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Liberty Ridge LLC v. RealTech Systems Corp.
S.D.N.Y.,2001.

United States District Court,S.D. New York.

LIBERTY RIDGE LLC

v.

REALTECH SYSTEMS CORP.

No. 01 Civ. 5974(MP).

Nov. 13, 2001.

Investors in corporation sued corporation and its principals for alleged violations of federal securities laws and for common-law fraud, fraudulent misrepresentation, fraudulent concealment, negligent misrepresentation, breach of contract, and breach of implied covenant of good faith and fair dealing. Corporation and principals moved to dismiss. The District Court, [Milton Pollack](#), Senior District Judge, held that: (1) Securities Act of 1933 did not apply to investors' claims; (2) issue of whether securities fraud claims were barred by statute of limitations could not be resolved on motion to dismiss; (3) allegations supported claims for alleged violations of § 10(b) and Rule 10b-5 under heightened pleading requirements for fraud; and (4) allegations supported scienter element of securities fraud claims against principals.

Motion granted in part and denied in part.

West Headnotes

[1] Federal Civil Procedure 170A  **1828**

170A Federal Civil Procedure

170AXI Dismissal

170AXI(B) Involuntary Dismissal

170AXI(B)5 Proceedings

170Ak1827 Determination

170Ak1828 k. Time of Determination; Reserving Decision. [Most Cited Cases](#)

Normally, motions to dismiss for lack of subject matter jurisdiction must be decided before other

procedural motions are considered, since dismissal for lack of subject matter jurisdiction will render all other accompanying defenses and motions moot. [Fed.Rules Civ.Proc.Rule 12\(b\)\(1\)](#), [28 U.S.C.A.](#)

[2] Securities Regulation 349B  **25.60**

349B Securities Regulation

349BI Federal Regulation

349BI(B) Registration and Distribution

349BI(B)5 Prospectuses and Communications

349Bk25.55 False Statements or Omissions; Accuracy

349Bk25.60 k. Persons Entitled to Sue or Recover. [Most Cited Cases](#)

Provision of Securities Act of 1933 imposing liability on persons offering or selling security “by means of a prospectus or oral communication” containing false or misleading statement did not apply to claims of investors, who asserted that corporation and its principals made misrepresentations through oral communications, given that communications at issue did not pertain to prospectus and underlying securities transactions involved private placements, not public offerings. Securities Act of 1933, § 12(a)(2), [15 U.S.C.A. § 77I\(a\)\(2\)](#).

[3] Federal Civil Procedure 170A  **1831**

170A Federal Civil Procedure

170AXI Dismissal

170AXI(B) Involuntary Dismissal

170AXI(B)5 Proceedings

170Ak1827 Determination

170Ak1831 k. Fact Issues. [Most Cited Cases](#)

Issue of whether investors' securities fraud claims were barred by statute of limitations could not be resolved on motion to dismiss, given factual dispute as to when investors learned of alleged fraud. Securities Act of 1933, § 13, [15 U.S.C.A. § 77\(m\)](#); Securities Exchange Act of 1934, §§ 9(e), 10(b), as amended, [15 U.S.C.A. §§ 78i\(e\), 78j\(b\)](#); [17 C.F.R.](#)

§ 240.10b-5; Fed.Rules Civ.Proc.Rule 12(b)(6), 28 U.S.C.A.

[4] Limitation of Actions 241 ↪95(18)

241 Limitation of Actions

241II Computation of Period of Limitation

241III(F) Ignorance, Mistake, Trust, Fraud, and Concealment or Discovery of Cause of Action

241k95 Ignorance of Cause of Action

241k95(18) k. Securities; Corpora-

tions. **Most Cited Cases**

Statutory one-year time period for bringing securities claims under § 10(b) and Rule 10b-5 begins to run at the point at which plaintiff has enough facts to be on inquiry notice of a potential claim; it does not wait until he has full knowledge of the eventual particulars of his case. Securities Act of 1933, § 13, 15 U.S.C.A. § 77(m); Securities Exchange Act of 1934, §§ 9(e), 10(b), as amended, 15 U.S.C.A. §§ 78i(e), 78j(b); 17 C.F.R. § 240.10b-5.

[5] Securities Regulation 349B ↪60.15

349B Securities Regulation

349BI Federal Regulation

349BI(C) Trading and Markets

349BI(C)7 Fraud and Manipulation

349Bk60.11 Transactions Subject to

Regulation

349Bk60.15 k. Connection with

Purchase or Sale. **Most Cited Cases**

Securities Regulation 349B ↪60.18

349B Securities Regulation

349BI Federal Regulation

349BI(C) Trading and Markets

349BI(C)7 Fraud and Manipulation

349Bk60.17 Manipulative, Deceptive

or Fraudulent Conduct

349Bk60.18 k. In General. **Most**

Cited Cases

To state a claim for relief pursuant to § 10(b) and Rule 10b-5, plaintiffs must allege that defendants (1) made misstatements or omissions of material

fact, (2) with scienter, (3) in connection with the purchase or sale of securities, (4) upon which plaintiffs relied, and (5) that plaintiffs' reliance was the proximate cause of their injury. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5.

