UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

IN RE TOWER GROUP INTERNATIONAL, LTD. SECURITIES LITIGATION	Master File No. 1:13-cv-5852-AT **JURY TRIAL REQUESTED**

LEAD PLAINTIFFS' MEMORANDUM OF LAW IN OPPOSITION TO DEFENDANTS TOWER GROUP INTERNATIONAL, LTD., TOWER GROUP, INC., ACP RE, LTD., MICHAEL H. LEE, AND WILLIAM E. HITSELBERGER'S MOTION TO DISMISS THE AMENDED CONSOLIDATED CLASS ACTION COMPLAINT

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GLOSSARY OF CERTAIN TERMS AND ABBREVIATIONS

Term/Abbreviation	Definition
ACP Merger	The merger with ACP Re Ltd. that Tower announced on January 3, 2014 and was effectuated on September 15, 2014.
ACP	ACP Re Ltd. is the successor to Tower. ACP is a Bermuda-based reinsurance company to which Tower became a wholly-owned subsidiary on September 15, 2014 pursuant to the ACP Merger. ACP is jointly owned by a trust established by Michael Karfunkel, the founder of National General Holdings Corporation, AmTrust Financial Services Inc., and Maiden Holdings Ltd.
Class	All persons or entities who purchased or otherwise acquired the common stock of Tower Group International, Ltd. or Tower Group, Inc. during the Class Period and were damaged thereby.
Class Period	March 1, 2010 through December 17, 2013, inclusive.
Complaint	Lead Plaintiffs' December 23, 2014 Amended Consolidated Class Action Complaint (Dkt. No.110).
Defendants	Tower Group, Inc. ("TGI"), Tower Group International Ltd. ("TGIL"), ACP Re Ltd. ("ACP"), Michael H. Lee ("Lee"), and William F. Hitselberger ("Hitselberger"), collectively.
Def. Br.	References to the February 3, 2015 Memorandum In Support Of Defendants Tower Group International Ltd., Tower Group, Inc., ACP Re, Ltd., Michael H. Lee and William E. Hitselberger's Motion To Dismiss (Dkt. No. 123).
FAS	Financial Accounting Standards.
FASB	Financial Accounting Standards Board; group to whom SEC has delegated authority to codify GAAP.
GAAP	United States Generally Accepted Accounting Principles.
Global Indemnity	An Ireland-based holding company and the parent company of Penn America.
Gross premiums	A measure of revenue for an insurance company that is based on the number of premiums written and the cost payable to the company by the policyholder.

Term/Abbreviation	Definition
Harrod Decl.	March 6, 2015 Declaration of James A. Harrod in Opposition to Defendants' Motion to Dismiss the Amended Consolidated Class Action Complaint.
Hitselberger	Defendant William F. Hitselberger served as Tower's Senior Vice President and CFO beginning in March 2010 and in 2011 was promoted to Executive Vice President and CFO, a title he still retains.
IBNR	"Incurred but not reported losses" – presently incurred by unliquidated claims.
Lead Plaintiffs or Plaintiffs	The Kansas City, Missouri Employees' Retirement System, Jacksonville Police and Fire Pension Fund, the Oklahoma Firefighters Pension & Retirement System (collectively the "Public Pension Funds"), ADAR Enhanced Investment Fund, Ltd. and ADAR Investment Fund, Ltd. (collectively, the "ADAR Funds).
Loss adjustment expense	Or "LAE"—reflects the costs associated with the payment of losses and settlement of claims other than the amount of the loss itself.
Lee	Defendant Michael H. Lee founded Tower's predecessor Company in 1990 and served as Chairman of Tower's Board of Directors and was the Company's President and CEO throughout the entirety of the Class Period. He resigned on February 6, 2014.
NASDAQ	The NASDAQ Global Select market, on which the common stock of TGI and TGIL were traded during the Class Period.
Officer Defendants	Defendants Michael H. Lee and William E. Hitselberger.
PWC	Defendant PricewaterhouseCoopers LLP was the Company's independent registered public accounting firm during the Class Period. PwC issued audit reports on Tower's financial statements and internal controls for the years 2010, 2011, and 2012.
Private Placement Class or PPC	A class of investors that acquired Canopius Holdings Bermuda Limited stock in the merger between Canopius and Tower Group, Inc., and were damaged thereby.
Restatement	Tower's restatement and revision of its financial statements for fiscal years 2009 through 2012 and the first quarter of 2013, which included an increase to the Company's loss reserves by $37.4 million and disclosure of material weaknesses in the Company's internal controls.

Term/Abbreviation	Definition
SEC	The U.S. Securities and Exchange Commission.
SOX	The Sarbanes-Oxley Act of 2002.
Tower or the Company	Tower Group International, Ltd. ("TGIL") and previously Tower Group, Inc. ("TGI").
Tower Group International, Ltd.	The parent company and successor to TGI. During the Class Period, Tower Group International, Ltd. ("TGIL") was a Bermuda-based corporation with its corporate headquarters in New York, New York, and, at all relevant times was an insurance and reinsurance holding company, providing, through its subsidiaries property and casualty insurance and reinsurance products.
Tower Group, Inc.	A Delaware-incorporated company, which, prior to March 13, 2013, was a public insurance and reinsurance holding company, providing through its subsidiaries, property and casualty insurance and reinsurance products. Effective March 13, 2013 and through the end of the Class Period, Tower Group, Inc. ("TGI") became an indirect wholly owned subsidiary of Tower Group International, Ltd ("TGIL").

Lead Plaintiffs, by their undersigned counsel, respectfully submit this Memorandum of Law in Opposition to the Motion to Dismiss the Amended Consolidated Class Action Complaint filed by Defendants Tower Group International, Ltd., Tower Group, Inc., ACP Re, Ltd., Michael H. Lee and William E. Hitselberger.[1]

I. PRELIMINARY STATEMENT

Throughout the Class Period, Tower portrayed itself as a healthy and solvent insurance company, reporting profits of $233 million from 2009 through 2012. An integral factor in the Company's purported health was its maintenance of loss reserves that properly accounted for Tower's obligations under the insurance policies it sold. To assure the market that its profits were based on sound underwriting and actuarial decisions, Tower and the Officer Defendants consistently touted the Company's adequate internal controls and "conservative, rigorous reserving process" that established losses and loss reserves only after "prudently" considering all known information. Defendants similarly assured investors that despite the numerous acquisitions in the years leading up to and throughout the beginning of the Class Period, all of those acquired businesses were fully integrated into Tower's accounting system and were captured in the Company's financial results and loss reserves. These statements were false and, once revealed, left Tower on the precipice of insolvency and forced it into a fire-sale merger with ACP.

As a result of these Class Period manipulations, Tower has been forced to restate its financial results, which constitutes an admission that those audited financial statements were materially false and that its critical internal controls were materially inadequate. Tower belatedly

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[1] All references to capitalized, defined terms are to those terms set forth in the Glossary. All citations to "¶_" are to the Complaint. All emphasis herein is added unless otherwise stated.

increased its loss reserves by a staggering $570 million (including the effect of the $37 million Restatement). This news caused Tower's shares to lose over 90% of their value. Indeed, in the wake of this scandal, the Company's own financial advisor opined that Tower either had "negative" value or was worth, at most, as little as $0.15 per share.

This Class Action primarily seeks to hold Defendants accountable for the hundreds of millions of dollars lost by investors as a result of endemic fraudulent accounting and an ingrained practice of reserve suppression that resulted in the over ***half a billion dollar*** reserve understatement. The admitted internal control problems underlying the Restatement and loss reserve deficiencies went to the heart of Tower's fundamentally broken processes. The inadequate controls allowed Defendants to manipulate loss reserves by falsely classifying reserves on "long tail" policies (that require large reserves) as reserves on "short" tail policies (requiring lower reserves) through the misclassification of policies by the wrong "lines of business." This misapplication was fostered and concealed by the Company's refusal to integrate data from the companies it acquired, and use of two different systems to record insurance premiums, on the one hand, and loss reserves, on the other.

The weak internal controls also fostered an environment that enabled Defendant Lee to freely bully and coerce the Company's employees into recording grossly inadequate reserves. As a result of these problems, Defendants' loss reserves and related disclosures were knowing and objective misrepresentations that violated GAAP and flew in the face of the many facts known and available to them. Indeed, numerous former Tower employees have described how it was common knowledge within Tower that the Company had an "ongoing problem" of misclassifying and reconciling premiums and losses. Moreover, former employees describe how Lee pressured actuaries into recording baselessly understated reserves in order to pump up

Tower's share price. At the same time that Lee suppressed Tower's loss reserves to inflate income and convince investors that the Company was profitable, he sold his own Tower shares and received proceeds in excess of $18 million.

There should be no serious question that the detailed allegations concerning the Company's objectively misstated loss reserves and fraudulently inadequate internal controls state claims under the Securities Exchange Act. While Defendants concede the falsity of the Company's internal control statements, their response otherwise attempts to redraft the well-pled allegations to minimize the impact of Tower's $37 million Restatement, which was part of a $570 million understatement of loss reserves. They posit that Tower's audited financial statements are "conjectural" by relying upon dicta from a 25-year old opinion (*Delta Holdings*) that is inapposite to the facts alleged. They also seek to have the Court resolve factual disputes concerning scienter, loss causation, successor liability and the PPC claims. These arguments should be swiftly rejected.

First, Defendants' brief is convoluted. Defendants have ignored the irrefutable requirement that Plaintiffs' allegations must be accepted as pled by attempting to divorce Tower's Restatement from its $533 million in belated loss reserve increases, which are clearly the product of the same underlying causes. *See* Section IV.A.1.a. Defendants' arguments seek to redraft the Complaint and separate the Restatement and reserve understatement into two watertight categories. Their effort to weaken the materiality and effect of the $570 million in understated loss reserves infects Defendants' falsity, scienter and loss causation arguments. Def. Br. at 2-4. As discussed below in Section IV.A.1, Defendants' disregard for the factual allegations and recasting of the fraud is improper and should be rejected. Their "whack-a-mole" approach unnecessarily complicates the issues but cannot successfully rebut any of the

Complaint's well-pled allegations. Defendants' baseless arguments that their misstatement of loss reserves in the amount of $570 million and related false statements concerning internal controls and reserve methodology were not false or material to investors—despite the fact that the revelation of this falsity brought the Company to near-insolvency—are addressed and dispensed with in Sections IV.A.2-4, B and C.

Second, Defendants contend that their entire "brief is based on a fundamental premise"—that Tower's woefully incorrect loss reserves, which were based on ***objectively false*** information, must nevertheless be treated as "opinions," which require allegations that Defendants had "actual knowledge" of their falsity as opposed to "conscious misbehavior or recklessness." Def. Br. at 1-2, 14-20. Their sole support for this "fundamental premise" is dicta concerning the calculation of a reinsurer's loss reserves in an entirely inapposite Second Circuit case from 1990. *Id.* (citing *Delta Holdings, Inc. v. National Distillers and Chem. Corp.*, 945 F.2d 1226 (2d Cir. 1991)). In reality, *Delta Holdings* was a direct action between two companies that discusses loss reserves for the reinsurance industry (which involves different assumptions and risks than those related to Tower's loss reserves) in an entirely different factual context. Further, *Delta Holdings* never refers to loss reserves as "opinions," and did not concern a company's objective errors in calculating loss reserves reported in SEC filings. There is no authority that creates a heightened scienter burden on Plaintiffs here. In any event, the allegations in the Complaint satisfy even this heightened standard.

Third, conceding the weakness of their "fundamental premise," Defendants argue that the Complaint fails to allege that they acted recklessly in connection with falsely-stated loss reserves and that they were motivated to overstate Tower's net income by understating loss reserves. Def. Br. at 20-44, 57-62. These arguments cannot stand. Indeed, the inferences that Defendants acted knowingly or recklessly are based, among other things, on Defendants' own admissions and detailed statements, the "core" nature of loss reserve issues to Tower's business, and the detailed and credible information from many confidential witnesses who had first-hand experience with Tower's loss reserve practices, internal controls and inability to properly integrate the data and operations of Tower's multiple acquisitions. Defendants present no legitimate inference of scienter that is as, let alone more, compelling than set forth in the Complaint, as discussed in Section VI, below.

Finally, the remainder of Defendants' arguments concerning Class Period duration (Def. Br. at 63-64, 95-96), loss causation (*id*. at 53-56, 62-63), insider trading and control person liability (*id*. at 76-77) and successor liability claims (*id.* at 65-76), delve deeply into the weeds and, at best, raise numerous factual issues unsuitable for resolution on a motion to dismiss. These arguments are addressed, respectively, in Sections V, VI.D, VII, VIII, and IX.

In sum, Defendants spend nearly 100 pages trying to dissemble their fraud, and then, based on their own narrative, lodge an army of disparate arguments based on inapposite law to explain away Plaintiffs' detailed Complaint. None of these arguments succeed.

Defendants' attacks on the Private Placement Class claims fare no better. The PPC alleges claims under Sections 10(b) and 18 of the Securities Exchange Act and breach of contract, breach of express warranty and negligent misrepresentation under state law. In March 2013, Tower entered into a $217 million private placement agreement with numerous institutional investors in connection with the Canopius Merger. That class of investors, which acquired Canopius stock in connection with that merger, has brought additional federal and state claims relating to various agreements that Tower breached. Indeed, among other things, Tower warrantied at the time of the Canopius Merger that it would not lock up the PPC's ability to sell registrable Tower shares, but in August 2013 it proceeded to do exactly that, locking up the PPC's ability to sell Tower shares while the price fell from $14.53 to $2.50.

Defendants make several attempts to challenge the state law claims, none of which bear scrutiny. For example, Defendants argue that SLUSA pre-empts the state law contract claims, but the PPC does not allege a misrepresentation or omission in connection with the purchase of a security on those claims—a requirement of SLUSA. Indeed, purchasing or selling a security is not required under breach of contract and breach of express warranty claims. Likewise, the PPC bought shares of Canopius, not Tower, and Canopius was not a "covered" security—also a requirement under SLUSA. *Id.* Defendants further argue that Plaintiffs' allegations sound in fraud, but the PPC's state law claims clearly allege no such thing. Indeed, as courts have routinely recognized, plaintiffs can allege non-fraud claims in a separate section of a complaint from fraud claims (as the PPC did) without invoking the requirements of Rule 9(b). Defendants' arguments against the PPC's federal claims also fail, as discussed in Section X.A.

II. STATEMENT OF FACTS

A. Tower Experienced Growth Through Serial Acquisitions While Falsely Assuring Investors Of Its "Conservative" Loss Reserves And Effective Internal Controls

Throughout the Class Period, Tower and the Officer Defendants portrayed the Company, a property-casualty insurance provider, as a profitable, growing company with conservative loss reserving practices, adequate reserves for expected losses and effective internal controls. ¶¶6, 58, 69. During this time, Tower primarily derived its income through three business segments: Commercial Insurance, Personal Insurance and Insurance Services. ¶53. The Company's Commercial Insurance lines—Tower's main driver of income—were at the heart of the Company's fraud. *See* ¶58.

Between 2009 and 2010, the Company engaged in an aggressive growth strategy through the acquisition of several insurance companies valued at nearly $1 billion. ¶¶54-57. On March 1, 2010, Tower reported just over $1 billion in total gross premiums for 2009. ¶58. Three years later, Tower purportedly doubled this, reporting $2 billion in gross premiums. *Id.* During this expansion, Tower's two largest lines of business, which were also at the core of the Company's massive loss reserve understatement, were commercial multi-peril insurance (with gross premiums of $477.9 million in 2012), and workers' compensation insurance (with gross premiums of $419 million in 2012). *Id.*

As an insurance company, Tower establishes loss reserves to ensure that it has sufficient liquid capital to pay claims that are submitted on its policies. Reserves represent losses incurred as of the financial reporting date that the Company will need to pay to its insured. ¶¶59-60. Tower's purported revenue and income growth were directly related to the amount of loss reserves it accrued during each financial reporting period. When reserves are accrued, the Company's income is reduced on a dollar-for-dollar basis. ¶67. Another key metric affected by reserves is the Company's loss ratio, which is the ratio of losses and LAE (costs associated with the payment of losses and settlement of claims other than the amount of the loss itself) incurred to premiums earned. ¶68.

During the Class Period, Tower stated that its loss reserves—which include case reserves tied to a specific reported claim (¶61) and IBNR (claims incurred but not yet reported) (¶62)—were determined using an "actuarial ***analysis of claims experience by product and segment***, and relevant insurance industry information such as ***loss settlement patterns for the type of business being reserved***." ¶63. Tower was obligated to analyze claims and "loss settlement patterns" by the correct "lines of business" or product type, since a policy's "business line" (*i.e.*, types of insurance—automobile, workers' compensation) greatly affects the ultimate reserve amount. ¶¶63-65. As discussed below (p. 11), differences in the "tails" on different lines of business, the failure to accurately assign claims and the related premiums to the correct line of business would cause those reserves to be materially misstated. Tower acknowledged the importance of taking proper reserves based on "all information" relevant to the Company's financial condition. ¶70. For example, the Company's 2009 Form 10-K stated that Tower's "***policy is to establish these losses and loss reserves prudently after considering all information known to us as of the date they are recorded.***" *Id.* Defendants similarly represented that they "carefully monitored" their "reserves by segment and line of business to ensure that they are adequate." ¶203.

Throughout the Class Period, Tower reported its loss reserves, net income, and loss ratio in its financial results on a quarterly and annual basis. ¶192. Defendants certified the accuracy of these financial results and that Tower had presented them in compliance with GAAP. *Id.* Moreover, the Company and the Officer Defendants repeatedly affirmed that they were personally responsible for and ensured that Tower maintained effective internal controls. ¶191. These statements were clearly false as Tower's financial results massively understated its loss reserves by over half a billion dollars, its financial statements did not comply with GAAP, and its internal controls had material weaknesses. *Id.*

During the second quarter of 2012, Tower announced that it had agreed to invest approximately $75 million to acquire a 10.7% stake in Canopius Group, Ltd., a privately owned Lloyd's insurance holding company. ¶393. In connection with that investment, Tower entered into an agreement dated April 25, 2012, under which Canopius granted Tower Group the option (the "Merger Option") to combine with Canopius Bermuda (the "Canopius Merger"). ¶394. On July 30, 2012, Tower announced that it had exercised the Merger Option and entered into a merger agreement with Canopius pursuant to which Canopius would acquire all of Tower's common stock. ¶398. Upon closing of the Merger, Tower Group merged with Canopius Bermuda, with Canopius Bermuda becoming the successor to Tower Group, succeeding to Tower Group's listing, and changing its name to Tower Group International, Ltd. ¶¶398, 406. Additional facts relating to the Canopius merger are discussed *infra* at Section X.

B. The Nature Of The Fraud At Tower — Loss Reserve Manipulation To Inflate The Company's Income And Stock Price

1. Defendants Knowingly Used Fundamentally Incorrect Loss Reserve Data That Resulted In Hundreds Of Millions In Reserve Deficiencies

Tower's loss reserves were fraudulently understated during the Class Period for two reasons: (i) Defendants did not properly reconcile premiums and loss reserves by the correct line of business (which Tower has since admitted), and (ii) Defendants engaged in intentional reserve suppression. ¶83. The admitted deficiencies in Tower's internal controls contributed to and allowed these fraudulent statements to be disseminated. The $570 million in reserve understatements, as detailed *infra* at Section C.1.c, enabled Tower to maintain the façade of a fundamentally sound and growing insurance company. *Id*.

Defendants Lee and Hitselberger falsely assured the market that the Company took a conservative approach to loss reserves on regular earnings conference calls with market analysts. ¶¶72-74. For instance, on a February 28, 2012 conference call, Defendant Lee stressed that "***we decided to select a loss ratio that was conservative … we feel very confident about our reserves, prior-year reserves …***" ¶73. Defendants further maintained that technological improvements and redesigned business processes gave Tower effective internal controls that enabled the Company to categorize claims by lines of business to accurately account for premiums and loss reserves, in compliance with GAAP. ¶¶76-77.

Despite these assurances, and as detailed in the Complaint, the Company was forced to restate its financial statements and book $570 million in additional reserves due to admitted internal control failures, including fundamental failures in "***premium receivable account reconciliation***." ¶26. The Complaint details Tower's failure to properly integrate the loss reserve data and IT systems from the companies it had acquired in a rapid acquisition spree onto a common platform, which compromised the Company's internal controls and financial reporting, including as they related to the issues underlying the Restatement. *See* ¶¶88-103. A former Assistant Vice President and Actuary at Tower confirmed the "***ongoing problem***" of misclassifying and reconciling premiums and losses. ¶92. In that regard, Defendant Lee was consistently warned of the effect that failing to implement a comprehensive data system would have on adequately determining loss reserves but rejected any solution in favor of saving capital. *Id*. Multiple former high-level Tower employees also confirmed Tower's integration failures, stating that the ***systems of acquired companies were never properly integrated***, indicating that Tower "had a data problem" and that the data available was known to be "junk" and "inconsistent." ¶93.

Top executives at Tower's New York headquarters, including Defendant Lee and Tower's Chief Actuary, were well-aware of the Company's reserve data problems "from the minute they [*i.e.* Tower] acquired the companies." ¶94. In fact, a former Tower Senior Business Analyst Consultant confirmed that Tower had ***up to eight policy systems at the same time*** as a result of its failure to integrate acquired companies. ¶93. The Company did not follow industry practice with regard to setting reserves and was disorganized with "***literally hundreds***" of spreadsheets as part of its reserve process, which relied on a "roll forward" process that was known to be highly unreliable and which did not conform to industry standards. ¶¶94-98.

These serious data problems resulted in the application of "inconsistent data" to reserves—Tower's admitted problem with "premium receivable account reconciliation." This allowed, for example, a workers' compensation claim to be incorrectly categorized as a general liability claim, which would have a substantial impact on reserve calculations. ¶97. Therefore, Tower's calculations were knowingly based upon ***objectively incorrect data*** and resulted in grossly inadequate reserves. For example when a "long-tail" workers' compensation claim was misclassified as a "short-tail" commercial auto claim, the long-term risks and exposures associated with the workers' compensation claims were not taken into account, and the IBNR for the claims was severely under-reported. ¶100. Significantly, the failure to properly account for loss reserves by the correct line of business is admitted in the Restatement. ¶¶11, 86. The Restatement also confirms that Tower used separate accounting systems for premium and reserve data. ¶102. The Restatement made adjustments to Tower's IBNR by line of business without any concomitant adjustments to historical premiums on those line of business. *Id*. This reflects that, contrary to Defendants' statements, Tower used separate unconnected accounting systems for premiums and reserves, which is consistent with the Company's admissions concerning its internal control weaknesses and "reconciliation problems." *Id.*

2. Defendants Intentionally Suppressed Reserves To Create The Appearance That Tower Was Profitable

In addition to misclassifying premiums and losses, Defendants implemented a top-down mandate to suppress reserves below appropriate levels at Tower, where "***the intent was to keep the reserves suppressed***." ¶¶104, 111. For instance, Defendant Lee, determined to artificially inflate the Company's net income, intimidated his staff by creating an environment where "underwriters [were] under pressure to just bring in premiums." ¶105. Lee would even tear into the chief actuary "like he was a child" when the proposed reserve levels were too high. ¶¶107-

08. The culture of trying to "appease the CEO" who "was God" at Tower, included reducing reserves by 10%-20%, and reducing the IBNR without justification, and setting case reserves for individual claims "under the projected exposure." ¶¶107-11.

By fostering the culture of reserve suppression, the Officer Defendants were well aware of these glaring accounting deficiencies. Their knowledge is further confirmed by the fact that Global Indemnity, a competing insurance company, foreshadowed the 2013 disclosure of the fraud when it informed Tower during 2012 that its actuarial consultant concluded that Tower was materially under-reserved. ¶112. Ultimately, once Tower's true loss reserve figure was disclosed, it wiped out Tower's Class Period net income and revealed that Tower was not, in fact, profitable.

