

**UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF COLUMBIA**

UNITED STATES SECURITIES  
AND EXCHANGE COMMISSION

Plaintiff,

v.

Case No. 1:09-cv-1423-GK

STEVEN R. CHAMBERLAIN,  
ELAINE M. BROWN, and  
GARY A. PRINCE

Defendants.

**DEFENDANT STEVEN R. CHAMBERLAIN’S MOTION TO DISMISS**

Comes now, Defendant Steven Chamberlain by and through his undersigned counsel and respectfully requests this Court to dismiss, with prejudice, the Complaint filed by the Securities and Exchange Commission against Mr. Chamberlain pursuant to Federal Rules of Civil Procedure 12(b)(6) and 9(b) on the following grounds:

1. The Legal Standards for a Motion to Dismiss under Rule 12(b)(6) and Rule 9(b) Warrant the Dismissal of the Complaint;
2. The First Claim for Relief Under Section 17(a) of the Securities Act of 1933, as amended, 15 U.S.C. § 77a *et seq.* Should be Dismissed Because it Fails to State a Claim Upon Which Relief Can be Granted;
3. The Fourth Claim for Relief Should be Dismissed Because Rule 13a-14 under the Securities Exchange Act of 1934, as amended, 15 U.S.C. § 78a *et seq.* (“Exchange Act”) Does not Create an Independent Cause of Action;
4. The Fifth Claim for Relief Under Section 14(a) and Rule 14a-9 of the Exchange Act Should be Dismissed Because One or More Elements of Proxy Fraud are not Present;
5. The First, Second, and Fifth Claims for Relief Should Be Dismissed Because the Complaint Fails to Plead Fraud with Particularity;
6. All Claims for Relief for Violations Prior to July 30, 2004 are Barred by the Statute of Limitations and Should be Dismissed;

7. The Claims for Relief Based on Allegations that Mr. Prince's Legal Background Should Have Been Disclosed After June 23, 2002, Should be Dismissed Because Integral and Mr. Chamberlain Were Under no Duty to Disclose Mr. Prince's Background After That Time; and
8. The Terms "Officer" and "Policy Making Function" are Void for Vagueness and any Omission to Disclose a *De Facto* Executive Officer Should not Form the Basis for any Claims for Relief Against Mr. Chamberlain.

In support of this Motion to Dismiss, attached hereto is Mr. Chamberlain's Memorandum of Points and Authorities in Support of his Motion to Dismiss. For the reasons set forth herein, Mr. Chamberlain requests the Court to grant the Motion and award him the relief requested.

Dated: September 27, 2009

Respectfully submitted,

BALL LAW OFFICES, P.C.



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STEVEN R. CHAMBERLAIN, :  
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GARY A. PRINCE :

Defendants. :

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**DEFENDANT STEVEN R. CHAMBERLAIN'S MEMORANDUM OF POINTS  
AND AUTHORITIES IN SUPPORT OF HIS MOTION TO DISMISS**

**INTRODUCTION**

Defendant Steven R. Chamberlain submits this Memorandum of Points and Authorities in support of his Motion to Dismiss the Complaint of the Securities and Exchange Commission (the "SEC") for failure to state a claim upon which relief can be granted. In the First Claim for Relief, the SEC alleges that all of the Defendants are primary violators of Section 17(a) of the Securities Act of 1933, as amended, 15 U.S.C. § 77a *et seq.* ("Securities Act"). In the Second Claim for Relief, the SEC alleges that all of the Defendants are primary violators of Section 10(b) of the Securities Exchange Act of 1934, as amended, 15 U.S.C. § 78a *et seq.* ("Exchange Act") and Rule 10b-5 thereunder. In the Fourth Claim for Relief, the SEC alleges that Mr. Chamberlain and Ms. Elaine Brown violated Rule 13a-14 promulgated under the Exchange Act in that they certified the annual reports on Form 10-K for Integral Systems, Inc. ("Integral" or "the Company") for fiscal years 2002 through 2005, which reports did not disclose Mr. Gary Prince as an executive officer of Integral. In the Fifth Claim for Relief, the SEC alleges that Mr. Chamberlain violated Section 14(a) of the

Exchange Act and Rule 14a-9 promulgated thereunder in that seven (7) proxy statements filed by Integral from March 2000 through March 2006 failed to disclose Defendant Prince as an executive officer of Integral. The First, Second, Third, Fourth and Fifth Claims for Relief against Mr. Chamberlain allege various violations of the Securities Act, the Exchange Act, and the Rules promulgated thereunder for conduct alleged to have occurred prior to July 30, 2004 (more than 5 years from the date the SEC filed its Complaint).

For reasons set forth below, (1) the Complaint fails to state a claim upon which relief can be granted under the First, Second, Fourth and Fifth Claims for Relief as to Mr. Chamberlain; (2) the Complaint fails to plead fraud with specificity under the First, Second and Fifth Claims for Relief; and (3) the violations alleged in the Complaint in the First, Second, Third, Fourth, and Fifth Claims for Relief occurring prior to July 30, 2004, are barred by the applicable statute of limitations and should be dismissed.

### **BACKGROUND**

Mr. Chamberlain is a founder and former Chief Executive Officer of Integral, a public company headquartered in Columbia, Maryland that builds satellite ground systems and equipment for command and control, integration and test, data processing, and simulation. Gary Prince worked for Integral from 1982 until 1995, when he was convicted of financial fraud for his role as an executive officer of Financial News Network. Mr. Prince resigned from Integral and served several months in a federal penitentiary. Later, in 1997, the SEC barred Mr. Prince from practicing before it as an accountant under SEC Rule 102(e). Mr. Chamberlain, who had worked with Mr. Prince since founding Integral over 25 years ago, brought Mr. Prince back as a part-time consultant in about May 1998 to work directly for Mr. Chamberlain at Integral. By December 1998, Mr. Prince had become a full-time employee serving at the behest of Mr. Chamberlain. The SEC does not allege that Mr.

Prince's background or role within the Company was hidden from the Board of Directors or the executive officers of the Company. Indeed, Mr. Prince was considered to be a valuable employee and was compensated as such, but the Company and Mr. Chamberlain did not delegate to Mr. Prince the authority and duties of an executive officer.

Over the course of Mr. Prince's tenure with Integral, the Company (and sometimes Mr. Chamberlain personally) made numerous inquiries of Integral's corporate and securities counsel, the law firm of Venable LLP ("Venable"), about Mr. Prince's role and whether it warranted disclosure. In addition, Integral's attorneys interacted with Mr. Prince directly on many Company matters. Venable had ample notice and knowledge of Mr. Prince's role at Integral but never advised Integral that Mr. Prince should be disclosed as an executive officer. Moreover, on August 14, 2006, Treazure Johnson, Esq., a partner of Venable, wrote a letter to the SEC's staff which detailed Mr. Prince's role at Integral and concluded "we strongly believe that Mr. Prince was not an executive officer during this period." Prior to joining Venable, Ms. Johnson served as a Senior Assistant Chief Litigation Counsel for the SEC's Division of Enforcement.

The case before this Court is, in part, about the definition of an executive officer, whether Mr. Prince was a *de facto* executive officer, and whether Integral and Mr. Chamberlain acted with the requisite motivation, scienter and recklessness in not disclosing Mr. Prince as an executive officer. The SEC itself recognizes that the definition of an officer is complex and that "[t]hese questions usually involve difficult assessments of fact which can best be made by the issuer and its counsel."<sup>1</sup> In 1991, the American Bar Association

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<sup>1</sup> See Interpretive Release on Rules Applicable to Insider Reporting and Trading, Exchange Act Release 34-18114, I.A., 23 SEC Docket 856 (Sept. 24, 1981); Ownership Reports and Trading By Officers, Directors and Principal Security Holders, Exchange Act Release No. 34-28869, VIII.C, 48 SEC Docket 216 (Feb. 9, 1991).

submitted a no-action letter to the SEC posing the following questions about the meaning of an officer under Section 16 of the Exchange Act.

