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No. 07-15083

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**FILED**

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U.S. COURT OF APPEALS

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**UNITED STATES COURT OF APPEALS  
FOR THE NINTH CIRCUIT**

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ELLEN RUBKE, AS TRUSTEE OF THE 1986 RUBKE  
LIVING TRUST and JACK FERGUSON, individually and on behalf of  
all others similarly situated shareholders of Napa Community Bank,

Plaintiffs-Appellants,

v.

CAPITOL BANCORP LIMITED and JOSEPH D. REID,

Defendants-Appellees.

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Appeal from the United States District Court  
For the Northern District of California  
Case No. C-05-4800 PJH

The Honorable Phyllis J. Hamilton, United States District Judge

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**BRIEF OF APPELLANTS**

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John F. Friedemann (115632)  
Kyle M. Fisher. (127334)  
**FRIEDEMANN GOLDBERG  
LLP**  
420 Aviation Blvd., Suite 201  
Santa Rosa, CA 95403  
Telephone (707) 543-4900

George S. Trevor (127875)  
**LAW OFFICE OF  
GEORGE S. TREVOR**  
300 Tamal Plaza, Suite 180  
Corte Madera, CA 94925-1131  
Telephone: (415) 777-2230

James V. Weixel, Jr. (166024)  
**WEIXEL LAW OFFICE**  
2370 Market Street – No. 133  
San Francisco, CA 94114  
Telephone: (415) 682-9785

Attorneys for Plaintiffs-Appellants

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## **I. JURISDICTIONAL STATEMENT**

This case is brought pursuant to Sections 10(b), 14(e) and 20(a) of the Securities Exchange Act of 1934 (the "1934 Act") [15 U.S.C. §§ 78j(b), 78n(e), and 78t(a)] and Rules 10b-5 and 14e-2 promulgated thereunder [17 C.F.R. § 240.10b-5 and 17 C.F.R. § 240.14e-2]. This action also arises under Sections 11, 12 and 15 of the Securities Act of 1933 (the "1933 Act") [15 U.S.C. §§ 77k, 77l and 77o]. The District Court had jurisdiction over the subject matter of this action pursuant to Section 27 of the 1934 act, [15 U.S.C. § 78aa], Section 22 of the 1933 Act [15 U.S.C. § 77v], and 28 U.S.C. §§ 1331 and 1337.

The District Court entered a final judgment on dismissed claims pursuant to Rule 54(b), Fed. R. Civ. P., giving this Court jurisdiction under 28 U.S.C. Section 1291. Appellants/Plaintiffs Ellen Rubke as Trustee of the 1986 Rubke Living Trust and Jack Ferguson (collectively "Plaintiffs") appeal from: (a) the order granting the motion to dismiss of Appellees/Defendants Capitol Bancorp Limited ("Capitol") and Joseph D. Reid ("Reid") (collectively "Defendants") entered June 6, 2006, Appellants' Excerpt of Record ("AR") 732, Docket 26; (b) the order granting Defendants' motion to dismiss the First Amended Complaint entered October 27, 2006, AR 796, Docket 38, 480 F.Supp.2d 1124; and (c) the related order granting final judgment under Rule 54(b) entered December 13, 2006, AR 835, Docket 41.

The District Court entered the Rule 54(b) judgment on December 13, 2006. AR 835, Docket 41. A Notice of Appeal was filed on January 10, 2007. AR 837, Docket 42. Accordingly, the appeal is timely. Fed. R. App. P. 3.

## **II. ISSUES FOR REVIEW**

1. Whether Plaintiffs' claims in the First Amended Complaint ("FAC") under Section 11 of the 1933 Act alleging that in the Registration Statement filed by Capitol with the Securities and Exchange Commission was materially false and misleading were pled with sufficient particularity under Rule 9(b), Fed. R. Civ. P.

2. Whether Plaintiffs' claims in the FAC under Section 14(e) of the 1934 Act, in which Plaintiffs allege that material misleading statements were made on behalf of Capitol in connection with the tender offer in a telephone campaign whereby Napa Community Bank ("NCB") shareholders were contacted by officers of NCB (at the request of defendants Capitol and Reid) and told, among other things, that their shares would be "worthless" if not sold to Capitol (the "Campaign of Deception"), were sufficiently pled under Rule 9(b), Fed. R. Civ. P.

3. Whether Plaintiffs' allegations in the FAC as to their claims under Section 10(b) of the 1934 Act, in which Plaintiffs alleged Defendants' liability for making false and misleading statements in connection with the Campaign of Deception, established with particularity falsity and scienter under

the Private Securities Litigation Reform Act of 1995 (“PSLRA”), 15 U.S.C. §§ 78u-4, *et seq.*

### **III. STANDARD OF REVIEW**

Dismissal for failure to state a claim under Rule 12(b)(6), Fed. R. Civ. P., is reviewed *de novo*. *No. 84 Employer-Teamster Joint Council Pension Trust v. America West Holding Corp.*, 320 F.3d 920, 931 (9th Cir. 2003). The FAC’s allegations must be taken as true and construed in the light most favorable to Plaintiffs. *Id.* Dismissal is appropriate only if “it appears beyond a doubt that the Plaintiff cannot prove any set of facts in support of a claim that would entitle him or her to relief.” *Id.* Dismissal of federal securities claims for failure to state a claim with the specificity required by Rule 9(b) and/or the PSLRA is reviewed *de novo* under the same set of standards. *Seinfeld v. Bartz*, 322 F.3d 693, 696 (9th Cir.), *cert. denied*, 540 U.S. 939 (2003); *In re GlenFed, Inc. Sec. Litig.*, 11 F.3d 843, 847 (9th Cir. 1993), *vacated on other grounds*, 42 F.3d 1541 (9th Cir. 1995) (*en banc*).

