UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF PENNSYLVANIA

BARRY J. BELMONT, PHILADELPHIA FINANCIAL SERVICES, LLC, THOMAS J. KELLY, JR., FRANCES R. KELLY and GARY O. PEREZ,

Plaintiffs,

v.

MB INVESTMENT PARTNERS, INC., CENTREMB HOLDINGS, CENTRE PARTNERS MANAGEMENT, LLC, ROBERT M. MACHINIST, MARK E. BLOOM, RONALD L. ALTMAN, LESTER POLLACK, WILLIAM M. TOMAI, GUILLAUME BEBEAR, P. BENJAMIN GROSSCUP, THOMAS N. BARR, CHRISTINE MUNN, ROBERT A. BERNHARD and BRUCE POLLACK,

Defendants.

CIVIL ACTION NO.: 09-cv-04951

REPLY MEMORANDUM OF LAW IN FURTHER SUPPORT OF MOTION OF DEFENDANTS MB INVESTMENT PARTNERS, INC., ROBERT M. MACHINIST, P. BENJAMIN GROSSCUP, THOMAS N. BARR, CHRISTINE MUNN AND ROBERT A. BERNHARD TO DISMISS AMENDED COMPLAINT

TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES **Pages**

Defendants MB Investment Partners, Inc. ("MB"), Robert M. Machinist, P. Benjamin Grosscup, Thomas N. Barr, Christine Munn and Robert A. Bernhard (the "Individual MB Defendants" and collectively with MB, the "MB Defendants") respectfully submit this Reply Memorandum of Law in further support of their Motion to Dismiss certain of the claims asserted against them in the Plaintiffs' Amended Complaint (the "Amended Complaint").

INTRODUCTION

In the MB Defendants' initial Memorandum of Law (the "Initial Memorandum") in support of their Motion to Dismiss the Amended Complaint, the MB Defendants argued that the Plaintiffs' Section 10(b) securities fraud claim against MB could not withstand dismissal at this stage for two independently dispositive reasons. First, the Amended Complaint fails to meet the heightened pleading requirements applicable to securities fraud claims by failing to allege facts sufficient to support a strong inference that MB intended to commit fraud or was reckless. *See Init. Mem.* at 2, 12.[1] Second, the Amended Complaint fails to allege facts sufficient to expose MB to derivative liability in that it fails to allege that MB benefited from Bloom's conduct. *Id.* at 2, 15. Plaintiffs' Consolidated Memorandum of Law in Opposition to Defendants' Motions to Dismiss the Amended Complaint ("Plaintiffs' Opposition") does not provide sufficient authority or citation to factual allegations in the Amended Complaint to avoid dismissal on either ground. Indeed, the Plaintiffs' Opposition seeks to limit this Court's analysis to merely those facts set forth in the Amended Complaint, utterly ignoring the other legitimate

[1] "Def. Init. Mem." refers to the MB Defendants' Memorandum of Law in Support of Motion to Dismiss the Amended Complaint. "Pl. Opp." refers to the Plaintiffs' Consolidated Memorandum of Law in Opposition to Defendants' Motions to Dismiss the Amended Complaint.

factual sources that clearly indicate that Defendant Bloom perpetrated a ponzi scheme solely for his own benefit without the knowledge of the MB Defendants.

The Plaintiffs' Opposition does not refute or respond to the facts set forth in the Information or the complaint filed by the Alexander Dawson Foundation (the "AD Complaint").[2] When these documents are reviewed together with the allegations set forth in the Amended Complaint, it becomes clear that the Plaintiffs' case is hardly plausible, much less cogent and compelling. In summary, the Plaintiffs would have this Court believe that when Bloom joined MB as a senior executive in 2004, he began running his already-existing fraudulent pyramid scheme through his new employer, and that the experienced securities professionals around him at his new firm either aided and abetted or recklessly ignored Bloom's gross violations of securities laws. According to the Plaintiffs' theory, MB's officers and directors willingly risked MB's status as a registered investment adviser, their own livelihood as professional investment advisers and potential criminal liability for absolutely no benefit to themselves. Plaintiffs implausibly argue that these allegations are "at least as compelling" as the inference that Bloom successfully concealed his criminal scheme from the Defendants, just as he had successfully concealed it for years from his clients, prior employers, and securities regulators. These theories simply do not stand up under the facts or the applicable legal standards on this motion.

