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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 REPLY TO THE
SEC’S OPPOSITION TO DEFENDANT’S MOTION TO DISMISS**

INTRODUCTION

Defendant Steven R. Chamberlain files this Reply to the SEC’s Consolidated Memorandum in Opposition to Mr. Chamberlain’s motion to dismiss. What emerges from the SEC’s Opposition is that (1) it largely disregards legal precedents from this jurisdiction when decisions from other courts suit its positions better, (2) it misconstrues or misapplies the relevant authorities on a number of important issues, and (3) it largely fails to address (sometime entirely, sometimes no more than superficially) many of the cogent legal arguments in Mr. Chamberlain’s motion to dismiss.

I. THE SEC’S OPPOSITION DOES NOT CURE THE RULE 9(b) PLEADING DEFICIENCIES IN ITS COMPLAINT.

The United States Securities and Exchange Commission (“SEC”) acknowledges that Rule 9(b) requires the SEC to state the “who, what, when, where and why” of the specific fraud allegations, citing decisions in the Second Circuit instead of the District of Columbia Circuit Court of Appeals and District Court cases cited in Mr. Chamberlain’s motion. (*See* Opposition at 7; *cf*

Chamberlain Memorandum at 5 - 6).¹ In the D.C. Circuit, the Rule 9(b) pleading standard requires the SEC to plead, “who, what, when, where and how” with respect to the circumstances of the alleged fraud. Though the SEC acknowledges a heightened pleading standard under Rule 9(b), it fails to reconcile its allegations with the legal standard. For instance, while the SEC takes a page and a half in its Opposition to cite the allegations in the Complaint that it claims cure the fraud pleading deficiencies, a considered review of the SEC’s argument shows that, in fact, it falls short of the mark set under Rule 9(b).

In addition, the SEC really uses its *Opposition* to attempt to cure the deficiencies in its Complaint. (*See, e.g.*, Opposition at 9-10, where the SEC’s sporadic “shotgun” allegations are combined into a page and a half.) Rather than address how the allegations are not pled in such a way as to create a shotgun and puzzle pleading, the SEC strives to put the puzzle pieces together. Since the Rule 9(b) standard applies to the Complaint and not arguments made elsewhere, the Court must consider how the Complaint has stated the allegations. Any deficiencies in the Complaint must be cured with an amended pleading, not by means of an argument in the Opposition.²

A. The SEC Has Not Shown How Its Complaint Overcomes The 9(b) Standard For Pleading The “What, When, Where and How” Elements.

In its Opposition, the SEC purportedly discusses the factual allegations in its Complaint that state with particularity the “what, when, where, and how” elements required by Rule 9(b). But many of these allegations are merely a recital of the legal duties owed by the company and its officers. (*See, e.g.*, Opposition at 7, stating that “The Complaint alleges that the federal securities laws require the disclosure of ...”). The SEC recounts these as *facts* that it contends demonstrate how Mr. Prince

¹ The SEC embarks upon a discussion of scienter in its Opposition, at 7, n. 10, and asserts that scienter has been amply alleged even though Mr. Chamberlain’s motion to dismiss does not challenge whether scienter has been adequately pled. The SEC’s general pleading that a defendant “knew or has reason to know” (*i.e.*, a state of mind) does nothing to cure the Complaint’s failure to plead the “who, what, when, where, and why” of each specific fraud.

² For a more complete discussion of the impermissibility of shotgun and puzzle pleading styles, *see* Chamberlain’s Memorandum of Points and Authorities at 23.

violated the law. For instance, on p. 8 of the Opposition, the SEC argues that “from December 1998 until August 4, 2006 Prince failed to timely file the Section 16(a) forms with the Commission . . . which gives rise to the fair inference that Prince was concealing his *de facto* officer status.” Opposition at 8. The SEC’s “factual” allegations fail to overcome the Rule 9(b) heightened pleading requirement for two reasons: (1) the SEC’s use of legal conclusions is insufficient to meet the Rule 9(b) requirements, and (2) the SEC has failed to show how Mr. Prince’s alleged failures implicate Mr. Chamberlain.

First, the SEC tries to use a conclusion of law (the requirements under Section 16(a)) to gain a *factual* inference that Mr. Prince was acting as a *de facto* officer. Not only is this reasoning circular, but it completely misapplies the relevant pleading standard under Rule 12(b)(6) – namely, that in examining a Complaint to see whether it fails to state a claim, the Court is only bound to accept as true all *factual* allegations and reasonable *factual* inferences - the Court need not accept legal conclusions.³ By using legal conclusions as a basis for *factual* inferences or allegations, the SEC is attempting to fill the gaps in its Complaint and circumvent the pleading requirements.

Second, although the SEC argues that Mr. Prince failed to submit forms under Section 16(a), the Complaint fails to state how this places Mr. Chamberlain on notice as to his role in Mr. Prince’s alleged failure to file the forms. Section 16(a) of the Securities Exchange Act of 1934, as amended (“Exchange Act) places the onus for filing securities holdings on the owner of the shares.⁴ It does not necessitate that any other officers of the issuer play a role in the owner’s filings. Mr.

³ *Warren v. District of Columbia*, 353 F.3d 36, 40 (D.C. Cir. 2004).

