UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

IN RE CONVERIUM HOLDING AG SECURITIES LITIGATION (Meyer v. Converium Holding AG, *et al.*)	:	No. 04 Civ. 7897 (MBM) (DFE)
This document relates to: 04 Civ. 7897 04 Civ. 8038 04 Civ. 8060 04 Civ. 8295 04 Civ. 8994 04 Civ. 9479	:	

REPLY MEMORANDUM OF LAW IN SUPPORT OF DEFENDANT ZURICH FINANCIAL SERVICES' MOTION TO DISMISS COUNTS III, V, IX, AND X OF THE CONSOLIDATED AMENDED CLASS ACTION COMPLAINT

Ralph C. Ferrara
Jonathan E. Richman (JR-2491)
John C. Letteri
LEBOEUF, LAMB, GREENE & MACRAE LLP
125 West 55th Street
New York, New York 10019
(212) 424-8000

Attorneys for Defendant Zurich Financial Services

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MEMORANDUM OF LAW

In its opening brief ("ZFS Br."), defendant Zurich Financial Services ("ZFS") established ample grounds to dismiss each of the claims alleged against it under §§ 12(a)(2) and 15 of the Securities Act of 1933 (the "Securities Act") and §§ 10(b) and 20(a) of the Securities Exchange Act of 1934 (the "Exchange Act"). Instead of directly addressing each of ZFS's grounds for dismissal, plaintiffs filed a single, 93-page opposition brief ("Pl. Br.") that attempts to address *all* of the arguments that *all* of the defendants raised in their three separate motions to dismiss. Plaintiffs claim (at 1 n.1) they prepared a single opposition brief because many of the defendants' arguments "overlap." But plaintiffs use their combined filing to create a confusing haze of allegations designed to blame each defendant for other defendants' alleged conduct.

For example, plaintiffs present lengthy lists of allegedly false and misleading statements that "defendants" purportedly made about Converium Holding AG's ("Converium's") loss reserves and financial condition both before and after the initial public offering (the "IPO") of Converium's securities on December 11, 2001, and they try to attribute *all* of the conduct to *all* of the defendants to create a "strong inference" of scienter. There is no dispute, however, that plaintiffs' claims *against ZFS* depend solely on any alleged conduct that *preceded* the IPO. After the IPO, ZFS had no ownership interest in Converium and was not – and is not alleged to have been – responsible for any of Converium's purported acts.

Plaintiffs also seek to avoid meaningful consideration of ZFS's arguments by asserting that nearly every one of them raises "issues of fact" that the Court may not resolve at the pleading stage. Reading plaintiffs' brief, one cannot help but wonder whether District Courts in this Circuit *ever* grant motions to dismiss in securities cases. But District Courts frequently grant such motions, and the Second Circuit frequently affirms them – especially since the

enactment of the Private Securities Litigation Reform Act of 1995 (the "PSLRA"), which was designed to facilitate disposition at the pleading stage.

Plaintiffs' brief impermissibly attempts to amend the Complaint by introducing an entirely new theory of the case: that defendants somehow "duped," "tricked," "deceived," and "conned" Tillinghast-Towers Perrin ("Tillinghast") – the independent actuarial firm retained to analyze Converium's loss reserves before the IPO – into lowering its estimate of Converium North America's reserves deficiency from an alleged $350 million to $186 million, and then to a final, "best estimate" of $162 million. The Complaint, however, does not contain any hint of this theory, or any purported facts to support it; nor does plaintiffs' brief. Accordingly, plaintiffs have not pled *any* facts to show any fraud before the IPO – the only time period relevant to ZFS.

This reply brief first will address plaintiffs' misguided effort to avoid the particularized pleading standards of Fed. R. Civ. P. 9(b). It then will show that, based on the allegations in the Complaint and admissible documentary evidence, plaintiffs have failed to plead a material misrepresentation about Converium's pre-IPO loss reserves. The brief next will demonstrate the other defects in each of plaintiffs' claims against ZFS.

I.
RULE 9(b) APPLIES TO ALL OF PLAINTIFFS' CLAIMS.

ZFS's opening brief established (at 9-15) that Rule 9(b)'s particularity requirements apply to all of plaintiffs' claims. Plaintiffs' opposition concedes (at 20-23) that Rule 9(b) governs claims under § 10(b) of the Exchange Act but argues (at 18-20) that only Fed. R. Civ. P. 8(a)'s notice-pleading requirements apply to the remaining claims against ZFS as well as to loss causation. Plaintiffs are incorrect. The entire Complaint sounds in fraud, and plaintiffs therefore must plead *all* of their claims with the particularity required by Rule 9(b).

A. Plaintiffs' Securities Act Claims Sound in Fraud and Must Satisfy Rule 9(b).

Plaintiffs contend (at 18-19) that Rule 9(b) does not apply to their Securities Act claims because they "explicitly averred that [those] claims are not premised on fraud." *See, e.g.*, Compl. ¶¶ 259, 277 ("This Count does not sound in fraud. All of the preceding allegations of fraud or fraudulent conduct and/or motive are specifically excluded from this Count."). Such boilerplate disclaimers, however, do not allow complaints that sound in fraud to evade Rule 9(b).

The Second Circuit rejected just such a ploy in *Rombach v. Chang*, 355 F.3d 164 (2d Cir. 2004), where the plaintiffs alleged – as do plaintiffs here – that their Securities Act claims "'do[] not sound in fraud.'" *Id.* at 172. The court looked past the disclaimer and focused instead on the complaint's actual language, which was essentially the same as that used here:

***Rombach* Complaint**	**Converium Complaint**
The Registration Statement "contained '*untrue* statements of material facts'";	The Registration Statement and Prospectus "contained *untrue* statements of material fact and omitted other facts necessary to make the statements *not misleading*" (¶¶ 250, 261) (emphasis added);
"[T]he Registration statement was 'inaccurate *and* misleading'";	The Registration Statement and Prospectus were "*false and misleading*" (*id.*) (emphasis added);
"'[M]aterially *false* and *misleading* written statements were issued . . . .'" 355 F.3d at 172 (emphasis in original).	ZFS failed "to ensure that such statements were true and that there was no omission of material fact necessary to prevent the statements contained [in the Prospectus] from being *misleading*" (¶ 264 (emphasis added)).

The Second Circuit concluded that the "wording and imputations of [plaintiffs'] complaint are classically associated with fraud" and held that Rule 9(b) applied. This Court should do so as well. *See, e.g., In re Corning Sec. Litig.*, No. 01-CV-6580-CJS, 2004 WL 1056063, at *9 (W.D.N.Y. Apr. 9, 2004) (holding that § 11 claims "sounded in fraud" and were subject to

Rule 9(b) despite disclaimer that "'[t]he claim asserted in Count I [and II] is not based on any allegation of fraud'"), *aff'd mem.*, No. 04-2845-CV, 2005 WL 714352 (2d Cir. Mar. 30, 2005).[1]

In fact, the reasons to apply Rule 9(b) here are even *stronger* than in *Rombach*, because plaintiffs' Securities Act claims expressly incorporate fraud-based allegations from *other* portions of the Complaint. For example, plaintiffs' § 12(a)(2) claim alleges that the Prospectus was false and misleading because it "failed to disclose material facts as described above in paragraphs 141-148." (Compl. ¶ 261). Paragraphs 141-148, in turn, contain a litany of allegations that sound in fraud under the caption "False And Misleading Statements":

- The Registration Statement and Prospectus contained "a series of materially *false and misleading* statements . . . [that were] *designed to create the impression* that Converium was a strong, growing company" (¶ 141 (emphasis added));
- "Converium's senior management *determined* to increase reserves by [less than Tillinghast's alleged estimate] because they believed that was the maximum amount by which Converium could increase reserves and still go public" (¶ 145 (emphasis added)), and
- Converium's "reserves were not reasonable estimates based on the information *known* at the time" (¶ 147 (emphasis added)).

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[1] *See also, e.g., Johnson v. NYFIX, Inc.*, 399 F. Supp. 2d 105, 121-22 (D. Conn. 2005) (applying Rule 9(b) to § 11 claim sounding in fraud, even though "[p]laintiffs have gone to great lengths in the Amended Complaint to disavow fraud as the basis for the § 11 claim and assert that it is a strict liability cause of action"); *In re JP Morgan Chase Sec. Litig.*, 363 F. Supp. 2d 595, 635 (S.D.N.Y. 2005) ("Plaintiffs cannot evade the Rule 9(b) strictures by summarily disclaiming any reliance on a theory of fraud or negligence"); *In re CIT Group, Inc. Sec. Litig.*, 349 F. Supp. 2d 685, 690 n.4 (S.D.N.Y. 2004) (§ 11 claims based on alleged misrepresentations about loan loss reserves "unquestionably sound[] in fraud and therefore implicate[] Rule 9(b)" despite plaintiffs' repeated statements that "their causes of action are not premised on fraud").

To the extent that *In re WorldCom, Inc. Securities Litigation*, No. 02 Civ. 3288, 2004 WL 1435356, at *4 n.6 (S.D.N.Y. June 28, 2004) – which plaintiffs cite (at 19) – held that an express disclaimer of fraud suffices to avoid Rule 9(b) scrutiny of Securities Act claims, it appears to be inconsistent with *Rombach* and the other cases cited above. However, the *WorldCom* court did not describe or analyze the language of the claims in any way. The court discussed the disclaimer's language only in the context of the plaintiffs' failed attempt to *abandon* it so they could characterize their Securities Act claims as fraud claims, which have a longer statute of limitations. The court refused to accept the plaintiffs' gambit and held that the shorter limitations period barred the claims.

Moreover, plaintiffs rely on the same alleged conduct to support their claim under § 10(b) of the Exchange Act. *See, e.g.*, Compl. ¶ 317 (ZFS intended to and did "deceive the public . . . regarding . . . Converium's loss reserves and financial results"). This Court has held that Rule 9(b) applies to Securities Act claims premised on the same conduct as § 10(b) claims. *In re Philip Servs. Corp. Sec. Litig.*, 383 F. Supp. 2d 463, 481 (S.D.N.Y. 2004) ("It is plain that the § 11 claims asserted against [defendants] sound in fraud: not only do allegations of fraud permeate the complaint, but also the claims asserted under § 11 are premised on the allegations supporting the § 10(b) claim").

In fact, to the extent plaintiffs contend that the reserves estimates in the IPO-related documents were false or misleading, plaintiffs cannot establish even a *misrepresentation* – an essential element of their Securities Act claims, *see, e.g.*, 15 U.S.C. § 77l(a)(2) – unless they also plead and prove that defendants committed *fraud* in issuing those estimates. As ZFS showed in its opening brief (at 21-22, 26-27), and as discussed below in Parts II.B and II.C, reserves estimates are forward-looking statements or opinions that cannot be false unless the speaker *did not believe them at the time they were issued.* Thus, the Securities Act claims themselves require plaintiffs to plead and prove defendants' fraudulent state of mind in 2001 – a matter clearly subject to Rule 9(b). (And if plaintiffs take the position that their Securities Act claims do *not* allege that defendants did not believe in the accuracy of their loss-reserves estimates in 2001, then plaintiffs have failed to plead a crucial element of their claims: a material misrepresentation.)

