IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

IN RE CONVERIUM HOLDING AG SECURITIES LITIGATION This Document Relates to: All Cases	)	MASTER FILE 04 Civ. 7897 (DLC)

LEAD PLAINTIFFS' REPLY MEMORANDUM OF LAW
IN FURTHER SUPPORT OF THEIR MOTION FOR RECONSIDERATION

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Lead Plaintiffs, the Public Employees' Retirement System of Mississippi and Avalon Holdings, Inc., respectfully submit this reply memorandum of law, pursuant to Federal Rule of Civil Procedure 59(e) and Local Rule 6.3, in further support of their motion for reconsideration of the Court's December 28, 2006 Opinion and Order.[1]

PRELIMINARY STATEMENT

Defendants' arguments in opposition to Lead Plaintiffs' Motion should be rejected. First, with respect to the claims arising under the Exchange Act, Defendants essentially concede that: (1) the market for Converium securities became efficient *after* the IPO; (2) the trier of fact can conclude that the false statements in the IPO Registration Statement continued to affect the price of Converium securities for months after the IPO; and (3) aftermarket purchasers may assert claims arising under the Exchange Act based on the false statements set forth in the IPO Registration Statement. As set forth in our opening brief, these admissions warrant reconsideration of that part of the Court's Order which held that aftermarket purchasers could not assert Exchange Act claims predicated on the false and misleading IPO Registration Statement.

Instead, Defendants argue that Lead Plaintiffs did not plead the fraud-on-the-market theory of reliance with requisite particularity, and further that Lead Plaintiffs failed to plead precisely "when and how" the market became efficient. However, this Court has already held that the Complaint "address[es] the basis for a presumption of reliance *after* the IPO (*In re Converium Holding AG Sec. Litig.*, No. 04-7897, 2006 WL 3804619, at *12 (S.D.N.Y. Dec. 28, 2006) (emphasis added)), and a plethora of federal courts have found market efficiency allegations that are virtually identical to the ones alleged in the Complaint to be sufficient. Moreover, Defendants cite no case to support their assertion that Lead Plaintiffs must plead

[1] Capitalized terms shall have the meaning assigned to them in the Memorandum of Law in Support of Lead Plaintiffs' Motion for Reconsideration, dated January 12, 2007.

when and how the market became efficient, and Lead Plaintiffs' research has uncovered none. It is well-settled that these issues create fact questions that should not be resolved at the pleading stage.

With respect to the Securities Act claims, Defendants' arguments also lack merit. Defendants do not – and cannot – point to "uncontroverted evidence" that Class members were on inquiry notice of their Securities Act claims in the fall of 2002. *Newman v. Warnaco Group, Inc.*, 335 F.3d 187, 195 (2d Cir. 2003). To the contrary, in light of the fact that Defendants specifically assured investors that the reserve increases in 2002 did *not* relate to the pre-IPO period, Defendants' arguments at best only demonstrate that there is a material issue of fact as to whether Class members were on inquiry notice of their Securities Act claims. Moreover, as set forth below, the facts of *LC Capital Partners LP v. Frontier Ins. Group, Inc.*, 318 F.3d 148 (2d Cir. 2003) are distinguishable. In that case, the Second Circuit did not hold that investors were on inquiry notice merely because the Company had increased its reserves, but also because there was other information – including a previously filed securities fraud class action and a magazine article – indicating that the defendants' statements about the adequacy of their reserves were false when made. *Id.* at 155 ("Also contributing to a duty of inquiry was the *National Underwriter* article discussing Frontier's reserve problems and the 1994 Eastern District litigation in *Frontier I*.")

For these reasons, and as further detailed in Lead Plaintiffs' initial brief and below, Lead Plaintiffs respectfully request that the Court grant the Motion and amend or clarify its Order.[2]

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[2] Lead Plaintiffs recognize that the standard for granting a motion for reconsideration is strict, but we respectfully submit that the standard is not insurmountable and has been satisfied here. *See, e.g., Cruz v. Barnhart*, No. 04 Civ. 9794, 2006 WL 547681, at *2 (S.D.N.Y. Mar. 7, 2006) ("While the decision whether to grant such a motion is left to the discretion of the district court, it may be an abuse of discretion to let stand an error of law brought to its attention in a timely manner.").

ARGUMENT

A. Plaintiffs Adequately Allege Reliance After the Initial Public Offering

In the Order, the Court dismissed Lead Plaintiffs' Exchange Act claims to the extent they were based on statements contained in the IPO Registration Statement because Lead Plaintiffs' allegations did "not constitute adequate allegations of reliance . . . at *the stage of the initial public offering*." *In re Converium Holding AG Sec. Litig.*, 2006 WL 3804619, at *12 (emphasis added). On this Motion, Lead Plaintiffs seek reconsideration or clarification of the Court's ruling as it relates to the claims of those investors who purchased Converium's stock *after* the IPO, once the market for the stock became efficient.