### **IV. STATEMENT OF THE CASE**

This class action lawsuit arises from a Registration Statement filed by Capitol with the Securities and Exchange Commission in April 2005 in connection with Capitol’s offer to exchange shares of Capitol common stock, which is publicly traded, for shares of NCB common stock which is not publicly traded ( the “Exchange Offer”). At the time of the Exchange Offer, Defendants were the

majority shareholders of NCB, with access to inside information regarding NCB's performance which was not available to NCB's minority shareholders. FAC, ¶¶ 20, 21, 24, 29-37, AR 13-14, 16-19.

The original class action complaint alleging violations of the 1933 Act, the 1934 Act and containing claims for relief based on state law was filed on November 23, 2005. AR 8. The District Court, following the PSLRA statutory procedure, appointed Plaintiffs to serve as lead class plaintiffs and Plaintiffs' counsel to serve as class counsel. Docket 18.

Defendants filed a motion to dismiss the original complaint on March 31, 2006. Docket 19. On June 16, 2006, the District Court (Hamilton, J.) granted the motion with the leave to amend. AR 732, Docket 26.

Plaintiffs filed the FAC on July 31, 2006. AR 761, Docket 28. The FAC contained claims for relief for violations of the 1933 Act and the 1934 Act but omitted the previously asserted state law claims. *Id.*

Defendants filed a motion to dismiss the FAC on August 30, 2006. Docket 30. On October 27, 2006, the District Court granted the motion with leave to amend with respect to Section 12 of the 1933 Act and Section 10(b) of the 1934 Act but only with respect to the allegations concerning the Campaign of Deception. The District Court granted the motion without leave to amend with respect to all

other claims under the 1933 Act and 1934 Act. AR 796, Docket 38; *Rubke v. Capitol Bancorp, Ltd.*, 480 F.Supp.2d 1124 (N.D. Cal. 2006).

In response to the order on the motion to dismiss the FAC, Plaintiffs on November 21, 2006 filed a Notice of Intention Not to File an Amended Pleading in order to pursue an appeal based on Plaintiffs' conclusion that the District Court had erred in dismissing Plaintiffs' claims. *See Edwards v. Marin Park, Inc.*, 356 F.3d 1058, 1064 (9th Cir. 2004). The District Court entered judgment on December 13, 2006. AR 835, Docket 41. Plaintiffs timely appealed. AR 837, Docket 42.

#### V. STATEMENT OF FACTS

Defendants are alleged to have purchased shares of NCB from Plaintiffs using a false and misleading Registration Statement and directing others to make oral misrepresentations about the tender offer. Defendants represented in the Registration Statement that the Exchange Offer whereby they offered to exchange shares of Capitol common stock for shares of NCB common stock was "fair" and was a "premium" over the shares' book value. At the time Defendants made these representations in the Registration Statement, Defendants were aware of but did not disclose information that would have been material to Plaintiffs' decision to tender their NCB shares. FAC ¶ 42, AR 771.

Capitol is a Michigan based bank holding company that controls numerous small “community” banks located chiefly in the Midwest and California. Registration Statement, Defendants’ Request for Judicial Notice (“RJN”) Ex. 2, AR 83. Defendant Joseph Reid is the longtime CEO and Chairman of Capitol’s board of directors. FAC ¶ 17, AR 765. As an officer and director of Capitol, Reid signed the Registration Statement at issue here. FAC ¶ 27, AR 767.

In 2001, Capitol began soliciting investors, mostly in Napa County, to provide capital for a new community-based bank in Napa County. Capitol used its typical business plan, which ensured that Capitol, and thus Reid, would always hold a majority of the new bank’s common stock. *Id.* After three years of a new bank’s operations, Capitol would offer the minority shareholders Capitol’s stock for that of the local banks at a price that represented 150% of the appraised book value of the stock. RJN Ex. 2, AR 83, FAC ¶ 34-38, AR 769-770.

The offering circular that Capitol provided in connection with the 2001 sale of NCB common stock stated that in Capitol’s previous tender offers, the minority shareholders of the banks had been allowed to vote to approve the transaction. Complaint ¶ 19, AR 12-13. Capitol also stated that it would vote its shares in accordance with the wishes of a majority of the minority shareholders. *Id.* This was reiterated by Reid at a meeting of NCB’s board of directors after NCB’s formation. *Id.*

During the formation and capitalization of NCB, Capitol organized a holding company named First California Northern (referred to herein as “NCB Holdings”). FAC ¶ 42, AR 771. The only function of NCB Holdings was to hold approximately 51% of NCB’s total shares. It had no other material assets, and its financial statements were consolidated with those of NCB. *Id.* Capitol sold about 49% of NCB Holding to other investors and kept 51% for itself through an intermediate subsidiary. *Id.*

In approximately May 2004, Capitol offered to exchange its own shares for those of NCB Holdings at a ratio that translated to a price of 167% of the book value of the common stock of NCB Holdings. FAC ¶ 43, AR 771-772. That exchange offer was accompanied by a fairness opinion from JMP Financial, Inc., a Michigan-based firm, which stated that the NCB Holdings shareholders received fair value in that exchange. FAC ¶ 44, AR 772. One or more directors and officers of NCB also held shares in NCB Holdings and participated in the NCB Holdings share exchange in 2004. *Id.* As shown below, the 167% value ratio is much higher than Capitol’s June 2005 offer to purchase the stock of NCB.

