. Public aftermarket sales were specifically identified in the distribution scheme constructed by CIBC, and Plaintiffs are part of the precise class of purchasers targeted by CIBC's deceit. So even under *Bily*, Plaintiffs showed intent to induce reliance.

While it is cited by CIBC, *Anderson v. Deloitte & Touche LLP* (1997) 56 Cal.App.4th 1468, actually supports Plaintiffs' position. AOB 35. In reviewing a negligent misrepresentation claim, the court held that a triable issue of fact existed regarding a defendant's "intent to induce reliance" in two partnerships. *Id.* at 1478-1479. The court based its holding on evidence, like that here, showing that the defendant knew its reports would be included in an OM and communicated to potential investors in those partnerships. *Id.* at 1478.

F. Substantial Evidence Established Justifiable Reliance

Justifiable reliance is a jury question unless "the undisputed facts leave no room for a reasonable difference of opinion." *West Shield Investigations & Sec. Consultants v. Superior Court, supra*, 82 Cal.App.4th at 957; *Blankenheim v. E.F. Hutton & Co.* (1990) 217 Cal.App.3d 1463, 1475; *Hart v. Browne, supra,* 103 Cal.App.3d at 959.

1. Plaintiffs Reasonably Relied On The OM

Subject to narrow exceptions discussed below, reliance is justifiable if the misrepresentation or omission was material. *Charpentier v. L.A.*

Rams Football Co., supra, 75 Cal.App.4th at 312-13; Restatement (2d) Torts §§ 537-538; *Engalla v. Permanente Med. Group, Inc.* (1997) 15 Cal.4th 951, 976-77. As shown above in Part V.C, substantial evidence demonstrated the omissions and misrepresentations were material.

Additionally, Plaintiffs reasonably relied on the OM because it was the most recent third-party-tested (specifically, CIBC-tested) document analyzing Renaissance's operations, brands, plans and management.[167]

2. Plaintiffs' Justifiably Relied On CIBC's Analyst Reports

Plaintiffs also justifiably relied on CIBC's analyst reports because they thoroughly examined Renaissance and because CIBC prepared them while it had special access through its role as Renaissance's financial advisor and through Dalton's attendance at board meetings.[168]

CIBC contends that, as a matter of law, reliance on the analyst reports was unreasonable because Plaintiffs purportedly purchased when the reports said "HOLD" and did not purchase when the reports said "BUY." AOB 43. However, in addition to such (arguably "opinion") summary recommendations, each report included detailed factual presentations about Renaissance.[169] Plaintiffs reasonably relied on those factual assertions.[170]

Goodman v. Kennedy (1976) 18 Cal.3d 335, 345, 347, does not help

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[167] 14RT2824:10-2824:25; 18RT3516:16-3517:5; 10RT1252:11-1254:1.

[168] 10RT1846:5-16; 12RT2256:5-2257:1; 13RT2624:9-20; 3RA347 (Dalton memo regarding October 1997 Renaissance board meeting).

[169] *Supra* n.60; 12RT2269:28-2272:16.

[170] 10RT1846:5-16, 1909:18-26; 12RT2250:13-2257:1, 2269:28-2272:16; 9RT1717:3-1719:9; 18RT3515:1-7, 3516:6-11, 3518:23-3520:18.

CIBC escape its analyst reports. In that case, buyers sued a seller's attorney *solely for omitting* information in a conversation with the buyers' attorney. Unlike in *Goodman*, the evidence here showed CIBC's analyst statements included misleading statements, as well as nondisclosures. Moreover, the relationship between CIBC, as an investment bank repeatedly touting a security, and Plaintiffs, as purchasers, is unlike the relationship between a seller's attorney and a buyer. *Id.* at 345 (one cannot reasonably draw inference from counter-party's lawyer's silence).

3. CIBC's Statements Were Not Stale

CIBC contends that Plaintiffs could not reasonably rely on the OM and the analyst reports because they were at least several months old. Misconstruing the use of the term "immediate" in *Alliance Mortgage Co. v. Rothwell* (1995) 10 Cal.4th 1226, 1239, CIBC argues that closeness in time is essential. AOB 38, 43. Nothing in *Alliance Mortgage*, however, suggests that justifiable reliance is automatically cut off by the passage of time. Rather, the court used the words "immediate cause" only to indicate that the Plaintiff had to "actually rely" on the misrepresentation, not to indicate anything about when such reliance is justifiable.[171] *Id.*

An Ohio court recently made clear that the passage of months is not a legal bar to reliance. *Federated Management Co. v. Coopers & Lybrand* (2000) 137 Ohio App.3d 366, 396-97. There, the court rejected defendant's argument that reliance on an offering document was unreasonable, as a matter of law, for after-market purchasers one year after initial distribution:

> There is little case law on the point at issue here – how long a person may rely on a prospectus when purchasing a security.

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[171] The case *Alliance Mortgage* relies on clarifies this point. *Spinks v. Clark* (1905) 147 Cal. 439, 444.

> While the trial court may have been correct that the area of securities is a fast-changing market and, therefore, investors are provided with 10-[K]'s, 10-Q's and annual reports throughout the year, it does not necessarily follow that all information in a one-year old prospectus automatically becomes immaterial.

Id. at 396. Analyzing facts similar to those here (testimony as to actual reliance, that reliance on offering document is standard when "re-visiting" a company, and that an offering document together with subsequent SEC filings "gives an overall picture of the company"), the court concluded that justifiable reliance was a jury issue. *Id.* at 396-97.

4. Limited Intervening Disclosures Did Not Vitiate CIBC's Fraud

CIBC argues that intervening disclosures made Plaintiffs' reliance on CIBC's misrepresentations and omissions unreasonable as a matter of law. AOB 47-49. None of the intervening disclosures, however, revealed the full truth.[172] This left it to the jury to decide whether Plaintiffs acted reasonably. *Engalla v. Permanente Medical Group, Inc., supra*, 15 Cal.4th at 977, 979 (factfinder can infer reliance from materiality, absent evidence "conclusively rebutting reliance"). While the interim disclosures confirmed that Renaissance's "business environment" had changed, and that it would default on Note interest payments,[173] they did not reveal the full picture.[174]

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[172] 15RT2975:28-2977:5; 14RT2689:11-2691:21; 9RT1728:7-1735:16; 10RT1806:16-1811:2; 12RT2257-65; 18RT3527:19-3530:5. *See also* 17RT3465:28-3467:7, 3485:22-3487:8, 3526:14-3527:16; 9RT1736:13-1737:16, 1739:2-1740:15; 13RT2622:27-2623:26; 12RT2278:16-2279:10; 18RT3523:18-3524:4, 3625:18-28, 3627:24-3628:7.

[173] For example, the auditor's "going concern" qualification (AOB 20) only meant that Renaissance could not continue in business if it had to make the scheduled Note payments. (13RT2605:28-2607:2, 2609:8-2610:15.)

They did not reveal the intentionally-inflated historical sales revenue, the destruction of brand equity through channel-stuffing and the brands' systemic failures. None of this was revealed by, for example, the February 1998 press release stating that Christmas 1997 was "the second holiday season in a row in which the mass market fragrance industry underperformed relative to industry expectations," and that Renaissance had to re-examine its business.[175] This was particularly so because this press release was accompanied by a misleading statement that, even with the new business environment, Renaissance "believe[s] that our long term strategy will be successful, but the way we execute that strategy must change."[176] In reviewing this press release, Plaintiffs concluded that it did not alter the basic "story" promoted by CIBC, that Renaissance had considerable value, successful brands and a well-managed business.[177]

Statements like those in the press release were held insufficient to defeat "channel stuffing" fraud claims in the recent *Friedman v. Rayovac Corp.* (W.D. Wis. 2003) 295 F.Supp.2d 957, 990 (citations omitted, emphasis added):

> I cannot conclude that an advisement regarding "competitive market factors" and "changes in our industry or the economy" would effectively put an investor on notice of *the risk of substantially decreased demand resulting from channel stuffing*. Market factors and change in the economy are

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[174] While CIBC showed the jury a notation in Pacholder's file saying, "I would not lend $1 to this co," CIBC never identified the note's author or its timing, necessarily minimizing its import. (18RT3597-3601)

[175] 64AA18020-21.

[176] 64AA18021.

[177] 18RT3517:24-3518:22, 13RT2528:19-2529:13.

> external sources of change over which defendants would have little control. The same cannot be said for selling a year's worth of product to a customer in one quarter in order to create the appearance of growth.[178]

Moreover, to the extent setbacks were disclosed, their impact was negated by CIBC's follow-on statements. Thus, in CIBC's February 20 analyst report, it did not disclose the failure of Renaissance's brands nor its cooked financials. Instead, at a price of $55, CIBC indicated the Notes were a "hold."[179] CIBC also reaffirmed that continuing profitability was expected: "[for the next fiscal year,] [i]f our estimates are correct they could imply a run-rate EBITDA in the $21 million range," perhaps higher.[180]

Thus, while (as CIBC points out) the February 3, 1998 press release caused TCW analyst Shawn Bookin to conclude that Renaissance was "very sick" and that its real operating results and prospects were "very difficult to assess,"[181] and to initially conclude that there might have been misrepresentations, the release did not reveal to him the truth of the stuffed

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[178] The same court later determined the channel stuffing allegations did not meet the rigorous pleading particularity requirements under the Public Securities Litigation Reform Act, but only because the plaintiff had not identified whether the channel stuffing took place in a relevant time period. *Friedman v. Rayovac Corp.* (W.D. Wis. 2003) 291 F.Supp.2d 845, 850-51.

[179] 4RA703.

[180] 4RA705; *see also* 18RT3542:5-28.

[181] 65AA18468, 184771, 18473.

channel and systemic brand failures.[182] While Bookin thought the release revealed "the full extent" of the problems, only later did he and Plaintiffs collectively learn that this disclosure was "just the tip of the iceberg."[183]

CIBC, moreover, omits the rest of the story. Although Bookin suspected that Renaissance had been misrepresenting reality, his superior reasonably concluded that Bookin did not have the facts to justify his suspicions and was "over-reaching."[184] Indeed, these TCW employees specifically recognized that estimated returns are always just that, an estimate, and actual results will vary, sometimes significantly, so a retailer's disclosure that returns have been higher than expected is not a revelation of fraud, let alone one of intentional channel stuffing.[185] Nothing indicated deliberate deceit, and TCW's final memo reflected that judgment.[186] Bookin and TCW concluded that Renaissance should be

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[182] In its Statement of the Case, CIBC refers to various other matters that arguably might be related to justifiable reliance. CIBC, however, does not embody those references in an affirmative argument. Nonetheless, Plaintiffs note that, even as characterized by CIBC, the referenced Chanin reports (AOB 19-20) would only have confirmed Plaintiffs' knowledge that Renaissance was unlikely to pay its debts when due. Moreover, as to Chanin's April 1998 report, CIBC states that "at Plaintiffs' request [Chanin] had been given unrestricted access to Renaissance's financial information." AOB 19. In support, CIBC cites only the report itself, which provides no support. Indeed, the trial testimony was to the contrary – Chanin prepared its April report before Plaintiffs hired Chanin, and prepared both its April and June reports based on publicly available information. (18RT3699:23-3701:10, 3695:23-3696:8; 14RT2878-86.)

[183] 12RT2268:21-2269:7; 13RT2591:15-22.

[184] 13RT2590:16-2591:28.

[185] 13RT2589:8-2592:27; 12RT2266:19-2268:3, 2269:11-27.

[186] *Id.*

valued by adjusting its prior financial statements by the amounts indicated in the February disclosures, just as CIBC had done in its analyst reports, and that the Notes were worth more than their $50 price.[187] After all, before TCW's first purchase, CIBC itself had orally told Mr. Bookin's superior the Notes' price had fallen unduly, while omitting the true facts.[188]

The material facts remained concealed despite the interim disclosures.[189] The jury therefore properly concluded that Plaintiffs' reliance was reasonable despite those disclosures.

5. CIBC's "Disclaimers" Did Not Immunize Its Deceit

CIBC also incorrectly asserts that, as a matter of law, the OM's disclaimers barred justifiable reliance on its representations. Disclaimers, however, are ineffective where, as here, liability is based on intentional nondisclosure.[190] *See Lingsch v. Savage, supra*, 213 Cal.App.2d at 742-43; *Kline v. First W. Gov't Sec.* (3d Cir. 1994) 24 F.3d 480, 489.

Moreover, while disclaimers may be relevant as to issues of negligent misrepresentation, they do not preclude justifiable reliance as a matter of law. *E.H. Morrill Co. v. California* (1967) 65 Cal.2d 787, 792-94; *Warner Constr. Corp. v. City of L.A.* (1970) 2 Cal.3d 285, 294-95; *Danzig v. Jack Grynberg & Assocs.* (1984) 161 Cal.App.3d 1128, 1137-39

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[187] 65AA18465, 18470-71;12RT2251:18-2257:1; 13RT2517:27-2518:10, 2530:22-2531:8; 15RT 2953:15-2954:9, 2955:16-21, 2984:28-2985:5.

[188] 10RT1811:3-1813:12.

[189] *Supra* Part II.H-J.

[190] This rule is consistent with the statute barring contracts exempting one from fraud liability. Civil Code § 1668; *Smith v. Rickards* (1957) 149 Cal.App.2d 648, 653-54; *see also* Corp. Code § 25701 (barring "condition, stipulation or provision" waiving compliance with securities law).

(rejecting sufficiency-of-evidence challenge: "It is well established that a party to an agreement induced by fraudulent misrepresentations or nondisclosures is entitled to rescind, notwithstanding the existence of purported exculpatory provisions contained in the agreement.").

The only exception is for pinpoint disclaimers calling into question the reliability of specific misrepresentations. *See Wunderlich v. California* (1967) 65 Cal.2d 777, 786 (pinpoint disclaimer in paragraph containing asserted warranty).[191] CIBC points to no such disclaimers here, and, even if it had, pinpoint disclaimers are ineffective with regard to matters peculiarly within defendant's knowledge.[192] *Warner Theatre Assocs. Ltd. Partnership v. Metropolitan Life Ins. Co.* (2d Cir. 1998) 149 F.3d 134, 136.

Here, the trial court appropriately determined that CIBC was not immunized from deceit claims by any of the referenced "disclaimers" (some of which do not "disclaim" anything):

(1) CIBC cites a provision stating that the OM's delivery or sales under it do not imply that its information is correct after February 3, 1997. AOB 39; 48AA13515. This provision merely meant that subsequent events might change the OM's "complete and accurate picture" of Renaissance as

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[191] *See also Kline v. First W. Gov't Sec., supra,* 24 F.3d at 489-90 (even under inapplicable federal "bespeaks caution" doctrine, "disclaimers must relate directly to that on which investors claim to have relied"); *Ron Greenspan Volkswagen, Inc. v. Ford Motor Land Dev. Corp.* (1995) 32 Cal.App.4th 985, 992 ("integration" or "merger" clauses do not bar reliance on oral misrepresentations that preceded a written document).

[192] This rule addresses situations where plaintiffs, as here, would have faced high costs in determining a representation's truth or falsity. *Warner Theatre Assocs. Ltd. Partnership v. Metropolitan Life Ins. Co., supra*, 149 F.3d at 136; and *supra* nn.13 & 141 (expensive IRI data).

of February 3.[193] The provision does not suggest, as CIBC contends, that the OM could be considered only on February 3, 1997. Indeed, this contention is nonsensical, since CIBC did not distribute the OM until February 4.[194] Warning that facts may change, as CIBC also did in its analyst reports, does not immunize a defendant from liability for misrepresenting those facts. *Wade v. Industrial Funding Corp.* (N.D. Cal., Aug. 30, 1993) 1993 U.S.Dist. Lexis 21245, *11-12 ("boilerplate" disclaimer that changed circumstances could have "material adverse effect" does not defeat reasonable reliance); *Winn v. McCulloch Corp.* (1976) 60 Cal.App.3d 663, 670-71 (statement that "specifications and performance [are] subject to change without notice" does not defeat justifiable reliance).

(2) CIBC relies on the OM's confidentiality and "material nonpublic information" clause, contending that it precludes justifiable reliance because reliance would have violated federal securities laws. AOB 41. CIBC does not explain how relying on information *omitted* from the OM could constitute reliance on nonpublic information. CIBC also fails to explain how reliance on false statements in a document designed to stimulate sales of a security could result in a securities violation by the victim. Moreover, CIBC has not identified a single OM representation that was both true and still confidential when Plaintiffs invested. Prior to Plaintiffs' purchases, the information in the OM had been widely

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[193] 12RT2392:2-16; 16RT3157:15-3158:5, 3165:3-24 ("complete and accurate"); 11RT2068:25-2069:2, 2060:2-17, 18RT3562:25-3563:1, 20RT3991:25-3993:1; 21RT4148:11-22; *see also* 48AA13712 (neither delivery of nor any sale made under OM should create implication that there has been no change in Company's affairs since February 3).

[194] 4RA722; 8RT1562:4-23; 12RT2390:26-2391:26; 7RT1253:7-1254:1.

disseminated: the draft OM was broadly distributed;[195] the Registration Statement had publicly reiterated almost the entire OM;[196] and even the OM's projections, about which CIBC made much ado during trial,[197] had been publicly released.[198]

(3) CIBC also cites the OM's statement that it was "prepared by [Renaissance] solely for use in connection with this Offering." This statement is not a pinpoint disclaimer of any particular representation. Perhaps more fundamentally, CIBC clips this phrase out of its context as part of yet another provision emphasizing that the OM's contents might be confidential.[199] As its context makes clear, the language CIBC excises is merely part of this repeated, but nonetheless inapplicable, restriction, not a separate restriction.[200] Indeed, substantial evidence established that CIBC intended the OM to be used for purposes beyond the initial offering, including influencing secondary market purchasers, and that it was used for

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[195] 8RT1556:11-1559:5; *Compare* 4RA503-700 (widely circulated draft OM) *with* 48AA13511-13712 (final OM).

[196] 7RT1247:21-28.

[197] 7RT1234:7-1235:2, 11RT2061:11-27, 16RT3173:25-3174:2.

[198] 19RT3786:3-3788:13.

[199] 48AA13515.

[200] 48AA13515. Despite CIBC's citation, *Anderson v. Deloitte & Touche, supra,* 56 Cal.App.4th 1468, does not augment this provision or the prior ones. The decision does not concern a time restriction. Nor does it say a plaintiff cannot justifiably rely on a document "confined to another transaction." *Anderson* instead establishes the unremarkable proposition that a class action cannot proceed on behalf of investors in two partnerships who were not provided the allegedly fraudulent document (which related to different partnerships), while the case could proceed on behalf of investors who did receive and rely on it. *Id.* at 1479.

such purposes. One year after the initial offering closed, CIBC sent the OM to TCW for consideration of an investment in the Notes.[201]

(4) CIBC relies on the following disclaimer:

> [Recipient acknowledges] that (i) such person has been afforded an opportunity to request from [Renaissance] and to review, and has received, all additional information considered by it to be necessary to verify the accuracy of or to supplement the information contained herein; (ii) such person has not relied on the Initial Purchaser or any person affiliated with the Initial Purchaser in connection with its investigation of the accuracy of such information or its investment decision; and (iii) no person has been authorized to give information or to make any representations concerning [Renaissance] or the Notes other than as contained herein and, if made, such other representations should not be relied upon as having been authorized by [Renaissance] or the Initial Purchaser.[202]

But CIBC admitted at trial that this disclaimer did not mean investors could not rely on the OM, and instead directed investors where to turn if seeking further information.[203] Indeed, CIBC fails to mention that the next paragraph expressly told prospective investors to rely on the OM:

> Each person receiving this [OM] represents that such person's investment decision is based solely on this [OM] and that such person is not relying on any other information it may have received from the Company, the Initial Purchaser or any other person. (48AA13515).

CIBC also omits the facts contradicting their broad reading of the disclaimer: the OM's cover prominently displays CIBC's name; the disclaimer specifically notes that the "Initial Purchaser" (CIBC) authorized

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[201] *Supra* n.164.

[202] 48AA13515.

[203] 16RT3169:27-3170:23, 3172:7-20; 19RT3888:8-24.

the OM's representations; CIBC had been intimately involved in the OM's preparation; and CIBC knew its imprimatur was important to investors.[204]

Beyond its factual failings, CIBC's contention is also legally untenable. The law disregards an author's attempt to disclaim authorship, to disclaim the existence of any representations, or to disclaim liability by obtaining plaintiff's commitment to investigate independently. *Gabriel Capital, L.P. v. NatWest Fin., Inc.* (S.D.N.Y. 2000) 94 F.Supp.2d 491, 501-502 (initial purchasers cannot use disclaimer to avoid responsibility as authors when OM's cover lists them as initial purchasers and when they distributed it to plaintiffs); *Danzig v. Jack Grynberg & Assocs., supra,* 161 Cal.App.3d at 1137-38 (ineffective disclaimer of any representations); *City of Salinas v. Souza & McCue Constr. Co.* (1967) 66 Cal.2d 217, 224 (reliance still "question of fact" notwithstanding clause representing that plaintiff had undertaken full examination and inspection of all relevant matters), *rev'd on other grounds, Helfend v. Southern Cal. Rapid Transit Dist.* (1970) 2 Cal.3d 1; *Smith v. Rickards, supra,* 149 Cal.App.2d at 653-54 (reliance not precluded by clause disavowing reliance). *See also Kline v. First W. Gov't Sec., supra,* 24 F.3d at 489-90 (potentially efficacious disclaimer would need to disclose that defendant knew represented facts were not true and that document "was a sham").

(5) CIBC quotes snippets from an OM disclaimer (and a similar analyst report disclaimer) purporting to withhold assurance of accuracy or completeness and advising investors to rely on their own examination of

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[204] 48AA13511, 8RT1568:5-1570:23, 1572:22-1576:12; 9RT1641:21-1642:14, 1650:6-1652:16, 11RT2187:6-2188:27.

the merits and risks.[205] Once again, CIBC ignores both facts and law. For example, it fails to disclose that the preface to the snippets states that the OM information was obtained from Renaissance and other sources, thus implying an honest effort by CIBC to investigate and present the true facts.[206] *Kline v. First W. Gov't Sec., supra,* 24 F.3d at 489. It also ignores evidence that such clauses are customarily understood as disclaiming only honest errors made notwithstanding due diligence.[207]

But even if, despite the facts, this disclaimer could be read as broadly as CIBC would like, it does not preclude justifiable reliance. *See, e.g., Northwest Bank & Trust Co. v. First Ill. Nat'l Bank* (8th Cir. 2003) 354 F.3d 721, 725-26 (rejecting "independent investigation," non-reliance, and "no warranty" disclaimers); *IDS Bond Fund, Inc. v. Gleacher NatWest Inc.* (D. Minn., March 6, 2002) 2002 U.S.Dist. Lexis 4073, *20-24 (analyzing nearly-identical disclaimer); *Warner Constr. Corp. v. City of L.A., supra,* 2 Cal.3d at 292 & n.2, 294-95 & n.8 (rejecting similar disclaimer); *E.H. Morrill Co. v. California, supra,* 65 Cal.2d at 792-94 (responsibility "not overcome [as a matter of law by] general clauses requiring the contractor, to examine the site, to check up the plans, and to assume responsibility for the work"). A contrary conclusion would inappropriately allow the creator of a disclosure document to immunize itself from liability for fraud. *Id.* at 726 (court will not authorize fraud based on "a boilerplate disclaimer").

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[205] 48AA13515.

[206] *Id.*; *see* 7RT1340:12-17, 1340:24-1342:15 (CIBC acknowledging that OM was supposed to be a truthful, complete description of Renaissance).

[207] 7RT1228:1-1231:16.

6. None Of The Cases Relied On By CIBC Supports Its Position

The cases cited by CIBC provide it no support. In *Podlasky v. Price* (1948) 87 Cal.App.2d 151, 158-60, a broker's disclosures, among other things, identified certain apartments as rent-controlled. The broker made a pinpoint disclaimer for errors in this one statement, which was incorrect as to a single apartment. Because of the pinpoint disclaimer and because the evidence showed the buyer's "complete reliance upon other considerations," the Court of Appeal held that the buyer could not have justifiably relied on the error. This finding was expressly influenced by the fact that the truth seemed to leave the buyer better off because he could charge rent at market rates. *Id. at 160.* Moreover, any broad "caveat emptor" reading of *Podlasky* was long ago rejected in favor of holding a seller liable where he "knows of facts which materially affect the desirability of the property which he knows are unknown to the buyer." *Lingsch v. Savage, supra*, 213 Cal.App.2d at 737-38.

In the unpublished *Resolution Trust Corp. v. Rowe* (N.D. Cal., May 7, 1993) 1993 WL 165303, the defendants were auditors (not OM preparers, like CIBC) who had prepared a financial "compilation" that contained disclaimers that it omitted substantially all GAAP disclosures and "[i]f the omitted disclosures were included in the financial statement, they might influence the user's conclusions." *Id.* at *3. With this targeted disclaimer, the court found plaintiffs could not have reasonably relied on any errors in the compilation – which the court had already noted was not material. *Id.* at *2-3.

In *McGonigle v. Combs* (9th Cir. 1992) 968 F.2d 810, plaintiffs claimed to have relied on an offering document's speculative valuations

based on the assumption a company could be valued as highly as three other publicly-traded companies in the same business. *Id.* at 816. But, unlike the OM in this case, the paragraph immediately following those valuations had a pinpoint disclaimer emphasizing that the valuations were not management's estimate of the company's value, nor what management felt the company would be worth if it went public, and instructing investors not to take comfort that the figures in any way represented the company's value. *Id.* at 816-17. Moreover, the paragraph concluded with a precise, much lower value for the company. The court decided the plaintiffs could not have relied on the higher valuations implied by the specifically-disclaimed provision in light of its openly hypothetical nature and the express representation of a lower value. *Id.* at 817. Contrary to CIBC's characterization, the court's "riddled with disclosures" statement referred to the particular page containing the statements plaintiffs relied upon, not, as with CIBC's OM, to general disclaimers covering a whole document. *Id.*

Atari Corp. v. Ernst & Whinney (9th Cir. 1992) 981 F.2d 1025, 1027-31, had unusual facts unlike those here. In *Atari*, the plaintiff sought to acquire a company whose financial report, audited by defendant, overvalued the company. The plaintiff's own auditors suspected the overvaluation, the company refused to verify the valuation, and plaintiff then confirmed that the valuation was materially inaccurate, but agreed to acquire the company anyway. *Id.* at 1027, 1030. When a further review determined the overvaluation was even more dramatic, the plaintiff chose not to opt out of the acquisition, but instead reached a compromise "Bet Agreement," under which the merger would close subject to a post-closing audit. If the audit revealed the need for adjustments beyond a particular level, the company's CEO personally guaranteed up to $5 million of the

excess – a cap Plaintiff unsuccessfully sought to eliminate. The deal closed, and the audit identified adjustments well beyond the level protected by the guarantee. *Id.* at 1029.

The court found reliance on the financial report was unreasonable because long before the deal closed, plaintiff was aware that the report reflected "a ridiculous overvaluation of the company's assets." *Id.* at 1030. The "daredevil Bet Agreement" and plaintiff's attempt to eliminate the cap on the guarantee demonstrated that plaintiff "fully expected that still more dirt would be uncovered" post-closing. *Id.* Accordingly, the court found any reliance on the report was unjustified, because it was "patently and obviously false." *Id.* at 1031. Such facts are not present here.

The record amply supports the jury's finding of justifiable reliance.

G. CIBC's "Proximate Cause" Contention Is Erroneous

1. Plaintiffs Proved The Necessary Causation By Proving Their Deceit Claims' Elements

CIBC contends Plaintiffs failed to establish "proximate cause." AOB 52-58. CIBC ignores the authorities establishing that there is no separate "proximate cause" requirement in this case – because the purpose served by requiring proximate cause for other torts was satisfied here by proof of the traditional elements of a deceit claim.

Civil Code Section 3343 sets forth the damage measures for fraud in the purchase or sale of property. Under Section 3343(a), the trial court properly instructed the jury that Plaintiffs could recover the "out of pocket" difference between the amounts Plaintiffs paid for the Notes and the Notes' actual value when purchased, *i.e.*, the amount by which Plaintiffs overpaid

for the Notes.[208] Section 3343(a) does not include any requirement that a plaintiff establish that such damages were proximately caused.[209] With regard to certain additional damages (not sought by Plaintiffs here) that can be recovered under Section 3343 (specifically, loss-of-use and lost-profits damages), the statute expressly requires a showing of "proximate cause." Civil Code § 3343(a)(2) & (a)(4)(iii); *see also* 6 Witkin, Summary of Cal. Law (9th ed. 2004)Torts, § 1446 ("proximate cause" required only for "additional damages" beyond out-of-pocket amounts).

Consistent with Section 3343(a), the traditional elements of a deceit claim omit a separate "proximate cause" element. *Lingsch v. Savage, supra,* 213 Cal.App.2d at 738; *Continental Airlines, Inc. v. McDonnell Douglas Corp.* (1989) 216 Cal.App.3d 388, 404; *Goehring v. Chapman Univ.* (2004) 121 Cal.App.4th 353, 362, BAJI 12.45 (negligent misrepresentation). *See also* BAJI 12.31 (intentional misrepresentation).

Basic principles establish the logic behind the traditional elements and behind the legislature's omission of any "proximate cause" language from the out-of-pocket measure, as well as the legislature's inclusion of the language for other, potentially more-attenuated recoveries. "Proximate cause" generally serves to establish that damages are not only a "but for" result of a defendant's misconduct, but that plaintiff's injury was not "highly unlikely" when the misconduct occurred, and that the causal chain

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[208] 32AA9073-74.

[209] CIBC instead cites cases concerning Civil Code Section 3333. *Gagne v. Bertran* (1954) 43 Cal.2d 481, 492; *Auerbach v. Great W. Bank* (1999) 74 Cal.App.4th 1172, 1184-85. Section 3333, however, is inapplicable here. *Alliance Mortgage v. Rothwell, supra,* 10 Cal.4th at 1240-41.

is not too attenuated.[210] Indeed, "proximate cause" is satisfied by showing that the defendant's misconduct was a "substantial factor," not a "remote or trivial factor," in the plaintiff's injury.[211] CACI 400, 430; *Soule v. General Motors Corp.* (1994) 8 Cal.4th 548, 572; Restatement (2d) Torts § 431 ("substantial factor" test to satisfy concept that "defendant's cause has such an effect in producing the harm as to lead reasonable men to regard it as a cause"); *Wilson v. Blue Cross of So. Cal.* (1990) 222 Cal.App.3d 660, 673.

In deceit cases, *particularly those with out-of-pocket damage measures*, the "substantial factor" concept, served by the "proximate cause" requirement for other torts, is satisfied principally through proof of justifiable reliance because the damage occurs and is measured at the moment of reliance on defendant's improper representation or omission.[212]

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[210] 6 Witkin, Summary of Cal. Law (9th ed. 2004) Torts, § 968 (proximate/legal cause protects defendant "where it would be considered unjust to hold him legally responsible"), § 969 (question is whether resulting injury "highly unlikely," not whether "foreseeable"), § 976 (when foreseeability considered, it is foreseeability of risk of harm, not of extent or manner in which incurred).

[211] Even as to negligence, "proximate cause" concepts, other than the "substantial factor" test, are only relevant to defendants' burden of proving a superseding cause or other defense. CACI 432; Restatement (2d) Torts § 431 ("substantial factor" sufficient unless rule of law relieves defendant from liability); *Lombardo v. Huysentruyt* (2001) 91 Cal.App.4th 656.