Significantly, in their opposition to the Motion, Defendants do not contest that the market for Converium securities became efficient after the IPO, or that aftermarket purchasers have cognizable claims under the Exchange Act based on the statements in the IPO Registration Statement. Rather, Defendants assert that the Motion should be denied because Lead Plaintiffs' allegations relating to market efficiency – even with respect to the secondary market – are inadequate as a matter of law. Def. Opp. at 13-14. Defendants are wrong.

First, contrary to Defendants' assertion, the Court's application of a recent Second Circuit decision to hold that the market for Converium shares was not efficient *at the time* of the IPO (*See In re Converium Holding AG Sec. Litig.*, 2006 WL 3804619, at *12) does not have any bearing on the adequacy of the Complaint's allegations relating to market efficiency *after* the IPO. To the contrary, in the Order, the Court specifically found that the allegations set forth in paragraph 45 of the Complaint – which identified six reasons why the markets for Converium securities were efficient – "address the basis for a presumption of reliance *after* the IPO." *Id.* (emphasis added). Moreover, this holding is supported by a plethora of cases, all of which held

similar market efficiency allegations to be adequate at the pleading stage. *See, e.g, In re WorldCom, Inc. Sec. Litig.*, 294 F. Supp.2d 392 (S.D.N.Y. 2003).[3]

Second, Defendants' assertion that Lead Plaintiffs need to plead "when and how" the post-IPO market became efficient (Def. Opp. at 14) is also incorrect. Lead Plaintiffs are unaware of any court holding such allegations to be necessary, and significantly, Defendants fail to cite to one. That is because the question of when the market becomes efficient presents factual issues that depend upon the testimony of expert witnesses and the presentation of other evidence. *See, e.g, In re Laser Arms Corp. Sec. Litig.*, 794 F. Supp. 475, 490 (S.D.N.Y. 1989).[4] Indeed, even Defendants concede that "in appropriate circumstances ... questions of market efficiency cannot be resolved at the pleading stage." Def. Opp. at 15. Where, as here, Lead Plaintiffs allege – and Defendants do not and could not credibly dispute – that the market for Converium securities became efficient after the IPO, the issue of exactly when the market became efficient should be decided by the trier of fact, after Lead Plaintiffs have had the opportunity to present supporting evidence, including expert reports.[5]

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[3] Defendants' suggestion that the Supreme Court's decision in *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336 (2005) made the pleading standard for market efficiency more demanding (Def. Opp. at 16) is wrong. In *Dura*, the Supreme Court reinforced the principle that those elements of an Exchange Act claim which do not aver fraud – such as loss causation – require only notice pleading in accordance with Rule 8 of the Federal Rules of Civil Procedure. *Dura,* 544 U.S. at 346-47. *See also In re Immucor Inc. Sec. Litig.*, No 1:05-CV-2276, 2006 WL 3000133 (N.D.Ga., Oct. 4, 2006) ("Unlike the pleading standard for materiality or scienter, the pleading standard for loss causation in securities fraud cases does not impose 'any special ... requirement ...'") (citing *Dura*, 544 U.S. at 346).

[4] *Bell v. Ascendant Solutions, Inc.* 422 F.3d 307, 315 (5th Cir. 2005), relied on by Defendants (*see* Def. Opp. at 15, n. 12), does not require a different result. In *Bell*, the Fifth Circuit addressed the issue of whether the plaintiffs had made a sufficient showing of market efficiency *after* presenting evidence, including the testimony of market efficiency experts, at the class certification stage – not the pleading stage. *Bell* is also distinguishable because in that case the company collapsed just weeks after the initial public offering occurred, which created an issue as to whether the market ever became efficient. In contrast, Converium securities have traded on the New York Stock Exchange since the IPO. Complaint, ¶45.