C. The Truth Regarding Tower's Financial Reporting Fraud Begins to Emerge

1. Tower Belatedly Begins To Increase Reserves

The truth about Tower's financial condition began to emerge on August 7, 2013, when the Company (i) postponed the release of its second quarter 2013 financial results and (ii) disclosed management's conclusion that additional time would be needed to review matters relating to its loss reserves. ¶115. The next day, Tower announced, *inter alia*, that it expected to increase loss reserves by between $60 million to $110 million—turning an expected profit for the quarter into a net loss of approximately $49 million. *Id*. Tower's stock price immediately declined by 25%, resulting in $311 million in lost market capitalization. ¶117.

Then, on September 17, 2013, Tower stunned investors by announcing, without further explanation, that it would ***again*** delay the filing of its 2013 fiscal second quarter financial results. ¶121. Upon this news, the price of Tower's common stock plunged 28%. ¶122.

Still, without actually disclosing its second quarter results, on October 7, 2013 Tower announced that it expected to increase its "loss reserves ***by approximately $365 million***…primarily for accident years 2009 through 2011 in commercial insurance lines of business, including workers' compensation, commercial multi-peril, commercial auto and other liability lines." ¶123. Tower's stock plummeted over 40% on this news. ¶¶126-27.

a. Tower Announces The Restatement And Admits It Failed To Properly Account For Premium And Loss Data By Line of Business And That There Were "Material Weaknesses" In Its Internal Controls

On November 14, 2013, Tower announced that it would restate its financial statements for 2011 and 2012 and the first quarter of 2013 and revise its financial statements for fiscal years 2009 and 2010. ¶128. Tower restated its loss reserves for 2010 through 2012 and retroactively increased them by ***an additional $37 million***. ¶¶22, 128. Tower claimed that its reserves were understated due to "***inadvertent mistakes in classification of insurance premiums by line of business used in the loss reserving process***" and also admitted that there were "***material weaknesses***" in its internal controls that directly contributed to these problems. ¶¶128, 130. As discussed above, the Restatement also revealed that Tower used two separate systems to account for loss reserves and premiums on related lines of business. ¶¶102, 128. In response to news of the Restatement, Tower shares declined by 13% during intraday trading on November 14. ¶131. Indicative of the market's harsh reaction to this news, Guggenheim Securities, LLC connected the Restatement to the previously announced loss reserve increases, stating that "***[A]n insurance company wouldn't take a surprise $365m reserve charge, representing 14% of its overall reserves, without having historical issues***." ¶132.

b. Additional Disclosures Further Confirm Tower's Fraudulent Loss Reserves

On November 22, 2013, Tower completed the "comprehensive review" of its loss reserves and finally reported its second quarter 2013 financial results, disclosing that it would ***increase its loss reserves by $326.7 million***, primarily arising from ***losses incurred for accident years 2008 through 2011***. ¶133.

Tower's reserve charges continued to grow exponentially. On December 17, 2013, Tower disclosed that it anticipated taking an additional ***$105 million in belated reserve charges***. ¶¶137-38. Upon this news, the price of Tower's common shares plummeted 30%. ¶138. On February 11, 2014, Tower reported that it had underestimated its expected reserve charge for the third quarter of 2013, increasing the charge to $143.7 million. ¶149.

This was not the end of Tower's reserve-induced collapse. On May 2, 2014, the Company further reported: (i) an additional belated reserve increase of $62 million; (ii) that $214.0 million of goodwill was impaired, eliminating all of Tower's goodwill; and (iii) that the Company had the six material internal control weaknesses noted below. ¶153.

c. The $570 Million In Loss Reserve Understatements

Tower's massive $570 million understatement of loss reserves that should have been reported during the Class Period can be summarized as follows:

Date	Event	Belated Reserve Increase (millions)	Relating To/Cause	¶¶
11/14/2013	Restatement	$37.4[2]	Restatement/revision of loss reserves for fiscal years 2010-2012 and the first quarter of 2013 based on "inadvertent mistakes in classification of insurance premiums by line of business"	128, 133, 252
11/22/2013	Q2 2013 Earnings	$326.7	Belated increases of loss reserves for accident years 2008-11, primarily in workers' compensation, commercial multi-peril liability, and commercial auto liability lines.	133, 252
2/11/2014	Q3 2013 Earnings	$143.7	Further belated increases in loss reserves for losses incurred primarily from accident years 2008-2011 relating to workers' compensation, commercial multi-peril and commercial auto lines.	149, 151
5/2/2014	FY 2013 Results	$62	Further belated increases in loss reserves for losses incurred in accident years 2008-2012 relating to workers' compensation, commercial multi-peril and commercial auto lines.	153
Total:		**$570**		

Ultimately, Tower was forced to report a staggering $570 million in increased loss reserves, an amount consisting of $533 million of charges taken for losses from accident years 2008 through 2012 and the Restatement, which increased loss reserves by $37.4 million for fiscal years 2010 through 2012. ¶137. The $570 million in fraudulent reserve manipulations was more than double the Company's cumulative net income of $203.2 million for the Class Period years 2009 through 2012, and resulted in Tower reporting a loss of $942.6 million for fiscal year 2013. ¶134.

d. Tower's Internal Controls Were Deficient

Despite the Tower Defendants' representations that the Company had "effective internal controls over financial reporting," and the Officer Defendants' repeated certifications under SOX

[2] On November 22, 2013, Tower, in a Form 8-K dated that day, adjusted the previously-disclosed $37 million in restated loss reserves to $37.4 million.

(¶¶192-93, 195, 197, 199, 201, 254), the Company was forced to admit in the Restatement that those statements were false. ¶¶19, 23.

Tower disclosed on November 14, 2013 in connection with the Restatement that its internal controls over the loss reserving and premiums receivable reconciliation processes had "material weaknesses." ¶130. Critically, Tower's 2013 Form 10-K, filed on May 2, 2014, confirmed that by no later than the end of fiscal year 2012, Tower's internal controls suffered from ***six material weaknesses***, including deficiencies relating to the Company's failure to maintain effective controls over: (i) "the loss reserve estimation process"; (ii) "premium receivable account reconciliation;" (iii) "the impairment process of the long-lived tangible and intangible assets;" (iv) "the effectiveness of the tax valuation allowance estimation process;" (v) "certain information technology controls;" and (vi) "the period-end financial reporting process." ¶153. The Company's admissions made clear that, throughout the Class Period, Tower knowingly and recklessly misstated key financial metrics—most significantly, its loss reserves and reported net income, that all of the Company's Class Period financial statements were inaccurate, and that the Company's purported financial health was a façade.

e. Continuing Impact Of The Fraud—A Fire-Sale Acquisition By ACP, Defendant Lee Is Fired And Government Investigations

On January 3, 2014, Tower announced the ACP Merger that involved its fire-sale to ACP at a price of $3.00 per share. ¶¶146-47. Not surprisingly, on January 14, 2014, Fitch declared Tower's "***level of corporate governance to be ineffective. In particular, Tower's current management and board has failed to put in adequate internal controls over financial reporting of the company's loss reserving processes and estimation of collectability of premium receivables.***" ¶143. On February 6, 2014, Defendant Lee announced his immediate resignation as Tower's President and CEO. ¶144.

In light of the adverse disclosures that continued through May 2014, Tower and ACP amended the proposed terms of the ACP Merger such that Tower shareholders would receive $2.50 in cash per share, as opposed to the previously agreed $3.00 per share. ¶156. Notably, J.P. Morgan Securities LLC ("J.P. Morgan") issued a fairness opinion regarding the ACP Merger, concluding that the per share equity value for the Company was either "negative" or no more than $0.15 to $0.31 per share. ¶157. Confirming J.P. Morgan's opinion, Bank of America Merrill Lynch concluded that the Company's per share equity value ranged between $0.19 and $0.29. *Id*. These opinions establish that prior to Tower's corrective disclosures, ***the Company's stock had been overvalued by far more than 90%***. ¶157. Then, on May 9, 2014, Tower fired Defendant PWC as its independent registered auditor.[3] ¶158.

News of Tower's staggering loss reserve increases sparked a host of credit downgrades (¶¶119, 126, 142-143), as well as a number of regulatory investigations into Tower's fraudulent financial reporting, including those by regulators in New York, New Jersey, Massachusetts, Maine, Illinois, Ohio and Bermuda. ¶¶162-67.

Moreover, in a February 21, 2014 letter, the SEC sharply questioned Tower's loss reserve increases, inquiring as to "why the $74.2 million increase for the year ended December 31, 2012 was reasonable given the loss development observed" and "why the trend was not recognized prior to the second quarter of 2013." ¶161. The Company failed to meaningfully respond to the SEC's letter, and accordingly, on August 29, 2014, Tower announced that the SEC had launched a formal investigation into the Company. *Id.* Facing intense scrutiny and teetering on the brink

[3] Plaintiffs respond to Defendant PWC's Motion to Dismiss (Dkt. No. 118-20) in the accompanying Memorandum Of Law In Opposition To Defendants Tower Group International, Ltd., Tower Group, Inc., ACP Re, Ltd., Michael H. Lee, and William E. Hitselberger's Motion To Dismiss The Amended Consolidated Class Action Complaint.

of bankruptcy, the Company effectuated the merger with ACP. ¶168. The ACP Merger closed on September 15, 2014. ¶¶7, 48.

All told, in response to the Defendants' numerous fraudulent disclosures and material misstatements dated from August 7, 2013 through December 19, 2013, Tower's stock price fell ***$18.81 per share*** in the aggregate, representing a ***staggering decline of nearly 90% in only four months***. ¶139.

ARGUMENT

III. PLEADING STANDARD

On a motion to dismiss under Rule 12(b)(6), "the Court must accept all well-pleaded allegations contained in the complaint as true and draw all reasonable inferences in the plaintiff's favor." *City of Livonia Emps. Ret. Sys. v. Wyeth*, 2010 WL 3910265, at *3 (S.D.N.Y. Sept. 29, 2010). "The test is not whether the plaintiff ultimately is likely to prevail, but whether he is entitled to offer evidence to support his claims." *In re Veeco Instruments, Inc. Sec. Litig.*, 235 F.R.D. 220, 226 (S.D.N.Y. 2006).

In order to state a claim under Section 10(b) of the Securities Exchange Act of 1934, a complaint must plead: (1) a material misrepresentation or omission; (2) scienter; (3) a connection between the misrepresentation and the purchase or sale of a security; (4) reliance; (5) economic loss; and (6) loss causation. 15 U.S.C. § 78u-4(b); *Ganino v. Citizens Utils. Co.*, 228 F.3d 154, 161 (2d Cir. 2000). "Although the PSLRA additionally requires that a plaintiff plead with particularity the requisite mental state under the law, it otherwise imposes the same standard as Rule 9(b)." *In re UBS AG Sec. Litig.*, 2012 WL 4471265, at *8 (S.D.N.Y. Sept. 28, 2012). As this Court articulated in *Deutsche Zentral-Genossenchaftsbank AG v. HSBC Holdings, Inc.*, "under Rule 9(b), a party must 'stat[e] with particularity the circumstances constituting the fraud.'" 2013 WL 6667601, *5 (S.D.N.Y. Dec. 10, 2013). That standard is readily met here.

IV. THE COMPLAINT ADEQUATELY ALLEGES MATERIALLY FALSE AND MISLEADING STATEMENTS AND OMISSIONS

"The federal securities laws impose an obligation on speakers to be both accurate and complete." *In re Lehman Bros. Sec. & ERISA Litig.*, 799 F. Supp. 2d 258, 282 (S.D.N.Y. 2011). Upon choosing to speak, "one must speak truthfully about material issues." *Caiola v. Citibank, N.A.*, 295 F.3d 312, 331 (2d Cir. 2002); *Meyer v. Jinkosolar Holdings Co., Ltd.*, 761 F. 3d 245, 250 (2d Cir. 2014) ("once a company speaks on an issue or topic, there is a duty to tell the whole truth"). Under the PSLRA, a complaint need only allege facts "sufficient to support a reasonable belief as to the misleading nature of the statement or omission." *Novak v. Kasaks*, 216 F.3d 300 at 314-15 n.1 (2d Cir. 2000). Here, the Complaint amply alleges such facts.

A. False Statements And Omissions Concerning Tower's Financial Results

1. Tower's Understated Loss Reserves And Misstated Financial Results Violated GAAP

Tower's Class Period loss reserves were understated by at least $570 million. ¶¶5, 84. The reserve deficiencies were announced through a series of disclosures, including three reserve increases totaling $533 million and the $37 million Restatement. *See* table at Section II.C.1.c.

By fraudulently understating its loss reserves, Defendants also caused Tower's loss ratio to be understated and its net income to be inflated for every quarter and fiscal year of the Class Period, all in violation of GAAP (¶¶114-40, 192-202), despite repeated assurances that Tower's financial statements complied with GAAP. ¶¶192-93, 195, 197, 199, 201. Specifically, Tower falsely reported the following in its filings with the SEC during the Class Period:

Filing[4]	Loss Reserves	Loss Ratio	Net Income	¶¶
2009 Form 10-K	$932.3 million	55.6%	$109.3 million	193
2010 Form 10-K	$1.3 billion	60.77%	$117 million	195
2011 Form 10-K	$1.2 billion	66.2%	$60.2 million	197
2012 Form 10-K	$1.3 billion	72.8%	($28.2 million)	199
1Q 2013 Form 10-Q	$1.4 billion	63.1%	$3.8 million	201

Had Defendants properly recorded the $570 million loss reserve understatement in fiscal 2009 through the first quarter of 2013, the financial results summarized in the above table would have been materially worse.

On November 14, 2013, Tower admitted that the above disclosures were materially false when it announced the Restatement.[5] ¶¶22, 128-32, 194, 196, 198, 200-01. GAAP states that previously-issued financial statements should be restated only where there is a need to correct ***material accounting errors that existed at the time the statements were originally issued***. ¶270 (citing FAC 250-10-45-22 to 24). Accordingly, Defendants concede, as they must, that the Restatement affected prior Class Period statements and constitutes an admission that the items affected by the Restatement were improper and violated GAAP. ¶¶4, 11, 26, 84-87, 154, 156, 176; *see* Def. Br. at 3, 8, 11, 18. In light of the Restatement, there can be no dispute that those financial statements (for 2009, 2010, 2011 and 2012) were materially false and misleading. *S.E.C. v. Espuelas*, 579 F. Supp. 2d 461, 472 (S.D.N.Y. 2008) (a complaint adequately pleads falsity if plaintiffs allege that there was a restatement correcting earlier corporate filings and identifies the restated financials); *In re BISYS Sec. Litig.*, 397 F. Supp. 2d 430, 437 (S.D.N.Y. 2005) (same); *In re Atlas Air Worldwide Holdings, Inc. Sec. Litig.*, 324 F. Supp. 2d 474, 486

[4] The Restatement also disclosed that Tower falsely reported its gross premiums receivable and operating expenses in 2009 through 2012. ¶194, 196, 198, 200.

[5] Although Tower attempts to downplay the charges to its loss reserves for 2010 and the first quarter of 2013 by referring to them as "revisions" as opposed to "restatements," the relevant accounting literature makes no distinction between these terms.

(S.D.N.Y. 2004) (the mere fact that financial results were restated is a sufficient basis for pleading that those statements were false when made).

The belated $533 million in reserve increases accrued during 2013 similarly should have been taken earlier as they reflect reserves for losses from accident years 2008 through 2012. ¶¶24, 84, 86, 140. These reserve deficiencies were caused by the same underlying causes as the Restatement, namely Tower's (i) admitted misclassification of data by line of business; (ii) admitted material weaknesses in its internal controls; and (iii) intentional under-reporting of its reserves to artificially inflate the Company's net income. ¶¶5, 69, 84, 86. Tower's reported fiscal 2009 through 2012 financial results were all materially false and misleading when made because Tower was under-reserved for claims filed in 2009 through 2012 ***by a material amount of the $533 million reserve charges*** taken in 2013 for accident years 2009 through 2012. ¶¶4, 22, 84, 114-40, 192-202. Accordingly, Tower should have reported materially higher loss reserves and loss ratio, and a materially lower net income. *Id*.

The loss reserve understatement, which also caused Tower's other financial results to be misstated (*e.g.*, net income and loss ratio), violated GAAP. Financial statements that do not comply with GAAP are presumptively false. *See* 17 C.F.R. § 210.4-01(a)(1); *see Novak*, 216 F.3d at 309; *In re CitiGroup Inc. Bond Litig.*, 723 F. Supp. 2d 568, 592 (S.D.N.Y. 2010) (financial disclosures not prepared in conformity with GAAP are presumed to be misleading); *Freudenberg v. E*Trade Fin. Corp.*, 712 F. Supp. 2d 171, 177-78 (S.D.N.Y. 2010) (allegations concerning, *inter alia*, defendants' failure to adequately set loss reserves sufficiently stated a claim for securities fraud). GAAP required Tower to establish loss reserves by taking into account all known facts and current trends in accordance with FAS and ASC Topic 944. ¶¶259, 266-67, 269-70.

Here, despite Tower's Class Period statements that its financial statements were prepared in accordance with GAAP and were accurate and should be relied upon, the Complaint describes how Tower's loss reserves were understated by as much as $570 million due to the Company's manipulations of its loss reserves, including through its misapplication of premium and loss data by line of business (caused by data and internal control problems) and internal, management-imposed pressure to intentionally understate Tower's loss reserves. ¶¶5, 8, 11, 69, 17, 83-112. The Complaint further alleges that as a result of Tower's failure to accurately report its loss reserves, the Company made false and misleading statements in violation of GAAP and violated a number of core GAAP provisions. ¶¶258-71; *see CitiGroup*, 723 F. Supp. 2d at 592 (actionable GAAP violation where company failed to accurately account for loss reserves likely to accrue in the future); *In re IMAX Sec. Litig.*, 587 F. Supp. 2d 471, 482 (S.D.N.Y. 2008) (misapplication of revenue resulted in actionable GAAP violations); *In re Scottish Re Grp. Sec. Litig.*, 524 F. Supp. 2d 370, 394 (S.D.N.Y. 2007) (GAAP violations in connection with restated financials); *see also In re SLM Corp. Sec. Litig.*, 740 F. Supp. 2d 542, 555 (S.D.N.Y. 2010) (actionable false statements where plaintiff alleged loan loss reserves were misrepresented and not calculated pursuant to GAAP); *Freudenberg*, 712 F. Supp. 2d at 200 (same).

a. Defendants' Attempts To Redraft The Complaint's Loss Reserve Allegations Must Be Rejected

In a blatant attempt to minimize the enormity of their fraudulent manipulation of the Company's loss reserves during the Class Period, Defendants artificially sever the Restatement from the $533 million in reserve increases and ignore the additional accrual of loss reserves taken by Tower that were announced on February 11, 2014, for $143.7 million (¶¶24, 149), and on May 2, 2014, for $62 million, respectively. ¶¶24, 153; *see* Def. Br. at 3. As discussed above, like the $326.7 million in reserves accrued during the second quarter of 2013, these additional reserve increases reflect accruals relating to accident years from 2008 to 2012, which should have been accrued in earlier years.

Defendants unconvincingly argue that the Restatement is not material, then make an improper factual argument that the Restatement and loss reserve increases are not related and that the $533 million in reserve increases do not reflect reserves that should have been taken prior to fiscal 2013. Def. Br. at 3. This argument is illogical and legally unsound.

First, Defendants cannot obtain dismissal by arguing that the factual allegations in the complaint are wrong. *See Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 572 (2007) (on a motion to dismiss, a judge "must accept as true all of the factual allegations contained in the complaint."); *see also Ganino*, 228 F.3d at 165 ("On a motion to dismiss, the allegations in the Complaint must be accepted as true."); *In re Parmalat Sec. Litig.*, 376 F. Supp. 2d 472, 507 (S.D.N.Y. 2005) (mischaracterizing allegations and ignoring "the language of the complaint" is an inadequate defense).

Second, despite the Complaint's allegations of an intractable, underlying connection between the Company's admitted internal control weakness, the Restatement and the $533 million in belated reserve increases, Defendants ineffectively argue for dismissal based on an alternative set of facts of their choosing. In support, Defendants contend that the $533 million in reserves taken in 2013 (for accidents that occurred as many as five years prior) were timely, but offer no explanation for this when these increases contributed to Tower's downward spiral from a seemingly profitable and healthy insurance company to an essentially insolvent one with "negative" equity value. Def. Br. at 47. This bald, "trust us" response flies in the face of common sense. The notion that Tower could have timely accrued $533 million in additional loss reserves during 2013, relating to incidents dating from 2008 through 2012, is simply not plausible. *See Twombly*, 550 U.S. at 572. At the end of 2012, Tower's purported total loss reserves were $1.2 billion. *See* Section II.C.1.a. *supra.* Defendants are not entitled to the incredible inference that Tower's loss reserves properly increased by $533 million (40%) in one year, the majority of which was booked in one quarter of 2013 (the second quarter). Even in the absence of Defendants' admissions (*e.g.*, the Restatement and material internal control deficiencies) and the myriad allegations of grossly reckless and intentional conduct, Defendants' attempt to benignly explain this massive loss reserve increase defies credulity.

Indeed, in Tower's own November 22, 2013 Form 8-K, announcing its second quarter 2013 financial results, Tower equated and connected the Restatement and "reserve strengthening" to "prior years": "***the Company had restatement adjustments of $37.4 million to loss reserves as of December 31, 2012, bringing the total prior year reserve strengthening to $364.1 million***." Harrod Decl. Ex. A.

b. The Complaint Adequately Asserts Falsity Concerning Tower's Loss Reserves

After attempting to redraft the Complaint's allegations concerning the falsity of the Company's financial statements, Defendants maintain that the Complaint's allegations are somehow insufficient because they are "conclusory" and fail to offer sufficient details as to why Tower's loss reserves were misstated. Def. Br. at 45. Specifically, Defendants argue that the Complaint does not allege what actuarial assumptions, loss ratio estimates or loss development factors Tower used or should have used, which demonstrates Defendants' misunderstanding of the standard for falsity under the PSLRA. *Id.* Defendants incorrectly articulate both the Complaint's allegations and Plaintiffs' burdens on a motion to dismiss.

Lead Plaintiffs are under no duty to explain in detail what Tower should have disclosed, what underlying assumptions were falsely applied, and what correct assumptions should have been used. *See In re Gentiva Sec. Litig.*, 932 F. Supp. 2d 352, 368 (E.D.N.Y. 2013) (false statements concerning the company's financial results held actionable even though plaintiffs did not quantify the effect of the claimed misrepresentation); *CitiGroup*, 723 F. Supp. 2d at 592 (actionable false statement where plaintiffs alleged that company failed to accurately represent its loss reserves, not by how much the loss reserve levels were inadequate); *Freudenberg*, 712 F. Supp. 2d at 188 (same); *Scottish Re*, 524 F. Supp. 2d at 383-84 (falsity requires only specifying a false statement and alleging why the statement is false).

Here, the Complaint adequately alleges that during the Class Period, Tower materially misstated its financial results by, *inter alia*, understating its loss reserves and overstating its net income. ¶¶192-202. The $570 million in understated reserves should have been accrued in a proportionate amount over fiscal years 2009 through 2012, the precise timing and amounts of which will be adduced only after discovery and likely through the assistance of accounting, insurance and actuarial experts. These issues cannot be sorted out on a pleading motion, particularly where, as here, Plaintiffs have met their falsity burden.

Moreover, the cases Defendants cite for this proposition are inapposite. In *Reese*, plaintiffs failed to allege that ***any*** financial items were ever misstated; in fact, plaintiffs themselves admitted that the company's "earnings figures were accurate." *Reese v. McGraw-Hill Companies, Inc.*, 2012 WL 9119573, at *2 (S.D.N.Y. Mar. 30, 2012).[6] Furthermore, in *Carpenters Pension Trust Fund of St. Louis v. Barclays PLC*, plaintiffs did not allege that the bank's financial line items were materially misstated and failed to connect statements regarding the company's internal controls and business practices with defendants' purported fraud. *See*

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[6] Rather than appropriately cite to the underlying district court decision, Defendants cite to *Reese v. Bahash*, 574 F. App'x 21, 24 (2d Cir. 2014), which was on appeal from plaintiffs' motions for relief from judgment and for leave to amend the complaint and did not address the adequacy of plaintiffs' pleadings.