[6] Federal Civil Procedure 170A ↪636

170A Federal Civil Procedure

170AVII Pleadings and Motions

170AVII(A) Pleadings in General

170Ak633 Certainty, Definiteness and Particularity

170Ak636 k. Fraud, Mistake and Condition of Mind. **Most Cited Cases**

Securities Regulation 349B ↪60.51(1)

349B Securities Regulation

349BI Federal Regulation

349BI(C) Trading and Markets

349BI(C)7 Fraud and Manipulation

349Bk60.50 Pleading

349Bk60.51 In General

349Bk60.51(1) k. In General.

Most Cited Cases

(Formerly 349Bk60.51)

When fraud is alleged in securities litigation, both procedural rule and Private Securities Litigation Reform Act (PSLRA) require it to be pleaded with particularity, and, when multiple defendants are involved, complaint must disclose the specific nature of each defendant's participation in the alleged fraud. Securities Exchange Act of 1934, §§ 10(b), 21D(b)(1), as amended, 15 U.S.C.A. §§ 78j(b), 78u-4(b)(1); 17 C.F.R. § 240.10b-5; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

[7] Securities Regulation 349B ↪60.51(1)

349B Securities Regulation

349BI Federal Regulation

349BI(C) Trading and Markets

349BI(C)7 Fraud and Manipulation

349Bk60.50 Pleading

[349Bk60.51](#) In General
[349Bk60.51\(1\)](#) k. In General.

Most Cited Cases

(Formerly [349Bk60.51](#))

Heightened pleading requirement for allegations of fraud in securities litigation serves a threefold purpose: first, to provide defendant with fair notice of plaintiff's claim, to enable him to prepare a defense; second, to protect defendant from harm to his reputation or goodwill; and, third, to reduce the number of strike suits. Securities Exchange Act of 1934, §§ 10(b), 21D(b)(1), as amended, [15 U.S.C.A. §§ 78j\(b\), 78u-4\(b\)\(1\)](#); [17 C.F.R. § 240.10b-5](#); [Fed.Rules Civ.Proc.Rule 9\(b\)](#), [28 U.S.C.A.](#)

[8] Securities Regulation [349B](#) [60.53](#)

[349B](#) Securities Regulation

[349BI](#) Federal Regulation

[349BI\(C\)](#) Trading and Markets

[349BI\(C\)7](#) Fraud and Manipulation

[349Bk60.50](#) Pleading

[349Bk60.53](#) k. Misrepresentation.

Most Cited Cases

Securities fraud plaintiff may satisfy heightened pleading requirement for allegations of fraud by specifying (1) precisely what statements were made in what documents or oral representations, or what omissions were made; (2) the time and place of each such statement and the person responsible for making them, or, in the case of omissions, not making them; (3) the content of such statements and the manner in which they misled plaintiff, and (4) what defendants obtained as a consequence of the fraud. Securities Exchange Act of 1934, §§ 10(b), 21D(b)(1), as amended, [15 U.S.C.A. §§ 78j\(b\), 78u-4\(b\)\(1\)](#); [17 C.F.R. § 240.10b-5](#); [Fed.Rules Civ.Proc.Rule 9\(b\)](#), [28 U.S.C.A.](#)

[9] Federal Civil Procedure [170A](#) [636](#)

[170A](#) Federal Civil Procedure

[170AVII](#) Pleadings and Motions

[170AVII\(A\)](#) Pleadings in General

[170Ak633](#) Certainty, Definiteness and Particularity

[170Ak636](#) k. Fraud, Mistake and Condition of Mind. **Most Cited Cases**

When matters are peculiarly within defendant's knowledge, the standards for pleading circumstances of alleged fraud are less stringent, and, in cases of malice, intent, knowledge, and other condition of mind of a person, plaintiff must simply state the facts upon which his belief of such knowledge is based; however, these pleadings must present a factual basis giving rise to a strong inference of fraudulent intent. [Fed.Rules Civ.Proc.Rule 9\(b\)](#), [28 U.S.C.A.](#)

[10] Securities Regulation [349B](#) [60.51\(2\)](#)

[349B](#) Securities Regulation

[349BI](#) Federal Regulation

[349BI\(C\)](#) Trading and Markets

[349BI\(C\)7](#) Fraud and Manipulation

[349Bk60.50](#) Pleading

[349Bk60.51](#) In General

[349Bk60.51\(2\)](#) k. Scienter. **Most**

Cited Cases

(Formerly [349Bk60.51](#))

