

No. 07-15083

---

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

---

ELLEN RUBKE, AS TRUSTEE OF THE 1986 RUBKE LIVING TRUST AND  
JACK FERGUSON, INDIVIDUALLY AND ON BEHALF OF ALL OTHER SIMILARLY  
SITUATED SHAREHOLDERS OF NAPA COMMUNITY BANK,

Plaintiffs-Appellants,

v.

CAPITOL BANCORP LIMITED AND JOSEPH D. REID,

Defendants-Appellees.

---

On Appeal from the United States District Court  
for the Northern District of California  
Honorable Phyllis J. Hamilton

---

**BRIEF OF APPELLEES**  
**CAPITOL BANCORP LIMITED and JOSEPH D. REID**

---

PILLSBURY WINTHROP SHAW PITTMAN LLP  
BRUCE A. ERICSON #76342  
KEVIN M. FONG #91037  
ANDREW D. LANPHERE #191479  
50 Fremont Street  
Post Office Box 7880  
San Francisco CA, 94120-7880  
Telephone: (415) 983-1000  
Facsimile: (415) 983-1200

Attorneys for Defendants-Appellees  
CAPITOL BANCORP LIMITED and JOSEPH D. REID

FILED

JUN 14 2007

CATHY A. CATTERSON, CLERK  
U.S. COURT OF APPEALS

## **CORPORATE DISCLOSURE STATEMENT**

Capitol Bancorp Limited is a publicly-traded Michigan corporation with its principal place of business in Michigan. No entity owns more than 10% of Capitol Bancorp Limited stock.

# TABLE OF CONTENTS

	Page
CORPORATE DISCLOSURE STATEMENT .....	1
INTRODUCTION.....	1
ISSUES PRESENTED FOR REVIEW .....	3
STATEMENT OF THE CASE.....	3
I. FACTUAL BACKGROUND.....	3
A. The parties. ....	3
B. Capitol’s business model and the founding of NCB.....	4
C. Capitol’s Exchange Offer to NCB shareholders. ....	5
II. PROCEDURAL BACKGROUND. ....	8
A. The allegations of the Original Complaint.....	8
B. The district court’s order dismissing the Original Complaint.....	9
C. The First Amended Complaint. ....	10
D. The district court’s order dismissing the First Amended Complaint. ....	11
STANDARD OF REVIEW .....	12
ARGUMENT .....	13
I. PLAINTIFFS HAVE WAIVED ANY ARGUMENTS ABOUT THEIR CLAIMS UNDER SECTIONS 12 AND 15 OF THE ’33 ACT AND SECTION 20(A) OF THE ’34 ACT.....	13
II. PLAINTIFFS HAVE FAILED TO ALLEGE FACTS SUFFICIENT TO STATE A CLAIM UNDER SECTION 11 OF THE ’33 ACT.....	13
A. Plaintiffs’ allegations about the JMP fairness opinion fail to state a section 11 claim.....	15

1.	To state a securities claim based on a fairness opinion, Plaintiffs must allege facts showing that the opinion was both objectively and subjectively false.....	15
2.	Plaintiffs have not alleged facts showing that the JMP fairness opinion was objectively or subjectively false.....	17
B.	Plaintiffs' other allegations do not state a section 11 claim.....	23
C.	Moreover, Plaintiffs have failed to allege section 11 damages.....	25
III.	PLAINTIFFS HAVE FAILED TO ALLEGE FACTS SUFFICIENT TO STATE A CLAIM UNDER SECTION 10(B) OR SECTION 14(E). .....	25
A.	Plaintiffs' claims under section 10(b) and 14(e) are governed by the PSLRA, which requires Plaintiffs to plead falsity and scienter with particularity.....	26
B.	Plaintiffs' allegations of oral misrepresentations by nonparties fail to satisfy the falsity and scienter requirements of the PSLRA.....	28
1.	Plaintiffs have not alleged facts with particularity showing that the alleged oral misrepresentations of a nonparty were made at Defendants' direction. ....	28
2.	The alleged oral misrepresentations of a nonparty were not made to or relied upon by Plaintiffs or other class members. ....	31
3.	The alleged oral misrepresentations of a nonparty do not create a strong inference of actual knowledge of fraud or deliberate recklessness by Defendants. ....	32
	CONCLUSION .....	37
	STATEMENT OF RELATED CASES .....	38
	CERTIFICATE OF COMPLIANCE PURSUANT TO FED. R. APP. P. 32(A)(7)(C) AND CIRCUIT RULE 32-1 FOR CASE NO. 07-15083 .....	39
	ADDENDUM OF STATUTES, REGULATIONS AND RULES.....	40

## TABLE OF AUTHORITIES

Page

### Cases

Adams v. Standard Knitting Mills, Inc., 623 F.2d 422 (6th Cir. 1980) .....	26
Balistreri v. Pacifica Police Dep't, 901 F.2d 696 (9th Cir. 1988) .....	12
Bell Atlantic Corp. v. Twombly, ___ U.S. ___, 127 S. Ct. 1955 (2007).....	12, 31
Bell v. Cameron Meadows Land Co., 669 F.2d 1278 (9th Cir. 1987) .....	16
Bloom v. Martin, 865 F. Supp. 1377 (N.D. Cal. 1994).....	12
Bond Opportunity Fund v. Unilab Corp., No. 99 Civ. 11074 (JSM), 2003 WL 21058251 (S.D.N.Y. May 9, 2003), aff'd, 87 Fed. Appx. 772 (2d Cir. 2004).....	15, 16, 18
Chiarella v. United States, 445 U.S. 222 (1980).....	24
Clearfield Bank & Trust Co. v. Omega Financial Corp., 65 F. Supp. 2d 325 (W.D. Pa. 1999).....	26
Conley v. Gibson, 355 U.S. 41 (1957).....	12
Conn Nat'l Bank v. Fluor Corp., 808 F.2d 957 (2d Cir. 1987) .....	26
Cooper v. Pickett, 137 F.3d 616 (9th Cir. 1997) .....	30
Dura Pharmaceuticals, Inc. v. Broudo, 544 U.S. 336 (2005).....	25