750 F.3d 227, 236 (2d Cir. 2014); *see also Gusinsky v. Barclays PLC,* 944 F. Supp. 2d 279, 289 (S.D.N.Y. 2013).

Defendants also make an opaque argument that the allegations concerning Tower's loss reserve increases are "fraud by hindsight." Def. Br. at 47. This is wrong. The accuracy of Tower's loss reserves were contradicted by numerous material facts that existed at the time the original loss reserves were disclosed, including but not limited to Tower's: (i) inaccurate designation of premiums and losses by lines of caused leading to a known (and admitted) understatement of loss reserves; (ii) ineffective integration of premium and loss data from the companies Tower acquired; (iii) culture of intimidation which pressured the Company's actuaries to lower Tower's loss reserves; and (iv) use of two distinct accounting systems for setting loss reserves and premiums. *See, e.g.*, ¶¶5, 8, 11-16, 21, 23, 88-102, 104-113, 285. These are not allegations of fraud by hindsight but rather reflect contradictory facts known or available to Defendants at the time these statements were made. *See In re CitiGroup*, 723 F. Supp. 2d at 592 (not fraud by hindsight where false statements were made with information available to defendants at the time the statements were made); *Freudenberg*, 712 F. Supp. 2d at 192 (same); *Hall v. The Children's Place Retail Stores, Inc.*, 580 F. Supp. 2d 212, 229 (S.D.N.Y. 2008) (same).

The cases that Defendants cite for this point are unavailing. In *Local No. 38 Int'l Bhd. of Elec. Workers Pension Fund v. Am. Exp. Co.*, 724 F. Supp. 2d 447, 463 (S.D.N.Y. 2010), the court dismissed plaintiffs' false statements concerning loss reserves because, unlike here, the plaintiffs alleged ***no facts*** suggesting scienter. Moreover, in *In re Fannie Mae 2008 Sec. Litig.*, 742 F. Supp. 2d 382, 412 (S.D.N.Y. 2010), the court dismissed plaintiffs' claims concerning the company's loss reserve charges because plaintiffs supported their loss reserve allegations with a report concerning ***losses for future events*** and the court noted that "reserves are required only for ***current*** impairments of liabilities as of the date of the financial statements at issue." Here, in contrast, Lead Plaintiffs have alleged detailed facts demonstrating a strong inference of scienter (*see* Section VI), and Plaintiffs' allegations are based on loss accruals for contemporaneously known facts and the objective misapplication of data ***for then-current losses and liabilities***. *See, e.g.*, ¶¶5, 8, 11-16, 21, 23, 88-102, 104-113. Finally, Defendants' reliance on *Acito v. IMCERA Grp., Inc.* is inapposite because there the materially false statements at issue did not concern the company's reported and objectively false financial results, but instead concerned the likelihood that a series of regulatory investigations would yield additional investigations that the company would fail. *See* 47 F.3d 47, 53 (2d Cir. 1995).

2. Tower's Loss Reserve Misstatements Are Actionable Statements Of Fact

The Second Circuit has repeatedly held that loss reserves, as well as statements concerning compliance with GAAP are actionable statements of fact that do not require allegations of subjective falsity, particularly when there are allegations of objectively false financial information and standards, as there are here. *See In re OSG Sec. Litig.*, 971 F. Supp. 2d 387, 398 n.76 (S.D.N.Y. 2013) (statements about reserves were opinions only because plaintiff failed to allege objective standard pertaining to reserves); *SLM Corp.*, 740 F. Supp. 2d at 556 (loss reserves not calculated pursuant to GAAP were actionable false statements); *In re Dynex Capital, Inc. Sec. Litig.*, 2009 WL 3380621, at *10 (S.D.N.Y. Oct. 19, 2009) (statements concerning adequacy of loss reserves were actionable).

In *Freudenberg*, for example, the court held that plaintiffs had satisfied the falsity element where defendants' financial statements were materially inaccurate because the company overstated its net income and earnings. *See Freudenberg*, 712 F. Supp. 2d at 178. There, the court found that such misstatements were not "projections of future performance," but misrepresentations of then-existing facts. *Id*. As discussed herein, as in *Freudenberg,* Tower's loss reserves were objectively false. *See, e.g.* ¶¶5, 8, 11-16, 21, 23, 88-102, 104-113, 285.

Because Tower's loss reserves were misstated due to a blatant failure to check objective facts—not a failure to make good judgments—the Complaint adequately alleges that the Company's financial results are actionable statements of fact under Section 10(b). *See Shapiro v. UJB Fin. Corp.*, 964 F.2d 272, 281 (3d Cir. 1992) ("There is nothing unique about representations and omissions regarding loan loss reserves that removes them from the purview of the antifraud provisions of the federal securities laws"); *In re Wilmington Trust Sec. Litig.*, 2014 WL 1151988, at *13 (D. Del. March 20, 2014) ("[c]ontrary to the plaintiff in *Fait*, which did not point to an objective standard for setting loan loss reserves…Plaintiffs' allegations suffice to allege that [Wilmington Trust] was inconsistently and arbitrarily applying the standards it claimed to use to calculate its loan reserve.") (distinguishing *Fait v. Regions Fin. Corp.*, 655 F.3d 105, 113 (2d Cir. 2011) (providing that an objective standard for setting loss reserves renders them actionable).[7]

Relying on *Delta Holdings*, Defendants argue that Tower's loss reserves are statements of opinion and actionable only if Plaintiffs allege that Defendants had "actual knowledge" of the reserves' falsity. Def. Br. at 14-20 (citing *Delta Holdings*, 945 F. 2d 1226 (2d Cir. 1991)).

[7] Defendants' prior reliance on *Fait v. Regions Fin. Corp*., 655 F.3d 105 (2d Cir. 2010) has been abandoned, apparently in view of the reality that the statements at issue here are not within the definition of opinion as set forth by the Second Circuit in that case and its progeny. *Cf.* Ltr. To Judge Torres, at 4, Oct. 3, 2014 (Dkt. No. 89).

However, *Delta Holdings* never refers to loss reserves as "opinions." First, Delta did not concern objective errors that led to materially false statements in annual and quarterly SEC filings. Second, the court's discussion of loss reserves is merely dicta within a discussion of reserve methodologies in the reinsurance industry. *Delta Holdings*, 945 F.2d at 1228-29. Finally, the holding was based on the question of whether the company's failure to share a report concerning the company's reserves with its potential purchasers was a material omission, a purportedly false statement that is entirely distinct from those presented here. *Id*. at 1246.

Additionally, Defendants' reliance on *Delta Holdings* for the proposition that loss reserves are speculative similarly fails because setting loss reserves for a reinsurer, as was the case in *Delta Holdings*, is inherently less precise as reinsurance involves estimations where access to claims data is secondary and diffuse, adding a level of complexity (and uncertainty) to the determination of reinsurance reserves that did not exist for Tower. *See* Harrod Decl., Ex. B (AICPA Accounting and Auditing Guide, Ch. 6, Reinsurance § 6.30).

Further, *Delta Holdings* is substantively and procedurally distinct from this case. That decision was an appellate review of a judgment from a bench trial after the development of a complete factual record. 945 F. 2d at 1228. Defendants also fail to mention that *Delta Holdings* was not a securities fraud class action but a private direct action "arising out of a commercial transaction" in which the plaintiff alleged that the defendant, who was the previous owner of a small reinsurance company, withheld an actuarial report that found a reserve deficiency of $20 million from the plaintiff-purchasers. *Id.*; *see also Delta Holdings, Inc. v. Nat'l Distillers & Chem. Corp.*, 1988 WL 36330, at *1 (S.D.N.Y. Apr. 11, 1988).

3. Defendants' Loss Reserve Disclosures Were Not Forward Looking And Defendants Cannot Hide Behind The Bespeaks Caution Doctrine

While the Tower Defendants argue that the Company's misstated loss reserves are "forward-looking" and subject to the protection of the bespeaks caution doctrine (Def. Br. at 48), financial statement line items such as loss reserves are neither forward looking nor protected by the safe harbor. *See* 15 U.S.C.A. § 78u-5(b)(2)(A) (statements included in a financial statement prepared in accordance with GAAP are excluded from safe harbor protection); *see Slayton v. Am. Express Co.*, 604 F.3d 758, 767 (2d Cir. 2010) (representations made in SEC filings are not protected by PSLRA safe harbor because such statements lay out the company's income, balance sheets and cash flows). Moreover, courts in this District routinely hold that loss reserves are objective facts reflecting the present economic state of the company and thus are not forward-looking statements protected by the bespeaks caution doctrine. *See In re MF Global Holdings Ltd. Sec. Litig.*, 982 F. Supp. 2d 277, 304 (S.D.N.Y. 2013) (the bespeaks caution doctrine does not protect statements concerning present or historical facts); *SLM Corp.*, 740 F. Supp. 2d at 556 ("loss reserves are not projections"); *Freudenberg*, 712 F. Supp. 2d at 194 (same). Accordingly, Defendants' misstatements concerning the Company's loss reserves are not protected by the bespeaks caution doctrine.[8]

[8] Defendants cite ***only*** out-of-circuit cases for the proposition that Tower's loss reserve statements are forward looking. Def. Br. at 48. Moreover, one of Defendants' cases, *In re Kindred Healthcare, Inc. Sec. Litig.*, supports Plaintiffs' position, as the court there determined that the "hard facts"—those that reflected the actual amounts reserved for future claims—as here, was precisely the type of information that is "historical," "objectively verifiable." 299 F. Supp. 2d 724, 733 (W.D. Ky. 2004). Additionally, *Hess v. Am. Physicians Capital, Inc.*, is inapposite because there the statements at issue were not the actual financial results, including loss reserves, but qualitative statements concerning the ***future*** adequacy of the company's reserves. *See* 2005 WL 459638, at *6 (W.D. Mich. Jan. 11, 2005).

Defendants are wrong that the supposed cautionary language was sufficient to warn investors of Tower's loss reserve fraud. The law is clear that generalized cautionary language, such as Tower's disclosures that its IBNR reserves are "inherently less susceptible to accurate actuarial estimation," that setting loss reserves is a purportedly "uncertain process," and that the Company could give investors "no assurances," does not bar a securities claim. *See Slayton*, 604 F.3d at 772 (cautionary language that is misleading in light of historical fact cannot be meaningful); *Rombach v. Chang*, 355 F.3d 164, 173 (2d Cir. 2004) (statements protected only "[i]f it cannot be said that any reasonable investor could consider them important in light of adequate cautionary language"); s*ee also Halperin v. eBanker USA.com*, 295 F.3d 352, 357 (2d Cir. 2002) (cautionary language is insufficient if it fails to expressly warn of or does not directly relate to the risk that caused plaintiff's loss).

Significantly, Tower's cautionary language failed to warn investors of its systemic data problems and the risks associated with its materially weak internal controls. *See MF Global*, 982 F. Supp. 2d at 315 (cautionary language referring to general risks that might affect the company's financial performance insufficient); *City of Pontiac Gen. Emps.' Ret. Sys. v. Lockheed Martin Corp.,* 875 F. Supp. 2d 359, 365 (S.D.N.Y. 2012) (cautionary language insufficient where it did not "speak[] to the substantive information that plaintiff alleges the defendants misrepresented").

Defendants' reliance on *Coronel v. Quanta Capital Holdings*, 2009 WL 174656, at *17 (S.D.N.Y, Jan. 26, 2009) also fails for at least two reasons. As discussed above, loss reserves are not forward looking. Moreover, the cautionary language in *Quanta* concerning loss estimates from Hurricanes Katrina and Rita is distinguishable because it discussed the unprecedented and unpredictable nature of natural catastrophes and the difficulty of receiving timely loss data resulting therefrom. Here, Tower's difficulty in integrating loss data in order to accurately set its loss reserves was its own doing. *See, e.g.*, ¶¶5, 8, 11-16, 21, 23, 88-102, 104-113. Moreover, setting the loss reserves for Tower's Commercial Insurance business, which represented the Company's core operation, is subject to significantly more predicable historical data than the natural disasters in *Quanta*.

The cases Defendants cite for the proposition that their cautionary language is purportedly sufficient are unavailing. *See Golesorkhi v. Green Mountain Coffee Roasters, Inc.*, 973 F. Supp. 2d 541, 554-55 (D. Vt. 2013) *aff'd*, 569 F. App'x 43 (2d Cir. 2014) (the alleged misstatements were specifically identified as "Forward-looking Information" and concerned revenue projections, not losses); *Iowa Pub. Employees' Ret. Sys. v. MF Global, Ltd.*, 620 F.3d 137, 144 (2d Cir. 2010) (the Second Circuit remanded the case on the grounds that defendants' purportedly cautionary language "communicate[d] present or historical facts as to the measures [of risk management] taken" [by the company]").

Additionally, even if Defendants' statements are considered forward looking, which they are not, such statements are still actionable because they were made with actual knowledge. *See* 15 U.S.C. §78u-5(c)(1)(B)(i); *P. Stolz Family P'ship L.P. v. Daum*, 355 F.3d 92, 97 (2d Cir. 2004) (no protection for statements known to be misleading when made); *SLM Corp.*, 740 F. Supp. 2d at 556 (where defendants "knew the statements regarding loan loss reserves were false when made … neither the bespeaks caution doctrine nor the PSLRA safe harbor provision apply"). As alleged in the Complaint and discussed in Section VI herein, the Tower Defendants made these false statements with knowledge of their falsity. *See also* ¶¶153-56, 169-90.

4. The Understatement Of Reserves And Restatement Are Material

Materiality is an issue for the trier of fact and has little bearing on the sufficiency of the pleadings. *See Basic Inc. v. Levinson*, 485 U.S. 224, 250 (1988) (materiality is inherently an intensely "fact-specific inquiry" that "depends on the significance the reasonable investor would place on the withheld or misrepresented information"); *In re The Warnaco Group Inc. Sec. Litig.,* 388 F. Supp. 2d 307, 313 (S.D.N.Y. 2005) (materiality is "generally inappropriate for determination at the pleading stage"). Accordingly, Defendants' argument that Tower's $533 million in reserve charges is immaterial is both incorrect and premature. *See* Def. Br. at 46.

Even if materiality were to be determined at the pleadings stage, Defendants' argument still fails. To begin with, it is hard to imagine a more material issue than an over half a billion dollar reserve deficiency. *See In re Kidder Peabody Sec. Litig.*, 10 F. Supp. 2d 398, 410 (S.D.N.Y. 1998) ("the Court is hard-pressed to find that misstatements of profits totaling over $338 million dollars are immaterial as a matter of law"). Indeed, even Defendants' convoluted argument that only $326.7 million of the reserve understatement is relevant here still compels a finding of materiality, particularly at the pleading stage. Def. Br. at 3, 46, 60.

Defendants also maintain that the $37 million Restatement was quantitatively immaterial, in the vein of a scienter argument, which misconstrues the law and the facts. Def. Br. at 60. Defendants are wrong because not only should the $37 million Restatement be viewed together with the $533 million reserve understatement, but because the Restatement is material as a matter of law. *See In re Atlas Air*, 324 F. Supp. 2d at 486 ("previously issued financial statements should be restated only to correct ***material accounting errors that existed at the time the statements were originally issued***."). Moreover, courts have found significantly lower misstated amounts to be material. *See New Orleans Empl. Ret. Sys. v. Celestica, Inc.*, 455 Fed.

Appx. 10, 15 (2d Cir. 2011) ($30 million write-off of inventory was material even though it was "miniscule in comparison to [the company's] global assets and annual revenues."); *Ganino v. Citizens Utilities Co.*, 228 F.3d 154, 166 (2d Cir. 2000) (plaintiffs alleged materiality for misstatements of $6.9 million and $10.1 million). The cases that Defendants cite to bolster their point regarding the immateriality of the Restatement fail to help them because those cases do not involve restatements. *See Freidus v. ING Groep N.V.*, 736 2d 816, 827-28 (S.D.N.Y. 2010) (defendants did not restate their financial results); *Hutchison v. Deutsche Bank Sec. Inc.*, 647 F.3d 479, 488 (2d Cir. 2011) (same).

Defendants also try to artificially diminish the magnitude of the $37 million Restatement. In that vein, Defendants compare the amount of Tower's restated loss reserves to the Company's previously filed-loss and loss adjustment expenses and total assets. Def. Br. at 61. Here, the dollar-for-dollar relationship between loss reserves and net income shows a clearly material effect. *See In re Westinghouse Sec. Litig.,* 90 F.3d 696, 715 & n. 15 (3d Cir. 1996) (comparing loss reserves, which for accounting purposes "most immediately" affects income, to total income for relevant period). Moreover, Tower's $37 million Restatement was clearly material when compared to Tower's total net income for 2009 through 2012. As the Company reported in its Form 10-K/A, filed with the SEC on November 26, 2013, Tower's net income for this four-year period was $203.2 million. The $37.4 million Restatement thus accounted for 18.2% of the Company's net income for 2009 through 2012 and 32.1% of the Company's net income for the years which Tower belatedly attributed the loss reserve increase, 2010 through 2012.

B. False Statements And Omissions Concerning The Effectiveness Of Tower's Internal Controls

During the Class Period, the Defendants' statements concerning the effectiveness of Tower's internal controls were materially false and misleading because Tower had ***no*** effective internal controls in place to prevent the fraudulent manipulation of the Company's financial statements which led to the $570 million reserve understatement. Defendants have ***admitted*** that the Company suffered from material weaknesses in its internal controls in connection with the Restatement. ¶¶102, 130, 153. Moreover, in its 2013 Form 10-K, the Company specifically admitted that, as of December 31, 2012, Tower suffered from ***six material weaknesses*** in its internal controls. ¶¶86, 153. Defendants notably do not challenge that they misrepresented the effectiveness of Tower's internal controls, conceding that Plaintiffs have properly established the falsity of the internal control statements identified with particularity in the Complaint.

Tower's admitted internal control failures are a critical aspect of the fraud. Despite the glaring deficiencies within Tower's internal controls throughout the Class Period, Defendants Lee and Hitselberger certified that they "ensure[d] that material information relating to the Company … is made known to us by others within the Company." ¶254. The Officer Defendants were "responsible for establishing and maintain[ing] disclosure controls and procedures," and for having "evaluated the effectiveness of the Company's disclosure controls and procedures." *Id*.

C. False Statements And Omissions Concerning Tower's Loss Reserve Methodology And Conservatism

1. Defendants' Statements Concerning Their Loss Reserving Practices Were Materially False And Misleading

As described above, during the Class Period, Tower's loss reserves were dramatically understated due to, *inter alia*, Defendants' misapplication of premium and loss data, Company-wide pressure to intentionally understate Tower's loss reserves, and internal control weaknesses. *See* Section II; ¶¶5, 8, 11-16, 21, 23, 88-102, 104-113. In its annual and quarterly filings with the SEC during the Class Period, Tower certified that it accounted for loss reserves in accordance with GAAP, that it established loss reserves "prudently after considering all information known to us as of the date of the[] [reserves] are recorded," and that the Company's reserves were "carefully monitor[ed] … by line of business to ensure that they are adequate." ¶¶70, 203. The Complaint also alleges that, in setting its loss reserves, Tower conducted an "in-depth, independent actuarial analysis" and that the Company had undergone a "comprehensive review of [its] reserves" in order to establish accurate loss reserves. ¶¶206, 224, 232. Throughout the Class Period, Defendants repeatedly touted their reserving policy as "conservative," "prudent" and "cautious" (¶¶17, 69-73, 90, 203, 207-08, 215-16, 220-21, 224-25, 230, 243), routinely stated that Tower had not undergone any "adverse reserve development" (¶¶72, 220), and that Tower's reserves were "truly reflective of accident year results." *Id*.

In reality, and contrary to Defendants' arguments (Def. Br. at 45-47), Defendants did not adhere to Tower's stated methodology for setting reserves. ***First***, the Complaint alleges that Tower's statements were false because contrary to that methodology, Defendants established a company-wide culture of pressuring employees to intentionally under-reserve for projected losses, as confirmed by CW1, CW7, CW10. ¶¶99-108. *See In re Gentiva Sec. Litig.*, 932 F. Supp. 2d 352, 359 (E.D.N.Y. 2013) (actionable false statements found in connection with top executives' pressuring lower level employees); *Freudenberg*, 712 F. Supp. 2d at 197 (corporate culture of increasing loan volume in derogation of underwriting standards).

Second, the falsity of Tower's statements concerning its methodology for setting loss reserves is confirmed by the admitted misapplication of claims and loss reserves by the wrong lines of business throughout the Class Period. ¶¶11, 86, 102. Further, the Complaint alleges that Tower (i) failed to properly integrate data from the companies it acquired into a coherent company-wide system to accurately determine IBNR and report loss reserves and accordingly was unable to properly track insurance claims by lines of business (¶¶17, 77, 86, 88-90); (ii) had a history of failing to properly account for is claims and premiums and failed to disclose that this was an "ongoing problem" (¶¶11, 13, 88-103, 178); (iii) had inconsistent and outdated basic actuarial recordkeeping (¶¶91, 95, 103); and (iv) used two different systems to separately account for loss reserves and premiums on related lines of business. f¶¶14, 102.

The above allegations establish the falsity of Defendants' statements in connection with a company's purported methodology for setting loss reserves. *See Freudenberg*, 712 F. Supp. 2d at 188 (defendants' representation that loss allowance was based on "careful monitoring" of its loan portfolio was actionable); *In re IMAX Sec. Litig.*, 587 F. Supp. 2d 471, 482 (S.D.N.Y. 2008) (misapplication of accounting policy resulted in actionable false statements); *In re Oxford Health Plans, Inc.*, 187 F.R.D. 133, 139 (S.D.N.Y. 1999) (complaint sustained where defendants used "inherently unreliable" data in formulating financial statements).

2. Defendants' Misrepresentations Were Not "Puffery"

Throughout the Class Period, the Tower Defendants made numerous statements regarding the Company's "conservative" and "prudent" approach to setting loss reserves. *See e.g.* ¶¶1, 17, 70-73, 90, 173, 205, 207. Such statements are actionable because they were empirically verifiable and are directed at the Company's then-existing financial condition, internal controls and processes. As discussed above, Tower's loss reserve process was beset by an intentional understatement of reserves and multiple controls problems. Such methodology could not be "conservative." *See City of Sterling Heights Police & Fire Ret. Sys. v. Abbey Nat., PLC*, 423 F. Supp. 2d 348, 360 (S.D.N.Y. 2006) (company's statements about its "very conservative" and "thorough" review of its portfolio and representations that its business was "sound" were all actionable); *In re Computer Assoc. Class Action Sec. Litig.,* 75 F. Supp. 2d 68, 71 (E.D.N.Y. 1999) (statements where defendant misrepresented itself as a "booming company" experiencing "rapidly rising sales and profits" found actionable).

Moreover, Tower's statements concerning its purportedly "conservative," "prudent," "careful" and "adequate" practice of setting loss reserves are actionable because the setting of loss reserves for an insurance company is the most fundamental aspect of the company's survival and growth. ¶¶9, 59-68; *see In re Moody's Corp. Sec. Litig.*, 599 F. Supp. 2d 493, 507-08 (S.D.N.Y. 2009) (statement that Moody's was an independent entity that issued ratings accurately and impartially was not puffery because independence was a cornerstone of Moody's business); *Lapin v. Goldman Sachs Group,* 506 F. Supp. 2d 221, 239 (S.D.N.Y. 2006) (statement that "integrity and honesty are at the heart of our business" held actionable).