None of plaintiffs' cited cases undermines Rule 9(b)'s applicability to the Securities Act claims. Indeed, one of those cases – *In re Initial Public Offering Securities Litigation*, 358 F. Supp. 2d 189, 210 (S.D.N.Y. 2004), relied on *Rombach* and applied Rule 9(b)

to a Securities Act claim that sounded in fraud. And in *In re WRT Energy Securities Litigation*, No. 96 Civ. 3610, 2005 WL 323729, at *6 (S.D.N.Y. Feb. 9, 2005), *reconsideration granted in part*, 2005 WL 2088406 (S.D.N.Y. Aug. 30, 2005), the court recognized that Rule 9(b) applies to Securities Act claims sounding in fraud but held that the particular complaint's language sounded only in negligence, not fraud. Unlike plaintiffs here, the *WRT* plaintiffs had merely tracked § 11 s language. *Id.* They had not made *Rombach*-like allegations or cited to earlier paragraphs sounding in fraud, as does the Complaint in this case.

B. Plaintiffs' Control-Person Claims Also Must Satisfy Rule 9(b).

Plaintiffs' assertion (at 20) that ZFS "did not contest" that Rule 8(a)'s notice-pleading requirements govern the control-person liability claims is incorrect. ZFS's opening brief showed (at 11, 13-14) – with case citations – that Rule 9(b) applies to the control-person claim under the Exchange Act and to *all* of the Securities Act claims.

Plaintiffs have not tried to distinguish any of ZFS's cited authorities on this point. And plaintiffs' reliance (at 20) on *In re Initial Public Offering Securities Litigation*, 241 F. Supp. 2d 281 (S.D.N.Y. 2003), is misplaced.

First, the *IPO* court applied notice-pleading standards to a §15 claim based on its review of how the plaintiffs had characterized their claim, instead of focusing on the conduct actually alleged. *Id.* at 352. This ruling predates and is inconsistent with the Second Circuit's *Rombach* decision, which, as explained above, requires the court to determine not how the plaintiffs have characterized their claim but whether it alleges conduct "classically associated with fraud." *Rombach*, 355 F.3d at 171. Here, plaintiffs' § 15 claim against ZFS depends on allegations that Converium and the director defendants violated §§ 11 and 12(a)(2). As shown above and in ZFS's opening brief (at 13-14), those claims sound in fraud. Accordingly, Rule 9(b) also applies to plaintiffs' § 15 claim.

Second, the *IPO* court declined to apply Rule 9(b) to a § 20(a) claim because it concluded that scienter is not an element of such a claim. 241 F. Supp. 2d at 396. As ZFS explained in its opening brief (at 53, 56) and in this reply, however, "culpable participation" *is* a requisite element of a § 20(a) claim, so Rule 9(b) applies.[2] Moreover, the cases cited in ZFS's opening brief (at 11 & n.8) show that Rule 9(b) also applies to the *control* element of a § 20(a) claim, not just to the culpability element. Plaintiffs do not address any of those cited authorities.

C. Rule 9(b) Applies to Loss Causation.

Plaintiffs' attempt (at 59) to avoid pleading loss causation in accordance with Rule 9(b) is equally misguided. Contrary to plaintiffs' suggestion, the Supreme Court did *not* hold in *Dura Pharmaceuticals, Inc. v. Broudo*, 125 S. Ct. 1627, 1634 (2005), that Rule 8(a) – rather than Rule 9(b) – applies to allegations of loss causation. To the contrary, the Court merely "*assume[d], at least for argument's sake*, that neither the Rules nor the securities statutes impose any special further requirement in respect to the pleading of proximate causation" – and then held that the plaintiff had not met even the lighter burden under Rule 8(a). *Id.* (emphasis added). The Supreme Court thus has expressly left the issue unresolved, and any case holding otherwise is clearly incorrect.

Plaintiffs do not address any of ZFS's authorities (at 11 & nn. 6-7) holding that Rule 9(b) applies to allegations of loss causation. Nor do they respond to ZFS's showing that

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[2] *See, e.g., In re Philip Servs. Corp. Sec. Litig.*, 383 F. Supp. 2d at 486 ("If scienter is an element of a § 20(a) claim, the PSLRA's pleading requirements apply, and plaintiffs must plead with particularity facts giving rise to a strong inference that the control person knew or should have known that the primary violator was engaging in fraudulent conduct."); *In re Bayer AG Sec. Litig.*, No. 03 Civ. 1546, 2004 WL 2190357, at *16 (S.D.N.Y. Sept. 30, 2004) (PSLRA's heightened pleading requirements apply to § 20(a) claim); *Mishkin v. Ageloff*, No. 97 Civ. 2690, 1998 WL 651065, at *23 (S.D.N.Y. Sept. 23, 1998) ("because a § 20(a) plaintiff must *ultimately* establish a defendant's state of mind, the PSLRA requires a plaintiff, at the pleading stage, to allege particular facts that give rise to a strong inference of the requisite state of mind") (internal quotations omitted).

both the SEC and the Department of Justice have opined that loss causation must be pled with particularity. *See also In re First Union Corp. Sec. Litig.*, No. 3:99CV237-H, 2006 WL 163616, at *6 (W.D.N.C. Jan. 20, 2006) (applying Rule 9(b) to allegations of loss causation).

In re NYSE Specialists Securities Litigation, 405 F. Supp. 2d 281 (S.D.N.Y. 2005), on which plaintiffs rely (at 59), is inapposite, because it involved allegations of market manipulation, not misrepresentation. This distinction appears to have influenced the court's decision about the pleading standard. *See id.* at 316 (because plaintiffs alleged market manipulation, "*Dura* is inapposite, and Plaintiffs have adequately pled loss causation *under the unique facts of this case*") (emphasis added).[3] Rule 9(b) thus applies to all of plaintiffs' claims.

II.
PLAINTIFFS HAVE NOT ALLEGED AN ACTIONABLE MISREPRESENTATION OR OMISSION ABOUT PRE-IPO RESERVES.

ZFS's opening brief showed (at 17-25) that (*i*) no material misrepresentations or omissions were made about Converium's pre-IPO loss reserves, because those reserves were in fact consistent with Tillinghast's best estimate; (*ii*) the "bespeaks caution" doctrine protects statements about the reserves because they were forward-looking statements accompanied by detailed and specific warnings about the relevant uncertainties, and (*iii*) the reserves estimates and related statements were expressions of opinion, and plaintiffs have not pled any facts demonstrating that ZFS did not believe (or even lacked a reasonable basis for) those opinions when they allegedly were formulated. Plaintiffs' attacks on these points are unavailing.

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[3] *See also In re Initial Pub. Offering Sec. Litig.*, 383 F. Supp. 2d 566, 579 ("If plaintiffs' alleged losses were caused by market manipulation, rather than misstatements or omissions, then plaintiffs face a lighter burden in pleading their claims"), *reconsideration granted in part*, 399 F. Supp. 2d 261 (reaffirming dismissal for failure to plead loss causation), *reconsideration denied*, 399 F. Supp. 2d 298 (S.D.N.Y. 2005).

A. No Material Misrepresentations or Omissions Were Made About Pre-IPO Reserves.

The Complaint's allegations about misrepresentations or omissions in the IPO Prospectus – the only document allegedly attributable to ZFS – depend entirely on the charge that Tillinghast had estimated a loss-reserves deficiency of $350 million at Zurich Re North America ("ZRNA") but that ZFS added only $125 million to those reserves. Plaintiffs thus allege that Converium was $225 million under-reserved as of December 31, 2000 – and that the Prospectus therefore misrepresented the purportedly true facts when it said that Converium's loss reserves were "in line with Tillinghast's best estimates" (Compl. ¶ 87).

Because Tillinghast's "best estimate" of ZRNA's pre-IPO reserves deficiency is so fundamental to plaintiffs' IPO-related claims, ZFS presented that "best estimate" in its motion papers. The "best estimate" turned out to be not $350 million, as plaintiffs allege, but only $162 million.[4] (In fact, plaintiffs concede that Tillinghast lowered its original alleged estimate to $186 million, which was not Tillinghast's *final* "best estimate." (Compl. ¶ 86; Ex. B).) Thus, when ZFS added $125 million to ZRNA's reserves in response to Tillinghast's study (Compl. ¶ 87), the "best estimate" deficiency shrank to only $37 million. As ZFS showed in its opening brief (at 18-19), the "best-estimate" reserves deficiency for all of Converium (not just ZRNA) was similarly insignificant – and Converium's total reserves *exceeded* Tillinghast's *low* estimate.

In response to this documentary evidence undermining their fundamental allegations about the IPO, plaintiffs have moved to strike the Tillinghast report, contending that it is not admissible on a Rule 12(b)(6) motion because it is not "integral" to their claims. ZFS has addressed that motion in a separate opposition brief but notes here that plaintiffs' assertion is specious. Nothing could be more "integral" to the IPO-related claims (the only ones pled against

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[4] *See* Declaration of Alyson L. Redman, dated Dec. 23, 2005, Ex. A at 5. Unless otherwise noted, all references to "Ex." refer to the exhibits to this Declaration.

ZFS) than Tillinghast's report: those claims depend *entirely* on whether the pre-IPO $125 million reserve increase was or was not consistent with Tillinghast's "best estimate."[5]

Plaintiffs also argue (at 3, 26-28, 58) that the Court cannot determine the adequacy of Converium's reserves on a motion to dismiss. But the IPO-related claims are not about the adequacy of Converium's reserves; they are about whether the Prospectus *misrepresented* that those reserves were consistent with Tillinghast's "best estimate" – regardless of whether that "best estimate" ultimately proved to be correct or incorrect.[6]

When they finally confront Tillinghast's *actual* "best estimate" of a $162 million deficiency at ZRNA (rather than the alleged preliminary report of a $350 million deficiency), plaintiffs seek to discredit it by arguing (at 29) that defendants "ignore[] the allegations of the Complaint that Tillinghast was duped into abandoning its original conclusion by Converium" and that defendants "tricked," "deceived" or "conned" Tillinghast into lowering its estimate (*id.* at 7, 30 n.12, 64, 65 & n.28, 70, 76). ZFS, however, did not "ignore" those allegations, because they *do not exist*.