Freedman v. Value Health, Inc., 958 F. Supp. 745 (D. Conn. 1997).....	15, 16
Gerber v. Bowditch, 05-cv-10782-DPW, 2006 WL 1284232 (D. Mass. May 8, 2006).....	16
In re Cabletron Systems, Inc., 311 F.3d 11 (1st Cir. 2002).....	30
In re Daou Systems, Inc., 411 F.3d 1006 (9th Cir. 2005) .....	14, 30
In re Digital Island Sec. Litig., 357 F.3d 322 (3d Cir. 2004) .....	26
In re McKesson HBOC Sec. Litig., 126 F. Supp. 2d 1248 (N.D. Cal. 2000).....	15, 16, 19
In re Merrill Lynch & Co., Inc. Research Reports Sec. Litig., 272 F. Supp. 2d 243 (S.D.N.Y. 2003) .....	21
In re Sagent Tech. Inc. Derivative Litig., 278 F. Supp. 2d 1079 (N.D. Cal. 2003).....	12
In re Silicon Graphics Inc. Sec. Litig., 183 F.3d 970 (9th Cir. 1999) .....	27, 30
In re Stac Electronics Sec. Litig., 89 F.3d 1399 (9th Cir. 1996) .....	14
In re Vantive Corp. Sec. Litig., 283 F.3d 1079 (9th Cir. 2002). .....	27, 28
In re VeriFone Sec. Litig., 11 F.3d 865 (9th Cir. 1993) .....	12
Independent Towers of Washington v. Washington, 350 F.3d 925 (9th Cir. 2003) .....	13
Kapps v. Torch Offshore, Inc., 379 F.3d 207 (5th Cir. 2004) .....	22

Krim v. BancTexas Group, Inc., 989 F.2d 1435 (5th Cir. 1993) .....	36
Lawton v. Nyman, 62 F. Supp. 2d 533 (D.R.I. 1999) .....	31
Lewis v. McGraw, 619 F.2d 192 (2d Cir. 1980) .....	26
McCormick v. Fund America Co. Inc., 26 F.3d 869 (9th Cir. 1994) .....	24
McMahan & Co. v. Wherehouse Entertainment, Inc., 65 F.3d 1044 (2d Cir. 1995) .....	25
Metz v. United Counties Bancorp, 61 F. Supp. 2d 364 (D.N.J. 1999) .....	25
Polar Int'l Brokerage Corp. v. Reeve, 108 F. Supp. 2d 225 (S.D.N.Y. 2000) .....	26
Ronconi v. Larkin, 253 F.3d 423 (9th Cir. 2001) .....	28
Rubke v. Capitol Bankcorp Ltd., 460 F. Supp. 2d 1124 (N.D. Cal. 2006) .....	11
Schreiber v. Burlington Northern, Inc., 472 U.S. 1 (1985) .....	26
Shurkin v. Golden State Vintner, Inc., 471 F. Supp. 2d 998 (N.D. Cal. 2006) .....	15
Simpson v. AOL Time Warner, Inc., 452 F.3d 1040 (9th Cir. 2006) .....	30
Smallwood v. Pearl Brewing Co., 489 F.2d 579 (5th Cir. 1974) .....	26
Steckman v. Hart Brewing, Inc., 143 F.3d 1293 (9th Cir. 1998) .....	13, 23

Virginia Bankshares v. Sandberg, 501 U.S. 1083 (1991).....	18
Warshaw v. Xoma Corp., 74 F.3d 955 (9th Cir. 1996) .....	30
Wielgos v. Commonwealth Edison Co., 892 F.2d 509 (7th Cir. 1989) .....	36
Wool v. Tandem Computers, Inc., 818 F.2d 1433 (9th Cir. 1987) .....	30

### **Statutes and Codes**

<b>California Corporations Code</b>	
Section 1110.....	35
Section 1300(a).....	35
Section 25401.....	9
Private Securities Litigation Reform Act of 1995 .....	passim
<b>Securities Exchange Act of 1933</b>	
Section 11.....	passim
Section 12.....	10, 11, 13
Section 15.....	9, 10, 11, 13
<b>Securities Exchange Act of 1934</b>	
Section 10(b).....	passim
Section 14(e).....	passim
Section 20(a).....	9, 10, 11, 13
<b>United States Code</b>	
Title 15, section 77k.....	13
Title 15, section 77k(e) .....	25
Title 15, section 78u-4(b)(1).....	27
Title 15, section 78u-4(b)(2).....	27

### **Rules and Regulations**

<b>Code of Federal Regulations</b>	
Title 17, section 230.175.....	36
Title 17, section 240.10b-5 .....	25

Federal Rules of Civil Procedure

Rule 9(b) ..... passim

Rules of the Securities and Exchange Commission

Rule 10b-5..... 25

## INTRODUCTION

This is an appeal from the dismissal of a securities class action against Capitol Bancorp Limited (“Capitol”) and its CEO and Chairman Joseph D. Reid (“Reid”). In 2001, Capitol offered investors in the Napa area the chance to invest in a new community bank called Napa Community Bank (“NCB”). Capitol said that it would own 51% of the bank; that any other investors would permanently be in the minority; that NCB’s stock would not trade publicly; and that Capitol would provide NCB with certain back-office services at prices that might not be the lowest. Capitol also suggested—not promised—that three years later it might offer to buy out the minority investors at 150% of NCB’s book value.

Plaintiffs invested in NCB. In 2005, Capitol made an “Exchange Offer” to buy out the minority shareholders for 150% of NCB’s book value (158% of the stock’s original price). Capitol cautioned that this offer price was “arbitrary.” The Exchange Offer was accompanied by two fairness opinions provided to Capitol; each said the Exchange Offer was “fair from a financial point of view.” Capitol cautioned the minority shareholders that it had paid for the fairness opinions, which had been rendered by its “financial advisor[s] and agent[s],” and that the opinions did *not* represent an appraisal of the market value of NCB’s stock or a recommendation that the minority shareholders should exchange their shares.