Would the general counsel of an issuer ordinarily be considered an “officer” within the meaning of Rule 16a-1(f)? Would the legal staff generally be regarded as a “principal business unit, division or function”? Would the answer depend upon the size of the legal staff in relation to the size of the issuer? Would the general counsel ordinarily be regarded as performing a “policy-making function”?

Am. Bar Ass’n, SEC No-Action Letter, 1991 WL 176795, at \*3 (July 3, 1991). In response, the SEC issued a no-action letter that explicitly refused to answer the question and directed issuers to seek advice of counsel:

The Division, as a matter of policy, will not express a view as to whether a general counsel or any other person is an officer under Section 16. A person's officer status depends on facts and circumstances and must be analyzed and determined by the issuer and its counsel.

Both the American Bar Association and the SEC recognized that it is indeed a difficult task to determine who is an executive officer. Since Integral and Mr. Chamberlain looked to their legal counsel for guidance, it is even more difficult to understand how Mr. Chamberlain could make that determination alone and how he could be charged with fraud for making that determination.

In August 2006, Mr. Prince was made an executive officer by Integral’s Board of Directors and disclosed in the Company’s public reports.<sup>2</sup> Three years after Mr. Prince was disclosed, the SEC has filed its Complaint alleging that from 1999 through to August 2006, Mr. Prince was a *de facto* executive officer of Integral and that Integral failed to disclose his

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<sup>2</sup> The price of Integral’s stock rose after Mr. Prince was disclosed. Nowhere in the Complaint is it alleged that the investors of Integral were harmed or suffered financial losses as a result of the non-disclosure of Mr. Prince’s alleged role as an executive officer or his background.

role and his background. For reasons set forth below, substantial portions of the Complaint should be dismissed as a matter of law.

## ARGUMENT

### I. LEGAL STANDARDS FOR A MOTION TO DISMISS UNDER RULE 12(B)(6) AND RULE 9(B)

A Rule 12(b)(6) motion to dismiss tests the legal sufficiency of a claim. *Browning v. Clinton*, 292 F.3d 235, 242 (D.C. Cir. 2002). The complaint need only set forth a short and plain statement of the claim, giving the party served fair notice of the claim and the grounds upon which it rests. *Kingman Park Civic Ass'n v. Williams*, 348 F.3d 1033, 1040 (D.C. Cir. 2003) (citing Fed. R. Civ. P. 8(a)(2) and *Conley v. Gibson*, 355 U.S. 41, 47 (1957)). In resolving a Rule 12(b)(6) motion, the court must treat the pleading's factual allegations – including mixed questions of law and fact – as true and draw all reasonable inferences there from in the pleader's favor. *Macharia v. United States*, 334 F.3d 61, 64, 67 (D.C. Cir. 2003); *Holy Land Found. for Relief & Dev. v. Ashcroft*, 333 F.3d 156, 165 (D.C. Cir. 2003); *Browning*, 292 F.3d at 242. However, the court need not accept as true inferences unsupported by facts set out in the complaint or legal conclusions cast as factual allegations. *Warren v. District of Columbia*, 353 F.3d 36, 40 (D.C. Cir. 2004); *Browning*, 292 F.3d at 242.

Dismissal under Fed. R. Civ. P. 12(b)(6) is appropriate only where the complaint lacks a cognizable legal theory or sufficient facts to support a cognizable legal theory. “While a complaint attacked by a Rule 12(b)(6) motion to dismiss does not need detailed factual allegations, a plaintiff's obligation to provide the ‘grounds’ of his ‘entitle[ment] to relief’ requires more than labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do.” *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 555 (2007) (internal citations omitted). Thus, a court need not accept as true conclusory

allegations, unreasonable inferences, legal characterizations, or unwarranted deductions of fact contained in the complaint. “[W]here the well-pleaded facts do not permit the court to infer more than the mere possibility of misconduct, the complaint has alleged – but it has not ‘show[n]’ – ‘that the pleader is entitled to relief.’ ” *Ashcroft v. Iqbal*, 556 U.S. \_\_\_, 129 S.Ct. 1937, 1950 (2009) (quoting Fed. R. Civ. P. 8(a)(2)). A complaint alleging facts which are “merely consistent with a defendant's liability . . . stops short of the line between possibility and plausibility of ‘entitlement to relief.’ ” *Iqbal*, 129 S.Ct. at 1950 (quoting *Twombly*, 550 U.S. at 557).

When a complaint alleges fraud, as the Complaint in this case does in the First and Second Claims for Relief, there is a heightened pleading standard under Fed. R. Civ. P. 9(b). Rule 9(b)'s standard requires the SEC to plead the “who, what, when, where, and how” with respect to the circumstances of the alleged fraud. *Burman v. Phoenix Worldwide Indus., Inc.*, 384 F. Supp. 2d 316, 325 (D.D.C. 2005) (citing *DiLeo v. Ernst & Young*, 901 F.2d 624, 627 (7th Cir. 1990)).

Even taking the SEC's factual allegations as true, the Complaint fails to state a claim for relief under Fed. R. Civ. P. 12(b)(6) in the First, Second, Fourth and Fifth Claims for Relief as to Mr. Chamberlain; (2) the Complaint fails to plead fraud with specificity against Mr. Chamberlain under Fed. R. Civ. P. 9(b) in the First, Second, and Fifth Claims for Relief; and (3) the violations alleged in the Complaint in the First, Second, Third, Fourth, and Fifth Claims for Relief for conduct occurring prior to July 30, 2004, are barred by the applicable statute of limitations and should be stricken or dismissed.

**II. THE FIRST CLAIM FOR RELIEF UNDER SECTION 17(A) SHOULD BE DISMISSED BECAUSE IT FAILS TO STATE A CLAIM UPON WHICH RELIEF CAN BE GRANTED.**

In the First Claim for Relief, the SEC alleges that all of the defendants violated each of the three subsections of Section 17(a) of the Securities Act. Section 17(a) is a general prohibition against fraud *in the offer or sale of securities*, using the mails or the instruments of interstate commerce. Section 17(a)(1) forbids the direct or indirect use of any device, scheme, or artifice to defraud; Section 17(a)(2) makes it unlawful to obtain money or property through misstatements or omissions about material facts; and, Section 17(a)(3) proscribes any transaction or course of business that operates as a fraud or deceit upon a securities buyer. *SEC v. Softpoint, Inc.*, 958 F. Supp. 846, 861 (S.D.N.Y. 1997), *aff'd*, 159 F.3d 1348, 1998 WL 537522 (2d Cir. 1998).

Section 17(a) provides in pertinent part:

**§77q. Fraudulent interstate transactions**

**(a) Use of interstate commerce for purpose of fraud or deceit**

It shall be unlawful for any person in the offer or sale of any securities or any security-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act) by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly—

- (1) to employ any device, scheme, or artifice to defraud, or
- (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or
- (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

Although Section 17(a) may appear on its face to provide the same relief as Section 10(b) of the Exchange Act, there are practical differences between the two. First, the Supreme Court has held that, unlike under Section 10(b), scienter is not required under

Section 17(a)(2) or 17(a)(3). See *Aaron v. S.E.C.*, 446 U.S. 680, 700 n.18 (1980). An action under Sections 17(a)(2) or (a)(3) may be maintained by a properly stated allegation of negligence. Scienter is required, however, under Section 17(a)(1). Second, unlike Section 10(b), there is no private right of action under Section 17(a).<sup>3</sup> Third, while Section 10(b) requires that the alleged fraud be “in connection with the purchase or sale” of a security, *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 733-734 (1975), Section 17(a) prohibits fraud “in the offer or sale” of a security. Thus, to state a claim under Section 17(a), the SEC must allege the existence of a fraud that occurred in the “offer” or in the “sale” of securities.

It is here under this third difference that the Complaint fails to state a claim for relief under Section 17(a). Even if the Court accepts as true the SEC’s allegation of fraud, there are no allegations in the Complaint of any offers or sales of securities. Section 17(a) on its face requires an “offer” or “sale” of securities. The Supreme Court in *United States v. Naftalin*, 441 U.S. 768, 772-773 (1979), analyzed the elements of Section 17(a) as it applied the statute to the conduct of a stockbroker. The Court undertook an extensive analysis of the meaning of the terms “offer” and “sale,” including the legislative history of the terms, in order to determine that the stockbroker’s fraudulent activity was in the offer and sale of securities. The Supreme Court analyzed the “offer” or “sale” made by Naftalin because Section 17(a) clearly expresses those terms as a required element under the statute.