The Tower Defendants incorrectly contend that their statements about the Company's loss reserve methodologies were immaterial puffery. Def. Br. at 50. Not so. These misstatements fall squarely within Second Circuit law holding that misrepresentations concerning a company's risk management discipline and credit quality constitute actionable misstatements. *See Novak,* 216 F.3d at 315 (statements that company's inventory situation was "in good shape" or "under control" were actionable because they were misrepresentations of existing, objective facts rather than unreliable statements of corporate optimism). The Tower Defendants' statements, including that the company "[c]arefully monitor[ed] [its reserves] … by segment and line of business," "our loss ratio is well below the industry average," and that the Company conducted both a "comprehensive review of our reserves" and an "in-depth, independent actuarial analysis" are all actionable because they constitute material, objective misrepresentations about then-existing facts. *See Freudenberg*, 712 F. Supp. 2d at 189 (defendants' statements such as "[w]e are seeing significant organic growth in cash, assets and credit," were actionable misrepresentations of then-existing facts because the vast majority of defendants' loans were purchased from questionable outside lenders).[9]

The cases Defendants cite for this point are inapposite and concern overly general statements about a company's prospects that deal primarily with general statements of hope or optimism, and not an objective fact or concerned a methodology core to the issuer's business. *See* Def. Br. at 50-53. Finally, Defendants' argument that these statements are inactionable opinions (Def Br. at 53 n.22) also fails because the statements concern objective, historical facts, and even if they did not, Lead Plaintiffs have adequately pled that they were made with actual knowledge of falsity. *See* ¶¶104-13; 169-90; Section VI, *supra*.

V. THE CLASS PERIOD SHOULD NOT BE ALTERED

Defendants make two unavailing attempts to reduce the temporal scope of Plaintiffs' claims. First, they claim that any misstatement before March 4, 2013 should be barred. Def. Br. at 63-64. Second, Defendants claim that any alleged misstatements that post-dates a purchase by a named plaintiff must be dismissed. *Id.* Neither argument bears scrutiny.

A. Statements Before March 3, 2013

In an attempt to cut away three years of misstatements, Defendants conveniently ignore that both the Restatement and Tower's $533 million belated loss reserve increases affected statements Defendants between March 2010 and March 2013. First, the Restatement impacted

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[9] Defendants' attempt to distinguish *Freudenberg* by relying on *City of Pontiac Policemen's & Firemen's Ret. Sys. v. UBS AG* is without merit because that case's holding concerning puffery was based on the "explicitly aspirational" statements on which an investor would not rely (none of which concerned loss reserves), and, as stated herein, statements concerning loss reserves, because they are inextricably tied to earnings, are specifically the type of representations that an investor would rely on. *See* 752 F.3d 173, 183 (2d Cir. 2014). Defendants' reliance on *In re Wachovia Equity Sec. Litig.* fails for the same reason. *See* 753 F. Supp. 2d 326, 354 (S.D.N.Y. 2011) (bank's statements were immaterial); *see also Kidder Peabody*, 10 F. Supp. 2d at 410 (materiality alleged because reports of earnings likely to aid in predicting future earnings).

the 2009 financial statements, which were issued on the first day of the Class Period. ¶¶5, 22, 128. Second, the tremendous $533 million belated reserves relate to accident years from 2008 through 2012, and should have been accrued beginning no later than fiscal year 2009. ¶202. Thus, statements dating back to the beginning of the Class Period in March 2010 are clearly implicated by both the Restatement and the $533 million reserve increases.

B. Post-Purchase Statements

Defendants next argue that Lead Plaintiffs are barred from pursuing claims based on any alleged misrepresentations or omissions that post-date any of Lead Plaintiffs' purchases of Tower stock. Def. Br. at 64. This argument is both entirely contrary to the law and premature.

Plaintiffs have standing to allege claims based on all inter-related misstatements in a complaint when they purchased stock at any point during the Class Period. *See In re Vivendi Universal, S.A.,* 242 F.R.D. 76, 87 (S.D.N.Y. 2007) ("it is well established that where, as here, plaintiffs allege that their losses were the result of a sustained course of conduct that propped up defendant's stock price throughout the class period, the class may be represented by an individual who purchased his shares prior to the close of the class period"); *Nicholas v. Poughkeepsie Sav. Bank/FSB*, 1990 WL 145154, at *5 (S.D.N.Y. Sept. 27, 1990) ("[w]hether plaintiff and other class members bought early in the Class Period or late, they are all alleged to have been injured by the inter-related misstatements and omissions" and noting that defendants' argument "implies that only someone who bought on the last day of a Class Period would be able to bring an action"); *Robbins v. Moore Med. Corp.*, 788 F. Supp. 179, 187 (S.D.N.Y. 1992) (same). Defendant's argument relies entirely on *Kelly v. Elec. Arts, Inc.*, 2014 WL 5361641, at *7 (N.D. Cal. Oct. 20, 2014), an outlier, out-of-circuit case that has not been followed by any case in the Ninth Circuit or in this Circuit and is in conflict with Second Circuit authority. *See e.g.*, *Vivendi*, 242 F.R.D. at 87.

Moreover, Defendants' argument is premature (at best) because it speaks to the adequacy of class representatives, which is a question only appropriate at class certification. *See In re Vivendi Universal, S.A.*, 242 F.R.D. 76, 87 (S.D.N.Y. 2007) (determining adequacy and typicality of class representatives at class certification in part based on damages sustained by defendants' conduct); *In re Oxford Health Plans, Inc. Sec. Litig.*, 199 F.R.D. 119, 123 (S.D.N.Y. 2001) (same).

VI. THE COMPLAINT RAISES A STRONG INFERENCE OF SCIENTER

"Scienter can be alleged in two ways: by pleading facts that evidence conscious misbehavior or recklessness or by pleading facts that evidence defendant's motive and opportunity to commit fraud." *In re EVCI Colls. Holding Corp. Sec. Litig.*, 469 F. Supp. 2d 88, 99 (S.D.N.Y. 2006). Scienter can also be established through the "core operations" doctrine. *See, e.g.*, *In re Hi-Crush Partners L.P. Sec. Litig.*, 2013 WL 6233561, at *26 (S.D.N.Y. Dec. 2, 2013).

The question 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." *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 322-33 (2007). The inference of scienter "need not be irrefutable, *i.e.*, of the 'smoking gun' genre, or even the most plausible of competing inferences." *Id*. at 324. Instead, an inference of scienter is "strong" when it is as likely as any other inference. *Id.*; *see also Akerman v. Arotech Corp*., 608 F. Supp. 2d 372, 382 (E.D.N.Y. 2009) ("When the competing inferences rest in equipoise, the 'tie . . . goes to the plaintiff.'"). "The inference that the defendant acted with scienter need not be irrefutable." *Tellabs*, 551 U.S. at 324 (citation omitted). "'[M]ost often, allegations about a defendant's culpable state of mind must be drawn from limited state of mind evidence augmented by circumstantial facts and logical inferences.'" *Carlson v. Xerox Corp.*, 392 F. Supp. 2d 267, 287 (D. Conn. 2005) (citation omitted).

At the outset, Defendants' arguments challenging scienter suffer from the same fatal errors as their falsity arguments in that they ask this Court to artificially segregate Defendants' scienter with respect to the $533 million loss reserve increases (which they incorrectly characterize as $326.7 million) from the $37 million Restatement. Such artificial segregation ignores the well-pled allegations in the Complaint, which demonstrate that the Restatement and reserve strengthening stemmed from the same fundamental problems with Tower's reserving process. In addition, Defendants' isolation of certain scienter arguments is, in any event, contrary to the Supreme Court's directive to consider whether all of the facts alleged "give rise to a strong inference of scienter" when "taken collectively." *Tellabs*, 551 U.S. at 322.

A. Defendants Knew Or Recklessly Disregarded Critical Facts Undermining Their Public Statements

As discussed above, Tower's misstatement of its loss reserves was not the result of miscalculated estimates or matters of judgment or opinion. Rather, Tower's financial statements, including its loss reserves, were ***objectively false*** due to the knowing use of incorrect data that formed the core input of those reserves and Defendants' intentional suppression of loss reserves. Thus, Defendants' claim that Plaintiffs must plead actual knowledge is based on a false premise—that the reported loss reserves were "opinions." Def. Br. at 14-20, 53 n.22.

Because Tower's loss reserve statements were not opinions, scienter is adequately pled by showing that Defendants acted recklessly. "Sufficient evidence of recklessness exists if the factual allegations demonstrate that defendants (1) possessed knowledge of facts or access to information contradicting their public statements, or (2) 'failed to review or check information that they had a duty to monitor, or ignored obvious signs of fraud.'" *Van Dongen v. CNinsure*

Inc., 951 F. Supp. 2d 457, 469 (S.D.N.Y. 2013). Indeed, the Second Circuit has made clear that allegations that defendants "failed to check information that they had a duty to monitor" supports a strong inference of scienter. *See Novak*, 216 F.3d at 201. After their repeated representations about reserves, the Officer Defendants cannot now claim they were ignorant of the extensive problems with Tower's loss reserve methodology.

Defendants' reckless or knowing fraud is compellingly demonstrated by multiple facts alleged in the Complaint and discussed below, including (i) the magnitude of Tower's $570 million financial misstatement (¶¶84,173, 205); (ii) Tower's culture of fear and Defendant Lee's bullying employees to understate loss reserves (¶¶5, 103, 107-08, 174); (iii) the failed acquisition of Global Indemnity (¶¶112, 173); (iv) Defendants' decision to reduce Tower's exposure to the lines of business that caused its loss reserves to be understated (¶177); (v) the contrast between Tower's wholly inadequate internal controls and the Officer Defendants' detailed statements, attestations and obligations under Sarbanes-Oxley that they were effective (¶170); (vi) Tower's rapid expansion through acquisition (¶¶54-58); (vii) Tower employees informing Defendant Lee that the Company needed more robust ways to organize data (¶92); (viii) investigations by the SEC and California insurance regulators (¶101); (ix) pressure from the Company's independent auditor, Defendant PWC (¶173); and (x) Defendant Lee's resignation and the termination of PWC as the Company's external auditor in early 2014.

Considering these allegations collectively, and in the light most favorable to Plaintiffs, the Complaint supports a strong inference that Defendants knew or recklessly disregarded the falsity of their statements and omissions. This inference is "at least as compelling as any opposing" non-culpable inference drawn from the facts alleged. *Tellabs*, 551 U.S. at 324;

Carpenters Pension Trust Fund of St. Louis v. Barclays PLC, 2014 WL 5334053, at *3 (S.D.N.Y. Oct. 20, 2014).

First, throughout the Class Period, Defendants knowingly, or at a minimum, recklessly, undertook a scheme to substantially inflate Tower's net income and earnings per share by $570 million by misapplying Tower's claims and loss reserves to the wrong line of business (¶¶88-103) and intentionally understating loss reserves. ¶¶104-13. Indeed, the magnitude of the misstated reserves, the correction of which amounted to an increase by nearly ***one third of the Company's total reserves***, clearly establishes a strong inference of scienter. *See In re Scholastic Corp. Sec. Litig.*, 252 F.3d 63, 77 (2d Cir. 2001) (a $24 million write-down supported an inference of scienter); *Rothman v. Gregor*, 220 F. 3d 81, 92 (2d Cir. 2000) (magnitude of write-off, combined with other factors, discredits inference suggested by defendants); *IMAX*, 587 F. Supp. 2d at 482 (misapplication of revenue accounting policy resulting in restated financials supports finding of scienter); *Scottish Re*, 524 F. Supp. 2d at 394 (restatement that wiped out an entire year's earnings supports a finding of scienter); *Atlas Air*, 324 F. Supp. 2d at 488-89 ("When a company is forced to restate its previously issued financial statements, the mere fact that the company had to make a large correction is some evidence of scienter.").

In response, Defendants argue that the magnitude of Tower's massive loss reserve misstatement was insufficient to raise an inference of scienter by improperly bifurcating the $37 million Restatement from the $533 million reserve increase, and then ignoring nearly half of the belated loss reserve increase. Def. Br. at 16-17, 57-62. As addressed above, Defendants' attempts to ignore the true breadth of Tower's reserve increases cannot be countenanced. *See* Section IV.A.1.

Nor do the cases cited by Defendants support their position that the magnitude of the fraud cannot establish scienter. Def. Br. at 16-17, 60-62. For example, in *Special Situations Fund III QP, L.P. v. Deloitte Touche Tohmatsu CPA, LTD.* (Def. Br. at 17), the court found that an auditor's scienter was not established by the magnitude of the fraud because the audited company's CEO actively concealed the massive fraud. *See id.,* 33 F. Supp. 3d 401, 432 (S.D.N.Y. 2014). Here, the fraudulent acts were well-known and easily detectable. *See also MHC Mut. Conversion Fund, L.P. v. Sandler O'Neill & Partners*, 761 F.3d 1109, 1114 (10th Cir. 2014) (making no findings concerning magnitude and noting that, aside from defendants' estimated impairment being wrong, "[t]he plaintiffs do not include any plausible allegations in their complaint suggesting that the defendants' expressed opinion wasn't their true opinion"); *In re PXRE Grp., Ltd., Sec. Litig*., 600 F. Supp. 2d 510, 545 (S.D.N.Y. 2009) (the "size of the fraud" is "certainly a relevant factor" in demonstrating scienter).

Defendants' citation to *Delta Holdings* on this point is particularly misguided. Def. Br. at 18. ***First***, contrary to Defendants' statement, the *Delta Holdings* Court did not "reject[] falsity and scienter as a matter of law." Indeed, *Delta Holdings* was the result of a heavily fact-intensive bench trial over the ill-fated acquisition of a reinsurance company negotiated between two sophisticated and arms'-length parties. *See* 945 F. 2d at 1240. And while the calculation of loss reserves was not the focus of the case, the Second Circuit noted that Defendants' failure to reveal an IBNR loss reserve of $11 million—and not $108 million as Defendants state after cherry-picking a sentence from the opinion—was not material and did not create an inference of scienter because the plaintiff acquiring the company was told of the loss and had access to the seller's books. *Id.* at 1244-45.

Second, by establishing a corporate culture of intimidation and intentionally browbeating employees to reduce reserves, Defendant Lee knew that Tower's loss reserves would be deficient. ¶¶104-13, 171, 174. The reserves that the actuaries and other staff determined were appropriate were constantly manipulated at the behest of Defendant Lee—who controlled all decisions and was viewed as "God" by employees. ¶¶104-13. As first-hand accounts by CWs 1, 7, 9 and 10 confirm, Defendant Lee consistently bullied Tower's actuaries when loss reserves were higher than he wanted them to be and directed employees to set reserves at insufficient levels. *Id.* These allegations plainly raise a strong inference of scienter. *See In re Gentiva Sec. Litig.*, 932 F. Supp. 2d 352, 377 (E.D.N.Y. 2013) ("Plaintiffs' numerous confidential witnesses [may] support a strong inference of a Company-wide culture") (*citing In re Countrywide Fin. Corp. Deriv. Litig.*, 554 F. Supp. 2d 1044, 1058 (C.D. Cal. 2008)); *Freudenberg*, 712 F. Supp. 2d at 197 (same); *In re Moody's Corp. Sec. Litig.*, 599 F. Supp. 2d 493, 508, 516 (S.D.N.Y. 2009) (same). In sum, Defendant Lee's conduct cannot be explained as anything but intentional and related directly to the heart of this action—loss reserves.

In response, Defendants paint Lee as merely an "intimidating" presence and point to two non-binding, out-of-circuit cases that do not address the facts presented here, that of a CEO's practice of bullying and pressuring employees to falsely report key financial metrics. Def. Br. at 21-22. Defendants' comparison of Lee's bullying to that purportedly of Steve Jobs or Thomas Edison (Def. Br. at 21-22) is obvious hyperbole and has no import.

Third, a strong inference of scienter is raised from Defendants' knowledge, no later than the second half of 2012, that Tower's loss reserves were inadequate when the proposed purchase of Global Indemnity (with Tower stock) fell through as a result of Global Indemnity's discovery that Tower was under-reserved by approximately $150 million. ¶¶112, 172. This failed transaction put Defendants on notice that Tower's reserves were inadequate. *Id.* Defendants' attempt to negate the impact of the Global Indemnity valuation and the conclusion that Tower was under-reserved by questioning Global Indemnity's motive for raising issues with Tower's loss reserves during the course of negotiations. Def. Br. at 23-25. Defendants' argument is a red herring. Particular allegations about an earlier deal that fell through because of understated reserves are damning and could not be more relevant. Defendants' speculation about Global Indemnity's motivations are just that--speculation.

The inference Defendants draw from these facts—that it is a mere coincidence that Global Indemnity found Tower under-reserved by $150 million when the Company later admitted it was under-reserved by over $500 million is preposterous. At the very least, it is not the most compelling inference to be drawn from Plaintiffs' well-pled allegations. Indeed, Defendants cite one case that concerns an investigation undertaken by plaintiffs in preparation of the complaint, not a contemporaneous analysis undertaken by a third-party in the context of a business transaction as was done by Global Indemnity. *See IKB Intern. S.A. v. Bank of Am. Corp*, 584 Fed. Appx. 26, *3 (2d Cir. 2014). The remainder of Defendants' cases addressing the inherent biases of short sellers, analysts and legal adversaries have no bearing here. Def. Br. at 24.

Fourth, throughout the Class Period, Tower and the Officer Defendants spoke to investors about the risk of losses related to its "long-tail" commercial lines of business. Indeed, while Defendants explicitly stated that they were aware of the risks from these business lines, Defendants disclosed that they had reduced such business to 3% of new premiums by 2012. ¶135. Despite knowing of the risks associated with this business and touting their reduction of exposure to it, Defendants failed to establish necessary reserves on the policies that they had already written. ¶¶11, 14, 100. This evidences a strong inference of knowledge. *See Credit Suisse First Boston Corp. v. ARM Fin. Grp., Inc.*, 2001 WL 300733, at *8 (S.D.N.Y. March 28, 2001) ("warnings of specific risks…do not shelter defendants from liability if they fail to disclose hard facts critical to appreciating the magnitude of the risks described").

Contrary to Defendants' contention, their statements that they were reducing revenue from certain business lines are not curative disclosures that revealed their chronic loss reserve understatement. Def. Br. at 23. Defendants' citations to *Plumbers & Pipefitters Local Union No. 719 Pension Trust Fund v. Conseco Inc.*, 2011 WL 1198712, at *22 (S.D.N.Y. Mar. 30, 2011) and *City of Pontiac Policemen's and Firemen's Ret. Sys. v. UBS AG*, 752 F.3d 173, 186 (2d Cir. 2014) have no bearing here. Unlike this case, where Defendants' loss reserve misstatements concealed the Company's true financial position, in *Conseco*, defendants made numerous and "extensive" disclosures of "negative information" regarding the problems facing a particular line of business and the difficulty in calculating reserves for that business throughout the class period, which weakened the inference of materiality and scienter. *Conseco*, 2011 WL 1198712, at **12, 20. Here Defendants did the opposite—they led investors to believe they had accounted for and reduced the risks. *City of Pontiac* is also entirely inapposite. There, the Court found that plaintiff had not alleged that defendant company's representations regarding asset concentrations and risk diversification of RMBS ownership were materially misleading because defendants made specific disclosures to investors concerning the extent of its RMBS ownership. 752 F.3d at 186. Here, there is no such direct correlation between reducing exposure to a line of business and materially understating the risk of loss or current exposure to that line of business.

Fifth, Defendants Lee and Hitselberger made detailed statements concerning the adequacy of the Company's loss reserves and the "conservative" methodology that Tower purportedly employed to determine its loss reserves, which they represented were based on their personal knowledge. Further, Tower's SEC filings stated that the Company's loss reserves were determined using an "actuarial analysis of claims experience by product and segment, and relevant insurance industry information such as loss settlement patterns for the type of business being reserved." ¶63. In other words, Tower stated that it determined loss reserves by utilizing "loss settlement patterns for the type of business being reserved"—exactly what Tower admitted in the Restatement that it failed to do. Defendants should not be allowed to make specific representations about the Company's reserve methodology and then claim to have no "knowledge" of what was really going on.

Where Defendants held themselves out as knowledgeable regarding Tower's loss reserving practices and controls they are deemed to have knowledge of related problems. Indeed, on every conference call and in every single SEC filing during the Class Period, the Officer Defendants specifically discussed these topics in detail. ¶¶206-44. When, as here, "facts that contradict a high-level officer's public statements were available when the statements were made, it is reasonable to conclude that the speaker had intimate knowledge of those facts or should have known them." *Atlas Air*, 324 F. Supp. 2d at 489; *see also In re Gen. Elec. Co. Sec. Litig.*, 857 F. Supp. 2d at 396 ("highly improbable" that a defendant who gave public accounts of the defendant company's financial health did not inquire into the basis of his statements).

Defendants Lee and Hitselberger also signed SOX certifications in the Company's SEC filings attesting to the adequacy of Tower's internal controls and made repeated, detailed statements to analysts and investors about Tower's loss reserves and reserve processes. *E.g.*, ¶¶170, 192, 203-04, 213-17, 220-21, 224-26, 254-55. The Officer Defendants' affirmative statements about the adequacy of the Company's loss reserves and reserve methodology together with their SOX certifications support a strong inference of scienter because, as the Company later disclosed, material weaknesses existed in the Company's internal controls over its loss reserving process throughout the Class Period. ¶153. The internal control problems are exemplified by the existence of two separate systems that Tower used to separately account for loss reserves and premiums on related lines of business—making it virtually impossible to properly reconcile the two and accurately set reserves. ¶102. "Where the complaint alleges that defendants knew or had access to non-public information contradicting their public statements, recklessness is adequately pled for defendants who knew or should have known they were misrepresenting material facts with respect to the corporate business." *Scholastic*, 252 F.3d at 76; *see also S.E.C. v. Egan*, 994 F. Supp. 2d 558, 565 (S.D.N.Y. 2014); *In re Bear Stearns Cos., Inc. Sec. Deriv., and ERISA Litig.*, 763 F. Supp. 2d 423, 504 (S.D.N.Y. 2011) (same); *Hall*, 580 F. Supp. 2d at 228 (false SOX certifications combined with knowledge or "access to information" showing stock backdating raises sufficient scienter inference).

Defendants argue that scienter cannot be inferred from Lee and Hitselberger's "repeated, detailed statements about Tower's loss reserves and processes," SOX Certifications and signed SEC filings. Def. Br. at 22. They are wrong. First, as set forth below in Section VI.B. under the "core operations" doctrine, the CEO's and CFO's affirmative statements about loss reserves and methodology—which are at the core of Tower's operations and financial viability—***do*** create a strong and independent inference of scienter. Second, the cases cited by Defendants are not controlling because defendants in those cases did not have access to contemporaneous information that contradicted the Company's public statements, nor were they speaking about a "core operation." *See, e.g.*, *In re MBIA, Inc. Sec. Litig.*, 700 F. Supp. 2d 566, 590 (S.D.N.Y. 2010); *In re Marsh & McLennan Co. Sec. Litig.*, 501 F. Supp. 2d 452, 485 (S.D.N.Y. 2006).

Defendants also argue (in the context of the Restatement) that the internal control failures that led to Defendants' manipulation of Tower's claims and loss reserves cannot raise an inference of scienter. Def. Br. at 57-62. This argument fails. The misclassification of reserves was not "mismanagement" or a mere technical "data system problem" but rather was the result of Tower's objective and systematic failure to incorporate accurate data into its calculations, a fact well-known to Defendants and corroborated by CWs 1, 5, 6, 7, and 8. ¶¶88-103. Moreover, the Officer Defendants were required to and did attest to their personal knowledge of the Company's internal controls. In an attempt to quash the inference of scienter on the controls allegations, Defendants again mischaracterize *Delta Holdings*. Indeed, it is false to state that *Delta Holdings* "refused to infer scienter based on restatements by insurance companies resulting from internal control problems affecting IBNR reserves" as there is no mention of a "restatement" or "internal control" issues within the opinion. Def. Br. at 59. Further, the only mention of scienter in the entire opinion is the Court's conclusion that, following a full bench trial, every employee of the acquired reinsurance company "w[as] ignorant of the ramifications" of the accounting issues, including the president. *Delta Holdings*, 945 F.2d at 1245. That is not the case here.