On or about June 2, 2005, just over three years after NCB’s March 2002 founding, Capitol made the Exchange Offer to NCB’s shareholders. FAC ¶¶ 23-25, AR 766-767. Capitol offered to exchange its common stock for all outstanding shares of NCB common stock at a price equal to approximately 150%

of the book value of NCB's common stock. *Id.* The Exchange Offer documents ("the Offer Documents") included a cover letter from Reid in which he referred to the original offering circular and "the plan" that Capitol had to acquire investors' shares in the proposed manner. FAC ¶ 34, AR 769; RJN Ex. 4, AR 304. The expiration date of the Exchange Offer was June 30, 2005. RJN Ex. 4, AR 304, 305. The terms of the Exchange Offer were set forth in certain documents, including an S-4 registration statement, that Capitol filed with the U.S. Securities and Exchange Commission ("the SEC") on or about April 28, 2005.<sup>1</sup> FAC ¶ 24, AR 766-767. Reid signed that registration statement, FAC ¶ 27, AR 767; RJN Ex. 4, AR 172, 298, and it was declared effective on June 2, 2005. FAC ¶ 24, AR 766-767; RJN Ex. 5, AR 367. The Exchange Offer Documents were sent by Capitol to every member of the plaintiff class. FAC ¶ 27, AR 767.

The Exchange Offer established a formula for computing the exact number of shares Capitol was to issue to the NCB shareholders in exchange for their NCB shares. FAC ¶ 25, AR 767. Capitol represented that the book value of NCB stock was approximately \$10.60 per share, meaning that Capitol was to issue approximately \$15.90 worth of Capitol shares for each NCB share tendered in

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<sup>1</sup> An amendment was filed by Capitol on or about May 27, 2005. RJN Ex. 3, AR 189.

response to the Exchange Offer. *Id.*, ¶ 26. That ratio worked out to approximately 0.49 Capitol shares in exchange for each NCB share. Complaint ¶ 28, AR 15-16.

Even before the Exchange Offer was made, and during its pendency, Capitol and Reid actively reiterated that an understanding or arrangement existed whereby Capitol would buy the NCB stock at 150% of those shares' book value, which they represented as fair regardless of the actual success of NCB. FAC ¶¶ 25, 34, 37-39, AR 767, 769-770. However, the absence of any such agreement or obligation by Capitol, as well as the arbitrary and artificially low price established for the NCB stock therein, was never disclosed in connection with the Exchange Offer. FAC ¶¶ 40-41, AR 770-771.

The statements made by Defendants that the Exchange Offer was "fair" and constituted a "premium" over NCB's book value failed to disclose material information related to the fairness opinion, prepared by JMP Financial, Inc. (the "JMP Fairness Opinion"), attached to the Registration Statement. Specifically, Defendants knew but did not disclose the fact that the JMP Fairness Opinion was not an independent evaluation of Capitol's offer. FAC ¶ 52, AR 774-775. Such undisclosed facts included: (1) JMP Financial, Inc. ("JMP") had opined one year before that shares equivalent to NCB shares were worth more than what Capitol was offering in the Exchange Offer, and (2) JMP had previously rendered approximately 26 out of a total of 30 fairness opinions for Capitol (or a Capitol

affiliate) in similar transactions. FAC ¶ 52, AR 774. In each of these opinions JMP concluded that approximately the same exchange rate offered by Capitol to NCB shareholders was fair even though the performance and profits of the banks involved necessarily differed due to their unique characteristics. FAC ¶ 53, AR 775.

Additionally with respect to the statements that the Exchange Offer was “fair” and constituted a “premium,” Defendants knew but did not disclose in the Registration Statement material information regarding the fairness of the Exchange Offer. FAC ¶¶ 60-65, AR 777-778. Defendants’ status as insiders and majority shareholders of NCB gave them access to this material non-public information. FAC ¶¶ 2-4, AR 762-763. A Capitol officer attended almost every meeting of the board of directors of NCB in 2005 and Capitol was provided with monthly reports of NCB’s financial performance. *Id.*

Specifically, Defendants knew but did not disclose that: (1) shareholders of NCB had provided Capitol and Reid with fairness evaluations that set forth in detail the reasons that NCB shares were worth approximately 33% more than the Exchange Offer price, FAC ¶¶ 49, 55-57, AR 774-776; (2) Capitol had paid directors and officers of NCB a higher price for equivalent shares than was offered to NCB shareholders, FAC ¶ 48, 773; (3) NCB management was projecting that NCB’s net income for 2006 would approximately \$1 million which

would be a 66% increase over 2005, FAC ¶¶ 32-33, AR 768-769; and (4) NCB was one of the best performing Capitol-affiliated banks at the time of the Exchange Offer. FAC ¶¶ 50, 54, AR 774-775.

Further, after the Exchange Offer was made and while it was pending, oral misrepresentations were made to NCB shareholders on Defendants' behalf which were intended to induce them to sell their shares. These oral misrepresentations were made by NCB directors and officers at Defendants' direction and included false statements such as the NCB shares would be "worthless" if not sold to Capitol. FAC ¶¶ 69-76, AR 778-780.

In June 2005, NCB shareholders received telephone calls from NCB directors and officers. During these calls, NCB officers and directors made oral misrepresentations as follows: (1) NCB shares would be worthless if not sold to Capitol, FAC ¶¶ 69-70, AR 778-779; (2) the NCB shareholders were required to sell their shares, FAC ¶ 77, AR 781; (3) the NCB shares would be illiquid if not sold, FAC ¶ 80, AR 781; (4) 98% of NCB shareholders were tendering their shares to Capitol, FAC ¶ 83, AR 782; and (5) all NCB board members had tendered their shares to Capitol, FAC ¶ 87, AR 783.

These statements were false and misleading because: (1) Capital knew that NCB's shares would be valuable after completion of the Exchange Offer since NCB's retained earnings had significantly increased, dividends would still be

payable, NCB shareholders would still possess valuable shareholder rights under the law including the right to receive performance information and persons other than Capital considered the shares to have value, FAC ¶¶ 71-76, AR 779-780; (2) NCB shareholders were under no legal obligation to tender their shares, FAC ¶¶ 78-79, AR 781; (3) an informal market existed for NCB shares as evidenced by a competing tender offer, FAC ¶¶ 81-82, AR 781-782; (4) only approximately 68% of NCB shareholders participated in the Exchange Offer, FAC ¶ 84, AR 782; and (5) a member of NCB's board of directors did not tender her shares to Capital because she was concerned about the decision-making process at NCB. FAC ¶ 88, AR 783.