[212] In this regard, "justifiable reliance" works with the other elements. "Actual reliance" established actual causation: "the representation or non-disclosure must have caused plaintiff's conduct in entering into the transaction and without [it] plaintiff would not have entered into the transaction. (32AA9057-58.) "Intent-to-induce-reliance" (32AA9049-50, 9053-54) establishes that damages were foreseeable – to the extent that is a "proximate cause" requirement. "Justifiable reliance" requires that plaintiff's reliance was "reasonable in the light of the circumstances and plaintiff's intelligence, experience and knowledge." (32AA9059-62.)

See Mirkin v. Wasserman (1993) 5 Cal.4th 1082, 1092 ("It may be true, as plaintiffs assert, that reliance can be thought of as the mechanism of causation in an action for deceit."); *Engalla v. Permanente Medical Group, supra,* 15 Cal.4th 951, 976-77 (using "substantial factor" test to explain reliance requirement); *Atari Corp. v. Ernst & Whinney, supra*, 981 F.2d at 1030 (justifiable reliance ensures causal connection). Having proven justifiable reliance, the Plaintiffs were only entitled to damages measured by the difference between the price paid by Plaintiffs and, at that same moment, the actual value of what Plaintiffs received.[213] By establishing their reliance on defendants' improper representation or omission was justified and that the true facts would have changed the Notes' value, Plaintiffs established a sufficiently tight "substantial factor" chain from CIBC's misconduct to Plaintiffs' injury.[214]

2. CIBC's Authorities Are Not To The Contrary

CIBC's reliance on cases that happen to use the words "proximate cause" is misplaced. These cases do not involve the "substantial factor" concept. Instead, they uniformly address a plaintiff's inability to show any damages because the misrepresentation or omission did not affect the "true

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[213] 32AA9073-74.

[214] This logic was followed in *Younan v. Equifax, Inc.* (1980) 111 Cal.App.3d 498, where a plaintiff sued his insurer after denial of a disability claim. Plaintiff alleged fraud based on defendant's arranging of a bogus medical exam. *Id.* at 513. The defendants argued that the plaintiff failed to allege "proximate cause." *Id.* The Younan court stated the true "causation aspects" of a deceit claim: "(1) actual reliance, (2) damage resulting from such reliance, and (3) right to rely or justifiable reliance." *Id.* Because the plaintiff alleged justifiable reliance resulting in plaintiff's "submitting to" the false examination, the Younan court found the defendants' proximate cause argument was "without merit."

value" of what Plaintiffs acquired. *Kruse v. Bank of America* (1988) 202 Cal.App.3d 38, 60-61 (plaintiff's pre-existing debt unaffected by defendant inducing plaintiff to honor the debt); *Laub v. Faessel* (App. Div. 2002) 745 N.Y.S.2d 534, 536-38 (misrepresentation did not concern companies' financial condition, so true value of investments unaffected); *Martin v. Heinold Commodities* (Ill. 1994) 643 N.E.2d 734, 746 (same).

CIBC asserts that the Prosser & Keaton treatise says that a plaintiff may not recover for investment declines unrelated to a misrepresentation. AOB 53. CIBC fails to note, however, that the treatise makes clear that this requirement only applies in "consequential damages" cases not involving "the transfer of property." *Prosser & Keeton on Torts* (5th ed.), § 110, p. 766. In contrast, in cases such as ours where "there was a transfer of something of value," the treatise advocates the out-of-pocket measure without a "proximate cause" qualifier. *Id.* at 767 & suppl. at 107 n.25.

In the same vein, CIBC asserts Plaintiffs did not present "loss causation" evidence that CIBC's omissions had something to do with the Notes' decline in value after Plaintiffs' purchases. AOB 54-55. As noted above, however, damages are measured at the moment of purchase by deducting the Notes' true value from the purchase price. Civ. Code § 3343. Accordingly, the "cause" of any subsequent price decline (or even its existence) is irrelevant.[215] *Small v. Fritz, supra*, 30 Cal.4th at 195 (out-of-pocket damages "will never diminish or disappear, no matter what happens to the price of the stock thereafter").

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[215] Thus, it is irrelevant when CIBC contends that GECC's decision to foreclose was "'due to unrelated causes' having nothing to do with" the truth CIBC knew in early 1997. AOB 56. CIBC's position is also unreasonable. The discovery of a fuller picture of Renaissance's finances predictably destroyed GECC's willingness to maintain a credit line.

Other cases cited by CIBC also are unavailing. *Safeco Ins. Co. v. J&D Painting* (1993) 17 Cal.App.4th 1199, was a negligence case in which there was no "justifiable reliance" element or "out of pocket" damages measure. The remaining cases involve harms not measured at the moment of reliance, but instead gradually realized over a subsequent period during which the causal chain could become attenuated. *Goehring v. Chapman Univ., supra*, 121 Cal.App.4th at 358-66 (inducement to enter school did not injure plaintiff because injury occurred only after he failed out, so damages did not result from reliance); *Garcia v. Superior Court* (1990) 50 Cal.3d 728, 735-37 (not a traditional negligent misrepresentation case, but instead involving Restatement § 311 tort of "negligent misrepresentation involving a risk of physical harm" in which injury may occur long after reliance with substantial intervening events); Restatement (2d) Torts § 311, cmt. a (two torts are different).[216]

Plaintiffs established the necessary causal link between CIBC's fraud and Plaintiffs' damages.

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[216] CIBC also cites cases involving federal Section 10(b) claims or parallel statutory claims. *Binder v. Gillespie* (9th Cir. 1999) 184 F.3d 1059, 1063-66 (discussing "loss causation," with allusion to proximate cause, only as to finding that misrepresentations and omissions were not made in a particular class period); *Specialized Tours, Inc. v. Hagen* (Minn. 1986) 392 N.W.2d 520, 537-38 (§ 10(b) law governs state statute; analyzing non-out-of-pocket, consequential damages claim based on inducing failure to make payment, "ultimately resulting" in failure to obtain desired tickets). Unlike the present case, such claims presume reliance and allow possible recovery of consequential damages incurred after a purchase – which together may require a further "causation" requirement. *See Mirkin v. Wasserman, supra*, 5 Cal.4th at 1101-1102 & n.8 (Section 10(b) concept inapplicable to common law deceit claim because federal claim presumes reliance).

3. Plaintiffs' Loan Damages Were Properly Recovered As Amounts Spent In Mitigation

As part of their "proximate cause" argument, CIBC contends Plaintiffs' "separate decision" to make the $2 million Mitigation Loan could not have resulted from reliance on CIBC's fraud. AOB 57-58. This argument is misdirected. Plaintiffs' theory for recovering the loan losses is, and always has been, based on recovery of amounts reasonably spent in mitigation.[217] *Brandon & Tibbs v. George Kevorkian Accountancy Corp.* (1990) 226 Cal.App.3d 442, 460-61 (losses from reasonable effort to avoid injury); Restatement (2d) Torts § 919(2) & cmt. c.

Mitigation losses do not require reliance on a deception or separate proof of causation, only a reasonable effort to minimize losses. Accordingly, Plaintiffs presented evidence regarding why they made the loan when they did,[218] and the jury was appropriately instructed on the mitigation theory and awarded such damages.[219]

H. Substantial Evidence Supported The Amount Awarded

As discussed above, the applicable non-mitigation damage measure was the "out of pocket" difference between the prices Plaintiffs paid for the Notes and their actual value at the moment of purchase. Civil Code

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[217] It was for this reason that the damages Plaintiffs requested on the Section 25500 and federal Section 11 claims were less than on the other claims, since mitigation damages were not recoverable on those claims. (23RT4382:8-4382:12; 9RT1742:9-1745:5.)

[218] 9RT1736:13-1740:23; 6RA935.

[219] 32AA9101-02; 6RA945, 1000-1001; 9RT1740:16-21; 10RT1802:3-1804:21, 1813:13-23. *See also* 66AA18561-64, 18565-66.

§ 3343(a); 32AA9074. CIBC incorrectly asserts Plaintiffs did not present "competent or substantial evidence" as to "actual value." AOB 58-62.

In focusing on the competence of Plaintiffs' evidence, CIBC disregards the nature of its appeal. In nonsuit/JNOV appeals, all evidence supporting the verdict, whether properly admitted or not, is given the "credit and benefit of its full probative strength." *Donahue v. Ziv Television Programs, Inc., supra*, 245 Cal.App.2d at 609-10; *Berger v. Lane* (1923) 190 Cal. 443, 452-53; *Gregg v. Western Pac. R.R. Co.* (1924) 193 Cal. 212, 216. Here, relying on the admitted testimony regarding the Notes' actual value, Plaintiffs were not required to put on duplicative testimony of value from, for example, their damages expert. (*Id.*; AOB 60 (noting Plaintiffs chose not to put on damages expert).)

CIBC also disregards the deferential standard of review applicable to damage awards. The quantum of proof required for the *amount* of damages is lower than that necessary to prove the *fact* of damage. *E.g., Clemente v. California* (1985) 40 Cal.3d 202, 219. The amount "may be left to reasonable approximation or inference." *Johnson v. Cayman Dev. Co.* (1980) 108 Cal.App.3d 977, 983. On appeal, CIBC bears the burden of proving that the jury's determination was erroneous. *Id.; City of Salinas v. Souza & McCue Constr. Co., supra,* 66 Cal.2d at 225 (additionally, appellate court not concerned with testimony's weight, "particularly with reference to the amount of damages"). CIBC has not carried this burden.

1. Plaintiffs Established The Fact Of Damages

Plaintiffs presented substantial evidence establishing the *fact* of damage, including testimony that the Notes were actually worthless at the

time of purchase.[220] Additionally, CIBC's own expert testified to the *fact* of out-of-pocket losses.[221] He admitted that if misrepresentations or omissions were proven, and if the true facts were not revealed by May 28, 1998,[222] each Plaintiff would have suffered some damage – up to a collective $18.3 million if the true facts were not revealed until June 29th.[223] The fact of damages was also established with respect to the losses that Plaintiffs suffered on their Mitigation Loan.[224]

2. The Amount Of Damages Was Correct

With the fact of damages shown, CIBC cannot establish that the jury incorrectly determined the amount. Plaintiff TCW's Group Managing Director Mark Attanasio testified that the Notes were worthless when purchased and explained why that was so.[225] *CIBC's* counsel elicited this testimony during an apparent attempt to "prove" that the Notes were not worthless merely because they were priced above zero. Attanasio

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[220] 15RT2944:24-2945:24, 2965:20-2966:16, 2973:27-2977:5; 13RT2466:6-20, 2618:10-2620:23, 2561:9-17; 14RT2689:11-2691:2.

[221] 21RT4241:7-4242:8.

[222] CIBC's expert also attempted to require that there be evidence that the declining price was at least partially due to the true facts reaching the market. The jury could have inferred this conclusion by noting the Notes' price decline as bad news came out. AOB chart between pages 22 and 23; 15RT2974:25-2975:12; *see also* n.172 *supra*. During discovery, Plaintiffs made further discovery principally of the fact that the mismanagement had been intentional and known to CIBC.

[223] 20RT4046:17-4051:26, 4086:22-4089:19; 4102:20-4106:7; 4241:7-4242:8; 32RA9266.

[224] *Supra* n.86 & accompanying text.

[225] 15RT2944:24-2945:24, 2965:20-2966:16, 2973:27-2977:5.

explained that such prices existed only because potential buyers did not know Renaissance's true, worthless state.[226]

Others echoed this testimony. TCW Senior V.P. Shawn Bookin testified the Notes were "worth zero" from issuance and they never would have been sold in the first place because the hidden facts would have shown Renaissance was a "house of cards" whose "whole business model, essentially, would have evaporated."[227] Oaktree Managing Director Richard Goldstein testified that IRI data and the incredible "Miracle March" plan to stuff more product into an already-stuffed channel meant Renaissance was "basically dying or dead" when the Notes first issued.[228] Even *CIBC* employees Dalton and Heyer supported Plaintiffs' contention by testifying that the Notes could never have been sold if it were known that RCI's management lacked integrity and was falsely describing its business.[229]

CIBC incorrectly contends that this testimony only indicates the value of the *private*, not the *public* Notes. AOB 61. To the contrary, Attanasio was responding to questions from CIBC's counsel relating to the value of the Public Notes in *1998*.[230]

As to Bookin's and Goldstein's testimony, CIBC's argument is untenable. For valuation purposes, the public Notes resulting from the May 1997 exchange offering were identical to the initial Notes. They embodied

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[226] 15RT2965:20-2966:16.

[227] 13RT2466:6-20, 2618:10-2620:23, 2561:9-17.

[228] 14RT2689:11-2691:2.

[229] 16RT3135:3-19, 19RT3893:27-3894:3.

[230] 15RT2944:24-2945:24, 2965:20-2966:16, 2973:27-2977:5.

the same payment obligations on the same timetable at the same interest rate by the same obligor.[231] The only post-registration difference was that the Notes became publicly tradable. The reasons why the Notes were valueless when issued in 1997—demonstrably failed brands, channel-stuffing, dishonest management and financial statements—were conditions that persisted in 1998. Accordingly, the jury could reasonably have inferred that the Notes were actually worth zero when issued and that they continued to be worth zero when Plaintiffs purchased them. *Castro v. California* (1981) 114 Cal.App.3d 503, 507 (in evaluating "no substantial evidence" attack, court draw all inferences in plaintiffs' favor).

3. The Valuation Evidence Was Properly Admitted

Although irrelevant to its JNOV appeal (because all evidence is considered whether or not properly admitted),[232] CIBC also objects to the admissibility of Plaintiffs' valuation testimony. CIBC cannot raise this issue on appeal as they did not object to most of this testimony at trial.[233]

Moreover, a lay witness can offer opinion testimony if it is "rationally based" on the witness's "perception" and helpful to an understanding of the witness's testimony. Evid. Code § 800. As percipient witnesses who analyzed Renaissance before and after their purchases and who were familiar with the company's true financial state, Attanasio, Bookin and Goldstein had rational bases for concluding the Notes were worthless upon issuance and thereafter. *See Donahue v. United Artists*

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[231] 51AA14475, 14394, 14402; 21RT4165:12-18.

[232] *See* n.104 & accompanying text.

[233] 13RT1561:9-17, 2466:6-20, 2561:9-17; 14RT2689:11-2691:21, 2695:20-25, 2696:10-16.

Corp., supra, 2 Cal.App.3d at 803 (owner of literary property may properly testify to value; and "'[i]f the witness disclosed an ample knowledge of the subject [of value] to entitle his opinion to go to the jury,'" degree of knowledge goes more to weight than admissibility); *Allied Sys. v. Teamsters Auto. Transp. Chauffeurs, Demonstrators & Helpers, Local 604* (8th Cir. 2002) 304 F.3d 785, 792 ("perceptions based on industry experience [are] sufficient foundation for lay opinion testimony," and "opinion testimony of an officer of a business as to value or projected profits" admissible because of "particularized knowledge" of business). Indeed, CIBC knew Attanasio, like Goldstein and Bookin, was a valuation expert. *See Naples Restaurant, Inc. v. Coberly Ford* (1968) 259 Cal.App.2d 881, 884-85 (car salesman can testify to car values, even those he does not sell). That is why CIBC tried so hard to elicit negative valuation testimony from him.[234]

CIBC's citation to *Fragale v. Faulkner* (2003) 110 Cal.App.4th 229, 237, is unavailing. *Fragale* affirmed a ruling preventing a plaintiff from opining on the effect on his home's value of missing permits and building code non-compliance. The plaintiff was not an appraiser and admitted his opinion was based solely on property visits and reviewing brochures and sales. *Id.* at 240. The court found that an expert would not reasonably rely on such matters in forming an opinion as to the valuation effect of code and structural defects. *Id.*

Unlike the witness in *Fragale*, Attanasio, Bookin and Goldstein are professional investors and financial experts and were analyzing facts well within their expertise. Securities valuation is the heart of their business,

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[234] 15RT2965:20-2966:16.

and CIBC itself made much of their expertise.[235] Consequently, the trial court properly admitted their testimony – particularly since it was responsive to the questions CIBC's own counsel had posed.

In sum, substantial evidence supports the judgment. CIBC is not entitled to judgment notwithstanding the verdict.

VI. THE DAMAGE PORTION OF THE JUDGMENT SHOULD BE AFFIRMED: CIBC HAS NOT ESTABLISHED THERE WAS AN IMPERMISSIBLE DOUBLE RECOVERY

CIBC contends the damage portion of the judgment should be reversed because it can be read only as a double recovery for the same injury. AOB 62-64. As appellant, CIBC has the burden of demonstrating this is so. *See Schiernbeck v. Haight* (1992) 7 Cal.App.4th 869, 875 (affirm if "any basis in the record to support the [trial] court's interpretation of the verdict."). CIBC has not carried this burden.

For multiple reasons this Court should affirm the judgment's damage award: It accurately awards the "total damages" determined by the jury; CIBC has waived any argument that there was a double recovery; the record supports the damage award and does not support CIBC's claim that the jury must have determined actual damages in half that amount.

A. The Jury Twice Explicitly Declared That It Intended To Award Plaintiffs "Total Damages" Of $51,971,156

Verdict No. 2 asked the jury: "What total amount of damages do you award each plaintiff?" The jury's answer was unequivocal: $51,971,156, broken down as follows: $26,178,337 "Total damages awarded to TCW," $21,889,633 "Total damages awarded to Oaktree," and $3,903,186 "Total

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[235] *E.g.*, 15RT2902:6-2907:12; 12RT2330:14-2339:17; 10RT2700:1-2702:3; *see also* 10RT1793:24-1799:24; 12RT2204-2206; 13RT2637:23-2639:22.

damages awarded to Pacholder." These were the exact amounts Plaintiffs presented in evidence and asked the jury to award in closing arguments.[236]

That $51,971,156 was the amount the jury intended to award was confirmed when, following post-verdict discussions as to whether the jury's by-claim damage entries in Verdict No. 1 created ambiguity in Verdict No. 2's award, the trial court further inquired as to the jury's intent. Using a question and methodology that CIBC had approved (if there were further inquiry),[237] the court referenced Verdict No. 2 and asked the foreman, in the presence of counsel and the full jury, "Are these the amounts you intended each plaintiff to receive by your verdict?"[238] The foreman's answer: "Yes, your honor."[239] The trial court entered judgment accordingly.[240]

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[236] *Supra* nn.87 & 91.

[237] 25RT4702:5-4703:10. Recounting none of this, CIBC notes only that the trial court "did not order further deliberations" and "instead posed a single question solely to the foreman." AOB 29. CIBC never acknowledges that it *consented* to this form of inquiry, if any inquiry was to be had, and that *CIBC* itself had unsuccessfully suggested the trial court inquire of the foreman outside the remaining jurors' presence. (25RT4702:11-4703:9.)

[238] 25RT4701:18-22. In determining jury intent, other courts have relied on pre-discharge jury foreperson communications to clarify verdicts where the entire jury was available for polling or further deliberations if requested or needed. *Indu Craft v. Bank of Baroda* (2d Cir. 1995) 47 F.3d 490, 497 (foreman questioned to clarify damage award); *Maxwell v. Powers* (1994) 22 Cal.App.4th 1596, 1602-1603 (foreman's note on verdict form was "concurrent statement by the jury explaining its verdict and incorporated by reference into the verdict.").

[239] 25RT4704:1-4704:13, 4705:5-4705:17. With this answer, CIBC sought no further proceedings, and the jury was dismissed. (25RT4705:18-26.)

[240] Prior to obtaining CIBC's consent to this inquiry, the trial court informed CIBC he would interpret an affirmative answer as confirmation that the damages were the Verdict No. 2 amounts. (25RT4695:8-17.)

B. CIBC Has Presented No Evidence That The Jury Could Have Found Damages In Half The Requested Amount.

As appellant, CIBC bears the burden of demonstrating that the awarded damages were duplicative. *See Indu Craft v. Bank of Baroda, supra*, 47 F.3d 490, 497 (requiring showing by defendant); *Gentile v. County of Suffolk* (2d Cir. 1991) 926 F.2d 142, 144, 153-54 (defendants "failed to establish [duplication] with any degree of certainty."); *U.S. Indus., Inc. v. Touche Ross & Co.* (10th Cir. 1988) 854 F.2d 1223, 1258-60 & n.53 (defendant bears burden regarding asserted duplication).

CIBC has not carried this burden. While contending the verdicts as initially returned can have only one possible interpretation (with Verdict No. 2 an improper summing of damages on two claims from Verdict No. 1),[241] CIBC has not demonstrated – with "certainty," or at all – that Verdict No.2's "total damages" embody a double recovery.[242]

Indeed, in asserting the jury must have found damages in the Verdict No. 1 amounts, representing very nearly half the amounts each Plaintiff sought ($13,089,168 for TCW, $10,944,816 for Oaktree and $1,951,593 for Pacholder), CIBC's brief lacks any record reference explaining how the jury could have reached those figures. This silence is because the record offers no support. In response to Plaintiffs' contention that they had damages of $51,971,156 as eventually set forth in Verdict No. 2, CIBC's

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[241] AOB 62-64.

[242] CIBC also asserts in passing that the verdict form mentioned Plaintiffs too many times and did not mention CIBC even once, implying it was difficult for the jury to find for CIBC. AOB 28. CIBC never raised this objection in the trial court. The form, moreover, uses the word "defendant" in the first column. (32AA9205.) And the jury obviously understood how to find in CIBC's favor, because it did so on one claim. (32AA9205.)

only argument and proffered analysis was that Plaintiffs' collective damages could not have exceeded $18.3 million, substantially less than the nearly $26 million that CIBC now asserts the jury determined.[243]

Indeed, there was no evidence that would have allowed the jury to determine damages in the Verdict No. 1 amounts, *i.e.*, each Plaintiff concurrently recovering half the amount it sought. Plaintiffs bought Notes on different days at different prices.[244] As a result, if, as CIBC contends, the Notes' actual value exceeded zero, the impact would not have been proportional across the Plaintiffs – as demonstrated by CIBC's own analysis of alternative "actual values." Using a June 29, 1998 price as the actual value, CIBC's expert calculated that the damages would have been $567,500 for Pacholder, $9,070,000 for Oaktree and $8,645,000 for TCW.[245] These amounts are significantly different percentages of the damages each Plaintiff sought (33%, 41% and 15%, respectively).

C. By Successfully Preventing Further Clarification Of The Jury's Intent, CIBC Waived Its Argument That The Award Should Be Halved.

Following the jury's verdict, there were extensive discussions as to whether the jury's responses to Verdict Nos. 1 and 2 were ambiguous. While the law treats unnecessary allocations of total damages to individual claims or defendants as surplusage (*see* introduction to Part V), Plaintiffs sought to avoid any issue in this regard and asked the trial court to obtain

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[243] 20RT 4086:22-4089:19, 4103:14-4106:7; 23 RT4464:19-4465:4.

[244] 66AA18561-64, 18565-66.

[245] 20RT4103:27-4104:13, 4104:26-4105:10, 4105:27-4106:7.

further clarification from the jury.[246] CIBC, in contrast, "strenuously" insisted that further clarification should not be sought.[247] While the trial court did make the inquiry to which CIBC consented, CIBC's opposition succeeded in preventing further inquiry or deliberations.

Having succeeded in blocking further inquiry that would have eliminated any remaining doubt, CIBC has waived any contention that the jury actually intended to award half the amounts it determined as "total damages." *See Woodcock v. Fontana Scaffolding Equipment Co.* (1968) 69 Cal.2d 452, 456-57 ("litigious strategy" aimed at reaping "technical advantage" disapproved).

Brown v. Regan (1938) 10 Cal.2d 519, 523-24, is on point. There, as here, the respondent sought clarification of a verdict to avoid any ambiguity, but appellant vigorously objected, arguing that clarification should not be sought and that the trial court was without power to seek clarification. The trial court acceded to appellant's position. Our Supreme Court held that the appellant, by successfully opposing further clarification in the trial court, waived the point on appeal:

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[246] 25RT4673:2-4673:28. Plaintiffs proposed an instruction asking the jurors to re-consider and adjust any aspect of the verdict that was necessary to achieve a consistent verdict. 1RA005, 009.

[247] 25RT4673:27-4675:21. CIBC contended that the trial court lacked the power to direct further deliberations, and that clarification was unnecessary because the jury's intent was "completely irrelevant." (32AA9224-25 & n.1; 25RT4684:25-4685:1.) On the contrary, the trial court had the power and discretion to direct further deliberations (C.C.P. § 619; *Mendoza v. Club Car, Inc.* (2000) 81 Cal.App.4th 287, 301-303; *Mizel v. City of Santa Monica* (2001) 93 Cal.App.4th 1059, 1072; *Tri-Delta Engineering, Inc. v. Ins. Co. of N. Am.* (1978) 80 Cal.App.3d 752, 758; *Johnson v. Visher* (1892) 96 Cal. 310, 314; 7 Witkin, Cal. Procedure (4th ed. 2004) Trial, § 374) and a verdict's fundamental purpose is to ascertain the jury's intent (*e.g., Maxwell v. Powers* (1994) 22 Cal.App.4th 1596, 1605).

> [I]t was not only within the power of the trial court to require the jury to clarify its verdict, but it was his duty to do so. . . . If mere inaction alone will constitute a waiver of a defect in a verdict, it is self-evident that the conduct of appellant's attorney in actively opposing the efforts . . . to have the defect cured will constitute a waiver.

Exactly like the appellant in *Brown*, CIBC persistently opposed all efforts to further clarify the jury's intent.[248] CIBC, moreover, did so despite warnings that such opposition would constitute a waiver and despite the trial court's informing CIBC that, absent further jury inquiry, it would interpret the verdict as awarding Plaintiffs the exact amounts specified in Verdict No. 2.[249] CIBC thereby waived its contention that the verdict should be re-interpreted to halve the damages.

D. The Way The Jury Tried To Allocate Total Damages Further Confirms The Total Amount of the Judgment

The Verdict No. 1 and Verdict No. 2 amounts support the conclusion that the jury allocated its total damages between individual claims – as courts have recognized that juries will sometimes mistakenly do. *E.g.*, *All-West Design, Inc. v. Boozer, supra,* 183 Cal.App.3d at 1219-25; *Med-Therapy Rehabilitation Servs., Inc. v. Diversicare Corp. of Am.* (4th Cir., Feb. 3, 1994) 1994 U.S.App. Lexis 1665 at *16-18; *Indu Craft, Inc. v. Bank of Baroda, supra,* 47 F.3d at 497; *Peckinpaugh v. Post-Newsweek Stations Conn., Inc.* (D. Conn., March 3, 1999) 1999 U.S.Dist. Lexis 21289 at *5-7.

Mathematics indicates the jury allocated its Verdict No. 2 "total damages" into the amounts it recorded in the Verdict No. 1 claims, rather than (as CIBC asserts) adding the Verdict No. 1 amounts to answer Verdict

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[248] 25RT4676:28-4695:7.

[249] 25RT4678:13-21, 4687:14-19, 4695:8-17.

No. 2. In its Verdict No. 2, the jury awarded two plaintiffs damages that were odd numbers ($26,178,337 and $21,889,633). Odd numbers could not have resulted if, as CIBC contends, the jury added its negligent misrepresentation damage numbers ($13,089,168 and $10,944,816) to its *identical* intentional nondisclosure damage numbers. Adding together each Plaintiff's identical Verdict No. 1 figures would have resulted in *even* numbers in Verdict No. 2: $26,178,336 and $21,889,632. But both Verdict No. 2 awards were actually $1 higher, and each was exactly the amount requested by that Plaintiff. CIBC offers no plausible theory (other than a desultory suggestion of a so-called "$2.00 scrivener's error")[250] as to how *two* one-dollar errors could have resulted when the jury was taking care to award damages with single-dollar precision.

In contrast, evenly dividing TCW's and Oaktree's Verdict No. 2 damages between the intentional omission and negligent misrepresentation claims would have resulted in damages of $13,089,168.50 and $10,944,816.50 on each claim.[251] Rounding down to the nearest whole dollar, the jury entered these amounts. Thus, allocation from Verdict No. 2 into Verdict No. 1 explains the jury's numbers, while CIBC's proffered "addition" theory does not.

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[250] AOB 63.

[251] There is no certain explanation for why the jury elected to allocate the total between only two claims. The likely explanation, however, is convenience. The claims to which damages were allocated were the only successful claims common to all three plaintiffs (because TCW did not assert any statutory claims) and allocating to the shared claims meant that the allocation method would be the same for each Plaintiff. Moreover, the statutory claims had slightly lower damages, because they did not allow recovery of mitigation losses. (23RT4382:8-12; 32AA9073-74, 9089-90.) Accordingly, allocating to the statutory claims might have been confusing.

As further explored in Plaintiffs' cross-appeal, the attempted allocation of zero damages to the Section 25500 claim is also erroneous surplusage given the large figure recorded on the intentional nondisclosure claim. The jury found CIBC liable on both claims. The measure of damages under each was essentially identical and was tied to the same purchases. The simplest and most plausible explanation is that the jurors allocated the total damages to the first-in-order common law claims, and mistakenly believed they should award no damages on a remaining claim, notwithstanding liability. *Bird v. John Chezik Homerun, Inc.* (8th Cir. 1998) 152 F.3d 1014, 1015-17.

E. Contrary To CIBC's Assertion, The Trial Court Did Not Direct The Jury To Award Duplicative Damages

In support of its double-recovery theory, CIBC incorrectly contends that the verdict form directed the jury that its response to Verdict No. 2 was to be the "total of the amounts entered in the right-hand column of General Verdict No. 1." AOB 63. In fact, the jury was instructed to the contrary – that its Verdict No. 2 figures could be less than the arithmetic sum of its Verdict No. 1 amounts. Specifically, the jury was told "not [to] be concerned if the total of the amounts entered in the right-hand column [in Verdict No. 1] when added together is greater than the total damages awarded in your response to General Verdict No. 2."[252]

This instruction, which CIBC understood and therefore did not object to, correctly told the jury that it was not a problem if a Plaintiff's claim-by-claim amounts in Verdict No. 1 summed to an amount larger than

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[252] 32AA9205.

that in Verdict No. 2, since the latter's "total damages" award would inform the trial court of the amount the jury intended to award.

F. CIBC's Reliance On The *DuBarry* Case Is Misplaced

CIBC incorrectly claims that *DuBarry Int'l, Inc. v Southwest Forest Indus., Inc.* (1991) 231 Cal.App.3d 552, supports its double-recovery theory.[253] In *DuBarry*, a jury considered two claims having identical damage measures. Unlike the present case, the jury was not asked to identify an amount of "total" damages, but only to assign an amount to each claim. During deliberations, the jury inquired whether the second claim's damages should include the amounts awarded on the first claim or only additional amounts. The court responded that the second claim's damage figure should include the first claim amounts. The jury then returned a verdict indicating $1.5 million in damages on each claim.

Despite the trial court's instruction that (as the Court of Appeal put it) told the jury "to award the same damages twice," the trial court inexplicably found the two awards were not duplicative, and entered judgment for $3 million. *Id.* at 565. The Court of Appeal reversed, concluding there was no post-verdict ambiguity, given the instruction.

In contrast to *DuBarry*, where, as here, a jury separately identifies total damages and also attempts to allocate portions to particular defendants or particular claims, courts routinely enter judgment *in the amount of the total damages*, not in the apportioned amounts. *Sparks v. Berntsen, supra,*

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[253] CIBC's other cases stand for the unremarkable proposition that "double or duplicative recovery for the same items of damage amounts to overcompensation and is therefore prohibited." *Tavaglione v. Billings* (1993) 4 Cal.4th 1150, 1158-1159; *Holliday v. Jones* (1989) 215 Cal.App.3d 102, 121; *Michelson v. Hamada* (1994) 29 Cal.App.4th 1566, 1582-1583.

19 Cal.2d at 311 (jury identified total damage amount, but awarded portion against each of two tortfeasors; proper judgment is against both in total amount); *Weddle v. Loges, supra*, 52 Cal.App.2d at 119-20 (same).