Some minority shareholders accepted the offer; some refused. Plaintiffs

accepted the offer and got Capitol's publicly-traded stock in return for their unlisted NCB stock. After Plaintiffs accepted the offer, Capitol's stock rose more some more—on top of the 58% they had made on their original investment.

Plaintiffs nonetheless filed suit on behalf of a putative class consisting of those NCB shareholders who accepted the Exchange Offer, alleging that the Exchange Offer was false and fraudulent. The district court dismissed Plaintiffs' initial Complaint and their First Amended Complaint ("FAC"), holding that Plaintiffs had not alleged facts stating a claim for relief under the Securities Act of 1933 (the "'33 Act") or the Securities Exchange Act of 1934 (the "'34 Act").

The district court properly dismissed Plaintiffs' claim under section 11 of the '33 Act. Plaintiffs failed to state a section 11 claim because (1) the First Amended Complaint failed to allege the existence of an actionable, material misrepresentation or omission with the particularity required by Rule 9(b) of the Federal Rules of Civil Procedure ("Rule 9(b)"), and (2) Plaintiffs failed to allege any damages cognizable under section 11. The district court also properly dismissed Plaintiffs' claims under sections 10(b) and 14(e) of the '34 Act because Plaintiffs failed to allege facts that satisfy the falsity and scienter requirements of the Private Securities Litigation Reform Act of 1995 ("PSLRA"). The district court offered Plaintiffs a further opportunity to amend as to certain claims, but Plaintiffs declined.

The district court's dismissal of the FAC should be affirmed.

### **ISSUES PRESENTED FOR REVIEW**

1. Whether the district court properly granted Defendants' motion to dismiss the First Amended Complaint for failure to state a claim.
2. Whether the district court properly found that the First Amended Complaint failed to allege an actionable material misstatement or omission under section 11 of the '33 Act with the particularity required by Rule 9(b).
3. Whether Plaintiffs' section 11 claim should be dismissed because of Plaintiffs' failure to allege damages.
4. Whether the district court properly found that the First Amended Complaint failed to allege claims under sections 10(b) and 14(e) of the '34 Act with the specificity required by the PSLRA.

### **STATEMENT OF THE CASE**

#### **I. FACTUAL BACKGROUND.**

##### **A. The parties.**

Defendant Capitol is a bank holding company headquartered in Lansing, Michigan. Appellants' Excerpt of Record ("ER") 765 (FAC ¶ 16). From 2001 until the Exchange Offer, it indirectly owned approximately 48% of NCB's stock. ER 762 (FAC ¶ 2), 350. Defendant Reid resides in Michigan and is the founder, Chief Executive Officer and Chairman of the Board of Directors of Capitol. ER

765 (FAC ¶ 17).

Plaintiffs Ellen Rubke and Jack Ferguson (collectively, "Plaintiffs") allege that they exchanged their shares in NCB for Capitol stock pursuant to an "Exchange Offer" that Capitol made to shareholders of NCB in June 2005. ER 765 (FAC ¶¶ 13-15). Plaintiffs purport to represent a class of approximately 340 NCB shareholders who likewise exchanged NCB stock for Capitol stock pursuant to the Exchange Offer. *Id.* (FAC ¶ 18).

**B. Capitol's business model and the founding of NCB.**

Capitol's business is founding and controlling small community banks. As of 2005, Capitol had founded 34 community banks, including NCB. ER 329.

Capitol follows a consistent business model: It works with local people to form and staff the new bank. It tells would-be investors that it may offer to buy them out at the new bank's third anniversary for 150% of the bank's book value. Capitol does not promise to do this, but it typically does make such an offer. ER 49. Capitol tells investors that it provides administrative and back-office services to the new bank at costs that might not be the lowest; that Capitol will always have effective control of the new bank; and that there likely will be no public market for their stock in the bank. *Id.*

Following this model, in November 2001 NCB offered its common stock to investors through a private placement (the "Offering Circular"), making all the

disclosures discussed above. ER 46-72. An indirect, not wholly-owned subsidiary of Capitol (First California Northern Bancorp (“First California Northern”)) purchased 51% of NCB’s common stock; other investors purchased, in the aggregate, the remaining 49%. ER 771 (FAC ¶ 42).

At the time of the 2001 NCB offering, Capitol owned 51% of First California Northern. ER 520. In 2004, Capitol purchased the remaining 49% of First California Northern through a share exchange. ER 518-731 (Form S-4 and Form 424b3 Prospectus filed with the Securities and Exchange Commission (“SEC”)). In this share exchange Capitol paid 167% of the book value of the First California Northern shares. ER 520 (offer of \$15.00, book value of \$9.04). As First California Northern had initially sold its stock at \$10 a share (ER 707), this represented a return of 150% on the original investment.

NCB opened for business in March 2002. ER 311. Three years went by and then Capitol made the Exchange Offer, just as it had said it might do.

**C. Capitol’s Exchange Offer to NCB shareholders.**

In April 2005, Capitol filed a registration statement with the SEC for the Exchange Offer, and in May 2005 Capitol filed an amended registration statement. ER 74-187, 189-301. On June 2, 2005, the effective date of the Exchange Offer, Capitol sent NCB shareholders the Exchange Offer itself. ER 303-365. In accordance with Capitol’s usual practice, the Exchange Offer was made at a price

of 150% of NCB's book value per share. At the time, NCB's book value was roughly \$10.54 a share, so the offering price was \$15.82 a share, to be paid in shares of Capitol common stock. ER 336. NCB stock had originally been sold at \$10 a share (ER 46); this represented a return of 158% on the original investment.

The Exchange Offer noted the "**Inherent Conflicts of Interest in the Exchange Offer.**" ER 322 (emphasis original). It said:

Capitol's proposal to value NCB shares at \$15.817461 in the exchange offer is based solely on its judgment in making such proposal. Accordingly, the NCB share value and related exchange ratio have not been determined absent the inherent conflicts of interest between Capitol and NCB. It is unknown what exchange ratio or NCB share value, if any, that might be negotiated between NCB and unaffiliated entities.

ER 322.

