UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

THE DEPARTMENT OF THE TREASURY OF THE STATE OF NEW JERSEY AND ITS DIVISION OF INVESTMENT, on behalf of itself and all others similarly situated, Plaintiff, v. CLIFFS NATURAL RESOURCES INC., JOSEPH CARRABBA, LAURIE BRLAS, TERRY PARADIE, and DAVID B. BLAKE, Defendants.	Case No. 14-CV-1031-DAP Judge Dan Aaron Polster Magistrate Judge Greg White

REPLY MEMORANDUM IN SUPPORT OF DEFENDANTS' MOTION TO DISMISS THE SECOND AMENDED COMPLAINT

Dated: October 6, 2015

John M. Newman, Jr. (0005763)
Geoffrey J. Ritts (0062603)
Adrienne Ferraro Mueller (0076332)
Brett W. Bell (0089168)
JONES DAY
901 Lakeside Avenue
Cleveland, Ohio 44114-1190
Telephone: 216.586.3939
Facsimile: 216.579.0212
jmnewman@jonesday.com
gjritts@jonesday.com
afmueller@jonesday.com
bbell@jonesday.com

Attorneys for Defendants Cliffs Natural Resources Inc., Joseph Carrabba, Laurie Brlas, Terry Paradie, and David B. Blake

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page

CASES

STATUTES

OTHER AUTHORITIES

SUMMARY OF THE ISSUES

See Memorandum of Law in Support of Defendants' Motion to Dismiss the Second Amended Complaint (Docket Item ("Doc.") No. 66-1) ("Br.") at ix.

SUMMARY OF ARGUMENTS

See Br. at ix-xi.

PRELIMINARY STATEMENT

This case harmonizes closely with the nearly one-half of all Rule 10b-5 cases dismissed under the strict standards of the Private Securities Litigation Reform Act ("PSLRA") and Rule 9(b), which our Circuit has described as an "elephant-sized boulder" blocking tenuous securities-fraud claims. *In re Omnicare, Inc. Sec. Litig.*, 769 F.3d 455, 461 (6th Cir. 2014). Plaintiff's failure to confront the SAC's shortfalls reinforces that conclusion. For example:

- The case proceeds on a farfetched scienter theory that posits the defendants intentionally pursued a strategy they knew would fail and would inevitably cost them their jobs and their sizable investments in Cliffs, for no concrete personal benefit of any kind.
    - The motion to dismiss suggested several non-fraudulent inferences that are far stronger. Br. at x-xi, 17-20. The opposition brief declines to address them.
    - And it utterly fails to distinguish the recent *Gold Resource* and *Molycorp* cases, which track precisely the circumstances here.
- The motion to dismiss identified 28 alleged misstatements that are shielded by the PSRLA safe harbor for forward-looking statements. The opposition brief addresses only six of them, and unpersuasively.
- The opposition does not dispute the SAC fails to identify a single specific document seen by a defendant that contradicted a public statement by that defendant. To address that lack of particularity, plaintiff relies on CW allegations that "must" be discounted under governing Circuit law, on top of being vague and unconnected to the defendants.[1]

Every securities case involves a corporate disaster of one form or another. This case is no exception. Disasters are what produce the big stock-price drops that motivate plaintiffs' lawyers to sue in the first place. But the law recognizes that a bad business result does not even begin to suggest fraud.

That is why the PSLRA and Rule 9(b) require a plaintiff to make a detailed showing of a strong reason to believe fraud really was afoot before opening the door to massive discovery that wastes shareholder assets, distracts corporate management, and poses the threat of blackmail

---

[1] And, in at least certain instances, concocted. *See* Mot. to Strike (Doc. No. 69).

settlements. The Supreme Court long ago recognized the securities laws present a "danger of vexatious litigation" that goes far beyond other kinds of cases. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 740 (1975).[2] Thus the high hurdle a plaintiff must clear at this stage: not just a short and plain statement of a claim that a reader might deem plausible, but a particularized factual account of circumstances constituting fraud that gives rise to a "strong," "cogent" inference of fraud that is at least as strong as any available non-fraudulent inference (and accompanied by a broad immunity for forward-looking statements, to boot). The SAC, which gets no boost on this score from the opposition brief, does not come close to clearing that hurdle and should be dismissed in full, or, at the very least, dramatically pared back after a careful statement-by-statement analysis.

ARGUMENT

I. The Safe Harbor For Forward-Looking Statements Bars Most Of The Complaint.

As explained in the opening brief, the PSLRA safe harbor is a logical way to thin out the SAC and simplify the analysis for the rest of this motion. The safe harbor test is straightforward: "Under the PSLRA, we ask if a statement meets the statutory definition of forward looking; if it does, we look to whether the defendants meaningfully alerted investors to the risks that might prevent it from reaching its financial targets." *Pension Fund Grp. v. Tempur-Pedic Int'l, Inc.*, No. 14-5696, 2015 WL 3746095, at *4 (6th Cir. June 4, 2015) (affirming dismissal under safe harbor). Here, no fewer than 28 of the 39 alleged misstatements were forward-looking,[3] and

---

[2] "[I]n the field of federal securities laws governing disclosure of information[,] even a complaint which by objective standards may have very little chance of success at trial has a settlement value to the plaintiff out of any proportion to its prospect of success at trial so long as he may prevent the suit from being resolved against him by dismissal or summary judgment. The very pendency of the lawsuit may frustrate or delay normal business activity of the defendant which is totally unrelated to the lawsuit." *Id.* at 740.

[3] Perhaps trying to confuse matters, plaintiff asserts that defendants "do not even contest the falsity of 11 of the alleged misstatements" (Opp. at 8), but that is wrong. While defendants are not arguing that the safe harbor applies to those 11 items, the motion to dismiss does explain at length how the SAC fails to allege with particularity

each was accompanied by meaningful cautionary language. Claims based on those statements can be discarded at the outset, without any need to consider particularity or scienter.

The SAC must be analyzed on a statement-by-statement basis. By "invit[ing the Court] to focus on the overall impression created by [defendants'] statements," plaintiff seems to be asking the Court to shirk its duty to "undertake a statement-by-statement analysis" of the SAC. *Bondali v. Yum! Brands, Inc.*, No. 15-5064, 2015 WL 4940374, at *8 (6th Cir. Aug. 20, 2015). That would be error. "[T]o survive a motion to dismiss, a federal securities fraud claim must withstand an exacting statement-by-statement analysis." *City of Monroe Employees Ret. Sys. v. Bridgestone Corp.*, 399 F.3d 651, 682 (6th Cir. 2005) (internal quotation omitted)). *Accord In re Goodyear Tire & Rubber Co. Sec. Litig.*, 436 F. Supp. 2d 873, 904 (N.D. Ohio 2006) ("It is Plaintiffs' burden to plead fraud on a statement-by-statement basis…."). Plaintiff offers no specific argument for most of the forward-looking statements, and for the few it does squarely address, its arguments do not make the grade.

A. The Safe Harbor Protects Forward-Looking Statements About Bloom Lake.

The opening brief pointed out 17 forward-looking statements about Bloom Lake that are protected by the safe harbor. App. A #1, 3-4, 7-10, 18, 21-22, 26, 30-33, 36, and 39; Br. at 6. Plaintiff's opposition addresses only four—App. A #3, 7, 10, and 31—offering no specific argument for the other thirteen. Claims attacking those thirteen Bloom Lake-related forward-looking statements thus may be dismissed out of hand.[4]

(continued…)

the contemporaneous falsity of *any* of the alleged misstatements, including the 11 that are not forward looking. *See* Br. at 10-16.

[4] Plaintiff presumably chose to address only the four forward-looking statements where it thought it had a valid argument. And indeed, the other 13 statements used language that was expressly forward-looking, and that has been determined as such in other cases.

The four statements actually addressed in plaintiff's brief were patently forward-looking. Statements that Cliffs was "**on track** to commence production [from Phase II] during the first half of **next year**" (App. A. #31) and that Bloom Lake's expansion to 16 million tons was "**progressing well**" (App. A #10) are "statements [that] predict that the current state of affairs will continue into the future, [which] are protected by the PSLRA safe harbor." *Tempur-Pedic*, 2015 WL 3746095, at *7; *Institutional Investors Grp. v. Avaya, Inc.*, 564 F.3d 242, 255 (3d Cir. 2009) (affirming dismissal, finding statement that defendant was "**on track**" to meet goals protected by safe harbor); *W. Washington Laborers-Employers Pension Trust v. Panera Bread Co.*, 697 F. Supp. 2d 1081, 1094 (E.D. Mo. 2010) (statement that introduction of new product was "**progressing more rapidly than planned**" covered by safe harbor).[5]

(continued…)

Alleged Misstatement (referring to App. A to the SAC)	Examples of Cases Holding Terms Are Forward-Looking
#1 ("Cliffs['] . . . cash flow generation **will allow** us to increasingly return large amounts of capital …")	*In re Empyrean Bioscience, Inc. Sec. Litig.*, 255 F. Supp. 2d 751, 764 (N.D. Ohio 2003) (statement that funding **will "allow** us to continue our aggressive program" was forward-looking)
#4 ("[Cliffs] operating cash generation in 2013 and beyond **continues on** to higher levels, driven primarily from Bloom Lake mine as we **expand** from 8 million tons to 16 million tons…")	*Tempur-Pedic*, 2015 WL 3746095, at *7 ("To the extent [defendants'] statements predict that the current state of affairs will **continue into the future**, they are protected by the [] safe harbor.") *Miller v. Champion Enters., Inc.*, 346 F.3d 660, 677 (6th Cir. 2003) ("**continuation** of outstanding earnings **growth**")
#8, 18 (stating Cliffs' "**target**" and "**goal**" for future cash costs)	*Local 295/Local 851 IBT Employer Grp. Pension Trust & Welfare Fund v. Fifth Third Bancorp.*, 731 F. Supp. 2d 689, 708 (S.D. Ohio 2010) (statement that defendants "expect our capital to be comfortably within our **targets**" was forward-looking)
# 9, 21, 22, 26, 33, 39 ("**expectations**" for cash flows, cash costs, volumes)	*In re Keithley Instruments, Inc. Sec. Litig.*, 268 F. Supp. 2d 887, 905-06 (N.D. Ohio 2002) ("**expectations**" of future performance protected under safe harbor)
#36 (belief Bloom Lake was "**on track**" to achieve certain run rates two years in the future)	*Avaya*, 564 F.3d at 255 (statements that defendant was "**on track**" to meet its **goals**)
#30, #32 (management "**remains focused"** on the Phase II expansion)	*In re Aetna, Inc. Securities Litig.*, 617 F.3d 272, 280-81, n.7 (3d Cir. 2010) (statement that defendant's "pricing policy **remains consistent**" was forward-looking)

[5] These cases, including the brand new *Tempur-Pedic* decision, expressly contradict the scattered cases cited by plaintiff for the proposition that Cliffs' statements that Bloom Lake was "on track" and "progressing well" were not forward-looking. *See* Opp. at 13-14 (citing *Sgalambo v. McKenzie*, 739 F. Supp. 2d 453, 468 (S.D.N.Y.

The March 2012 statement that Bloom Lake offered "a **pathway** to 16 million tons **in 2013**" (App. A #3) expressly projects production capacity a year or more into the future and is thus forward-looking. *Keithley*, 268 F. Supp. 2d at 905-06 (granting dismissal, holding stated "expectations of … future growth" were the "very type of statements" that the "safe harbor was designed to protect"); *Rochester Laborers Pension Fund v. Monsanto Co.*, 883 F. Supp. 2d 835, 880 (E.D. Mo. 2012) (granting dismissal, holding statement that defendant had a "**clear path**" to higher profits was forward-looking).

The same is true of statements that Cliffs aimed to "**increase[]** Bloom Lake's production **reliability**" by "**improving ore recovery rates** through blending and adjustments to the mine's flow sheet." App. A #7. That statement relates to plans for future operations at Bloom Lake and is thus protected. *In re Anadigics, Inc. Sec. Litig.*, No. 08-cv-5572, 2011 WL 4594845, at *21 (D.N.J. Sept. 30, 2011) (dismissing complaint, holding statement that defendants "continue to **improve our manufacturing efficiencies**" was forward-looking); *In re Humana, Inc. Sec. Litig.*, No. 3:08-cv-00162, 2009 WL 1767193, at *11 (W.D. Ky. June 23, 2009) (granting dismissal, finding statement that defendant's process improvements would "**increase the reliability** of our commercial pricing and profit planning" was forward-looking).

Plaintiff's cursory argument that the cautionary statements were somehow insufficient (Opp. at 15) does not bear scrutiny. Cliffs was not, as plaintiff would have it (*id.*), required to "predict all of the details of the contingency that came to pass." *In re NovaGold Resources, Inc. Sec. Litig.*, 629 F. Supp. 2d 272, 294 (S.D.N.Y. 2009). Nor was it required to refer specifically

(continued…)

2010), and *Mulligan v. Impax Labs., Inc.*, 36 F. Supp. 3d 942, 965 (N.D. Cal. 2014)). Moreover, *Sgalambo* involved allegations that defendants misrepresented the company's production capabilities where those capabilities were based on specific, disprovable test results. 739 F. Supp. 2d at 468. There are no similar statements at issue here.

to Bloom Lake in every risk disclosure, since the safe harbor requires only that "an investor has been warned of risks of a significance similar to that actually realized." *Keithley*, 268 F. Supp. 2d at 905; *Tempur-Pedic*, 2015 WL 3746095, at *5 (a company "is not required to detail every facet or extent of that risk to have adequately disclosed the nature of the risk"). Besides, it is uncontested that Cliffs operated many mines, and plaintiff does not (and cannot) assert that the risks addressed in the cautionary statements did not also exist at its other mines. The fact that other mines besides Bloom Lake also faced risks arising from, for example, "adverse geotechnical conditions" makes that a *more* meaningful risk disclosure for Cliffs and its investors, and not, as plaintiff illogically would have it, somehow "insipid" and meaningless.

Besides, Cliffs *did* specifically caution investors about risks attending the acquisition and development of Bloom Lake, warning that it might not be able to "successfully integrate acquired companies into [Cliffs'] operations . . . including without limitation, Cliffs Quebec Iron Mining Limited (formerly Consolidated Thompson)." Br. Ex. A at 93. This is in addition to the numerous warnings and risk factors also applicable to Bloom Lake (*see* Br. App. D), including that "[e]stimates relating to new development projects are uncertain and [Cliffs] may incur higher costs and lower economic returns than estimated." *Id.* at 34.

The language Cliffs used was far more detailed and comprehensive than in plaintiff's cases. For example, the defendants in *In re Cardinal Health Inc. Sec. Litig.* told investors of a change in the company's distribution model but never warned the change could negatively affect performance. 426 F. Supp. 2d 688, 749-56 (S.D. Ohio 2006). The defendants in *FirstEnergy* stated that "[a]ctual results may differ materially due to a number of factors" but named only one—"the nature and speed of regulatory approvals"—when there were many others. 316 F. Supp. 2d 581, 596 n.9 (N.D. Ohio 2004). In comparison, Cliffs' 2011 Form 10-K described not one but *21* factors that could cause results to differ from projections. Br. Ex. A at 92-93. It spent *eleven pages* discussing risks that could affect Cliffs' business, including the precise issues that emerged at Bloom Lake. Br. Ex. A at 25-35. Significantly, plaintiff never argues that any of these 21 factors were not in fact real risks that bore upon Cliffs' mines, including Bloom Lake.[6]

B. <u>The Safe Harbor Protects Forward-Looking Statements About Dividends.</u>

The opening brief identified 15 forward-looking statements about dividends that are subject to the safe harbor. App. A #1, 4-6, 11, 13-15, 19-20, 28-30, 32, and 34; Br. at 9. Plaintiff offers no specific response as to most. The opposition expressly treats only two of the statements on dividends—App. A #5 and 13—letting the rest pass without comment, thus simplifying the Court's work here. *See* Opp. at 13.

App. A #5 and 13 plainly addressed the sustainability of the dividend into the future, and thus were forward-looking. Those statements did not relate to Cliffs' ability to pay its then-current dividends out of then-current cash reserves, but to its ability to pay ***future*** dividends from ***future*** cash flow derived from ***future*** earnings under ***future*** pricing scenarios. App. A #5 spoke of "**sustain[ing]** the dividend payout" and Cliffs' intention to "**continue growing** the dividend" in the ***future***. Similarly, App. A #13 referred to Cliffs' "belief that we can **sustain** this dividend under quite a few variations of pricing scenarios" that might unfold in the ***future***. These statements easily qualify under the safe harbor.[7] *Marsh Group v. Prime Retail, Inc.*, 46 Fed.

[6] The notion that Cliffs was required to change its cautionary statements periodically in order for the safe harbor to apply (Opp. at 15) is flat wrong. "We have never held that a company's repeated use of similarly worded warnings renders them meaningless." *Tempur-Pedic*, 2015 WL 3746095, at *9.

[7] So also do the several separate dividend-related statements to which plaintiff offers no response. *See* App. A #1, 4, 11, 19, 20, 34 (statements about Cliffs' confidence in its ability to pay **future dividends** in light of financial performance and projections); #6, 28, 29 (similar statements regarding Cliffs' confidence in its ability to pay **future dividends**); #15 (July 2012 statement that Cliffs "would **expect** to exit the year [*i.e.*, five months in the **future**] with . . . more than enough cash on the balance sheet to pay a full year of dividends"); #30, 32 (management remained focused on "**maintaining**" the dividend into the future despite volatile pricing).

App'x 140, 146-47 (4th Cir. 2002) (statements about **future dividends** are forward-looking); *Monsanto*, 883 F. Supp. 2d at 850 (statement that business would "continue to generate a **sustainable source of cash**" was forward-looking).[8]

Cliffs' cautionary language sufficiently warned investors of the possibility of a dividend decrease. The disclosures identified several risk factors that bore upon—and, if they turned south, could undermine the sustainability of—the dividend, including the critical one: "[Cliffs'] ability to maintain adequate liquidity." Br. Ex. A at 93; Br. Ex. P at 54; Br. Ex. Q at 63; Br. Ex. R at 66. Defendants also cautioned that whether to maintain the dividend was a "Board decision" and thus subject to change. Br. Ex. E at 12, 14. Along with the array of more general risk factors that bore upon Bloom Lake and Cliffs' business as a whole (*see* Br. App. D), these disclosures were at least as specific as—if not more informative than—the disclosures found decisive in *In re Humphrey Hospitality Trust, Inc. Sec. Litig.*, 219 F. Supp. 2d 675, 683-84 (D. Md. 2002).[9] This is more than enough to bring the statements within safe harbor protection.

Finally, even if the Court were to find Cliffs' cautionary language inadequate, the forward-looking statements "would only be actionable if they were made with actual knowledge

---

[8] The portions of statements #5 and 13 that say Cliffs had tested the dividend were not forward-looking, true enough. But that is of no moment, because there is no well-pled claim that the dividend was not actually tested. The SAC and opposition both acknowledge that stress-testing was performed. *See* Opp. at 6 ("The Individual Defendants were also directly involved in testing the dividend."); ¶ 38 (alleging CW7 "provided cash tax inputs in connection with Defendants' stress-testing of the dividend"); ¶ 142 (identifying the Cliffs employees responsible for the stress testing). Plaintiff's challenge is only to the adequacy of the dividend testing, not whether it was performed at all. ¶ 38 ("Cliffs could not adequately test its dividend."). Section II, *infra* at 9-12, explains that the SAC lacks particularized allegations specifying how any purported inadequacy of the dividend testing constitutes fraud.

[9] *See* Humphrey Hosp. Trust, Inc. Form 10-K at 6 (filed March 29, 2000), excerpt attached as Ex. A ("The Hotels are subject to all operating risks common to the hotel industry. These risks include, among other things, competition from other hotels; recent over-building in the hotel industry, which has adversely affected occupancy and room rates; increases in operating costs due to inflation and other factors, which increases have not in recent years been, and may not necessarily in the future be, offset by increased room rates; significant dependence on business and commercial travelers and tourism; increases in energy costs and other expenses of travel; and adverse effects of general and local economic conditions. These factors could adversely affect the Lessee's ability to make lease payments and, therefore, the Company's ability to make expected distributions to shareholders."); *Humphrey*, 219 F. Supp. 2d at 684 n.5 (judicially noticing Form 10-K).

as to their falsity." *Miller*, 346 F.3d at 680. As explained in Section III, *infra* at 12-14, the SAC fails to allege defendants' scienter as to any of the alleged statements, even under a recklessness standard. Far less does it set forth particularized facts showing that a specific defendant made a specific forward-looking statement with actual knowledge it was false.

II. All Plaintiff's Claims Are Based On "Fraud By Hindsight."

As an afterthought at the end of its brief, plaintiff devotes two paragraphs to the argument that the SAC pleads impermissible fraud-by-hindsight. Opp. at 29-30. Earlier, plaintiff attempts to argue that the SAC adequately alleges statements that were false when made, Opp. at 8-12, but that discussion merely summarizes the SAC, without addressing its fundamental failure to plead fraud with particularity as to ***any*** of the alleged misstatements, far less all 39 of them.

As with the safe harbor, plaintiff runs as fast as it can from a statement-by-statement analysis of the SAC, knowing it cannot survive that kind of scrutiny. Never does plaintiff squarely confront a basic flaw in the 50-page, 160-paragraph SAC—its failure to identify ***any*** specific document given to a defendant, or ***any*** private statement by or to a defendant, that contradicted ***any*** contemporaneous public statement by a defendant. Failing to do that for even a single alleged misstatement, the SAC and the opposition brief perforce do not do it for all 39.

Rather than pleading fraud with particularity as directed by Rule 9(b) and PSLRA—which require "plaintiffs [who] contend defendants had access to contrary facts [to] specifically identify the reports or statements containing this information"[10]—plaintiff merely asserts the defendants "must have known" (Opp. at 6) that all of their statements, in gross, were untrue because they received "reports" or visited Bloom Lake. "Must have known" pleading, however,

[10] *Albert Fadem Trust v. Am. Elec. Power Co.*, 334 F. Supp. 2d 985, 1026 (S.D. Ohio 2004) (dismissing securities fraud claims) (quoting *Novak v. Kasaks*, 216 F.3d 300, 309 (2d Cir. 2000)).

is inconsistent with the particularity mandate. *In re DRD Gold Ltd.*, 472 F. Supp. 2d 562, 571-72 (S.D.N.Y. 2007) (allegation defendants "must have known … that the [mine] restructuring could not succeed" held insufficient where complaint "fail[ed] to reference any actual reports reviewed by any specific individuals … on any specific dates" that would support that claim).

To be sure, the SAC and the opposition brief both assert over and over that "the defendants knew." What they do not do, though, is set forth any particularized facts to back up those conclusory assertions. As to the argument that the defendants knew their statements about Bloom Lake and the dividend were inaccurate because they received "numerous . . . reports" that were "detailed" (Opp. at 5, 1), neither the SAC nor the opposition brief identifies even one "report" provided to a specific defendant at a specific point in time that contained any specific "detail" that was at odds with a contemporaneous public statement by that defendant. We pointed this out in the opening brief, Br. at 11-14, and the opposition has no response.

As to the argument that "the defendants knew" their statements were false because they visited Bloom Lake, neither the SAC nor the opposition points to specific information provided to a specific defendant in conjunction with any particular visit that contradicted a later public statement by that defendant. Here, again, we pointed out this deficiency in our opening brief, Br. at 11, and plaintiff declined to respond, other than to rehash the SAC's fuzzy allegations.

These are mortal flaws. It is not enough for a securities plaintiff merely to ***say*** that challenged statements were false-when-made: to survive scrutiny under Rule 9(b) and the PSLRA, that plaintiff must set forth ***particularized facts*** that would support a conclusion of contemporaneous falsity. Otherwise, the plaintiff has failed to allege "circumstances constituting fraud" with particularity, as Rule 9(b) commands, and instead merely has shown a divergence between earlier hopes or expectations and later results, or what courts regularly call fraud-by-hindsight. *Sinay v. Lamson & Sessions Co.*, 948 F.2d 1037, 1040, 1042 (6th Cir. 1991) ("[T]he falsity of a statement does not depend on whether the prediction in fact proved to be wrong.").

That is exactly what separates this case from those plaintiff cites. Those cases, unlike ours, alleged specific facts showing the contemporaneous falsity of alleged statements:

- *In re Fannie Mae*: Plaintiff pleaded the existence of an email that pre-dated the alleged misstatements and showed defendants' knowledge of issues that made the statements misleading. 891 F. Supp. 2d 458, 475-76 (S.D.N.Y. 2012).
- *City of Austin Police Ret. Sys. v. Kinross*, 957 F. Supp. 2d 277 (S.D.N.Y. 2013): Plaintiff identified an announcement by defendants that contradicted alleged misstatements about Kinross's schedule for developing a mine. *Id.* at 305-06. Moreover, the court *granted* defendants' motion to dismiss on fraud-by-hindsight grounds as to statements made *before* the contradictory announcement. *Id*. at 304-05.
- *Sgalambo*: Plaintiff pleaded specific unreported test results known to defendants that contradicted optimistic statements about the value of natural gas wells. 739 F. Supp. 2d at 477. Notably, those claims were supported by the sworn affidavit of a *known* witness, not anonymous hearsay taken out of context. *Id*. at 466-68, 476-77.
- *In re Miller Energy Res. Sec. Litig.*, 2014 WL 415730 (E.D. Tenn. Feb. 4, 2014): Plaintiff cited bankruptcy filings and historical financial data known to defendants that directly contradicted their statements about the value of assets. *Id.* at *5.
- *In re Nevsun Res. Ltd.*, No. 12-1845, 2013 WL 6017402 (S.D.N.Y. Sept. 27, 2013): Plaintiff alleged a specific date when defendants learned that a mine contained less ore than expected—a date preceding the allegedly false statements. *Id.* at *2. Moreover, the complaint showed precisely how defendants became aware of contradictory facts—real-time updates from computer software, specific production reports, and an on-site manager who reported directly to defendants. *Id.* at *4, 8.

The SAC is a far cry from those complaints. By contrast, we cited numerous cases in the opening brief (including mining cases) applying a fraud-by-hindsight analysis to dismiss securities claims on particularity grounds, and plaintiff did not even try to distinguish them. Br. at 10-16 (citing, among others, the *Molycorp*, *Gold Resource*, and *Agnico-Eagle* cases, all of which dismissed securities complaints for failure to plead fraud with particularity).

As to the dividend-related claims, plaintiff makes no response to the thrust of the argument in the opening brief: that there is not a single particularized fact in the SAC to suggest that stress-testing of the dividend under multiple hypothetical scenarios was not in fact performed before the dividend was raised. Br. at 16. All the SAC offers are vague assertions by a secret source about supposed weaknesses in "price modeling" relating to the company's Australian taxes that were the subject of a discussion months after the dividend was raised. Br. at 16; ¶ 114. But the SAC never explains precisely how that made Cliffs' stress testing inadequate, let alone how it caused statements about the dividend to be false.[11]

Finally, the allegations about CWs do not show with particularity the falsity-when-made of any statement. Opp. at 9-12, 29-30. Even if those allegations were not heavily discounted (as the Sixth Circuit says they "must" be; *infra* at 17-20), they still would be unavailing, for the reasons addressed in the CW discussion below (Section IV) and in the opening brief (at 27-30).

III. Plaintiff's Scienter Argument Fails To Address The SAC's Deficiencies.

A. Plaintiff's Allegations Are Still Woefully Insufficient.

Plaintiff seeks to downplay the lack of particularized facts supporting a strong, cogent inference of scienter by hammering on the notion that scienter allegations should be viewed "holistically." Opp. at 19. Defendants agree with the need for a holistic approach and stated as much in the opening brief. Br. at 17. But the parties are miles apart as to what holistic review *means*. In line with case law and common sense, "holistic" review is to be understood as a method to aggregate and analyze the *factual* allegations of a complaint. *Cf. Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309, 1314-24 (2011) (analyzing "all the allegations holistically,"

[11] In any event, the allegations about Cliffs' price-prediction capabilities are beside the point. Opp. at 9; ¶ 110-17. Stress testing inherently involved evaluating Cliffs' financial position across a *range* of hypothetical future iron-ore price scenarios, not banking on a prediction of an exact price on a future date. If one could confidently foretell commodity prices as of a specific future date—with a Ouija board, perhaps—there would be no need for stress-testing at all. And the SAC never even says what price scenarios actually were used (or should have been used) in the stress testing, much less explain why the choices actually made constituted a fraud.

Whether Cliffs (or anyone) could accurately prophesy future market prices, supposed deficiencies in the stress-testing cannot amount to fraud. *See, e.g., Alaska Elec. Pension Fund v. Adecco S.A.*, 434 F. Supp. 2d 815, 827 (S.D. Cal. 2006) (granting dismissal; allegations that defendants were unable to accurately apply customer payments to invoices "suggest[ed] at most poor management, not fraud"); *In re Wachovia Equity Sec. Litig.*, 753 F. Supp. 2d 326, 367 (S.D.N.Y. 2011) (granting dismissal in part; "[b]ad judgment and poor management are not fraud").

but only after setting forth the precise, particularized *facts* on which the allegations were premised). Plaintiff, on the other hand, sees it as a license to avoid pleading particularized facts altogether.[12] The message plaintiff seeks to convey is this: So long as, "holistically," we've told a good story, we've met our pleading burden, there is no need for particularized facts. Rule 9(b), the PSLRA, and the case law say otherwise.[13] *See* Br. at 4, 25, 29.

Moving from standard to substance, plaintiff fails to offer any meaningful counter to defendants' proffered non-fraudulent inferences, *i.e.*, that the challenges Cliffs faced were due not to fraud but rather to garden-variety mismanagement, errors in business judgment, and/or external forces, including dramatic fluctuations in the price of iron ore. Br. at x-xi, 17-20. Given that the scienter analysis requires a weighing of the available inferences, plaintiff's silence as to the obvious non-fraudulent inferences is telling, even dispositive. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 323 (2007) ("in determining whether the pleaded facts give rise to

---

[12] The *Helwig* factors are alive and well, and the Sixth Circuit continues to use them. *See Omnicare,* 769 F.3d at 473. As much as plaintiff tries to downplay them (Opp. at 19-20), it is still true that "[t]he more of these factors that are present, the stronger the inference that the defendant made his statement with" scienter. *Id.* Further, *Ashland*, as plaintiff admits, "eschewed" not the *Helwig* **factors** but rather a mere "checklist approach" to scienter. *Ashland, Inc. v. Oppenheimer & Co.*, 648 F.3d 461, 469 (6th Cir. 2011).

[13] Plaintiff also tries to water down 'recklessness' by suggesting it is something akin to gross negligence. This is way off base. Post-PSLRA, the recklessness standard in securities actions is akin to actual intent. *See, e.g.*, *Stratte-McClure v. Stanley*, 776 F.3d 94, 106 (2d Cir. 2015) (recklessness for Rule 10b-5 cases is "a state of mind approximating actual intent, and not merely a heightened form of negligence"); *In re Credit Acceptance Corp. Sec. Litig.*, 50 F. Supp. 2d 662, 672, 675 (E.D. Mich. 1999) ("standard now requires conscious recklessness *which* approximates actual intent"; post-PSLRA, "mere recklessness will not suffice"); *Burns v. Prudential Sec.*, 116 F. Supp. 2d 917, 925 (N.D. Ohio 2000) ("Plaintiffs proceeding under . . . PSLRA . . . must state specific facts indicating no less than a degree of recklessness that strongly suggests actual intent." (internal quotation marks omitted)); *Republic Bank & Trust Co. v. Bear Stearns & Co.*, 707 F. Supp. 2d 702, 715 (W.D. Ky. 2010) ("This form of recklessness is *a lesser form of intent* rather than a greater degree of ordinary negligence.").

Far from pleading anything akin to actual intent, the opposition is rife with speculation about what plaintiff thinks defendants *might have* known. *See* Opp. at 5 (defendants "would have" observed "cost overruns and missed revenue targets" during visits to Bloom Lake), 6 (defendants "must have known . . . that Bloom Lake was a colossal failure"), 18 (defendants "would have observed . . . issues"), 22 (cost issues "would have arisen" in meetings), 24 ("[d]efendants' awareness of the problems at Bloom Lake and the inability to test the dividend *can be presumed*" (emphasis added)), and 30 (resorting to the passive voice to avoid alleging defendants' knowledge: "it was known" that "operational problems" at Bloom Lake "made it impossible to achieve the specified production and cost goals").

a 'strong' inference of scienter, the court must take into account plausible opposing inferences"; vacating opinion that "expressly declined to engage in such a comparative inquiry").

The opposition's motive argument is perplexing. Its most obvious flaw is the failure to confront the reality that, because all individual defendants had large holdings of Cliffs stock and *increased* them during the class period, they, by the dictates of case law and logic, had a "*dis*incentive" "to engage in deceptive practices." *In re Officemax, Inc. Sec. Litig.*, No. 1:00-CV-2432, 2002 WL 33959993, at *14 (N.D. Ohio Mar. 26, 2002) (emphasis added). There is, in sooth, no sensible response to be had. Literally "dozens of cases dismiss complaints on scienter grounds where . . . motive allegations were undermined by increases in [defendants'] total holdings."[14] *In re eSpeed Inc. Sec. Litig.*, 457 F. Supp. 2d 266, 290 n.182 (S.D.N.Y. 2006).

Moreover, though it now admits such a motive would be "stupid[]" and "foolish," Opp. at 26 n.14, plaintiff clings to the notion that defendants raised Cliffs' dividend, *knowing that doing so would contribute to collapse*, in hopes this somehow would save their jobs and the company, all while continuing to accumulate stock they knew would soon drop in value significantly.[15] *Cf. Morse v. McWhorter*, 200 F. Supp. 2d 853, 898 (M.D. Tenn. 1998) ("company's decision to

---

[14] Plaintiff tries to muddy the waters by saying that defendants "spen[t] a great deal of time arguing that there was no insider trading" and quoting *PR Diamonds, Inc. v. Chandler*, 364 F.3d 671, 691 (6th Cir. 2004), for the proposition that the Sixth Circuit has "never held that the absence of insider trading defeats an inference of scienter." Opp. at 20 n.9. Defendants' insider trading point was concisely presented in two sentences. What plaintiff is doing is trying to conflate the absence of insider trading (*i.e.*, sales of allegedly overpriced stock by defendants), on the one hand, with the fact that all the defendants actually increased their Cliffs stock holdings during the class period, on the other. The latter is the more damning fact for plaintiff, who makes no effort to counter it.

But that is not to say, as plaintiff suggests, that the absence of insider trading is not a weighty consideration cutting against an inference of scienter. To the contrary, the absence of insider trading, while not *by itself* a knock-out punch to a scienter inference, is nevertheless a severe blow. *PR Diamonds*, 364 F.3d at 691 (under facts much more plaintiff-friendly than here, "the absence of stock sales by the Individual Defendants *work[ed] against* but d[id] not conclusively defeat an inference of scienter" (emphasis added)); *Fifth Third Bancorp*, 731 F. Supp. 2d at 718 ("[T]he lack of insider trading[] suggests . . . an uphill climb to establish . . . scienter[.]").

[15] Plaintiff also tries to support its scienter accusation by insinuating that the impairment analysis on Bloom Lake in the second quarter of 2012 was conducted surreptitiously. Opp. at 23. But that analysis was contemporaneously disclosed in Cliffs' quarterly 10-Q report. *See* Br. Ex. Q (7/26/12 Form 10-Q at 56).

[repurchase] its own stock undermine[d] an inference of scienter" since it would "make no sense to purchase th[e] stock if defendant knew the prices to be inflated" (quotation omitted)). Courts consistently reject fanciful, implausible motive theories like this one.[16]

Even if one suspends disbelief and assumes defendants really were motivated to initiate a strategy they knew would fail because "[their] own jobs were directly on the line," plaintiff still can't prevail. Opp. at 25. For legal support it proffers a misreading of the Sixth Circuit's decision in *Omnicare*. Properly understood, *Omnicare* stands for the proposition that a bare allegation of motivation to save one's "job[] or salar[y]" does not, by itself, provide *any* support for an inference of scienter. *Omnicare*, 769 F.3d at 484. It *can* be relevant to scienter, but only if backed up by factual pleading of "a *particular link* between [an] actual [fraudulent] statement and a *specific payment*." *Id.* (emphasis added).[17] Plaintiff hasn't done that here, or even tried.[18]

B. Plaintiff's Approach To *Gold Resource*, *Molycorp*, And *Kinross* Is Wrong.

Plaintiff's attempts to distinguish *Gold Resource* and *Molycorp*, while relying on *Kinross*, go nowhere. For starters, the efforts rest on a double standard. *Gold Resource* and

[16] In addition to the cases cited at pages 21-22 of our opening brief, *see also, e.g.*, *Morse v. McWhorter*, 200 F. Supp. 2d at 898; *Doshi v. Gen. Cable Corp.*, No. 2:14-CV-22, 2015 U.S. Dist. LEXIS 9306, *18 n.7 (E.D. Ky. Jan. 27, 2015) ("Plaintiff's motive allegation as it pertains to stock option compensation does not make sense without allegations that [defendants] exercised . . . the options when the stock price was inflated."); *P. Schoenfeld Asset Mgmt. LLC v. Cendant Corp.*, 142 F. Supp. 2d 589, 615 (D.N.J. 2001) (proffered motive rejected because it was "illogical and inconsistent"); *Coates v. Heartland Wireless Communs., Inc.*, 55 F. Supp. 2d 628, 643 (N.D. Tex. 1999) (motive theory inadequate because it "defie[d] common sense [and was] facially implausible"); *In re CDNOW, Inc. Sec. Litig.*, 138 F. Supp. 2d 624, 642 (E.D. Pa. 2001) (same).

[17] Relatedly, plaintiff tries to dodge *Omnicare*'s statement that there can be no support for an inference of scienter where a plaintiff has "alleged no facts, other than the [i]ndividual [d]efendants' general interest in being paid, that lead to an inference that the [defendants] fraudulently misled the public to save their jobs." Opp. at 25 n.13 (quoting *Omnicare*, 769 F.3d at 484). *Omnicare* thus says it is not enough merely to allege that a defendant's salary or position is on the line. Yet plaintiff inexplicably contends its allegation that "[d]efendants misled investors . . . because their jobs and Cliffs' future were on the line" somehow passes muster. That assertion is congruent with what was rejected in *Omnicare* in that it "alleges no facts, other than the [i]ndividual [d]efendants' general interest" in preserving their jobs and their company. *Omnicare*, 769 F.3d at 484.

[18] The absence of motive makes the deficiency of the other scienter allegations more pronounced. *See Kalnit v. Eichler*, 264 F.3d 131, 142 (2d Cir. 2001) ("Where motive is not apparent . . . the strength of the circumstantial allegations must be correspondingly greater.").

Molycorp, plaintiff says, are inapposite because they didn't involve the "'stress testing' or 'sustainability' of a dividend." Opp. at 27. But *Kinross*, which plaintiff continues to push on the Court, not only did not involve the stress-testing of a dividend—it didn't involve a dividend *at all*. *Gold Resource*, in contrast, involved exactly that: "a considerable dividend program for shareholders." *In re Gold Resource Corp. Sec. Litig.*, 776 F.3d 1103, 1107 (10th Cir. 2015).

Gold Resource, moreover, involved (1) a new mine, (2) a three-stage plan to increase the mine's production, (3) the "considerable dividend program," (4) subsequent production and pricing problems concerning the mine's ore, (5) management touting the production plan well into the proposed class period, and (6) an eventual major drop in the company's stock price, to say nothing of numerous other similarities between that case and this one. *See* Br. at 17-19. But *Gold Resource* was different, plaintiff says, because the company attributed its problems to "issues with ventilation, power distribution, and water flow." Opp. at 27. For reasons known only to plaintiff, citing "issues with ventilation, power distribution, and water flow" constitutes "candid and specific" disclosure (Opp. at 27)—the model of corporate frankness—while citing the higher-than-expected silica content of ore, a fire at the mine, contract labor problems, and dramatic fluctuation in the price of iron ore doesn't pass muster. *See* Br. at 20; Opp. at 27-28.

Molycorp, likewise, involved (1) a multi-phase mine expansion that (2) included a planned Phase I six-fold increase in output, (3) early statements the project was on track, (4) a delayed completion date caused by (5) labor and operational issues, (6) CW allegations parallel to those here (mine shutdowns, crucial equipment failures, inadequate mine procedures, on-site mismanagement, etc.), and (7) executive resignations, and other similarities. Br. at 19. Casting them all aside, plaintiff says *Molycorp* is inapposite because, there, "management had given directions to address known problems," while "here, there is nothing suggesting that [d]efendants were taking action to disclose the truth concerning the problems at Bloom Lake."[19] Opp. at 28. Setting aside the logical disjunct between the former assertion and the latter (directions to address problems v. disclosure of problems), plaintiff is wrong. The only "direction[] to address known problems" to which plaintiff cites in *Molycorp* is the instruction from management to "redesign the leach process [at the mine] and to [do so] quickly."[20] *Molycorp*, 2015 WL 1097355, at *10. And as far as defendants "taking [no] action to disclose the truth" that Cliffs faced challenges at Bloom Lake, plaintiff deliberately ignores the disclosures about the silica content of the ore, ore blending needs, cash costs, a fire at the mine, etc., mentioned above. As with *Gold Resource*, plaintiff's scramble to distinguish *Molycorp* actually loses yardage.[21]

IV. <u>The Confidential Witness Allegations Carry Little Weight.</u>

With a nonsensical motive theory and bereft of particularized facts, all plaintiff has left is the CWs—which is why it grossly exaggerates the weight those allegations can bear.

Out of the box, plaintiff gets Sixth Circuit law on CWs wrong, rejecting the principle that "CW allegations are discounted as a matter of course." Opp. at 16. This, plaintiff says, "is not

[19] Plaintiff also says *Molycorp* should be disregarded because some CWs there said some of the defendants were not aware of the problems until after the class period ended (and thus could not have acted fraudulently), whereas in our case, the "problems at Bloom Lake were . . . known internally." Opp. at 28. Notice what plaintiff does *not* say: that *defendants* knew about all the problems plaintiff alleges and yet deliberately misled investors about them. Plaintiff can't say that because the SAC doesn't back it up with any particularized facts.

[20] Cliffs publicly discussed, throughout the class period, a number of steps it was taking to address problems that had arisen at Bloom Lake (many more than the *one* plaintiff identifies from *Molycorp*). *E.g.*, Br. Ex. B (4/26/12 Earnings Call Transcript) (seeking to mitigate higher-than-expected production costs by reengineering tailings management and mining and process flow sheets); Br. Ex. C (7/25/12 Press Release) (discussing revised strategy focused on producing higher grade of ore); Br. Ex. D (7/26/12 Earnings Call Transcript) (discussing plan to implement cost management processes, decreasing reliance on contract labor, and lowering per-ton fixed costs).

[21] In *Kinross*, the court ***dismissed*** most of the complaint. Only a sliver survived, with "the [c]ourt emphasiz[ing] that its determination on [the] point was a close one." 957 F. Supp. 2d at 307. And the claims that survived differed dispositively from the ones in this case. In *Kinross*, unlike here, "the record [did] not reflect that Kinross used cautionary language in connection" with the statements at issue. *Id.* at 305. And the complaint in *Kinross* alleged "concrete facts" that included, among other things, a *specific report* (an initial feasibility study) that indicated "a negative rate of return for the mine." *Id.* at 306 (quotation omitted). Additionally, the case turned in large part on Kinross's decision to slavishly claim adherence to its original development schedule to the bitter end, in defiance of concrete facts. *Id.* Cliffs, in contrast, constantly recalibrated expectations. *See, e.g.*, ¶ 49 (lowering Phase I output target on July 25, 2012), ¶ 58 (lowering Phase I target again on Nov. 19, 2012; suspending Phase II).

the law." *Id.* But *Ley v. Visteon Corp.* **is** the law, and the Sixth Circuit said there that CW allegations "***must*** be discounted and 'usually that discount will be steep.'" *Ley v. Visteon Corp.*, 543 F.3d 801, 811 (6th Cir. 2008) (emphasis added; quoting *Higginbotham v. Baxter Int'l Inc.*, 495 F.3d 753, 757 (7th Cir. 2007)). Recognizing the impossible burden this places on the flimsy CW allegations,[22] plaintiff does what little it can to discredit the rule, arguing that the Seventh Circuit limited *Higginbotham*—on which *Ley* relies—in *Makor Issues & Rights, Ltd. v. Tellabs Inc.*, 513 F.3d 702 (7th Cir. 2008). *Tellabs* is distinguishable for multiple reasons.[23] But more importantly, *Tellabs* is not Sixth Circuit law. *Ley* is. And the Sixth Circuit has, post-*Tellabs*, reaffirmed the *Ley* rule: CW allegations "must be discounted." *See Konkol v. Diebold, Inc.*, 590 F.3d 390, 399 (6th Cir. 2009) (citing *Ley* and *Higginbotham*).

Attempting to set up an alternative to the mandatory-discount rule, plaintiff asserts that "the Sixth Circuit has instructed courts" not to discount CW statements "where . . . the allegations 'give sufficient detail about a confidential witness'[s] position in the company such that the Court can discern the probable basis of a witness'[s] belief.'" Opp. at 16-17 (quoting *Chamberlain v. Reddy Ice Holdings, Inc.*, 757 F. Supp. 2d 683, 703 (E.D. Mich. 2010)). But that is just a portion of what *Chamberlain* said on the subject. Here's the full sentence:

> [W]here the allegations . . . give sufficient detail about a confidential witness'[s] position in the company such that the Court can discern the probable basis of a

[22] On the flimsiness of the allegations, s*ee also* Mem. in Support of Motion to Strike; Reply Mem. in Support of Motion to Strike ("Reply"). As we showed in the Reply, the CW allegations most crucial to plaintiff (*e.g.*, those attributed to CW7 regarding dividend stress-testing and iron-ore price-modeling) are also the most unreliable. Further, "[t]he sheer volume of confidential sources . . . cannot compensate for these inadequacies . . . . Cobbling together a litany of inadequate allegations does not render those allegations particularized in accordance with Rule 9(b) or the PSLRA." *In re Huntington Bancshares Sec. Litig.*, 674 F. Supp. 2d 951, 964 (S.D. Ohio 2009).

[23] In *Tellabs* "[t]he information that the confidential informants [were] reported to have obtained [was] set forth in convincing detail." *Tellabs*, 513 F.3d at 712. The SAC, in contrast, does not allege the existence of a single internal document relied upon by any CW and, or that matter, *any* details made known to a CW by *any* means (let alone any documents or details conveyed to any of the defendants themselves). And unlike the multiple CWs in this case who adamantly disavow many of the statements attributed to them by the SAC, in *Tellabs* the confidential sources were "prepared to testify" to the facts attributed to them in the complaint—facts they knew "first hand." *Id.*

> witness'[s] belief, such "anonymous sources are **not altogether irrelevant**." *Ley v. Visteon Corp.*, 543 F.3d [at 811].

Chamberlain, 757 F. Supp. 2d at 703 (emphasis added). Plaintiff is thus wrong to say that CW allegations that "give sufficient detail about a confidential witness'[s] position in the company such that the Court can discern the probable basis of a witness'[s] belief" should not be discounted. Opp. at 16-17. Rather, under the very rule plaintiff (selectively) endorses, the most that can be said for even well-attested CW allegations (i.e., ones stronger than here) is that they "are not altogether irrelevant." *Chamberlain*, 757 F. Supp. 2d at 703. That is, even well-attested allegations "must be discounted," and the discount will still "usually . . . be steep."[24]

The confidential-witness argument suffers from an independently fatal flaw: the failure to show how the SAC connects the CW allegations to defendants' knowledge. In fact they do not, and CW allegations that do not tie defendants to alleged improprieties have *no* value. *See, e.g.*, *Ind. State Dist. Council v. Omnicare, Inc.*, 583 F.3d 935, 945-46 (6th Cir. 2009) (affirming dismissal; complaint did not connect CW allegations to defendants); *Diebold*, 590 F.3d at 401 (affirming dismissal; CW allegations did not support scienter where only "general statements" without "any specific facts" linked the defendants to the supposed misconduct).[25]

---

[24] This isn't plaintiff's only surgically treated quote. It also quotes *Halford v. AtriCure, Inc.*, No. 1:08-CV-867, 2010 U.S. Dist. LEXIS 144377, at *10 (S.D. Ohio Mar. 29, 2010) for the proposition that "[a] plaintiff 'complie[s] with the pleading requirements contained in the PSLRA' by proffering 'descriptions of each [CW's] job to ascertain whether any would have been in a position to have gained first-hand knowledge of the facts attributed to him or her, and the detail of the information each is to have provided.'" Opp. at 17. The case *actually* says:

> "[W]hen deciding *whether to consider the statements* attributed to confidential or anonymous witnesses . . . , as *part of* the calculus to be applied to determine *whether* the Plaintiffs have complied with the pleading requirements contained in the PSLRA, this Court will examine the descriptions of each of those individuals' jobs to ascertain *whether* any would have been in a position to have gained first[-]hand knowledge of the facts attributed to him or her, and *the detail of the information each is reported to have provided*."

Atricure, 2010 U.S. Dist. LEXIS 144377, at *10 (emphasis added; quoting *In re Huffy Corp. Sec. Litig.*, 577 F. Supp. 2d 968, 993 (S.D. Ohio 2008)).

[25] The closest plaintiff comes to touching on this topic is the assertion that CW17 "made numerous reports of overages that were passed on to Cliffs' CFO (Brlas, and then Paradie). (¶ 77.)" Opp. at 17. But this statement is

Applying the wrong "discounting" standard and failing to connect the CWs' allegations of purported knowledge to the individual defendants are both sufficient reason to disregard the CW allegations. But the opposition's treatment of the CW issue has yet other flaws. Thus, our opening brief supplied on-point Sixth Circuit precedent that information from CWs not employed during the class period is irrelevant. Br. at 27-28. All plaintiff offers in response are cites to two out-of-circuit cases. The first concerns a statement made *nine days* after the close of the class period by a *defendant* who was CFO of the defendant corporation throughout the *entire class period*. *Avaya,* 564 F.3d at 242, 245, 249 n.13. The second does *not* concern a CW and is cited only for the insipid proposition that "any information that sheds light on whether class period statements were false or misleading is relevant." *Hollin v. Scholastic Corp.*, 252 F.3d 63, 72 (2d Cir. 2001). Additionally, plaintiff fails to answer the charge that the CW allegations are vague and conclusory, choosing, instead, in the opening paragraphs of the CW section of its brief, to list four categories of "problems at Bloom Lake" and shower the Court with adjectives rather than facts. The CWs and their allegations, plaintiff assures us, are "detailed," "reliable," "consistent," "powerful," "numerous," "cogent." Opp. at 15-16. The Court need not credit such unsupported characterizations, especially where, as here, the substance of the SAC proves them inapt.

CONCLUSION

The SAC must be dismissed with prejudice.

(continued…)

in the context of attempting to show *CW17*'s knowledge. Further, it is bereft of detail and mischaracterizes the SAC, which alleges only that CW17 "reported . . . overages to the management of IT" and that, in the chain of command, IT management reported to the CFO. ¶ 77. The SAC does *not* allege that either Ms. Brlas or Mr. Paradie, as CFO, actually received any specific item of information CW17 may have passed to IT management. *Id.*

Dated: October 6, 2015

Respectfully submitted,

/s/ *John M. Newman, Jr.*

John M. Newman, Jr. (0005763)
Geoffrey J. Ritts (0062603)
Adrienne Ferraro Mueller (0076332)
Brett W. Bell (0089168)
JONES DAY
901 Lakeside Avenue
Cleveland, Ohio 44114-1190
Telephone: 216.586.3939
Facsimile: 216.579.0212
jmnewman@jonesday.com
gjritts@jonesday.com
afmueller@jonesday.com
bbell@jonesday.com

Attorneys for Defendants Cliffs Natural Resources Inc., Joseph Carrabba, Laurie Brlas, Terry Paradie, and David B. Blake

LOCAL RULE 7.1(f) CERTIFICATION

Pursuant to Local Civil Rule 7.1(f), I hereby certify the foregoing Reply Memorandum adheres to the page limitation for unassigned cases and is a total of 20 pages in length.

/s/ *John M. Newman, Jr.*
John M. Newman, Jr.
One of the Attorneys for Defendants Cliffs Natural Resources Inc., Joseph Carrabba, Laurie Brlas, Terry Paradie, and David B. Blake

CERTIFICATE OF SERVICE

The undersigned hereby certifies that on October 6, 2015, copies of the Reply Memorandum in Support of Defendants' Motion to Dismiss the Second Amended Complaint and the Declaration of Adrienne Ferraro Mueller were filed electronically with the Court. Notice of this filing will be sent by operation of the Court's electronic filing system to all parties indicated on the electronic filing receipt. Parties may access this filing through the Court's system.

/s/ *John M. Newman, Jr.*
John M. Newman, Jr. (0005763)
One of the Attorneys for Defendants Cliffs Natural Resources Inc., Joseph Carrabba, Laurie Brlas, Terry Paradie, and David B. Blake

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

THE DEPARTMENT OF THE TREASURY OF THE STATE OF NEW JERSEY AND ITS DIVISION OF INVESTMENT, on behalf of itself and all others similarly situated, Plaintiff, v. CLIFFS NATURAL RESOURCES INC., JOSEPH CARRABBA, LAURIE BRLAS, TERRY PARADIE, and DAVID B. BLAKE Defendants.	Civ. A. No. 14-CV-1031-DAP Judge Dan Aaron Polster Magistrate Judge Greg White

DECLARATION OF ADRIENNE FERRARO MUELLER

ADRIENNE FERRARO MUELLER declares under penalty of perjury, pursuant to 28 U.S.C. § 1746, as follows:

1. I am a partner in the law firm of Jones Day. I am a member in good standing of the Bar of the State of Ohio, and I am licensed to practice before this Court. I represent defendants Cliffs Natural Resources Inc. ("Cliffs"), Joseph Carrabba, Laurie Brlas, Terrance Paradie, and David B. Blake in this action.

2. I make this declaration to authenticate copies of materials to be considered in connection with the Reply Memorandum in Support of Defendants' Motion to Dismiss the Second Amended Complaint ("Reply").

3. Submitted herewith are true and correct copies of the following:

Exhibit A: Excerpts from Humphrey Hospitality Trust, Inc.'s Fiscal Year 1999 Form 10-K, filed with the Securities and Exchange Commission on March 29, 2000.

Exhibit B: All unreported cases cited in defendants' Reply.

4. I declare under penalty of perjury that the foregoing is true and correct, based upon my knowledge, information, and belief.

Dated: October 6, 2014

Adrienne Ferraro Mueller

Adrienne Ferraro Mueller
(Ohio Bar Registration No. 0076332)

EXHIBIT A

```
-----BEGIN PRIVACY-ENHANCED MESSAGE-----
Proc-Type: 2001,MIC-CLEAR
Originator-Name: webmaster@www.sec.gov
Originator-Key-Asymmetric:
 MFgwCgYEVQgBAQICAf8DSgAwRwJAW2sNKK9AVtBzYZmr6aGjlWyK3XmZv3dTINen
 TWSM7vrzLADbmYQaionwg5sDW3P6oaM5D3tdezXMm7z1T+B+twIDAQAB
MIC-Info: RSA-MD5,RSA,
 GGzTVLmvwdAqucKINfX2a2IEcCyhYX5Aaqn4/wAxf7nKWli7LtTZKgqOicJLS1pq
 8+to+LX7nlpqZUzeY39mMw==

<SEC-DOCUMENT>0000916641-00-000416.txt : 20000331
<SEC-HEADER>0000916641-00-000416.hdr.sgml : 20000331
ACCESSION NUMBER:		0000916641-00-000416
CONFORMED SUBMISSION TYPE:	10-K405
PUBLIC DOCUMENT COUNT:		3
CONFORMED PERIOD OF REPORT:	19991231
FILED AS OF DATE:		20000330

FILER:

	COMPANY DATA:	
		COMPANY CONFORMED NAME:			HUMPHREY HOSPITALITY TRUST INC
		CENTRAL INDEX KEY:			0000929545
		STANDARD INDUSTRIAL CLASSIFICATION:	REAL ESTATE INVESTMENT TRUSTS [6798]
		IRS NUMBER:				521889548
		STATE OF INCORPORATION:			VA
		FISCAL YEAR END:			1231

	FILING VALUES:
		FORM TYPE:		10-K405
		SEC ACT:		
		SEC FILE NUMBER:	000-25060
		FILM NUMBER:		587331

	BUSINESS ADDRESS:	
		STREET 1:		12301 OLD COLUMBIA PIKE
		CITY:			SILVER SPRING
		STATE:			MD
		ZIP:			20904
		BUSINESS PHONE:		3016804343

	MAIL ADDRESS:	
		STREET 1:		12301 OLD COLUMBIA PIKE
		CITY:			SILVE SPRING
		STATE:			MD
		ZIP:			20904
</SEC-HEADER>
<DOCUMENT>
<TYPE>10-K405
<SEQUENCE>1
<DESCRIPTION>FORM 10-K
<TEXT>
```


- --

SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-K

|X| ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES

EXCHANGE ACT OF 1934 For the fiscal year ended December 31, 1999

|_| TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ____________ to _____________

Commission File Number: 0-25060

HUMPHREY HOSPITALITY TRUST, INC.
(Exact name of registrant as specified in its charter)

Virginia	52-1889548
(State of Incorporation)	(I.R.S. employer identification no.)
12301 Old Columbia Pike, Silver Spring MD 20904	(301) 680-4343
(Address of principal executive offices)	(Registrant's telephone number)

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, $.01 par value
(Title of Class)

THE NASDAQ STOCK MARKET
(Name of Market)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months and (2) has been subject to such filing requirements for the past 90 days.
YES __X____ NO _______

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10K. |X|

The aggregate market value of the voting stock held by non-affiliates of the registrant was approximately $77,516,455 based on the last sale price in The Nasdaq Stock Market for such stock on March 20, 2000.

The number of shares of the registrant's common stock outstanding was 11,173,543 as of March 20, 2000.

Documents Incorporated by Reference

Part III of the Registration Statement is incorporated by reference from the Company's proxy statement for its 2000 Annual Meeting.

- --

<PAGE>

TABLE OF CONTENTS

Item No.		Form 10-K Report Page
	PART I	

<PAGE>

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain information both included and incorporated by reference in this Form 10-K may contain forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act, and as such may involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements. Forward-looking statements, which are based on certain assumptions and describe our future plans, strategies and expectations are generally identifiable by use of the words "may," "will," "should," "expect," "anticipate," "estimate," "believe," "intend" or "project" or the negative thereof or other variations thereon or comparable terminology. Factors which could have a material adverse effect on the operations and future prospects of the Company include, but are not limited to, changes in: economic conditions generally and the real estate market specifically, legislative/regulatory changes (including changes to laws governing the taxation of real estate investment trusts), availability of capital, interest rates, competition, supply and demand for hotel rooms in the Company's current and proposed market areas and general accounting principles, policies and guidelines applicable to real estate investment trusts. These risks and uncertainties should be considered in evaluating any forward-looking statements contained or incorporated by reference herein.

PART I

Item 1. Description of Business

(a) General Development of Business

Humphrey Hospitality Trust, Inc. was incorporated under the laws of the Commonwealth of Virginia on August 23, 1994 and is a real estate investment trust ("REIT") for federal income tax purposes. Humphrey Hospitality Trust, Inc., through its wholly owned subsidiaries, Humphrey Hospitality REIT Trust and E&P REIT Trust (collectively, the "Company"), owns a controlling interest in Humphrey Hospitality Limited Partnership and E&P Financing Limited Partnership (the "Partnerships"). As of December 31, 1999, the Company owned a 92.79% interest in Humphrey Hospitality Limited Partnership. Humphrey Hospitality Limited Partnership owns a 99% general partnership interest and the Company a 1% limited partnership interest in Solomons Beacon Inn Limited Partnership (the "Subsidiary Partnership").

As of December 31, 1999, the Company, through the Partnerships and the Subsidiary Partnership, owned 88 existing limited service hotels (the "Hotels"), including 63 hotels acquired during 1999, and one office building. The Hotels (containing approximately 6,200 rooms in 19 states) and office building are leased to Humphrey Hospitality Management, Inc. and its subsidiary Supertel Hospitality Management, Inc. (collectively, the "Lessee").

On October 30, 1996, the Common Stock began to trade on The Nasdaq Stock Market. Prior to that date, the Common Stock was traded on The Nasdaq SmallCap Market. The Company believes that by trading on The Nasdaq Stock Market, shares of the Common Stock may become more liquid, and the shareholder base of the Company may expand geographically and structurally with the potential for the Common Stock to be held by residents of almost every state and by institutional investors.

From its inception in late 1994 through mid-1998, the Company had completed four capital stock offerings, permitting it to grow from eight hotels to twenty-five hotels. Through these years the Company entertained a variety of strategies in order to grow the company, including major acquisitions, additional capital offerings and strategic alliances. The Company's board concluded in mid-1998 that the consolidation in the lodging industry, and the difficult capital markets environment that existed in 1998 for hotel real estate investment trusts to raise additional capital, made it necessary to seek possible business combinations with other companies in order to continue to grow.

On October 26, 1999, the Company and Supertel Hospitality, Inc. ("Supertel"), consummated a merger pursuant to which the Company exchanged 1.30 shares of its common stock for each outstanding share of Supertel's common stock (the "Merger"). As a result of the Merger and in accordance with the provisions of Accounting Principles Board Opinion No. 16, "Business Combinations," Supertel is considered the acquiring enterprise for financial reporting purposes. Accordingly, the financial statements herein present Supertel's historical financial information for periods prior to the Merger. So that the Company could continue to qualify as a REIT after the Merger, the Merger agreement provided for the shareholders of Supertel to receive a pre-closing dividend of Supertel's earnings and profits. The earnings and profits dividend of $5.13 per share was paid to Supertel shareholders on October 25, 1999. The boards and shareholders

The Board of Directors may change the Company's Investment Policy without shareholder approval.

Replacement Reserves. The Percentage Leases obligate the Partnerships or the Subsidiary Partnership, as applicable, to make available to the Lessee an amount equal to 6% of room revenue per quarter, on a cumulative basis, for upgrading and maintaining the Hotels ("Replacement Reserve Deposits").

Operating Practices. The Lessee utilizes a centralized accounting and data processing system, which facilitates financial statement and budget preparation, payroll management, internal auditing and other support functions for the on-site hotel management team. The Lessee provides centralized control over purchasing and project management (which can create economies of scale in purchasing) while emphasizing local discretion within specific guidelines.

Each Hotel managed by the Lessee employs a general manager who is responsible for the overall operations of the Hotel. General managers report to regional managers, who generally have responsibility for six to nine Hotels.

<PAGE>

Daily operations are managed using a centralized approach through regional operations managers who report to the Lessee's offices as applicable. The Lessee's strategy is to encourage decision-making by those people closest to the hotel operation level at the lowest administrative cost.

Property Management. In order for the Company to qualify as a REIT, neither the Company, the Partnerships nor the Subsidiary Partnership can operate hotels. Therefore, each of the Hotels is leased to the Lessee under Percentage Leases. Mr. Humphrey is the majority shareholder of the Lessee.

Competition. The hotel industry is highly competitive. Each of the Hotels is located in a developed area that includes other hotel properties. The number of competitive hotel properties in a particular area could have a material adverse effect on revenues, occupancy and the average daily room rate ("ADR") of the Hotels or at hotel properties acquired in the future.

The Company may be competing for investment opportunities with entities that have substantially greater financial resources than the Company. These entities generally may be able to accept more risk than the Company can prudently manage. Competition in general may reduce the number of suitable investment opportunities offered to the Company and increase the bargaining power of property owners seeking to sell. Further, the Company believes that competition from entities organized for purposes substantially similar to the Company's objectives could increase significantly.

Employees. The Company has an agreement between it and the Lessee (the "Services Agreement") to provide accounting and securities reporting services for the Company. Until the Merger, the Services Agreement provided that the Lessee would perform such services for an annual fee of $100,000 per year . At the time of the Merger, the Company and the Lessee executed an amendment to the Services Agreement that increased the annual fee to $300,000 per year. For the period from October 26, 1999 through December 31, 1999, the Company paid $50,000 pursuant to the Services Agreement. The Lessee employs approximately 1,900 people in operating the hotels. The Lessee has advised the Company that its relationship with its employees is good.

Business Risks. The Hotels are subject to all operating risks common to the hotel industry. These risks include, among other things, competition from other hotels; recent over-building in the hotel industry, which has adversely affected occupancy and room rates; increases in operating costs due to inflation and other factors, which increases have not in recent years been, and may not necessarily in the future be, offset by increased room rates; significant dependence on business and commercial travelers and tourism; increases in energy costs and other expenses of travel; and adverse effects of general and local economic conditions. These factors could adversely affect the Lessee's ability to make lease payments and, therefore, the Company's ability to make expected distributions to shareholders. Further, decreases in room revenue at the Hotels will result in decreased revenue to the Partnerships and the Subsidiary Partnership, as applicable, under the Percentage Leases.

The Company must rely on the Lessee to generate sufficient cash flow from the operations of the hotels to enable the Lessee to meet the rent obligations under the Leases. The obligations of the Lessee are unsecured. The Lessee has only nominal assets, consisting primarily of working capital.

The Company's investments are subject to varying degrees of risk generally incident to the ownership of real property. The underlying value of the Company's real estate investments, as well as the Company's income and ability to make distributions to its shareholders, is dependent upon the ability of the Lessee to operate the Hotels in a manner sufficient to maintain or increase revenue and to generate sufficient income in excess of operating expenses to make rent payments under the Leases. Income from the Hotels may be adversely affected by changes in national or local economic conditions,changes in neighborhood characteristics, competition from other hotel properties, changes in present or future environmental legislation and laws, changes in the ongoing need for capital improvements, changes in real estate tax rates and other operating expenses, changes in governmental rules and fiscal policies, civil unrest, acts of God (including earthquakes and other natural disasters), which may result in uninsured losses, acts of war, changes in zoning laws and other factors that are beyond the control of the Company and the Lessee.

Capitalization Policy. Hotel properties are carried at the lower of cost or net realizable value. In September 1999, the Company determined that the carrying value of the hotel in Bullhead City, Arizona, exceeded its fair value.

<PAGE>

Accordingly, an impairment loss of approximately $1,300,000, which represents the excess of the carrying value over the fair value, net of costs to sell, was charged to operations in 1999.

Environmental Matters. Under various federal, state and local laws and regulations, an owner or operator of real estate may be liable for the costs of removal or remediation of certain hazardous or toxic substances on such property. Such laws often impose liability without regard to whether the owner knew of, or was responsible for, the presence of hazardous or toxic substances. Furthermore, a person that arranges for the disposal or transports for disposal or treatment of a hazardous substance at a property owned by another party may be liable for the costs of removal or remediation of hazardous substances released into the environment at that property. The costs of remediation or removal of hazardous substances may be substantial, and the presence of hazardous substances, or the failure to promptly remediate hazardous substances, may adversely affect the owner's ability to sell real estate or use real estate as collateral. In connection with the ownership and operation of the Hotels, the Company, the Partnerships, the Subsidiary Partnership or the Lessee, as the case may be, may be potentially liable for any such costs.

EXHIBIT B

2015 WL 4940374
Only the Westlaw citation is currently available.
This case was not selected for
publication in West's Federal Reporter.
See Fed. Rule of Appellate Procedure 32.1
generally governing citation of judicial
decisions issued on or after Jan. 1, 2007.
See also U.S.Ct. of App. 6th Cir. Rule 32.1.
United States Court of Appeals,
Sixth Circuit.

Arun BONDALI, et al., Plaintiffs–Appellants,
v.
YUM! BRANDS, INC., et al. Defendants–Appellees.

No. 15–5064. | Aug. 20, 2015.

On Appeal from the United States District Court for the Western District of Kentucky.

Before: CLAY and McKEAGUE, Circuit Judges; BERTELSMAN, District Judge. [*]

* The Honorable William O. Bertelsman, Senior United States District Judge for the Eastern District of Kentucky, sitting by designation.

Opinion

McKEAGUE, Circuit Judge.

***1** In this securities class action, investors sued Yum! Brands, Inc. ("Yum"), a publicly traded corporation which owns restaurant chains Taco Bell and Kentucky Fried Chicken ("KFC"). The investors also sued three of Yum's senior officers: CEO David C. Novak, Richard T. Carucci, and Jing–Shyh Su. In their amended complaint, the investors allege that Yum and its senior officers knew batches of chicken being supplied to Yum's KFC China subsidiary [1] had tested positive for drug and antibiotic residues and that Yum's food standards and safety protocols were ineffective and also inadequate. The thrust of the amended complaint is that it was false or misleading for Yum not to disclose the adverse results and system failures to the public, the result of which was a 17 percent drop in stock price after the media began exposing the issues. The district court dismissed the amended complaint for failure to state a claim on which relief could be granted. For the reasons below, we affirm.

1 Yum! China is a division of Yum! Brands, Inc. and is based in Shanghai, China. (*See* R. 72, Page ID # 638.) KFC China is a brand of Yum! China. (*See id.* at Page ID # 679.)

I.

Between 2010 and 2011, Yum received a series of test results from the Shanghai Institute for Food and Drug Control ("SIFDC"). The SIFDC is an independent laboratory Yum retained to conduct bimonthly spot testing on the chickens it accepted for distribution to its Chinese KFCs. The results showed that eight of nineteen batches of chicken from one supplier, the Shandong Liuhe Group ("Liuhe"), had tested positive for drug and antibiotic residues prohibited under Chinese law. (R. 72, Page ID # 650.) In a December 2012 statement, Yum reported that, after receiving the test results in 2011, it disqualified the Linyi Factory ("Linyi"), a Liuhe subsidiary, identifying Linyi as "the factory saddled with the major problems."In that same statement, Yum also explained that, in August 2012, it also disqualified Liuhe. (R. 72–11, Page ID # 827.)

Yum, however, did not immediately disclose the SIFDC results or disqualifications of Liuhe and Linyi to regulators or the public. Moreover, Yum did not immediately disclose that, in 2010, it learned of another supplier's poultry—the Yingtai Group—also testing positive for drug and antibiotic residues. (R. 72, Page ID # 672.) [2]

2 The amended complaint also identifies two other suppliers, Wintop Food and Shanxi Suhai, as having sold contaminated poultry to Yum. (R. 72, ¶ 11, Page ID # 635.) The plaintiffs' Section 10(b) claim, however, rests only on Yum's failure to disclose the issues with Liuhe and Yingtai. (*See id.* at Page ID # 701–703.)

Indeed, Yum did not publicly acknowledge any issues with drug or antibiotic residues until the media began reporting on the issues in late 2012. The first media report mentioned in the amended complaint is a November 23, 2012 *Bloomberg News* article. It suggested that another supplier, the Shanxi Suhai Group, was using hormones to increase the size of its chickens. (*See id.* at Page ID # 711.) The most comprehensive media report aired on December 18, 2012 on Chinese Central Television ("CCTV"). That report suggested that Yum's issues with food safety went beyond a single supplier. Rather, several farmers in Shandong Province, including farmers selling to Liuhe and Yingtai, were feeding their poultry antibiotics and other drugs to increase the chickens' size and reduce the chickens' mortality rates. (*See* R. 72–18, Page ID # 895–897.) CCTV also reported that farmers were not maintaining the legally required “feeding journals” and that suppliers like Liuhe were fabricating their inspection and quarantine certificates to show there were no drug residues in the chicken. (*See id.* at Page ID # 899–900.)

***2** The day after the CCTV report aired, Chinese regulators “raided, ransacked, then shuttered several farms and plants that had supplied chicken to KFC.” Yum's stock price also declined 2.7 percent. (*See id.* at Page ID # 717.) By the end of the Class Period, Yum stock had “f[a]ll[en] nearly 17% from $74.47 per share on November 29, 2012, to $68.08 per share on February 5, 2013.”(*Id.* at Page ID # 720.) February 5, 2013—the day after the close of the Class Period—was, according to the plaintiffs, the day on which “the truth was fully revealed” by Yum admitting that: “Due to continued negative same-store sales and [Yum's] assumption that it will take time to recover consumer confidence, we no longer expect to achieve [earnings per share] growth in 2013.”(*Id.* at Page ID # 676).

The plaintiffs allege the market's negative response to the media reports was unsurprising, given first the “hypersensitive” nature of Chinese consumers to food contamination issues, (*see* R. 72, Page ID # 634), and second the consumer backlash that has followed previous food safety issues at Yum. For example, in 2005, news that Chinese KFCs were using Sudan Red Dye, “a known and prohibited carcinogen,” caused “Yum's sales to drop immediately and remain depressed for months.”(*See id.* at Page ID # 634.) Likewise, in 2007, Yum's “reputation, and bottom line ... took a severe hit when E.coli was found in food sold by several Taco Bell restaurants in the U.S.” (*See id.*)

II.

The cases forming this class action were consolidated on May 1, 2013. An amended complaint on behalf of the consolidated class was filed on August 5, 2013, contaning three counts: Count I alleged that Yum violated Section 10(b) of the 1934 Securities Exchange Act, 15 U.S.C. § 78j(b), and SEC Rule 10b–5, 17 C.F.R. § 240.10b–5; Count II alleged Section 10(b) and Rule 10b–5 liability against the individual defendants; and Count III alleged controlling-person liability against the individual defendants under Section 20(a) of the 1934 Securities Exchange Act, 15 U.S.C. § 78t(a). On October 14, 2013, the defendants filed a motion to dismiss pursuant to Federal Rule of Civil Procedure 12(b)(6), and on December 23, 2014, the district court granted the motion, dismissing all three counts with prejudice.

The amended complaint avers that during the Class Period, the defendants made ten materially false or misleading statements. These statements can be divided into four categories. [3]

3 Because of their length, we have copied the statements only in relevant part. To do so, we have relied on the amended complaint's own italicization of those portions of the statements which the plaintiffs believed most supported their claims. The statements as they originally appeared in the amended complaint can be found at R. 72 in the district court record.

Cautionary Statements or Risk Disclosures. The defendants made statements on the investment risk that food safety issues posed. One appears in each of Yum's Earnings Announcements and 10–Qs during the Class Period:

- Our forward-looking statements are subject to *risks and uncertainties,* which may cause actual results to differ materially from those projected. *Factors that can cause our actual results to differ materially include, but are not limited to: food borne-illness or food safety issues[.]* (R. 72, Page ID # 701.)

***3** The other appears in the “Risk Factors” section of Yum's 2011 Form 10–K:

- [F]ood safety issues have occurred in the past, and could occur in the future. Any report or publicity linking us or one of our Concept restaurants, including restaurants operated by our franchisees, to instances of food-borne illness or other food safety issues, including food tampering or contamination, could adversely affect our Concepts' brands and reputations as well as our revenues and profits....In addition, instances of food-borne illness, food tampering or food contamination solely involving our suppliers or distributors or solely at restaurants of competitors could adversely affect our sales as a result of negative publicity about the foodservice industry generally. Such instances of food-borne illness, food tampering and food contamination may not be within our control. (*Id.* at Page ID # 702–703.)

The plaintiffs allege these statements were misleading because they portrayed food safety issues as a potential risk instead of a risk that had already materialized, given the issues with Liuhe and Yingtai.

Statements Touting Standards and Protocols.Yum also made statements generally touting its food standards and safety protocols. Two appear in Yum's 2011 Form 10–K:

- These suppliers are required to meet and maintain compliance with the Company's standards and specifications. (*Id.* at Page ID # 703.)

- All restaurants, regardless of their ownership structure or location, must adhere to strict food quality and safety standards. The guidelines are translated to local market requirements and regulations were appropriate and without compromising the standards. (*Id.* at Page ID # 704.)