DuBarry also did not present, as this case does, a record disclosing that the total damage amount obtained by summing the two underlying claim awards exactly matched the liquidated total damage sum presented by Plaintiffs. Such evidentiary ties to amounts awarded as total damages are, so far as Plaintiffs' research has disclosed, uniformly given effect. *Indu Craft v. Bank of Baroda, supra*, 47 F.3d at 497; *Peckinpaugh v. Post-Newsweek Stations Ct., Inc., supra*, 1999 U.S.Dist. Lexis 21289 at *6. *See also Med-Therapy Rehabilitation Servs., Inc. v. Diversicare Corp. of Am., supra*, 1994 U.S.App. Lexis 1665, *3 (total of two cross-claim awards tied to amount awarded on claim).

VII. CONCLUSION

For the foregoing reasons, CIBC's arguments are all without merit.

Dated: January 18, 2005

Respectfully submitted,

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CROSS-APPELLANTS' BRIEF

I. INTRODUCTION

The jury's Verdict No. 2 awarded Oaktree and Pacholder, respectively, $21,889,633 and $3,903,186 in damages. The jury's Verdict No. 1 found these Plaintiffs had established CIBC's liability under Corporations Code Section 25500.[254] Because Section 25500 provides for automatic prejudgment interest, these Plaintiffs are therefore entitled to prejudgment interest from the date of their losses. Corp. Code § 25500 (damages "plus interest at the legal rate").

The trial court erroneously denied prejudgment interest on the theory that in Verdict No. 1 the jury did not allocate any of the damages to the Section 25500 claim. That reasoning was incorrect because the jury had no legal or factual basis for attempting to allocate damages among the various claims; the claims had the same elements and were premised on the same underlying facts. As Plaintiffs prevailed on their Section 25500 claim, the judgment should be modified to reflect Plaintiffs' entitlement to an award with automatic prejudgment interest.

II. STATEMENT OF FACTS

Plaintiffs incorporate by reference the Statement Of Facts from their Respondents' Brief, particularly Part II.M.

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[254] Corporations Code Section 25500 creates civil liability for any act or transaction in violation of Corporations Code Section 25400. Section 25400(d), in turn, makes it unlawful for one to make false or misleading statements with respect to any material fact or to omit any material fact in selling or offering to sell a security. Corp. Code §§ 25400, 25500.

III. STATEMENT OF THE CASE

Plaintiffs incorporate by reference the Statement Of The Case from their Respondents' Brief.

After the jury returned its verdict, finding CIBC liable on the Section 25500 claim and liable on the intentional omission claim, Plaintiffs moved for entry of a judgment with prejudgment interest.[255] Among other arguments, Oaktree and Pacholder sought prejudgment interest based on the jury's finding that CIBC was liable under Section 25500.[256]

CIBC opposed Plaintiffs' request and contended that the jury's allocation of zero damages to the Section 25500 claim established that Plaintiffs were not entitled to prejudgment interest.[257] The trial court denied Plaintiffs' request for prejudgment interest.[258] Plaintiffs appeal from the trial court's judgment.[259]

IV. PLAINTIFFS ARE ENTITLED TO PREJUDGMENT INTEREST UNDER SECTION 25500

The same reasoning that establishes that Verdict No. 2 represents Plaintiffs' recoverable damages (Respondents' Brief, Part VI) establishes Oaktree and Pacholder's entitlement to prejudgment interest under Section 25500. In the process of purporting to allocate its "total damages" findings to two other claims, the jury found liability but awarded no damages on the

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[255] 1RA010.

[256] 1RA017-19, 76-79.

[257] 6RA1069-73.

[258] 1RA086.

[259] 47AA13392, 13404-405, 13423-24, 13426-27; 33AA9420-27.

Section 25500 claim.[260] This attempted allocation is mere surplusage and should be disregarded, with the total award (less mitigation losses not recoverable under Section 25500) deemed applicable to that claim. *All-West Design, Inc. v. Boozer, supra,* 183 Cal.App.3d at 1225; *Bird v. John Chezik Homerun, Inc., supra,* 152 F.3d at 1016-17. Once it is clarified that Plaintiffs are entitled to an award under Section 25500, that section further establishes that prejudgment interest is automatic. Corp. Code § 25500 ("Such damages shall be the difference between the price at which such other person purchased or sold securities and the market value which such securities would have had at the time of his purchase and sale in the absence of such act or transaction, *plus interest at the legal rate.*") (emphasis added).

All-West Design centered on a jury's allocation of damages across three cross-complaint claims, one for breach of contract and two for torts. The cross-complainant introduced evidence of a $10,975 injury.[261] The jury awarded that precise amount, spread across two claims ($9,350 for breach of contract and $1,625 for fraudulent concealment), while awarding "no additional damages" on the second tort claim. *Id.* at 1219, 1221. This was significant, since the jury also awarded punitive damages on the tort claims without indicating which one(s) underlay that award. The cross-defendants argued the jury's failure to allocate any damages to one claim meant the

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[260] 32AA9205. Plaintiffs also established liability but received zero damages on the Section 11 claim. This cross-appeal does not address Section 11 damages because interest on that claim would only duplicate the interest Plaintiffs seek under Section 25500.

[261] In a recurring error, the $10,975 figure is then mistyped as $10,375.

punitive award could not stand since it might have been improperly based on a claim without any actual damages. *Id.* at 1222.

The appellate court disagreed. Since, as here, the measure of damages was the same on all claims, and the total amount awarded, as here, was equal to the claimed damages, the court concluded that the jury had simply attempted to allocate the total damages across two of the three claims, leaving "no further damages" for the second tort claim. *Id.* at 1224. Given this unnecessary allocation, the court held that the verdict should be interpreted as awarding the full damage amount on both the "tort claims," thus saving the punitive award.[262] *Id.* at 1224-25.

Courts take a similar approach when a jury identifies a total damage figure, but purports to allocate it among jointly-liable defendants. *Sparks v. Berntsen, supra*, 19 Cal.2d at 310-12; *Dauenhauer v. Sullivan* (1963) 215 Cal.App.2d 231, 233-35; *Weddle v Loges, supra*, 52 Cal.App.2d at 119-20; *Mixon v. Riverview Hospital* (1967) 254 Cal.App.2d 364, 372, 374 (rule applies unless "verdict on its face does not fix a total"). Rejecting such

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[262] *All-West Design, supra,* 183 Cal.App.3d at 1222-23, does note that a jury's award of "no additional damages" may be different from a jury's award of "zero" damages. In *All-West*'s particular context (*i.e.,* whether punitive damages were recoverable), that distinction may matter because California law apparently holds that an express award of "$0" in actual damages precludes exemplary damages. However, in the present context, *All-West* instructs that a jury's response to a verdict form may indicate a mistaken effort to allocate the total damages among the verdict blanks and that both a jury award of "$1,650" and a jury award of "no additional damages" may properly be interpreted as a finding of $10,975 in damages. Even in the punitive damages context, the Supreme Court has recognized that jury inadvertence or misunderstanding may cause peculiar results in responding to verdict forms with multiple damage blanks and that courts should disregard such a mistake as an "error of form rather than of substance." *Clark v. McClurg* (1932) 215 Cal. 279, 284-85.

allocations is "almost a commonplace." *Mixon v. Riverview Hospital, supra*, 254 Cal.App.2d at 374.

The Eighth Circuit's decision in *Bird v. John Chezik Homerun, Inc., supra*, 152 F.3d 1014, is particularly instructive. In *Bird*, the court determined that the jury had allocated its total damage assessment to one claim while finding liability and awarding zero damages on another claim with parallel damages. In such circumstances, *Bird* held that a judgment should follow that attaches the damage award to the "zero damages" claim. *Id.* at 1016-17 & n.2 ("[i]f the misrepresentations caused $6,900 in actual damages under Count I, then they must have caused that amount of actual damages under Count II"). Here, the Section 25500 claim's damage measure was the same as that for intentional nondisclosure (except that Section 25500 does not allow for the recovery of mitigation losses).[263] Thus, as in *Bird*, "[t]he only plausible explanation for the jury's failure to award damages on [the Section 25500 claim] is that the jury had already awarded [plaintiff] damages on [another claim] for essentially the same conduct and did not want to award [plaintiff] the same damages twice." *Bird v. John Chezik Homerun, Inc., supra*, 152 F.3d at 1016-17.

Because the damage measure on the Section 25500 claim was the same as that on the common law claims,[264] and the jury found CIBC liable

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[263] The jury instructions made this very clear. *Compare* 32AA9073-74 (non-mitigation damages on common-law claims are difference "between the actual value of that with which the plaintiff parted and the actual value of that which was received" where "[a]ctual value means market value") *with* 32AA9089-90 (Section 25500 damages are "difference between the price at which the person purchased securities and the market value the securities would have had at the time of purchase in the absence of the false or misleading statement").

[264] *Supra* n.263.

on both claims, these principles and cases establish that the present verdict should be interpreted as an award of the Verdict No. 2 "total damages" (less the Mitigation Loan losses) on the Section 25500 claim, just as they were an award on the common law claims.

In any event, like the *Bird* defendant, CIBC waived any right to rely on the "$0" award on the Section 25500 claim when it improperly resisted Plaintiffs' effort to clarify the jury's verdicts. *See* Respondents' Brief, Parts III.C & V.B.1.e.

At trial, CIBC contended that the jury's attempted apportionment of damages among claims could be explained by Section 25500's "willfulness" element, which was purportedly absent from the other claims.[265] This explanation fails for two reasons. First, the Section 25500 claim actually had a lower *mens rea* requirement than that required for intentional nondisclosure. The Section 25500 claim required proof of CIBC's "purpose or willingness" to make the misrepresentation or omission, but not proof of intent to induce reliance, while the intentional nondisclosure claim required proof of such intent.[266] Moreover, Plaintiffs *did* establish all the elements of their Section 25500 claim, including willfulness, because the jury found CIBC was liable on that claim.

V. CONCLUSION

With regard to the propriety of an award under Section 25500, the trial court misinterpreted the verdict. Accordingly, this Court should remand with instructions to enter judgment for Oaktree and Pacholder on the Section 25500 claim in the Verdict No. 2 amounts less their Mitigation

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[265] 25RT4697:28-4698:12.

[266] *Compare* 32AA9081-82, 9087-88 *with* 32AA9049-50, 9069-70.

Loan losses (*i.e.*, $21,434,456 for Oaktree and $3,773,135 for Pacholder), with prejudgment interest at the legal rate (7%) from the purchase dates to September 9, 2003 when the verdict was returned.

Dated: January 18, 2005

Respectfully submitted,

Hennigan, Bennett & Dorman LLP

Greines, Martin, Stein & Richland LLP

By: _____,
Michael Swartz

Attorneys for Respondents and Cross-Appellants

EXHIBIT 1

IDS Bond Fund, Inc., IDS Life Managed Fund, Inc., IncomeTrust, Growth and Income Trust, and IDS Life Special Income Fund, Inc.,Plaintiffs, v. Gleacher NatWest Inc. d/b/a Natwest Capital Markets Limited,McDonald Investments Inc. f/k/a McDonald & Company Securities, Inc. and SteelDynamics Inc., Defendants.
Civil No. 99-116(MJD/JGL)

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MINNESOTA

2002 U.S. Dist. LEXIS 4073; Fed. Sec. L. Rep. (CCH) P91,750

March 6, 2002, Decided

DISPOSITION: [*1] Motions of Gleacher NatWest Inc., NatWest Capital Markets Limited, and National Westminister Bank plc and of Steel Dynamics Inc. for summary judgment DENIED.

CASE SUMMARY:

PROCEDURAL POSTURE: Defendant investment companies filed motions for summary judgment in connection with plaintiff investors' securities fraud case. The investors had alleged that the investment companies made a number of misrepresentations and omissions concerning the offering of notes to finance a steel mini-mill in Thailand.

OVERVIEW: The court initially addressed the contention that the investment companies were entitled to summary judgment because the state law securities fraud claims were preempted by the *15 U.S.C.S. § 77r* of the National Securities Markets Improvement Act. The court, however, found that such claims were specifically preserved in *15 U.S.C.S. § 77r*(c)(1). The court further found that genuine issues of material fact existed as to whether the investors reasonably relied on the alleged misrepresentations made at the road shows, in the slide show, and in the offering memorandum. Moreover, the facts of the case did not warrant summary judgment based on the application of the second investment decision doctrine. There was no market in which to sell the security once the fraud was discovered, particularly as this was a case in which the securities at issue were not publicly traded, but sold in a private placement. Furthermore, summary judgment was not warranted on the basis of the Minnesota Securities Act because limiting secondary liability to natural persons under *Minn. Stat. § 80A.23(3)* would have lead to an absurd result. The court accordingly denied the motions for summary judgment.

OUTCOME: The court denied the investment companies' motions for summary judgment as to the investors' securities fraud claims.

CORE TERMS: misrepresentation, offering, securities fraud, issuer, purchaser, slide, entitled to summary judgment, summary judgment, federal law, state law, registration, presentation, mill, indirectly, regulation, mini-mill, omission, preempt, preempted, listing, steel, genuine, preemption, attributed, investors, exempt, plc, secondary liability, reasonable jury, misleading

LexisNexis(R) Headnotes

Civil Procedure: Summary Judgment: Summary Judgment Standard
[HN1] Summary judgment as a matter of law is appropriate when no genuine issue of material fact exists in the record. *Fed. R. Civ. P. 56(c)*. A fact is material if resolving disputes concerning that fact affects the outcome of the case. A dispute is genuine if, based on the evidence, a reasonable jury could return a verdict for either party. On a motion for summary judgment, the Court views all evidence and inferences in a light most favorable to the nonmoving party. The moving party carries the burden to demonstrate the absence of any genuine issue of material fact. *Fed. R. Civ. P. 56(b)*.

Constitutional Law: Supremacy Clause
[HN2] Preemption analysis begins with the acknowledgment of the Supremacy Clause of the U.S. Constitution, which provides that the laws of the United States shall be the supreme law of the land; any thing in the constitution or laws of any state to the contrary notwithstanding. U.S. Const. art. VI, cl. 2. State law that conflicts with federal law is thus considered to be "without effect." Consideration of issues arising under the Supremacy Clause starts with the assumption that the historic police powers of the states are not to be superseded by federal act unless that is the clear and manifest purpose of Congress.

Constitutional Law: Supremacy Clause
[HN3] Thus, to determine whether a federal statute preempts state securities fraud claims, the court must look to Congress' intent in passing such legislation. Congress' intent may be explicitly stated in the statute's language, or implicitly in its structure and purpose. In the absence of an express congressional command, state law is preempted if that law actually conflicts with federal law or if federal law so thoroughly occupies a legislative field as to make reasonable the inference that Congress left no room for the states to supplement it.

Securities Law: Exemptions From Registration: Classes of Securities
[HN4] See *15 U.S.C.S. § 77r*(a).

Securities Law: Exemptions From Registration: Classes of Securities
[HN5] See *15 U.S.C.S. § 77r*(b).

Securities Law: Exemptions From Registration: Classes of Securities
[HN6] See *15 U.S.C.S. § 77r*(c)(1).

Securities Law: Additional Offerings, Disclosure & the Securities Exchange Act of 1934: Scope & Jurisdiction: Limitations on Remedies
Securities Law: Bases for Liability: Remedies
[HN7] The savings clauses of the 1933 and 1934 Securities Act provide that the rights and remedies provided by such acts shall be in addition to all other rights and remedies that exist at law or in equity. *15 U.S.C.S. §§ 77p*(a) and 78bb(a).

Securities Law: Bases for Liability: Liability for Fraud
Securities Law: Bases for Liability: Remedies
[HN8] In securities fraud cases, damages are determined in accordance with the extent to which a plaintiff is actually damaged as a result of the defendant's fraudulent conduct. Actual damages are generally measured by determining the plaintiff's out-of-pocket loss, which is in turn measured by the difference between the purchase price of the security and its actual value. The actual value of the security may be determined either on the date of purchase or on the date the fraud was discovered. In some cases, especially when the security is traded publicly, it may be difficult to ascertain the value of the security transferred in connection with the fraudulent and in such cases the value may be determined on the date the fraud is discovered. In any event, the function of the court is to fashion the remedy best suited to the harm.

Securities Law: Bases for Liability: Liability for Fraud
[HN9] In cases in which the securities at issue were not publicly traded, but were sold in a private placement, there is no market in which to sell the security once the fraud is uncovered.

Securities Law: Blue Sky Laws: Civil Liability
[HN10] Minnesota courts do not interpret *Minn. Stat. § 80A.23(3)* not applying to corporations. Rather, the courts focus on whether the alleged agent, both corporations, represented the seller in effecting or attempting to effect purchases or sale of securities.

COUNSEL: James R. Safely, Thomas B. Hatch, Randall Tietjen, Kari Thoe Crone, Bethany D. Krueger and John P. Morgan, Robins, Kaplan, Miller & Ciresi LLP, for and on behalf of Plaintiffs.

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David I. Gindler and Richard H. Zelichov, Irell & Manella LLP, Charles N. Nauen and Eric C. Tostrud, Lockridge Grindal Nauen P.L.L.P. and Robert S. Walters, Barrett & McNagny, for and on behalf of Steel Dynamics, Inc, Defendant.

JUDGES: Michael J. Davis, United States District Court.

OPINIONBY: Michael J. Davis

OPINION: MEMORANDUM OPINION AND ORDER

This is a securities fraud case, in which Plaintiffs allege that the Defendants made a number of misrepresentations and omissions concerning the offering of notes to finance a steel mini-mill in Thailand. Before the Court are the motions of Defendants Gleacher NatWest, Inc., NatWest[*2] Capital Markets Limited and National Westminister Bank, plc and of Steel Dynamics, Inc. for summary judgment.

Factual Background

In December 1997, the Nakornthai Strip Mill Public Company Limited ("NSM") completed the construction of the first part of a steel mini-mill (the "NSM Mill"). NSM had run out of cash, and was unable to secure financing in Thailand because of an economic crisis in that country. As a result, NSM decided to raise money in the U.S. by making an offering of debt securities ("NSM Notes"). The Plaintiffs (collectively referred to as "IDS") are investment funds that purchased approximately $62 million of the NSM Notes in March 1998. Defendant National Westminster Bank plc is a banking institution

that is headquartered in London, England that was the lead underwriter in the NSM Note offering at issue in this case. Defendants NatWest Capital Markets Limited and Gleacher NatWest, Inc. were agents of the National Westminster Bank plc (collectively referred to as "NatWest"). Defendant McDonald Investments, Inc. f/k/a McDonald & Company Securities ("McDonald") was also an underwriter for the note offering.

The NSM Notes were considered high-risk, non-investment[*3] grade notes given the fact that NSM already had an enormous debt, and because the NSM Mill had no operating history and was located in Thailand. The NSM Notes were offered only to "Qualified Institutional Buyers"; institutional investors holding more than $100 million in assets that are qualified under federal law to trade high-risk, unregistered securities in private markets. Each named plaintiff is a "Qualified Institutional Buyer".

In January 1998, representatives of NatWest and McDonald invited IDS to attend an informal presentation concerning the NSM Notes. IDS thereafter attended a formal presentation, or road show, on February 11, 1998. Keith Busse, President of Defendant Steel Dynamics, Inc. ("SDI"), attended both meetings. SDI owns a successful steel mill in Indiana, and because of its expertise in operating a steel mini-mill, SDI was asked to provide consulting services by NatWest and McDonald. IDS alleges that SDI's presence at the meetings, and affirmation of the steel mini-mill, is central to its claims of securities fraud because SDI's success with its own steel mini-mill provided credibility to the NSM Note transaction.

Mr. John Schultes, President and CEO of NSM, [*4] made the major presentation concerning the NSM Mill at the road show. In his presentation, Schultes represented that the NSM mill provided a "significant cost advantage versus most global competitors", with a "world class management team and significant strategic equity partners". Gindler Decl., Ex. 9 at IDS0002910. He further represented that the NSM Mill had "technological enhancements over existing mini-mills [that] allow for even greater operating efficiencies and significantly higher quality". Id. at IDS0002911. It was further represented that SDI was a 10% managing owner that would provide "managerial and technical support under a 10-year Management Agreement" Id. at IDS0002917, and that the "concept and operating assumptions [were] verified by Steel Dynamics, Nucor, Hylsa, Preussag and Klockner". Id. at IDS0002926.

Although Busse did not make a formal presentation, he is alleged to have interjected himself on several points, making positive comments concerning the technological capabilities of the NSM Mill, the cost advantage, and about SDI's commitment to the deal. Koehl Dep. at 492-493. Busse may have also reviewed and commented on the slide show prior to[*5] its presentation. Busse Dep. at 457-458.

In addition to the road show presentations, NatWest and McDonald prepared and distributed a number of memoranda; one dated February 9, 1998, a supplemental offering memoranda dated February 27, 1998, and a final Offering Memorandum ("OM") dated March 2, 1998. SDI was sent drafts of the offering memoranda, and did provide comments on those portions referring to SDI and its role in the transaction. Walters Dep. at 154-161.

The role of SDI in the transaction is defined in a separate agreement between SDI and the NSM Management Co. titled the "Management Advisory and Technical Assistance Agreement" (hereinafter the "Advisory Agreement"). Crone Decl. Ex. 12. NatWest and McDonald originally wanted SDI to assume the management of the NSM Mill, but SDI did not have the personnel to undertake the management. Walsh Decl. Ex. 19 at 5. Thereafter, SDI agreed to provide consulting and training, and also agreed to become a member of a management company; the manager of which was an individual from McDonald, David Stickler. Walsh Decl. Ex. 25; Crone Decl. Ex. 12. The Advisory Agreement further provided that:

2.3 The parties agree that SDI has undertaken[*6] no independent study or analysis of NSM's proposed operations, or of its Mill, its proposed Products, its technology and equipment, its raw materials, its markets, its transportation system, or the impact of its Thai culture, legal system, or tax laws upon its proposed business or upon Mill operations. SDI does not know whether, and has made no representations to NSM, express or implied, to the effect that SDI Technology or SDI's techniques and culture are appropriate for or best suited to NSM's needs SDI's undertaking herein, is solely to make available to Management Co., and, through Management Co. to NSM, it own understandings, experience, and know-how, based upon its own operations, for Management Co.'s and/or NSM's use, rejection, modification or adaptation as Management Co. and/or NSM deems appropriate. The parties likewise agree that SDI shall have no ongoing monitoring or oversight functions over NSM's Mill operations.

Crone Decl. Ex. 12. The Advisory Agreement further provided that "SDI has been granted no authority, does not intend to exercise any such power or authority, and is undertaking no obligations to directly or indirectly manage, control or supervise any[*7] of NSM's

management or operating personnel or any of NSM's policies, practices or procedures . . . " Id. § 2.4.

For its contributions to the NSM Mill, SDI was given reciprocal rights to technical information and assistance, an annual fee of $2 million dollars, a one-time payment of $1.3 million payable upon the start-up of the Finishing Facilities, and would be reimbursed its costs. Id. at § § 3.1 and 4.1. SDI was also to receive a 10% equity interest in NSM, the receipt of which would result in taxable income. The Thai tax liability amounted to $5.4 million, which was paid by NSM from the proceeds of the offering. Healy Dep. 1068-1070 and 1075-1079. IDS asserts that at no time prior to purchasing the NSM was it given a copy of the Advisory Agreement, or were otherwise informed of SDI's true role in this transaction. Koehl Decl. P 4

IDS alleges that after reviewing the OM, and listening to road show presentations, as well as reviewing the slides, IDS made the decision to purchase 12% Senior Mortgage Notes, 121/4% Senior Subordinated Mortgage Notes, with Warrants to Purchase Ordinary Shares of NSM in the aggregate amount of $62 million on March 12, 1998. Koehl Decl. [*8] P 5; Crone Decl. Ex. 21 at 24-25.

On May 7, 1998, IDS's analyst, Michael Koehl called Busse to discuss the NSM Mill. Koehl Dep. at 1159. During this conversation, the two discussed the operations of the mill and the problems it was experiencing, and what SDI was going to do to address such problems. Koehl Dep. at 1168-1217; Busse Dep. at 1137. One topic discussed was that the NSM Mill was behind schedule for the melt-shop ramp up. Koehl Dep. at 1167-1168. Busse also told Koehl that SDI was going to step up its involvement at the NSM Mill, and that he was shocked at the disarray. Id. at 1169-1173. Busse also told him that NSM Management had no sense of urgency. Id. at 1176. From this conversation, Koehl walked away with the impression that he "wasn't happy with what I was hearing, but that the potential was there for this thing to get back on track because a lot of what we talked about were managerial things that seemingly would have been fixable in shorter order than if, had there been a massive technical problem with the mill itself." Id. at 1202.

In October 1998, a meeting of bondholders was held at SDI's plant in Indiana. Koehl Dep. at 1218. At this meeting, Busse[*9] informed the attendees of the developments concerning the NSM Mill. Walsh Decl. Ex. 47. Specifically, Busse discussed the failing economy in Thailand, then proceeded to discuss major problems occurring because of bad management. Id. For example, Busse informed the attendees that the furnace had a hole burned through the top, and when it was repaired, the old, defective refactories were reinstalled in the furnace. Id. at 17. Busse commented that SDI made recommendations to the NSM Management Company, but that their recommendations were completely ignored. Id. at 19.

After this meeting, the price of the NSM Notes plummeted. Cobb Aff., Ex. A. The NSM Mill shut down in December 1998, and NSM is in default on the Notes. Koehl Decl. P 15.

In the Third Amended Complaint, IDS has asserted claims of securities fraud pursuant to federal and state law against all defendants, as well as a claim of fraud and negligent misrepresentation, and a claim that defendants violated the Minnesota Consumer Fraud Act. IDS's claims of securities fraud are based on a number allegations of misrepresentations or omissions contained in, or concerning, the information provided to IDS at the road shows[*10] and in the OM. Recently, the Court allowed IDS to amend its Complaint to allow IDS to seek punitive damages.

Standard for Summary Judgment

[HN1] Summary judgment as a matter of law is appropriate when no genuine issue of material fact exists in the record. *Fed. R. Civ. P. 56(c); Celotex Corp. v. Catrett, 477 U.S. 317, 322-23, 91 L. Ed. 2d 265, 106 S. Ct. 2548 (1986); Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 249-250, 91 L. Ed. 2d 202, 106 S. Ct. 2505 (1986).* A fact is material if resolving disputes concerning that fact affects the outcome of the case. See *Anderson, 477 U.S. at 248.* A dispute is genuine if, based on the evidence, a reasonable jury could return a verdict for either party. See *id. at 252.* On a motion for summary judgment, the Court views all evidence and inferences in a light most favorable to the nonmoving party. See *id., 477 U.S. at 250.* The moving party carries the burden to demonstrate the absence of any genuine issue of material fact. *Fed. R. Civ. P. 56(b); Celotex, 477 U.S. at 323.*

NatWest's Motion for Summary Judgment

1. Preemption

NatWest argues[*11] that IDS's state law securities fraud claims, Counts III, IV and VI, must be dismissed as they are preempted by the National Securities Markets Improvement Act ("NSMIA"), Pub. L. No. 104-290, 110 Stat. 3416 (1996) codified in part at *15 U.S.C. § 77r.*

[HN2] Preemption analysis begins with the acknowledgment of the Supremacy Clause of the U.S.

Constitution, which provides that the laws of the United States "shall be the supreme Law of the Land; . . . any Thing in the Constitution or Laws of any state to the Contrary notwithstanding." Art. VI, cl. 2. State law that conflicts with federal law is thus considered to be "without effect." *Cipollone v. Liggett Group, Inc., 505 U.S. 504, 516, 120 L. Ed. 2d 407, 112 S. Ct. 2608 (1992)*(citing *McCulloch v. Maryland, 17 U.S. 316, 4 Wheat. 316, 427, 4 L. Ed. 579(1819))*. "Consideration of issues arising under the Supremacy Clause "starts with the assumption that the historic police powers of the States [are] not to be superseded by . . . Federal Act unless that [is] the clear and manifest purpose of Congress." Id. (citing *Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230, 91 L. Ed. 1447, 67 S. Ct. 1146 (1947))*.[*12]

[HN3] Thus, to determine whether the NSMIA preempts state securities fraud claims, the Court must look to Congress' intent in passing such legislation.

Congress' intent may be "explicitly stated in the statute's language, or implicitly in its structure and purpose." . . . In the absence of an express congressional command, state law is preempted if that law actually conflicts with federal law . . . or if federal law so thoroughly occupies a legislative field "'as to make reasonable the inference that Congress left no room for the States to supplement it.'"

Id. (citations omitted).

A. Explicit Preemption

The applicable provisions of NSMIA provide the following:

[HN4] (a) Scope of exemption

Except as otherwise provided in this section, no law, rule, regulation, or order, or other administrative action of any State or any political subdivision thereof--

(1) requiring, or with respect to, registration or qualification of securities, or registration or qualification of securities transactions, shall directly or indirectly apply to a security that--

(A) is a covered security; or

(B) will be a covered security upon completion of the transaction;

(2) [*13] shall directly or indirectly prohibit, limit, or impose any conditions upon the use of--

(A) with respect to a covered security described in subsection (b) of this section, any offering document that is prepared by or on behalf of the issuer; or

(B) any proxy statement, report to shareholders, or other disclosure document relating to a covered security or the issuer thereof that is required to be and is filed with the Commission or any national securities organization registered under section 78o-3 of this title, except that this subparagraph does not apply to the laws, rules, regulations, or orders, or other administrative actions of the State of incorporation of the issuer; or

(3) shall directly or indirectly prohibit, limit, or impose conditions, based on the merits of such offering or issuer, upon the offer or sale of any security described in paragraph (1).

[HN5] (b) Covered securities

For purposes of this section, the following are covered securities:

(1) Exclusive Federal registration of nationally traded securities

A security is a covered security if such security is--

(A) listed, or authorized for listing, on the New York Stock Exchange[*14] or the American Stock Exchange, or listed, or authorized for listing, on the National Market System of the Nasdaq Stock Market (or any successor to such entities);

(B) listed, or authorized for listing, on a national securities exchange (or tier or segment thereof) that has listing standards that the Commission determines by rule (on its own initiative or on the basis of a petition) are substantially similar to the listing standards applicable to securities described in subparagraph (A); or

(C) is a security of the same issuer that is equal in seniority or that is a senior security to a security described in subparagraph (A) or (B).

(2) Exclusive Federal registration of investment companies

A security is a covered security if such security is a security issued by an investment company that is registered, or that has filed a registration statement, under the Investment Company Act of 1940.

(3) Sales to qualified purchasers

A security is a covered security with respect to the offer or sale of the security to qualified purchasers, as defined by the Commission by rule. In prescribing such rule, the Commission may define the term "qualified purchaser" differently[*15] with respect to different categories of securities, consistent with the public interest and the protection of investors.

(4) Exemption in connection with certain exempt offerings

A security is a covered security with respect to a transaction that is exempt from registration under this subchapter pursuant to--

(A) paragraph (1) or (3) of section 77d of this title, and the issuer of such security files reports with the Commission pursuant to section 78m or 78o(d) of this title;

(B) section 77d(4) of this title;

(C) section 77c(a) of this title, other than the offer or sale of a security that is exempt from such registration pursuant to paragraph (4), (10), or (11) of such section, except that a municipal security that is exempt from such registration pursuant to paragraph (2) of such section is not a covered security with respect to the offer or sale of such security in the State in which the issuer of such security is located; or

(D) Commission rules or regulations issued under section 77d(2) of this title, except that this subparagraph does not prohibit a State from imposing notice filing requirements that are substantially similar to those required by[*16] rule or regulation under section 77d(2) of this title that are in effect on September 1, 1996.