The Exchange Offer included two financial fairness opinions, one by JMP Financial, Inc. ("JMP") and the other by Howe Barnes Investments, Inc. ("Howe"). ER 256-65, 346-51. Capitol disclosed that it had hired each firm as its "financial advisor and agent". ER 199, 312. Capitol said that the JMP opinion:

is directed to Capitol and addresses only the fairness from a financial point of view of the consideration received pursuant to the exchange offer as of the date of the opinion. It does not address any other aspect of the exchange offer and goes not constitute a recommendation that any holder of NCB common stock as to whether or not to exchange their shares pursuant to the exchange offer.

ER 346. Capitol also disclosed that it had paid each firm for its opinion—and how much it had paid. ER 236, 349 (JMP was paid \$9,000 plus expenses), 238, 351 (Howe Barnes was paid \$30,000 plus expenses).

In their opinions, JMP and Howe both concluded that the Exchange Offer was “fair from a financial point of view.” ER 256-65. They did so after considering multiple factors—including liquidity issues, the fact that the transaction more closely resembled the sale of a minority block of stock than a change of control, the lack of any acquisition premium, and the price-to-book-value and price-to-earnings ratios of Capitol and NCB relative to other banks. ER 256-65, 346-51.

The Exchange Offer began on June 2, 2005. ER 304. Thereafter, a self-styled Minority Shareholders Committee comprised of several minority shareholders of NCB common stock (the “Minority Committee”) began a publicity campaign against the Exchange Offer. ER 371, 375-88. The publicity campaign resulted in articles in local business newspapers summarizing the Minority Committee’s contentions. ER 369, 373, 508-10. The Minority Committee hired two banks, which produced opinions stating that “the fair market value of NCB shares was at least \$21 per share.” ER 775 (FAC ¶ 55). This too received publicity. ER 373, 508-510. On June 18, the Minority Committee held a public meeting for shareholders at which it made an extensive presentation, including a

slideshow, critiquing the Exchange Offer. ER 375-82. On June 24, it sent a letter to NCB's minority shareholders criticizing the Exchange Offer's price as too low and making an offer to purchase up to 6.4% of the outstanding shares of NCB's stock—not however at the \$21 a share they said was “fair” but at \$17.50 a share. ER 384-88. On June 27, members of the Minority Committee filed a lawsuit criticizing the Exchange Offer price as too low and attempting (unsuccessfully) to block the Exchange Offer. ER 390-402. The lawsuit attached as exhibits the opinions obtained by the Minority Committee. ER 404-57.

The Exchange Offer closed on June 30, 2005, after which Capitol owned roughly 87% of NCB. ER 304, 471. On June 30, 2005, Capitol's stock closed at \$33.61. ER 502. By November 23, 2005, when Plaintiffs filed this action, Capitol's stock had risen to \$37.05. ER 504.

## II. **PROCEDURAL BACKGROUND.**

### A. **The allegations of the Original Complaint.**

Plaintiffs filed their Original Complaint (“Orig. Compl.”) on November 23, 2005. ER 8. The Original Complaint alleged that Capitol, via the Exchange Offer, purchased NCB stock at a price below fair market value and misled NCB shareholders by: failing to disclose the “true value” of NCB stock; failing to criticize the independence and accuracy of the fairness opinions included with the Exchange Offer; failing to disclose enough about the nature and price of the

administrative services that Capitol provides to NCB; and failing to disclose that Defendants “colluded” with members of the NCB board of directors. ER 9, 16-19 (Orig. Compl. ¶¶ 2, 29-37). Plaintiffs alleged claims under sections 11 and 15 of the '33 Act, sections 10(b), 14(e) and 20(a) of the '34 Act, section 25401 of the California Corporations Code and the common law (breach of fiduciary duty and abuse of control). ER 19-27.

**B. The district court’s order dismissing the Original Complaint.**

Defendants moved to dismiss the Original Complaint. On June 16, 2006, the district court granted Defendants’ motion with leave to amend. ER 732-59. The district court held that, because the Original Complaint “sounds in fraud,” Plaintiffs’ section 11 claim was subject to the heightened pleadings standards of Rule 9(b). ER 748-49. The district court dismissed Plaintiffs’ section 11 claim for failing to plead material misstatements and omissions with the particularity required by Rule 9(b). ER 750-51, 759. In dismissing Plaintiffs’ claims under sections 10(b) and 14(e) of the '34 Act, the district court found that the PSLRA’s heightened pleading standards applied, and that Plaintiffs had failed to allege falsity and scienter with particularity. ER 757-58. The district court dismissed Plaintiffs’ control person claims without prejudice because Plaintiffs failed to state a claim for primary liability and Plaintiffs’ state law claims with prejudice because they were preempted by SLUSA (a point Plaintiffs conceded). ER 759.

### **C. The First Amended Complaint.**

Plaintiffs filed the First Amended Complaint on July 31, 2006. The First Amended Complaint purported to state claims for violation of sections 11, 12 and 15 of the '33 Act and sections 10(b), 14(e) and 20(a) of the '34 Act. ER 761-95.

The First Amended Complaint reiterated some of the factual allegations of the Original Complaint, including that the Exchange Offer was misleading because Defendants allegedly failed to disclose the Minority Committee's fairness opinion (ER 775-76 (FAC ¶¶ 54-57)) and the First California Northern fairness opinion (ER 771-73 (FAC ¶¶ 42-48)). The First Amended Complaint also alleged several new misrepresentations or omissions: that Capitol's statement that it believed "that NCB's profitability would increase" was not a positive enough projection and therefore was misleading (ER 768-69 (FAC ¶¶ 30-33)); that Defendants' references to a "plan" to do the Exchange Offer allegedly misled NCB shareholders into believing they had a "moral or legal" obligation to sell their shares (ER 769-71 (FAC ¶¶ 34-41)); that the NCB shareholders were misled into believing they were being paid a premium to the fair value of their NCB stock (ER 777-78 (FAC ¶¶ 60-67)); and that a nonparty, NCB's President, made telephonic misrepresentations to certain shareholders (albeit not to Plaintiffs themselves) between June 15 and June 24, 2005 (ER 778-84 (FAC ¶¶ 68-90)). On appeal, Plaintiffs label these alleged telephone calls the "Campaign of Deception."