Nowhere does the Complaint contain these charges of "duping," "tricking," or "conning." Plaintiffs have invented this new theory in their opposition brief, disregarding the

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[5] The Complaint's allegations about internal reserves analyses *preceding* the Tillinghast study do not add anything to plaintiffs' claims. Those internal reviews purportedly found deficiencies of "at least $100 million" for ZRNA (Compl. ¶ 79) – substantially *less* than the $125 million that ZFS added to ZRNA's reserves as a result of Tillinghast's study. Thus, plaintiffs' claims necessarily depend on Tillinghast's *higher* estimates of a reserves deficiency, not on the lower internal estimates.

[6] Contrary to plaintiffs' assertions (at 1, 25), the Prospectus did *not* say that Converium's reserves were "adequate." It said only that the reserves were "reasonable estimates based on the information known at the time," "correspond[ed] to Tillinghast's best estimate of our liabilities for net loss and loss adjustment expenses," and were "in line with Tillinghast's principally top-down reserve estimate within its range of estimates." (Ex. F at 123.)

rule that a party may not amend its complaint through statements in motion papers, *see, e.g., Wright v. Ernst & Young LLP*, 152 F.3d 169, 178 (2d. Cir. 1998).

Plaintiffs even resort to rewriting the Complaint to fit their new, previously unpled theory. For example, plaintiffs' brief asserts (at 29) that "Confidential Witness No. 1 explicitly stated Converium 'pulled a fast one' on Tillinghast" (emphasis omitted) (citing Compl. ¶¶ 86-87). But the Complaint (¶ 87) does not charge that Converium "'pulled a fast one' *on Tillinghast*," as plaintiffs' brief represents (at 29). Instead, the Complaint alleges that,

> while Converium offered its shares and ADSs to the investing public with the express representation that the company's loss reserves had been subject to a thorough review by Tillinghast and were in line with Tillinghast's best estimates, the Company and its officers knew that Converium was under-reserved by hundreds of millions of dollars. As Confidential Witness No. 1 explained, the pervasive belief at Converium was that the Company had "*pulled a fast one*" (emphasis added).

This allegation charges that Converium had "pulled on fast one" *on the investing public*, not on Tillinghast. Nowhere does the Complaint allege that any defendant misled, withheld information from, provided incorrect or incomplete information to, or perpetrated any kind of fraud on Tillinghast. Nor have plaintiffs pled a single purported *fact* suggesting that Tillinghast – one of the world's premier actuarial firms – acted in anything other than a competent, professional manner.

B. <u>The Loss-Reserves Estimates Were Not Actionable Opinions.</u>

ZFS's opening brief showed (at 26-27) that loss-reserves estimates and statements about those estimates are opinions – and that plaintiffs have not pled any facts suggesting that those opinions are actionable. Plaintiffs argue in response (at 31) that the Court should "summarily reject [ZFS's] argument that their alleged misstatements relating to Converium's reserves are not actionable as a matter of law simply because they were estimates or 'opinions.'"

ZFS, however, never claimed that opinions cannot be actionable as a matter of law. ZFS said only that the opinions here are not actionable because plaintiffs have not pled any facts showing that the opinions *were not believed when expressed.* Plaintiffs' own case citations (at 31-32) confirm this well-established principle.[7]

The record on this motion demonstrates that plaintiffs have not alleged any *facts* suggesting that ZFS did *not* believe that Converium's pre-IPO reserves were in line with Tillinghast's best estimates, or even that ZFS lacked a reasonable basis for such a belief. To the contrary, ZFS had every reason to rely on Tillinghast's best estimate – especially when Converium's independent auditor gave Converium a clean audit opinion (Ex. F at F-2).

C. <u>The Bespeaks-Caution Doctrine Protects the Loss-Reserves Estimates.</u>

ZFS demonstrated in its opening brief (at 20-25) that the pre-IPO statements about Converium's loss reserves are protected under the "bespeaks caution" doctrine, because the Prospectus contained detailed, specific warnings about the many uncertainties surrounding loss-reserves calculations. Plaintiffs contend (at 32-34) that "bespeaks caution" does not apply

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[7] *See, e.g., Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1090 (1991) (affirming "verdict as finding that the directors' statements of belief and opinion [about value of stock] were made *with knowledge that the directors did not hold the beliefs or opinions expressed*") (emphasis added); *In re Westinghouse Sec. Litig.*, 90 F.3d 696, 709-10 (3d Cir. 1996) (upholding misrepresentation claim because plaintiffs alleged defendants had *known* statements about adequacy of loss reserves were inaccurate when made); *In re Wells Fargo Sec. Litig.*, 12 F.3d 922, 927, 930 (9th Cir. 1993) (reversing dismissal of claims about adequacy of loan loss reserves because plaintiffs alleged defendants had *known* reserves were inadequate); *Hayes v. Gross*, 982 F.2d 104, 106 (3d Cir. 1992) ("A statement of opinion or belief [about loss reserves], if *known* to be false, may be the basis" of securities-fraud claim) (emphasis added); *Shapiro v. UJB Fin. Corp.*, 964 F.2d 272, 281 (3d Cir. 1992) (defendant can be liable if it "characterizes loan loss reserves as 'adequate' or 'solid' even though it *knows* that they are inadequate or unstable") (emphasis added); *In re Direct Gen. Corp. Sec. Litig.*, 398 F. Supp. 2d 888, 895 (M.D. Tenn. 2005) (if defendant states that loss reserves are adequate "even though it *knows* that the reserves really are not adequate, [the statement] may be actionable") (emphasis added); *In re PMA Capital Corp. Sec. Litig.*, No. 03-6121, 2005 WL 1806503, at *6, *12 (E.D. Pa. July 27, 2005) ("A company cannot characterize loss reserves as adequate when it *knows* that this is not the case") (emphasis added).

here, because the doctrine does not cover "facts and events that have already occurred." This argument betrays a fundamental misunderstanding of loss-reserving.

Loss-reserves estimates and related statements do not constitute "facts and events that have already occurred." Even if the underlying *events* that trigger the losses might have occurred, the *amounts* of the losses – and maybe even the *fact* of the losses – are not yet known to the reinsurer. Case-reserve decisions – for claims that have been reported to the reinsurer – "entail uncertainty as to the amount of final loss." *Delta Holdings, Inc. v. Nat'l Distillers & Chem. Corp.*, 945 F.2d 1226, 1231 (2d Cir. 1991). And Incurred But Not Reported ("IBNR") reserves – for claims that have not yet even been reported – "must be calculated without knowing even the number of claims," much less their severity and value. *Id.* at 1229. "[N]o actuarial method is so accurate that it eliminates conjecture in the calculation of [a reinsurer's] IBNR liabilities." *Id.* at 1231; *see generally* ZFS Br. at 3-5 (discussing loss-reserving).

Not surprisingly, plaintiffs do not even attempt to challenge the cases that ZFS cited (at 21-22) holding that loss reserves and statements about loss reserves are forward-looking statements. Indeed, plaintiffs' own cases (at 32-34) make the same point.[8] And the Prospectus repeatedly emphasized that loss reserves are merely *estimates*, based in large part on presently unknowable information.[9]

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[8] *See, e.g., In re Westinghouse Sec. Litig.*, 90 F.3d at 710 n.11 ("economic judgments made in setting loan loss reserves can be validated only at some future date"); *In re Wells Fargo Sec. Litig.*, 12 F.3d at 927 ("the setting of loan loss reserves is, by all accounts, 'an art and not a science'"); *Shapiro*, 964 F.2d at 281 (loan loss reserves are based on "expectations about future loan losses. . . . No matter what method is used, the economic judgments made in setting loan loss reserves can be validated only at some future date").

[9] *See, e.g.*, Ex. F at 122 ("*estimation* of loss reserves is an inherently uncertain process, [in which] quantitative techniques frequently have to be supplemented by professional and managerial judgment") (emphasis added); *id.* ("[t]he uncertainty inherent in loss estimation is particularly pronounced for long-tail lines"); *id.* at 123 ("*estimates* of loss reserves were based on [*inter alia*] original pricing analysis as well as our experience with similar lines of business and

As discussed above, plaintiffs do not plead any alleged *factual* support for their allegations that ZFS did *not* believe Converium's reserves were in line with Tillinghast's best estimate and that it *knew* Converium would need to increase reserves. Nor do plaintiffs impugn the adequacy of the Prospectus' cautionary language *per se*. Plaintiffs argue (at 33) only that no amount of cautionary language can immunize "hard" or "historical" facts. But the premise for this argument is incorrect: loss reserves are *not* "hard" or "historical" facts. Plaintiffs' challenge to the cautionary language thus fails on its own terms.

For all the above reasons, plaintiffs have failed to plead an actionable misrepresentation or omission – an essential element of all their claims.

III.
PLAINTIFFS HAVE NOT PLED A COGNIZABLE CLAIM UNDER § 12(a)(2) OF THE SECURITIES ACT.

ZFS's opening brief showed (at 28-34) that plaintiffs have not pled a cognizable claim against ZFS under § 12(a)(2) of the Securities Act because (*i*) ZFS did not sell or offer to sell Converium securities to any plaintiff or putative class member in the firm-commitment underwriting of the IPO; (*ii*) putative class members – including the two Lead Plaintiffs – who did not purchase Converium stock *in the IPO* cannot sue under § 12(a)(2), and (*iii*) IPO purchasers who later sold their Converium stock at or above the IPO price lack standing to sue. Plaintiffs' opposition brief fails to rebut any of these arguments.

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historical trends, such as reserving patterns, exposure growth, loss payments, pending levels of unpaid claims and product mix, as well as court decisions and economic conditions") (emphasis added); *id.* ("since the establishment of loss reserves is an *inherently uncertain process*, the ultimate cost of settling claims may exceed our existing loss and loss adjustment reserves, perhaps materially") (emphasis added).

A. ZFS Cannot Be Sued as a Seller or Solicitor Under § 12(a)(2).

As ZFS explained in its opening brief (at 29), §12(a)(2) imposes liability only on a person or entity that either (*i*) actually passes title of the security to the plaintiff purchaser or (*ii*) successfully solicits the plaintiff's purchase, motivated at least in part by the solicitor's own financial interest or that of the security's owner. *Wilson v Saintine Exploration & Drilling Corp.*, 872 F.2d 1124, 1125-26 (2d Cir. 1989).

Plaintiffs (at 47-48) do not even attempt to argue that ZFS *sold* Converium securities in the IPO. Nor could they do so, in light of the numerous cases holding that, in firm-commitment underwritings, the *underwriters* are the ones who sell the securities to the public.

Instead, plaintiffs focus solely on the "solicitation" prong as to ZFS. But the only thing plaintiffs say about ZFS is that "ZFS *sold* 40 million shares of Converium" (Pl. Br. at 48 (quoting Compl. ¶ 21) (emphasis added)). However, ZFS's mere *sale* of securities *to the underwriters* does not satisfy § 12(a)(2)'s separate *solicitation* test.