In reliance on the statements made by Defendants, Plaintiffs and the class accepted Capitol's Exchange Offer and exchanged their NCB common stock for Capitol stock at the price stated in the offer. That price was materially below the fair value of the NCB shares. The class members made the decision to tender their shares in reliance upon the misrepresentations and omissions of material fact that were contained in the Registration Statement as well as the oral misrepresentations Defendants orchestrated. FAC ¶¶ 8, 15, 40, 95-97, 123-132, 142-144, AR 764-765, 770-771, 785, 790-792, 793-794.

## **VI. SUMMARY OF ARGUMENT**

The District Court erred in dismissing the FAC since it alleged with sufficient particularity violations of Section 11 of the 1933 Act and Sections 10(b) and 14(e) of the 1934 Act. With respect to the Section 11 violation, Defendants represented in the Registration Statement that the Exchange Offer was “fair” and constituted a “premium” but in making these representations failed to include qualifying information in the Registration Statement that would have been material to a reasonable investor. Defendants’ duty to include the material qualifying information in the Registration Statement arose by virtue of the specific representations in the Registration Statement as well as due to Defendants’ status as insiders and majority shareholder even assuming that the omissions were not tied to a specific statement in the Registration Statement. With respect to the Sections 10(b) and 14(e) violations, the Campaign of Deception was waged on Defendants’ behalf and at their direction. The oral misrepresentations and omissions were false and material and induced NCB shareholders to tender their shares. The District Court’s dismissal of plaintiffs’ claims must be reversed and the case remanded.

## **VII. ARGUMENT**

### **A. The FAC States A Claim Under Section 11 Of The 1933 Act Because Defendants’ Failed To Disclose Material Information In The Registration Statement.**

The federal securities laws are disclosure statutes designed to ensure

that decisions to purchase or sell stock are based on full and complete disclosure of all material facts. “[T]he disclosure required by the securities laws is measured not by literal truth, but by the ability of the material to accurately inform rather than mislead prospective buyers.” *McMahan & Co. v. Warehouse Entertainment, Inc.*, 900 F.2d 576, 579 (2d Cir. 1990); *Greenapple v. Detroit Edison Co.*, 618 F.2d 198, 205 (2d Cir. 1980) (“gloss” which is placed on information to distort the significance of material facts is actionable).

Here, Defendants had a duty to provide to NCB shareholders all material information in their possession in connection with the Exchange Offer. Instead, the Registration Statement omitted such facts in violation of Section 11 of the 1933 Act.

Defendants violated Section 11 of the 1933 Act, if the Registration Statement “contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading.” 15 U.S.C. § 77k(a). The elements of a Section 11 claim are straightforward: the Registration Statement: (1) must have contained an omission or misrepresentation; (2) the misleading statements must have been material; (3) Defendants must have been under a duty to disclose the omitted information; and (4) omitted information must have existed at the time the Registration Statement became effective. *Cooperman v. Industrial, Inc.*, 171 F.3d

43, 47 (9th Cir. 1996); *In Re Stac Elecs. Sec. Litig.*, 89 F.3d 1399, 1403-04 (9th Cir. 1996) (an omission or representation is material if “it would have misled a reasonable investor about the nature of his or her investment”). Section 11 “concerns matters that would have significance to the purchaser of securities in understanding what is being purchased.” *Monroe v. Hughes*, 31 F.3d 772, 775 (9th Cir. 1994).

The District Court held that Rule 9(b) applied to Plaintiffs’ Section 11 claim because it “sounded in fraud.” AR 822-823, citing *In Re Daou Systems, Inc.*, 411 F.3d 1006, 1027-28 (9th Cir. 2005). However, the District Court also held that section 11 claims do not require scienter and need not meet the heightened pleading requirements of the PSLRA applicable to 10(b) claims. AR 805. Thus, under Rule 9(b), Plaintiffs are required to set forth what was misleading about the Registration Statement and why it was misleading. *Yourish v. California Amplifier*, 191 F.3d 983, 992-93 (9th Cir. 1999). Nothing further is necessary.

Here the FAC meets the above standard since it alleges that the Registration Statement was materially misleading because Defendants failed to include information that would have materially qualified the statements in the Registration Statement and because the Registration Statement omitted information that Defendants were under a duty to disclose by virtue of their status as insiders and the majority shareholder of NCB.

First, the Registration Statement stated that the price for the shares was “fair” and constituted a “premium.” AR 774-775. These statements were based, in part, on the JMP Fairness Opinion attached to and incorporated by reference in the Registration Statement. AR 117, 137-138. The FAC alleged that Capitol knew that the JMP Fairness Opinion was untrustworthy and biased because JMP had previously prepared 30 fairness opinions for Capitol (or an affiliate of Capitol) and in 26 out of 30 instances had blessed Capitol’s offer by opining that the “fair” price for the shares was the same ratio being offered by Capitol to NCB shareholders even though each of the banks evaluated by JMP had different backgrounds and performance histories. FAC ¶¶ 52-54, AR 774-775.

Moreover, Defendants failed to disclose to NCB shareholders that JMP had opined one year before that shares equivalent to NCB shares were worth more than what Capitol was offering in the Exchange Offer. FAC ¶ 51, AR 774. These shares were purchased by Capitol after JMP issued a letter to the board of directors of NCB’s holding company which stated that Capitol’s higher offer for those shares was also “fair from a financial point of view.” FAC ¶¶ 43-44, AR 771-772. Just one year later, JMP reached the same conclusion with respect to Capitol’s lower offer for essentially the same shares. FAC ¶ 45, AR 772-773.