NatWest argues that the NSMIA's preemption provisions apply in this case because the NSM Notes are "covered securities" and IDS are "qualified purchasers" as defined by the NSMIA. NatWest further argues that the NSMIA preempts state laws that "directly or indirectly prohibit, limit or impose any condition upon" the use of an offering document that is prepared by or on behalf of the issuer, and it preempts state laws that "directly or indirectly prohibit, limit or impose conditions, based on the merits of such offering or issuer, upon the offer or sale" of a covered security. *15 U.S.C. §§ 77r* (a)(2) and (3). Because IDS's state law claims involve, in part, alleged misrepresentations contained in the OM, such claims would, if successful, impose limits on the use of an offering memorandum by subjecting defendants to civil damages for misstatements contained therein. Similarly, the claims based on misrepresentations contained in the slide show or with respect to oral statements, would impose limitations and conditions upon the offer and sale of a covered security[*17] by proscribing false or misleading statements with respect to the merits of the offer or sale of such security.

Assuming without deciding that the NSM Notes are "covered securities" and that IDS are "qualified purchasers", the Court finds that the state securities fraud claims are not preempted pursuant to the NSMIA, because the statute specifically preserves such claims:

[HN6] (c) Preservation of authority

(1) Fraud authority

Consistent with this section, the securities commission (or any agency or officer performing like functions) of any State shall retain jurisdiction under the laws of such State to investigate and bring enforcement actions with respect to fraud or deceit, or unlawful conduct by a broker or dealer, in connection with securities or securities transactions.

15 U.S.C. § 77r(c)(1).

NatWest responds that this provision actually supports preemption, because the language refers only to securities fraud actions instituted by state agencies, not private actions, as is the case here. This interpretation is not supported by the congressional purpose or the legislative history of the NSMIA, however.

The NSMIA was passed "in order to promote[*18] efficiency and capital formation in the financial markets." Pub. L. No. 104-290, 110 Stat. 3416 (1996). The Second Circuit noted that to promote such efficiency, the NSMIA was enacted primarily to:

preempt state "Blue Sky" laws which required issuers to register many securities with state authorities prior to marketing in the state. By 1996, Congress recognized the redundancy and inefficiencies inherent in such a system and passed NSMIA to preclude states from requiring issuers to register or qualify certain securities with state authorities.

Lander v. Hartford Life & Annuity Insurance Company, 251 F.3d 101, 109 (2nd Cir. 2001).

The legislative history shows that by passing the NSMIA, Congress intended that the Act have no effect on private civil actions under state law. "It is also the Committee's intention not to alter, limit, expand, or

otherwise affect in any way any State statutory or common law with respect to fraud or deceit, including broker-dealer sales practices, in connection with securities and securities transactions." H.R. 104-622, at 34, reprinted in 1996 U.S.C.C.A.N. 3877, 3897. See, *Zuri-Invest AG v. Natwest . Inc. 177 F. Supp. 2d 189, 193.* [*19]

As support for its position, NatWest cites the Court to the decision of the Ninth Circuit in *Myers v. Merrill Lynch & Co., Inc., 1999 U.S. Dist. LEXIS 22642, 1999 WL 696082 (N.D. Cal. 1999)* aff'd, *249 F.3d 1087 (9th Cir. 2001).* Myers, however, involved a state statute that placed limitations on the practice of penalty bids, where no federal law imposed a similar limitation. The court found that because the SEC Regulations specifically contemplated that penalty bids would be used, state law prohibiting such practice was preempted. Based on its facts, Myers is distinguishable from this case. More importantly, Myers does not stand for the proposition that private causes of action asserting state law securities fraud claims are preempted, while state actions are not.

Further, the Court finds that the NSMIA was not intended to preempt state securities fraud claims because in enacting the NSMIA, Congress did not amend [HN7] the savings clauses of the 1933 and 1934 Securities Act, which provide that the rights and remedies provided by such Acts shall be in addition to all other rights and remedies that exist at law or in equity. *15 U.S.C. §§ 77p*(a) and 78bb(a). [*20]

B. Implied Preemption

NatWest argues that the NSMIA implicitly preempts state securities fraud claims because such claims pose an obstacle to the statute's purpose of creating a federal scheme for the regulation of securities offerings. As noted above, the purpose of the NSMIA is to establish a single, federal scheme for the regulation and qualification of securities. Allowing state fraud claims to proceed does not impede this purpose, because federal law prohibits the same conduct.

2. Merits of the Claims

NatWest also argues that they are entitled to summary judgment, because the OM contains the following provision:

NO REPRESENTATION OR WARRANTY, EXPRESS OR IMPLIED, IS MADE BY THE INITIAL PURCHASERS AS TO THE ACCURACY OR COMPLETENESS OF THE INFORMATION SET FORTH HEREIN, AND NOTHING CONTAINED IN THIS OFFERING MEMORANDUM IS, OR SHOULD BE RELIED UPON AS, A PROMISE OR REPRESENTATION, WHETHER AS TO THE PAST OR FUTURE. THE INITIAL PURCHASERS DO NOT ASSUME ANY RESPONSIBILITY FOR THE ACCURACY OR COMPLETENESS OF SUCH INFORMATION.

OM at iii. The OM further provides that the statements, estimates and projections contained therein are those of NSM, not of NatWest. NatWest[*21] thus argues that the statements made in the OM cannot be attributed to NatWest, and thus IDS cannot meet its burden that NatWest made material false or misleading statements.

The above quoted disclaimer does not state that the initial purchasers made no representations in the OM. Rather, the disclaimer provides that the initial purchasers make no warranty as to the accuracy or completeness of the statements contained therein. In addition, the OM provides that it contains "certain statements, estimates and projections by the issuers" not that all such statements, estimates and projections were provided by the issuers. OM at iii (emphasis added). Because NatWest was an initial purchaser, it is an "insider or affiliate" and a specific connection need not be made between the alleged misrepresentations and NatWest. *Luce v. Edelstein, 802 F.2d 49, 55 (2nd Cir. 1986).*

NatWest also argues that it merely assisted in the drafting of the Offering Memorandum, therefore it cannot be held liable for alleged misrepresentations or omissions that were not specifically attributed to NatWest. The cases that NatWest has cited in support of this argument are factually distinguishable [*22]from this case because they involve either attorneys or accountants that drafted the document at issue, but were not initial purchasers or otherwise a participant in the sale of the securities. In this case, NatWest is an initial purchaser, and as discussed above, may be held liable for the alleged misrepresentations or omissions in the OM. *Gabrielson v. Capital, L.P. v. NatWest Finance, Inc., 94 F. Supp. 2d 491, 501-503 (S.D.N.Y. 2000).*

Finally, NatWest argues that the OM superseded any statements made at the road shows, and that the OM provided any investment decision must be based solely on information contained in the OM:

No dealer, salesperson, or other person has been authorized in connection with the offering made hereby to give any information or to make any representation not contained in this Offering Memorandum, and, if given or made, such information or representation must not be relied upon as having been authorized by the Notes Issuers, the Company or by the Initial Purchasers.

Thus, any alleged misrepresentations that are not contained in the OM cannot form the basis of a securities fraud claim. The cases cited by NatWest stand for the proposition[*23] that a securities fraud claim cannot be based on an oral representation that is later contradicted by a written document or offering memorandum. See eg., *Platsis v. E.F. Hutton & Co., 642 F. Supp. 1277, 1298 (W.D. Mich. 1986); In re Hyperion Securities Litigation, 1995 U.S. Dist. LEXIS 10020, No. 93 Civ. 7179 (MBM), 1995 WL 422480* at *7 (S.D.N.Y. July 14, 1995). NatWest has not shown which, if any, alleged misrepresentations are contradicted by the OM. Until such a showing is made, NatWest is not entitled to summary judgment.

In response to NatWest's motion, IDS asserts that notwithstanding the disclaimer language in the OM, it was reasonable for IDS to rely on any statements made at the road shows and in particular, in the OM. In support, IDS notes that certain NatWest employees testified at their depositions that it was reasonable for investors to rely on the information contained in the OM. See eg., Goldthorpe Dep. at 139, 229-30; Wheeler Dep. 1050, 1514.

Genuine issues of material fact exist as to whether IDS reasonably relied on the alleged misrepresentations made at the road shows, in the slide show and in the OM. Accordingly, summary judgment in favor of NatWest is[*24] not appropriate.

SDI's Motion for Summary Judgment

1. Loss Causation

SDI argues that it is entitled to summary judgment as to all of IDS's claims against it, as IDS cannot prove that any alleged misrepresentation or omission attributed to SDI caused IDS's losses. SDI argues that on May 7, 1998, two months after IDS purchased the NSM Notes, Busse notified IDS of certain problems facing NSM. However, rather than sell the NSM Notes at that time, which were trading at a premium, IDS made the conscious decision to hold on to the Notes, attributing the problems to the usual start up problems. SDI thus argues that after the May 7th call, IDS made a "second investment decision" to keep the Notes, and that this decision severed any causal connection between SDI's actions and IDS's losses.

SDI principally relies on *Nye v. Blyth Eastman Dillon & Co., 588 F.2d 1189, 1198 (8th Cir. 1978)* to support its argument that IDS cannot show a causal connection between its losses and the alleged fraudulent conduct of SDI. In Nye, the Eighth Circuit held that in determining damages from a Rule 10b-5 violation,

the relevant time period is the date the [plaintiffs] [*25] no longer relied on the misrepresentations in making their investment decisions. Thereafter, the [plaintiffs] had a reasonable time in which to make a 'second investment decision' to either hold the shares or sell them and reinvest the proceeds elsewhere. . . . Any increase or decrease in the value of the stock after a reasonable time is causally unrelated to the initial decision to purchase and can serve to neither decrease nor increase the amount of damages.

Id. 588 F.2d at 1198.

IDS argues that the second investment decision doctrine does not apply because damages in this case are measured at the time of the initial purchase, not when the alleged fraud had been discovered. IDS asserts that in this case, the NSM Notes were worthless when initially purchased, because the investment was not as it was represented. In a more recent Eighth Circuit decision, the court again discussed the proper measure of damages in securities fraud cases.

[HN8] In securities fraud cases, damages are determined in accordance with the extent to which a plaintiff is actually damaged as a result of the defendant's fraudulent conduct. Actual damages are generally measured by determining [*26]the plaintiff's out-of-pocket loss, which is in turn measured by the difference between the purchase price of the security and its actual value. In Harris v. American Investment Co., the court recognized that the actual value of the security may be determined either on the date of purchase or on the date the fraud was discovered. The court acknowledged that in some cases, especially when the security is traded publicly, it may be difficult to ascertain the value of the security transferred in connection with the fraudulent and in such cases the value may be determined on the date the fraud is discovered. In any event, 'the function of the court 'is to fashion the remedy best suited to the harm.'

Harris v. Union Electric Company, 787 F.2d 355, 367 (8th Cir. 1986) (citing *Harris v. American Investment Co. 523 F.2d 220, 225 (8th Cir. 1975)*, cert. denied, *423 U.S. 1054, 46 L. Ed. 2d 643, 96 S. Ct. 784 (1976)).*

The Court agrees that the facts of this case do warrant summary judgment on behalf of SDI based on application of the second investment decision doctrine. [HN9] In cases in which the securities at issue were not publicly traded, [*27]but were sold in a private placement such as in this case, there is no market in

which to sell the security once the fraud is uncovered. See, *Alexander v. Evans, 1993 U.S. Dist. LEXIS 14560, 1993 WL 427409* at *12 (S.D.N.Y. 1993)(holdings acquired through private placement are restricted, therefore no market to sell interests once fraud discovered). IDS has put forth evidence that the NSM Notes had little or no market value in May 1998, because only a small number were being traded, and IDS was one of the largest holders of the notes at that time. Koehl Decl. P 11. If IDS had attempted to sell them, the price would have gone down, and after a time, no bids would have been available. SDI has not put forth any evidence to the contrary.

2. Source of Misleading Statements

SDI also asserts that it is entitled to summary judgment because IDS cannot show that any SDI employee, particularly Keith Busse, made any material misrepresentations. It argues that it only had a peripheral role in the NSM Notes transaction; merely providing consulting services. However, IDS has put forth evidence to show that a reasonable jury could find that SDI's true role was misrepresented to IDS to induce its participation[*28] in the NSM Notes transaction through misrepresentations or omissions, made by or attributed to, SDI.

At the road show, SDI was described, not as a consultant, but as a "10% Managing Owner" working under a management agreement. Crone Decl. Ex. 13, IDS002916 and IDS0002917. IDS representatives believed that based on the information provided them at the road show and in the OM, and in particular by assurances given them by Busse, SDI would be "on the ground, sleeves rolled up" making sure the NSM Mill succeeded. Merrill Dep. 605. Investors were not provided a copy of the Advisory Agreement, which clearly defined SDI's role as a consultant and further provided how limited its role would be.

SDI also argues that it did not draft the slide show documents, therefore it cannot be held liable for any alleged misrepresentations contained therein. There is evidence suggesting that SDI was given the opportunity to comment on the slide show prior to its presentation. Busse admitted that he was sent the slide show materials before they were presented, and may have commented on such slides. Busse Dep. 1457. One such slide provided that SDI had verified the NSM Mill's concept and operating assumptions. [*29] Crone Decl. Ex. 13., IDS 0002926. In his deposition, Busse stated that SDI didn't verify anything, as that was not SDI's role. Busse Dep. 133-136. Yet, Busse never made this fact clear to IDS before the closing. By attending the road shows, a reasonable jury could find that the representations concerning SDI could be attributable to SDI, given the fact that SDI did not state otherwise, and did not provide any information contradicting the slides.

There is also evidence that SDI was sent portions of the drafts of the OM that discussed SDI's role in the transaction. Walters Dep. 154-161; Gindler Decl. Exs. 14 and 15. This evidence shows that SDI's counsel believed that comments in the drafts, which appear in the final, are misleading as to SDI's role in the transaction.

SDI also argues that Busse's comments were all true, therefore IDS claims of fraud and misrepresentation must fail. The Court finds that genuine issues of material fact exist in the record as to whether such statements were, in fact, true. The Court further finds genuine issues of fact exist on the record as to whether SDI acted with the requisite intent.

3. Minnesota Securities Act

Finally, SDI asserts that it is[*30] entitled to summary judgment on the Minnesota Securities Act ("MSA") claims because SDI did not actually sell the NSM Notes to IDS. IDS responds that SDI can be liable under the MSA if its participation in the transaction was a substantial factor, citing to *Anders v. Dakota Land & Development Co., 380 N.W.2d 862 (Minn. Ct. App. 1986)*(relying on federal law as a useful guide in defining a seller of securities). SDI asserts that the substantial factor test was overruled in *Pinter v. Dahl, 486 U.S. 622, 100 L. Ed. 2d 658, 108 S. Ct. 2063 (1988).* What the Court rejected in Pinter however, was the "substantial factor test" to the extent it held those liable who only tangentially were involved in the sale or purchase of a security. The Court specifically held that § 12(1) liability extends to those who "successfully solicits the purchase, motivated at least in part by a desire to serve his own financial interests or those of the securities owner." *Pinter, 486 U.S. at 647.* Accordingly, SDI's has failed to show it is entitled to summary judgment with respect to the MSA.

SDI further argues that IDS's MSA claim, to the extent it imposes[*31] secondary liability upon "agents" who materially aid in the fraud, must be dismissed as "agents" are defined in the statute as an "individual". *Minn. Stat. §§ 80A.23*, Subd. 3, and 80A.14, Subd. 3. At first glance, it would appear that a corporation cannot be an agent, as the term is defined in § 80A.14. However, in reviewing Minnesota case law addressing secondary liability of an agent pursuant to § 80A.23, Subd. 3, [HN10] the courts do not interpret this statutory provisions as not applying to corporations. See, *Jenson v. Touche Ross & Co., 335 N.W.2d 720 (Minn. 1983); Norwest Bank Hastings v. Clapp, 394 N.W.2d 176 (Minn.*

Ct. App. 1986). Rather, the courts focused on whether the alleged agent, both corporations, represented the seller in effecting or attempting to effect purchases or sale of securities. See, eg., *Jenson, 335 N.W.2d at 728.*

Pursuant to the rules of statutory construction, *Minn. Stat. § 645.17*, the Court finds that limiting secondary liability to natural persons under § 80A.23, Subd. 3 would lead to an absurd result. Accordingly, SDI is not entitled to summary judgment on that basis.

IT IS HEREBY ORDERED that the motions[*32] of Gleacher NatWest Inc., NatWest Capital Markets Limited, and National Westminister Bank plc and of Steel Dynamics Inc. are DENIED.

Date: March 6, 2002

Michael J. Davis

United States District Court

EXHIBIT 2

In the Matter of DONALDSON, LUFKIN & JENRETTE SECURITIESCORPORATION, Respondent.
Admin. Proc. File No. 3- 7863

SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933, Release No. 6959; SECURITIESEXCHANGE ACT OF 1934, Release No. 31207

1992 SEC LEXIS 2422

September 22, 1992

CORE TERMS: offering, registration statement, underwriter, vice-president, underwriting, senior, Tax Reform Act, totalling, credit union, remarketing, business activities, underwritten, billion, entity, fraudulent, financing, disclose, recommendation, law firm, tax law, underwrite, effective, endorsed, team, issuer, investment banking, disclosure, correspondent, anticipated, tax-exempt

TEXT: [*1]

ORDER INSTITUTING PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTIONS 15(b), 19(h) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, IMPOSING REMEDIAL SANCTIONS, AND CEASE AND DESIST ORDER

I.

The Commission deems it appropriate and in the public interest that public administrative proceedings be and they hereby are instituted against Donaldson, Lufkin & Jenrette Securities Corporation ("DLJ") pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Sections 15(b), 19(h) and 21C of the Securities Exchange Act of 1934 ("Exchange Act").

II.

In anticipation of the institution of these administrative proceedings, DLJ has submitted an Offer of Settlement which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission or to which the Commission is a party, prior to a hearing pursuant to the Commission's Rules of Practice, and without admitting or denying the findings herein, DLJ consents to entry of the findings, and the imposition of the remedial sanctions, set forth below.

III.

On the basis of this Order and the Respondent's Offer[*2] of Settlement, the Commission finds the following: n1

A. FACTS

n1 The findings herein are solely for the purposes of this proceeding and are not binding on any other person or entity named as a respondent in any other proceeding.

1. Respondent

Donaldson, Lufkin & Jenrette Securities Corporation has been registered with the Commission as a broker-dealer pursuant to Section 15(b) of the Exchange Act since 1973. DLJ is a Delaware corporation with its principal place of business at 140 Broadway, New York, New York.

2. Other Entity

Matthews & Wright Group, Inc. ("Matthews & Wright") was a Delaware corporation with offices located at 14 Wall Street, New York, New York. Matthews & Wright was formed in 1968 and until approximately November of 1987 was engaged in the underwriting, trading and brokering of municipal securities. Matthews & Wright ceased its investment banking activities in approximately November of 1987. Since that time, the Company, which in December of 1991 changed its name to Helmstar Group Inc., has been engaged primarily in real estate development.

On June 13, 1986, Matthews & Wright filed a Registration Statement ("the Registration[*3] Statement") with the Commission on Form S-1 under the Securities Act in connection with a planned initial public offering ("IPO") of 1.75 million shares of common stock. The Registration Statement was amended on July 2, 1986 and became effective on August 14, 1986. Under the registration statement as declared effective, Matthews & Wright sold 1.5 million shares of common stock at a price of $11 per share.

After the conclusion of the IPO, Matthews & Wright reported revenue of $47.2 million and income of $11 million on its Form 10-K for the year ended December 31, 1986. For the fiscal year ended December 31, 1990, Matthews & Wright reported revenue of $989,273 and a net loss of $8.78 million.

On April 27, 1989, the Commission filed a complaint in United States District Court for the Southern District of New York against Matthews & Wright and several officers of Matthews & Wright alleging violations of the antifraud, reporting, books and records and internal controls provisions of the federal securities laws. The matters alleged in the complaint included the failure of the Registration Statement to disclose certain material facts concerning the Company's business activities, [*4] including those discussed in this Order. On the day the complaint was filed, Matthews & Wright consented, without admitting or denying the allegations of the complaint, to the entry of a permanent injunction against future violations of the provisions alleged in the complaint. On the same day, in a separate administrative proceeding, the Commission revoked the broker-dealer registration of Matthews & Wright, Inc., a wholly-owned subsidiary of the Company.

3. Background

(a) The Fraudulent Closings Conducted by Matthews & Wright

On December 31, 1985, Matthews & Wright closed 24 offerings of municipal tax-exempt bonds totalling $786 million. Those offerings accounted for 27% of the firm's new issues for all of 1985 and 20% of the total dollar volume of such offerings for the year. The offerings were closed through the use of a fraudulent arrangement which jeopardized the tax-exempt status of the bonds and created significant risks and potential liabilities for Matthews & Wright.

To "close" the offerings, Matthews & Wright used starter checks drawn on a non-existent account at a credit union controlled by the Company's executive vice-president. The account on which [*5] the checks were drawn was not opened at the time of the closings, and Matthews & Wright had only $30,000 on deposit in another account at the credit union. The checks were thus worthless. n2

n2 In fact, the total amount of the checks far exceeded the total assets of the credit union, which were less than $50 million.

To avoid deposit of the checks in banking channels, Matthews & Wright's executive vice-president arranged for the checks to be immediately endorsed by the trustees at the closings to an offshore bank known as the Commercial Bank of the Americas (the "CBA"). The CBA was at the time a defunct bank with no offices and virtually no assets, and had a mailing address in Saipan in the Commonwealth of the Northern Mariana Islands in the South Pacific.

In return for endorsing the checks to the CBA, the trustees were provided with investment agreements from the CBA promising to repay the amount of the checks plus interest within six months. The investment agreements were executed by an employee of the credit union acting as a temporary "executive vice-president" of the CBA. The "executive vice-president" of the CBA then endorsed the checks back to Matthews & Wright, [*6] in return for the bonds. The checks

were thus circularly endorsed during the closings back to Matthews & Wright. The bonds were to be held by the CBA until they could be sold to the public in subsequent remarketings.

The December 31 closings were conducted to avoid an anticipated change in the tax law expected to be imposed by the Tax Reform Act of 1986 ("Tax Reform Act"). The Tax Reform Act was then pending before Congress but was expected to be enacted into law before the end of 1985, with an anticipated effective date of January 1, 1986. The restrictions to be imposed by the legislation would have made the offerings closed by Matthews & Wright on December 31 impossible to do after the effective date. Those transactions were thus an attempt to conduct "closings" before the end of the year, despite the firm's lack of capital to purchase the bonds at those closings, in order to obtain tax treatment for the offerings under the law prior to the Tax Reform Act.

The Tax Reform Act also imposed similar restrictions on other types of tax-exempt municipal bond offerings effective as of August 31, 1986. To avoid that expected change in the tax law, Matthews & Wright used the fraudulent [*7]closing mechanism described above to close an additional seven offerings totalling over $1.453 billion in August of 1986. The closings were conducted on four separate days, including August 14, 1986, the day of Matthews & Wright's IPO. By the time the August closings were completed, Matthews & Wright had fraudulently closed 31 offerings of municipal bonds totalling over $2.24 billion.

Matthews & Wright subsequently sold 27 of the 31 offerings, totalling over $1.34 billion, to the public in "remarketings." Those "remarketings" occurred after the applicable effective dates of the Tax Reform Act. The Secondary Offering Statements for the "remarketings" stated that the bonds had been sold on a specified prior date, thus indicating to purchasers that the bonds were entitled to tax exempt status under the law prior to the Tax Reform Act. Because of the nature of the "closings," however, there was a substantial risk that the bonds were sold for the first time during the "remarketings," after the applicable effective dates of December 31, 1985 and August 31, 1986, and that the bonds were not entitled to tax-exempt status.

(b) The Origin of the Closing Arrangement

In December[*8] of 1985, a senior vice-president in DLJ's Public Finance Division had assembled 19 offerings, totalling over $294 million, which he wanted to close before the end of the year. n3 The senior vice-president wanted DLJ to conduct the closings before the end of the year to avoid the same December 31, 1985 Tax Reform Act deadline that had prompted the Matthews & Wright closings.

n3 The senior vice-president joined DLJ in 1984 and left the employment of the firm in March of 1986.

In mid-December of 1985, the senior vice-president was informed that DLJ would not be in a position to commit the resources necessary to close the offerings before the end of the year. The senior vice-president then proposed a method to close the offerings without a commitment of capital. Under the proposed arrangement, DLJ would initially pay for the bonds at closing but would immediately receive the money back from the trustee in return for an investment agreement. The investment agreement would obligate DLJ to pay the trustee the offering amount, plus interest, at some time within six months. Because DLJ's Public Finance Division did not have sufficient capital at that time to carry the inventory [*9] of bonds into the new year, the proposal provided that the bonds would be transferred to a clearing correspondent of DLJ in return for the assumption by the correspondent of the investment agreement. The correspondent would then hold the bonds for a period of up to six months. At some point during the six month period, if interest rates had improved sufficiently, the correspondent would return the bonds to DLJ, which would then sell them to the public. If interest rates did not improve sufficiently, the offerings would be terminated at the end of the six-month period and would not be sold to the public.

The proposal was discussed with senior management of DLJ in late December of 1985. In a meeting on December 27, DLJ's then-Chief Executive Officer raised concerns about the legality of the proposal and directed a review of the proposal by an outside law firm. The proposal was then discussed with an attorney from an outside law firm later in the day on December 27. The lawyer raised several concerns about the proposal and indicated that he could not render an opinion without undertaking a detailed review. DLJ's management subsequently decided not to request such a review and [*10] not to use the proposal to close the offerings. The senior vice-president was then informed of that decision.

On December 20, prior to the rejection by DLJ of the proposal, the DLJ senior vice-president had provided Matthews & Wright's executive vice-president with a written description of his proposal.

(c) The Underwriting by Matthews & Wright of 18 Offerings Taken Over from DLJ

After being told of DLJ's decision to reject the proposed closing arrangement, the DLJ senior vice-president received permission to contact other investment banking firms about underwriting the offerings. He contacted several firms on December 27 and 28, but none indicated any interest in taking the offerings.

The senior vice-president then contacted Matthews & Wright's executive vice-president on the evening of December 28. Notwithstanding the short amount of time before the end of the year, Matthews & Wright's executive vice-president indicated that the firm would take the offerings. The DLJ senior vice-president then met with another Matthews & Wright executive in Houston, Texas on December 31 to arrange for Matthews & Wright to become the underwriter for 18 of the offerings, totalling over [*11] $221 million. Prior to the decision by Matthews & Wright to underwrite the 18 offerings, the Matthews & Wright executive vice-president had modified the closing proposal received from the DLJ senior vice-president on December 20 to involve the use of worthless credit union checks and investment agreements provided by the CBA. The modified proposal then became the basis for the fraudulent closing arrangement used by Matthews & Wright to close 24 offerings on December 31, including the 18 offerings taken over from DLJ, in the manner described above.

Because of the short amount of time between the decision by Matthews & Wright to underwrite the offerings taken over from DLJ and the December 31 closings conducted by Matthews & Wright, certain important documents for the offerings were not revised prior to the closings to reflect the change in underwriters. Those documents included the resolutions passed by the municipalities which authorized the selection of underwriters and various counsel opinions rendered in connection with the transactions. At the time of the December 31 closings, those documents, which were contained in the closing transcripts for each of the offerings, indicated[*12] that DLJ was still the underwriter for the offerings.

(d) The Matthews & Wright Initial Public Offering

(i) Disclosure in the Registration Statement

On August 14, 1986, Matthews & Wright offered 1.5 million shares of common stock to the public at a price of $11 per share. The Registration Statement filed with the Commission in connection with the offering did not disclose the closing arrangement described above which had been used by Matthews & Wright in December of 1985 and again in August of 1986 to close over $2.24 billion of offerings. n4 The Registration Statement did contain discussion, however, of the remarketings of the offerings closed with the arrangement and emphasized the business and revenue increases attributable to those offerings. The following language appeared in a section of the Registration Statement discussing Matthews & Wright's business for the first six months of 1986:

Total revenues of the Company increased 161% from $7,138,970 to $18,646,132. This increase reflects the continued trend of business growth on a comparable quarterly basis over the last three years, particularly with respect to substantial investment banking revenues and principal[*13] transaction revenues derived from business inventories carried over from the last quarter of 1985. During the first half of 1986, the Company managed or co-managed only five new issues, reflecting a substantial decline in the overall volume of new issue municipal financings when compared to the fourth quarter of 1985. Despite this, the Company's investment banking revenue rose 289% to $11,281,570. This increase in revenues was due primarily to an exceptionally high level of secondary remarketing activities of the Company with respect to municipal bond issues initially underwritten in late 1985.

Similar language was also included elsewhere in the Registration Statement.

n4 Offerings totalling over $1.286 billion had been closed with the arrangement prior to the IPO; in addition, one offering of $65 million was closed on the day of the IPO, and offerings totalling over $888 million were closed in the two weeks following the IPO.

(ii) Information Provided to DLJ During its Work on the IPO

In April of 1986, Matthews & Wright retained DLJ to act as underwriter for its IPO. DLJ in turn retained an outside law firm to advise it as underwriter's counsel during the course[*14] of its work on the underwriting. That firm was the same law firm consulted by DLJ's Public Finance Division in December of 1985. During the course of its work on the underwriting, DLJ learned of the closing arrangement used by Matthews & Wright on December 31, 1985 and of a number of the details of that arrangement, as described below.

The information was provided to DLJ in a meeting on May 14, 1986 by a former Matthews & Wright executive who was then working in DLJ's Public Finance Division. The executive had previously participated in one of the Matthews & Wright closings and thus had knowledge of the closing arrangement. At the May 14 meeting, the executive described the closing arrangement in detail. In particular, he explained that the trustee received the proceeds of the offering and then provided those proceeds to a financial institution known as the Commercial Bank of the Americas, in return for an investment agreement. He explained that the CBA held the bonds until remarketing, at which time they would be returned to Matthews & Wright. He also explained that the checks used at the closings were issued by Matthews & Wright, endorsed by the trustee to the CBA, and then[*15] endorsed by the CBA back to Matthews & Wright. Although the executive did not say that the checks used at the closings were worthless or that the CBA was an unlicensed shell, he did inform DLJ of the circular path of the bond proceeds during the closings, and of other facts which raised questions about the closings.

Despite learning of this unusual closing arrangement and knowing that it had been used to close a substantial portion of Matthews & Wright's offerings for 1985, the period just prior to the IPO, the DLJ IPO team failed to undertake any evaluation or review of the arrangement or to disclose its existence in the Registration Statement. The DLJ team also failed to review any of the documents used at the closings for the offerings.

The DLJ IPO team also learned of some of the circumstances of the decision by Matthews & Wright to take the offerings from DLJ in late December of 1985 and close those offerings before the end of the year. At the May 14 meeting, and again at a meeting on June 4, 1986, the decision by DLJ not to underwrite certain offerings and the subsequent underwriting of those offerings by Matthews & Wright was discussed. At both meetings, the involvement[*16] of DLJ's Chief Executive Officer in the decision not to underwrite the offerings was noted. At the June 4 meeting, those matters were noted by a co-managing director of DLJ's Public Finance Division who had been involved in the decision by DLJ not to close the offerings and who had been informed that Matthews & Wright had decided to take the offerings and close them before the end of the year. However, there was no inquiry by the DLJ IPO team into the circumstances surrounding the last-minute underwriting of the offerings by Matthews & Wright, despite the fact that Matthews & Wright had closed the offerings shortly after receiving them from DLJ. There was also no inquiry into how Matthews & Wright had obtained the capital necessary to close the offerings at a time during 1985 when, as was discussed at the June 4 meeting, DLJ could not close the offerings because of a lack of capital then available to its Public Finance Division.