Nor does plaintiffs' assertion (at 48) that ZFS's sale to the underwriters "was 'motivated at least in part by a desire to serve [its] own financial interests'" help plaintiffs' argument. Liability under § 12(a)(2)'s second prong requires *solicitation* as well as an alleged financial motive. *See, e.g., Pinter v. Dahl*, 486 U.S. 622, 651 (1988) (§ 12 liability depends on "defendant's *relationship with the plaintiff-purchaser*," not "defendant's degree of involvement in the securities transaction and its surrounding circumstances") (emphasis added); *Rosenzweig v. Azurix Corp.*, 332 F.3d 854, 871 (5th Cir. 2003) ("To count as 'solicitation,' the seller must, at a minimum, *directly communicate with the buyer.*") (emphasis added); *In re Craftmatic Sec. Litig.*, 890 F.2d 628, 636 (3d Cir. 1989) ("[t]he purchaser must demonstrate *direct and active participation in the solicitation* of the immediate sale to hold the [seller] liable as a § 12(2) seller") (emphasis added). Plaintiffs do not allege any such solicitation.

Plaintiffs also contend (at 48) that "Converium and the Individual Defendants" signed the Registration Statement. But plaintiffs do not – and could not – claim that *ZFS* did so. The Court therefore should dismiss the entire § 12(a)(2) claim against ZFS.

B. All Non-IPO Purchasers Lack Standing.

Plaintiffs implicitly concede (at 46-47) that the two Lead Plaintiffs lack standing to sue under § 12(a)(2) because they did not purchase any Converium stock in the IPO. Instead, plaintiffs argue only about named plaintiff LASERS' alleged right to sue.

ZFS, however, did not challenge LASERS' standing to sue for its IPO purchases. Instead, ZFS argued (at 33) only that the *Lead Plaintiffs* cannot sue under § 12(a)(2) – and that LASERS cannot do so for its *post*-IPO purchases. Thus, all parties appear to agree that, if the Court does not dismiss the entire § 12(a)(2) against ZFS, it at least should dismiss Lead Plaintiffs' § 12(a)(2) claim, as well as LASERS' § 12(a)(2) claim for its post-IPO purchases.

C. IPO Purchasers Who Sold at or Above the IPO Price Lack Standing.

ZFS's opening brief also showed (at 33-34) that, if the Court does not dismiss the entire § 12(a)(2) claim, it should dismiss it as to all IPO purchasers who later sold their Converium stock at or above the IPO price. Plaintiffs' response (at 50-51) ignores ZFS's point and instead addresses the underwriter defendants' *separate* argument based on § 11, not § 12(a)(2). To the extent plaintiffs address § 12(a)(2) at all, they quote the statutory language authorizing *rescissory* damages for people *who still hold* the stock and can tender it back.

ZFS's motion, however, did not address *current* holders; it addressed only those who *cannot* tender the stock because they *already sold it* at or above the IPO price. Plaintiffs thus have not disputed ZFS's showing that such putative class members cannot establish any compensable loss under the Supreme Court's decision in *Randall v. Loftsgaarden*, 478 U.S. 647, 655-56 (1986) (plaintiff who sold stock "is entitled to a return of the consideration paid, *reduced*

by the amount realized when he sold the security and by any 'income received' on the security") (emphasis added). Those putative class members do not have a § 12(a)(2) claim.

IV.
THE SECURITIES ACT CLAIMS ARE TIME-BARRED.

ZFS's opening brief (at 46-53) explained that plaintiffs' Securities Act claims are time-barred under the one-year "discovery" statute of limitations. Plaintiffs respond (at 37-43) that (*i*) limitations issues should not be decided on a motion to dismiss, and (*ii*) plaintiffs were not on inquiry notice of their claims until July 20, 2004. Neither argument withstands scrutiny.

A. Storm Warnings Are Frequently Determined on Motions to Dismiss.

Plaintiffs' argument (at 39) that questions of "inquiry notice [are] 'often inappropriate for a resolution on a motion to dismiss under Rule 12(b)(6)'" is belied by a long line of cases where this Court has dismissed securities-law claims on Rule 12(b)(6) motions – and the Second Circuit has upheld those dismissals. Indeed, the Second Circuit confirmed just two months ago that, "[w]here inquiry notice is clearly established, dismissal of a securities-fraud complaint as untimely may be readily affirmed." *Shah v. Meeker*, 435 F.3d 244, 248 (2d Cir. 2006) (internal quotations omitted).[10]

ZFS's citation of documents outside the pleadings to bolster its position that inquiry notice was triggered (Pl. Br. at 43) has no bearing on whether the issue can be decided

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[10] *Accord, e.g., LC Capital Partners, LP v. Frontier Ins. Group, Inc.*, 318 F.3d 148, 156 (2d Cir. 2003) ("Where . . . the facts needed for determination of when a reasonable investor of ordinary intelligence would have been aware of the existence of fraud can be gleaned from the complaint and papers . . . integral to the complaint, resolution of the issue on a motion to dismiss is appropriate, . . . and we have done so in a vast number of cases") (internal quotations omitted); *Dodds v. Cigna Sec., Inc.*, 12 F.3d 346, 352 n.3 (2d Cir. 1993) ("appellant's suggestion that the question of constructive notice is an improper subject for resolution as a matter of law is contradicted by a vast number of cases in this circuit resolving these issues at the pleading stage"); *White v. H&R Block, Inc.*, No. 02 Civ. 8965, 2004 WL 1698628, at *5 (S.D.N.Y. July 28, 2004) ("Dismissal is appropriate when the facts from which knowledge may be imputed are clear from the pleadings and the public disclosures themselves.").

now. Dismissals based on storm warnings, and Second Circuit decisions affirming those dismissals, routinely consider documents not cited in pleadings. *See, e.g., Shah*, 435 F.3d at 247, 249-51 (affirming limitations dismissal based on magazine article, because "[i]nformation contained in articles in the financial press may trigger the duty to investigate").[11]

B. Numerous Storm Warnings Existed Before October 4, 2003.

Plaintiffs also argue they were not on inquiry notice until July 20, 2004. First, they contend (at 40-41) that Converium's four reserves increases in 2002 – $11.6 million and $24.2 million in the first half, $60 million in the third quarter, and $70 million in the fourth quarter – somehow "did not in any way put investors on notice that Converium's reserves were materially understated." Those four increases, however, totaled $166 million – *74%* of the alleged $225 million deficiency that underlies plaintiffs' IPO-related claims. It is difficult to imagine how much more notice plaintiffs could have had that Converium allegedly was under-reserved.

In *LC Capital Partners*, for example, the Second Circuit affirmed the dismissal of securities claims on limitations grounds because "a series of three charges [to increase loss reserves] in substantial and increasing amounts for the same purpose within four years should alert any reasonable investor that something is seriously wrong." 318 F.3d at 155. The inquiry

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[11] *See also, e.g., LC Capital Partners*, 318 F.3d at 155 (affirming dismissal based on SEC filings and news article); *In re Salomon Analyst Winstar Litig.*, 373 F. Supp. 2d 241, 245 (S.D.N.Y. 2005) (when inquiry notice can be determined from "the complaint, papers integral to the complaint, and publicly disclosed documents, resolution of the issue on a motion to dismiss is appropriate and has been done in the Second Circuit in a vast number of cases") (internal quotations omitted), *reconsideration granted*, No. 02 Civ. 6171, 2006 WL 510526 (S.D.N.Y. Feb. 28, 2006) (reaffirming dismissal of securities claims as time-barred); *White*, 2004 WL 1698628, at *5 ("The information that triggers inquiry notice of the probability of an alleged securities fraud is any financial, legal, or other data, including public disclosures in the media about the financial condition of the corporation . . . available to the plaintiff").

notice here is even more glaring than it was in *LC Capital Partners*, because the four reserves increases occurred not over four years but within *less than one year* after the IPO.[12]

Moreover, plaintiffs conveniently ignore the market's reaction to these reserves increases (*see* ZFS Br. at 50) and named plaintiff LASERS' own sale of nearly one-third (32%) of its Converium holdings starting just two days after the announcement of the third-quarter 2002 reserves increase (*id.* at 51; Ex. Y).

Perhaps because they realize that the reserves increases and the market's reaction (including LASERS' own sales) suffice to establish inquiry notice, plaintiffs argue (at 41) that Converium's "assurances" to the market on October 28, 2002 – after the third reserves increase – somehow negated that notice. But management's statements generally do not excuse a plaintiff's duty to make a reasonable investigation once inquiry notice has arisen. *See, e.g., Ezra Charitable Trust v. Frontier Ins. Group, Inc.*, No. 00 Civ. 5361, 2002 WL 87723, at *5 (S.D.N.Y. Jan. 23, 2002) ("when an investor has received information that places her on inquiry notice, she is not relieved of her duty of inquiry because management contemporaneously makes reassuring statements"), *aff'd sub nom. LC Capital Partners*, 318 F.3d 148.[13]

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[12] *Newman v. Warnaco Group, Inc.*, 335 F.3d 187 (2d Cir. 2003), which plaintiffs cite (at 38, 42), has no bearing on this case. *Newman* held that earnings write-downs based on certain alleged reasons (changed accounting rules and start-up and inefficiency costs) did not trigger inquiry notice because they did not attribute the write-downs to the subject of the alleged fraud (inventory). *Id.* at 194. Here, however, the reason for the four reserves increases was *identical* to the subject of the alleged fraud: purported deficiencies in Converium's loss reserves.

[13] *See also, e.g., In re Merrill Lynch Ltd. P'ships Litig.*, 7 F. Supp. 2d 256, 275 (S.D.N.Y. 1997) ("plaintiff may not avoid her duty to inquire merely by relying on reassuring statements that management made in conjunction with the information that placed plaintiff on notice"), *aff'd*, 154 F.3d 56 (2d Cir. 1998); *In re JWP Inc. Sec. Litig.*, 928 F. Supp. 1239, 1248-50 (S.D.N.Y. 1996) (publicly available information provided indicia of fraud, so reassuring statements did not relieve plaintiffs of duty to inquire); *In re Integrated Res. Real Estate Ltd. P'ships Sec. Litig.*, 815 F. Supp. 620, 640 (S.D.N.Y. 1993) ("statements of cautious optimism . . . and explanations for past poor performance do not rise to the level . . . necessary to excuse a reasonable investor from the duty of inquiry presented by the cold numbers"); *Westinghouse*

Reassuring statements might "prevent the emergence of a duty to inquire or dissipate such a duty only if an investor of ordinary intelligence would reasonably rely on the statements to allay the investor's concern." *LC Capital Partners*, 318 F.3d at 155. The assurances here did not prevent or dissipate inquiry notice, just as they did not do so in *LC Capital Partners*.

The Converium statements that plaintiffs quote (Pl. Br. at 41; Compl. ¶¶ 161-62) are far too general to justify a reasonable investor's reliance in light of the inquiry notice's magnitude. Those statements only express management's general intention to address the reserving issues at Converium and its *feeling* that investors would see a turnaround in the future. Such vague expressions of hope do not nullify inquiry notice.