⁴ Section 16 of the Exchange Act states “[e]very *person* who is directly or indirectly the beneficial owner of more than 10 percent of any class of any equity security (other than an exempted security) which is registered pursuant to Section 12, or who is a director or an officer of the issuer of such security, *shall file* the statements required by this subsection with the Commission...” (emphasis added).

Chamberlain, the former CEO of Integral, was not required in any way to oversee Mr. Prince's filings.⁵

In its Opposition, at 9-10, the SEC has referenced numerous allegations from the Complaint that it contends are sufficient under Rule 9(b) to overcome a motion to dismiss. In general, a Complaint should identify the "circumstances, occurrences, and events" giving rise to the claim, *Bell Atlantic Corp. v. Twombly*, 127 S.Ct. 1955, 1965 at n. 3 (2007), quoting 5 Charles A. Wright & Arthur R. Miller, *Federal Practice and Procedure* § 1202, at 94-95 (3d ed.2004). The SEC's Complaint alleges that in each year, starting with 1998 and continuing through to August 2006, Mr. Prince was a *de facto* executive officer and that Integral failed to disclose him in the annual reports and proxy solicitation statements associated with those years. While it is a simple task to identify the allegedly offending annual reports and proxy statements, the same cannot be said for identifying the actions or transactions that allegedly made Mr. Prince a *de facto* executive officer in 1998, or 1999, or 2000, or 2001, or 2002, or 2003, or 2004, or 2005, or 2006. The claim made by the SEC is that in each of those years Mr. Chamberlain violated the law by failing to disclose Mr. Prince. The "circumstance, occurrences, and events" giving rise to the claim as to each one of those years are not alleged. Given the breadth of the SEC's allegations, the Complaint does not give Mr. Chamberlain fair notice of what the factual claim is as to each year, and the Complaint fails to identify "circumstances, occurrences and events" or the "transaction to be litigated" for each of those years. *Aktieselskabet AF 21 Nov. 2001 v. Fames Jeans, Inc.*, 525 F.3d 8, 16 (D.C. Cir. 2008). Although the SEC in its Opposition, at 9-10, has been able to pick out from its Complaint a series of allegations that it

⁵ The SEC has reiterated its position that the proxy statements "incorporated the ISI annual reports..." Opposition at 8. While the Court is normally bound to accept all allegations as true, the Court is also allowed to examine facts contained in public documents. In his initial motion, Mr. Chamberlain brought to the Court's (and the SEC's) attention that - contrary to what was stated in the Complaint - the proxy statements **do not** incorporate the annual reports by reference. Chamberlain Memorandum of Points and Authorities at 20. The SEC's insistence on using this fact as a basis for its argument is both myopic and illogical.

contends demonstrate particular misstatements and omissions, neither the SEC's Opposition nor the Complaint relate them to any particular year. Using this umbrella approach, the SEC seeks to use "circumstances, occurrences and events" that occurred in 2004 and 2005, for example, for proving that Mr. Prince was a *de facto* executive officer in 1999, 2000 or 2001. By way of example, the Complaint (¶26) alleges that in August 2005, Mr. Prince became head of the Company's Contracts Department. That allegation relates to the SEC's claim that Mr. Prince was a *de facto* executive officer in 2005 and 2006, but it cannot possibly be considered a circumstance, occurrence or event giving rise to the SEC's claim that Mr. Prince was a *de facto* executive officer in 2004, or any of the years prior. Most importantly, the Opposition argues that Mr. Prince engaged in policy making functions but neither the Complaint nor the Opposition set forth any allegations of *fact* as to policies that Mr. Prince supposedly made and implemented. Absent the details, the allegation is, at best, a legal conclusion.

Rather than meet its burden of pleading fraud with particularity, the SEC in its Opposition continues to make sweeping allegations about events that occurred over an 8 year period, failing to link them to any particular year or person. This style of pleading is not sufficient to meet the heightened pleading requirements under Rule 9(b). Mr. Chamberlain urges this Court to dismiss these allegations, or in the alternative, to require the SEC to re-plead.

B. The SEC Has Not Shown How Its Complaint Overcomes The 9(b) Standard For Pleading The "Who" Element.

The only argument that the SEC can mount in its Opposition to show that its Complaint adequately meets the "who" requirement with respect to Mr. Chamberlain is by arguing that because Mr. Chamberlain signed some public filings, the SEC has met its burden. (Opposition at 10). The SEC's burden of pleading with particularity the "who" element under Rule 9(b) requires more than merely alleging who signed what. Rather, the element requires showing how each particular defendant was involved in the *underlying fraud alleged*. In *SEC v. Fraser*, No. CV-09-00443-PHX-GMS,

2009 WL 2450508 (Aug. 11, 2009 D. Ariz.), the court dismissed the SEC's action for failing to meet the "who" requirement despite the SEC's allegations that the defendant had signed the relevant filings. *Id.* at *9 (stating "[n]or is the mere fact that Fraser signed statements certifying that, to the best of his knowledge, the forms were correct sufficient to establish that he substantially participated in making the financial statements themselves.") Here again, the Complaint fails to meet the particularity pleading standards under Rule 9(b).