Sixth, during 2009 and 2010, Tower undertook a rapid expansion of its business through a series of acquisitions. ¶¶54-56. Despite knowing that Tower's disparate data systems posed a serious risk to the Company's stability and the accuracy of its financial reporting, Defendants failed to ensure that the systems of each of the companies that it acquired were properly integrated into Tower's main system, as confirmed by multiple CWs and Tower's admitted internal control deficiencies. ¶¶92-100, 176. Defendants' willful failure to ensure integration supports a strong inference of scienter.

Seventh, as discussed in Section VI.E. below, multiple CWs informed Tower executives, including Defendant Lee personally, that because there were as many as eight different systems being used in the case reserve and IBNR actuarial process that Tower had severe problems ensuring that its reserves were properly determined. Despite this knowledge, Defendant Lee refused to consolidate such systems or rectify the problem.

Eighth, the Complaint also alleges multiple regulatory investigations concerning Tower's loss reserve practices, including investigations by the SEC and by the state of California into Tower's accounting for premiums associated with workers' compensation claims. ¶¶101, 161. At a minimum, the California investigation put Defendants on notice of Tower's issues with improperly classifying premiums by line of business, and the SEC's investigation corroborates the facts alleged regarding Tower's deficient loss reserving practices and inadequate internal controls. *See In re ITT Educational Services Sec. Litig*., 2014 WL 3611095, at *9 (S.D.N.Y. July 22, 2014) ("given the directive to consider *all* evidence of scienter…the Court will consider the pending investigations as evidence of scienter").

Defendants do not contest that the California investigation was focused on Tower's failure to properly code premiums but contend only that the investigation was resolved in late November 2012 and did not put them on notice. Def. Br. at 25. Contrary to Defendants' contention, the letter they submitted indicates that the regulator's oversight was continuing. Dugan Decl., Ex. 21. Indeed, the California regulatory entity specified that "for the next two years, Tower will continue to (a) arrange for [an insurance consultant] to provide a report to the [regulator] on a quarterly bases as to the accuracy of Tower's unit statistical submissions and (b) coordinate a quarterly meeting with [the regulator's] staff to discuss the [] report as well as other data reporting issues that must arise." *Id*. Defendants' cases do not address situations where an ongoing investigation by a regulator concerns the core misstatements in the case. *See* Def. Br. at 26.

Ninth, the Complaint details Tower's relationship with PWC and alleges that, as confirmed by the CWs, PWC explicitly warned Tower that it needed to take a reserve increase by early 2013. ¶¶173, 291-92. This indisputably put Tower on notice that it was required to increase its reserves earlier than it did and contributes to an inference of scienter. *See, e.g.*, *In re Am. Int'l Grp., Inc. 2008 Sec. Litig.*, 741 F. Supp. 2d 511, 533 (S.D.N.Y. 2010) (finding an inference of scienter where defendants' public statements of confidence were contradicted by its auditor's "warnings of a potential material weakness").

In response, Defendants ignore the Complaint's allegations that PWC warned Tower to "take a [significant] reserve increase [and charge] in the early part of 2013" (¶¶291-93), and argue that scienter cannot be inferred because "the allegations are silent as to amount and . . . time period." Def. Br. at 26-27. Defendants further argue that scienter is not supported because Plaintiffs' allegations that PWC was both complicit in, and concerned over, the fraud are somehow inconsistent and implausible. Def. Br. at 27-28. To the contrary, courts have found that an inference of scienter exists even when an auditor both raises red flags and furthers the fraud. *See Wilmington Trust*, 29 F. Supp. 3d at 449-50 (finding scienter on the part of auditor who was complicit in the fraud and who also later raised questions). Defendants yet again misuse *Delta Holdings* in support of this argument. Def. Br. at 27-28. *Delta Holdings* did not involve an independent audit or an auditor at all.

Finally, Defendant Lee's sudden resignation on February 6, 2014 is highly suspicious and contributes to a strong inference of scienter. ¶¶144, 179. *See Glaser v. The9, Ltd.*, 772 F. Supp. 2d 573, 598 (S.D.N.Y. 2011) ("highly unusual or suspicious" resignations "add to a pleading of circumstantial evidence of fraud"); *Hall*, 580 F. Supp. 2d at 233 (resignation of company's CEO supported inference of scienter); *Scottish Re*, 524 F. Supp. 2d at 394 n. 176 ("the resignations of [the defendants], although not sufficient in and of themselves, add to the overall pleading of circumstantial evidence of fraud"). In response, Defendants argue that the fact that Lee was paid to resign somehow negates scienter. Def. Br. at 28. Not so. This evidences the fact that the Company was desperate to rid itself of Lee.

B. The Core Operations Doctrine Supports An Independent Inference Of Scienter

The amount of Tower's loss reserves "are a critical, if not the most important, measure of [Tower's] financial health as they represent expected future losses that the company will be required to pay out for claims on the insurance policies it has issued and underwritten." ¶59. As an insurance company, Tower's loss reserving practices are highly material to investors and central to investors' assessments of the Company's financial health, as demonstrated by questions from analysts on every earnings conference call during the Class Period. *See, e.g.*, ¶¶59, 71-74, 90. Accurate information, coordinated data systems and adequate internal controls are essential to properly assess loss reserves. ¶60. Throughout the Class Period, Defendants repeatedly represented that Tower successfully integrated the data systems of its newly acquired companies with its own. ¶256. As the Company has admitted, this was far from true. Indeed, Tower's internal controls over a key part of its business, namely the reconciliation of loss reserves and premiums by the correct line of business, had such material weaknesses that Defendants must have known of the deficiencies. ¶¶86-87, 153.

As discussed above, Defendants materially misstated the Company's loss reserves by $570 million—or nearly ***one third of the Company's total reserves of $1.895 billion*** during the Class Period. Defendants also misstated the adequacy of the Company's internal controls.

Defendants do not and cannot dispute that the calculation and controls over Tower's loss reserves are a "core operation" of the Company.

Courts have held that "[t]o fulfill the scienter pleading requirement, a plaintiff may rely on the 'core operations doctrine,' which permits an inference that a company and its senior executives have knowledge of information concerning the 'core operations' of a business." *Hi-Crush*, 2013 WL 6233561, at *26. "Core operations include matters 'critical to the long term viability' of the company." *Id.*, at *26 (citations omitted). As Tower's most senior officers who signed its SEC filings, *see, e.g.*, ¶¶ 45-47, Lee and Hitselberger had an affirmative "'duty to familiarize themselves with the facts relevant to the core operations"' of Tower. *See In re Alstom SA Sec. Litig.,* 406 F. Supp. 2d 433, 459 (S.D.N.Y. 2005) (citation omitted).

Atlas Air is instructive. The false statements in *Atlas Air* concerned the Company's failure to take a timely impairment charge to reflect the decreased value of its assets that led to an ultimate restatement. 324 F. Supp. 2d at 489. The Court specifically found that the scienter of the company's CEO and CFO (and thereby, the company) was adequately pled because "[t]he individual defendants were not entitled to make statements concerning the company's financial statements and ignore reasonably available data that would have indicated that those statements were materially false or misleading." *Id.* at 491. The *Atlas* court stated: "if a plaintiff can plead that a defendant made false or misleading statements when contradictory facts of critical importance to the company either were apparent, or should have been apparent, an inference arises that high-level officers and directors had knowledge of those facts by virtue of their positions with the company." *Id.* at 489 (citing *Cosmas v. Hassett*, 886 F.2d 8, 13 (2d Cir. 1989)). Like here,

> Knowledge of the falsity of a company's financial statements can be imputed to key officers who should have known of facts relating to the core operations of

> their company that would have led them to the realization that the company's financial statements were false when issued.

Id. at 474. Moreover, Tower's widespread integration problems (¶¶91, 93) alerted Defendants to deficiencies in the Company's core operations and support an independent strong inference of scienter. *See In re Aetna Inc. Sec. Litig.*, 34 F. Supp. 2d 935, 953 (E.D. Pa. 1999) (individual defendants' scienter was established because of defendants' high-level positions and because they knew or should have known that an important acquisition was experiencing integration problems that resulted in false financial statements).

Plaintiffs allege that Defendants massively inflated Tower's financial results by grossly understating loss reserves through the manipulation of its core business functions such that the fraud arose from, *inter alia*, (i) fundamental and obvious flaws in Tower's application of claims and loss reserves to the wrong line of business (¶¶79-98) and (ii) intentional misconduct to understate loss reserves (¶¶99-107). It is indisputable that the Officer Defendants portrayed themselves as exceedingly aware and knowledgeable of Tower's loss reserves and loss reserving practices. ¶¶206-44. As stated above, Defendants concede that their alleged false statements and omissions concerned the Company's "core operations." Defendants do, however, mischaracterize the law in this Circuit in several ways.

First, Defendants argue that "courts in this District generally agree that, following the PSLRA's enactment, the 'core operations' inference cannot provide an independent basis for scienter." Def. Br. at 20. There is no such agreement. In fact, ***numerous*** courts in this District have ***confirmed and independently applied the "core operations" inference of scienter*** against high-level executives following the 1995 enactment of the PSLRA. *See In re Fairway Grp. Holdings Corp. Sec. Litig.*, 2015 WL 249508, at *15 (S.D.N.Y. Jan. 20, 2015) (scienter was adequately alleged because "high level corporate executives with responsibility for the financial statements" made "misstatements [that] concerned a core operation of [the company]"); *Hi-Crush*, 2013 WL 6233561, at *26 (scienter of high-level executives adequately alleged where those executives made false statements about a customer relationship that was within the "core operations" of the company because it provided 18% of the company's revenue and was "critical to the [company's] long term viability"); *In re Reserve Fund Sec. and Deriv. Litig.*, 732 F. Supp. 2d 310, 322-23 (S.D.N.Y. 2010) ("Once a plaintiff has adequately alleged that a defendant made false or misleading statements about the core operations of a company, however, an inference arises the individual defendants made false statements that the defendant knew or should have known the statements were false when made.").

While the Second Circuit has not expressly opined on whether the PSLRA has altered the viability of the core operations doctrine, it has twice recently supported its continued application. *See Frederick v. Mechel OAO*, 475 Fed. Appx. 353, 356 (2d Cir. 2012) (noting that the Second Circuit has not yet opined on the "core operations" doctrine's viability post-PSLRA, but citing *Novak*, 216 F.3d at 311 for the point that "the enactment of [the PSLRA] did not change the basic pleading standard for scienter in this circuit...."); *see also Celestica, Inc.*, 455 Fed. App'x. at 14 n.3 (scienter was adequately pled based on confidential witness statements, but noting that "both parties . . . agree that allegations of a company's core operations . . . can provide supplemental support for allegations of scienter.").[10]

[10] Even if this court were to find that the core operations inference does not provide an independent basis for scienter, it nonetheless provides additional support for Defendants' scienter under *Tellabs* that must be weighed together with the other evidence of scienter discussed in this brief. Indeed, the cases cited by Defendants (Def. Br. at 20) (two out of three that predate *Mechel* or *Celestica*), found that, at the least, "core operations" allegations provide supplementary evidence of scienter. *See In re Wachovia Equity Sec. Litig.*, 753 F. Supp. 2d 326, 353 (S.D.N.Y.); *Plumbers and Pipefitters Local Union No. 630 Pension-Annuity Trust Fund v. Arbitron*, Inc., 741 F. Supp. 2d 474, 490 (S.D.N.Y. 2010); *La. Mun. Police Employees' Ret. Sys. v. Green Mountain Coffee Roasters, Inc.*, 2013 WL 6728869, at *16 (D. Vt. Dec. 20, 2013).

Second, there is simply no support whatsoever for Defendants' novel argument that the "core operations" inference of scienter applies only when "there is a large fraud at junior levels," and senior executives ignored the lower-level fraud. Def. Br. at 19-20. In *Hi-Crush*—the only case Defendants cite for this proposition—the Court simply noted that the Complaint alleged that "at least someone"—the high-level individual defendants or another person—received a letter repudiating an important contract prior to making a statement that discussed the contract. *Hi-Crush*, 2013 WL 6233561, at *26. There is no mention whatsoever of a junior-level fraud being a prerequisite for the "core operations" doctrine, and Plaintiffs have found no case that presents such a strained conclusion.

Finally, relying solely on a non-binding case from the Northern District of California, Defendants contend that should the core operations doctrine apply, at most it allows an inference of recklessness to be drawn and not knowledge. Def. Br. at 19. Because, as discussed herein, allegations of knowledge are not required, this argument is moot. In any event, Courts in this District clearly find that the core operations doctrine allows an inference of knowledge. *See, e.g., Atlas Air*, 324 F. Supp. 2d at 489 ("[I]f a plaintiff can plead that a defendant made false or misleading statements when contradictory facts of critical importance to the company either were apparent, or should have been apparent, an inference arises that high-level officers and directors ***had knowledge of those facts by virtue of their positions with the company***.") (citing *Cosmas v. Hassett*, 886 F.2d 8, 13 (2d Cir. 1989)).

C. Defendants' Arguments Do Not Present An Equally, Let Alone More Compelling Inference That Defendants Acted Without Scienter

Plaintiffs are not required to disprove competing, less plausible explanations for Defendants' conduct. *See MF Global*, 982 F. Supp. 2d at 320 ("at this stage, Plaintiffs need not show that the inference of fraudulent intent is 'irrefutable…or even the most plausible of competing inferences'") (citing *Tellabs*, 551 U.S. at 324); *In re Top Tankers Inc. Sec. Litig.*, 528 F. Supp. 2d 408, 414-15 (S.D.N.Y. 2007) ("If the inference plaintiff asks the court to draw is at least as compelling as the inference defendant asks the court to draw (i.e., in the case of a tie), the complaint will not be dismissed.").

After making piecemeal attacks on the numerous allegations of scienter, Defendants' principal contention is that the Court should conclude that a more plausible inference is that Defendants acted innocently because the disastrous $533 million added to the Company's loss reserves in 2013 (reflecting one-third of the current reserves), were only a rote adjustment (Def. Br. at 42-44), and that the $37 million Restatement was—if (and only if) viewed separately—simply an immaterial data error insufficient to evidence scienter. *Id.* at 60-62 (*see* Section IV.A.4). Defendants are wrong. Indeed, Defendants' proposed inference is based on a purposeful distortion of the Complaint's allegations.

Defendants primarily argue that this Court should conclude that its ***$570 million*** misstatement cannot indicate scienter because the calculation of those reserves—which are governed by GAAP and which Defendants portrayed as accurate and conservative—are really nothing more than the result of a guessing game that is "conjectural" and tantamount to election polling. Def. Br. at 42-43. This is preposterous, particularly where Plaintiffs plead detailed facts relating to Defendants' fundamental failures relating to objective issues. As discussed above in Section IV.A.2, loss reserves, including IBNR, are not "conjectural." Indeed the case cited by Defendants for that proposition—*Delta Holdings*—and its related case *Stephens v. Nat'l Distillers & Chem. Corp.*, 6 F.3d 63, 65 (2d Cir. 1993)—do not even address the calculation of IBNR for primary insurers. To the contrary, as discussed *supra*, at Section IV.A.2, in *Delta Holdings*, the court devoted much attention to the calculation of "loss reserves and reinsurance," noting that "GAAP neither specifies a precise actuarial method nor requires that the reinsurer retain an independent actuary to prepare or review loss reserve estimates." 945 F.2d at 1229.

The additional inferences Defendants ask this Court to draw and find to be as—or more—compelling than the allegations in the Complaint do not hold water and involve contested questions of fact that are inappropriate on this motion. Def. Br. at 43-44. Plaintiffs do not allege that Tower's independent actuary, Towers Watson, participated in the fraud because Tower and PWC were obligated to "provide and audit the data upon which Towers Watson or any other outside actuarial firm would have relied in reviewing Tower's loss reserves." ¶271. Because the objective data that was supplied to Towers Watson was fraudulently misstated, the Company may not shift blame to Towers Watson for failing to detect the fraud.

Defendants' remaining argument that scienter cannot be inferred because Plaintiffs have not sufficiently explained what caused the fraud to start in March 2010 or end in September 2013 does not negate scienter in the least. Further, the Complaint details that Tower's fraud began as a result of the multiple, rapid acquisitions it completed and its failure to ensure that data from the acquired companies was accurately consolidated. These facts strongly support the inference that Defendants' intentional conduct was the cause of Tower's understated loss reserves. ¶¶54-57, 69, 77, 88-100; *see, e.g., Scottish Re*, 524 F. Supp. 2d at 379 (finding inference of scienter where plaintiffs alleged internal control weaknesses exacerbated by company's rapid growth by acquisition). Moreover, this argument is highly factual and inappropriate at the pleading stage.

D. Defendants Were Motivated And Had The Opportunity To Commit The Fraud

"A complaint has sufficiently alleged 'motive and opportunity to commit fraud' if it pleads facts showing that the defendant 'benefited in some concrete and personal way from the purported fraud.'" *Van Dongen*, 951 F. Supp. 2d at 468 (citing *Novak*, 216 F.3d at 307-08).

Defendants were highly motivated to maintain Tower's loss reserves at an artificially low level and artificially inflate its net income to protect and enhance their executives' positions, substantial compensation, and/or the value of their personal holdings in Tower. *See, e.g.*, ¶¶9, 189. First, Defendants were motivated to overstate Tower's net income and understate reserves in order to use the inflated share value to make less dilutive acquisitions using its shares as currency. ¶81. As the Complaint details, in July 2012, at a time when analysts were expressing concerns about Tower's future, Tower entered into a merger with Canopius using Tower common stock as currency. ¶¶79-81. This clearly evidences a strong motive to maintain Tower's stock price at an inflated level. *See SLM Corp.*, 740 F. Supp. 2d at 557 ("artificial inflation of a stock price in order to achieve some more specific goal may satisfy the pleading requirement") (citation omitted).

Defendants' cited cases are not to the contrary and concern, unlike here, highly generalized allegations of motive. These cases do not further the requirement set forth in *Tellabs* to consider all allegations of scienter collectively or in a holistic manner. *See In re Yukos Oil Co. Sec. Litig.*, 2006 WL 3026024, at *18 (S.D.N.Y. Oct. 25, 2006) (merely noting that generalized allegations of scienter are insufficient); *ECA, Local 134 IBEW Joint Pension Trust v. JPMorgan Chase Co.*, 553 F.3d 187, 203 (2d Cir. 2009) (plaintiffs did not sufficiently allege company's intent to defraud its own shareholders, rather than the shareholders of other companies).

Second, Defendant Lee's insider trading establishes an additional motive for Defendants to maintain Tower's price at artificially inflated levels. "Insider trading represents a classic example of a 'concrete and personal' benefit that suffices to plead motive to commit securities fraud." *Bd. of Trustees of City of Ft. Lauderdale Gen. Emps.' Ret. Sys. v. Mechel OAO*, 811 F. Supp. 2d 853, 867 (S.D.N.Y. 2011). While in possession of material inside information, Defendant Lee sold significant amounts of Tower common stock at artificially inflated prices and reaped substantial profits. ¶¶180-83. Lee sold nearly 1.5 million shares of Tower common stock during the Class Period ***for gross proceeds of over $18 million dollars, more than 18 times his base annual salary***. *Id.* The sheer amount of proceeds received by Lee is sufficient to support a strong inference of scienter. *See, e.g., Stevelman v. Alias Research, Inc.*, 174 F.3d 79, 85 (2d Cir. 1999) ($3.5 million); *Freudenberg*, 712 F. Supp. 2d at 200 ($5.7 million and $5.9 million).

Defendant Lee's sales are also suspiciously timed. Lee sold $1 million worth of Tower stock right after the successful completion of the Canopius merger. ¶183. Likewise, Lee sold 1.2 million shares in September 2013—shortly before the bottom dropped out of Tower stock. *Id.* Suspiciously timed sales are probative of scienter. *See Oxford Health*, 187 F.R.D. at 140 ("[t]rades made a short time before a negative public announcement are suspiciously timed").

Defendants cite to a number of cases on this point that do not bear scrutiny. *See In re Gildan Activewear, Inc. Sec. Litig.*, 636 F. Supp. 2d 261, 270 (S.D.N.Y. 2009) (plaintiffs merely alleged that the insider stock sales had occurred and did not sufficiently state that the sales were suspicious or unusual); *Druskin v. Answerthink, Inc.*, 299 F. Supp. 2d 1307, 1337 (S.D. Fla. 2004) (same).

Defendants next argue that the fact that the Complaint does not allege Hitselberger improperly sold any Tower stock cuts against the inference of scienter. Def. Br. at 34. The cases that Defendants cite for this proposition are inapplicable. *See San Leandro Emergency Med. Grp. Profit Sharing Plan v. Philip Morris Co.*, 75 F.3d 801, 814 (2d Cir. 1996) (defendant retained a large position in the company and had acquired more shares than he had sold); *In re Credit Acceptance Corp. Sec. Litig.*, 50 F. Supp. 2d 662, 677 (E.D. Mich. 1999) (lack of allegations concerning the CFO's insider sales was additive only after determining that insider sales by two other senior executives were not suspicious or unusual).

E. The Confidential Witness Statements Are Probative Of Defendants' Scienter And Should Be Given Substantial Weight

The Complaint includes detailed allegations from former Tower employees who held positions in the Company that describe Tower's fraud. ¶¶88-113. Relying on CWs like these to satisfy the PSLRA's pleading requirements is routine and widely accepted in this Circuit. *See Novak*, 216 F.3d at 313.

It is sufficient that confidential witness statements allege that Defendants had access to information contradicting their public statements. *Novak*, 216 F.3d at 314; *Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309 (2011) (scienter adequately alleged against three defendants, even though only one defendant received reports); *In re Countrywide Fin. Corp. Derivative Litig*., 554 F. Supp. 2d 1044, 1060 (C.D. Cal. 2008) (scienter adequately alleged even though witnesses had never "spoken or had other contact with" any of the defendant directors).

At a minimum, the confidential witness statements corroborate the allegations that the deficiencies in Tower's loss-reserving practices were widespread and well-known throughout the Company, and that the Officer Defendants had access to information regarding these deficiencies that contracted their public statements. *Cornwell v. Credit Suisse Grp*., 689 F. Supp. 2d 629 (S.D.N.Y. 2010) (allegations of widespread internal knowledge of problems alleged scienter); *Alstom*, 406 F. Supp. 2d 433, at 503, n. 80 (S.D.N.Y. 2005) (same). Indeed, Defendants' Class Period and post-Class Period admissions of deficient internal controls—which are corroborated by former employees who consistently recount that Defendants were aware of the problems before and during the Class Period—support a strong inference of scienter. *See Freudenberg,* 712 F. Supp. 2d at 183-84 (finding scienter adequately alleged based on, among other things, class period and post-class period admissions); *Vivendi*, 381 F. Supp. 2d at 169, 181 (same).

In an attempt to discredit the strength of the CWs statements, Defendants poke at the information provided by a handful of these former employees without success. Defendants first claim they did not act with scienter because the CW statements make conclusory allegations without a basis for stating that Defendants had illicit intent or knowledge. This is wrong.

As an initial matter, CW1 possessed knowledge confirming that Defendant Lee pressured and bullied Tower's actuaries to lower reported reserves and that Defendant Lee had information available to him that contradicted his public statements that Tower's loss reserves were "prudent" and "conservative." ¶¶105-08. While CW1 was not a Tower employee at the time of Tower's $326.7 million reserve increase in the second quarter of 2013, CW1's statements go to the fact that Tower had a long-standing practice of failing to properly integrate the data systems of its acquired companies, which significantly increased the risk for mistakes in reconciling losses to premiums by line of business. ¶¶92-100. Further, CW1's statements regarding Tower's poor data systems were corroborated by numerous other CWs, including CW2, CW4, CW5, CW6 and CW7, who all confirmed that Tower had serious problems with its data integration, that these problems were well-known throughout the Company and that these problems meant that Defendants were not able to view an accurate picture of the Company's business. ¶¶92-99.[11] Defendant Lee's knowledge of both Tower's insufficient systems and data

[11] When former employees corroborate each other's statements, the probative value of their allegations increases exponentially. *See, e.g., In re Dynex Capital, Inc. Sec. Litig*., 2009 WL 3380621, *7 (S.D.N.Y. Oct. 19, 2009) (finding that confidential witness statements regarding defendants' routine violations of underwriting guidelines were corroborated by other confidential witnesses working in different departments); *Local 731 I.B. of T. Excavators & Pavers Pension Trust Fund v. Swanson*, 2011 WL 2444675, at *12 (D. Del. June 14, 2011) (scienter inferred where CW accounts corroborated each other); *In re Daou Systems, Inc.*, 411 F.3d 1006, 1015

issues, combined with his practice of pressuring employees to lower reserves, caused the Company to systematically under-reserve for losses. ¶¶92, 95, 97.