[5] To the extent the Court finds that the Second Circuit's recent *In re IPO* decision (*In re Initial Public Offering Sec. Litig.*, 471 F.3d 24 (2d Cir. 2006)) requires Lead Plaintiffs to plead "when and how" the

Third, the questions of how and for how long the misrepresentations and omissions in the IPO Registration Statement affected the price of Converium securities also raise factual issues that should be left to the trier of fact. It is well established that "SEC filings are the quintessential statement on which a reasonable investor may rely." *In re Worldcom*, 294 F.Supp.2d at 417. Further, "material misleading public statements continue to affect the market price of publicly traded securities until there is a corrective disclosure of sufficient force and effect to counter the false impression created by the prior misstatement." *In re ZZZZ Best Sec. Litig.*, 864 F. Supp. 960, 975 (C.D. Cal. 1994). While Defendants contend that the IPO Registration Statement was supposedly "superseded" on May 23, 2002, when the Company filed its Form F-20 containing "new reserve information" (Def. Opp. at 16, n. 15), such contention raises a fact question that may not be resolved at the pleading stage. Moreover, even assuming Defendants were correct in their argument (which they are not), it would mean that the false IPO Registration Statement inflated the price of Converium securities *for nearly six months after the IPO*. In sum, contrary to Defendants' assertion (Def. Opp. at 16, n. 15), the determination of how and for how long the IPO Registration Statement could have affected the prices of Converium's securities cannot be decided at the pleading stage.

B. Class Members Were Not on Inquiry Notice of the Securities Act Claims

"Inquiry notice exists only when *uncontroverted* evidence *irrefutably* demonstrates when plaintiff discovered or should have discovered the fraudulent conduct." *Newman v. Warnaco*

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market became efficient after the IPO, Lead Plaintiffs respectfully request leave to amend the Complaint to add such allegations. Contrary to Defendants' assertions, *In re IPO* marked the first time that the Second Circuit ever held that, as a matter of law, the market was not efficient at the time of an initial public offering of common stock. As a result, if Lead Plaintiffs are now required to plead when and how the market became efficient, Lead Plaintiffs should have an opportunity to amend the Complaint. *See Issen v. GSC Enters, Inc.*, 522 F. Supp. 390, 394 (N.D. Ill. 1981) (granting plaintiffs' motion to amend securities fraud complaint based primarily on "developments in federal securities law").

Group, Inc., 335 F.3d 187, 195 (2d Cir. 2003) (emphasis added). As set forth in Lead Plaintiffs' initial brief in support of the Motion and below, Lead Plaintiffs respectfully submit that the Court erred when it found that such "uncontroverted evidence" existed here.

First, Defendants do not dispute that Converium and its most senior officers specifically assured investors in October 2002 that the reserve increases were occasioned by *new* developments which did not exist at the time of the IPO.[6] It is well established that investors "may not be considered to have been placed on inquiry notice because the warnings are accompanied by reliable words of comfort from management." *LC Capital Partners LP v. Frontier Ins. Group, Inc.*, 318 F.3d 148, 155 (2d Cir. 2003). Thus, where, as here, investors were specifically (and falsely) told that the reserve increases did not relate to the pre-IPO period, the finding that Lead Plaintiffs were on inquiry notice that the IPO Registration Statement contained false statements about Converium's reserves is unwarranted.[7]

Moreover, this case is distinguishable from the facts of *LC Capital*. In that case, the Second Circuit did *not* hold that the reserve increases *alone* put investors on inquiry notice. To the contrary, the Second Circuit explicitly recognized that there were two other significant

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[6] *See, e.g.,* statements referenced in Memorandum of Law in Support of Lead Plaintiffs' Motion for Reconsideration, at 8.

[7] Defendants' contention that Lead Plaintiffs' reference to the October 28, 2002 conference call is tantamount to advancing new arguments (Def. Opp. at 10-11) is unpersuasive. Lead Plaintiffs have argued that they were not on inquiry notice because, among other reasons, the statements in the October 28, 2002 conference call reassured investors that Converium had addressed the reserves issues in a forthright and proactive manner, and that there was no reason to suspect that the IPO Registration Statement was materially false. *See* Lead Plaintiffs' Memorandum of Law in Opposition to All Defendants' Motions to Dismiss at 41. The fact that Lead Plaintiffs now bring to the Court's attention another statement from that conference call to bolster that argument is not tantamount to advancing a new argument, because the Court may consider the entirety of that conference call in resolving Defendants' motions to dismiss. *Cortec Indus., Inc. v. Sum Holding L.P.*, 949 F.2d 42, 48 (2d Cir. 1991) ("the district court ...could have viewed [the documents] on the motion to dismiss because there was undisputed notice to plaintiffs of their contents and they were integral to plaintiffs' claim"). *See also* Memorandum of Law in Support of Lead Plaintiffs' Motion for Reconsideration at 8, n. 5.

factors which "contributed" to that conclusion – namely, a magazine article which revealed that the losses which necessitated those reserve increases had existed for years, and a securities fraud class action lawsuit that had been filed years earlier, after the first reserve increase. *Id.* at 155 ("Also contributing to a duty of inquiry was the *National Underwriter* article discussing Frontier's reserve problems and the 1994 Eastern District litigation in *Frontier I.*") Notably, the magazine article cited by the Second Circuit in its opinion indicated that the company's last reserve increase, which occurred in November 1998, *applied to losses incurred from 1995 to 1998. Id.* at 153. Thus, the magazine article made clear that the reserve increase was attributable to facts which had previously existed, and *not* to new developments.