II. THE SEC'S ARGUMENT UNDER SECTION 17(A) IGNORES BOTH THE PLAIN LANGUAGE OF THE STATUTE AND THE SUPREME COURT'S OFFER OR SALE REQUIREMENT.

In its Opposition, the SEC contends that the allegation that Integral is a "public company, whose stock is registered with the Commission and trades on the NASDAQ Global select market" is enough to satisfy the "offer and sale" requirements for Section 17(a) (Opposition at 5). This argument completely ignores the plain language of the statute. Section 17(a) of the Securities Act of 1933, as amended (the "Securities Act") states that a fraud must be in connection with the "offer" or "sale" of securities. Discussing Integral's listing requirements is not sufficient to show how Mr. Chamberlain violated Section 17(a) in the offer or sale of securities. In fact, the promulgation of Rule 10b-5 of the Exchange Act grew directly out of the Commission's recognition of the limitations of Section 17(a).⁶ Despite the SEC's exhortations, there are no specific allegations of an offer or a sale by Mr. Chamberlain anywhere in this Complaint.⁷ In fact, there are no allegations of

⁶ Rule 10b-5 was promulgated in 1943. Immediately prior to its adoption, the SEC had discovered that a company president was purchasing shares at a lower market value from his shareholders by telling them that the company was doing poorly when in fact the company was doing well and was set to quadruple in value. Recognizing that the language of Section 17 did not address the issue at hand (since the executive was buying and not selling the stock), the SEC voted to adopt language under Rule 10b-5 that would relate to the "purchase or sale of a security." *See Conference on Codification of the Federal Securities Laws*, 22 BUS. LAW. 793, 922 (1967).

⁷ The SEC's indignation on this point seems to be an attempt to mask what was clearly a deficiency in its pleading. In other cases, the SEC has in fact pled this prong with particularity. *See, e.g.*, Plaintiff's Complaint, *SEC v. Grocock*, No. 6:09 CV 1833-ORL-28GJ (Oct. 28, 2009) (Compl. ¶ 62; detailing the defendant's various sales; Complaint at 16; stating, in support of its claim for relief under Section 17(a) of the Securities Act: "as described in paragraphs 23-53, Grocock

any offer or sale in the Complaint.⁸ The SEC's argument that Mr. Chamberlain has no supporting authority for this argument is sophomoric. For indeed, Mr. Chamberlain relies upon the authority of the plain language of the statute itself. In addition, the Supreme Court in *U.S. v. Naftalin*, 441 U.S. 768 (1979), analyzed the circumstances that satisfied the "offer" or "sale" requirement under Section 17(a) with respect to a stockbroker alleged to have violated the statute by engaging in fraudulent short selling. The *Naftalin* Court's discussion that the statute covered any fraudulent scheme in the offer or sale of securities, whether in an initial distribution or ordinary market trading, did not eliminate the requirement that there be an "offer" or "sale." For *Naftalin*, his "offer" or "sale" was the fraudulent market trading of short sales. The Complaint filed by the SEC does not plead the existence of an offer or sale of securities in an initial distribution, secondary offering or as a fraud on the market. It should not be lost on this Court that what is also missing from the Complaint is any allegation of any market losses suffered by any stockholders as a result of the alleged fraud. Thus, the SEC fails to plead that there was an "offer" or "sale" of securities or that

knew or was reckless in not knowing that he sold CyberKey sock while in possession of confidential, material nonpublic information.")

⁸ None of the published cases cited by the SEC support the government's argument that it is not required to plead the facts that comprise an "offer" or "sale" of securities or otherwise support its "ordinary marketing trading" fraud under Section 17(a). Instead, the cases discuss other aspects of Section 17(a). *See, e.g., SEC v. Wolfson*, 539 F.3d 1249 (10th Cir. 2008)(using an analysis regarding the nature of misstatements and omissions to find that defendant's were not liable under Section 17(a)). The SEC also refers to *SEC v. Power*, 525 F.Supp.2d 415 (S.D.N.Y. 2007), to contend that Section 17(a) is coextensive with Section 10(b), and that to allege that there is a misstatement or omission in a public filing satisfies the "offer or sale of a security" requirement of Section 17(a) just as it would satisfy the "in connection with" requirement of Section 10(b). The court in *SEC v. Power*, however, did not reach that conclusion, and the fraud in *SEC v. Power* is much different than the fraud alleged in the instant case. In *Power*, the defendants engaged in an accounting fraud to give the illusion of larger profits at Tyco. Discussing the elements generally of a Section 10(b) and Section 17(a) violation, the third element discussed by the court was the existence of a fraud "(3) which affected the market for securities or was otherwise in connection with their offer, sale or purchase." *Power*, 525 F.Supp.2d at 419. The *Power* case illustrates a classic financial fraud on the market, *i.e.*, the inflation of revenues or shifting of expenses to affect the market price for the securities. No such facts exist in the SEC's case against Mr. Chamberlain. There is no allegation that the market for the Company's securities was adversely affected or that there were market losses as a result of the nondisclosure of Mr. Prince's role. There is one additional factor that the court considered in *Power* which satisfied the "offer or sale of securities" requirement. In connection with the fraudulent and sham accounting practice, Tyco filed a Form S-4 registration statement with the SEC. A Form S-4 is used to register securities to be issued in connection with a merger. Lastly, the defendants in *Power* did not challenge the Section 17(a) violation on grounds that the Complaint failed to plead an "offer or sale of securities."

there was marketing trading fraud that otherwise could satisfy the “offer” or “sale” of securities requirement.