The Complaint's CW allegations are confirmed and corroborated by Defendants' admissions that Tower's inadequate internal controls led to its inability to maintain unified and accurate records of claims and losses where even basic information necessary to calculate losses and establish reserves was impossible to obtain. ¶100. Additionally, multiple CWs confirmed that Tower had a long-standing practice of systematically under-reserving for losses in large part due to intimidation tactics implemented by Defendant Lee. For example, CW1 stated that Defendant Lee "tore into" Tower's chief actuary "like he was a child" if the proposed reserve levels were too high. ¶107. Indeed, CW1 confirmed that actuarial estimates at properly run companies are not substantially challenged downward (typically no more than 2% to 5%). Tower's actuaries were instructed to reduce their reserve estimates by 10%-20%, and mostly on business lines that had longer tails and carried greater risk for sustained losses. *Id.* Similarly, CW7 and CW10 each independently recalled that Tower employees, both actuaries and claims supervisors, were directed by senior management to keep reserve levels lower than the expected exposure of claims in order to keep income artificially inflated (¶110) and that whenever employees requested a higher reserve for a specific claim, there was push back to keep reserves down because "the intent [at Tower] was to keep the reserves suppressed." ¶111. CW9 likewise stated that contrary to Defendants' public representations that Tower adopted a "conservative approach" to loss reserving, the Company instead intentionally reserved "under the projected exposure" and even adopted a new software program in 2012 that reduced reserves even further

(9th Cir. 2005) ("criteria for assessing reliability for confidential witnesses" include the "corroborative nature of the other facts allege (including from other sources)…").

and identified damages that "were well below where the [claim] settlement ranges" should have been. ¶109.

Defendants' cited cases are distinguishable. In *Glaser,* 772 F. Supp. 2d 573, three of the confidential witnesses did not even work for the defendant corporation and plaintiffs failed to allege that these three individuals had any contact with individuals at the defendant company or with the individual defendants; with respect to the fourth confidential witness, plaintiff failed to identify the CW's job duties and how those duties gave access to the alleged statements. *See also Gavish v. Revlon, Inc*., 2004 WL 2210269, at *13 (S.D.N.Y. Sept. 30, 2004) (plaintiffs failed to allege any particulars of the confidential sources, as required by *Novak*); *Gentiva*, 932 F. Supp. 2d at 375 (court considered CW allegations in isolation); *In re Elan Corp. Sec. Litig*., 543 F. Supp. 2d 187, 220 (S.D.N.Y. 2008) (complaint did not allege CW was in position to have knowledge of communications with senior management); *In re IAC/InterActiveCorp. Sec. Litig*., 695 F. Supp. 2d 109, 120-21 (S.D.N.Y. 2010) (plaintiffs did not plead facts that corroborated the confidential witness statements); *Deutsche Zentral*, 2013 WL 6667601, at **20-21 (the complaint failed to describe defendants' actual due diligence process and thus insufficiently stated that defendants knew appraisals were inflated as a result of their due diligence process).

F. The Complaint Adequately Alleges Subjective Falsity

As argued above, *supra* at Section IV.A.2, Defendants' misstated loss reserves and misrepresentations regarding Tower's loss reserving methodologies are statements of fact and not opinion. Therefore, allegations of recklessness suffice to establish scienter. Even if the Court gives credence to Defendants' arguments that certain statements are "opinions" and not misstatements of fact (Def. Br. at 14-20; 53 n.22), the Complaint's allegations clearly plead that Defendants did not subjectively believe those statements.

For example, as discussed in detail above, (i) Lee and Hitselberger's knowledge of Tower's misstated reserves and fraudulent reserve practices is ascribed to them because the establishment of loss reserves was one of Tower's "core operations" (Section VI.B); (ii) numerous CWs confirmed that the Tower Defendants knew of the Company's fraudulent reserves and reserve practices, including the misapplication of data and that Defendant Lee pressured the Company's actuaries to lower reported reserves (Section VI.D.); (iii) Lee and Hitselberger regularly held themselves out to be knowledgeable about the Company's loss reserves and loss reserving practices (VI.A); and (iv) Global Indemnity's refusal to go through with an acquisition on the basis of Tower's inadequate loss reserves put Defendants on actual notice of the reserves' falsity. *Id*.

MF Global is instructive here. There, while the court held that certain statements regarding allowances for deferred tax assets were opinions, the Court easily found that the officer defendants "did not honestly believe their stated opinions" because the complaint alleged that the officer defendants "were aware of the relevant GAAP accounting standard" and knew that the underlying evidence on which they relied was insufficient to support the deferred tax asset valuation. *MF Global*, 982 F. Supp. 2d at 314 (citing *Hoff v. Popular, Inc.*, 727 F. Supp. 2d 77, 93 (D. Puerto Rico 2010) and *Scottish Re*, 524 F. Supp. 2d at 393-94 as coming to the same conclusion). To the extent this Court views any of the alleged misstatements as opinions, it should come to the same conclusion as the court in *MF Global, Hoff*, and *Scottish Re*. The Complaint alleges in great detail that the Officer Defendants often spoke about the Company's reserves and reserve methodology—evidencing their knowledge of the applicable accounting principles—and knew that the acquired companies were not being properly integrated and that

Lee intentionally suppressed reserves. Plaintiffs' allegations of Defendants' scienter fully satisfies any subjective falsity analysis.

VII. PLAINTIFFS READILY MEET THE LOW PLEADING STANDARD FOR LOSS CAUSATION

A. Rule 8's Notice Pleading Standard Applies To Plaintiffs' Loss Causation Allegations

As the Supreme Court held in *Dura Pharmaceuticals, Inc. v. Broudo*, the "ordinary pleading rules" that apply to loss causation "are not meant to impose a great burden upon a plaintiff[.]" 544 U.S. 336, 347 (2005). The Complaint's loss causation allegations are evaluated under Rule 8's notice pleading standard. *Bricklayers & Masons Local Union No. 5 Ohio Pension Fund v. Transocean Ltd.*, 866 F. Supp. 2d 223, 244-46 (S.D.N.Y. 2012); *see also, Wallace v. IntraLinks*, 2013 WL 1907685, at *9 (S.D.N.Y. May 8, 2013) ("The pleading of loss causation is governed by Rule 8 notice pleading, and therefore a complaint only needs to provide 'some indication of the loss and the causal connection that the plaintiff has in mind.'" (*quoting Dura*, 544 U.S. at 346-47)); *Dodona I, LLC v. Goldman Sachs & Co.*, 847 F. Supp. 2d 624, 639 (S.D.N.Y. 2012); *Solow v. Citigroup Inc.*, 827 F. Supp. 2d 280, 291 (S.D.N.Y. 2011).

B. Plaintiffs' Loss Causation Allegations Readily Meet The Rule 8 Standard

To adequately plead loss causation, a plaintiff need only allege either (a) that the market reacted negatively to a corrective disclosure of the fraud, or (b) that the "loss was foreseeable and caused by the materialization of the risk concealed by the fraudulent statement." *Barclays*, 750 F.3d at 233. Plaintiffs alleged and readily satisfy loss causation under both standards. *See* ¶323 ("[t]he artificial inflation in Tower's stock price was removed when the conditions and facts that had been misstated and/or omitted by Defendants were revealed to the market, and/or the effects thereof, were revealed, and/or the risks that had been fraudulently concealed by Defendants materialized.”).

Courts recognize that pleading loss causation must be flexible. For example, it is well-settled in the Second Circuit that “a corrective disclosure need not take the form of a single announcement, but rather, can occur through a series of disclosing events.” *Richman v. Goldman Sachs Group, Inc*., 2012 WL 2362539, at *13 (S.D.N.Y. June 21, 2012). More importantly, “no court addressing the loss causation pleading standard requires a corrective disclosure be a ‘mirror image’ tantamount to a confession of fraud.” *Freudenberg*, 712 F. Supp. 2d at 202.

Defendants take issue with only two of the Complaint’s loss causation dates, October 7 and November 14, 2013. On October 7, 2013, Tower revealed that it expected to strengthen its loss reserves by $365 million. ¶328. This disclosure partially revealed that, *inter alia*, Defendants’ prior materially misleading statements and omissions concerning the amount of the Company’s loss reserves and whether such amounts were “conservative.” ¶329. Moreover, this disclosure partially revealed that the concealed risks associated with Tower’s reserving processes—calculating reserves through the inconsistent application of Tower’s insurance contracts to the wrong business lines (¶¶83, 89, 100) and the intentional suppression of loss reserves (¶107)—had materialized. *Id.*

Defendants hinge their loss causation arguments on the faulty premise that any statements about reserves were necessarily opinions and so Plaintiffs must plead that Defendants did not subjectively believe these opinions. Def. Br. at 55. This is a straw man. As discussed above (*see supra* at Section IV.A.2), Defendants’ misstatements and omissions about reserves were not opinions because Defendants calculated loss reserves by objectively misapplying insurance premiums to the wrong business lines. Thus, their statements relating to, or implicating, reserves, were misstatements of material fact rather than subjective beliefs. Since Defendants' misstatements were not opinions, their loss causation argument predicated on such a finding falls apart.

Defendants cite *Lentell v. Merrill Lynch*, 396 F.3d 161, 176 (2d Cir. 2005), in support of their argument that their statements were opinions and that loss causation for opinions requires a revelation that they were not the speaker's true opinion. Def. Br. at 55. In *Lentell*, the plaintiffs alleged that analysts committed securities fraud by issuing reports recommending that investors purchase shares of two companies, even though the analysts did not then believe that those companies were a good investment. *Lentell*, 396 F.3d at 176. Indeed, the Second Circuit held that "[t]he only misrepresentation that can inhere to the 'buy' and 'accumulate' recommendations is that they were not Merrill's true and sincere opinion." *Id.* In addition, the Second Circuit noted that the plaintiffs had not alleged a negative market reaction or that the omitted risks led to their loss. *Id.*

This case could not be more different. Here, Plaintiffs did not allege that Defendants' misstatements were opinions and Defendants' attempt to recast their misrepresentations as opinions is untenable given the factual circumstances of this case. *See* Section IV.A.2. Accordingly, *Lentell* has no bearing on this action.

On November 14, 2013, the Company disclosed that the cause of the falsely reported reserves was "inadvertent mistakes in classification of insurance premiums" (¶128); that it would be restating and revising its financial statements for 2009 through the first quarter of 2013 (¶129); and that its "internal control over financial reporting related to the company's loss reserving and premiums receivable reconciliation processes" was inadequate. ¶130. These statements partially revealed the truth about Tower's fundamental loss reserve problems; that a restatement was warranted; and that omitted risks concerning internal controls had materialized. ¶¶330-33.

Defendants misleadingly claim that Tower revealed its misclassifications and the imminent Restatement after the market closed on November 14, 2013, and thus, Defendants argue, Plaintiffs' allegations that Tower's stock price dropped from its November 13 close are purportedly irrelevant. Def. Br. at 63. Defendants are wrong. In fact, Tower first announced the Restatement during the trading day in a press release issued at 10:33 a.m. on November 14, not after the close of markets on November 14. Harrod Decl. Ex. C. As alleged in the Complaint, Tower shares declined materially during intra-day trading on November 14, 2013 in reaction to this news. ¶131. Accordingly, Defendants' loss causation argument for November 14 lacks any basis in fact and should be disregarded entirely.

None of Defendants' other cited cases relate to the factual circumstances of the alleged disclosures and accompanying stock drops here. *See Stratte-McClure v. Ap-Fonden*, 2015 WL 136314, at *4 (2d Cir. Jan. 12, 2015) (affirming dismissal on loss causation grounds where intervening event of subprime market decline could have caused decline in stock price); *Solow*, 507 Fed. App'x. at 82 (failure to plead connection between misstatements and materialization of risk and failure to distinguish adverse market conditions at the time); *cf. Solow*, 2012 WL 1813277, at **6-9 (lower court decision); *North Port Firefighters' Pension-Local Option Plan v. Temple-Inland, Inc.*, 936 F. Supp. 2d 722, 762 (N.D. Tex. 2013) (rejecting loss causation allegations because "they do not state or infer that Guaranty's previously reported valuations were incorrect"); *Kuriakose v. Fed. Home Loan Mortg. Corp.*, 2011 WL 1158028, at *14 (S.D.N.Y. Mar. 30, 2011) (plaintiffs "made no specific factual allegations about disclosure of concealed information" and the marketwide phenomenon of the housing market's collapse also cast into question relation between misstatements and decline in stock price).

Defendants also continue their strategy of trying to divide the case into two purportedly unrelated parts when arguing about loss causation from the November 14, 2013 disclosure. Def. Br. at 62-63. On that date, Defendants revealed the Restatement, the Company's internal controls problems, and the purported cause of the false loss reserve reporting. Defendants claim that the November 14 disclosures only related to the Restatement, but not to the massive millions reserve strengthening for the second quarter of 2013.[12] However, Plaintiffs allege otherwise; namely, that the November 14 disclosure also revealed facts about the reserve strengthening by announcing that Tower "would be taking an additional reserve charge of up to $105 million for fiscal year 2013." ¶334.

Moreover, the Complaint describes Tower's endemic problems with reserves that were caused by their practice of calculating reserves based on chronic misapplication of insurance premiums to the wrong business lines. Plaintiffs further allege that the Company had systemic internal control problems relating to reserves throughout the Class Period. Defendants are not entitled to their own version of the facts on this motion and their attempt to proffer their own narrative should be rejected.

Defendants' claim that "[t]here was no revelation that Tower had ***any*** misclassifications ***before*** the November 14, 2013 announcement" is not consistent with the Complaint's allegations and misses the point. The Complaint alleges that the reserve increases and related information announced on August 7, 2013 (¶¶323-25), September 17, 2013 (¶¶326-27) and October 7, 2013 (¶¶328-29) ***did*** reveal the existence of understatements to Tower's loss reserves and reflected the

[12] Defendants first stated on August 7, 2013 that the reserve strengthening would be between $60 million and $110 million (324), then on October 7, 2013 that figure leapt to $365 million (328).

materialization of the risk that Tower's financial results had been misstated. Moreover, the point of these allegations is that the misclassifications and the reserve strengthening are branches of the same tree – fatally flawed reserve calculations reached not by poor judgment but by consistently misapplying insurance contracts to the wrong business lines

VIII. PLAINTIFFS ADEQUATELY PLEAD SECTION 20

Defendants' arguments regarding Plaintiffs' 20(A) claims are baseless. Def. Br. at 76-77. Section 20(A) provides:

> Any person who violates any provision of this chapter or the rules or regulations thereunder by purchasing or selling a security while in possession of material, nonpublic information shall be liable in an action in any court of competent jurisdiction to any person who, contemporaneously with the purchase or sale of securities that is the subject of such violation, has purchased (where such violation is based on a sale of securities) or sold (where such violation is based on a purchase of securities) securities of the same class.

Co-Lead Plaintiff Oklahoma Firefighters bought Tower stock on March 19, 20, and 21, 2013—just days after Defendant Lee's March 14 and 15 collective sale of 57,000 shares. ¶180; *see* Dkt. No. 110 at 163 (Complaint Appendix A). This is sufficient to plead a Section 20(A) violation. *See In re Pfizer Inc. Sec. Litig.*, 584 F. Supp. 2d 621, 642 (S.D.N.Y. 2008) ("While courts have interpreted the contemporaneousness requirement of Section 20A differently, the Court cannot say as a matter of law that trades made within less than week are insufficiently contemporaneous"). Likewise, one of the ADAR Funds bought 1,138 Tower shares on April 4, 2013, less than two weeks after Lee's sales. *See* Dkt. No. 110 at 165 Complaint Appendix A. Such purchase was also "contemporaneous" for purposes of Section 20(A).

Defendants cite several cases in support of their claim that for a purchase to be contemporaneous, it must occur on the same day as an insider's sale. Defendants' cases are either non-binding, out of Circuit cases or are otherwise distinguishable. *See Brodzinsky v. FrontPoint Partner, LLC*, 2012 WL 1468507, at *5 (D. Ct. Apr. 26, 2012) (after noting that "[t]he legislative history to the statutes indicate that a trade within seven days should be considered contemporaneous," the court held that two weeks between insider sale and plaintiff purchase was too long. Here, the interim between Lee's insider sales and Oklahoma's purchases was between 4 and 7 days). *In re Fed Nat'l Mortg. Ass'n Sec. Deriv. and ERISA Litig*., 503 F. Supp. 2d 25, 47 (D.D.C. 2000) and *In re AST Research Sec. Litig*, 887 F. Supp. 231, 234 (C.D. Ca. 1995), are from out of this District.

Defendants make no arguments with regard to Plaintiffs' Section 20(a) control person claims other than that the underlying 10(b) claims should be dismissed. Def. Br. at 76. As argued above, because Plaintiffs sufficiently allege violations of Section 10(b), their control person claims under Section 20(a) should also be sustained.

IX. PLAINTIFFS HAVE ADEQUATELY ALLEGED SUCCESSOR LIABILITY AGAINST ACP

The Complaint properly alleges that ACP is liable for the Section 10(b) violations of Tower as the successor in interest to those entities. This is an uncontroversial proposition and courts frequently find that successors are responsible for the Exchange Act liabilities of the companies they acquire. *See In re Parmalat Sec. Litig.*, 493 F. Supp. 2d 723, 730 (S.D.N.Y. 2007) (denying defendants' motion to dismiss plaintiffs' successor liability claim where plaintiffs alleged 10(b) violations against predecessor company); *In re NYSE Specialists Sec. Litig.*, 405 F. Supp. 2d 281, 317 (S.D.N.Y. 2005) (same); *In re Pronetlink Sec. Litig.*, 403 F. Supp. 2d 330, 336 (S.D.N.Y. 2005) (same); *Goldstein v. Gardner*, 444 F. Supp. 581, 584 (N.D. Ill. 1978) (denying successor corporation's motion for summary judgment where plaintiffs alleged violations under the Exchange Act and questions of fact existed as to whether successor entity assumed the liabilities of its predecessor); *Ladjevardian v. Laidlaw-Coggeshall, Inc.*, 431 F. Supp. 834, 841 (S.D.N.Y. 1977) (same). The Complaint's successor liability allegations against ACP, which should be interpreted under New York law, are subject to a Rule 8 pleading standard and readily meet that standard. Defendants' arguments that attempt to confuse and convert ACP's Exchange Act liability into a state or Bermuda law claim are misplaced. Count II of the Complaint adequately asserts a claim under federal law based on ACP's successor liability. ¶¶365-72.

A. Successor Liability Allegations Are Analyzed Under Rule 8's Pleading Requirements

Rule 8 requires only "a short and plain statement of the claim." Fed. R. Civ. P. 8(a). It is well-settled that "pleadings of successor liability are subject to the lenient pleading requirements of Rule 8(a), not the more rigorous standards of Rule 9(b)." *Vorcom Internet Services, Inc., v. L & H Engineering & Design, LLC*, 2013 WL 335717 at *5 (S.D.N.Y. Jan. 9, 2013); *Kuhns Brothers Inc., v. Fushi Int'l., Inc.,* 2007 WL 2071622, at *5 (D. Ct. July 16, 2007); *Old Republic Ins. Co.*, *v. Hansa World Cargo Svc., Inc.,* 170 F.R.D. 361, 385 (S.D.N.Y. 1997). Plaintiffs' detailed successor liability allegations amply satisfy Rule 8.

B. Choice of Law Principles

The parties agree that New York choice of law principles apply. Under New York choice of law rules, when substantive differences exist between the law of two relevant jurisdictions, courts look to the jurisdiction with the greatest interest in regulating the conduct at issue. *Prime Mover Capital Partners L.P. v. Elixir Gaming Tech., Inc.*, 898 F. Supp. 2d 673, 678 (S.D.N.Y. 2012). The "law of the jurisdiction where the tort occurred will generally apply because that jurisdiction has the greatest interest in regulating behavior within its borders." *Id.*

Here, the facts support a finding that New York law should govern the issue of successor liability because New York "has the greatest interest in regulating behavior within its borders." *Id.* Throughout the Class Period, the alleged violations occurred in at TGI and TGIL's New

York headquarters. ¶¶41, 43.[13] Thus, every entity at issue here is located in New York except ACP, an entity with a Bermuda mailbox that is the vehicle of the Karfunkel trust.[14]

Here, Defendants claim that there is a conflict between New York and Bermuda law on the question of ACP's liability. Def. Br. at 71-72. As discussed below, there is a genuine factual dispute as to whether Bermuda law would result in a different outcome than New York law. Nevertheless, assuming for purposes of the conflicts analysis that differences in legal doctrine may exist. The parties agree that courts must engage in an "interest analysis." Def. Br. at 71. Defendants' own citation states that an "[i]nterest analysis is a 'flexible approach intended to give controlling effect to the law of the jurisdiction which, because of its relationship or contact with the occurrence or the parties, has the greatest concern with the specific issue raised in the litigation.'" *Hayden Capital USA, LLC v. Northstar Agri Industries, LLC*, 2012 WL 1449257, at

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[13] Moreover, AmTrust is headquartered in New York City (*see* https://www.amtrustgroup.com/contact (AmTrust Financial Services, Inc. is located at 59 Maiden Lane, 43rd Floor, New York, NY 10038), as is National General (*see* www.sec.gov\nationalgeneral\noticeofeffectiveness (business address listed as 59 Maiden Lane, 38th Floor, New York, NY 10038).

[14] ACP, AmTrust and NGHC are all affiliated entities controlled by the Michael Karfunkel 2005 Grantor Retained Annuity Trust (the "Karfunkel Trust"). ¶343. Indeed, AmTrust's recent annual report demonstrates that every entity at issue is intimately inter-related: "As of December 31, 2014, our principal stockholders, Michael Karfunkel, Leah Karfunkel (the wife of Michael Karfunkel and sole trustee of the Trust), George Karfunkel and Barry Zyskind own or control approximately 6.2%, 7.6%, 9.3% and 5.1%, respectively, of the issued and outstanding capital stock of Maiden Holdings, Ltd. ("Maiden"), a publicly-held Bermuda insurance holding company. Our Chief Executive Officer, Barry Zyskind, serves as the non-executive chairman of Maiden's board of directors. We own 13.2% of the issued and outstanding common stock of NGHC, a publicly-held insurance holding company. NGHC's two largest stockholders, who collectively own 48.8% of the issued and outstanding stock of NGHC, are the Trust and Michael Karfunkel, individually. Michael Karfunkel is our Chairman and the father-in-law of Barry Zyskind, our Chief Executive Officer. The ultimate beneficiaries of the Trust include Michael Karfunkel's children, one of whom is married to Mr. Zyskind. In addition, Michael Karfunkel is the Chairman, President and Chief Executive Offer of NGHC. ACP Re, Ltd. ("ACP Re") is a privately-held Bermuda reinsurance holding company formed by Michael Karfunkel, and a subsidiary of the Trust. As of December 31, 2014, the Trust beneficially owned 12.9% of our issued and outstanding stock. Michael Karfunkel is the chairman of ACP Re." See Harrod Decl., Ex. D (relevant excerpt from AmTrust March 2, 2015 Form 10-K) at 40.

*5 (S.D.N.Y. Apr. 23, 2012). The Court noted in *Hayden* that "[t]he contacts of the parties and occurrences with each jurisdiction are thus factors to be considered in applying interest analysis, together with the policies underlying each jurisdiction's rules, the strength of the governmental interests embodied in these policies, and the extent to which these interests are implicated by the contacts." *Id.* Notably, while the *Hayden* court rejected plaintiffs' argument that successor liability applied, it did so, in part, because the plaintiffs did not allege that the entity did "business in New York." *Id.* at *7. As discussed herein, the Tower Defendants as well as ACP affiliates and the Trust that operates ACP, are all based in New York. Thus, an interest analysis—to the extent it can even be adjudicated at this stage—compels the conclusion that New York has the "greatest concern" in this case.