**D. The district court's order dismissing the First Amended Complaint.**

Defendants moved to dismiss the First Amended Complaint. The district court granted the motion on October 27, 2006. ER 796-834; *Rubke v. Capitol Bancorp Ltd.*, 460 F. Supp. 2d 1124 (N.D. Cal. 2006). With respect to Plaintiffs' '33 Act claims (sections 11 and 12), the district court held that Plaintiffs failed to allege specific facts demonstrating the falsity of the alleged misrepresentations and omissions in the registration statement. ER 823-26. With respect to Plaintiffs' '34 Act claims (sections 10(b) and 14(e)), the district court held that Plaintiffs had failed to plead falsity and scienter with the specificity required by the PSLRA. ER 830-32. Finally, the district court held that Plaintiffs' control person claims (section 15 of the '33 Act and section 20(a) of the '34 Act) failed because of Plaintiffs' failure to allege a claim for primary liability. ER 832.

The district court dismissed Plaintiffs' section 11, section 14(e), section 15 and section 20(a) claims with prejudice. ER 834. The district court dismissed Plaintiffs' section 12 and section 10(b) claims *without* prejudice and gave Plaintiffs leave to amend their complaint to add allegations regarding the so-called "Campaign of Deception." ER 833. 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." *Id.*

Plaintiffs elected not to "tie the alleged misrepresentations to Capitol."

Instead, Plaintiffs filed a Notice of Intention Not to File an Amended Complaint. ER 835. The district court entered judgment on December 13, 2006. ER 835-36. Plaintiffs filed a notice of appeal on January 10, 2007. ER 837.

### STANDARD OF REVIEW

This Court reviews the district court's dismissal *de novo*. *In re VeriFone Sec. Litig.*, 11 F.3d 865, 868 (9th Cir. 1993). A motion to dismiss should be granted when "it is clear from the face of the complaint and judicially-noticed documents that [plaintiffs] cannot prevail as a matter of law." *Bloom v. Martin*, 865 F. Supp. 1377, 1381 (N.D. Cal. 1994), *aff'd*, 77 F.3d 318 (9th Cir. 1996). Dismissal is warranted if the complaint fails to assert a cognizable legal theory, or if it fails to allege sufficient facts under a cognizable legal theory. *Balistreri v. Pacifica Police Dep't*, 901 F.2d 696, 699 (9th Cir. 1988). For purposes of the motion, the Court is obligated to accept only well-pled facts as true: "[c]onclusory allegations of law and unwarranted inferences are insufficient to defeat a motion to dismiss . . . ." *In re VeriFone Sec. Litig.*, 11 F.3d at 868; *In re Sagent Tech. Inc. Derivative Litig.*, 278 F. Supp. 2d 1079, 1085 (N.D. Cal. 2003); *see also Bell Atlantic Corp. v. Twombly*, \_\_\_ U.S. \_\_\_, 127 S. Ct. 1955, 1965 (2007). No longer should a complaint survive on speculation that discovery might turn up something that the complaint lacks. *Twombly*, 127 S. Ct. at 1968-69 (overruling the "no set of facts" language of *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957)). Likewise,

allegations contradicted by documents referenced in the pleadings or judicially noticed information may be disregarded by the Court. *Steckman v. Hart Brewing, Inc.*, 143 F.3d 1293, 1295-96 (9th Cir. 1998).

## ARGUMENT

### I. **PLAINTIFFS HAVE WAIVED ANY ARGUMENTS ABOUT THEIR CLAIMS UNDER SECTIONS 12 AND 15 OF THE '33 ACT AND SECTION 20(A) OF THE '34 ACT.**

On appeal, Plaintiffs contest only the dismissal of their claims under section 11 of the '33 Act and sections 10(b) and 14(e) of the '34 Act. *See* Appellants Brief at 2-3 (Issues for Review), 13-28 (Summary of Argument and Argument). Plaintiffs make no arguments concerning the dismissal of their claims under section 12 and 15 of the '33 Act and section 20(a) of the '34 Act and, as a result, have waived them. *Independent Towers of Washington v. Washington*, 350 F.3d 925, 929 (9th Cir. 2003) (“Our circuit has repeatedly admonished that we cannot manufacture arguments for an appellant and therefore we will not consider any claims that were not actually argued in appellant’s opening brief” (internal quotations and citation omitted)).

### II. **PLAINTIFFS HAVE FAILED TO ALLEGE FACTS SUFFICIENT TO STATE A CLAIM UNDER SECTION 11 OF THE '33 ACT.**

To state a claim under Section 11 of the '33 Act (15 U.S.C. § 77k), the First Amended Complaint must establish that Capitol issued a registration statement

containing a material misstatement or omission. *In re Daou Systems, Inc.*, 411 F.3d 1006, 1027 (9th Cir. 2005). By “material,” courts mean something that “would have misled a reasonable investor about the nature of his or her investment.” *In re Stac Electronics Sec. Litig.*, 89 F.3d 1399, 1403-04 (9th Cir. 1996).

Although fraud is not an essential element of a section 11 claim, a Section 11 claim is governed by Rule 9(b) if it “sounds in fraud.” *Stac*, 89 F.3d at 1404-05. Plaintiffs do not dispute that the First Amended Complaint sounds in fraud and that Rule 9(b) governs their Section 11 claim. Because Rule 9(b) applies, Plaintiffs must state with particularity the circumstances constituting the alleged fraud giving rise to their Section 11 claim, such as the time, date, place and content of the alleged fraudulent representation, and how and why the representation was false or misleading. *Stac*, 89 F.3d at 1404-05.

On appeal, Plaintiffs focus on the First Amended Complaint’s allegations (1) that the JMP fairness opinion was false and misleading (ER 771-77 (FAC ¶¶ 42-60)); (2) that the NCB shareholders were misled into believing they were receiving a “premium to fair value” (ER 777-78 (FAC ¶¶ 61-67)); and (3) that Capitol failed to disclose information regarding NCB’s annual income projections (ER 768-69 (FAC ¶¶ 30-33)). None states a claim.