The third appears in Yum's Code of Conduct, cited by Yum in its 2012 Proxy Statement:

- Food safety is a primary responsibility of Yum!, and nothing, including cost, is allowed to interfere with this responsibility.

To ensure that our customers receive safe, wholesome food, and "food you crave," Yum!:

- Maintains strict specifications for raw products including specifications which meet or exceed government requirements.

...

- Adheres to a strict food safety testing program.

- Continually monitors and improves its procedures and practices to ensure food safety.

The responsibility for food safety is shared by everyone in our system:

...

- Any product suspected to be unsafe must immediately be pulled from distribution until safety can be assured....

(*Id.* at Page ID # 706–707.)

Lastly, during a March 2012 investor conference, Carucci told the audience:

- But realistically, we know there's probably more risk [in China] than there is in places like Western Europe and the U.S. in terms of just the way the food chain works. But we've spent a lot of time and energy getting that right and having the right suppliers. (*Id.* at Page ID # 654.)

***4** The plaintiffs allege these statements were false or misleading because Yum's standards and protocols were nowhere near strict. Rather, Yum's standards and protocols were "woefully inadequate to cope with the known problem of local farmers administering dangerous chemicals to chickens supplied to Yum."(R. 72, Page ID # 705.) The plaintiffs raise several inadequacies with Yum's standards and protocols: that spot testing was performed only bimonthly and that suppliers violating the standards were not immediately disqualified, just to name a few. (*See* R. 72, Page ID # 660–61, 666.)

Responses to Negative Publicity.The next statements were responses made to the negative publicity that began in November 2012. They concern the actions Yum was undertaking or promising to undertake to protect consumers.

- KFC always attaches importance to food safety, requesting all chicken suppliers to adopt complete food safety management measures. It also makes spot checks on their products. Shanxi Suhai Group is a relatively small regional supplier within KFC's chicken supply system, supplying only about 1% of the chicken for KFC, and it has maintained a normal food safety record in the past. KFC will carry out investigations according to the media reports, enhance inspections and mete out punishments according to the results of the investigations. (*Id.* at Page ID # 712.)

- All chickens will undergo inspection by the government, suppliers, and KFC before entering KFC. KFC will continue to supervise all the suppliers, strength the management of the suppliers continuously to ease people's concern about food safety risks, and keep the superior and eliminate inferior suppliers to minimize the risks. (*Id.* at Page ID # 714.)

- KFC requires all the suppliers to conduct drug residue inspections of their chicken products supplied to KFC....KFC makes spot checks on drug residues in all the chickens purchased. (*Id.* at Page ID # 716.)

Statement on Softer Sales. Lastly, the plaintiffs allege it was false or misleading for Novak in a November 29, 2012 Press Release to attribute lowered same-store sales projections to "softer sales in China" because, in fact, the lowered projections were due to the negative publicity. (See id. at Page ID # 712.)

III.

We review de novo a district court's Rule 12(b)(6) dismissal of a complaint. "[C]onstru[ing] the complaint in the light most favorable to the plaintiff" and "accept[ing] all well-pleaded factual allegations as true,"*La. Sch. Emps. Ret. Sys. v. Ernst & Young, LLP*, 622 F.3d 471, 477 (6th Cir.2010), we must determine whether the complaint alleges "enough facts to state a claim that is plausible on its face,"*Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 570 (2007). A claim is plausible if the court can "draw the reasonable inference that the defendant is liable for the misconduct alleged."*Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009). A claim is not plausible if the facts alleged are "merely consistent with a defendant's liability."*Id.* (quotation marks and citation omitted).

***5** Because Section 10(b) and 20(a) claims sound in fraud, this court must also impose the pleading requirements of Federal Rule of Civil Procedure 9(b) and determine whether the complaint alleges fraud with particularity. Fraud is alleged with particularity by identifying the statements or omissions alleged to be false or misleading and detailing the "who, what, when, where, and how" of the alleged fraud. *See Sanderson v. HCA–The Healthcare Co.*, 447 F.3d 873, 877 (6th Cir.2006) (quoting *United States ex rel. Thompson v. Columbia/HCA Healthcare Corp.*, 125 F.3d 899, 903 (5th Cir.(1987)). Lastly, the complaint must satisfy the pleading requirements of the Private Securities Litigation Reform Act ("PSLRA"). Under the PSLRA, a complaint bringing Section 10(b) or Rule 10b–5 claims must, with respect to each actionable statement, allege "with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind [i.e., scienter.]"15 U.S.C. § 78u–4(b)(2)(A)."Scienter may take the form of knowing and deliberate intent to manipulate, deceive, or defraud, and recklessness."*Frank v. Dana Corp.*, 646 F.3d 954, 959 (6th Cir.2011) (quotation omitted).

IV.

To state a claim under Section 10(b) and Rule 10(b)(5), the plaintiffs must plausibly allege the following elements:

> (1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation.

Stoneridge Inv. Partners, LLC v. Scientific–Atlanta, Inc., 552 U.S. 148, 157 (2008).

The district court dismissed the amended complaint for failure to allege the first and second of these elements. We begin with its assessment as to the first element and agree that a "material misrepresentation or omission" has not been alleged because the amended complaint fails to assert facts showing Yum's statements were "objectively false or misleading in light of the information now known,"*In re Omnicare, Inc. Sec. Litig.*, 769 F.3d 455, 478 (6th Cir.2014).

A.

Beginning with Yum's general statements touting its standards and protocols, the plaintiffs have alleged no facts to suggest that Yum *did not* require its suppliers to adhere to corporate food standards and safety protocols. In fact, the amended complaint makes several assertions of fact to suggest that Yum *did* impose such requirements. As detailed in the amended complaint, Yum performed bimonthly spot testing of its chickens, conducted evaluations of its suppliers, and disqualified suppliers that did not meet its requirements like Liuhe.[4] (*See* R. 72, Page ID # 658 (discussing example of supplier disqualification); 660–61 (discussing supplier evaluations); 666 (discussing spot testing); 682–83 (discussing audit system).) That a few suppliers did not adhere to the standards does not mean Yum did not have the standards in place, and it is not reasonable to interpret Yum's statements as a guarantee that its suppliers would, in all instances, abide by the corporate standards and protocols.

4 Counsel for the plaintiffs suggested at oral argument that the panel could not accept as true that Yum had disqualified Liuhe. However, it was *the plaintiffs* who made the allegation in the first instance. (*See* R. 72, Page ID # 658.) At the Rule 12(b)(6) stage, the court is obligated to accept all well-pleaded allegations in a complaint as true. The plaintiffs cannot direct the court as to which well-pleaded allegations should be accepted and which should be disregarded merely because, upon further examination, some well-pleaded allegations might not be to their benefit.

***6** It is also difficult to see how Yum misled investors by describing its food quality and safety standards as "strict." The fact of the matter is Yum had multiple protocols in place to promote food quality and safety, including spot checks, supplier evaluations, and an auditing system. Describing those protocols as "strict" was reasonably grounded in objective fact and, thus, is not "disproven" just because Yum could have strengthened its standards and protocols. By pointing out the structural weaknesses of Yum's standards and protocols, all the plaintiffs have done is shown that whether Yum's standards and protocols could be described as "strict" is a question subject to reasonable debate.

The only portion of these statements that could be arguably false or misleading is Yum's statement that "[a]ny product suspected to be unsafe must immediately be pulled from distribution until safety can be assured."*See supra* at 6. As the amended complaint alleges, Yum did not immediately pull Liuhe and Yingtai poultry from distribution because according to Su it was already "too late." (*See* R. 72, Page ID # 708.)

Nevertheless, Yum's statement is not actionable because it was a statement of aspiration made in Yum's corporate Code of Conduct rather than rather an assertion of objective fact made in a public filing or press release. As the district court properly explained, a code of conduct is not a guarantee that a corporation will adhere to everything set forth in its code of conduct. Instead, a code of conduct is a declaration of corporate aspirations. (*See* R. 119, Page ID # 1453); *see also Andropolis v. Red Robin Gourmet Burgers, Inc.*, 505 F.Supp.2d 662, 685–86 (D.Colo.2007). To treat a corporate code of conduct as a statement of what a corporation will do, rather than what a corporation aspires to do, would turn the purpose of a code of conduct on its head.

B.

Similarly, Yum's responses to the negative publicity that began in November 2012 also do not appear false or misleading, given the facts alleged in the amended complaint. Yum *did* take the actions it outlined in these statements. It conducted spot checks on its chickens and required suppliers to conduct drug-residue inspections before KFC China would accept the chickens for distribution. To the extent the plaintiffs chastise Yum for not "keep[ing] the superior and eliminat[ing] the inferior suppliers to minimize the risk," it is clear from the amended complaint that Yum did eliminate "inferior" suppliers like Liuhe even if it did not do as efficiently as the plaintiffs would have preferred. To the extent the plaintiffs take issue with the efficiency or effectiveness of Yum's monitoring system, the plaintiffs raise a claim of corporate mismanagement, not investor deception. *See Marsh v. Armada Corp.*, 533 F.2d 978, 986 (6th Cir.1976) ("Congress by § 10(b) did not seek to regulate transactions which constitute no more than internal corporate mismanagement.").

C.

***7** The plaintiffs contend that Yum's risk disclosures were false or misleading, emphasizing the statement that food safety issues "have occurred in the past, and could occur in the future."That statement, the plaintiffs contend, and its failure to mention Liuhe and Yingtai, created a misleading impression: that it was only *possible* for food safety issues to harm investment in Yum when, in fact, food safety issues had already come to pass and were presently harming investment in Yum.

But, as several courts have concluded, "cautionary statements are 'not actionable to the extent plaintiffs contend defendants should have disclosed risk factors 'are' affecting financial results rather than 'may' affect financial results."*In re FBR, Inc. Sec. Litig.*, 544 F.Supp.2d 346, 362 (S.D.N.Y.2008) (citations omitted). This conclusion, we believe, is one reached for good reason. Risk disclosures like the ones accompanying 10–Qs and other SEC filings are inherently *prospective* in nature. They warn an investor of what harms *may* come to their investment. They are not meant to educate investors on what harms are currently affecting the company. This is apparent from any dictionary definition of "risk." For example, Webster's Third New International Dictionary lists the primary definition of "risk" as a "*possibility* of loss, injury, disadvantage, or destruction." *Webster's Third New International Dictionary* 1961 (1986) (emphasis added). For these reasons, a reasonable investor would be unlikely to infer anything regarding the current state of a corporation's compliance, safety, or other operations from a statement intended to educate the investor on *future* harms. While there may be circumstances under which a risk disclosure might support Section 10(b) liability, this is not that case.

In any event, the plaintiffs have not alleged facts suggesting the issues with Liuhe and Yingtai were so severe that they would have resulted in financial loss for Yum. Thus, the plaintiffs have not alleged facts showing any investment risk had already materialized. *See FBR,* 544 F.Supp.2d at 362 (finding the complaint did not sufficiently allege that defendant's noncompliance would cause financial loss) (citing *Rombach v. Chang,* 355 F.3d 164, 173 (2d Cir.2004)). Taken alone, eight batches of chicken testing positive for drug and antibiotic residues is hardly a companywide food safety epidemic, and the plaintiffs allege no facts to suggest otherwise: they allege neither the proportion of chicken possibly contaminated nor whether Liuhe and Yingtai were two of a mere handful of suppliers or two of thousands of other suppliers. While we are obligated to construe the facts in the light most favorable to the plaintiffs, we need not speculate into existence facts which might favor the plaintiffs.

D.

The remaining statement can be cast aside with little fanfare: While Yum's "softer sales" were due to the negative publicity concerning its tainted poultry, as the plaintiffs allege, Novak did not commit any misstatement by simply explaining that because sales were lower, projections would be lower.

E.

***8** Perhaps recognizing the futility of isolating any one statement as false or misleading, the plaintiffs, relying on out-of-circuit precedent, invite us to focus on the *overall impression* created by Yum's statements. Appellee Reply Br. at 1. According to the plaintiffs, the sum total of Yum's statements—touting its standards and protocols, failing to disclose issues with Liuhe and Yingtai, detailing its food safety action items—was what created a "misleading impression of an effective monitoring system."Appellant Br. at 15.

We decline the plaintiffs' invitation as it is based on a misinterpretation of the case law. Other circuits do *not* forego a statement-by-statement analysis of objective falsity in favor of analyzing the overall impression made by a set of statements. Rather, other circuits, like this circuit, undertake a statement-by-statement analysis. In doing so, they ask not only whether the statement is literally true but also whether the statement creates an impression that is false by, for example, impliedly asserting an objective fact that is false. As the Ninth Circuit has explained, the complaint "must demonstrate that a *particular statement,* when read in light of all the information then available to the market, or a failure to disclose particular information, conveyed a false or misleading impression."*In re Oracle Corp. Sec. Litig.,* 627 F.3d 376, 390 (9th Cir.2010) (emphasis added) (quotation omitted); *see also*15 U.S.C. § 78u–4(b)(1) (requiring the complaint to "specify *each* statement alleged to have been misleading" and "the reason or reasons why the statement is misleading" (emphasis added)). Because each statement is neither literally false nor created a false impression about the effectiveness of Yum's monitoring system, we AFFIRM the district court's dismissal of the amended complaint.

V.

In the alternative, we would affirm the district court's dismissal of the amended complaint on the ground that a strong inference of scienter has not been alleged. The facts the amended complaint alleges to establish scienter boil down to the following:

- KFC China is the "core" of Yum's business. (*See* R. 72, Page ID # 680–81.)

- In response to the negative publicity beginning in November 2012, Su made statements discussing the issues with contaminated poultry and the SIFDC results. (*See id.* at Page ID # 678–79.)

- The individual defendants paid close attention to food safety as it was important to Yum's operations. The attention paid is clear from Yum's formation of a Food Safety Council, adoption of a Code of Conduct requiring the reporting of food safety issues, and creation of a global audit system. (*See id.* at Page ID # 681–82.)

- The individual defendants had reason not to disclose the SIFDC results because doing so would have harmed Yum's financial bottom line and, in turn, their own performance-based compensation. (*See id.* at Page ID # 683–700.)

***9** All these alleged facts establish, as the district court noted, is that Su, Carucci, and Novak had the motive (because of their overall concern with food safety and its importance to profitability and their compensation) as well as the opportunity (because of their high-level positions) to conceal any knowledge of the issues with Yingtai and Liuhe. But, as this court has made abundantly clear, "plaintiffs may plead scienter ... by alleging facts giving rise to a strong inference of recklessness, but not by alleging facts merely establishing that a defendant had the motive and opportunity to commit securities fraud."*In re Comshare, Inc. Sec. Litig.,* 183 F.3d 542, 549 (6th Cir.2009).

To be sure, some Yum employees received and reviewed the SIFDC results. The issue, however, is whether there is a strong inference that the individual defendants—Novak, Carucci, or Su—received the test results and, thus, knew or should have known that Yum's statements discussing investment risks or touting its safety protocols were false or misleading. The amended complaint fails to include facts sufficiently tying the individual defendants to the SIFDC results like, for example, by alleging that senior officers were regularly notified of test results or that Yingtai and Liuhe supplied such a substantial proportion of KFC China's chickens that senior officers would have *had* to be aware of any issues with such major suppliers. [5]

5 The only fact alleged in this regard is that another supplier, the Shanxi Suhai Group, constituted 1 percent of the overall supply. (*See* R. 72, Page ID # 712.)

As to corporate scienter, this court held in *Omnicare* that a corporation's state of mind in making a false or deceptive statement is assessed by reference to the state of mind of:

> [1] The individual agent who uttered or issued the misrepresentation; [2] Any individual agent who authorized, requested, commanded, furnished information for, prepared (including suggesting or contributing language for inclusion therein or omission therefrom), reviewed, or approved the statement in which the misrepresentation was made before its utterance or issuance; [or 3] Any high managerial agent or member of the board of directors who ratified, recklessly disregarded, or tolerated the misrepresentation after its utterance of issuance....

Omnicare, 769 F.3d at 476 (citation omitted).

Because the amended complaint has not established that Novak, Carucci, or Su (senior officers falling within the third *Omnicare* category) acted with scienter, the plaintiffs would need to establish scienter on the part of another agent, falling into one of the *Omnicare* categories, to successfully allege corporate scienter. This the plaintiffs have not done. Though some Yum employees were aware of the issues with Liuhe and Yingtai, the amended complaint alleges no facts to suggest it was those employees who prepared or were otherwise involved in making the allegedly false or misleading statements at issue. As such, the plaintiffs have not plausibly alleged scienter on the part of Yum the corporate entity and have not made out a sufficient claim of Section 10(b) or Rule 10b–5 liability.

VI.

***10** Because Yum has not sufficiently alleged a Section 10(b) violation, there is no primary violation to support Section 20(a) liability with respect to any of the individual defendants.

VII.

For the foregoing reasons, we AFFIRM the district court's dismissal of the amended complaint.

All Citations

--- Fed.Appx. ----, 2015 WL 4940374

End of Document

Doshi v. Gen. Cable Corp.

United States District Court for the Eastern District of Kentucky, Northern Division

January 27, 2015, Decided; January 27, 2015, Filed

CIVIL ACTION NO. 2:14-cv-22 (WOB-CJS)

Reporter
2015 U.S. Dist. LEXIS 9306

SATISH DOSHI, Individually And on behalf of all other Persons similarly situated and CITY OF LIVONIA EMPLOYEES' RETIREMENT SYSTEM, Individually And on behalf of all others Similarly situated, PLAINTIFFS vs. GENERAL CABLE CORP., ET AL., DEFENDANTS

Subsequent History: Motion denied by Doshi v. General Cable Corp., 2015 U.S. Dist. LEXIS 61686 (E.D. Ky., May 12, 2015)

Counsel: [*1] For Satish Doshi, individually and on behalf of all other persons similarly situated, Plaintiff: Jeremy Alan Lieberman, PRO HAC VICE, Pomerantz LLP - New York, New York, NY; Lesley Frank Portnoy, Glancy Binkow & Goldberg, LLP, Los Angeles, CA; Patrick V. Dahlstrom, PRO HAC VICE, Pomerantz Grossman Hufford Dahlstrome & Gross LLP, Chicago, IL.

For City of Livonia Employees' Retirement System, individually and on behalf of all others similarly situated (Plaintiff in 2:14-cv-24-WOB), Plaintiff: James Albert Caputo, PRO HAC VICE, Robbins Geller Rudman & Dowd LLP, San Diego, CA; John K. Grant, LEAD ATTORNEY, Robbins Geller Rudman & Dowd, LLP - San Francisco, San Francisco, CA; M. Alexandra Royal, LEAD ATTORNEY, Robbins Geller Rudman & Dowd, LLP - San Diego, San Diego, CA; Samuel H. Rudman, LEAD ATTORNEY, David Avi Rosenfeld, Robbins, Geller Rudman Dowd LLP - Melville, Melville, NY; Thomas C. Michaud, LEAD ATTORNEY, Vanoverbeke, Michaud, Timmony, PC, Detroit, MI; Steven D. Jaeger, Steven R. Jaeger, The Jaeger Firm, PLLC, Erlanger, KY.

For General Cable Corporation, Gregory B. Kenny, Brian J. Robinson, Defendant: Karen Pieslak Pohlmann, Matthew J. Siembieda, LEAD ATTORNEYS, Marc Sonnenfeld, Morgan [*2] Lewis & Bockius LLP - Philadelphia, Philadelphia, PA; David F. Fessler, Fessler, Schneider & Grimme, Ft. Thomas, KY; .

Judges: William O. Bertelsman, United States District Judge.

Opinion by: William O. Bertelsman

Opinion

OPINION AND ORDER

Lead Plaintiff City of Livonia Employees' Retirement System brings this action on behalf of a class of persons and entities that purchased General Cable Corporation common stock between November 3, 2010, and October 14, 2013, inclusive (the "Class Period"). Plaintiffs allege that Defendant General Cable Corporation and two of its senior executives, individual Defendants Gregory B. Kenny and Brian J. Robinson,[1] engaged in a fraudulent scheme to inflate artificially General Cable's stock price in violation of *§ 10(b)* of the Securities Exchange Act of 1934, *15 U.S.C. § 78j(b)*, and Rule 10b-5, 17 C.F.R. § 240.10b-5. Plaintiffs further allege that Kenny and Robinson are liable as "controlling persons" of General Cable, pursuant to § 20(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78t(a). As evidence of fraud, Plaintiffs point to General Cable's need to restate, on two occasions, previously issued financial data to correct material errors. These restatements -- announced in 2012 and 2013[2] -- resulted in significant declines in General Cable's stock price. [*3]

This putative class action is before the Court on the defendants' motion to dismiss (Doc. 98). Defendants argue that Plaintiffs have failed to state a claim upon which relief may be granted, asserting that Plaintiffs have not adequately pled scienter. The Court heard oral argument on Wednesday, January 7, 2015, and thereafter took the motion under advisement. After further study, the Court now issues the following Memorandum Opinion and Order.

I. FACTUAL AND PROCEDURAL BACKGROUND

[1] Kenny has been President and Chief Executive Officer of General Cable since August 2001, and a Director since 1997. Robinson has been General Cable's Chief Financial Officer and Treasurer since 2007, and Executive Vice President since January 2008.

[2] General Cable released the actual restated financial data in January 2013 and October 2013, respectively.

A. Parties and Summary of Allegations

General Cable is a publicly traded company that manufactures cable and wire for industrial uses around the world. Based in Highland Heights, Kentucky, the company's operations, management, and financial reporting are divided into three geographic segments: North America; Europe and Mediterranean; and Rest of World ("ROW").

Plaintiffs' [*4] allegations focus on accounting errors principally affecting the ROW division -- specifically, operations in Brazil. General Cable established the ROW division in October 2007 after it acquired Phelps Dodge International Corp. ("Phelps Dodge") as a privately held subsidiary. Phelps Dodge, which served markets in developing economies, was acquired to allow General Cable to expand its international operations. General Cable placed Phelps Dodge and the entire ROW division under the supervision of Mathias Sandoval, who had been Phelps Dodge's CEO and President.

Plaintiffs assert that the Defendants failed to integrate Phelps Dodge into General Cable's internal management and financial reporting control systems, allowing "a multitude of material accounting irregularities to occur." Doc. 97, Complaint, ¶ 6. Further, Plaintiffs allege that the Defendants affirmatively shielded the ROW division from "meaningful financial supervision," *id.*, instead instructing corporate finance staffers not to interfere with ROW as it appeared to be a successful operation. *Id.* ¶ 5.

Allegedly as a result of this lax supervision, General Cable failed to detect not only the accounting errors but also a complex inventory [*5] theft scheme in the ROW division's Brazilian operation that resulted in the loss of millions of dollars' worth of raw materials and finished goods. Plaintiffs assert that ROW division executives learned of the theft and other errors in January 2012 but did not notify General Cable's corporate headquarters until September 2012.

B. Restatement of Financial Information - 2012 and 2013

On October 29, 2012, General Cable announced that financial statements filed between 2007 and second quarter 2012 contained material accounting errors and should not be relied upon. The company further announced that it would be restating fourteen financial statements covering 2009 through Second Quarter 2012.

Then, on October 10, 2013, General Cable announced that it needed to restate the *corrected* financial statements, as well as three other publicly filed reports, to correct material errors related to (1) improperly recognized revenue on Brazilian "bill-and-hold" sales; (2) Value Added Tax (VAT) assets related to the missing Brazilian inventory; and (3) other accounting irregularities unrelated to Brazil. General Cable explained that it discovered these errors while remedying the errors that necessitated [*6] the first restatement.

Plaintiffs allege that the restatements are evidence that General Cable's financial statements for the fiscal quarters and years 2008 through First Quarter 2013 and related earnings releases were materially false and misleading, in violation of Generally Accepted Accounting Principles (GAAP). More specifically, Plaintiffs allege that Defendants violated GAAP by:

> (1) inflating operating income, net income, and earnings per share by improperly recognizing bill-and-hold sales;
>
> (2) understating cost of sales expenses and overstating operating income, net income, earnings per share, and inventory balances by improperly accounting for inventory and the related VAT assets in General Cable's Brazilian subsidiary;
>
> (3) understating cost of sales expense and overstating inventory, property, plant & equipment assets, and comprehensive income by recording erroneous foreign currency adjustments in or related to its Canadian and Mexican subsidiaries; and
>
> (4) improperly accounting for other transactions by understating expense accounts while overstating related asset accounts by improperly delaying the reporting of expenses or other charges.

Following the issuance of the Restatements, [*7] General Cable made significant changes in the ROW division, including adjustments to inventory-related processes and security in Brazil. Moreover, the ROW CEO and CFO resigned and numerous other managers in Brazil were terminated from employment. Kenny and Robinson assumed leadership responsibilities for the ROW division. Finally, General Cable took steps to better integrate ROW division financial reporting and communication. Doc. 97-2, Year 2012 Form 10-K/A, at 7-8.

C. Facts Supporting Scienter

In the Corrected Consolidated Complaint ("Complaint") (Doc. 97), Plaintiffs also pleaded facts related to scienter, as they are required to do.

Plaintiffs assert that Kenny and Robinson knew or recklessly disregarded that adverse facts had not been disclosed to, and were being concealed from, the investing public. Specifically, Plaintiffs allege that Kenny and Robinson, through their positions as senior executive officers of General Cable, had direct access to confidential and proprietary information and an opportunity to commit fraud by way of their control of the contents of General Cable's public reports, filings, and press releases, and their participation in the company's management and operations. [*8] Doc. 97, Complaint, ¶¶ 20-22. Plaintiffs also contend that Kenny and Robinson had motive to commit fraud because stock options and bonuses tied to stock price and earnings comprised significant portions of their compensation during the years covered by the restatements. *Id.* ¶¶ 129-30.

Plaintiffs also emphasize the nature and scope of the restatements, noting that General Cable was required to restate its financial information twice, that the restatements covered a lengthy period and numerous filings, that the required adjustments were material, and that errors were beneficial to General Cable's bottom line. *Id.* ¶¶ 35, 39, 47, 49, 53. Further, Plaintiffs allege that the time between the initial disclosure of the errors and General Cable's issuance of restatements was longer than average for public companies. *Id.* ¶ 50.

Plaintiffs also allege that General Cable's internal controls were ineffective and insufficient, despite Kenny and Robinson signing Sarbanes-Oxley certifications attesting to the controls' adequacy. *Id.* ¶¶ 51-52, 54-56, 58. Plaintiffs aver that Kenny and Robinson were bound by the company's Code of Ethics, which required them to follow internal controls to ensure accurate [*9] financial reporting. *Id.* ¶ 114. Plaintiffs allege that a proper evaluation of the company's internal controls would have alerted (or did alert) Defendants to the deficiencies leading to the restatements. *Id.* ¶¶ 60-61.

Next, Plaintiffs allege that Kenny and Robinson provided lax oversight of the ROW group, allowing accounting problems to persist. Specifically, they assert that Kenny and Robinson failed to insist upon open communications between ROW upper management and the corporate controller. *Id.* ¶¶ 64-65. Moreover, they allege that Defendants failed to require the ROW division to fully explain its financial data to corporate finance leaders, instead instructing the controller and other finance staff to "back off" when they sought clarifying information from the ROW division. *Id.* ¶ 126.

Plaintiffs emphasize Defendants' failure to integrate the Phelps Dodge subsidiary into the parent company's internal control and compliance framework, instead allowing Phelps Dodge to continue its own internal financial control system. *Id.* ¶ 121. A confidential witness states that Kenny justified the lack of integration by saying, "Hey, [Phelps Dodge is] a successful organization, leave them alone, let [*10] them do their thing." *Id.*

Plaintiffs also allege that ROW accounting personnel were aware that several physical inventory counts did not match the Brazilian subsidiary's inventory records. *Id.* ¶ 34. Further, personnel in Brazil knew that the inventory module was "decoupled" from the General Ledger, such that adjustments to inventory did not automatically update the general ledger, making errors more likely. *Id.* According to confidential witnesses (an Account Manager and a Cost Analyst in Brazil), managers in the ROW division were aware of significant discrepancies between the physical inventory counts and the amounts shown in the accounting system but did not address them. *Id.* ¶ 122. Another confidential witness (CW 1) states that during finance meetings, the Brazilian operations were described as "a bit of a train wreck. . . like a bunch of cowboys." *Id.* ¶ 125. Further, Plaintiffs assert that the measures General Cable implemented in response to the inventory control deficiencies were simple and could have prevented the harm to the company and investors if implemented sooner. *Id.* ¶ 127.[3]

As further evidence of scienter, Plaintiffs point to General Cable's recognition of revenue from bill-and-hold sales -- transactions structured to allow earnings to be recorded prematurely, and known to be "red flags" to the SEC, analysts, and investors. *Id.* ¶¶ 31, 46. According to Confidential Witness 3, who served as General Cable's Senior Vice President for Latin America during the Class Period, Robinson personally approved these transactions via e-mail. *Id.* ¶ 30.

II. ANALYSIS

A. Section 10(b) and Rule 10b-5 Claim

Section 10(b) of the Securities Exchange Act of 1934 makes it unlawful for any person to "use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of

[3] Plaintiffs assert in their Response (Doc. 103, at 39), but not in the Complaint, that these measures **[*11]** included installing a working security camera and a truck scale at the Brazil facility to combat inventory loss.

investors." *15 U.S.C. § 78j(b)*. Implementing this provision, SEC Rule 10b-5 makes it unlawful to "make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they [*12] were made, not misleading." 17 C.F.R. § 240.10b-5(b). To prevail on a *§ 10(b)* or Rule 10b-5 claim, a plaintiff must prove the following elements: (1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation. *Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309, 1317-18, 179 L. Ed. 2d 398 (2011). Defendants challenge only the sufficiency of the complaint with regard to scienter.

1. Standards for Pleading Scienter

The Supreme Court has defined scienter as a mental state embracing "intent to deceive, manipulate, or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193, 96 S. Ct. 1375, 47 L. Ed. 2d 668 (1976). The Sixth Circuit has held that in addition to knowing or intentional fraud, recklessness may also constitute scienter in a securities fraud action. *See* *In re Comshare, Inc. Sec. Litig.*, 183 F.3d 542, 550 (6th Cir. 1999). Recklessness is "akin to conscious disregard" and is defined as "highly unreasonable conduct which is an extreme departure from the standards of ordinary care." *Id.* (citing *Mansbach v. Prescott, Ball & Turben*, 598 F.2d 1017, 1025 (6th Cir. 1979)). The danger "need not be known," but "it must be at least so obvious that any reasonable man would have known of it." *Id.* An inference of recklessness typically requires "multiple, obvious red flags" -- "egregious refusal[s] to see the obvious, or to investigate the doubtful." [*13] *PR Diamonds, Inc. v. Chandler*, 364 F.3d 671, 687, 695, 91 Fed. Appx. 418 (6th Cir. 2004), *abrogated on other grounds by* *Matrixx Initiatives*, 131 S. Ct. 1309, 179 L. Ed. 2d 398.

In addition to Federal Rule of Civil Procedure 9(b), which requires a plaintiff alleging fraud to state the circumstances constituting fraud "with particularity," Plaintiffs must also satisfy the heightened pleading standards of the Private Securities Litigation Reform Act (PSLRA), 15 U.S.C. § 78u-4(b)(2). The PSLRA requires a complaint to "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." 15 U.S.C. § 78u-4(b)(2)(A).[4]

The inference of scienter "need not be irrefutable, *i.e.*, of the 'smoking-gun' genre, or even the 'most plausible of competing inferences.'" *Tellabs Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 324, 127 S. Ct. 2499, 168 L. Ed. 2d 179 (2007)(citation omitted). Instead, courts must consider "plausible opposing inferences." *Matrixx Initiatives*, 131 S. Ct. at 1324. "A complaint adequately pleads scienter 'only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged.'" *Id.* (quoting *Tellabs*, 551 U.S. at 324). Pleadings that fail to meet this standard "shall" be dismissed. 15 U.S.C. § 78u-4(b)(3).

2. Analytical Framework

In evaluating a securities fraud complaint, a court must review the allegations of scienter "holistically." [*14] *Matrixx Initiatives*, 131 S. Ct. at 1324. A court's analysis of the sufficiency of a plaintiff's scienter allegations proceeds in three steps. *See* *Tellabs*, 551 U.S. at 322-23. First, a court must "accept all factual allegations in the complaint as true." *Id.* at 322. Second, the court must "consider the complaint in its entirety," deciding whether the facts alleged, taken "collectively," give rise to a strong inference of scienter. *Id.* at 322-23. Finally, if the allegations present a "cogent" inference of scienter, a court is to evaluate competing inferences. *Id.* at 323.

3. Evaluating Corporate Scienter

In determining whether a corporation has acted with the requisite state of mind, the pertinent question becomes, "Whose knowledge and state of mind matters?" *See* *In re Omnicare Sec. Litig.*, 769 F.3d 455, 473 (6th Cir. 2014). In other words, when can a court impute the scienter of a corporation's agent to the corporation?

The Sixth Circuit recently sought to clarify the answer to this question in *In re Omnicare, Inc. Securities Litigation*, 769 F.3d 455 (6th Cir. 2014). After reviewing several approaches, the Sixth Circuit determined that the states of mind of three categories of people are "probative for purposes of determining whether a misrepresentation made by a corporation was made by it with the requisite scienter." *Id.* at 476. These individuals are:

> a. The individual agent who uttered or issued the misrepresentation; [*15]
>
> b. Any individual agent who authorized, requested, commanded, furnished information for, prepared

[4] Plaintiffs do not allege forward-looking statements, to which the PSLRA applies different scienter requirements.

(including suggesting or contributing language for inclusion therein or omission therefrom), reviewed, or approved the statement in which the misrepresentation was made before its utterance or issuance;

c. Any high managerial agent or member of the board of directors who ratified, recklessly disregarded, or tolerated the misrepresentation after its utterance or issuance....

Id. (citing Patricia S. Abril & Ann Morales Olazábal, *The Locus of Corporate Scienter*, 2006 Colum. Bus. L. Rev. 81, 135 (2006)).

The Sixth Circuit explained that "a corporation is not insulated if lower-level employees, contributing to the misstatement, knowingly provide false information to their superiors *with the intent to defraud* the public" and noted that corporations that "willfully permit or encourage the shielding of bad news from management" may be liable. *Id.* at 477 (emphasis added). But, the Court explained, even if a corporate agent's state of mind can be imputed to the corporation under this standard, the complaint must still plead particular facts that give rise to a strong inference of fraudulent intent by that agent. *See id.* at 484 (explaining that even though [*16] an employee's knowledge could be imputed to the corporation, the plaintiff failed to plead sufficient facts to "give rise to a strong inference that [the corporation] acted to defraud the public").

4. Application

Viewed holistically and collectively, the facts pled here fail to give rise to a strong inference of scienter, much less one that is at least as compelling as the opposing inference proffered by Defendants: that General Cable, Kenny, and Robinson were unaware of the problems leading to the restated financial results and that they addressed them when they became aware.

Initially, the complaint contains no particularized facts to support an inference that General Cable knew of the intentional misconduct occurring in Brazil and deliberately concealed it.[5] Thus, the Court focuses on indicia of recklessness -- particular facts that would suggest that Defendants had reason to know of the accounting problems and consciously disregarded them.

a. Kenny and Robinson

Plaintiffs state a bevy of general allegations related to scienter, perhaps attempting to make up in quantity what they lack in substance. The bulk of these allegations would apply to any corporation that has restated financial results and thus a strong inference of scienter does not naturally follow.

For example, Plaintiffs cite Kenny's and Robinson's knowledge of company affairs due to their positions, their access to information, and their responsibility for financial reporting and internal controls, as proof of opportunity and intent to commit fraud. But Plaintiffs do not specify any instance where Defendants gained relevant knowledge through these channels and disregarded it. *See PR Diamonds*, 364 F.3d at 688 (explaining that fraudulent intent "cannot be inferred merely from [high-level executives] positions in the [c]ompany and alleged access to information" and requiring complaints to instead "allege specific facts or circumstances suggestive of [executives'] knowledge"). Likewise, the bare allegation that Defendants were bound by General Cable's Code of Ethics and legally obligated to oversee compliance does not support an inference that [*18] Defendants knowingly or recklessly shirked those duties.

Plaintiffs similarly emphasize that Kenny and Robinson's incentive-based compensation gave them a motive to commit fraud. But again Plaintiffs fail to allege something more -- allegations of insider trading, for example -- from which to infer scienter.[6] *See In re Comshare*, 183 F.3d at 552 (finding

[5] Plaintiffs admit this indirectly by their emphasis on Defendants' decision to allow the Phelps Dodge subsidiary to operate "without meaningful financial supervision" and on Defendants' failure to force the ROW group to provide the kind of financial **[*17]** information that would have given Defendants' knowledge.

[6] In *Helwig v. Vencor, Inc.*, 251 F.3d 540, 550 (6th Cir. 2001) (en banc), *abrogated on other grounds by Tellabs*, 551 U.S. 308, 127 S. Ct. 2499, 168 L. Ed. 2d 179, the Sixth Circuit offered a nonexhaustive list of factors "usually relevant to scienter:"

(1) insider trading at a suspicious time or in an unusual amount;

(2) divergence between internal reports and external statements on the same subject;

(3) closeness **[*19]** in time of an allegedly fraudulent statement or omission and the later disclosure of inconsistent information;

plaintiffs' allegation that defendants stood to receive greater compensation if the company's stock price increased ″probative of motive″ where defendants *actually did profit* by selling their shares at artificially inflated prices during the class period); *cf. PR Diamonds*, 364 F.3d at 691 (noting that the absence of insider trading ″dulls allegations of fraudulent motive″ in cases where plaintiffs allege that defendants sought to personally enrich themselves through the fraud). Without other facts, these allegations could pin a fraudulent motive on any executive with stock-related incentive compensation.[7]

Plaintiffs next point to the ″magnitude″ of the restatements: the five-year period covered, the number of financial statements revised, the amount of time and effort General Cable needed to investigate and release the restatements, and the amount of money at issue. The Sixth Circuit has stated that the ″magnitude″ of restatements can ″serve to amplify the inference of scienter.″ *PR Diamonds*, 364 F.3d at 685. But the *PR Diamonds* Court also stated that a strong inference of scienter flows only from ″in your face″ accounting errors that ″cry out scienter″ unless ″additional 'specific, highly suspicious facts and circumstances'″ are also cited. *See id.* at 686, 695. The accounting errors must be ″drastic,″ ″pervasive,″ and ″egregious.″ *Id.* at 685-86.

Recalling that the majority of errors were the result of a complex theft scheme, the duration of the errors speaks less to Defendants' states of mind and more to the thieves' sophistication. Likewise, the opposing [*21] inference that the investigation and compilation of corrected financial data took longer than ″average″ due to the duration of the scheme is most plausible.

Moreover, Defendants have offered a compelling explanation for why two restatements were necessary: the errors necessitating the second restatement were discovered while remedying the first. *See* Doc. 97-2, General Cable 2011 Form 10 K/A, at 3 (noting that it discovered additional errors ″in remediating the material weaknesses associated with Restatement No. 1″).

As to the financial ″magnitude″ of the restatements, although General Cable erred by millions, the errors' relative financial impact was minimal (despite being material according to GAAP standards). For instance, the largest understatement of costs (FY2011) was $17.9 million, or 0.3% of the company's $5.2 billion cost of sales. This error's impact on Net Income and basic Earnings per Share was more significant, causing a 30% overstatement and 26.7% decrease, respectively. But, from a day-to-day management perspective, a deviation of 0.3% in costs would not raise an ″obvious red flag.″[8] *See Konkol v. Diebold, Inc.*, 590 F. 3d 390, 400 (6th Cir. 2009) (explaining that in a multi-billion dollar company, the amount of improperly recognized revenue [*22] ″would have to be significant to support a finding of scienter″ and distinguishing improper revenue recognition from errors leading a company to report profits when it should have reported losses); *PR Diamonds*, 364 F.3d at 694 (″To support an inference of fraudulent scienter,

(4) evidence of bribery by a top company official;

(5) existence of an ancillary lawsuit charging fraud by a company and the company's quick settlement of that suit;

(6) disregard of the most current factual information before making statements;

(7) disclosure of accounting information in such a way that its negative implications could only be understood by someone with a high degree of sophistication;

(8) the personal interest of certain directors in not informing disinterested directors of an impending sale of stock; and

(9) the self-interested motivation of defendants in the form of saving their salaries or jobs.

The Court notes that Plaintiffs have not pled particular facts related to any of these factors.

[7] Although the complaint asserts generally that Kenny and Robinson received bonuses tied to stock price, it does not make any specific allegation that the inflated stock price during the Class Period was necessary to earn those bonuses. Further, the complaint alleges no facts related to Kenny's, Robinson's, or any other General Cable official's trading activity before, during, **[*20]** or after the Class Period. And, as Defendants correctly note in their Reply, Doc. 105, Plaintiffs' motive allegation as it pertains to stock option compensation does not make sense without allegations that Kenny and Robinson exercised or sold the options when the stock price was inflated.

[8] The comparison is similar for overstatement of inventory. In 2011, for example, General Cable overstated inventory by $43.2 million, which represented 3.6% of total inventory and 0.9% of total assets.

allegations of GAAP . . . violations must extend in nature and magnitude beyond merely the materiality threshold.").

Plaintiffs also argue that it is highly suspicious that so many "errors" were in General Cable's favor.[9] While scienter could be inferred from this circumstance, the argument ignores the origin of most of the errors: theft. To operate without detection, a theft scheme must disguise the losses, as unexplained losses might elicit investigation and discovery. Thus, any corporation victimized by theft would report inventories that were greater than the actual figures until discovering the theft. Likewise, any error related to understatement of costs will lead to a "favorable" adjustment for the corporation.

Plaintiffs' allegations that General Cable was required to restate financial information, that restatements are uncommon, and that the required adjustments were material add little. As Plaintiffs admit, *all* restatements correct material errors in prior financial statements because that is all GAAP permits. *See* Doc. 97, Complaint, ¶ 44. And the law is clear that fraudulent intent cannot be inferred from the mere fact that a company makes a restatement. *See* In re Comshare, 183 F.3d at 553 (rejecting the argument that a "subsequent revelation of the falsehood of previous statements implies scienter" and noting that "mere allegations that statements in one report should have been made in earlier reports do not make out a claim of securities fraud"); *PR Diamonds*, 364 F.3d at 694 ("To support an inference of fraudulent scienter, allegations of GAAP and GAAS violations must extend in nature and magnitude beyond merely the materiality threshold.").

Plaintiffs also argue that because General Cable issued a restatement in 2005 that involved inventory-related [*24] accounting problems, its restatements eight years later stemming from other inventory-related problems suggest fraudulent intent. Although one could infer that a prior inventory problem would put Defendants on notice to scrutinize inventory controls, the Sixth Circuit has rejected the argument that such circumstances can form the basis of a strong inference of scienter. *See* *Ricker v. Zoo Entm't, Inc.*, 534 F. App'x 495, 500-01 (6th Cir. 2013) (praising the district court's holding that even if a defendant company knew or should have known of a potentially problematic account, it does not reasonably follow that the company knew or should have known that the related financial statements were false).

Moreover, Plaintiffs describe the 2005 problems generally, *see* Doc. 97, Complaint, ¶ 117 ("controls over the recording of inventory shipments"; "controls over [] financial reporting"), and allege no specific facts showing how the prior problems would cause Defendants to know of the later problems. Furthermore, that the inventory control problems occurred in a subsidiary that Plaintiffs admit was allowed to operate with *separate* internal control systems further weakens Plaintiffs' position. That General Cable had encountered problems in its own system does not [*25] support the inference that General Cable was on notice of problems in *another company's* system.

As to Kenny and Robinson's signing of Sarbanes-Oxley certifications, the Sixth Circuit has concluded that such acts are probative of scienter only "if the person signing the certification was severely reckless in certifying the accuracy of the financial statements." *Konkol*, 590 F.3d at 402. Plaintiffs have alleged no facts to support an inference that Kenny and Robinson were severely reckless in signing the forms. Plaintiffs instead rely on the conclusory statement that, had the required internal controls evaluation been carried out properly, the errors would have been discovered. They argue, thus, that Defendants must have either known their certifications were false when made or Defendants must not have evaluated the company's internal controls at all. The facts alleged support neither conclusion. *See* *id.* at 403 (explaining that finding scienter under such facts would be equivalent to the 'classic fraud by hindsight case'").

The argument that Defendants' failure to implement "readily available" control measures supports an inference of scienter is similarly unavailing. Plaintiffs do not allege specific facts suggesting [*26] that Defendants had reason to believe these controls were necessary or that Defendants considered them and recklessly rejected them. Their failure to implement the measures thus suggests little about their state of mind.

Statements by confidential witnesses that individuals in Brazil knew about the inventory-related accounting problems suffer from the same flaw. *See* Doc. 97, Complaint, ¶ 34, ¶ 122. Plaintiffs allege no facts showing that Kenny or Robinson were aware of the discrepancies or Phelps Dodge managers' failure to address them. Moreover, Plaintiffs do not allege that Kenny or Robinson, when confronted by a subordinate with bad news, had a policy of putting their heads in the sand.

Plaintiffs speculate that had the company implemented remedial measures earlier, the accounting errors and false statements could have been avoided. Given that a complex

---

[9] Defendants remind the Court **[*23]** that not all errors in the original financial statements were in General Cable's favor. *See* Doc. 98, at 12 (highlighting that restated figures for 2012 increased rather than decreased net income).

theft scheme was at work -- one that employed efforts to *actively conceal* the inventory loss -- there is no guarantee that better internal control measures could have prevented the losses. The thieves might simply have adjusted their strategy to continue avoiding detection. *See In re Comshare*, 183 F.3d at 554 ("Claims of securities fraud cannot rest on speculation [*27] and conclusory allegations.")(internal quotations omitted).

Plaintiffs rely heavily on allegations that Defendants allowed Phelps Dodge to continue its own financial and internal control systems and shielded the ROW group from meaningful financial scrutiny. If scienter were to be found in this complaint, these facts seem most likely to harbor it. But, again, the allegations are insufficient.

Sixth Circuit law is clear that courts should not "presume recklessness or intentional misconduct from a parent corporation's reliance on its subsidiary's internal controls." *In re Comshare*, 183 F.3d at 554. Moreover, Defendants' decision not to integrate Phelps Dodge into the company's general compliance framework, while perhaps imprudent in hindsight, is not evidence of scienter. It is not an "extreme departure from the standards of ordinary care" for a parent corporation executive to insist that his subordinates not micromanage a subsidiary. That, in hindsight, micromanagement might have been the wiser course is not relevant to a scienter analysis. *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 214, 96 S. Ct. 1375, 47 L. Ed. 2d 668 (1976) ("Negligent conduct cannot give rise to liability under *§ 10(b)* or Rule 10b-5."). Plaintiffs allege no specific facts suggesting that Defendants made these business decisions for the purpose [*28] of concealing fraud or that Defendants ignored "red flags" in deciding not to integrate certain Phelps Dodge systems.

Plaintiffs' argument that confidential witness statements provide these "red flags" is unconvincing. Confidential Witness 1's statement that he or she participated in finance meetings where Brazilian operations were discussed and described as "a bit of a train wreck . . . like a bunch of cowboys," Doc. 97, Complaint ¶ 125, is properly discounted because it lacks context. Plaintiffs provide no facts linking Kenny or Robinson to these meetings. Moreover, Plaintiffs do not specify the timing of these statements or identify which aspects of the Brazilian operations were like a "train wreck." These statements are irrelevant if not linked to the specific problems that led to the restatements.

Plaintiffs also emphasize Confidential Witness 1's assertion that Kenny justified the lack of integration by saying, "Hey, they are a successful organization, leave them alone, let them do their thing." *Id.* ¶ 121. This statement suggests not that Defendants ignored obvious "red flags" but instead that they held a genuine belief that Phelps Dodge did not need closer scrutiny.

Most importantly, [*29] the inquiry is not whether management decisions related to ROW were prudent; the question is whether Defendants knew or should have known the financial statements were false when reported. *See Ricker v. Zoo Entm't, Inc.*, 534 F. App'x 495, 501 (6th Cir. 2013) (declining to find scienter even where the defendant corporation knew that a particular account was "potentially problematic"). The facts alleged simply do not lead to this inference.

Finally, Robinson's approval of bill-and-hold sales via email does not naturally lead to an inference of scienter because Plaintiffs allege no facts suggesting that Robinson knew or had reason to believe that the transactions were improper. As Plaintiffs admit, bill-and-hold sales are not per se improper; they simply are subject to stricter revenue recognition criteria. Plaintiffs also vilify Defendants for failing to disclose that General Cable recognized revenue from bill-and-hold sales, allegedly because those transactions are "red flags" to the SEC and investors. Yet Plaintiffs describe no GAAP or other regulation that requires such a disclosure. Nor do Plaintiffs assert that General Cable's bill-and-hold practices were hidden from its auditors to avoid that heightened scrutiny.

Analyzing these allegations collectively, [*30] the complaint fails to support a strong inference of scienter as to either Kenny or Robinson.

b. Corporate Scienter

Having found no facts from which to draw a strong inference of scienter as to Kenny or Robinson, the Court now looks to other actors whose states of mind might be imputed to the corporation.

At oral argument, Plaintiffs pointed to Sandoval, chief executive of the ROW group. The emphasis on Sandoval stemmed from an admission by General Cable in its 2012 Form 10-K/A (Doc. 97-2, at 7, attached to the Complaint), that "ROW executive management" became aware of allegations of theft and inventory accounting issues in January 2012 but failed to notify General Cable's executive management of the issues until September 2012. General Cable further admitted that "ROW executive management placed excessive emphasis on meeting business plan goals rather than on the integrity of the financial reporting process." *Id.*

In their Response (Doc. 103, at 16-18), Plaintiffs argue that Sandoval was one of these ROW executives and asks the Court to infer that he engaged in intentional misconduct by referring to facts contained in General Cable's March 28, 2013 Schedule 14A Proxy Statement, Doc. 105-1, [*31] detailing General Cable's recoupment, pursuant to the corporation's "Clawback Policy," of a bonus award paid to Sandoval.[10] This policy allows the corporation to recover incentive-based compensation from an executive in circumstances where the corporation is required to restate accounting data due to material noncompliance and the executive is found to have materially violated the corporation's Code of Ethics. *Id*. Plaintiffs argue that scienter on the part of Sandoval can be inferred from these circumstances and then imputed to the corporation.

Although Sandoval -- as an individual who furnished information for financial reports -- falls within the categories of persons described in *Omnicare* whose knowledge may be imputed to the corporation, the allegations [*32] against him are nonetheless insufficient to support an inference of corporate scienter. As discussed previously, to impute an agent's state of mind to the corporation, a complaint must allege particular facts to support a strong inference that the agent acted with the requisite state of mind. Plaintiffs have failed to do so here. Although Sandoval may have been aware of problems and failed to disclose them, there are no facts to support that he did so with intent to defraud. Instead, the allegations support an inference that his intent was one shared by most corporate executives: to be profitable and achieve business goals. Not surprisingly, when the Court asked Plaintiffs' counsel during oral argument to identify specific facts showing Sandoval's fraudulent intent, Plaintiffs' counsel struggled to answer. As such, the Court concludes that scienter cannot be imputed to General Cable based on allegations related to Sandoval.

Analyzing the allegations collectively, the complaint fails to support a strong inference of scienter. Plaintiffs simply lack the type of particularized facts that would lead a reasonable person to find a powerful or cogent inference of fraudulent intent as to any [*33] of the defendants. The Court thus finds that Plaintiffs have failed to state a claim for securities fraud under *Section 10(b)* or Rule 10b-5.

B. Section 20(a) "Controlling Person" Claim

Section 20(a) of the Securities Exchange Act provides for joint and several liability against "controlling persons" -- those who "directly or indirectly" control any person liable for securities violations "unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action." 15 U.S.C. § 78t(a)(2012). Thus, Section 20(a) claims "are predicated upon at least one underlying violation committed by a controlled party." *Frank v. Dana Corp.*, 646 F.3d 954, 962 (6th Cir. 2011). Therefore, "[w]here plaintiffs do not state a claim for a primary securities law violation under Rule 10b-5, dismissal of a "control person" liability claim under 15 U.S.C. § 78t(a) is also proper." *Dailey v. Medlock*, 551 F. App'x 841, 849 (6th Cir. 2014) (citing *Ind. St. Dist. Council of Laborers & Hod Carriers Pension & Welfare Fund v. Omnicare, Inc.*, 583 F.3d 935, 947 (6th Cir. 2009)). Because Plaintiffs fail to state a claim for a securities fraud, the Court concludes that their § 20(a) claims also fail.

III. CONCLUSION

Therefore, having reviewed this matter, and the Court being otherwise sufficiently advised,

IT IS ORDERED that

(1) Defendants' motion to dismiss (Doc. 98) be, and hereby is, **GRANTED**, and Plaintiffs' claims against Defendants be, and hereby are, **DISMISSED WITH PREJUDICE;** and

(2) A separate [*34] judgment shall enter concurrently herewith.

This 27th day of January, 2015.

Signed By:

/s/ William O. Bertelsman

United States District Judge

JUDGMENT

Pursuant to the Memorandum Opinion and Order entered concurrently herewith,

IT IS HEREBY ORDERED AND ADJUDGED that:

(1) Judgment is entered in favor of Defendants with respect to Plaintiffs' claims, and these claims are accordingly **DISMISSED WITH PREJUDICE**; and

[10] The Court notes that this proxy statement —— the first to mention Sandoval by name —— was not referenced in or attached to the Complaint and acknowledges Plaintiffs' Corrected Request for Judicial Notice (Doc. 106) of General Cable's Schedule 14A. The Court need not decide whether these facts are properly before the Court because even assuming they are, Plaintiffs' scienter allegations pertaining to Sandoval fail for other reasons.

(2) This matter is stricken from the docket of this Court.

This 27th day of January, 2015.

Signed by:

William O. Bertelsman

United States District Judge

Halford v. AtriCure, Inc.

United States District Court for the Southern District of Ohio, Western Division

March 29, 2010, Filed

Case No. 1:08cv867

Reporter
2010 U.S. Dist. LEXIS 144377; 2010 WL 8973625

Brian Halford, et al., Plaintiffs, v. AtriCure, Inc., et al., Defendants.

Counsel: [*1] For Brian Halford, Individually and On Behalf of All Others Similarly Situated, Ron DeHart, Individually and On Behalf of All Others Similarly Situated, Plaintiffs: Richard Stuart Wayne, William Kendall Flynn, LEAD ATTORNEYS, Strauss & Troy - 1, Cincinnati, OH; John Michael Levy, Strauss & Troy, Cincinnati, OH; Lionel Z Glancy, PRO HAC VICE, Glancy Binkow & Goldberg LLP, Los Angeles, CA.

For AtriCure, Inc., Defendant: James Eugene Burke, LEAD ATTORNEY, Keating Muething & Klekamp - 1, Cincinnati, OH; Richard Stuart Wayne, LEAD ATTORNEY, Strauss & Troy - 1, Cincinnati, OH; Rachel E Caplan, Stuart Gerson, PRO HAC VICE, Epstein Becker & Green PC, Washington, DC.

For David J Drachman, Julie A. Piton, Defendants: James Eugene Burke, LEAD ATTORNEY, Keating Muething & Klekamp - 1, Cincinnati, OH; Richard Stuart Wayne, LEAD ATTORNEY, Strauss & Troy - 1, Cincinnati, OH; Stuart Gerson, PRO HAC VICE, Epstein Becker & Green PC, Washington, DC.

Judges: Michael R. Barrett, United States District Judge.

Opinion by: Michael R. Barrett

Opinion

ORDER

This matter is before the Court upon Defendants' Motion to Dismiss (Doc. 26), Plaintiffs' Response in Opposition (Doc. 30), and Defendants' Reply (Doc. 33). Defendants have requested oral [*2] argument on their Motion to Dismiss. (Doc. 34.)[1]

Also before the Court is Plaintiffs' Motion to Strike Defendants' Affidavits of Confidential Witnesses, Defendants' Response in Opposition (Doc. 36), and Plaintiffs' Reply (Doc. 38).

I. BACKGROUND

Plaintiffs filed a class action complaint on behalf of purchasers of AtriCure's stock from May 10, 2007 through October 31, 2008. Defendants are AtriCure and two of its officers: David Drachman, the president of AtriCure, and Julie Piton, the chief financial officer for AtriCure. According to the Amended Complaint, AtriCure is a medical device company which develops and sells surgical ablation systems. (Doc. 21, ¶ 2.) These products create precise lesions in soft tissue. (Id., ¶¶ 2, 25.) Some of AtriCure's products have been approved by the Food and Drug Administration ("FDA") for general soft tissue and cardiac ablation procedures. (Id.) The [*3] FDA has not approved any of AtriCure's products for the treatment of atrial fibrillation ("AF"). (Id., ¶ 4.) However, AtriCure derives substantially all its revenue from the sale of its products to ablate cardiac tissue as an AF treatment. (Id., ¶ 5.) While the FDA permits the sale of these product for such "off-label" use, FDA regulations prohibit the promotion of off-label use. (Id., ¶ 6.)

Because off-label use may not be eligible for reimbursement by Medicare and private insurance companies, AtriCure employed a consultant to assist physicians in obtaining reimbursement and insurance coverage. (Id., ¶¶ 10-11.)

On October 21, 2008, AtriCure publicly announced that it had been notified that the Department of Justice ("DOJ") had opened an investigation into AtriCure's marketing practices and Medicare billing instructions to hospitals. (Id.,

[1] ***Local Rule 7.1(b)(2)*** provides that the Court will order oral argument on a motion if the Court determines argument would be helpful due to the complexity of the factual or legal issues presented. The Court finds that oral argument on the pending motions is not necessary for the resolution of this matter.

¶ 12.) The next business day, AtriCure's shares declined 39.41 percent. (Id., ¶ 13.)

In their Amended Complaint, Plaintiffs bring the following claims: (1) violation of *Section 10(b)* of the Securities and Exchange Act of 1934 and Rule 10b-5 against all Defendants; and (2) violation of Section 20(a) of the Exchange Act against Defendants Drachman and [*4] Piton. Plaintiffs allege that Defendants made false and misleading statements and omissions regarding: (1) Defendants' illegal promotion of AtriCure's products to physicians; (2) Defendants' illegal promotion of the filing of false claims for reimbursement; and (3) AtriCure's publicly-reported revenue and earnings, which were improperly inflated thereby, and AtriCure's forecasts, which were materially misleading because Defendants knew that AtriCure's financial results would be materially impacted if the Company could not continue the illegal behavior. (Doc. 30.)

II. ANALYSIS

A. Motion to Dismiss Standard

Defendants' Motion to Dismiss is made pursuant to Federal Rule of Civil Procedure 12(b)(6) for a failure to state a claim. In reviewing a motion to dismiss for failure to state a claim, this Court must "construe the complaint in the light most favorable to the plaintiff, accept its allegations as true, and draw all reasonable inferences in favor of the plaintiff." *Bassett v. National Collegiate Athletic Ass'n*, 528 F.3d 426, 430 (6th Cir. 2008), *quoting* *Directv, Inc. v. Treesh*, 487 F.3d 471, 476 (6th Cir. 2007). "[T]o survive a motion to dismiss a complaint must contain (1) 'enough facts [*5] to state a claim to relief that is plausible,' (2) more than 'a formulaic recitation of a cause of action's elements,' and (3) allegations that suggest a 'right to relief above a speculative level.'" *Tackett v. M & G Polymers, USA, LLC*, 561 F.3d 478, 488 (6th Cir. 2009), *quoting* *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 127 S. Ct. 1955, 167 L. Ed. 2d 929 (2007). "A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Ashcroft v. Iqbal*, 556 U.S. 662, 129 S.Ct. 1937, 1949-50, 173 L. Ed. 2d 868 (2009). Although the plausibility standard is not equivalent to a "'probability requirement,' . . . it asks for more than a sheer possibility that a defendant has acted unlawfully." *Id.* at 1949, *quoting* *Twombly*, 550 U.S. at 556.

B. Pleading standards in securities-fraud claims

Section 10(b) and Rule 10b-5 prohibit "fraudulent, material misstatements or omissions in connection with the sale or purchase of a security." *Konkol v. Diebold, Inc.*, 590 F.3d 390, 395 (6th Cir. 2009), *citing* *Morse v. McWhorter*, 290 F.3d 795, 798 (6th Cir. 2002).[2] A plaintiff must demonstrate: "(1) a material misrepresentation or omission by the defendant; [*6] (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation." *Indiana State Dist. Council Of Laborers And Hod Carriers Pension And Welfare Fund v. Omnicare, Inc.*, 583 F.3d 935, 942 (6th Cir. 2009), *quoting* *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta*, 552 U.S. 148, 128 S. Ct. 761, 169 L. Ed. 2d 627 (2008).

---

[2] Section 10(b), ***15 U.S.C. § 78j(b)*** of the Private Securities Litigation Reform Act (PLSRA) provides that it is unlawful:

> To use or employ, in connection with the purchase or sale of any security ... any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 10b-5, 17 C.F.R. § 240.10b-5, states that:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or **[*7]** to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Section 20(a) imposes control-person liability on "[e]very person who, directly or indirectly, controls any person liable" under the Act and accompanying rules, unless "the controlling person acted in good faith and did not directly or indirectly" induce the illegal acts. *Konkol*, 590 F.3d at 396, *quoting* 15 U.S.C. § 78t(a). A claim under Section 20(a) is contingent upon the investors' ability to establish an "underlying" violation of *Section 10(b)* and Rule 10b-5. *Id., citing PR Diamonds, Inc. v. Chandler*, 364 F.3d 671, 696, 91 Fed. Appx. 418 (6th Cir. 2004).

Securities-fraud claims must satisfy the requirement in Federal Rule of Civil Procedure 9(b) that fraud be plead with particularity. *Id., citing PR Diamonds*, 364 F.3d at 681. Therefore, the complaint must "'(1) specify the statements that the plaintiff contends were fraudulent, (2) identify the speaker, (3) state [*8] where and when the statements were made, and (4) explain why the statements were fraudulent.'" *Id.* at 942-43, *quoting Frank v. Dana*, 547 F.3d 564, 569-70 (6th Cir. 2008).

In addition, the Private Securities Litigation Reform Act of 1995 ("PSLRA") imposes additional and more exacting pleading requirements. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 313, 127 S. Ct. 2499, 168 L. Ed. 2d 179 (2007). First, the complaint must "specify each statement alleged to have been misleading" along with "the reason or reasons why the statement is misleading." *Indiana State Dist. Council*, 583 F.3d at 943, *quoting* 15 U.S.C. § 78u-4(b)(1). Second, the complaint must "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." *Id., quoting* 15 U.S.C. § 78u-4(b)(2). "To qualify as 'strong' . . . , an inference of scienter must be more than merely plausible or reasonable-it must be cogent and at least as compelling as any opposing inference of nonfraudulent intent." *Konkol*, 590 F.3d at 396, *quoting Tellabs*, 551 U.S. at 314.[3]

C. Motion to Strike

Plaintiffs' Amended Complaint is based in part upon the statements of six confidential witnesses. (Doc. 21, ¶¶ 52-90.) In support of its Reply to its Motion to Dismiss, Defendants submitted three affidavits of individuals who are identified as three of the confidential witnesses in the Amended Complaint. Defendants argue that the affidavits directly refute the allegations in the Amended Complaint attributed to the confidential witnesses.

In considering the weight to be given to allegations from confidential witnesses under the PSLRA, this Court has adopted the reasoning and result reached by the Seventh Circuit in *Makor Issues & Rights, Ltd. v. Tellabs Inc.*, 513 F.3d 702 (7th Cir. 2008) (*Tellabs II*) and *In re Amgen Inc. Securities Litigation*, 544 F.Supp.2d 1009 (C.D.Cal. 2008). *See In re Huffy Corp. Secs. Litig.*, 577 F. Supp. 2d 968, 993 (S.D.Ohio 2008); *see also In re Huntington Bancshares Inc. Securities Litigation*, 674 F. Supp. 2d 951, 2009 WL 4666455, *7 (S.D.Ohio 2009) (slip op.). In [*10] doing so, this Court has explained: "when deciding whether to consider the statements attributed to confidential or anonymous witnesses in the Amended Complaint, as part of the calculus to be applied to determine whether the Plaintiffs have complied with the pleading requirements contained in the PSLRA, this Court will examine the descriptions of each of those individuals' jobs to ascertain whether any would have been in a position to have gained first hand knowledge of the facts attributed to him or her, and the detail of the information each is reported to have provided." *In re Huffy*, 577 F.Supp.2d at 993.

When presented with confidential witnesses who were later identified and provided conflicting affidavits or declarations, courts are reluctant to strike the original statements by the confidential witnesses. *In re Proquest Securities Litigation*, 527 F.Supp.2d 728 (E.D. Mich. 2007), the district court noted that:

> [the defendant] in seeking out and obtaining a declaration from CI 1, engaged in discovery which was wholly improper. Plaintiffs have not yet had the opportunity to respond or otherwise challenge the statements in CI 1's declaration. . . . But for [the defendant] engaging [*11] in inappropriate discovery, the Court would have no contradictory information regarding the allegations in the CAC. Thus, as to both CI 1 and CI 2, the allegations, to the extent they are

[3] As the Sixth Circuit explained in *Konkol*:

> This "at least as compelling" standard replaced the old standard used by this court, which provided **[*9]** that "plaintiffs are entitled only to the *most plausible* of competing inferences." *See Helwig v. Vencor, Inc.*, 251 F.3d 540, 553 (6th Cir. 2001) (emphasis added).

590 F.3d at 396.

> consistent with or otherwise supportive of other evidence of scienter, will be considered.

Id. at 740. Likewise, in *In re Par Pharmaceutical Securities Litigation*, 2009 U.S. Dist. LEXIS 90602, 2009 WL 3234273 (D.N.J. Sep. 30, 2009) (slip op.), the district court did not strike the allegations of the confidential witness:

> the Court does not want to establish mechanisms whereby discovery must be conducted every time confidential informants are utilized, forcing the Court to reconcile competing facts to determine whether allegations in a complaint should be struck. If, however, discovery in the normal course reveals that factual contentions have indeed been alleged in bad faith, Defendants may renew their Rule 11 motion. They are also permitted, of course, to file a summary judgment motion.

2009 U.S. Dist. LEXIS 90602, [WL] at *12. The district court granted the plaintiff's motion to strike the declaration of the later-identified confidential witness. *Id.*

This Court finds the rationale of these district courts to be correct. Therefore, the Court will consider the [*12] allegations of all the confidential witnesses under the standards outlined above. Accordingly, Plaintiffs' Motion to Strike Defendants' Affidavits of Confidential Witnesses is GRANTED. The Court will not consider the affidavits of Sara N. McIntosh, Leslie Lopez, and Cheryl A. Kulesza, which are attached to Defendants' Reply (Doc. 33).

D. Section 10(b) claim

a. Material misrepresentation or omission

Defendants argue that Plaintiffs have failed to allege any facts showing that AtriCure's marketing practices were illegal, and only rely upon legal conclusions. Defendants maintain that the mere investigation by the DOJ is insufficient to support Plaintiffs' claim. In response, Plaintiffs argue that they have sufficiently alleged that Defendants made false and misleading statements or omissions in three different categories. Plaintiffs argue that these statements were false or misleading, regardless of whether Defendants were violating FDA regulations.

First, Plaintiffs allege Defendants made false and misleading statements or omissions regarding AtriCure's marketing and promotion of its products and training of physicians. Plaintiffs point to the following allegations in the Amended Complaint:

AtriCure's [*13] 2006 Form 10-K states: "Our sales team educates doctors in the technology and general application of our Isolator system, but it is our policy not to educate or train doctors to use our system for the ablation of cardiac tissue, except with respect to our Pen, or for the surgical treatment of AF." (Doc. 21, ¶ 106.)

During a August 9, 2007 conference call with investors and analysts, Defendant Piton stated: "I would like to remind everyone . . . that the Food and Drug Administration has not cleared or approved the company's Isolator bipolar ablation clamps or its ablation and sensing units for treatment of AF . . . The company and others acting on its behalf may not promote any of its products for the surgical treatment of AF or train doctors to use the products for the surgical treatment of AF. These restrictions do not prevent . . . AtriCure from engaging in sales and marketing efforts that focus only on the general attributes of the products for the current cleared uses and not for the treatment of AF." (Id., ¶119.)

During a February 14, 2008 conference call with investors and analysts, Defendant Piton stated: "AtriCure educates and trains doctors in the proper use of its products [*14] and related technologies and does not educate or train doctors to use any of its products for the surgical treatment of AF." (Id., ¶¶155-56.)

AtriCure's March 17, 2008 Form 10-K states:

> We may only promote our products to doctors and provide education and training on the use of our devices for their cleared indications, which does not include the treatment of AF.
>
> Because the FDA has not cleared our products for the treatment of AF, we and others acting on our behalf may not promote our products for the treatment of AF, make any claim that they are safe and effective for the treatment of AF or train doctors to use them for the treatment of AF outside of the clinical trial setting. However, these restrictions do not prevent doctors from choosing to use our Isolator system and other products for the treatment of AF or prevent us from engaging in sales and marketing efforts that focus only on the general attributes of our products and their FDA-cleared uses and not on the treatment of AF. Although we educate and train doctors as to the general skills involved in the proper use of our products, it is our policy not to educate or train them to use our products for the treatment of AF.

> . . .
>
> Sales, [*15] Marketing and Medical Education
>
> Our United States sales and marketing efforts focus on educating doctors concerning our unique technologies and the technical benefits of our Isolator system for the ablation of cardiac tissue. It is our policy not to market or promote our products for the treatment of AF.
>
> . . .
>
> Our current inability to educate or train doctors in the use of our Isolator system and other products for the treatment of AF, due to legal prohibitions on off-label promotion of medical devices, could result in injuries to patients or other adverse events that lead to litigation against us, which could be costly to our business. Our sales team educates doctors in the technology and general application of our products, but it is our policy not to educate or train doctors to use our system for the surgical treatment of AF." (Id., ¶163.)

During a May 6, 2008 conference call with investors and analysts, Defendant Piton stated: "AtriCure educates and trains doctors in the proper use of its products and related technologies and does not educate or train doctors to use any of its products for the surgical treatment of AF." (Id., ¶¶156-57.)

During an August 5, 2008 conference call with [*16] investors and analysts, Defendant Piton again stated: "AtriCure educates and trains doctors in the proper use of its products and related technologies and does not educate or train doctors to use any of its products for the surgical treatment of AF." (Id., ¶¶191-92.)

Plaintiffs argue that while Defendants stated that AtriCure engaged in sales and marketing efforts that focused only on the general attributes and cleared uses of its products, that it did not market or promote its products for the treatment of AF, and that it did not educate or train doctors to use its products for the treatment of AF, these statements were false and misleading regardless of whether AtriCure was in compliance with FDA regulations. As support, Plaintiffs cite to the following allegations in the Amended Complaint:

> During 2007, AtriCure maintained a website which provided "up-to-date information concerning Atrial Fibrillation, to educate patients and the medical community about the options regarding AFib." (Doc. 21, ¶ 39.)
>
> The website states: "the FDA has not approved any surgeries for the treatment of atrial fibrillation, but clinical trials are underway for the purpose of obtaining FDA approval." (Id., ¶ [*17] 40)
>
> The website lists treatment options including Cox Maze III surgery, surgical ablation, minimally-invasive surgical ablation, catheter ablation, medical management, and participation in a surgical ablation clinical trial. (Id.)
>
> AtriCure is currently one of the sponsors of a website which states: "While medication and cardioversion can treat and in many cases even manage atrial fibrillation, they won't cure your afib. The surgical and catheter procedures listed below can cure your afib. . . "

Plaintiffs cite to a third website that is not sponsored by AtriCure, but mentions AtriCure in reference to the "Mini-Maze" procedure, and states the procedure "has been proven effective to cure AF . . ." (Id., ¶ 44.) Plaintiffs also allege that there is video at www.youtube.com which features AtriCure's products.

Plaintiffs also rely upon statements made by six confidential witnesses, included in the Amended Complaint:

> CW1 was employed as a Regional Sales Manager for AtriCure from late 2006 until March 2008. (Id., ¶ 53.) CW1 described his or her sales and marketing duties as to "educate, train, and teach cardiac surgeons, cardiologists, and electrophysiologists" how to use AtriCure products for [*18] the "treatment of atrial fibrillation." (Id., ¶ 54.) CW1 was trained to educate surgeons on how to perform specific surgical lesion sets for different types of AF using AtriCure's products. (Id., ¶ 58.) CW1 was provided with brochures and marketing materials which contained information explaining how AtriCure's products worked in the treatment of AF. (Id., ¶ 59.) CW1 was provided with a rubber heart which was used to demonstrate how to make lesions using AtriCure's products. (Id.)
>
> CW2 was employed by AtriCure beginning in the fall of 2006 until the spring of 2008 to review marketing materials to ensure that they did not use the words "treatment of atrial fibrillation." (Id., ¶ 62.) CW2 was taught how to make marks or incisions on a heart. (Id., ¶ 64.)
>
> CW3 was employed by AtriCure as a quality coordinator for most of 2008. (Id., ¶ 67.) CW3 received a compact disk which explained how the "Mini-Maze" procedure

was performed. (Id., ¶ 69.) CW3 received calls from sales representatives or nurses during live procedures with questions about the "Mini-Maze" procedure. (Id., ¶ 71.) These live procedures were not being conducted as part of a clinical trial. (Id.)

CW4 was an intern who worked on [*19] a marketing campaign for AtriCure to increase awareness about AF. (Id., ¶ 74.) CW4 was asked to improve the website www.afibfacts.com, but was told that AtriCure's name could not be used, marketing materials could not be geared towards a specific "AtriCure procedure," and no AtriCure products could be named. (Id., ¶ 75.)

CW5 was employed by AtriCure from 2004 until 2008. (Id., ¶ 78.) CW5 was responsible for tasks related to educating new physicians to perform procedures using AtriCure products. (Id., ¶¶ 78-80.)

CW6 is a cardiothoracic surgeon who uses AtriCure products to treat AF. (Id., ¶ 84.) AtriCure approached CW6 about using AtriCure products to treat AF in conjunction with another cardiac procedure, such as valve replacement. (Id., ¶ 84.) CW6 learned about the "Mini-Maze" procedure during a conference presentation by Dr. Randall Wolf. (Id.) CW6 learned to use AtriCure products for the treatment of AF from three other doctors. (Id., ¶ 86, 87).

As explained above, the Court must determine what weight to give to the allegations of the confidential witnesses based on "the descriptions of each of those individuals' jobs to ascertain whether any would have been in a position to have gained [*20] first hand knowledge of the facts attributed to him or her, and the detail of the information each is reported to have provided." The Court finds that based on the descriptions of each of the individuals' jobs and the dates employed, the confidential witnesses were in a position to gain first-hand knowledge of the facts in their statements. CW1 was a Regional Sales Manager, a position which would have given CW1 more than sufficient opportunity to know the details of Atri-Cure's marketing practices. CW2 reviewed marketing materials as part of his or her job. CW3 received information about procedures in which AtriCure's products were being used to treat AF. CW4 only worked on a short-term project for AtriCure, but that project was dedicated solely to marketing AtriCure's products. CW5 was responsible for handling the training of physicians in the use of AtriCure's products in the treatment of AF. Finally, CW 6 was a surgeon who was trained in the use of AtriCure's products in the treatment of AF.