DLJ also learned that Matthews & Wright would engage in a significant amount of underwriting activity prior to the August 31, 1986 deadline expected to be imposed by the Tax Reform Act. The Registration Statement discussed the anticipated tax law changes[*17] to be imposed by the Tax Reform Act and the prospectus was stickered to discuss additional developments concerning the legislation. Despite that discussion in the Registration Statement and prospectus, however, there was no inquiry into the anticipated volume of the offerings or the ability or plans of Matthews & Wright to obtain the capital necessary to close those offerings. As noted above, Matthews & Wright used the fraudulent closing arrangement a second time in August, just as the IPO was going forward, to close an additional $1.453 billion of offerings.

In addition to the matters described above which raised questions about Matthews & Wright's business activities, articles had also appeared in the press by the time of DLJ's retention as underwriter for the IPO which raised questions about bond offerings underwritten by Matthews & Wright. On October 31, 1984, an article appeared in a major New York newspaper which questioned a $300 million offering to be underwritten by Matthews & Wright for Guam. The article noted that the proposed changes in the tax law had prompted several "unusual financings," including the Guam offering underwritten by Matthews & Wright. The article[*18] noted that although Guam had a population of only

100,000, Matthews & Wright had proposed to raise $300 million to construct housing on the island. The article stated that "[o]fficials at Matthews & Wright declined to comment on the transaction" and that "[a]ccording to market sources, who asked not to be identified because of their business relationship with Matthews & Wright, the financing is very unusual because no permanent financing has been arranged for the housing project."

On February 10, 1986, less than three months before the first meetings concerning the Matthews & Wright IPO, an article appeared in a major national financial publication which questioned the same offering. That article noted that bond offerings had been "rushed to market under the tax-reform wire in the last quarter of 1985" and that the offerings presented "opportunities for outright fraud in mythical or questionable projects." Among the financings specifically questioned in the article was the Guam offering underwritten by Matthews & Wright. Both of the articles described above were in a collection of news articles contained in DLJ's IPO file. The DLJ IPO team did not, however, make an adequate [*19] inquiry into the matters raised by the articles at any time during its work on the IPO.

B. FINDINGS

The Registration Statement filed with the Commission by Matthews & Wright failed to disclose the closing transactions involving the credit union checks and the CBA, as well as the risks and potential liabilities of those transactions. The Registration Statement thus failed to state material information about Matthews & Wright's business activities. The Registration Statement was also materially misleading in its characterization of the closing transactions as prior "underwritings" and "marketings" of the bonds. As a result of these material misstatements and omissions, purchasers of Matthews & Wright stock in the IPO were not aware of the closing transactions, of the risks and potential liabilities associated with those transactions, or of the potential adverse consequences to revenue and earnings of the Company that might be caused by the transactions.

The Commission has long recognized that an underwriter can bear liability under the antifraud provisions of the federal securities laws for materially false or misleading statements in a registration statement. Such liability [*20]can exist where an underwriter knows, should know, or recklessly disregards facts giving rise to a potential disclosure deficiency and fails to adequately and reasonably investigate to ensure the accuracy of the registration statement. See In the *Matter of Hamilton Grant & Co., 38 SEC Docket 1346* (July 7, 1987), Sec. Exchange Act Rel. No. 34-24679; In the *Matter of The Richmond Corporation, 41 SEC 398, 405-06 (1963).* In the release proposing adoption of Rule 15c2-12 under Section 15(c) of the Exchange Act ("the Release"), we reviewed the responsibilities of underwriters and noted that:

An underwriter, whether of municipal or other securities, occupies a vital position in an offering. The underwriter stands between the issuer and the public purchasers, assisting the issuer in pricing and, at times, in structuring the financing and preparing disclosure documents. Most importantly, its role is to place the offered securities with public investors. By participating in an offering, an underwriter makes an implied recommendation about the securities. Because the underwriter holds itself out as a securities professional, and especially in light of its position vis-a-vis the[*21] issuer, this recommendation itself implies that the underwriter has a reasonable basis for belief in the truthfulness and completeness of the key representations made in any disclosure documents used in the offerings. *41 SEC Docket 1402, 1411,* Sec. Exchange Act Rel. No. 26100 (Sept. 28, 1988).

As indicated in the Release, an underwriter is bound by the standards applicable to a broker-dealer who recommends the purchase of a security to investors. In *Hanly v. SEC, 415 F.2d 589, 597 (2d Cir. 1969),* which was cited in the Release, the court described those standards as follows:

In summary, the standards by which the actions of each petitioner must be judged are strict. He cannot recommend a security unless there is an adequate and reasonable basis for such recommendation. He must disclose facts which he knows and those which are reasonably ascertainable. By his recommendation he implies that a reasonable investigation has been made and that his recommendation rests on the conclusions based on such investigation. Where the salesman lacks essential information about a security, he should disclose this as well as the risks which arise from his lack of information.

The offerings[*22] closed by Matthews & Wright on December 31 represented a significant amount of Matthews & Wright's business activities for all of 1985. The 24 offerings accounted for 27% of the 90 new issues underwritten by the firm during 1985 and almost 20% of the dollar volume of all of Matthews & Wright's underwritings for the year.

The offerings thus should have been explored even without the information actually known by DLJ which raised specific questions about the transactions. Moreover, though DLJ was not informed that the closing arrangement was fraudulent, it did learn additional facts about the offerings and the closing arrangement which obligated it to undertake an adequate and reasonable investigation to determine whether those transactions were legitimate.

At the May 14 meeting, for instance, a former Matthews & Wright executive described the closing arrangement in detail. As described by the executive, the arrangement involved transfer of the bond proceeds to several parties and then back to Matthews & Wright and the provision of investment agreements to issuers by a bank called the Commercial Bank of the Americas, in return for the bond proceeds. Because of the unusual nature[*23] of the arrangement and the importance of the offerings to Matthews & Wright's recent business activities, DLJ was obligated to pursue this information and its implications for the Company. DLJ did not conduct such an inquiry or attempt to verify the details of the closing arrangement, though simple inquiry into the arrangement would have revealed the unusual and questionable nature of the transactions. Inquiry into the source of the funds used at the closings would have revealed that the offerings were "closed" with checks totalling over $786 million drawn on an account at a credit union controlled by a Matthews & Wright senior executive. Inquiries directed to Matthews & Wright about the credit union would have revealed that neither Matthews & Wright's account at that entity, nor all of the assets of the entity, were sufficient to cover even a small percentage of the checks. However, no one from DLJ pursued these matters or reviewed any documents relating to the closings, including the credit union checks.

A review of the documents used at the closings, including the investment agreements (which were part of the closing transcript for each of the offerings), would have shown[*24] that the bonds had immediately been transferred to an entity called "the Commercial Bank of the Americas" in return for investment agreements from that entity. Routine checking into the "Commercial Bank of the Americas" would have shown that that entity was not listed in any financial directory and was not known in the financial community, raising obvious questions about the ability of the entity to purchase $786 million of bonds on one day. A review of other important documents used at the closings, such as counsel opinions and inducement resolutions, would have revealed that DLJ, and not Matthews & Wright, was listed as underwriter for 18 of the offerings closed on December 31. This information raised obvious questions about the prior history of the offerings and the involvement of DLJ itself in those offerings.

DLJ also failed to inquire into or explore the information it did learn about the last-minute underwriting by Matthews & Wright of a number of offerings taken over from DLJ at the end of 1985. This information was significant because it raised questions about the reasons DLJ declined to underwrite the offerings, the due diligence conducted by Matthews & Wright once[*25] it obtained the offerings, and the source of capital used to close the offerings. Had DLJ inquired into the circumstances surrounding these offerings, it would have discovered that $221 million of offerings had been taken over by Matthews & Wright from DLJ less than 72 hours before the closings for the offerings. Further inquiry would have revealed that the offerings and a variant of the closing mechanism used by Matthews & Wright had previously been rejected by DLJ because of a lack of available resources and because of questions about the legality of the arrangement.

DLJ also knew that Matthews & Wright would engage in underwriting activity prior to the August 31, 1986 change in the tax law to be imposed by the Tax Reform Act but failed to inquire into that activity. Such an inquiry was important not only because of the significance of the underwriting activity to Matthews & Wright's business activities at the time of the IPO, but also because the Registration Statement contained a discussion of the effects of the legislation on the Company's business activities and the prospectus had been stickered to disclose additional developments concerning the legislation. By failing[*26] to inquire into this underwriting activity, DLJ failed to learn that Matthews & Wright would again use a fraudulent closing arrangement at the time of the IPO to close seven offerings totalling over $1.453 billion, including one closing for $65 million which occurred on the day of the IPO itself.

As noted above, DLJ did retain an outside law firm to act as underwriter's counsel for the transaction. Various lawyers from that firm were present at meetings during the course of the underwriting at which the matters described above were discussed. Despite the presence of counsel at those meetings, and discussion with counsel about some of those matters, however, it was the role and obligation of DLJ as the underwriter for the transaction to adequately explore questions concerning the business and financial aspects of the offering which were raised during the due diligence process.

DLJ also ignored publicly-available information which raised questions about the legitimacy of bond offerings underwritten by Matthews & Wright and the rush to close offerings at the end of 1985. Those questions were raised in news articles which had been published prior to DLJ's retention as underwriter [*27]for the IPO and which DLJ had in its possession at the time of its work on the IPO. Given the nature of the questions raised in the articles about Matthews & Wright's business activities, DLJ was obligated to pursue the information, but failed to do so.

In light of all of the information known and available to DLJ, the firm did not have a reasonable basis to believe that the representations in the Registration Statement concerning the "secondary remarketing" transactions were accurate and complete. Given its vital role and responsibilities in the transaction as underwriter for the offering, DLJ was reckless in not knowing that the Registration Statement would fail to state material facts about the transactions closed by Matthews & Wright in December of 1985 and again in August of 1986. Accordingly, we find that DLJ wilfully violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

IV. ORDER

In view of the foregoing, it is in the public interest to impose the sanctions specified in the Offer of Settlement submitted by DLJ.

Accordingly, IT IS HEREBY ORDERED that:

A. DLJ be, and hereby is, censured; and

B. DLJ permanently[*28] cease and desist from committing or causing any violation, and from committing or causing any future violation, of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

By the Commission.

EXHIBIT 3

C
Only the Westlaw citation is currently available.

United States District Court,
D. South Carolina, Columbia Division.

IN RE SAFETY-KLEEN CORPORATION Bondholders Litigation

No. C/A 3:00-1145-17.

March 27, 2002.

L. Joel Chastain, William J. Cook, Ness Motley Loadholt Richardson and Poole, Barnwell, SC, Jeffrey H. Squire, Ira M. Press, Kirby McInerney, New York, NY, Mark Levine, Stull Stull and Brody, New York, NY, Kevin K. O'Brien, Grant and Eisenhofer, Wilmington, DE, Terry Edward Richardson, Jr., Richardson Patrick Westbrook and Brickman, Barnwell, SC, Pope D. Johnson, III, McCutchen Blanton Rhodes and Johnson, Columbia, SC, Stuart M. Grant, R. Michael Lindsey, Megan D. McIntyre, Diane T. Zilka, James P. McEvilly, III, Andrew Kirk Susong, Brian C. Wille, Bryan C. Skarlatos, Kostelanetz and Fink, New York, NY, for plaintiffs.

James Lehman, Nelson Mullins Riley and Scarborough, Manton McCutchen Grier, Haynsworth Sinkler Boyd, Peter L. Murphy, Peter L. Murphy Law Offices, Columbia, SC, Tyson Knight Harper, Cotsirilos Tighe and Streicker, Chicago, IL, J. Theodore Gentry, Wyche Burgess Freeman and Parham, Greenville, SC, Wilmot B. Irvin, Wilmot B. Irvin Law Offices, Rebecca G. Fulmer, Wilmot B. Irving Law Office, Columbia, SC, Paul R. Humphreys, pro se, Calgary, Alberta, Canada, John Hamilton Smith, Young Clement Rivers and Tisdale, John Phillips Linton, Haynsworth Sinkler Boyd, Charleston, SC, Scott R Lassar Sidley Austin Brown and Wood Chicago, IL, David Eidson Dukes, James J. McGovern, Stephen G. Morrison, William Parham Simpson, Michael Woodrow Hogue, Nelson Mullins Riley and Scarborough, Columbia, SC, John B. Missing, Christopher H McGrath, Brobeck Phleger and Harrison, Washington, DC, James R Streicker, Terence H Campbell, Cotsirilos Tighe and Streicker, Chicago, IL, for defendants.

ORDER

ANDERSON, J.

*1 The current Safety-Kleen corporation represents an amalgamation of three different entities. In May of 1997, Rollins Environmental ("Rollins") acquired Laidlaw, Inc.'s waste division and became Laidlaw Environmental Services ("LES"). In April of 1998, LES acquired "Old Safety-Kleen" and began to do business as Safety-Kleen Corporation ("Safety-Kleen").

This litigation concerns two similar bond offerings which occurred in 1998 and 1999. In each year, Safety-Kleen sold unregistered bonds to TD Securities, NationsBanc, and Raymond James & Associates, Inc. [FN1] These parties resold the bonds to qualified institutional buyers, or "QIBs," pursuant to offering memoranda.

FN1. Raymond James participated only in the 1999 bond transaction.

The bonds contained a provision requiring Safety-Kleen to use its best efforts to file a registration statement for identical bonds with the SEC and each QIB purchaser of the bonds could then exchange the new registered bonds for the old unregistered bonds.

In response to a March 6, 2000 announcement by Safety-Kleen that it was beginning an investigation into possible accounting irregularities, the value of the bonds dropped precipitously and this litigation ensued.

This Court has previously issued an order dismissing Counts 1-5 and 12 of the complaint, but noted an explanation would follow. Consequently, those counts are discussed in this Order, though they have already been dismissed.

Counts 1--2

These counts allege violations of Section 11(a) of the Securities Act 1933, codified at 15 U.S.C. § 77k(a). That section, by its plain language, limits causes of actions to "untrue" statements included in "registration statements." *Id.* Because the bonds purchased by the plaintiffs were *unregistered,* any Section 11 claim based on this purchase must be dismissed. Subsequently Safety-Kleen did file registration statements for identical bonds that could be exchanged for the unregistered bonds. As to any exchange, though, no damages can be demonstrated because the transaction involves two sets of identical bonds. Furthermore, reliance cannot be demonstrated because any false statements in the registration of the second set of bonds could not have any influence on the purchasers' decision to exchange one set of identical bonds for another.

The plaintiffs attempt to escape this result by arguing this two-step process (*i.e.*, purchase of unregistered bonds and exchange for registered bonds) is really one "integrated" transaction. The Court rejects this argument for the reasons

enunciated by the SEC in its *amicus curiae* brief to this Court: namely, that the doctrine of "integration" has a specific meaning: whether multiple transactions should be combined *for registration purposes*. Thus, the traditional "integration" doctrine is irrelevant to this case. The Court concurs with the SEC's opinion, and does "not perceive any basis under the allegations of the complaint on which the Rule 144A offering may be validly exempted from registration ... yet somehow be deemed ... part of a registered transaction for purpose [sic] of Section 11." Brief of SEC at 4.

Counts 3-4

*2 These counts allege violations of Section 12(a)(2), and are deficient for reasons similar to those involved in the Section 11(a) claims. Section 12(a)(2) of the 1933 Act, codified at 15 U.S.C. 771(a)(2), provides a cause of action for misstatements and omissions in a prospectus or oral communication used to sell the security. Significantly narrowing this broad language, the Supreme Court has held these terms are restricted to public offerings. *Gustafson v. Alloyd*, 513 U.S. 561, 569, 115 S.Ct. 1061, 131 L.Ed.2d 1 (1995). In this case, there was no public offering. The securities were sold only to sophisticated QIBs, and the exchange transaction was open only to those who had previously purchased the unregistered bonds (*i.e*, the QIBs). If "Rule 144A" 17 C.F.R. 230.144A expressly provides that offerings to QIBs under its provisions "shall not be deemed to have been offered to the public." As there was no public offering, there can be no Section 12(a)(2) liability.

Count 5

Count 5 alleges a "control person" cause of action under Section 15 of the 1933 Act, codified at 15 U.S.C. § 77o. This claim requires an underlying predicate Section 11 or Section 12 violation, and must be dismissed because there is no such predicate violation--*see supra*.

Counts 6--10

These counts assert violations of Section 10(b) of the Securities Exchange Act of 1934, codified at 15 U.S.C. § 78j(b), and Rule 10b-5, codified at 17 C.F.R. § 240.10b-5. Collectively, the Court will refer to these claims as the "fraud claims."

To survive a motion to dismiss, plaintiffs must allege (1) a false statement or material omission by the defendant (2) made with scienter (3) relied upon by the plaintiff (4) that proximately caused plaintiff's damages. *Phillips v. LCI Int'l, Inc.*, 190 F.3d 609, 613 (4th Cir.1999). As these claims are subject to the Private Securities Litigation Reform Act, plaintiffs must "specify each statement alleged to have been misleading" and explain why the statement is misleading. 15 U.S.C. § 78u-4(b)(1). Further, plaintiffs must "state with particularity facts giving rise to a strong inference" of scienter. 15 U.S.C. § 78u-4(b)(2). The Fourth Circuit has held the scienter requirement demands an inference of recklessness, at a minimum. *Phillips*, 190 F.3d at 621.

Nevertheless, at this stage of the case, plaintiffs need only *allege* these requirements, not *prove* them. Applying that standard, the Court must deny the motions to dismiss the fraud claims. After reviewing the specific allegations of the voluminous 454 paragraph complaint, and noting plaintiffs allege financial misstatements totaling half a billion dollars, the Court finds the heightened pleading requirements of the Reform Act have been satisfied as to the fraud claims and the motions to dismiss are DENIED as to Counts 6--10.

Count 11

This claim is a "control person" claim under Section 20(a) of the 1934 Act, codified at 15 U.S.C. § 78t(a), and is predicated on the alleged 10(b) violations. As an initial matter, the Court notes that determining whether a particular individual or entity "controlled" an alleged primary violator of the securities laws is, by its nature, a fact-intensive inquiry not normally appropriate for resolution on a motion to dismiss. *See In re Microstrategy, Inc. Sec. Litig.*, 115 F.Supp.2d 620, 661 (E.D.Va.2000). In this matter, plaintiffs have sufficiently alleged facts preventing a dismissal of the Section 20(a) claim at this stage of the litigation. The motions to dismiss are DENIED as to Count 11.

Count 12

*3 The final claim asserts a violation of Section 18 of the 1934 Act, codified at 15 U.S.C. § 78r. Although in some ways similar to a 10(b) claim, courts have interpreted Section 18 to require *actual reliance* on the asserted misstatements. *See, e.g., Ross v. A.H. Robbins Co.*, 607 F.2d 545, 552-53 (2d Cir.1979). Plaintiffs implausibly allege that "class members and their agents specifically read and relied on" the allegedly false statements. Cmplt. ¶ 450. When plaintiffs also assert that the "exact number of class members is unknown," they cannot simultaneously allege each and every unknown class member *specifically relied* on a certain document or filing. Cmplt. ¶ 40. This claim, therefore, must be dismissed.

Conclusion

Counts 1-5 and 12 of this complaint were dismissed by a

prior order of this Court. All pending motions to dismiss are DENIED in all other respects. The motion to lift the discovery stay is MOOT.

IT IS SO ORDERED.

2002 WL 32349819 (D.S.C.)

END OF DOCUMENT

EXHIBIT 4

MED-THERAPY REHABILITATION SERVICES, INCORPORATED,Plaintiff-Appellee, v. DIVERSICARE CORPORATION OF AMERICA, Defendant & ThirdParty Plaintiff-Appellant, v. N S & H, INCORPORATED; BRIAN CENTER MANAGEMENTCORPORATION, Third Party Defendants-Appellees. MED-THERAPY REHABILITATIONSERVICES, INCORPORATED, Plaintiff-Appellant, v. DIVERSICARE CORPORATION OFAMERICA, Defendant & Third Party Plaintiff-Appellee, v. N S & H, INCORPORATED;BRIAN CENTER MANAGEMENT CORPORATION, Third Party Defendants.
No. 93-1176, No. 93-1210

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

1994 U.S. App. LEXIS 1665

December 7, 1993, Argued
February 3, 1994, Decided

NOTICE:

[*1] RULES OF THE FOURTH CIRCUIT COURT OF APPEALS MAY LIMIT CITATION TO UNPUBLISHED OPINIONS. PLEASE REFER TO THE RULES OF THE UNITED STATES COURT OF APPEALS FOR THIS CIRCUIT.

SUBSEQUENT HISTORY: Reported in Table Case Format at: *16 F.3d 410, 1994 U.S. App. LEXIS 7490.* Certiorari Denied October 3, 1994, Reported at: *1994 U.S. LEXIS 5540.*

PRIOR HISTORY: Appeals from the United States District Court for the Western District of North Carolina, at Statesville. Richard L. Williams, Senior District Judge, sitting by designation. (CA-91-28)

DISPOSITION: AFFIRMED IN PART, REVERSED IN PART, AND REMANDED

CASE SUMMARY:

PROCEDURAL POSTURE: Plaintiff purchaser and defendant seller appeal a judgment of the United States District Court for the Western District of North Carolina that modified a jury's verdict, cancelled a promissory note issued to the seller, denied the seller's motions for judgment on its counterclaims, granted the purchaser's motion for declaratory judgment, denied the purchasers motion for a new trial, and refused aggregation of the verdict.

OVERVIEW: Stock was sold by the seller to the purchaser. Pursuant to a stock purchase agreement, the purchaser paid cash for the stock and issued a promissory note to the seller. Subsequently, the purchaser brought suit against the seller claiming that the seller breached its agreement with the purchaser, violated the federal and state securities acts, committed common law fraud, and engaged in negligent misrepresentation. The district court dismissed the state law and negligence claims and the jury returned a verdict. The district court then cancelled the note issued, denied the seller's motions for judgment on its counterclaim, granted the purchasers motion for declaratory judgment requiring indemnification, denied the purchaser's motion for a new trial, and refused to aggregate the jury's verdict in favor of the purchaser. On appeal, the court reversed in part, affirmed in part, and remanded for reinstatement of the jury verdict as rendered. The district court erred by cancelling the note, as the ruling contradicted the jury's finding. The district court also erred by ordering the seller to indemnify the purchaser. The trial court's order with respect to aggregation was also reversed.

OUTCOME: The court reversed in part and affirmed in part a judgment of the district court that modified a jury's verdict. The cause was remanded for reinstatement of the jury's verdict as rendered.

CORE TERMS: common law fraud, indemnification, federal securities, new trial, stock purchase agreement, probable, logical, jury verdict, aggregation, aggregated, cancelling, equitable, aggregate, legal claim, void, punitive damages award, declaratory judgment, punitive damages, special verdict, jury trial, counter-claim,

illustrated, indemnify, indemnity, awarding, provider, medicare, owed, equitable claim, innocent party

LexisNexis(R) Headnotes

Contracts Law: Remedies: Specific Performance
[HN1] Once a contract is affirmed, either party can sue under the agreement to enforce any rights arising under that agreement. One party may be successful on a fraud claim while the opposing party is successful on a breach of contract claim. The principle applies to both common law fraud and federal securities fraud violation.

Civil Procedure: Relief From Judgment: Motions to Alter & Amend
[HN2] When a party has the right to a jury trial on an issue involved in a legal claim, the judge is of course bound by the jury's determination of that issue as it affects his disposition of an accompanying equitable claim. Although the judge may have broad legal and equitable powers to order the relief necessary to effectuate the purposes of the securities laws, those powers are circumscribed when the judge is fashioning that relief subsequent to a jury verdict. The facts on which the judge bases his equitable or declaratory relief must not contravene the facts as found by the jury.

Civil Procedure: Relief From Judgment: Motions to Alter & Amend
Civil Procedure: Jury Trials: Province of Court & Jury
[HN3] A district court may aggregate verdicts without violating the U.S. Const. amend. VII right to a jury trial if the verdicts are logical and probable only if they are aggregated. The requirement that aggregation occur only if the aggregated verdict is what the jury must have intended stems from the fact that a district court's reexamination of record evidence is barred by the U.S. Const. amend. VII.

COUNSEL: Argued: Glenn Benton Rose, HARWELL, HOWARD, HYNE, GABBERT & MANNER, P.C., Nashville, Tennessee, for Appellant.

Argued: Michael Jackson Betts, REED, SMITH, SHAW & MCCLAY, Pittsburgh, Pennsylvania, for Appellees.

On Brief: Lin S. Howard, D. Alexander Fardon, HARWELL, HOWARD, HYNE, GABBERT & MANNER, P.C., Nashville, Tennessee; James C. Smith, RAYBURN, MOON & SMITH, Charlotte, North Carolina, for Appellant.

On Brief: Mary J. Hackett, REED, SMITH, SHAW & MCCLAY, Pittsburgh, Pennsylvania, for Appellees.

JUDGES: Before MURNAGHAN, WILKINSON, and WILKINS, Circuit Judges.

OPINIONBY: PER CURIAM

OPINION: OPINION

PER CURIAM:

Diversicare Corporation of America (Diversicare) sold the stock of National Speech and Hearing Services, Inc. (National) to Med-Therapy Rehabilitation Services, Inc. (Med-Therapy) in April 1988. [*2] Pursuant to a stock purchase agreement (the "Agreement"), Med-Therapy paid $750,000 in cash for National. In addition, Med-Therapy caused National to sign a promissory note to Diversicare for $700,000 (the "Note"). Med-Therapy and its parent corporation, Brian Center Management, Inc., guaranteed the payment of the Note.

In April 1991, Med-Therapy brought suit against Diversicare claiming that Diversicare breached its agreement with Med-Therapy; violated § 10(b) of the Securities Exchange Act of 1934; committed common law fraud; violated the North Carolina and Tennessee Securities Acts; and engaged in negligent misrepresentation and omissions. Med-Therapy sought damages, indemnity under the terms of the Agreement, and attorney's fees. Diversicare filed a counter-claim against Med-Therapy and a third-party complaint against National and Brian Center in an attempt to recover the amount due under the Note.

The case was tried before a jury in October 1992. In response to Diversicare's motion for judgment as a matter of law, the district court dismissed Med-Therapy's state securities law and negligent misrepresentation and omission claims. The court submitted the rest of the claims[*3] to the jury on special verdict forms.

The jury found for Med-Therapy on the federal securities and the common law fraud claims, awarding the company $300,000 for the § 10(b) violation, $252,527 for common law fraud, and $1,000 in punitive damages. The jury found against Med-Therapy on the breach of contract claim because Diversicare did not breach any representation or warranty made in Article Four of the Stock Purchase Agreement. Finally, the jury awarded Diversicare the entire amount due under the note -- $552,527. n1 The net result of the jury's verdict was a $1,000 victory for Med-Therapy.

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

n1 Section 3.2 of the Stock Purchase Agreement provided for possible offsets to the $700,000 Note depending on National's future collection of accounts receivable and on the accuracy of a preliminary balance sheet. Although Med-Therapy claimed at trial that a $1,500,000 downward adjustment was warranted, the jury accepted the testimony of Diversicare's Chief Financial Officer that the Note should be adjusted by only $147,473, awarding Diversicare the remaining $552,527. That amount precisely equalled the sum of $300,000 and $252,527 awarded to Med-Therapy by the jury.

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

[*4]

Both parties submitted several post-trial motions. In a Final Order and Memorandum Opinion, the United States District Court for the Western District of North Carolina granted Med-Therapy judgment on the federal securities fraud and common law fraud claims insofar as liability was concerned. Despite the jury's verdict, however, the court cancelled the Note, denying Diversicare's motion for judgment on its counter-claim for the amount due under the Note plus interest. n2 In addition, the court granted Med-Therapy's motion for declaratory judgment requiring Diversicare to indemnify Med-Therapy for any liability that might arise out of claims that might hereafter be asserted against Med-Therapy relating to National's pre-acquisition cost reports. Denying Med-Therapy's motion for a new trial, and refusing to aggregate the jury's verdicts in favor of Med-Therapy, the court awarded Med-Therapy $301,000 n3 and an additional $108,480 in pre-judgment interest. In contrast to the $1,000 victory that resulted from the jury's verdict, Med-Therapy won a $497,480 award plus indemnification as a result of the district court's Order. n4

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

n2 Diversicare made a post-trial motion for a judgment on its counter-claim under the Note for both principal ($552,527) and interest, so the total amount sought came to $776,507. The district court denied that motion. Diversicare also requested $322,022.09 in attorney's fees and costs which the court denied.

[*5]

n3 In an Amended Final Order, the judge stated that the interest due on the $300,000 judgment was $88,000. He entered judgment for MedTherapy in the amount of $388,000 on January 25, 1993. In April of 1993, Judge Williams amended the order once again to reflect the $1,000 punitive damages award which had been left out of the January Order. The final total was $389,000.

n4 The total is obtained by adding the $389,000 to the $108,480 pre-judgment interest award.

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

Both Med-Therapy and Diversicare have appealed discrete portions of the district court's Order. Med-Therapy has appealed the district court's denial of its motion for a new trial on the issue of damages. In the alternative, Med-Therapy has argued that the district court should have aggregated the jury's verdicts in favor of Med-Therapy on the federal securities and common law fraud claims (rendering a total award of $552,527 as the jury apparently intended rather than the $300,000 award the judge entered). Diversicare, on the other hand, has appealed the district court's order that effectively rescinded the stock purchase[*6] agreement which Med-Therapy had asked the court to enforce. In addition, Diversicare has appealed the district court's order requiring Diversicare to indemnify Med-Therapy for the losses that might arise out of National's medicare liabilities in that such a requirement 1) is premature and 2) contradicts the jury's finding that Diversicare did not breach the Agreement. n5

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

n5 Because Diversicare did not breach the contract, Med-Therapy was not entitled to indemnification under Section 10.2(a) of the Agreement. Rather, the judge awarded what appears to be "implied-in-law" indemnity as an equitable remedy for losses suffered by Med-Therapy arising out of National's cost

reports. The indemnification issue, as illustrated below, is problematic in that Med-Therapy has not been held liable for National's overpayment liabilities.

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

Discussion

In an apparent attempt to resolve the situation in an equitable manner, the trial court accepted only part of the jury's verdict and rejected the other part. As illustrated above, [*7] such a resolution significantly altered the outcome intended by the jury and, in some cases, contradicted the jury's factual findings. We reverse in part and affirm in part the trial court's order and remand for reinstatement of the jury verdict as rendered.

I. Med-Therapy's Motion for a New Trial on Damages

The district court did not err in denying Med-Therapy's motion for a new trial on damages. In *Walker v. Crigler, 976 F.2d 900, 903 (4th Cir. 1992),* we held that a trial court's "denial of a motion for a new trial should be reversed only when abuse of discretion on the part of the trial court is shown in its determination that'the jury's verdict was not against the clear weight of the evidence . . ."

In denying Med-Therapy's motion for a new trial on damages, the judge held that the jury had the prerogative to disregard the "uncontroverted" testimony of Med-Therapy's expert witness. In addition, the judge found that "the jury could certainly have concluded, consistent with the evidence presented at trial, that the stock of [National] was not worthless; and/or that Med-Therapy failed to mitigate whatever damages it may have suffered." [*8] n6 The judge continued, "What is obvious to the Court is that Med-Therapy, having opted for a jury trial on a rather complex securities dispute (as it is entitled to do), and having failed to 'ring the bell' with the jury, now wishes to have a second go at it." Because the evidence adduced at trial supports the trial court's conclusions, the trial court did not abuse its discretion in denying the motion for a new trial on the damages issue.

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

n6 Evidence adduced at trial suggested that Med-Therapy lacked diligence in pursuing the appeals of the Notices of Program Reimbursement (NPRs) submitted to National by Mutual of Omaha. Issued when adjustments become final, the NPR is the first statement of the amount the provider actually owes on its Medicare settlement. A provider can appeal an NPR to the Provider Reimbursement Review Board within 120 days. The provider can also ask the intermediary to re-open the relevant cost report within three years of the date the intermediary issues the report. Although Med-Therapy filed several appeals consistent with its obligation under the terms of the Agreement, it failed to prosecute those appeals and they were dismissed.