Allegations of scienter may be based on information and belief under heightened pleading standards for allegations of fraud in securities litigation. Securities Exchange Act of 1934, §§ 10(b), 21D(b)(1), as amended, [15 U.S.C.A. §§ 78j\(b\), 78u-4\(b\)\(1\)](#); [17 C.F.R. § 240.10b-5](#); [Fed.Rules Civ.Proc.Rule 9\(b\)](#), [28 U.S.C.A.](#)

[11] Securities Regulation [349B](#) [60.51\(2\)](#)

[349B](#) Securities Regulation

[349BI](#) Federal Regulation

[349BI\(C\)](#) Trading and Markets

[349BI\(C\)7](#) Fraud and Manipulation

[349Bk60.50](#) Pleading

[349Bk60.51](#) In General

[349Bk60.51\(2\)](#) k. Scienter. **Most**

Cited Cases

(Formerly [349Bk60.51](#))

Even when pleading scienter on information and belief, securities fraud plaintiffs are required to include a statement of facts upon which the allega-

tions of fraud are based. Securities Exchange Act of 1934, §§ 10(b), 21D(b)(1), as amended, 15 U.S.C.A. §§ 78j(b), 78u-4(b)(1); 17 C.F.R. § 240.10b-5; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

[12] Securities Regulation 349B ↪60.51(1)

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.50 Pleading
349Bk60.51 In General
349Bk60.51(1) k. In General.

Most Cited Cases

(Formerly 349Bk60.51)

While securities fraud complaint must give adequate notice of the charges against defendant, it need not marshal all the evidence, and courts should not demand a level of specificity in fraud pleadings that can only be achieved through discovery. Securities Exchange Act of 1934, §§ 10(b), 21D(b)(1), as amended, 15 U.S.C.A. §§ 78j(b), 78u-4(b)(1); 17 C.F.R. § 240.10b-5; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

[13] Securities Regulation 349B ↪60.53

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.50 Pleading
349Bk60.53 k. Misrepresentation.

Most Cited Cases

Securities Regulation 349B ↪60.54

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.50 Pleading
349Bk60.54 k. Nondisclosure. **Most**

Cited Cases

Allegations supported claims for alleged violations of § 10(b) and Rule 10b-5, under heightened pleading requirements for fraud, when complaint set forth strong circumstantial evidence showing corporation's principals knew that statements were false and misleading at the time they made alleged misrepresentations and omissions about corporation's financial and business position, investors specified statements at issue and basis for belief that they were intentionally false and misleading, investors alleged that their reliance was reasonable, and investors alleged that they would not have invested in corporation had its true financial and business position been disclosed and that misrepresentations induced disparity between transaction price and securities' true investment quality at time of transaction. Securities Exchange Act of 1934, §§ 10(b), 21D(b)(1), as amended, 15 U.S.C.A. §§ 78j(b), 78u-4(b)(1); 17 C.F.R. § 240.10b-5; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

[14] Securities Regulation 349B ↪60.47

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.43 Grounds of and Defenses to Liability
349Bk60.47 k. Causation; Existence of Injury. **Most Cited Cases**

To plead adequately causation element of federal securities fraud claim, plaintiff must allege both transaction causation, i.e., that but for the fraudulent statement or omission, plaintiff would not have entered into securities transaction, and loss causation, i.e., that the subject of the fraudulent statement or omission was the cause of the actual loss suffered. Securities Exchange Act of 1934, §§ 10(b), 21D(b)(1), as amended, 15 U.S.C.A. §§ 78j(b), 78u-4(b)(1); 17 C.F.R. § 240.10b-5; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

[15] Securities Regulation 349B ↪60.45(1)

349B Securities Regulation

349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.43 Grounds of and Defenses
to Liability
349Bk60.45 Scienter, Intent,
Knowledge, Negligence or Recklessness
349Bk60.45(1) k. In General.

Most Cited Cases

Allegations supported scienter element of securities fraud claims against corporation's principals where investors contended that principals participated directly in generating and disseminating allegedly misleading financial information about corporation to investors, putting them in position to know whether representations were accurate. Securities Exchange Act of 1934, §§ 10(b), 21D(b)(1), as amended, 15 U.S.C.A. §§ 78j(b), 78u-4(b)(1); 17 C.F.R. § 240.10b-5; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

[16] Securities Regulation 349B ↪60.51(2)

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.50 Pleading
349Bk60.51 In General
349Bk60.51(2) k. Scienter. Most

Cited Cases

(Formerly 349Bk60.51)

In federal securities litigation, boilerplate allegations that defendants knew or should have known of fraudulent conduct based solely on their board membership or executive positions are insufficient to plead scienter. Securities Exchange Act of 1934, §§ 10(b), 21D(b)(1), as amended, 15 U.S.C.A. §§ 78j(b), 78u-4(b)(1); 17 C.F.R. § 240.10b-5; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

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Jenkins & Gilchrist Parker Chapin LLP (Stephen G. Rinehart, of counsel), New York City, for Defend-

ants.