Capitol’s reliance on JMP to provide essentially the same fairness opinion regardless of the circumstances is clearly material. Defendants attached

the JMP Fairness Opinion to the Registration Statement to assure NCB shareholders that an objective and reliable analysis had been done which concluded that they were getting a fair price for their shares. By incorporating the JMP Fairness Opinion, Defendants were obligated to reveal the facts that the JMP Fairness Opinion was not objective (the longstanding relationship between JMP and Capitol) or reliable (the repeated conclusions of JMP that the exchange rates offered by Capitol in 26 out of 30 different transactions was “fair” even though the banks were dissimilar).

The Ninth Circuit has recognized that a duty of complete disclosure arises when an offeror represents that an offer is fair. The Ninth Circuit held in *Bell v. Cameron Meadows Land Co.*, 669 F.2d 1278, 1284 (9th Cir. 1982) that the federal securities laws require full disclosure of material facts and prohibit making material misstatements and omissions relating to fair value particularly where a fairness opinion is attached to the offer to create the belief that an independent third party has concluded that the offer is fair. *See also Brewer v. Lincoln Int’l Corp.*, 148 F.Supp.2d 792, 804 (W.D. Ky. 2000).

In *Bell*, defendant offered to buy all outstanding shares of Cameron Meadows Land Co., contingent on acceptance of the offer by at least 80% of the target company’s shareholders. *Id.* at 1280. The target company possessed only one significant asset, a tract of oil and gas producing property. *Id.* The tender

offer documents included a land appraisal (the “Perret Report”) that suggested that the value per share of the target company was well below the tender offer price. *Id.* at 1280. In a separate letter accompanying the tender offer, Mr. Arnold, the target company’s president, told the target company’s shareholders that he believed the offer was “extremely fair.” *Id.* at 1282.

Plaintiffs offered evidence that Mr. Arnold had expressly directed the appraiser to prepare a conservative (low) valuation. *Id.* at 1280. Plaintiffs also offered evidence that a separate evaluation concluded that the target company’s oil and gas revenues would be ten (10) times what was estimated in the appraisal sent to shareholders. *Id.*

The Ninth Circuit was clear: “With respect to the federal securities law claims. . . , numerous genuine issues of material fact remain to be resolved at trial. These include . . . “*whether the tender offer price was below fair market value.*” *Id.* at 1284 (emphasis added). The Court said further, “[c]onsidered in the light most favorable to plaintiffs, this evidence raises a genuine issue of material fact whether the Perret Report in the Tender Offer was materially misleading.” *Id.* at 1282.

The holding in *Cameron Meadows* is directly relevant to the issues raised in this appeal. Both involve a tender offer and a written tender offer document. Both offers were conditioned on receiving tenders from at least 80% of

the shareholders. In both cases, the written tender offer documents included an appraisal stating that the offered price was fair, yet the evidence and/or the allegations showed that the appraiser was not unbiased or independent. *Cameron Meadows* holds that where a written tender offer statement is materially misleading as to the fairness of the transaction, it is actionable under Section 10(b) and 14(e). The same logic compels the conclusion that materially misleading statements made in a tender offer document that is filed as a registration statement are also actionable under Section 11. District courts in other circuits have reached the same conclusion.<sup>2</sup>

The District Court held that the JMP Fairness Opinion was not actionable unless Plaintiffs alleged with particularity that it was wrong. Specifically, the District Court held that Plaintiffs must allege with particularity that the JMP Fairness Opinion was “both subjectively and objectively false.” AR 824, citing *Shurkin v. Golden State Ventures Inc.*, 2005 WL 192 6620 (N.D. Cal. 2005) (“A fairness opinion is objectively false if the subject matter of the opinion is not, in fact, fair, and is subjectively false if the speaker does not, in fact, believe the subject matter.”)

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<sup>2</sup> See, e.g., *Gerber v. Bowditch*, 2006 U.S. Dist. LEXIS 27552, \*3232 (D. Mass. 2006) (holding that allegations as to tender offeror’s misstatements as to value of the target company’s securities met the PSLRA and Rule 9(b)’s requirements for pleading material statements and omissions with particularity).

First, as discussed above, the FAC contained sufficient allegations that the JMP Fairness Opinion was both subjectively and objectively false due to JMP's lack of independence and the higher price opined by JMP just one year prior. FAC ¶¶ 43-45, 52-54, AR 771-775. The fact that Defendants attached the JMP Fairness Opinion and represented to NCB shareholders that the Exchange Offer was "fair" and constituted a "premium" based, in part, on the JMP Fairness Opinion, imposed on Defendants the duty to reveal information in Defendants' possession that would have materially qualified those representations including the nature of the relationship between JMP and Defendants. Defendants had the duty to include this omitted information, regardless of whether the JMP Fairness Opinion was ultimately accurate.

Defendants were required to include all necessary facts "to make the statements [in the Registration Statement] not misleading." 15 U.S.C. § 77k(a). "When a corporation does make a disclosure – whether it be voluntary or required – there is a duty to make it complete and accurate." *Roeder v. Alpha Industries, Inc.*, 814 F.2d 22, 26 (1st Cir. 1987); *In Re Prudential Securities Inc. Limited Partnership Litigation*, 930 F. Supp. 68, 72 (S.D.N.Y. 1996) (warning in prospectuses that residual value of defendant's aircraft could decline were

inadequate where defendant failed to disclose expert's opinion that residual value would decline drastically.).<sup>3</sup>

Moreover, Defendants' status as insiders and majority shareholder of NCB imposed an additional and independent duty to reveal the material information in their possession regarding the Exchange Offer. The Supreme Court established the rule that "a corporate insider must abstain from trading in shares of his corporation unless he has first disclosed all material inside information known to him." *Chiarella v. United States*, 445 U.S. 222, 230 (1980). *Chiarella's* "disclose or abstain" rule applies "[n]ot only to majority stockholders of corporations and corporate insiders, but equally to corporations themselves in acting through their officers, directors, or agents." *McCormick v. Fund America Co. Inc.*, 26 F.3d 869, 876 (9th Cir. 1994).