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

[*9]

II. The Amount Due Under the Note

The district court erred by cancelling the Note guaranteed by Med-Therapy as part of the underlying transaction. That ruling contradicts the jury's finding that Diversicare did not breach the contract, and that Med-Therapy still owed Diversicare the amount due under the Note.

Med-Therapy elected to enforce the Agreement by suing for damages for fraud on the basis of that Agreement. A party who brings suit on the basis of an allegedly fraudulent contract must choose to prove fraud and seek recovery under the terms of the contract or to rescind the contract and pursue restitution if applicable. A party may not do both. In *Miller v. Premier Corp., 608 F.2d 973, 983 (4th Cir. 1979),* we delineated a complainant's choice of remedies emphasizing "the principle that a party to a contract who sues to recover damages for fraud in its inducement rather than seeking rescission has thereby affirmed the contract and consequently assumed liability for its breach." n7

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

n7 In that case, we found that "it was perfectly possible for Premier to recover on its contract claim despite being liable for damages for fraud in its inducement." Id.

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

[*10]
[HN1]
Once a contract is affirmed, either party can sue under the agreement to enforce any rights arising under that agreement. One party may be successful on a fraud claim while the opposing party is successful on a breach of contract claim. *Miller , 608 F.2d at 983.*

The principle applies to both common law fraud and federal securities fraud violations. In *Randall v. LoftsGaarden, 478 U.S. 647, 662, 92 L. Ed. 2d 525, 106 S. Ct. 3143 (1986),* the Supreme Court wrote that a § 10(b) plaintiff, in some circumstances, may "choose between 'undoing the bargain (when events since the transaction have not made rescission impossible) or holding the defendant to the bargain by requiring him to pay[out-of-pocket] damages.'" n8

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

n8 The Supreme Court cited *Affiliated Ute Citizens v. United States, 406 U.S. 128, 155, 31 L. Ed. 2d 741, 92 S. Ct. 1456 (1972),* which involved § 10(b) violations, for the principle that the correct measure of damages under § 28 of the Act, *15 U.S.C. § 78bb*(a), is the difference between the fair value of all that the plaintiff received and the fair value of what he would have received had there been no fraudulent conduct. Id. at 661-62.

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

[*11]

In its Order cancelling the Note, the district court relied on language from § 29(b) of the 1934 Act which suggests that a contract made in violation of that Title is void. Although the judge cited the language of § 29(b) correctly, the courts have interpreted the provision more loosely. Section 29(b) provides: "Every contract made in violation of any provision of this chapter or of any rule or regulation thereunder . . . shall be void . . . ." *15 U.S.C. § 78cc*(b).

In *Mills v. Electric Auto-Lite Co., 396 U.S. 375, 387, 24 L. Ed. 2d 593, 90 S. Ct. 616 (1970),* the Supreme Court wrote that it did not read § 29(b) of the Act as requiring that a given transaction be set aside simply because the agreement giving rise to that transaction is a "void" contract. The language of § 29(b)

establishes that the guilty party is precluded from enforcing the contract against an unwilling, innocent party, but it does not compel the conclusion that the contract is a nullity, creating no enforceable rights even in a party innocent of the violation. The lower federal courts have read § 29(b) . . . as rendering the contract merely voidable at the option[*12] of the innocent party. . . . This interpretation is eminently sensible. The interests of the victim are sufficiently protected by giving him the right to rescind . . . .

Id. at 387-88 (citations omitted)(emphasis added).

The jury specifically affirmed Med-Therapy's obligation to Diversicare under the Note. Although it awarded Med-Therapy damages for fraud, simultaneously it found that Diversicare did not breach the contract and that Med-Therapy owed Diversicare the remaining $552,527. The judge voided the jury's verdict in favor of Diversicare on its claim for the amount due under the Note by entering an order cancelling the Note pursuant to § 29(b). The judge did not have the authority to disregard the jury's factual findings.

" [HN2] When a party has the right to a jury trial on an issue involved in a legal claim, the judge is of course bound by the jury's determination of that issue as it affects his disposition of an accompanying equitable claim." *Lincoln v. Board of Regents, 697 F.2d 928, 934* (11th Cir.), cert. denied, *464 U.S. 826, 78 L. Ed. 2d 102, 104 S. Ct. 97 (1983)* (holding that the district court's judgment[*13] in that case was not inconsistent with the jury's verdict). Although the judge may have broad legal and equitable powers to order the relief necessary to effectuate the purposes of the securities laws under Mills v. Electric Auto-Lite, those powers are circumscribed when the judge is fashioning that relief subsequent to a jury verdict. The facts on which the judge bases his equitable or declaratory relief must not contravene the facts as found by the jury. *In re Lewis, 845 F.2d 624, 629 (6th Cir. 1988)*("according to the progeny of *Beacon Theatres, Inc. v. Westover, 359 U.S. 500, 3 L. Ed. 2d 988, 79 S. Ct. 948 (1959),* the legal claim . . . must be tried first before a jury and the equitable claim resolved subsequently in light of the jury's determination of the legal claim." Id.). n9

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

n9 Lewis continues, "'it is well-settled that the "court may not make findings" contrary to or inconsistent with the jury's resolution . . . of that same issue as implicitly reflected in its general verdict.'" Id. at 629. In the instant case, the district court contravened the findings explicitly stated in the jury's special verdict.

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

[*14]

III. Indemnification

The district court also erred by ordering Diversicare to indemnify Med-Therapy against liability that might arise from potential claims when 1) the jury found that Diversicare did not breach the contract; and 2) no such claims have been asserted.

Section 10.2(a) of the Stock Purchase Agreement provided for contractual indemnification in the event of breach by either party. Med-Therapy sought indemnification under this provision. The jury found that Diversicare did not breach the agreement. Thus, Med-Therapy was not entitled to contractual indemnification. Rather, the court entered a declaratory judgment awarding Med-Therapy" implied-in-law" or equitable indemnification. The Declaratory Judgment Act did not give the judge the authority to disregard the jury's factual findings.

In addition, the district court judge entered the declaratory judgment for Med-Therapy in anticipation of that company's potential liability. National does not have the assets to satisfy the claims, giving rise to "the possibility that the Government may assert claims against Med-Therapy." As of the date of the Order, the government had not asserted any claims against Med-Therapy. [*15] Under the Declaratory Judgment Act, the moving party must demonstrate an actual controversy:

in the normal indemnity situation, where, as here, no contractual duty to defend exists, no duty to do anything arises until the alleged indemnitee is adjudged liable.

Cunningham Bros., Inc. v. Bail, 407 F.2d 1165 (7th Cir.), cert. denied, *395 U.S. 959, 23 L. Ed. 2d 745, 89 S. Ct. 2100 (1969).* In addition, the Restatement of Restitution explains that one is entitled to indemnity only if one discharges a debt that he or she owes.

A person who, in whole or in part, has discharged a debt which is owed by him but which as between himself and another, should have been discharged by the other, is entitled to indemnification from the other, unless the payor is barred by the wrongful nature of his conduct.

Restatement of Restitution § 76. Med-Therapy did not produce any evidence that Medicare has filed or is currently filing claims against Med-Therapy. Thus, aside from the district court's order's inconsistency with the jury verdict, that order was premature.

IV. Aggregation of Damages

The district court awarded Med-Therapy only $300,000, [*16] holding "as a matter of law" that the larger award for the federal securities violation subsumed the smaller award for common law fraud. The court held that recovery on both counts would constitute double recovery because both claims arose from the same allegation of wrong-doing and harm. Med-Therapy has appealed this portion of the judge's order.

Under *Richmond v. Madison Management Group, Inc. , 918 F.2d 438, 461 (4th Cir. 1990),*
[HN3]
[a] district court may aggregate verdicts without violating the seventh amendment right to a jury trial if the verdicts are "'logical and probable' only if they are aggregated." . . . The requirement that aggregation occur only if the aggregated verdict is what the jury must have intended stems from the fact that a district court's reexamination of record evidence is barred by the Seventh Amendment.

Med-Therapy has argued that the jury clearly intended to award MedTherapy a total of $552,527 for both claims; that, under Richmond, it is logical and probable to aggregate the two awards; and that the trial court erred by refusing to do so.

The district judge acknowledged Richmond's "logical and probable" [*17] language in his Order. He held, however, that permitting Med-Therapy to recover on both claims would constitute double recovery. The question whether damage awards are duplicative is one of fact. As such, it is reviewable under the clearly erroneous standard. *U.S. Indus., Inc. v. Touche Ross & Co., 854 F.2d 1223, 1259 n.53 (10th Cir. 1988).*

In refusing to aggregate the verdicts, the judge contravened the intent of the jury. The jury clearly intended the parties to come out "in a wash" aside from Med-Therapy's $1000 punitive damages award. n10 In an attempt to award Med-Therapy a total of $553,527

(including punitive damages), the jury apportioned the money among the claims contained in the special verdict forms provided by the judge: $300,000 for the federal securities violation; $252,527 for the common law fraud; and $1000 for punitive damages. Because the awards in favor of each party are identical with the exception of the $1,000 punitive damages award for Med-Therapy, it is an inescapable fact that the jury intended to award Med-Therapy $552,527 for Diversicare's fraud. The verdicts are "logical and probable" under Richmond only if they[*18] are aggregated.

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

n10 The district judge acknowledged that point in his Order.

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

The jury, then, did not award duplicative damages. Rather, the jury arrived at a lump sum damages decision and appears to have divided it in order to give Med-Therapy something on each claim. The court did not inform the jury prior to its deliberation that such an action would result in the elimination of the lesser award. The court instructed the jury with respect to Med-Therapy's federal securities fraud claim and potential out-of-pocket and consequential damages. The court also instructed the jury as to the six elements of common law fraud under North Carolina law and potential damages. The district court, however, did not instruct the jury as to the "duplication" issue as it affected the federal securities and common law fraud awards.

Aside from the fact that the jury intended to give Med-therapy $552,527, it appears that the district judge, in exercising his discretion under Richmond, was unduly influenced by his own decision[*19] to cancel the Note, rendered in response to Med-Therapy's post trial motion, effectively eradicating the verdict in favor of Diversicare. n11

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

n11 It is clear from the record that the judge believed a verdict in favor of Med-Therapy on the fraud claims would be inconsistent with an award for Diversicare for the amount due under the Note. As illustrated above, under Miller, the former does not preclude the latter.

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

Our ultimate purpose in reaching a result in the case, is to adhere fully to the jury's verdict. Because aggregation seems to accomplish the most equitable result, and a result that is consistent with the jury's verdict, we hold that the trial court's order with respect to aggregation should be reversed, and the jury's verdict reinstated as rendered.

V. Constitutional Claims

We have held in *Cooke v. Manufactured Homes, Inc., 998 F.2d 1256 (4th Cir. 1993),* that § 27A of the Securities Exchange Act of 1934 (as amended *15 U.S.C.A. § 78aa-1*[*20] (a)), is constitutional. As such, Med-Therapy's § 10b claim was timely filed, and Diversicare's argument that we reconsider Cooke is without merit.

VI. Conclusion

The judgment is accordingly affirmed with respect to the district court's denial of a new trial on the damages issue. The parts of the judgment cancelling the Note, requiring indemnification by Diversicare, and refusing aggregation of awards in favor of Med-therapy are reversed, and we remand for reinstatement of the jury verdict as rendered.

AFFIRMED IN PART, REVERSED IN PART, AND REMANDED

EXHIBIT 5

JANET S. PECKINPAUGH, Plaintiff, v. POST-NEWSWEEK STATIONSCONNECTICUT, INC., G. WILLIAM RYAN, CHRISTOPHER J. ROHRS and MARK EFFRON,Defendants.
Civil No. 3:96CV2475(AVC)

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF CONNECTICUT

1999 U.S. Dist. LEXIS 21289

March 10, 1999, Decided
March 17, 1999, Filed

DISPOSITION: [*1] Defendants' motion for form of judgment (document no. 291) granted in part and denied in part. Judgment entered in favor of plaintiff.

CASE SUMMARY:

PROCEDURAL POSTURE: Defendant employer filed a motion for form of a judgment pursuant to *Fed. R. Civ. P. 58*, seeking to limit a jury award in order to avoid a duplicative award of damages and in accordance with the applicable statutory cap on punitive damages in a suit filed by plaintiff employee for gender discrimination, retaliation, breach of written and oral contract, and negligent misrepresentation.

OVERVIEW: Plaintiff employee sued defendant employer for gender discrimination, retaliation, breach of written and oral contract, and negligent misrepresentation. A jury awarded plaintiff compensatory and punitive damages. Defendant filed a motion seeking to limit a jury award in order to avoid a duplicative award of damages and in accordance with the applicable statutory cap on punitive damages. The court granted defendant's motion in part and denied it in part. The court held that plaintiff was entitled to the total compensatory damages award, representing the amounts awarded for breach of written contract, breach of oral contract and negligent misrepresentation. The court held further that defendant's failure to raise the statutory cap pursuant to *42 U.S.C.S. § 1981a*(b)(3) until after the jury returned its verdict did not bar application of the statutory provisions in the case, and, therefore, punitive damages were limited to $100,000.

OUTCOME: The court granted defendant employer's motion for form of a judgment in part and denied it in part, holding that plaintiff employee was entitled to the total compensatory damage award but that punitive damages were limited to $100,000 by statute.

CORE TERMS: punitive damages, retaliation, gender discrimination, calendar, duplicative, cap, negligent misrepresentation, breach of written contract, causes of action, oral contract, allocated, statutory limitation, calendar year, preceding, punitive damages awarded, compensatory damages, complaining party, total award, compensated, jury awarded, different causes of action, affirmative defense, factual issue, fair dealing, first cause, jury award, discriminated, compensate, allocate, malice

LexisNexis(R) Headnotes

Torts: Damages: Compensatory Damages
[HN1] A basic principal of compensatory damages is that an injury can be compensated only once. If two causes of action provide a legal theory for compensating one injury, only one recovery may be obtained. Further, only if the second cause of action entitles the plaintiff to recover for an injury separate from the injury compensated by the award for the first cause of action, or at least for an additional component of injury not covered by the first cause of action, may additional damages be awarded.

Torts: Damages: Compensatory Damages
[HN2] Defendants do not demonstrate that a jury's award is duplicative merely by noting that it allocated the damages under two different causes of action.

Torts: Damages: Compensatory Damages
[HN3] The juries may determine a total award to compensate the plaintiff and allocate that figure between multiple causes of action.

Torts: Damages: Punitive Damages
Constitutional Law: Civil Rights Enforcement: Civil Rights Generally
[HN4] Plaintiffs asserting federal gender discrimination and retaliation causes of action are entitled to an award of punitive damages whenever they prove that a defendant unlawfully discriminated with malice or reckless indifference. *42 U.S.C.S. § 1981a*(b)(1). Such

punitive damages awards, however, on are limited by the provisions of *42 U.S.C.S. § 1981a*(b)(3).

Torts: Damages: Punitive Damages
Constitutional Law: Civil Rights Enforcement: Civil Rights Generally
[HN5] See *42 U.S.C.S. § 1981a*(b)(3).

Torts: Damages: Punitive Damages
Constitutional Law: Civil Rights Enforcement: Civil Rights Generally
[HN6] *42 U.S.C.S. § 1981a*(c)(2) prohibits the court from informing the jury of the limitations described in *42 U.S.C.S. § 1981a*(b)(3).

COUNSEL: For JANET S. PECKINPAUGH, plaintiff: Joseph Michael Lewis, Robinson & Cole, Stamford, CT.

For JANET S. PECKINPAUGH, plaintiff: David S. Golub, Jonathan M. Levine, Jennifer Cohen Goldstein, Silver, Golub & Teitell, Stamford, CT.

For POST-NEWSWEEK STATIONS, CT., INC., G. WILLIAM RYAN, CHRISTOPHER J. ROHRS, MARK EFFRON, defendants: Victoria Radd Rollins, Kevin T. Baine, Williams & Connolly, Washington, DC.

For POST-NEWSWEEK STATIONS, CT., INC., G. WILLIAM RYAN, CHRISTOPHER J. ROHRS, MARK EFFRON, defendants: Joseph A. Moniz, Robert J. O'Hara, Alexandra D. Mease-White, Day, Berry & Howard, Hartford, CT.

For POST-NEWSWEEK STATIONS, CT., INC., G. WILLIAM RYAN, CHRISTOPHER J. ROHRS, MARK EFFRON, defendants: Margaret J. Strange, Jackson, Lewis, Schnitzler & Krupman, Hartford, CT.

For POST-NEWSWEEK STATIONS, CT., INC., G. WILLIAM RYAN, CHRISTOPHER J. ROHRS, MARK EFFRON, defendants: Robert E. Branson, Post-Newsweek Connecticut Stations, Inc, Hartford, CT.

For POST-NEWSWEEK STATIONS, CT., INC., G. WILLIAM RYAN, CHRISTOPHER J. ROHRS, [*2]MARK EFFRON, counter-claimants: Joseph A. Moniz, Day, Berry & Howard, Hartford, CT.

For POST-NEWSWEEK STATIONS, CT., INC., G. WILLIAM RYAN, CHRISTOPHER J. ROHRS, MARK EFFRON, counter-claimants: Margaret J. Strange, Jackson, Lewis, Schnitzler & Krupman, Hartford, CT.

For JANET S. PECKINPAUGH, counter-defendant: David S. Golub, Jonathan M. Levine, Jennifer Cohen Goldstein, Silver, Golub & Teitell, Stamford, CT.

JUDGES: Alfred V. Covello, Chief United States District Judge.

OPINIONBY: Alfred V. Covello

OPINION: RULING ON THE DEFENDANTS' MOTION FOR FORM OF JUDGMENT

The defendants, Post Newsweek Stations Connecticut Inc., G. William Ryan, Christopher Rohrs and Mark Effron, have filed a motion for form of a judgment pursuant to *Federal Rule of Civil Procedure 58*. n1 Specifically, the defendants seek to limit the jury award in this case in order to avoid a duplicative award of damages and in accordance with the applicable statutory cap on punitive damages. For the reasons that follow, the defendants' motion is granted.

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

n1 The plaintiff argues that the defendants' arguments should have been presented to the court in a post-judgment proceeding. The court concludes, however, that these issues are properly considered at this stage of the proceedings. See *Paolitto v. Brown, 953 F. Supp. 17 (D. Conn. 1997)*.

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

[*3]

On January 28, 1999, after a trial on the merits, the jury in this case returned a verdict in favor of the plaintiff on her gender discrimination, retaliation, breach of contract and negligent misrepresentation causes of action. The jury awarded compensatory and punitive damages as follows:

Gender Discrimination	$ 312,000
Punitive damages	$ 1,000,000
Retaliation	$ 312,000
Punitive Damages	$ 3,000,000
Breach of Written Contract	$ 2,750,000

Breach of Oral Contract	$ 470,000
Negligent Misrepresentation	$ 470,000

The defendants argue that the jury's awards for economic damages under the plaintiff's gender discrimination ($312,000), retaliation ($312,000), breach of written contract ($2,750,000), breach of oral contract ($470,000), and negligent misrepresentation ($470,000) claims are duplicative and that the court should limit the amount of economic damages to one of these amounts. The plaintiff responds that the jury's awards are not entirely duplicative. Specifically, the plaintiff states that the jury allocated a total amount of damages over several claims and, therefore, that the awards on those claims are not duplicative. The[*4] defendants reply that the plaintiff suffered only a single injury for "past and future economic loss" and that the plaintiff's allocation theory is not persuasive.

The defendants also argue that pursuant to *42 U.S.C. § 1981a*(b)(3)(B), the amount of punitive damages awarded under the plaintiff's gender discrimination and retaliation claims should be limited to a total award of $100,000. The plaintiff responds that the statutory limitation on punitive damages does not apply in this case because the defendant failed to raise it as an affirmative defense.

For the reasons that follow, the court concludes that the plaintiff is entitled to a total compensatory damage award of $3,690,000, based upon the jury's awards for breach of written contract, breach of oral contract and negligent misrepresentation. Further, the court concludes that the jury's punitive damage award should be reduced, in accordance with the applicable statutory provisions, *42 U.S.C. § 1981a*(b).

" [HN1] A basic principal of compensatory damages is that an injury can be compensated only once. If two causes of action provide a legal theory for compensating one injury, only one[*5] recovery may be obtained." *Bender v. City of New York, 78 F.3d 787, 793 (2d Cir. 1996).* Further, "only if the second cause of action entitles the plaintiff to recover for an injury separate from the injury compensated by the award for the first cause of action, or at least for an additional component of injury not covered by the first cause of action, may additional damages be awarded." Id. However, the court has noted that " [HN2] defendants do not demonstrate that a jury's award is duplicative merely by noting that it allocated the damages under two different causes of action." *Gentile v. County of Suffolk, 926 F.2d 142, 154 (2d Cir. 1991).*

Although the court has made it clear that a jury verdict should not compensate a plaintiff more than once for one injury, the second circuit has recognized [HN3] the juries may determine a total award to compensate the plaintiff and allocate that figure between multiple causes of action. For example, in *Indu Craft, Inc. V. Bank of Baroda, 47 F.3d 490, 497 (2d Cir. 1995),* the jury awarded the plaintiff $3.25 million on her good faith and fair dealing and prima facie tort causes of action. The court concluded[*6] that "the jury's award of a net total of $3.25 million was in accordance with the expert's testimony." Id. The court further stated that "while it is possible that the jury impermissibly compensated [the plaintiff] twice for the same injury, it is equally rational to believe that the jury found that [the plaintiff] suffered $3.25 million worth if injuries and merely allocated that amount between the two different causes of action . . . ." Id. (citing *Gentile v. County of Suffolk, 926 F.2d 142, 153-54 (2d Cir. 1991)* (concluding that in case where jury awarded $75,000 for state malicious prosecution claim and $75,000 for federal section 1983 claim, it was conceivable that the jury found $150,000 in unduplicated injuries and merely allocated the amount between the claims)).

In the case at bar, the jury determined that the plaintiff was entitled to recover under both the plaintiff's gender discrimination and retaliation claims in the amount of $312,000 each. At trial, Professor Gary M. Crakes, Ph.D., the plaintiff's expert on damages, testified that under his second theory, the plaintiff suffered a total lost wages through February 1, 1999, of $623,977. [*7]This figure is consistent with the jury award of $312,000 on each of the gender and retaliation claims for a total of $624,000. It therefore appears that the jury allocated the total amount of lost wages between these two claims. Moreover, there was evidence that the plaintiff suffered different injuries on these two claims. n2

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

n2 With respect to her gender discrimination claim, the plaintiff was not seleeted for the second team anchor position and suffered injuries from the defendants' denial of that position. With respect to her retaliation claim, the plaintiff was removed from her position as first team anchor and suffered damages as a result of that removal.

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

With respect to the awards for breach of written contract, breach of oral contract and negligent misrepresentation, it again appears as though the jury came to a bottom line award of $3,690,000, and then proceeded to allocate that amount between the claims. This is supported by the fact that at trial, Professor Crakes testified, again under his second[*8] theory, that the plaintiff's total career loss was $3,693,000. The plaintiff concedes, however, that this award is duplicative of the $624,000 award for gender discrimination and retaliation in that both awards recognize past and future losses.

The court concludes that the plaintiff is entitled to a total compensatory damages award of $3,690,000, representing the amounts awarded for breach of written contract, breach of oral contract and negligent misrepresentation.

The defendant next argues that the jury's award of punitive damages should be limited to the applicable $100,000 cap pursuant to *42 U.S.C. section 1981a*(b)(3). The plaintiff responds that the statutory cap is not applicable here because the defendants failed to raise it as an affirmative defense and that their failure to so plead constitutes a waiver of the statutory limitation on damages. The plaintiff also argues that because the statutory limitation was not raised until after the jury's verdict, the plaintiff was denied the opportunity to contest the defendant's assertions with respect to the factual determination under the statute. n3 Finally, the plaintiff argues that regardless of any[*9] federal statutory cap on punitive damages, she is entitled to punitive damages on her state law claims brought pursuant to the Connecticut Fair Employment Practices Act ("CFEPA").

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

n3 The statute requires a determination of the number of employees the defendant employed during the relevant time period. The plaintiff further argues that this issue should have been presented to the jury.

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

[HN4] Plaintiffs asserting federal gender discrimination and retaliation causes of action are entitled to an award of punitive damages whenever they prove that a defendant unlawfully discriminated "with malice or reckless indifference." *42 U.S.C. § 1981a*(b)(1). Such punitive damages awards, however, on are limited by the provisions of *42 U.S.C. section 1981a*(b)(3), which provides, in relevant part, as follows: [HN5]

(3) Limitations

. . . the amount of punitive damages awarded under this section, shall not exceed, for each complaining party--

(A) in the case of a respondent who[*10] has more than 14 and fewer than 101 employees in each of 20 or more calendar weeks in the current or preceding calendar year, $50,000;

(B) in the case of a respondent who has more than 100 and fewer than 201 employees in each of 20 or more calendar weeks in the current or preceding calendar year, $100,000; and

(C) in the case of a respondent who has more than 200 and fewer than 501 employees in each of 20 or more calendar weeks in the current or preceding calendar year, $200,000; and

(D) in the case of a respondent who has more than 500 employees in each of 20 or more calendar weeks in the current or preceding calendar year, $300,000.

Further, [HN6] "subsection (c)(2) prohibits the court from "informing the jury of the limitations described in subsection (b)(3)." *Luciano v. Olsten Corp., 110 F.3d 210, 221 (2d Cir. 1997).*

In this case, the jury found that the defendants discriminated against the plaintiff and in doing so acted with malice. The jury's verdict included $4,000,000 in punitive damages on the plaintiff's gender discrimination and retaliation causes of action.

The defendants state that subsection (b)(3)(B) of *42 U.S.C. section 1981a,* [*11]applies in this case and that the jury's award of punitive damages should, therefore, be limited to $100,000. In support of their request for application of subsection (b)(3)(B), the defendants submit the affidavit of one Barbara Reising, the Vice President of Human Resources for Post-Newsweek Stations, Inc. She states as follows:

. . . for the calendar years of 1994 and 1995 . . . the defendant Post-Newsweek Stations, Connecticut, Inc. had more than 100 but fewer than 201 employees in each of 20 or more calendar weeks for calendar years 1994 and 1995.

That Post-Newsweek Stations Connecticut, Inc. had 158 employees as of February 28, 1994 and 159 employees as of February 28, 1995. This information was obtained from reports which the Company is required to file yearly with the Federal Communications Commission.

Although the plaintiff states that she was prejudiced by the defendants' late assertion of the statutory limitation, she does not present any evidence tending to call into question the facts in Ms. Reising's affidavit. Further, it appears that the plaintiff was aware of the statutory cap as the complaint includes a reference to the number of the defendant's employees, [*12] a figure which the defendants, in their answer, denied.

The court concludes that the defendants' failure to raise the statutory cap pursuant to *42 U.S.C. section 1981a*(b)(3), until after the jury returned its verdict does not bar application of the statutory provisions in this case. The defendant has submitted evidence, unrebutted by the plaintiff, that it employed between 100-201 people during the relevant time period. In order to provide the plaintiff with a fair opportunity to litigate this issue, however, the plaintiff may submit, within 10 days of the date of this ruling, a request for a determination of the factual issue underlying the application of *42 U.S.C. § 1981a*(b). If the plaintiff does not submit such a request, judgment will enter in accordance with this decision, including punitive damages in the amount of $100,000.

The plaintiff also argues that because the defendant failed to object to separate interrogatories being submitted to the jury on the plaintiff's claims for punitive damages under both gender discrimination and retaliation, she is entitled to a statutory award of punitive damages on both of those claims. [*13]The court disagrees.

The language of the statute provides, in relevant part, that "the amount of punitive damages awarded under this section, shall not exceed, for each complaining party . . . $100,000 . . . ." Section 1981a(b) refers to a total award of punitive damages as to each complaining party. From a plain reading of the statute, therefore, the court concludes that the plaintiff is entitled to only one award of punitive damages pursuant to *42 U.S.C. section 1981a*(b)(3).

With respect to the plaintiff's argument that her punitive damages are recoverable under the CFEPA, the court concludes that the statute does not expressly authorize such a recovery and, therefore, the plaintiff may not recover punitive damages under this theory.

In her response, the plaintiff also requests dismissal of the defendants' counterclaims and that judgment enter in favor of the defendants in accordance with the court's September 10, 1997 and December 16, 1998 rulings. Those requests are granted. The defendants counterclaims are hereby dismissed with prejudice. Further, judgment shall enter in favor of the plaintiff in accordance with the conclusion section of this ruling[*14] and in favor of the defendants in accordance with the court's rulings dated September 10, 1997 and December 16, 1998.

CONCLUSION

The defendants' motion in for a form of judgment (document no. 291) is granted in part and denied in part. If the plaintiff fails to file, within ten days of the date of this ruling, a request for a determination of the factual issue underlying the application of *42 U.S.C. § 1981a*(b), judgment shall enter in favor of the plaintiff on her claims for gender discrimination, retaliation, breach of written contract, breach of the covenant of good faith and fair dealing, breach of oral contract and negligent misrepresentation in the amount of $3,790,000, representing compensatory damages of $3,690,000, and punitive damages in the amount of $100,000.

SO ORDERED this 10th day of March, 1999 at Hartford, Connecticut.

Alfred V. Covello

Chief United States District Judge

EXHIBIT 6

C
Only the Westlaw citation is currently available.

United States District Court, N.D. California.

RESOLUTION TRUST CORPORATION as Receiver for Mercury Savings & Loan Association, Plaintiff,
v.
Anthony P. ROWE; et al., Defendants.

No. C 91-3968 BAC.

May 7, 1993.

ORDER GRANTING BACKSTROM DEFENDANTS' MOTION FOR SUMMARY JUDGMENT

CAULFIELD, District Judge.

*1 This action arises out of a series of loan transactions between Mercury as lender and defendant Richard J. Orosel, and various real estate partnerships which Orosel managed as borrowed. The Resolution Trust Corporation ("RTC") alleges in this matter that defendants participated in a serious of sham loan agreements whereby they fraudulently obtained loans by bribing defendant Anthony P. Rowe.

Defendants Richard Backstrom and Backstrom, Neal & Co. (collectively "Backstrom") performed accounting services for Orosel, the Orosel Partnerships, and defendant Orosel Enterprises, Inc. Richard Backstrom and his wife, Butahn I. Backstrom, are named defendants in this action. The specific allegations against the Backstrom defendants arise out of compilations of client financial statements for Orosel and Orosel Enterprises. Richard Backstrom is also a co-owner of property owned by Orosel through another venture unrelated to this action. Backstrom did not prepare any loan applications on behalf of Orosel or the Orosel entities. Nor did Backstrom prepare audit reports for the entities. As indicated above, Backstrom did prepare the compilations of financial information. The compilation in question states as follows:

> A compilation is limited to presenting, in the form of financial statements, information that is the representation of the individuals whose financial statements are presented. We have not audited or reviewed the accompanying statement of financial condition and, accordingly, do not express an opinion or any other form of assurance on it.
> Richard J. and JoAnn Orosel have elected to omit substantially all of the disclosures required by generally accepted accounting principles. If the omitted disclosures were included in the financial statement, they might influence the user's conclusions about the financial condition of Richard J. and JoAnn Orosel. Accordingly, this financial statement is not designed for those who are not informed about such matters.

The RTC sets forth allegations of common law fraud, negligence, negligent misrepresentation and aiding and abetting liability against Backstrom. The allegations against the Backstrom defendants arise out of a $3.5 million dollar loan to Orosel to develop lots Orosel and the Orosel entities owned at the Hollister Business Park.