In analogous situations, courts considering alleged criminal violations of Section 17(a) consistently require that indictments specify separate offer or sale transactions accompanied by a use of interstate commerce or the mails. Since the same statute is used for SEC Enforcement actions, the same interpretation is warranted. Each alleged violation of

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<sup>3</sup>*Bender v. Rocky Mountain Drilling Associates*, 648 F. Supp. 330, 332 (D.D.C. 1986).

Section 17(a) must occur in the offer or sale of a security. *See, e.g., United States v. Ashdown*, 509 F.2d 793, 800 (5th Cir.), *cert. denied*, 423 U.S. 829 (1975); *United States v. Dioguardi*, 492 F.2d 70, 83 (2d Cir.), *cert. denied*, 419 U.S. 873 (1974); *United States v. Aldridge*, 484 F.2d 655, 660 (7th Cir. 1973), *cert. denied*, 415 U.S. 921 (1974); *Sanders v. United States*, 415 F.2d 621, 626 (5th Cir. 1969), *cert. denied*, 397 U.S. 976 (1970).

In the Complaint, the first and only mention of any “offer” of securities occurs in Paragraph 41 of the First Claim for Relief. The first mention of any “sale” of securities occurs in Paragraph 41 of the First Claim for Relief and the only other mention of any “sale” of securities occurs in Paragraph 44 of the Second Claim for Relief. In each instance, however, the SEC merely paraphrases the statutes allegedly violated - Section 17(a) in the First Claim for Relief and Section 10(b) in the Second Claim for Relief. No other information has been alleged in the Complaint. The Complaint is devoid of any allegation of fact about the purported offer or sale of securities in which the alleged violation occurred. The Complaint does not allege how Mr. Chamberlain violated Section 17(a) or when he allegedly violated it. Mr. Chamberlain is entitled to know the alleged offer or sale of securities which he is defending against and whether any such allegations are barred by the statute of limitations. The SEC seeks to hold Mr. Chamberlain liable as a primary violator of Section 17(a), but it fails to plead any facts necessary to sustain its burden that the violation of Section 17(a) was “in the offer or sale of securities.” Thus, the First Claim for Relief fails to state a claim upon which relief can be granted and must be dismissed.

In addition, for reasons set forth in Section V *infra*, the Court should dismiss the First Claim for Relief for failure to plead fraud with specificity under Fed. R. Civ. P. 9(b).

**III. THE FOURTH CLAIM FOR RELIEF SHOULD BE DISMISSED BECAUSE RULE 13A-14 DOES NOT CREATE AN INDEPENDENT CAUSE OF ACTION.**

The Fourth Claim for Relief in the Complaint purports to allege a separate and distinct cause of action against Mr. Chamberlain and Ms. Brown under Rule 13a-14 of the Exchange Act. The Complaint alleges that they certified as true the Company's annual reports on Forms 10-K, which Forms were allegedly false and misleading because they did not disclose Mr. Prince as an executive officer of the Company. However, the case law and the SEC's own statements in promulgating Rule 13a-14 make it very clear that the Rule, as adopted, was never meant to create a separate cause of action.

**A. The SEC's Own Regulatory History Shows That An Independent Cause Of Action Was Rejected.**

On July 30, 2002, the Sarbanes-Oxley Act of 2002 was enacted. *See* Pub. L. 107-204, 116 Stat. 745 (2002). Section 302 of the Act required the SEC to adopt various rules to require an issuer's principal executive and financial officers each to certify the financial and other information contained in the issuer's quarterly and annual reports. One of rules adopted by the SEC and made effective as of August 29, 2002, was Rule 13a-14. *See* SEC Release No. 33-8124 (Aug. 29, 2002). The adopting Release stated the following:

**6. Liability for False Certification**

An issuer's principal executive and financial officers already are responsible as signatories for the issuer's disclosures under the Exchange Act liability provisions and can be liable for material misstatements or omissions under general antifraud standards and under our authority to seek redress against those who cause or aid or abet securities law violations. An officer providing a false certification potentially could be subject to Commission action for violating Section 13(a) or 15(d) of the Exchange Act and to both Commission and private actions for violating Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5. *Id.* at \*9.

In adopting Exchange Act Rule 13a-14, the SEC made it very clear that it was not creating a separate cause of action under Rule 13a-14 because other antifraud standards of the Exchange Act already provided a claim for relief against executive officers and financial officers as signatories for the issuer's disclosures. The SEC expressed in the adopting Release that it could prosecute false certifications under existing anti-fraud provisions. No where in the adopting Release does the SEC discuss that Section 13a-14 creates a separate redress for a violation of the Rule itself. Instead, the SEC posits that liability for a false certification already exists under Section 13(a) or Section 15(d) as to an action brought by the SEC or under Section 10(b) or Rule 10b-5 as to a private right of action or one brought by the SEC. If the SEC had intended on establishing an independent cause of action under Rule 13a-14 for false certifications, the adopting Release would have expounded upon the liability created under Rule 13a-14.

Before adopting SEC Release No. 33-8124, the SEC issued a proposed release for public comments on proposed Rule 13a-14. *See* SEC Release No. 34-46079. Within Section II.A of the proposed release, the SEC discussed the need for a company's senior management to be active in the disclosures made in the company's quarterly and annual reports. The SEC then stated:

Existing antifraud law, as well as the disclosure rules governing documents filed with or submitted to the Commission, already place responsibility for the accuracy and completeness of disclosure, and liability for failure to satisfy disclosure requirements, on corporate management and directors.

. . . As discussed below, we do not believe that the proposed certification would create any untoward risk of increased individual liability for the certifying officers.

*Id.* at section II.A.1, \*3

The proposed certification requirement would reinforce the responsibility of these corporate officers to security holders for the

content of companies' quarterly and annual reports. Similarly, the proposed rule is not intended to affect other existing bases of liability for principal executive officers and principal financial officers . . . .

*Id.* at section II.A.2, \*4.

The SEC plainly contemplated in adopting Rule 13a-14 that the Rule would simply “reinforce” the responsibility of corporate officers, would not expose them to the “risk of increased individual liability,” and would not “affect other existing bases of liability” under the law. The SEC’s prosecution of Mr. Chamberlain and Ms. Brown under the Fourth Claim for Relief is contrary to the legislative intention of Rule 13a-14 and the SEC’s public position in promulgating the Rule.

**B. Courts Have Consistently Dismissed Causes Of Action Under Rule 13a-14.**

It appears that every court that has examined whether Rule 13a-14 creates a separate cause of action for a false filing has found that it does not. *See In re Intelligroup Sec. Litig.*, 468 F. Supp. 2d 670, 706-07 (D.N.J. 2006)(holding that a private right of action is not conferred by the certification provisions); *In re Silicon Storage Tech Sec. Litig.*, No. C-05-0295 2007 WL 760535, at \*17 (N.D. Cal. Mar. 9, 2007)(finding that the certification provisions do not establish a separate basis for liability). The most fulsome discussion of the issue comes from *SEC v. Black*, No. 04 C 7377, 2008 WL 4394891 (N.D. Ill. Sep. 24, 2008). In that case, the court specifically examined whether the SEC had the right to bring a cause of action under Rule 13a-14 as a separate cause of action. The court looked at both existing case law and the SEC’s own regulatory history for Rule 13a-14. The court rejected the SEC’s argument that a separate cause of action existed and concluded that “consistent with the SEC Release and the two cases that have addressed the issue, it is held that a false Sarbanes-Oxley certification does not state an independent violation of the securities laws.” *Id.* at \*17. Thus, even if the

Court were to find that a false certification was filed, under prevailing case law (and the SEC's own policy) this cause of action should still be dismissed as a matter of law.