The Plaintiffs claims for control person liability under Section 20(a) of the Securities Exchange Act of 1934 and negligent supervision are also insufficiently pled, the former because there is no primary violation, and the latter because Defendant Bloom's crimes were not foreseeable.

[2] Filed as Exhibits A and B, respectively, to the Initial Memorandum.

ARGUMENT

I. The Plaintiffs' Opposition Fails to Establish that MB Acted with Scienter.

The Plaintiffs' Opposition argues that the Amended Complaint sufficiently pleads MB's scienter by virtue of its allegations that MB recklessly failed to supervise Bloom by both (1) failing to review or check information that it had a duty to monitor, and (2) ignoring "red flags" of Bloom's fraud. *Pl. Opp.* at 14-24. Many of the Plaintiffs' allegations are conclusory and implausible and, moreover, a "holistic" review of all of the materials this Court is permitted to consider reveals that the Plaintiffs' claims fail to meet the cogent and compelling standard applicable to claims of securities fraud.

A. *Plaintiffs' Failure to Monitor Allegations are Conclusory and Implausible*

In order to withstand a motion to dismiss, a securities fraud claim must plead with particularity facts establishing that the defendant acted intentionally or recklessly. Reckless conduct is defined as conduct "involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of care." *In re Advanta Corp. Sec. Litig.*, 180 F.3d 525, 535 (3d Cir. 1999). Indeed, "claims essentially grounded on corporate mismanagement are not cognizable under federal law." *Id.* at 540. Such allegations must also meet the heightened pleading standards applicable to the scienter element of securities fraud claims, i.e. the "who, what, when, where and how" of the events at issue. *In re Suprema Specialties Inc. Sec. Litig.*, 438 F.3d 256, 276 (3d Cir. 2006).

The Plaintiffs' Opposition begins by seeking to establish that MB was reckless in failing to adequately monitor Bloom and his activities. *Pl. Opp.*. at 14. In summary, Plaintiffs allege that Bloom's North Hills fraud was perpetrated through MB, that MB

failed to have "even the most basic of compliance mechanisms and procedures" required of investment advisors such as MB, failed to supervise Defendant Bloom, failed to perform due diligence on North Hills and in general "turned a blind eye to the activities of Defendants Bloom and Altman. *Id.*. at 14-18. In addition to being grossly inaccurate, Plaintiffs' allegations are both conclusory and implausible.[3]

The Plaintiffs' Opposition and underlying Amended Complaint rely on a number of general unsupported allegations. They fail to allege the "who, what, when, where, and how" of any of these supposed failures. They also fall into the category of blanket allegations of weak internal controls that may not form the basis for inferring scienter. *See, e.g., In re Rent-Way Sec. Litig.*, 209 F.Supp.2d 493, 508 (W.D.Pa. 2002). Indeed, the specificity of the claims asserted in *Rent-Way*, when contrasted with those at bar, exemplifies the deficiencies in the Amended Complaint. The *Rent-Way* plaintiffs sought to hold an accounting firm liable for alleged accounting improprieties. *Id.* at 496-497. In that case, however, plaintiffs' claims included detailed and specific explanations of precisely how the accounting firm violated GAAP and/or GAAS. *Id.* at 506-508 (noting that "where plaintiffs have pled facts explaining how the standards were recklessly or consciously violated, however, courts have found them probative.") Examples of the specific allegations of weak internal controls pled in *Rent-Way* include:

1. that the accounting firm "knew that Rent-Way's Point-of-Sale ("POS") system, in place until the last month of fiscal year 1999,

[3] Plaintiffs gratuitously suggest that the "failure" of the MB Defendants to specifically refute the Plaintiffs' allegations suggests that the allegations are in fact true. Pl. Opp. at p. 11, n.8 ("the MB Defendants do not state that they, in fact, had those procedures and compliance mechanisms in place or that they ever inquired of Bloom as to North Hills."). In fact, the Amended Complaint is replete with factual inaccuracies since MB had at all times a robust compliance program. For purposes of this motion, however, as the Plaintiffs are well aware, the MB Defendants unfortunately have no choice but to accept the Plaintiffs' allegations as true. The MB Defendants wish to reemphasize, however, as stated in footnote 2 of the Initial Memorandum, that they dispute many of the Plaintiffs' factual assertions.

failed to properly record critical rental merchandise depreciation value";

2. that this same system "was especially ill-equipped to handle Rent-Way's rapid expansion and was easy to manipulate";

3. that the "accounting firm urged Rent-Way to install the PeopleSoft system in August of 1999 and that this system failed to interface with the POS system and permitted entries to be manually altered"; and

4. that the "accounting firm knew that [a corporate officer] made manual adjustments to the ledger in order to force the bottom line numbers to balance at the end of fiscal years 1998 and 1999"

Id. at 508. By contrast, Plaintiffs' claims here are far too general to establish securities fraud under the applicable heightened pleading standard.