Orosel's application for the loan included Backstrom's July 13, 1983 compilation. The RTC maintains that Backstrom failed to include in the liabilities section a listing of a $100,000 loan made by Backstrom to Orosel to purchase the property. Second, the RTC argues that Backstrom's failure to include a statement of interest in an Orosel entity was a material omission. Third, the RTC argues that Backstrom fraudulently overvalued the lots for which the loan was obtained.

Backstrom brings this motion for summary judgment seeking dismissal of all plaintiff's claims against the Backstrom defendants. In the alternative, at a minimum defendants seek dismissal of Mrs. Backstrom. Plaintiff does not set forth specific allegations against Mrs. Backstrom. Nor is she part of the accounting enterprise. For reasons stated fully below, defendants' motion for summary judgment is GRANTED.

ARGUMENT

A. *Summary Judgment Standard*

*2 Summary judgment is appropriate where "there are no genuine issues as to any material fact and ... the moving party is entitled to summary judgment as a matter of law." Fed.R.Civ.P. 56(c). Summary judgment should be granted when it can be determined that judgment may be entered as a matter of law. *Pepper and Tanner, Inc. v. Shamrock Broadcasting, Inc.*, 563 F.2d 391 (9th Cir.1977). All reasonable inferences from the evidence are to be drawn in favor of the non-moving party. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242 (1986).

Once the movant meets its burden of establishing that there is no genuine issue as to any material fact, the nonmovant must make a showing sufficient to establish a genuine issue of fact with respect to any element for which it bears the burden of proof at trial. *British Motor Car Distributing v. San Francisco Auto*, 882 F.2d 371, 374, (9th Cir.1989). The

nonmovant "must come forward with specific facts, not allegations, to show that factual issues remain for trial." DeHorney v. Bank of America Nat'l Trust and Savings, 879 F.2d 459, 464 (9th Cir.1989).

B. *Mrs. Backstrom Should Be Dismissed*

Plaintiff does not set forth any specific allegations against Mrs. Backstrom. She is not a partner in the accounting business operated by her husband, nor does plaintiff set forth a theory of liability against her individually in its opposition papers. The sole basis of liability against Mrs. Backstrom is communal. Plaintiff does not cite to any authority supporting its claims against Mrs. Backstrom. Accordingly, plaintiff's claims against Mrs. Backstrom are DISMISSED.

C. *Plaintiff's Fraud Claims*

A claim for fraud and deceit requires proof of a representation, *i.e.*, an affirmation of fact. *See* Cal.Civ.Code § 1710(1). Generally mere expression of an opinion cannot give rise to a claim of fraud. Daniels v. Oldenburg, 100 Cal.App.2d 724, 726 (1950).

A misrepresentation claim requires actual and justifiable reliance upon the representation of material fact. *See Cortez v. Weymouth*, 235 Cal.App.2d 140, 149 (1965). *See also*, Atari Corp. v. Ernst & Whinney, 981 F.2d 1025 (9th Cir.Dec.1992). Plaintiff asserts that the Backstrom defendants knowingly failed to disclose investments made by Backstrom to an Orosel entity, that the Backstrom defendants improperly overvalued the lots for which loans were obtained, and that Backstrom failed to include a statement of interests in the Orosel entity.

The court does not view these omissions as material; however, the materiality issue need not be addressed in ruling on the instant motion. Plaintiff's submissions are also deficient because they fail to address a threshold issue necessary to plaintiff's fraud allegations. It has been well established that "[t]o recover for fraud under California law, it's not enough ... [to] have relied on ... false statements. [R]eliance must also have been reasonable in light of its (plaintiff's) 'intelligence and experience.' " *General American Life Ins. Co. v. Castonguay*, 984 F.2d 1518, ---- (1993), *citing*, Wagner v. Benson, 101 Cal.App.3d 27, 36 (1980). Backstrom is entitled to summary judgment if no rational trier of fact could find that Mercury's reliance on the statements was reasonable. *Id.*

*3 As the Ninth Circuit recently made clear, "[t]he question the reliance analysis ultimately seeks to resolve is simply whether the alleged misrepresentations were a cause in fact of plaintiff's injury." Atari Corp. v. Ernst & Whinney, 981 F.2d 1025, 1030 (9th Cir.1992). The *Atari* court made clear that under California law, reasonable reliance, judged in light of the plaintiff's intelligence and experience remains the standard in fraudulent misrepresentation cases. *Id.*

Under the facts of this case, no reasonable or rational trier of fact could determine that Mercury's alleged reliance was reasonable. First, the compilation's disclaimers themselves are more than sufficient to put a reasonably prudent lender on notice that the figures contained therein should be verified by the lender's independent auditors. Aside from the unequivocal statement by the Backstrom defendants that the compilation was not the result of an audit, of particular significance to this court's ruling is the disclaimer contained in the compilation which states that Richard and JoAnn Orosel:

> [h]ave elected to omit substantially all of the disclosures required by generally accepted accounting principles. If the omitted disclosures were included in the financial statement, they might influence the user's conclusions about the financial condition of Richard J. and JoAnn Orosel. *Accordingly, this financial statement is not designed for those who are not informed about such matters.* (Emphasis added.)

Plaintiff's claims against the Backstrom defendants arise out of a $3.5 million dollar loan. Given the amount of the loan, the sophistication of the lender, and the disclaimers contained in the compilation report, the court finds that no rational lender could have relied upon the report in making its loan decision. Accordingly, the Backstrom defendants are entitled to summary judgment on plaintiff's fraud claims.

D. *Plaintiff's Negligence Claims Should Be Dismissed*

Plaintiff also sets forth claims for negligence and negligent misrepresentation. Recently, the California Supreme Court held that an auditor's liability for general negligence is confined to its client. Bily v. Arthur Young and Co., 11 Cal.Rptr.2d 51, 73 (1992). The court also held that the auditor's liability under a negligent misrepresentation theory is limited to intended beneficiaries of the audit report. *Id.* at 77.

Clearly Mercury is not entitled to recover under a negligence theory. Mercury is not a client of the Backstrom defendants. Nor did the compilation expressly identify Mercury as a third party beneficiary of the compilation report. [FN1]

In defining intended beneficiaries under a negligent

misrepresentation theory, the *Bily* court noted that other courts applied the Restatement Second of Torts § 552 and its intended beneficiary standard to determine whether liability to third parties would be imposed. The court noted that in those cases,

> *4 [the] title companies were found liable only to persons (1) for whose guidance information was supplied; (2) who justifiably relied on the information; and, most importantly, (3) who were intended to be influenced by the communication. *Intent to influence is a threshold issue. In its absence there is no liability even though a plaintiff has relied on the misrepresentation to his or her detriment, even if such reliance were reasonably foreseeable.*

Stagen v. Stewart-West Coast Title Co., 149 Cal.App.3d 114, 121-122 (1983); as cited in, *Bily*, 11 Cal.Rptr. at 71.

This court has already concluded that any reliance Mercury placed on the compilation report was unreasonable. Moreover, plaintiff has presented no evidence that the compilation was prepared for the intended use of Mercury. In fact, the disclaimers contained in the compilation suggest that the compilation was not intended for use by lenders. As indicated above, the compilation, in stating that the Orosels have elected to omit substantially all disclosures required by generally accepted accounting principles, specifically stressed that the compilation is not designed for those not familiar with the Orosels' financial condition.

In light of the above, defendants' motion for summary judgment on plaintiff's negligence claims is GRANTED.

E. *Aiding and Abetting and RICO*

Plaintiff acknowledges that in order to establish aiding and abetting it must show (a) the fact of perpetration of the overall fraud scheme, (b) Backstrom's knowledge of the scheme, and (c) substantial assistance. Plaintiff has made no showing of knowledge on the part of Backstrom. Accordingly, defendants' motion for summary judgment on plaintiff's aiding and abetting and RICO claims is GRANTED.

F. *Plaintiff's Remaining Claims*

Plaintiff's remaining claims which include claims arising out of alleged contractual relationships with plaintiff are also DISMISSED. Plaintiff has presented no facts which point towards a contractual relationship between plaintiff and defendants. Accordingly, plaintiff's contract based claims are DISMISSED.

CONCLUSION

For the foregoing reasons, plaintiff's claims against the Backstrom defendants are HEREBY DISMISSED.

IT IS SO ORDERED.

> FN1. *See, Bily*, 10 Cal.Rptr.2d 51, 73 n. 16 in which the California Supreme Court, in dicta, suggests that "[t]hird party beneficiaries may under appropriate circumstances posses the rights to the contract." In defining such third party beneficiaries, the *Bily* court specifically identified parties expressly identified in the contract.

1993 WL 165303 (N.D.Cal.)

END OF DOCUMENT

EXHIBIT 7

GEORGE J. WADE, et al., Plaintiffs, v. INDUSTRIAL FUNDINGCORP., et al., Defendants.
NO. C 92-0343 TEH

UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OFCALIFORNIA

1993 U.S. Dist. LEXIS 21245; Fed. Sec. L. Rep. (CCH) P98,144

August 30, 1993, Decided
August 30, 1993, Filed

DISPOSITION: [*1] Defendants' motion to dismiss DENIED in part and GRANTED in part. Plaintiffs' Section 12(2) claims against the non-underwriter Defendants DISMISSED WITHOUT PREJUDICE. Plaintiffs' § 12(2) claims against Defendants Samuel Belzberg, Brent Belzberg, and Alan Hibben DISMISSED WITHOUT PREJUDICE. JURISDICTION RETAINED and JUDGMENT RESERVED. Plaintiffs' negligent misrepresentation claims DISMISSED.

CASE SUMMARY:

PROCEDURAL POSTURE: Defendants, corporate officers, corporations, accountants, and underwriters, filed motions to dismiss plaintiff class' securities fraud case. Defendants argued that the alleged misrepresentations and omissions were not actionable under federal securities laws.

OVERVIEW: Plaintiff class brought this securities fraud case under various sections of the federal securities laws, as well as under California law. The class included purchasers of securities. Defendants included various corporate officers, corporations, accountants, and underwriters. The class alleged that while the corporation was experiencing a tremendous growth surge, defendants covered up underlying problems. Defendants filed motions to dismiss. The corporations and underwriters argued that the alleged misrepresentations and omissions were not actionable under federal securities laws. The corporate officers argued that the class failed to properly allege their involvement in the scheme. The court rejected defendants' arguments that this case was about mismanagement of the company. Instead, the court ruled it concerned misrepresentations about the state of affairs of the company, which were actionable. The court also ruled that because the corporate officers were control persons of the corporation and the class pleaded in detail that the alleged misrepresentations were conveyed in "group-published information" sources, the class met the requirements of the group pleading presumption.

OUTCOME: The court denied defendants' motions to dismiss as to most of the claims because the class pleaded facts upon which if true, relief could be granted. The court ruled that despite defendants' minimal disclosures, the class of investors may still have reasonably relied upon the alleged misrepresentations in the prospectus.

CORE TERMS: misrepresentation, offering, motion to dismiss, prospectus, initial public offering, stock, conspiracy, underwriter, particularity, aftermarket, discovery, investor, plead, entitle, seller, misleading, negligent misrepresentation, aiding and abetting, pleaded, supplemental jurisdiction, actionable, mismanagement, fraudulent, purchaser, annual, failure to state a claim, original jurisdiction, one year, acknowledgment, inappropriate

LexisNexis(R) Headnotes

Civil Procedure: Pleading & Practice: Defenses, Objections & Demurrers: Motions to Dismiss
[HN1] Under Fed. R. Civ. P. 12(b)(6), the court should grant a motion to dismiss only if it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief. On a motion to dismiss for failure to state a claim, the complaint is to be construed in the light most favorable to the plaintiff, and the court must take as true the factual allegations of the complaint.

Securities Law: Bases for Liability: Deceptive Devices
Governments: Legislation: Statutes of Limitations: Time Limitations
[HN2] Litigation instituted pursuant to § 10(b) and Rule 10b-5 must be commenced within one year after the discovery of the facts constituting the violation and within three years after such violation.

Civil Procedure: Trials: Bench Trials
Securities Law: Bases for Liability: Liability for Fraud
[HN3] The question of when fraud was or should have been discovered is a question of fact. It may be decided

as a matter of law only when uncontroverted evidence irrefutably demonstrates plaintiff discovered or should have discovered the fraudulent conduct.

Civil Procedure: Pleading & Practice: Defenses, Objections & Demurrers: Motions to Dismiss
[HN4] When faced with a motion to dismiss under Fed. R. Civ. P. 12(b)(6), the court must consider whether it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief. The complaint is to be construed in the light most favorable to the plaintiff, and the court must take as true the factual allegations of the complaint.

Securities Law: Bases for Liability: Deceptive Devices
[HN5] Section 10(b) does not seek to regulate transactions which constitute no more than internal corporate mismanagement. The term "manipulation," as regulated by securities laws, refers to practices that are intended to mislead investors by artificially affecting market activity.

Securities Law: Bases for Liability: Deceptive Devices
[HN6] Estimates or forecasts of future performance in a prospectus are not actionable if the prospectus contains conspicuous language that bespeaks caution as to actual results. While every prospectus need not detail all of the gloomy possibilities, minimal boilerplate language is insufficient to warn a potential investor about serious danger.

Securities Law: Bases for Liability: Controlling Persons Liability
[HN7] Under § 15 of the 1933 Securities Act, *15 U.S.C.S. § 77o,* a person who controls a violator of §§ 11 or 12 may be held jointly and severally liable with the violators. To establish that someone is a "controlling person" the complainant must show that there was a relationship between the controlling and controlled person and that actual power or influence was exerted over the alleged controlled person.

Securities Law: Bases for Liability: Controlling Persons Liability
[HN8] Making a factual determination as to who is a control person is difficult. The focus should be on how to characterize the relationship between the various alleged controlling persons and the alleged violator of the securities law. The relevant inquiry is whether plaintiff alleged that the individual defendants, who served as the officers of defendant corporation, were in some meaningful sense the persons who stood behind the alleged fraud.

Securities Law: Bases for Liability: Civil Liability
[HN9] *15 U.S.C.S. § 771* provides that one who "offers or sells" a security by means of a misleading prospectus or oral communication shall be liable to the person purchasing such security from him. Liability extends beyond those who pass title to a security; those who solicit a purchase may also face liability as sellers. Liability extends only to those who solicit a purchase, motivated at least in part by a desire to serve his own financial interests or those of a securities owner.

Securities Law: Bases for Liability: Civil Liability
[HN10] *15 U.S.C.S. § 771* requires specific allegations of solicitation as a prerequisite to liability.

Securities Law: Bases for Liability: Civil Liability
[HN11] *15 U.S.C.S. § 771* should not be applied to purchases made after the initial public offering except when such purchases take on the characteristics of a new offering by reason of the control of the issuer. Thus the Securities Act may be appropriately applied when a corporate insider sells his own stock in such a manner that it takes on the characteristics of a new offering. Section 4(3)(B) of the Securities Act, *15 U.S.C.S. § 77d*(3)(B), statutorily extends the period of an initial public offering by 90 days following the commencement of the offering.

Securities Law: Bases for Liability: Liability for Fraud
[HN12] The Eleventh Circuit Court of Appeals endorses the theory that when the fraud alleged is so pervasive that absent the fraud the bonds could not have been marketed, the reliance element is established by the buyer's reliance on the integrity of the market. This theory has not been adopted by the Ninth Circuit Court of Appeals.

Securities Law: Bases for Liability: Liability for Fraud
[HN13] The Ninth Circuit Court of Appeals accepts a presumption of reliance on the integrity of the regulatory process as a substitute for proof of individual reliance in initial public offerings.

Civil Procedure: Pleading & Practice: Pleadings: Heightened Pleading Requirements
[HN14] Fed. R. Civ. P. 9(b) provides that in all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity.

Civil Procedure: Pleading & Practice: Pleadings: Heightened Pleading Requirements
[HN15] In the Ninth Circuit Court of Appeals, Fed. R. Civ. P. 9(b) is satisfied if the pleading identifies the circumstances constituting fraud so that the defendant can prepare an adequate response from the allegations. Plaintiffs need only state the time, place, and nature of

the fraudulent activities of the identified defendant. Although the Ninth Circuit also holds that where discovery has not taken place and the information is in the sole possession of the defendant, identities need not be specified. Without specific identification of the speaker, it is unnecessary to specifically identify his or her access to particular sources of knowledge. The Ninth Circuit offers a relaxed standard of pleading where the facts are peculiarly within the opposing party's knowledge. In addition, when considering such a motion, the requirements of Rule 9 must also be reconciled with Fed. R. Civ. P. 8, which requires a short and plain statement of the claim showing that the pleader is entitled to relief.

Securities Law: Bases for Liability: Civil Liability
[HN16] To state a claim of aiding and abetting securities fraud, one must plead (1) the existence of an independent primary wrong, (2) actual knowledge or reckless disregard by the alleged aider and abettor of the wrong, and (3) substantial assistance in the wrong. Plaintiffs are not required to plead each and every act committed in furtherance of the alleged conspiracy and aiding and abetting, under the standards by which the appellate court must judge motions under Fed. R. Civ. P. 9(b).

Securities Law: Bases for Liability: Liability for Fraud
[HN17] Responsibility by a group of officers may be presumed for pleading purposes where the group is narrowly defined and the pleadings allege direct involvement not only in the day-to-day affairs of the corporation in general but also in the preparation of the corporation's statements. The Wool collective action presumption is equally applicable to members of a board of directors in a corporate fraud action.

Civil Procedure: Pleading & Practice: Pleadings: Heightened Pleading Requirements
Securities Law: Bases for Liability: Liability for Fraud
[HN18] In cases of corporate fraud where the false or misleading information is conveyed in prospectuses, registration statements, annual reports, press releases, or other "group-published information," it is reasonable to presume that these are the collective actions of the officers. Under such circumstances, a plaintiff fulfills the particularity requirement of Fed. R. Civ. P. 9(b) by pleading the misrepresentations with particularity and where possible the roles of the individual defendants in the misrepresentations.

Civil Procedure: Pleading & Practice: Pleadings: Heightened Pleading Requirements
Securities Law: Bases for Liability: Liability for Fraud
[HN19] Where a plaintiff does not yet have access to facts within the sole possession of the defendants but has described the circumstances of the misstatements, a connection between individual corporate defendants and the statements, and finally, a connection between the statements and the fraud alleged, the pleading provides the defendant with sufficient notice with which to defend against the allegations.

Civil Procedure: Jurisdiction: Subject Matter Jurisdiction: Supplemental Jurisdiction
[HN20] In any civil action of which the district courts have original jurisdiction, the district courts shall have supplemental jurisdiction over all other claims that are so related to claims in the action within such original jurisdiction that they form part of the same case or controversy. *28 U.S.C.S. § 1367*(a). This jurisdictional requirement is a successor to the pendent jurisdiction doctrine, which allows federal courts to hear related state law claims arising from a common nucleus of operative fact.

Civil Procedure: Jurisdiction: Subject Matter Jurisdiction: Supplemental Jurisdiction
[HN21] *28 U.S.C.S. § 1367* also provides that district courts may decline to exercise supplemental jurisdiction over a claim if the claim raises a novel or complex issue of state law.

Torts: Business & Employment Torts: Negligent Misrepresentation
[HN22] No legal duty runs to the investing public premised on "aftermarket" documents. Negligent misrepresentation claims based solely on "aftermarket" documents should be dismissed because unlike offering materials, the purpose of aftermarket financial reports is not to create a market for the stock. In this regard, courts consider whether aftermarket documents were targeted at future stockholders; foreseeability; and the connection between the aftermarket statements and any alleged harm to plaintiffs.

Civil Procedure: Pleading & Practice: Service of Process
[HN23] Fed. R. Civ. P. 4(c)(2)(C)(ii) provides that a summons and complaint may be served upon a defendant by mailing a copy of the summons and of the complaint to the person to be served, together with two copies of a notice and acknowledgment. If no acknowledgment of service under this subdivision of this rule is received by the sender within 20 days after the date of mailing, service shall be made personally.

Civil Procedure: Pleading & Practice: Service of Process
[HN24] Even if the defendant receives actual notice by mail, service is ineffective unless the defendant timely returns the acknowledgment form or the plaintiff attempts follow-up service by some other method.

Civil Procedure: Pleading & Practice: Service of Process

Civil Procedure: Pleading & Practice: Defenses, Objections & Demurrers
[HN25] Defendants can waive the defect of lack of personal jurisdiction by appearing generally without first challenging the defect in a preliminary motion. The question of whether a party has "appeared" in a matter depends upon a clear intention or purpose to defend the suit. That decision suggests that in regards to such notice questions, if one acts like a party via one's actions in regard to the pending matter, then one may be considered to be a party in that matter, and service requirements may be waived.

Torts: Malpractice Liability: Professional Services
[HN26] Conclusory allegations made by plaintiffs regarding violations of professional auditing standards fail to state a claim.

Securities Law: Bases for Liability: Civil Liability
[HN27] *15 U.S.C.S. § 77k*(a)(4) limits an outside auditor's liability to statements in a registration statement, report, or valuation, which purport to have been prepared or certified by him.

Civil Procedure: Pleading & Practice: Pleadings: Relation Back
[HN28] Under Fed. R. Civ. P. 15(c)(3), a complaint may relate back to include a particular party, if that party (A) has received such notice of the institution of the action that the party will not be prejudiced in maintaining a defense on the merits, and (B) knew or should have known that, but for a mistake concerning the identify of the proper party, the action would have been brought against the party.

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For INDUSTRIAL FUNDING CORPORATION, INDUSTRIAL LEASING CORPORATION, FIRST CITY 100 CORPORATION, FIRST CITY REALTY INVESTMENT CORPORATION, 1988 FIRST CITY REALTY INVESTMENT (1988) LTD., 1987 FIRST CITY REALTY INVESTMENT (1987) LTD., FIRST CITY TRUST CO., FIRST CITY TRUSTCO INCORPORATED, FIRST CITY FINANCIAL CORPORATION LTD., SAMUEL BELZBERG, BRENT S. BELZBERG, JOSEPH COSTELLO, JR., CLARK M. BENTLEY, ALAN R. HIBBEN, defendants: Gary Ewell, Ewell & Levy, San Francisco, CA.

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For WILLIAM J. TEXIDO, defendant: Michael L. Charlson, Heller Ehrman White & McAuliffe, Palo Alto, CA.

For JOHN A. ELORRIAGA, WILLIAM J. TEXIDO, Third-party Defendants: Michael L. Charlson, Heller Ehrman White & McAuliffe, Palo Alto, CA.

For JOHN A. ELORRIAGA, WILLIAM J. TEXIDO, Third-party Defendants: Douglas M. Schwab, Heller Ehrman White & McAuliffe, San Francisco, CA.

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JUDGES: Thelton E. Henderson, Chief Judge, United States District Court.

OPINIONBY: Thelton E. Henderson

OPINION: ORDER

BACKGROUND:

This is a securities fraud case, brought under various sections of the federal securities laws, as well as under California law. n1 Plaintiff class includes purchasers of securities, and Defendants[*4] include various corporate officers, corporations, accountants, and underwriters. n2 Defendant Industrial Funding Corporation ("IFC") is an Oregon-based company that, through an operating subsidiary, Industrial Leasing Company ("ILC"), is in the small equipment leasing business. Plaintiffs allege that while IFC suffered from extreme mismanagement, Defendants consistently represented to the investing public that IFC was a well-managed, highly competitive and successful company which had experienced tremendous growth in the "small ticket" leasing field. Plaintiffs allege that while IFC was experiencing a tremendous growth surge, underlying problems were covered up by Defendants, who, inter alia: engaged in improper bookkeeping procedures; entered into risky, poor quality leases; manipulated its reported delinquency rates by establishing a depository for bad or fraudulent leases called "Company 13;" and converted to a new computer system which caused tremendous problems which were not reported.

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

n1 This case was originally assigned to the late Judge Robert F. Peckham. This motion was heard by Judge Peckham on October 21, 1992, and the case has since been transferred to Chief Judge Thelton E. Henderson.

[*5]

n2 A motion for class certification will be heard on September 27, 1993.

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

On December 8, 1989, IFC made an initial public offering of its stock. In the offering, IFC sold 1,875,000 shares of common stock at $12.25 per share to the investing public, including Plaintiffs and other members of the class, for gross proceeds of approximately $23 million. Over the next 15 months, IFC prepared numerous public reports, including annual reports, quarterly reports, and press releases. Plaintiffs allege that these items contained false or misleading statements about the condition, stability, growth potential, success, and management abilities of IFC. Plaintiffs allege that they relied upon these allegedly false and misleading statements in their purchases of shares of IFC stock.

Defendants have filed motions to dismiss Plaintiffs' Amended Complaint ("Complaint"), on many different grounds. There are four separate groups of moving Defendants, all of whose claims are intertwined. These Defendants are: IFC, plus other related subsidiaries and holding companies, officers and directors ("IFC Defendants"); Deloitte[*6] & Touche, IFC's accountant ("Deloitte"); William Texido and John Elorriaga, two outside directors of IFC; and Alex. Brown and Piper Jaffray, underwriters ("Underwriter Defendants"). Each set of papers cross-references to the others; we will consider each issue separately, cross-referencing when and where appropriate.

DISCUSSION:

A. Plaintiffs' Claims were Timely Filed.

Pursuant to *Fed. R. Civ. P. 12(b)(6)*, all Defendants move to dismiss Plaintiffs' complaint for failure to state a claim. [HN1] Under *Fed. R. Civ. P. 12(b)(6)*, the court should grant such a motion only if "it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Conley v. Gibson, 355 U.S. 41, 45-46, 2 L. Ed. 2d 80, 78 S. Ct. 99 (1957).* On a motion to dismiss for failure to state a claim, the complaint is to be construed in the light most favorable to the plaintiff, and the court must take as true the factual allegations of the complaint. Wright & Miller, Federal Practice and Procedure: Civil § 1357.

Defendants argue that Plaintiffs' claims are time-barred, and thus they have failed to state a claim upon which relief[*7] can be granted. In *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 501 U.S. 350, 111 S. Ct. 2773, 2782, 115 L. Ed. 2d 321 (1991),* reh'g denied, *501 U.S. 1277, 112 S. Ct. 27, 115 L. Ed. 2d 1109 (1991),* the United States Supreme Court held: [HN2] "Litigation instituted pursuant to § 10(b) and Rule 10b-5 . . . must be commenced within one year after the discovery of the facts constituting the violation and within three years after such violation." The dispute arises over whether the one year limitation period runs from the date of plaintiff's actual discovery or from the date when plaintiff should have discovered the alleged materially misleading statements or omissions.

Because the Lampf decision was recently handed down, this question is still being debated in the District Courts. See *Werner v. Satterlee, Stephens, Burke & Burke, 797 F. Supp. 1196 (S.D.N.Y. 1992); Continental Bank v. Ludlow, 777 F. Supp. 92 (D. Mass. 1991); Henley v. Slone, 774 F. Supp. 98 (D. Conn. 1991),* vacated on other grounds, *961 F.2d 23 (2d Cir. 1992); Johnson v. Mitchell, 1992 U.S. Dist. LEXIS 8583*[*8] (N.D.Cal. May 13, 1992). We need not resolve this debate, however, for regardless of which standard is employed, dismissal is inappropriate. First, Plaintiffs persuasively argue that the question of when a reasonable person should have discovered fraud is a question which would be inappropriate to resolve at this stage in the pleadings. The Court of Appeals offered guidance as to this question in *Mosesian v. Peat, Marwick, Mitchell & Co., 727 F.2d 873* (9th Cir.), cert. denied, *469 U.S. 932, 105 S. Ct. 329, 83 L. Ed. 2d 265 (1984).* Although this case was decided before Lampf, its guidance on the discovery question still is instructive. [HN3] "The question of when [fraud] was or should have been discovered is a question of fact. . . It may be decided as a matter of law only when 'uncontroverted evidence irrefutably demonstrates plaintiff discovered or should have discovered the fraudulent conduct.'" Mosesian at 877 (citations omitted).

Second, applying the actual discovery standard, there is still a dispute as to whether Plaintiffs' claims were timely filed. While Plaintiffs claim not to have discovered Defendants' alleged fraud until shortly[*9] before filing this action (January 16, 1992), Defendants claim that the facts upon which Plaintiffs base their claims were revealed more than one year prior to filing. Plaintiffs however, have alleged that they had no reason to know of the alleged fraud before February 28, 1991. Reading the allegations in the light most favorable to Plaintiffs, it appears as though they may be able to prove facts which would entitle them to relief. Accordingly, we DENY Defendants' motion to dismiss under *Fed. R. Civ. P. 12(b)(6)* for failure to timely file.

B. Defendants' Alleged Omissions and Misrepresentations are Actionable.

Both the IFC Defendants and the Underwriter Defendants argue that the alleged misrepresentations and omissions by Defendants are not actionable under federal securities laws. Accordingly, they move to dismiss for failure to state a claim under *Fed. R. Civ. P. 12(b)(6).*

[HN4] When faced with a motion to dismiss under Rule 12(b)(6), we must consider whether "it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Conley, supra, 355 U.S. at 45-46.* See also, *Cytryn v. Cook, Fed. Sec. L. Rep. (CCH) P95,409 at 97,013*[*10] [1990 Transfer Binder] (N.D. Cal. July 2, 1990) (Peckham, J.). The complaint is to be construed in the light most favorable to the plaintiff, and the court must take as true the factual allegations of the complaint. *Abramson v. Brownstein, 897 F.2d 389, 391 (9th Cir. 1990);* Wright & Miller, Federal Practice and Procedure: Civil § 1357. Throughout their complaint, Plaintiffs allege numerous specific false or misleading statements, misrepresentations and omissions made by Defendants, in violation of federal securities law. Complaint PP66-106. If true, these allegations could state a claim which would entitle Plaintiffs to relief. Based on these allegations, it does not appear beyond doubt that Plaintiffs can prove no set of facts which would entitle them to relief.

Further, Defendants argue that Plaintiffs merely plead poor management in P106. Under the United States Supreme Court decision in *Santa Fe Industries, Inc. v. Green, 430 U.S. 462, 51 L. Ed. 2d 480, 97 S. Ct. 1292 (1977),* such an allegation would not be actionable. "We thus adhere to the position that 'Congress by [HN5] § 10(b) did not seek to regulate transactions which constitute no more than[*11] internal corporate mismanagement.'" *Id. at 479* (citation omitted). In Santa Fe, the Court observed that the term "manipulation", as regulated by securities laws, "refers to practices . . . that are intended to mislead investors by artificially affecting market activity." *Id. at 476.* That is precisely what is alleged in this case. This is not a case about the mismanagement of a company; rather, it concerns misrepresentations about the state of affairs of a company, upon which Plaintiffs allegedly relied. Again, Defendants' arguments are unpersuasive.

Next, Defendants contend that because of "risk disclosure" statements in the prospectus, what Plaintiffs allege were "misrepresentations" were in fact fully

disclosed risks. Defendants thus seek protection in the form of the "bespeaks caution" doctrine. [HN6] "Estimates or forecasts of future performance in a prospectus are not actionable if the prospectus contains conspicuous language that bespeaks caution as to actual results." *In re Worlds of Wonder Securities Litigation, 814 F. Supp. 850, 859,* [Current Transfer Binder] *Fed. Sec. L. Rep. (CCH) P97355 (N.D. Cal. 1993).* Defendants included boilerplate[*12] language indicating that changed circumstances "could have a material adverse effect on the Company . . . ." Alex. Brown Memo at 10, 11, 12, citing Prospectus at 6, 7, 8. This language, they contend, "fully reveals the risks associated with that potential mismanagement." Id. at 13. While every prospectus need not detail all of the gloomy possibilities, minimal boilerplate language is insufficient to warn a potential investor about serious danger. See *Huddleston v. Herman & MacLean, 640 F.2d 534, 543-44,* (5th Cir. 1981), aff'd in part and rev'd in part on other grounds, *459 U.S. 375 (1983).* Despite these minimal disclosures, investors may still have reasonably relied upon the alleged misrepresentations contained in the Prospectus. Plaintiffs have pleaded facts upon which, if true, relief could be granted. Thus, dismissal at this point would be inappropriate.