In addition, the Court finds that the confidential witnesses have provided sufficient detail to give weight to their statements. Each statement includes specific information about AtriCure's [*21] marketing practices, marketing materials, and the training of surgeons in the use of AtriCure's products in the treatment of AF. Therefore, despite their confidentiality, the Court affords the witnesses' statements substantial weight for purposes of deciding whether Plaintiffs have sufficiently alleged material misrepresentations or omissions to support their section 10(b) claim.

The second category of false and misleading statements or omissions alleged by Plaintiffs relate to Defendants' promotion of and participation in the filing of improper claims for reimbursement. Plaintiffs claim that in the following statements AtriCure failed to inform investors of their promotion of and participation in the filing of improper claims for reimbursement: (1) an August 9, 2007 conference call with investors and analysts (Id., ¶¶ 121-22); a February 14, 2008 press release (Id., ¶¶ 151-52); AtriCure's March 17, 2008 Form 10-K (Id., ¶¶ 167-68); and an August 5, 2008 press release (Id., ¶¶ 187-88). Plaintiffs claim that Defendants were obligated to inform investors that AtriCure drafted template letters on behalf of health care providers to be sent to insurance companies to obtain reimbursement for [*22] various procedures using its products. (Id., ¶46.)

Plaintiffs also allege that during conference calls with investors, Defendants made false and misleading statements regarding the status of certain regulatory milestones, the state of peer-reviewed literature, and the status of and time-frame for completing clinical trials to obtain clearance from the FDA to use AtriCure's products in the treatment of AF.[4] Plaintiffs cite to the following allegations in the Amended Complaint:

> On May 10, 2007, AtriCure issued a press release which stated: "We are pleased with our first quarter financial results and extremely encouraged regarding our achievement of a series of product and regulatory milestones, including the full commercial release of our open Isolator Synergy(TM) ablation system," said David Drachman, President and Chief Executive Officer. "Additional achievements included a FDA regulatory

[4] The Court would categorize the statements regarding the status and pace of FDA approval as a separate category of false and misleading statements. The Court does not view these statements, as Plaintiffs do, as supporting Plaintiff's claim that Defendants failed to disclose to investors that AtriCure was promoting or participating in the filing of improper claims for reimbursement.

> filing in support of a cardiac ablation indication for our Isolator® bipolar ablation clamps and our FDA filing to support our left atrial appendage occlusion clip . . . ." (Id., ¶ 91.)
>
> During a May 10, 2007 conference call Drachman stated that AtriCure had presented a redesigned clinical trial which [*23] the FDA approved. Drachman also stated: "I think that the ABLATE trial again will really stimulate AtriCure in terms of being able to allow us to become the first company to receive an AF labeling." (Id., ¶ 99.)
>
> During the same conference call, Drachman stated that "There was a mounting body of peer review literature . . . reporting superior and reproducible outcome with the use of our minimally-invasive products." (Id., ¶ 102.)
>
> On July 9, 2007, AtriCure announced that it received, ahead of schedule, FDA 510(k) clearance for the Isolator Bipolar Clamp System for the ablation of cardiac tissue. Drachman stated: "[W]e continue to make significant progress toward obtaining an atrial fibrillation indication for our Isolator ablation clamp and pen systems." (Id., ¶ 112.)
>
> During a August 9, 2007 conference call Drachman made statements which suggested that the FDA would revamp the rules concerning clinical trials testing the safety and efficacy of ablation as a treatment for AF. (Id., ¶ 125.)

Plaintiffs claim that these statements are false and misleading because Defendants knew that the state of peer-reviewed literature was not such as to support the statements; an FDA Panel Meeting on September [*24] 20, 2007 had noted that the widespread availability of off-label AF treatment had detracted from the ability to enroll patients in clinical trials; and the FDA had steadfastly refused, over the course of almost 10 years, to radically alter the study design of trials for ablation testing for AF treatment. (Id., ¶¶ 92, 100, 102, 112, 126.)

The third category of false and misleading statements or omissions alleged by Plaintiffs relate to Defendants' publicly-reported revenue and earnings. Plaintiffs do not claim that the numbers reported were inaccurate, but instead claim that AtriCure's revenues and earning forecasts were misleading because Defendants knew that these numbers were not sustainable without off-label marketing. Specifically, Plaintiffs allege that Defendants' announcement in an August 9, 2007 press [*25] release that the company experienced "record revenues" and Drachman's statement that the company is "pleased with our financial results," "confident that we are building momentum across all sectors of our business," and "well-positioned to expand the treatment alternatives for patients and grow the markets for our products" were materially misleading because Defendants knew that their marketing practices in connection with the use of AtriCure's products in procedures to treat AF were illegal. (Id., ¶ 116.) Plaintiffs also cite as misleading the statements made by Drachman during an August 9, 2007 conference call with analysts and investors regarding the "momentum" building for AtriCure's minimally-invasive procedures and AtriCure's cardiac ablation approval by the FDA. (Id., ¶¶ 121-22.)

Additionally, Plaintiffs cite: (1) a November 6, 2007 press release which includes Drachman's statements that the Company is "encouraged by our momentum, operating leverage and overall financial performance during the third quarter," and that the "men and women of AtriCure have amassed greater penetration and stronger market presence in each of our current business sectors" (Id., ¶¶ 136-37); (2) a May [*26] 6, 2008 press release which included statements by Drachman that the Company was "pleased with our first quarter financial results," that adoption of AtriCure's MIS products was "growing rapidly, evidenced by increased physician adoption and a record 92 U.S. medical centers performing procedures during the first quarter," and that "[m]inimally invasive results for the quarter confirm the power of our strategy and our capacity to quickly develop and commercialize innovative cardiac ablation systems," as well as the Company's report of "record" revenues for Q1 2008 (Id., ¶¶ 172-73); and (3) a August 5, 2008 press release reporting "record" revenues for Q1 2008 (Id., ¶¶ 187-88). Plaintiffs allege that when Drachman was asked whether FDA-approval was "important to the company, in order to allow you to market and train people with more facility," Drachman downplayed the impact FDA-approval would have on business by stating:

> I think that the ablation market has been ongoing since the early 1990s and that companies are fairly well-conditioned to selling products off-label. I don't want to minimize the importance of an AF labeling and [are] working with the FDA to do that, but in terms of stimulating [*27] adoption for AF ablation, I think that the companies — the physicians [sic] have been reasonably aggressive in promoting their products as well as reaching out to patients and cardiologists over the last 10 or 15 years. So we don't really see a significant lift just based on labeling, I think the real issue is will the technologies and procedures have a more significant impact on the disease state.

(Id., ¶ 196.)

The Court finds that these three categories of allegations are more than just legal conclusions. The Court also finds that Plaintiffs have sufficiently alleged false and misleading statements or omissions by Defendants to support their section 10(b) claim. The Court accepts Defendants' argument that the initiation of the DOJ investigation alone cannot form the basis for Plaintiffs' claim. However, Plaintiffs have identified specific statements it contends are fraudulent, identified the speaker, stated where and when the statements were made, and explain why the statements were allegedly fraudulent. These allegations meet the pleading requirements for a section 10(b) claim and are not dependant on the legality or illegality of Defendants' promotion and sales activities. For example, [*28] Defendants made several statements indicating that the company does not educate or train doctors to use any of its products for the surgical treatment of AF. However, the allegations in the Amended Complaint based on the confidential witnesses statements indicate that this statement is false or misleading. It is the falsity of Defendants' statements which is critical, not whether the underlying activity is found to be illegal by the DOJ.[5]

For this same reason, the Court rejects Defendants arguments regarding the viability of a claim brought by a private litigant under the Federal Food, Drug, and Cosmetic Act ("FDCA"). Plaintiffs claims are not based upon Defendants' compliance with the FDCA. *Accord* *In re Amgen Inc. Securities Litigation*, 544 F. Supp. 2d 1009, 1033 (C.D.Cal. 2008) ("The issue before the Court is not [*29] whether the FDA improperly approved Amgen's products as safe and effective, but rather whether Defendants violated securities laws by improperly marketing Epogen and Aranesp for off-label uses."), *citing* *In re Genentech, Inc., Securities Litigation*, 1989 U.S. Dist. LEXIS 14819, 1989 WL 106834 *1 (N.D.Cal. 1989) (unpublished) ("The FDA has no jurisdiction, primary or otherwise, to decide whether disclosures in the market violate the securities laws.").

b. Duty to disclose

Defendants argue that they had no duty to announce that AtriCure's business practices possibly violated the FDCA and might become the subject of a DOJ investigation.

It is well-settled that "federal securities laws do not create an affirmative duty on the part of a company to disclose the details of its business practices, opine as to their legality, or make predictions as to the likelihood and/or impact of potential litigation surrounding those practices." *In re Unumprovident Corp. Securities Litigation*, 396 F.Supp.2d 858, 886 (E.D.Tenn. 2005), *citing* *In re Sofamor Danek Group, Inc.*, 123 F.3d 394, 399-401 (6th Cir. 1997). An affirmative duty of disclosure arises if "(1) created by SEC statute or rule; (2) there is insider trading; or (3) there was [*30] a prior statement of material fact that is false, inaccurate, incomplete or misleading in light of the undisclosed information." *Albert Fadem Trust v. American Elec. Power Co., Inc.*, 334 F.Supp.2d 985, 1004 (S.D.Ohio 2004), *quoting* *In re Ford Motor Co. Secs. Litig.*, 184 F. Supp. 2d 626, 631-32 (E.D.Mich. 2001), *aff'd*, 381 F.3d 563 (6th Cir. 2004).

Defendants rely upon the Sixth Circuit's decision in *Sofamor Danek*, where the defendant company marketed spinal implant devices for uses not yet approved by FDA. 123 F.3d at 399. The court made a distinction between "soft information" and "hard information." The court explained:

> Hard information is typically historical information or other factual information that is objectively verifiable. Such information is to be contrasted with "soft" information, which includes predications and matters of opinion.

Id. at 401 (internal quotations and omissions omitted). The court explained that a company has a duty to disclose hard information but not soft information unless other criteria are met. *Id.* at 402. The failure to disclose soft information is actionable "'only if [it is] . . . virtually as certain as hard facts.'" *Id., quoting* *Starkman v. Marathon Oil Co.*, 772 F.2d 231, 241 (6th Cir. 1985).

The [*31] Court finds that this case is distinguishable from *Sofamor Danek*. In that case, the FDA had issued warnings to the defendant and similar companies on two occasions that regulatory action would be taken if they promoted the spinal implant devices for unapproved use or supported medical education programs that demonstrate the unapproved use of the devices. 123 F.3d at 397-98. Both of these warnings were disclosed in the company's SEC filings along with a statement that the company could not rule out the possibility of regulatory action. *Id.* The plaintiffs alleged fraud based upon a conference with stock analysts, where the company's president allegedly downplayed the FDA's

[5] Of course at this stage of the proceedings, it is not necessary for Plaintiffs to prove that the statements are in fact false. Therefore, the Court does not find that Plaintiffs need to show, as Defendants argue, that there were specific meetings or communications where AtriCure employees promoted or marketed the use of AtriCure's products for the surgical treatment of AF.

warning letter and "stated that [the defendant] would continue to comply with the FDA rules regarding medical education." *Id.* at 401 n.2. The plaintiffs also pointed to the statements in the company's SEC filings that the company could not predict the use of products for applications not approved by the FDA and did not encourage such use. *Id.*

The Sixth Circuit found that the defendant had no duty to disclose its support of the medical education programs because the legality of that program was a matter of opinion, and [*32] therefore "soft information." *Id.* at 402. The court also found significant that the company disclosed the warnings from the FDA. *Id.* The court explained that while "it is true, the company 'downplayed' the significance of the warning letter-but any analyst could easily obtain a copy of the letter and could make an independent judgment of its significance." *Id.* The court also noted that the SEC filings each year explicitly mentioned that there was a risk of regulatory action by the FDA. *Id.*

In contrast, in this case Defendants' statements regarding their off-label marketing contain "hard information." Plaintiffs allege that Defendants repeatedly made statements such as: (1) "it is our policy not to educate or train doctors to use our system for the ablation of cardiac tissue, except with respect to our Pen, or for the surgical treatment of AF;" (2) "AtriCure educates and trains doctors in the proper use of its products and related technologies and does not educate or train doctors to use any of its products for the surgical treatment of AF;" and (3) "Although we educate and train doctors as to the general skills involved in the proper use of our products, it is our policy not to educate [*33] or train them to use our products for the treatment of AF."[6] These statements do not contain "soft" information, such as predications and matters of opinion. Instead, this is factual information which is objectively verifiable. Defendants had a duty to speak truthfully about its marketing practices. As the Sixth Circuit has explained "even absent a duty to speak, a party who discloses material facts in connection with securities transactions "assume[s] a duty to speak fully and truthfully on those subjects." *Helwig v. Vencor, Inc.*, 251 F.3d 540, 561 (6th Cir. 2001) (en banc), *abrogated in part by Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 127 S. Ct. 2499, 168 L. Ed. 2d 179 (2007).

In so ruling, the Court recognizes that Defendants were under no obligation to speak regarding the legality of their marketing practices. *See Morse v. McWhorter*, 200 F. Supp. 2d 853, 858-61 (M.D.Tenn. 2000), *vacated on other grounds*, 290 F.3d 795 (6th Cir. 2002) (holding that although defendants had no duty to opine as to the legality of company's business practices, plaintiffs had adequately alleged an actionable misstatement or omission where they also alleged defendants failed to disclose fact of those practices). Similarly, Defendants did not have an obligation to disclose that the DOJ may decide to investigate its marketing practices. *See Zaluski v. United American Health-*

[6] Defendants argue that they did in fact disclose information regarding their marketing practices. Defendants point to AtriCure's March 17, 2008 10-K, which explained:

> [O]ur sales and marketing efforts focus only on the general technical attributes and benefits of our Isolator system and products and not on the use of our products for AF treatment. At the same time, we provide certain support for the use of our Isolator system and our multifunctional pen in the treatment of AF that we believe is non-promotional and therefore permitted. **[*34]** In particular, since our Isolator system is only being used by doctors for the treatment of AF, we train our sales force on the use of our system by cardiothoracic surgeons to treat AF, and off-label sales are included in our sales force compensation structure. . . . In addition, medically trained clinical application specialists attend surgical procedures to discuss the general attributes of our Isolator system and products and respond to unsolicited requests for information on the use of our products for the treatment of AF.
>
> . . . In addition, we provide financial support in the form of research and educational grants to several leading institutions in the cardiac field, which they may use to conduct physician training programs, including programs relating to the surgical treatment of AF using our products. We also provide some guidance to physicians and medical institutions regarding what physicians are available and qualified for training other physicians on the use of our products in the treatment of AF. We also continue to make improvements in our Isolator system and other products which could be viewed as supporting the treatment of AF.

(Doc. 26-10.). While this disclosure may **[*35]** explain some of the statements made by the confidential witnesses, the Court finds that this statement in the 10-K does not counter the affirmative statements identified by the Court, *i.e.*, that AtriCure does not educate or train doctors to use any of its products for the surgical treatment of AF. At best, the statement in the 10-K turns the question from one of falsity into a question of whether the statements identified were misleading.

care Corp., 527 F.3d 564, 576 (6th Cir. 2008) ("Defendants' failure to disclose [*36] the potential consequences of the [allegedly illegal] payments to [a state senator in support of a state contract], consequences which turn on decisions made by actors outside of Defendants' control, did not constitute the type of hard information that this Court considers to be actionable.").

While Defendants had a duty to speak fully and truthfully about their marketing practices, the same cannot be said with regard to Defendants' promotion of and participation in the filing of improper claims for reimbursement. Plaintiffs have not alleged that Defendants made any false statements regarding its promotion or participation in filing claims. Plaintiffs only claim that Defendants were obligated to disclose that it participated in this allegedly improper activity. The Court finds that this information is the type of "soft" information which Defendants had no obligation to disclose. As the Sixth Circuit explained in *Sofamor Danek*:

> Ordinarily, at least, a company is under no duty to disclose the details of its merchandising practices. If we were prepared to assume in the case at bar that Sofamor Danek's merchandising practices constituted material information for purpose of the federal securities [*37] laws, however, that in itself would not be dispositive of the question whether disclosure was required. Materiality alone is not sufficient to place a company under a duty of disclosure.

123 F.3d at 400; *see also* *Zaluski*, 527 F.3d at 574 ("Plaintiffs argue that [the defendant's] failure to disclose the payments to [a state sentator] resulted in a breach because as a result of those payments, Tennessee could choose to sanction [the defendant] or terminate [the defendant's contract with the state]. However, as in *In re Sofamor Danek*, while the payment to [the senator] could arguably have been a piece of hard information that was subject to disclosure, the potential consequences of these payments are the type of predictions and soft information that do not give rise to a duty of disclosure."). Therefore, Defendants did not have a duty to disclose their alleged promotion of and participation in the filing of improper claims for reimbursement.

With regards to Defendants' allegedly false and misleading statements regarding the status of certain regulatory milestones, the state of peer-reviewed literature, and the status of and time-frame for completing clinical trials to obtain clearance from [*38] the FDA to use AtriCure's products in the treatment of AF, the Court finds that to the extent that these statements relate to historical or factual information, these statements are actionable. This would include the statements regarding regulatory milestones and the statement regarding the "mounting body of peer review literature."

To the extent that Defendants' statements regarding the FDA's approval of AtriCure's products for use in treating AF were predictions or opinions, that information is "soft" information which Defendants did not need to disclose. This would include (1) Drachman's statement that "I think that the ABLATE trial again will really stimulate AtriCure in terms of being able to allow us to become the first company to receive an AF labeling;" Drachman's statement on July 9, 2007 that "[W]e continue to make significant progress toward obtaining an atrial fibrillation indication for our Isolator ablation claim and pen systems;" and Drachman's statements regarding FDA rules concerning clinical trials. Moreover, as will be discussed below, the PSLRA provides that under certain circumstances a person or entity shall not be liable for any written or oral forward-looking [*39] statements. 15 U.S.C. § 78u-5(c)(1), (2).

Finally, Plaintiffs claim that AtriCure's revenues and earning forecasts were misleading because Defendants knew that these numbers were not sustainable without off-label marketing. The Court finds that the statements identified are not actionable.[7] As explained previously, there is no affirmative duty on the part of a company to disclose the details of its business practices or opine as to their legality; nor is there a duty to disclose "soft" information such as opinions, unless the opinion is virtually as certain as hard facts. Moreover, "liability does not attach to mere corporate puffery or statements of corporate optimism." *Indiana State Dist. Council*, 583 F.3d at 943, *citing* *In re Ford Motor Co. Sec. Litig.*, 381 F.3d 563, 570 (6th Cir. 2004). However, to the extent that there are statements regarding the approval of AtriCure's products by the FDA or adoption of cardiac ablation procedures by surgeons, the Court finds that these statements are to be analyzed as forward-looking, and the application of the safe-harbor provision of the PSLRA will be discussed below.

---

[7] The Court notes that there are no statements identified by Plaintiffs which **[*40]** specifically tie the success or growth of AtriCure to its marketing practices. *Accord* *In re Sofamor Danek Group, Inc.*, 123 F.3d at 401 ("The sales and earnings data publicly reported by Sofamor Danek during the Class Period are "hard" numbers, the accuracy of which has never been challenged by the plaintiffs. Neither have the plaintiffs pointed to any affirmative misstatement in the company's explanations of the numbers."). While AtriCure may have derived substantially all of its revenue from off-label use of its products, that does not necessarily mean that all the revenue was the result of marketing their products for the treatment of AF.

c. Forward-looking statements

PSLRA's safe-harbor provision "excuses liability for defendants' projections, statements of plans and objectives, and estimates of future economic performance." *Helwig*, 251 F.3d at 547-48, *citing* 15 U.S.C. § 78u-5(i)(1). This protection is overcome only "if the statement was material; if defendants had actual knowledge that it was false or misleading; and if the statement was not identified as 'forward-looking' or lacked meaningful cautionary statements." *Indiana State Dist. Council*, 583 F.3d at 943, *citing* *Helwig*, 251 F.3d at 548; [*41] *see also* 15 U.S.C. § 78u-5(c)(1)(A)(i) (explaining that meaningful cautionary statements identify "important factors that could cause actual results to differ materially from those in the forward-looking statement.").

Defendants argue that there are three categories of allegations in the Amended Complaint which concern forward-looking statements: (1) statements concerning the momentum of surgeon adoption of cardiac ablation procedures; (2) statements concerning AtriCure's expectations of progress for regulatory approval; and (3) financial or business performance projections.[8]

Defendants argue that each of the SEC filings and press releases challenged by Plaintiffs contained a detailed disclosure regarding the risks involved in AtriCure's business. Plaintiffs argue that Defendants' cautionary language is not sufficiently detailed to be meaningful and the statements are mere "boilerplate warnings." The Court disagrees. AtriCure's press releases during the asserted class period stated:

> These risks and uncertainties include the rate and degree of market acceptance of AtriCure's products, AtriCure's ability to develop and market new and enhanced products, the timing of and ability to obtain and maintain regulatory [*43] clearances and approvals for its products, the timing of and ability to obtain reimbursement of procedures utilizing AtriCure's products, competition from existing and new products and procedures or AtriCure's ability to effectively react to other risks and uncertainties described from time to time in AtriCure's SEC filings, such as fluctuation of quarterly financial results, reliance on third party manufacturers and suppliers, litigation (including the purported class action lawsuit) or other proceedings, government regulation and stock price volatility. AtriCure does not guarantee any forward-looking statement, and actual results may differ materially from those projected. AtriCure undertakes no obligation to publicly update any forward-looking statement, whether as a result of new information, future events or otherwise.

(Docs. 26-1 to 26-7.) In addition, AtriCure's 10-K and 10-Q forms filed with the SEC contained a detailed discussion and explanation beneath headings such as:

> Unless we are able to complete the clinical trials required to support future submissions to the FDA, and

---

[8] Plaintiffs have not argued that these statements 8 are not forward-looking. The statute defines the term "forward-looking" as:

> (A) a statement containing a projection of revenues, income (including income loss), earnings (including earnings loss) per share, capital expenditures, dividends, capital structure, or other financial items;
>
> (B) a statement of the plans and objectives of management for future operations, including plans or objectives relating to the products or services of the issuer;
>
> (C) a statement of future economic performance, including any such statement contained in a discussion and analysis of financial **[*42]** condition by the management or in the results of operations included pursuant to the rules and regulations of the Commission;
>
> (D) any statement of the assumptions underlying or relating to any statement described in subparagraph (A), (B), or (C);
>
> (E) any report issued by an outside reviewer retained by an issuer, to the extent that the report assesses a forward-looking statement made by the issuer; or
>
> (F) a statement containing a projection or estimate of such other items as may be specified by rule or regulation of the Commission.

15 U.S.C. § 78u-5 (i)(1).

> unless the data generated by such trials supported the use of our Isolator system for the treatment of [*44] AF as safe and effective, we may not be able to secure additional FDA clearances or approvals and our ability to maintain and grow our business could be harmed.
>
> We may be subject to fines, penalties, injunctions and other sanctions if we are deemed to be promoting the use of our products for non-FDA-approved, or off-label, uses.
>
> We have limited long-term clinical data regarding the safety and efficacy of our Isolator system. Any long-term data that is generated may not be positive or consistent with our limited short-term data, which would affect the rate at which our Isolator system is adopted by the medical community.

(Docs. 26-8 to 26-13.) Finally, each conference call identified in the Amended Complaint began with a disclaimer that the call may include forward-looking statements, and referred to the risk factors identified in AtriCure's SEC filings. (Docs. 26-20 to 26-26.)

The Court finds that this language is specific and detailed enough to render the cautionary language "meaningful." Defendants have identified important factors that could cause actual results to differ materially from those in the forward-looking statement, such as the ability to complete clinical trials and the [*45] positive outcome of such trials.

Plaintiffs argue that the cautionary language cannot insulate Defendants because the statements identified by Defendants are material; and Defendants had actual knowledge that the statements were false and misleading when they were made. However, as this Court has made clear, state of mind becomes irrelevant where forward-looking statements are appropriately qualified. *Gruhn v. Tween Brands, Inc.*, 2009 U.S. Dist. LEXIS 47853, 2009 WL 1542795, *5-6 (S.D.Ohio June 2, 2009) (unpublished). Forward-looking statements accompanied by meaningful cautionary language satisfy the first prong of the safe harbor provided for in the PSLRA, and makes the state of mind irrelevant. 2009 U.S. Dist. LEXIS 47853, [WL] at *6, *citing* *Miller v. Champion Enterprises Inc*., 346 F.3d 660, 672 (6th Cir. 2003); *see also* 15 U.S.C. § 78u-5(c)(1) & (2).[9] "In other words, if the statement qualifies as 'forward-looking' and is accompanied by sufficient cautionary language, a defendant's statement is protected regardless of the actual state of mind." *Id., quoting* *Miller*, 346 F.3d at 672.

---

[9] PSLRA's safe-harbor provision provides as follows:

(1) In general

Except as provided in subsection (b) of this section, in any private action arising under this **[*46]** chapter that is based on an untrue statement of a material fact or omission of a material fact necessary to make the statement not misleading, a person referred to in subsection (a) of this section shall not be liable with respect to any forward-looking statement, whether written or oral, if and to the extent that--

(A) the forward-looking statement is--

(i) identified as a forward-looking statement, and is accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement; or

(ii) immaterial; or

(B) the plaintiff fails to prove that the forward-looking statement--

(i) if made by a natural person, was made with actual knowledge by that person that the statement was false or misleading; or

(ii) if made by a business entity; was--

(I) made by or with the approval of an executive officer of that entity; and

(II) made or approved by such officer with actual knowledge by that officer that the statement was false or misleading.

(2) Oral forward-looking statements

In the case of an oral forward-looking statement made by an issuer that is subject to the reporting requirements of section 78m(a) **[*47]** of this title or section 78o(d) of this title, or by a person acting on behalf of such issuer, the requirement set forth in paragraph (1)(A) shall be deemed to be satisfied--

Because the Court finds that the oral and written forward-looking statements identified by Defendants [*48] included meaningful cautionary language, Defendants' state of mind is irrelevant. Therefore, the statements are entitled to protection under the PLSRA's safe-harbor provision.

d. Scienter

The only statements which remain viable and warrant further discussion are those related to AtriCure's marketing and promotion of its products, training of physicians, and the state of peer-reviewed literature addressing the use of Atri-Cure's products as of May 10, 2007.

As the Sixth Circuit has explained:

> Negligence alone on the part of a defendant cannot support a finding of scienter. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193, 200-01, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976). Recklessness, however, "is a sufficiently culpable state of mind for liability under *[section] 10(b)* and Rule 10b-5." *Mansbach v. Prescott, Ball & Turben*, 598 F.2d 1017, 1023 (6th Cir. 1979). This court has long defined recklessness as "highly unreasonable conduct which is an extreme departure from the standards of ordinary care. While the danger need not be known, it must at least be so obvious that any reasonable man would have known of it." *Id.* at 1025.

Konkol, 590 F.3d at 396; *see also* *Brown v. Earthboard Sports USA, Inc.*, 481 F.3d 901, 917-18 (6th Cir. 2007) [*49] (explaining scienter is limited to those highly unreasonable omissions or misrepresentations that involve not merely simple or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and that present a danger of misleading buyers or sellers which is either known to the defendant or is so obvious that the defendant must have been aware of it).

The Supreme Court has set forth three main principles for analyzing a Rule 12(b)(6) motion to dismiss a section 10(b) action. *Tellabs*, 551 U.S. at 322-23. First, as with any motion to dismiss for failure to plead a claim on which relief can be granted, a court must accept all factual allegations in the complaint as true. *Id.* at 322. Second, the inquiry "is whether all of the facts alleged, taken collectively, give rise to a strong inference of scienter, not whether any individual allegation, scrutinized in isolation, meets that standard." *Id.* at 322-23. Third, in determining whether the pleaded facts give rise to a "strong" inference of scienter, the court must take into account plausible opposing inferences. *Id.* at 323. The Court explained this third principle further:

> To determine whether the plaintiff has alleged [*50] facts that give rise to the requisite "strong inference" of scienter, a court must consider plausible nonculpable explanations for the defendant's conduct, as well as inferences favoring the plaintiff. The inference that the defendant acted with scienter need not be irrefutable, *i.e.*, of the "smoking-gun" genre, or even the "most plausible of competing inferences," . . . . Yet the inference of scienter must be more than merely "reasonable" or "permissible"-it must be cogent and compelling, thus strong in light of other explanations. A complaint will survive, we hold, only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged.

(A) if the oral forward-looking statement is accompanied by a cautionary statement--

(i) that the particular oral statement is a forward-looking statement; and

(ii) that the actual results might differ materially from those projected in the forward-looking statement; and

(B) if--

(i) the oral forward-looking statement is accompanied by an oral statement that additional information concerning factors that could cause actual results to materially differ from those in the forward-looking statement is contained in a readily available written document, or portion thereof;

(ii) the accompanying oral statement referred to in clause (i) identifies the document, or portion thereof, that contains the additional information about those factors relating to the forward-looking statement; and

(iii) the information contained in that written document is a cautionary statement that satisfies the standard established in paragraph (1)(A).

Id. at 323-24 (citation omitted).

With respect to AtriCure's marketing and promotion of its products and training of physicians, Defendants first argue that the DOJ investigation cannot support an inference of scienter. The Court agrees. *See* *Frank v. Dana Corp.*, 649 F.Supp.2d 729, 742 (N.D.Ohio 2009) (SEC investigation that has not resulted in charges or any finding of wrongdoing cannot support an inference of scienter).

Defendants next argue that the allegations [*51] concerning the confidential witnesses do not meet the particularity requirement imposed by the PSLRA and should not be afforded any weight. As one district court has explained:

> After *Tellabs*, courts must "discount allegations from confidential witnesses" if the plaintiffs do not provide enough information about the witnesses to assess the witness's basis of knowledge and veracity, or to determine what plausible opposing inferences the witness testimony may support. *Higginbotham v. Baxter*, 495 F.3d 753, 756-57 (7th Cir. 2007). "Vague and conclusory" statements by confidential witnesses add little to a scienter inference. *Ley [v. Visteon Corp.*, 543 F.3d 801, 811 (6th Cir. 2008)]. If plaintiffs identify the confidential witnesses with sufficient particularity and denominate "what, when, where, and how they knew" the alleged facts, confidential sources are not "altogether irrelevant." *Id.*

Frank v. Dana Corp., 649 F.Supp.2d 729, 747 (N.D.Ohio 2009).

The Court finds that the allegations in the Amended Complaint are sufficient in terms of detail:

> CW1 and CW6 stated that Defendants never marketed AtriCure's products for anything other than the treatment of AF. (Doc. 21, ¶¶54, 85.)
>
> CW1, CW2, and CW3 explained [*52] that AtriCure provided its sales associates with training programs, which were attended and observed by Drachman, as well as brochures and marketing materials which contained information explaining how AtriCure's products worked in the treatment of AF. (Id. ¶¶58-59, 64, 69)
>
> CW1 explained that AtriCure conducted weekly conference calls with sales associates and upper management, including Drachman, to discuss the marketing and sales of AtriCure's products for the treatment of AF. (Id., ¶60).
>
> CW5, who worked for Drachman, made arrangements for programs at which surgeons were trained to use AtriCure's products to treat AF. (Id., ¶¶ 78-87, 97.)
>
> CW6, a cardiothoracic surgeon, was trained and proctored by AtriCure's paid consultants in the use of AtriCure products to treat AF. (Id., ¶84, 86-87.)

Defendants argue that none of the confidential witness allegations give rise to an inference that the individual Defendants knew or were reckless in disregarding that AtriCure's marketing or training program was illegal or unlawful. The Court finds that this is not the proper inquiry. Instead, Plaintiffs must allege that Defendants knew that its statements that it did not promote its products for the [*53] treatment of AF or train doctors to use any of its products for the treatment of AF were false or misleading. As discussed above, the legality of AtriCure's marketing practices is not an issue in this case.

Defendants also argue that scienter cannot be based solely on the position held by an individual in the company or the individual's access to proprietary information. The Court agrees that such allegations *alone* cannot support a finding of scienter. *See* *PR Diamonds, Inc. v. Chandler*, 364 F.3d at 688 ("fraudulent intent cannot be inferred merely from the Individual Defendants' positions in the Company and alleged access to information. . . . the Complaint must allege specific facts or circumstances suggestive of their knowledge."). However, the confidential witness statements cite to specific instances where there were discussions regarding the marketing of AtriCure's products for use in treating AF. The statements also reference training programs for physicians, and CW6 allegedly was trained by physicians employed as consultants by AtriCure.

Finally, Defendants point out that Plaintiffs have failed to allege the existence of insider stock sales. However, this Court has held that the [*54] absence of such allegations is not dispositive. *See* *Huffy*, 577 F.Supp.2d at 991 ("As long as the inference of scienter from Plaintiffs' Amended Complaint is 'at least as compelling as any opposing inference of nonfraudulent intent' (*Tellabs*, 127 S.Ct. at 2505), it does not matter whether any one or more or all of the Defendants personally derived a benefit from the alleged scheme."). However, this Court has acknowledged that the existence or nonexistence of a personal benefit could certainly be important in determining whether a plaintiff has met the burden of pleading scienter. *Id.; see also* *Tellabs I*, 551 U.S. 325 ("While it is true that motive can be a relevant consideration, and personal financial gain may weigh heavily in favor of a scienter inference, . . . the absence of a motive allegation is not fatal."). Plaintiffs allege that Drachman and Piton profited personally from AtriCure's marketing activities because they received millions of dollars in option grants, performance share grants, bonuses and restricted shares that were dependent on AtriCure's financial results. (Doc. 21, ¶¶ 227-231.) The Court finds that this allegation weighs in favor of a finding that Plaintiffs have [*55] adequately pled scienter.

The Court recognizes that there are "plausible nonculpable explanations" for Defendant's conduct. There is no dispute that AtriCure was permitted to promote its products for general use, and physicians were able to use AtriCure's products for the treatment of AF. However, there are inferences favoring Plaintiffs as well. The statements of the confidential witnesses indicate that despite statements to the contrary, Defendants were marketing their products specifically for the treatment of AF, and AtriCure was training physicians in the use of their products for the treatment of AF. Furthermore, as alleged in the Amended Complaint, AtriCure consistently reported in its SEC filings, that "substantially all" of AtriCure's revenues are "generated through the non-FDA-approved, or off-label, use of our systems for the treatment of AF." (Doc. 21, ¶ 35.) This creates a motivation to promote AtriCure's products for the treatment of AF. Certainly nothing alleged by Plaintiffs is of the "smoking-gun" genre, but the Court finds that the inferences raised by Plaintiffs allegations regarding AtriCure's marketing and training programs are "cogent and compelling, thus strong [*56] in light of other explanations."

However, the Court does not reach the same conclusion with respect to the statements about the state of peer-reviewed literature addressing the use of Atri-Cure's products. Upon review of the Amended Complaint, the Court notes that Plaintiffs cite to a number of insurance companies which concluded that the state of peer-review literature was such that the minimally invasive procedure endorsed by AtriCure was still considered experimental. (Doc. 21, ¶ 49.) However, there is nothing pled with any specificity in the Amended Complaint which indicates that Defendants were aware of the conclusions of these insurance companies. Nor is there anything in the Amended Complaint which indicates that Defendants had made their own investigation of the peer-review literature or reached a conclusion contrary to the statements which were made. Therefore, the Court finds that Plaintiffs have failed to present allegations which give rise to a strong inference of scienter with regard to the statements regarding the state of peer-reviewed literature. Accordingly, these statements cannot support Plaintiffs' section 10(b) claim.

e. Loss causation

Under section 78u-4(b)(4) of the PSLRA, [*57] a plaintiff must prove that a defendant's securities fraud caused their economic loss. 15 U.S.C. § 78u-4(b)(4) ("[i]n any private action arising under this chapter, the plaintiff shall have the burden of proving that the act or omission of the defendant alleged to violate this chapter caused the loss for which the plaintiff seeks to recover damages."). A plaintiff must show "a causal connection between the material misrepresentation and the loss." *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 342, 125 S. Ct. 1627, 161 L. Ed. 2d 577 (2005); *see also* *D.E.&J Ltd. Partnership v. Conaway*, 284 F.Supp.2d 719, 748 (E.D.Mich. 2003) ("'loss causation' requires the plaintiff to point to some causal link between the alleged misrepresentations and a concrete decline in the value of the plaintiff's stock."). "Price inflation alone is insufficient; rather, a plaintiff must show that an economic loss occurred after the truth behind the misrepresentation or omission became known to the market." *Indiana State Dist. Council*, 583 F.3d at 944, *citing* *Dura*, 544 U.S. at 346-47.

Plaintiffs allege that AtriCure's share price fell nearly forty percent following the October 31, 2008 announcement that "[t]he DOJ is investigating the Company's [*58] marketing practices utilized in connection with its surgical ablation system to treat atrial fibrilation . . ." (Doc. 21, ¶ 205.)

Defendants argue that Plaintiffs cannot plausibly connect the decline in AtriCure's stock price following the announcement of the DOJ investigation to any fraud. Defendants explain that the October 31 press release merely announced the commencement of the investigation and was not a "corrective disclosure."

However, this Court has concluded that "where the Plaintiffs allege that the subject of the misrepresentations and omissions caused their losses, they need not specify 'corrective disclosures' causing the decline in stock value." *In re Cardinal Health Inc. Securities Litigations*, 426 F.Supp.2d 688, 760 (S.D.Ohio 2006) (and cases cited therein). Here, Plaintiffs allege that Defendants made false statements regarding their marketing of the products for the treatment of AF. The October 31 press release revealed that the DOJ was investigating those very statements. The market reacted immediately with a drop in AtriCure's stock price. The Court finds that this is sufficient to show that "economic loss occurred after the truth behind the misrepresentation or [*59] omission became known to the market." Therefore, the Court finds that Plaintiffs have adequately pled loss causation.

E. Section 20(a) claim

Section 20(a) imposes secondary liability on the "controlling person" in a company for Rule 10b-5 violations:

> Every person who, directly or indirectly, controls any person liable under any provision of this title or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such control person is liable unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

15 U.S.C. § 78t(a).

Defendants argue that Plaintiffs' section 20(a) claims against Defendants Drachman and Piton fail because Plaintiffs cannot simultaneously assert claims against Defendants for primary and secondary violations of securities laws. Defendants cite to dicta in a footnote in the Sixth Circuit's decision in *PR Diamonds, Inc. v. Chandler*: ″Without deciding the question, we note that some authority suggests that a plaintiff may not be able simultaneously to assert both *Section 10(b)* and Rule 10b-5 [*60] claims and Section 20(a) claims against the same defendant.″ 364 F.3d at 697, n.4. However, this Court has permitted claims based upon primary and secondary liability to go forward. *See In re Cardinal Health Inc.*, 426 F.Supp.2d at 762; *In re National Century Financial Enterprises, Inc., Investment Litigation*, 2006 U.S. Dist. LEXIS 16612, 2006 WL 469468, *24 (S.D.Ohio Feb. 27, 2006) (″The Court will allow MetLife and Lloyds to pursue both their *§ 10(b)* and their § 20(a) claims against Poulsen at this time. Under Rule 8(e)(2) [sic], Fed.R.Civ.P., plaintiffs may plead alternate legal theories 'regardless of consistency.'″).

Next, Defendants argue that Plaintiffs have failed to allege ″culpable participation″ in the underlying *section 10(b)* violation. In *In re National Century Financial Enterprises, Inc.*, this Court has explained that ″[c]ourts use different tests in determining whether a plaintiff has sufficiently alleged the element of control in a Section 20(a) claim,″ and this area of the law is unsettled. 504 F.Supp.2d 287, 301 (S.D.Ohio 2007). This Court explained that the ″culpable participation″ test used by the Second Circuit is the most rigorous standard employed. *Id.* This Court noted that the Sixth Circuit [*61] has not adopted a test for liability as a controlling person. *Id.* at 303. After a careful review of caselaw within this Circuit, this Court adopted the following test: ″a Section 20(a) plaintiff must allege only the power to control, and not an actual exercise of control, in order to survive a motion to dismiss.″ *Id., citing In re Enron Corporation Securities, Derivative & ERISA Litigation* (Enron II), 2003 U.S. Dist. LEXIS 1668, 2003 WL 230688, *12 (S.D. Tex. Jan. 28, 2003) (unpublished). In addition, this Court concluded that the heightened pleading standard which applies to section 20(a) claims does not apply to section 10(b) claims. *Id.* (explaining that a majority of courts have concluded that Rule 8(a) applies to controlling person claims and therefore the complaint need only contain a ″'short plain statement of the claim showing that the pleader is entitled to relief.'″).

The Court finds that Plaintiffs have adequately alleged that Defendants Drachman and Piton had the ″power to control.″ In the Amended Complaint Plaintiffs allege that: (1) Drachman and Piton were high-level executives and/or directors at the Company during the Class Period and members of the Company's management team or had control thereof; [*62] (2) each of these defendants, by virtue of their responsibilities and activities as a senior officer and/or director of the Company, was privy to and participated in the creation, development and reporting of the Company's internal budgets, plans, projections and/or reports; (3) each of these defendants enjoyed significant personal contact and familiarity with the other defendants and was advised of, and had access to, other members of the Company's management team, internal reports and other data and information about the Company's finances, operations, and sales at all relevant times; and (4) Defendants Drachman and Piton were aware of the Company's dissemination of information to the investing public which they knew and/or recklessly disregarded was materially false and misleading. (Doc. 21, ¶ 245.) Accordingly, the Court DENIES Defendant's Motion to Dismiss the Section 20(a) claims against Defendants Drachman and Piton.

III. CONCLUSION

Based on the foregoing, it is hereby **ORDERED** that:

1. Plaintiffs' Motion to Strike Defendants' Affidavits of Confidential Witnesses (Doc. 35) is **GRANTED**;

2. Defendants' Motion to Dismiss (Doc. 26) is **GRANTED in PART and DENIED in PART**.

   a. Plaintiffs' section 10(b) [*63] claims shall proceed in accordance with the rulings in this Order.

   b. Plaintiffs' section 20(a) claims against Defendants Drachman and Piton shall proceed in accordance with the rulings in this Order.

IT IS SO ORDERED.

/s/ Michael R. Barrett

Michael R. Barrett, Judge

United States District Court

2011 WL 4594845
Only the Westlaw citation is currently available.
NOT FOR PUBLICATION
United States District Court,
D. New Jersey.

In re ANADIGICS, INC.,
SECURITIES LITIGATION.

Civil Action No. 08–5572
(MLC). | Sept. 30, 2011.

Attorneys and Law Firms

Joseph J. Depalma, Katrina Carroll, Lite, Depalma, Greenberg, LLC, Newark, NJ, Jeffrey W. Herrmann, Cohn Lifland Pearlman Herrmann & Knopf LLP, Saddle Brook, NJ, Peter L. Masnik, Kalikman and Masnik, Haddonfield, NJ, Olimpio Lee Squitieri, Squitieri & Fearon, LLP, Jersey City, NJ, for Plaintiffs.

Robert A. Alessi, Amy D. Lamberti, Mary McCann, Cahill Gordon & Reindel LLP, New York, NY; John L. Thurman, Farrell & Thurman, PC, Skillman, NJ, for Anadigics, Inc., Thomas C. Shields, and Bamdad Bastani, Defendants.

MEMORANDUM OPINION

COOPER, District Judge.

***1** Plaintiffs bring this putative class action against defendants, Anadigics, Inc. ("Anadigics"), Bamdad Bastani ("Bastani"), and Thomas C. Shields ("Shields" and together with Bastani, "Individual Defendants") (collectively, "Defendants"), on behalf of all buyers of Anadigics's publicly traded securities between February 12, 2008, and August 7, 2008 (the "class period"). (Dkt. entry no. 68, 2d Am. Compl. at ¶ 1.) [1]

1 Although Plaintiffs style the current pleading under consideration as the "First Amended Class Action Complaint for Violations of Federal Securities Laws," they were instructed, pursuant to a Stipulation and Order entered on 8–10–10, to file a "Second Amended Complaint." (Dkt. entry no. 66, 8–10–10 Stip. & Order at 2.) Because plaintiffs have previously filed a Complaint (dkt. entry no. 1) and a Consolidated Class Action Complaint (dkt. entry no. 52) which was, for all intents and purposes, an amended complaint, we will refer to the current Complaint as the "Second Amended Complaint" insofar as it constitutes the third pleading by plaintiffs. (*See* dkt. entry no. 43, 9–15–09 Stip. & Order at 2 (granting leave to plaintiffs to file a "Consolidated Amended Complaint").)

Plaintiffs allege that Defendants violated Section 10(b) of the Securities Exchange Act of 1934 ("1934 Act"), 15 U.S.C. § 78j(b), and Securities Exchange Commission Rule 10b–5 ("Rule 10b5"), 17 C.F.R. § 240.10b–5. (*Id.* at ¶¶ 202–211, 214–221.)Plaintiffs also allege that the Individual Defendants violated Section 20(b) of the 1934 Act, 15 U.S.C. § 78t(a), as control persons of Anadigics. (2d Am. Compl. at ¶¶ 223–225.) The Second Amended Complaint alleges that Defendants misled investors about Anadigics's capability to meet demand for its products.

Defendants move to dismiss the Second Amended Complaint pursuant to Federal Rule of Civil Procedure ("Rule") 9(b) and the Private Securities Litigation Reform Act of 1995 ("PSLRA"), Section 78u–4 *et seq.* (Dkt. entry no. 69, Mot. to Dismiss.) Plaintiffs cross-move to strike the Appendices submitted by Defendants in support of Defendants' motions to dismiss the Consolidated Class Action Complaint and the Second Amended Complaint, as well as certain exhibits attached to the affidavits of Robert A. Alessi dated December 3, 2010, and December 23, 2009. (Dkt. entry no. 71, Cross Mot. to Strike; dkt. entry no. 69, Defs. Br., App'x A (discussing 15 sets of Anadigics statements identified in the Second Amended Complaint as "Defendants' Materially False and Misleading Statements and Omissions"); dkt. entry no. 69, 12–3–10 Alessi Aff.; dkt. entry no. 54, 12–23–09 Alessi Aff.) For the reasons stated herein, the Court will grant the motion and deny the cross motion.

BACKGROUND

A. Anadigics's Business

Anadigics designs and manufactures radio frequency integrated circuits, primarily using gallium arsenide semiconductor materials, for the wireless broadband and cable infrastructure markets. (2d Am. Compl. at ¶ 2.) Its main products are power amplifier modules, which are used in wireless handsets, WiFi routers for computers, and cable set-top boxes. (*Id.*) During the class period, Bastani served as Anadigics's President, Chief Executive Officer, and a director, and Shields served as Anadigics's Chief Financial Officer and Executive Vice President. (*Id.* at ¶¶ 27–28.)

1. Demand Increase and Manufacturing Capacity "Ramp–Up"

Anadigics's manufacturing operations took place in its Warren, New Jersey, fabrication facility (the "fab").(*Id.* at ¶ 2.) Demand for Anadigics's products increased in early 2007, as the wireless handset industry began to transition from second-generation cell phones to third-generation ("3G") technology utilizing compound (as opposed to silicon) semiconductor chips such as those manufactured by Anadigics. (*Id.* at ¶ 8.) In an effort to meet rising customer demand, Anadigics began to "ramp up" its manufacturing capacity to increase production. The "ramp up" process involved both increasing production at the Warren fab, which was allegedly not operating at its full capacity, as well as construction of a new fab in China. (*Id.* at ¶¶ 8, 63–64, 67–69.)The "ramp up" process was initially hindered by the lack of a key manufacturing tool, a "via etcher." (*Id.* at ¶ 9.) Additional via etchers were not ordered until January 2008, with a delivery time of approximately six months, such that production at the fab was constrained by the limited number of via etchers then on hand (the "via etcher problem").(*Id.*)

***2** The Second Amended Complaint alleges a situation in which Anadigics was unable to meet increasing demand for its products, to which customers responded by "dual sourcing" or "double ordering" products, meaning such customers would simultaneously place identical orders with both Anadigics and a competitor in hopes of receiving the products from one of them in a timely fashion. (*Id.* at ¶¶ 12–13, 81, 101.)Customers also allegedly engaged in "over-ordering" when Anadigics was unable to fill orders completely, in hopes of getting a larger proportion of available inventory. (*Id.* at ¶¶ 15, 106.)Plaintiffs claim that Defendants were aware of this situation, yet continued to assure the market that Anadigics was poised to capitalize on the increased demand for its products and would continue to gain market share vis-a-vis its competitors.(*Id.* at ¶ 16.)

2. The Intel Yield Problem

At the beginning of 2008, Anadigics employees discovered a yield problem with respect to wireless devices it was manufacturing for Intel, allegedly one of Anadigics's most important customers: as many as 50% of the devices were failing in late-stage testing, rather than the anticipated failure rate of 10% (the "Intel yield problem").(*Id.* at ¶ 10.)Because of the 16–week lead time required for the manufacturing process, this yield problem led to a failure to ship the devices to Intel on time, and Anadigics diverted manufacturing capacity to Intel orders at the expense of other customers. (*Id.* at ¶¶ 10–11.)This allegedly caused Anadigics to "short" the orders of other important customers, including LG Electronics Inc. ("LG") and Samsung Electronics Co. ("Samsung"). (*Id.* at ¶¶ 11, 49, 66.)LG and Samsung allegedly began dual sourcing in the first quarter of 2008, whereas prior to that, both had used Anadigics as their sole source. (*Id.* at ¶ 99.)Plaintiffs complain that even though Defendants were aware of their manufacturing capacity problems, Bastani "repeatedly told customers that Anadigics would be able to fill their orders even when production managers told him there was simply not enough capacity in the fab, given the lack of via etchers and the diversion of capacity to Intel," to support such commitments. (*Id.* at ¶ 14.)Eventually, even these assurances did not suffice to retain existing customers after Anadigics failed to fill firm orders on time, and Anadigics lost market share to its competitors by the end of 2008. (*Id.* at ¶¶ 108–114.)

B. The Allegedly Fraudulent or Misleading Statements

1. February 12, 2008 Press Release

The class period relevant to this action began on February 12, 2008, when Anadigics issued a press release touting the growth in demand from its wireless customers and its ability to meet that increased demand. (*Id.* at ¶ 116.)In that press release, Bastani stated that Anadigics was "working to build further market share with [its] top-tier customers" and "we continue to improve our manufacturing efficiencies and our production capacity plans continue to progress through equipment expansion in our New Jersey fab, qualifying external foundries and building our next fab in China."(*Id.;* 12–23–09 Alessi Aff., Ex. 23, 2–12–08 Press Release.) The February 12, 2008 Press Release contains the following cautionary language: "The statements regarding outlook are forward looking and actual results may differ materially. Please see safe harbor statement at the end of the press release."(2–12–08 Press Release at 2.) [2]

2 The "Safe Harbor Statement" advises:

> Except for historical information contained herein, this press release contains projections and other forward-looking statements 6 (as that term is defined in the Securities Exchange Act of 1934, as amended). These projections and forward-looking statements reflect the Company's current views with respect to future events and financial performance and can generally be identified as such because the context of

the statement will include words such as "believe," "anticipate," "expect," or words of similar import. Similarly, statements that describe our future plans, objectives, estimates or goals are forward-looking statements. No assurances can be given, however, that these events will occur or that these projections will be achieved and actual results and developments could differ materially from those projected as a result of certain factors. Important factors that could cause actual results and developments to be materially different from those expressed or implied by such projections and forward-looking statements include those factors detailed from time to time in our reports filed with the Securities and Exchange Commission, including the Company's Annual Report on Form 10–K for the year ended December 31, 2006, and those discussed elsewhere herein.

(2–12–08 Press Release at 2.)

***3** Plaintiffs allege that this statement was false and misleading because Bastani allegedly had been informed that Anadigics's most important wireless handset customers were dual sourcing and, as a result, Anadigics was losing market share. (2d Am. Compl. at ¶ 117 .)

2. February 12, 2008 Earnings Call

Bastani conducted an earnings call, also on February 12, 2008, to discuss the fourth quarter of 2007, in which he allegedly misleadingly denied that Anadigics's customers were over-ordering product. The transcript of that earnings call shows the following exchange:

John Pitzer [Credit Analyst, Credit Suisse]—Concept[u]ally whenever a key supplier's capacity constrained customers often times order more than they need in hopes of getting what they can. How do you manage against that risk? And I guess at what point do you feel your capacity growth starts to meet the expected demand curve that we have to worry about, maybe the demand curve being overheated because of tight capacity?

Bami Bastani—Let me answer that from one or two different angles. In terms of over ordering in our interactions with our customers, we believe they are running very lean in their channels too, in a sense that we have very tight communication between us and between them on [ ] adjusting time deliveries. So, I do not see where we are today, any of them have over ordered. And now, in terms of would there be a possibility as they look at Q1 or Q2, they would like to build some buffer inventories, they might. And I'm sure they would like to. But again, we have kind of [engaged] our capacity growth to the point that we know what they want and what we can serve and we work very close hand-in-glove with them to meet their demand. At this point in time, based on the visibility I have, I do not see that as an issue.

(*Id.* at ¶ 18; 12–23–09 Alessi Aff., Ex. 24, 2–12–08 CallStreet Tr. at 18–19; *accord* dkt. entry no. 72, Gardner Decl., Ex. A, 2–12–08 Thomson Tr. at 24–25.)[3] Bastani also made statements addressing Anadigics's efforts to increase manufacturing capacity:

3 Defendants' motion cites transcripts of earnings calls that were prepared by CallStreet, whereas Plaintiffs rely on alternative transcripts published by Thomson StreetEvents for purposes of both the Second Amended Complaint and their opposition to Defendants' motion to dismiss. (*See* dkt. entry no. 72, Pls. Opp'n at 26 n. 16; *id.*, Gardner Decl., Exs. A–D (Thomson transcripts of earnings calls dated 2–12–08, 4–22–08, 7–22–08, and 8–8–08).) In setting forth the allegations in the Second Amended Complaint, the Court has attempted to provide citations to both versions of the relevant transcript, because the Court has expanded upon some of the statements contained in the Second Amended Complaint in order to adhere to the rule of completeness. *See*Fed.R.Evid. 106. Where the transcripts differ or the cited transcript contains obvious incongruities or transcription errors, the Court has provided the alternative transcription in brackets.

We will continue to work directly with our customers on meeting their increased demands for our products and while we continue to operate with very lean inventory levels in finished goods, our increased production capacity plans continue to progress forward through continuous improvement in manufacturing efficiencies, operations of staffing, additions, and equipment expansions in New Jersey fab as well as engaging qualifying external foundries and building our next fab in China.

(2d Am. Compl. at ¶ 120; 2–12–08 CallStreet Tr. at 5; *accord* 2–12–08 Thomson Tr. at 4.)

Plaintiffs allege that Bastani's statements in response to the question about over-ordering were false and misleading because Bastani knew about the constraints on capacity imposed by the lack of via etchers, had diverted capacity to filling Intel orders at the expense of other customers, and was aware that wireless handset customers had begun dual sourcing due to Anadigics's failure to fill firm orders on time. (2d Am. Compl. at ¶ 119.) Plaintiffs argue that the statement about "increased production plans" was misleading because Bastani knew at the time of that statement that the fab was operating at maximum possible capacity. (*Id.* at ¶ 121.)

***4** Plaintiffs also allege that the Individual Defendants made material omissions during the February 12, 2008 Earnings Call when asked directly about the Intel yield problem, by failing to inform the market that the diversion of production capacity to Intel was causing Anadigics to miss orders for its wireless handset customers and, in turn, causing those wireless handset customers to dual source:

> John Lau [Analyst, Jeffries and Company]—And, okay, none of that implies any yield problems. So I guess we are, you are pretty comfortable with your yield progress in the product lines?
>
> Thomas Shields—John, this is Tom. To your point and a reference made earlier was that we believe we're one of the best relative to our manufacturing operations and yield. So it's not a material number relative to the total gross margin. Relative to the gross margin that we're talking about is you hit the relative items that are causing the change from Q4 to Q1.
>
> John Lau—Great. And then the final point is that a lot of concerns with regards to the Intel business that you have and Bami had indicated that your relationships are very good and that your visibility continues to improve with work on them. Do you believe—I know it's hard to give full, very detailed guidance, but Bami and Tom, do you believe your Intel business will grow year-over-year in that area?... [D]o you have enough visibility into the design shift to know that yet?
>
> Bami Bastani—It just falls along the conversation that, or the comments that Tom made, John that we are not giving annual or beyond Q1 guidance. However, in my prepared remarks I made a comment that looking into the business as it shapes up into Q2 wireless LAN is absolutely one of the strengths.

(*Id.* at ¶ 125; 2–12–08 CallStreet Tr. at 12; 2–12–08 Thomson Tr. at 14.)

3. February 29, 2008 Form 10–K

Anadigics filed its Form 10–K for fiscal year 2007 on February 29, 2008. (12–23–09 Alessi Aff., Ex. 25, 2–29–08 Form 10–K.) Plaintiffs allege that the Individual Defendants "misleadingly omitted to inform the market" in the 2–29–08 Form 10–K that the "ramp up" had been delayed due to the fab's lack of via etchers, and the fact that production could not be increased until such via etchers were delivered and installed in summer 2008. (2d Am. Compl. at ¶¶ 128–129.) Plaintiffs identify the following statement as false or misleading:

> At December 31, 2007, the Company had unconditional purchase obligations of approximately $20.3 million, of which $17.6 million relates to capital equipment purchase requirements primarily over the first half of 2008. Such capital purchase requirements will serve to increase the installed equipment capacity of the Company's manufacturing operations in response to increases in customer demand for the Company's products.

(2–29–08 Form 10–K at 25.)

4. April 22, 2008 Earnings Call

Defendants conducted an earnings call to discuss the first quarter of 2008 on April 22, 2008. Plaintiffs allege that the Individual Defendants "misleadingly touted the Company's ability to meet their customers' demand while omitting information about the fab's equipment constraints," specifically (1) the via etcher problem and (2) the Intel yield problem. (2d Am. Compl. at ¶ 130; 12–23–09 Alessi Aff., Ex. 27, 4–22–08 CallStreet Tr. at 9.) The 4–22–08 Earnings Call stated in relevant part:

> ***5** George Iwanyc [Analyst, Oppenheimer & Co.]—At this point are you meeting full customer demand[?][A]re you still constrained in some cases?
>
> Bami Bastani—Given that—one of the things I talked about is we've had a lot of high level relationship discussions with our customer. So basically we have matched our expectations and their expectation. And part of that is of course driving gross margin and driving high-end phones. So [where] we care, answer is yes, we are perfectly aligned. Where there is low end phone for some developing market, we have basically said given those to our competitors. So we have been aligning our strategies very well with our partners and our customers and they are being happy and now we are happy.

(4–22–08 CallStreet Tr. at 9; Gardner Decl., Ex. B, 4–22–08 Thomson Tr. at 10.) Plaintiffs allege that Bastani's response to this question was "materially false and misleading" because Bastani knew at the time that "Anadigics had lost all credibility with its wireless handset customers" and, contrary to Bastani's assertions, customers were dual sourcing their orders as opposed to being "perfectly aligned" and happy with Anadigics. (2d Am. Compl. at ¶ 131.)

During the same earnings call, Bastani allegedly denied that Anadigics had lost business from Samsung:

> Aalok Shah [Analyst, D.A. Davidson & Co.]—[O]ne specific competitor has been talking about taking some shares of Samsung because the current [incumbent] doesn't have the full suite of products for [a] front end module. My guess is they're referring to you, can you give me a sense Bami what they are talking about, number one?
>
> Bastani—Yeah, let me just answer the first concern that you raised, frankly I don't believe I am losing anything to anybody, there is just so much demand out there, there is plenty to go around for everybody. I hope everybody gets a piece of it. Certainly, as you can see from our growth we are riding the wave in a very strong way.... So today we are getting more than our fair share of whatever we produce today.
>
> ... [9 pages later]
>
> Bastani [closing remarks]—[F]or those of you who follow us and there has been relentless rumors left and right about market share gain and loss and things like that [by] our peers, [by] our competitors, but some analysts have faith in us [and] I don't know of any company that has delivered 12 consecutive quarters of growth that is market share and have guided to the 13th, [there is] a competitiveness in our DNA. Our leadership is validated by the success of our products, our strong financial performance and our Q2 guidance momentum as we work towards delighting our customers and creating value for our shareholders. Thank you very much.

(4–22–08 CallStreet Tr. at 10, 19.) Plaintiffs allege that these statements by Bastani were false and misleading because "Bastani knew that Samsung had downgraded Anadigics to a 'D' rating, meaning that it had internally decided to stop using Anadigics as a supplier, and was sourcing from [Anadigics's] competitors."(2d Am. Compl. at ¶ 133.)

***6** Shields also participated in the April 22, 2008 Earnings Call. Plaintiffs highlight the following passage:

> Thomas Shields—This is Tom. I would just add that the revenue that we reported was very important in the eyes of our customers. Because it actually demonstrated that yeah we may have had issues where we—haven't had finished goods at the start of the quarter. [What it basically tells you is] that cycle time is improving and really gaining the confidence of the customers relative to the shipments going forward.... Obviously just look at our customer base today and we've also been discussing and while we haven't any press release to comment on relative to additional customers and wireless stage—we've been growing relative share with our customers. So as we look at the perhaps the platform to be shifting [shipped in] the second half is [an] opportunity for us to continue to gain share.

(2d Am. Compl. at ¶ 134; 4–22–08 CallStreet Tr. at 14; 4–22–08 Thomson Tr. at 16.) Plaintiffs allege Shields's statement was false and misleading because he allegedly knew that wireless handset customers were resorting to dual sourcing from Anadigics's competitors, and Anadigics was losing market share as a result. (2d Am. Compl. at ¶ 135.)

5. July 22, 2008 Press Release

Anadigics issued a press release on July 22, 2008, announcing its second quarter 2008 results and stating that "[t]he low end of the net sales guidance [range of $75.0 million to $81.0 million] reflects softness in industry demand and inventory re-balancing that may occur in the third quarter 2008 from our Wireless customers."(2d Am. Compl. at ¶ 144; 12–23–09 Alessi Aff., Ex. 30, 7–22–08 Press Release at 1.) The 7–22–08 Press Release also quotes Bastani as saying:

> As we enter the third quarter 2008, Broadband will continue to have strong momentum, which will partially offset an expected decline in Wireless as certain of our customers have lowered their

> demand expectations and are reducing inventory levels. However, we believe this to be temporary as design-in activity has increased and therefore, are aggressively pursuing our capacity expansion plans in China to meet future demand.

(*Id.*) Plaintiffs allege that this statement was materially false and misleading because Bastani allegedly knew that the decreased demand was a direct result of Anadigics's inability to fill its wireless handset customers' firm orders and concomitant loss in market share. (2d Am. Compl. at ¶ 145.) Plaintiffs also claim Bastani misleadingly failed to disclose to the market that Anadigics's inability to fill orders was due to (1) lack of via etchers at the fab, and (2) diversion of manufacturing capacity to resolve the Intel yield problem. (*Id.*)

6. July 22, 2008 Earnings Call

Plaintiffs allege that during a July 22, 2008 earnings call, Bastani "continued to falsely attribute the drop in wireless handset demand as excess inventory on the part of the Company's customers," and failed to acknowledge that the real reason for declining demand was allegedly loss of market share:

> ***7** Bami Bastani—Back to our business outlook, we are seeing strength in broadband and some softness in wireless sector as we enter[ ] the second half of '08. At present we believe the softness in wireless is more [of a Q3] phenomenon as customers have been building up inventory in the channel and in critical components such as PAs.
>
> ... [several pages later]
>
> John Lau—Then finally just as a follow-up, I think that we'll clarify the wireless commentary that you had[,] you mentioned the weakness that you had. Bami, if you can kind of put it in a different way, how much of that wireless weakness that you're seeing in Q3 is more related to the end-market versus an inventory correction at a specific vendor?
>
> Bami Bastani—John, I can't quantify the two but I know, for example in China we have both of it going ...
>
> John Lau—I see.
>
> Bami Bastani—... and on the other side in Korea it is more of a market correction.
>
> John Lau—Okay. So there is a [factor] of both in there and it is not a market share loss issue, but just a combination of the inventory correction and the overall macro?
>
> Bami Bastani—The answers, those are the primary. We did turn over some socket to competitors because we just couldn't fill the prescription, right? But we are engaged in every design that goes on right now. So, that is why for us having that capacity is critical.
>
> I mean that the number one thing that people ask is-we are investing to reap the benefits of our strong market position. If we didn't have a strong market position, we wouldn't be investing.

(2d Am. Compl. at ¶ 146; 12–23–09 Alessi Aff., Ex. 31, 7–22–08 CallStreet Tr. at 4, 11–12; Gardner Decl., Ex. C, 7–22–08 Thomson Tr. at 4, 15.)

Plaintiffs contend that Bastani's statements during the 7–22–08 earnings call were false and misleading because he knew that decreased demand by wireless handset customers was not due to "inventory correction" or "macro" economic conditions, but rather because of the dual sourcing and loss of market share. (2d Am. Compl. at ¶ 147.)

Plaintiffs also point to the following statement by Bastani as being false and misleading for the same reasons:

> George Iwanyc—[That] softness you are seeing. Can you give us an idea of how widespread is it? Is it across the customer base or is that one or two customers that you are seeing the weakness at?
>
> Bami Bastani—The weakness[es] we have seen are no different than what has already been talked in the industry, one of the large Korean customers, for example, is cutting inventory in half, the other one already announced a phenomenal Q2 and guided to Q3. We see some weakness also in China customers. So I think that none of them are out of the order rate that has already not been announced the marketplace by the analysts before.
>
> George Iwanyc—Okay. And what signs do you see that gives you confidence that the trends are temporary?
>
> Bami Bastani—If I look at our fourth-quarter backlog, quarter to date for fourth quarter, we are running stronger

than last year, quarter to date, on the wireless backlog. So I think what is happening, that is [my] personal view, or our view, in a sense that these things kick in in September, October timeframe generally. And we are all going to wait and see to see what is the shape of that in terms of the preparation for fourth quarter, which third quarter—which September—is [the] beneficiary. On the other side we see a lot of designing activities for our products, so we are very highly engaged with our existing customers plus some new ones as we mentioned. So the designing activity plus the stuff that is already pre-positioned itself in the fourth quarter gives us that confidence.

***8** (2d Am. Compl. at ¶ 148; 7–22–08 CallStreet Tr. at 5; Gardner Decl., 7–22–08 Thomson Tr. at 4–5.) Plaintiffs further allege that on the same earnings call, Shields also falsely stated that the drop in demand was due to a customer "inventory issue," as opposed to loss of market share:

Edward Snyder [analyst]—... [W]hen you go back to your customers and say, look your forecasts are one thing, your order books are another, what do they tell you, why did they see it as a slowdown now and why did—do you think it is going to be temporary?

Thomas Shields—Well, first of all, I just look at Samsung and Samsung has said that they still envision doing 200 million units for the year, while they may have been down from Q1 to Q2 and they're still probably suggesting [200 million], or if not better. So unless they come back to the Street and tell the folks that it is going to be less than 200 [million], the[re's] reason to believe that—based upon our share—that we should be a recipient of some nice growth.

So there are certain indications at least that when we sit down with customers that could call for better performance. Now obviously we are cautious just like the next guy because sometimes [things do] take one [or] two quarters to correct itself. So, yes, in fact it is at really an inventory rebalancing as one customer has indicated, yes, therefore does that mean then you lose a temporary inventory bill for [a] certain month, however we know we're entering the holiday trade season.

So the question is they are probably looking at the market from a consumer side and say hey, what's the market going to look like? So we believe that it's going to be—maybe it is not a September p[u]ll maybe becomes a[ ] very strong October, that's the question mark. So I think the direct correspondence relative [to] what the customer is suggesting then also hinting the same time relative to certainly some weaknesses that may occur. But on the surface we are following the market.

(2d Am. Compl. at ¶ 150; 7–22–08 CallStreet Tr. at 6; 7–22–08 Thomson Tr. at 6.)

Plaintiffs further point to statements by the Individual Defendants regarding Anadigics's capacity to meet demand as false and misleading due to their failure to acknowledge that the additional via etchers would not be delivered and brought online until September 2008 at the earliest:

Bami Bastani—On the other side, Ed, as we experienced last year when these guys turn on a dime, they turn on a dime, so you better be prepared serving them. So you cannot go cautious on your ability to serve them.

Edward Snyder—This is why you are continuing with it?

Bami Bastani—Exactly.

Edward Snyder—Obviously a long-term forecast is still very robust and Nokia did talk pretty positively about the overall demand for the industry this year from a guidance [standpoint] and you are expecting it's going to snap back just as quick once you had this—

Bami Bastani—So you have to be ready.

***9** Edward Snyder—Okay.

Thomas Shields—And we made our commitment to our customers to do that.

Edward Snyder—Say that again, I'm sorry Tom?

Thomas Shields—We made the commitment to make sure that we are going to be there when that demand surge potentially happens.

(2d Am. Compl. at ¶¶ 152–153; 7–22–08 CallStreet Tr. at 7; 7–22–08 Thomson Tr. at 7.)

Plaintiffs allege that Bastani also falsely stated during the July 22, 2008 earnings call that Anadigics's supply problems were a problem of the past, omitting to inform the market that the fab would continue to be constrained through summer 2008:

Aalok Shah [Analyst, D.A. Davidson & Co.]—... Bami, you mentioned that you just don't have the capacity to meet some of the demand out there. Is that all on the 3G side of things right now? Or is that some other legacy as well?

Bami Bastani—Well that was a comment about the past. That was like a Q4 [2007], Q1 [2008] comment. We have shipped a lot of the stuff.

(2d Am. Compl. at ¶¶ 154–155; 7–22–08 CallStreet Tr. at 12; 7–22–08 Thomson Tr. at 16.)

The final statements alleged by Plaintiffs to be false or misleading were made by Bastani (1) to analyst John Pitzer, and (2) to conclude the call:

John Pitzer—... Thanks for taking my questions—a lot of them have been answered. But I guess to the extent that you guys have been managing a fairly tight capacity situation over the last couple of quarters, can you help me understand that, how that progressed through the June quarter, whether it would be customers and allocation, lead times to customers, your ability to compete for incremental design sockets?

Bami Bastani—Yeah, in Q2, demand and supply were pretty much in balance. So it is where I like to put it. We saw the—areas that we saw a lot of pull-ins was primarily in the broadband area. And it included WiFi, it included FiOS, it included DOCSIS 3.0, so a lot of it was new products and then new things coming to market, and then we saw pull-ins extend that it was within our lead time, of course, we served them to the extent that—it still takes about 10 to 12 weeks to get thin[g]s out of [fab] and into the assembly and testing [and] ship[ped] to customers. And to an extent that it wasn't within the 10 to 12 week lead time, we had to [start] Q3. So—but broadband across-the-board was, the story was more pull-in oriented than anything it has been in the past year.

John Pitzer—Just to be clear[,] to the extent that one of the concerns has been your lack of supply kind of opening the door for incremental competition. You don't think that was the case in the June quarter. You think, your supply got up to demand?

Bami Bastani—Yes, yes.

...

Bami Bastani [to conclude earnings call after conclusion of questions]—So let me recap by saying broadband is robust and growing sequentially and literally in all fronts. Wireless is sequentially down. We believe that's primarily due to softness in the market and some inventory correction at customers. Our relationships are very strong. This includes QUALCOMM, Intel, Motorola, Cisco. We have brought new customers [ ] such as RIM, and [a] good set of ODMs. We are investing in the future. We have a positive longterm outlook and we'd like to invest to reap the benefits of our strong market position. And that reflects in our China build-out plan that we discussed in very [great] detail today. Thank you very much for being with us.

***10** (2d Am. Compl. at ¶ 156; 7–22–08 CallStreet Tr. at 16–17, 18; 7–22–08 Thomson Tr. at 22–24.) Plaintiffs allege that these statements were false and misleading insofar as they omitted that customers were dual sourcing, and Samsung had allegedly "by April 2008, given Anadigics a 'D' rating and was no longer using the Company as a supplier."(2d Am. Compl. at ¶ 157.)

C. Post–Class Period Allegations

The class period proposed by Plaintiffs ended August 7, 2008. Plaintiffs allege that on that date, Anadigics issued a press release lowering third quarter 2008 financial guidance due to "a decrease in product demand from its wireless handset customers" and announcing that the planned acceleration of capital investment in the China fab would be delayed. (2d Am. Compl. at ¶ 165; 12–23–09 Alessi Aff., Ex. 37, 8–7–08 Press Release.) This press release was followed on August 8, 2008, by an analyst call, during which Bastani announced that demand for Anadigics's products had decreased in the wireless handset market because many customers were "carrying more inventory than we thought," which Bastani stated "may be attributed to over-ordering to build buffer inventory and/or some share loss."(12–23–09 Alessi Aff., Ex. 38, 8–8–08 CallStreet Tr. at 1; Gardner Decl., Ex. D, 8–8–08 Thomson Tr. at 2; *see also* 2d Am. Compl. at ¶ 166.) Bastani acknowledged during this call that dual sourcing had occurred in the first and second quarters of 2008:

Cameron Wright [Analyst, J. Fishman Limited]—Did you verify the numbers your customers are giving you at all or didn't they just ... [not] show up as expected[?] I don't quite understand what happened between not expecting double ordering to happen, you didn't expect it two quarters ago and now ... if I go back to your Q4 revenue you're talking, it was at 15% of that, was it all double orders, I mean[?]

Bami Bastani—No, Q4 revenue, everything was consumed in Q4.

Cameron Wright—So the double ordering came from Q1, Q2?

Bami Bastani—Probably in that timeframe.

Cameron Wright—Probably in that timeframe. So that's—if it was all Q1, it would have been 20% of your Q1 revenue is double ordering?

Bami Bastani—It's hard to quantify because it's not the information that is line-by-line shared with [Anadigics].

(2d Am. Compl. at ¶ 167; 8–8–08 CallStreet Tr. at 15; 8–8–08 Thomson Tr. at 23.)

The day after Anadigics announced its revised guidance for third quarter 2008, its stock price fell 38%. (*Id.* at ¶ 174.)Anadigics announced Bastani's resignation on August 18, 2008. (*Id.* at ¶ 175.)

D. Parties' Contentions

Defendants argue in support of their motion to dismiss the Second Amended Complaint that it fails to state a claim for securities fraud because (1) it does not allege particularized facts that the alleged statements were false or misleading when made, (2) the market was on notice of the high demand for Anadigics's products and the fact that Anadigics had placed its customers on allocation, (3) Plaintiffs engage in tautological reasoning, specifically, that the Defendants should be held liable for securities fraud for failing to disclose what the Defendants characterize as unsupported, conclusory allegations regarding dual sourcing, over-ordering, and manufacturing capacity, (4) the statements of confidential witnesses ("CWs") relied upon by Plaintiffs lack personal knowledge, are conclusory, and cannot be used to support an inference of scienter, (5) the alleged statements are immaterial as a matter of law as non-actionable puffery or forward-looking statements subject to the PSLRA's safe harbor provision and the Bespeaks Caution Doctrine, and (6) the Second Amended Complaint fails to plead loss causation. (Defs. Br. at 3.) [4] Insofar as Defendants conclude the Second Amended Complaint does not adequately allege violations of Section 10(b), they contend Plaintiffs' claims brought under Rule 10b–5(a), Rule 10b–5(c), and Section 20(a) also fail. (Defs. Br. at 3, 79–80, 82.) Defendants urge the Court to dismiss the Second Amended Complaint with prejudice because Plaintiffs have been afforded an opportunity to cure deficiencies. (*Id.* at 3, 82–83.)