Here, Capitol withheld material information that was in its possession due to its status as an insider and majority shareholder regarding NCB's performance expectations. Capitol knew that NCB management was projecting that NCB's net income for 2006 would be approximately \$1 million which would be a 66% increase over 2005. Capitol used the information for its own benefit in

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<sup>3</sup> The District Court suggested that Plaintiffs must cite to a SEC rule or regulation requiring disclosure of the omitted facts. This is incorrect since once a defendant speaks on a material matter it has an obligation to speak fully and completely. *Roeder*, 814 F.2d at 22.

deciding to make an offer for NCB shares. However, Capitol omitted the information from the Registration Statement. FAC ¶¶ 31-33, AR 768-769. Considering the allegations of the FAC as whole, Plaintiffs have met their burden under Rule 9(b). Thus, the Registration Statement is alleged to have set forth materially false and misleading statements and a claim under Section 11 of the 1933 Act is stated.

**B. The FAC Adequately Pleads All Elements Of A Claim Under Sections 10(b) And 14(e) Of The 1934 Act**

The federal securities laws prohibit making oral misrepresentations by or on behalf of the purchaser in connection with the sale or purchase of shares. Section 10(b) prohibits the use of “any manipulative or deceptive device or contrivance” in connection with the sale or purchase of shares. Section 14(e) prohibits “any fraudulent, deceptive or manipulative acts or practices” in connection with a tender offer.

The District Court granted without leave to amend the motion to dismiss the Section 14(e) claim based, in part, on the assertion that oral misrepresentations which accompany a tender offer are not actionable. Specifically, the District Court held that claims based on Section 14(e) “must be based on misrepresentations contained in the tender documents themselves – not oral misrepresentations.” AR 833.

The District Court's interpretation of Section 14(e) was in error. Section 14(e) prohibits false or misleading statements "in connection with" a tender offer. There is no statutory requirement that the misrepresentation must arise from the four corners of the written tender offer. *Smallwood v. Pearl Brewing Company*, 489 F.2d 579, 596 (5th Cir. 1974) (Section 14(e) claim exists if plaintiff "has been injured by fraudulent activities of others perpetrated in connection with a tender offer..."). Indeed, misrepresentations have been held to be actionable which were made even before a formal request for a proxy has been issued. *Id.* at 600 ("[t]here are sound reasons for limiting the ability of interested parties to color the issue prior to the disclosure of complete information as required in a proxy statement"). *Lewis v. McGraw*, 619 F.2d 192, 195 (2d Cir. 1980) (representations made on the eve of a tender offer must be actionable, "[o]therwise, either party would be free to disseminate misinformation up to the effective date of the tender offer, thus defeating in substantial part the very purpose of the Act informed decision making by shareholders").

Pursuant to the PSLRA, falsity and scienter must be alleged with particularity to state a claim under Section 10(b). With respect to scienter, the allegations must contain "particular facts giving rise to a strong inference of deliberate recklessness." *In Re Silicon Graphics Inc. Sec. Lit.*, 183 F.3d 970, 974 (9th Cir. 1999).

With respect to Section 14(e), the Ninth Circuit has not ruled that scienter must be alleged to state a claim. Nevertheless, the District Court held that the standards to state a claim under Section 10(b) and 14(e) are “identical,” including the requirement that scienter be alleged with particularity. AR 830-831.

However, even assuming that scienter is a requirement for both the 10(b) and 14(e) claims, the allegations are sufficient to find a strong inference of scienter. NCB shareholders received telephone calls from NCB directors and officers in June 2005. During these calls, oral misrepresentations were made as follows: (1) the shares would be worthless if not sold to Capitol, FAC ¶¶ 69-70, AR 778-779; (2) the NCB shareholders were required to sell the shares, FAC ¶ 77, AR 781; (3) the NCB shares would be illiquid if not sold, FAC ¶ 80, AR 781; (4) 98% of NCB shareholders were tendering their shares to Capitol, FAC ¶ 83, AR 782; and (5) all NCB board members had tendered their shares to Capitol, FAC ¶ 87, AR 783. Each of these statements was false and misleading.

Each of the statements was false and misleading because: (1) Capitol knew that NCB’s shares would be valuable after completion of the Exchange Offer because NCB’s retained earnings had significantly increased, dividends would still be payable, NCB shareholders would still possess valuable shareholder rights under the law including the right to receive performance information and persons other than Capital considered the shares to have value, FAC ¶¶ 71-76, AR 779-

780; (2) NCB shareholders were under no legal obligation to tender their shares, FAC ¶¶ 78-79, AR 781; (3) an informal market existed for NCB shares as evidenced by a competing tender offer, FAC ¶¶ 81-82, AR 781-782; (4) only approximately 68% of NCB shareholders participated in the Exchange Offer, FAC ¶ 84, AR 782; and (5) a member of NCB's board of directors did not tender her shares to Capital because she was concerned about the decision-making process at NCB. FAC ¶ 88, AR 783.

Recognizing the strength of these allegations, the District Court stated that “[i]f plaintiffs were able to amend the complaint to tie the alleged misrepresentations to Capitol, they might be able to state a claim for which relief could be granted.” AR 833. In the FAC, Capitol and Reid were clearly tied to the Campaign of Deception. The FAC alleged that “at the request of Reid on behalf of Capitol, NCB's President and other members of NCB's management made a series of telephone calls to NCB shareholders while the tender offer was pending.” FAC ¶ 1, AR 762. Additionally, the FAC alleged that “[d]uring these telephone calls, misrepresentations were made to NCB shareholders to pressure the shareholders into selling their shares to Capitol.” *Id.* Further, the FAC alleged that Capitol and Reid together owned over 50% of NCB shares and that Capitol admitted that it held effective control over NCB at all relevant times. FAC ¶ 2, AR 762.