Converium's statements are essentially the same as those the Second Circuit found *insufficient* to dissipate inquiry notice in *LC Capital Partners*. As did Converium's officials, corporate officers in *LC Capital Partners* had tried to reassure investors that any reserving issues resulting from several recent reserves increases were under control:

Elec. Corp. v. '21 Int'l Holdings, Inc., 821 F. Supp. 212, 223 (S.D.N.Y. 1993) ("plaintiffs charged with a duty to investigate may not merely rely on reassurances given by management").

Frontier's "Assurances"[14]	Converium's "Assurances"
"[Frontier] has strengthened its control and oversight of its operations . . . [and] adopted a more conservative reserving philosophy."	"We are proactively addressing the issues, and taking the pertinent measures to solve them."
"[W]ith these charges, we have 'paid the bill' for past over emphasis on growth . . . provid[ing] further evidence of our commitment to maintain reserves at the best estimate."	"The steps taken in the third and fourth quarter underline Converium management's determination to confront emerging reserve issues in a forthright and proactive manner . . . ."
"[T]he [reserving] issue is now behind us."	"I do . . . feel that we have turned the corner on the reserve thing with this further study . . . ."
"[H]idden beneath the financial impact of the reserve strengthening . . . was a significant amount of profitable growth which augurs well for 1999 and the future."	"As a result [of the reserve charges], I am confident that the underlying earnings power of our in-force business will manifest itself."
"While financial results were negatively impacted in 1998, it was a year of many accomplishments. We . . . put many of our past problems behind us and start 1999 well positioned to achieve our financial goals."	"I really feel very strongly that [in] 2003 you are not going to see this sort of development impairing our good performance in the business year 2003, and the improvements that we had hoped would flow through fully in the bottom line of 2002 will flow through in 2003."

But the Second Circuit held that, even though management had stated the company had "paid the bill" with its most recent loss-reserves increase and had put its reserving issues "behind us," the three prior reserves increases in four years "indicat[ed] the likelihood of either a fundamental defect in the company's reserve methodology or the company's refusal to face reality" – and did not excuse the plaintiff from fulfilling its duty to inquire. 318 F.3d at 156. There, as here, "[t]he 'reassuring' statements by management were mere expressions of hope, devoid of any specific steps taken to avoid under-reserving in the future. In these circumstances, the claimed reassurances are unavailing." *Id.*

[14] These quotations come from *LC Capital Partners,* 318 F.3d at 151-52, and *Ezra Charitable Trust*, 2002 WL 87723, at *3. The quoted Converium "assurances" come from plaintiffs' brief (at 41) and the Complaint ¶¶ 161-62 (all quoting defendant Lohmann).

In fact, even plaintiff LASERS apparently was not comforted by the October 28, 2002 "assurances" that plaintiffs cite (at 41): it sold nearly one-third of its Converium securities between October 30 and November 8, 2002, *after* those "assurances" were issued (Ex. Y).

Moreover, statements about management's perceptions of a company's *future* prospects do not negate storm warnings about its *past*. By late 2002, Converium *already* had announced four reserves increases totaling $166 million. Even if no *additional* reserves increases ever were to be needed, plaintiffs still were on inquiry notice of the duty to investigate whether Converium's *past* statements had been accurate. *See, e.g., de la Fuente v. DCI Telecommc'ns, Inc.*, 206 F.R.D. 369, 385 (S.D.N.Y. 2002) (no lulling where positive statements "focused on [company's] overall future," instead of defending past).

Plaintiffs try (at 42 & n.16) to distinguish *LC Capital Partners* by arguing that Converium's "reassurances" in October 2002 were followed by "record income for 2003 and the first quarter of 2004 and a reserves reduction for 2003. There are several problems with this argument.

First, plaintiffs do not suggest that they began investigating their claims when inquiry notice arose in 2002 but then dropped their investigation when the increased income and reserves reduction were later announced. To the contrary, plaintiffs do not dispute that they made *no* investigation whatsoever until July 20, 2004.[15]

Second, plaintiffs allege that the 2003 "record income" and the reserves reduction were announced with Converium's "2003 year-end financial results on February 17, *2004*." (Pl.

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[15] *Rothman v. Gregor*, 220 F.3d 81 (2d Cir. 2000), which plaintiffs cite (at 39, 42), is inapposite, because it deals with the separate question of "*when*, after obtaining inquiry notice . . . , the [plaintiffs], in the exercise of reasonable diligence, should have discovered the facts underlying the alleged fraud," *id.* at 97. Here, in contrast, plaintiffs dispute the existence of inquiry notice in the first place. This case does not involve how long it should have taken plaintiffs to find particular facts once they began an investigation (that they never did begin).

Br. at 42; Compl. ¶ 4 (emphasis added).) February 2004 was well over a year after the four reserves increases announced in 2002, so the one-year limitations period *already* had run by 2004.

Third, positive statements do not excuse the duty to inquire where those statements are made *after* a plaintiff has been put on inquiry notice. *See, e.g., de la Fuente*, 206 F.R.D. at 385 (in cases where "[c]ourts have been reluctant to find that public disclosures provided inquiry notice [because] those disclosures were tempered with positive statements . . . [the] storm warnings were in and of themselves reassuring to the plaintiff" – in the same report or filing); *Farr v. Shearson Lehman Hutton, Inc.*, 755 F. Supp. 1219, 1228 (S.D.N.Y. 1991) (where May 19, 1987 Annual Reports put plaintiff on inquiry notice, "as to those statements made after May 19, [he was] not entitled to rely on reassuring comments given [him] after [he] received [clear] knowledge of the fraud") (internal quotations omitted).

Fourth, plaintiffs have ignored the additional storm warnings that arose *after* the 2002 reserves increases and the allegedly "reassuring statements": a drop in Converium's credit rating, analysts' negative reaction to Converium's first-quarter 2003 financial results, and a substantial shareholder's decision to bail out of Converium stock. *See* ZFS Br. at 51-52. But even though the storm clouds kept piling up, plaintiffs continued to do nothing.

The Court therefore should dismiss plaintiffs' Securities Act claims as time-barred. But if the Court does not do so, it should dismiss *all* claims based on securities purchased and sold before July 20, 2004, because any alleged misrepresentations or omissions could not have *caused* any loss to those shares, as ZFS discusses below in Part VI.B.

V.
PLAINTIFFS HAVE FAILED TO PLEAD A CLAIM UNDER § 10(b) OF THE EXCHANGE ACT.

ZFS's opening brief showed (at 34-40) that plaintiffs failed to plead an actionable claim against ZFS under § 10(b) of the Exchange Act because (*i*) plaintiffs did not plead any facts showing an alleged misstatement publicly attributable to ZFS; (*ii*) plaintiffs did not adequately plead reliance, and (*iii*) plaintiffs did not plead particularized facts creating a strong inference of ZFS's scienter. Plaintiffs' opposition brief (at 51-57, 60-78) does not undermine these points.

A. ZFS Cannot Be Liable for Statements Not Publicly Attributed to It.

As ZFS previously explained (at 35), the Second Circuit follows a "bright line" test for primary liability under § 10(b): a misrepresentation "must be attributed to [a] specific actor at the time of public dissemination" if that actor is to be held liable for it. *Wright v. Ernst & Young LLP*, 152 F.3d 169, 175 (2d Cir. 1998).

Plaintiffs do not dispute that ZFS did not *sign* the Registration Statement or the Prospectus. And their assertion (at 54; Compl. ¶¶ 261, 319) that ZFS "participated" in preparing the Prospectus is nothing more than aiding/abetting liability, which was abolished by *Central Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164, 174-75 (1994). Nor do plaintiffs allege that ZFS was involved in any roadshows in connection with the IPO.

Plaintiffs do contend (at 55) that ZFS issued a "joint[]" press release with Converium discussing Converium's loss reserves, but the admissible documents – which trump plaintiffs' bare allegations – belie this assertion. There was no "joint" press release announcing the IPO; ZFS and Converium issued *separate* press releases. ZFS's press releases (Exs. J, K) did not say anything at all about Converium's financial condition or the sufficiency of Converium's loss reserves. Only Converium's press release (Ex. D) addressed those subjects.

Without any statements publicly attributable to ZFS, plaintiffs resort to suggesting (at 52-54) that *Wright*'s public-attribution rule is no longer the law in this Circuit. Plaintiffs are incorrect. In fact, the Second Circuit recently reiterated that test in *Filler v. Hanvit Bank*, 156 Fed. Appx. 413, 415-16 (2d Cir. 2005) (affirming dismissal of claims against issuer's banks, which did not make any statements and were not named in issuer's statements), and several of plaintiffs' cited cases (at 52, 54 n.22) also applied *Wright*'s public-attribution standard.[16]

Contrary to plaintiffs' contention (at 52), *In re Scholastic Corporation Securities Litigation*, 252 F.3d 63 (2d Cir. 2001), did not undermine *Wright's* bright-line test. *Scholastic* held that a company officer (Marchuk) could be held primarily liable for the company's false and misleading statements, but the officer himself had publicly spoken: he had participated in making allegedly false statements to securities analysts – the market's representatives, who allegedly relied on him and reported his statements to the public. *Id.* at 68, 70, 76.

Scholastic thus appears to be consistent with *Wright*'s public-attribution rule. *See, e.g., SEC v. Cedric Kushner Promotions, Inc.*, __ F. Supp. 2d __, No. 04 CV 2324, 2006 WL 397903, at *6 (S.D.N.Y. Feb. 17, 2006) ("*Scholastic* offers no departure from the substance

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[16] *See In re Parmalat Sec. Litig.*, 376 F. Supp. 2d 472, 513-14 (S.D.N.Y. 2005) (banks could not be liable for issuer's alleged misrepresentations that were not *publicly attributed* to banks; allegations of liability for "approv[ing]" issuer's statements "run afoul of the bright line rule requiring *attribution* to the defendant at the time the statement was made"; bank cannot be liable for issuer's press release "allegedly co-written by [bank]," because "the press release was issued by [issuer] and not attributed to [bank]") (emphasis added); *SEC v. PIMCO Advisors Fund Mgmt. LLC*, 341 F. Supp. 2d 454, 465, 466-67 (S.D.N.Y. 2004) (upholding claims against defendant (Treadway) who "personally signed the misleading disclosures," but *dismissing* primary-liability claims against other defendant (Corba) who did *not* "personally ma[k]e misleading statements" and did not even "personally draft[]" them in capacity of someone who had primary, publicly known responsibility for making such statements), *reconsideration denied sub nom. SEC v. Treadway*, 354 F. Supp. 2d 311 (S.D.N.Y. 2005); *In re Livent, Inc. Noteholders Sec. Litig.*, 174 F. Supp. 2d 144, 151, 154 (S.D.N.Y. 2001) (upholding claim against broker who allegedly made misstatements *directly* to investors; "in *directly* soliciting and selling securities to public investors, [broker] effectively communicated" alleged misrepresentations to public) (emphasis added).

of the decision in *Wright*"); *In re Parmalat Sec. Litig.*, 376 F. Supp. 2d at 513 n.203 (*Scholastic* "did not question, let alone purport to set aside, the attribution rule set forth in *Wright*").