4 The "Bespeaks Caution" doctrine provided the standard for evaluating allegedly "meaningful cautionary language" prior to the enactment of the PSLRA and its safe harbor provision in 1995. *See Nat'l Junior Baseball League v. Pharmanet Dev. Grp. Inc.,* 720 F.Supp.2d 517, 533 n. 14 (D.N.J.2010). Insofar as the PSLRA provides the broader protection for such language, and the PSLRA applies to this case, we do not address the Bespeaks Caution doctrine, except to note that pre-PSLRA case law may address it, and the Third Circuit Court of Appeals has thus incorporated much of the doctrine into its analysis of the PSLRA. *Id.* at 533–34.

***11** Plaintiffs contend that Defendants make factual arguments inappropriate at the motion to dismiss stage. (Pls. Opp'n at 3.) Plaintiffs further argue that Defendants' allegedly false and misleading statements do not fall within the PSLRA's safe harbor provision by virtue of "tangential references to the future." (*Id.* at 4.) Finally, Plaintiffs contend that Defendants "cannot plausibly contend they remained ignorant of production capacity and their deteriorating relationships with key wireless handset customers," and that the CWs' statements support the inference of scienter. (*Id.*)

E. Procedural History

The Court heard oral argument on Defendants' motion to dismiss the Consolidated Class Action Complaint on August 3, 2010. (Dkt. entry no. 67, 8–3–10 Hr'g Tr.) The Court denied the motion to dismiss without prejudice, but instructed Plaintiffs to file an amended pleading to cure deficiencies noted by the Court during oral argument. (Dkt. entry no. 65, 8–3–10 Order.) At the August 3, 2010 hearing, the Court observed of the Consolidated Class Action Complaint:

I find this complaint to be at once cumbersome and yet insufficient. It's cumbersome because it contains a tremendous amount of repetition of the same words over and over again; the formulaic recitation of whatever was allegedly untrue or materially omitted, with no detail ... about what the actual underlying factual situation was.

Now, I have sat here with you through this whole oral argument, and what I get out of it is that according to the plaintiff what was really wrong ... here is that this company had a very severe problem filling customer orders ... as they came in....

I do not believe that a court could ever find that just because the potential demand out in the market was greater than the production capacity of a given supplier, that could somehow amount to securities fraud when the supplier said, yes, we want to get a bigger ability to make more widgets and sell more widgets into the marketplace.

> And here, this company, throughout this so-called class period, is saying there's a huge market out there, it's exploding. We want to take advantage of as much of it as we can to sell our product into that high demand market. And we're gearing up, as fast as we can, our production capacity.
>
> I can't see how their failure to gear up fast enough or effectively enough to attract additional orders ... could possibly constitute securities fraud by saying we're—you know, we're gearing up but we have production capability limitations that we're growing ourselves to be bigger so as to overcome.
>
> If that's all this case is, then it's not a case. On the other hand, if the internal situation with the company was a disaster in the sense that it was constantly overbidding what it could deliver to its customers and then disappointing the customer who had ordered from them and gradually driving the customers away by inability to meet existing orders, as distinguished from potential market demand, then maybe, maybe there's something that this company isn't stating fully and fairly to the marketplace in terms of its own problems with its own customers.

***12** (8–3–10 Hr'g Tr. at 98:4–99:23.) The Court further observed that Anadigics's practice of allocating available inventory to customers had been disclosed to the market and could not be used to support a claim for securities fraud, and instructed the parties that Plaintiffs would have to show "something going on in terms of this company's relationships with the customers who were ordering from them and who were being disappointed in their business relationship" with Anadigics. (8–3–10 Hr'g Tr. at 99:24–100:8.)

Plaintiffs filed their amended pleading, referred to herein as the Second Amended Complaint, on October 4, 2010. Defendants then moved to dismiss the Second Amended Complaint, as contemplated by the Court's August 3, 2010 Order. (8–3–10 Order at 2.) Plaintiffs moved to strike the Appendix to Defendants' moving brief, as well as certain exhibits attached to the 12–23–09 Alessi Affidavit and the 12–3–10 Alessi Affidavit, on the basis that those documents (1) constitute an improper attempt to subvert the ninety-page briefing limit agreed to by the parties and ordered by the Court, (2) improperly attempt to contradict the alleged falsity of the statements at issue, and (3) for the most part, are not referred to or relied upon in the Second Amended Complaint. (Pls. Br. Supp. Cross Mot. Strike at 1–2.)

We find Plaintiffs' cross motion to strike procedurally improper. While the cross motion to strike does not specify a procedural basis for the relief sought, Rule 12(f) permits a party to move to strike "from a pleading an insufficient defense or any redundant, immaterial, impertinent, or scandalous matter."Fed.R.Civ.P. 12(f). The documents at issue in the cross motion to strike do not constitute "pleadings," and thus will not be stricken pursuant to Rule 12(f).*See In re Schering–Plough Corp./Enhance Sec. Litig.*, No. 08–397, 2009 1410961, at *2 (D.N.J. May 19, 2009) ("[B]ecause Plaintiffs attempt to strike declaration exhibits attached to Defendants' motions, rather than parts to a pleading, Plaintiffs' motion is procedurally incorrect and should be denied.").

We reject Plaintiffs' contention that the documents at issue constitute an attempt to avoid the constraints of page limits as having no basis in the record. (*See* dkt. entry no. 59, 2–4–10 Stip. & Order (granting Defendants permission to file a moving brief not exceeding ninety pages, "excluding any exhibits or appendices"); dkt. entry no. 53, 12–10–09 Thurman Letter; dkt. entry no. 57, 2–1–10 DePalma Letter; dkt. entry no. 66, 8–10–10 Stip. & Order at ¶ 3 (referencing 12–10–09 Thurman Letter).) The Court advised the parties at the August 3, 2010 oral argument that it would "look at the entire body of documentation for the rule of completeness so that [the Court] can see in context whether the items that are alleged to be false or materially silent or misleading are actionable."(8–3–10 Hr'g Tr. at 101:7–11.)

The Court will therefore deny the cross motion to strike, but apply the applicable legal standards in determining which documents to consider in the context of the pending motion to dismiss. *See Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 322–23, 127 S.Ct. 2499, 168 L.Ed.2d 179 (2007) (stating that when faced with motion to dismiss a Section 10(b) action, "courts must consider the complaint in its entirety, as well as other sources courts ordinarily examine when ruling on Rule 12(b)(6) motions to dismiss, in particular, documents incorporated into the complaint by reference, and matters of which a court may take judicial notice"); *In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1425–26 (3d Cir.1997); *In re Synchronoss Sec. Litig.*, 705 F.Supp.2d 367, 389–91 (D.N.J.2010) (discussing judicial notice pursuant to Federal Rule of Evidence 201).

DISCUSSION

I. Legal Standards

A. Rule 12(b)(6), Rule 9(b), and the PSLRA

***13** A court may dismiss a complaint pursuant to Rule 12(b)(6) for "failure to state a claim upon which relief can be granted."Fed.R .Civ.P. 12(b)(6). In addressing a motion to dismiss a complaint under Rule 12(b)(6), the court must "accept all factual allegations as true, construe the complaint in the light most favorable to the plaintiff, and determine, whether under any reasonable reading of the complaint, the plaintiff may be entitled to relief."*Phillips v. Cnty. of Allegheny,* 515 F.3d 224, 233 (3d Cir.2008). At this stage, a "complaint must contain sufficient factual matter, accepted as true to 'state a claim to relief that is plausible on its face.'A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged."*Ashcroft v. Iqbal,* ––– U.S. ––––, ––––, 129 S.Ct. 1937, 1949, 173 L.Ed.2d 868 (2009) (quoting *Bell Atl. Corp. v. Twombly,* 550 U.S. 544, 556, 127 S.Ct. 1955, 167 L.Ed.2d 929 (2007)).“[W]here the well-pleaded facts do not permit the court to infer more than the mere possibility of misconduct, the complaint has alleged-but it has not 'show[n]'-that the 'pleader is entitled to relief.' "*Iqbal,* 129 S.Ct. at 1950 (quoting Rule 8(a)(2)).

A securities fraud action, however, "requires more than mere reference to the conventional standard applicable to motions under Rule 12(b)(6)."*C.W. Sommer & Co. v. Rockefeller (In re Rockefeller Ctr. Props., Inc.*), 311 F.3d 198, 215 (3d Cir.2002). Rather, the PSLRA and Rule 9(b) impose heightened pleading requirements that must be satisfied for a complaint sounding in securities fraud to survive a motion to dismiss. *See In re Advanta Corp. Sec. Litig.,* 180 F.3d 525, 531 (3d Cir.1999).

Rule 9(b) states, "[i]n alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake."Fed.R.Civ.P. 9(b).“This particularity requirement has been rigorously applied in securities fraud cases."*In re Burlington Coat Factory,* 114 F.3d at 1417. Though Rule 9(b) does not require plaintiffs to plead every material detail of the fraud, it nevertheless "requires, at a minimum, that plaintiffs support their allegations of securities fraud with all of the essential factual background that would accompany the first paragraph of any newspaper story—that is, the who, what, when, where and how of the events at issue."*Cal. Pub. Emps.' Ret. Sys. v. Chubb Corp.,* 394 F.3d 126, 144 (3d Cir.2004); *In re Rockefeller,* 311 F.3d at 217.

Plaintiffs alleging securities fraud must also comply with the heightened pleading requirements of the PSLRA. *Chubb Corp.,* 394 F.3d at 144. The PSLRA requires plaintiffs to

> specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed.

***14** 15 U.S.C. § 78u–4(b)(1). This "particularity [requirement] extends that of Rule 9(b) and requires plaintiffs to set forth the details of allegedly fraudulent statements or omissions, including who was involved, where the events took place, when the events took place, and why any statements were misleading."*In re Rockefeller,* 311 F.3d at 218. Thus, the PSLRA imposes another layer of factual particularity on securities fraud claims. *Chubb Corp.,* 394 F.3d at 144.

The PSLRA also modifies the burden of pleading intent, or scienter, by requiring plaintiffs to "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind."15 U.S.C. § 78u–4(b)(2). The required state of mind is "either reckless or conscious" behavior, which may be bolstered—but not shown solely-by allegations tending to show that defendants had the motive and opportunity to commit fraud. *Inst'l Investors Grp. v. Avaya, Inc.,* 564 F.3d 242, 267–68, 276–77 (3d Cir.2009) (noting that "[a] showing of motive and opportunity" is no longer an independent means of establishing scienter, in light of *Tellabs*).“[T]he inference of scienter must be more than merely 'reasonable' or 'permissible'—it must be cogent and compelling, thus strong in light of other explanations."*Tellabs,* 551 U.S. at 324.

The PSLRA's "strong inference" requirement thus "alters the normal operation of inferences under Rule 12(b)(6)."*In re Digital Is. Sec. Litig.,* 357 F.3d 322, 328 (3d Cir.2004).“A complaint will survive ... only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged."*Tellabs,* 551 U.S. at 324;*see also Winer Family Trust v. Queen,* 503 F.3d 319, 327 (3d Cir.2007).

A plaintiff's failure to meet the heightened pleading requirements set forth in Rule 9(b) and the PSLRA justifies dismissal of the complaint apart from dismissal pursuant to Rule 12(b)(6).*Chubb Corp.,* 394 F.3d at 145; *In re Intelligroup Sec. Litig.,* 527 F.Supp.2d 262, 276 (D.N.J.2007) ("In sum, Rule 9(b) and the [PSLRA] modified the traditional Rule 12(b)(6) analysis for the purposes of pleading 'misrepresentation' and 'scienter' elements."). Accordingly, a modified Rule 12(b)(6) analysis is employed in the securities fraud context in which "catch-all" or "blanket" assertions that do not comply with the particularity requirements of Rule 9(b) and the PSLRA are disregarded. *Chubb Corp.,* 394 F.3d at 145. Therefore, "unless plaintiffs in securities fraud actions allege facts supporting their contentions of fraud with the requisite particularity mandated by Rule 9(b) and [the PSLRA], they may not benefit from inferences flowing from vague or unspecific allegations-inferences that may arguably have been justified under a traditional Rule 12(b)(6) analysis."*Id.* at 145.

B. Section 10(b) and Rule 10b–5

***15** Section 78j ("Section 10(b)") [5] and Rule 10b–5 create liability for securities fraud. Section 10(b) provides, in pertinent part:

5 Before the Securities Exchange Act was codified, the contents of Section 78j appeared in section 10(b) of Public Law 73–291.*See* 73 Pub.L.No. 291, 48 Stat. 881 (1934). As a result, this provision is commonly referred to as Section 10(b) of the Securities Exchange Act.

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, ... any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [Securities Exchange Commission] may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j. Rule 10b–5, which establishes a private cause of action, was promulgated by the Securities and Exchange Commission ("SEC") in order to implement this section. *Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723, 729, 95 S.Ct. 1917, 44 L.Ed.2d 539 (1975). Rule 10b5 makes it unlawful:

> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b–5.

To state a claim for relief under Section 10(b) and Rule 10b–5, a plaintiff must establish six elements: "(1) a material misrepresentation (or omission); (2) scienter, *i.e.,* a wrongful state of mind; (3) a connection with the purchase or sale of a security; (4) reliance, often referred to in cases involving public securities markets (fraud-on-the-market cases) as 'transaction causation'; (5) economic loss; and (6) 'loss causation,' *i.e.,* a causal connection between the material misrepresentation and the loss."*In re Aetna, Inc. Sec. Litig.,* 617 F.3d 272, 277 (3d Cir.2010) (citation omitted); *see Dura Pharms., Inc. v. Broudo,* 544 U.S. 336, 341–42, 125 S.Ct. 1627, 161 L.Ed.2d 577 (2005). The misrepresentation or omission and scienter elements must, as discussed above, be pleaded with particularity. 15 U.S.C. § 78u–4(b); *In re Intelligroup,* 527 F.Supp.2d at 277 ("It appears that the heightened pleading requirements of PSLRA are inapplicable to the remaining elements of a 10b–5 claim.").

Defendants dispute that Plaintiffs have adequately pleaded the falsity, materiality, scienter, and loss causation elements of their cause of action for securities fraud. (Defs. Br. at 9, 43, 72, 80–81.)

1. False or Misleading Statements

Rule 10b–5 liability can attach for both affirmative misstatements and misleading omissions. Omissions, however, can give rise to liability only where the defendant had an affirmative duty to disclose the information in question, such as "when there is insider trading, a statute requiring disclosure, or an inaccurate, incomplete or misleading prior disclosure."*Oran v. Stafford,* 226 F.3d 275, 285–86 (3d Cir.2000); *see Matrixx Initiatives, Inc. v. Siracusano,* ––– U.S. ––––, ––––, 131 S.Ct. 1309, 1321, 179 L.Ed.2d 398 (2011) ("Disclosure is required ... only when necessary 'to make ... statements made, in the light of the circumstances under which they were made, not misleading.'") (quoting 17 C.F.R. § 240.10b–5(b)).

***16** Under Section 10(b) and Rule 10b–5, each statement at issue must be analyzed to determine whether each alleged misrepresentation is pled with the requisite particularity. *In re Westinghouse Sec. Litig.,* 90 F.3d 696, 712 (3d Cir.1996). Both pre-class period data and post-class period data can be used to ascertain what the defendant should have known during the class period. *In re Merck & Co., Inc. Sec. Litig.,* 432 F.3d 261, 272 (3d Cir.2005) (explaining that "any information that sheds light on whether class period statements were false or materially misleading is relevant").

2. Materiality

Rule 10b–5 "explicitly require[s] a well-pleaded allegation that the purported misrepresentations or omissions at issue were material ."*In re Rockefeller,* 311 F.3d at 211. A fact is material only if "there [is] a substantial likelihood that [it] would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available" to the investing public. *TSC Indus., Inc. v. Northway, Inc.,* 426 U.S. 438, 449, 96 S.Ct. 2126, 48 L.Ed.2d 757 (1976). The "materiality of disclosed information may be measured post hoc by looking to the movement, in the period immediately following disclosure, of the price of the firm's stock."*In re Merck & Co., Inc.,* 432 F.3d at 269 (discussing the efficient market hypothesis).

3. Scienter

"To establish liability under § 10(b) and Rule 10b–5, a private plaintiff must prove that the defendant acted with scienter, 'a mental state embracing intent to deceive, manipulate, or defraud.' " *Tellabs,* 551 U.S. at 319 (quoting *Ernst & Ernst v. Hochfelder,* 425 U.S. 186, 193–94 & n. 12 (1976)). It requires a knowing or reckless state of mind. *Avaya,* 564 F.3d at 252. Statements are reckless when they indicate "an extreme departure from the standards of ordinary care ... which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it ." *Id.* at 267 n. 42.In determining whether a plaintiff has pleaded scienter with particularity, as required by the PSLRA, a court must take into account "plausible opposing inferences." *Tellabs,* 551 U.S. at 323. A plaintiff's pleading standard is satisfied where "a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged." *Id.* at 324.

4. Reasonable Reliance

To state a claim for securities fraud under Section 10(b) and Rule 10b–5, the plaintiffs must demonstrate that they reasonably relied on the defendants' allegedly fraudulent misrepresentations or omissions. *Jones v. Intelli–Check, Inc.,* 274 F.Supp.2d 615, 632 (D.N.J.2003)."In order to facilitate securities class-actions, the Supreme Court created a rebuttable presumption of class-wide reliance based on the fraud-on-themarket theory," which is based on the "efficient capital market hypothesis," which in turn posits that " 'in an open and developed securities market, the price of a company's stock is determined by the available material information regarding the company and its business.' " *In re DVI, Inc. Sec. Litig.,* 639 F.3d 623, 631 (3d Cir.2011) (quoting *Basic, Inc. v. Levinson,* 485 U.S. 224, 241–42, 108 S.Ct. 978, 99 L.Ed.2d 194 (1988)). According to this hypothesis, "[m]isleading statements will therefore defraud purchasers of stock even if the purchasers do not directly rely on the misstatements." *Id.*

***17** To invoke this rebuttable presumption of reliance, Plaintiffs must show that (1) they traded shares in an efficient market, and (2) the misrepresentation at issue became public. *Id.* Defendants may rebut the presumption by " '[a]ny showing that severs the link between the alleged misrepresentation and either the price received (or paid) by the plaintiff, or his decision to trade at a fair market price.'"*Id.* at 631–32 (quoting Basic, 485 U .S. at 248).

5. Damages and Loss Causation

Plaintiffs in securities fraud cases must plead (1) damages, and (2) that their reliance on the fraud proximately caused those damages. *See Semerenko v. Cendant Corp.,* 223 F.3d 165, 174 (3d Cir.2000). This second requirement is sometimes called "loss causation." *See id.* at 184.Loss causation "requires a plaintiff to show that a misrepresentation that affected the integrity of [a stock's] market price *also* caused a subsequent economic loss."*Erica P. John Fund, Inc. v. Halliburton Co.,* ––– U.S. ––––, ––––, 131 S.Ct. 2179, 2186, 180 L.Ed.2d 24 (2011). To establish loss causation, a plaintiff "must allege that the subject of the fraudulent statement was the cause of the actual loss suffered, *i.e.,* that the misstatement or omission concealed something from the market that, when disclosed, negatively affected the value of the security."*In re Intelligroup,* 527 F.Supp.2d at 297 (internal quotation and citations omitted). Merely pleading that the price of the security was inflated at the time of purchase is insufficient. *Dura Pharms., Inc.,* 544 U.S. at 346–47. A plaintiff must also plead that the truth was "revealed to the investing public" through means such as the "defendant's corrective disclosure ...., whistleblowers, analysts questioning financial results, resignation of CFOs or auditors, announcements by the company of changes in accounting treatment going forward," and the like. *In re Intelligroup,* 527 F.Supp.2d at 297 n. 18.

C. The PSLRA's Safe Harbor for Forward–Looking Statements

The PSLRA contains a safe harbor provision, which protects certain forward-looking statements from Section 10(b) and Rule 10b–5 liability. The safe harbor provision states:

> in any private action arising under [the PSLRA] that is based on an untrue statement of a material fact or omission of a material fact necessary to make the statement not misleading, a person ... shall not be liable with respect to any forward-looking statement, whether written or oral, if and to the extent that—
>
> (A) the forward-looking statement is—
>
> (I) identified as a forward-looking statement, and is accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement; or
>
> (ii) immaterial; or
>
> (B) the plaintiff fails to prove that the forward-looking statement—
>
> (I) if made by a natural person, was made with knowledge by that person that the statement was false or misleading.

***18** 15 U.S.C. § 78u–5(c)(1). In the case of an oral forward-looking statement, the requirements set forth in paragraph (A) are satisfied if (1) the oral statement is accompanied by a cautionary statement noting that the statement is forward-looking and results might materially differ from the projections, (2) the oral statement is accompanied by another oral statement indicating that information concerning risk factors that might cause the actual results to materially differ from the projections is readily available in a written document, (3) such written document is specifically identified, and (4) such written document contains a cautionary statement listing important factors that could cause actual results to differ from the projections. 15 U.S.C. § 78u–5(c)(2). This safe harbor was designed to protect statements discussing revenue projections and future business plans from causing liability. *In re Merck & Co., Inc.,* 432 F.3d at 272.

The safe harbor provision therefore applies to statements that are forward-looking as defined by the statute, provided that they are "(1) identified as such, and accompanied by meaningful cautionary statements; or (2) immaterial; or (3) made without actual knowledge that the statement was false and misleading."*In re Aetna, Inc.,* 617 F.3d at 278–79. "Forward-looking statement" is defined as

> (A) a statement containing a projection of revenues, income (including income loss), earnings (including earnings loss) per share, capital expenditures, dividends, capital structure, or other financial items;
>
> (B) a statement of the plans and objectives of management for future operations, including plans or objectives relating to the products or services of the issuer;
>
> (C) a statement of future economic performance, including any such statement contained in a discussion and analysis of financial condition by the management or in the results of operations included pursuant to the rules and regulations of the [SEC];
>
> (D) any statement of the assumptions underlying or relating to any statement described in subparagraph (A), (B), or (C);
>
> (E) any report issued by an outside reviewer retained by an issuer, to the extent that the report assesses a forward-looking statement made by the issuer; or
>
> (F) a statement containing a projection or estimate of such other items as may be specified by a rule or regulation of the [SEC].

15 U.S.C. § 78u–5(i)(1)."[A] mixed present/future statement is not entitled to the safe harbor with respect to the part of the statement that refers to the present."*Avaya,* 564 F.3d at 255 (citation omitted). Furthermore, cautionary language

must be "extensive and specific"; "a vague or blanket (boilerplate) disclaimer which merely warns the reader that the investment has risks will ordinarily be inadequate to prevent misinformation."*Id.* at 256.

D. Section 20(a)

Section 78t (a) ("Section 20(a)") [6] creates a cause of action against individuals who are "control persons" of companies liable for securities fraud. *Jones*, 274 F.Supp.2d at 644. It states:

6 Before the Securities Exchange Act was codified, the contents of Section 78t(a) appeared in section 20(a) of Public Law 73–291.*See* 73 Pub.L.No. 291, 48 Stat. 881 (1934). As a result, this provision is commonly referred to as Section 20(a) of the Securities Exchange Act.

> ***19** Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.
> 15 U.S.C. § 78t(a).

Under this section, individuals are held liable for exercising control over a corporation that has committed securities fraud. *In re MobileMedia Sec. Litig.*, 28 F.Supp.2d 901, 940 (D.N.J.1998). Plaintiffs alleging a Section 20(a) violation "must plead facts showing: (1) an underlying violation by the company; and (2) circumstances establishing defendant's control over the company's actions."*Jones*, 274 F.Supp.2d at 645. Thus, if the plaintiff does not establish that any controlled person is liable under the PSLRA, then there can be no controlling person liability under Section 20(a).*In re Suprema Specialties, Inc. Sec. Litig.*, 438 F.3d 256, 287 (3d Cir.2006); *Avaya*, 564 F.3d at 252 ("[L]iability under Section 20(a) is derivative of an underlying violation of Section 10(b) by the controlled person.").

II. Section 10(b) and Rule 10b–5 Standards Applied Here

We find that Plaintiffs have failed to state a claim for relief for securities fraud with respect to all counts in the Second Amended Complaint. The allegedly false and misleading statements identified in the Second Amended Complaint are not actionable, because they have either not been pleaded with the requisite particularity as to either falsity or scienter, or constitute forward-looking statements subject to the PSLRA's safe harbor provision.

A. Alleged Material Misrepresentations and False Statements

The statements alleged to be false or misleading by Plaintiffs generally address four topics, all of which relate to the overarching theme of Anadigics's ability to meet customer demand: (1) wireless handset customers' over-ordering, or stockpiling, of Anadigics's products; (2) wireless handset customers' practice of dual-sourcing, or ordering from both Anadigics and a competitor for the same products with the intention of cancelling one order once the other is filled; (3) the availability of additional via etchers to increase manufacturing capacity at the fab; and (4) Anadigics's response to the Intel yield problem and its effect on available stock for wireless handset customers. (2d Am. Compl. at ¶ 115.) We consider the statements alleged to be false and misleading in context below, considering at the same time their materiality and whether the statements are forward-looking and accompanied by meaningful cautionary language such that they might be protected by the PSLRA's safe harbor provision.

1. February 12, 2008 Press Release

a. "Working to build further market share"

***20** We find that Bastani's statement in the February 12, 2008 press release that Anadigics was "working to build further market share with [its] top-tier customers" is both not demonstrably false or misleading, and moreover, non-actionable optimistic language. Although Bastani acknowledged in the earnings call held the same day that demand had exceeded supply in the fourth quarter of 2007, that earnings call also explains that the concept of Anadigics's "working ... with" customers was in the context of having put customers on allocation. (*See* 2–12–08 CallStreet Tr. at 8 ("We work very closely with customers and do our best ... [to] match it up to the availability of product at any given time"); *id.* at 16 ("Clearly in fourth quarter [2007] demand exceeded our supply. And that's why we're engaged with a portfolio management and also *working with our top tier customers* in terms of anticipating what part of their demand we can satisfy and what parts of it we will not.") (emphasis added).)

To the extent Plaintiffs contend this statement was false and misleading because "Bastani had been informed ... that the Company's key wireless handset customers were dual sourcing" sometime in the beginning of the first quarter of 2008, this suggests a failure to disclose rather than an affirmative false statement. (2d Am. Compl. at ¶ 117.) However, "[w]hen an allegation of fraud is based upon nondisclosure, there can be no fraud absent a duty to speak [since a] duty to disclose under § 10(b) does not arise from the mere possession of nonpublic market information.... Silence, absent a duty to disclose, is not misleading under Rule 10b–5."*In re Intelligroup,* 527 F.Supp.2d at 281–82 (citations omitted); *see also In re Burlington Coat Factory,* 114 F.3d at 1432 ("[A] corporation is not required to disclose a fact merely because a reasonable investor would very much like to know that fact. [Management's] possession of material nonpublic information alone does not create a duty to disclose it."). Plaintiffs have alleged no particularized facts showing "insider trading, a statute requiring disclosure, or an inaccurate, incomplete or misleading prior disclosure" to support an inference that a duty to disclose existed. *Oran v. Stafford,* 226 F.3d 275, 285–86 (3d Cir.2000); *see In re Synchronoss Sec. Litig.,* 705 F.Supp.2d 367, 421 (D.N.J.2010) (observing that a duty to update prior statements through a disclosure contradicting rumors in the marketplace would arise only if defendants themselves affirmatively introduced such rumors into the market).

Plaintiffs' vague allegations that someone at Anadigics was aware that wireless handset customers were dual sourcing beginning in January 2008 is immaterial in any event, because, as the Second Amended Complaint acknowledges, due to lead times and production cycles, any cancelled orders resulting from the alleged dual sourcing would not become evident until the second or third quarters of 2008. (2d Am. Compl. at ¶ 105.)

***21** The statement can also be deemed to fall within the safe harbor provision of the PSLRA in stating, "We are *expecting* to buck seasonality in Wireless in the first quarter while working to build further market share with our top tier customers."(2–12–08 Press Release at 1 (emphasis added).) Accompanied by the meaningful cautionary language in the Safe Harbor statement on the second page of the press release, which advises, "projections and other forward-looking statements ... can generally be identified as such because the context of the statement will include words such as 'believe', 'anticipate', or 'expect'," this statement constitutes a statement of future economic performance. 15 U.S.C. § 78u–5(i)(1) (C). Moreover, "[w]orking to build market share" is a vaguely optimistic statement understood by reasonable investors as puffery. *See Bldg. Trades United Pension Trust Fund v. Kenexa Corp.,* No. 09–2642, 2010 WL 3749459, at *11 (E.D.Pa. Sept.27, 2010) ("A securities defendant's statements that the company will 'continue to do well and gain market share and outperform the competition [are], without more, simply expressions of confidence in the viability of [defendant's] future business which do not give rise to a securities violation.'" (quoting *Steinberg v. Ericsson LM Tel. Co.,* No. 07–9615, 2008 WL 5170640, at *9 (S.D.N.Y. Dec.10, 2008)).

b. "We continue to improve ... manufacturing efficiencies"

The Court finds the statement, "We continue to improve our manufacturing efficiencies and our production capacity plans continue to progress through equipment expansion in our New Jersey fab, qualifying external foundries and building our next fab in China," not materially false or misleading. The allegations in the Second Amended Complaint are consistent with this statement. (*See, e.g.,* 2d Am. Compl. at ¶ 57 ("Defendants realized that ... ensuring sufficient production capacity was a critical issue they would have to address"); *id.* at ¶ 62 ("Shields confirmed that Anadigics was preparing ... to meet the anticipated increase in demand," including "the installation of additional fab equipment"); *id.* at ¶ 63 ("Anadigics looked to further expand its capacity by building a new fab facility in China"); *id.* at ¶ 67 ("Defendants knew that the Company needed to 'ramp up' production at the fab to keep up with demand, and started to invest in new machines even before the Class Period began"); *id.* at ¶¶ 68–69 (stating that Anadigics hired a fabrication specialist to help management discern how to increase manufacturing capacity at the fab); *id.* at ¶ 73 ("CW 2 stated that the ramping up process was intense.... At least initially, Anadigics was able to increase the fab's production capacity.").) Plaintiffs' argument appears based on the notion that Defendants should have disclosed to the market that production capacity improvement was constrained by the lack of via etchers. But as noted above, Plaintiffs have pleaded no facts showing that there was a duty for Anadigics to disclose that information. *In re Intelligroup,* 527 F.Supp.2d at 281–82.

***22** We further find this statement forward-looking insofar as it refers to the future implementation of "plans." 15 U.S.C. § 78u5(i)(1)(B) (defining forward-looking statement as including "a statement of the plans and objectives of management for future operations, including plans or objectives relating to the products or services of the user").

2. February 12, 2008 Earnings Call

a. Denial of Knowledge of Customer Over–Ordering

The February 12, 2008 Earnings Call contains Bastani's assertion that Anadigics had "very tight communications" with its customers and did not suggest any problem of customer over-ordering. (2–12–08 CallStreet Tr. at 18–19; 2–12–08 Thomson Tr. at 24–25; 2d Am. Compl. at ¶ 118.) He stated that while customers "would like to build some buffer inventories," Anadigics was working "hand in glove with them to meet their demands."(*Id.*) Plaintiffs have made no allegations whatsoever suggesting that Anadigics was not in fact in close communication with its customers or working with them to meet demand to the best of its ability. Bastani references this communication, necessitated by allocation of available inventory, during the February 12, 2008 Earnings Call. *See supra* at 47 (discussing 2–12–08 CallStreet Tr. at 16). Bastani acknowledged that customers might wish to build a buffer inventory, but that "based on the visibility" he had at the time, he did not see it as an issue. (2–12–08 CallStreet Tr. at 19.)

We find that Plaintiffs have not shown Bastani's statements regarding possible customer over-ordering to be materially false or misleading. Based on the projections for increased demand and customers' optimistic guidance for the first quarter of 2008, the Court fails to see how Bastani might have determined whether over-ordering had occurred or was occurring at that time, given the allegations that cancelled orders would not become evident until later on due to lead times and production cycles. (2d Am. Compl. at ¶¶ 4, 6, 105.) However, we find that these statements are not forward-looking, as Bastani refers to "where we are today" and Anadigics's present engagement with customers. (*Id.* at ¶ 118.)

b. Working With Customers to Meet Increased Demands and Increased Production Capacity Plans

Plaintiffs allege that Defendants misleadingly stated during the February 12, 2008 Earnings Call that Anadigics would "continue to work directly with our customers on meeting their increased demands" and that Anadigics's "increased production capacity plans continue to progress forward through continuous improvement in manufacturing efficiencies ... and equipment expansions in the New Jersey fab as well as engaging qualifying external foundries" and building the China fab. (2d Am. Compl. at ¶ 120.) These statements are substantively similar to those identified in the February 12, 2008 Press Release, and are not actionable for the same reasons discussed above.

***23** Plaintiffs have not met their burden of demonstrating with particularity that these statements are materially false, but instead seem to imply that Defendants should have disclosed the via etcher problem and other constraints on meeting demand. As noted previously, there is no such duty, and perhaps more importantly, the manufacturing problems identified by Plaintiffs do not compel the conclusion that it was false for Bastani to represent that Anadigics was working with customers to meet demand or that Anadigics was continuing to pursue production capacity expansion plans. Regardless, Defendants disclosed during the call that the New Jersey fab had not yet reached full manufacturing capacity, and they did not expect it to do so until "the late third quarter, early fourth quarter" of 2008 due to "equipment coming in, getting installed, people trained."(2–12–08 CallStreet Tr. at 16.) This representation is entirely consistent with Plaintiffs' allegation that additional via etchers ordered in January 2008 would be delivered within six months and take another "couple of months" to come online. (*See* 2d Am. Compl. at ¶¶ 9, 71, 155.) Thus, the timeline in which the via etcher problem would be remedied was effectively part of the total mix of information available to investors, such that failure to disclose the via etcher problem specifically was not materially false or misleading.

We further note that the reference to plans to increase capacity continuing to progress forward is a forward-looking statement. 15 U .S.C. § 78u–5(i)(1)(B).

c. Alleged Material Omissions Regarding the Intel Yield Problem

Plaintiffs allege that Defendants "omitted material information regarding the Intel yield issues when asked directly about their relationship with Intel" during the February 12, 2008 Earnings Call. (2d Am. Compl. at ¶ 125.) Specifically, Plaintiffs point to Shields's statement that "we believe we are one of the best relative to our manufacturing operations and yield" in response to an analyst's question about whether Anadigics felt comfortable with its yield progress.

We find Shields's statement to be a vague and qualified statement of optimism and puffery, and there is no indication in the transcripts of the call that the question related to Intel specifically. "We believe we are one of the best" is not a material representation, but rather a subjective statement of optimism too vague to be actionable. *See In re Aetna, Inc.,* 617 F.3d at 283.

Plaintiffs also take issue with Bastani's response to a question about Anadigics's relationship with Intel ("Do you believe your Intel business will grow year over year?"). (2d Am. Compl. at ¶ 125.) Bastani stated, "Looking into the business as it shapes up into Q2 wireless LAN is absolutely one of the strengths."(*Id.*) We find that the Second Amended Complaint does not allege any facts that would support a plausible inference that this statement was materially false or misleading. Plaintiffs' allegations that Defendants chose to divert manufacturing capacity from wireless handset customers in order to fill Intel orders only supports Bastani's statement that business with Intel was strong. Nothing about the analyst's Intel question imposed a duty on Anadigics to disclose the Intel yield problem at that time. Furthermore, this is a forward-looking statement subject to the safe harbor provisions of the PSLRA in the context of the question posed. 15 U.S.C. § 78u5 (i)(1)(C).

3. February 29, 2008 Form 10–K

***24** Plaintiffs allege that Anadigics's Form 10–K for fiscal year 2007, filed on February 29, 2008, misleadingly failed to inform the market about the via etcher problem and that manufacturing capacity would be constrained at least until the summer of 2008. (2d Am. Compl. at ¶ 128.) The form states that Anadigics had capital equipment purchase requirements of $17.6 million, primarily over the first half of 2008, which "will serve to increase the installed equipment capacity of the Company's manufacturing operations in response to increases in customer demand for the Company's products."(*Id.*)

As noted previously, the mere existence of the via etcher problem, which Defendants generally disclosed in the February 12, 2008 Earnings Call by providing guidance that due to production constraints caused by delivery and installation of new equipment, the fab was not expected to be operating at capacity until the "late third quarter, early fourth quarter" of 2008, does not compel the logical conclusion that any statement by Defendants regarding efforts to increase manufacturing capacity must be false or misleading. (2–12–08 CallStreet Tr. at 16.) Nor have Plaintiffs pleaded any facts that either this statement is materially false or misleading, or Defendants were under some duty to disclose the exact nature of the via etcher problem specifically. *See Kenexa Corp.,* 2010 WL 3749459, at *12. Additionally, the statement is forward-looking, regarding expected future increase in manufacturing capacity. 15 U.S.C. § 78u–5 (i)(1)(B).

Because the Form 10–K contains meaningful cautionary language in its discussion of "risk factors," we find that the challenged statement regarding manufacturing capacity is subject to the safe harbor provision of the PSLRA. (*See* 2–29–08 Form 10K at 11–12.) Significantly for purposes of this action, the Form 10–K expressly states:

> Our customers' demand has outpaced our current manufacturing capacity. In the event that we are unable to satisfy demand from any one of our customers or our customers in the aggregate, we may not be viewed as a dependable high volume supplier and our customers may source their demand elsewhere.
>
> The Company has had significant growth in revenues over the past two years whereby demand has exceeded our available capacity. While the Company has made capital investments to expand equipment capacity in its primary fab in Warren, NJ and is constructing a facility in China and pursuing foundry relationships, we may not be able to add capacity at a sustainable pace with the growth of the market or with the growth of our customer's [sic]. In the event we continue to be unable to meet our customers' demand, we may be considered an undependable supplier and our customers may seek alternative suppliers. If our customers seek alternative suppliers, our operating results could be adversely affected, as we may be unable to find alternative sources of revenue.

(*Id.* at 12.) [7]

7 Insofar as the April and July press releases and conference calls relied upon by Plaintiffs in this action directly incorporate Anadigics's 2007 Form 10–K filing, we find that the above language suffices as the required meaningful cautionary language that is "substantive, extensive, and tailored to the future-looking statements" referenced with respect to statements reflected in those documents as well. *Avaya,* 564 F.3d at 257–58; *Kenexa Corp.,* 2010 WL 3749459, at *14 (stating that risk disclosures "need not actually accompany the alleged misrepresentation," because "language contained in the company's SEC filings may be incorporated into earnings releases and conference calls"). (*See* 4–22–08 Press Release at 4; 4–22–08 CallStreet Tr. at 1; 7–22–08 Press Release at 4; 7–22–08 CallStreet Tr. at 1.)

4. April 22, 2008 Earnings Call

a. Statements Regarding Meeting Customer Demand

***25** During Anadigics's April 22, 2008 Earnings Call to discuss the first quarter of 2008, an analyst asked: "[Y]ou said you'd be at full capacity in the second half of 2008. At this point, are you meeting full customer demand? Are you still constrained in some cases?"(2d Am. Compl. at ¶ 129.) Bastani responded that having "had a lot of high level relationship discussions with our customer ... basically, we have matched our expectations and their expectations.... So where we care, the answer is yes. We are perfectly aligned."(*Id.*) Bastani conceded that in the low end phone and developing markets, Anadigics was not making an effort to meet demand, but concluded that Anadigics had "been aligning our strategies very well with our partners and our customers and they are being happy and now we are happy."(*Id.*)

Plaintiffs assert this statement was materially false and misleading because Bastani and Shields already knew that their customers were frustrated with Anadigics's inability to fill orders on time and had resorted to over-ordering and dual sourcing. (*Id.* at ¶ 130.)Defendants contend that this statement about "aligning ... strategies very well with our partners" should be properly taken in context of a preceding discussion about Anadigics's optimism for strength in the high-margin 3G high end cell phone and smartphone market due to having done design work for Qualcomm, which was "doing phenomenally well" according to Shields. (4–22–08 CallStreet Tr. at 8–9.) Bastani further observed in response to a question about 3G customers that Anadigics viewed "Qualcomm as the strongest force out there ... and there are new players coming in," including Sony Ericsson, Broadcom, NXT/STMicro, and others. (*Id.* at 13.)

We agree with Defendants that taken in context, Bastani's statement about "where we care, ... we are perfectly aligned" with customer demand is reasonably viewed as referring to customers such as Qualcomm, not Samsung or LG. The Second Amended Complaint's allegations of customer over-ordering and dual sourcing refer specifically only to Samsung and, to a lesser extent, LG. Even accepting those as true, the Second Amended Complaint notes that cancelled orders due to over-ordering or dual sourcing would not become evident until "the second to third quarters of 2008."(2d Am. Compl. at ¶ 105.) Plaintiffs' allegation that this statement was materially false and misleading because "Bastani knew that Anadigics had lost all credibility with its wireless handset customers" is not supported by particularized factual allegations. (*Id.* at ¶ 131.)

We take judicial notice that Anadigics reported in its Form 10–K for 2008 that Samsung remained one of Anadigics's top customers in 2008, accounting for 16% of net sales, an increase over Samsung's 13% of net sales in 2007. (2–29–08 Form 10–K at 10; 12–3–10 Alessi Aff., Ex. 57, 3–2–09 Form 10–K at 9.) *See In re IAC/InterActive Corp. Sec. Litig.*, 695 F.Supp.2d 109, 121 (S.D.N.Y.2010) (noting that "there is no question that the Court may consider public SEC filings" on a motion to dismiss, and rejecting plaintiffs' characterization of defendants' reliance on financial results from the time period in question and the following year as "inappropriate factual disputation"). Thus, Anadigics's financial results belie Plaintiffs' claim that Anadigics had "lost all credibility" with its wireless handset customers. Nothing in the record before the Court supports an inference that either Samsung or LG would constitute the type of low-end phone customers that Anadigics apparently made the strategic decision to not supply. (*See* 2–29–08 Form 10–K at 10 (stating that sales to Samsung accounted for 13% and sales to LG accounted for 10% of net sales during 2007); 4–22–08 CallStreet Tr. at 2 ("Our top customers in revenue for the first quarter 2008 included Samsung, Intel, LG and Huawei.").)

***26** This statement is not subject to the protection of the safe harbor provision. Both the question and the answer ("*At this point,* are you meeting full customer demand?... The answer is yes, we *are* perfectly aligned") refer to present time, not a future projection.

b. Statements Regarding Samsung

During the same earnings call, an analyst asked Bastani about a rumor that one of Anadigics's competitors was talking about taking a share of Samsung business away from Anadigics, the current incumbent, with respect to front-end module phones. (2d Am. Compl. at ¶ 132.) Bastani replied, "I don't believe I am losing anything to anybody. There's so much demand out there. There's plenty to go around for everybody. I hope everybody gets a piece of it. Certainly, as you can see from our growth, we are riding the wave in a very strong way."(*Id.*)

Defendants argue that Bastani's statements regarding the front-end module market are forward-looking. The Court agrees. Plaintiffs disregard the language of the analyst's question, which stated: "How competitive do you think *you will be* on the front end module side and when do you think the front end modules really *become* more important for the Korean guys?"(4–22–08 CallStreet Tr. at 10 (emphasis added).) This question clearly seeks forward-looking guidance. Bastani's response consists of subjective, non-actionable optimism, and forward-looking statements subject to the safe harbor provision "guesstimat [ing]" the future demand and usage for front-end modules. (*Id.*) Plaintiffs also allege that Bastani's remarks acknowledging "relentless rumors left and right about market share and gain and loss and things like that," but asking the analysts to "have faith in us" in light of Anadigics having "delivered 12 consecutive quarters of growth that is market share had have guided to the 13th ... as we work toward delighting our customers," were false and misleading because Samsung had allegedly "internally decided to stop using Anadigics as a supplier."(2d Am. Compl. at ¶¶ 132–33; 4–22–08 CallStreet Tr. at 19.) Defendants correctly assert that the Second Amended Complaint is misleading insofar as it suggests that this reference to "rumors about ... market share" has anything to do with Samsung or the question regarding front-end modules specifically. Rather, this statement concludes the conference call and contains mere sales talk and forward-looking statements about "Q2 guidance momentum." (2d Am. Compl. at ¶ 132.)

Plaintiffs make no allegation that Bastani's statement regarding Anadigics's 12 consecutive quarters of growth was false or misleading. Even presuming Plaintiffs pleaded particularized facts showing that Samsung had made an internal decision to stop using Anadigics as a vendor sometime in April 2008, we find that Bastani's concluding remarks are simply not actionable insofar as they are forward-looking and immaterial. [8]

8 Whether Bastani knew at the time of the 4–22–08 Earnings Call that Samsung had decided to stop using Anadigics as a supplier goes more to scienter than falsity. Regardless, the allegations are not sufficiently particularized to support the inference that as of the date of the call, Bastani would have known of Samsung's alleged internal decision. (*See* 2d Am. Compl. at ¶¶ 103–104 & n. 3 (stating that CW 6 was told while working at Intel that Samsung gave Anadigics a "disqualified rating *around April 2008"* (emphasis added)).) Moreover, Plaintiffs overstate Samsung's alleged internal decision to "stop using Anadigics" as a vendor, insofar as they also allege that CW 6, once he became employed at Anadigics, successfully rehabilitated Anadigics's relationship with Samsung. (*Id.* at ¶ 104.)Additionally, Anadigics noted during its July 22, 2008 Earnings Call that Intel, Samsung, LG, and Huawei remained its top customers in revenues for the second quarter of 2008. (7–22–08 CallStreet Tr. at 2.)

c. Representations Regarding Market Share

***27** Plaintiffs allege that Shields falsely and misleadingly stated during the 4–22–08 Earnings Call that "efficiencies are improving and we are really gaining the confidence of our customers relative to shipments going forward."(2d Am. Compl. at ¶ 134.) In response to a question about anticipated volume of wireless handset components for the second quarter of 2008, Shields stated, "while we haven't had any press release to comment on relative to additional customers in the wireless space, we've been growing relative share with our customers. So as we look at the perhaps the platform to be shifting the second half is opportunity for us to continue to gain share. So if the customers in the market and the economy bodes well, obviously we are looking to have a continuation of the increasing revenue [in] wireless each quarter."(*Id.;* 4–22–08 CallStreet Tr. at 14.)

We find Shields's statements, in context, to be forward-looking optimistic projections about the upcoming quarter, subject to the safe harbor provision of the PSLRA. Qualifying the statement regarding customer confidence as "relative to shipments going forward" makes clear that it does not refer to present fact or condition. And we find "growing relative share with our customers" so vague as to be non-actionable, but generally corroborated by the fact of Anadigics's continued growth in the second quarter of 2008 over the first quarter being discussed in the 4–22–08 Earnings Call. (12–23–09 Alessi Aff., Ex. 30, 7–22–08 Press Release.) Finally, as noted previously, the mere existence of manufacturing difficulties such as the via etcher problem does not compel the conclusion that it would be false for Defendants to reference its efforts and plans toward increasing manufacturing efficiencies.

5. July 22, 2008 Press Release

Defendants announced in a July 22, 2008 Press Release that "softness in industry demand and inventory re-balancing ... may occur in the third quarter 2008 from our Wireless customers."(4–22–08 Press Release at 1; 2d Am. Compl. at ¶ 144.) Defendants attributed this expected decline to customers' lowering demand expectations and reducing inventory levels. (*Id.*) However, Defendants stated that they believed the softness in the wireless market to be "temporary," in light of an increase in "design-in activity." (*Id.*) Plaintiffs contend these statements are misleading because the decline in demand actually reflected "the likely permanent loss of market share to Anadigics' competitors" as a result of the company's inability to fill customers' firm orders. (2d Am. Compl. at ¶ 145.)

As the Court has already noted, the allegations in the Second Amended Complaint do not support the conclusion that Anadigics permanently lost the business of, *e.g.,* Samsung. *See supra* n. 8. Additionally, the statement in the 7–22–08 Press Release that demand was expected to decrease for the third quarter of 2008 due to "inventory re-balancing" is consistent with Plaintiffs' allegations that Anadigics's wireless handset customers were over-ordering or stockpiling inventory, undermining any inference that Anadigics's proffered explanation is false or misleading. Plaintiffs have not pleaded particularized factual allegations showing that the statements at issue were materially false or misleading. But in any event, the Court would find that the statements are forward-looking forecasts of future demand, accompanied by meaningful cautionary language, subject to the safe harbor provision of the PSLRA. *See In re Cutera Sec. Litig.,* 610 F.3d 1103, 1111–12 (9th Cir.2010); *Avaya,* 564 F.3d at 258–59.

6. July 22, 2008 Earnings Call

a. Reasons for Anticipated Decrease in Demand

***28** Plaintiffs allege that Bastani "continued to falsely attribute the drop in wireless handset demand as excess inventory on the part of the Company's customers" during a July 22, 2008 Earnings Call. (2d Am. Compl. at ¶ 146.) Plaintiffs contend that the real reason for the decrease in demand was loss of market share, not excess inventory. (*Id.*) Plaintiffs also allege that Bastani misleadingly or falsely indicated that the decrease in demand was a general marketplace phenomenon. (*Id.* at ¶ 148; 7–22–08 CallStreet Tr. at 5 ("The weaknesses we have seen are no different than what has already been talked about in the industry.").)

The transcript of the earnings call shows that Defendants did acknowledge a loss of market share resulting from Anadigics's inability to "fill the prescription" as part of the reason for anticipating decreased demand from wireless handset customers. (7–22–08 CallStreet Tr. at 11–12.) Bastani went on to observe that Anadigics was "engaged in every design that goes on right now" such that it remained committed to increasing manufacturing capacity. (*Id.* at 12.)He also made a non-actionable statement of subjective sales talk that Anadigics intended to "reap the benefits of [its] strong market position."(*Id.*)*See Kenexa Corp.,* 2010 WL 3749459, at *11.

As we observed with respect to the July 22, 2008 Press Release, representations by Anadigics that customer demand was weaker than expected due to excess inventory is consistent both with Plaintiffs' allegations that customers had engaged in over-ordering and/or dual sourcing, as well as Anadigics's disclosures to the market throughout the Class period that it was not able to consistently meet customer demand and had allocated available inventory, working with customers in doing so. Bastani explained that Anadigics had reason to believe that decrease in demand would be temporary because Anadigics was (1) "running stronger than last year, quarter to date, on the wireless backlog," in projections for the last quarter of 2008, and (2) seeing "a lot of designing activities" for its products with both existing and new customers. (7–22–08 CallStreet Tr. at 5.) Plaintiffs' contention that "Bastani was aware that the drop in demand was not a general marketplace phenomenon" is conclusory and disregards the context of the rest of the earnings call. (2d Am. Compl. at ¶ 149.) These statements thus are not materially false or misleading in light of the total mix of information available to investors, and furthermore are forward-looking projections of future economic performance in the next quarter subject to the safe harbor provision of the PSLRA.

b. Statements Regarding Samsung

An analyst asked Shields during the July 22, 2008 Earnings Call about what reasons Anadigics's customers were giving Anadigics for the decrease in demand and whether Shields thought the slowdown would be temporary. (7–22–08 CallStreet Tr. at 6.) Shields responded, "I just look at Samsung and Samsung has said that they still envision doing 200 million units for the year, while they may have been down from Q1 to Q2, ... unless they come back to the Street and tell folks it will be less than 200 million, there's reason to believe that based on our share we should be the recipient of nice growth."(*Id.;* 2d Am. Compl. at ¶ 150.) Shields further stated that "there are certain indications at least that when we sit down with customers that could call for better performance, now obviously we are cautious just like the next guy because sometimes you would think it would take one, two quarters to correct itself. So yes, the fact is really an inventory rebalancing as one customer has indicated."(*Id.*)

***29** We find that Shields's statement of subjective belief that Anadigics "should be the recipient of nice growth" is vague and non-actionable as immaterial, and was qualified by cautionary language. 15 U.S.C.A. § 78u–5(c)(1)(A)(ii); *In* *re Aetna, Inc.*, 617 F.3d at 283–84. (*See* 7–22–08 CallStreet Tr. at 6.) The statement, "The fact is really an inventory rebalancing as one customer has indicated," is vague and immaterial insofar as it does not express which customer allegedly indicated the same to Defendants; the Court finds no factual basis to support an inference that this references Samsung particularly.

c. Statements Regarding Expansion Plans

Plaintiffs allege that Defendants falsely claimed that Anadigics was ready and able to meet a potential surge in wireless customer demand, and accordingly continued to pursue its plans to install additional equipment at the fab. (2d Am. Compl. at ¶ 152; 7–22–08 CallStreet Tr. at 7 (Bastani: "[A]s we experienced last year, when these guys [customers] turn on a dine they turn on a dime. So you better be prepared serving them."); *id.*(Shields: "We made the commitment to make sure that we are going to be there when that demand surge potentially happens.").)

Plaintiffs take these statements out of context. Immediately prior to these statements, an analyst made the observation that "[o]bviously a long-term forecast is still very robust and Nokia did talk pretty positively about the overall demand for the industry this year from a guidance."(*Id.*) The statements regarding Anadigics's intention to be prepared for a "potential surge" in demand at some future point were forward-looking, made in response to the analyst's point about long-term forecasts looking robust, and thus subject to the safe harbor provisions of the PSLRA. We further find that insofar as they are consistent with Defendants' stated position that the downturn in demand was temporary, Plaintiffs have not shown them to be materially false or misleading.

d. Current Ability to Meet Customer Demand

An analyst asked Bastani during the July 22, 2008 Earnings Call the following question: "You know Bami, you mentioned that you just don't have the capacity to meet some of the demand out there. Is that all on the 3G side of things right now? Or is that some other legacy as well?"(7–22–08 CallStreet Tr. at 12; 2d Am. Compl. at ¶ 154.) Bastani replied, "That was a comment about the past. That was like a Q4, Q1 comment. We have shipped a lot of the stuff ."(*Id.*) Another analyst asked, "To the extent you guys have been managing a fairly tight capacity over the past couple of quarters, can you help me understand how that progressed through the June quarter, whether it be customers and allocation, lead time to customers?"(7–22–08 CallStreet Tr. at 16; 2d Am. Compl. at ¶ 156.) Bastani responded that "in Q2, demand and supply were pretty much in balance.... The areas we saw a lot of pull-in was primarily in the broadband area and included WiFi, included FiOS, [and] DOCSIS 3. So a lot of it was new products and new things coming to market."(*Id.*) Bastani was also asked directly whether he thought Anadigics's supply had caught up to demand, to which Bastani answered, "Yes." (7–22–08 CallStreet Tr. at 16–17; 2d Am. Compl. at ¶ 156.) Bastani concluded the earnings call with the following statement: "Wireless is sequentially down. We believe that is primarily due to softness in the market and some inventory correction at customers. Our relationships are very strong. This includes Qualcomm, Intel, Motorola, Cisco."(7–22–08 CallStreet Tr. at 18.)

***30** Plaintiffs have alleged no facts that the manufacturing constraints at the fab would have affected the balance of supply and demand with respect to WiFi, FiOS, and DOCSIS 3 products, none of which involve wireless handsets. Accordingly, we find that this second statement has not been shown to be materially false or misleading. We also find that Plaintiffs have pleaded no facts showing that Bastani's concluding statements that the wireless market had softened due to economic conditions and inventory correction, and that Anadigics enjoyed strong relationships with Qualcomm, Intel, Motorola, and Cisco, were materially false or misleading.

However, we do find that Plaintiffs have made a showing, based on the facts pleaded in the Second Amended Complaint, that if production capacity for power amplifier modules at the fab was constrained due to the via etcher problem and compounded by the Intel yield problem, it could plausibly be false and misleading for Bastani to represent to investors that (1) as of July 22, 2008, demand for 3G products had fallen into balance and back orders had been shipped, and (2) supply had caught up to demand, where Plaintiffs have also plausibly alleged that an increase in manufacturing capacity of that magnitude would not occur until somewhere between June and September 2008 due to equipment delivery time as well as lead time for the production cycle. [9]

9 Defendants acknowledge that Bastani's statement that Anadigics's supply had caught up to demand is a not forward-looking statement subject to the safe harbor provision. (*See* Defs. Br. at 73 & 17.)

7. Summary of Alleged Materially False or Misleading Statements Satisfying Plaintiffs' Pleading Standard

The Court has found that only two of the statements identified by Plaintiffs as materially false or misleading have satisfied Plaintiffs' pleading standard under the PSLRA and Rule 9(b). Bastani's assertions during the July 22, 2008 Earnings Call that supply shortages were no longer a concern because supply and demand were in balance at that point, suggesting that demand no longer outstripped available manufacturing capacity despite the fact that as alleged, additional via etchers were unlikely to have yet come online at the New Jersey fab, could plausibly be false. (2d Am. Compl. at ¶¶ 154, 156.) Thus, we continue with our analysis as to that representation.

Furthermore, we found many of the statements identified in the Second Amended Complaint as allegedly false or misleading to be forward-looking, such that they are not actionable pursuant to the safe harbor provision of the PSLRA. Because we found that each of the forward-looking statements was accompanied by meaningful cautionary language and/or immaterial, *see supra* at n. 7, we need not address the question of whether they were made with actual knowledge that the statement was false and misleading. (*See* 2d. Am. Compl. at ¶¶ 120, 125, 128, 132, 134, 144, 146, 148, 150, 152.) *In re Aetna, Inc.*, 617 F.3d at 278–79 ("[T]he safe harbor applies to statements that are forward-looking ... provided that they are (1) identified as such, and accompanied by meaningful cautionary statements; or (2) immaterial; or (3) made without actual knowledge that the statement was false or misleading.").

B. Scienter

1. Failure to Disclose Alleged Over–Ordering and Dual Sourcing by Wireless Handset Customers

***31** Although we have found that a vast majority of the statements identified in the Second Amended Complaint are not actionable, and that Plaintiffs pleaded no facts that would support the inference that Defendants were under a duty to disclose to the market the alleged over-ordering and dual sourcing allegedly being done by Anadigics's wireless handset customers, we will still address what we perceive to be an inadequate pleading of scienter.

With respect to the allegations that Defendants misleadingly omitted to disclose to the market that Anadigics's customers were engaging in over-ordering or dual sourcing, or that Defendants' affirmative statements were false and misleading because they were allegedly made with the knowledge that customers were over-ordering or dual sourcing, Defendants contend that the allegations are not stated with particularity. Although the Second Amended Complaint states that the CWs indicated that as early as September 2007, Anadigics was "already behind the eight ball," "struggling to fill orders," and "not always successful in keeping up with demand," Defendants contend that Plaintiffs failed "to allege any particularized facts demonstrating that any specific Anadigics customer *actually* cancelled any existing order."(2d Am. Compl. at ¶ 74; Defs. Br. at 18.) The Second Amended Complaint alleges that CW 1 "witnessed Bastani making product commitments before and during the Class Period to customers that the Company's two principal sales managers ... would later be forced to rescind because of the fab's capacity restrains."(2d Am. Compl. at ¶ 95.)

The Second Amended Complaint, however, does not include any particular examples of missed orders. Rather, the premise that Anadigics was missing orders is inferred from allegations that Samsung and LG began double sourcing in the first quarter of 2008, according to CW 1. (2d Am. Compl. at ¶ 99.) These allegations vaguely state that "[a]ccording to CW1," Samsung and LG informed unnamed Anadigics sales representatives "that they were extremely frustrated with the continuous missed orders, and were going to 'dual source' the components they needed."(*Id.* at ¶ 100.)The sales representatives allegedly informed an Anadigics employee named Marcus Wise about Samsung and LG's frustration with missed orders, who in turn allegedly informed the Individual Defendants at a weekly production meeting sometime "early in the first quarter" of 2008. (*Id.*)

A securities fraud plaintiff may provide factual support for a complaint through confidential sources, but "statements from such sources can only be used: (1) if the complaint sets forth other factual allegations, such as documentary evidence, which are alone sufficient to support a fraud allegation, or (2) when the confidential sources are described in the complaint with sufficient particularity to support the probability that a person in the position occupied by the [confidential] source would possess the information alleged."*Nat'l Junior Baseball League,* 720 F.Supp .2d at 538. To satisfy this burden, "the complaint must disclose: (1) the time period that the confidential source worked at the defendant-company, (2) the dates on which the relevant information was acquired, and (3) the facts detailing how the source obtained access to the information."*Id.* Furthermore, "allegations attributed to the information obtained from a confidential source must contain specific details regarding the basis for the source's personal knowledge and describe supporting events in detail."*Id.; see Chubb Corp.,* 394 F.3d at 146. Where such detail is lacking, courts may discount confidential source allegations. *Avaya,* 564 F.3d at 263.

***32** We find that the confidential source allegations proffered in support of the inference that Anadigics was missing orders and the CW's statement that LG and Samsung were double sourcing their orders lack the level of detail necessary to meet the PSLRA's heightened pleading standard, such that the statements attributed to the CWs may be discounted. While the Second Amended Complaint does detail the positions held by the CWs and the time frame in which they worked at Anadigics, there are no reference to particular dates on which material information was discovered and allegedly conveyed to management that would permit the Court to infer a strong inference of scienter on the part of Defendants at the time the allegedly false and misleading statements were made; rather, Plaintiffs rely on vague references to "hallway conversations" and "daily production meetings" presumably taking place during the Class period. (2d Am. Compl. at ¶¶ 75–76.) Similarly, allegations by CW1 and CW4 that Anadigics was "having some difficulty meeting firm orders" as of late 2007 and "missing firm orders on a continuous basis" after the Intel yield problem manifested in early 2008 simply do not explain with the requisite particularity which customers were actually not receiving orders, to what extent, and when Defendants would have become aware of the alleged missing orders. As discussed above, in light of the Complaint as a whole, the most plausible inference to draw from the allegations is that missed orders, and more importantly the resultant effect on Anadigics's relationships with its customers (in light of the high demand for the products in general), would not have become evident to Anadigics until "the second and third quarters of 2008."(2d Am. Compl. at ¶ 105.)

2. Bastani's July 22, 2008 Statements that Supply and Demand Were Even

We next consider whether Plaintiffs can establish a strong inference of scienter with respect to whether Bastani acted with the requisite state of mind, intent to deceive or recklessness, in indicating that Anadigics was fully meeting customer demand as of July 22, 2008. The PSLRA requires that "with respect to each act or omission alleged," a plaintiff must "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind."15 U.S.C. § 78u–4 (b)(2)(A).

Scienter may be established by setting forth facts that constitute circumstantial evidence of either recklessness or conscious behavior and supported by evidence of motive and opportunity to commit fraud. *Advanta,* 180 F.3d at 534. After *Tellabs,* however, evidence of motive and opportunity is no longer an independent means of establishing scienter absent evidence of facts from which to infer defendants' knowing deceit or recklessness. *Avaya,* 564 F.3d at 276. [10] To prove scienter by circumstantial evidence, the plaintiff must support his allegations by detailing with particularity the "who, what, when, where and how" of the events at issue and present clear facts verifying plaintiff's deductions with respect to defendant's state of mind.*In re Synchronoss,* 705 F.Supp.2d at 400 n. 43 (citing *In re Burlington Coat Factory,* 114 F.3d at 1422).

10 Examples of motive and opportunity include: (1) benefitting in a concrete and personal way from the purported fraud; (2) engaging in deliberately illegal behavior; (3) knowledge of facts or access to information suggesting that public statements were not accurate, or (4) failing to check information the defendant had a duty to monitor. *In re Synchronoss,* 705 F.Supp.2d at 399.

***33** Weighing the competing plausible inferences, we find that Plaintiffs have not pleaded with the requisite particularity any facts from which to infer that Bastani possessed evidence as of July 22, 2008, that Anadigics was not meeting customer demand at that time, such that his representations that problems meeting demand were a thing of the past and supply and demand had evened out could be said to have been made with the knowledge that they were not accurate.

The CWs' assertions lack any particularized assertions as to what Bastani knew or should have known about manufacturing capacity or customer demand during that time frame. (*See* Pls. Opp'n at 74–75.) For example, Plaintiffs allege that CW1 was a Senior Vice President of Operations from September 2007 through August 2008 and "personally communicated with Bastani on a daily basis" and participated in weekly meetings attended by Bastani where "fab capacity and customer orders were discussed."(*Id.* at 74.)The Second Amended Complaint makes no representation as to the status of fab capacity and customer orders as of July 22, 2008, however, except to state that "Bastani had known since January 2008, when the orders for the via etchers were placed, that the fab would be capacity constrained until the etchers were delivered six months later, not accounting for the additional couple of months needed to make the etchers production ready."(2d Am. Compl. at ¶ 155.) This assertion is vague as to timing; "additional couple of months" does not allow for a "strong inference" that as of the end of July, Bastani knew that the via etchers had not been installed and brought online at the fab.

We also find that Bastani's comment that Anadigics had been constrained to meet customer demand in the 3G market "was a comment about the past .... like a Q1/Q4 comment. We have shipped a lot of the stuff now," does not rise to the level of recklessness or intent to deceive, but rather comes off as, at most, careless or negligent. (*Id.* at ¶ 154.)"Recklessness" in the scienter context means "highly unreasonable conduct, involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care .... recklessness is a lesser form of intent rather than a greater degree of negligence."*In re Intelligroup,* 527 F.Supp.2d at 282–83 (citations omitted); *see also Avaya,* 564 F.3d at 267 n. 42.

With respect to Bastani's comment that "in Q2 [2008], demand and supply were pretty well in balance," Plaintiffs plead no facts from which to infer the requisite strong inference of scienter. (2d Am. Compl. at ¶ 156.) Plaintiffs merely allege that this statement was false and misleading because (1) "customers had lost faith in Anadigics' ability to fill their firm orders," (2) Samsung "was no longer using the Company as a supplier," and (3) "Bastani knew that the Company had lost market share from its wireless handset customers by this time."(*Id.* at ¶¶ 157.)Only the last assertion goes to Bastani's mental state. But if Bastani knew that the Company had lost market share as of July 22, 2008, and was also predicting weakened demand in the wireless handset market during that same earnings call, this is consistent with his statement that supply and demand were now "pretty well in balance," given that demand had far exceeded supply before then. Even considering "all of the facts alleged, taken collectively," we find that this nonculpable explanation for the statements is cogent and more compelling than the competing inference that Bastani was motivated to make a misleading statement to make Anadigics look better to investors. *See Avaya*, 564 F.3d at 267–68.

***34** Plaintiffs' "Core Operations" allegations do not establish scienter, either. Plaintiffs allege that, according to CW1, "Bastani was in frequent direct contact with the Company's wireless handset customers, and even undertook a 'tour' of the Company's key wireless handset customers in July–August 2008," but this allegation says nothing about what Bastani might have learned as a result of this "tour" or, significantly, whether he learned any material information prior to the date at issue, July 22, 2008. (2d Am. Compl. at ¶ 185.)

We therefore conclude that while Bastani's statements may have plausibly been demonstrably false based on an acceptance of the inference that not all of the via etchers had yet been brought online at the fab, Plaintiffs simply alleged no facts from which the Court could infer that Bastani acted with the requisite mental state in stating in the July 22, 2008 Earnings Call that supply and demand had evened out.

C. Loss Causation

Plaintiffs allege that "the truth about Anadigics" was revealed in part during the July 22, 2008 Earnings Call, and then in a full disclosure on August 8, 2008. (2d Am. Compl. at ¶ 201.) However, because we find that Plaintiffs have not established the material misrepresentation or omission element of their securities fraud claim with respect to any representations made before these alleged revelations, we need not reach the parties' contentions regarding whether Plaintiffs adequately pleaded loss causation. *See In re Intelligroup*, 527 F.Supp.2d at 334 ("[I]n order to be correctively disclosed-and, thus, provide the basis for the loss causation element-the information needs to be initially misrepresented in order to provide the basis for the transactional causation element.")

III. Rule 10b–5(a) and (c) Claim

Plaintiffs assert a separate claim under Rule 10b–5(a) and (c), asserting that with respect to this claim, "Plaintiffs need not allege ... nor prove ... that any of the Defendants made any misrepresentations or omissions of material fact for which they also be liable under Rule 10b–5(b)." (2d Am. Compl. at ¶ 214.) However, this claim is unmistakably predicated on the same factual basis as the Rule 10b–5(b) claim—that Defendants allegedly "deceived the investing public" by the "knowing and/or reckless suppression and concealment of information regarding Anadigics' true capacity potential and profitability during the Class Period."(2d Am. Compl. at ¶¶ 215, 217.) This is just another formulation of Plaintiffs' assertion that Defendants made material omissions in failing to disclose that the via etcher and Intel yield problems were affecting Anadigics's ability to meet customer demand. Accordingly, we find that the analysis above applies to Plaintiffs' Section 10(b) and Rule 10b–5 claims in their entirety, such that both Count I, alleging violation of Rule 10b–5(b), and the alternative theory of liability pleaded in Count II of the Second Amended Complaint must be dismissed. [11] *See The Lautenberg Found. V. Madoff,* No. 09–

816, 2009 WL 2928913, at *12 (D.N.J. Sept.9, 2009) ("A Rule 10b–5(a) and/or (c) claim cannot be premised on the alleged misrepresentations or omissions that form the basis of a Rule 10b–5(b) claim."); *see also S.E.C. v. Lucent Techs., Inc.*, 610 F.Supp.2d 342, 359–61 (D.N.J.2009).

11 Plaintiffs' counsel acknowledged to the Court that Count II "relies upon most of the same facts and circumstances and the C.W. testimony to establish scienter.... the allegations under (a) and (c) rise and fall with the allegations under the 10[b–5] (b)." (8–3–10 Hr'g Tr. at 90:17–18, 91:6–7.)

IV. Section 20(a) Claim

***35** Plaintiffs allege that the Individual Defendants, "[b]y virtue of their high-level positions, and their ownership and contractual rights, participation in and/or awareness of the Company's operations and/or intimate knowledge of the statements filed by the Company with the SEC and otherwise disseminated to the investing public" were "controlling persons" of Anadigics under Section 20(a). (2d Am. Compl. at ¶ 223.) However, Plaintiffs have not pleaded facts adequate to establish that Anadigics is liable under Section 10(b) or Rule 10b–5 with the particularity required by the PSLRA. Thus, because there can be no liability for the underlying company, there can be no "controlling person" liability under Section 20(a) for either Bastani or Shields. *See In re Suprema Specialties, Inc.*, 438 F.3d at 287; *Chubb Corp.*, 394 F.3d at 159 n. 21.

CONCLUSION

The Court, for the reasons stated *supra*, will (1) grant the motion, (2) deny the cross motion, and (3) dismiss Plaintiffs' claims with prejudice. [12] The Court will issue an appropriate order and judgment.

12 We do not believe that Plaintiffs should be given an opportunity to amend the Second Amended Complaint, because it appears that they have already set forth all facts available to them in support of their claims, and have not shown that Defendants are liable under Section 10(b) and Rule 10b–5. Thus, allowing plaintiffs to replead would be futile since no amendment would satisfy the stringent pleading requirements of Rule 9(b) and the PSLRA. *See In re Alpharma Inc. Sec. Litig.*, 372 F.3d 137, 153–54 (3d Cir.2004). Thus, dismissal here is with prejudice.

All Citations

Not Reported in F.Supp.2d, 2011 WL 4594845, Fed. Sec. L. Rep. P 96,559

End of Document

2009 WL 1767193
United States District Court, W.D. Kentucky,
Louisville Division.

In re HUMANA, INC. SECURITIES LITIGATION.

Civil Action No. 3:08CV–00162–JHM. | June 23, 2009.

Attorneys and Law Firms

David A. Rosenfeld, Samuel H. Rudman, Coughlin Stoia Geller Rudman & Robbins LLP, Melville, NY, Deborah R. Gross, Law Office Of Bernard M. Gross, P.C., Philadelphia, PA, Douglas Wilens, David J. George, James L. Davidson, Paul J. Geller, Robert J. Robbins, Coughlin Stoia Geller Rudman & Robbins Llp, Boca Raton, FL, John Frith Stewart, Stewart, Roelandt, Stoess, Craigmyle & Emery, PLLC, Crestwood, KY, Alan J. Statman, Jeffrey P. Harris, Statman Harris & Eyrich, LLC, Cincinnati, OH, C. Richard Colvin, Matthew R. Chasar, Richard S. Wayne, Thomas P. Glass, William K. Flynn, Strauss & Troy, LPA, Covington, KY, Charles G. Middleton, III, James E. Milliman, Rebecca Grady Jennings, Middleton Reutlinger, Louisville, KY, D. Seamus Kaskela, David M. Promisloff, Richard M. Maniskas, Schiffrin Barroway Topaz & Kessler LLP, Radnor, PA, for Plaintiffs.

David B. Hennes, Domonic A. Arni, William G. McGuinness, Fried, Frank, Harris, Shriver & Jacobson, Washington, DC, J. Bruce Miller, Michael J. Kitchen, J. Bruce Miller Law Group, Louisville, KY, for Defendants.

MEMORANDUM OPINION AND ORDER

JOSEPH H. McKINLEY, District Judge.

***1** This matter is before the Court on a motion by Defendants, Humana Inc., Michael McCallister, James Bloem, and James Murray, to dismiss the Consolidated Amended Class Action Complaint pursuant to Fed.R.Civ.P. 9(b) and 12(b)(6) and the Private Securities Litigation Reform Act of 1995, 15 U.S.C. §§ 78u–4, 78u–5. [DN 51]. Fully briefed, this matter is ripe for decision.

I. BACKGROUND

Plaintiffs represent a class of investors who purchased the publically traded common stock of Humana, Inc. ("Humana") between February 4, 2008 and March 11, 2008 (the "Class Period"). Defendant Humana is a full-service benefits solutions company offering health and supplemental benefit plans for employer groups, government benefit programs, and individuals. Humana's operations are divided into two business segments: (i) a Commercial segment, which offers products to entities, employer groups, and individuals; and (ii) a Government segment, which offers products and government benefit programs, such as Medicare, Medicaid, and United Stated Department of Defense's TRICARE program. (Humana 2007 Form 10–K at 3.) Defendant, Michael McCallister, was Humana's President, Chief Executive Officer, and a member of Humana's Board of Directors during the class period. Defendant, James Bloem, was Humana's Chief Financial Officer, Senior Vice President, and Treasurer during the class period. Defendant, James Murray, was Humana's Chief Operating Officer during the class period.

Plaintiffs' consolidated amended class action complaint alleges that the Defendants violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, 15 U.S.C. § § 78(b) and 78t(a), and Rule 10b–5 promulgated thereunder by the Securities and Exchange Commission, 17 C.F.R. § 240. 1 0b–5. Plaintiffs allege that Humana and the three chief corporate officers are responsible for a number of intentional or reckless misstatements and material omissions which Plaintiffs' allege were calculated to artificially inflate the price of Humana's stock.

A. Humana's Prescription Drug Plans ("PDP") under Medicare Part D

Under the federal Medicare Part D Program, private insurers offer insurance coverage for prescription drugs to Medicare eligible individuals. Under Part D, insurers may offer both: (i) PDPs, which cover only a member's prescription drug purchases; and (ii) plans under the Medicare Advantage Prescription Drug Program, which cover both prescription drugs and medical services. (Humana 2007 Form 10–K at 5–6.) On January 1, 2006, Humana began offering stand-alone PDP's under the federal Medicare Part D Program. A PDP is an insurance plan that helps an individual pay for prescription drugs. Prescription drugs are typically divided into three tiers based upon cost. Each tier has a copay level for covered prescription drugs with the health plan setting the copay for the drugs covered in each tier. Tier I typically includes generic drugs. Tier II typically includes mid-range copay drugs and covered brand-name drugs that have been selected as Tier II drugs. Tier III typically includes drugs with the highest copay and includes all other covered prescription drugs.