**IV. THE FIFTH CLAIM FOR RELIEF UNDER SECTION 14(A) AND RULE 14A-9 SHOULD BE DISMISSED BECAUSE ONE OR MORE ELEMENTS OF PROXY FRAUD ARE NOT PRESENT.**

The Fifth Claim for Relief alleges that Mr. Chamberlain violated Section 14(a) and Rule 14a-9 because seven proxy statements filed by Integral from “at least March 2000 through at least March 2006” did not disclose Mr. Prince as an executive officer and Mr. Chamberlain solicited the proxies or permitted his name to be used in the solicitation of those proxies. (Complaint ¶ 55) The Complaint fails to state a claim for relief under Section 14(a) and Rule 14a-9 because the Complaint fails to allege one or more of the necessary elements of proxy fraud.

Section 14 is meant to protect investors in their status as shareholders by providing a cause of action for misleading proxy statements which affect the corporate voting process. To state a claim under Section 14(a) and Rule 14a-9, “a plaintiff must show that (1) a proxy statement contained a material misrepresentation or omission which (2) caused the plaintiff injury and (3) that the proxy solicitation . . . was an essential link in the accomplishment of the transaction.” *Bender v. Jordan*, 439 F. Supp. 2d 139, 163 (D.D.C. 2006) *appeal dismissed*, No. 06-7141, 2007 WL 117831 (D.C. Cir. Jan. 11, 2007), *citing Atlantic Coast Airlines Holdings Inc. v. Mesa Air Group*, 295 F. Supp. 2d 75, 81-82 (D.D.C. 2003); *General Electric Co. v. Cathcart*, 980 F.2d 927, 932 (3d Cir.1992) (*quoting Mills v. Elec. Auto-Lite Co.*, 396 U.S. 375, 385, (1970)).

<sup>4</sup> *See also, In re Browning-Ferris Industries Shareholder Derivative Litigation*, 830 F. Supp. 361, 365

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<sup>4</sup>Although case law on the subject generally relates to a private right of action, at least one court has explicitly stated that the essential link element applies to an SEC Enforcement action. *SEC v. American Realty Trust*, 429 F. Supp. 1148, 1171 n.10 (E.D. Va. 1977).

(S.D. Tex. 1993); *Hullung v. Bolen*, 548 F. Supp. 2d 336, 339 (N.D. Tex. 2008); *Desaigouard v. Meyercord*, 223 F.3d 1020, 1022 (9th Cir. 2000). Each of these requirements – and the “essential link” requirement in particular – reflects the purpose of Section 14(a), which “is to prevent management or others from obtaining authorization for corporate action by means of deceptive or inadequate disclosure in proxy solicitation.” *J.I. Case Co. v. Borak*, 377 U.S. 426, 431(1964).

**A. There Is No “Essential Link” Between The Alleged Omission Of Mr. Prince’s Role As An Executive Officer In The Proxy Filings And Any Corporate Voting Action.**

An essential element of a Section 14(a) and Rule 14a-9 violation is that there must be an “essential link” between the material misrepresentation or omission and the purpose of the proxy statement. To state a claim for proxy fraud, plaintiffs must plead an essential link between the proxies at issue and the harm they have alleged. “[T]hey must establish that their alleged injury resulted from a transaction directly authorized by the proxy solicitation.” *Hullung v. Bolen*, 548 F. Supp. 2d at 340 (*quoting In re Browning-Ferris Indus., Inc.*, 830 F. Supp. at 361); *see also In re NAHC, Inc. Sec. Litig.*, No. Civ. A. 00-4020, 2001 WL 1241007, at \*22 (E.D. Pa. Oct. 17, 2001). The “essential link” element highlights the purpose of Rule 14a-9 to ensure that stockholder vote would not be rendered under deceitful circumstances. The legislative history of Section 14(a) indicates that Congress meant to promote the “free exercise” of stockholder voting rights, H.R. Rep. No. 1383, 73d Cong., 2d Sess. 14 (1934), and to protect fair “corporate suffrage” from the abuses exemplified by proxy solicitations that conceal what the Senate Report called the “real nature” of the issues to be settled by the subsequent votes. S. Rep. No. 792, 73d Cong., 2d Sess., 12 (1934). *See Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1103 (1991). It is insufficient to merely allege a fraudulent activity on the one hand and a proxy solicitation on the other hand. There must be a clear

connection, that is - an “essential link” between the alleged fraud in the proxy statement and the corporate transaction authorized by the proxy solicitation.

The case of *Markewich v. Adikes*, 422 F. Supp. 1144 (E.D.N.Y. 1976) is illustrative. In *Markewich*, plaintiff brought an action alleging that an REIT’s financial statements were inaccurate and, because those reports were “incorporated by reference” into the proxy statements, a claim under Rule 14a-9 was appropriate. Significantly, there were no allegations that the misrepresentations in the proxy statements related in any way to the voting process. In dismissing plaintiff’s Rule 14a-9 claim, the Court ruled that a causal link was needed between the alleged misstatement and the purpose of the proxy. The Court determined that liability under Section 14(a) and Rule 14a-9 had been limited to situations involving corporate mergers or the qualifications of directors to serve as such. *Id.* at 1146. Finding no link, the Court dismissed the claim.

In the Complaint, the SEC alleges that in seven proxy statements from “at least March 2000 through at least March 2006” Integral did not disclose: (1) that Mr. Prince acted as an executive officer; (2) that he was a highly compensated person; and (3) Mr. Prince’s stock holdings and transactions. (Complaint ¶ 55) The SEC also alleges that the proxy statements incorporated the Company’s “annual filings from 1999 through 2005.” (Complaint ¶ 35) Lastly, the SEC alleges that Mr. Chamberlain solicited the proxies or permitted the use of his name to solicit the proxies. (Complaint ¶ 55). These scant allegations form the basis for the claim that Mr. Chamberlain violated Section 14 (a) and Rule 14a-9.

As in *Markewich*, the Complaint does not allege any causal relationship between Mr. Prince’s alleged role as an executive officer and the proxy solicitations. From 2000 through 2006, the only matters on which Integral’s proxies were solicited were (1) the election of

directors, (2) appointment of accountants, (3) approval of a stock option plan in just two of those years, and (4) to generally transact other business at the annual meetings of the shareholders. The Complaint does not allege that the vote of the stockholders was solicited to approve any transaction involving Mr. Prince. Mr. Prince was never a member of the Board of Directors and he never stood for election to the Board. The Complaint does not allege how the omission to disclose Mr. Prince's role at the Company, or his background, affected the proxy solicitations or had any causal connection to the solicitations. There is no "essential link" between disclosing Mr. Prince's role in the Company, or his background, and the voting for election of directors, appointment of accountants, approval of a stock option plan, or general authority to transact business at the annual meetings.

The Complaint does not now, and even upon amendment cannot possibly, demonstrate any causal connection or "essential link" between the alleged impropriety and the proxy process. *In re General Tire and Rubber Co. Securities Litig.*, 726 F.2d 1075, 1082 (6<sup>th</sup> Cir. 1984); *Cohen v. Ayers*, 449 F. Supp. 298 (N.D. Ill. 1978)(stating "the purpose of §14(a) is to prevent management from obtaining shareholder authorization for corporate activities by means of deceptive or insufficient disclosure of proxies . . . [this] guarantees that the shareholders have sufficient information to make an informed choice when corporate matters are put to them for decision.") *See also General Electric Co. v. Catbcart*, 980 F.2d 927, 933 (3<sup>rd</sup> Cir. 1992)(stating that Section 14(a) is only valid when the votes for a "specific corporate transaction requiring shareholder authorization, such as corporate merger, are obtained by a false proxy statement."); *United Canso Oil & Gas Ltd. v. Catawba Corp.*, 566 F. Supp. 232, 237 (D. Conn 1983)(rejecting claim that decades long fraud was a valid basis for a 14a-9 action merely because board of directors' - who stood for re-election under proxy statements - were needed to implement it.)