III. THE SEC’S ARGUMENT ABOUT RULE 14a-9 LIABILITY MISCONSTRUES THE CASE LAW ON THE SUBJECT.

In its Opposition, the SEC refuses to acknowledge the law under Rule 14a-9 that requires an “essential link” between a fraudulent misrepresentation or omission and the subject of the proxy solicitation. Instead, the SEC uses cases outside of the 14a-9 context, and dismisses out of hand Mr. Chamberlain’s analysis. The government’s position demonstrates a complete lack of understanding, or respect for, both the purpose and proper analysis of the “essential link” requirement. Likewise, the SEC largely uses cases outside of the Rule 14a-9 context to argue that its Complaint meets the materiality standard under Rule 14a-9. Here again, the government’s position demonstrates a lack of understanding of how the materiality standard is to be applied under Rule 14a-9.⁹

A. The SEC’s Opposition Demonstrates A Lack Of Understanding About The “Essential Link” Element Under Rule 14a-9.

In its Opposition, the SEC has blithely stated that the “essential link” element does not apply to these proceedings because the SEC, as a public agency, does not need to prove causality. The SEC cites cases that discuss traditional notions of causality outside of the Rule 14a-9 context to buttress its argument that this is a point of “settled law.” Opposition at 17. The cases which the SEC cites regarding the issue at hand are irrelevant and demonstrate a complete lack of understanding about the purpose of the essential link element under Rule 14a-9. Contrary to the SEC’s assertions, the essential link argument is not a traditional causality element (such as Rule 10b-

⁹ In Mr. Chamberlain’s Memorandum of Points and Authorities at 13 n.4, counsel for Chamberlain, inadvertently left in a citation to the case of *SEC v. American Realty Trust*, 429 F.2d Supp. 1148 (E.D. Va. 1977), from a prior draft. The court may disregard *SEC v. American Realty Trust* for the proposition for which it was cited.

5's requirement of causation).¹⁰ Rather, the element is designed to ensure that the alleged misrepresentation or omission is tied to the proper effectuation of the proxy statement. As such, it matters not whether the plaintiff alleging the claim is a public agency or a private litigant; the "essential link" is the same. Indeed, in stating that the essential link argument does not need to be pled, the SEC has ignored numerous cases the agency itself has brought in which the court explicitly discusses this requirement as a necessary element. *See e.g., SEC v. Mercury Interactive LLC*, No. C 07-2822 JF 2008 WL 4544443, *4 (N.D. Cal. Sept. 30, 2008)(stating "each of these requirements - and the 'essential link' requirement in particular - reflects the purpose of Section 14(a), which is to prevent corporate management 'from obtaining authorization for corporate action by means of deceptive or inadequate disclosure of proxy solicitation.'" (internal citations omitted) *Id.* at *4; *SEC v. Black*, No. 04 C 7377, 2008 WL 4394891, *13 (N.D. Ill. Sep. 24, 2008)(discussing the essential link requirements within a SEC action).¹¹ The essential link element does apply and, for reasons stated in Mr. Chamberlain's Memorandum of Points and Authorities, the SEC has failed to allege this element in its Complaint and has failed to state a claim under Rule 14a-9.

B. The SEC's Opposition Demonstrates A Lack Of Understanding About The Element of Materiality Under Rule 14a-9.

The SEC's argument about materiality under Rule 14a-9 also demonstrates a lack of understanding about the element of materiality under the rule. The SEC is dismissive in characterizing Mr. Chamberlain's argument as without merit, and supercilious in claiming that it has adequately pled materiality under Rule 14a-9. The cases that the SEC relies upon to support its position do not relate to Rule 14a-9 but instead are cases based on Rule 10b-5. *See e.g., SEC v. Enterprise Solutions, Inc.*, 142 F.Supp.2d 561 (S.D.N.Y. 2001)(cited in Opposition at 19, analyzing

¹⁰*See Basic, Inc. v. Levinson*, 485 U.S. 224 (1988)

¹¹ For a much more extensive treatment of the purpose of the "essential link" element under Rule 14a-9, please *see* Mr. Chamberlain's Memorandum of Points and Authorities at 14 - 18.

materiality under Section 10 of the Exchange Act and Rule 10b-5 thereunder); *Ganino v. Citizens Utility Co.*, 228 F.3d 154, 161 (2nd Cir. 2000)(cited in Opposition at 18, also analyzing materiality under Section 10(b) and Rule 10b-5). In fact, courts apply the materiality standard under Rule 14a-9 quite different than they do under Rule 10b-5.¹² At its core, the distinction between a Rule 14a-9 materiality analysis and a Rule 10b-5 analysis goes to the crux of what Rule 14a-9 claims should involve – a material misrepresentation or omission that affected the corporate voting process. The analysis of materiality under Rule 14a-9 must be within the context of whether a reasonable investor would consider the information material in voting upon a particular corporate transaction. The SEC’s generalized argument that “the Commission’s rules require disclosure of this information is strong evidence of its materiality” is irrelevant to the issue *here* under Rule 14a-9, namely - that the SEC must demonstrate materiality of the omission in light of the question before the shareholders. *Coben v. Ayers*, 449 F. Supp. 298, 315 (N.D. Ill. 1978). The SEC’s allegations regarding Mr. Prince’s non disclosure have no merit since they in no way relate to the corporate votes at issue, namely the election of board members.¹³