***2** Humana offers three Medicare PDPs, a Standard, Enhanced, and Complete product. Humana's PDP Standard Plan is a basic plan that provides the member with coverage equal to the federal government's minimum requirements. Humana's PDP Enhanced Plan is similar to the Standard Plan, but provides broader coverage and fixed copayments with no deductible for the member to pay. Humana's PDP Complete Plan is designed for those individuals who need maximum coverage for all of their specific drug needs. Medicare-eligible individuals may enroll in one of Humana's three plan choices between November 15 and December 31 for coverage that begins January 1. (Consolidated Amended Complaint at ¶ 32–38.)

Humana's revenue from the Center for Medicare and Medicaid Services ("CMS") (the federal agency that administers Medicare programs) and the medicare-eligible member are determined from Humana's bids submitted annually to CMS. Humana's stand-alone PDP contracts with CMS are renewed generally for a one-year term each December 31.

B. Statements

On February 4, 2008, Humana issued a press release reporting its Fourth Quarter and full year 2007 earnings results. For 2007, Humana earned $1.4 billion on $25.3 billion in revenue, or $4.91 per share. As part of the February 4, 2008 earnings announcement, Humana raised its 2008 earnings per share ("EPS") guidance to a range of $5.35 to $5.55, and its first quarter EPS guidance to a range of $0.80 to $0.85, forecasting an increase of between 9% to 13% over the prior year. In that press release, Humana stated that it was raising its previously issued earnings guidance for 2008 to reflect a lower tax rate than previously anticipated. In teleconferences on February 4, 2008, and February 12, 2008, and an investor meeting on February 28, 2008, Defendants reiterated and explained Humana's EPS guidance for 2008 and made additional statements regarding Humana's operations and outlook.

Plaintiffs argue that notwithstanding Defendants' knowledge of Humana's significant internal control problems causing inaccurate pricing and claims data, Defendants knowingly or recklessly issued the February 4, 2008 press release, signed false certifications in the Company's SEC filing during the class period, and made the following additional false and misleading statements concerning Humana's anticipated earnings. Specifically, on February 4, 2008, Defendant Michael McCallister, Humana's President and CEO, stated in part: (1) "[T]his morning we raised our 2008 earnings per share guidance to a range of $5.35 to $5.55, with continued membership growth and strong operational execution driving these results."(2) "In June of this past year we submitted our 2008 Medicare Plan bids similarly targeting an operating margin of approximately 5%."(3) "We believe that 2007 achievements just described position us well for 2008 both in terms of the existing environment and future trends."(4) "Regardless, as we've done over the past 20 years we will adjust the benefits to ensure the Medicare medical costs trends matches the net level of premium increase."(Consolidated Amended Complaint at ¶ 72.)

***3** Plaintiffs assert that during the February 4, 2008 earnings conference call, Defendant James Bloem, Humana's Chief Financial Officer, likewise made the following false and misleading statements:

- "[T]he 2008 quarterly benefit ratio progression will be less pronounced verses 2007 as shown by the illustration on this slide. The primary factor driving this less pronounced pattern in the composition of our 2008 PDP membership which has changed from last year."
- "Consequently our lower membership in the low income block is anticipated to lower the quarterly benefits ratio pattern in the first half of the year and raise it slightly in the back half of the year compared to 2007."
- "Here's the twofold take away, the composition of our PDP membership will have a significant impact on the quarterly pattern of our Medicare benefits ratio without necessarily impacting the full year ratio. Secondly, the 2008 quarterly Medicare benefits ratio pattern is expected to drive our quarterly earnings per share for this year."
- "Our rigorous benefit expense trend analysis and forecasting includes regular interaction of many disciplines within our organization, this increases the reliability of our commercial pricing and profit planning."

- "Based on our ongoing deep dive analysis of benefit expense trend factors we do not foresee any significant changes to the components of our cost trends as we move into 2008, as is stated in this morning's press release. Accordingly we remain confident of our ability to meet our 2008 commercial pre-tax earnings target of $280 million to $300 million. We look forward to sharing our progress with you each quarter."

- In response to a question concerning Humana's PDP benefit ratio for the first quarter of 2008, Defendant Bloem stated "[y]ou are right directionally in terms of the PDP benefit ratio, what we had said, based on the low income fees there is going to be quite a difference in the front end of this year versus last year and it has to do with having fewer low income."

(*Id.* at ¶ 73.)

During the same February 4, 2008, conference call, Defendant James Murray, Humana's Chief Operating Officer, responded to a question regarding whether there were any kind of positive or negative surprises on the PDP upselling so far or the agents sales:

> [I]ts pretty remarkable that we can look and see how much of a spend we have for a particular, for example how much we spend for a cable ad and how many calls that will drive, and then we have statistics around how many of those calls will convert to a lead and how many of those leads will convert to a sale and how many of those sales will result in a referral of a friend or a family member. I mean it's fairly remarkable and all of the different sales channels that we have, a direct mail versus a cable TV, that is pretty predictable, and there's a lot of levers that we pull. Nothing has surprised us this year. We talked last year when we were together that we were surprised with some of our competitors and some of their benefit offerings. Nothing really has been a big surprise for us this year.

***4** (Humana Conference Call, February 4, 2008 at 3; Consolidated Amended Complaint at ¶ 75.) Finally, on February 12, 2008, and February 28, 2008, Defendant Bloem and Defendant McCallister respectively participated in investor meetings and reiterated that Humana expected EPS in the range of $5.35 to $5.55 for the full year 2008. (*Consolidated Amended Complaint* at ¶¶ 80, 81.)

Plaintiffs assert that these statements were materially false and misleading because: (i) the Company had significant material weaknesses in its internal controls such that the Company's financial reporting lacked a reasonable basis at all relevant times and was therefore materially false and misleading; (ii) due to the significant material weaknesses in the Company's internal controls, the Company was unable to properly calculate the prescription drug costs of its newly acquired members; (iii) due to the significant material weaknesses in the Company's internal controls, the Company was unable to properly calculate the correct pricing and discounts for members in its PDP plans; (iv) due to the significant material weaknesses in the Company's internal controls, the Company was unable to properly calculate the mix shift of high and low cost members in its PDP plans; and (v) due to the significant material weaknesses in the Company's internal controls, the assumptions underlying Humana's first quarter and full year earnings guidance provided by Defendants in February of 2008 were flawed and therefore materially false and misleading. (Consolidated Amended Complaint at ¶ 82.)

C. Humana's Internal Controls

In support of their allegation that Defendants knew or recklessly disregarded the significant internal control problems relating to the pharmacy claims processing and claims data at the Company prior to the start of the class period, the Plaintiffs submit the testimony of two former Humana employees and Humana's second quarter earnings results for the fiscal year 2006. (Consolidated Amended Complaint at ¶¶ 43–70.)

First, Plaintiffs rely in part on information provided by a former Senior Information Technology Consultant at Humana who was employed by Humana from January of 2005 to June of 2008. The former consultant was in charge of Humana's Medicare Part D information technology and ran a project that monitored Humana pricing charged by pharmacies. (*Id.* at ¶¶ 43–46.)The former consultant represented that Humana had very poor internal controls relating to the pharmacy claims processing and claims data.

Humana used a third party, Argus Health Systems, to serve as the interface between Humana and the pharmacies that filled prescriptions for Humana enrollees and to process claims for Humana. Argus, and therefore the pharmacies, depended upon accurate pricing and discount information from Humana's Pharmacy Business Unit to accurately charge Humana enrollees. (*Id.* at ¶¶ 49–50.)The former consultant represents that there was complete chaos at Humana with respect to pharmacy claims processing because there was fifteen separate data feeds from Argus to Humana and certain of the feeds were inaccurate. (*Id.* at ¶ 51.)

***5** According to the former consultant, Humana actuaries were relying on the flawed data flowing between Argus and Humana, making a great deal of information upon which projections were based inaccurate. (*Id.* at ¶ 57.)The former consultant: (i) advised Pharmacy Business Unit Directors, management level employees and business analysts of these problems and the potential inaccuracies in the claims data (*id.* at ¶ 56), (ii) told individuals at Humana on many occasions that there were "terrible inaccuracies" in Humana's discounting and pricing within the PDP plan, and that the errors may have been as much as 15% to 20% (*id.* at ¶ 52), and (iii) in a presentation to "higher-level individuals at Humana with responsibility for Medicare pharmacy information" informed them that the current data-exchange system between Humana, Argus, and the pharmacies regarding pharmacy claim information was seriously flawed and led to inconsistent data being used by different entities within Humana and in contact with Argus (*id.* at ¶¶ 60–62.).

Second, Plaintiffs assert that a second former Humana employee confirmed that significant internal control problems were present at Humana prior to and during the class period. The former Humana employee was a Product Manager for Medicare Products from the Spring of 2004 until April of 2008 with job duties that included planning and designing Humana Medicare products and working with CMS to get those products approved. (*Id.* at ¶ 65.)According to the Product Manager, Humana retained the outside actuarial firm of Reden & Anders to help build the plan models for the PDP offerings. However, employees in Humana's PDP actuarial department input the wrong information into the model for developing the PDP plans and the error "snowballed." (*Id.* at ¶ 67.)According to the Product Manager, Humana failed to perform the mandated peer review of this actuarial work and, thus, the errors were not discovered. (*Id.* at ¶ 68.)

Third, Plaintiffs assert that Humana's second quarter earnings results for the fiscal year 2006 also support Plaintiffs' contention that Defendants knew or recklessly disregarded the significant internal control problems. On July 31, 2006, Humana issued its second quarter earnings results for the fiscal year 2006 with PDP margins that were lower than expected. Plaintiffs argue that the PDP margins issued hinted at the larger problem with internal controls at Humana. Plaintiffs assert that instead of addressing the internal control problems, Humana instead diverted potential customers of its Complete Plan to a competitor's similar plan preventing the high-cost customers from adversely impacting the Company's PDP revenue. (*Id.* at ¶¶ 100–106.)

D. March 12, 2008 Press Release

Plaintiffs contend that investors did not learn the truth concerning the financial condition of Humana until March 12, 2008, when Humana issued a press release indicating that it was revising downward by $360 million the financial guidance it had provided five weeks earlier and reiterated less than two weeks earlier. Humana cut its guidance by approximately 47% for the first quarter of 2008 ($0.44 to $0.46 versus previous guidance of $0.80 to $0.85 per share) and by approximately 24% for the full year 2008 ($4.00 to $4.25 versus previous guidance of $5.35 to $5.55 per share). As a result of the alleged false statements and material omissions, Plaintiffs assert that the Defendants deceived the investing public regarding Humana's business, artificially inflated the price of Humana stock, caused Plaintiffs and other putative class members to purchase Humana stock at inflated prices, and caused a severe decline in Humana's stock price when the artificial inflation was revealed.

E. Humana's Explanation

***6** In the March 12, 2008, press release, Humana explained that the revision of its 2008 earnings guidance was based upon an analysis of its members' actual pharmacy claims made in its standalone PDPs through February 2008. In a March 12, 2008, teleconference with investors and analysts, the Individual Defendants explained that in preparing the bids for Humana's 2008 PDPs in early 2007, Humana re-categorized some prescription drugs that were originally in the lower cost Tier II as higher cost Tier III drugs for 2008. When Humana made these changes, Humana's actuaries, who prepared the bids, assumed incorrectly that its members would utilize the same amounts of those drugs in 2008 as they did in 2007, notwithstanding the change in the tiers and the corresponding increase in members' copayments. (March 12, 2008, Humana Conference Call Transcript at 3 .) Because copayments for drugs in Tier III are higher than Tier II, Humana explained that the movement of certain drugs to a higher tier increased the Company's calculated member cost. As a result, in order to comply with the member cost threshold allowed by CMS, Humana lowered the copayments payable by its members. (*Id.*)

In March of 2008, based on two full months of actual claims experience, Humana concluded that its PDP members had substituted lower cost Tier II drugs for certain higher cost Tier III drugs. (*Id.* at 3.) Because Humana did not take into account the likelihood of this substitution in its 2008 PDP bids, Humana was now bearing a higher share of its members' drug costs than it had projected as a result of the reduced copayments. Since Humana lowered the copayments that its members were required to pay, its PDPs were cheaper than those of competitors and, as a result, approximately 188,000 new high-utilization/high-cost members enrolled in Humana's Enhanced Plans. Additionally, due to the favorable pricing structure of Humana's PDPs, the proportion of low-income/high-utilization members assigned to Humana's Standard Plans by CMS did not decrease as Humana had predicted. Humana characterized the cause of the 2008 earnings guidance revision as a mistaken actuarial assumption in Humana's PDP bids. (*Id.*)

II. STANDARD OF REVIEW

Upon a motion to dismiss for failure to state a claim pursuant to Fed.R.Civ.P. 12(b)(6), the Court "must construe the complaint in the light most favorable to plaintiffs, accept all well-pled factual allegations as true and determine whether plaintiffs undoubtedly can prove no set of facts consistent with their allegations that would entitle them to relief."*League of United Latin American Citizens v. Bredesen,* 500 F.3d 523, 527 (6th Cir.2007) (citing *Kottmyer v. Maas,* 436 F.3d 684, 688 (6th Cir.2006)). This standard requires more than bare assertions of legal conclusions. *Bovee v. Coopers & Lybrand C.P.A.,* 272 F.3d 356, 361 (6th Cir.2001)."[A] complaint must contain either direct or inferential allegations respecting all the material elements to sustain recovery under some viable legal theory."*Bredesen,* 500 F.3d at 527 (citing *Bell Atlantic Corp. v. Twombly,* 550 U.S. 544, 127 S.Ct. 1955, 1964–65, 167 L.Ed.2d 929 (2007)).

III. SECTION 10(b) OF THE SECURITIES EXCHANGE ACT

***7** The Plaintiffs allege that the Defendants violated the "anti-fraud" provision, § 10(b), of the Exchange Act, 15 U.S.C. § 78j(b). In relevant part, § 10(b) provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange ... [t]o use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement ..., any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j(b). The S.E.C. regulation promulgated under § 10(b) provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.1 0b–5. The basic elements of a cause of action under this anti-fraud provision are "(1) a material misrepresentation or omission; (2) scienter; (3) a connection with the purchase or sale of a security; (4) reliance (or transaction causation); (5) economic loss; and (6) loss causation."*Brown v. Earthboard Sports USA, Inc.,* 481 F.3d 901, 917 (6th Cir.2007) (citing *Dura Pharm., Inc. v. Broudo,* 544 U.S. 336, 341–42, 125 S.Ct. 1627, 161 L.Ed.2d 577 (2005)). In securities fraud claims based on statements of present or historical fact, scienter can be established by knowledge or recklessness. *PR Diamonds, Inc. v. Chandler,* 364 F.3d 671, 681 (6th Cir.2004) (citing *Helwig v. Vencor, Inc.,* 251 F.3d 540, 552 (6th Cir.2001)); *Grillo v. Tempur–Pedic International, Inc.,* 553 F.Supp.2d 809, 817 (E.D.Ky.2008). Recklessness is defined as " 'highly unreasonable conduct which is an extreme departure from the standards of ordinary care. While the danger need not be known, it must at least be so obvious that any reasonable man would have known of it.' " *Miller v. Champion Enterprises, Inc.,* 346 F.3d 660, 672 (6th Cir.2003) (quoting *Mansbach v. Prescott, Ball & Turben,* 598 F.2d 1017, 1025 (6th Cir.1979)). As discussed more fully below, different scienter requirements apply to forward-looking statements pursuant to the PSLRA's "safe harbor" provision. *Grillo,* 553 F.Supp.2d at 817 n. 2 (quoting *PR Diamonds,* 364 F.3d at 681 n. 3).

***8** Traditionally, a party alleging fraud under the anti-fraud provision of the Exchange Act was required to "state with particularity the circumstances constituting fraud[,]" but was permitted to generally allege "[m]alice, intent, knowledge, and other conditions of a person's mind...."Fed.R.Civ.P. 9(b); *PR Diamonds,* 364 F.3d at 682. Under this pleading standard, plaintiffs were permitted to plead scienter generally. However, in enacting the Private Securities Litigation Reform Act of 1995 ("PSLRA"), Congress created § 21D of the Exchange Act, 15 U.S.C. § 78u–4, which heightened this pleading standard. Section 21D(b)(2) requires that:

> In any private action arising under this chapter in which the plaintiff may recover money damages only on proof that the defendant acted with a particular state of mind, the complaint shall, with respect to each act or omission alleged to violate this chapter, state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.

15 U.S.C. § 78u–4(b)(2). In imposing this heightened pleading standard, " 'the PSLRA did not change the scienter that a plaintiff must prove to prevail in a securities fraud case but instead changed what a plaintiff must plead in his complaint in order to survive a motion to dismiss.' " *Chandler,* 364 F.3d at 682 (quoting *Hoffman v. Comshare, Inc. (In re Comshare, Inc. Sec. Litig.),* 183 F.3d 542, 548–49 (6th Cir.1999)). Therefore, if a plaintiff does not plead "with particularity facts giving rise to a strong inference" of scienter, i.e. knowledge or recklessness, "a court may, on any defendant's motion, dismiss the complaint." *Id.* (citing 15 U.S.C. § 78u–4(b)(3)).

"The Supreme Court recently clarified the process courts should use in determining whether a securities fraud complaint gives rise to a 'strong inference' of scienter as required by the PSLRA."*Grillo,* 553 F.Supp.2d at 818 (quoting *Tellabs, Inc. v. Makor Issues & Rights, Ltd.,* 551 U.S. 308, 127 S.Ct. 2499, 2502–03, 168 L.Ed.2d 179 (2007)). First, as when ruling upon any other Rule 12(b)(6) motion, the Court must "accept all factual allegations in the complaint as true."*Tellabs,* 127 S.Ct. at 2509 (citation omitted). Second, the Court "must consider the complaint in its entirety, as well as other sources courts ordinarily examine when ruling on Rule 12(b)(6) motions to dismiss...."*Id.*"The inquiry is whether all the facts alleged, taken collectively, give rise to a strong inference of scienter."*Grillo,* 553 F.Supp.2d at 818; *Tellabs,* 127 S.Ct. at 2509. Third, in determining whether the alleged facts give rise to a strong inference of scienter, the Court is to perform a "comparative inquiry" by taking "into account plausible opposing inferences." *Tellabs,* 127 S.Ct. at 2509. The facts alleged in the complaint, when considered in their entirety, give rise to a strong inference of scienter "if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged."*Id.* at 2510."[W]here two equally compelling inferences can be drawn, one demonstrating scienter and the other supporting a nonculpable explanation, *Tellabs* instructs that the complaint should be permitted to move forward."*Frank v. Dana Corp.,* 547 F.3d 564, 571 (6th Cir.2008).

***9** In *Helwig v. Vencor, Inc.,* 251 F.3d 540 (6th Cir.2001), the Sixth Circuit listed factors, that while not exhaustive, are probative of scienter in securities fraud cases:

> (1) insider trading at a suspicious time or in an unusual amount; (2) divergence between internal reports

> and external statements on the same subject; (3) closeness in time of an allegedly fraudulent statement or omission and the later disclosure of inconsistent information; (4) evidence of bribery by a top company official; (5) existence of an ancillary lawsuit charging fraud by a company and the company's quick settlement of that suit; (6) disregard of the most current factual information before making statements; (7) disclosure of accounting information in such a way that its negative implications could only be understood by someone with a high degree of sophistication; (8) the personal interest of certain directors in not informing disinterested directors of an impending sale of stock; and (9) the self-interested motivation of defendants in the form of saving their salaries or jobs.

Id. at 552.*See also Ley v. Visteon Corp.,* 543 F.3d 801, 917 (6th Cir.2008).

Defendants move to dismiss the Consolidated Amended Complaint arguing that (1) the statements were forward-looking statements and thus Plaintiffs' claims are barred by the PSLRA's safe-harbor provision, 15 U.S.C. § 78u–5(c), and the "bespeaks caution" doctrine, (2) Plaintiffs fail to allege facts giving rise to a strong inference of "scienter," (3) the statements are immaterial puffery, (4) the Plaintiffs fail to plead loss causation, and (5) Plaintiffs fail to plead claims for control person liability under § 20(a) of the Exchange Act.

IV. DISCUSSION

A. Safe Harbor Provision

Defendants assert that the majority of their statements concerning Humana's EPS guidance for 2008 are protected by the safe harbor provision set forth in 15 U.S.C. § 78u–5. The PSLRA provides that under certain circumstances a person or entity shall not be liable with respect to any written or oral forward-looking statements. 15 U.S.C. § 78u–5(c)(1), (2). The PSLRA defines "forward looking statements" broadly to include projections of future financial results, statements of plans and objectives for future operations, and statements of future economic performance. 15 U.S.C. § 78–5(i). [1] Specifically, the safe harbor provision provides that "in any private action arising under this chapter that is based on an untrue statement of a material fact or omission of a material fact necessary to make the statement not misleading," a company or entity shall not be held liable with respect to any written or oral forward-looking statement to the extent that:

1 The PSLRA defines "forward-looking statement" as

> (A) a statement containing a projection of revenues, income (including income loss), earnings (including earnings loss) per share, capital expenditures, dividends, capital structure, or other financial items;
>
> (B) a statement of the plans and objectives of management for future operations, including plans or objectives relating to the products or services of the issuer;
>
> (C) a statement of future economic performance, including any such statement contained in a discussion and analysis of financial condition by the management or in the results of operations included pursuant to the rules and regulations of the Commission;
>
> (D) any statement of the assumptions underlying or relating to any statement described in subparagraph (A), (B), or (C);
>
> (E) any report issued by an outside reviewer retained by an issuer, to the extent that the report assesses a forward-looking statement made by the issuer; or
>
> (F) a statement containing a projection or estimate of such other items as may be specified by rule or regulation of the Commission.

15 U.S.C. § 78u–5(i)(1).

> (A) the forward-looking statement is—
>
> > (i) identified as a forward-looking statement, and is accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement; or
> >
> > ***10** (ii) immaterial; or
>
> (B) the plaintiff fails to prove that the forward-looking statement—

(i) if made by a natural person, was made with actual knowledge by that person that the statement was false or misleading; or

(ii) if made by a business entity; was—

(I) made by or with the approval of an executive officer of that entity; and

(II) made or approved by such officer with actual knowledge by that officer that the statement was false or misleading.

15 U.S.C. § 78u–5(c)(1).“In other words, if a forward-looking statement is accompanied by meaningful cautionary language, the issuer is immune from liability and state of mind is irrelevant.”*Beaver County Retirement Bd. v. LCA–Vision, Inc.,* 2009 WL 806714, *10 (S.D.Ohio March 25, 2009)(citing *Miller v. Champion Enter., Inc.,* 346 F.3d 660, 672 (6th Cir.2003)); 15 U.S.C. § 78u5(c)(1)(A).“If the statement is not accompanied by meaningful cautionary language, the plaintiff must allege specific facts giving rise to a strong inference that the misleading statement was made with actual knowledge that the statement was misleading.”*Id.* (citing *Miller,* 346 F.3d at 672–73); 15 U.S.C. § 78u–5(c)(1)(B).*See also PR Diamonds, Inc.,* 364 F.3d at 682 n. 3; *In re Huffy Corporation Securities Litigation,* 577 F.Supp.2d 968, 990 (S.D.Ohio 2008); *Helwig,* 251 F.3d at 547.

Plaintiffs contend that Defendants' statements are not entitled to immunity under the PSLRA's safe harbor. Plaintiffs argue that some of the statements at issue are not forward-looking statements, that the false guidance statements are not accompanied by meaningful cautionary language sufficient to warn investors of the risk, and that they have adequately alleged that Defendants' statements regarding the Company's earnings guidance were knowingly false when made.

1. Forward-looking statements

Plaintiffs' concede that some of the Defendants' statements, including the revised earnings per share guidance, made in the February 4, 2008 press release and corresponding conference calls concern future economic performance or objectives, and as such, are forward-looking as defined in the PSLRA. *See Beaver County Retirement Bd.,* 2009 WL 806714, * 10 (“guidance, or projections, are by definition forward-looking statements”). However, Plaintiffs identify six present-tense or historical statements that they contend do not qualify for protection under the safe harbor provision of the Exchange Act:

• “In June of this past year we submitted our 2008 Medicare Plan bids similarly targeting an operating margin of approximately 5%.”(Consolidated Amended Complaint at ¶ 72.)

• “We believe that 2007 achievements just described position us well for 2008 both in terms of the existing environment and future trends.”(*Id.*)

• “Regardless, as we've done over the past 20 years we will adjust the benefits to ensure the Medicare medical costs trends matches the net level of premium increase.”(*Id.*)

***11** • “Our rigorous benefit expense trend analysis and forecasting includes regular interaction of many disciplines within our organization, this increases the reliability of our commercial pricing and profit planning.”(*Id.* at ¶ 73.)

• “[I]ts pretty remarkable that we can look and see how much of a spend we have for a particular, for example how much we spend for a cable ad and how many calls that will drive, and then we have statistics around how many of those calls will convert to a lead and how many of those leads will convert to a sale and how many of those sales will result in a referral of a friend or a family member.”(*Id.* at ¶ 75.)

• “Nothing has surprised us this year. We talked last year when we were together that we were surprised with some of our competitors and some of their benefit offerings. Nothing really has been a big surprise for us this year.”(*Id.*)

In response, Defendants agree that four of these statements are present or historical statements. The Court will address these four statements separately in Section IV(B) of this Opinion. Defendants contend that two of the statements identified by Plaintiffs are actually forward-looking: (1) “We believe that 2007 achievements just described position us well for 2008 both in terms of the existing environment and future trends;” and (2) “Regardless, as we've done over the past 20 years we will adjust the benefits to ensure the Medicare medical costs trends matches the net level of premium increase.”

The Court agrees with the Defendants. These statements appear to be forward-looking. The statements refer to being positioned well for 2008 and adjusting benefits in the future to ensure Medicare medical cost trends match premium increases. These statements imply "projections or objectives" and thus fall within the definition of forward-looking statements. *Miller,* 346 F.3d at 678. *See also Hess v. American Physicians Capital, Inc.,* 2005 WL 459638, *6 (W.D.Mich. January 11, 2005); *Harris v. Ivax Corp.,182* F.3d 799, 803 (11th Cir.1999)(statements that defendant's "fundamental business and its underlying strategies remain intact" and that it is "well positioned" were forward-looking). While both statements imply some present facts or circumstances, they are the basis for the later forward-looking statements, and thus qualify as assumptions underlying or relating to a forward-looking statement. *Miller,* 346 F.3d at 677 (statements that "given the continuation of outstanding earnings growth and the successful implementation of our retail strategy" while implying some present circumstances is the basis for the later forward-looking statements and qualifies as an "assumption underlying" a forward-looking statement); *Hess,* 2005 WL 459638, *6 ("[w]e accomplished our major objectives ... in 2002" and "our focus on our current business has resulted in outstanding persistency" qualifies as assumptions underlying forward-looking statements); 15 U.S.C. § 78u–5(i)(1)(D) (a forward-looking statement includes a statement of the assumptions underlying or relating to any forward-looking statements).

2. Cautionary Language

***12** Plaintiffs do not dispute that Defendants' business projections and guidance were accompanied by cautionary language. Instead, Plaintiffs argue that the Court cannot evaluate the adequacy of Defendants' cautionary language on a motion to dismiss. Plaintiffs further contend that these statements were not accompanied by *meaningful* cautionary statements sufficient to warn investors of risks that posed concerns to Humana's financial health. According to Plaintiffs, the cautionary language accompanying Humana's press release, teleconferences, investor meetings, and SEC filings consisted of merely boilerplate disclaimers and were "so broad that they apply to *any* business that sells products to consumers."(Plaintiffs' Response at 31 (quoting *Yanek v. Staar Surgical Co.,* 388 F.Supp.2d 1110, 1123 (C.D.Cal.2005)).

First, Plaintiffs argue that the adequacy of cautionary language is typically a jury question and should not be decided upon a motion to dismiss. Contrary to Plaintiffs' argument, the Sixth Circuit recognizes that applicability of the safe harbor provision of the PSLRA is appropriately considered on a motion to dismiss. *See Miller,* 346 F.3d at 677–78 (affirming dismissal because, among other things, meaningful cautionary language protected the defendants' forward-looking statements); *Helwig,* 251 F.3d at 554 ("Congress apparently intended the applicability of the safe harbor to be addressed even on a motion to dismiss."); 15 U.S.C. § 78u–5(e)(instructing courts to consider "any cautionary statement accompanying the forward-looking statement" upon a motion to dismiss based on the safe harbor provisions); *In re Huffy Corp. Securities Litigation,* 577 F.Supp.2d at 1013 n. 45 ("[T]his Court rejects the Plaintiffs' assertion ... that the question of whether a particular statement has been immunized by the safe harbor provision in the PSLRA cannot be resolved when ruling on a motion to dismiss....").

Second, the Plaintiffs maintain that the statements were not accompanied by meaningful cautionary language to qualify for protection under the safe harbor provision. In order to be protected by the safe harbor provision of the PSLRA, these statements identified as forward-looking must also have been accompanied by "meaningful cautionary language." *Miller,* 346 F.3d at 677. " 'The cautionary statements must convey substantive information about factors that realistically could cause results to differ materially from those projected in the forward-looking statements, such as, for example, information about the issuer's business.'"*Helwig,* 251 F.3d at 558–559 (quoting H.R. Conf. Rep. No. 104–369, at 43 (1995), U.S.Code Cong. & Admin. News at 742); 15 U.S.C. § 78u–5(c)(1)(A)(i))."[B]oilerplate warnings will not suffice."*Id.* (citation omitted)." '[C]autionary statements must be substantive and tailored to the specific future projections, estimates, or opinions ... which the plaintiffs challenge." *Helwig,* 251 F.3d at 559 (citation omitted). However, the PSLRA does not require companies to warn of " 'the particular factor that ultimately causes the forward-looking statement not to come true" in order to receive protection under the safe harbor provision. *Harris,* 182 F.3d at 807. " 'In short, when an investor has been warned of risks of a significance similar to that actually realized, she is sufficiently on notice of the danger of the investment to make an intelligent decision about it according to her own preferences for risk and reward.' " *Helwig,* 251 F.3d at 559 (quoting *Harris,* 182 F.3d at 807).

***13** Defendants' cautionary language here was extensive and specific, and accordingly, "meaningful." At the time Humana issued the February 4, 2008, press release, Humana identified its earnings guidance and statements contained in the news release as "forward-looking" within the meaning of the PSLRA and specifically warned investors that its guidance "may be significantly impacted by certain risks and uncertainties" described in its previous filings with the SEC. (February 4, 2008, Press Release at 1.) Similarly, in the teleconferences and meetings with investors and securities analysts on February 4, February 12, and February 28, Humana representatives at the outset of each of those calls and meetings (i) stated that the presentation included forward-looking statements and (ii) directed participants to Humana's SEC filings which warned of the risks and uncertainties that could impact those forward-looking statements. (Transcript of Humana Conference Call on Feb. 4, 2008 at 1; Humana UBS Global Healthcare Service Conference Presentation on Feb. 12, 2008 at 2; Humana Merrill Lynch Investor Meetings Presentation on Feb. 28, 2008 at 2.)

Humana's SEC filings contained a detailed list of specific factors and uncertainties that could affect its future economic performance, including its earnings guidance. *See* Humana 2006 Form 10–K (February 23, 2007); Humana Form 10–Q (October 29, 2007); Humana 2007 Form 10–K (February 25, 2008). Humana included in its list of risk factors uncertainties related to the Company's internal controls which Plaintiffs assert was responsible for Humana's incorrect earnings projections. Specifically, Humana warned:

> Our business depends significantly on effective information systems and the integrity and timeliness of the data we use to run our business.... Our ability to adequately price our products and services, provide effective and efficient service to our customers, and to timely and accurately report our financial results depends significantly on the integrity of the data in our information systems. As a result of our past and on-going acquisition activities, we have acquired additional information systems. We have been taking steps to reduce the number of systems we operate, have upgraded and expanded our information systems capabilities, and are gradually migrating existing business to fewer systems. Our information systems require an ongoing commitment of significant resources to maintain, protect and enhance existing systems and develop new systems to keep pace with continuing changes in information processing technology, evolving industry and regulatory standards, and changing customer preferences. If the information we rely upon to run our business was found to be inaccurate or unreliable or if we fail to maintain effectively our information systems and data integrity, we could have operational disruptions, have problems in determining medical cost estimates and establishing appropriate pricing, have customer and physician and other health care provider disputes, have regulatory or other legal problems, have increases in operating expenses, lose existing customers, have difficulty attracting new customers, or suffer other adverse consequences.

***14** (Humana 2007 Form 10–K at 18; Humana 2006 Form 10–K at 18.); *see also id.* at 19 ("Failure to adequately protect and maintain the integrity of our information systems and data may result in a material adverse effect on our financial positions, results in operations and cash flows.")

Humana's cautionary language also warned explicitly that its expected earnings were susceptible to risks associated not only with inaccuracies in Humana's data and information systems, but also in the design and pricing of its products. Humana specifically warned investors that failure by the Company to "design and price our products properly and competitively" could cause its profitability to decline. (Humana Form 10–Q (October 29, 2007) at 26.) *See also* Humana 2006 Form 10–K at 17 ("[I]f we lose accounts with favorable medical cost experience while retaining or increasing membership in accounts with unfavorable medical cost experience, our business and results of operations could be materially adversely affected.") Similarly, Humana also informed investors of the manner in which it calculated future benefit and medical claims, the numerous risks associated with its estimation of the costs of the claims and other expenses, and the potential impact of these items on the profitability of the company. (Humana 2007 Form 10–K at 16) ("We estimate the costs of our future benefit claims and other expenses using actuarial methods and assumptions based upon claim payment patterns, medical inflation, historical developments, including claim inventory levels and claim receipt patterns, and other relevant factors.");

see also Humana 2006 Form 10–K at 16). Humana expressly identified numerous factors that could potentially "cause actual health care costs to exceed what was estimated and used to set [Humana's] premiums," including "increased use of medical facilities and services, including prescription drugs; ... our membership mix; variances in actual versus estimated levels of cost associated with new products, benefits or lines of business, product changes or benefit level changes."*Id.*

The cautionary language used gave investors particular information about the effect that utilization of inaccurate benefit claims information and the effect that possible variances in actual verses estimated levels of cost associated with new products, benefits or benefit level changes could have on Humana's financial health. Humana's cautionary statements provided investors company and industry specific-risks and described their impact on Humana's financial results. This cautionary language warned of risks similar to those that ultimately led Humana to revise its earnings guidance downward on March 12, 2008. The Court finds that these " 'cautionary statements are not vague or blanket disclaimers, but instead are substantive, extensive, and tailored to the future-looking statements they reference.' " *Institutional Investors Group v. Avaya, Inc.,* 564 F.3d 242, 258 (3d Cir.2009) (citation omitted). Furthermore, contrary to Plaintiffs' argument, these warnings cannot be characterized as vague or boilerplate simply because Humana made them more than once. *In re Kindred Healthcare, Inc. Securities Litigation,* 299 F.Supp.2d 724, 739 (W.D.Ky.2004) ("Simply because [a warning] is repeated does not classify it as 'boilerplate.' ").

***15** For these reasons, the Court concludes that the forward-looking statements were accompanied by meaningful cautionary language.

3. Actual Knowledge

Finally, Plaintiffs contend that the safe harbor provision does not apply because they have sufficiently alleged that the Defendants had actual knowledge of the internal control problems which led to the inaccurate earnings guidance. Plaintiffs' allegation that the Defendants had actual knowledge of the internal control problems "does not save the claim because the existence of the meaningful cautionary statement renders the issuer's state of mind irrelevant."*Beaver County Retirement Bd.,* 2009 WL 806714, *14. *See Miller,* 346 F.3d at 672("[F]or "forward-looking statements" that are accompanied by meaningful cautionary language, the first prong of the safe harbor provided for in the PSLRA makes the state of mind irrelevant."); *Harris v. Ivax Corp.,* 182 F.3d 799, 803–04, 808 n. 10 (11th Cir.1999)(quoting H.R. Conf. Rep. 104–369, at 44 (1995), reprinted in 1995 U.S.C.C.A.N. 730, 743 ("The first prong of the safe harbor requires courts to examine only the cautionary statement accompanying the forward-looking statement. Courts should not examine the state of mind of the person making the statement.").

B. Present or Historical Statements

Defendants argue that the remaining four present-tense or historical statements not covered by the PSLRA's safe harbor provision are not actionable under Section 10(b) or Rule 10b–5 because Plaintiffs fail to plead facts to support their claim that these statements were false or misleading when made."[T]he PSLRA requires that the complaint 'specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed.'"*PR Diamonds,* 364 F.3d at 681 (quoting 15 U.S.C. § 78u–4(b)(1)).

In their Consolidated Amended Complaint, Plaintiffs identified the following statement as false or misleading: "In June of this past year we submitted our 2008 Medicare Plan bids similarly targeting an operating margin of approximately 5%."(Consolidated Amended Complaint at ¶ 72.) While arguing that this statement is a present or historical statement, Plaintiffs do not contest that Humana submitted its 2008 Medicare Plan bids in June of 2007 or that those bids targeted a 5% operating margin. In as much as Plaintiffs challenge as misleading the actual target set by Humana, this operating margin target is a projection or objective related to the Company's operating margin for Medicare Plan bids, and as such, falls squarely within the PSLRA's definition of forward-looking statements. Accordingly, the Court finds that this statement is not actionable under Section 10(b) of the Exchange Act.

Plaintiffs likewise plead no facts to support the assertion that the statement by Mr. James Bloem, Chief Financial Officer at Humana, that "[o]ur rigorous benefit expense trend analysis and forecasting includes regular interaction of many disciplines within our organization, this increases the reliability of our [C]ommercial pricing and profit planning"(*id.* at ¶ 73) was false or misleading. A review of the

February 4, 2008, teleconference reveals that this statement related to Humana's Commercial business segment and not its Medicare/PDP business. There is no allegation that Humana's Commercial business played any role in the 2008 earnings guidance reduction. Furthermore, Plaintiffs also fail to plead with particularity that the described analysis and forecasting for Humana's Commercial products was false or misleading when made. Plaintiffs securities' fraud claim centers around internal data and control problems related to the PDP pricing and claims information, not Humana's Commercial products.

***16** Finally, Plaintiffs fail to allege the reason or reasons why the remaining statements are false or misleading. In the February 4, 2008, teleconference, Michael McCallister, President and Chief Executive Officer of Humana, discussed Medicare sales stating in relevant part:

> Turning to Medicare sales, we're pleased with the results we're seeing to date with January Medicare Advantage net enrollment up 100,000. The components of this increase include higher retention levels than we had originally expected indicative of the loyalty of our senior members. Gross individual sales are on track while group sales continue to prove challenging as employers continue a wait and see approach.

(Humana Conference Call, February 4, 2008 at 3.) During the question and answer portion of the conference call, Matt Perry with Wachovia initially asked a question related to Humana's spending associated with the Medicare Advantage program. Mr. Perry then asked: "And from your comments, it sounds like attrition is a little bit lower and then the group sales are also a little bit lower, any kind of positive or negative surprises on the PDP upselling so far or the agent sales?"(*Id.* at 16–17.)In response, Jim Murray stated as follows:

> You know, Mike talked about this in some of his remarks. **It's pretty remarkable that we can look and see how much of a spend we have for a particular, for example how much we spend for a cable ad and how many calls that will drive, and then we have statistics around how many of those calls will convert to a lead and how many of those leads will convert to a sale and how many of those sales will result in a referral of a friend or a family member.**I mean, its fairly remarkable, and all of the different sales channels that we have, a direct mail versus a cable TV, and so that is pretty predictable, and there's a lot of levers that we pull. **Nothing has surprised us this year. We talked last year when we were together that we were surprised with some of our competitors and some of their benefit offerings. Nothing really has been a big surprise for us this year.**

(*Id.*) Plaintiffs allege that the statements in bold were false and misleading.

With respect to the statement that "[n]othing has surprised us this year," Jim Murray's response addressed a question related to surprises encountered in Humana's effort to upsell current PDP members into Medicare Advantage plans offered by Humana or in agent sales. Contrary to Plaintiffs' implication, this statement does not address surprises in Humana's PDP pricing and claims information. Plaintiffs have not demonstrated with particularity how the challenged statements regarding Humana's efforts to upsell PDP plan members into Medicare Advantage plans or Humana's agent sales were false or misleading when made. In fact, Plaintiffs have not alleged that PDP upselling or agents sales in any way contributed to the revised earnings guidance. Similarly, with respect to Mr. Murray's discussion of cable advertising and its relation to insurance sales, Plaintiffs fail to plead facts demonstrating that Humana cannot trace its cable advertising to sales of its insurance products. Further, as discussed above, the question and subsequent answer are related to Humana's Medicare Advantage program and not Humana's PDP program pricing and claims information. As a result, Plaintiffs fail to plead facts to support its allegation that these statements were false or misleading.

***17** In sum, the alleged misrepresentations by Humana are either protected by the PSLRA's safe harbor provision for forward-looking statements or are not actionable because Plaintiffs failed to plead sufficient facts to support the claim that the present or historical statements were false or misleading. Accordingly, Humana's motion to dismiss the Plaintiffs' claims under § 10(a) and Rule 10b–5 is granted.

C. Plaintiffs' Section 20(a) Claim Is Dismissed As A Matter Of Law

Control person liability under Section 20(a) is contingent upon the Plaintiffs' ability to prove a primary violation under Section 10(b).*PR Diamonds, Inc.*, 364 F.3d at 696. Because Plaintiffs have not established a primary violation under Section 10(b), the Section 20(a) claim is hereby dismissed as well.

V. CONCLUSION

For the reasons set forth above, **IT IS HEREBY ORDERED** that the motion by the Defendants, Humana Inc., Michael McCallister, James Bloem, and James Murray, to dismiss the Consolidated Amended Class Action Complaint [DN 51] is **GRANTED.**

All Citations

Not Reported in F.Supp.2d, 2009 WL 1767193, Fed. Sec. L. Rep. P 95,260

2014 WL 415730
United States District Court, E.D. Tennessee.

In re MILLER ENERGY RESOURCES SECURITIES LITIGATION.

No. 3:11–CV–386–TAV–CCS. | Feb. 4, 2014.

MEMORANDUM OPINION

THOMAS A. VARLAN, Chief Judge.

***1** Several putative securities class actions were filed against Miller Energy and certain of its officers and directors and subsequently consolidated [Doc. 31]. Oklahoma Firefighters Pension and Retirement System was appointed lead plaintiff and filed a corrected consolidated amended class action complaint (the "complaint") [Doc. 47].

The action is now before the Court on the following motions: Defendant Ford Graham's Rule 12(b)(6) Motion to Dismiss [Doc. 61],[1] Defendants Miller Energy Resources, Inc., Scott M. Boruff, Paul W. Boyd, David J. Voyticky, David M. Hall, and Deloy Miller's Motion to Dismiss Plaintiff's Corrected Consolidated Amended Class Action Complaint [Doc. 63][2] and request for judicial notice [Doc. 63–2][3] and the Request for Oral Argument [Doc. 64].[4] Upon consideration of the motions and the relevant law, and for the reasons explained herein, the Court will **GRANT** Defendant Ford Graham's Rule 12(b)(6) Motion to Dismiss [Doc. 61], **GRANT** Defendants Miller Energy Resources, Inc., Scott M. Boruff, Paul W. Boyd, David J. Voyticky, David M. Hall, and Deloy Miller's request for judicial notice [Doc. 63–2], and **DENY** Defendants Miller Energy Resources, Inc., Scott M. Boruff, Paul W. Boyd, David J. Voyticky, David M. Hall, and Deloy Miller's Motion to Dismiss Plaintiff's Corrected Consolidated Amended Class Action Complaint [Doc. 63].

1 Plaintiff filed a response in opposition [Doc. 66], and defendant Graham replied [Doc. 69].

2 Plaintiff filed a response in opposition [Doc. 68], and defendants replied [Doc. 70].

3 Plaintiff filed a response [Doc. 65], and defendants replied [Doc. 71].

4 Plaintiff filed a response [Doc. 67], and defendants replied [Doc. 71].

With respect to the request for oral argument, this Court considers requests for oral argument on a case-by-case basis. After reviewing the pending motions, the Court finds that oral argument is not necessary. Accordingly, it will **DENY** the Request for Oral Argument [Doc. 64].

I. Background[5]

5 For the purposes of a motion to dismiss, the Court takes plaintiff's factual allegations as true. *See Erickson v. Pardus*, 551 U.S. 89, 94 (2007) (noting that, "when ruling on a defendant's motion to dismiss, a judge must accept as true all the factual allegations contained in the complaint" (citations omitted)).

Lead plaintiff, Oklahoma Firefighters Pension & Retirement System ("plaintiff") commenced this federal securities class action under the Securities Exchange Act of 1934 (the "Exchange Act"), on behalf of itself and all other persons and entities, except defendants and their affiliates, who purchased the common stock of Miller Energy Resources, Inc. ("Miller" or the "Company")[6] between December 16, 2009, and August 8, 2011, inclusive (the "Class Period") [Doc. 47 ¶ 1]. Plaintiff alleges that Miller and members of its senior management—Scott M. Boruff ("Boruff"),[7] Paul W. Boyd ("Boyd"),[8] David J. Voyticky ("Voyticky"),[9] David M. Hall ("Hall")[10] Ford Graham ("Graham"),[11] and Deloy Miller[12]—made false and misleading statements relating to Miller's business and financial condition and the value of its assets, and violated generally accepted accounting principles ("GAAP") in reporting and accounting for the Company's assets, liabilities, revenues, expenses, net income and cash flow, which artificially inflated the price of Miller's common stock during the Class Period [*Id.*].

6 Miller is a Tennessee corporation [Doc. 47 ¶ 21]. Its common stock was traded on the OTC Bulletin Board until May 6, 2010, when it began trading on the NASDAQ Global Market under the trading symbol "MILL" [*Id.*]. Miller was formerly known as Miller Petroleum, Inc. [*Id.*].

7 Scott Boruff has been Miller's Chief Executive Officer and a member of its Board of Directors since August 6, 2008 [Doc. 47 ¶ 22]. He was the President of Miller from June 26, 2010, until June 9, 2011, and is the son-in-law of defendant Deloy Miller [*Id.*].

8 Paul W. Boyd was Miller's Chief Financial Officer and its principal accounting and financial officer from September 23, 2008, through September 19, 2011 [Doc. 47 ¶ 23].

9 David J. Voyticky has been a member of Miller's Board of Directors since April 26, 2010, and has been President of Miller since June 9, 2011 [Doc. 47 ¶ 25]. He was named Miller's acting Chief Financial Officer on September 19, 2011 [*Id.*].

10 David M. Hall has been the Chief Executive Officer of Cook Inlet Energy and a member of Miller's Board of Directors since December 10, 2009 [Doc. 47 ¶ 24]. From January 2008 through December 2009, he was the Vice President and General Manager of Alaska Operations for Pacific Energy Resources, Ltd. [*Id.*]. Prior to that time, he served as Production Foreman and Lead Operator in Alaska and then Production Manager for all of Alaska operations for Forest Oil Corporation, the company that sold the assets at issue to Pacific Energy Resources [*Id.*].

11 Ford F. Graham was appointed as Vice–Chairman of the Board of Directors and President of Miller on December 10, 2009 [Doc. 47 ¶ 26]. He resigned from both positions on June 25, 2010 [*Id.*]. Graham was also the President of Vulcan Capital Corporation, LLC [*Id.*].

12 Deloy Miller founded Miller in 1978 [Doc. 47 ¶ 27]. He has been the Chairman of the Board of Directors since December 1996 [*Id.*]. He served as Miller's Chief Executive Officer from 1967 through August 2008 [*Id.*]. Since that time, he has served as Miller's Chief Operating Officer [*Id.*].

A. Company Background

According to plaintiff, Miller "was a struggling, top-heavy company with little revenue and few assets" that "spent years trying to escape from the penny-stock arena, where it traded for mere cents a share on the OTC Bulletin Board, by attempting to broker small deals that ended up backfiring and triggering serious ongoing legal disputes" [*Id.* ¶ 30]. In August 2008, Deloy Miller arranged for Boruff, his son-in-law, to become the company's Chief Executive Officer ("CEO") [*Id.* ¶ 31]. Boruff previously had been a broker at GunnAllen Financial Inc. ("GunnAllen"), which was "closed by regulators and entered bankruptcy in the wake of investor lawsuits and allegations of a major Ponzi scheme involving Provident Asset Management ("Provident")" [*Id.*]. Boruff hired Darren Gibson, who was Provident's former National Sales Director during the alleged Ponzi scheme, as Miller's National Sales Director, stating in a press release that he had a "proven track record in raising capital" that would "allow Miller to aggressively pursue [Miller's] acquisition and drilling program goals" [*Id.*(quotation marks omitted)].

***2** Plaintiff alleges that Boruff worked at two firms that Miller utilized in connection with a deal that "was a complete failure for Miller" [*Id.* ¶ 32]. In particular, Miller used GunnAllen to broker a sale of 2.9 million shares of its stock to Wind City Oil & Gas, LLC ("Wind City") [*Id.*]. Boruff left GunnAllen in October 2006 and joined Cresta Capital Strategies, LLC ("Cresta"), which also had ties to the Miller–Wind City deal [*Id.*]. That deal ultimately "turned sour" and Miller paid Wind City $10 million to settle the dispute [*Id.*]. Plaintiff further alleges that the Wind City deal was Boruff's only experience in the oil and gas industry prior to becoming Miller's CEO [*Id.* ¶ 33].

According to plaintiff, Boruff "received an extremely lucrative compensation package" when he became CEO of Miller:

> [A] signing bonus of $300,000; a base salary of $250,000 per year; a grant of 250,000 shares of common stock, vesting in equal annual installments over four years or on an accelerated basis if there were a change of control of the Company; options to purchase 250,000 shares of common stock at $0.33 per share; and participation in an incentive compensation program based on meeting various gross revenue and EBITDA targets.

[*Id.* ¶ 34]. Plaintiff avers that this compensation "was not commensurate with Miller's performance" because in 2009, for example, Miller sustained a $3.2 million loss from operations and incurred more than $2.7 in administrative expenses, but had only $1.6 million in revenue [*Id.*].

By September 2008, plaintiff alleges that Miller "was essentially insolvent," as it "had a $751,732 loss from operations, on revenue of only $485,000, for its quarter ended October 31, 2008" and had "an accumulated deficit of $1.4 million" [*Id.* ¶ 35]. Further, for its 2009 fiscal year, which ended April 30, 2009, Miller "had a $3.2 million loss from operations and an accumulated deficit of $1.3 million" [*Id.*]. Plaintiff points to Miller's 2009 10–K, filed August 10, 2009, which indicated that the Company had little ability to obtain significant additional capital, which was needed to implement its business plan [*Id.*]. That filing, according to plaintiff, also "states that the 'ability of the Company to continue as a going concern is dependent upon the successful completion of additional financing and/or generating profitable operations in future periods' " [*Id.* ¶ 36].

B. Miller's Purchase of the Alaska Assets

In August 2007, Pacific Energy acquired the oil and gas properties and operations of Forest Oil Corporation ("Forest Oil") for $463.2 million in a bankruptcy auction, which included certain oil and gas reserves in Alaska that were later purchased by Miller (the "Alaska Assets") as well as other assets in Alaska [*Id.* ¶ 37]. According to plaintiff, Pacific Energy's valuation of the assets was based upon incorrect reservoir estimates [*Id.*]. By spring 2009, Pacific Energy was unable to operate profitably and filed a petition under Chapter 11 with the United States Bankruptcy Court for the District of Delaware [*Id.* ¶ 38].

***3** According to plaintiff, Pacific Energy then attempted to attract a buyer for the Alaska Assets, retaining Lazard Freres & Company LLC ("Lazard") to market the assets [*Id.* ¶ 40]. Lazard prepared an offering memorandum in April 2009 describing the assets; it approached more than forty buyers, of whom only two decided to bid [*Id.*]. An auction was conducted in July 2009 and Pacific Energy received a bid from Ammadon for $8.1 million and from New Alaska Energy for $7 million [*Id.*]. Neither bidder obtained financing, so no sale was consummated [*Id.*]. Pacific Energy then received permission from the Bankruptcy Court to abandon the Alaska Assets, and the State of Alaska retained Nabors Industries ("Nabors") to serve as a monitor of the assets [*Id.* ¶ 41].

In or around September 2009, plaintiff alleges Miller contacted Cook Inlet Enterprises, LLC ("CIE"), which was formed by Hall, Walker Wilcox, and Troy Stafford, for the purpose of acquiring the Alaska Assets [*Id.* ¶ 42]. [13] Plaintiff states Miller agreed to finance CIE's purchase of the Alaska Assets and used CIE to acquire them for itself—the parties executed a non-binding memorandum of understanding, pursuant to which Miller agreed to purchase 100% of the membership interests of CIE upon CIE's successful purchase of the Alaska Assets [*Id.* ¶ 43].

13 Hall and Wilcox were Pacific Energy employees and both had worked at Forest Oil [Doc. 47 ¶ 42]. From January 2008 to December 2009, Hall was the Vice President and General Manager of Alaska Operations for Pacific Energy [*Id.*]. Prior to that time, he had served as the Production Foreman and Lead Operator in Alaska, and then as the Production Manager for all of Alaska operations for Forest Oil [*Id.*]. As such, plaintiff avers, Hall had intimate knowledge of the Alaska Assets, their value, the costs associated with their operation and their production capabilities [*Id.*]

Plaintiff claims this arrangement with CIE was necessary because Miller did not have sufficient funding to purchase the assets [*Id.* ¶ 44]. To secure funding, plaintiff states Miller entered into a letter agreement with Vulcan Capital Corporation ("Vulcan"), a company controlled by Graham, on October 8, 2009, to provide $5.5 million for the purchase of the Alaska Assets [*Id.*]. Miller also borrowed an aggregate of $2.7 million from Miller Energy Income 2009–A, LP ("MEI"), an entity run by Boruff, Boyd, and Deloy Miller, which plaintiff alleges was "formed to covertly raise funds on [Miller's] behalf" [*Id.*].

Plaintiff states CIE sought to purchase the Alaska Assets from Pacific Energy for approximately $875,000 [*Id.* ¶ 45]. Nabor's subsidiary Ramshorn Investments ("Ramshorn") also emerged as a bidder, and a second auction took place on November 5, 2009 [*Id.*]. CIE won the auction with a bid of $2.25 million over Ramshorn's bid of $2.15 million, which was for both the Alaska Assets and additional assets owned by Pacific Energy that CIE did not seek to purchase [*Id.*]. As part of the purchase, CIE agreed to assume the liability to pay $2.2 million for contract cure payments, bonds, and other local, state, and federal requirements [*Id.*].

Also on November 5, 2009, Miller entered into a second financing agreement with Vulcan, which replaced the October 8, 2009 agreement [*Id.* ¶ 46]. Vulcan committed to lend Miller at least $36.5 million at the closing of the Alaska Assets purchase [*Id.*].

The next day, the Bankruptcy Court held a hearing to consider the sale of the Alaska Assets and determine whether Miller was a bona fide purchaser capable of satisfying the bonding and retirement liabilities [*Id.* ¶ 47]. Graham testified that Vulcan would provide the financing for Miller and CIE's acquisition of the Alaska Assets and that Vulcan would stand behind Miller's bonding requirements with Alaska [*Id.*]. He further testified that Vulcan had entered into three or four transactions with Miller in the past and that Vulcan and Miller had conversations weekly about various transactions, and that there would not be a normal operating event that would cause Vulcan to be relieved of an obligation to continue to pay [*Id.*].

Boruff also testified at the hearing, stating that " 'Vulcan Capital Corporation [has agreed to] financial commitments necessary to fund the significant requirements imposed by the State of Alaska ... and that Miller, in connection with Vulcan, has secured all of the financing commitments that have been required' " [*Id.* ¶ 49 (alteration in original)]. Plaintiffs allege this representation, however, was false because Vulcan never provided any funds to Miller and Miller never sought funds from Vulcan, citing Miller's 2010 10–K, which disclosed that " 'We accepted the [Vulcan] letter agreement on November 5, 2009, however we have not proceeded towards a closing of the financing agreement' " [*Id.* ¶ 50 (alteration in original)]. Plaintiff also notes Miller disclosed that Vulcan had advised that the previously promised funds were no longer available [*Id.*].

***4** Plaintiff alleges that Graham was "rewarded handsomely" despite not providing any financing for the acquisition: he became Miller's President and Vice–Chairman of its Board on December 16, 2009, and he received a signing bonus of $200,000, a base compensation of $200,000, and warrants to purchase an aggregate of 1,000,000 shares of Miller common stock [14] [*Id.* ¶ 51]. Graham left Miller on June 25, 2010, because of " 'conflicting business and personal time commitments[;]' " he received $100,000 in severance and was allowed to retain his warrants and certain options [*Id.*]. That same day, the trading volume in Miller's common stock rose to over 2 .8 million shares, more than ten times the average daily trading volume for May 6, 2010, through November 30, 2010 [*Id.*]. Plaintiff alleges that there was no company-specific news that day or previous days to explain the spike in volume and that the reasonable inference is that Graham cashed out his warrants [*Id.*].

14 This consisted of warrants to purchase 400,000 shares exercisable at $0.01 per share, warrants to purchase 200,000 shares exercisable at $0.69 share, warrants to purchase 200,000 shares exercisable at $1.00 per share, and warrants to purchase 200,000 shares exercisable at $2.00 per share [Doc. 47 ¶ 51].

The Bankruptcy Court approved the sale of the Alaska Assets to Miller on November 25, 2009, based in part on Miller's financial commitments from Graham [*Id.* ¶ 52]. [15] On December 10, 2009, Miller acquired 100% of the membership interests in CIE in exchange for four-year stock warrants to purchase Miller stock, as well as $250,000 in cash and an agreement to appoint Hall as a member of the Board of Directors [*Id.* ¶ 53]. That same day, CIE, as a wholly-owned subsidiary of Miller, acquired the Alaska Assets, which consist of onshore and offshore production and processing facilities located in Cook Inlet, Alaska, the Osprey offshore energy platform, over 600,000 net lease acres of land with geologic seismic data, and miscellaneous roads, pads, and facilities [*Id.*].

15 Plaintiff states:

> In the November 25, 2009 order vacating the abandonment of the assets, the Bankruptcy Court found that: "The Sale Agreement constitutes the highest and best offer for the Sold Assets, and would provide a greater recovery for the Debtors' estates than would be provided by any other available alternative."In approving the sale to CIE, the Bankruptcy Court found that the purchase price ($2.5 million cash plus $2.22 million assumed liabilities) was fair consideration for the value of the assets sold: "[t]he consideration provided by the Buyer pursuant to the Sale Agreement constitutes reasonably equivalent value and fair consideration for the Sold Assets."

[Doc. 47 ¶ 52].

C. Alleged False and Misleading Statements and GAAP Violations

Plaintiff alleges that defendants made a series of statements in press releases, SEC disclosure documents, and elsewhere concerning the Alaska Assets and their value, as well as Miller's assets, liabilities, results of operations, and financial condition, during the class period [*Id.* ¶ 54]. In particular, plaintiff alleges that on December 16, 2009, Miller issued a press release announcing the acquisition of the Alaska Assets and declaring that they were worth $325 million, which news caused the price of Miller stock nearly to double overnight [*Id.* ¶¶ 55, 57]. Plaintiff further alleges that defendants continued to remind investors of Miller's investment in Alaska at every possible opportunity during the Class Period [*Id.* ¶¶ 58–84], including increasing the stated value of the Alaska Assets from $325 million to $540 million by May 2010 [*Id.* ¶ 74]. As a result, according to plaintiff, Miller's stock price soared, reaching a Class Period high of $8.04 per share from its pre-acquisition level of $0.70 per share [*Id.* ¶ 140]. Plaintiffs state that valuing the Alaska Assets at over $500 million enabled Miller to secure financing previously unavailable to Miller, which included $100 million from two investment firms [*Id.* ¶¶ 142–46]. And, plaintiff avers, the individual defendants rewarded themselves with pay hikes, bonuses, and stock options [*Id.* ¶¶ 231–36].

***5** Plaintiff alleges that despite these statements and unbeknownst to the marketplace, the actual fair value of the Alaska Assets Miller acquired was not $540 million, or $325 million, but only $34 million [*Id.* ¶ 114]. Plaintiff alleges that defendants fraudulently exaggerated the value of the Alaska Assets in three ways. First, in calculating the asset value, Miller used 11% of net revenues as the assumed cost of extracting oil from the Alaska reserves, a figure completely unreasonable and far below industry standards and Miller's own historical drilling costs [*Id.* ¶¶ 95–106]. Second, in violation of SEC rules, which provide that only oil and gas reserves that can reasonably be exploited within five years should be included in reserve valuations, Miller improperly included the estimated value of reserves that it had no chance of developing within the five-year window [*Id.* ¶¶ 107–113]. Third, Miller ascribed a value of $110 million to fixed assets that it acquired, such as pipelines and drilling stations. Plaintiff states this figure was made up, given Pacific Energy's representation to the bankruptcy court that a fair price for the totality of these fixed assets was under $1 million and Miller itself eliminated this fixed asset valuation from its financial statements in its 2010 10–K [*Id.* ¶¶ 121, 122].

In addition to the misrepresentations concerning the Alaska Assets, plaintiff alleges that defendants also committed a series of accounting violations designed to make Miller look more profitable than it was, such as, *inter alia,* failing to report revenues net of royalty payments [*Id.* ¶¶ 163–200]. Plaintiff states that because Miller lacked any semblance of adequate internal controls, its reported financial statements allegedly violated GAAP throughout the Class Period [*Id.* ¶¶ 135–38]. In March 2011, plaintiff states Miller was forced to restate its financial statements for the first two quarters of fiscal 2011 (the "First Restatement") [*Id.* ¶ 160].

According to plaintiff, on July 28, 2011, two investigative reporters published the first of two articles in Streetsweeper.org based on their independent research, which included interviews with industry veterans, describing how Miller had vastly overstated the value of the Alaska Assets [*Id.* ¶¶ 150–58]. The very next day, on July 29, 2011, Miller filed its Form 10–K for the fiscal year 2011 (the "Second Restatement") disclosing that certain of its prior financial statements-which had already been restated in March 2011–could not be relied upon [*Id.* ¶¶ 161, 177–78]. Days later, on August 1, 2011, Miller retracted this Second Restatement, explaining that its accountants had not approved it [*Id.* ¶ 171], and on August 9, 2011, filed yet another 2011 Form 10–K, disclosing still more accounting violations and admitting that its First Restatement was incomplete [*Id.* ¶¶ 162, 181]. Plaintiffs allege that the sum total of defendants' fraud cost Miller investors over 70% of the value of Miller stock during the Class Period, as the value of Miller's stock rapidly collapsed upon the disclosure of true information exposing Miller's prior accounting and asset valuation improprieties [*Id.* ¶¶ 150–58, 206–14].

D. Claims for Relief and Response to the Complaint

***6** On the basis of these allegations, plaintiff asserts defendants violated Section 10(b) of the Exchange Act and Rule 10b–5 and that defendants Boruff, Boyd and Deloy Miller violated Section 20(a) of the Exchange Act [*Id.* ¶¶ 227–56]. Plaintiff seeks damages pursuant to Section 10(b) and 20(a) in addition to reasonable costs and expenses [*Id.* ¶ 257].

In response, Graham filed a motion to dismiss pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure [Doc. 61], as did defendants Miller, Boruff, Boyd, Voyticky, Hall, and Deloy Miller (the "Miller Defendants") [Doc. 63]. Plaintiff responded in opposition [Docs. 66, 68] and defendants replied [Docs. 69, 70].

In connection with their motion to dismiss, the Miller Defendants filed a request for the Court to take judicial notice [Doc. 63–2]. Plaintiff responded to the motion [Doc. 65] and the Miller Defendants replied [Doc. 71].

II. Standard of Review

A. Rule 12(b)(6) Motions

Federal Rule of Civil Procedure 8(a)(2) sets out a liberal pleading standard, *Smith v. City of Salem,* 378 F.3d 566, 576 n. 1 (6th Cir.2004), requiring only " 'a short and plain statement of the claim showing that the pleader is entitled to relief,' in order to 'give the [opposing party] fair notice of what the ... claim is and the grounds upon which it rests,' " *Bell Atl. Corp. v. Twombly,* 550 U.S. 544, 555 (2007) (quoting *Conley v. Gibson,* 355 U.S. 41, 47 (1957)). Detailed factual allegations are not required, but a party's "obligation to provide the 'grounds' of his 'entitle[ment] to relief' requires more than labels and conclusions." *Twombly,* 550 U.S. at 555."[A] formulaic recitation of the elements of a cause of action will not do," nor will "an unadorned, the-defendantunlawfully-harmed-me accusation." *Ashcroft v. Iqbal,* 556 U.S. 662, 678 (2009).

In deciding a Rule 12(b)(6) motion to dismiss, a court must construe the complaint in the light most favorable to the plaintiff, accept all factual allegations as true, draw all reasonable inferences in favor of the plaintiff, and determine whether the complaint contains "enough facts to state a claim to relief that is plausible on its face."*Twombly,* 550 U.S. at 570; *Directv, Inc. v. Treesh,* 487 F.3d 471, 476 (6th Cir.2007) (citation omitted)."A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged."*Iqbal,* 556 U.S. at 678."Determining whether a complaint states a plausible claim for relief will [ultimately] ... be a context-specific task that requires th[is Court] to draw on its judicial experience and common sense."*Id.* at 679.

B. Securities Claims

Section 10(b) of the Securities Exchange Act and Rule 10b–5, promulgated thereunder, prohibit fraudulent, material misrepresentations in relation to the sale or purchase of securities. *Ind. State Dist. Council of Laborers and Hod Carriers Pension and Welfare Fund v. Omnicare, Inc.,* 583 F.3d 935, 942 (6th Cir.2009). To succeed on a private cause of action for violations thereof, a plaintiff must prove six elements: "(1) a material misrepresentation or omission ...; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation."*Matrixx Initiatives, Inc. v. Siracusano,* ––– U.S. ––––, ––––, 131 S.Ct. 1309, 1317 (2011) (internal quotation marks and citation omitted). Recklessness satisfies § 10(b)'s scienter element if the plaintiff demonstrates that the defendant engaged in "highly unreasonable conduct which is an extreme departure from the standards of ordinary care."*La. Sch. Emps. Ret. Sys. v. Ernst & Young, LLP,* 622 F.3d 471, 478 (6th Cir.2010) (internal quotation marks and citation omitted).

***7** No party disputes that the Private Securities Litigation Reform Act ("PSLRA"), 15 U.S.C. §§ 78u–4 *et seq.,* which was enacted "[a]s a check against abusive litigation by private parties,"*Tellabs, Inc. v. Makor Issues & Rights, Ltd.,* 551 U.S. 308, 313 (2007), applies to this case. The PSLSA "imposes more exacting pleading requirements than Federal Rules of Civil Procedure 8(a) and 9(b)."*Ricker v. Zoo Entm't, Inc.,* 534 F. App'x 495, ––––, 2013 WL 4516095, at *4 (6th Cir. Aug. 27, 2013) (citations omitted).

PSLRA's "exacting pleading requirements" obligate a plaintiff to "state with particularity both the facts constituting the alleged violation, and the facts evidencing scienter, *i.e.,* the defendant's intention 'to deceive, manipulate, or defraud.' " *Tellabs,* 551 U.S. at 313 (citation omitted). To plead "the facts constituting the alleged violation," the complaint "must (1) specify the statements that the plaintiff contends were fraudulent, (2) identify the speaker, (3) state where and when the statements were made, and (4) explain why the statements were fraudulent." *Frank v. Dana Corp.,* 547 F.3d 564, 570 (6th Cir.2008) (internal quotation marks and citation omitted).

For a pleading to qualify as raising a strong inference of scienter, the inference "must be more than merely plausible or reasonable—it must be cogent and at least as compelling as any opposing inference of nonfraudulent intent."*Tellabs,* 551 U.S. at 314.In making this analysis, a court must accept all factual allegations in the complaint as true, consider the complaint in its entirety, including documents incorporated into the complaint by reference and matters of which a court may take judicial notice, and "take into account plausible opposing inferences."*Id.* at 322–24.A complaint failing to comply with PSLRA's pleading requirements "shall" be dismissed. 15 U.S.C. § 78u4(b)(3)(A).

III. Graham's Rule 12(b)(6) Motion to Dismiss [Doc. 61]

Graham was appointed as Vice–Chairman of the Board of Directors and President of Miller on December 10, 2009. He resigned from both positions on June 25, 2010. Graham was also the President of Vulcan Capital Corporation, LLC, with which Miller Energy arranged a financial debt agreement for the acquisition of the Alaska Assets [Doc. 47 ¶ 26]. Plaintiff alleges that Graham was responsible for Miller's statements made during his tenure as President [*Id.*]. Plaintiff notes that Graham received substantial financial compensation for his tenure as President of Miller, including a $100,000 severance payment upon his resignation after seven months on the job [*Id.* ¶ 51]. Plaintiff also notes that trading volume in the Company's common stock was up on the day of Graham's resignation and speculates that the surge in trading volume reflects Graham cashing out his warrants [*Id.*].

In Count I, plaintiff alleges that the defendants disseminated or approved the materially false and misleading statements outlined in the complaint, which they knew, or deliberately or recklessly disregarded, were misleading in that they contained misrepresentations and failed to disclose material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading in violation of Section 10(b) of the Exchange Act and Rule 10b–5 [*Id.* at ¶ 229]. Plaintiff alleges that Graham is liable as a maker of each false and misleading statement specified in paragraphs 55, 58, 61, 63, 65–66, 68, 71, and 74 of the complaint [*Id.* ¶ 235(a)]. Plaintiff alleges that Graham acted with scienter in that he specifically knew the statements were false or misleading or was reckless as to their truth or falsity [*Id.* ¶ 235(b)]. Specifically, plaintiff claims that Graham worked with Hall, Boruff, and Boyd to devise the plan to implement the acquisition of the Alaska Assets [*Id.* ¶ 235(b)(1)]. Graham allegedly learned from Hall the facts regarding the Alaska Assets, including their operating expenses and the value of the fixed assets attached thereto [*Id.*]. Plaintiff also claims that Graham personally participated in convincing the Bankruptcy Court to approve the acquisition [*Id.*]. Further, plaintiff alleges that, as President of Miller, Graham "was duty-bound to inform himself of the true facts regarding the Company and its most important assets" [*Id.* ¶ 235(b)(2)]. Finally, plaintiff claims that Graham was motivated to make the false and misleading statements because he profited handsomely from his involvement in the fraudulent scheme [*Id.* ¶ 235(c)].

***8** In his motion to dismiss, Graham argues that plaintiff fails to meet the heightened pleading requirements articulated above because plaintiff fails "to allege any facts, much less particularized facts, detailing Graham's involvement in making any statements which were materially false or misleading" [Doc. 62]. More particularly, Graham asserts that the complaint fails to identify a single action taken by Graham in preparing or issuing the allegedly false statements and does not allege that Graham was even aware of the statements [*Id.*]. Further, Graham asserts that the complaint does not establish the requisite level of scienter that is required by the heightened pleading requirements of § 10(b) of the Securities Exchange Act and Rule 10b–5 [*Id.*]. The Court finds both of these arguments persuasive.

A. Whether the Amended Complaint States Facts with Particularity Constituting the Alleged Violation

Defendant Graham argues that plaintiff has failed to state with particularity the facts constituting the alleged violation by Graham. Specifically, Graham contends that the complaint fails to connect any of the allegedly false or misleading statements to him. Graham argues that the general allegations that he was "a maker" of the statements and "was responsible" for statements during his tenure as President of the Company fall short of the standard set by the PSLRA [Doc. 62].

In response, plaintiff argues that Graham was responsible for the false and misleading statements made by Miller during his tenure as President. Relying on *Winslow v. BankcorpSouth, Inc.*, No. 3:10–00463, 2011 WL 7090820 (M.D.Tenn. Apr. 26, 2011), and *Janus Capital Group, Inc. v. First Derivative Traders*, ––– U.S. ––––, ––––, 131 S.Ct. 2296 (2011), plaintiff contends that, as President, Graham had the "ultimate authority" for the statements issued by the Company and is therefore liable for those statements [Doc. 66]. Plaintiff also argues that Graham is liable for the false and misleading statements issued by Miller Energy under the group-pleading doctrine [Doc. 66].

In reply, Graham notes that even the complaint alleges that the other individual defendants, not Graham, were the Company's "most senior corporate officers" [Doc. 47 ¶ 237]. Further, Graham notes that none of the statements released during his tenure at Miller were issued by him, signed by him, presented by him, or quote him. Thus, he cannot be a "maker" of the allegedly false statements as required by *Janus* [Doc. 69]. Further, Graham argues that the current validity of the group-pleading doctrine following passage of the PSLRA has not been addressed by the Sixth Circuit [Doc. 69].

Under Rule 10b–5, it is unlawful for "any person, directly or indirectly, ... [t]o make any untrue statement of a material fact" in connection with the purchase or sale of securities. 17 C.F.R. § 240.10b–5(b). The complaint alleges that Graham "is liable as a maker of each false and misleading statement specified in paragraphs: 55, 58, 61, 63, 65–66, 68, 71, and 74" [Doc. 47 ¶ 235]. As noted by Graham, however, none of those paragraphs mention Graham in any way. He is not alleged to have signed any reports, issued any press releases, or made any presentations on the Company's financial status. The complaint generally alleges that the "Individual Defendants possessed the authority to control the contents of Miller's quarterly reports, press releases, and presentations to securities analysts, money and portfolio managers, and institutional investors" and that they "had the ability and opportunity to prevent" the issuance of the Company's reports and press releases or cause them to be corrected [Doc. 47 ¶ 29]. The issue then is whether these allegations state with particularity the facts of the alleged violation; that is, whether Graham "made" the materially false or misleading statements.

***9** In *Janus*, the Supreme Court considered the meaning of "to make" a false statement in Rule 10b–5. 131 S.Ct.

2296.Concluding that the phrase " '[t]o make any ... statement' is the approximate equivalent of 'to state,' " the Court explained as follows:

> For purposes of Rule 10b–5, the maker of a statement is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it. Without control, a person or entity can merely suggest what to say, not "make" a statement in its own right. One who prepares or publishes a statement on behalf of another is not its maker.... This rule might best be exemplified by the relationship between a speechwriter and a speaker. Even when a speechwriter drafts a speech, the content is entirely within the control of the person who delivers it. And it is the speaker who takes credit—or blame—for what is ultimately said.

131 S.Ct. at 2302.Thus, the Court must determine whether the complaint has alleged facts with particularity that Graham had ultimate authority over any of the statements, including their content and whether and how to communicate them.

In light of the admittedly narrow definition adopted by *Janus,* the Court cannot conclude that the complaint sets forth with sufficient particularity facts supporting the conclusion that Graham was a "maker" of the allegedly false statements. As noted above, there are no allegations tying any actions by Graham to any of the statements. Simply asserting that he was a "maker" of the statements with "the authority to control" them, without more, is not enough; these are conclusions, not allegations of facts stated with particularity. In contrast to the allegations in *Winslow* where the complaint "ma[d]e [ ] specific allegations of false ... statements" against the board chairman and "that a particular Defendant merely participated in a conference call or presentation, or approved a document in which false statements allegedly were made,"2011 WL 7090820, at *15, the present case contains no similar allegations against Graham.