Moreover, *Scholastic* did not even mention *Wright* and could not have overruled it, because a panel of the Second Circuit cannot overrule a prior panel. *E.g., In re Sokolowski*, 205 F.3d 532, 534-35 (2d Cir. 2000) ("[T]his court is bound by a decision of a prior panel unless and until its rationale is overruled, implicitly or expressly, by the Supreme Court or this court *en banc*."). And if *Scholastic* were inconsistent with *Wright*, the *earlier* decision (*Wright*) would govern. *See, e.g., U.S. v. Int'l Bhd. of Teamsters*, 51 F. Supp. 2d 314, 317-18 (S.D.N.Y. 1999) (subsequent panel decision, purporting to implement new standard for future cases, did not and could not overrule prior panel's standard).

A few District Court cases that plaintiffs cite (at 53-55) have stretched *Wright*'s public-attribution requirement by predicating liability on "constructive attribution": even if a particular misrepresentation does not expressly name the defendant, "investors are sufficiently aware of defendant's participation that they may be found to have *relied* on it as if the statement had been attributed to that defendant." *In re Global Crossing, Ltd. Sec. Litig.*, 322 F. Supp. 2d 319, 332-33 (S.D.N.Y. 2004) (because auditor's identity was publicly known from audited financial statements, public also could have attributed *unaudited* reports to auditor).[17]

ZFS respectfully questions whether "constructive attribution" comports with governing law in this Circuit under *Wright*. *See In re Parmalat Sec. Litig.*, 376 F. Supp. 2d at

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[17] *See also In re Lernout & Hauspie Sec. Litig.*, 230 F. Supp. 2d 152, 166-67, 171 (D. Mass. 2002) (even though accounting firm (KMPG US) did not sign audited statement, it was "publicly" identified as auditor "in the annual reports disseminated to shareholders," so it was "appropriate to infer that . . . investors reasonably attributed the statements . . . to KPMG US"; dismissing claim against KPMG Singapore, which did *not* sign audit, was *not* listed as auditor, and did *not* make any statement "upon which investors relied"). The *Lernout* court, however, was not bound by Second Circuit law, and it called the *Wright* test "controversial," *id.* at 163.

513 n.203, 514 n.207 (*Global Crossing* "formulated a new version of the *Wright* rule . . . . Even if this variation on *Wright* were correct, . . ."; "[e]ven if [*Global Crossing*] states the correct rule . . . ."); *cf. Filler*, 156 Fed. Appx. at 416 (*Global Crossing* is "factually distinguishable" from *Wright* because, even though auditor had not publicly spoken as to *unaudited* statements, its "involvement was well known to investors").

But in any event, "constructive attribution" would not apply here, because plaintiffs have not pled any reason why investors would have assumed that *ZFS* was speaking when *Converium* issued statements about its own financial condition and loss reserves – especially when those documents were signed solely by Converium officials, and not by ZFS. *See, e.g., In re Global Crossing, Ltd. Sec. Litig.*, No. 02 Civ. 910, 2005 WL 1907005, at *8, *10 (S.D.N.Y. Aug. 8, 2005) (statements by issuer's directors cannot be attributed to companies that appointed those directors, because statements were not publicly attributed to those companies; even though companies had been mentioned in public disclosures, nothing "suggest[ed] that [companies] guaranteed any particular decision by or information about [issuer], such that the public could reasonably rely on it").

Plaintiffs' reliance (at 53-54) on *In re LaBranche Securities Litigation*, 405 F. Supp. 2d 333 (S.D.N.Y. 2005), is equally misplaced. That case – relying on the potentially questionable *Global Crossing* decision – also applied a version of "constructive attribution" and held that a subsidiary could be held primarily liable for its parent's alleged misrepresentations about the subsidiary. The parent in *LaBranche* had reported its subsidiary's financial results as part of the parent's report for the entire enterprise. The court ruled that, because the subsidiary was the entity through which the parent conducted all of its specialist operations, any alleged misrepresentations about the subsidiary's finances "could have come only from [the subsidiary]."

Id. at 351. The parent thus "was the 'mere' conduit through which the information [about the subsidiary] was disseminated." And because the parent's report referred only to the subsidiary in relaying the subsidiary's earnings, "investors may be deemed to have been sufficiently aware of [the subsidiary's] participation that they may be found to have relied on it as if the statement[s] had been publicly attributed to [it]." *Id.* (internal quotations omitted).

The situation here is the reverse of the one in *LaBranche*, because plaintiffs here seek to hold a parent (ZFS) liable for its subsidiary's (Converium's) statements *about itself.* Converium was reporting *its own information* in the Registration Statement, Prospectus, and press release. Thus, unlike in *LaBranche*, there is no reason to assume that the parent provided the subsidiary with the subsidiary's own information, or that the subsidiary's information *about itself* "could have come only from" its parent. Unlike in *LaBranche*, ZFS was not the "conduit" through which Converium disclosed its own financial information. Accordingly, contrary to *LaBranche*'s concern, *id.* at 352, this case does not present a situation where the parent might try to create an operating subsidiary to shield the subsidiary from liability for the *parent's* financial report about the whole corporate enterprise.[18]

For all of the above reasons, plaintiffs have failed to plead that ZFS made any alleged misrepresentation or omission that satisfies *Wright*'s public-attribution test.

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[18] *In re Vivendi Universal, S.A. Securities Litigation*, 381 F. Supp. 2d 158 (S.D.N.Y. 2003), *reconsideration denied*, No. 02 Civ. 5571, 2004 WL 2375830 (S.D.N.Y. Oct. 22, 2004), which plaintiffs also cite (at 54 n.22), is inapposite, because it does not involve either actual or constructive attribution. *Vivendi* held that the issuer's CFO could be liable for the issuer's statements under the group-pleading doctrine, not under some expansion of the bright-line rule. *Id.* at 190-92. That doctrine makes individual members of the management group liable for "group-published" documents produced only in the *corporation's* name, on the theory that a company can speak only through its management group. *Id.* (holding, for that reason, that group pleading does not apply to *oral* statements, because oral statements are made by individuals, not by management group). Plaintiffs here do not and cannot invoke group pleading as to ZFS. ZFS is not alleged to have been a member of Converium's management group, and Converium could (and did) speak without using ZFS as a mouthpiece.

B. Plaintiffs Have Failed to Allege Reliance with the Requisite Particularity.

ZFS showed in its opening brief (at 36-38) that plaintiffs had not adequately pled the reliance element of their § 10(b) claim. Plaintiffs respond (at 55-56) by arguing that reliance can be presumed based on the "fraud on the market" theory and that they do not need to make more than a bare, unsupported allegation of market efficiency to survive a motion to dismiss.

ZFS's motion did not question the presumption of reliance *when a market is efficient.* Nor did ZFS ask the Court to make a factual "determination" whether the market for Converium securities was efficient, as plaintiffs now assert (at 56). Instead, ZFS contended only that plaintiffs had failed to *plead any facts* – in accordance with Rule 9(b) (or even Rule 8(a)) – to support their naked allegation of market efficiency *at the time of the IPO.* (Nor did plaintiffs plead any *actual* reliance; the § 10(b) claim depends on *presumed* reliance (Compl. ¶ 45).)

An IPO does not involve an "open and developed market," because no market yet exists. *E.g., In re MDC Holdings Sec. Litig.*, 754 F. Supp. 785, 806 (S.D. Cal. 1990). The stock price in an IPO is not "determined by the available material information regarding the company and its business," *Basic Inc. v. Levinson*, 485 U.S. 224, 241 (1988). Instead, the selling shareholder(s), the issuer, and the underwriters set the offering price. *See* ZFS Br. at 37-38.[19]

The few alleged facts that plaintiffs cite (at 56-57) do not support their assertion that the market for Converium securities was efficient *at the time of the IPO*, because those

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[19] Not surprisingly, most of the cases plaintiffs cite (at 56) in support of their efficient-market argument are not IPO cases. *See In re Parmalat Sec. Litig.*, 376 F. Supp. 2d 472 (S.D.N.Y. 2005); *RMED Int'l, Inc. v. Sloan's Supermarkets, Inc.*, 185 F. Supp. 2d 389 (S.D.N.Y. 2002); *Ellison v. Am. Image Motor Co.*, 36 F. Supp. 2d 628 (S.D.N.Y. 1999); *In re Laser Arms Corp. Sec. Litig.*, 794 F. Supp. 475 (S.D.N.Y. 1989), *aff'd*, 969 F.2d 15 (2d Cir. 1992). The remaining cases do not explain why the efficient-market theory underlying *non-IPO,* aftermarket cases such as *Basic Inc.* should apply at the time of an IPO. *See In re Initial Pub. Offering Sec. Litig.*, 241 F. Supp. 2d 281, 375-77 (S.D.N.Y. 2003); *In re Promixa Corp. Sec. Litig.*, No. 93-1139-IEG, 1994 WL 374306, at *19 (S.D. Cal. May 3, 1994); *Werner v. Satterlee, Stephens, Burke & Burke*, 797 F. Supp. 1196, 1215 (S.D.N.Y. 1992).

alleged facts involve *post*-IPO events. Converium did not file "periodic public reports with the SEC" *before* the IPO; nor was its stock "followed by numerous securities analyst firms" *before* the IPO. Until the IPO occurred, Converium was not a public company.

That Converium's securities traded on the New York Stock Exchange and the SWX Swiss Exchange – which plaintiffs (at 56-57) call "highly efficient markets" – is meaningless. "The [m]ere fact that a stock trades on a national exchange does not necessarily indicate that the market *for that particular security* is efficient." *Bell v. Ascendant Solutions, Inc.*, 422 F.3d 307, 340 (5th Cir. 2005) (emphasis added); *accord, e.g., Harman v. LyphoMed, Inc.*, 122 F.R.D. 522, 525 (N.D. Ill. 1988) ("the inquiry in an individual case remains the development of the market for that stock, and not the location where the stock trades").