IV. THE SEC’S OPPOSITION COMPLETELY DISMISSES MR. CHAMBERLAIN’S LEGITIMATE VOID FOR VAGUENESS ARGUMENT

The SEC’s challenge of defendants’ void for vagueness argument shows a blatant contempt for the defendants’ right to raise this issue. Rather than address the issues raised by the defense (that what makes a person an officer is unsettled, that the term “policy-making” function is undefined, that the SEC, in response to a request for guidance on this issue, referred issuers back to their attorneys), the SEC dismissed the argument as “spurious” and “meritless.” (Opposition at 20).

¹² While the language of materiality is similar in both contexts (in that courts must evaluate whether the information would be considered important by a reasonable shareholder), the materiality language under 14a-9 provides a crucial qualifier - the information is assessed through the lens of how a shareholder would vote on the proxy solicitation at issue. *See Virginia Bankshares v. Sandberg*, 501 U.S. 1116 - 1117 (1991)(articulating the 14a-9 materiality standard as “the likelihood that reasonable shareholders would consider it important in deciding how to vote”).

¹³ For further information, please *see* Chamberlain’s Memorandum of Points and Authorities at 18 - 20.

Rather than focus on the merits of the argument, the SEC merely repeats the definition of executive officer under the securities laws - without any attempt to show how that definition can be applied in a way that does not deny Mr. Chamberlain of his constitutional due process rights. The SEC has tried this dismissive tactic before without success. In *Timpinaro v. SEC*, 2 F.3d 453 (D.C. Cir. 1993), the SEC issued orders approving new rules that affected broker-dealers. The broker-dealers petitioned the court for a review of these rules. One of the issues raised by the broker-dealers was that the rules were unconstitutionally vague. Instead of addressing the substance of the issue, the SEC cavalierly dismissed it. The D.C. Circuit Court of Appeals disapproved of the SEC's tactic, stating that even though "the agency did not deign to address the petitioners' void for vagueness argument" many of the factors raised by the petitioners did in fact raise legitimate constitutional issues. As a result, the Court directed the SEC on remand to consider the vagueness issue and "respond to petitioners' challenge." *Id.* at 460. Just as in *Timpinaro*, the SEC has not, in any meaningful way, addressed the defendants' concerns regarding the unconstitutional vagueness of the terms "executive officer" and "policy-making function."

V. THE SEC'S POSITION THAT RULE 13a-14 CREATES A SEPARATE CAUSE OF ACTION HAS NO MERIT UNDER THE LAW.

The SEC relies upon the injunctive relief powers afforded by Section 21(d)(1) of the Exchange Act to oppose dismissal of the Fourth Claim for Relief – the alleged violation of Rule 13a-14. To support its contention, the SEC refers to (1) prior SEC consent decrees, and (2) Section 21(d)(1) of the Exchange Act.¹⁴

¹⁴ In footnote 17 of its Opposition, the SEC also cites the proposed release soliciting comments from the public. SEC Release No. 34-46079, quoted in Mr. Chamberlain's Memorandum at 11-12. Here, the SEC offers up its novel and strained misinterpretation of the proposed release, suggesting that the *proposal's* discussion of the Rule not creating an "unacceptable risk of increased liability" somehow meant that the Rule created increased liability, *i.e.*, a separate cause of action, though the cause of action was similar to other enforcement rules already on the books (according to the SEC). Ironically, the SEC quoted some of the same language quoted in Mr. Chamberlain's Memorandum but added its own view of it. In doing so, the SEC had to turn a blind eye to *In re Intelligroup Sec. Litig.*, 468 F.Supp.2d 670, 706-07 (D.N.J.

The SEC's use of Section 21(d)(1) is inapposite. Section 21(d)(1) of the Exchange Act provides the SEC with remedial injunctive powers to enforce the securities laws. Section 21(d)(1) does not create a separate cause of action, or establish the foundation for the SEC's attempt to create a separate cause of action (Fourth Claim for Relief), for an alleged Rule 13a-14 violation. Under the SEC's theory, any purported violation of any federal securities statute or rule, whether a right of action was expressly or impliedly created, would be enforceable by the SEC under Section 21(d)(1). There is no such authority for the SEC's attempt to empower itself with rights and privileges not otherwise accorded by Congress. Section 21(d)(1) is simply not relevant to whether the Complaint states a separate cause of action under Rule 13a-14.