These allegations are sufficient to hold Defendants liable for the misrepresentations made on their behalf by NCB board members and officers. Although addressing 12(2) and 10b-5 claims, this Court's reasoning in *Warshaw v. Xoma Corp.*, 74 F.3d 955 (9th Cir. 1996) and *Cooper v. Pickett*, 137 F.3d 616 (9th Cir. 1997) applies to the facts here. In *Cooper*, this Court held that where the issuer of the subject securities used a third party stock analyst to convey the alleged false statements to the market, the issuer could be liable for those statements. In *Xoma*, this Court also upheld a claim where "[t]he Complaint asserts that Xoma intentionally used these third parties to disseminate false information to the investing public. Complaint ¶¶ 43-43C, 54. If this is true, Xoma cannot escape liability simply because it carried out its alleged fraud through the public statements of third parties." *Xoma*, 74 F.3d at 959. The securities laws preclude a seller from evading liability for misrepresentations made by others which were contemplated, authorized by and for the benefit the seller in connection with the sale of securities.

For example, cases under Section 10(b) have consistently held under several different theories that a seller can be held liable for urging others to make false statements to induce a tender of shares. These cases are applicable by analogy to Section 14(e) claims because of the similarity of purpose between Section 10(b) and Section 14(e). *Chris-Kraft Industries, Inc. v. Piper Aircraft*

*Corp.*, 480 F.2d 341, 362 (2d Cir. 1973) (“the underlying proscription of § 14(e) is virtually identical to that of Rule 10b-5. . . .”)

In *Simpson v. AOL Time Warner Inc.*, 452 F.3d 1040 (9th Cir. 2006), this Court held that liability can be imposed on any person who is engaged in a “scheme to defraud” whereby the defendant’s conduct had “the principal purpose and effect of creating a false appearance of fact in furtherance of the scheme.” *Id.* at 1048. In so doing, the Court rejected the notion that “one can be liable only for one’s statements . . . .” *Id.*

In *Lawton v. Nyman*, 62 F.Supp.2d 533 (D.R.I. 1999), the court noted that “[a] party may violate §10(b) even though that party, itself, did not directly commit the manipulative or deceptive act in question.” *Id.* at 536. Accordingly, the court held that “a party that causes or is responsible for the commission of manipulative or deceptive acts may not escape liability on the ground that those acts were performed through a proxy rather than by the party itself.” *Id.*

In *In re Cabletron Systems Inc.*, 311 F.3d 11 (1st Cir. 2002), the Court of Appeals held that an issuer can be responsible for an analyst’s statement “where company officials ‘intentionally foster a mistaken belief concerning a material fact.’” *Id.* at 38, quoting *Elkind v. Liggett & Myers Inc.*, 635 F.2d 156, 163-64 (2d Cir. 1980). The “entanglement” test encompasses situations where an analyst makes statements based on misinformation provided directly by the issuer. *Id.*

Simply put, the “entanglement” test is intended to prevent “a primary violator’s use of a third party as a mouthpiece to shield itself from liability.” *Quaak v. Dexia S.A.*, 445 F.Supp.2d 130, 146 (D.Mass. 2006).

The axiomatic principle that a seller cannot use proxies to commit securities fraud is evidenced by cases in other contexts as well. For example, in *Capri v. Murphy*, 856 F.2d 472 (2d Cir. 1988), the Court of Appeals held the defendants liable for a Section 12 violation because of the promotional activities at issue were done “at the behest” of the defendants and a third party “provided no information to the investors other than what was supplied by defendants,” “took no action in relation to the investors other than that which was contemplated and authorized by defendants.” *Id.* at 478.

#### **VIII. CONCLUSION**

For the reasons stated above, the Rule 54(b) judgment should be reversed and the claims against Defendants under Section 11 of the 1933 Act and Sections 10(b) and 14(e) of the 1934 Act should be reinstated.

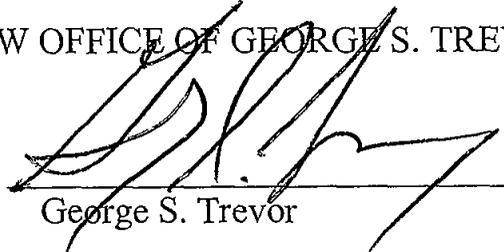
STATEMENT OF RELATED CASE

Appellant is not aware of any cases that should be deemed related to this case within the meaning of Ninth Circuit Rule 28-2.6.

DATED: May 4, 2007

LAW OFFICE OF GEORGE S. TREVOR

By:



George S. Trevor

FRIEDEMANN GOLDBERG, LLP

WEIXEL LAW OFFICE

*Attorneys for Plaintiffs-Appellants*

**CERTIFICATE OF COMPLIANCE**

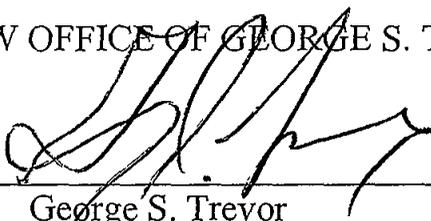
**Pursuant to Fed.R.App. 32(a)(7)(C) and Circuit Rule 32-1**

I, George S. Trevor, certify as follows:

1. This brief is not subject to the type-volume limitations of Fed. R. App. P. 32(a)(7)(B) because this brief complies with Fed. R. App. 32(a)(1)-(7) and is a principal brief of no more than 30 pages.

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and type style requirements of Fed. R. App. P. 32(a)(6) because it has been prepared in a proportionally spaced typeface using Microsoft Word 2002 in 14 point Times New Roman.