**A. Plaintiffs' allegations about the JMP fairness opinion fail to state a section 11 claim.**

- 1. To state a securities claim based on a fairness opinion, Plaintiffs must allege facts showing that the opinion was both objectively and subjectively false.**

The district court held that, to base a securities claim on fairness opinions included in the Exchange Offer, Plaintiffs would have to allege facts showing that the fairness opinions were *both* objectively and subjectively false. ER 824.

Although this Court has not yet addressed the proper pleading standard for stating a claim based on a fairness opinion, the standard articulated by the district court has been consistently followed by district courts in this and other circuits. *See Shurkin v. Golden State Vintner, Inc.*, 471 F. Supp. 2d 998, 1013 (N.D. Cal. 2006); *In re McKesson HBOC Sec. Litig.*, 126 F. Supp. 2d 1248, 1265 (N.D. Cal. 2000); *Bond Opportunity Fund v. Unilab Corp.*, No. 99 Civ. 11074 (JSM), 2003 WL 21058251, \*5 (S.D.N.Y. May 9, 2003), *aff'd*, 87 Fed. Appx. 772 (2d Cir. 2004); *Freedman v. Value Health, Inc.*, 958 F. Supp. 745, 752 (D. Conn. 1997). As the court in *Shurkin* explained,

A representation in a proxy statement that a proposed plan of action is fair, from a financial point of view, to the shareholders is a statement of opinion. To plead the falsity of a statement of opinion, a plaintiff must plead with particularity why the statement of opinion was objectively and subjectively false. 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 of the opinion to be fair.

471 F. Supp. 2d at 1013 (internal quotations and citations omitted); *see also In re McKesson HBOC Sec. Litig.*, 126 F. Supp. 2d at 1265; *Bond Opportunity Fund*, 2003 WL 21058251, at \*5; *Freedman*, 958 F. Supp. at 752. Thus, to state a claim based on the JMP fairness opinion, Plaintiffs must allege particularized facts demonstrating that the offer price was *objectively* not fair (from a financial point of view) and that Defendants *subjectively* believed the offer price was not fair.

Plaintiffs' reliance on *Bell v. Cameron Meadows Land Co.*, 669 F.2d 1278 (9th Cir. 1987) (Appellants' Brief at 17-18) is misplaced. *Bell* concerned a summary judgment; it did not address or purport to establish the standards for pleading a Section 11 claim in compliance with Rule 9(b). *Bell* is also easily distinguished on its facts. The tender offer at issue in *Bell* contained an appraisal which suggested the "fair market value" of the shares at issue was substantially below the tender offer price. *See id.* at 1281; ER 823-24. Here, by contrast, Plaintiffs have not alleged that the JMP opinion said anything about the "fair market value" of the NCB shares. Indeed, the Exchange Offer stated that the offer price was entirely arbitrary and did *not* reflect the arms'-length fair market value of NCB's shares. ER 322, 346.

The same is true of the other case cited by Plaintiffs, *Gerber v. Bowditch*, 05-cv-10782-DPW, 2006 WL 1284232 (D. Mass. May 8, 2006), which involved a

tender offer for shares in a real estate partnership. In *Gerber*, the defendants did not provide an opinion regarding the fairness of a tender offer from a financial point of view. Rather, their tender offer portrayed a “dismal future” for the partnership, “invite[d] an inference that the Partnership had little to no prospects for increased income” and suggested the partnership’s assets were worth only \$7 million. *Id.* at \*7-\*10. The defendants said these things while in the midst of undisclosed transactions that soon increased income by 45% and showed the partnership’s assets to be worth not \$7 million but \$15 million. *Id.* at \*3-\*4. On facts much stronger than those alleged here, the court said that the *Gerber* complaint “narrowly clears the pleadings hurdle.” *Id.* at \*13. Not so this one.

**2. Plaintiffs have not alleged facts showing that the JMP fairness opinion was objectively or subjectively false.**

Plaintiffs argue that the JMP fairness opinion (but *not* the Howe fairness opinion that reached the same conclusion) was both objectively and subjectively false “due to JMP’s lack of independence and the higher price opined by JMP just one year prior [in connection with the First California Northern share exchange].” Appellants’ Brief at 20. As a result, argue Plaintiffs, Defendants were required “to reveal information in Defendants’ possession that would have materially qualified these representations including the nature of the relationship between JMP and Defendants.” *Id.* This argument is flawed in at least six respects.

*First, Plaintiffs conceded below:* “[W]e’re no longer alleging that Capitol

should have disclosed the minority shareholder fairness opinions.”. Reporter’s Transcript of hearing of October 11, 2007. At 21:16-17.

*Second, the existence of the Minority Committee’s fairness opinions does not demonstrate or suggest objective falsity.* Plaintiffs argued below that the Minority’s Committee’s competing “fair market value” opinions showed that the Exchange Offer was unfair. *See* ER 814, 824. But the Minority Committee’s opinions are just that—opinions. That there was a difference of opinion between the Minority Committee’s advisors on the one hand, and JMP and Howe on the other, does not demonstrate that the JMP and Howe fairness opinions were objectively false. *See Bond Opportunity Fund*, 2003 WL 21058251, at \*5 (“Plaintiffs who charge that a statement of opinion, including a fairness opinion, is materially misleading, must allege ‘with particularity’ ‘*provable facts*’ to demonstrate that the statement of opinion is both objectively and subjectively false.”) (emphasis added) (quoting *Virginia Bankshares v. Sandberg*, 501 U.S. 1083, 1093-98 (1991)). This is particularly true since the Minority Committee’s opinions concerned “fair market value,” while the Exchange Offer’s opinions expressly disclaimed any attempt to determine the arms’-length fair market value of the NCB shares. ER 322, 346; *see also infra*. In any event, the First Amended Complaint does not allege with particularity that Defendants misstated any of the

*facts* upon which the fairness opinions were based. Plaintiffs just disagree with the opinions themselves.