C. Plaintiffs Meet The Requirements For Alleging Successor Liability Under New York Law

It is axiomatic that, in a typical merger, the surviving corporation assumes the duties and liabilities of a constituent corporation. *Local 348-S, UFCW, AFL-CIO v. Meridian Mgmt. Corp.*, 583 F.3d 65, 71 (2d Cir. 2009). Even where there is a substantial asset purchase rather than a formal merger, courts will still hold successors liable in circumstances like those present here. Under New York law, a successor in a merger or similar agreement[15] is liable if one of four criteria are satisfied: (1) the successor expressly or impliedly assumed the predecessor's tort liability, (2) there was a consolidation or merger of seller and purchaser, (3) the purchasing corporation was a mere continuation of the selling corporation, or (4) the transaction is entered into fraudulently to escape such obligations. *Douglas v. Stamco*, 363 Fed. App'x. 100, 102 (2d Cir. 2010). *See also N.Y. v. Nat'l Serv. Indus., Inc.,* 460 F.3d 201, 209 (2d Cir. 2006) (applying New York law). Here, Plaintiffs satisfy criteria (1) and (3).

[15] ACP and Tower term their merger an "Agreement and Plan of Merger." ¶¶48, 146.

1. ACP Assumed Substantially All Of Tower's Liabilities

A corporation acquiring the assets of another succeeds to the liabilities of the successor corporation where "the successor expressly or impliedly assumed the liability." *In re Tronox, Inc. Securities Litigation*, 2010 WL 2835545, at *15 (S.D.N.Y. June 28, 2010). Lead Plaintiffs allege that on September 15, 2014, "ACP acquired substantially all of the assets of Tower at that time; Tower ceased submitting filings to the SEC; and, upon information and belief, Tower's assets and liabilities are now included in ACP's financial statements." ¶370. Steven Ungar, General Counsel of AmTrust Financial Services and one of ACP's owners (¶49), confirmed that "ACP Re is acquiring the Tower business" and "entities" in a hearing before the Maine Superintendent (¶50).[16]

Ungar also stated that National General and AmTrust would administer the runoff of Tower's legacy businesses:

> ACP Re has agreed to acquire Tower Group International, Ltd., and in connection therewith, its affiliates, National General Holdings Corp. and AmTrust Financial Services, Inc., both publicly listed companies on NASDAQ, have agreed to administer the runoff of Tower Group's legacy business and provide stop-loss coverage with respect to such runoff, and, prospectively, to manage and reinsure all business written by TNIC and Mass Homeland as well as the other Tower Group Insurers as will be further explained later.

Dugan Decl., Ex. 42 at 7-8.[17] Finally, Ungar stated that "[w]e believe there are sufficient reserves and surplus to run off the historic liabilities. If not, policyholders will have the

[16] Defendants claim that Ungar did not, in fact, state that ACP was acquiring Tower's prior liabilities in the Maine Hearing. Def. Br. at 75 n. 29. First, this argument only raises factual issues. Second, one of the documents submitted by Defendants apparently demonstrates the opposite, Ungar stated in the Massachusetts hearing that "ACP Re will retain the liability relating to the legacy Tower business." Dugan Decl., Ex. 42 at 10:19-21.

[17] Thus, Defendants' claim that "Tower's assets pre-merger remained Tower's assets post-merger" (Def. Br. at 66) is inaccurate. Dugan Decl., Ex. 37 at 4 (AmTrust and NGHC to "(i) acquire the Commercial Lines Assets and the Personal Lines Assets; (ii) administer the run-off of Tower's historical commercial lines claims and personal lines claims at cost; (iii) in their

additional protection of a $250 million Stop Loss policy issued by National General and Am Trust to [Tower subsidiary] Castlepoint Re." *Id.* at 11. This laundry list of facts is sufficient to plead that ACP assumed substantially all of Tower's liabilities—particularly under a Rule 8 standard—rendering ACP liable as Tower's successor. *See Nettis v. Levitt*, 241 F.3d 186, 193 (2d Cir. 2001) (successor liability defendants successfully joined based on allegations that successor firm acquired some of predecessor's assets and carries on predecessor's operations).

2. ACP Is Liable as Tower's Successor Because there is Continuity of Ownership

Even if ACP's assumption of liability is considered to be less than explicit, which it should not be—the circumstances here meet the criteria under New York law's four-part disjunctive test for determining whether liability transfers to an acquirer under the *de facto* merger doctrine. Part three of that doctrine involves determining whether "the purchasing corporation was a mere continuation of the selling corporation." *Douglas*, 363 Fed. App'x at 102. In weighing successor liability, courts also look at the federal "substantial continuity" test, which is very similar to the third criterion of the *de facto* merger test. *See Atl. Richfield Co. v. Blosenski*, 847 F. Supp. 1261, 1284 n. 22 (E.D. Pa. 1994) (noting, under federal common law, that "[t]he 'substantial continuity' test shares many features with the traditional '*de facto* merger' exception"). Further, courts have applied federal law to the issue of successor liability for various federal causes of action. *See, e.g., Chicago Truck Drivers, Helpers, and Warehouse*

discretion, place commercial lines business and personal lines business with the Tower insurance companies, which they will exclusively manage and fully reinsure for a net 2% ceding fee payable to the Tower insurance companies; (iv) retain the expirations on all business written by the Tower insurance companies through the Company and National General, as managers; and (v) receive the agreement of the Tower insurance companies and ACP Re not to compete with respect to the commercial lines business and personal lines business.")

Workers Union (Independent) Pension Fund v. Tasemkin, Inc., 59 F.3d 48, 49 (7th Cir. 1995) (applying federal common law of successorship to ERISA claims).

Under the "substantial continuity" test, courts have found a successor to be liable where (1) it "had notice of its predecessor's obligations" and (2) a 'sufficient continuity of identity' exists between the two businesses." *Romita v. Anchor Tank Lines, LLC*, 2014 WL 1092867, at *4 (S.D.N.Y. Mar. 17, 2014); *see also Lewis v. Blackman Plumbing Supply L.L.C.*, 2014 WL 5009487, at *10 (S.D.N.Y. Sept. 29, 2014). Courts generally analyze nine factors:

> (1) whether the successor company had notice of the charge or pending lawsuit prior to acquiring the business or assets of the predecessor; (2) the ability of the predecessor to provide relief; (3) whether there has been a substantial continuity of business operations; (4) whether the new employer uses the same plant; (5) whether he uses the same or substantially the same work force; (6) whether he uses the same or substantially the same supervisory personnel; (7) whether the same jobs exist under substantially the same working conditions; (8) whether he uses the same machinery, equipment, and methods of production; and (9) whether he produces the same product.

Id. at *20.

Here, an application of these factors further supports a finding that ACP is liable for Tower's 10(b) violations. As to the first, ACP indisputably had "notice of the charge or pending lawsuit prior to acquiring the business or assets of the predecessor" (*see id.*) as the first cases in this action were filed against Tower in August 2013 four months before the ACP Merger was announced and over one year before it was consummated in September 2014. *See* ¶7. As to the second, ACP can assist Tower in providing relief should a settlement or judgment occur. As to the third, as discussed above, there has been a substantial continuity of business since ACP has assumed substantial assets of Tower including through its affiliates AmTrust and National General. As to the fourth, fifth, seventh, eighth and ninth, ACP has hired Tower employees (*see* Ex. 42 at 14:15) and ACP, like Tower, is an insurance company performing the same, or similar business using the same or similar means.

As to the sixth factor, the substantial overlap between the boards of Tower and ACP speaks volumes. *See* Dugan Decl., Exs. 39-40. As of January 28, 2015, Tower had six board members; three of whom were also ACP board members, and all of whom have identical corporate titles and used identical addresses. *Id*. *See also* ¶368 ("[t]he acquisition resulted in continuity of ownership…because it involved a wholly-owned ACP subsidiary that was created for the sole purpose of facilitating ACP's acquisition of Tower. ACP has described the transaction as a merger and has actively incorporated Tower's lines of business into its own."). For all of these reasons, there is "substantial continuity" between ACP and Tower sufficient to hold ACP liable as a successor entity. It is also telling that ACP and Tower are represented by the same counsel in this Action. That also demonstrates the continuity between the two companies, because two different defendant companies invariably have separate legal representation.

ACP's attempt to explain away its liability is of no avail. ACP contends that because TGIL survived as a subsidiary after the ACP Merger, ACP has no successor liability. Def. Br. at 66, 73-74. But that is beside the point. Tower is now a wholly-owned subsidiary of ACP, whose assets were substantially acquired by ACP; there is substantial overlap between ACP's and Tower's boards of directors; and AmTrust and NGHC, the actual acquirers of large portions of Tower's assets, are the real businesses comprising ACP, which is just a paper entity.

Defendants cite a number of cases on the *de facto* merger argument that simply do not apply to the facts at issue. *See New York v. Nat'l Service Indus., Inc.*, 460 F.3d 201, 215 (the parties "agree[d] that there is no continuity of ownership" because there was no overlap between predecessor and current ownership or management); *Cargo Partner AG v. Albatrans, Inc.*, 352 F.3d 41 (2d Cir. 2003) (rejected successor liability where there was no continuity of ownership);

In re New York City Asbestos Litig., 789 N.Y.S. 2d 484, 487 (1st Dep. 2015) (same); *Desclafani v. Pave-Mark Corp*., 2008 WL 3914881, at *4 (S.D.N.Y. Aug. 22, 2008) (same); *In re Tronox Inc. Sec. Lit.*, 2010 WL 2835545, at*15 (S.D.N.Y. June 28, 2010) (court noted that successor liability was warranted where "the successor expressly or impliedly assumed the liability" but finding that a plausible inference of liability assumption was not pled).

ACP also fundamentally misconstrues many of Plaintiffs' allegations. Plaintiffs do not allege that ACP is responsible for *making* the alleged misstatements and omissions at issue; rather, it alleges that ACP is liable solely as successor to Tower. Likewise, Plaintiffs do not allege that ACP is liable to the Class for claims under state law. Accordingly, Defendants' lengthy discussion relating to *Janus Capital Group and Central Bank of Denver* (Def. Br. at 66-70) is irrelevant.

3. Bermuda Law Should Not Apply, But If It Did, It Would Result In The Same Outcome

Defendants claim that Bermuda law applies to Plaintiffs' claims against ACP. Such a conclusion is contrary to the analysis of the "interest" test described above, which makes clear that New York has an overwhelming interest in this dispute. That said, even if Bermuda law applies, the purchase of Tower by ACP could still result in successor liability for ACP. As described in the accompanying declaration of Jan Woloniecki, an expert on Bermuda law, successor liability exists under Bermuda law in cases of merger and amalgamations. *See* Harrod Decl., Ex. E. ACP could similarly be held liable under a "veil piercing" doctrine of Bermuda law, which is an inherently factual analysis. *Id.* In any event, there are numerous factual issues that should not be resolved now as to whether, and under what theory, a Bermuda court would deem the ACP Merger to result in successor liability.

4. Successor Liability—Particularly Where There Are Such Complex Facts at Issue—Is Inappropriate To Decide On A Pleading Motion

It is axiomatic that factual issues are unripe for adjudication on a motion to dismiss. *See, e.g., Sommerville v. Wright*, 2014 WL 794275, at *10 (E.D.N.Y. Feb. 25, 2014). This is all the more true when adjudicating inherently fact-intensive contested issues relating to successor liability. *See, e.g., In re NYSE Specialists Litig.*, 405 F. Supp. 2d 281, 317 (S.D.N.Y. 2007) (denying motion to dismiss where "the analysis of whether a defendant can be held liable for a predecessor's obligations, whether such obligations arise in tort or contract, is fact-intensive"); *Tommy Lee Handbags Mfg. Ltd. v. 1948 Corp.*, 971 F. Supp. 2d 368, 380 (S.D.N.Y. 2013) ("what the Plaintiff needs to show to ultimately prevail on a *de facto* merger claim and what the Plaintiff must plead to state a claim are two separate inquiries"). Plaintiffs allege detailed facts relating to the ACP Merger, and explain why such facts lead to the proper conclusion that (i) ACP assumed substantially all of Tower's liabilities; and (ii) the merger was a *de facto* merger. *See* ¶¶7, 48-50; 342-49. For example:

- ACP is jointly owned by a trust established by Michael Karfunkel, the founder of NGHC, AmTrust, and Maiden Holdings Ltd. At the closing of the ACP Merger, NGHC would acquire the renewal rights and assets of Tower's personal business, and AmTrust would acquire the renewal rights and assets of Tower's commercial business. ¶49.

- NGHC acquired the rights for new and renewal business for Tower's personal lines insurance operations, as well as entering into a 100% quota share reinsurance agreement and providing a cut-through endorsement on most of Tower's personal lines policies and on new and renewal personal lines business. NGHC acquired the assets necessary to support its acquisition of Tower's personal lines from ACP. ¶342.

- ACP, AmTrust and NGHC are all affiliated entities controlled by the Michael Karfunkel 2005 Grantor Retained Annuity Trust. ¶343.

- During the Massachusetts hearing, ACP's general counsel, Jeffrey Weissmann, testified that ACP would acquire Tower's insurance subsidiaries, and that its affiliates National General and AmTrust would administer Tower's existing policies, handle claims on those policies, and manage and reinsure new business that the Tower subsidiaries would write. ¶346.

- ACP and Tower's boards of directors substantially overlap. *See* Dugan Decl., Ex. 39-40.

These facts, accepted as true, particularly under a Rule 8 standard, are more than adequate to state a claim against ACP. Defendants' arguments counter these allegations with their own narrative based on numerous filings outside the pleadings to demonstrate that ACP should be dismissed.[18] But it is not for Defendants to determine a disputed fact issue on a motion to dismiss. Indeed, this is precisely the point—Defendants raise so many factual issues it is clear that this issue—to the extent in dispute—cannot be decided in Defendants' favor at this juncture. Plaintiffs' well-pled claims cannot be dismissed at the pleading stage and prior to the development of a full record in discovery based on Defendants' contrary factual contentions.

X. THE PPC CLAIMS ARE ADEQUATELY PLED

A. The ADAR Funds Adequately Allege Section 10(b) Violations on Behalf of the PPC

For substantially the same reasons detailed above, including, *inter alia*, Sections VI and VII relating to loss causation and scienter, Co-Lead Plaintiffs the ADAR Funds adequately allege

[18] Defendants submit at least six documents to this effect, including a Massachusetts hearing transcript—which was not cited in the Complaint—and various Bermuda company registers. *See* Defendants Br. at 65-70. First, these documents are not akin to those that courts routinely take judicial notice of, *e.g.*, SEC filings. *See, e.g., Garber v. Legg Mason, In*c. 347 Fed. App'x. 665, 669 (2d Cir. 2009) (a "court may consider matters of which judicial notice may be taken … including the fact that press coverage ... or regulatory filings contained certain information, without regard to the truth of their contents"). Second, the Court should not take judicial notice of these six documents because they are offered for the truth of the matter asserted. *See Global Network Commc'ns, Inc. v. City of New York*, 458 F.3d 150, 157 (2d Cir. 2006) ("[A]lthough [certain court documents] may be public records of which a court may take judicial notice, it may do so on a motion to dismiss only to establish the existence of the opinion, not for the truth of the facts asserted in the opinion"). Here, Defendants impermissibly submit these six documents for the truth of the matter asserted; namely, that ACP did not assume any of Tower's liabilities.

claims under Section 10(b) of the Exchange Act against the Defendants on behalf of the PPC. In connection with and in anticipation of the Canopius Merger, the ADAR Funds bought 107,000 Canopius shares for $15.45 per share pursuant to a Purchase Agreement executed on March 7, 2013. ¶406. Other members of the PPC likewise made substantially similar purchases of Canopius shares on or around the same date, subject to substantially similar Purchase Agreements. These Purchase Agreements, which the ADAR Funds and the PPC relied upon, contained materially false and misleading statements and omissions made by the Defendants, including *inter alia* that the past three years of Tower's financial statements "present fairly in all material respects the financial condition" of the Company and satisfy GAAP. ¶¶411, 416, 434.

Moreover, "Defendants Tower omitted to disclose material facts in the Purchase Agreement and Similar Agreements, which it knew or recklessly disregarded rendered its statements materially false and misleading, in light of the circumstances under which they were made, not misleading." ¶427. For example, Tower omitted to disclose that its financial statements for 2010 through 2012 did not "fairly present in all material respects its financial condition." ¶412. For omissions of material fact, the PPC need not plead reliance, though, as discussed *infra*, they have done so anyway. *See, e.g., Levitt v. J.P. Morgan Sec., Inc.*, 710 F.3d 454, 465 (2d Cir. 2013) ("an omission of a material fact by a defendant with a duty to disclose establishes a rebuttable presumption of reliance upon the omission by investors to whom the duty was owed") (citing *Affiliated Ute. Citizens v. United States*, 406 U.S. 128, 153–54 (1972)). In light of the foregoing, the PPC has adequately alleged Section 10(b) claims here.

B. Section 18 Claims

1. The ADAR Funds Adequately Allege Section 18 Violations on Behalf of the PPC

Co-Lead Plaintiffs the ADAR Funds, on behalf of the PPC, also adequately allege that Defendants violated Section 18 of the Exchange Act. Section 18 requires plaintiffs to plead "that (1) a false or misleading statement was contained in a document filed pursuant to the Exchange Act (or any rule or regulation thereunder); (2) defendant made or caused to be made the false or misleading statement; (3) plaintiff relied on the false statement; and (4) the reliance caused loss to the plaintiff." *Int'l Fund Mgmt. S.A. v. Citigroup Inc.*, 822 F. Supp. 2d 368, 385 (S.D.N.Y. 2011). As is demonstrated in the Complaint, the PPC handily meets each of the elements of a Section 18 claim.

Defendants nevertheless challenge whether the ADAR Funds adequately alleged actual reliance, but that challenge falls flat. The ADAR Funds clearly identify and describe in the Complaint each of Tower's false and misleading statements in both the Purchase and Registration Rights Agreements. ¶¶409-16. The ADAR Funds also clearly allege that both they and the PPC relied on the specific misstatements identified in the Complaint to their detriment. For example, the Complaint states that "[s]pecifically, the PPC, including the ADAR Funds, and/or their respective agents, read and relied on the Purchase Agreement and Similar Agreements regarding the Company's financial condition without knowing that such information was false and misleading." ¶434. The Complaint also states that "[t]he ADAR Funds and/or their agents specifically read and relied upon, among other things, the language from the Registration Rights Agreement." ¶416. Additionally, the ADAR Funds unambiguously allege that the PPC was harmed by Tower's misstatements and omissions in both the Purchase and Registration Rights Agreements. *See* ¶¶436-37 (describing the PPC's harm after Tower stock fell as the truth was disclosed). Contrary to Defendants' assertion, which is purely conclusory, nothing more is required at this stage to plead a Section 18 claim.

Defendants' attempt to add requirements to Section 18, by asserting that the Complaint must specifically allege precisely ***who*** at the ADAR Funds relied on Defendants' misstatements, is unsupported by case law. Likewise, Defendants' reliance on *Marsh*, 501 F. Supp. 2d at 493, is misplaced because Judge Kram dismissed the Section 18 claims where there were ***no*** allegations that the named plaintiff relied on the misstatements at issue. That is not the case here.

2. Plaintiffs' Section 18 Claims Are Timely

In recognition that their challenge to actual reliance is unfounded, Defendants desperately argue that the PPC's Section 18 claims nevertheless should be barred by the statute of limitations. Again, however, Defendants' challenge is unavailing. Section 18 provides that "[n]o action shall be maintained to enforce any liability created under this section unless brought within one year after the discovery of the facts constituting the cause of action and within three years after such cause of action accrued." 15 U.S.C. §78r(c). Courts in this District routinely deem the ***last*** disclosure in a given class period as the starting point from which the clock starts to run for purposes of Section 18. *See, e.g., In re Bear Stearns Cos., Inc. Sec., Derivative, and ERISA Litig.*, 995 F. Supp. 2d 291, 308 (S.D.N.Y. 2014) (last disclosure triggered Section 18 statute of limitations).[19] Here, that would make December 18, 2013 the relevant date for discovery of the "facts constituting the cause of action," and the starting point from which the statute of limitations began to run. 15 U.S.C. §78(r)(c). As the record reflects, however, Plaintiffs filed their consolidated complaint on August 22, 2014, which is less than a year after

[19] Indeed, Defendants' case citation on this point supports Plaintiffs' argument. *See Alpha Capital Anstalt v. New Generation Biofuels, Inc.*, 2014 WL 6466994, at *15-16 (S.D.N.Y. Nov. 18, 2014) (Section 18 claims time-barred because plaintiffs were on notice one year after *final* disclosure).

the last corrective disclosure was made in this case. Thus, Plaintiffs here did not run afoul of the limitations period.

Defendants' claim that the August 7, 2013 partial disclosure started the clock for the statute of limitations does not bear scrutiny. Def. Br. at 79. On that day, Tower announced that the Company's financial statements would be delayed and that it expected to increase reserves between $60 million and $110 million. ¶¶19, 324. On October 7, 2013, the Company began to disclose the possible magnitude of its problems—revealing that it expected to strengthen reserves by $365 million—five times the amount discussed on August 7, 2013. Even then, however, Tower did not reveal that it would restate its financials dating back to 2009. That disclosure, which is indisputably part of the "facts constituting the cause of action," was first revealed on November 14, 2013. ¶330. *See* 15 U.S.C. § 78r(c). Thus, August 7 clearly did not trigger the limitations period for the PPC claims, and the Complaint was timely filed regardless of whether the limitations period for the claims started in October or November.

Defendants' citation to *In re NovaGold Res. Inc. Sec. Litig.*, 629 F. Supp. 2d 272, 288 (S.D.N.Y. 2009) highlights the weakness of their argument in several ways. First, that case held that "storm warnings exist only when the available information makes wrongdoing "probable, not merely possible" (citing *Shah v. Meeker*, 435 F.3d 244, 249 (2d Cir. 2006)). Here, investors were only on notice that wrongdoing was "probable" with either the October 7 statement concerning the undreamt-of extent of the reserve strengthening or the November 14 announcement that the reserve issues would force the Restatement. Second, Judge Cote noted in *NovaGold* that "[i]n some cases, despite the presence of storm warnings, investors are not placed on inquiry notice "because the warning signs are accompanied by reliable words of comfort from management." *NovaGold*, 629 F. Supp. 2d at 285 (citation omitted). That is precisely the case here, as Defendant Lee comforted investors after the August 7 disclosure, stating that the anticipated loss reserve increases would "strengthen the Company" and would allow Tower "to achieve our long-term financial objectives." ¶116.

3. Even If Plaintiffs' Section 18 Claims Were "Untimely" And They Are Not—They Relate Back to the Earlier Complaints

Even if the Court determines that the August 7, 2013 disclosure started the limitations period for the PPC's Section 18 claims, which it should not do, those claims would nevertheless still survive because they relate back to earlier complaints, including, *inter alia*, *Lang v. Tower Grp. Int'l., Ltd*, 13-cv-5852 ("*Lang*") and *Sharma v. Tower Grp. Int'l, Ltd.*, 13-cv-7085 ("*Sharma*"), which were filed on August 20, 2013 and October 15, 2013, respectively. Federal Rule of Civil Procedure 15(c) governs the relation back of amendments to a complaint. "There are ... three requirements that must be met before an amended complaint that names a new party can be deemed to relate back to the original timely complaint. First, both complaints must arise out of the same conduct, transaction, or occurrence. Second, the additional defendant must have been omitted from the original complaint by mistake. Third, the additional defendant must not be prejudiced by the delay." *VKK Corp. v. Nat'l Football League,* 244 F.3d 114, 128 (2d Cir. 2001). "The rationale underlying the relation-back doctrine is that one who has been given adequate notice of litigation concerning a given transaction or occurrence has been provided with all the protection that statutes of limitations are designed to afford." *Padilla v. Payco Gen. Am. Credits, Inc.*, 161 F. Supp. 2d 264, 273 n.15 (S.D.N.Y. 2001).