Relying on *City of Monroe Employees Retirement System v. Bridgestone Corp.,* 399 F.3d 651, 689 (6th Cir.2005), plaintiff urges the Court to find Graham liable for the allegedly false and misleading statements under the group-pleading doctrine [Doc. 66]. In that case, the Sixth Circuit was asked to find sufficient allegations of scienter against the defendant company's CEO and Executive Vice–President. Quoting the Ninth Circuit, the court noted that the group-pleading doctrine is an exception to the pleading-withparticularity requirements of Rule 9(b) whereby "[i]n 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."399 F.3d at 689 (alteration in original and internal quotation marks omitted) (quoting *Wool v. Tandem Computers Inc.,* 919 F.2d 1433, 1440 (9th Cir.1987)). The Sixth Circuit also noted that some courts have questioned the continued viability of the group-pleading doctrine subsequent to passage of the PSLRA. *Id.* at 689–90.However, the Sixth Circuit declined to decide the current viability of the group-pleading doctrine because the complaint failed to contain sufficient allegations against the individual defendant:

> ***10** The Retirement Fund does not allege by direct allegation or even upon information and belief that Ono played any role in drafting, reviewing, or approving the Firestone's 'objective data' representation or the Bridgestone annual reports, 1999 or any other years. Nor does it allege that he was, as a matter of practice, or by job description, typically involved in the creation of such documents. Even if we permit the group-pleading inference, these alleged facts, without more, are not enough to attribute the alleged misstatements to Ono.

Id. at 690.

It is beyond the purview of this Court to adopt a doctrine that the Sixth Circuit has expressly declined to follow. Further, the absence of any specific factual allegations that defendant Graham took any action, failed to take any action, or played any role whatsoever in preparing or issuing the alleged false or misleading statements supports the conclusion that the plaintiff has failed to allege with sufficient particularity the alleged violations committed by Graham. *See N. Port Firefighters' Pension Local Option Plan v. Fushi Copperweld Inc.,* No., 3:11–cv–00595, 2013 WL 866943, at *29 (M.D.Tenn. Mar. 7, 2013) (declining to follow the group-pleading doctrine because "a fraud claim requires specific allegations as to each defendant's alleged involvement in the securities violations"); *Garden City Emps. Ret. Sys. v. Psychiatric Solutions, Inc.,* No. 3:09–00882, 2011 WL 1335803, at *43 (M.D.Tenn. Mar. 31, 2011) (same); *In re Am. Serv. Grp., Inc.,* No. 3:06–0323, 2009 WL 1348163, at *30 (M.D.Tenn. Mar. 31, 2009) (same).

B. Whether the Complaint States Facts with Particularity That Graham Acted with Scienter

Assuming arguendo that plaintiff's allegations against Graham are sufficient to show he made untrue statements or committed omissions of material facts, the Court turns to Graham's alternative argument that the complaint fails to state facts with particularity that give rise to a strong inference that Graham acted with the requisite state of mind.

Relying on *Konkol v. Diebold, Inc.,* 590 F.3d 390 (6th Cir.2009), *abrogated in part by Matrixx Initiatives,* 131 S.Ct. 1309, Graham argues that fraudulent intent cannot be inferred from his position in the Company and alleged access to information. The allegations that "Graham learned through defendant Hall the facts regarding the Alaska Assets, including their operating expenses and the value of the fixed assets attached thereto[,]" and that, as President, he was "duty-bound to inform himself of the true facts regarding the Company and its most important assets" are, according to Graham, insufficient to show that he recklessly disregarded the information or fraudulently withheld it [Doc. 62].

In response, plaintiff contends that the complaint alleges that Graham had actual knowledge that the value of the Alaska Assets were inflated and of the GAAP violations. Plaintiff also notes the allegations that Graham worked with defendants Hall, Boruff, and Boyd to devise the plan to acquire the assets, "including making it appear that Miller had the financial wherewithal to buy the Alaska Assets" and personally participated in convincing the Bankruptcy Court to approve the acquisition [Doc. 66]. Plaintiff suggests that the "Court may presume that Graham was aware of the true value of the Alaska Assets" based on his position as President and that this "provides support for a strong inference that he acted with scienter, knowingly or, at least recklessly, disregarding the statements inflating their value" [Doc. 66]. Finally, plaintiff contends that Graham was personally motivated to inflate the value of the Alaskan assets and commit GAAP violations for his own financial gain [*Id.*].

***11** As noted initially, the PSLRA requires a plaintiff to "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind."15 U.S.C. § 78u–4(b)(2)(A). That is, the plaintiff must allege with particularity facts showing "the defendant's intention to deceive, manipulate, or defraud,"*Tellabs,* 551 U.S. at 313 (internal quotation marks and citation omitted), or recklessness, " 'a mental state apart from negligence and akin to conscious disregard,' " *La. School Emps. Ret. Sys.,* 622 F.3d at 478 (quoting *In re Comshare Inc. Sec. Litig.,* 183 F.3d 542, 550 (6th Cir.1999)). Recklessness is " 'highly unreasonable conduct which is an extreme departure from the standards of ordinary care. While the danger need not be known, it must at least be so obvious that any reasonable man would have known of it.' " *Id.* at 478 (citation omitted). The Court must take into account "plausible opposing inferences" and review "all the allegations holistically." *Tellabs,* 551 U.S. at 323, 326.A complaint adequately pleads scienter "only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged." *Id.* at 324.

According to the complaint, Graham was President of Miller for approximately seven months, from December 10, 2009, to June 25, 2010 [Doc. 47 ¶ 26]. Graham worked with defendants Hall, Boruff, and Boyd to devise the plan to implement the acquisition of the Alaska Assets through CIE [*Id.* ¶ 235]. Graham learned through defendant Hall the facts regarding the Alaska Assets, including their operating expenses and the value of their fixed assets [*Id.*] and was, in his role as President, "duty-bound to inform himself of the true facts regarding the Company and its most important assets" [*Id.* ¶ 235]. Finally, the complaint alleges that Graham was motivated because he "profited handsomely" from his involvement in the allegedly fraudulent scheme by receiving substantial compensation and options to purchase Company stock for his short tenure [*Id.* ¶¶ 51, 235]. The complaint asserts that, on the day Graham resigned, the trading volume in the Company's common stock was "more than ten times the average daily trading volume" with "the reasonable inference ... that this surge in trading volume reflects Graham cashing out his warrants" [*Id.* ¶ 51].

Taking all the allegations as true, and reviewing the complaint as a whole, a reasonable person could conclude that Graham knew the "true value" of the Alaska Assets. [16] A reasonable person could further infer that the "true value" of these assets was less than represented in statements to the public. There are no allegations, and thus no reasonable inferences to be drawn, however, that Graham took any action whatsoever with respect to this knowledge. There are no specific allegations that Graham intended to deceive, manipulate, or defraud, or that he engaged in highly unreasonable conduct. "Fraudulent intent cannot be inferred merely from the [defendant's] position[ ] in the Company and alleged access to information,"*Konkol,* 590 F.3d at 397, which plaintiff alleges here. Without more, these allegations do not show that it was "obvious" to Graham that Miller was improperly inflating its financial statements. *See id.* at 398.In contrast with the allegations of *In re America Service Group, Inc.,* 2009 WL 1348163, at *60, cited by the plaintiff, the complaint contains no allegations that Graham participated in meetings, signed SEC filings, or participated in earnings announcements sufficient to infer scienter based merely on his position with the Company.

16 It is worth noting, though, that the alleged "plan" to acquire the Alaska Assets occurred prior to Graham's tenure with the Company.

***12** With respect to Graham's compensation, the alleged facts demonstrate only that he received compensation totaling $500,000 (consisting of base compensation, signing bonus, and severance) plus options to purchase Company stock. The allegations regarding the increase in trading volume on the day of Graham's resignation are speculation. There are no factual allegations that Graham exercised his stock options at any time or that such activity would constitute insider trading and thus evidence of scienter. Such an inferential leap is too far to satisfy the high standards of the PSLRA. Accordingly, the Court concludes that plaintiff has not pled facts with sufficient particularity that defendant Graham acted with scienter.

For all these reasons, the Court will grant defendant Graham's motion to dismiss.

IV. Defendants Miller Energy Resources, Inc., Scott M. Boruff, Paul W. Boyd, David J. Voyticky, David M. Hall, and Deloy Miller's Motion to Dismiss Plaintiff's Corrected Consolidated Amended Class Action Complaint [Doc. 63]

The Miller Defendants have moved to dismiss the complaint for failure to state a claim, pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure [Doc. 63]. In connection with this request, the Miller Defendants also ask the Court to take judicial notice of several documents. The Court turns to that request before addressing the merits of the motion.

A. Request for the Court to Take Judicial Notice of Documents in Connection with Motion to Dismiss [Doc. 63–2]

The Miller Defendants move the Court to take judicial notice of certain documents cited in their motion to dismiss, pursuant to Rule 201 of the Federal Rules of Evidence. These documents include: (1) certain filings with the SEC, including (a) Form 10–Q for the quarterly period ended July 31, 2009 [Doc. 63–3 Ex. D], (b) Form 10–Q for the quarterly period ended January 31, 2010 [*Id.*Ex. E], (c) Form 10–Q for the quarterly period ended July 31, 2010 [*Id* .Ex. H], (d) Form 10–Q for the quarterly period ended October 31, 2010 [*Id.*Ex. I], (e) Form 10–Q for the quarterly period ended January 31, 2011 [*Id.*Ex. J], (f) Form 10–Q for the quarterly period ended July 31, 2011 [*Id.*Ex. P], (g) Form 8–K filed with the SEC on May 17, 2010 [*Id.*Ex. F], (h) Form 8–K/A filed with the SEC on March 29, 2010 [*Id.*Ex. Q], (i) Form 10–K for the fiscal year ending April 30, 2010 [*Id.*Ex. G], (j) Form 10–K for the fiscal year ending April 30, 2011 [*Id.*Ex. M], (k) Form 10–K/A for the fiscal year ended April 30, 2011 [*Id.*Ex. N], and (l) the filing detail for Miller Energy Resources Inc.'s Form 10–K for the period ending April 30, 2011 [*Id.*Ex. O]; (2) a Pacific Energy SEDAR filing; (3) the entire *StreetSweeper* reports; and (4) the documents filed in the United States Bankruptcy Court for the District of Delaware. Plaintiff objects only to the Court taking judicial notice of Form 10–Q for the quarterly period ended July 31, 2011 [*Id.*Ex. P], the SEDAR filing, and the documents filed in the United States Bankruptcy Court for the District of Delaware [Doc. 67].

***13** As already noted, in ruling on a motion made pursuant to Rule 12(b)(6), as here, the Court must accept as true all factual allegations in the complaint and draw all reasonable inferences from those allegations, construing the complaint in the light most favorable to the plaintiff. *Ashland, Inc. v. Oppenheimer & Co.,* 648 F.3d 461, 467 (6th Cir.2011). A court may consider other materials, however, if those matters are integral to the complaint, are public records, or are otherwise appropriate for the taking of judicial notice under Rule 201 of the Federal Rules of Evidence. *In re Unumprovident Corp. Sec. Litig.,* 396 F.Supp.2d 858, 875, (E.D.Tenn.2005) (citing *Bovee v. Coopers & Lybrand C.P.A.,* 272 F.3d 356, 360–61 (6th Cir.2001)). The determination of whether a document is "integral" to the complaint is within the court's discretion and is guided by the judicial notice standards of Federal Rule of Evidence 201. *In re Cardinal Health, Inc. Sec. Litig.,* 426 F.Supp.2d 688, 712 (S.D.Ohio 2006).Rule 201 of the Federal Rules of Evidence permits the Court to take judicial notice of facts that are "not subject to reasonable dispute in that [they are] either (1) generally known within the territorial jurisdiction of the trial court or (2) capable of accurate and ready determination by resort to sources whose accuracy cannot reasonably be questioned."Fed.R.Evid. 201(b).

In light of plaintiff's acquiescence, the Court need address only whether it should take judicial notice of the following: Form 10–Q for the quarterly period ended July 31, 2011, the SEDAR filing, and the documents filed in the United States Bankruptcy Court for the District of Delaware.

1. Form 10–Q for the quarterly period ended July 31, 2011

Plaintiff submits that the Court should not consider the Form 10–Q for the quarterly period ended July 31, 2011, because it was filed on September 9, 2011, thirty days after the end of the Class Period, it is not referred to in the complaint, and it is not integral to the allegations made in the complaint [Doc. 67]. Defendants assert that the document is integral to the allegations made in the complaint because it relates to the value of the Alaska Assets. More specifically, defendants state that the complaint alleges the Alaska Assets are worth only $25 million to $30 million, offset by $40 million of liabilities, and the SEC filing demonstrates that the Alaska Assets had generated more than $30 million in oil revenue within eighteen months of the acquisition of the Alaska Assets [Docs. 63–2, 71].

The Court agrees with the Miller Defendants. While the Form 10–Q for the quarterly period ended July 31, 2011, was filed outside the Class Period, it is integral to the complaint because it relates to the value of the Alaska Assets. Moreover, with respect to a claim for securities fraud, a court may consider "the contents of relevant public disclosure documents which are required to be filed with the [SEC] and are actually filed with the SEC."*In re Direct Gen. Corp. Sec. Litig.,* 398 F.Supp.2d 888, 893 (M.D.Tenn.2005). Such documents, however, should be used "only for the purpose of determining what statements the documents contain, not to prove the truth of the documents' contents."*Id.*

2. Pacific Energy SEDAR Filing

***14** Plaintiff argues that the Court should not take judicial notice of Pacific Energy's SEDAR filing because it is not cited in the complaint, nor integral to any statement made in the complaint [Doc. 67]. The Miller Defendants assert that SEDAR is the Canadian system used for electronically filing most securities-related information with the Canadian securities regulatory authorities and thus, like SEC filings, are appropriate for judicial notice. The Miller Defendants also assert the SEDAR filing is integral to the complaint because it "give[s] the Court context of how assets, like the Alaskan Assets, are valued" [Doc. 71]. Alternatively, the Miller Defendants ask the Court to judicially notice "the fluctuating oil process for their impact on the valuation of the Alaskan Assets" [*Id.*].

As noted, a court may consider public records in deciding a Rule 12(b)(6) motion, including SEC filings. *In re Direct Gen. Corp. Sec. Litig.,* 398 F.Supp.2d at 893; *Jackson v. City of Columbus,* 194 F.3d 737, 745 (6th Cir.1999), *overruled on other grounds by Swierkiewicz v. Sorema N.A.,* 534 U.S. 506 (2002); *see also United States ex rel. Dingle v. BioPort Corp.,* 270 F. Supp 2d 968, 972 (W.D.Mich.2003) ("Public records and government documents are generally considered not to be subject to reasonable dispute. This includes public records and government documents available from reliable sources on the Internet."(internal quotation marks and citation omitted)). SEDAR is the Canadian securities document database and thus, the Court may properly consider documents filed therein in ruling on a Rule 12(b)(6) motion. *See Sgalambo v. McKenzie,* 739 F.Supp.2d 453, 464 n. 8 (S.D.N.Y.2010) (taking judicial notice of document " 'filed publicly pursuant to the laws of Canada' ").

3. Bankruptcy Filings

Plaintiff urges the Court not to take judicial notice of the excerpts of the two bankruptcy court filings because the Miller Defendants have failed to provide the Court with "necessary information" from those filings, that is, the entire content of the bankruptcy court filings [Doc. 67]. Plaintiff also asserts the filings are neither cited in the complaint nor integral to the complaint. The Miller Defendants responded by providing the Court with the complete filings and asserting that the documents contain facts relied upon by plaintiff in the complaint [Doc. 71].

A court "may take judicial notice of pertinent matters of public record such as [a] bankruptcy order."*Signature Combs, Inc. v. United States,* 253 F.Supp.2d 1028, 1041 n. 5 (W.D.Tenn.2003); *see also Malin v. JP Morgan,* 860 F.Supp.2d 574, 578 (E.D.Tenn.2012) (judicially noticing bankruptcy petitions and orders from the bankruptcy court). The Court finds that the bankruptcy filings at issue are integral to the complaint because they relate to the Alaska Assets and that the Court may, therefore, properly consider them in connection with the motion to dismiss.

***15** In sum, the Court takes judicial notice of all of the documents identified in the Miller Defendants' request, but does so only to the extent that their "existence or contents prove facts whose accuracy cannot be reasonably questioned." *Passa v. City of Columbus,* 123 F. App'x 694, 697 (6th Cir.2005).

B. Analysis of Motion to Dismiss

The Miller Defendants assert various grounds for dismissal of the complaint, including that plaintiff's allegations regarding Miller's estimates of the value of the Alaska Assets are insufficient, that plaintiff fails to allege particular facts necessary to show the Miller Defendants' statements regarding Miller's internal controls were not true, that plaintiff's allegations regarding Miller's GAAP violations are insufficient, that the complaint fails to raise a strong inference of scienter, and that plaintiff fails to plead loss causation. The Court, however, finds none of these arguments persuasive.

1. Whether the Complaint States Facts with Particularity Constituting the Alleged Violation

The complaint identifies three categories of statements that plaintiff claims were false and misleading: (1) statements regarding the value of the Alaska Assets [Doc. 47 ¶¶ 54–84]; (2) GAAP violations [*Id.* ¶¶ 159–200]; and (3) statements regarding the adequacy of Miller's internal controls [*Id.* ¶¶ 99–123, 137]. With respect to the statements regarding the value of the Alaska Assets, the Miller Defendants argue that the allegations are insufficient and break down plaintiff's allegations about the Alaska Assets into two categories: (1) the estimated value Miller ascribed to the Alaska Assets as an asset on its balance sheet, and (2) estimates of future cash flows that potentially could be generated from the Alaska Assets [Doc. 63–1]. To this end, the Miller Defendants argue that the estimates of the Alaska Assets as an asset are opinions and that plaintiff has not pled that the opinions were not held at the time they were made and that the estimates of future cash flows are protected by the safe harbor. With respect to the GAAP violations, the Miller Defendants assert that plaintiff's allegations do not "cry out" scienter and that the Company's corrected errors improved the Company's financial condition. Finally, regarding the statements about the adequacy of Miller's internal controls, the Miller Defendants assert that "Miller disclosed the very thing Plaintiff contends was concealed" and that Boyd and Boruff never certified that Miller had adequate internal controls [Doc. 63–1].

Turning first to the Miller Defendants' arguments regarding the allegations about the value of the Alaska Assets, the Court finds that the allegations in the complaint are sufficient. First, the Court finds that even if the statements were opinions, as the Miller Defendants assert, plaintiff has pleaded particular facts sufficient to demonstrate that the Miller Defendants [17] did not believe those opinions at the time they were made. Indeed, taking all the allegations as true, and viewing the complaint as a whole, a reasonable person could conclude that the Miller Defendants knew the alleged "true value" of the Alaska Assets and infer that the "true value" of these assets was less than represented in statements to the public [*See* Doc. 47 ¶¶ 99, 111–12, 120–23 (alleging that defendants assumed operating costs of 11% of net revenues, even though historical costs had never been less than 35%, and had even reached over 60%; that defendants could not reasonably have believed that they could develop the undeveloped portions of the Alaska Assets given financial constraints; and that defendants' valuation of the fixed assets was knowingly overblown)]. Second, the Court finds that the valuations of the Alaska Assets are not protected by the safe harbor. As discussed with respect to the Court's analysis of whether plaintiff adequately pleaded scienter, *see infra* Section IV.B.2, even if the valuations were forward-looking statements, plaintiff has pled that the Miller Defendants had knowledge that they were false. *See*15 U.S.C. § 78u–5(c)(1)(B)(i) (safe harbor protection applies only if plaintiff "fails to prove that the forward-looking statement ... was made with actual knowledge by that person that the statement was false or misleading"); *In re Cardinal Health Inc. Sec. Litig.,* 426 F.Supp.2d at 756 ("[B]ecause the Court concluded the Plaintiffs adequately pled scienter based on their numerous allegations, the Court finds that Plaintiff's allegations are, for pleading purposes, sufficient to show scienter as to ... Defendants' forward-looking statements."); *In re SmarTalk Teleservices, Inc. Sec. Litig.,* 124 F.Supp.2d 527, 544 (S.D.Ohio 2000) (finding that scienter for accounting errors was sufficient to establish knowledge of falsity of forward-looking statements).

17 The Court addresses the Miller Defendants collectively, as the parties do in their briefs.

***16** Next, the Court addresses plaintiff's allegations regarding Miller's GAAP violations. The Sixth Circuit has held that "[t]he failure to follow GAAP is, by itself, insufficient to state a securities fraud claim."*In re Comshare, Inc. Sec. Litig.,* 183 F.3d at 553(internal citation omitted). However, where the alleged errors are "especially dramatic" and resemble "pervasive and egregious manipulations" "that 'cry out' scienter," they may be sufficient. *PR Diamonds, Inc. v. Chandler,* 364 F.3d 671, 686 (6th Cir.2004), *abrogated on other grounds byMatrixx Initiatives,* 131 S.Ct. 1309.As discussed *infra* Section IV.B .2, the Court finds that there are sufficient allegations of scienter with respect to the Miller Defendants. Moreover, plaintiff has adequately pled that the Miller Defendants violated GAAP and that such violations were material [*See, e.g.,* Doc. 47 ¶¶ 183–88]. To the extent the Miller Defendants argue that these errors were not material, consideration of that argument is not appropriate at this stage. *See Litwin v. Blackstone Group, L.P.,* 634 F.3d 706, 716–17 (2d Cir.2011) ("Materiality is an 'inherently fact-specific' " finding that can form the basis for dismissal only where the alleged misstatements are "so obviously unimportant to a reasonable investor that reasonable minds could not differ on the question of their importance." (internal quotation marks and citations omitted)). Indeed, plaintiff alleges that Miller restated its financials, which one could infer suggests that Miller "thereby tacitly acknowledged that the previous financial statements were materially misstated, since under [GAAP], restatements are only required to correct material accounting errors." *In re Monster Worldwide, Inc. Sec. Litig.,* 251 F.R.D. 132, 138 (S.D.N.Y.2008).

Finally, the Court turns to plaintiff's allegations about the statements concerning the adequacy of Miller's internal controls. The Miller Defendants argue that, with respect to these allegations, the complaint does not specify each statement that is alleged to have been misleading and the reasons why. The Court disagrees. The complaint alleges that defendants' assurances concerning its internal controls were false because of various known weaknesses and that defendants had to restate their financial statements due in part to inadequate internal controls [*See* Doc. 47 ¶¶ 135–38].*See Simons v. Dynacq Healthcare, Inc.,* No. H–03–05825, 2006 WL 1897270, at *5 (S.D.Tex. July 10, 2006). The Miller Defendants also argue that Boyd and Boruff never certified that Miller had adequate internal controls, but this is a quibble about facts and the complaint, which much be taken as true, alleges that Boyd and Boruff attested to the adequacy of the internal controls [*See id.* ¶¶ 58–59].

Moreover, the complaint specifies why the three types of statements were false and misleading [*Id.* ¶¶ 99–123, 137]. While the Miller Defendants disagree that the statements were false and misleading, their arguments, again, amount to quibbling with the facts alleged. *Ing v. Rock Fin. Corp.,* 281 F.3d 613, 623 (6th Cir.2002) (argument that "invites some degree of inquiry into the facts and circumstances of the case" cannot be resolved on a Rule 12(b)(6) motion). And the complaint alleges with particularity the dates on which the statements were made [*Id.* ¶¶ 55–84], as well as the particular defendant to whom each alleged false statement is attributed [*Id.* ¶¶ 22–27, 231, 232, 233, 234, 236]. Thus, for these reasons, the Court finds that the complaint states with particularity the facts constituting the alleged violation.

2. Whether the Complaint States Facts with Particularity That the Miller Defendants Acted with Scienter

***17** As noted already, the PSLRA requires a plaintiff to "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind."15 U.S.C. § 78u–4(b)(2)(A). That is, the plaintiff must allege with particularity facts showing "the defendant's intention to deceive, manipulate, or defraud,"*Tellabs,* 551 U.S. at 313 (internal quotation marks and citation omitted), or recklessness, "a mental state apart from negligence and akin to conscious disregard,"*La. School Emps. Ret. Sys.,* 622 F.3d at 478 (quoting *In re Comshare Inc. Sec. Litig.,* 183 F.3d at 550). Recklessness is "highly unreasonable conduct which is an extreme departure from the standards of ordinary care. While the danger need not be known, it must at least be so obvious that any reasonable man would have known of it."*Id.* at 478 (citation omitted). The Court must take into account "plausible opposing inferences" and review "all the allegations holistically." *Tellabs,* 551 U.S. at 323, 326.A complaint adequately pleads scienter "only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged."*Id.* at 324.

The Miller Defendants urge the Court to consider whether the complaint adequately pleads scienter by considering the factors set forth in *Helwig v. Vencor, Inc.,* 251 F.3d 540, 550 (6th Cir.2001), *abrogated on other grounds byTellabs,* 551 U.S. 308.The non-exhaustive list of factors is:

(1) insider trading at a suspicious time or in an unusual amount;

(2) divergence between internal reports and external statements on the same subject;

(3) closeness in time of an allegedly fraudulent statement or omission and the later disclosure of inconsistent information;

(4) evidence of bribery by a top company official;

(5) existence of an ancillary lawsuit charging fraud by a company and the company's quick settlement of that suit;

(6) disregard of the most current factual information before making statements;

(7) disclosure of accounting information in such a way that its negative implications could only be understood by someone with a high degree of sophistication;

(8) the personal interest of certain directors in not informing disinterested directors of an impending sale of stock; and

(9) the self-interested motivation of defendants in the form of saving their salaries or jobs.

251 F.3d at 552.While plaintiff suggests that these factors no longer have a place in determining whether a complaint adequately pleads scienter, neither the Sixth Circuit nor the Supreme Court has so stated and, indeed, courts within the Sixth Circuit continue to employ them. *See, e.g., S.E.C. v. Delphi Corp.,* 508 F. App'x 527, 532 (6th Cir.2012); *I.B.E.W. v. Ltd. Brands, Inc.*, 788 F.Supp.2d 609, 630 (S.D.Ohio 2011). This Court will as well, while keeping in mind that it must review the complaint holistically and that an inference of scienter must be "cogent and at least as compelling as any opposing inference of nonfraudulent intent."551 U.S. at 314.

***18** The complaint alleges that Miller knew the statements about the value of the Alaska Assets were false and misleading because it restated its financial statements for the fourth quarter of fiscal year 2010 and for each quarter in fiscal year 2011, its senior officers knew the statements were false, and it knew that its internal controls were inadequate [Doc. 47 ¶ 230]. Regarding the individual Miller Defendants, plaintiff alleges Boruff knew the statements were false because he worked with Boyd, Graham, and Hall, who had experience managing the Alaska Assets (as discussed below), to devise the plan to implement the acquisition of the assets, was responsible, as CEO, for reviewing the information Miller provided to Ralph E. Davis & Associates, the engineering firm Miller retained to prepare reserve estimates for oil and gas in the Alaska Assets, was duty-bound to know the true facts underlying the Company's public filings and inform himself of the true facts regarding the Company, and is an officer of MEI, an entity that raised funds for the acquisition of the assets [*Id.* ¶ 231]. Further, plaintiff alleges that Boruff was "motivated and had the opportunity to make the false and misleading statements because" he would lose his "lucrative compensation package as Miller's CEO" if Miller did not continue as a going concern, he received approximately $169,000 in connection with the acquisition through a side business, he was relieved of his individual exposures, he received compensation tied to Miller's earning results, and he is "so heavily invested in the price of Miller's stock" [*Id.*].

Regarding Boyd, the complaint asserts that he knew the statements were false or misleading because he worked with Boruff, Graham, and Hall, he reviewed the information provided to Davis as Miller's CFO, he signed certifications for Miller's public filings, he was duty-bound, as CFO, to inform himself of the true facts regarding Miller, and he is an officer of MEI [*Id.* ¶ 232]. And plaintiff claims he was motivated to make the statements to "preserve his compensation arrangement and increase the value of his shares and options" [*Id.*].

Plaintiff alleges that Voyticky knew the statements were false and misleading because he served as a member of Miller's board beginning April 26, 2010, has been Miller's President since June 9, 2011, and was named the Company's acting CFO on September 19, 2011, and therefore duty-bound to inform himself of the true facts regarding the company, and because he signed the July 29, 2011 10–K [*Id.* ¶ 233]. And plaintiff states he was motivated to make the statements to receive compensation [*Id.*].

With respect to Hall, plaintiff alleges that he knew the statements regarding the assets were false because he "had spent at least 15 years working with the Alaska Assets, first at Forest Oil Corporation, and then with Pacific Energy, both of which got rid of the Alaska Assets when they filed for bankruptcy, and now at CIE and Miller[,]" he worked with Boyd, Boruff, and Graham to devise the plan to acquire the assets, and he was director of Miller and signed the July 29, 2011 10–K [*Id.* ¶ 234]. Plaintiff claims he was motivated to make the statements "so as to receive compensation from Miller and increase the value of his Miller shares and options" [*Id.*].

***19** Finally, with respect to Deloy Miller, plaintiff asserts that he knew the statements were false and misleading because, as COO, he was duty-bound to inform himself of the true facts regarding Miller, he is one of the officers of MEI, and he signed the July 29, 2011 10–K [*Id.* ¶ 236]. And plaintiff claims he was motivated to make the false statements because, "as the founder of Miller, he had personal interest in seeing that he Company was able to secure funding so that it could continue as a going concern" and because he received financial benefits [*Id.*].

As the Court found in addressing defendant Graham's motion to dismiss, taking all the allegations as true, and viewing the complaint as a whole, a reasonable person could conclude that the Miller Defendants knew the alleged "true value" of the Alaska Assets. A reasonable person could further infer that the "true value" of these assets was less than represented in statements to the public. Contrary to the findings with respect to defendant Graham, though, the Court finds that plaintiff has adequately pleaded scienter with respect to the Miller Defendants. [18]

18 Again, the Court addresses the Miller Defendants collectively, as the parties do in their briefs.

As a general matter, plaintiff alleges that the individual Miller Defendants were in positions within the Company that made them "duty bound" to keep apprised of the true facts regarding the Company, the same as with Graham. While "[f]raudulent intent cannot be inferred merely from [a defendant's] position[ ] in the Company and alleged access to information,"*Konkol,* 590 F.3d at 397, plaintiff asserts more with respect to the individual Miller Defendants. Specifically, the complaint asserts not only that Boruff was the CEO, that Boyd was CFO, that Voyticky was a board member, President, and acting CFO, and that Deloy Miller was COO, but also that the these defendants signed SEC filings and participated in the plan to acquire the Alaska Assets. *See In re Am. Serv. Grp., Inc.,* 2009 WL 1348163, at *60 ("A company's chief executive officer who regularly participates in meetings, signs SEC filings and participates in earnings announcements can be sufficiently involved so as to raise strong inference of scienter."(citation omitted)). Plaintiff also alleges that some of the individual Miller Defendants were or are officers of MEI, an entity that raised funds for the acquisition of the Alaska Assets, as well.

Moreover, while "motive and opportunity alone do not establish strong inference of scienter, ... they may be relevant in scienter pleading."*Hess v. Am. Physicians Capital, Inc.,* No. 5:04–CV–31, 2005 WL 459638, at *12 (W.D.Mich. Jan. 11, 2005) (citing *In re Comshare, Inc. Sec. Litig.,* 183 F.3d at 551)).“In order to demonstrate motive, a plaintiff must show concrete benefits that could be realized by one or more of the false statements...."*PR Diamonds,* 364 F.3d at 690 (citing *Phillips v. LCI Int'l, Inc.,* 190 F.3d 609, 621 (4th Cir.1999)) (recognizing the distinction between "motives common to corporations and executives generally from motives to commit fraud").

***20** The Court finds that the assertions in the complaint about the individual Miller Defendant's motives further support a strong inference of scienter. Plaintiff claims that one motive was to facilitate financing and that the Company was "dependent upon the successful completion of additional financing and/or generating profitable operations in future periods" [Doc. 47 ¶ 36]. Courts have, in fact, recognized that where companies and the individuals who run them are under unusual pressure to achieve certain financial goals, that pressure, "coupled with other factors, can provide motive."*In re Am. Serv. Grp.,* 2009 WL 1348163, at *57 (concluding that "Defendants' motivation to falsify information to assure investors" and "to remain a financially viable company in which to invest" gave rise to strong inference of scienter); *Haw. Ironworkers Annuity Trust Fund v. Cole,* No. 3:10CV371, 2011 WL 1257756, at *10 (N.D.Ohio Mar. 31, 2011) (finding complaint alleged strong inference of scienter where, among other allegations, plaintiff alleged that defendants "deliberately manipulated ... revenue and accounts payable to meet pressure [imposed] to achieve unattainable six percent profit increases").

In addition, the "magnitude of a defendant's compensation package, together with other factors, may provide a heightened showing of motive to commit fraud."*In re Cardinal Health,* 426 F.Supp.2d at 737–38;*see also Tellabs,* 551 U.S. at 325 (pecuniary "motive can be a relevant consideration, and personal financial gain may weigh heavily in favor of a scienter inference"). The complaint contains allegations of the individual Miller Defendant's "lucrative compensation packages," which included stock options, that would have been lost had Miller failed [*See* Doc. 47 ¶¶ 231, 232, 233, 234, 236]. The Court recognizes, though, that the individual Miller Defendants did not sell any stock during the Class Period. *See PR Diamonds,* 364 F.3d at 691 (noting lack of inside sales "dulls allegations of fraudulent motive").

The Court also recognizes the Miller Defendants' arguments that Miller disclosed that it had material weaknesses in its internal controls, that there are no allegations that the public disclosures diverged from internal documents, and that there is a lack of company-insider allegations. *See Helwig,* 251 F.3d at 552.Despite these arguments, the Court finds upon review of the entire complaint that a "reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference ."*Tellabs,* 551 U.S. at 314.

3. Whether the Complaint Sufficiently Pleads Loss Causation

Loss causation is "a causal connection between the material misrepresentation and the loss."*Dura Pharms., Inc. v. Broudo,* 544 U.S. 336, 342 (2005). The Supreme Court has explained that liability for fraud attaches "when the facts ... become generally known and as a result share value depreciates."*Id.* (internal quotation marks and citation omitted).

***21** Loss causation is not subject to heightened pleading standards; rather, allegations of loss causation must be supported only by a "short and plain statement of the claim showing that the pleader is entitled to relief."*See id.* at 346 (citing Fed.R.Civ.P. 8(a)(2)) (assuming without deciding that loss causation is subject to normal pleading standards). Even so, to sufficiently plead loss causation, a complaint must allege more than mere boilerplate. It must specify "the relevant economic loss" sustained by plaintiff and explain "how the loss occurred." *D.E. & J. Ltd. P'ship v. Conaway,* 133 F. App'x 994, 999–1000 (6th Cir.2005)."This includes pleading when the alleged fraud became known, estimating the damages the alleged fraud caused, and (most critically) connecting, other than in "boilerplate language," the alleged loss with the defendants' disclosure."*Fla. Carpenters Reg'l Council Pension Plan v. Eaton Corp.,* ––– F.Supp.2d ––––, ––––, 2013 WL 4054630, at *13 (N.D.Ohio Aug. 9, 2013).

Plaintiff alleges that, throughout the Class Period, defendants' materially false and misleading statements and omissions about the Alaska Assets artificially inflated the price of Miller common stock [Doc. 47 ¶ 207–209]. Plaintiff and the class purchased the common stock at allegedly inflated prices and plaintiff alleges that these purchases would not have been made but for the misrepresentations and fraudulent acts of defendants [*Id.* ¶ 207].

Regarding losses, plaintiff alleges that the July 28, 2011 *StreetSweeper* report "called into question the values Miller had attributed to the Alaska Assets and the accuracy of Miller's financial reporting[,]" causing the price of Miller's stock to fall by $1.64 per share, or 23.3%, and then by $0.99, or 18.33%, the following day [*Id.* ¶ 210]. Plaintiff further alleges that Miller's disclosure on July 29, 2011, that it had misstated its financial statements in prior fiscal periods and revealed that its unaudited consolidated statements of operations and cash flows for the quarterly and year to date periods then ended could no longer be relied upon as a result of improper accounting caused Miller's stock to fall an additional 18% [*Id.* ¶ 211]. Even further, plaintiff alleges that Miller's disclosure on August 1, 2011, before the market opened, that the July 29, 2011 filing should not be relied upon caused Miller's stock to fall 23.5%, or $1.04 [*Id.* ¶ 212]. And finally, plaintiff alleges that Miller's August 9, 2011 disclosure that its financial statements were unaudited and should not be relied upon, among other things, caused Miller's stock to fall 13%, or $0.37 [*Id.* ¶ 213]. In total, plaintiff asserts Miller's stock fell by $5.68, or 70%, as a result of these disclosures [*Id.* ¶ 214]. The Miller Defendants argue that plaintiff fails to adequately plead loss causation because (1) the *StreetSweeper* report was comprised of previously disclosed public information, (2) the July 29 SEC filing was filed after the market closed and therefore could not have caused any loss, and (3) the August 9 SEC filing included information that had been disclosed more than a week earlier in the August 2 SEC filing [Docs. 63–1, 70].

***22** Despite the Miller Defendants' argument, the Court finds plaintiff has sufficiently pleaded loss causation. "[I]n addition to formal disclosure by a defendant, 'the market may learn of possible fraud [from] a number of sources: e.g., from whistleblowers, analysts' questioning financial results, resignation of CFOs or auditors, announcements by the company of changes in accounting treatment going forward, newspapers and journals, etc.'" *In re Winstar Communs.,* No. 01 CV 3014(GBD), 01 CV 11522, 2006 WL 473885, at * 14 (S.D.N.Y. Feb. 27, 2006) (citing *In re Enron Corp. Sec. Derivative & "ERISA" Litig.,* No. MDL–1446, Civ.A H013624, Civ.A. H040087, 2005 WL 3504860, at *16 (S.D.Tex. Dec. 22, 2005)). However, as another district court has recognized, there is no "bright-line test of when a report based on publically released data becomes a corrective disclosure" and the apparent key "is whether the report contains genuinely new information beyond a mere re-characterization of previously disclosed facts."*Meyer v.. St. Joe Co.,* No. 11–cv–27, 2011 WL 3750324, at *6 (N.D.Fla. Aug. 24, 2011)."The author must add significant original insight that identifies, reveals, or corrects prior misstatements, omissions, or improper accounting practices."*Id.*

While the *StreetSweeper* report did include information previously disclosed publicly, the report also included some “new” information from what plaintiff calls “an oil industry veteran with first-hand knowledge of the true costs and difficulties involved in pumping those wells” forming the Alaska Assets [*See* Doc. 47 ¶ 150–58].*Cf. In re Omnicom Group Inc. Sec. Litig.,* 597 F.3d 501, 512 (2d Cir.2010) (affirming dismissal on summary judgment, finding that plaintiff failed to demonstrate any new information in an article regarding defendant's alleged fraud); *In re Almost Family, Inc. Sec. Litig.,* No. 3:10–CV–520–H, 2012 WL 443461, at *13 (W.D.Ky. Feb. 10, 2012) (finding allegations of complaint insufficient where news article that plaintiffs alleged constituted partial disclosure of defendant's misrepresentations because the article focused on a different company, revealed no information about the alleged fraud, and presented no new information to the market); *Meyer,* 2011 WL 3750324, at *3–6 (finding failure to plead loss causation where presentation of an investor with a short position in the defendant's stock did not “indicate an impermissible practice” and only suggested future action the company needed to take). And the Court notes, “to be corrective, the disclosure need not precisely mirror the earlier misrepresentation.”*In re Williams Sec. Litig.-WCG Subclass,* 558 F.3d 1130, 1140 (10th Cir.2009). Further, the Court finds that the *StreetSweeper* report, when considered with the July 29 and August 9 SEC filings supports the finding that plaintiff has met its burden. Indeed, the truth of an alleged misrepresentation may be revealed through a series of disclosures. *See In re DVI, Inc. Sec. Litig.,* No. 2:03–cv–05336, 2010 WL 3522090, at *6 (E.D.Pa. Sept. 3, 2010) (citing cases). Defendants argue that the SEC filings could not have caused any loss, but they do not point the Court to any authority supporting their position.

***23** Thus, construing the complaint in the light most favorable to plaintiff, accepting all factual allegations as true, and drawing all reasonable inferences in favor of plaintiff, the Court finds that plaintiff has sufficiently plead “a causal connection between the material misrepresentation and the loss.”*Dura,* 544 U.S. at 342;*see also D.E. & J. Ltd. P'ship,* 133 F. App'x at 1000 (finding complaint insufficient where plaintiff had “done nothing more than note that a stock price dropped ... never alleging that the market's acknowledgment of prior misrepresentations caused that drop”).

V. Section 20(a) Claim Against Scott M. Boruff, Paul W. Boyd and Deloy Miller

As noted, the complaint alleges violations of Section 20(a) of the Exchange Act against Boruff, Boyd and Deloy Miller [Doc. 47 ¶¶ 247–56]. The only argument defendants make to dismiss this claim is that plaintiff failed to state a claim under Section 10(b) [Doc. 63–1]. In light of the Court's disagreement with this position, *see supra* Section IV, the Section 20(a) claim will survive.

VI. Conclusion

For the reasons explained, the Court will **GRANT** Defendant Ford Graham's Rule 12(b)(6) Motion to Dismiss [Doc. 61], **DENY** Defendants Miller Energy Resources, Inc., Scott M. Boruff, Paul W. Boyd, David J. Voyticky, David M. Hall, and Deloy Miller's Motion to Dismiss Plaintiff's Corrected Consolidated Amended Class Action Complaint [Doc. 63], **GRANT** the request for judicial notice [Doc. 63–2], and **DENY** the Request for Oral Argument [Doc. 64]. Defendant Ford Graham will be **DISMISSED** as a party to this action. The Clerk of Court will be directed to **LIFT** the stay previously imposed in this case. *See*15 U.S.C. § 78u–4(b)(3)(B).

ORDER ACCORDINGLY.

All Citations

Slip Copy, 2014 WL 415730, Fed. Sec. L. Rep. P 97,810

End of Document

KeyCite Blue Flag – Appeal Notification
Appeal Filed by IN RE MOLYCORP. INC. SECURITIE, 2nd Cir., August 17, 2015

2015 WL 1097355
United States District Court,
S.D. New York.

In re MOLYCORP, INC. SECURITIES LITIGATION.

No. 13 Civ. 5697(PAC). | Signed March 12, 2015.

OPINION & ORDER

Honorable PAUL A. CROTTY, District Judge.

***1** Plaintiffs in this putative class action allege that Molycorp Inc. ("Molycorp"), Constantine Karayannopoulos, Mark A. Smith, Michael F. Doolan, John L. Burba, and John F. Ashburn (the "Individual Defendants," and collectively with Molycorp, the "Defendants") violated § 10(b) of the Exchange Act, and Rule 10b–5 promulgated thereunder (Count One), and § 20(a) of the Exchange Act (Count II), Plaintiffs, who purchased Molycorp's common stock between February 21, 2012 and October 15, 2013 (the "Class Period"), claim that Defendants made material misstatements and omissions during the Class Period regarding: (1) the progress of the first phase of Project Phoenix, an effort to modernize Molycorp's rare earths mine in Mountain Pass, California to expand its production capacity; (2) the amount of inventory carried on Molycorp's balance sheet and its cost of sales in the first quarter of 2013; and (3) Molycorp's progress in building commercial potential for SorbX, Molycorp's proprietary water filtration product made of cerium gleaned from Molycorp's Mountain Pass mine.

In January of 2013, after Project Phoenix should already have been completed, Molycorp announced that the project would not be completed for another six months, at which point the stock price fell 22.7% in one day. Likewise, the stock price dropped almost ten percent following Moiycorp's announcement that it was restating its financial results from the first quarter of 2013. Similarly, in October 2013, when Molycorp announced that SorbX had not yet achieved meaningful commercial potential, the stock price fell 21.4%, to $5.58.

Defendants move, pursuant to Fed. R. Civ, P. 12(b)(6) and 9(b), to dismiss the Consolidated Amended Class Action Complaint (the "Complaint"). As discussed below, the Complaint is dismissed because Plaintiffs have insufficiently pled scienter with respect to the Project Phoenix statements and the restatement of financial results, and the statements regarding SorbX are protected forward-looking statements.

FACTS

The allegations in the Complaint, taken as true for the purposes of the motion to dismiss, reflect the following. [1]

1 The Court also includes information from Securities and Exchange Commission ("SEC") filings by Molycorp, which Plaintiffs refer to in their Complaint. *See Litwin v. Blackstone Group, L.P.,* 634 F.3d 706, 707 (2d Cir.2011).

A. Background [2]

2 The Complaint includes allegations from ten confidential witnesses ("CWs"). Plaintiffs identify the confidential witnesses by their dates of employment, positions, and direct supervisors. Compl. ¶¶ 28–38. The Court accepts the allegations of the confidential witnesses, as the information provided "is sufficient to support the probability that someone in their position would possess the information they each have alleged."*In re Fairway Grp. Holding Corp. Sec. Litig.*, 2015 WL 249508, at *9 (S.D.N.Y Jan. 20, 2015) (citing *Novak v. Kasaks,* 216 F.3d 300, 314 (2d Cir.2000)).

Molycorp, a Delaware corporation with headquarters in Greenwood Village, Colorado, produces and sells rare earth and rare metal products. Compl. ¶¶ 18, 39–40. These products are used in clean energy technologies, high-tech devices, critical defenses applications, and advanced water treatment technology. *Id.* ¶ 39. Molycorp's Resources segment extracts rare earth minerals, which Molycorp then markets and sells. *Id.* ¶ 40.

Karayannopoulos is currently the Chairman of the Board of Molycorp, and served as Vice Chairman and Director starting in June 2012, and Interim President and Chief Executive Officer from December 2012 until December 2013. *Id.* ¶ 19. Smith served as Molycorp's Chief Executive Officer until December 2012. *Id.* ¶ 20. Doolan has been Executive Vice President and Chief Financial Officer of Molycorp since June 2012, and its Principal Accounting Officer since August

2012. *Id.* ¶ 21. Burba served as Molycorp's Executive Vice President and Chief Technology Officer from December 2009 until March 2013. *Id.* ¶ 22.

B. Project Phoenix

***2** In 2010, prior to the Class Period, Molycorp announced a "plan to reopen and modernize its long-closed mining facility in Mountain Pass, California, which had been previously shuttered in 2002 due to, among other factors, low demand for rare earths."*Id.* ¶¶ 43, 45. This plan was triggered by the Chinese government's 2010 announcement of new restrictions and export quotas on rare earth metals from China, which provided a favorable market position for non-Chinese rare earth producers. *Id.* ¶ 42. Molycorp named the project "Project Phoenix," [3] and it was intended to increase the run rate of the facility from approximately 3,000 metric tons ("mt") to 19,050 mts of rare earth oxides per year. *Id.* ¶ 45. The production increase was deemed "Phase 1" of Project Phoenix. *Id.* ¶ 46. This project "was expected to take eighteen months and cost $531 million to complete."*Id.* ¶ 45. In its Form 10–K. (Annual Report) for the period ending December 31, 2010, Molycorp stated that "[t]here is no assurance that we will be able to successfully implement our capacity expansion plan within our current timetable."Levin Decl., Ex. D at 19.

3 A phoenix is a mythical creature which achieves a new life by rising from its ashes. This lawsuit may be said to deal with a phoenix's delayed lift off.

On February 21, 2012, Molycorp issued a press release, quoting Smith, stating that Project Phoenix was "on track to achieve its full Phase 1 annual production rate of 19,050 mt of rare earth oxide equivalent by the end of the third quarter of 2012."Compl. ¶ 49. This time table was frequently repeated and confirmed by Individual Defendants. For example, on February 23, 2012, during a conference call with investors to discuss Molycorp's financial results, Smith stated, "[W]e've accelerated the Project Phoenix modernization and expansion of our flagship Mountain Pass facility, which remained on time for a Phase 1 production rate of 19,050 metric tons by the end of third quarter 2012."*Id.* ¶ 51. He also stated that "we succeeded in launching the formal start up of our new Project Phoenix facility this week with early stage operations such as mining, crushing and initial cracking [leaching] operations now underway ... I am pleased to note that this sequential start up of Project Phoenix has occurred well in advance of our previously announced April 1, 2012 timeline."*Id.* ¶ 52. A 10–K filed on February 28, 2012, again warned investors that "[t]here is no assurance that we will be able to successful implement Project Phoenix Phase 1 ... within our current timetable," and that any unanticipated delays of Phase 1 would adversely affect Molycorp's financial condition. Levin Decl., Ex. E at 19–20.

A confidential witness alleges that the press release, and Smith's statements, were misleading because the leaching process was not running at the time; that the development of the leaching process was plagued with problems throughout 2012; and that by August of 2012 management realized that the process as designed would not work. Compl. ¶¶ 52–53. The same witness alleges that despite Smith's statement that the leach process was operational in February 2012, as late as January 2013, the process was only running at a tenth of its capacity. *Id.* ¶ 53. Molycorp continued to reiterate this timetable for the project, however, filing Form 10–Ks and Form 10–Qs (Quarterly Reports) with the SEC with similar language and including the same information in press releases to investors. *Id.* ¶¶ 54–55.

***3** These SEC forms were certified by certain Individual Defendants pursuant to the Sarbanes–Oxley Act of 2002 ("SOX").*Id.* ¶¶ 54–56. On May 10, 2012, Molycorp filed a Quarterly Report with the SEC, which stated that Molycorp "expect[s] our labor and benefits costs to increase through at least 2012 due to the addition of personnel and contractors required to implement Project Phoenix Phase 1 and Project Phoenix Phase 2."*Id.* ¶ 56. This statement also reiterated the schedule for Molycorp's accelerated modernization plan. *Id.* ¶ 57. On May 10, 2012, Molycorp issued a press release announcing its financial results for the first quarter of 2012, quoting Smith as saying, "The start of 2012 has been tremendously productive as we continue to hit each of our major milestones on the path to completion of Project Phoenix."*Id.* ¶ 58. The release went on to say that "the Company anticipates no material changes to its Project Phoenix ... capital budget."*Id.* In a conference call with investors on May 10, 2012, Smith stated that "[w]e remain on track for Phase 1 operations by the beginning of the fourth quarter."*Id.* ¶ 59. He highlighted how smoothly the modernization was going, and praised the work of "the more than 1,850 employees and contractors working daily" on Phase 1. *Id.*Another press release issued on August 2, 2012 reiterated the previously stated schedule for Project Phoenix. *Id.* ¶ 60. That press release, however, identified a fourth quarter completion date for Phase 1, when it previously had been scheduled to be completed in the third quarter of 2012. *Id.* ¶ 61. On August 9, 2012, an SEC filing stated that Molycorp's labor and benefits costs would again increase through "at least 2012" because of additional personnel and contractors necessary to complete Project Phoenix. *Id.* ¶ 63. Press releases issued on August 27, 2012 and August 29, 2012 reiterated that Project Phoenix remained on schedule. *Id.* ¶¶ 64–65. Both the August 9 and August 29 documents mentioned that it was a possibility that the projected schedule would not be met. *See* Levin Decl., Ex. L at 35; Ex. M at 1–2,

Confidential witnesses contend that by early 2012, Defendants knew that there would be delays to Phase 1 because of serious problems in work performed by a contractor, M & K Chemical Engineering. Compl. ¶¶ 67–70. On May 18, 2012, Molycorp terminated M & K, *id.* ¶ 67, and on October 31, 2012, Molycorp sued M & K in the United States District Court for the District of Colorado, *id.* ¶ 105. From November 1 to November 2, 2012, Molycorp's stock dropped 6.7%. *Id.* ¶ 106. Molycorp made no public announcement regarding the suit until November 5, when the company issued a press release informing the public of the suit, but stating that these problems would not impact the timing of plans to increase production at Mountain Pass. *Id.* ¶ 107. On November 8, 2012, Smith stated on a conference call with investors that M & K's poor workmanship would cost Molycorp approximately $150 million in damages. *Id.* ¶ 109. In that same conference call, when asked whether Phase 1 would be complete by the beginning of the fourth quarter of 2012, Smith stated, "I think what we've been saying is that we will have Phase 1 up and running in the fourth quarter. And we are still on track to achieve that."*Id.* ¶ 114. From November 8 to November 9, 2012, Molycorp's stock dropped 14%. *Id.* ¶ 111.

***4** Molycorp reiterated this timetable for Phase 1 in a November 9, 2012 10–Q, a November 23 Form S–4, and a December 11, 2012 press release. *Id.* ¶¶ 116–19. In the December 11 press release, Molycorp announced that Smith had left the company and that Karayannopolous would replace Smith temporarily. *Id.* ¶ 120. JPMorgan analyst Michael Gambardella stated that the reason for Smith's departure was that he had "lost credibility with a number of constituents, shareholders, potential investors and analysts."*Id.* This press release again acknowledged the possibility that the project would not be completed on schedule. *See* Levin Decl., Ex. O at 2. On December 12, 201[2], [4] Molycorp's stock fell from $11.33 to $10.99 and to $10.24 the following day. Compl. ¶ 121.

4 The Complaint reads "December 12, 2013." Comp. ¶ 121. The Court assumes this is a typographical error and that Plaintiffs intended to write December 12, 2012.

Plaintiffs allege that this was but one example of information regarding the project's progress that Molycorp failed to disclose, as the project was plagued with disorganization and poor contracting work. *Id.* ¶¶ 71–104. For example, one confidential witness alleges that "the rare earth mine was shut down for one and a half months in the last quarter of 2012, thereby making it impossible to meet the Phase 1 target date."*Id.* ¶ 85. Likewise, the "caustic crack program," which was Burba's " 'baby,' ' never worked, although $100 million was spent on building a plant for the program, for which management had not done the proper due diligence. *Id.* ¶ 93. Confidential witnesses allege that Burba was involved with all of the operations of the mine and knew about the delays, and that Burba reported numbers regarding the project's progress to Smith. *Id.* ¶ 88.

One witness alleges that Burba and Smith "ignored the reality of the progress of the Project and projected false but promising numbers related to the mine to investors."*Id.* Another witness alleged that there were "periodic presentations, meetings, and general discussions before July of 2012 with both the Molycorp senior management and the team on the ground in Mountain Pass" to discuss the status of Project Phoenix. *Id.* ¶ 97. At these meetings, issues began to pile up, "being constantly behind schedule [was] a theme at Mountain Pass," and "the problems with the Project were so pervasive that employees sometimes referred to the Company as 'Molymess.' " *Id.* Plaintiffs allege that "[b]ecause of these presentations, Defendants were aware that the Project was not progressing according to the announced schedule." *Id.*

On January 10, 2013, when Phase 1 should have already been completed, Molycorp slipped the completion date for Phase 1 to mid-year 2013. *Id.* ¶ 122. In an interview that day, Karayannopoulos admitted to Bloomberg News that Molycorp's projected completion date for Phase 1 of fourth quarter 2012 was too aggressive, not realistic, and should not have been the expectation. *Id.* ¶ 124. That day, Molycorp stock fell to $8.34, a single-day loss of 22.7%. *Id.* ¶ 125. On May 9, 2013, in its 10–Q, Molycorp admitted that the project encountered delays in bringing the leach and multi-stage crack processes up to initial run rate capacity, which Plaintiffs allege directly contradicts Molycorp's February 23, 2012 statement that it had already succeeded in launching the leaching process. *Id.* ¶ 126. Molycorp also admitted that defective engineering work contributed to the delay. *Id.* ¶ 127.

C. Marketability of SorbX

***5** Forty-eight percent of the rare earth content of the Mountain Pass mine is cerium, which is a low-value rare earth metal. *Id.* ¶ 153. Cerium is priced low because "it is an abundant metal in ready supply that has few specialized applications in which it excels."*Id.* ¶ 155. In 2010, Molycorp developed a cerium-based filtration product called SorbX (originally named XSORBX) "in an attempt to build commercial potential for the large amount of cerium in the Mountain Pass mine."*Id.* ¶ 156.

In February 2012, Smith told investors on a conference call that 78% of Phase 1 was "being signed in customer agreement or reserved for XSORBX production. And with regard to XSORBX, we sold a total of 55 metric tons of this product last year. We anticipate sale[s rising] strongly in 2012 and beyond.... Indeed, we expect to sell approximately 1,000 tons of XSORBX product during 2012."*Id* .¶ 159. Molycorp repeated these expectations, including a statement in its 2011 Annual Report released on May 6, 2012, which stated that "XSORBX hold[s] the potential to revolutionize water treatment and purification, [and] also creates high-volume, high value end markets for the cerium produced at Mountain Pass. This greatly improves our cost competitiveness and shields us from traditionally lower cerium prices."*Id.* ¶¶ 162–63.

In its 10–Q, its Results of Operation and Financial Condition, and a conference call with investors, all on May 10, 2012, Molycorp repeated these SorbX sales goals and "emphasized that Molycorp's sales goals were realistic and attainable."*Id.* ¶¶ 164–67. In August, Molycorp told investors that the SorbX commercialization team was "on track with its development efforts, and our 2012 target of selling 1,000 metric tons of [SorbX] has not changed."*Id.* ¶ ¶ 168–69. In November 2012, Molycorp told investors that customer demand was beginning to stabilize and that the company had customer agreements in place or were in advance discussions with customers on the sales in excess of Phase 1 capacity. *Id.* ¶ 171. Doolan noted that Molycorp had made "significant traction on commercializing our XSORBX products."*Id.* In March 2013, Karayannopoulos announced a five-year agreement under which Univar, a distributor of industrial and specialty chemicals, would purchase SorbX for distribution to municipal and industrial wastewater facilities. *Id.* ¶ 175. He also stated that "if the SorbX volumes get to that point, pretty well the entire output of separated cerium from Mountain Pass will be dedicated to SorbX."*Id.* He also stated goals for Mountain Pass's cerium: by the end of 2013, he expected being sold out of the run rate capacity of cerium. *Id.*

Molycorp's 10–K filed on March 18, 2013, stated that the market for SorbX was not yet fully developed and that cerium, of which Molycorp would possess excess amounts if SorbX was not commercially accepted, was in global surplus and faced a significant price decline. Levin Decl., Ex. FF at 21, 24. Molycorp also warned investors that SorbX had not yet been sold or fully commercialized. *Id.* at 24. On May 9, 2013, Karayannopoulos told investors that three municipal waste water trials for SorbX had been scheduled and one was complete. Compl. ¶ 177.

***6** Five months later, in its October 15, 2013 8–K, Molycorp stated that it had "not yet realized meaningful market penetration" for SorbX or other products from the Mountain Pass facility and that Molycorp "continu[d] to expect that we will be unable to sell a substantial portion of our cerium production during 2014."*Id.* ¶ 179. That day, Molycorp's stock price fell 21.4%, to $5.58. *Id.* ¶ 180. A journalist explained the reasons for this drop, stating that Molycorp's announcement "shows ... that Molycorp's rare earths might not be the great source that investors thought the company had."*Id.* ¶ 181. Molycorp allegedly "knew from the beginning of the development of SorbX that initially demand for the product would not be strong, and that building its market position would be a slow and difficult process."*Id.* ¶ 183. Plaintiffs allege that "if anybody within Molycorp was really paying attention and understanding that market, they would have known in 2012 ... [and] certainly by late 2012 that SorbX had no short term potential of achieving market acceptance."*Id.* (internal alterations omitted).

In fact, a confidential witness alleges that Molycorp "knew about a year prior to the October 15, 2013 public announcement regarding cerium that SorbX sales were not going to be profitable and that cerium sales would not be meaningful."*Id.* ¶ 186. Confidential witnesses allege that, from May or June 2011 until at least the end of 2012, Molycorp was stockpiling SorbX in warehouses. *Id.* ¶ 188. Previously, Molycorp had a deal with the Russian government to buy SorbX, but the Russian government backed out of the deal towards the end of 2011 into 2012. *Id.* ¶ 189. Molycorp sold SorbX to itself from January 2012 to August or September 2012. *Id.* ¶ 190, The SorbX plant "never [did] what they had said it was going to do" and only operated at a tenth of the running rate necessary to "keep the damn thing running." *Id* . ¶ 193. Moreover, issues with solvents in the material in several bags sent out by Molycorp meant that these bags had to be returned, refiltered, and shipped back to customers. *Id.* ¶ 194. A confidential witness alleges that employees "never saw much of [SorbX] leaving the plant."*Id.* ¶ 195.

D. Restatement of Financial Results

On May 9, 2013, Molycorp filed a 10–Q with the SEC for the period which ended March 31, 2013, signed by Karayannopoulos and Doolan. *Id.* ¶ 140. On August 8, 2013, Molycorp announced that it would delay the filing of its 10–Q for the period ending June 30, 2013, and that the May 9, 2013 10–Q should not be relied on because it:

> contained an error with respect to the reconciliation of its physical inventory to the general ledger, which resulted in a cumulative overstatement of cost of sales and understatement of current inventory of approximately $ 16.0 million. This error also caused the income tax benefit in the first quarter of 2013 to be overstated by approximately $6.5 million, the disclosure of the consolidated assessment of normal production levels to be understated by approximately $17.4 million, and the consolidated total write-down of inventory to be overstated by $ 18.0 million.... [These statements also] contained an error with respect to the accrual of certain severance charges, which resulted in an understatement of accrued expenses and selling, general, and administrative expense of approximately $2.1 million. This error also caused the income tax benefit in the first quarter of 2013 to be understated by approximately $0.8 million.

***7** *Id.* ¶ 143. This information was important to investors because "if the increased production from the Mountain Pass facility could not be sold, as was indicated by the growing stockpile of unsold inventory, [Project Phoenix] would be a failed investment."*Id.* ¶ 145. From August 8 to August 9, 2013, following this disclosure, Molycorp stock declined 9.7%, dropping to $6.69. *Id.* ¶ 147. This restatement was due to inadequate oversight and rushed inventory counting procedures. *Id.* ¶ 148. Plaintiffs allege that "[d]espite that Defendants were aware of the work environment at the mine, and were aware that employees did not have adequate time or resources to appropriately keep track of inventory, Defendants participated in the preparation and/or dissemination of statements that were likely incomplete or inaccurate."*Id.* ¶ 150. The restatement ultimately decreased Molycorp's net loss attributable to shareholders by $8.3 million, from a net loss of $47,223,000 to a net loss of $38,971,000. *Compare* Levin Decl., Ex. H at 5 to Ex. EE at 5.

E. Procedural History

On August 14, 2013, investors filed the first of two putative securities class action lawsuits. Dkt. 1. The second was filed on August 22, 2013. *See* 13 Civ. 5943. On April 2, 2014, the Court consolidated the two actions and appointed Gary Armstrong Lead Plaintiff. Dkt. 28. Plaintiffs filed the Consolidated Amended Complaint on May 19, 2014, which expanded the Class Period and changed certain defendants.

DISCUSSION

I. Applicable Law

A. Pleading Standards

The Court "must accept as true all of the factual allegations contained in the complaint," and construe the complaint in the light most favorable to the plaintiff, when considering a motion to dismiss pursuant to Fed.R.Civ.P. 12(b)(6).*Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 572 (2007); *see Ashcroft v. Iqbal,* 556 U.S. 662 (2009). The Court does not "assay the weight of the evidence which might be offered in support thereof;" it only "assess[es] the legal feasibility of the complaint."*Lopez v. Jet Blue Airways,* 662 F.3d 593, 596 (2d Cir.2011) (internal quotation marks omitted).

Allegations of securities fraud, however, must meet the heightened pleading standards of Fed.R.Civ.P. 9(b): "[i]n alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake."*See ECA & Local 134 IBEW Joint Pension Trust of Chi. v. JP Morgan Chase Co.*, 553 F .3d 187, 196 (2d Cir.2009) ("*ECA* "). Complaints alleging fraud must: "(1) specify the statements that the plaintiff contends were fraudulent, (2) identify the speaker, (3) state where and when the statements were made, and (4) explain why the statements were fraudulent."*See ATSI Commc'ns, Inc. v. Shaar Fund. Ltd.,* 493 F .3d 87, 99 (2d Cir.2007).

In addition to meeting the requirements of Fed.R.Civ.P. 9(b), a securities fraud complaint must meet the heightened pleading requirements of the Private Securities Litigation Reform Act ("PSLRA"), 15 U.S.C. § 78u–4(b). The PSLRA requires that a securities fraud complaint "state with particularity facts giving rise to a strong inference that the defendants acted with the required state of mind," with respect to each act or omission. 15 U .S.C. § 78u–4(b)(2). Thus, a securities fraud complaint must include facts "(1) showing that the defendants had both motive and opportunity to commit the fraud or (2) constituting strong circumstantial evidence of conscious misbehavior or recklessness."*ATSI,* 493 F.3d at 99. The Court will deem an inference of scienter strong if "a reasonable person would deem [it] cogent and at least as compelling as any opposing inference one could draw from the facts alleged."*Tellabs, Inc. v. Makor Issues & Rights, Ltd.,* 551 U.S. 308, 324 (2007).

B. Claims Under Rule 10b–5

***8** A successful claim under Section 10(b) of the Exchange Act and Rule 10b–5 requires that plaintiff establish each of the following elements: " '[defendants] (1) made misstatements or omissions of material fact; (2) with scienter; (3) in connection with the purchase or sale of securities; (4) upon which plaintiffs relied; and (5) that plaintiffs' reliance was the proximate cause of their injury.' " *In re Puda Coal Sec. Inc., Litig.,* 30 F.Supp.3d 261, 265–66 (S.D.N.Y.2014) (quoting *In re IBM Corp. Sec, Litig.,* 163 F.3d 102, 106 (2d Cir.1998)). In a 10b–5 action, the requisite state of mind is "an intent 'to deceive, manipulate, or defraud.' " *ECA,* 553 F.3d at 198 (quoting *Tellabs*). In the Second Circuit, a "strong showing of reckless disregard for the truth" satisfies the scienter element. *In re Puda Coal Sec. Inc. Litig.,* 30 F.Supp.3d at 266. A defendant executive may be held accountable under Section 10(b) or Rule 10b–5 where the executive had ultimate authority over the company's statement, signed the statement, ratified and approved the statement, or where the statement is attributed to the executive.*Carpenters Pension Trust Fund v. Barclays PLC,* 2014 WL 5334053, at *6 n.59 (S.D.N.Y. Oct. 20, 2014) (quoting *In re Fannie Mae 2008 Sec. Litig.,* 891 F.Supp.2d 458, 473 (S.D.N.Y.2012)).

C. The Safe Harbor Provision of the PSLRA and The Bespeaks–Caution Doctrine

The PSLRA contains a "safe harbor" provision, which protects "forward looking" statements from liability. The PSLRA directs that "a defendant is not liable if the forward-looking statement is identified and accompanied by meaningful cautionary language *or* is immaterial *or* the plaintiff fails to prove that it was made with actual knowledge that it was false or misleading."*Slayton v. Am. Express Co.,* 604 F.3d 758, 766 (2d Cir.2010) (emphasis in original); 15 U.S.C. § 78u–5(c). Similarly, the "bespeaks-caution" doctrine, a "counterpart" to the safe-harbor provision, protects "forward-looking statements that adequately disclose the risk factors that might cause a different outcome to occur than the one forecast by the issuer."*City of Austin Police Ret. Sys. v. Kinross Gold Corp.,* 957 F.Supp.2d 277, 300–01 (S.D.N.Y.2013) (*citing Iowa Pub. Emps.' Ret. Sys. v. MF Global, Ltd.,* 620 F.3d 137, 141 & n.8 (2d Cir.2010)).

II. Analysis of Section 10(b) and Rule 10b–5 Allegations

Defendants argue that Plaintiffs' Complaint should be dismissed because (1) the relevant statements were forward-looking and accompanied by meaningful cautionary language; were non-actionable statements of opinion, corporate optimism, and puffery; and were not made with actual knowledge that they were false or misleading; (2) Individual Defendants cannot be held liable under Section 10(b) for statements they did not make; (3) the Complaint fails to plead a strong inference of scienter; and (4) the Complaint does not adequately allege corporate scienter of Molycorp.[5] Moreover, Defendants argue that because Plaintiffs have not alleged an underlying primary violation by either Molycorp or the Individual Defendants, Plaintiffs' Section 20(a) claim must fail. *See* Def. Mem.[6] Plaintiffs reject each of these arguments. *See* Pl. Mem.

5 Defendants briefly suggest that Plaintiffs have insufficiently pled reliance and have failed to allege "that each alleged misrepresentation actually affected the price of Molycorp stock."Def. Mem. at 7 n.8. Plaintiffs incorrectly state that "Defendants challenge only the first two elements [of a 10b–5 action, that is, material misrepresentation or omission and scienter] and thus have waived any challenges to the others."Pl. Mem. at 5. Since the Court's finding with respect to these first two elements is dispositive of the case, the Court does not address Defendants' arguments about Plaintiffs' reliance allegations.

6 Defendants also argue that Plaintiffs' Complaint fails to meet the requirements of the PSLRA and Fed.R.Civ.P.

9(b) because the Complaint simply makes "a single boilerplate, conclusory allegation of falsity" after each set of alleged misstatements and that this makes it impossible to discern specifically why each particular statement was false or misleading when made. Def. Mem. at 8–9. The Court, however, finds that the structure of Plaintiffs' Complaint is not a basis for dismissal of the Complaint.

A. Project Phoenix

***9** Although several of Defendants' statements regarding Project Phoenix constitute forward-looking statements which merit protection under the safe harbor provision and the bespeaks-caution doctrine, Plaintiffs have failed to demonstrate that these statements were made with the required scienter, and this issue is dispositive of all allegations regarding Project Phoenix statements. Accordingly, the Court does not distinguish between those statements that are protected by the safe harbor provisions and those that are not.

As discussed above in Section 1.A (pp. 12–13, *supra*), with respect to scienter, Plaintiffs must allege facts demonstrating that defendants either had motive and opportunity to commit the alleged fraud or constituting strong circumstantial evidence of conscious misbehavior or recklessnesss. *ATSI,* 493 F.3d at 99; *accord Stratte–McClure v. Morgan Stanley,* 2015 WL 136312, at *10 (2d Cir.2015). To prevail on a showing of motive, Plaintiffs must plead more than simply "motives that are generally possessed by most corporate directors and officers;""plaintiffs must assert a concrete and personal benefit to the individual defendants resulting from the fraud."*Kalnit v. Eichler,* 264 F.3d 131, 139 (2d Cir.2001); *see also Bd. of Trs. of City of Ft. Lauderdale Gen. Emps' Ret. Sys. v. Meckel OAO,* 811 F.Supp.2d 853, 867 (S.D.N.Y.2011) (finding that a "unique connection between the fraud and the [benefit]" must exist). Here, Plaintiffs have failed to allege motive, and do not dispute Defendants' contention that they fail to so allege.

Pleading a conscious misbehavior or recklessness theory comes with an attendant stricter standard. *See In re Citigroup Sec. Litig.,* 753 F.Supp.2d 206, 233 (S.D.N.Y.2010) (" 'Where motive is not apparent, it is still possible to plead scienter by identifying circumstances indicating conscious behavior by the defendant, though the strength of circumstantial allegations must be correspondingly greater.'") (quoting *Kalnit,* 264 F.3d at 142). A finding of recklessness requires a showing of "conduct which is highly unreasonable and which represents an extreme departure from the standards of ordinary care ... to the extent that the danger was either known to the defendant or so obvious the defendant must have been aware of it."*Novak v. Kasaks,* 216 F.3d 300, 308 (2d Cir.2000) (internal quotation marks and citations omitted). Several "important limitations on the scope of liability for securities fraud based on reckless conduct" exist, including that "allegations that defendants should have anticipated future events and made certain disclosures earlier than they actually did do not suffice to make out a claim of securities fraud," and that "as long as the public statements are consistent with reasonably available data, corporate officers need not present an overly gloomy or cautious picture of current performance and future prospects."*Id.; accord In re Agnico–Eagle Mines Ltd. Sec. Litig.,* 2013 WL 144041, at *13 (S.D.N.Y. Jan. 14, 2013).

***10** Plaintiffs' allegations fail to meet this high burden. First, a close analysis of the allegations of confidential witnesses reveals that the Complaint does not actually come close to alleging Defendants' knowledge of delays at the mine until, at the earliest, June 2012. For example, CW5 alleges that "by August of 2012, management realized that the process as designed would not work."Compl. ¶ 53. CW5 also alleges that "this information [that the leach process was only running at a tenth of its capacity] was presented to Defendants Karayannopoulos and Burba ... in January of 2013."*Id.* CW1 asserts that when he was hired in July of 2012, Project Phoenix was ' "a mess.' " *Id.* ¶ 72. CW3 alleges that "in June or July of 2012, the Mountain Pass power plant, which was built to power the Project, only ran for a few hours at a time." *Id.* ¶ 81. CW4 "stated that the rare earth mine was shut down for one and a half months in the last quarter of 2012, thereby making it impossible to meet the Phase 1 target date." *Id.* ¶ 85. The same witness alleged that the mine did not receive a major piece of equipment for the "Chloro Alkali plant until January or February 2013." *Id.* ¶ 87. He also stated that between June 2012 and November 2012, Burba was on site on a monthly basis and was apprised of the site problems, "including the obstacles to meeting Project Phoenix deadlines." *Id.* ¶ 88.

None of these claims even suggest Defendants' awareness of the problems prior to June 2012.[7] Accordingly, this dearth of scienter allegations means that a large portion of the statements which Plaintiffs allege are actionable, made during February and May, are patently not actionable. Plaintiffs' attempt to rely on allegations regarding the defects in the work performed by M & K to demonstrate scienter during this time fails because the allegations do not present a compelling inference of the requisite state of mind. That poor work was done and that the damages were significant enough for

Molycorp to sue M & K does not mean that Molycorp knew its proposed schedule was no longer viable. It is equally as likely, and indeed more compelling, that Molycorp believed it could remedy this damage within the existing time frame, particularly because Molycorp had numerous contractors and sub-contractors working on Phase 1, and sought to repair the damage swiftly. *See* Compl. ¶ 107.

7 With respect to the allegation that there were periodic meetings before July of 2012, Compl. ¶ 97, these allegations do not specify which, if any, defendants were there, and what, if any, information was discussed regarding delays that would prevent the completion of Project Phoenix on the announced timetable. Likewise, the allegation that “[b]y early 2012, Defendants knew that there would be delays to Phase 1,” Compl. ¶ 67, is wholly conclusory.

With respect to Defendants' statements in August, November, and December 2012, Plaintiffs' allegations still do not suffice to provide strong circumstantial evidence of conscious misbehavior or recklessness. The remaining allegations from confidential witnesses are equally devoid of facts demonstrating that Defendants knew they would fail to meet the announced schedule when the statements were made. For example, even if it is true that “by August of 2012, management realized that the [leaching] process as designed would not work,” Plaintiffs fail to show that Defendants should not have believed that its instruction to engineers to “redesign the leach process and to build the redesigned process quickly,” Compl. ¶ 53, was feasible and would ensure completion on the previously-stated timetable. Likewise, Plaintiffs' allegation that Defendant Burba “was apprised of site problems,” Compl. ¶ 88, in addition to being largely conclusory, also suggests the more compelling inference that Burba simply believed these problems could be overcome within the announced timeframe. These allegations may show “ ‘that the defendants should have been more alert and more skeptical, but nothing alleged indicates that management was promoting a fraud.’ “ *In re Agnico–Eagle Mines,* 2013 WL 144041, at *15 (quoting *Shields v. CityTrust Bancorp., Inc.,* 25 F.3d 1124, 1129–30 (2d Cir, 1994)); *accord S. Cherry Street, LLC v.. Hen nessee Grp. LLC,* 573 F.3d 98, 110–11 (2d Cir.2009) (“To meet the ‘strong inference’ standard, it is not sufficient to set out facts from which, if true, a reasonable person *could* infer that the defendant acted with the required intent.”) (quoting *Tellabs,* 551 U.S. at 314) (internal quotation marks omitted).