Nor have plaintiffs pled any *facts* to support their allegation that the market for Converium securities became efficient at some point *after* the IPO. Although the Complaint (¶ 45) mentions the average daily trading volume for Converium securities, "the relevant indicator is turnover measured as a percentage of outstanding shares," *Bell*, 422 F.3d at 315, and plaintiffs have not made any such factual allegation. Nor have plaintiffs alleged any other key factors, such as the extent to which market makers and arbitrageurs trade in the securities, Converium's market capitalization, the bid-ask spread for stock sales, the float, and the stock's trading volume excluding insider-owned shares. *Id.*

For all of the above reasons, the IPO purchasers have failed to plead particularized *facts* suggesting that the market for Converium securities was efficient at the time of the IPO, and the post-IPO purchasers have failed to plead facts suggesting how and when the originally inefficient market purportedly became efficient after the IPO.

C. Plaintiffs Have Not Pled Particularized Facts Creating a Strong Inference of Scienter.

In response to ZFS's showing (at 38-40) that the Complaint does not plead particularized facts creating a strong inference of ZFS's scienter, plaintiffs (at 60-78) launch a barrage of charges that indiscriminately blend pre-IPO and post-IPO allegations, hoping to tar ZFS with accusations that relate only to Converium. For example, only one of the nine "bullet points" on pages 62-63 – the first point – concerns the pre-IPO period; the other eight relate to the post-IPO period, by which time ZFS undisputedly played no role in Converium's affairs. *See also, e.g.* Pl. Br. at 63, 74 (combining pre-IPO Tillinghast and post-IPO Deloitte reports); *id.* at 65-67 (allegations about post-IPO reserves studies and discussions) *id.* at 68 (discussing post-IPO reports); *id.* at 70-71 (allegations about post-IPO reserves bookings and "novation scheme").

The sole allegations that even arguably could lie against ZFS relate to the 2001 Tillinghast study (which purportedly showed a $350 million reserves deficiency for ZRNA) and the statements in the Prospectus (which ZFS did *not* sign) that Converium's loss reserves were consistent with Tillinghast's "best estimate." However, as ZFS explained in its opening brief and in this reply, Tillinghast's "best estimate" actually showed a deficiency of only $162 million (Ex. A at 5), which ZFS almost completely eliminated by adding $125 million to ZRNA's loss reserves before the IPO (Compl. ¶ 87).

ZFS thus did not act recklessly (or worse) in relying on Tillinghast's best estimate – and on the clean audit from Converium's auditor, PricewaterhouseCoopers. As discussed above, the Complaint does not plead plaintiffs' newly invented theory that Tillinghast somehow was "duped" into finding a "best estimate" deficiency of only $162 million. And neither the Complaint nor plaintiffs' brief asserts a single fact to support a suggestion that any information was misrepresented to or withheld from Tillinghast.

VI.
THE COURT SHOULD DISMISS THE CLAIMS AGAINST ZFS ON LOSS-CAUSATION GROUNDS.

A. Plaintiffs Have Not Pled Facts Showing That ZFS Caused Their Loss.

ZFS's opening brief asserted (at 40-46) that the Court should dismiss plaintiffs' Exchange Act claims because plaintiffs have not pled particularized facts showing how ZFS's pre-IPO conduct before December 11, 2001 allegedly caused their losses in late 2004 – and should dismiss plaintiffs' Securities Act claims for lack of loss causation.

Plaintiffs argue in response (at 58) that whether ZFS's pre-IPO conduct was a "legal cause" of plaintiffs' alleged losses three years later poses a "question of fact that can not be resolved at this stage of the litigation." Contrary to plaintiffs' contention, however, ZFS did not assert only that its pre-IPO conduct "could not have been a legal cause" of plaintiffs' alleged losses. Rather, ZFS demonstrated that plaintiffs had not *pled any facts* showing a causal connection between the 2001 Prospectus and the 2004 stock-price drop. Resolution of a *pleading* question is entirely appropriate at this stage of the litigation. In fact, the Second Circuit affirmed a decision of this Court granting a Rule 12(b)(6) motion on precisely these grounds. *See First Nationwide Bank v. Gelt Funding Corp.*, 27 F.3d 763, 769 (2d Cir. 1994).

Plaintiffs also assert (at 60) that causation exists because Converium's stock price dropped after the company announced its reserves increases in 2004. This argument begs the question. ZFS did not contend that plaintiffs could not establish loss causation at all. ZFS said only (at 42-45) that plaintiffs have not pled any particularized facts showing how the price drop and ensuing purported losses in 2004 were caused by the alleged *pre-IPO* conduct three years earlier, rather than by the alleged *post-IPO* events, which included (*i*) a long list of public statements, SEC filings, reserves studies, and several major reserves increases – none of which has been or could be attributed to ZFS – and (*ii*) difficulties in the reinsurance industry in

general. This loss-causation problem is fatal to all of plaintiffs' claims against ZFS. *See, e.g., Dura Pharm., Inc. v. Broudo*, 125 S. Ct. 1627, 1631 (2005) ("the longer the time between purchase and sale, the more likely that . . . other factors [*i.e.*, other than the alleged fraud] caused the loss").

B. The Court Should Dismiss All Claims Arising from Shares Purchased and Sold Before July 20, 2004.

If the Court does not dismiss plaintiffs' Securities Act claims as time-barred, the Court should dismiss *all* claims arising from shares that were purchased and sold before July 20, 2004. Those shares did not suffer any loss *caused* by the conduct alleged in the Complaint.[20]

As ZFS explained in its opening brief (at 40-45), loss causation – "a causal connection between the material misrepresentation and the [alleged] loss" – is an essential element of a § 10(b) claim. *Dura Pharm., Inc.*, 125 S. Ct. at 1631. The PSLRA requires plaintiffs to prove loss causation, 15 U.S.C. § 78u-4(b)(4), and plaintiffs must plead that element of their claim with the particularity required by Rule 9(b), *see supra*. Lack of loss causation is a defense to a claim under § 12(a) of the Securities Act. 15 U.S.C. § 77l(b).

Plaintiffs contend that Converium's stock price was artificially inflated during the putative class period because the company allegedly had misrepresented or concealed its "true" financial condition and the adequacy of its loss reserves. (*E.g.*, Compl. ¶ 234.) Converium's July 20, 2004 announcement "that it would take a $400 million charge to increase its loss reserves corrected the previously issued false and misleading statements" and purportedly caused the company's stock price to fall, thereby allegedly causing plaintiffs' loss. (*Id.* ¶¶ 234-35.)

In opposing defendants' motions to dismiss their Securities Act claims as time-barred, plaintiffs argue vociferously that, before July 20, 2004, "the market did not have any idea

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20 ZFS noted this issue in its opening brief (at 40 n.21), but plaintiffs chose to ignore it.

that Converium was materially under-reserved" (Pl. Br. at 38), "Lead Plaintiffs and the members of the class . . . had no reason to suspect that the Company was concealing a massive reserve deficiency" (*id.* at 37), and "inquiry notice was not triggered [for limitations purposes] until July 20, 2004, when the Company shocked investors" by announcing the $400 million charge (*id.* at 39). The Complaint contains similar allegations. *See, e.g.*, Compl. ¶ 1 ("Defendants' fraudulent conduct *began to come to light* on July 20, 2004) (emphasis added); *id.* ¶¶ 208, 210, 211 (Converium's July 20, 2004 announcement "shocked the financial markets," "shocked the market," and "shocked" analysts); *id.* ¶ 211 (analysts "expressed similar astonishment").

If the Court – at the pleading stage – accepts plaintiffs' argument that the allegedly fraudulent conduct "began to come to light [only] on July 20, 2004 (*id.* ¶ 1) and that "inquiry notice was not triggered until July 20, 2004 (Pl. Br. at 39), then the Court should dismiss all claims based on shares purchased and sold *before* that date, because the allegedly *undisclosed* fraud could not have *caused* any loss.

In *Dura Pharmaceuticals,* the Supreme Court held that, if a plaintiff buys stock at an allegedly inflated purchase price, "at the moment the transaction takes place, the plaintiff has suffered no loss: the inflated purchase payment is offset by ownership of a share that *at that instant* possesses equivalent value." 125 S. Ct. at 1631 (emphasis in original). Similarly, if the plaintiff then "sells the shares quickly *before the relevant truth begins to leak out*, the misrepresentation will not have led to any loss," because the still-undisclosed "truth" could not yet have affected the market price. *Id.* (emphasis added).

Courts therefore have recognized that investors cannot establish loss causation for shares that are both *purchased and sold* before the alleged truth has been revealed. *E.g., Barr v. Matria Healthcare, Inc.*, 324 F. Supp. 2d 1369, 1380 (N.D. Ga. 2004) (dismissing for lack of

loss causation where "misrepresentations were not disclosed until after the Plaintiff had sold his stock at the still artificially inflated price").[21]

Plaintiffs here cannot have it both ways. If "the market did not have any idea [until July 20, 2004] that Converium was materially under-reserved" (Pl. Br. at 38), and if Converium's July 20, 2004 announcement "shocked" an unsuspecting market and "astonished" securities analysts, then Converium's stock price before that date could not have been affected by the allegedly *undisclosed* fraud. Accordingly, if the Court accepts plaintiffs' argument that they had no reason to be aware of their alleged claims before July 20, 2004, the Court should dismiss all claims based on shares purchased and sold before that date for lack of loss causation. However, if the Court grants ZFS's motion to dismiss the Securities Act claims as time-barred, ZFS is willing to withdraw this loss-causation argument at the pleading stage.

VII.
PLAINTIFFS HAVE FAILED TO PLEAD CONTROL-PERSON LIABILITY.

In response to ZFS's showing (at 53-57) that plaintiffs have failed to plead cognizable control-person liability claims against ZFS, plaintiffs argue (at 79-83, 85) that

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[21] *Accord, e.g., Davidco Inv., LLC v. Anchor Glass Container Corp.*, No. 8:04CV2561T-24EAJ, 2006 WL 547989, at *10, *22, *25 (M.D. Fla. Mar. 6, 2006) (dismissing Securities Act and Exchange Act claims for lack of loss causation to extent plaintiffs had sold stock before alleged truth was disclosed); *In re Compuware Sec. Litig.*, 386 F. Supp. 2d 913, 920 (E.D. Mich. 2005) (granting summary judgment for lack of loss causation where plaintiff had sold stock before truth was revealed); *Argent Classic Convertible Arbitrage Fund v. Rite Aid Corp.*, 315 F. Supp. 2d 666, 681-82 (E.D. Pa. 2004) (dismissing, for lack of loss causation, claims based on shares purchased and sold before disclosure, "[b]ecause the misrepresentations could not have affected the price until then"); *Arduini/Messina P'ship v. Nat'l Med. Fin. Servs. Corp.*, 74 F. Supp. 2d 352, 361-62 (S.D.N.Y. 1999) (dismissing for lack of loss causation where plaintiffs sold their stock before alleged fraud had been fully implemented); *see also, e.g., Packer v. Yampol*, 630 F. Supp. 1237, 1240 (S.D.N.Y. 1986) (if plaintiffs allege fraud is continuing, they have not been injured, because they could sell their stock at still-inflated price); *cf., e.g., Akerman v. Oryx Commc'ns, Inc.*, 810 F.2d 336, 342 (2d Cir. 1987) ("The price decline before disclosure may not be charged to defendants."); *In re Merrill Lynch & Co., Inc. Research Reports Sec. Litig.*, 272 F. Supp. 2d 243, 254 (S.D.N.Y. 2003) (no recovery possible under §§ 11 or 12 for price declines before public disclosure of allegedly concealed information).