OPINION

MILTON POLLACK, Senior District Judge.

Plaintiffs are Liberty Ridge, LLC ("Liberty Ridge") and individual investors in Defendant RealTech Systems Corporation ("RealTech"). Plaintiffs claim that Defendants are liable under Sections 12, 15, and 20(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 promulgated thereunder. Plaintiffs also allege that defendants committed common law fraud, fraudulent misrepresentation, fraudulent concealment, negligent misrepresentation, breach of contract, and breach of the implied covenant of good faith and fair dealing.

Plaintiffs seek to recover the consideration paid by them to Defendant RealTech in the amount of \$3,080,022.00, with interest, and damages in the amount of \$3,080,022.00.

Defendants have filed a Motion to Dismiss the Complaint pursuant to: (1) *133Rule 12(b)(6) of the Federal Rules of Civil Procedure ("Fed. R. Civ.P."), for failure to state a claim upon which relief can be granted; (2) Rule 9(b), Fed.R.Civ.P., for failure to plead fraud with particularity; (3) Rule 12(b)(1), Fed.R.Civ.P., dismissing the pendant state claims for lack of subject matter jurisdiction; and (4) granting such other and further relief as the court may deem just and proper.

I. BACKGROUND

Plaintiffs' claims arise out of (1) the sale of 560,000 shares of Series C Preferred Stock by RealTech to Liberty Ridge for an aggregate purchase price of \$1,885,352, and (2) the sale of 360,000 shares of common stock by RealTech to the individual plaintiffs for an aggregate purchase price of \$1,194,670, in transactions that occurred between December, 1999 and March, 2000.

According to Plaintiffs, in selling these securities Defendants misrepresented and omitted material facts relating to RealTech's financial and business positions. They further allege that, due to the relationships among the individual Plaintiffs and between the individual Plaintiffs and Liberty Ridge, the Defendants could and did make representations to Liberty Ridge and one or more of the individual Plaintiffs with the intent and knowledge that the representations would be shared with other Plaintiffs.

First, Plaintiffs claim that Defendants made misrepresentations and omitted material facts relating to RealTech's financial position for the year 1999. According to their allegations, prior to the investments by Liberty Ridge and the individual investors, Defendants disclosed information relating to RealTech's financial position up to September 30, 1999 which materially understated the losses sustained by RealTech in the first three quarters of that year. Plaintiffs further allege that, although Defendants characterized RealTech's fourth quarter as "going well," the company in fact sustained a fourth quarter loss that was more than one and a half times the recorded losses for the first three quarters of the year combined and exceeded the projected fourth quarter losses in the Business Plan given to one of the individual investors by more than \$2 million. Thus, Plaintiffs assert that Defendants' optimistic statements regarding the outlook for RealTech's fourth quarter 1999 performance were intentionally false and misleading.

Second, Plaintiffs allege that Defendants made misrepresentations and omitted material facts relating to RealTech's business position. Plaintiffs allege that defendants falsely represented that RealTech was shifting the focus of its business by phasing out its value added reseller ("VAR") business in favor of services business, and that the cash generated by the Plaintiffs' investments would be used to expand RealTech's business presence in the service provider market by financing, *inter alia*, strategic office expansion nationwide and the hiring of top in-

dustry engineers. They argue that these representations were false and misleading, because within approximately two weeks of closing the majority of the Plaintiffs' investments, Defendants sent out nearly \$3 million in satisfaction of an apparently past-due account in connection with RealTech's old VAR business, leaving RealTech with inadequate operating capital despite the infusion of the Plaintiff's funds. Plaintiffs allege that their investments were used to satisfy this account instead of for the expansion of RealTech's business presence in the service provider market.

Finally, Plaintiffs claim that Defendants LaChance, Yanneck and Mesich, because of the positions they occupied at RealTech and the responsibilities and duties associated with those positions, knew or recklessly*134 failed to know RealTech's true financial and business positions and thus knew or recklessly failed to know of the falsity of RealTech's representations to Plaintiffs. Amended Complaint (hereinafter "Am. Compl.") ¶¶ 74-76. Plaintiffs further allege that Defendants LaChance and Yanneck affirmatively misrepresented RealTech's business plan and financial situation to both Liberty Ridge and to a number of the individual investors. Am. Compl. ¶ 78, 84.