Therefore, we DENY Defendants' motion to dismiss under *Fed. R. Civ. P. 12(b)(6),* because Defendants have not shown that Plaintiffs will be unable to plead any set of facts upon which relief may be granted.

C. § 11 Liability for Certain Defendants.

Defendants argue that[*13] the court should dismiss § 11 claims against Defendants Samuel Belzberg, Brent Belzberg, and Alan Hibben for control person liability because Plaintiffs fail to allege a basis for such liability. [HN7] Under § 15 of the 1933 Securities Act, a person who controls a violator of §§ 11 or 12 may be held jointly and severally liable with the violators. *15 U.S.C. § 77o.* Plaintiffs allege that these three Defendants are secondarily liable under § 15 as control persons of IFC. "To establish that someone is a 'controlling person' the complainant must show that there was a relationship between the controlling and controlled person and that actual power or influence was exerted over the alleged controlled person." *Durham v. Kelly, 810 F.2d 1500, 1503-04 (9th Cir. 1987).* In *Wool v. Tandem Computers, Inc., 818 F.2d 1433 (9th Cir. 1987),* the Ninth Circuit recognized that [HN8] making a factual determination as to who is a control person is difficult. According to Wool, the

focus should be on how to characterize the relationship between the various alleged controlling persons and the alleged violator of the securities law . . . [The relevant[*14] inquiry] is whether [plaintiff] alleged that the individual defendants, who served as the officers of [Defendant corporation], were in some meaningful sense the persons who stood behind the alleged fraud.

Wool, 818 F.2d at 1441. We now examine the relevant allegations.

Plaintiffs allege that in 1986, Defendant ILC was acquired by Defendant First City 100 ("FC 100"), a holding company formed by Defendants Samuel Belzberg, Brent Belzberg and Alan Hibben. Plaintiffs further contend that Samuel Belzberg served as Chairman of the Board of Directors of IFC; as Chairman of the Board of Directors, President, and CEO of Defendant First City Financial, the ultimate parent of IFC; and as Chairman of the Board of Directors of First City Trustco, a parent company of FC 100. The First Amended Complaint alleges that Brent Belzberg served as a Director and Vice Chairman of the Board of Directors of IFC; as a Director, President and COO of First City Trustco; and as President and CFO of First City Financial. Alan Hibben has served as a Director of IFC and as Vice President and CFO of First City Trustco. Samuel Belzberg, Brent Belzberg and Alan Hibben all signed IFC's[*15] registration statement and the Form 10-K Report for the fiscal year ended November 30, 1989. Moreover, these three Defendants financially own and control a large majority stake in IFC and its parent companies. First Amended Complaint PP3-11. Plaintiffs have sufficiently alleged that these three defendants were in a position with power to influence IFC and that they exerted their control by, inter alia, preparing and signing the allegedly fraudulent documents upon which Plaintiffs allegedly relied. Plaintiffs also have sufficiently alleged that these three defendants were in a meaningful sense the persons who stood behind the alleged fraud. We find that Defendants Samuel Belzberg, Brent Belzberg and Alan Hibben are control persons, who therefore may be held liable under Section 11.

D. § 12(2) "Seller" Liability.

Defendants move to dismiss the § 12(2) claims on the grounds that they did not "sell" IFC stock to Plaintiffs. [HN9] Section 12(2) provides that one who "offers or sells" a security by means of a misleading prospectus or oral communication "shall be liable to the person purchasing such security from him . . . ." *15 U.S.C. § 771.* Defendants[*16] claim that Plaintiffs have failed to identify any of the Defendants, besides the Underwriters, as "sellers" of IFC stock. In *Moore v. Kayport Package Express, Inc., 885 F.2d 531 (9th Cir. 1989),* the Ninth Circuit explored the definition of "seller," as applied to § 12(2) cases, relying on the Supreme Court's opinion in

Pinter v. Dahl, 486 U.S. 622, 100 L. Ed. 2d 658, 108 S. Ct. 2063 (1988).

In Pinter, the Court held that liability extends beyond those who pass title to a security; those who solicit a purchase may also face liability as sellers . . . Liability extends only to those who solicit a purchase, "motivated at least in part by a desire to serve his own financial interests or those of a securities owner."

Moore at 535 (citations omitted).

In XOMA Corp. Securities Litigation [1991-1992 Transfer Binder] (CCH) P96,491 at 92,162 (December 27, 1991), this court considered the same issue that is presented today. In XOMA, we stated:

The XOMA defendants move to dismiss the § 12(2) claims for failure to allege that XOMA, the Officers/Directors, or the outside directors were statutory sellers. They are correct. [*17] Plaintiffs painstakingly allege different ways in which defendants, in general, solicited buyers for XOMA's securities. They allege that the defendants provided information to securities analysts, employed the underwriter defendants, distributed the prospectuses, and made contact with members of the investment community. However, they do not allege that any particular defendants solicited any particular plaintiff, and that is what § 12(2) requires.

XOMA also was a case involving an initial public offering, and we stand by our holding that [HN10] Section 12(2) requires specific allegations of solicitation as a prerequisite to liability. Since plaintiffs have not alleged that they were solicited by IFC, plaintiffs will not be entitled to relief under Section 12(2). Therefore, we GRANT Defendants' motion and DISMISS WITHOUT PREJUDICE Plaintiffs' Section 12(2) claims against the non-underwriter Defendants.

E. § 12(2) Liability for Certain Defendants.

Defendants argue that the court should dismiss § 12(2) claims against Defendants Samuel Belzberg, Brent Belzberg, and Alan Hibben because they did not sell stock to plaintiffs. These arguments are the same[*18] as have just been presented, and we GRANT Defendants' motion and DISMISS WITHOUT PREJUDICE Plaintiffs' § 12(2) claims against Defendants Samuel Belzberg, Brent Belzberg, and Alan Hibben.

F. § 12(2) Claims for Plaintiffs who did not Purchase in the Initial Public Offering.

Next, Defendants seek to dismiss the § 12(2) claims for those Plaintiffs who did not purchase their stock in the initial public offering. Defendants argue that only investors who purchase stock in initial public offerings may obtain relief under § 12(2). Judge Peckham addressed the same issue in *Hedden v. Marinelli, 796 F. Supp. 432,* [1991-1992 Transfer Binder] *Fed. Sec. L. Rep. (CCH) P96,526 (N.D.Cal. 1992)* (Peckham, J.). In Hedden, the court first observed that "a majority of district courts and the Third Circuit have held that Section 12(2) is limited to initial offerings and does not apply to secondary market transactions." Id. at 92,412. The court then held "that under the facts presented to those courts, involving instances of secondary trading conducted through brokerage firms, it [is] prudent to withhold the application of the 1933 Act since such entities[*19] are quite removed from the initial issuer and not necessarily privy to inside information regarding the company." Id. at 92,412. Judge Peckham concluded that [HN11] § 12(2) should not be applied to purchases made after the initial public offering except when such purchases "take on the characteristics of a new offering by reason of the control of the issuer . . . Thus the Act may be appropriately applied when a corporate insider sells his own stock in such a manner that it takes on the characteristics of a new offering." Id. at 92,412 (citation omitted). Because Section 4(3)(B) of the Securities Act, *15 U.S.C. § 77d*(3)(B), statutorily extends the period of an initial public offering by ninety (90) days following the commencement of the offering, those Plaintiffs who purchased within this period did so in such a way that retained the characteristics of the new offering. All persons who purchased IFC shares during this 90 day post-offering period received a copy of the prospectus from sources privy to inside information regarding IFC, and their purchases thus retained the characteristics of the new offering. These Plaintiffs may therefore be considered to have[*20] purchased on the initial public offering. n3

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

n3 We note that recently the Seventh Circuit, and previously the First and Tenth Circuits, have also held that Section 12(2) liability applies both to initial public offerings and to secondary market transactions. See *Pacific Dunlop Holdings, Inc. v. Allen & Co., 993 F.2d 578,* [Current Binder] *Fed.Sec.L.Rep. (CCH) P97,450 (7th Cir. 1993); Woodward v. Wright, 266 F.2d 108 (10th Cir. 1959); Cady v. Murphy, 113 F.2d 988, 989* (1st Cir.), cert. denied, *311 U.S. 705, 85 L. Ed. 458, 61 S. Ct. 175 (1940).* But cf. *Ballay v. Legg Mason Wood Walker, Inc., 925 F.2d 682* (3d Cir.), cert. denied, *502 U.S. 820, 112 S. Ct. 79, 116 L. Ed. 2d 52 (1991).*

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

Therefore, we GRANT Defendants' motion to dismiss the § 12(2) claim for those Plaintiffs who did not purchase their IFC stock in the initial public offering, except for those who purchased within 90 days of the initial public offering, [*21]whose § 12(2) claims we do not dismiss.

G. 10b-5 and § 10(b) Claims and Reliance.

Defendants IFC and the Underwriters argue that the court should dismiss Plaintiffs' § 10(b)/Rule 10b-5 claims because purchasers in the initial public offering cannot establish reliance on alleged fraudulent statements.

1. The "Fraud Created the Market" Presumption.

Plaintiffs contend that they are entitled to a presumption of reliance if they can show that the securities were brought to market fraudulently. See *Shores v. Sklar, 647 F.2d 462 (5th Cir. 1981)* (en banc), cert. denied, *451 U.S. 1102 (1983).* The theory was stated by [HN12] the 11th Circuit as follows: "When the fraud alleged is so pervasive that absent the fraud the bonds could not have been marketed, the reliance element is established by the buyer's reliance on the integrity of the market." *Ross v. Bank South N.A., 885 F.2d 723, 729 (11th Cir. 1989)* (en banc), cert. denied, *495 U.S. 905, 109 L. Ed. 2d 287, 110 S. Ct. 1924 (1990).* While this theory "has not been adopted by the Ninth Circuit and it has been criticized by courts and commentators," *In re MDC Holdings Securities Litigation, 754 F. Supp. 785, 805 (S.D.Cal. 1990)*[*22] (citations omitted), Judge Bilby recently endorsed the theory in *In re American Continental/Lincoln S&L Securities Litigation, 140 F.R.D. 425 (D.Ariz. 1992).* We find his reasoning to be quite persuasive:

If an enterprise is so laden with fraud that its entire public image is distorted, it is sensible to presume that reasonable investors relied on many material misrepresentations which, in aggregate, created a false image. In this situation, the offending misrepresentations are not merely presumed to compete successfully for the investor's attention amidst a mix of material, undistorted facts. Rather, the entire picture of the company's economic health and lawful character is skewed. *Id. at 432.*

Here, Plaintiffs allege that IFC misrepresented its stability and fiscal well-being to the extent that its entire public image was distorted. Plaintiffs allege that they relied upon this distorted image in purchasing shares of IFC stock. We hold that Plaintiffs have pleaded sufficient facts to state a claim upon which relief may be granted, based on the fraud created the market presumption.

2. Reliance on the Regulatory Process.

Plaintiffs[*23] also rely on a presumption recognized in *Arthur Young & Co. v. United States District Court, 549 F.2d 686* (9th Cir.), cert. denied, *434 U.S. 829, 54 L. Ed. 2d 88, 98 S. Ct. 109 (1977).* In Arthur Young, the Ninth Circuit stated: "Just as the open market purchaser relies on the integrity of the market and the price of the security traded on the open market to reflect the true value of securities in which he invests, so the purchaser of an original issue security relies, at least indirectly, on the integrity of the regulatory process and the truth of any representations made to the appropriate agencies and the investors at the time of the original issue." *549 F.2d at 695.* "Thus, [HN13] the Ninth Circuit has accepted a presumption of reliance on the integrity of the regulatory process as a substitute for proof of individual reliance in initial public offerings." *In re MDC, 754 F. Supp. at 806.* In the instant case, Plaintiffs allege that false representations were made by Defendants to regulators and that Plaintiffs relied on the integrity of the regulatory process and therefore, on the statements made by Defendants at the time[*24] of the offering. The regulatory presumption thus provides another sound legal theory upon which Plaintiffs may be able to establish reliance. For the reasons stated in Parts 1 and 2, we therefore DENY Defendants' motion to dismiss.

H. 10b-5 and § 10(b) Claims--Pleading with Sufficient Particularity (Rule 9(b)).

All Defendants also claim that Plaintiffs have failed to plead their claims under Rule 10b-5 with sufficient particularity, in violation of [HN14] *Fed. R. Civ. P. 9(b),* which provides that "in all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity." Id.

In *Cytryn, supra,* the court spelled out the appropriate standard for reviewing a Rule 9(b) claim in a securities case:

[HN15]

In the Ninth Circuit, Rule 9(b) is satisfied if the pleading identifies the circumstances constituting fraud so that the defendant can prepare an adequate response from the allegations. . . . Plaintiffs need only state the time, place, and nature of the fraudulent activities of the identified

defendant. . . . Although the Ninth Circuit has also held that where discovery has not taken place and the information[*25] is in the sole possession of the defendant, identities need not be specified. . . . Without specific identification of the speaker, it is unnecessary to specifically identify his or her access to particular sources of knowledge. . . . The Ninth Circuit offers a relaxed standard of pleading where the facts are "peculiarly within the opposing party's knowledge." Cytryn at 97,016 (citations omitted).

In addition, when considering such a motion, the requirements of Rule 9 must also be reconciled with Rule 8, which requires "a short and plain statement of the claim showing that the pleader is entitled to relief." *Fed. R. Civ. P. 8(a)(2).* Defendants break their argument down into four areas, each of which shall be explored in turn, measured against these standards.

1. Conspiracy/Aiding & Abetting.

[HN16] "To state a claim of aiding and abetting securities fraud, one must plead (1) the existence of an independent primary wrong, (2) actual knowledge or reckless disregard by the alleged aider and abettor of the wrong, and (3) substantial assistance in the wrong." *Levine v. Diamanthuset, 950 F.2d 1478, 1483 (9th Cir. 1991).* Defendants contend that plaintiffs do[*26] not allege how or where the conspiracy was established and do not identify the specific acts by each defendant that were undertaken to further the conspiracy. While Plaintiffs may not have pleaded each and every act committed in furtherance of the alleged conspiracy and aiding and abetting, such pleading is not required by the standards by which this court must judge motions under Rule 9(b). Plaintiffs have alleged enough acts to satisfy the standard set by the Rules and case law. For example Plaintiffs allege:

A conspiracy, common enterprise and common course of conduct commenced in or about December 1989 involving the defendants . . . The purpose of the aforementioned conspiracy, common enterprise and common course of conduct was to enable defendant IFC to (1) commence and successfully conclude the Offering at a price of $12.25 per share and (2) continue and prolong the illusion of rapid growth, financial soundness and optimistic business prospects, in order to artificially support the after-market trading price of IFC's publicly-traded common stock . . . The defendants accomplished their conspiracy . . . by, inter alia, issuing a false and misleading Prospectus dated[*27] December 8, 1989, and a series of false and misleading annual and quarterly reports, financial statements, releases and other reports, including those particularized below.

First Amended Complaint, P23. The first amended complaint details, inter alia, alleged tampering with the balance sheets, manipulation of financial ratios contained in the Prospectus, understatement of bad debt reserves, overstatement of the value of leased equipment, etc., as part of the alleged conspiracy and aiding and abetting. See Id., PP13-19, 23-30, 51-120. Accordingly, we DENY Defendants' motion to dismiss the conspiracy/aiding and abetting claims.

2. Claims Against Defendants Samuel Belzberg, Brent Belzberg and Alan Hibben.

Defendants next argue that Plaintiffs have failed to properly allege the involvement of Defendants Samuel Belzberg, Brent Belzberg, and Alan Hibben. Plaintiffs allege that these three Defendants were officers and directors of IFC and its parent company, and that they were control persons of IFC. In *Cytryn, supra,* Judge Peckham held:

[HN17]
Responsibility by a group of officers may be presumed for pleading purposes where the group is narrowly[*28] defined and the pleadings allege direct involvement not only in the day-to-day affairs of the corporation in general but also in the preparation of the corporation's statements. [Citation to Wool]. The Wool collective action presumption was later held to be "equally applicable to members of a board of directors in a corporate fraud action." *Blake, 856 F.2d 1365 at 1369 (9th Cir. 1988).* We are persuaded by that approach.

Cytryn at 97,016. In Wool, the Ninth Circuit held:

[HN18]
In cases of corporate fraud where the false or misleading information is conveyed in prospectuses, registration statements, annual reports, press releases, or other "group-published information," it is reasonable to presume that these are the collective actions of the officers. Under such circumstances, a plaintiff fulfills the particularity requirement of Rule 9(b) by pleading the misrepresentations with particularity and where possible the roles of the individual defendants in the misrepresentations.

Wool, 818 F.2d at 1440. Samuel Belzberg, Brent Belzberg and Alan Hibben are control persons of IFC, and Plaintiffs have pleaded in detail that the[*29] alleged misrepresentations were conveyed in "group-published information" sources (prospectuses, registration statements, annual reports, press releases, and other reports). See First Amended Complaint PP13-19, 23-30, 51-120. Plaintiffs have met the requirements of the Wool group pleading presumption. Therefore, we DENY Defendants' motion. However, if evidence develops after sufficient discovery that these three individual

defendants were not sufficiently involved in the affairs of IFC, then a summary judgment motion may be appropriate.

3. Section 10(b)/Rule 10b-5 Claims against First City Defendants.

Next, Defendants argue that Plaintiffs have failed to identify statements or acts by the First City companies that constitute securities fraud. Applying the Wool "group pleading presumption," we find that only power to control has been alleged. Wool also requires Plaintiffs to allege "culpable participation," such as more specific facts to support a finding of the First City companies' day-to-day involvement in the affairs of IFC. See *Wool, 818 F.2d at 1442.* Accordingly, we DISMISS the § 10(b)/Rule 10b-5 claims against First City [*30]Defendants WITH LEAVE TO AMEND WITHIN THIRTY (30) DAYS OF THE DATE OF THIS ORDER.

4. Particularity of Claims Based on Statements made by IFC.

Defendants' last Rule 9(b) challenge is that the Plaintiffs' claims based on statements made by IFC lack particularity. In Cytryn, Judge Peckham wrote:

Although defendants will often contend that a plaintiff has failed to plead with sufficient particularity under Rule 9(b), we find that [HN19] where a plaintiff does not yet have access to facts within the sole possession of the defendants but has described the circumstances of the misstatements, a connection between individual corporate defendants and the statements, and finally, a connection between the statements and the fraud alleged, the pleading provides the defendant with sufficient notice with which to defend against the allegations. Cytryn at 97,017.

Applying the same standard to the facts before the court today, we find that Plaintiffs have thoroughly described the circumstances of the alleged misrepresentations and the connection with the Defendants with sufficient particularity to meet the requirements of Rule 9(b). See First Amended Complaint, [*31] PP13-19, 23-30, 51-120. Plaintiffs have met their burden under Rule 9(b), so we DENY Defendants' motion.

I. Dismiss State Law Claims.

All Defendants seek to have Plaintiffs' state law claims dismissed, arguing three major points.

1. Supplemental Jurisdiction.

First, Defendants dispute Plaintiffs' claim that this court has supplemental jurisdiction under *28 U.S.C. § 1367.* [HN20] "In any civil action of which the district courts have original jurisdiction, the district courts shall have supplemental jurisdiction over all other claims that are so related to claims in the action within such original jurisdiction that they form part of the same case or controversy." *28 U.S.C. § 1367*(a). This jurisdictional requirement is a successor to the pendent jurisdiction doctrine, which allowed federal courts to hear related state law claims arising "from a common nucleus of operative fact." *United Mine Workers v. Gibbs, 383 U.S. 715, 725, 16 L. Ed. 2d 218, 86 S. Ct. 1130 (1996).* The state and federal claims all stem from the same alleged misrepresentations by Defendants about the stability and financial health [*32]of IFC, and the subsequent purchases of IFC securities by Plaintiffs. Plaintiffs seek both state and federal relief for the alleged harm they suffered as a result of these actions. Thus, the state law claims are derived from a common nucleus of operative fact and form part of the same case and controversy as the federal claims. The court has original jurisdiction over the federal claims and properly may hear the state claims as well as the federal claims.

2. Novel and Complex Issues of State Law.

Defendants next point out that [HN21] § 1367 also provides that "district courts may decline to exercise supplemental jurisdiction over a claim . . . if (1) the claim raises a novel or complex issue of State law." *28 U.S.C. § 1367*(c)(1). The California Supreme Court has granted review in a case in which the Court of Appeal held that the fraud on the market theory does not apply to claims for fraud and negligent misrepresentation. *Mirkin v. Wasserman, 234 Cal. App. 3d 719 (1991),* review granted, June 20, 1991. At argument, Plaintiffs' counsel represented to the court that the briefs had been filed in Mirkin, but a date had not been set for[*33] argument. Because this issue is to be decided by the California Supreme Court, we believe that it would be best to reserve judgment as to this question. We therefore DENY Defendants' motion to dismiss on § 1367(c)(1) grounds, RETAIN JURISDICTION and RESERVE JUDGMENT. When the California Supreme Court rules on this matter, new motions may be appropriate, but to dismiss this claim at this point would be premature.

3. Defendants' Duty to Aftermarket Purchasers.

The Underwriter Defendants and IFC also argue that Plaintiffs' negligent misrepresentation claims based on public reports should be dismissed because Defendants owed no legal duty to Plaintiffs. *Alfus v. Pyramid Technology Corp., 745 F. Supp. 1511 (N.D.Cal. 1990),* supports the proposition that [HN22] no legal duty runs

to the investing public premised on "aftermarket" documents. Alfus favorably cited "a number of recent Northern District cases [which] have held that negligent misrepresentation claims based solely on 'aftermarket' documents . . . should be dismissed because unlike offering materials, the purpose of aftermarket financial reports is not to create a market for the stock. [*34] " *Id. at 1523* (citations omitted). In this regard, courts have considered whether aftermarket documents were targeted at future stockholders; foreseeability; and the connection between the aftermarket statements and any alleged harm to Plaintiffs. *Id. at 1523, n. 8.* Also see *Goodman v. Kennedy, 18 Cal. 3d 335, 342-43, 134 Cal. Rptr. 375, 556 P.2d 737 (1976).* Such considerations would be relevant in our inquiry in this case as well. We DISMISS Plaintiffs' negligent misrepresentation claims under State law, to the extent that these claims are based on alleged misrepresentations in aftermarket documents, but Plaintiffs are granted LEAVE TO AMEND WITHIN THIRTY (30) DAYS OF THE DATE OF THIS ORDER so that they may attempt to spell out how aftermarket documents were allegedly used to inflate the price of IFC stock and how that may have injured Plaintiffs. If such amendment is made, then any appropriate related motions from Defendants will be entertained by this court.

J. Timely Service of Defendant Costello.

Defendants request that the court dismiss Plaintiffs' claims against Defendant Joseph Costello, for failure[*35] to serve him within 120 days of filing their complaint. Plaintiffs did not serve him personally but did mail a copy to him on February 10, 1992, 25 days after filing, pursuant to [HN23] Rule 4(c)(2)(C)(ii), which provides:

A summons and complaint may be served upon a defendant . . . by mailing a copy of the summons and of the complaint . . . to the person to be served, together with two copies of a notice and acknowledgment . . . If no acknowledgment of service under this subdivision of this rule is received by the sender within 20 days after the date of mailing, service . . . shall be made [personally]. *Fed. R. Civ. P. 4(c)(2)(C)(ii).*

On February 25, 1992, fewer than 20 days after the mailing, Plaintiffs' counsel and Costello's counsel entered into a stipulation to allow Costello more time in which to answer or otherwise respond to the Complaint. Plaintiffs claim that this stipulation constituted acknowledgement of service. Further, they argue that by generally participating in this litigation, Defendant Costello has waived any technical defect in service by appearing generally. Defendants counter that the letter of the Rule has been violated, and that therefore, Defendant[*36] Costello has not been properly served.

The Ninth Circuit has held: [HN24] "even if the defendant receives actual notice by mail, service is ineffective unless the defendant timely returns the acknowledgment form or the plaintiff attempts follow-up service by some other method." *Mason v. Genisco Technology Corp., 960 F.2d 849 (9th Cir. 1992).* However, Plaintiffs argue that "Costello has nevertheless waived any such technical defect in service by appearing generally and actively litigating this action." Plaintiff's Memo in Opposition, 60:7-9. In *Jackson v. Hayakawa, 682 F.2d 1344 (9th Cir. 1982),* the court of appeals held: [HN25] "Defendants can waive the defect of lack of personal jurisdiction by appearing generally without first challenging the defect in a preliminary motion." *Id. at 1347.* In *Direct Mail Specialists v. Eclat Computerized Technologies, 840 F.2d 685, 689* (9th Cir, 1988) the Court of Appeals held that the question of whether a party has "appeared" in a matter depends upon a clear intention or purpose to defend the suit. That decision suggests that in regards to such notice questions, if one acts like a party via[*37] one's actions in regard to the pending matter, then one may be considered to be a party in that matter, and service requirements may be waived. We find that Defendant Costello's actions in (1) entering into a stipulation to extend time, (2) filing a motion to transfer venue, (3) filing a declaration in court that he is "one of the named defendants in this matter," and (4) otherwise initiating and maintaining contact with Plaintiffs' counsel support a finding that Defendant Costello did appear generally, with the clear purpose to defend the suit, and that such appearance constitutes a waiver of the technical defect of incomplete compliance with Rule 4(c)(2)(C)(ii). In holding this way, we are giving "the provisions of Rule 4 . . . a liberal and flexible construction," *Borzeka v. Heckler, 739 F.2d 444, 447 (9th Cir. 1984).* n4 Therefore, we DENY Defendants' motion to dismiss Defendant Costello, for failure to timely serve.

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

n4 Also, in so holding, we are specifically not allowing Defendant Costello to employ deceptive and evasive tactics in order to foil Plaintiffs' efforts. Disingenuous abuse of the Rules is not well-regarded and will not be tolerated by this court.

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

[*38]

K. Inaccuracies in Financial Statements and Claims Against Deloitte.

Defendant Deloitte seeks dismissal in part, arguing that Plaintiffs must plead facts to establish that it knew of (or recklessly failed to discover) inaccuracies in IFC's financial statements and that they have failed to do so. At argument, counsel for both sides indicated a basic agreement on this issue and represented to the Court that a proposed order would be forthcoming. Therefore we DENY Defendants' motion to dismiss on these grounds, but we will issue any appropriate orders when received from counsel.

L. Allegations Regarding Violations of Generally Accepted Accounting Principles.

Defendant Deloitte also argues that [HN26] conclusory allegations made by Plaintiffs regarding violations of professional auditing standards fail to state a claim. In *In re Victor Technologies Securities Litigation, 1987 U.S. Dist. LEXIS 13584,* [1987 Transfer Binder] *Fed. Sec. L. Rep. (CCH) P 93158 (N.D.Cal. Jan. 8 1987),* Judge Peckham held that "based upon the evidence in the record and the testimony of the plaintiffs' expert witness, a reasonable jury might well find that the accounting techniques employed by[*39] [defendants] departed to such an extent from accepted accounting principles as to warrant an inference of recklessness or actual intent to deceive." Id. at 95, 715. Plaintiffs have set forth specific facts regarding alleged violations of generally accepted auditing/accounting principles, from which a jury might find intent to deceive on Deloitte's behalf. Plaintiffs therefore meet the standard elaborated and applied in In re Victor, and we DENY Defendants' motion.

M. Statutory Scope of § 11 Claim.

Defendant Deloitte argues that any claims against it under § 11 are narrowly limited by statute to those portions of the registration statement and Prospectus it allegedly prepared. [HN27] § 11 limits an outside auditor's liability to "statement[s] in [a] registration statement, report, or valuation, which purport[] to have been prepared or certified by him." *15 U.S.C. § 77k*(a)(4). The language of the statute indicates that accountants should therefore only be held liable for the work which they prepared, upon which plaintiffs may have relied. Therefore, we will only consider Plaintiffs' claims to the extent that they seek to impose[*40] liability on Deloitte for statements that Deloitte either prepared or certified. We DENY the motion to dismiss § 11 claims against Deloitte.

N. Statute of Limitations re: Defendants Texido and Elorriaga.

Defendants Texido and Elorriaga argue that the claims against them were added on June 8, 1992, beyond the one year statute of limitations. (See *Lampf, supra.)* Even accepting Plaintiffs' allegations that they discovered the alleged misrepresentations on February 28, 1991, the addition of these Defendants in June, 1992 would fall outside the statute of limitations.

Further, Defendants Texido and Elorriaga argue that the Complaint does not relate back under Rule 15(c). [HN28] Under this Rule, a complaint may relate back to include a particular party, if that party "(A) has received such notice of the institution of the action that the party will not be prejudiced in maintaining a defense on the merits, and (B) knew or should have known that, but for a mistake concerning the identify of the proper party, the action would have been brought against the party." *Fed. R. Civ. P. 15(c)(3).* While these Defendants most likely would not be prejudiced by having[*41] to prepare a defense in this action, Plaintiffs fail to clear the second hurdle. Defendants effectively argue that Texido and Elorriaga had no reason to believe that they should have been named as Defendants from the start. Therefore, we DISMISS WITH LEAVE TO AMEND WITHIN THIRTY (30) DAYS OF THE DATE OF THIS ORDER the claims against Defendants Texido and Elorriaga. We grant Plaintiffs leave to amend to show that Defendants Texido and Elorriaga knew or had reason to believe that this action should have been brought against them.

O. Status Conference.

In order to move this case toward its ultimate resolution, a status conference shall be held in this case on September 27, 1993, the date on which the court will hear argument on the pending class certification motion.

IT IS SO ORDERED.

DATED 8/30/93

Thelton E. Henderson, Chief Judge

United States District Court

CERTIFICATE OF WORD COUNT

The undersigned certifies, pursuant to Rule of Court 14(c)(1), that this brief contains 22115 words, including footnotes, but excluding the caption page, signature blocks and this Certification page, as counted by Microsoft Word 2002 (10.6612.6626) SP-3, the word processing program used to prepare the brief.

DATED January 18, 2005 _____

Michael Swartz

PROOF OF SERVICE - MESSENGER

I am employed in the County of Los Angeles, State of California. I am over the age of 18 and not a party to the within action; my business address is First Courier Service/First Legal Support Services, 1511 West Beverly Boulevard, Los Angeles, CA 90026.

On January 19, 2005, I served sealed envelope(s) containing the foregoing document(s) described as: (1) **COMBINED RESPONDENTS' AND CROSS-APPELLANTS' BRIEF** and; (2) **VOLS. 1-6 of RESPONDENTS' AND CROSS-APPELLANTS' APPENDIX** on the interested parties in this action by hand to the offices of the below-mentioned addressees:

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Executed on January 19, 2005, at Los Angeles, California.

I declare under penalty of perjury under the laws of the State of California that the above is true and correct.

/Print Name

First Courier Service
First Legal Support Services

PROOF OF SERVICE - MAIL

I am employed in the County of Los Angeles, State of California. I am over the age of 18 years and not a party to the within action; my business address is 601 South Figueroa Street, Suite 3300, Los Angeles, California 90017.

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I caused such envelope(s) with postage thereon fully prepaid to be placed in the United States mail at Los Angeles, California. I am readily familiar with the firm's practice of collection and processing correspondence for mailing. Under that practice it would be deposited with U.S. postal service on that same day with postage thereon fully prepaid at Los Angeles, California in the ordinary course of business. I am aware that on motion of the party served, service is presumed invalid if postal cancellation date or postage meter date is more than one day after date of deposit for mailing in affidavit.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Executed on January 19, 2005 at Los Angeles, California.

Olivette C. Sasser