*Third, the existence of the Minority Committee's fairness opinions does not demonstrate or suggest subjective falsity.* The fact that the Minority Committee—a group motivated to get the highest possible price for their NCB shares—put forward different, higher fairness opinions does not demonstrate that Defendants, JMP or Howe did not sincerely believe that the offer price was fair. *See In re McKesson HBOC, Inc. Securities Litig.*, 126 F. Supp. 2d at 1265 (“While material statements of fact are false if they are contradicted by true facts, material statements of opinion are false *only if the opinion was not sincerely held.*”) (emphasis added). Indeed, the First Amended Complaint does not allege with particularity that Defendants, JMP or Howe actually knew of the Minority Committee fairness opinions. *See* ER 776 (FAC ¶ 56) (“Based on information and belief, copies of the Fairness Opinion and the Fairness Memorandum, *and/or* a written *or* oral summary of their terms, were delivered to Capitol and Reid, *and/or* Capitol and Reid knew *or should have known* about the substance of the Fairness Opinion and the Fairness Memorandum”) (emphasis added). Such fact-bare conclusory pleading cannot satisfy Rule 9(b).

*Fourth, JMP's prior fairness opinion regarding the First California Northern share exchange in 2004 does not demonstrate or suggest that its fairness*

*opinion regarding the Exchange Offer in 2005 was objectively or subjectively false.*

(a) The First California Northern exchange took place a year before the Exchange Offer, and it was not equivalent to the Exchange Offer. First California Northern was a holding company; NCB a subsidiary. The two transactions were materially different. Unlike the Exchange Offer, in which individual NCB shareholders could decide whether or not to tender their shares, a simple majority vote forced the exchange of *all* First California Northern shares other than those already owned by Capitol. ER 641, 675. So even if the First California Northern and NCB shares were “equivalent,” which they were not, Capitol could logically pay more for a share exchange by which it purchased all outstanding shares than in one where it did not. Plaintiffs acknowledge as much elsewhere when they allege that Capitol placed particular value on acquiring ownership of all of NCB’s outstanding shares. ER 789 (FAC ¶ 117) (alleging defendants were “motivated to cause Capitol to acquire at least 90% of the NCB shares” so that Capitol could effect a “squeeze out” merger).

(b) Even if the two transactions had been contemporaneous and equivalent, this would not demonstrate that the Exchange Offer’s fairness opinions were objectively and subjectively false, because there is no single fair value for

any transaction.<sup>1</sup> Thus, both 150% of book value and 167% of book value can constitute fair value—particularly when the transactions are a year apart and not identical. That is especially true where, as here, the Exchange Offer actually resulted in a greater total return on the investors' original investment (158%) than did the First California Northern share exchange (150%), albeit over a longer holding period. ER 46, 336, 707.

*Fifth, the First California Northern share exchange and JMP's fairness opinion regarding it were part of the total mix of information available to NCB shareholders.* The share exchange and JMP's opinion regarding it had been filed with the SEC and were publicly available. *See* ER 518-731 (First California Northern share exchange SEC filings), ER 537-38, 649-50 (JMP opinions regarding First California Northern share exchange). Anyone who looked at the numbers (*see* ER 633 (offer of \$15.00, book value of \$9.04)) would have realized that the offer was for more than 150% of book value. "Sections 11 and 12(a)(2) do not require the disclosure of publicly available information." *In re Merrill Lynch & Co., Inc. Research Reports Sec. Litig.*, 272 F. Supp. 2d 243, 249-50 (S.D.N.Y. 2003) (holding that compilation of information showing work performed by

---

<sup>1</sup> Obviously, if \$ X is deemed fair, any price above \$ X also is fair and one cannot conclude, without knowing more, that a price below \$ X is unfair. Fairness opinions do not purport to state the lowest or only fair price; they simply opine whether a given price is fair.

Merrill Lynch that was obtained from SEC filings for 66 separate companies was publicly available and need not be disclosed by Merrill Lynch in its SEC filings); *see also Kapps v. Torch Offshore, Inc.*, 379 F.3d 207, 214 (5th Cir. 2004).

*Sixthh, Capitol provided meaningful cautionary disclosures regarding the offer price and the JMP fairness opinion.* Capitol told NCB shareholders that “Capitol’s determination of the share value of NCB [150% of book value], for purposes of the proposed exchange offer, is *solely* based on its *arbitrary* valuation as offered by Capitol.” ER 335 (emphasis added). Capitol also disclosed what it labeled (in boldface type) “**Inherent Conflicts of Interest in the Exchange Offer**” (ER 322) (emphasis original), adding:

NCB is already a majority controlled subsidiary of Capitol. By virtue of the existing relationship between NCB and Capitol, the proposed exchange offer presents inherent conflicts of interest. For example, no other exchange offers, offers to purchase, mergers or share exchanges are being considered and, if there were any, Capitol would likely vote its NCB shares against any other proposals. Capitol's proposal to value NCB shares at \$15.817461 in the exchange offer is based solely on its judgment in making such proposal. *Accordingly, the NCB share value and related exchange ratio have not been determined absent the inherent conflicts of interest between Capitol and NCB. It is unknown what exchange ratio or NCB share value, if any, that might be negotiated between NBC and unaffiliated entities.*

ER 322 (emphasis added).<sup>2</sup> Capitol also told the NCB shareholders that the JMP opinion was directed to Capitol, not them, and “does not constitute a recommendation to any holder of NCB common stock as to whether or not to exchange their shares pursuant to the exchange offer.” ER 346.<sup>3</sup> Capitol also disclosed that it had retained JMP “as its financial advisor and agent” and also disclosed how much it had paid for JMP’s (and Howe’s) fairness opinions. ER 199, 236, 238.