II. DISCUSSION

1. Motion to Dismiss Pursuant to Rule 12(b)(1)

[1] Normally, motions to dismiss for lack of jurisdiction pursuant to Rule 12(b)(1) must be decided before motions pursuant to other Federal Rules of Civil Procedure are considered, *Integrated Utilities Inc. v. United States*, 1997 WL 529007 at *2 (S.D.N.Y.1997) (Scheidlin, J.), "[s]ince dismissal of an action for lack of subject matter jurisdiction will render all other accompanying defenses and motions moot." *United States v. Space Hunters, Inc.*, 2001 WL 968993 at *3 (S.D.N.Y.2001) (Casey, J); see *United States ex rel Kreindler & Kreindler v. United Techs. Corp.*, 985 F.2d 1148, 1155-56 (2d Cir.1993), *cert. denied sub*

Kreindler & Kreindler v. United Techs. Corp., 508 U.S. 973, 113 S.Ct. 2962, 125 L.Ed.2d 663 (1993). In this case, however, Defendants' 12(b)(1) motion relates solely to Plaintiffs' state law claims, requesting their dismissal for lack of supplemental jurisdiction should the Plaintiffs' federal claims be dismissed. It is therefore necessary to consider the substance of Defendants' claims, and render a decision on 12(b)(6) grounds, before returning to the 12(b)(1) motion.

2. Motion to Dismiss Pursuant to Rule 12(b)(6)

On a motion to dismiss pursuant to Rule 12(b)(6), “a court must accept as true all well-pleaded factual allegations of the complaint and must draw all inferences in favor of the pleader.” *Dafofin Holdings S.A. v. Hotelworks.com, Inc.*, 2001 WL 940632 at *2 (S.D.N.Y.2001) (Preska, J). Mere “[c]onclusory allegations or legal conclusions masquerading as factual conclusions” will not suffice to avoid dismissal. *Gebhardt v. Allspect, Inc.*, 96 F.Supp.2d 331, 333 (S.D.N.Y.2000) (Conner, J) (quoting 2 James Wm. Moore et al., Moore's Federal Practice § 12.34[a][b] (3d ed.1997)). A motion for dismissal should be granted only when “it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief.” *Conley v. Gibson*, 355 U.S. 41, 45-46, 78 S.Ct. 99, 2 L.Ed.2d 80 (1957); *accord Cohen v. Koenig*, 25 F.3d 1168, 1172 (2d Cir.1994).

3. Section 12(a)(2) Claims Under the 1933 Act.

[2] Section 12(a)(2) of the Securities Act of 1933 imposes liability on any person who “offers or sells a security ... by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements ... not misleading.”

Defendants argue that plaintiffs lack standing to sue under Section 12(a)(2) of the Securities Act of 1933, since that section applies only to the initial

public offering of stock, not to secondary private offerings. See *Gustafson v. Alloyd Co., Inc.*, 513 U.S. 561, 576, 115 S.Ct. 1061, 1070, 131 L.Ed.2d 1 (1995).^{FN1} In *Gustafson*, the *135 Court held that the term “prospectus,” as it is used in Section 12(a)(2), “is confined to documents related to public offerings by an issuer or its controlling shareholders.” *Gustafson* at 569, 115 S.Ct. 1061. Plaintiffs counter that they have alleged misrepresentations made by oral communications, not by a prospectus, and that this case is therefore distinguishable from *Gustafson*. They point out that, while the *Gustafson* Court noted agreement amongst the Courts of Appeals that “the phrase ‘oral communications’ is restricted to oral communications that relate to a prospectus,” *Gustafson* at 567-568, 115 S.Ct. 1061, the Court did not analyze the issue and thus ruled only on the meaning of the term “prospectus.”

FN1. See generally Paul C. Curnin and Christine M. Ford, *The Critical Issue of Standing Under Section 11 of the Securities Act of 1933*, 6 Fordham J. Corp. & Fin. L. 155, 170-174 (2001).

In this District, courts have consistently interpreted *Gustafson* to hold that the term “oral communication” in Section 12(a)(2) is a “communication that relates to a public written communication, such as a prospectus.” *Dietrich v. Bauer*, 76 F.Supp.2d 312, 330 (S.D.N.Y.1999) (Sweet, J); *accord Waltree Ltd. v. ING Furman Selz LLC*, 97 F.Supp.2d 464, 469-70 (S.D.N.Y.2000) (Scheidlin, J); *Double Alpha, Inc. v. Mako Partners, L.P.*, 2000 WL 1036034, at *3 (S.D.N.Y.2000) (Chin, J). Furthermore, in *Laser Mortgage Mgmt. Inc. v. Asset Securitization Corp.*, 2001 WL 1029407 (S.D.N.Y.2001) (Buchwald, J), the court noted that “*Gustafson* suggests that the purpose of Section 12 is to protect public purchasers of securities ... [t]hat purpose would not be served by extending liability to those who purchase securities in private placements.” *Laser Mortgage* at *7.