DATED: May 14, 2007      LAW OFFICE OF GEORGE S. TREVOR

By:   
George S. Trevor

FRIEDEMANN GOLDBERG, LLP

WEIXEL LAW OFFICE

*Attorneys for Plaintiffs-Appellants*

## ADDENDUM OF STATUTES, REGULATIONS, AND RULES

1. Securities Act of 1933, § 11(a) (15 U.S.C. § 77k(a))
2. Securities Exchange Act of 1934, § 10(b) (15 U.S.C. § 78j(b))
3. Securities Exchange Act of 1934, § 14(e) (15 U.S.C. § 78n(e))
4. SEC Rule 10b-5 (17 C.F.R. § 240.10b-5)
5. SEC Rule 14e-2 (17 C.F.R. § 240.14e-2)
6. Private Securities Litigation Reform Act of 1995, 15 U.S.C. 78u-4(b)
7. Rule 9(b), Federal Rules of Civil Procedure

**Securities Act of 1933, § 11(a) (15 U.S.C. § 77k(a))**

Section 77k. Civil liabilities on account of false registration statement

(a) Persons possessing cause of action; persons liable

In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may, either at law or in equity, in any court of competent jurisdiction, sue -

- (1) every person who signed the registration statement;
- (2) every person who was a director of (or person performing similar functions) or partner in the issuer at the time of the filing of the part of the registration statement with respect to which his liability is asserted;
- (3) every person who, with his consent, is named in the registration statement as being or about to become a director, person performing similar functions, or partner;
- (4) every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared or certified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration statement, with respect to the statement in such registration statement, report, or valuation, which purports to have been prepared or certified by him;
- (5) every underwriter with respect to such security.

If such person acquired the security after the issuer has made generally available to its security holders an earning statement covering a period of at least twelve months beginning after the effective date of the registration statement, then the right of recovery under this subsection shall be conditioned on proof that such person acquired the security relying upon such untrue statement in the registration statement or relying upon the registration statement and not knowing of such omission, but such reliance may be established without proof of the reading of the registration statement by such person.

**Securities Exchange Act of 1934, § 10(b) (15 U.S.C. § 78j(b))**

Section 78j. Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange -

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act), any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

**Securities Exchange Act of 1934, § 14(e) (15 U.S.C. § 78n(e))**

Section 78n. Proxies

(e) Untrue statement of material fact or omission of fact with respect to tender offer

It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation. The Commission shall, for the purposes of this subsection, by rules and regulations define, and prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive, or manipulative.

**SEC Rule 10b-5 (17 C.F.R. § 240.10b-5)**

Sec. 240.10b-5 Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

- (a) To employ any device, scheme, or artifice to defraud,
- (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
- (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person in connection with the purchase or sale of any security.

**SEC Rule 14e-2 (17 C.F.R. § 240.14e-2)**

Sec. 240.14e-2 Position of subject company with respect to a tender offer.

(a) Position of subject company. As a means reasonably designed to prevent fraudulent, deceptive or manipulative acts or practices within the meaning of section 14(e) of the Act, the subject company, no later than 10 business days from the date the tender offer is first published or sent or given, shall publish, send or give to security holders a statement disclosing that the subject company:

- (1) Recommends acceptance or rejection of the bidder's tender offer;
- (2) Expresses no opinion and is remaining neutral toward the bidder's tender offer; or
- (3) Is unable to take a position with respect to the bidder's tender offer. Such statement shall also include the reason(s) for the position (including the inability to take a position) disclosed therein.

(b) Material change. If any material change occurs in the disclosure required by paragraph (a) of this section, the subject company shall promptly publish or send or give a statement disclosing such material change to security holders.

**Private Securities Litigation Reform Act of 1995 (15 U.S.C. § 78u-4(b))**

Section 78u-4. Private securities litigation

(b) Requirements for securities fraud actions

(1) Misleading statements and omissions

In any private action arising under this chapter in which the plaintiff alleges that the defendant -

(A) made an untrue statement of a material fact; or

(B) omitted to state a material fact necessary in order to make the statements made, in the light of the circumstances in which they were made, not misleading;

the complaint shall specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed.

(2) Required state of mind

In any private action arising under this chapter in which the plaintiff may recover money damages only on proof that the defendant acted with a particular state of mind, the complaint shall, with respect to each act or omission alleged to violate this chapter, state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.

**Rule 9, Federal Rules of Civil Procedure**

Rule 9. Pleading Special Matters

(b) Fraud, Mistake, Condition of the Mind.

In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other condition of mind of a person may be averred generally.

**CERTIFICATE OF SERVICE**

I, George S. Trevor, declare as follows:

I am an attorney with the Law Offices of George S. Trevor. I am over the age of eighteen years and am not a party to this action. My business address is 300 Tamal Plaza, Suite 180, Corte Madera, California 94925.

On May 14, 2007, I served two copies of "**Brief of Appellant**" by placing true and correct copies of same, enclosed in sealed envelopes with first class postage prepaid, addressed as indicated below:

**Counsel for Defendants**

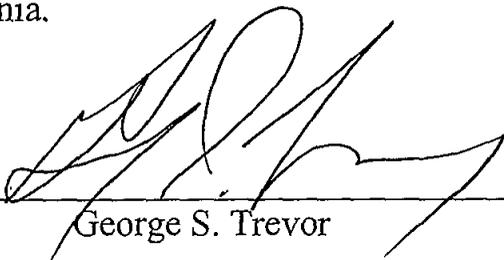
Bruce A. Ericson  
Andrew D. Lanphere  
Pillsbury Winthrop Shaw Pittman LLP  
50 Fremont Street  
P.O. Box 7880  
San Francisco, CA 94120-7880

**Counsel for Plaintiffs**

John F. Friedemann  
Kyle M. Fisher (Bar No. 127334)  
FRIEDEMANN GOLDBERG, LLP  
420 Aviation Boulevard, Suite 201  
Santa Rosa, CA 95403

James V. Weixel, Jr.  
**WEIXEL LAW OFFICE**  
2370 Market Street – No. 133  
San Francisco, CA 94114

I declare under penalty of perjury under the laws of the United States that the foregoing is true and correct, that the foregoing document was printed on recycled paper, and that this declaration of service was executed on the 14th day of May, 2007 at Corte Madera, California.



George S. Trevor