The SEC contends that "since Rule 13a-14 has become law, the Commission has brought, and prevailed on, many cases that include Rule 13a-14 claims." Opposition at 15. Yet, some of the cases primarily cited by the SEC are consent decrees brought as a result of settled actions.¹⁵ Opposition at 15, n.15. Using unlitigated consent decrees to advance the argument that Rule 13a-14 creates a separate cause of action is disingenuous, at best. To cite to consent decrees for support that the SEC has prevailed is tantamount to using settled cases as legal precedent - this is unsupported in our system of *stare decisis*.¹⁶ And while the SEC also cites to litigated cases, in none of the cases cited did the litigants challenge Rule 13a-14 as has been challenged in this action.¹⁷ Those cases have no precedential value either.¹⁸

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; and *SEC v. Black*, 2008 WL 4394891 (N.D. Ill. Sep. 24, 2008).

¹⁵ *SEC v. Miller*, SEC Litigation Release No. 34-21058 (settled action), cited in Opposition at 15, n.15; *SEC v. Fischer*, SEC Litigation Release No. 34-20219 (settled action), cited in Opposition at 15, n. 15.

¹⁶ See Leandra Lederman, *Precedent Lost: Why Encourage Settlement, And Why Permit Non-Party Involvement In Settlements?*, 75 NOTRE DAME L. REV. 221, 221(1999)(stating "A judicial precedent requires not only an aggrieved party who files a lawsuit, but also that the case goes to trial, and perhaps appeal, without a settlement.)

¹⁷ See e.g., *SEC v. Stanard*, No. 06-Civ. 7736 (GEL) 2009 WL 196023, (Jan. 27, 2009 S.D.N.Y.)(cited in Opposition at 15, n.15), Memorandum in Support of James N Stanard's Motion to Dismiss , 2007 WL 698001 (Jan. 2, 2007))(no mention

In essence, the SEC's use of consent decrees and cases in which Rule 13a-14 has been allegedly violated but not challenged by the defendant is a thinly veiled diversion from the fact that the court's holding in *SEC v. Black* was correct for the reasons stated therein. Notably, the SEC cannot point to any authority where the court, having been presented with the Rule 13a-14 argument as presented herein, has reached a different conclusion than *SEC v. Black*.¹⁹ In addition, the SEC's position regarding Rule 13a-14 as a separate cause of action ignores the general consensus that both academics and practitioners in the field had (in the wake of the Rule's promulgation) regarding whether the Sarbanes Oxley (SOX) certification provision gives rise to a separate cause of action. See e.g., Lisa Fairfax, *Form over Substance? Officer Certification and the Promise of Enhanced Personal Accountability under the Sarbanes-Oxley Act*, 55 RUTGERS L. REV. 1, 1 (2002)(stating that "the SEC has explained that a personal certification requirement does not alter the existing law related to officer liability for a company's financial statement.") Indeed this consensus is also reflected in the Commission's own programmatic posture since Rule 13a-14 has been enacted. As one commentator noted "a review of the SEC enforcement action brought during the last five years reveals that, absent some independent fraudulent activity or significant accounting irregularity, the Commission is disinclined to pursue violations [under Rule 13a-14]." Robert Zito, *SOX 302 Certifications: What are They Good For?* N.Y. LAW JOURNAL (November 19, 2007). The SEC's Division of Enforcement is

of the impermissibility of 13a-14 being pled as a separate cause of action), Memorandum in Support of James N. Stanard's Motion for Summary Judgment, 2008 WL 2310765 (Mar. 17, 2008)(same); *SEC v. Brady*, 2006 WL 1310320, No. 05-cv-1416 (N.D. Tex. May 12, 2006)(cited in Opposition at 15, n.15), Defendant William Beecher's Motion to Dismiss the Complaint Pursuant to 12(b)(6) and 9(b) of the Federal Rules of Civil Procedure and Memorandum in Support of, 2005 WL 2758872 (Sep. 27, 2005)(same); *SEC v. Sandifur*, 2006 WL 538210, No. C05-1631C (W.D. Wash. March 2, 2006), Defendant Robert Ness's Motion to Dismiss Plaintiff Securities and Exchange Commission's Complaint or in the Alternative, Motion for a More Definite Statement, 2005 WL 6109091 (Dec. 1, 2005)(same).

¹⁸ *C.f.*, *Carducci v. Regan*, 714 F.2d 171, 177 (D.C. Cir. 1983)(stating "[t]he premise of our adversarial system is that appellate courts do not sit as self-directed boards of legal inquiry and research, but essentially as arbiters of legal questions presented and argued by the parties before them.")

¹⁹ See Defendant Chamberlain's Memorandum of Points and Authorities at 11-12, for a complete discussion.

now doing by way of litigation in this case what the Commission dared not do pursuant to its rulemaking authority. This Court should not allow for this result.

VI. THE SEC MISREADS THE LOOK-BACK PROVISION OF REGULATION S-K.

In its Opposition, the SEC argues that Regulation S-K's look back provision applies not simply to those issues that arose more than five years ago but specifically to any fact that is material. Opposition at 19. The SEC's argument on this issue fails for two reasons. First, the SEC's argument is at odds with the plain language of the regulation itself. Item 401 of Regulation S-K is clear: "Involvement in certain legal proceedings. Describe any of the following events that occurred during the past five years **and** that are material to an evaluation of the ability or integrity of any director, person nominated to become a director or executive officer of the registrant:" (emphasis added). The conjunctive in this sentence leaves no ambiguity - the regulation requires disclosure of any legal proceeding that (1) occurred within the last five years and (2) was material. Second, the SEC's use of case law to support its position - that materiality trumps the look back provision - is misguided. The cases that the SEC cites are not relevant for the simple fact that they are not cases that analyze Regulation S-K. For instance, the SEC's use of *SEC v. Enterprise Solutions*, 142 F.Supp.2d 561 (2001) once again demonstrates a misuse of relevant legal authority. In *Enterprise Solutions*, the court determined the use a consultant's disclosure obligations within the context of Rule 10b-5 and Regulation S-B.²⁰ Similarly, the court's analysis in *SEC v. Solucorp*, 274 F.Supp.2d 379 (S.D.N.Y. 2003) in no way discussed the specific look-back provision at issue - the appropriate disclosure requirements under *Regulation S-K*.