All of Plaintiffs' allegations, moreover, when considered along with the Information and the AD Complaint, present a dubious story that hardly meets the plausibility standard applicable to all actions filed in federal court. *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 570 (2007); *Ashcroft v. Iqbal*, 129 S.Ct. 1937, 1953 (2009). The Plaintiffs seemingly assert that MB lacked any compliance program whatsoever, notwithstanding that MB was an operating investment adviser for several decades.[4] Additionally, for no monetary or other discernible benefit to themselves, MB's officers and directors were either willing accomplices to Defendant Bloom's fraudulent scheme or "turned a blind eye" to his misconduct. While the Plaintiffs derisively try dismiss the argument, the fact remains that highly successful professionals are not normally in the practice of committing crimes and put their livelihood at risk for absolutely no benefit

[4] Plaintiffs appear confused as to whether they want to assert that MB had no compliance program whatsoever, or whether MB violated the program they had in place. *See, e.g.*, Pl. Opp. at p.17 "MB failed to install or implement even the most basic of compliance mechanisms and procedures employed throughout the investment advising industry" (quoting Amended Complaint ¶ 57) and "MB failed to inquire whether (or how) Bloom's operation and MB personnel's sales of North Hills (Bloom's private fund") comported with MB's code of ethics" (quoting Amended Complaint ¶ 55).

whatsoever. Rather, there is an obvious, and certainly more plausible, alternative explanation – that Bloom continued to conceal from everyone the exact same fraudulent scheme that he had been perpetrating for years prior to joining MB.

Even if the Court were to find that these allegations are at least plausible, the heightened pleading standard established by the Supreme Court in *Tellabs* forecloses the outcome. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 332 (2007). As set forth in detail in the Initial Memorandum, *Tellabs* mandates that the Court engage in a "holistic" review of all documents that it is permitted to review and a determination that the inference of recklessness be "at least as compelling" as any inference of non-fraudulent intent. In this case, the facts pled, when reviewed in the context of the other documents this Court is permitted to consider, do not compel or justify an inference of fraudulent intent or recklessness by MB. Rather, at most the claims would be "grounded on corporate mismanagement [and therefore] not cognizable under federal law." *In re Advanta Corp. Sec. Litig.*, 180 F.3d 525, 540 (3d Cir. 1999).

B. *There Were No "Red Flags" that MB Ignored.*

Plaintiffs' Opposition correctly notes that an inference of scienter may be drawn from a party's refusal to act on "red flags" signifying fraud. Plaintiffs supposed red flags, however, do not support such an inference. They can be reduced to two categories. The first is that MB supposedly knew that Defendant Bloom was operating a fund and that the fund enjoyed consistent, low-risk returns. *Pl. Opp.* at 21. This red flag is preposterous for two reasons. First, if we accept as true that Bloom's assertion of North Hills's performance claims to Plaintiffs should have been a red flag to MB, it should have also been an obvious indicator of fraud to the Plaintiffs, themselves experienced and savvy

investors. Second, and more importantly, MB was completely unaware that Bloom was making any such claims of North Hills' performance because MB was not even aware that Defendant Bloom was using North Hills to operate a hedge fund, much less Defendant Bloom's marketing efforts or performance claims on its behalf.