***11** Plaintiffs' allegation that numbers were reported to Smith and that Smith was in turn reporting false numbers to investors is too conclusory to support a finding of scienter. Compl. ¶¶ 88, 100–01. Plaintiffs do not point to specific, existing reports that were given to Smith, nor does the confidential witness allege that he directly spoke to Smith or Burba or was present when such information was conveyed. *See In re Gildan Activewear, Inc. Sec. Litig.,* 636 F.Supp.2d 261, 272–73 (S.D.N.Y.2009) (“Where plaintiffs contend defendants had access to contrary facts, they must specifically identify the reports or statements containing this information to indicate how it was inconsistent with the statements made.”),

While Plaintiffs argue that Defendants must have known of the delay in completion of Phase 1 prior to its announcement on January 10, 2013, “[m]anagers ... are entitled to investigate for a reasonable time, until they have a full story to reveal.”*Higginbotham v. Baxter Int'l, Inc.,* 495 F.3d 753, 761 (7th Cir.2007); *accord Kinross,* 957 F.Supp.2d at 304 (“Although today it is known that the schedule was not met, [Plaintiff] has not sufficiently alleged that defendants [at the time the statements were made] knew or were reckless in setting or adhering to that schedule.”).[8] Just because something is wrong or incorrect as a matter of fact does not mean it was reckless. Likewise, Plaintiffs' assertion that Karayannopoulos admitted that Phase 1 timelines were not realistic, and that this constitutes an admission that Defendants' prior statements had been reckless, must fail because recklessness and erroneousness are not equivalent. While Plaintiffs argue that “ ‘the Court does not need to identify the precise moment at which the culpable inference overtook the innocent one,’ “ Pl. Mem. at 15 (quoting *In re ITT Educ. Servs., Sec. Litig.,* 34 F.Supp.2d 298, 310 (S.D.N.Y.2014)), here, Plaintiffs have failed to show that a culpable inference ever overtook an innocent one. Because Defendants eventually disclosed the delay, Plaintiffs' position, that these statements should be found actionable, “would impose too high a burden of clairvoyance and continuous disclosure on corporate officials.” *In re Agnico–Eagle,* 2013 WL 144041, at *19.

8 Plaintiffs argue that *Kinross* ultimately supports their scienter argument because there the Court found two statements actionable, finding that Defendants ultimately should have known of delays that would affect the projected schedule. Pl. Mem. at 17. But in *Kinross,* Plaintiffs had sufficiently alleged that Defendants had to have known that their predicted schedule would not

be met, under circumstances that do not exist here, such as "concrete facts known to Kinross, but not the public, ... that made it all the more likely that the old construction schedule could no longer realistically be met."957 F.Supp.2d at 306–07. Moreover, in *Kinross* the information that arose made it clear that Defendants' projected schedule would be impossible to meet; here, Plaintiffs have failed to show that any facts existed at the time Defendants made the challenged statement that demonstrated that the schedule was *impossible* to meet.

In its entirety, Plaintiffs' allegations regarding Project Phoenix read as a classic example of "fraud by hindsight." *See In re Bank of Am. Corp. Sec., Derivative, and ERISA Litig.,* 2012 WL 1353523, at *9 (S.D.N.Y. Apr. 12, 2012) (criticizing the practice of pleading "a retrospective critique" of Defendants' actions) (citing *Novak,* 216 F.3d at 309). Plaintiffs respond to this argument by merely citing precedent holding that allegations of misrepresentations and omissions that were misleading and false at the time they were made do not constitute fraud by hindsight. Pl. Mem. at 14–15. But, as Plaintiffs have failed to show that Defendants' statements were made with the required scienter, Plaintiffs have also failed to show that they are not simply pleading fraud by hindsight. *See, e.g., Kinross,* 957 F.Supp.2d at 304 ("To permit [plaintiff's] claim to go forward based on [Defendants'] later abandonment of the schedule would effectively permit plaintiffs to allege 'fraud by hindsight.' ").

***12** Plaintiffs urge the Court to take a "holistic[ ]" view of the scienter allegations and to consider in support of a demonstration of scienter the facts that the financials were SOX-certified; that Project Phoenix was a "core operation" of Molycorp; and that certain Individual Defendants were "forced" to resign during the class period. Pl. Mem. at 21, 22–24. In support of this argument, Plaintiffs cite *In re Atlas Air Worldwide Holdings Inc. Securities Litigation,* 324 F.Supp.2d 474 (S.D.N.Y.2004), which found Defendants liable under Rule 10b–5 and considered allegations of scienter buttressed by the fact that Defendants provided signatures and certifications pursuant to SOX, *id.* at 492. But in *Atlas Air,* unlike here, confidential witnesses specifically alleged that a named defendant was in possession of the results of a specific corrected inventory and that prior to the disclosure of the financial misstatements, a confidential witness overheard a manager of revenue accounting state that the company had failed to write down debts that should have been written off. *Id.* at 492.

Such allegations, directly tying defendants to knowledge of the falsity of financial statements, are lacking in the instant case. Accordingly, in the absence of more particularized allegations of scienter, that certain Defendants signed or certified SEC disclosures is insufficient to support a finding of scienter. *See In re MBIA, Inc. Sec. Litig.,* 700 F.Supp.2d 566, 589–90 (S.D.N.Y.2010). Likewise, without factual allegations linking Defendants' resignations to the alleged fraud, the mere fact of the resignations provides no support for a finding of scienter.[9] *See In re UBS AG Sec. Litig.,* 2012 WL 4471265, at *18 (S.D.N.Y. Sept. 28, 2012). With respect to Plaintiffs' argument that the "core operations" doctrine provides support for a finding of scienter here, Compl. ¶ 135; Pl. Mem. at 22–23, while the Second Circuit has "expressed some support for the idea that the core operations doctrine survived the enactment of the PSLRA in some form," the majority approach has been to consider such allegations as a "supplementary but not independently sufficient means to plead scienter."*Johnson,* 2013 WL 214297, at *17–18 (S.D.N.Y. Jan. 17, 2013) (quoting *In re Wachovia Equity Sec. Litig.,* 753 F.Supp.2d 326, 353 (S.D.N.Y.2011)). In light of the fact that there is no other basis for finding scienter here, Plaintiffs' core operations allegations are inadequate to provide such support.

9 Plaintiffs' bare allegation regarding an industry analyst's statement that Smith had "lost credibility," Compl. ¶ 120, is not sufficient to link Smith's resignation to the alleged fraud.

For the foregoing reasons, Plaintiffs have inadequately pled scienter with respect to the Project Phoenix statements, and accordingly Plaintiffs' claims based on these statements are dismissed.

B. Statements Regarding SorbX

With respect to the allegations of fraudulent statements regarding SorbX, Plaintiffs allege that Defendants' statements are not protected by the safe harbor provision or the bespeaks-caution doctrine because these doctrines do not protect "statements based upon historical or current fact, or contradicted by contemporaneous knowledge of the statement's falsity."Pl. Mem. at 6. Even if protected by these doctrines, Plaintiffs argue, "even truthful announcements of apparent business successes—like those at issue here-give rise to a duty to disclose known related problems."*Id.* at 7. Plaintiffs also allege that the statements concealed known risks, do not constitute inactionable opinion statements, were too specific to constitute puffery, and were made with scienter.

***13** These arguments fail in light of the fact that Plaintiffs have not shown that these forward-looking statements were made with actual knowledge that the statement was false or misleading when made. The majority of statements regarding SorbX identified in the complaint are "classically forward-looking—they address what defendants expected to occur in the future."*In re Sanofi Sec. Litig.,* 2015 WL 365702, at *19 (S.D.N.Y. Jan. 28, 2015). For example, that Molycorp "expect[ed] to sell approximately 1,000 ton of XSORBX product during 2012," Compl. ¶ 159, and believed that "achieving the internal target penetration rates [was] very realistic,"*id.* ¶ 166, reflects the company's future intentions and expectations for SorbX. *See Johnson v. Sequans Commc'ns S.A.,* 2013 WL 214297, at *15 (S.D.N.Y. Jan. 17, 2013).

Plaintiffs' allegations regarding Defendants' knowledge that SorbX sales would be lower than previously stated fail to present a strong inference of actual knowledge. "The scienter requirement for forward-looking statements—actual knowledge—is stricter than statements of current fact.'" *In re Sanofi,* 2015 WL 365702, at *14 (internal citations omitted). Here, Plaintiffs' allegations of Defendants' knowledge are both speculative and conclusory. For example, the allegation from a confidential witness that if anyone in management was "paying attention," they would know by late 2012 that SorbX had no short term commercial potential, does not meet this standard.

Nor do the following allegations marshaled by Plaintiffs in an attempt to demonstrate Defendants' actual knowledge of the falsity of the SorbX statements: (1) that Burba was involved in all operations at the mine; (2) that a former Main Project Manager and Shift Supervisor told a confidential witness that executive management already knew the sales of SorbX would not be productive; (3) that Smith or the Head of Shift Foremen would have known about the SorbX problems because "CW9 was told that the information was passed down to CW9 from the 'top;' " and (4) that SorbX was being stockpiled in warehouses, previously had a buyer in the Russian government who backed out, and that Molycorp was selling SorbX to itself. Compl. ¶¶ 183–196. None of these allegations provide support for the assertion that Defendants had actual knowledge of SorbX's likelihood of failure in commercial markets at the time the forward-looking statements were made. While Plaintiffs seize on the fact that Molycorp's October 15, 2013 8–K acknowledged that Molycorp "continue[d] to expect that we will be unable to sell a substantial portion of our cerium production during 2014" as evidence that "Defendants knew these adverse SorbX facts substantially earlier than the date of this Form 8–K," Compl. ¶ 179, this statement is ambiguous, Plaintiffs' interpretation of it is speculative, and Plaintiffs have not presented allegations that compel a finding that this statement demonstrates Defendants' actual knowledge of the problems with SorbX's commercial potential. Even if the Court were to find that this statement demonstrated that Defendants were aware of these problems prior to the announcement, it certainly fails to suggest that Defendants had this knowledge when the allegedly misleading statements were made. [10]

10 Plaintiffs' assertion that the Complaint's allegations demonstrate that Defendants knew of problems with SorbX's marketability is further weakened by its statement that "due to product demand," Molycorp increased the price of SorbX. Compl. ¶ 189. It is unclear how Defendants could simultaneously have been aware that SorbX would not meet commercial success while increasing the price of the product due to demand.

***14** Plaintiffs argue that Defendants' statement that "We also believe that we're on the path for market acceptance of XSORBX into drinking water purification markets," Compl. ¶ 159, is not forward-looking. Pl. Mem. at 7. The Court finds that this statement is forward-looking, as it clearly identifies future intentions and includes language signaling a forward-looking statement, and is accordingly protected by the safe harbor provision. [11] *See Johnson,* 2013 WL 214297, at *15 (citing *Slayton,* 604 F.3d at 769).

11 Even if the Court were to find this statement not forward-looking, Plaintiffs have failed to demonstrate Defendants' scienter with respect to this statement. Plaintiffs do not even suggest that Defendants knew of problems with sales of SorbX in February 2012. *See, e.g.,* Compl. ¶ 186 ("CW9 related that Molycorp management knew about a year prior to the October 15, 2013 public announcement regarding cerium that SorbX sales were not going to be profitable.").

The remaining statements regarding SorbX constitute non-forward-looking statements, which are not actionable, however, because they contain statements of historical fact, the truth of which Plaintiffs have not disputed. For example, Plaintiffs have not disputed the truth of Molycorp's statement that "[i]n 2011, we began to realize the full extent of XSORBX's capabilities and the prominent role the technology will play in Molycorp's future."Compl. ¶ 163. Nor have they alleged that Smith's statements regarding "a customer from last year that tested our product" and is planning to take more, made in the May 10, 2012 conference call with investors, was false. *See id.* ¶ 167. Plaintiffs' allegations fail to provide a basis for finding any of Defendants' SorbX statements actionable, and accordingly the claims relating to SorbX are dismissed.

C. Financial Restatements

Plaintiffs' allegations regarding Defendants' financial restatements also fail to meet the required pleading standards. Defendants challenge these allegations on the grounds that Plaintiffs have failed to demonstrate Defendants' scienter with respect to the misstatement. Def. Mem. at 22. Defendants also note that the restatement "*decreased* the Company's net loss attributable to shareholders by approximately $8.3 million." *Id.* at 6,

Plaintiffs allege that "[f]ormer Molycorp employees confirm that the Company's restatement of earnings was due in large part to inadequate oversight and rushed inventory counting procedures on the part of Defendants and other Molycorp executives."Compl. ¶ 148. The Complaint includes statements from confidential witnesses that the inventory was improperly managed and organized, stored in ways that could compromise its quality or effectiveness, and that the operating conditions were " 'just chaos.' " Compl. ¶¶ 148–49. Additionally, a confidential witness stated that Burba, who was "involved with all of the operations of the mine," reported numbers directly to Smith. *Id.* ¶ 150.

But these allegations from confidential witnesses are insufficient allegations of scienter and fail to demonstrate that Defendants had the requisite state of mind for the restatement to be actionable. It is "well settled that mere fact of a restatement of earnings does not support a strong, or even a weak, inference of scienter."*City of Brockton Ret. Sys. v. Shaw Grp. Inc.*, 540 F.Supp.2d 464, 472–73 (S.D.N.Y.2008) (noting that "[m]istakes ... happen a lot in the third grade, and sometimes they happen in public companies, too. There is no reason to make a federal case out of it.").

***15** The allegations of the confidential witnesses regarding inadequate storage, inventory, and oversight fail to demonstrate that any Defendant knew or had reason to know, or were reckless in not knowing, that the numbers in the original 10–Q were incorrect. *See id.* at 473 ("While various confidential informants assert that knowledge of weaknesses in the accounting department was 'widespread' at [defendant company], not a single informant offers any information from which one could infer that ... individual defendants knew or had reason to know anything about [the erroneous numbers]—except by virtue of their purported status as 'hands on' senior executives.' "). Moreover, for the same reasons as discussed above, Plaintiffs' arguments in support of a holistic view of scienter, buttressed by inferences from the Defendants' signatures, certifications, and resignations, are rejected. Accordingly, Defendants' motion to dismiss the claims based on the financial restatement is granted.

D. Corporate Scienter

Plaintiffs' insufficient allegations of individual scienter extend to its allegations of corporate scienter. *See Oklahoma Firefighters Pension & Ret. Sys. v. Student Loan Corp.*, 951 F.Supp.2d 479, 503 (S.D.N.Y.2013) (citing *Teamsters Local 445 Freight Div. Pension Fund v. Dynex Capital Inc.*, 531 F.3d 190, 195 (2d Cir.2008)). While Plaintiffs argue, and are correct, that "it is possible to raise the required inference [of corporate scienter] with regard to a corporate defendant without doing so with regard to a specific individual defendant," Pl. Mem. at 25 (quoting *Dynex*, 531 F.3d at 195), here Plaintiffs' allegations provide no basis for such a finding of corporate scienter, *see In re Gentiva Sec. Litig.*, 971 F.Supp.2d 305, 329 (E.D.N.Y.2013) (providing examples for showing corporate scienter without finding individual scienter). Accordingly, Plaintiffs' Section 10(b) claims against Molycorp are dismissed.

E. Analysis of Section 20(a) Claim

Plaintiffs' Section 20(a) claim, Count 2 of the Complaint, must be dismissed in light of the failure to allege a primary violation by an individual defendant. *See Slayton*, 604 F.3d at 778; *ATSI Commc'ns*, 493 F.3d at 108.

CONCLUSION

For the foregoing reasons, Defendants' motion to dismiss the Complaint is granted. The Clerk of the Court is directed to terminate the motion at Docket Number 40 and close this case.

SO ORDERED.

All Citations

Slip Copy, 2015 WL 1097355, Fed. Sec. L. Rep. P 98,398

End of Document

2013 WL 6017402
Only the Westlaw citation is currently available.
United States District Court,
S.D. New York.

In re NEVSUN RESOURCES LTD.

No. 12 Civ. 1845(PGG). | Sept. 27, 2013.

ORDER

PAUL G. GARDEPHE, District Judge.

***1** This is a consolidated putative class action brought on behalf of purchasers of Defendant Nevsun Resources Ltd.'s common stock between March 31, 2011 and February 6, 2012 (the "Class Period"). According to the Consolidated Class Action Complaint ("Complaint"), Nevsun and its senior management issued materially false and misleading statements concerning operations at Bisha Mine ("Bisha"), in which Nevsun holds a controlling interest. The Complaint alleges claims under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b–5. Defendants have moved to dismiss, arguing that the challenged statements are non-actionable forward-looking statements and that Plaintiffs have not pled facts supporting a strong inference of scienter. For the reasons stated below, Defendants' motion to dismiss will be denied.

BACKGROUND

Nevsun is a "natural resource" company based in Vancouver, British Columbia. (Cmplt.¶¶ 18, 22) Its common shares are traded on both the New York Stock Exchange Amex and the Toronto Stock Exchange. (*Id.* ¶ 18) Nevsun's only revenue-producing property is the Bisha Mine, a gold and base metal (copper and zinc) mine in Eritrea. (*Id.* ¶¶ 2, 24)

On February 7, 2012, Nevsun issued a press release announcing that (1) it had overstated gold ore reserves at the Bisha Mine by 30–35%, (or approximately 1.2 million tons); and (2) 2012 gold production at Bisha Mine would be "about half of what Nevsun was previously expecting."(Cmplt.¶¶ 4, 14, 92–93) Nevsun blamed a "resource estimate used for mine planning" for the overstatement. (*Id.* ¶ 93) The value of Nevsun's stock dropped nearly 31 % in one day, wiping out approximately $388 million in market capitalization. (*Id.* ¶¶ 96, 166)

Plaintiffs allege that Nevsun; its President and Chief Executive Officer, Cliff F. Davis; its Chief Financial Officer, Peter Hardie; and its Vice President of Business Development and Investor Relations, Scott Trebilcock, violated the Securities Exchange Act through a series of false statements and omissions of material fact about the gold reserves at B isha. (*Id.* ¶¶ 27, 31, 34) The alleged Class Period begins on March 28, 2011—when Defendants issued what Plaintiffs assert is a misleading press release concerning gold ore reserves at B isha—and ends on February 6, 2012 the day before the announcement concerning Bisha's reduced gold production. (Cmplt.¶¶ 4, 14, 93, 107, 183)

The Complaint alleges that Defendants false statements of material fact and omissions of material fact include the following:

(a) Nevsun's reported gold ore reserves were materially overstated by approximately 1.2 to 1.3 million tons, or by 35%, an overstatement of approximately 190,000 to 230,000 ounces of gold, (representing lost sales of approximately $303 to $368 million based on the price of gold per ounce as reported by Nevsun as of June 30, 2012 ($1,599 per ounce));

(b) Defendants failed to disclose that they caused Nevsun to progress through Bisha's *Oxide* zone materially faster than reported because Defendants encountered pockets of worthless waste rock instead of gold ore, as reflected in an ever increasing Strip Ratio, indicating that Bisha's gold ore reserves would be exhausted sooner than Defendants reported;

***2** (c) Defendants failed to disclose that Bisha's three most senior executives left Nevsun/Bisha Mining Share Company;

(d) Defendants failed to disclose that the Company's *Oxide* reserve model was materially defective, as evidenced by routine reconciliation reports, actual production at the Bisha Mine and mining statistics that showed the gold ore mined in the *Oxide* zone at Bisha was materially less than the gold ore reserves Defendants reported to investors. Indeed, Defendants knew that Nevsun's resource *Oxide* reserve model was so deficient that in the Fall 2011, Defendants caused two outside engineering firms to review and "rebuild" the model; and

(e) Defendants failed to disclose that, as a result of the overstatement of gold ore reserves, the Company's gold production in 2011 was unsustainable and Nevsun's 2012 and 2013 cash flows were materially negatively affected. Bisha's gold production was ultimately revised downward, to 280,000 to 300,000 ounces for 2012, a decline of between 79,000 to 99,000 ounces (32% to 37%) from the Bisha Mine's 2011 production level of 379,000 ounces, representing a loss of between approximately $126 to $158 million in sales and cash flows in 2012 (at $1,599 per ounce).

(*Id.* ¶ 106)

I. *FACTUAL BACKGROUND* [1]

1 The Court's statement of facts is drawn from the Complaint's factual allegations, which are presumed to be true for purpose of this motion. In deciding a motion to dismiss, a Court "may consider any written instrument attached to the complaint, statements or documents incorporated into the complaint by reference, legally required public disclosure documents filed with the SEC, and documents possessed by or known to the plaintiff and upon which it relied in bringing the suit."*ATSI Commc'ns, Inc. v. Shaar Fund, Ltd.,* 493 F.3d 87, 98 (2d Cir.2007). Accordingly, in connection with this motion, the Court has considered the exhibits attached to the Levin Declaration, which fall within this rule.

In December 2007, Nevsun entered into an agreement with the Eritrean National Mining Company ("ENAMCO") in which ENAMCO took a 10% stake in the mine and agreed to purchase an additional 30% interest at market value, once Bisha made its first gold shipment. (*Id.* ¶ 64)

On January 4, 2011, Nevsun issued a press release announcing the "successful first gold pour" at the Bisha Mine, and the first gold shipment from B isha took place on January 28, 2011. (*Id.* ¶¶ 66–67) This shipment triggered a 90–day valuation period for ENAMCO's 30% stake. (*Id.* ¶ 67)

Nevsun began commercial production of gold at the Bisha Mine on February 22, 2011. (*Id.* ¶ 68) Bisha has three mining zones: the top or "Oxide" zone, which contains gold ore; the middle or "Supergene" zone, which contains copper; and the lowest or "Primary" zone, which primarily contains zinc. (*Id.* ¶ 5) After beginning commercial production of gold on February 22, 2011, the Complaint alleges that Defendants quickly learned that the Oxide Zone—where the gold ore was located—contained a much high percentage of waste rock, and a lower percentage of gold ore, than had been anticipated and reported. (*Id.* ¶¶ 9, 73) This discovery meant that Bisha's gold ore reserves would be exhausted sooner than had been reported, negatively affecting Nevsun's cash flow and valuation. (*Id.* ¶ 74)

On March 28, 2011, Defendants issued a press release stating that Bisha Mine had gold ore reserves of 4.651 million tons and that there were 919,000 ounces of gold in the Oxide zone of the mine. (*Id.* ¶ 107) Defendants further represented that Bisha's 2011 Strip Ratio—the ratio of waste rock mined compared to valuable gold ore—was 2.71, and that Defendants planned a reserve "restatement" by the end of 2011 that would reflect further increased gold reserves. (*Id.* ¶¶ 7, 111) The Complaint alleges that the Strip Ratio is an important metric for investors and affects the value of a mining company's stock, because it reflects the time and expense necessary to mine a certain amount of gold. (*Id.* ¶¶ 7, 57)"A material increase in Strip Ratio was a red flag because it indicates an increase in expenses, including increased costs and expenses for labor, water and diesel fuel, and importantly, exhaustion of the *Oxide* zone sooner than reported."(*Id.* ¶ 57)

***3** Plaintiffs allege that the March 28, 2011 press release contains several materially false statements. Plaintiffs claim that B isha's gold ore reserves in the Oxide zone were overstated by approximately 1.2–1.3 million tons, or by 35%, and that the ounces of gold in Bisha's Oxide zone were overstated by approximately 190,000 to 230,000 ounces. (*Id.* ¶ 108) Plaintiffs further represent that, as of late March 2011, Bisha's strip ratio was actually 4.9, approximately 81% higher than the Strip Ratio reported in Defendants' press release. (*Id.* ¶ 72)

On April 1, 2011, Nevsun filed its 2010 Annual Report with the SEC. The Annual Report represented that Bisha's gold ore reserves were 28.3 million tons, that the mine held 919,000 ounces of gold in the Oxide zone, and "that Bisha's life time Strip Ratio was 4.2."(*Id.* ¶ 113) Plaintiffs claim that all of these statements were false, for the reasons stated above. (*Id.* ¶ 114)

On April 6, 2011, Defendants issued a press release discussing operating highlights for the quarter ending March 31, 2011. (*Id.* ¶ 117) The press release states that "[t]he Bisha mine continues to perform very well and is now producing over 1,000 oz gold per day."(*Id.*) On April 14, 2011, Defendant Trebilcock made a presentation at the

Denver Gold Group European Gold Forum in Switzerland in which he stated that Nevsun had increased its estimate of gold reserves at Bisha "from 20 to 28 million tonnes," and that Nevsun's "plan is to bring the total reserve table up to 40 million tonnes by the end of the year."(*Id.* 119) Plaintiffs claim that Trebi lock's statements were false and misleading because Bisha's gold reserves were not increasing, and in fact were overstated. (*Id.* ¶¶ 108, 110, 120)

On May 11, 2011, Nevsun announced its results for the first quarter of 2011. Nevsun reported that the strip ratio for the three-month period ending March 31, 2011 was 4.9, which was "in line with expectations." (Levin Decl., Ex. I (5/11/116–K) Management Discussion and Analysis ("MD & A"), at 3) By June 30, 2013, however, the Strip Ratio had increased to 5.1, [2] but Defendants did not disclose the increase to investors. (Cmplt.¶ 77) Indeed, when asked about the strip ratio during an August 11, 2011 conference call with investors, Defendant Davis falsely represented that Bisha was stripping 20,000 tons of rock per day, indicating that the strip ratio was unchanged at 4.9. (*Id.* ¶ 137) Plaintiffs allege that Bisha was actually stripping 23,000 tons of rock per day—approximately 15% more than Davis represented—and that when compared with the amount of gold ore that was mined per day, correlates to a strip ratio of 5.1.(*Id.*) Throughout the fall of 2011, Defendants represented to investors that Bisha "continues to perform very well" and "in excess of plan," despite knowing that conditions at the mine had deteriorated, as reflected in a steadily increasing strip ratio. (*Id.* ¶¶ 109–110, 112, 117, 130, 139, 158)

2 Defendants dispute that the strip ratio in June 30, 2011 was 5.1, arguing that Plaintiff's math is wrong. (Def. Br. 15 n. 17) However, Defendants disclosed the 5.1 number in their August 8, 2012 6–K. (*See* Levin Decl., Ex. Z at M D & A—2012 Second Quarter, at 5)

***4** The Complaint further alleges that Defendants were aware of the true nature of the gold reserves and the true strip ratios because they received real-time information concerning "the Bisha Mine's mining statistics and production records" through use of specialized computer software. (*Id.* ¶¶ 58–63, 75) Plaintiffs further allege that the negative trend in strip ratio would have been obvious to Defendants "based on routine reconciliations of actual production to the reported reserves and through the day to day observation of production."(*Id.* ¶ 75) In addition, the mine's on-site General Manager—Stanley C. Rogers—reported directly to Defendants. (*Id.* ¶ 53)

Plaintiffs allege that Defendants' material misstatements and omissions about the Bisha Mine's gold reserves and the ever-increasing strip ratio were motivated in part by their then ongoing negotiations with ENAMCO to sell it a 30% stake in the mine. The amount of gold reserves and the strip ratio would affect the purchase price. (*Id.* ¶¶ 4, 78–80) In August 2011, Defendants and ENAMCO agreed to a purchase price of $253 million for ENAMCO's 30% stake, resulting in a personal gain to Defendants Davis, Hardie, and Trebilcock, because their compensation was affected by the sale. (*Id.* ¶¶ 78–80, 177–179; Levin Decl., Ex. Y (May 2012 Form 6–K), at 5–6) By September 2011, Defendants' transaction with ENAMCO had caused Nevsun's stock price to reach Class Period-highs. (*Id.* ¶ 82)

While the stock was trading at record highs, the negative trend in the Strip Ratio and in the amount of gold reserves continued, and no disclosure of this trend was made to investors. For example, Defendants knew that the true Strip Ratio for the second half of 2011 was 6.6, but did not disclose that to investors. (*Id.* ¶ 160) Meanwhile, Defendants Davis and Hardie sold their holdings in Nevsun's common stock. On September 2 and 6, 2011, Hardie sold all of his 180,000 shares of Nevsun common stock for approximately $1.3 million.(*Id.* ¶ 82) On September 18, 2011, Davis sold 224,600 shares for $1.5 million. (*Id.* ¶ 83)

In late 2011, Defendants hired AGP Mining Consultants ("AGP") and another engineering firm to "rebuild Bisha's Oxide reserve model." (*Id.* ¶ 86) Plaintiffs argue that this step—which was not disclosed to investors—demonstrates that Defendant knew that their current model for determining Bisha's gold ore reserves was not reliable. (*Id.* ¶¶ 86, 144) By November 2011, the three senior executives on-site at the Bisha Mine—Rogers, Vickers, and Pretori us—had all left the Company. Their departure was likewise not publicly disclosed. (*Id.* ¶¶ 11, 84–85)

On January 10, 2012, Nevsun issued a press release stating that "[t] he Bisha Mine continued to operate in excess of plan for gold recovery and maintained planned milling and gold production rates in Q4."(*Id.* ¶ 90) Defendant Davis "congratulate[d] the Bisha team for a strong performance."(*Id.*) The press release did not disclose the overstatement of the gold reserves, the steady increase in Strip Ratio, Defendants' decision to hire two engineering firms to rebuild the Company's model for determining gold ore reserves at the Bisha Mine, or that Bisha's entire on-site senior management team had left the Company. (*Id.* ¶ 91)

***5** Less than a month later, on February 7, 2012, Defendants disclosed to investors that Nevsun's gold ore reserves in the Oxide zone had been overstated by 35%; that the amount of gold that Bisha would produce in 2012 would be about half of what Nevsun had previously represented to investors; and that they had hired engineers to rebuild their gold ore reserve model. (*Id.* ¶¶ 14, 92–93) On a conference call with analysts that day, Davis offered this explanation for the overstatement: "we were progressing through the [Oxide zone] much more quickly" and "there were significant pockets that we would have hoped had been grade and [gold] ore previously that we ended up sending to the waste pile."(*Id.* ¶ 95) An analyst on the call asked Davis whether what he was "saying is [that] the strip ratio was basically a lot higher in 2011 than you thought?"Davis answered, "Exactly." (*Id.*)

The overstatement of gold reserves represents a loss of sales and cash flows of approximately $126 to $158 million for 2012 and 2013. (*Id.* ¶ 106(e)) By the next day—February 8, 2012—Nevsun's stock had fallen 31%. (*Id.* ¶ 14)

II. *PROCEDURAL HISTORY*

On March 13, 2012, the first of two putative securities fraud class action lawsuits was filed on behalf of investors in Nevsun common stock during the Class Period. (Dkt. No. 1) On June 28, 2012, this Court consolidated the two actions and appointed Lead Plaintiff and Lead Counsel. (Dkt. No. 16) The Consolidated Class Action Complaint was filed on August 12, 2012. (Dkt. No. 18) Defendants filed their motion to dismiss on November 7, 2012. (Dkt. No. 19)

DISCUSSION

I. *LEGAL STANDARD*

A. *Motion to Dismiss*

"To survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.' " *Ashcroft v.* Iqbal, 556 U.S. 662, 678, 129 S.Ct. 1937, 173 L.Ed.2d 868 (2009) (quoting *Bell Atl. Corp. v. Twombly,* 550 U.S. 544, 570, 127 S.Ct. 1955, 167 L.Ed.2d 929 (2007)). "In considering a motion to dismiss ... the court is to accept as true all facts alleged in the complaint," *Kassner v. 2nd Ave. Delicatessen Inc.,* 496 F.3d 229, 237 (2d Ci r.2007) (citing *Dougherty v. Town of N. Hempstead Bd. of Zoning Appeals*, 282 F.3d 83, 87 (2d Cir.2002)), and must "draw all reasonable inferences in favor of the plaintiff." *Id.* (citing *Fernandez v. Chertoff,* 471 F.3d 45, 51 (2d Cir.2006)).

A complaint is inadequately pled "if it tenders 'naked assertion[s]' devoid of 'further factual enhancement,' " *Iqbal,* 556 U.S. at 678 (quoting *Twombly,* 550 U.S. at 557), and does not provide factual allegations sufficient "to give the defendant fair notice of what the claim is and the grounds upon which it rests." *Port Dock & Stone Corp. v. Oldcastle N E., Inc.,* 507 F.3d 117, 121 (2d Cir.2007) (citing *Twombly,* 550 U.S. at 555).

"In considering a motion to dismiss for failure to state a claim pursuant to Rule 12(b)(6), a district court may consider the facts alleged in the complaint, documents attached to the complaint as exhibits, and documents incorporated by reference in the complaint."*D i Folco v. MSNBC Cable L.L.C.,* 622 F.3d 104, 111 (2d Cir.2010) (citing *Chambers v. Time Warner,* Inc., 282 F.3d 147, 153 (2d Cir.2002); *Hayden v. County of Nassau,* 180 F.3d 42, 54 (2d Cir.1999)). Moreover, "[w]here a document is not incorporated by reference, the court may never[the]less consider it where the complaint 'relies heavily upon its terms and effect,' thereby rendering the document 'integral' to the complaint."*Di Folco,* 622 F.3d at 111 (quoting *Mangiafico v. Blumenthal,* 471 F.3d 391, 398 (2d Cir.2006)). A court may also consider "legally required public disclosure documents filed with the SEC."*ATSI Commc'ns, Inc.,* 493 F.3d at 98.

B. *Securities Fraud*

***6** "A complaint alleging securities fraud pursuant to Section 10(b) of the Securities Exchange Act is subject to two heightened pleading standards."*In re Gen. Elec. Co. Sec. Litig.,* 857 F.Supp.2d 367, 383 (S.D.N.Y.2010). First, the complaint must satisfy Federal Rule of Civil Procedure 9(b), which requires that "the circumstances constituting fraud ... shall be stated with particularity."Fed.R.Civ.P. 9(b). Second, the complaint must meet the pleading requirements of the Private Securities Litigation Reform Act ("PSLRA"), 15 U.S.C. § 78u–4(b).

The heightened pleading requirement under Rule 9(b)"serves to provide a defendant with fair notice of a plaintiff's claim, safeguard his reputation from improvident charges of wrongdoing, and protect him against strike suits."*ATSI Communications, Inc.,* 493 F.3d at 99. Thus, a securities fraud complaint based on misstatements must " '(1) specify the statements that the plaintiff contends were fraudulent, (2) identify the speaker, (3) state where and when the statements were made, and (4) explain why the statements were fraudulent.' " *Rombach v. Chang,* 355 F.3d 164, 170 (2d Cir.2004) (quoting *Mills v. Polar Molecular Corp.,* 12 F.3d 1170, 1175 (2d Cir.1993)).

Moreover, under the PSL RA, a plaintiff must "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind."15 U.S.C. § 78u–4(b)(2); *see Tel labs, Inc. v. Makor Issues & Rights, Ltd.,* 551 U.S. 308, 313, 127 S.Ct. 2499, 168 L.Ed.2d 179 (2007) ("The PSLRA requires plaintiffs to state with particularity both the facts constituting the alleged violation, and the facts evidencing scienter, *i.e.,* the defendant's intention to deceive, manipulate, or defraud.")."To qualify as 'strong' within the intendment of [the PLSRA], ... an inference of scienter must be more than merely plausible or reasonable—it must be cogent and at least as compelling as any opposing inference of nonfraudulent intent."*Tellabs,* 551 U.S. at 314;*see also id.*("[T]o determine whether a complaint's scienter allegations can survive threshold inspection for sufficiency, a court governed by [the PLSRA] must engage in a comparative evaluation; it must consider, not only inferences urged by the plaintiff ... but also competing inferences rationally drawn from the facts alleged.")."A complaint will survive ... only if a reasonable person would deem the inference of sci enter cogent and at least as compelling as any opposing inference one could draw from the facts alleged."*Id.* at 324.

I. THE COMPLAINT ADEQUATELY ALLEGES CLAIMS UNDER SECTION 10(B) OF THE EXCHANGE ACT

Defendants contend that Plaintiffs' claims under Section 10(b) of the Securities Exchange Act of 1934 must be dismissed because "none of Defendants' alleged misstatements or omissions is actionable as a matter of law."(Def.Br.8) Defendants argue that the alleged misrepresentations and omissions concerning Bisha's gold reserves, Strip Ratio, and expected gold production for 2012 are non-actionable "forward-looking statements" and are protected by the "bespeaks caution" doctrine. (Def. Br. 9 & n. 11) Defendants further argue that statements that Bisha "continues to perform well" and is operating "in excess of plan" are non-actionable statements of corporate optimism or puffery.(*Id.* at 11–12) With respect to alleged omissions, Defendants assert that they had no duty to disclose that Vickers, Pretori us, and Rogers had left the company, or that there were "negative trends" at the mine. (*Id.* at 13–16) Finally, Defendants argue that they did not "make" certain statements pursuant to *Janus Capital Group., Inc. v. First Derivative Traders,* ––– U.S. ––––, 131 S.Ct. 2296, 180 L.Ed.2d 166 (2011).(*Id.* at 16)

A. *Statutory Framework*

***7** Section 10(b) of the Securities Exchange Act of 1934 makes it unlawful "for any person, directly or indirectly ... [t]o use or employ, in connection with the purchase or sale of any security ... any manipulative or deceptive device or contrivance" in violation of the rules set forth by the Securities and Exchange Commission ("SEC") for the protection of investors. 15 U.S.C. § 78j. Pursuant to SEC Rule 10b–5, promulgated thereunder, it is unlawful:

> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b–5.

To sustain a private cause of action for securities fraud under Section 10(b) and Rule 10b–5

> a plaintiff must prove (1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation.

Stoneridge Inv. Partners, LLC v. Scientific–Atlanta, Inc., 552 U.S. 148, 157, 128 S.Ct. 761, 169 L.Ed.2d 627 (2008) (citing *Dura Pharmaceuticals, Inc. v. Broudo,* 544 U.S. 336, 341–42, 125 S.Ct. 1627, 161 L.Ed.2d 577 (2005)).

B. *The Complaint Adequatel Alleges Actionable Misstatements or Omissions*

1. *The PSLRA Safe Harbor for Forward–Looking Statements*

a. ***Applicable Law***

"The PSLRA established a statutory safe-harbor for forward-looking statements."*Slayton v. Am. Exp. Co.,* 604 F.3d 758, 765 (2d Cir.2010). Under the PSLRA, where a

> private action ... is based on an untrue statement of a material fact or omission of a material fact necessary to make the statement not misleading, [a defendant] shall not be liable with respect to any forward-looking statement ... if and to the extent that—
>
> (A) the forward-looking statement is—
>
> (i) identified as a forward-looking statement, and is accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement; or
>
> (ii) immaterial; or
>
> (B) the plaintiff fails to prove that the forward-looking statement—...
>
> (ii) if made by a business entity; was—
>
> (I) made by or with the approval of an executive officer of that entity; and
>
> (II) made or approved by such officer with actual knowledge by that officer that the statement was false or misleading.

15 U.S.C. § 78u–5(c)(1).

"The safe harbor is written in the disjunctive; that is, a defendant is not liable if the forward-looking statement is identified and accompanied by meaningful cautionary language or is immaterial or the plaintiff fails to prove that it was made with actual knowledge that it was false or misleading."*Slayton,* 604 F.3d at 766.

b. ***Analysis***

***8** Defendants argue that the statements Plaintiffs cite in Defendants' March 28, 2011 press release are "forward-looking statements" and are accompanied by "meaningful cautionary language ." (Def.Br.9) For example, Defendants' 2010 Form 40–F warns that the Company's reserve figures are "estimates," "inherently uncertain," and are a "prediction of what mineralization might be found to be present."(Levin Decl., Ex. E (2010 40–F) at 3; Annual Information Form ("AI F") at III, 6, 9; MD & A, at 8–9) The Form 40–F also states that there could be a "material downward or upward revision" of the reserve estimates. (*Id.,* AIF at 6, MD & A at 8)

Forward-looking statements include only those which "speak predictively about the future, such as ... a statement of the plans and objectives of management for future operations."*Gissin v. Endres,* 739 F.Supp.2d 488, 505 (S.D.N.Y.2010) Here, the Complaint's factual allegations —which this Court must accept as true for purposes of Defendants' motion to dismiss—include that Defendants knew at the time they issued the March 28, 2011 press release that the gold reserves were overstated and that the Strip Ratio was much less favorable than was represented. (Cmplt.¶ 76) The Complaint further alleges that Defendants knew that their representations were false because they had access to real-time mining statistics, and production reconciliation reports, demonstrating that the Strip Ratio was much higher than represented in the press release, and that mining through the Oxide zone was proceeding much faster than reported. (*Id.* ¶¶ 74–77). Because the statements cited by Plaintiffs are representations of present fact, they do not fall within the PSLRA's safe harbor for forward-looking statements. *See Rombach,* 355 F.3d at 173 ("Cautionary words about future risk cannot insulate from liability the failure to disclose that the risk has transpired."); see also *In re Nortel Networks Corp. Sec. Litig.,* 238 F.Supp.2d 613, 629 (S.D.N.Y.2003). (" '[I]t is well recognized that even when an allegedly false statement has both a forward-looking aspect and an aspect that encompasses a representation of present fact, the safe harbor provision of the PSL RA does not apply.' " (quoting *In re A PAC Teleservice, Inc. Sec. Litig.,* No. 97 Civ. 9145, 1999 WL 1052004, at *7 (S.D.N.Y. Nov.19, 1999))). [3]

3 In a footnote, Defendants contend that their statements concerning gold reserves are protected by the "bespeaks caution" doctrine, under which alleged misrepresentations are immaterial and therefore not actionable if "it cannot be said that any reasonable investor could consider them important in light of adequate cautionary language."*Halperin v. eB anker USA.com, Inc.,* 295 F.3d 352, 357 (2d Cir.2002). (Def. Br. 9 n. 11) The doctrine does not apply, however, where, as alleged here, "a defendant knew that its statement was false when made."*Gabriel Capital, L.P. v. NatWest Fin., Inc.,* 122 F.Supp.2d 407, 419 (S.D.N.Y.2000); see also *Milman v. Box Hill Systems Corp.,* 72 F.Supp.2d 220, 231 (S.D.N.Y.1999) ("[N]o degree of cautionary language will protect material misrepresentations or

omissions where defendants knew their statements were false when made.").

2. ***Representations that are "Puffery"***

Defendants argue that certain statements Plaintiffs rely on —including that Bisha "continues to perform well," "in excess of plan," "ha[s] an impeccable record, and is "well positioned"—are non-actionable statements of corporate optimism or puffery or non-actionable opinion. (Def. Br. 11–12 (citing Cmplt. ¶ ¶ 109, 117, 130, 139, 148, 156, 158–59))

Statements of "puffery" are not actionable as securities fraud because investors do not rely on "generalizations regarding integrity, fiscal discipline and risk management."*In re JP Morgan Chase Sec. Litig.,* 363 F.Supp.2d 595, 633 (S.D.N.Y.2005) (citing *Lasker v. N.Y. State Elec. & Gas Corp.,* 85 F.3d 55, 59 (2d Ci r.1996) (statements that a company refused to "compromise its financial integrity," that it had a "commitment to create earnings opportunities" and that these "business strategies [would] lead to continued prosperity" constituted "precisely the type of 'puffery' that this and other circuits have consistently held to be inactionable")).“Similarly, statements of 'corporate optimism' do not give rise to securities violations because 'companies must be permitted to operate with a hopeful outlook.' " *In re Ambac Fin. Grp., Inc. Sec. Litig.,* 693 F.Supp.2d 241, 272 n. 35 (S.D.N.Y.2010) (quoting *Rombach,* 355 F.3d at 174).

***9** Similarly, statements of opinion are generally not-actionable. *See Fait v. Regions Fin. Corp.,* 655 F.3d 105, 110 (2d Ci r.2011) (holding that under Sections 11 and 12 of the Securities Act of 1933, "liability [for opinions] lies only to the extent that the statement was both objectively false and disbelieved by the defendant at the time it was expressed."); *City of Omaha, Neb. Civilian Employees'Ret. Sys. v. CBS Corp.,* 679 F.3d 64, 67 (2d Ci r.2012) (extending Fait to claims under Section 10(b)).

Here, when examined in context, the statements that Defendants challenge as puffery or expressions of opinion are in fact non-actionable. Moreover, none of these statements address Bisha's gold reserves, strip ratio, or life of mine —the areas in which Plaintiffs allege Defendants made misrepresentations:

- On October 6, 2011, Defendants issued a press release stating that "[t]he Bisha Mine continues to operate *in excess of plan* for mill gold recovery" and that B isha had an *"impeccable track record."*(Cmplt. ¶ 139 (emphasis added))

- On November 14, 2011, during a conference call with investors, Davis stated:

  I am going to go through a lot of numbers that truly demonstrate what a great operation the Bisha Mine really is. We produced 110,000 ounces of gold in Q3 compared to 93,000 in Q2 and 75,000 in Q1. Our total year-todate production for 2011 is 278,000 ounces to September 30. We continue to produce at a rate of over 1000 ounces of gold per day, and during October we broke through the 300,000 accumulative ounces produced. *Things are going very well,* indeed.

  (*Id.* ¶ 148 (emphasis added))

- On November 21, 2011, Nevsun issued a press release, which quoted Davis as stating: "Nevsun is *well positioned* to fund growth and provide a dividend return to our shareholders ... Today's increased dividend further differentiates Nevsun from its peer group and demonstrates our confidence in future cash flow."(*Id.* ¶ 156 (emphasis added))

- On January 10, 2012, Nevsun issued a press release which quoted Davis as stating *"2011 was a very successful year....* I would like to congratulate the B isha team for a strong performance, producing 379,000 ounces of gold in the first year of operations at Bisha. We look forward to 2012...." (*Id.* ¶ 159 (emphasis added))

Plaintiffs do not contend that Defendants made misleading statements about actual gold production at Bisha in 2011. Accordingly, to the extent that the above statements address that issue, they do not provide a basis for liability. Moreover, courts have generally not found actionable statements such as "things are going very well," a company is "well positioned," or operations are "successful," unless the statements addressed concrete and measurable areas of the defendant company's performance. For example, in *A mbac Financial Group, Inc. Securities Litigation,* Defendants reported that "Ambac's CDO portfolio was currently outperforming the market and relevant indices."693 F.Supp.2d at 272. The court held that this statement was not "puffery" or "corporate optimism" because it "convey[ed] something concrete and measurable about Ambac's financial situation, and a reasonable investor could certainly find [such a statement] important to the 'total mix' of information available."*Id.*

***10** Likewise, in *Novak v. Kasaks,* the Second Circuit held that certain statements were not puffery because they were specifically tied to alleged false and misleading statements about retail chain AnnTaylor's inventory. 216 F.3d 300, 315 (2d Ci r.2000). In that case, Plaintiffs alleged that Defendants made materially false and misleading statements about AnnTaylor's financial performance. I d. at 303. Plaintiffs complained in particular about AnnTaylor's "so-called 'Box and Hold' practice, whereby a substantial and growing quantity of out-of-date inventory was stored in several warehouses during the Class Period without being marked down."*Id* . at 304.AnnTaylor did not distinguish "Box and Hold" inventory from new inventory, or write-off any of the "Box and Hold" inventory. Instead, the defendants described AnnTaylor's inventory as " 'under control,' 'i n good shape,' and at 'reasonable' or 'expected' levels; stating that 'no major or unusual markdowns were anticipated'; and attributing rising levels of inventory to growth, expansion, and planned future sales."*Id.*

The Second Circuit held that these statements were not "puffery" or "corporate optimism," noting that the Complaint alleged that the defendants made these statements "while they allegedly knew that the contrary was true. Assuming, as we must at this stage, the accuracy of the plaintiffs' allegations about AnnTaylor's "Box and Hold" practices, these statements were plainly false and misleading."*Id.* at 315.

Here, by contrast, Defendants' optimistic statements do not address the subjects about which Plaintiffs claim Defendants made false and misleading statements: Bisha's gold reserves, strip ratio, and life of mine. Statements addressing matters about which Plaintiffs have not claimed that Defendants made misleading statements—such as Bisha's actual gold production in 2011—or statements expressing a general view that "things are going well," that the company is "well positioned," or that a year was "successful" are generally not actionable. *See Lasker* 85 F.3d 55 at 59 (general statements such as touting the company's "commitment to create earnings opportunities" and that certain "business strategies [would] lead to continued prosperity" constituted "precisely the type of 'puffery' that this and other circuits have consistently held to be inactionable")). Moreover, statements that "things are going very well," that Bisha had an "impeccable track record," that Nevsun was "well positioned," and that "2011 was a very successful year" are—in the context in which they were said here—non-actionable statements of opinion.

Accordingly, Plaintiffs cannot base their Section 10(b) claim on these statements.

3. *Plaintiffs have Pled Materially False Statements or Omissions about the Bisha Mine's Operations*

The Court concludes that Plaintiffs have adequately pled materially false statements relating to the Bisha Mine's strip ratio, gold reserves, and life of mine. Plantiffs have pled facts demonstrating that strip ratio is a critical metric for analysts and investors, and that strip ratio has important implications for calculating reserves and life of mine. They have also pleaded facts demonstrating that Defendants repeatedly issued statements that represented Bisha's strip ratio to be lower than they then knew it to be. *See Caiola v. Citibank, N.A.,* 295 F.3d 312, 331 (2d Ci r.2002) ("upon choosing to speak, one must speak truthfully ... [and] accurate[ly]"); *In re Gen. Elec. Co. Sec. Litig.,* 857 F.Supp.2d 367, 387 (S.D.N.Y.2012) ("once a company chooses to speak ...'it has a duty to disclose any additional material fact 'necessary to make the statements [already contained therein] not misleading' ") (quoting *In re Citi Group Inc. Bond Litig.,* 723 F.Supp.2d 568, 590 (S.D.N.Y.2010)); *In re Sanofi–Aventis Sec. Litig.,* 774 F.Supp.2d 549, 561 (S.D.N.Y.2011) (noting that under Section 10(b), "a duty may arise as a result of the ongoing duty to avoid rendering existing statements misleading by failing to disclose material facts").

***11** As to Defendants' failure to disclose the departure of its entire on-site management team at B isha, or its retention of two engineering firms to re-build the reserves model on which prior estimates of gold reserves disseminated to investors had been based, the Court cannot say at this stage of the proceedings that such information would not have been material to investors. *See ECA, Local 134 IBEW Joint Pension Trust of Chicago v. JP Morgan Chase Co.,* 553 F.3d 187, 197 (2d Cir.2009) (" '[A] complaint may not properly be dismissed ... on the ground that the alleged misstatements or omissions are not material unless they are so obviously unimportant to a reasonable investor that reasonable minds could not differ on the question of their importance.' " (quoting *Gani no v. Citizens Uti ls. Co.,* 228 F.3d 154, 162 (2d Ci r.2000)). [4]

4 The Complaint also alleges that Defendants violated Item 303 of SEC Regulation S–K in failing to disclose

> the negative trends at the Bisha Mine. (Cmplt.¶ 194) Defendants argue that Plaintiffs cannot base their Section 10(b) claim on a violation of Item 303, which requires a company in certain circumstances to disclose "any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations ."17 C.F.R. § 229.303(a)(3)(ii). (Def.Br.13) This Court agrees. In the Second Circuit, "[i]t is far from certain that the requirement that there be a duty to disclose under Rule 10b–5 may be satisfied by importing the disclosure duties from S–K 303."*In re Canandaigua Sec. Litig.,* 944 F.Supp. 1202, 1209 n. 4 (S.D.N.Y.1996); see also *In re Quintel Entm't Inc. Sec. Litig.,* 72 F.Supp.2d 283, 293 (S.D.N.Y.1999) ("In light of the absence of authority for the position that a failure to comply with the disclosure duties under Item 303 can be the basis of a § 10(b) action, this Court refuses so to hold."); *accord Oran v. Stafford,* 226 F.3d 275, 288 (3d Cir.2000) (Alito, J.) ("[A] violation of SK–303's reporting requirements does not automatically give rise to a material omission under Rule 10b5."). Accordingly, Plaintiffs cannot base their Section 10(b) claim on a theory that Defendants violated Item 303.

4. *Statements Purportedly "Made" by AMEC are Attributable to Defendants*

Defendants' March 28, 2011 press release sets forth Bisha Mine gold ore reserve figures, estimates of gold that will be recovered from the Bisha Mine's Oxide zone, and a life of mine estimate of 13 years. These figures are based on a report prepared by AMEC Americas Limited ("AMEC"), an independent engineering firm. (*See* Levin Decl., Ex. C (Mar. 30, 2011 Form 6–K) at 1–1, 1–10, and 2–1)

Relying on *Janus Capital Group., I nc. v. First Derivative Traders,* ––U.S. ––, 131 S.Ct. 2296, 180 L.Ed.2d 166 (2011), Defendants argue that AMEC, and not Defendants, was the "maker" of the alleged false and misleading statements concerning Bisha's gold ore reserves, ultimate expected gold production, and life of mine. (Def.Br.16–17)

In *Janus,* the shareholders of parent company Janus Capital Group ("JCG") sued wholly-owned subsidiary Janus Capital Management ("JCM"), a mutual fund investment advisor, alleging that JCM had made misstatements in fund prospectuses in violation of Rule 10b–5. The prospectuses were filed with the SEC by the Janus Investment Fund, a separate legal entity owned by mutual fund investors that had no assets apart from those owned by fund investors. The Investment Fund had the same officers as JCM, but had an independent board of trustees.

The question for the Court was whether JCM had "made" the allegedly misleading statements in the prospectuses under Rule 10b–5, given its role as investment advisor to the fund. The Supreme Court held that JCM was not liable under Rule 10b–5, because a defendant only "makes" a statement for purposes of a private Rule 10b–5 action if the defendant "is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it."Janus, 131 S.Ct. at 2302. "[I] n the ordinary case, attribution within a statement or implicit from surrounding circumstances is strong evidence that a statement was made by—and only by—the party to whom it is attributed."*Id.*

Here, although Defendants purported to rely on AMEC's report for certain of their statements, the Complaint alleges that Defendants adopted those statements, filed them with the SEC, and thereafter repeated them to investors. (*See* Cmplt. ¶¶ 107, 109, 117, 119, 130, 139, 158) That is sufficient for the Court to find that Defendants "made" the statements under Janus. *See*Janus, 131 S.Ct. at 2302 ("Even when a speechwriter drafts a speech, the content is entirely within the control of the person who delivers it. And it is the speaker who takes credit—or blame—for what is ultimately said."). [5]

5 Trebilcock argues in a footnote that Plaintiffs have not alleged facts showing that he "made" the challenged statements in Nevsun's press releases and securities filings, given that he did not sign these materials. Trebi lcock further argues that if he "made" the statements during investor presentations, he was merely repeating statements from the filings. (Def. B r. 17 n. 20) Plaintiffs rely on the "group pleading" doctrine,"which allows a plaintiff to rely on a presumption that written statements that are 'group-published,' e.g., SEC filings and press releases, are statements made by all individuals 'with direct involvement in the everyday business of the company.'" *City of Pontiac Gen. Employees ' Ret. Sys. v. Lockheed Martin* Corp., 875 F.Supp.2d 359, 373 (S.D.N.Y.2012) (quoting *Camofi Master LDC v. Riptide Worldwide, Inc.,* No. 10 Civ. 4020(CM), 2011 WL 1197659, at *6 (S.D.N.Y. Mar.25, 2011)). "[M]ost judges in this District have continued to conclude that group pleading is alive and well [after *Janus]." Id.* at 374.

Under the group pleading doctrine, Trebilcock—and Davis and Hardie, the other senior executives named in the Complaint—"made" the statements in Nevsun's press releases and securities filings. As for the statements Trebi lcock made to investors during investor conference calls, "[i]n the post-*Janus* world, an executive may be held accountable ... where the statement is attributed to the executive."*In re Fannie Mae 2008 Sec. Litig.,* 891 F.Supp.2d 458, 473 (S.D.N.Y.2012). In sum, Plaintiffs have adequately alleges that Trebilcock "made" the statements at issue.

C. *The Complaint Adequately Pleads Facts Giving Rise to a Strong Inference of Scienter*

***12** Defendants argue that "Plaintiffs utterly fail to allege scienter against any Defendant, and therefore fall far short of the stringent pleading requirements of the PSLRA."(Def.Br.17)

1. *Applicable Law*

Rule 9(b) reflects a "relaxation" of the specificity requirement in pleading the scienter element of fraud claims, requiring that fraudulent intent need only be "alleged generally." *See Shields v. Citytrust Bancorp, Inc.,* 25 F.3d 1124, 1128 (2d Cir.1994); Fed.R.Civ.P. 9(b). The Second Circuit has made clear, however, that this "relaxation ... 'must not be mistaken for license to base claims of fraud on speculation and concl usory allegations.' " *Shields,* 25 F.3d at 1128 (quoting *O'Brien v. Nat'l Prop. Analysts Partners,* 396 F.2d 674, 676 (2d Cir.1991)). Accordingly, the Second Circuit has long required plaintiffs making securities fraud claims to "allege facts that give rise to a strong inference of fraudulent intent." *Novak v. Kasaks,* 216 F.3d 300, 307 (2d Cir.2000); *see also Shields,* 25 F.3d at 1128.

The PSLRA adopts the "strong inference" standard set by the Second Circuit, and provides that "where proof of scienter is a required element ... a complaint must 'state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.' " *Slayton v. Am. Exp. Co.,* 604 F.3d 758, 766 (2d Cir.2010) (quoting 15 U.S.C. § 78u4(b)(2)). "Under this heightened pleading standard for scienter, a 'complaint will survive ... only if a reasonable person would deem the inference of sci enter cogent and at least as compelling as any opposing inference one could draw from the facts alleged.' " *Slayton,* 604 F.3d at 766 (quoting *Tel l abs,* 551 U.S. at 324). "I n determining whether a strong inference exists, the allegations are not to be reviewed independently or in isolation, but the facts alleged must be 'taken collectively.' " *Id.*

"The 'strong inference' standard is met when the inference of fraud is at least as likely as any non-culpable explanations offered ."*Id.*"The plaintiff may satisfy [the PSLRA's heightened pleading] requirement by alleging facts (1) showing that the defendants had both motive and opportunity to commit the fraud or (2) constituting strong circumstantial evidence of conscious misbehavior or recklessness."*ATSI Commc'ns, Inc.,* 493 F.3d at 99 (citing *Gani no,* 228 F.3d at 168–69).

2. *Analysis*

a. *The Complaint Adequately Alleges that Defendants Had Motive and Opportunity to Commit Fraud*

Defendants do not argue that they had no opportunity to commit fraud. Instead, they contend that Plaintiffs have not alleged facts demonstrating motive—i.e., " 'concrete benefits that could be realized by one or more of the false statements and wrongful disclosures alleged.' " (Def. Br. 18 (quoting *Kalnit,* 264 F.3d at 139)) The Court concludes that Plaintiffs have pled sufficient facts to demonstrate that Defendants had both the motive and the opportunity to commit fraud under the heightened standard set by the PSLRA.

***13** The Complaint alleges that Davis, Hardie, and Trebilcock "derived concrete and personal benefits from the fraud, including massive cash bonuses and sales of Nevsun stock at inflated prices."(Cmplt.¶ 176) The Complaint further alleges that these Defendants were motivated to overstate the gold reserves at Bisha in order to extract a high price from ENA MCO for the 30% stake it was purchasing in the mine. (*Id.* ¶ 177)

With respect to bonuses and sales of stock, the Complaint alleges that in September 2011—when Nevsun stock was trading at record highs—Davis sold 224,600 common shares of Nevsun stock for $1.5 million. Davis also received $1.14 million in 2011 compensation, including a $600,000 cash bonus. (I d. ¶ 29) In early September, Hardie likewise sold 180,000 shares—his entire Nevsun stock holdings—for $1.3 million. His 2011 compensation was $889,816 including a cash bonus of $125,000. (*Id.* ¶ 33) Trebi lcock earned $556,939 in 2011, including a cash bonus of $150,000.[6] (*Id.* ¶ 35)

6 Rogers—a "Named Executive Officer" in Nevsun's May 2012 Form 6–K—also sold 100% of his Nevsun stock in November and December 2011. (Cmplt.¶ 12)

> Defendants argue that Rogers' sale was not suspicious because "it is commonplace, not 'suspicious' or 'unusual' for individuals who depart a company to sell their stock in that company."(Def.Br.21) While that may be true in some cases—*see In re Health Mgmt. Sys., Inc. Sec. Litig.*, No. 97 Civ. 1865(HB), 1998 WL 283286, at *6 n. 4 (S.D.N.Y. June 1, 1998) ("While defendant McIntyre's sales were quite high during the Class Period, this was most likely on account of the fact that he resigned as an HMS director prior to January 1997 and was divesting himself of his shares.")—the Court cannot speculate about Rogers' reasons for selling his shares at this stage of the proceedings.

Nevsun's board approved bonuses for the Individual Defendants in December 2011. (Levin Decl., Ex. Y (May 2012 Form 6–K), at 7–8 n. 4) Their compensation and bonuses were linked to the success of the Bisha Mine, and to the transaction with ENAMCO. (*Id.* at 5 (the "compensation program" for these Defendants "is designed to reward contributions to"*inter alia*, Bisha's "successful operations [and] expansion of existing assets")) Furthermore, Davis's compensation was based, in part, on "managing Eritrea Government relations and strategic arrangements" and "achieving successful negotiations in Company transactions."(*Id.*)

Plaintiffs plausibly allege that the timing and magnitude of Defendants' stock sales support a strong inference of scienter. Defendants' stock sales took place shortly after the transaction with ENAMCO and shortly before (1) Defendants' retention of two engineering firms to re-build their reserve model, and (2) the departure of Bisha Mine's three top on-site executives.[7] *See Stevel man v. Alias Research Inc.*, 174 F.3d 79, 85 (2d Ci r.1999) (holding that plaintiff had adequately alleged motive where "during the period of the misrepresentations ... insiders unloaded large positions in Alias"); *In re SL M Corp. Sec. L itig.*, 740 F.Supp.2d 542, 558 (S.D.N.Y.2010) (finding motive sufficiently alleged against one defendant "who dumped nearly all of his shares during the Class Period").

7 Defendants argue that Davis also purchased Nevsun shares during the Class Period. (Def. Br. 18; see Levin Decl., Ex. BB, at 6, 9) However, the shares Davis purchased were acquired through the exercise of stock appreciation rights and options that were granted to Davis as part of his compensation. He did not buy any shares on the open market.

Moreover, Plaintiffs' allegation that Defendants were motivated to overstate the gold reserves in order to increase the price paid by ENA MCO for its 30% stake in the mine is sufficient to survive a motion to dismiss. *See Rothman v. Gregor*, 220 F.3d 81, 93 (2d Cir.2000) ("[T]he artificial inflation of stock price in the acquisition context may be sufficient for securities fraud scienter."); *Glidepath Holding B.V. v. Spherion Corp.*, 590 F.Supp.2d 435, 455 (S.D.N.Y.2007) ("[A] business seeking to ... induce a beneficial sale has sufficient motive to commit fraud to raise the requisite 'strong inference' of fraud under Rule 9(b)."); *In re Complete Mgmt. Inc. Sec. Litig.*, 153 F.Supp.2d 314, 328 (S.D.N.Y.2001) (allegation that defendants "sought to maintain the artificially high stock price so that [the company] might use that stock as currency for acquisitions ... is a sufficiently concrete motive to support a strong inference of scienter").

b. *The Complaint Adequately Alleges Conscious Misbehavior or Recklessness*

***14** Rule 9(b)'s scienter requirement is also satisfied where a complaint contains factual allegations " 'that constitute strong circumstantial evidence of conscious misbehavior or recklessness.' " *Kalnit*, 264 F.3d at 138 (quoting *Acito v. Imcera Group, Inc.*, 47 F.3d 47, 52 (2d Cir.1995)). Plaintiffs proceeding under the "conscious misbehavior or recklessness" theory must allege reckless conduct that is "at the least ... highly unreasonable and which represents an extreme departure from the standards of ordinary care to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it." *Kal nit*, 264 F.3d at 142 (quoting *Honeyman v. Hoyt*, 220 F.3d 36, 39 (2d Cir.2000)).

While this is a "highly fact-based inquiry," securities fraud claims "typically" survive motions to dismiss where a plaintiff has " 'specifically alleged defendants' knowledge of facts or access to information contradicting their public statements.'" *Kal nit*, 264 F.3d at 142 (quoting *Novak*, 216 F.3d at 308). A failure "to check information [defendants'] had a duty to monitor" may also give rise to a strong inference of recklessness. *Novak*, 216 F.3d at 311; see also *N athel v. Siegal*, 592 F.Supp.2d 452, 464 (S.D.N.Y.2008). Under such circumstances, "defendants knew or, more importantly, should have known that they were misrepresenting material facts related to the corporation."*Kal nit*, 264 F.3d at 142.

Where, as here, “information contrary to the alleged misrepresentations is alleged to have been known by defendants at the time the misrepresentations were made, the falsity and scienter requirements are essentially combined.”*In re Revlon, Inc. Sec. Litig.,* No. 99 Civ. 10192(SHS), 2001 WL 293820, at *7 (S.D.N.Y. March 27, 2001) (citing *Rothman,* 220 F.3d att 89–90).

As discussed above, Plaintiffs have adequately pled that Defendants “knew or, more importantly, should have known that they were misrepresenting material facts” concerning Bisha Mine's strip ratio, gold reserves, and life of mine. *See Kal nit,* 264 F.3d at 142 (citations omitted). Accordingly, Plaintiffs have alleged “strong circumstantial evidence of conscious misbehavior or recklessness.”*Id.* at 138 (citations omitted).

Defendants' motion to dismiss Plaintiffs' Section 10(b) claim will be denied.

II. *THE COMPLAINT ADEQUATELY ALLEGES CLAIMS UNDER SECTION 20(A) OF THE EXCHANGE ACT*

Under Section 20(a) of the Exchange Act, a person exercising “control” over a person liable under § 10(b) is also liable, subject only to the defense of “good faith.” 15 U.S.C. § 78t(a).“ ‘In order to establish a prima facie case of liability under § 20(a), a plaintiff must show: (1) a primary violation by a controlled person; (2) control of the primary violator by the defendant; and (3) that the controlling person was in some meaningful sense a culpable participant in the primary violation.’ “ *In re Am. Int'l Grp., Inc.2008 Sec. Litig.,* 741 F.Supp.2d 511, 535 (S.D.N.Y.2010) (quoting *Boguslavsky v. Kaplan,* 159 F.3d 715, 720 (2d Cir.1998)).

***15** Defendants' sole argument for dismissal of this claim is that “Plaintiffs have not properly alleged an underlying primary violation by Nevsun.”(Def.Br.25) Given that this Court has concluded that Plaintiffs have adequately alleged a primary violation of Section 10(b), Defendants' motion to dismiss Plaintiffs' Section 20(a) claim will be denied.

CONCLUSION

Defendants' motion to dismiss is DENIED. The Clerk of the Court is directed to terminate the motion (Dkt. No. 19).

SO ORDERED.

All Citations

Slip Copy, 2013 WL 6017402

2002 WL 33959993
Only the Westlaw citation is currently available.
United States District Court,
N.D. Ohio,
Eastern Division.

In re OFFICEMAX, INC.
SECURITIES LITIGATION.

No. 1:00–CV–2432. | March 26, 2002.

Attorneys and Law Firms

Frederick B. Burnside, Stephen P. Polapink, William S. Lerach, Milberg, Weiss, Bershad, Hynes & Lerach, San Diego, CA, Jack Landskroner, Landskroner Law Firm, Cleveland, OH, for Bernard Fidel.

Daniel P. Mascaro, Progressive Corporation, Mayfield Village, OH, James R. Wooley, Marcia E. Marsteller, Baker & Hostetler, Cleveland, OH, Robert S. Rifkind, Roger G. Brooks, Worldwide Plaza, New York, NY, for Defendants Officemax, Inc., Michael Feuer, and Jeffrey L. Rutherford.

MEMORANDUM & ORDER

KATHLEEN McDONALD O'MALLEY, District Judge.

***1** Defendants OfficeMax, Inc. (OfficeMax), Michael Feuer, and Jeffrey L. Rutherford, pursuant to Federal Rules of Civil Procedure 9(b) and 12(b)(6), move this Court to dismiss Plaintiffs' Second Amended Complaint alleging securities fraud. (Docket No. 52.)Plaintiffs, a class consisting of stockholders who purchased OfficeMax stock (or publicly-traded options) between March 2, 1999, and September 30, 1999, allege that the Defendants made false or misleading statements which had the effect of artificially inflating the price of that stock to the detriment of the Plaintiffs. In moving for dismissal, Defendants argue, among other things, that the Complaint fails to sufficiently allege scienter, both because it lacks particularity as to that element and because it does not allege facts creating a "strong inference" of scienter as required under the Private Securities Litigation Reform Act of 1995, Pub.L. No. 104–67, 109 Stat. 737 (codified in various sections of 15 U.S.C. §§ 77a *et seq.* and §§ 78a *et seq.*) ("PSLRA").

After considering the parties' briefs and the points raised at oral argument, [1] the Court finds Defendants' argument with respect to scienter well taken. Because the allegations in the Complaint do not state with particularity facts giving rise to a strong inference of scienter, the Court **GRANTS** Defendants' motion and **DISMISSES** the case.

1 During oral argument on August 9, 2001, the Court denied on the record the Plaintiffs' Motion to Strike Extrinsic Exhibits and All References thereto. (Docket No. 58.)At that time the Court noted that the motion was denied because it was not the most appropriate vehicle for making determinations concerning whether these items were appropriate for the Court's consideration. Except to the limited extent noted in footnote 6 below, the Court has found it unnecessary to rely on the items to which Plaintiffs objected. (Mot. to Strike at 1, n. 2.) Thus, again except as noted below, the objections underlying that motion are moot.

I. THE COMPLAINT

Plaintiffs claim financial harm arising from false or misleading statements by Defendants that allegedly had the effect of artificially inflating the price of OfficeMax stock during the period in which Plaintiffs purchased the stock or options—between March 2, 1999, and September 30, 1999 (the "Class Period"). Specifically, Plaintiffs claim that Defendants made, or induced others to make, a series of statements about anticipated profitability and earnings potential which Defendants knew were false or misleading in light of the true state of OfficeMax's operations.

OfficeMax, headquartered in Shaker Heights, Ohio, operates a chain of high volume, deep-discount office supply superstores across the United States, as well as many smaller format stores and an online office supply e-commerce site. Its business is separated into two segments: A Core Business Segment, consisting of everything but computer sales (e.g., office supplies, business machines, peripherals, and copying services), and a Computer Business Segment. Defendant Feuer is the founder and Chief Executive Officer (CEO) of the company, while Defendant Rutherford is the Chief Financial Officer (CFO). The 68–page Complaint outlines Plaintiffs allegations by, first, describing the Defendants' "scienter and scheme." Then, the Complaint sets forth a number of allegedly false or misleading statements either made by Defendants directly or made by analysts but, Plaintiffs allege, attributable to Defendants. These statements are separated into three time periods: March–April, May–June, and August of 1999. For each of the three time periods, a separate list of "true but concealed facts" are alleged which, Plaintiffs assert, render the statements either false or misleading. Each list of facts contains between 24 and 26 allegations each, although many "true but concealed" facts alleged in one list are also contained in the others. Finally, the Complaint alleges several violations of Generally Accepted Accounting Principles (GAAP). The allegations are described in more detail below.

A. *Conditions of OfficeMax Prior to the Class Period.*

***2** 1. *Stock price downturn.*The Complaint alleges that, in the months immediately preceding the Class Period, OfficeMax was in deep trouble. In the second quarter of fiscal year 1998, OfficeMax stock fell to between $7 and $8 per share, down from a $19 5/8 high of two quarters earlier. Describing OfficeMax as the office supply industry "stepchild," perennially ranking behind the industry leaders Office Depot and Staples, the Complaint notes that, despite rapidly expanding its number of warehouse stores during fiscal years 1996, 1997, and 1998, OfficeMax reported sharply declining earnings per share (EPS) in fiscal year 1998 (ending on January 23, 1999).

The Plaintiffs postulate both a number of causes, and a number of effects, of this downturn. Among its causes were increasing losses from its computer sales and an "extraordinarily-high executive turnover, particularly during the summer of 1999, as many executives refused to work with Feuer, who maintained ironclad control over all of OfficeMax's day-to-day operations."(Compl.¶ 3.)[2] The effect of the downturn was to pressure OfficeMax's top officers, Feuer and Rutherford, to improve its operating results and stock price. (Compl.¶ 4.) According to the Complaint, the pressure was of such magnitude that Feuer realized that "unless OfficeMax was turned around, his position as CEO was in danger."(*Id.*)

2 Stressing that the executive turnover problem was most acute in the summer of *1999* in a paragraph alleging its causative role in the stock price drop of *1998* creates, at least, some chronological confusion for the reader of the Complaint. The effects of the Complaint's numerous inconsistencies is more generally discussed in Section III.B, *infra.*

2. *Hidden condition of OfficeMax.*

The Complaint's "true but concealed facts" sections allege a multitude of troubling conditions at OfficeMax, many of which allegedly preexisted the Class Period and all of which the investing public was purportedly unaware. The Complaint alleges that the procurement system for its Core Business Segment was "badly flawed" and "defective" (Compl.¶¶ 11(b), 11(o)). Moreover, it alleges, OfficeMax's inventory control systems for both its Core and Computer Business Segments operated inefficiently and ineffectively (Compl.¶ 11(g)) and lacked internal infrastructure (Compl.¶ 11(c)), resulting in massive excess inventory. OfficeMax policies, according to the Complaint, exacerbated the procurement and inventory problems. These policies included (1) a policy of never having sales (Compl.¶ 11(p)); (2) a policy of putting older inventory in back rooms so that customers would be more likely to buy new items (Compl.¶ 11(q)); and a policy of overstocking its stores with merchandise (Compl.¶ 11(u)). The Complaint also alleges that Feuer did not open or close stores responsibly. It states, "Not only did Feuer require certain new stores to open knowing that the forecasted sales for those new stores would be less than the internally required amount to open a new store ... but Feuer also refused to close existing stores that continually operated at a loss."(Compl.¶ 11(k)). Moreover, new store openings were not well coordinated with purchasing. For example, many stores were opened after back-to-school shopping season and remained overstocked with back-to-school merchandise. (Compl.¶ 11(t)). According to the Complaint, this was the state of affairs prior to the Class Period.

***3** 3. *Feuer's and Rutherford's scienter.*The Complaint alleges that Feuer and Rutherford behaved either purposely or recklessly in deceiving the investing public about OfficeMax's condition. It alleges knowledge of the "true but concealed facts" detailed throughout the Complaint, along with opportunity to conceal them and a motive to do so.

a. *Knowledge.*Feuer and Rutherford, as top OfficeMax executives, had access to a bevy of reports and records that purportedly kept them informed of OfficeMax's operating and financial conditions. The Complaint alleges that each were "hands on" managers, dealing *daily* with important issues facing OfficeMax's business. (Compl.¶ 23.) Inventory is a major concern for an office supply superstore such as OfficeMax, particularly because of its strategy to compete with Staples and Office Depot by continuing to open new stores. The Complaint alleges that, because inventory control was so important, both Feuer and Rutherford "must have had" knowledge of the inventory problems described above.

In particular, each had access to reports generated by "StoreMax," such as "Top Performer" reports (used to track inventory by quantity and to assess margin and total sales dollars of products) and an "inventory control book" (a program that tracked discontinued products), as well as daily reports directly from stores. (Compl.¶ 26.)