Here, the PPC readily meets each of the above requirements. First and foremost, the underlying factual predicate of the Section 18 claims is the same as the originally-filed Section 10(b) claims. Tellingly, the original three complaints filed in this action discuss the Canopius Merger at great length; and therefore, it should have been perfectly obvious to Defendants that their misconduct surrounding that Merger was part and parcel of the PPC's allegations. *See Lang*, ¶¶19-20; 27-32; *Sharma*, ¶¶9, 45-54. The mere fact that the Section 18 claims concern Private Placement Purchase and Registration Rights Agreements, and the Section 10(b) claims concern public misstatements in SEC filings and teleconferences is inapposite because the claims are factually the same. There have been no surprises here. In addition, no new defendants were named in these claims, so there is also no danger of prejudice or delay.[20] Accordingly, because adequate notice was given here to Defendants concerning the Section 18 claims, relation back should apply, and Defendants' statute of limitations defense should be rejected.

C. The ADAR Funds Also Adequately Allege State Law Violations On Behalf Of The PPC

The Complaint also adequately alleges valid state law claims on behalf of the PPC that, contrary to Defendants' assertions, are neither barred by the Court's consolidation order nor by SLUSA. These state law claims include breach of contract, breach of warranty, and negligent misrepresentation claims arising from the Private Placement Purchase and Registration Rights Agreements. Because none of these state law claims sounds in fraud, none of them are subject to the particularized pleading requirements of Rule 9(b), as Defendants claim. Instead, each of these state law claims are subject to the general pleading requirements of Rule 8. *See, e.g.*, *Bayerische Landesbank, N.Y. Branch v. Aladdin Capital Mgmt. LLC*, 692 F.3d 42, 64 (2d Cir. 2012) (breach of contract typically subject to Rule 8); *Columbia Sav. & Loan Ass'n. v. Am. Int'l Grp., Inc.*, 1994 WL 114828, at *5 (S.D.N.Y. Mar. 31, 1994) (holding that Rule 9(b) does not apply to a breach of warranty claim notwithstanding defendants' argument that the warranty

[20] Defendants' citation to *Stoll v. Ardizzone*, 2007 WL 2982250, at *5 (S.D.N.Y. Oct. 9, 2007), is distinguishable. In that case, the court rejected relation back allegations, dismissing Section 14 claims based on a misleading proxy where the plaintiffs did not even mention the proxy until filing a memorandum in opposition to defendants' motion to dismiss.

claim was "in essence a claim for fraud"). Nevertheless, even if the Court finds that these state law claims sound in fraud, which they do not, the PPC readily satisfies the Rule 9(b) standard, as is articulated *supra* in connection with the Complaint's fraud-based claims.

1. SLUSA Does Not Insulate Defendants From The PPC's State Law Claims

Defendants cannot escape liability from the PPC's state law claims by asserting SLUSA preclusion here. SLUSA was enacted to "prevent plaintiffs from seeking to evade the protections that Federal law provides against abusive litigation by filing suit in State court, rather than Federal court…The purpose of SLUSA is to ensure that securities fraud cases are heard only in federal courts and only under federal law." *Xpedior Creditor Trust v. Credit Suisse First Boston (USA) Inc.*, 341 F. Supp. 2d 258, 264 (S.D.N.Y. 2004). This action was filed in federal court, it is subject to the PSLRA, and it alleges, distinctly from these state law claims, federal securities fraud claims against the Defendants that must satisfy the heightened Rule 9(b) pleading standard. Accordingly, there has been no attempt whatsoever to evade federal law or the federal courts here, and the policy objectives of SLUSA are simply not implicated in this case. *Anwar v. Fairfield Greenwich Ltd.*, 728 F. Supp. 2d 372, 399 (S.D.N.Y. 2010) (finding SLUSA's policy objectives were not implicated where plaintiffs also "press federal securities law claims against many of the Defendants and have not attempted to bypass the higher pleading requirements required for these claims by resorting to more lenient state law"). The mere assertion of state law claims by the PPC does not automatically entitle Defendants to SLUSA preclusion here.

To invoke SLUSA, Defendants must show that: (1) the underlying suit must be a 'covered class action'; (2) the action must be based on state or local law; (3) the action must concern a 'covered security'; and (4) the action must allege misrepresentations 'in connection with the purchase or sale of' that security. *Liberty Media Corp. v. Vivendi Universal, S.A.*, 842 F. Supp. 2d 587, 591-92 (S.D.N.Y. 2012). Defendants cannot do that here, *inter alia*, because the PPC's breach of contract and breach of warranty claims do not involve or even require allegations of misrepresentations or omissions in connection with the purchase or sale of a covered security. *See Anwar,* 728 F. Supp. 2d at 399 n.7 ("A court, after considering both technical elements of a claim as well as factual allegations intrinsic to the claim as alleged, "must dismiss under SLUSA ***only*** claims that include "misstatements or omissions" as a "***necessary component***") (emphasis added); *Xpedior*, 341 F. Supp. 2d at 266-70 (S.D.N.Y. 2004) (holding that the claims of violation of an underwriting agreement were not preempted by SLUSA, reasoning that fraud was not a necessary component of the breach of contract claims). Thus, to find that SLUSA applies to those claims would yield an absurd result. *See LaSala v. TSB Bank, PLC*, 514 F. Supp. 2d 447, 473 (S.D.N.Y. 2007) ("If merely making allegations of fraud somewhere in the complaint were sufficient to bring the case within the reach of SLUSA, a class action complaint for commission of an environmental tort, that also alleged that the company fraudulently altered its books and thereby deceived shareholders, would be preempted, even if the claim against the defendant had nothing to do with securities fraud.").

SLUSA also would not apply to the PPC's state law claims, including negligent misrepresentation, if the Court finds that no covered securities were purchased or sold in the Private Placement. As is set forth in the Complaint, only Canopius shares were sold in the Private Placement, and Canopius was the subsidiary of a privately held company whose securities were neither listed nor authorized for listing on any national exchange. *Cf.* ¶79; *see Chadbourne & Parke LLP v. Troice*, 134 S. Ct. 1058, 1066 (2014) (reaffirming that SLUSA "focuses upon transactions in covered securities, not upon transactions in uncovered securities," about which SLUSA "expresses no concern"). Moreover, the "covered" Tower securities that Defendants assert backed the Private Placement did not exist when the Purchase Agreements were executed by the PPC and would not exist until the Merger was approved approximately one week later by TGI shareholders.

Defendants misplace reliance on *Sulkow v. Crosstown Apparel Inc.*, 807 F.2d 33, 36 (2d Cir. 1986) to argue that the PPC's state law claims are subject to SLUSA because "[a]n agreement to purchase [a covered security] is, by definition, a purchase within the meaning of the [1934] Act". Def. Br. at 85. *Sulkow* is inapplicable here because the plaintiffs there bought investment contracts for shares that were never issued to them. In *Sulkow*, the Second Circuit "reject[ed] the district court's view that if a security allegedly purchased by the plaintiff has not been issued there is no claim on which relief can be granted under Rule 10b–5." 807 F.2d at 36. Here, however, the PPC was not deprived of any shares. They received exactly the shares that they paid for in the Private Placement, *i.e.*, shares in Canopius, which only later were converted to Tower. Accordingly, Defendants' transparent attempt to misconstrue the Private Placement purely as an agreement to purchase "covered" Tower securities to trigger SLUSA is misguided and should be rejected.

Defendants also mistakenly claim that even if PPC members only bought Canopius shares, their claims would still be precluded because they were holders of Canopius shares at the time of the Canopius Merger. This argument fails because the PPC entered into the Purchase Agreements on or about March 7, 2013—a week before the Canopius Merger closed. ¶408. Thus, the PPC were acquirers at the time of the Purchase Agreements, not holders.[21]

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[21] Defendants' citation to *Rubery v. Radian Group, Inc.*, 2007 WL 1575211, at *3 (E.D. Penn. May 31, 2007), is distinguishable because the plaintiffs brought that case on behalf of *holders*.

Likewise, Defendants incorrectly argue that even if only Canopius shares were bought in connection with the Private Placement, the PPC's claims should still be dismissed because the PPC alleges misstatements and omissions related to Tower, not Canopius. This is a non sequitur. The security purchased by the PPC is not determined by the subject matter of Defendants' misstatements and omissions.

a. The PPC's Breach Of Contract And Breach Of Express Warranty Claims Should Be Sustained

The PPC has adequately alleged breach of contract and breach of warranty claims against the Defendants. Under New York law, the elements of a breach of contract claim are: (1) the existence of a contract, (2) performance of the contract by one party, (3) breach by the other party, and (4) damages suffered as a result of the breach. *Johnson v. Nextel Commc'ns, Inc.*, 660 F.3d 131, 142 (2d Cir. 2011). The elements of a breach of express warranty claim are substantially similar, with the exception of a reliance element, which is also satisfied as is set forth *supra* in connection with the Section 18 claims. *See Goldemberg v. Johnson & Johnson Consumer Cos*., Inc., 2014 WL 1285137, at *12 (S.D.N.Y. Mar. 27, 2014). Accordingly, the same analysis will apply. Neither misrepresentation, nor omission, nor scienter are elements of breach of contract or warranty claims under New York law. *See, e.g., Norman v. Salomon Smith Barney, Inc*. 350 F. Supp. 2d 382, 386 (S.D.N.Y. 2008) ("The claims at issue are for breach of contract and breach of fiduciary duty, neither of which has fraud or misrepresentation as an element"). Accordingly, neither SLUSA nor Rule 9(b) apply to these claims.

The Complaint easily satisfies the elements for breach of contract and breach of warranty. The Purchase Agreements and the Registration Rights Agreements associated therewith were

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Here, the PPC is an acquirer class; *i.e.*, those who acquired Canopius shares on or about the day of the Purchase Agreement, which is the basis for their state law claims.

contracts. The PPC performed its end of the contracts by paying valuable consideration for Canopius shares, *e.g.* ADAR Funds alone paid over $1.6 million for 107,000 Canopius shares. ¶406. Tower, in turn, breached material terms of the contract, including: (1) by suspending the PPC from selling Registrable Shares for longer than the permissible timeframe set forth in the Registration Rights Agreements to the PPC's detriment; and (2) by selling the PPC a bill of goods that culminated in a material restatement of Tower's financials for a three year period. ¶¶411-22.

Specifically, Tower's March 13, 2013 Registration Rights Agreements, which were executed approximately one week after the Purchase Agreements in connection to the Private Placement, represented and warranted to the PPC, in relevant part, as follows:

> Pursuant to Section 5(a), the Holders shall be required to suspend sales of Registrable Shares pursuant to the applicable Registration Statement for such times as the Company reasonably may determine is necessary and advisable, but in no event for more than 60 days in any 90-day period or more than 120 days in any 12-month period.

¶¶415-16.

On March 28, 2013, Tower filed a registration statement and supplement with the SEC that registered the restricted Tower shares in accordance with the Registration Rights Agreements. ¶418. As of that date, the PPC was permitted to sell their Registrable Shares. ¶¶418-19. However, on or about August 29, 2013, the ADAR Funds and the PPC received a notice from Tower that their ability to sell their Registrable Shares had been suspended. ¶420. To date, no "End of Suspension Notice" has been received by ADAR Funds or the PPC. ¶421. Thus, the ADAR Funds were forced to hold on to their Registrable Tower shares, while Tower stock plummeted from an August 29, 2013 closing price of $14.53 to the fire-sale ACP Merger price of $2.50.[22]

In light of the foregoing, Tower clearly breached its contract and express warranty with the ADAR Funds and the PPC. The PPC did not receive what it paid for and what it was promised in connection to the Private Placement. Importantly, Tower's breach of the Registration Rights Agreements was also not immediate, and it is highly unlikely that Tower even knew that it would breach these agreements when they were first executed. Indeed, Tower's breach of the Registration Rights Agreements occurred several months later when the ADAR Funds received the suspension notice. These facts are significant because: (1) they demonstrate that the breach was not based on a misrepresentation in the contract or warranty; and (2) that such breach did not occur in connection "with the purchase or sale of a security" because it occurred six months after the Private Placement was consummated.

Tower also represented and warranted, in relevant part, as follows in the Purchase Agreements executed on March 7, 2013:

> The financial statements and the related notes and supporting schedules thereto filed by Tower with the Commission for the past three fiscal years and any interim periods since the most recent fiscal year end present fairly in all material respects the financial condition, results of operations and cash flows of the entities purported to be shown thereby, at the dates and for the periods indicated, and have been prepared in conformity with accounting principles generally accepted in the United States applied on a consistent basis throughout the periods involved.

¶411. By restating Tower's financial statements for a three year period, Tower admitted that it sold the PPC a bill of goods; that its representations and warranties concerning the Company's financial condition were false; that its representations and warranties did not fairly represent "in

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[22] The notice did not reveal any of Defendants' fraudulent activity – it only stated that the ADAR Funds could not sell their registrable shares until the Company filed its second quarter 2013 quarterly report and the ADAR Funds receive an end of suspension notice. *See* Faber Decl. Ex. E. (Dkt. No. 42).

all material respects the financial condition, results of operations and cash flows of the entities purported to be shown thereby, at the dates and for the periods indicated;" and that Tower's financials were not "prepared in conformity with accounting principles generally accepted in the United States applied on a consistent basis throughout the periods involved." ¶412.

The Complaint also unambiguously alleges that the ADAR Funds and the PPC relied on the above statements, among others, and suffered damages as a result thereof (*e.g.*, ¶¶417, 435, 444, 450); *e.g.*, a decline in the value of Tower shares as the truth was slowly revealed about the Company's false financial statements. Accordingly, the ADAR Funds and the PPC meet all of the required elements (which are distinct from their fraud-based claims) for alleging breach of contract and breach of express warranty claims.[23]

Defendants' reliance on *Delta Holdings* in support of its argument that the PPC's breach of contract claim should be dismissed is unavailing, because, as explained above, unlike in *Delta Holdings,* Defendants represented and warranted that *historical* financial information discussed in the Purchase Agreements was fairly represented—and Tower has now admitted that such information was not fairly represented and it is being restated.

Defendants also wrongly assert that the claims on behalf of members of the PPC whose Registrable Shares were unduly suspended are "holder" claims that are not recognized in New York. In support of this meritless argument, Defendants rely on *Starr Found v. Am. Int'l Group, Inc*., 901 N.Y.S.2d 246, 250 (App. Div. 2010), which is clearly distinguishable from this case. There, the plaintiffs were allegedly fraudulently induced to *hold* their shares, whereas here

[23] Defendants claim that Plaintiffs did not plead causation or damages with reference to the contract and warranty claims based on suspension, but the Complaint suffices to answer these concerns on a pleading motion. ¶444, 450; *see id*. ("[a]s a direct and proximate result of the [breaches of contract and breaches of express warranty], the ADAR Funds and other members of the [PPC] have been damaged in an amount to be proven at trial").

members of the PPC were actually *suspended* from selling their Registrable Shares in clear breach of the Registration Rights Agreement. *See* ¶¶393-95. Accordingly, this case cannot be treated as a holder case because there was no actual decision to hold here by the members of the PPC—their hands were tied by Defendants' suspension notice.

Likewise, Defendants' claim that the ADAR Funds sold some, but not all, of their Tower shares after receipt of the notice is irrelevant. As an initial matter, these were ***unregistered*** Tower shares that the ADAR Funds were allowed to sell. *See* ¶415.[24] Moreover, the fact that the ADAR Funds did not completely liquidate their unregistered shares is a red herring. The ADAR Funds could have had many reasons for this investment decision—none of which is relevant on this motion.

b. Negligent Misrepresentation

The PPC has also adequately alleged negligent misrepresentation claims against the Defendants. To state a claim for negligent misrepresentation under New York law, the plaintiff must allege (1) the existence of a special or privity-like relationship imposing a duty on the defendant to impart correct information to the plaintiff; (2) that the information was incorrect; and (3) reasonable reliance on the information. *Mandarin Trading Ltd. v Wildenstein*, 944 N.E.2d 1104, 1109 (N.Y. 2011). To allege privity of contract requires an awareness by the maker of the statement that it is to be used for a particular purpose; reliance by a known party on the statement in furtherance of that purpose; and some conduct by the maker of the statement linking it to the relying party and evincing its understanding of that reliance. *Ridge Seneca Plaza, LLC v. BP Prods. N. Am. Inc.*, 545 F. App'x 44, 46 (2d Cir. 2013). A "special

[24] Defendants' claim that the ADAR Funds may have violated the Notice is wrong. *See* November 18, 2013 Faber Decl. ¶10 (stating that the ADAR Funds sold no unregistered shares after receipt of the Notice) (Dkt. No. 42).

relationship" is more likely to exist if, as here, the misrepresented facts were "peculiarly within the Defendant[s'] knowledge." *LBBW Luxemburg S.A. v. Wells Fargo Sec. LLC*, 10 F. Supp. 3d 504, 526 (S.D.N.Y. 2014). Negligent misrepresentation claims do not include the element of scienter and are not subject to Rule 9(b).

The PPC meets each of the above elements. Members of the PPC were in privity, or a special relationship, with Canopius (now Tower) because Canopius had "unique or specialized expertise" or was "in a special position of confidence and trust with the injured party." *Mandarin Trading*, 944 N.E.2d at 1109. Indeed, Canopius, by virtue of the proposed merger with TGI, was in a unique position to perform due diligence into TGI's financial condition. Canopius represented that TGI's financial statements for 2010 through 2012 "presented fairly" and in accordance with GAAP "all material respects" of Tower's "financial condition." ¶411. Members of the PPC, including the ADAR Funds, believed these representations were accurate – and only Canopius had the information to determine whether that was the case. Indeed, these allegedly misrepresented facts were "peculiarly within [Canopius's] knowledge." *LBBW*, 10 F. Supp. 3d at 517. Likewise, the ADAR Funds, like other members of the PPC, reasonably relied on such false information, which was critical to the Private Placement, as no investor in their right mind would trust a company whose financial statements were false. And Tower "evince[ed] its understanding of that reliance." *Ridge Seneca Plaza, LLC*, 545 F. App'x at 46. *See* ¶410 (the Purchase Agreement stated that "Tower understands and confirms that the undersigned investor will rely on such representations and warranties and the bringdowns thereof in making its investment decision with respect to the Shares"). Furthermore, the Second Circuit has held that for pleading purposes, a special relationship of trust or confidence is not even required where the plaintiff "emphatically alleges" that the defendant held a unique or special expertise, and that the defendant provided information knowing how that information would be used by the plaintiff. *See Eternity Global Master Fund Ltd. v. Morgan Guar. Trust Co. of N.Y.*, 375 F.3d 168, 188 (2d Cir. 2004).[25] Defendants knew the importance of Tower's financial condition to the PPC.

Defendants seek dismissal of the PPC's negligent misrepresentation claims by regurgitating their arguments relating to the alleged federal securities violations. Defendants argue that the negligent misrepresentation claims should be dismissed because the PPC has not alleged a materially false statement,[26] and have not alleged loss causation. Def. Br. at 74. As discussed above, neither of these arguments hold any water. *See supra* at Section X.C.1.a.[27]

c. Defendants' Claim That Plaintiffs Do Not Have Authority To Assert State Claims Is Groundless

Finally, Defendants make a half-hearted argument that Plaintiffs "failed to provide notice of the…new [PPC] and their claims within 20 days of filing the CAC, as required by the

[25] Defendants' citation to *Basis Pac-Rim Opportunity Fund v. TCW Asset Mgmt. Co.*, 124 A.D. 3d 538, 539 (N.Y. App. Div. 2015) falls flat. There, the plaintiffs "failed to establish a special relationship." *Id.* Here, Tower had "special expertise" (*Mandarin Trading*, 944 N.E.2d at 1109) and the misstated facts at issue were "peculiarly within [Tower's] knowledge[,]" giving rise to a special relationship between the PPC and Tower. *LBBW*, 10 F. Supp. 3d at 517.

[26] Defendants cite *Hydro Investors, Inc. v. Trafalgar Power Inc.*, 227 F.3d 8, 20 (2d Cir. 2000), *appeal after remand*, 328 F. App'x 10 (2d Cir. 2009) and *Sheth v. New York Life Ins. Co.*, 709 N.Y.S.2d 74, 75 (App. Div. 2000) on this point but these cases involved future projections and promises and statements of opinion. Tower misrepresented current and historical facts relating to Tower's financial statements in the Purchase Agreements which, as discussed above, cannot be characterized as statements of opinion. *See supra* at Section IV.A.2.

[27] Defendants' citations to *IKB Int'l S.A. v. Bank of Am.*, No. 12 CIV. 4036 LAK, 2014 WL 1377801, at *24 (S.D.N.Y. Mar. 31, 2014), *aff'd*, 584 F. App'x 26 (2d Cir. 2014) and *In re Citigroup Inc. Sec. Litig.*, 987 F. Supp. 2d 377, 390 (S.D.N.Y. 2013), do not apply here. In *IKB*, the plaintiffs failed to allege any basis for either a special relationship or justifiable reliance. Here, Plaintiffs allege both. Likewise, in *Citigroup*, the court held that "no special relationship exists between an issuer of securities to the general public and a purchaser of such securities." Here, the PPC alleges a special relationship between ***the PPC*** and Tower; not between the "general public" and Tower.

PSLRA." Def. Br. at 63. This claim falls flat. Courts have ruled that when claims are based on substantially similar allegations or conduct, no additional notice to investors is required. *See In re Thornburg Mortg., Inc. Sec. Litig.*, 629 F. Supp. 2d 1233, 1242 (D.N.M. 2009) (as long as the amended allegations are "substantially similar" or arise out of a "continuing course of similar conduct" as the original claims, republication of notice is unwarranted); *In re Int'l Rectifier Corp. Sec. Litig.*, 2008 WL 4555794, at *23 (C.D. Cal. May 23, 2008) (republishing notice unwarranted where amendments to the pleading extended the class period but did not change the facts giving rise to the action).[28]

Here, the facts demonstrate that a new notice was unnecessary. The Complaint and the facts discussed in the Notices clearly arise out of similar operative facts—fundamentally flawed loss reserves. Further, before lead plaintiff motions were filed, counsel issued two notices, each of which stated that Tower had "failed to properly estimate its loss reserve provisions as required by Generally Accepted Accounting Principles". *See* Dkt. No. 25-4 and 25-5. Thus, these notices demonstrate that the facts alleged in the Complaint and the facts alleged in the initial complaints are closely related. In addition, the Class Period here—March 1, 2010 through December 17, 2013, is not markedly different from the class period at the time of the lead plaintiff motions

[28] Defendants' citation to *Poptech*, *LP v. Stewardship Inv. Advisors, LLC*, 2010 WL 4365669, at *2 (D. Conn. Oct. 28, 2010), actually supports Plaintiffs' argument. In that case, the court held that "[B]ecause the PSLRA applies only to class actions that arise under federal securities law, …the primary purpose of a PSLRA notice is to inform potential class members about the federal securities law claims in the complaint…federal district courts have interpreted the PSLRA to require nothing more than a reasonably detailed notice about the federal claims asserted in a securities class action complaint"). Moreover, here, unlike in *Poptech*, there were no state law claims at the time the notices were issued.

(March 1, 2011 through October 7, 2013). In sum, as the cases discussed above illustrate, the addition of intimately related claims in these circumstances does not require a new notice.[29]

CONCLUSION

For all the foregoing reasons, Defendants' motion to dismiss should be denied in its entirety.

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Respectfully submitted,

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[29] Indeed, the fact that the ADAR Funds came forward to make a lead plaintiff motion undermines Defendants' argument. The ADAR Funds lost a huge amount of money in the Private Placement (as well as in connection with open market Tower purchases), yet they decided to move for lead plaintiff. The Court's Consolidation Order is not to the contrary—the Court did not limit the claims that Co-Lead Plaintiffs could assert.

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