²⁰ The precarious use of the SEC's position is shown by their complete abandonment of proper pleading analysis in the 12(b)(6) context. To wit - their use of facts not originally pled in the complaint as support for their argument. Specifically, the SEC states, "[t]he Commission expects the evidence in this case to show that the defendants ... did in fact consult with counsel." Opposition at 21. Introducing this allegation outside the confines of the Complaint has no place in a well-supported brief.

VII. THE SEC HAS FAILED TO MEET ITS BURDEN TO SUFFICIENTLY PLEAD THE FRAUDULENT CONCEALMENT DOCTRINE.

The SEC relies on decisions from the Second Circuit Court of Appeals to endeavor to overcome the five-years statute of limitations period of 28 U.S.C. §2462. The SEC looks to the court's analysis in *SEC v. Power*, 525 F.Supp.2d 415, 426 (S.D.N.Y. 2007), to argue that the fraudulent concealment doctrine equitably tolls the statute of limitations period.²¹

There are only two specific allegations in the Complaint that actually touch and concern the fraudulent concealment doctrine. The Complaint, ¶1, makes the general claim that Mr. Chamberlain and the other defendants *fraudulently concealed* the role and involvement of a *de facto* executive officer for over 7 years. The Complaint, ¶9, alleges that by *concealing* the true scope of Mr. Prince's duties and authority, all of the defendants violated the antifraud provisions of the securities laws.

As the Court stated in *SEC v. Jones*, No. 05 Civ. 7044(RCC), 2006 WL 1084276 (S.D.N.Y. April 25, 2006) ("*Jones I*"):

Plaintiff can establish the concealment element by pleading "either that the [Defendants] took affirmative steps to prevent [discovery of the fraud] or that the wrong itself was ... self-concealing." Normally, "a plaintiff seeking to toll the applicable statute of limitations due to fraudulent concealment ... must meet the particularity standard of Rule 9(b)." *In re Natural Gas Commodity Litig.*, 337 F.Supp.2d 498, 513-14 (S.D.N.Y. 2004). "When an alleged violation is inherently self-concealing, [however], an assertion of such a scheme is sufficient and a plaintiff need not plead any affirmative actions by a defendant." *Id.* at 514.

Id. at *6.

²¹ There is a reason that the SEC uses Second Circuit decisions to establish its claim in this instance - the binding authority from this Circuit is hostile to plaintiff's claim. (See Chamberlain's Memorandum of Points and Authorities at 30 for a discussion of *Johnson v. SEC*, 87 F.3d 484 (D.C. Cir. 1996) and its application to the case at bar). Indeed, the SEC itself has recognized *Johnson's* power; as one commentator noted "[s]ince Johnson, the Commission in at least two proceedings has dismissed charges on the basis of Johnson without objection from the Division of Enforcement." HAROLD S. BLOOMENTHAL, SECURITIES LAW HANDBOOK § 36:35 (Updated 2008)(citing *inter alia*, *In re Angelo P. Danna, CPA*, SEC Release No. 34-38499 in which the SEC dismissed the case pending before it on the basis of the DC Circuit's decision)

“[T]he burden of establishing a fraudulent concealment reply to a defendant’s statute of limitations defense rests squarely on the plaintiff.” *In re Issuer Plaintiff IPO Antitrust Litig.*, No. 00 Civ. 7084, 2004 WL 487222 (S.D.N.Y. March 12, 2004), cited by *SEC v. Jones*, 476 F.Supp.2d 374, 382 (S.D.N.Y.2007). The Complaint does not assert that the defendants took affirmative steps to conceal the alleged fraud. To shore up this genuine weakness, the SEC’s opposition instead asserts that the Complaint “alleges a scheme to conceal a *de facto* executive officer (defendant Prince).” Opposition at 24. The scheme, according to the SEC, was the omission to disclose Mr. Prince in the annual reports and proxy statements. The SEC’s argument is entirely circular, to wit: The fraud is the nondisclosure of a *de facto* executive officer and the scheme is the concealment to disclose. One attempts to define the other without sufficiently demonstrating any particular acts of concealment. Plus, because this is an omission to disclose case, the SEC contends in its Opposition that the violations by the defendants were inherently self-concealing without alleging anything further in the Complaint or its Opposition.