Plaintiffs' second red flag consists of a series of examples of Defendant Bloom's supposedly ostentatious wealth. *Pl. Opp.* at 21. This assertion also fails for a number of reasons. First, Plaintiffs' fail to allege when Bloom purchased the cited assets (i.e. whether they were before or during his period of employment at MB), or how his co-workers would have had any knowledge of the extent of Defendant Bloom's wealth or the assets that he purchased. The AD Complaint, however, sheds some light on this matter, noting that the most ostentatious item of wealth Defendant Bloom possessed – the multimillion dollar home at 10 Gracie Square – was purchased by Defendant Bloom for $5.2 million and then subsequently transferred to his wife for no consideration in July 2005, which is less than one year after he began his employment at MB. AD Complaint, at ¶ 29. He then sold the home in 2007 for $11.2 million, a profit margin that could likely fund the purchase of everything else recited in the Plaintiffs' list of extravagant expenses. *Id.* Second, and more importantly, such expenditures would certainly not lead one to suspect that a highly paid colleague with many years of experience as a partner at a national accounting firm and at other trading firms was in fact engaged in a massive pyramid scheme. Unlike the red flags set forth in the various cases cited by the Plaintiffs, there is a significant disconnect between the supposed red flag of leading a rich lifestyle and the fraud that was being committed outside the auspices of MB.

II. Plaintiffs' Opposition Fails to Establish a Claim under Section 20(a).

As argued in the Initial Memorandum and in the Centre Defendants' Brief and Reply Brief, the Plaintiffs have failed to allege a violation of Section 20(a) of the Exchange Act by a controlled person over which the MB Defendants exerted control sufficient to give rise to Section 20(a) liability. As has been repeatedly pointed out, without a violation by a controlled person, there can be no liability on the person exerting the control.

Furthermore, the Plaintiffs' Opposition fails to supply the additional critical connection between the MB Defendants, as allegedly controlling persons, and a controlled entity that is guilty of such violations. The mere fact that the MB Defendants served as corporate officers of MB does not provide an adequate nexus. *In re Digital Island Sec. Litig.*, 223 F. Supp 2d 546 (D. Del. 2002). Moreover, although the Plaintiffs' Opposition and Amended Complaint occasionally cite the specific involvement of Defendant Robert Machinist, neither makes any specific references whatsoever to any actions by any of the other individual MB Defendants. Therefore, the Plaintiffs' Section 20(a) claims should be dismissed.

III. Plaintiffs' Opposition Fails to Adequately Plead Negligent Supervision.

The litany of cases cited by the Plaintiffs in trying to buttress their claim for negligent supervision on the part of the individual MB Defendants are all easily distinguished. *In re RCN Litig.* was a case involving a breach of fiduciary duties by directors in the context of ERISA, and the word "negligence" does not even appear in the court's decision. 2006 WL 753149 (D.N.J. Mar. 21, 2006). Similarly, *Baltimore & O.R. Co. v. Foar* related to a breach of contract and had nothing to do with negligence on the part of either the company or its directors, much less negligent supervision specifically.

84 F.2d 67, 71 (7th Cir. 1936). The statutory authority cited by Plaintiffs does not give rise to third party liability for negligent supervision, nor has any case cited by Plaintiffs or found by the MB Defendants supported such a proposition. *See* 70 Pa. Stat. §§ 1-102(j), 1-305. *O'Mara Enterprises, Inc. v. Mellon Bank* is a convoluted case which is completely inapposite. 101 F.R.D. 668, 671 (W.D.Pa. 1983). In *O'Mara Enterprises*, the court allowed a corporate defendant to implead the officers and directors of the plaintiff for failing to use reasonable care and diligence in carrying out their duties. *Id.* What is crucial to note, however, is that the officers and directors liability was to the plaintiff itself (i.e., their employer) and not to the third party. *Id.* (the defendant "contends that the [employees] as officers and directors of [the plaintiff] owed a duty to the corporate Plaintiff to use reasonable care and diligence in carrying out their duties). *Lazarski v. Archdiocese of Phila.*, meanwhile, dealt with a lawsuit against the Catholic Church, not a corporation, and involved no definitive ruling whatsoever on the issue of negligent supervision. 2006 WL 4959566 (Pa. Ct. Com. Pl. Oct. 10, 2006). It is clear that the Plaintiffs' negligent supervision claims should be dismissed.

CONCLUSION

For the reasons set forth above, Counts I, III and IV should be dismissed with prejudice as to the MB Defendants.

Dated: May 4, 2010

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Reply Memorandum of Law in Further Support of Motion of Defendants MB Investment Partners, Inc., Robert M. Machinist, P. Benjamin Grosscup, Thomas N. Barr, Christine Munn and Robert A. Bernhard to Dismiss Amended Complaint was served on this date via filing with this Court's ECF system (with the exception of Mark Bloom who has been served by U.S. Mail) and is available for viewing and downloading from the ECF system on this 4th day of May, 2010 by the following counsel:

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