Indeed, the type of situations that usually result in Rule 14a-9 actions highlight how inappropriate the use of Rule 14a-9 is in this case. In almost every situation, Rule 14a-9 cases have been brought only when the alleged impropriety at issue relates substantially to a subsequent corporate action. *See generally TSC Industries Inc., v. Northway, Inc.*, 426 U.S. 438 (1976)(proposed acquisition); *Chris-Craft Industries c. Piper Aircraft*, 480 F. 2d 341 (2<sup>nd</sup> Cir. 1973)(voting required for acquiring shares in target corporation); and *Cohen v. Ayers*, 449 F. Supp. 298 (N.D. Ill. 1978)(lawsuit related to claimed impropriety over stock option plans requiring shareholder approval). In almost every litigated SEC case under Rule 14a-9 where a subsequent opinion has been published, a corporate governance action requiring shareholder approval has been the main thrust of the charges against the defendants. (*See, e.g., Dyer v. SEC*, 287 F.2d 773 (2<sup>nd</sup> Cir. 1973)(fraud allegations in connection with a proxy solicitation); *SEC v. Diversified Industries*, 465 F. Supp. 104 (D.D.C. 1979)(SEC charges were the result of a proxy contest); *SEC v. Wills*, 472 F. Supp. 1250 (D.D.C. 1978)(SEC's allegation related to a debenture exchange offer); *SEC v. National Student Marketing Corp.*, 457 F. Supp. 682 (D.D.C. 1978)(SEC investigation into post merger corporation). There are no reported cases where the SEC asserted a Rule 14a-9 violation for the omission of a purported *de facto* executive officer who was not a member of the company's board of directors.

As courts have made clear, in order for a Section 14(a) claim to stand, there must be a *direct* connection between the alleged damage and the corporate vote at issue. For instance, in *General Electric Co. v. Cathcart*, 980 F.2d at 928, a shareholder brought suit against General Electric directors, "some of whom were also senior officers of the company," for failing to disclose, among other activities, what plaintiff alleged to be "criminal activity and misconduct of company employees." *Id.* Plaintiff alleged that defendant had violated Rule

14a-9 for omitting this information from the proxy statements to shareholders over the course of five years. The district court dismissed the claims and the plaintiff appealed. The Third Circuit affirmed the decision. The Court found that the claims alleged did not satisfy the essential link element under Rule 14a-9:

this is precisely the sort of claim the courts have repeatedly found insufficient to satisfy the transaction causation requirement. ... the mere fact that omissions in the proxy materials, by permitting directors to win re-election, *indirectly* lead to financial loss through mismanagement will not create a sufficient nexus [under Rule 14a-9]. Rather, damages are recoverable under Section 14(a) only when the votes for a specific corporate transaction requiring shareholder authorization, such as a corporate merger, are obtained by a false proxy statement, and that transaction was the direct cause of the ... injury for which recovery is sought.

*Id.* at 933. (emphasis in original)

Similar to *General Electric Co. v. Cathcart*, the essence of the Complaint is that Mr. Chamberlain and others failed to disclose the “criminal activity and misconduct” of a Company employee – Gary Prince.<sup>5</sup> However, just as in *Cathcart*, the Fifth Claim for Relief under Section 14(a) and Rule 14a-9 should be dismissed because the alleged false proxy statements were not an “essential link” in a proxy solicitation to accomplish a corporate transaction.

**B. The Alleged Omission Of Mr. Prince’s Role As An Executive Officer In the Proxy Filings Was Not A Material Omission In The Proxy Solicitations.**

A misstatement or omission in a proxy statement does not violate Section 14(a) unless “there is a substantial likelihood that reasonable shareholders would consider it important in deciding how to vote.” *Virginia Bankshares, Inc. v. Sandberg, supra*, 501 U.S. at

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<sup>5</sup> Indeed the allegations in *Cathcart* were much more incriminating than in this case. In *Cathcart*, there were specific allegations of financial loss to shareholders. Here no such claims were pled, nor can any be pled because the stock price of Integral went up after Mr. Prince was disclosed in August 2006.

1116-1117 (J. Kennedy concurring), *quoting TSC Industries v. Northway, Inc.*, 426 U.S. 438, 449 (1976). In addition to the causality requirement, courts have uniformly held that a Rule 14a-9 claim can only stand if the alleged omission or misstatement was material to the proxy solicitation at issue. For instance, *In re Browning-Ferris Industries Shareholder Derivative Litigation*, 830 F. Supp. 361 (S.D. Tex. 1993), the company's massive price-fixing, environmental activities and anti-trust activities resulted in numerous lawsuits and criminal investigations. Plaintiffs alleged that the company's failure to disclose either the potential criminal activity or the pending lawsuit amounted to a violation under Rule 14a-9. The district court disagreed. The court reasoned that "plaintiffs do not indicate that any of the pending suits were against directors *elected by votes on the proxy solicitations at issue*. The cases plaintiffs cite only hold that pending lawsuits against the directors *elected by the proxy solicitations* can be material." *Id.* at 366. (emphasis added). The court reasoned that - since none of the alleged omissions were related to *specific* directors who were standing for election - there was no *relationship* between the omissions and the directors' elections. *Id.* at 367. For this reason, the court found that the omissions were not material and should be dismissed for failure to state a claim. *Id.* at 361. *See also Cohen v. Ayers*, 449 F. Supp. 298, 315 (N.D. Ill. 1978)(plaintiff cannot show materiality under Rule 14a-9 if the information is only "tangentially related to the question before the shareholders.")<sup>6</sup>

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<sup>6</sup> Courts have recognized that absent an independent duty to disclose certain information, nondisclosure is not a basis for liability under the federal securities laws. *New Jersey, Div. of Inv. v. Sprint Corp.*, 314 F. Supp. 2d 1119, 1128 (D. Kan. 2004). An omission of information from a proxy statement is actionable under securities laws only when the SEC regulations specifically require disclosure of the omitted information in a proxy statement. *Seinfeld v. Gray*, 404 F.3d 645, 650 (2d Cir. 2005). At the time that Integral had issued proxy statements (2000 – 2006) the SEC had not charged either Integral or any of the defendants in this case with wrongdoing. Since the SEC's proxy rules do not require management to confess wrongdoing to an uncharged allegation, even if it is later found in this case that Mr. Prince was acting as an executive officer and should have been disclosed, it is not a violation of the proxy solicitation rules not to have disclosed him at the time the proxies were issued. *Ballan v Wilfred American Educational Corp.*, 720 F. Supp.241, 249 (E.D.N.Y. 1989). To require Integral and the defendants to disclose Mr. Prince as an executive officer in the proxy statements is tantamount to requiring them to admit that they had been violating the law or had committed unlawful acts. Case law imposes no such

Just as in *In re Browning-Ferris*, the issues raised in the Complaint are of a most general nature – they in no way relate back to the specific board members up for election – rather they are about Mr. Prince, a non-Board member. Case law is clear that in order to satisfy the materiality prong, the omission must relate *directly* to the election of one of the Company’s Board Members. The SEC’s allegation of the obvious – that Mr. Chamberlain was a member of the Board of Directors – is not enough to meet the materiality requirement.

**C. The Complaint Attempts To Convert An Alleged Section 10(b) Violation Into A Proxy Fraud Violation Under Section 14(a).**

Paragraphs 35 and 57 of the Complaint allege that the Proxy Statements of Integral “incorporated the company’s annual filings from 1999 through 2005” and that Ms. Brown and Mr. Prince reviewed the Proxy Statements, including the periodic reports incorporated by reference. However, none of the proxy statements “incorporate by reference” the annual report or other periodic reports.<sup>7</sup> Each of the Proxy Statements indicates that the Annual Report to the Stockholders is being mailed with the Proxy Statements, but delivery of the Annual Report is not the same as “incorporation by reference.” For example, the 2006 Proxy Statement has the following language:

**Annual Report**

The Company’s Annual Report to Stockholders on Form 10-K for the fiscal year ended September 30, 2005, is included with these proxy solicitation materials. A copy of the Company’s Annual Report, including the financial statements and the financial statement schedules included therein, is also available without charge by visiting

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duty. See *In re Browning-Ferris Industries, Inc. Shareholder Derivative Litigation*, 830 F. Supp. 361, 365 (S.D. Tex. 1993); *United States v. Matthews*, 787 F.2d 38 (2<sup>nd</sup> Cir. 1986)(stating that defendant could not be liable under Rule 14a-9 for failing to disclose an uncharged offense), *cited with approval in United States v. Crop Growers Corporation*, 954 F. Supp. 335 (D.D.C. 1997).