As the Court in *SEC v. Jones, supra* (“*Jones II*”), stated:

Standing alone, allegations of fraud are generally insufficient to demonstrate that a particular act is self-concealing. Indeed, for a fraud to be self-concealing, the defendant must have engaged in “some misleading, deceptive or otherwise contrived action or scheme, in the course of committing the wrong, that [was] designed to mask the cause of action.” *Hobson v. Wilson*, 737 F.2d 1, 34 (D.C. Cir. 1984) (citing *Wood v. Carpenter*, 101 U.S. (11 Otto) 135, 143 (1879)) (“Concealment by mere silence is not enough. There must be some trick or contrivance intended to exclude suspicion and prevent inquiry.”). As one court in this Circuit explained:

The requirement that the fraud “conceal itself” must mean more than that the plaintiff is ignorant of the deception. A better reading of the phrase is that it encompasses an enterprise where the particular fraud is, by its nature, unknowable. A fraud “conceal(s) itself” when a plaintiff, even by the exercise of due diligence, could not uncover it...[A] fraud conceals itself when the defendant does only what is necessary to perpetrate the fraud, and that alone makes the fraud unknowable...

Long v. Abbott Mortgage Corp., 459 F. Supp. 108, 118, 120 (D. Conn. 1978) (Newman, J.) (dismissing plaintiff's securities fraud claims as untimely because, *inter alia*, the allegedly fraudulent activity was not incapable of being known.)

Here, the SEC has not met its burden to demonstrate that the defendants' alleged deception was unknowable and hence self-concealing. There are no allegations in the Complaint of any affirmative steps taken by Mr. Chamberlain to prevent discovery of Mr. Prince's role and involvement. There are no allegations in the Complaint that Mr. Chamberlain engaged in some misleading, deceptive or contrived action or scheme during the course of committing the wrong that was designed to mask the cause of action. There are no allegations in the Complaint either that the alleged wrong was "self-concealing." Here, the SEC has failed to meet the particularity standards of Rule 9(b) again.

The duties and responsibilities which Mr. Prince undertook over an alleged 8 year time frame were not inherently self-concealing, just from judging the allegations levied in the Complaint. The reverse is perhaps true. Most of the activities which the SEC alleges made Mr. Prince a *de facto* executive officer were so openly known inside the Company, to its Board of Directors, to management, and to outside persons that they can hardly be characterized as "inherently self-concealing." Taking the SEC's allegations as true, the Complaint alleges:

- That Mr. Prince was among the highest compensated individuals at the Company. (Complaint ¶¶7,28)
- That he was listed on the Company's organizational charts at the level of "Executive Vice President." (Complaint ¶4)
- That his office was located in the same area as other executive officers. (Complaint 24)
- That he attended Board of Director meetings. (Complaint ¶4)
- That he gave regular presentations to the Board of Directors. (Complaint ¶27)

- That he received an indemnification agreement from the Company (Complaint ¶24)²²
- That he was the Director of Mergers and Acquisitions and the Director of Strategic & Financial Planning. (Complaint ¶¶16, 25)
- That he oversaw the subsidiaries that the Company acquired and the heads of the acquired Companies reported to Mr. Prince. (Complaint ¶25)
- That he was the Chairman of the Board of one of the Company's subsidiaries, Newpoint (Complaint ¶ 26)
- That he became the head of the Company's Contracts Department. (Complaint ¶26)
- That he was a member of the G-7. (Complaint ¶23)

The Complaint is short on any acts of concealment, but is long on acts that were openly carried out. The Complaint fails to plead in any sense that the fraudulent concealment document operates to toll the statute of limitations. Taking the SEC's position to its logical extreme, every omission to disclose case would involve a fraud that is "inherently self-concealing," and therefore, the five-year statute of limitations of Section 2462 would never apply.²³ Surely, this is not the law on pleading fraud under Rule 9(b), nor is it the law under Section 2462.

²² In particular, this allegation stretches the notion of "fraudulent concealment" to absurdity. The same indemnification agreements that the SEC uses as a basis for its claim were filed with the Commission in one of the Company's public filings.

²³ Plaintiff's use of the continuing violation doctrine as an attempt to ward off the statute of limitations is misplaced. The continuing violation doctrine has primarily been analyzed within the context of the language of Title VII cases to delay the implementation of its statute of limitations. *National R.R. Passenger Corp. v. Morgan*, 536 U.S. 101, 107 (2001)(analyzing the continuing violations provision in light of the specific language of 42 U.S.C. § 2000(e)-5(e)). Consequently, the underlying case law development - application of the doctrine to litigation involving employment practices - simply does not apply here. For this reason, at least one court in the Second Circuit (from which all of plaintiff's cases on this subject hale) has noted that: "[t]he weight of authority in this circuit is skeptical of the application of the continuing violations doctrine in securities fraud cases." *In re Converse Technology Inc., Securities Litigation*, 543 F.Supp.2d 134, 155 (E.D.N.Y. 2008).

WHEREFORE, for all of the reasons set forth in Mr. Chamberlain's Motion to Dismiss, Memorandum of Points and Authorities in Support, and this Reply, Mr. Chamberlain requests the Court to grant his Motion.

Dated: November 2, 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 "A".

Daniel A. Ball (DC Bar #370474)

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CERTIFICATE OF SERVICE

I hereby certify that on the 2nd day of November 2009, I caused a copy of the foregoing Reply to be filed electronically and served electronically upon the following attorneys:

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