(*i*) control-person liability cannot be resolved on a motion to dismiss; (*ii*) plaintiffs do not need to plead culpable participation, and (*iii*) they have adequately alleged ZFS's "control" of Converium. Plaintiffs are incorrect on each point.

A. The Adequacy of Pleadings Is Appropriate for Rule 12(b)(6) Resolution.

Plaintiffs assert (at 79) that "the question of control person liability is incapable of resolution at the motion to dismiss stage." While *factual* disputes about control-person liability might not be resolvable at this point, issues about the *adequacy of plaintiffs' allegations* can be resolved – as plaintiffs' own cases demonstrate. *See, e.g., In re Hayes Lemmerz Int'l, Inc.*, 271 F. Supp. 2d 1007, 1021 (E.D. Mich. 2003) ("The only question before the Court is whether Plaintiffs sufficiently *pleaded* that the Individual Defendants are controlling persons.") (emphasis added); *In re MicroStrategy, Inc. Sec. Litig.*, 115 F. Supp. 2d 620, 661 (E.D. Va. 2000) ("dismissal is appropriate only when a plaintiff does not *plead* any facts from which it can reasonably be inferred the defendant was a control person") (emphasis added; internal quotations omitted).[22]

Indeed, several of plaintiffs' cases (at 81-82) actually *granted* motions to dismiss certain control-person claims. *See, e.g., Suez Equity Investors, L.P. v. Toronto-Dominion Bank*, 250 F.3d 87, 102 (2d Cir. 2001) ("These vague allegations are conclusory at best . . . and are

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[22] Other cases that plaintiffs cite are not even Rule 12(b)(6) decisions. *See, e.g., Terrydale Liquidating Trust v. Barness*, 611 F. Supp. 1006 (S.D.N.Y. 1984) (summary-judgment ruling regarding potentially self-interested conduct by majority of a real estate investment trust's trustees); *SEC v. Franklin Atlas Corp.*, 154 F. Supp. 395, 400 (S.D.N.Y. 1957) (preliminary injunction proceeding to enjoin defendants from engaging in alleged violations of Securities Act). Other cited cases held only that the plaintiffs had sufficiently alleged their claims. *See, e.g., In re Executive Telecard, Ltd. Sec. Litig.*, 913 F. Supp. 280, 286 (S.D.N.Y. 1996) (noting that, despite adequate pleading, "a jury may well find that Mr. Bertoli did not possess such control over the alleged primary violators"); *see also No. 84 Employer-Teamster Joint Council Pension Trust Fund v. Am. W. Holding Corp.*, 320 F.3d 920, 945 (9th Cir. 2003) ("[p]laintiffs have established a prima face showing that [defendants] were controlling persons").

insufficient under § 20 as a matter of law"); *Fezzani v. Bear Stearns & Co.*, 384 F. Supp. 2d 618, 646 n.9 (S.D.N.Y. 2004) (dismissing § 20(a) claim because "the complaint provides sparse facts regarding Defendants' control over" the purportedly controlled person), *reconsideration granted in part*, No. 99 Civ. 0793, 2004 WL 1781148 (S.D.N.Y. Aug. 10, 2004); *Food & Allied Serv. Trades Dep't, AFL-CIO v. Millfeld Trading Co.*, 841 F. Supp. 1386, 1392 (S.D.N.Y. 1994) (plaintiff "has failed to allege [defendant's] control status adequately and so has failed to state a claim under Section 20(a)"). Thus, there is no reason why the Court cannot address the adequacy of plaintiffs' §§ 15 and 20(a) pleadings now.

B. Culpable Participation Is Required, and Plaintiffs Have Not Pled It.

Plaintiffs also contend (at 80-83) that they need not plead culpable participation to state a control-person claim. But the Second Circuit has squarely held that, "to establish a *prima facie* case of liability under §20(a), a plaintiff must show: (1) a primary violation by a controlled person; (2) control of the primary violator by the defendant; and (3) 'that the controlling person was in some meaningful sense a *culpable participant* in the primary violation.'" *Boguslavsky v. Kaplan*, 159 F.3d 715, 720 (2d Cir. 1998) (quoting *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1472 (2d Cir. 1996)) (emphasis added).

The Second Circuit has not defined "culpable participation" other than to say that "a determination of Section 20(a) culpability requires an individual determination of a . . . defendant's particular culpability." *Boguslavsky*, 159 F.3d at 720. District Courts in this Circuit therefore have differed about whether plaintiffs must allege scienter to state a control-person liability claim. *See In re Philip Servs. Corp. Sec. Litig.*, 383 F. Supp. 2d 463, 486 (S.D.N.Y. 2004) (discussing two lines of cases).

ZFS submits, however, that the Court should read *Boguslavsky* for what it actually says: "culpable participation" is required. And plaintiffs' own case citations support that conclusion. As the court held in *Dietrich v. Bauer*, 126 F. Supp. 2d 759 (S.D.N.Y. 2001):

> At one time, it was not clear whether scienter or culpable participation was required to make out a prima facie case of control person liability. . . . However, in *First Jersey*, 101 F.3d 1450, the Second Circuit clarified that in addition to control person status, *culpable participation* "in some meaningful sense," *id.* at 1472, *is an element of the plaintiff's prima facie ca*se, and in *Boguslavsky*, 159 F.3d 715, the Second Circuit reaffirmed this view.

Id. at 764 n.3 (emphasis added; internal quotations omitted), *reconsideration granted*, No. 95 Civ. 7051, 2001 WL 536971 (S.D.N.Y. May 21, 2001) (reaffirming prior ruling).[23]

Plaintiffs also assert (at 81) that this Court should disregard *Boguslavsky*'s holding because it was a summary-judgment decision based on pre-PSLRA law. These

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[23] *See, e.g., In re Livent, Inc. Noteholders Sec. Litig.*, 151 F. Supp. 2d 371, 416 (S.D.N.Y. 2001) ("While this Court would wish clearer guidance, until the Court of Appeals addresses the issue more explicitly, it seems that the authority available balances toward holding that the plaintiff bears the burden of pleading culpability as part of a *prima facie* case under [Section] 20(a)"); *see also, e.g., Suez Equity Investors*, 250 F.3d at 101 ("Controlling-person liability is a form of secondary liability, under which a plaintiff may allege a primary § 10(b) violation by a person controlled by the defendant and *culpable participation* by the defendant in the perpetration of the fraud.") (emphasis added; internal quotations omitted); *In re Vivendi Univ., S.A. Sec. Litig.*, 381 F. Supp. 2d 158, 189 (S.D.N.Y. 2003) ("Courts in this district have adopted various standards to plead culpable participation. . . . At bottom, plaintiffs must plead facts showing either conscious misbehavior or recklessness by the defendant."), *reconsideration denied*, No. 02 Civ. 5571, 2004 WL 2375830 (S.D.N.Y. Oct. 22, 2004); *In re Oxford Health Plans, Inc. Sec. Litig.*, 187 F.R.D. 133, 142 n.2 (S.D.N.Y. 1999) ("Plaintiffs argue that the proper standard for pleading a Section 20(a) violation does not include pleading culpable participation in the fraudulent activity. The Court rejects this contention. *First Jersey* clearly states that a *prima facie* case requires a showing of culpable participation in addition to control status."); *Ellison v. Am. Image Motor Co.*, 36 F. Supp. 2d 628, 642 (S.D.N.Y. 1999) ("A plaintiff may not allege controlling person status . . . without alleging actual control and the nature of the controlling person's culpable participation in the fraud.") (internal quotations omitted).

contentions are misguided. First, *Boguslavsky* is not a pre-PSLRA case; it was filed in October 1996, ten months *after* the PSLRA took effect. 159 F.3d at 178.[24]

Second, plaintiffs do not cite *any* authority for their contention that they can avoid *pleading* a prima facie element of their claim even if they must *prove* that element at trial (or create a fact issue as to that element at the summary-judgment stage). The whole point of a motion to dismiss is to require plaintiffs to *plead* the elements of their claims with the requisite particularity. *See, e.g., Mishkin v. Ageloff*, No. 97 Civ. 2690, 1998 WL 651065, at *23 (S.D.N.Y. Sept. 23, 1998) ("*First Jersey* established that as part of a plaintiff's prima face case, a plaintiff must show that the controlling person was in some meaningful sense a culpable participant in the fraud perpetrated by the controlled person. As a result, because a section 20(a) plaintiff must *ultimately* establish a defendant's state of mind, the PSLRA requires a plaintiff, at the pleading stage, to allege particular facts that give rise to a strong inference of the requisite state of mind.").

C. Plaintiffs Have Not Pled Any *Facts* Suggesting ZFS's Actual Control.

Finally, plaintiffs insist (at 85) that they have adequately pled ZFS's control of Converium at the time of the IPO by alleging that ZFS "participated" in Converium's management and operation and in the preparation of the IPO documents. But as ZFS noted in its opening brief (at 55), plaintiffs have not pled any *factual* basis for these conclusory assertions of "participation." Nor have plaintiffs addressed ZFS's showing that Converium was incorporated as a separate entity nearly six months *before* the IPO – and that, in the absence of *factual*

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[24] In any event, plaintiffs' suggestion that the PSLRA somehow *reduced* pleading standards for Exchange Act claims is clearly wrong. *See, e.g., Kalnit v. Eichler*, 264 F.3d 131, 138 (2d Cir. 2001) (PSLRA *heightened* Second Circuit's Rule 9(b) standards by *adding* "with particularity" requirements for pleading facts to support allegations based on information and belief and to support strong inference of scienter).

allegations, there is no reason for the Court to accept plaintiffs' conclusory assertions that ZFS actually controlled that separate company.

As discussed above in Part I.B and in ZFS's opening brief (at 11), Rule 9(b) applies to allegations of control-person liability. Plaintiffs have failed to comply with Rule 9(b) in alleging ZFS's actual exercise of control over Converium before the IPO.

CONCLUSION

For all of the foregoing reasons, and for those stated in ZFS's opening brief, the Court should dismiss Counts III, V, IX, and X of the Complaint as against ZFS.

Dated: March 31, 2006

LEBOEUF, LAMB, GREENE & MACRAE LLP

By: /s/ Jonathan E. Richman

Ralph C. Ferrara
Jonathan E. Richman (JR-2491)
John C. Letteri
125 West 55th Street
New York, New York 10019
(212) 424-8000

Attorneys for Defendant Zurich Financial Services

NYB 631621