<sup>7</sup> Even though the SEC filings are not attached to the complaint, they are a matter of public record and the Court may take judicial notice of them in reviewing a motion to dismiss. *DiLorenzo v. Norton*, No. 07-144 (RJL), 2009 WL 2381327 (D.D.C. July 31, 2009)(*citing Marshall County Health Care Auth. v. Shalala*, 988 F.2d 1221, 1226 n. 6 (D.C.Cir.1993)).

www.integ.com or upon written request to the Company at 5000 Philadelphia Way, Lanham, Maryland 20706-4417, Attn.: Elaine M. Brown, Corporate Secretary.

Similar language is found in all of the other Proxy Statements.

Rule 14(a)(3) requires that each Proxy Statement be accompanied or preceded by an annual report to the shareholders. Since the Proxy Statements did not incorporate the annual report or periodic reports by reference, the SEC cannot allege a proxy violation based on an alleged material misrepresentation or omission in the annual report or periodic reports. See *Markewich v. Aidkes*, 422 F. Supp. 1144, 1147 (E.D.N.Y. 1976) (“Absent a specific declaration of incorporation, a mere mention of the annual report does not incorporate it by reference, cf. Black's Law Dictionary 907 (rev. 4th ed. 1968); otherwise, an annual report would automatically be incorporated by reference in any proxy statement which ever recognized the existence of, or merely accompanies, an annual report. *Dillon v. Berg*, 326 F. Supp. 1214, 1230-31, *aff'd*, 453 F.2d 876 (C.A.3 1971). Even if the annual reports were false and misleading, the SEC cannot convert an alleged Section 10(b) action into a Section 14(a).

In essence, the Complaint appears to imply some form of mismanagement by Mr. Chamberlain of Mr. Prince's role at the Company, but the Complaint does not plead this with specificity. Case law is clear, however, that “mismanagement” cases are not to be brought under Section 14(a). See *In re Browning Ferris*, 830 F. Supp. at 370, stating that “the cases uniformly hold that a claim seeking relief for injuries occasioned by mismanagement or breach of fiduciary duty is not redressable under the proxy rules simply by virtue of the facts that acts were committed by directors who would not have been elected but for the proxy solicitation.” quoting *In re: Commonwealth Oil Tesoro/Petroleum Corp.*, 467 F. Supp. 227, 237 (W.D. Tex. 1979).

If the Court permits the SEC to proceed with its Rule 14a-9 claim against Mr. Chamberlain, the reach of Section 14(a) would be tremendously expanded. If the SEC's strategy in this case became the norm, a claim for proxy fraud would accompany every Section 10(b) claim against a public company that filed a proxy statement.

For reasons set forth above, the Court should dismiss the Fifth Claim for Relief under Section 14(a) and Rule 14a-9.

In addition, for reasons set forth in Section V *infra*, the Court should dismiss the Fifth Claim for Relief for failure to plead fraud with particularity under Fed. R. Civ. P. 9(b).

**V. THE FIRST, SECOND, AND FIFTH CLAIMS FOR RELIEF SHOULD BE DISMISSED BECAUSE THE COMPLAINT FAILS TO PLEAD FRAUD WITH PARTICULARITY.**

Rule 9(b) of the Federal Rules of Civil Procedure requires that “[i]n all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity.” The instant enforcement action by the SEC involves claims of securities fraud, and thus, the heightened pleading requirements apply.<sup>8</sup> Once a plaintiff states a claim for fraud he is subject to the particularity pleading standard under Fed. R. Civ. P. 9(b).<sup>9</sup> *Bell Atlantic v. Twombly*, 550 U.S. 544 (2007). As such, the SEC is required to state the “time, place and content” of the alleged omission. *Kowal v. MCI Communications, Corp.*, 16 F.3d 1271, 1278 (D.C. Cir. 1994); or, in journalistic terms, the pleadings must allege the “who, when, where and what” of the particular fraudulent statement or omission at issue. *S.E.C. v.*

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<sup>8</sup> The pleading requirements of F.R.C.P. 9(b) apply not just to explicit claims of fraud, but also claims that “sound in fraud.” At least one court in the United States District Court for the District of Columbia has found that claims under Section 14(a) of the Exchange Act sound in fraud, and that, as a result, the pleading requirements of 9(b) should apply. *In re U.S. Office Products Securities Litigation*, 326 F. Supp. 2d 68, 81 (D.D.C. 2004)(citing *Shapiro v. UJB Financial Corp.*, 964 F.2d 272, 287 (3<sup>rd</sup> Cir. 1992); *Needletrades, Indus. & Textile Employees v. May Dep’t Stores Co.*, 26 F. Supp. 2d 577, 583 (S.D.N.Y. 1997); *Hershey v. MNC Financial*, 774 F. Supp. 2d 367, 375 n.9 (D. Md. 1991).

<sup>9</sup> This is different from the heightened pleading requirements under the Private Securities Litigation Reform Act of 1995, which do not apply to SEC Enforcement actions.

*Scrushy*, No. CV-03-J-615S, 2005 WL 3279894 at \*1 (N.D.Ala. Nov. 29, 2005). In addition, it is not enough for the complaint to have general allegations that are not tied to specific claims for relief (or vaguely incorporated by reference). Rather, to put the defendant on notice of the particular charges against him, each claim for relief must be tied to the specific fraud at issue.

In this case, the SEC has not met its burden under Fed. R. Civ. P. 9(b). The First, Second, and Fifth Claims for Relief are not tied to any specific fraud alleging “time, place and content.” Instead, the SEC has engaged in the proverbial “shotgun” and “puzzle” style of pleading. With a shotgun pleading, the claims for relief “ ‘incorporate every antecedent allegation by reference to each subsequent claim for relief or affirmative defense.’ ” *S.E.C. v. Fraser*, No. CV-09-00443-PHX-GMS, 2009 WL 2450508, at \*14 (D. Ariz. Aug. 11, 2009). This is exactly the way the SEC has pleaded its Complaint. Likewise, puzzle pleading “require[s] the defendant and the court to match the statements up with the reasons they are false or misleading.” *Id.* (internal citations omitted). Once again, this is exactly the way the SEC has pleaded its Complaint. The two styles are similar in that it is the defendant (and the court) that must do all the work to discover which facts are tied to which claims for relief.

Courts have instructed that a “shotgun” or a “puzzle” style of pleading cannot satisfy the pleading requirements under Rule 9(b). *Id.* at \*14 (stating that “[a] complaint which relies on shotgun or puzzle pleading *does not meet Rule 9(b)'s particularity requirement.*)(emphasis in original). In *Fraser*, the SEC brought an action alleging that the various defendants at issue engaged in a scheme to “hide the uncollectible receivables” that resulted in the corporation’s income remaining “artificially inflated.” *Id.* at \*1 The defendants filed a motion to dismiss asserting that the SEC’s complaint was vague and unspecific. The court agreed. Specifically the court stated:

The Complaint incorporates every factual paragraph into each claim section, and it makes no attempt to lay out which conduct constitutes the violations alleged. Rather, the claims sections simply paraphrase or quote the language of the statutes and rules, leaving Defendants (and the Court) with the task of combing the Complaint and inferring, rightly or wrongly, what specific conduct the SEC intended to assert as a violation. Given the multiple defendants at issue in each claim, the lack of clarity about which actions apply to each claim, and the general vagueness of the factual allegations, the Complaint does not satisfy Rule 9(b). *Id.* at \*15.

Other courts have held the same. For instance, in the case of *SEC v. Patel*, No. 07-cv-39-SM, 2009 WL 2015794, at \*1 (D.N.H. July 07, 2009), the District Court for the District of New Hampshire was confronted with a similarly ill-constructed complaint. The court noted that the claims for relief were constructed by “incorporating by reference all 187 paragraphs of factual allegations and closely paraphrasing the statutes and rule upon which it relies.” The court found that such a construction made it “difficult to determine” the exact contours of the SEC’s allegations, sufficient to survive a motion to dismiss. *Patel*, at \*1. As the court stated:

In an ideal world, the SEC would have provided the necessary clarification in its objections to the pending dispositive motions. That is, plaintiff would have gone through the complaint, count by count (or theory by theory), stating the elements of each claim and then identifying the specific factual allegations in the complaint which, if proved, would subject a particular defendant to liability under each challenged claim. The court could then determine whether, under the applicable pleading standard, plaintiff had stated a claim under one or more of the asserted legal theories. Regrettably, the SEC’s objections do not work that way. *Id.* at \*2.