Here, the oral communications alleged by Plaintiffs

to have contained misrepresentations did not pertain to a prospectus. Furthermore, the securities transaction at issue here is not a public one, but rather is a private placement. Consequently, the Court grants so much of Defendants' motion to dismiss Plaintiffs' claims as asserts liability under Section 12(a)(2) of the Securities Act of 1933.

4. 10(b) and 10b-5 Claims

A. Timeliness

[3][4] Defendants contend that Plaintiffs' claims under Section 10(b) of the Exchange Act of 1934, 15 U.S.C. § 78j(b) and Rule 10b-5 promulgated thereunder ("Section 10(b) and Rule 10b-5") are time-barred, as they were not "brought within one year after the discovery of the facts constituting the violation and within three years after such violation" as required by Section 9(e) of the Securities Exchange Act of 1934, 15 U.S.C. § 78i(e) (governing claims under Section 10(b) and Rule 10b-5) and by Section 13 of the Securities Act of 1933, 15 U.S.C. § 77(m). The one-year time period begins to run "at the point at which a plaintiff has enough facts to be on inquiry notice of a potential claim; it does not wait until he has full knowledge of the eventual particulars of his case." *Ingenito v. Bermec Corp.*, 441 F.Supp. 525, 554-55 (S.D.N.Y.1977) (Lasker, J) citing *Klein v. Shields & Co.*, 470 F.2d 1344, 1347 (2d Cir.1972). Defendants maintain that Plaintiffs had adequate "storm warnings" of trouble at RealTech to put them on inquiry notice of fraud.

Dodds v. Cigna Sec., Inc., 12 F.3d 346, 350 (2d Cir.1993), cert. denied, 511 U.S. 1019, 114 S.Ct. 1401, 128 L.Ed.2d 74, alleging, for example, that the loss projections in RealTech's business plans and the fact that RealTech had not hired a CFO to complete the fourth quarter*136 and year end financial statements should have indicated the possibility of fraud to Plaintiffs. Defendants contend that Plaintiffs, as insiders, had access to RealTech's books and records, had the means by which to conduct an inquiry into any suspected misconduct, and were under a duty to do so.

Plaintiffs counter that the one year limitations periods applicable here, by their terms, do not begin until the plaintiff has "discovered" the facts constituting the violation. *Rothman v. Gregor*, 220 F.3d 81, 96 (2d Cir.2000), citing *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 364 & n. 9, 111 S.Ct. 2773, 115 L.Ed.2d 321 (1991). Further, that inquiry notice requires a plaintiff to know that the alleged fraud is probable, not merely possible. *In re Integrated Resources Real Estate Ltd. Partnerships Sec. Litig.*, 815 F.Supp. 620, 638 (S.D.N.Y.1993) (Sweet, J). Plaintiffs argue that RealTech's business plans were consistent with Defendants' representations to Plaintiffs and, as such, could not serve as warnings of fraud. They maintain that they did not know of the possibility of fraud until the December, 2000 bankruptcy of a RealTech customer that owed the company \$2.5 million.

The question of Plaintiffs' knowledge of Defendants' alleged fraud, and when this knowledge arose, is clearly a question of fact. Plaintiffs' allegations on this issue are sufficient to defeat Defendants' motion to dismiss pursuant to Rule 12(b)(6).

B. Satisfaction of the Particularity Requirements of PSLRA and Rule 9(b)

[5][6][7][8] To state a claim for relief pursuant to Section 10(b) and Rule 10b-5, Plaintiffs must allege that Defendants "(1) made misstatements or omissions of material fact; (2) with scienter; (3) in connection with the purchase or sale of securities; (4) upon which plaintiffs relied; and (5) that plaintiffs' reliance was the proximate cause of their injury." *In re IBM Corp. Sec. Litig.*, 163 F.3d 102, 106 (2d Cir.1998). Where fraud is alleged, both Fed.R.Civ.P. 9(b) ("Rule 9(b)") and the Private Securities Litigation Reform Act, 15 U.S.C. § 78u-4(b)(1) ("PSLRA") require it to be pleaded with particularity, and where multiple defendants are involved, "the complaint must disclose the specific nature of each defendant's participation in the alleged fraud." *Stander v. Financial Clearing & Services Corporation*, 718 F.Supp. 1204, 1210

(S.D.N.Y.1989) (Leisure, J), *citing DiVittorio v. Equidyne Extractive Industries, Inc.*, 822 F.2d 1242, 1247 (2d Cir.1987). This heightened pleading requirement serves a threefold purpose: first, to provide the defendant with fair notice of the plaintiff's claim, to enable him to prepare a defense; second, to protect the defendant from harm to his reputation or goodwill; and, third, to reduce the number of strike suits. *DiVittorio* at 1247. A plaintiff may satisfy the requirement by specifying “(1) precisely what statements were made in what documents or oral representations or what omissions were made; (2) the time and place of each such statement and the person responsible for making (or, in the case of omissions, not making same); (3) the content of such statements and the manner in which they misled the plaintiff, and (4) what the defendants ‘obtained as a consequence of the fraud.’ ” *Stander* at 1209, *citing Conan Properties, Inc. v. Mattel, Inc.*, 619 F.Supp. 1167, 1172 (S.D.N.Y.1985) (Duffy, J) (citations omitted).