Further, in *LC Capital*, a securities fraud class action based on the exact same subject matter as the action later found to be time-barred had been pending *for six years* when the time-barred action was filed. Indeed, that initial action (referred to as *Frontier I* by the Second Circuit) was filed shortly after the company *first* disclosed in 1994 that it would have to increase its reserves, and that action specifically alleged that the defendant had "fraudulently concealed and misrepresented its knowledge of, among other things, the fact that Frontier's reserves for losses ... were grossly inadequate." 318 F.3d at 155. In contrast, in this case no lawsuits were filed against Converium or any other Defendant after the October 28, 2002 (or November 2002) disclosures. Lead Plaintiffs respectfully submit that the absence of any lawsuits (even one asserting a Securities Act claim) is compelling evidence that the market had accepted management's assurances and had no idea (or reasons to suspect) that Converium was under-reserved at the time of the IPO.

LC Capital is distinguishable for other reasons as well. In that case, "the reassuring statements by management were mere expressions of hope, devoid of any specific steps taken to

avoid under-reserving in the future." *Id.* at 156 (internal citations omitted).[8] Here, however, the statements at issue did refer to specific steps that management had taken to ensure that under-reserving would not recur. Indeed, when Converium announced the reserve increases, it assured investors that it had undertaken a rigorous loss reserve analysis and actuarial analysis to ensure that its reserves were adequate. When viewed in their entirety, a jury could reasonably conclude that these statements could have caused investors to believe that the reserve increases did not relate to the pre-IPO period, and that the accuracy of the statements in the Registration Statement was therefore not suspect.

Second, Defendants' argument that Lead Plaintiffs were on inquiry notice because Converium's press releases issued in 2002 stated that the reserve increases related, at least in part, to policies written before the IPO, is nonsense. Def. Opp. at 6. The fact that the policies were written in earlier years does not mean that the reserves established at that time were inadequate, because reserves may have to be increased as new information becomes available. As Defendant Lohmann stated in the Company's October 28, 2002 press release, "it is the nature of our business that problems surface with a significant time lag." Complaint, ¶ 161. Indeed, if Defendants' argument was correct, it would mean that every reserve increase would necessarily indicate that the facts which led to that increase had been in existence for years. That is obviously not correct, and here, Defendants specifically represented that the reserves in place at the time the policies were written were fully adequate, and that the increases were only necessitated by new developments which did not previously exist. When one considers these express assurances, Converium's statements that the reserve increases related to policies written

[8] *See* Lead Plaintiffs' Memorandum of Law in Opposition to All Defendants' Motions to Dismiss at 38-43 and Memorandum of Law in Support of Lead Plaintiffs' Motion for Reconsideration at 8-9.

in earlier years cannot be considered to have put investors on inquiry notice that reserves at the time of the IPO were inadequate.

Finally, Defendants' argument that Class members were on inquiry notice because the Complaint alleged that the October 28, 2002 press release was a partial disclosure (Def. Opp. at 8) is inapposite. Lead Plaintiffs referred to the October 28, 2002 conference call as a partial disclosure only *after* Converium increased its reserves by more than half a billion dollars in 2004, and Converium North America went out of business shortly thereafter. This hindsight recognition has nothing to do with whether Class members were on inquiry notice almost two years earlier *at the time* the partial disclosure was made. Further, the fact that Named Plaintiff LASERS sold some – but not all – of its holdings in Converium following the October 28, 2002 announcement does not alter the analysis. Def. Opp. at 8-9. Convierum's stock dropped almost 10% following the October 28, 2002 disclosure and, in such circumstances, many investors make a business decision to divest some or all of their holdings. That decision, however, is not – and should not be considered – evidence that an investor was on inquiry notice of fraud. If that were the standard, then every time a company makes a disclosure that results in a stock drop, investors would be compelled to sue – even on inadequate facts – for fear of later suffering the pain of bar. Indeed, if LASERS' trading is a supposed indicator of whether investors were on inquiry notice, then it is clear they were not, as LASERS retained more than two-thirds of its holdings after this disclosure.

In sum, Lead Plaintiffs respectfully submit that the facts as pled in the Complaint are distinguishable from the facts in *LC Capital*, and that the Court therefore erred in finding as a matter of law that Lead Plaintiffs were on inquiry notice of their Securities Act claims.

CONCLUSION

For the forgoing reasons, Lead Plaintiffs' Motion should be granted.

Dated: New York, New York
February 20, 2007

Respectfully submitted,

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