*See also SEC v. Mercury Interactive, LLC*, No. C 07-2822 JF (RS), 2008 WL 4544443, at \*8 (N.D. Cal. Sept. 30, 2008).

Here, the SEC has pled factual allegations in the first 39 paragraphs spanning 14 pages, which are all incorporated by reference in the First, Second and Fifth Claims for Relief as to Mr. Chamberlain. The First Claim for Relief paraphrases or quotes Section 17(a)

but the Complaint makes no attempt to lay out which specific conduct in the first 39 paragraphs constitutes a violation of Section 17(a) by Mr. Chamberlain. The Second Claim for Relief does the same with paraphrasing or quoting Section 10(b) and Rule 10b-5, but the Complaint also does not attempt to identify the factual allegations in the first 39 paragraphs that constitute a violation of Section 10(b) and Rule 10b-5 by Mr. Chamberlain. The Complaint makes no attempt to match up the elements of a violation of Section 17(a), Section 10(b) and Rule 10b-5 with any of the allegations pled in the first 39 paragraphs. Mr. Chamberlain and the Court are left with the task of combing through the Complaint and trying to match the factual allegations to the alleged violations under Section 17(a), Section 10(b) and Rule 10b-5. It is unclear what specific conduct, which specific acts and at what point in time, are deemed to be a violation of Section 17(a), Section 10(b) and Rule 10b-5. The exact contours of the Complaint are uncertain without engaging in much guesswork and supposition.

As discussed in Section II above, to state a claim under Section 17(a), the SEC must allege the existence of a fraud that occurred in the “offer” or in the “sale” of securities. The Complaint does not plead with particularity any offer or sale of securities. Likewise, to state a claim for relief under Section 10(b) and Rule 10b-5, the SEC must allege the existence of a fraud that occurred “in connection with the purchase or sale of securities.” The Complaint does not plead with particularity how this element is satisfied. There is no allegation in the Complaint of any facts that comprise “in connection with the purchase or sale of securities,” a necessary element of proving a Section 10(b) and Rule 10b-5 violation.

Furthermore, as discussed in Section IV above, the Complaint fails to plead the elements of a Section 14(a) violation in the Fifth Claim for Relief. There is no allegation, for example, of the “essential link” between the alleged impropriety and the proxy process. The

alleged proxy fraud is not pled with any particularity. Here again, Mr. Chamberlain is left with the daunting task of trying to understand or anticipate what the SEC has in mind.

The Complaint alleges that Mr. Prince was a *de facto* executive officer without alleging when he became an executive officer and what specific acts made him an executive officer. The most fundamental details are missing. The Complaint alleges that he became an executive officer after he was rehired in 1998, but it does not specify what he did during 8 years (from 1998 to 2006) to be deemed to be an executive officer. This is especially necessary in light of the SEC's position that "[a] person's officer status depends on facts and circumstances and must be analyzed and determined by the issuer and its counsel." Am. Bar Ass'n, SEC No-Action Letter, 1991 WL 176795, at \*3 (July 3, 1991). It is also important because the SEC is required under Rule 9(b) to plead with specificity the factual allegations that it contends caused Mr. Chamberlain to violate Section 17(a), Section 10(b), Rule 10b-5, Section 14(a) and Rule 14a-9. The Complaint alleges many things about Mr. Prince over 8 years, but it does not allege what specific acts made Mr. Prince a *de facto* executive officer and when he became an executive officer.

The Complaint alleges that "an executive officer generally includes anyone who performs a policy making function similar to those performed by the company's president, vice presidents in charge of a principal business unit, division or function." (Complaint ¶ 21). This is the SEC's benchmark against which it appears to judge Mr. Prince's actions. Yet, the Complaint fails to plead the policy making functions performed by Mr. Chamberlain or others at the Company and how Mr. Prince performed similar policy making functions. There are allegedly 8 years that Mr. Prince performed policy making functions but the Complaint fails to plead any of them. The Complaint does not

plead any policies established by Mr. Prince. If Mr. Prince performed policy making functions and those caused him to become a *de facto* executive officer and caused Mr. Chamberlain to violate the anti-fraud provisions, the SEC is required to plead with particularity the policy making functions and policies instituted by Mr. Prince during the years that he is alleged to have been a *de facto* executive officer. The Complaint does not provide these specifics.

The allegations in the Complaint are conclusory and circular. For example, the Complaint alleges that Mr. Prince was rehired by Integral in 1998 “to work as a *de facto* executive officer” (Complaint ¶ 22) but it does not plead with any specificity the activities of Mr. Prince in 1998, 1999, or 2000 that made him an executive officer. In Complaint ¶ 23, the SEC jumps from 1998 to Mr. Prince’s role at Integral “[b]y early 2002.” Later, the Complaint alleges that Mr. Prince was among the five highest compensated employees in 1999, 2000, 2001, 2004 and 2005. (Complaint ¶ 28). The Complaint does not then allege that or how Mr. Prince’s compensation made him an executive officer. The Complaint alleges that after Mr. Prince was rehired, he “directed Integral System’s mergers and acquisitions program” (Complaint ¶ 25) without specifying when he “directed” the program or when the program was allegedly implemented. It is unclear from the Complaint whether the SEC is alleging that Mr. Prince directed the program in 1999, 2000, 2001 or 2002, for example, and whether his direction of the program in those years caused him to become a *de facto* executive officer. The first 39 paragraphs of the Complaint jump around frequently as the Complaint muddles the facts and their occurrences and seeks to use Mr. Prince’s activities in the later years to imply a factual basis for alleging that Mr. Prince was a *de facto* executive officer in the early years. For example, Mr. Prince is alleged to have become the head of the Contracts Department in August 2005 (7 years after he was rehired). Assuming

for purposes of a Motion to Dismiss under Rule 12(b)(6) that the allegation is true, the Complaint does not allege how becoming the head of the Contract Department in 2005 caused Mr. Prince to become an executive officer in the prior years. Yet, the Complaint appears to allege, without specificity, that Mr. Prince was a *de facto* executive officer in the early years.

For a Complaint that is alleging fraud based on Mr. Prince's alleged role as an executive officer, the omission to plead with particularity the "who, what, when, where and how" of Mr. Prince's actions that are alleged to make him an executive officer is fatal under Rule 9(b). For these reasons, the Complaint fails to plead fraud with particularity as required by Rule 9(b) and these claims must therefore be dismissed.

**VI. ALL CLAIMS FOR RELIEF FOR VIOLATIONS PRIOR TO JULY 30, 2004 ARE BARRED BY THE STATUTE OF LIMITATIONS AND SHOULD BE DISMISSED.**

The Complaint alleges violations of the securities laws from 1998 through August 2006. Yet, the Complaint was not filed until July 30, 2009. Violations that occurred more than five (5) years from the date the Complaint was filed are barred by the statute of limitations. All claims for relief for violations that allegedly occurred prior to July 30, 2004, should be dismissed as a matter of law.

Because the Securities Act and the Exchange Act do not contain a limitations period applicable to the charges in the Complaint, the applicable "catch-all" statute of limitations for federal causes of action is 28 USC § 2462. Section 2462 provides:

Except as otherwise provided by Act of Congress, an action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued if, within the same period, the offender or the property is found within the United States in order that proper service may be made thereon.

The language of Section 2462 is unambiguous and its applicability to this case is controlling without a “clearly expressed legislative intention to the contrary.” *SEC v. Jones*, 476 F. Supp. 2d 374, 380 (S.D.N.Y. 2007)(citing *Consumer Prod. Safety Comm’n v. GTE Sylvania*, 447 U.S. 102, 108 (1980)). Under Section 2462, a claim accrues “at the moment a violation occurs.” *3M Co. v. Browner*, 17 F.3d 1453, 1462 (D.C. Cir. 1994). All claims for violations that occurred more than five (5) years from the date of filing of the Complaint are barred by the statute of limitations. Thus, all claims for violations prior to July 30, 2004, should be dismissed as a matter of law.