[9] Where matters are “peculiarly within the defendant's knowledge,” *Ahmed v. Trupin*, 781 F.Supp. 1017, 1024 (S.D.N.Y.1992) (Sweet, J), however, the standards for pleading under **Rule 9(b)** are *137 less stringent. In cases of “[m]alice, intent, knowledge, and other condition of mind of a person” a general assertion is sufficient, **Fed.R.Civ.P. 9(b)**; the plaintiff must simply state “the facts upon which [his] belief of such knowledge is based.” These pleadings must “present a factual basis giving rise to a strong inference of fraudulent intent.” *Ahmed* at 1024, *citing O'Brien v. National Property Analysts Partners*, 936 F.2d 674, 676 (2d Cir.1991).

[10][11] Allegations of scienter may be based on information and belief. *DiVittorio, supra*, 822 F.2d at 1247. “Even when pleading on information and belief, however, plaintiffs are required to include a statement of facts upon which the allegations of fraud are based.” *Stander* at 1210, *citing Stern v. Leucadia National Corp.*, 844 F.2d 997, 1004 (2d Cir.), *cert denied*, 488 U.S. 852, 109 S.Ct. 137, 102

L.Ed.2d 109(1988).

[12] Defendants contend that Plaintiffs have not stated a claim for relief under Section 10(b) or Rule 10b-5, since: they have not alleged that Defendants acted with scienter; they have not pleaded Defendants' alleged misstatements with particularity; they have not pleaded reasonable reliance upon the alleged representations; and, finally, they have not alleged causation. Plaintiffs point out that, the heightened pleading requirements of **Rule 9(b)** and the PSLRA notwithstanding, the Second Circuit “do[es] not require the pleading of detailed evidentiary matter in securities litigation.” *In re Scholastic Corporation Securities Litigation*, 252 F.3d 63, 72 (2d Cir.2001). While a complaint must give adequate notice of the charges against a defendant, “it need not marshal all the evidence.” *Sierra Rutile Ltd. v. Katz*, 1992 WL 236208 at *6 (S.D.N.Y. Sept. 8, 1992) (Keenan, J). Furthermore, courts should not demand a level of specificity in fraud pleadings that can only be achieved through discovery. *See Gibbons v. Udaras na Gaeltachta*, 549 F.Supp. 1094, 1124 (S.D.N.Y.1982) (Ward, J) (“**Rule 9(b)** is not a vehicle by which potentially meritorious claims are to be driven out of court because the plaintiff has failed to allege facts that he can only obtain through taking discovery that he has thus far been denied.”); *Rich v. Touche Ross & Co.*, 68 F.R.D. 243, 247 (S.D.N.Y.1975) (Briant, J). (“At this early stage in the proceedings, plaintiffs' pleadings should not be judged by the standard to be applied on trial of the ultimate merits.”).

[13] It is clear that Plaintiffs have adequately stated a claim for relief under Section 10(b) and Rule 10b-5 pursuant to the standards outlined above. First, “[a]llegations of scienter are not subject to the same exacting scrutiny applied to the other components of fraud.” *Dietrich, supra*, 76 F.Supp.2d at 329. Plaintiffs' Amended Complaint sets forth strong circumstantial evidence showing that Defendants knew at the time that they made the misrepresentations and omissions described above that

those statements were false and misleading. Specifically, Plaintiffs point to the timing of RealTech's \$3 million dollar payment to Cisco in connection with the Company's VAR business, Am. Compl. ¶ 70, coming, as it did, within days of RealTech's receipt of Plaintiffs' investment funds, as an indication that defendants never intended to use the proceeds of Plaintiffs investments to expand the services business. Am. Compl. ¶ 72. These allegations therefore plead scienter with sufficient specificity to withstand a motion to dismiss.

Second, Plaintiffs have specified Defendants' misrepresentations regarding RealTech's financial health and the use of the proceeds of Plaintiffs' investments with sufficient particularity to satisfy Rule 9(b) and the PSLRA. Plaintiffs claim that Defendants*138 presented RealTech's cash position as "sound." Am. Compl. ¶ 48. Defendants allegedly told the Liberty Ridge investors that RealTech was seeking investments to expand its services business, and that the company was turning attention from its VAR business to the services side. Am. Compl. ¶ 43. According to Plaintiffs, Defendants told them their investment funds would be used to complete the transition and expand the services business. Am. Compl. ¶ 71.