The Complaint also notes that a consultant report highlighted these inventory problems. During fiscal years 1998 and 1999, Kurt Salmon & Associates ("Salmon") conducted a three stage study of OfficeMax's inventory management. The Complaint notes that "by early F99, as Salmon was about to begin the third phase of the comprehensive business study," it had reached several conclusions which are paraphrased in the Complaint. These conclusions include that "OfficeMax's procurement and inventory policies were materially deficient and inadequate for the size of its business—especially given its expansion program," and "OfficeMax's rapid expansion program was outstripping OfficeMax's already inadequate procurement and inventory policies."(Compl.¶ 37.) With an inadequate inventory control system and "lack of management talent," the Salmon study concluded that OfficeMax would need to curtail its expansion program to regain control over its Core Business Segment. (Compl.¶ 21.)

b. *Motive/Opportunity.*

The Complaint alleges that Feuer and Rutherford had the opportunity to commit fraud, because they controlled company press releases and Securities and Exchange Commission (SEC) filings, while their executive positions gave them access to insider information. As for motive, the Complaint cites the stock drop noted above—from an all time high of 19–5/8 in April 1998 to $7–$8 per share in February 1999, just before the start of the Class Period. Plaintiffs claim that this downturn caused "extreme dissatisfaction" among OfficeMax shareholders, causing Feuer to realize that, absent improved operating performance, his position as CEO would be "in danger." (Compl.¶ 44.) The Complaint does not, however, describe any particular conditions that would highlight or quantify that danger, such as an imminent takeover bid or proxy war. Nor does it suggest any insider trading, bribery, or other financial self-dealing by the Defendants.

***4** 4. *Restructuring.*In January 1999, two months before the Class Period began, OfficeMax announced that it was dramatically changing its business model. From then on, it would only sell computers made by IBM and one other manufacturer (Comp.¶ 5). It launched an experimental program of selling IBM computers in a "store-within-a-store" format, whereby IBM personnel (or OfficeMax personnel trained by IBM) handled the computer sales and in which IBM bore the risk associated with computer inventory control. Coincident with the restructuring, OfficeMax announced that it would now report its Core Business Segment and Computer Business Segment financial results separately. It also announced that it was raising its Core Business Segment inventory items by about 1,000 items per store. Finally, it announced an approximately $80 million pre-tax inventory writedown to address obsolete and discontinued computer inventory. (Compl.¶ 45.) Plaintiffs claim that Defendants' $80 million writedown of inventory, in context, was understood by investors as eliminating "all" excess inventory. (Compl.¶ 11(a)). Plaintiffs do not point to any statement made by OfficeMax or anyone acting on its behalf, however, assuring investors that the $80 million writedown would have such an effect on its inventory.

Plaintiffs highlight particular aspects of OfficeMax's announcement about its new strategy, including the following excerpts from OfficeMax's January 19, 1999, press release:

> The Company stated that this will give investors better visibility to OfficeMax's financial results and the consistent positive growth for its Core Business Segment.... OfficeMax said that its Core Business Segment has been strong and gaining momentum over the past three years.... [Feuer stated,] "Our consistent sales and earnings growth in the Core Business Segment has been overshadowed on a consolidated basis by the losses sustained in our computer business. Our improving operating results will be more clearly depicted through segment reporting as we continue to develop and implement the new strategy for our computer business as well as ongoing improvements in our core supply business."

(Compl.¶ 46.) [3]

3 Although not at issue in this motion, the Court notes that the timing of the deceptive practices appears somewhat inconsistent with the Class Period selected. Plaintiffs suggest, without actually alleging, that the entire restructuring initiative, from the very beginning, was a ruse to artificially inflate OfficeMax's stock. (*See* Compl. ¶ 44–46). If this were the case, then the deception would have begun in January 1999, when the restructuring was announced, rather than March 2, 1999, when the Class Period begins.

The Complaint also concedes, however, that OfficeMax was addressing its inventory problems in two other ways. During the Class Period, “OfficeMax was in the process of attempting to remedy the procurement and inventory management problems by reconfiguring its supply chain-store-distribution processes.”Moreover, OfficeMax was “installing a new, more high powered and sophisticated computerized purchasing and inventory control system made by SAP—a huge European software maker.”(Compl.¶ 30.) The Complaint nevertheless alleges that these changes were “taking much longer than had been anticipated.”(*Id.*)

B. *Statements Made During the Class Period.*

Plaintiffs allege that, during the Class Period, Defendants made numerous statements about OfficeMax's financial and operating condition that were either false or misleading; Plaintiffs allege that the Defendants knew that OfficeMax could not perform at the optimistic level that the Defendants communicated to the investing public. The bulk of these statements were made in releases of quarterly reports, during follow-up discussions of those releases with analysts, or by analysts themselves, who, Plaintiffs claim, were just parroting what they were told by Defendants. The Complaint alleges that the fraudulent statements ceased on September 30, 1999, when OfficeMax revised its forecasts and adopted a substantially more pessimistic stance. Each time segment is discussed below.

1. *March 2, 1999 through April 1999.*

***5** The Class Period begins on March 2, 1999, when OfficeMax reported its results for the fourth quarter of fiscal year 1998 and for the balance of that fiscal year. Plaintiffs highlight two excerpts from the report that they consider deceptive: first, a quote from Feuer in which he says, “Our focus on improving merchandise margins through an enhanced product assortment ... is reflected in our overall improved gross profit” and “[t]he strength of our balance sheet ... provides us financial flexibility to take advantage of future opportunities.”(Compl.¶ 49.) Plaintiffs then allege that, on the same day, subsequent to the release of the report, OfficeMax held a conference call for analysts and other interested parties to discuss OfficeMax's results and future prospects. The Complaint summarizes the statements allegedly made by Feuer and/or Rutherford during the conference call as follows:

- OfficeMax had revised its business model to lessen the losses from its Computer Segment, while increasing its profits from its Core Business Segment—which were due to a large increase in the number of SKUs sold by the Core Business Segment and to an improving inventory management in its Core Business Segment—which would result in OfficeMax achieving strong EPS growth during fiscal year 1999 and fiscal year 2000.

- OfficeMax's Core Business Segment was performing extremely well and had strong positive momentum, which would lead that Segment to achieve strong EPS growth during fiscal years 1999 and 2000.

- OfficeMax's Core Business Segment was significantly improving its inventory management and control, such that OfficeMax's inventories in the Core Business Management Segment were being more effectively and efficiently utilized and managed, boosting the profits and EPS of the Core Business Segment and of OfficeMax overall.

- OfficeMax's Core Business Segment profitability was boosted by the significant expansion of the number of SKUs carried by OfficeMax's Core Business Segment (about 1,000 items per store) and in the increased sales of more profitable items.

- The inventories in OfficeMax's Core Business Segment were well managed and under control.

- The acceleration of OfficeMax's aggressive new store expansion plan was proceeding successfully, was under control and would further boost OfficeMax's revenues and profits and EPS.

- OfficeMax's new store expansion program would boost OfficeMax's revenues, profits, and EPS during the 3rd quarter and 4th quarter of fiscal year 1999.

- As a result of the foregoing, OfficeMax was forecasting fiscal year 1999 EPS of $.90–.93 and fiscal year 2000 EPS of $1.05–$1.10.

(Compl.¶ 50.) As a result of the conference call and follow up discussions with senior management, many analysts wrote reports about OfficeMax's current financial position and future prospects. Plaintiffs imply, without specifically alleging, that all the statements contained in the analysts' reports are directly attributable to Feuer and Rutherford. The analysts' reports, excerpted in some detail in the Complaint, each generally paint an optimistic view of the changes being made by OfficeMax, including quotes such as “core business is on the upswing and quite profitable" (Compl.¶ 51). Some contain specific comments on inventory control: "While management intends to reduce the FY end inventory tally by approximately $200 million, the addition of 100 new stores (stocking about $1.3 million in inventory each), plus two new delivery centers and a new PowerMax distribution facility should offset."(Compl ¶ 56.) The Complaint summarizes Plaintiffs' view of the March 1999 communications to analysts and investors as follows:

> ***6** OfficeMax assured analysts and investors that its newly organized business model was off to a good start, with its 1 st quarter F99 Core Business Segment sales running at or ahead of plan; that the Core Business Segment's profit margins were increasing; and that OfficeMax's Core Business Segment would achieve comparable "same store" sales growth (sales in the Core Business Segment at stores open at least a year) in the mid-single digits during F99.

(Compl.¶ 7.) In April 1999, OfficeMax issued its fiscal year 1998 Annual Report. It included a letter from Feuer that is excerpted in detail in the Complaint. The excerpts include a summary of yearly sales and three paragraphs concerning the PowerMax system, a supply-chain distribution system launched in 1998. Although much is excerpted, two of Feuer's statements are highlighted in bold by Plaintiffs: first, "We positioned the Company for future growth and market leadership by implementing our latest superstore format —Millennium 8.0—and launching our smaller footprint OfficeMax PDQ pilot store"; and second, "We believe the major changes we have made in 1998 and our future expansion plans will provide very meaningful returns in the years ahead."(Compl.¶ 58.)

After describing the statements made in the March 2nd report, the conference call statements, the statements made by analysts but attributed to Feuer and Rutherford, and the Feuer letter contained in the 1998 Annual Report, the Complaint then asserts that "each of the statements made between March 2, 1999 and April 1999 were false or misleading when issued."(Compl.¶ 59.) It then lists twenty-four "true but concealed facts" that allegedly demonstrate the falsity of each of the statements made. As summarized earlier, these alleged facts describe problems at OfficeMax, including inventory problems, policies which exacerbated those problems, unprofitable policies with regard to opening new stores or closing existing ones, and the high level of executive turnover caused by Feuer's harsh management style. (*Id.*) The Complaint alleges that the Defendants knew that, "as a result of the foregoing adverse conditions in OfficeMax's business, OfficeMax could not, and would not" achieve anything near the optimistic forecasts made by the company. (*Id.*)

2. *May and June 1999.*

On May 11, 1999, OfficeMax reported its first quarter fiscal year 1999 results. That release is quoted in much detail, with approximately half of it highlighted by the Plaintiffs in bold typeface. (Compl.¶ 60.) In the Complaint's "summary" section, the Plaintiffs identify the particular aspects of the May and June 1999 statements that they assert are particularly relevant:

> OfficeMax reported better than forecast 1st quarter F99 results—consolidated EPS of $.19. OfficeMax also reported its separate Core Business Segment results for the first time, showing Core Business Segment EPS of $.25. OfficeMax attributed these better-than-expected results to the success of its revamped business model and attributed the increased earnings of its Core Business Segment to the Core Business Segment's enhanced merchandise selection, better product assurances and OfficeMax's success in managing the inventories of its Core Business and Computer Business Segments. OfficeMax also stated that its ambitious new store expansion program was proceeding ahead of plan ... and that this would mean "very positive implications" for 2nd half F99 financial results. OfficeMax also assured investors that its enhanced cash flow was the result of its improved supply chain management.

***7** (Compl.¶ 7.) Following the release of the first quarter results, OfficeMax again held a conference call with analysts to discuss the results and future projections, during which, according to the Complaint, Feuer and Rutherford essentially repeated the points they made in the March 2, 1999 conference call, except that they allegedly increased their "forecasted" F99 EPS to $.93–.95 and F00 EPS to $1.05–$1.15. Following a summary of that conference call, the Complaint lays out in detail a number of analysts' reports throughout May and June that, again, it implies are directly attributable to Feuer and Rutherford. These statements, again, are generally optimistic statements about OfficeMax's short term and long term prospects. They include, and the Complaint sets out in bold, statements such as, "The Company believes the acceleration of store openings will be very beneficial in the fourth quarter, when OfficeMax typically generates about 30% of OfficeMax's sales and nearly 45% of the company's earnings" (Compl.¶ 62) and, "We see significant upside potential in second half of year."(Compl.¶ 65.)

After detailing these analysts' reports (which stretch through May and the beginning of June), the Complaint then asserts that "each of the statements made between May 11, 1999 and June 8, 1999 were false or misleading when issued."(Compl.¶ 70.) It then lists the "true but concealed facts" that substantially repeat the "true but concealed facts" that were earlier listed to demonstrate the falsity of the March and April statements. Again, these "true but concealed facts" include reference to inventory problems, procurement problems, executive retention problems, as well as allegations that OfficeMax's revised business model "was not working, as its rapid expansion of the number of SKUs sold by its Core Business Segment, about a thousand items per store, was resulting in the accumulation of millions of dollars worth of merchandise, which was not selling well."(Compl.¶ 70(d).) It also highlights other policy changes that had not done well, particularly a new program called the "flat rate discount program" which applied only to new corporate customers, allegedly outraging existing customers who did not benefit from the program; existing customers allegedly ceased doing business with OfficeMax. (Compl.¶ 70(j).) As it did with the March and April statements, the Complaint here alleges with respect to the May and June statements that Defendants knew that, "as a result of the foregoing adverse conditions in OfficeMax's business, OfficeMax could not, and would not" achieve anything near the optimistic forecasts made by the company. (Compl.¶ 70.)

3. *August 1999.*

On August 10, 1999, OfficeMax reported its second quarter fiscal year 1999 results. Again, the Complaint sets out the press release, again it describes a conference call to analysts on the same day in which optimistic forecasts were made, and again it describes, in detail, analysts reports following the conference call. The Complaint summarizes these statements as follows:

> ***8** OfficeMax reported its 2nd quarter F99 results (typically the weakest quarter of OfficeMax's fiscal year), which were in line with forecasted levels: consolidated EPS of $.02 and Core Business Segment EPS of $.07. OfficeMax also announced that it was going to further accelerate its ambitious new store expansion program so that it would open more stores in F99 than previously indicated (115 stores instead of the previously announced 100 stores) and would open those stores earlier in F99 than previously indicated. OfficeMax told investors that this acceleration would have a very positive impact on OfficeMax's financial results during the 2nd half F99 and especially during the 4th quarter F99—by far the most important quarter of OfficeMax's fiscal year, a quarter in which OfficeMax achieved about 40% of its earnings for the full year. OfficeMax further represented that the positive financial impact of these accelerated new store openings and of OfficeMax's aggressive new store expansion plan would continue into F00. When OfficeMax revealed that its same store sales for its Core Business Segment had declined slightly during the 2nd quarter F99, instead of increasing to mid-single digits as previously promised, it assured investors that this was due to price declines limited to a few products (i.e. printers and fax machines). OfficeMax further stated that its Core Business Segment operations were continuing to improve due to the Core Business Segment's enhanced merchandise mix, tightly focused product assortment and the successful management of its inventories, which

> led to increased Core Business Segment EPS. OfficeMax stressed that the Core Business Segment's inventories were in good shape with decreased per-store inventories, with overall inventory increasing less than sales and with inventory turns increasing. OfficeMax forecasted 3rd quarter F99 EPS of $.30–$.32 and 4th quarter F99 EPS of $.41–$.42, which would lead to F99 EPS of $.93–$.95 and F00 EPS of $1.05–$1.15.

(Compl.¶ 9.) Again, the Complaint alleges that each of these statements "were false or misleading when issued," followed by essentially the same "true but concealed facts" recited for the earlier time periods, and alleges that, "as a result of the foregoing adverse conditions in OfficeMax's business, OfficeMax could not, and would not," achieve anywhere near the optimistic forecasts made by the company. (Compl.¶ 80(z).)

4. *September 30, 1999.*

At the end of September, OfficeMax announced that it was revising its forecasts for the second half of fiscal year 1999 as well as for fiscal year 2000 and expected much less favorable results. OfficeMax also announced that it would take an $83 million writedown due to excessive, overvalued, or unsaleable inventory in its Core Business Segment, that it was sharply reducing the number of merchandise items carried by its Core Business Segment, and that it was sharply curtailing its new store expansion program to save money. The stock price fell over 32% in two days to $5 per share.

C. *GAAP Violations.*

***9** Finally, the Complaint alleges two distinct GAAP violations to accompany the fraudulent statements described above. It alleges, first, that OfficeMax improperly accounted for its inventory, and second, that it improperly accounted for vendor rebates as current income.

1. *Inventory accounting.*

The Complaint alleges that the company "did not take adequate reserves for excess and overvalued inventory."(Compl.¶ 92.) The Complaint notes here a long list of reasons why the company had problems with inventory, some of which were included in the "true but concealed facts" portions above, others of which are alleged here for the first time (e.g., "The problem with the Computer Business Segment was the return rate."(Compl.¶ 91(p)).) In regard to the $83 million inventory writeoff, the Complaint alleges:

> Had OfficeMax appropriately reserved for excess and overvalued inventory in prior quarters, such a large charge would have been unnecessary. Moreover, had OfficeMax accrued timely and adequate reserves for excess inventory during the Class Period, its Core Business Segment would have reported minimal, if any, net income in the 1 st quarter F99, instead of the $29 million it reported, and would have further reported a large loss in the 2nd quarter F99 instead of the $8 million it actually reported. Additionally, OfficeMax's assets and retained earnings as reported in the Company's balance sheet for the 1 st and 2nd quarters F99 were materially overstated due to the Company's failure to properly value its inventory.

(Compl.¶ 96.) Other than the fact of the $83 million writedown, the Complaint does not further quantify by what degree reserves taken during the Class Period were inadequate.

2. *Vendor rebates.*

Plaintiffs also allege that Defendants improperly applied vendor rebates to current income, rather than to a reduction in the purchase price of the merchandise, in violation of GAAP principles. While Plaintiffs do not allege when this policy began, and it, in fact, appears that the policy significantly predated the Class Period, Plaintiffs nevertheless allege that it was part of the scheme to artificially inflate the price of the stock. After approximating OfficeMax's retail sales, markup rates, costs of goods, and percentage of rebates, Plaintiffs estimate the vendor rebates were "$100 million to $126 million per year."(Compl.¶ 99.) At the end of the Class Period, OfficeMax announced a "vendor rationalization" policy in which it "unbundled" vendor rebate benefits from income, thus effectively ending this practice. (*Id.*)

With respect to vendor rebates, the Complaint alleges not only a GAAP violation for inventory that may have been responsibly purchased, but also a scheme to purposely purchase more inventory than was needed. Plaintiffs allege that Defendants acquired excess inventory not by mistake but "solely to benefit from associated vendor credits for advertising and other costs, and then recognizing the credits as income prior to using the inventory and/or incurring the costs."(Compl.¶ 97.)

***10** The effect of the GAAP violations, according to the Complaint, was that net income was reported as favorable in the first and second quarter of F99. While Feuer attributed these favorable quarterly results to better product assortment and other indicators of better management, according to the Complaint, those results would have shown minimal, if any, income for those quarters absent GAAP violations.

II. MOTION TO DISMISS STANDARD FOR SECURITIES FRAUD COMPLAINTS

In deciding a motion to dismiss under Rule 12(b)(6), the Court must take all well-pleaded allegations in the complaint as true and construe those allegations in a light most favorable to the plaintiff. *Summit Health, Ltd. v. Pinhas,* 500 U.S. 322, 325 (1991); *Dana Corp. v. Blue Cross & Blue Shield Mut.,* 900 F.2d 882 (6th Cir.1990); *Craighead v. E.F. Hutton & Co.,* 899 F.2d 485, 489 (6th Cir.1990). However, the Court need not accept as true a legal conclusion couched as a factual allegation. *Papasan v. Allain,* 478 U.S. 265, 286 (1986). A well-pleaded allegation is one that alleges specific facts and does not merely rely upon conclusory statements. In the context of a motion to dismiss a securities fraud claim, a court "may consider the full texts of the SEC filings, prospectus, analyst's reports and statements 'integral to the complaint,' even if not attached, without converting the motion into one for summary judgment under Rule 56."*In re Royal Appliance Securities Litigation,* 1995 WL 490131, at *2 (6th Cir. Aug. 15, 1995). In addition, the Court may consider documents to which the plaintiffs refer in their complaint, even if the plaintiffs do not attach them as exhibits as long as these documents are central to plaintiffs' claims, *Weiner v. Klais & Co.,* 108 F.3d 86, 89 (6th Cir.1997), as well as public records and matter of which a court may take judicial notice, *Jackson v. City of Columbus,* 194 F.2d 737, 745 (6th Cir.1999), without converting the motion to dismiss into a motion for summary judgment.

In 1995, Congress passed the PSLRA which heightened the pleading standard in securities litigation. The PSLRA requires a plaintiff to state with particularity all facts supporting an allegation made on information and belief, and all facts establishing scienter. Section 78u–4(b) states:

> **(b) Requirements for securities fraud actions**
>
> **(1) Misleading statements and omissions**
>
> In any private action arising under this chapter in which the plaintiff alleges that the defendant—
>
> (A) made an untrue statement of a material fact; or
>
> (B) omitted to state a material fact necessary in order to make the statements made, in the light of circumstances in which they were made, not misleading;
>
> the complaint shall specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed.
>
> ***11 (2) Required state of mind**
>
> In any private action arising under this chapter in which the plaintiff may recover money damages only on proof that the defendant acted with a particular state of mind, the complaint shall, with respect to each act or omission alleged to violate this chapter, state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.

15 U.S.C. § 78u4(b)(1) & (2).

The Sixth Circuit, in *In re Comshare, Inc. Securities Litigation,* 183 F.3d 542 (6th Cir.1999), held that plaintiffs may meet PSLRA pleading requirements "by alleging facts that give rise to a strong inference of reckless behavior but not by alleging facts that illustrate nothing more than a defendant's motive and opportunity to commit fraud."*Id.* at 551.The Court in *Comshare* defined recklessness as "highly unreasonable conduct which is an extreme departure from the standards of ordinary care. While the danger may not be known, it must at least be so obvious that any reasonable man would have known of it."*Id.* at 550 (citing *Mansbach v. Prescott,* 598 F.2d 1017, 1025 (6th Cir.1979)). Recklessness is to be understood as a "mental state apart from negligence and akin to conscious disregard."*Id.*

The Court in *Comshare,* in explaining the role allegations of motive and opportunity play in the assessment of scienter, stated:

> [W]e cannot agree that under the PSLRA, plaintiffs may establish a "strong inference" of scienter merely by alleging facts demonstrating motive and opportunity where those facts do not simultaneously establish that the defendant acted recklessly or knowingly, or with the requisite state of mind. While facts regarding motive and opportunity may be "relevant to pleading circumstances from which a strong inference of fraudulent scienter may be inferred,"In re Baesa, 969 F.Supp. at 242, and may, on occasion, rise to the level of creating a strong inference of reckless or knowing conduct, the bare pleading of motive and opportunity does not, standing alone, constitute the pleading of a strong inference of scienter.

Id. at 551 (footnote omitted). In *Helwig v. Vencor, Inc.,* 251 F.3d 540 (6th Cir.2001) (en banc), the Sixth Circuit clarified its *Comshare* decision regarding the role that motive and opportunity play to showing recklessness:

> While it is true that motive and opportunity are not substitutes for a showing of recklessness, they can be catalysts to fraud and so serve as external markers to the required state of mind. Comshare made this distinction clear by refusing to equate motive and opportunity with scienter but yet recognizing that facts showing each may support a strong inference of recklessness. We reaffirm that plaintiffs cannot simply plead "motive and opportunity" as a mantra for recovery under the Reform Act.

Id. at 550.Courts must focus on the facts of the case before them and not simply look to the labels that the parties place on them. *Id.* at 550–51."Accordingly, facts presenting motive and opportunity may be of enough weight to state a claim under the PSLRA, whereas pleading conclusory labels of motive and opportunity will not suffice."*Id.* at 551 (citing *Comshare,* 183 F.3d at 551).

***12** The Court in *Helwig* found this fact-specific approach best reflected the intent of Congress. *Helwig,* 251 F.3d at 551 (citing *Greebel v. FTP Software, Inc.,* 194 F.3d 185, 196 (1st Cir.1999) ("whatever the characteristic patterns of the facts alleged, those facts must now present a strong inference of scienter")). Thus, in order to determine whether scienter has been pled adequately under the PSLRA, the Court must assess whether the allegations in the complaint, taken as a whole, including those relating to motive and opportunity, give rise to a strong inference of recklessness on the part of the defendants. While recognizing such a fact-specific inquiry does not lend itself to rigid formulas for determining when a plaintiff has sufficiently alleged scienter, the Court did indicate several factors that are usually relevant to this inquiry:

> (1) insider trading at a suspicious time or in an unusual amount;
>
> (2) divergence between internal reports and external statements on the same subject;
>
> (3) closeness in time of an allegedly fraudulent statement or omission and the later disclosure of inconsistent information;
>
> (4) evidence of bribery by a top company official;
>
> (5) existence of ancillary lawsuit charging fraud by a company and the company's quick settlement of that suit;
>
> (6) disregard of the most current factual information before making statements;
>
> (7) disclosure of accounting information in such a way that its negative implications could only be understood by someone with a high degree of sophistication;
>
> (8) the personal interest of certain directors in not informing the disinterested directors of an impending sale of stock; and
>
> (9) the self-interested motivation of defendants in the form of saving their salaries or jobs.

Id. at 552 (citing *Greebel,* 194 F.3d at 196). The Court emphasized, however, that this list was not exhaustive, and was only meant to "point to fixed constellations of facts that courts have found probative of securities fraud."*Id.* at 552.

In adopting this standard, the Sixth Circuit expressly rejected the views of those courts with both broader and narrower views of the PSLRA. Thus, the Court in *Comshare,* reiterated by its decision in *Helwig,* rejected the view espoused by a number of courts, including the Second Circuit, that the

PSLRA simply requires a plaintiff to either (1) allege facts constituting strong circumstantial evidence of conscious or reckless behavior, or (2) allege facts showing a defendant's motive and opportunity to commit fraud. *Comshare,* 183 F.3d at 549.And, the Court in *Comshare* rejected the view, espoused by the district court in that case, that a plaintiff must allege facts indicating a knowing misrepresentation or conscious intent to defraud before a complaint can pass muster under the PSLRA. *Id.* at 551–52.

Instead, after a careful analysis of the plain language of the PSLRA, the Court in *Comshare* concluded that, while a plaintiff may state a valid claim under the PSLRA premised on recklessness alone (as distinct from knowing misconduct), the facts alleged collectively must give rise to a "strong inference" that the defendants did, indeed, behave recklessly. *Helwig* reaffirms this approach. Thus, the Sixth Circuit employs a form of "totality of the circumstances" analysis; this Court, accordingly, declines to examine plaintiffs allegations in piecemeal fashion and, will instead, assess them collectively to determine what inferences may be drawn therefrom.

III. ANALYSIS

***13** To state a claim under § 10(b) of the Securities and Exchange Act of 1934, and Rule 10b–5, a plaintiff must allege in connection with the purchase or sale of securities (1) a misrepresentation or omission, (2) of a material fact, (3) made with scienter, (4) upon which the plaintiff relied, and (5) which proximately caused the plaintiff's injury. *Comshare,* 183 F.3d at 548.Defendants move for dismissal of the Complaint, focusing on the first three elements: With regard to misrepresentations and materiality, Defendants argue (1) that many of the alleged misrepresentations were neither made by Defendants nor can be attributed to them; (2) that the Complaint does not sufficiently allege with particularity why or how the alleged misrepresentations were false; (3) that many of the alleged misrepresentations were not material; and (4) that the Defendants' forward looking statements were appropriately qualified and are, thus, not actionable. With regard to scienter, Defendants argue that the Complaint lacks particularity in its allegations, and, in any case, the facts alleged do not create a strong inference of either an intent to deceive or recklessness. Defendants also argue separately that, with respect to GAAP violations, the Complaint is deficient because those allegations are made with insufficient particularity and do not raise an inference of scienter either alone or in combination with Plaintiffs' other allegations of wrongdoing.

Because the Court finds that the Complaint does not allege facts with particularity which give rise to a strong inference of scienter, the Court dismisses the Complaint without reaching Defendants other arguments. [4]

4 The Court notes, however, that many of Defendants' contentions appear to have merit, either in whole or in part. Plaintiffs, for instance, focus many of their allegations of fraud on forward looking statements of optimism about the future which are not generally actionable under the PSLRA. In addition, while the Complaint charges Defendants with responsibility for all of the statements and predictions made by analysts, many of the statements to which Plaintiffs point are clearly couched as opinions of the analysts which, similarly, are not actionable. Finally, it appears that many of the statements with which Plaintiffs purport to take issue simply are not false. Because the Court resolves Defendants' motion on other grounds, the Court does not undertake here to parse Plaintiffs' allegations and determine which could, in the appropriate circumstances, otherwise support a claim under § 10(b). The Court confirms, though, that it has closely examined Plaintiffs' allegations on an individual and collective basis to determine, to the extent possible, the totality of the circumstances actually presented by Plaintiffs' Complaint.

Scienter generally refers to a "mental state embracing intent to deceive, manipulate, or defraud."*Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 193 (1976). While Defendants contend that the Complaint insufficiently pleads scienter, Plaintiffs argue that their Complaint gives rise to a strong inference of scienter through the combination of (1) its allegations regarding Feuer's and Rutherford's motive and opportunity to defraud, (2) its allegations showing a divergence between internal reports and statements made to the public, and (3) its allegations of GAAP violations. Each is discussed below.

A. *Motive and Opportunity.*

The Complaint alleges that Feuer and Rutherford each had the opportunity and the motive to defraud stockholders. The Plaintiffs argue that these allegations help create a strong inference of scienter.

The Complaint first makes the unsurprising allegation that, as top executives in the company, Feuer and Rutherford enjoyed access to a wide selection of internal reports and information, as well as control over OfficeMax public releases and financial disclosures, providing them an opportunity to defraud the public. In regard to motive, however, the Complaint makes only a passing reference to the "extreme dissatisfaction" of stockholders because of the substantial decline in stock price, concluding that Feuer "realized that unless the Company was turned around, his position as CEO was in danger."(Compl.¶ 44.) Plaintiffs argue in their brief that Feuer felt particular pressure because he had launched the major restructuring of the company. [5] They also argue that, as early as March 2, 1999, Feuer must have already known that the major restructuring announced two months earlier would not and could not work; with that knowledge, he nevertheless lied about it, or recklessly disregarded its failure, in order to save his job.

5 This is somewhat at odds, again, with the suggestion that the restructuring itself was part of the fraudulent scheme. *See supra* note 2. In other words, Plaintiffs suggest that the pressure on Feuer was both caused by, and a result of, the restructuring.

***14** Plaintiffs cite this Court's opinion in *In re Telxon Corp. Securities Litigation,* 133 F.Supp.2d 1010 (N.D.Ohio 2000), for the proposition that particular pressure that an executive may face to demonstrate the wisdom of changes that he has made or to otherwise secure his executive position are relevant to a scienter inquiry. *Id.* at 1028;*see also Helwig,* 251 F.3d at 552.Plaintiffs are quite correct in arguing that these types of allegations are relevant. They are, however, more or less meaningful depending upon the circumstances in which they are made. The defendants in *Telxon* were new executives under pressure to "improve performance after several initial quarters of poor performance under their oversight."The *Telxon* executives were, moreover, "motivated by the promise of substantial additional compensation to make sure their predictions of profitable performance became a reality" and by "the need to stave off ... take over efforts and an ensuing proxy battle."*Telxon,* 133 F.Supp.2d at 1028.Plaintiffs' Complaint does not allege facts similar, in scope or degree, to *Telxon.*Feuer was no neophyte anxious to prove his mettle, he was the founder of the company. No take over efforts, proxy battles, or particular compensation methods are alleged which would give rise to some particular danger to the Defendants. *See City of Philadelphia v. Fleming Co.,* 264 F.3d 1245, 1270 (10th Cir.2001) (finding alleged motives insufficient to raise strong inference of scienter when no allegations of personal financial benefit from misrepresentations); *Phillips v. LCI Int'l, Inc.,* 190 F.3d 609 (4th Cir.1999) (finding that "assertions that a corporate officer or director committed fraud in order to retain an executive position ... simply do not, in themselves, adequately plead scienter" (citations omitted)). Merely concluding that stockholders were extremely dissatisfied by a stock falling, even plummeting, does not lend any *particular* weight to allegations of reckless or intentional conduct. The Court notes, as well, the absence of other "fixed constellations of facts that courts have found probative,"*Helwig,* 251 F.3d at 552, in this inquiry: No insider trading, at suspicious times or otherwise, is alleged, let alone bribery or other financial self-dealing. *See id.*Indeed, there is not only no apparent financial incentive for Defendants to engage in the deceptive practices alleged in the Complaint, given their respective shareholdings, which Defendants retained throughout the Class Period and beyond, there appears to have been a disincentive to do so. [6]

6 The documents disclosing the scope of share ownership by Feuer and Rutherford, as well as the absence of trading in those shares, were attached to Defendants' motion to dismiss and were the subject of Plaintiffs' motion to strike. Because those public filings (OfficeMax's reports on Forms 10–K) are integral to the allegations of the Complaint and because the facts Defendants attempt to glean from them are undisputed, the Court finds no prohibition against reference to them. To that limited extent, Plaintiffs' motion to strike is DENIED.

Although Plaintiffs' allegations are most certainly relevant to the Court's totality of the circumstances analysis, the Court finds, in the context of this case, that they are significantly weak allegations, and, thus, they do not substantially assist the Court in drawing the inferences of reckless or intentional conduct Plaintiffs ask the Court to draw. [7]

7 To the extent that Defendants imply in their motion that the absence of allegations of motive is *fatal* to a claim under the PSLRA, the Court expressly rejects that notion. Motive is but one factor, in the totality of circumstances, which the Court must consider. Its presence or absence is more or less meaningful in any given case, depending on all of the other facts and circumstances presented.

B. ***Divergence between Internal Reports and External Statements .***

***15** The Complaint alleges that Defendants made repeated optimistic statements about OfficeMax's profitability and the efficiency of its operations when it knew of massive inventory problems from the Salmon study, internal inventory and finance reports, management meetings, and through their active management roles. Citing *Helwig,* Plaintiffs note that this divergence is relevant to scienter. *See id.* at 552.

Although Plaintiffs claim that a multitude of reports and internal communications must have been inconsistent with the optimistic public statements about OfficeMax, they cite only one report in particular: the Salmon study. According to the Complaint, the Salmon study reviewed OfficeMax's inventory control systems in three stages. At the end of fiscal year 1998, before the study was complete, Salmon concluded that OfficeMax had inadequate management talent and procurement and inventory policies; thus, it would need to curtail its expansion program to regain control over its Core Business Segment. (Compl.¶ 21.) Plaintiffs claim that Defendants either recklessly or intentionally concealed these findings from the investing public.

Plaintiffs' argument is undercut in several respects, however. Most notable is the Complaint's concession that OfficeMax, before and during the Class Period, was reconfiguring its entire supply distribution process in order to remedy the procurement and inventory problems that had been identified. (Compl.¶ 30.) The Complaint also concedes that OfficeMax was addressing its inventory problems during the Class Period by "installing a new, more high powered and sophisticated computerized purchasing and inventory control system made by SAP—a huge European software maker."(*Id* .) Given the substantial changes being made in order to address the problems identified in the Salmon study, the Court does not find that the Defendants' optimistic statements—about the company in general or the inventory control systems in particular—are inconsistent with the preliminary conclusions of that as-yet-incomplete study. The fact that these changes were "taking much longer than had been anticipated,"(*id.*), only points up the fact that hindsight is more accurate than forecasting. OfficeMax's optimism about its new business model and its designs for "improving" inventory control, *see* Complaint at ¶ 50, do not conflict with a study that identified those problems before these changes took place.

Comparison with the facts of *Helwig* is instructive on this point. In that case, a health care organization publicly claimed that "it could not predict whether Medicare reform proposals would be adopted by Congress or if adopted, what effect, if any, such proposals would have on its business."*Helwig,* 251 F.3d at 546.But a month before, company executives gave employees notice that they would be laid off in sixty days because "there were tough times coming in the industry because of the likely cutbacks in Medicare" and told them they would have been laid off anyway because "the proposed Medicare regulations were going to make it difficult for [the company] to make money and stay profitable."*Id.* Thus, the company was telling its employees that it clearly understood what was coming, while telling the public that it did not. Here, the Complaint does not state facts that demonstrate such "divergence" between the Salmon study and the company's optimistic statements during the Class Period.

***16** What is left after the Salmon study is a number of conclusory allegations about the condition of the company along with assumptions not only that the Defendants were aware of those characterizations at the time, but also that they understood their materiality and either recklessly or intentionally concealed them. This portion of the Complaint, which constitutes the bulk of the allegations, lacks the particularity required under the PSLRA when alleging scienter. *See*15 U.S.C. § 78u4(b)(2). In fact, most of the "true but concealed facts" appear to be bare conclusions that do not arise from either particular, or even generally identified, reports, meetings, or management responsibilities. For example, what is the basis for the allegation that "Feuer require[d] certain new stores to open knowing that the forecasted sales for those stores would be less than the internally required amount to open a new store—$4 million per store—[and] refused to close existing stores that continually operated at a loss"? (Compl.¶ 59(i).) Not only do the long and repeated lists of alleged "true but concealed facts" appear without an explanation of the facts upon which each allegation is based, but most appear to be allegations of mere bad management, rather than indications of bad faith.

Moreover, many of the "concealed facts" appear either internally inconsistent or chronologically problematic. For example, the Complaint alleges the pre-class period stock price drop (the drop that allegedly placed so much pressure on Feuer, et al.) was caused, in part, by "high executive turnover" due to "Feuer's autocratic management style and ego" and inability to work with senior management." According to the Complaint, these problems were "known throughout the industry." (Compl.¶ 42.) But this alleged problem, if it were known throughout the industry and was already having a negative affect on the stock price when the Class Period began, can hardly be considered a "true but *concealed* fact" as the Complaint elsewhere describes it. (Compl.¶ 70(x), 80(y).) Similarly, the fact that OfficeMax had a policy of "not having sales" does not seem to be the sort of "concealed" insider-information that would surprise members of the public familiar with the company. (Compl.¶ 70(n).)

Several allegations are also chronologically inconsistent. For example, when alleging that OfficeMax's optimistic May and June 1999 statements were false or misleading, Plaintiffs describe as a "true but concealed fact" that "[i]n August 1999, OfficeMax rolled out a new program called the 'flat rate discount program' that only applied to new, large, corporate customers."(Compl.¶ 70(j).) The Complaint then alleges that this new program irritated existing customers who could not benefit from the discount, driving them to other stores. (*Id.*) It is not clear how the Court is to infer the falsity of optimistic statements made in May or June from the fact that a policy, *not even begun until two months* later, subsequently backfired. [8]

8 The timing of Plaintiffs major allegations is also problematic in a different respect: Plaintiffs attempt to draw a parallel with the facts of *Fidel v. Farley*, 2001 U.S. Dist. LEXIS 9461, No. 1:00–CV–48–M (W.D. Ky. June 27, 2001). In that case, a restructuring of Fruit of the Loom was begun in 1995, while the alleged failure of that restructuring (and defendants' knowledge and concealment of that failure) occurred years later. It appears far different to allege, as the Plaintiffs do here, that as early as March 2, 1999, only two months after the restructuring had begun, Defendants were already in a position to know that the restructuring was failing and would continue to fail. Because the Complaint fails to identify any basis underlying that allegation, the Court finds it particularly difficult to draw the inferences Plaintiff suggests are apparent from this sequence of events.

***17** These particular inconsistencies, in addition to the repetitive and somewhat confusing organization of the Complaint as a whole, do not assist Plaintiffs. Although inartful pleading does not, by itself, warrant dismissal of a Complaint, it can, and here does, weaken any inferences that might be drawn from it. For all these reasons, the Court finds little, if any, divergence between any identified internal reports and external statements, and thus little, if any, inference of scienter. [9]

9 It is not insignificant that, throughout the Class Period, OfficeMax was openly discussing efforts to improve its inventory control. Contrary to Plaintiffs' implications, these statements, when considered as a whole, can be read as public acknowledgments of continuing problems with its inventory, rather than a guarantee that all such problems had been solved.

C. *GAAP Violations.*

Violations of GAAP, by themselves, are generally not enough, without more, to create an inference of reckless conduct. *See, e.g ., Comshare,* 183 F.3d at 553.They are, however, part of the totality of circumstances which the Court must assess. As discussed below, the Plaintiffs allege that OfficeMax violated GAAP by failing to record appropriate reserves and by improperly accounting for vendor rebates.

1. *Improper accounting for inventory.*Noting that GAAP requires evaluation of inventory at each quarter-end, the Complaint alleges that OfficeMax failed to do so during the Class Period. It notes, moreover, that GAAP requires that "where the utility of goods is no longer as great as its cost, whether due to physical deterioration, obsolescence, changes in price levels, or other causes, the difference should be recognized as a loss of the current period."(Compl.¶ 90.) It alleges that, instead, OfficeMax kept its deteriorating excess inventory at its original value until it ultimately took an $83 million writedown in September 1999. The Complaint also alleges that the Defendants each must have known of this failure, due to their positions as top managers. It then alleges a host of "practices" or "conditions" that Plaintiffs claim caused the company to accumulate excess, obsolete, or otherwise overvalued inventory.

The Court finds little—beyond speculation—in these allegations. Plaintiffs merely identify a GAAP provision and apply it to the $83 million writedown in September by suggesting that writedowns should have occurred earlier or in stages. Plaintiffs do not, however, explain when these writedowns should have occurred nor offer any basis to assume that periodic writedowns would have had a meaningful impact on the value of OfficeMax stock.

These references to GAAP add little weight to Plaintiffs' scienter allegations. GAAP violations must be plead with particularity. *See Greebel v. FTP Software, Inc.,* 194 F.3d 185, 203–04 (1st Cir.1999) (noting that "a general allegation that the practices at issue resulted in a false report of company earnings is not a sufficiently particular claim of misrepresentation"). One of the reasons this is true is because GAAP is not "a canonical set of rules that will ensure identical accounting treatment of identical transactions," instead they "tolerate a range of 'reasonable' treatments, leaving the choice among alternatives to management."*Thor Power Tool Co. v. Commissioner of Internal Revenue,* 439 U.S. 522, 544 (1979); *Chalverus v. Pagasystems,* 59 F.Supp.2d 266 (D.Mass.1999). Thus, one person's accounting decisions on a given matter, even if open to debate, are not necessarily improper, much less intentionally misleading. Plaintiffs must allege "specific facts that illustrate 'red flags' that should have put Defendant on notice of the revenue recognition errors" before evidence of GAAP errors may be considered meaningful. *Comshare,* 183 F.3d at 553.

***18** In an effort to satisfy this standard, Plaintiffs cite *Helwig,* 251 F.3d at 552, for the proposition that "closeness in time of an allegedly fraudulent statement or omission and the later disclosure of inconsistent information" is relevant to scienter. (Mot. Opp'n at 23.) They then point out that the September 30, 1999 announcement of an $83 million writedown and revised downward forecasts occurred less than two months after OfficeMax's optimistic forecasts in August. While the Court generally agrees with Plaintiffs' proposition of law, its application here does not help create a strong inference of scienter. As discussed earlier, OfficeMax's inventory control system was being entirely restructured, and the Complaint alleges an ongoing Salmon study of those systems. In fact, the September 30, 1999 press release announced that the policy changes, which resulted in the writedown, themselves resulted from a comprehensive business assessment study undertaken in the Spring of 1999 and finished in September. (Mot.Dismiss, Ex. 17.) Plaintiffs, thus, are not able to negate the inference that "something has changed" which explains the difference between the forecasts in August and those in September. *See Telxon,* 133 F.Supp.2d, at 1031 n. 4.

Finally, while Plaintiffs assert that the revenue recognition methodology used by OfficeMax violated GAAP, there is no allegation that the accounting principle Plaintiffs would have had OfficeMax employ was widely accepted or employed throughout other segments of the industry. Despite the ultimate writedown, moreover, there is no allegation of a restatement of any of the periods during which this revenue recognition methodology was used.

2. *Vendor rebates.*

The Complaint also alleges that OfficeMax recognized vendor rebates as income, in violation of GAAP. It asserts, moreover, that Feuer and Rutherford not only were aware of this practice, but also exacerbated the problem by purposely buying more inventory during the Class Period than they needed, so that the failure of their new business model would be hidden.

These allegations are, again, conclusory. It is not clear from the Complaint whether it alleges that the vendor rebate "scheme" began at the beginning of the Class Period or long before, thus, the Court cannot assess whether the problem was a longstanding one or a short term policy that aligns with the Class Period. *See Comshare,* 183 F.3d 553 (noting that even if GAAP violations occurred over long period of time, that fact alone is not sufficient inference of scienter). Nor does the Complaint identify any particular transactions to elucidate its claim. Its only detail is a hypothetical: "If OfficeMax bought merchandise for $50 with 15 points of vendor funding, OfficeMax received $15 back in rebate, but the company valued the inventory at $50."(Compl.¶ 99.) Although the Complaint purports to calculate the monetary difference created by the alleged improper accounting, its calculations are based on nothing more than approximations of total sales in an average year. Moreover, the allegation identifies no underlying set of facts giving rise to Plaintiffs' belief that vendor rebates were treated improperly. The Court also finds the additional charge—that Defendants purposely purchased excess inventory solely to reap the short-term gain of vendor rebates, to the detriment of longer term profits—somewhat mystifying. This asserts, apparently, that, in order to hide the company's problems of excess inventory, Feuer and Rutherford bought *more* excess inventory. Plaintiffs do not appear even to acknowledge the peculiarity of this assertion.

***19** Plaintiffs contend that the "enormity" of the alleged GAAP violations mandate the inference that the Defendants knew of them or were reckless in disregarding them. (Mot. Opp'n at 22.) The Court agrees that GAAP violations resulting in substantial misstatements of a company's financial condition may, under appropriate circumstances, create such an inference. *See Hayman v. PricewaterhouseCoopers, LLP,* Case No. 1:01–CV–1078 (N.D.Ohio March 26, 2002) (finding that numerous egregious violations of relatively simple GAAP and GAAS violations, resulting in substantial restatements, contributed to strong inference of scienter). But this inference may only arise if the GAAP violations —"enormous" or otherwise—are plead with sufficient specificity to make the allegations meaningful. *See id.*(noting specific facts, specific transactions, and specific "red flags" alleged in regard to GAAP and GAAS violations). This the Plaintiffs have failed to do here. Indeed, the Court finds that Plaintiffs' allegations of GAAP violations do not survive under the particularity standards of the PSLRA, and may not survive even under the more lenient standard of Federal Rule of Civil Procedure 9(b). Because the allegations are vague and conclusory at best, the Court finds that they add little weight to any inference of recklessness or intentional deception.

Taken as a whole, Plaintiffs' allegations of scienter lack strength. Plaintiffs fail to hypothesize any motive for Feuer, the founder of OfficeMax and its largest shareholder, to undercut his companies' long term financial health. In fact, in alleging motive, the Plaintiffs demonstrate only the lack of it—notably absent is any circumstance particular to Feuer or Rutherford which puts them in a position different than any other top executive whose company's stock has recently slumped. Moreover, although Plaintiffs attempt to show that OfficeMax's internal reports were inconsistent with its optimistic public statements, they identify but one report, and do not demonstrate that report's inconsistency with those public statements. They rely instead on conclusory representations of the company's health, along with bare allegations that Defendants not only "must have" reached those same conclusions but recklessly or purposely concealed them. Finally, what is left of the Complaint is two assertions of GAAP violations that are without any supporting detail; neither identifies any underlying set of facts giving rise to a belief that GAAP was, indeed, violated. On the contrary, the allegations are so conclusory that the Court does not, indeed cannot, draw any particular inference from them. Fraud or reckless behavior is, arguably, one of many reasonable inferences which may be drawn from the facts alleged here. But it is not the strongest inference created by these facts, or even one of several *strong* inferences that may be drawn. Because the Complaint does not give rise to a strong inference of scienter, as it must under the PSLRA, the Court dismisses the Complaint without reaching Defendants' other arguments.

***20 IT IS SO ORDERED.**

All Citations

Not Reported in F.Supp.2d, 2002 WL 33959993

2015 WL 3746095
Only the Westlaw citation is currently available.
This case was not selected for
publication in West's Federal Reporter.
See Fed. Rule of Appellate Procedure 32.1
generally governing citation of judicial
decisions issued on or after Jan. 1, 2007.
See also U.S.Ct. of App. 6th Cir. Rule 32.1.
United States Court of Appeals,
Sixth Circuit.

PENSION FUND GROUP, consisting of Norfolk County Retirement System, Plymouth County Retirement System and Oklahoma Police Pension & Retirement System; Police and Fire Retirement System of the City of Detroit, Plaintiffs–Appellants,
and
Arthur Benning, Jr., Plaintiff,
v.
TEMPUR–PEDIC INTERNATIONAL, INC.; Mark A. Sarvary; Dale E. Williams, Defendants–Appellees.

No. 14–5696. | June 4, 2015.

Synopsis
Background: Group of pension funds representing class of investors who purchased common stock of mattress manufacturer filed securities fraud action against manufacturer, chief executive officer (CEO), and chief financial officer (CFO), claiming violations of § 10(b) and Rule 10b–5 as well as control person liability by allegedly misleading investors due to issuance of rosy financial projections and by failing to disclose manufacturer's deteriorating competitive position. The United States District Court for the Eastern District of Kentucky, Karen K. Caldwell, J., 22 F.Supp.3d 669, granted defendants' motion to dismiss for failure to state claim. Fund appealed.

Holdings: The Court of Appeals, Cook, Circuit Judge, held that:

[1] manufacturer's financial guidance was forward-looking statement within Private Securities Litigation Reform Act (PSLRA) safe harbor;

[2] CEO's alleged false statement regarding competitiveness was not material;

[3] statements about growth and competition at January earnings call were not actionable securities fraud;

[4] forecasting statements at January earnings call were within PSLRA safe harbor;

[5] statement in Form 10-K that mattress collection continued to be well received by retailers was not false;

[6] statement in Form 10-K regarding channel profit strategy was within PSLRA safe harbor;

[7] CEO's statement in webcast about consumer preferred product line was not material;

[8] CEO's webcast statement about growth was not false;

[9] CFO's statements at investors' conference presentation were within PSLRA safe harbor;

[10] statements in April press release were within PSLRA safe harbor; and

[11] statements at April earnings call were not actionable securities fraud.

Affirmed.

On Appeal From The United States District Court For The Eastern District Of Kentucky.

Before KEITH, COOK, and DONALD, Circuit Judges.

Opinion

COOK, Circuit Judge.

***1** After posting record sales for five straight quarters, mattress manufacturer Tempur–Pedic International, Inc.'s business declined in the second quarter of 2012. Plaintiffs–Appellants—a group of pension funds who purchased Tempur–Pedic stock before the price-per-share fell nearly seventy-five percent over a seven-week period—filed a consolidated class-action complaint against Defendants–Appellees Tempur–Pedic, president and chief executive officer Mark A. Sarvary, and executive vice president and chief financial officer Dale E. Williams (collectively, "Tempur–Pedic") on behalf of all investors who purchased Tempur–Pedic common stock between January 25, 2012, and June 5, 2012 ("the Class Period"). The complaint alleges that Tempur–Pedic misled investors by issuing rosy financial projections and failing to disclose the company's deteriorating competitive position.

The district court dismissed the complaint for failure to state a plausible claim of securities fraud. We AFFIRM.

I.

Tempur–Pedic manufactures and distributes viscoelastic (i.e., memory-foam) mattresses and pillows. Its primary competitors—Sealy, Serta, and Simmons—historically sold innerspring mattresses, which accounted for the bulk of mattresses sold in the United States. Tempur–Pedic, in contrast, targets the "specialty premium" market for non-inner-spring mattresses that retail for at least $1,000.

In April 2011, Serta launched its competing "iComfort" gel-foam mattress line. According to the complaint, several iComfort mattresses cost less than Tempur–Pedic's cheapest model, and Serta's advertising touted the gel-based iComfort's technological superiority over traditional memory-foam mattresses. The pension funds contend that Tempur–Pedic's management grew concerned about Serta's inroads in the memory-foam market even though Tempur–Pedic's sales continued to grow in the aggregate throughout 2011. According to a former Tempur–Pedic business development manager, sales at his retail accounts declined forty to sixty percent within a three-month period after retailers began selling the iComfort. He provided the pension funds with company emails soliciting weekly sales reports and a document titled "iComfort Risk Analysis for Mark Meeting Sept 11" that compared Tempur–Pedic's sales at certain retailers before and after Serta introduced the iComfort. According to the pension funds, the "Risk Analysis" document shows that Tempur–Pedic's year-over-year sales grew by three percent between April and September 2011 at retailers that carried the iComfort and thirty-three percent at comparable mid-size retailers that did not. The former business development manager also disclosed that company executives learned at an August 2011 industry conference that four of the company's highest-grossing accounts planned to start carrying the iComfort in January 2012.

Notwithstanding Serta's inroads, Tempur–Pedic reported a company-record $1.4 billion in net sales in 2011—a twenty-eight percent increase over 2010. On January 24, 2012, Tempur–Pedic released financial guidance projecting that its annual net sales would grow by about fifteen percent in 2012 and total between $1.6 and $1.65 billion for the year. By mid-April, the company appeared to be on track to meet or exceed its projections: net sales for the first quarter of 2012 surpassed the previous year's first-quarter sales by eighteen percent. But business slowed soon thereafter. On June 6, the company revised its full-year guidance downward to $1.43 billion in projected net sales, explaining in a press release that "[s]ales trends in our North America business during the second quarter have been disappointing and below plan, primarily due to changes in the competitive environment, including an unprecedented number of new competitive product introductions, which have been supported by aggressive marketing and promotion."(R. 91–31, June 6, 2012 Form 8–K.)

***2** Tempur–Pedic's stock price hit a Class Period high of $87.26 per share on April 19, 2012, before declining precipitously over the next month-and-a-half. The stock price dropped to $66.53 on April 20 after the company adhered to its full-year guidance despite its better-than-predicted first quarter. It fell again to $48.29 per share in early May after Tempur–Pedic issued a press release announcing a Memorial Day discount on its Cloud Supreme mattress line. Finally, after the company revised its yearly projections downward on June 6, the stock price hit a Class Period low of $22.39 per share.

Ultimately, Tempur–Pedic's 2012 net sales totaled $1.4 billion. According to the pension funds, those results confirm that the initial projection ($1.6 to $1.65 billion) was "wildly off the mark and ... had no reasonable basis in fact."They maintain that Tempur–Pedic, Sarvary, and Williams violated Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and related Securities and Exchange Commission (SEC) Rule 10b–5, 17 C.F.R. § 240 .10b–5, by touting the company's recent successes and issuing rosy financial projections while failing to disclose that sales growth slowed at retailers carrying Serta's iComfort.

Tempur–Pedic, Sarvary, and Williams moved to dismiss the pension funds' consolidated amended complaint for failure to state a plausible securities-fraud claim. The pension funds opposed that motion and sought leave to file a second amended complaint that included two exhibits referenced in the first amended complaint. The district court granted the motion to dismiss and denied the motion to amend, finding that none of the challenged statements were actionable and that amendment would be futile. The pension funds timely appealed.

II.

We review the district court's decision to dismiss the complaint de novo, "constru[ing] the complaint in the light most favorable to the plaintiff" and "accept[ing] all well-pleaded factual allegations as true."*La. Sch. Emps. Ret. Sys. v. Ernst & Young, LLP,* 622 F.3d 471, 477 (6th Cir.2010).

"To state a securities fraud claim ..., a plaintiff must allege, in connection with the purchase or sale of securities, the misstatement or omission of a material fact, made with scienter, upon which the plaintiff justifiably relied and which proximately caused the plaintiff's injury."*Frank v. Dana Corp.,* 547 F.3d 564, 569 (6th Cir.2008) (internal quotation marks and citation omitted). A defendant is liable for omitting a fact only if he had a duty to disclose it. *City of Monroe Emps. Ret. Sys. v. Bridgestone Corp.,* 399 F.3d 651, 669 (6th Cir.2005). But a defendant who speaks voluntarily on a subject when he has no duty to do so " 'assume[s] a duty to speak fully and truthfully on th[at] subject.' " *Helwig v. Vencor, Inc.,* 251 F.3d 540, 561 (6th Cir .2001) (en banc) (first alteration in original) (quoting *Rubin v. Schottenstein, Zox & Dunn,* 143 F.3d 263, 268 (6th Cir.1998) (en banc)), *overruled on other grounds as recognized in Ricker v. Zoo Entm' t, Inc.,* 534 F. App'x 495, 501 n. 3 (6th Cir.2013).

***3** "A misrepresentation or an omission is material only if there is a substantial likelihood that 'a reasonable investor would have viewed the misrepresentation or omission as having significantly altered the total mix of information made available.' " *In re Ford Motor Co. Sec. Litig.,* 381 F.3d 563, 570 (6th Cir.2004) (quoting *In re Sofamor Danek Grp., Inc.,* 123 F.3d 394, 400 (6th Cir.1997)). A court may dismiss a securities-fraud action if the challenged statements "are so obviously unimportant to a reasonable investor that reasonable minds could not differ on the question of their unimportance." *Helwig,* 251 F.3d at 563 (quoting *Ganino v. Citizens Util. Co.,* 228 F.3d 154, 162 (2d Cir.2000)). Applying that standard,

> [c]ourts everywhere "have demonstrated a willingness to find immaterial as a matter of law a certain kind of rosy affirmation commonly heard from corporate managers and numbingly familiar to the marketplace—loosely optimistic statements that are so vague, so lacking in specificity, or so clearly constituting the opinions of the speaker, that no reasonable investor could find them important to the total mix of information available."

Ford, 381 F.3d at 570–71 (quoting *Shaw v. Digital Equip. Corp.,* 82 F.3d 1194, 1217 (1st Cir.1996)).

The Private Securities Litigation Reform Act of 1995 (PSLRA), Pub.L. 104–67, 109 Stat. 737, created a limited safe harbor for "forward-looking statements." *Helwig,* 251 F.3d at 547–48. Forward-looking statements covered by the Act include projections of revenues, income, and earnings-per-share; statements concerning a company's future economic performance; and statements about the assumptions underlying forward-looking statements. 15 U.S.C. § 78u–5(i)(1). Such statements are actionable as securities fraud only if (1) a reasonable investor would find the statement material, (2) the defendant failed to identify its statement as forward looking or provide "meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement," and (3) the defendant made the statement "with actual knowledge ... that [it] was false or misleading."15 U.S.C. § 78u–5(c)(1); *see also Miller v. Champion Enters., Inc.,* 346 F.3d 660, 672 (6th Cir.2003).

III.

The pension funds allege that Tempur–Pedic, Williams, and Sarvary made numerous false and misleading statements during the Class Period. We agree with the district court that none of the challenged statements or omissions constituted securities fraud.

A. January 24 Press Release

On January 24, 2012, Tempur–Pedic issued a press release announcing the company's 2011 financial results and issuing financial guidance for the upcoming year. The pension funds argue that the company's financial guidance and a statement about "competitiveness" were materially false or misleading. Both arguments fail. The financial guidance falls within the PSLRA safe harbor, and Sarvary's vague mention of "competitiveness" was immaterial corporate puffery that no reasonable investor would find important.

1. 2012 Financial Guidance

***4** **[1]** For the upcoming year, Tempur–Pedic projected between $1.60 and $1.65 billion in net sales and between $3.80 and $3.95 in earnings-per-diluted-share. Such guidance falls squarely within the PSLRA's definition of forward-looking statements. *See*15 U.S.C. § 78u–5(i)(1).

The pension funds nevertheless argue that Tempur–Pedic's 2012 financial guidance was not, in fact, forward looking because it omitted how Serta had already affected the company's sales growth. But they find no support in our precedent for characterizing financial projections as representations of historical or current fact. Under the PSLRA, we ask if a statement meets the statutory definition of forward looking; if it does, we look to whether the defendant meaningfully alerted investors to the risks that might prevent it from reaching its financial targets. *See Miller,* 346 F.3d at 672, 678. In other words, we ask if Tempur–Pedic "convey[ed] substantive information about factors that realistically could cause results to differ materially from those projected in the forward-looking statements."*Helwig,* 251 F.3d at 558–59.

Here, the January 24 press release warned about competitive risks and incorporated warnings in other SEC filings by reference. The press release identified numerous "risks and uncertainties that could cause actual results to differ materially" from projected results, including "industry competition." (R. 91–14, Jan. 24. 2012 Form 8–K.) The warning referred readers to the company's SEC filings, particularly the "Risk Factors" section of the company's most recent Form 10–K annual report. That report, released in January 2011, disclosed: "The mattress and pillow industries are highly competitive. Participants in the mattress and pillow industries have traditionally competed based primarily on price."(R. 91–4, FY 2010 Form 10–K at 4.) It mentioned Serta specifically:

> The standard mattress market in the U.S. is dominated by manufacturers of innerspring mattresses, with three nationally recognized brand names: Sealy, Serta and Simmons. These three competitors also offer premium innerspring mattresses and collectively have a significant share of the premium mattress market in the U.S.... [Many of our] competitors and, in particular, the three largest brands of innerspring mattresses named above, have significant financial, marketing and manufacturing resources, strong brand name recognition, and sell their products through broader and more established distribution channels. *During the past several years, a number of our competitors, including Sealy, Serta and Simmons, have offered viscoelastic mattress and pillow products.*

(*Id.* at 5 (emphasis added).) The "Risk Factor" section further explained: "[A] number of our significant competitors offer non-innerspring mattress and viscoelastic pillow products. Any such competition by established manufacturers or new entrants into the market could have a material adverse effect on our business, financial condition and operating results by causing our products to lose market share."(*Id.* at 8.)

***5** The press release's warning about industry competition —which incorporates by reference the Form 10–K's more thorough risk disclosures, *see Miller,* 346 F.3d at 677–78— adequately disclosed the risk that Tempur–Pedic would fail to sustain its current rate of growth due to increased competition from Serta for share of the memory-foam market. We found similar disclosures meaningful in *Miller v. Champion Enterprises, Inc.,* rejecting the argument that a model-home company should have disclosed its loan to a struggling retailer whose default might leave it saddled with excess inventory:

> The July 8 letter cited Champion's risk disclosures in its 1998 Form 10–K, which included a risk related to inventory levels of manufactured housing retailers. Additionally, the letter itself contained warnings that "housing stocks in general have underperformed the markets in 1999," and that "in certain regions we see too many retail locations, suggesting an over supply of retail inventory of homes in that region."Plaintiff argues that Champion should also have disclosed the nature of their loans to Parker Homes. This goes too far. Champion disclosed the exact risk that occurred in this situation: excess retailer inventory that could lead to negative economic effects on Champion. Champion is not required to detail every facet or extent of that risk to have adequately disclosed the nature of the risk.

346 F.3d at 677–78. Similarly, having disclosed the risks posed by competition, Tempur–Pedic was not required to

disclose its internal analyses of how a specific competitor affected sales to claim safe-harbor protection.

The pension funds' argument to the contrary finds no support in *Helwig v. Vencor, Inc.,* which denied safe-harbor protection to a healthcare provider's "cursory and abstract" statements disclaiming any knowledge of how a pending federal law might affect its business. 251 F.3d at 558–59. *Helwig* stands for the proposition that a defendant fails to provide meaningful cautionary language when it refuses to identify or address imminent risks; it does not address the level of specificity required once a defendant discloses such risks. *Id.* at 559. *Miller,* not *Helwig,* controls our consideration of Tempur–Pedic's cautionary language.

Further, Tempur–Pedic's warning remained meaningful even if sales at certain retailers grew at a slower rate in the months leading up to the January 24 press release. Although several district courts have denied safe-harbor protection when defendants' risk disclosures treat currently existing conditions as mere possibilities, they have done so only where the warnings clearly misrepresented facts. *See, e.g., In re Compuware Sec. Litig.,* 301 F.Supp.2d 672, 685 (E.D.Mich.2004) ("Defendants' statement that 'there can be no assurance that IBM will not choose to offer significant competing products in the future,' implied that IBM's development of competing software was a possibility as opposed to an actuality, and therefore, this statement does not qualify as *meaningful* cautionary language."). We decline to find Tempur–Pedic's risk disclosures inadequate merely because the company's growth appeared to slow—but not reverse—due to competition in 2011. Holding otherwise would deny safe-harbor protection any time a plaintiff could show that a defendant perceived a general negative trend, even if the trend had not yet affected its bottom line. Such a rule would undermine the PSLRA's pro-disclosure objective. *See Helwig,* 251 F.3d at 559.

2. Sarvary's "competitiveness" statement

***6 [2]** The January 24 press release also attributed the following comment to Sarvary: "In 2011, we delivered strong financial performance, strengthened our competitiveness and implemented a range of strategic growth initiatives."(R. 91–14, Jan. 24, 2012 Form 8–K.) The pension funds contend that Sarvary's statement was false or misleading because he knew that Tempur–Pedic's growth slowed at retailers carrying the iComfort. But Sarvary's unspecific reference to the company's "competitiveness" is immaterial as a matter of law: the term is "too squishy, too untethered to anything measurable, to communicate anything that a reasonable person would deem important to a securities investment decision."*City of Monroe,* 399 F.3d at 671. The pension funds fail to identify a "standard against which a reasonable investor could expect [Sarvary's reference to competitiveness] to be pegged."*Id.*

B. January 24 Earnings Call

Williams and Sarvary also discussed the company's 2011 results and 2012 guidance during a January 24 "earnings call." The pension funds challenge several of their statements.

1. Statements about growth and competition

[3] Sarvary and Williams both spoke about the company's recent successes during the call. For instance, Sarvary said: "Sales growth [in 2011] was strong, both in the U.S. and overseas, and we have gained share domestically and around the world."(R. 91–15, Jan. 24, 2012 Earnings Call Tr. at 4.) Williams informed investors that the company "experienced improving growth rates by month" during the final quarter of 2011 and that "sales trends through the first 23 days [of the first quarter of 2012] have continued to be strong."(*Id.* at 7.) Later, he said: "We're very pleased with how the business is performing.... Both the international business and the North American business are performing well but it's early in the quarter and this can be a fluctuating industry so we don't take 23 days lightly but we also don't project it out forever."(*Id.* at 10.)

Although most of the analysts on the call asked about Tempur–Pedic's recent performance and future plans, one asked whether Sarvary and Williams perceived a connection between competitors' recent launches and the overall growth in consumer demand for memory-foam mattresses. (*Id.* at 14–15.) Sarvary acknowledged that Tempur–Pedic operated in a "tough market with some very good competitors in it and they will continue to introduce products."(*Id.* at 15.) He attributed both Tempur–Pedic's recent successes and the increase in memory-foam sales generally to "customers [who] are increasingly prepared to pay a premium for a product that will enable them to sleep better."(*Id.*)

The pension funds do not contend that Tempur–Pedic misstated its sales figures in 2011 or early 2012. Instead, citing the duty to "provide complete and non-misleading information with respect to subjects on which [one] undertakes to speak,"*Helwig,* 251 F.3d at 561, the pension funds argue that Williams and Sarvary misled investors by speaking about growth and competition without disclosing how Serta specifically affected Tempur–Pedic's growth rate. They also contend that Sarvary's response to the analyst's question about competition falsely implied that Tempur–Pedic maintained a competitive edge over Serta.

***7** But we do not read *Helwig* to require Williams and Sarvary to disclose that Tempur–Pedic's sales might have grown more without competition from Serta's iComfort once they chose to speak about the company's recent positive results or competition generally. Holding an earnings call did not obligate them to disclose all facts contributing to or undermining the company's recent successes. "Such a rule would require almost unlimited disclosure on any conceivable topic related to an issuer's financial condition whenever an issuer released any kind of financial data."*Miller,* 346 F.3d at 682.

2. Statements forecasting that the current state of affairs would "continue "

[4] The pension funds also challenge Williams's statement that Tempur–Pedic's domestic business "will continue to perform" and Sarvary's statement that the company would look "to capitalize on this fundamental trend [of consumers buying specialty mattresses] by continuing to have products that are both genuinely differentiated and preferred by consumers."(R. 91–15, Jan. 24, 2012 Earnings Call Tr. at 9, 15.)

To the extent that Williams and Sarvary's statements predict that the current state of affairs will continue into the future, they are protected by the PSLRA safe harbor. *See Miller,* 346 F.3d at 677. At the beginning of the call, a Tempur–Pedic executive cautioned investors that any forward-looking statements, including financial projections, fell within the safe harbor, added that "economic, competitive, operating and other factors" could cause actual results to differ materially from projected results, and referred investors to the annual Form 10–K report discussed above. (R. 91–15, Jan. 24, 2012 Earnings Call Tr. at 3.) Those warnings meaningfully warned investors of the risks of purchasing Tempur–Pedic stock.

[5] Moreover, to the extent that Williams and Sarvary's statements suggest that Tempur–Pedic was currently "performing" and producing customer-preferred mattresses, such representations are the kind of "loosely optimistic" statements that we have elsewhere found immaterial. *See City of Monroe,* 399 F.3d at 670–72 (finding general claims about quality and safety immaterial); *Ford,* 381 F.3d at 570–71 (finding self-praising statements about "quality, safety, and corporate citizenship" immaterial).

C. January 30 FY 2011 Annual Report (Form 10–K)

On January 30, the company filed its annual Form 10–K for the period ending December 31, 2011. The pension funds contend that the report contains two false statements.

[6] First, the pension funds challenge the statement: "The TEMPUR–Cloud® collection continues to be well received by retailers."(R. 91–8, FY 2011 Form 10–K at 29, 38.) But they have not alleged facts that would plausibly render the "well received" statement misleading, and any evidence that four major Tempur–Pedic retailers decided to sell Serta's iComfort has no bearing on their attitude toward Tempur–Pedic's TEMPUR–Cloud® line.

***8** **[7]** **[8]** Second, the pension funds suggest that Tempur–Pedic spoke falsely when it claimed to "provide strong channel profits to our retailers and distributors which management believes will continue to provide an attractive business model for our retailers and discourage them from carrying competing lower-priced products."(*Id.* at 38.) They argue that the statement, among others, "drew a false and misleading parallel between their successful results in 2011 and future results."As noted above, the word "continue" renders the statement both a representation of current fact and a forward-looking projection. To the extent that the statement predicted how retailers might respond to incentives in the future, the pension funds have not argued that Tempur–Pedic failed to adequately warn investors of the risks underlying its channel-profit strategy. Further, to the extent the statement represents management's current opinion, it is immaterial as a matter of law. The complaint includes no facts that would tend to show that management either did not believe that strong channel profits could have that effect or lacked a factual basis for that belief. *See Helwig,* 251 F.3d at 562 (" 'Material statements which contian the speaker's opinion are actionable ... if the speaker does not believe the opinion and the opinion is not factually well-grounded.' " (quoting *Mayer v. Mylod,* 988 F.2d 635, 639 (6th Cir.1993))).

D. February 22 Webcast

[9] During Tempur–Pedic's "Investor Day" webcast in mid-February, Sarvary allegedly referred to Tempur–Pedic's "consumer preferred" product line. (R. 87, Am. Compl. at ¶ 114.) That statement is immaterial puffery. As we have noted elsewhere, "[a]ll public companies praise their products," and Sarvary's statement that the company sells a "consumer preferred" product is the sort of "rosy affirmation commonly heard from corporate managers" that we hold immaterial as a matter of law. *Ford,* 381 F.3d at 570–71.

[10] During the same webcast, Sarvary allegedly said that the company had grown and continued to grow, and added that there were "a variety of reasons why we're very confident [in projections of continued] growth."(R. 87, Am. Compl. at ¶ 114.) The pension funds allege no facts tending to show that the company lacked confidence in continued growth as of February 22 or had no reasonable basis for that confidence. *See Helwig,* 251 F.3d at 562. According to their complaint, Tempur–Pedic's internal data showed that its growth slowed at retailers carrying the iComfort, not that it stopped or reversed course.

E. March 5 Presentation

[11] Williams continued to tout Tempur–Pedic's successes during the company's presentation at the Raymond James Institutional Investors Conference on March 5, 2012. He told participants: "2011 [was] another great year for the company ... just a phenomenal year for the company, very pleased with the performance, and we look for that kind of growth opportunity to continue into the long-term in the future."(R. 91–17, Mar. 5, 2012 Conf. Tr. at 3.) Later he said: "2011 was a record year on every measure of the business. And we are looking for continued growth."(*Id.* at 5.) With respect to future growth, he advised, "We continue to see ... a long runway of opportunity, to continue to improve gross margins in the business."(*Id.*)

***9** The pension funds contend that Williams misled investors by linking the company's recent successes to its future prospects. But his statements concerning expected future growth are forward looking and were accompanied by meaningful cautionary language that insulated them from liability. Although the company did not issue a formal warning about forward-looking statements, Williams began his presentation by saying: "As usual—we may say something today that's forward-looking, so it's under the safe harbor provisions."(*Id.* at 2.) He described his comments as a "very condensed version" of the Investor Day webcast and referred participants to the full presentation on the company's website, which warned about industry competition and referred to the more thorough disclosures in the company's SEC filings.

F. April 19 Press Release

[12] On April 19, Tempur–Pedic issued a press release announcing better-than-expected first-quarter results and reaffirming its financial guidance for the full year. The pension funds contend that the reaffirmed guidance falls outside the safe harbor because Tempur–Pedic failed to adequately amend its cautionary language as the threat posed by Serta increased. We have never held that a company's repeated use of similarly worded warnings renders them meaningless. Further, Tempur–Pedic updated its warning in its 2011 Form 10–K to disclose that "[d]uring the past several years, a number of our competitors, including Sealy, Serta and Simmons, have offered viscoelastic mattress and pillow products, *including several new prominent product introductions in 2011*." (R. 91–8, FY 2011 Form 10–K at 5 (emphasis added).) That new language adequately warned investors of the risks posed by Serta's launch of the iComfort in April 2011.

G. April 19 Earnings Call

[13] Shortly after the company issued the press release reaffirming its full-year guidance, Sarvary and Williams answered several questions about competition during an earnings call with industry analysts. Sarvary acknowledged from the outset that the company faced "significant new competitive launches and aggressive price promotion in the industry[ ] as it has moved increasingly toward non-spring mattresses."(R. 91–20, Apr. 19, 2012 Earnings Call Tr. at 4.)

One analyst asked whether increased competition influenced the decision to adhere to their original guidance after a better-than-expected first quarter:

> I think you've had some branded competition in this space for almost a year now. Is there something that's changed in the landscape in the last three months or so? Is the competition getting more price-competitive? Have there been new entrants in the last three months? Or, has something changed recently that's caused you to tone down your comments today?

(*Id.* at 10.) Sarvary responded that "there's been competition forever, and the competition, we've always said, is very strong," and suggested that the company's competitors were "very promotional and very focused on price."(*Id.*)

***10** Another analyst pressed Williams and Sarvary to address whether they thought the growing demand for specialty mattresses reflected a "different approach that's being taken by some of your competitors."(*Id.* at 12–13.) Sarvary replied that the trend "provides us an opportunity" and "it's happening something like we expected."(*Id.* at 13.)

Relying on *Helwig,* the pension funds argue that Williams and Sarvary incurred a duty to disclose Serta's adverse effect on Tempur–Pedic's sales when they chose to speak about competition on April 19. But they fail to explain how statements acknowledging "significant new competitive launches" and "strong competition" required them to also disclose Serta's specific effects on their business. *Helwig* requires defendants to disclose information "essential to complete a picture they had only partially revealed."251 F.3d at 560. Here, Williams and Sarvary spoke fully when they acknowledged increased competition; they were not required to mention specific competitors to avoid misleading investors.

IV.

We discern no error in the district court's dismissal of the amended complaint or abuse of discretion in its order denying the pension funds' motion to file a second amended complaint. Amendment was futile because the proposed second amended complaint included the same factual and legal allegations as the first amended complaint, and the district court properly considered the new exhibits appended to the proposed amended complaint when ruling on the motion to dismiss. We AFFIRM.

All Citations

--- Fed.Appx. ----, 2015 WL 3746095