In the Prayer for Relief, the Complaint seeks to impose a civil monetary penalty on Mr. Chamberlain. It also seeks to impose the penalties of a permanent injunction against Mr. Chamberlain and an order barring him from serving as an officer or director of a public company. Under a plain reading of the statute, any action that is commenced for the purposes of enforcing any civil penalty must be brought within five years from when the claim first accrued. The five-year statute of limitations under Section 2462 applies to this action. All claims prior to July 30, 2004, are time barred and should be dismissed.

Courts that have addressed the statute of limitations for SEC enforcement actions where civil monetary penalties were sought have held that those actions are subject to the five-year bar under 24 USC § 2462. *See, e.g., SEC v. Jones*, 476 F. Supp. 2d 374, 381 (S.D.N.Y. 2007)(dismissing a case as being untimely when the predicate facts occurred in 1999 and the Commission did not bring its case until 2006)(citing *Johnson v. SEC*, 87 F.3d 484 (D.C. Cir. 1996)). It matters not whether the Staff is seeking a monetary penalty or injunctive relief based on conduct occurring more than 5 years ago. In *SEC v. Jones*, 476 F. Supp. 2d 374 at 380, the court held that the SEC’s request for injunctive relief was a penalty subject to the five-year statute of limitations. The United States Court of Appeals for the District of

Columbia Circuit held in *Johnson v. SEC*, 87 F.3d at 489, that a bar order banning Johnson from acting as a registered representative in the future was punitive in nature, not remedial, thereby requiring application of Section 2462. The Circuit Court in *Johnson* held that when equitable relief goes beyond remedying the harm caused to parties by the defendant's actions, it is a "penalty", not a remedial measure, and therefore, the five-year limitations period applies. *Id.* at 496-92. See also *SEC v. DiBella*, 409 F. Supp. 2d 122, 127-28 & n.3 (D. Conn. 2006) (holding that civil penalties, permanent injunctions and officer and director bars are subject to Section 2462, but not claims for disgorgement.)

The equitable relief which the SEC seeks against Mr. Chamberlain is penal in nature, not remedial. The SEC seeks a monetary penalty against Mr. Chamberlain, individually. The agency does not request disgorgement because it cannot - there is no claim that investors in Integral lost money or were harmed financially. Mr. Chamberlain resigned as an officer and director from Integral in 2006, and he has not served as an officer or director of any publicly held company since retiring from Integral. Yet, even though Mr. Chamberlain has not been an officer or director of a public company for more than 3 years, the SEC seeks a permanent injunction against him for future violations of the law. Moreover, the permanent injunction would be based on purported violations of the securities laws that occurred from 1998 through August 2006. A permanent injunction at this point in time is unquestionably punitive and not remedial. Lastly, it is equally clear that imposing a permanent officer and director bar on Mr. Chamberlain in the future is a penalty meant to punish him allegedly for past conduct.

For these reasons, all claims for relief for violations alleged to have occurred prior to July 30, 2004, are barred by the statute of limitations and should be dismissed.

**VII. THE CLAIMS FOR RELIEF BASED ON ALLEGATIONS THAT MR. PRINCE'S LEGAL BACKGROUND SHOULD HAVE BEEN DISCLOSED AFTER JUNE 23, 2002, SHOULD BE DISMISSED BECAUSE INTEGRAL AND MR. CHAMBERLAIN WERE UNDER NO DUTY TO DISCLOSE MR. PRINCE'S BACKGROUND AFTER THAT TIME.**

The Complaint alleges that Mr. Prince's legal background, including his criminal conviction in 1995 and the SEC's Rule 102(e) bar order on June 24, 1997, should have been disclosed until mid-2006. (*See* Complaint ¶ 31 stating "after Chamberlain rehired Prince in 1998, Integral Systems did not make any disclosures regarding Prince's status as an officer, compensation or legal background until mid-2006.") These allegations, however, are contrary to the SEC's regulations and plainly misconstrue the SEC's stated policy on the issue. Item 401 of Regulation S-K, 17 C.F.R. § 229.401(f) requires disclosure of directors' and officers' criminal convictions and orders enjoining them from any type of business "that occurred during the past five years and that are material to an evaluation of the ability or integrity of any director . . . or executive officer." Assuming that Mr. Prince was a *de facto* executive officer and should have been disclosed, under the SEC's own policy his "legal background" need only have been disclosed for five years after the event giving rise to the disclosure. The last reportable event that would have triggered any disclosure is the SEC's Rule 102(e) order on June 24, 1997, barring Mr. Prince from practicing before it as an accountant. Applying the five year rule, Integral and Mr. Chamberlain were under no duty to disclose Mr. Prince's background after June 23, 2002.

In its rulemaking functions, the SEC has discussed the types of information that need to be disclosed by "management, promoters, control persons, and others." SEC Release 33-7106 (Nov. 1, 1994). Currently, the SEC's policy provides that legal proceedings, which include, "[a]ll judicial and administrative findings, orders and sanctions based on alleged violations of federal or state securities, commodities, banking and insurance laws and

regulations” must be disclosed for five years from the date of the event. *Id.* at \*1. In fact, in 1994 the SEC proposed changing the rule to expand disclosure of a relevant person’s background from five years to ten years. *Id.* The proposed rule was rejected and the explicit rule remained. 17 C.F.R. § 229.401(f). As such, even assuming that the SEC is able to state a claim that Mr. Prince was a *de facto* executive officer, it is clear Integral and Mr. Chamberlain were not required to disclose Mr. Prince’s “legal background” after June 23, 2002. Absent a duty to disclose, there can be no finding of liability. *S.E.C. v. Pasternak*, 561 F. Supp. 2d 459, 499 (D.N.J. 2008)(“When the plaintiff asserts that the defendant failed to disclose information, the plaintiff must show the existence of a duty to disclose.”)

The claims for relief based on the allegation that Mr. Prince’s legal background should have been disclosed after June 23, 2002, should be dismissed. In furtherance of this legal argument, Mr. Chamberlain incorporates by reference and adopts the legal argument of Ms. Brown in her Motion to Dismiss and Memorandum in support thereof.

**VIII. THE TERMS “OFFICER” AND “POLICY MAKING FUNCTION” ARE VOID FOR VAGUENESS AND ANY OMISSION TO DISCLOSE A *DE FACTO* EXECUTIVE OFFICER SHOULD NOT FORM THE BASIS FOR ANY CLAIMS FOR RELIEF AGAINST MR. CHAMBERLAIN.**

As discussed above in the Background of this Memorandum, Integral and Mr. Chamberlain relied upon experienced corporate and securities counsel for making corporate disclosures. Although the facts of the reliance on counsel defense are not before this Court for the purpose of deciding this Motion to Dismiss, the SEC itself recognizes that the definition of an officer is very complex. It is so complex that the SEC refused to answer the question submitted by the American Bar Association. In this case, the SEC has defined officer as someone who performs policy making functions similar to other officers within a company. Given the uncertainties and vagueness surrounding the meanings of “officer”

and “policy making functions,” these terms are impermissibly void and should not for the basis for any claims for relief against Mr. Chamberlain. In furtherance of this legal argument, Mr. Chamberlain incorporates by reference and adopts the legal argument of Ms. Brown in her Motion to Dismiss and Memorandum in support thereof.

Dated: September 27, 2009

Respectfully submitted,

BALL LAW OFFICES, P.C.

A handwritten signature in black ink, appearing to read "Daniel A. Ball". The signature is fluid and cursive, with a large initial "D" and "B".

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**CERTIFICATE OF SERVICE**

I hereby certify that on the 27th day of September 2009, I caused a copy of Defendant Steven R. Chamberlain's Motion to Dismiss, Memorandum of Points and Authorities in Support, and Order to be filed electronically and served electronically upon the following attorneys:

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