Plaintiffs assert that these representations were intentionally false and misleading because, at the time they were made, RealTech was in fact not in a position to move forward unencumbered by its VAR business, or to use the proceeds of the investment for growth. Within approximately two weeks of closing the majority of Plaintiffs' investments, Defendants sent out nearly \$3 million in payment of the company's overdue VAR debt. Am. Compl. ¶ 70.

Fourth, Defendants contend that there were sufficient "storm warnings," *Dodds v. Cigna, supra*, at 350, about RealTech's financial difficulties to render any reliance on Defendants' assertions unreasonable. Plaintiffs argue that there were no such warnings of trouble at RealTech, and that it was reasonable for them to rely on the information and

assurances given to them by Defendants. Since the question of whether Plaintiffs' reliance on Defendants' assurances of RealTech's fiscal health was reasonable is largely one of fact, it is not amenable to disposition on motion to dismiss.

[14] Finally, on the question of causation, a two-pronged approach is taken under Federal securities law. "[A] plaintiff must allege both transaction causation, i.e., that but for the fraudulent statement or omission, the plaintiff would not have entered into the transaction; and loss causation, i.e., that the subject of the fraudulent statement or omission was the cause of the actual loss suffered." *Castellano v. Young & Rubicam, Inc.*, 257 F.3d 171, 186 (2d Cir.2001) (quoting *Suez Equity Investors v. Toronto-Dominion Bank*, 250 F.3d 87, 95 (2d Cir.2001)). Plaintiffs have sufficiently alleged both. Plaintiffs allege that they would not have invested if RealTech's true financial and business position had been disclosed, Am. Compl. ¶ 73, an allegation which satisfies the transaction causation requirement. They argue that Defendants' representations regarding the Company's business and financial positions at the time of plaintiffs' investments set the (apparent) value of the Company, and accordingly the price of the stock that Plaintiffs purchased. Plaintiffs argue that Defendants' misrepresentations induced a disparity between the transaction price and the true "investment quality" of the securities at the time of the transaction. On a motion to dismiss, this allegation of loss causation is sufficient.

ii. As Against Individual Defendants

[15][16] Defendants claim that Plaintiffs have not sufficiently alleged scienter on the part of the individual defendants. "Boilerplate allegations that defendants knew or should have known of fraudulent conduct based solely on their board membership or executive positions are insufficient to plead scienter." *In Re Sotheby's Holdings, Inc.*, 2000 WL 1234601 at *7 (S.D.N.Y. Aug. 31, 2000).

Plaintiffs do not, however, allege scienter on the

basis of the individual Defendants' holding of executive positions alone. Rather, they claim that Defendants' specific roles with regard to the finances of the Company, and their direct participation in generating financial information given to the Plaintiffs, put each in a position to know whether the representations being *139 made were accurate or not. Am. Compl. ¶¶ 74-76. Plaintiffs assert that Defendant Mesich, as Controller and Director of Accounting and Analysis for RealTech, was responsible for the financial misrepresentations and material misstatements made by the company, was aware of the falsity of the financials and other information provided to the Plaintiffs, and was aware of the material significance of these misrepresentations. Am. Compl. ¶¶ 88, 89, 91. With respect to Defendants Yanneck and LaChance, Plaintiffs have alleged direct and specific involvement in presenting the false and misleading information to the investors. For example, Plaintiffs assert that Yanneck was directly involved in the solicitation and consummation of Plaintiffs' investments. Am. Compl. ¶ 76. Both Yanneck and LaChance allegedly participated in a meeting at RealTech's New York offices at which the company's financial statements as of September 1999 were presented to Plaintiffs. Am. Compl. ¶¶ 78, 84, and during which they represented that RealTech's "fourth quarter was proceeding 'on track' and that the company was 'doing well.'" Am. Compl. ¶ 49. In addition, Plaintiffs claim Defendant LaChance "significantly participated in the compilation and preparation of RealTech's financial statements while it had no acting CFO." Am. Compl. ¶ 74. These claims allege enough of an individual, affirmative role on the part of Defendants Mesich, LaChance and Yanneck in the making misrepresentations to Plaintiffs to survive a motion to dismiss.

III. CONCLUSION

Defendants' motion to dismiss Counts I and II is granted and their motion to dismiss the balance of the Amended Complaint is denied in all respects. Since Plaintiffs' federal law claims are not being

dismissed, the Court retains supplemental jurisdiction over their state law claims.

So Ordered

S.D.N.Y., 2001.

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173 F.Supp.2d 129, Fed. Sec. L. Rep. P 91,638

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