**B. Plaintiffs’ other allegations do not state a section 11 claim.**

The Exchange Offer’s use of the word “premium” (*see* ER 777 (FAC ¶¶ 62-65)), was neither false nor misleading. The NCB stockholders who participated in the Exchange Offer *did* receive a premium of 50% to the book value of their NCB shares. None of the statements quoted by Plaintiffs says or could reasonably be read to imply that shareholders would receive a “premium to the shares’ fair value,” as Plaintiffs have alleged. ER 778 (FAC ¶ 66). The Court is “not required to accept as true conclusory allegations which are contradicted by documents referred to in the complaint.” *Steckman*, 143 F.3d at 1295-96.

---

<sup>2</sup> There were no other proposals as of June 2, 2005, when the Exchange Offer was made. The Minority Committee did not make its competing tender offer until June 24, 2005. ER 384-88.

<sup>3</sup> Similarly, the Howe opinion letter states that it was prepared for Capitol’s benefit and “should not be taken to be [Howe’s] view of the actual value of [NCB].” ER 213.

Similarly without merit is Plaintiffs' argument that Capitol "withheld material information . . . regarding NCB's performance expectations" (Appellants' Brief at 21) by *not* applying breathless adjectives such as "dramatically" when forecasting that NCB's future income would increase. *See* ER 824-25. The general "disclose or abstain" principle described in *Chiarella v. United States*, 445 U.S. 222, 230 (1980) and *McCormick v. Fund America Co. Inc.*, 26 F.3d 869, 876 (9th Cir. 1994) has no application here. Far from failing to disclose information, the Exchange Offer disclosed that NCB's net income for the first quarter of 2005 was almost *four times* as large as for the same period in 2004. ER 318 (\$228,000 for first quarter 2005 versus \$68,000 for first quarter of 2004). The Exchange Offer also said that "Capitol believes that NCB's profitability will increase." ER 768 (FAC ¶ 30). No reasonable person reviewing this information could, as Plaintiffs alleged, have been "induce[d] to believe that NCB's income growth would be modest."<sup>4</sup> ER 769 (FAC ¶ 33).

---

<sup>4</sup> Although the First Amended Complaint alleges that "[m]any NCB shareholders did not know that the unaudited first quarter's results for 2005 were considered a realistic projection of the full year's financial performance" (ER 769 (FAC ¶ 32)), it does not allege with any specificity who these "many" NCB shareholders were, or that Plaintiffs were among them. Such conclusory pleading does not satisfy Rule 9(b).

**C. Moreover, Plaintiffs have failed to allege section 11 damages.**

To state a section 11 claim, Plaintiffs must plead that Defendants' alleged misrepresentations or omissions caused Capitol's stock to be worth less at the time suit was filed than the price they paid for it. 15 U.S.C. § 77k(e); *McMahan & Co. v. Warehouse Entertainment, Inc.*, 65 F.3d 1044, 1047-49 (2d Cir. 1995) ("The plain language of section 11(e) prescribes the method of calculating damages, *see* 15 U.S.C. § 77k(e), and the court must apply that method in every case."); *Metz v. United Counties Bancorp*, 61 F. Supp. 2d 364, 378 (D.N.J. 1999). This means Plaintiffs can state a section 11 claim only if, on the date this action was filed, Capitol stock was trading for less than the price Plaintiffs paid for it. This is not the case. ER 502 (stock price \$33.61 on June 30, 2005), 504 (stock price \$37.05 on November 23, 2005).<sup>5</sup>

**III. PLAINTIFFS HAVE FAILED TO ALLEGE FACTS SUFFICIENT TO STATE A CLAIM UNDER SECTION 10(B) OR SECTION 14(E).**

To state a claim under section 10(b) of the '34 Act and Rule 10b-5 (17 C.F.R. § 240.10b-5), Plaintiffs must plead (1) a material misstatement or omission, (2) scienter, (3) a connection between the misstatement and the purchase or sale of a security, (4) reliance, (5) economic loss and (6) loss causation. *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336, 341-42 (2005).

---

<sup>5</sup> The district court did not reach the issue of section 11 damages, having dismissed Plaintiffs' section 11 claim on other grounds. ER 826.

Section 14(e) is modeled after section 10(b) and applies specifically to tender offers. *See Schreiber v. Burlington Northern, Inc.*, 472 U.S. 1, 10-11 (1985). The elements of section 14(e) are similar: (1) a material misstatement or omission; (2) made with scienter; (3) in connection with a tender offer; (4) upon which the plaintiff relied; (5) that proximately caused damages. *Lewis v. McGraw*, 619 F.2d 192, 194-95 (2d Cir. 1980). Proof of scienter is required.<sup>6</sup>

**A. Plaintiffs' claims under section 10(b) and 14(e) are governed by the PSLRA, which requires Plaintiffs to plead falsity and scienter with particularity.**

Although Plaintiffs concede that their section 10(b) claim is governed by the PSLRA, they appear to contend that the PSLRA does *not* apply to their section 14(e) claim. *See* Appellants' Brief at 2-3 (stating that second issue for review is whether section 14(e) claim was "sufficiently pled under Rule 9(b)"). In any event, the pleading requirements of the PSLRA apply to section 14(e) claims. *See In re Digital Island Sec. Litig.*, 357 F.3d 322, 328-31 (3d Cir. 2004) (applying PSLRA to section 14(e) claims); *accord, Polar Int'l Brokerage Corp. v. Reeve*, 108 F. Supp. 2d 225, 230-31 (S.D.N.Y. 2000).

---

<sup>6</sup> Plaintiffs do not cite any authority suggesting that scienter is *not* a required element of a Section 14(e) claim. To the contrary, courts that have considered the issue have held that scienter *is* a required element of a section 14(e) claim. *See In re Digital Island Sec. Litig.*, 357 F.3d 322, 328 (3d Cir. 2004); *Conn. Nat'l Bank v. Fluor Corp.*, 808 F.2d 957, 961 (2d Cir. 1987); *Adams v. Standard Knitting Mills, Inc.*, 623 F.2d 422, 431 (6th Cir. 1980); *Smallwood v. Pearl Brewing Co.*, 489 F.2d 579, 605 (5th Cir. 1974).

The PSLRA requires that a complaint plead with particularity both falsity and scienter. *In re Vantive Corp. Sec. Litig.*, 283 F.3d 1079, 1084-85 (9th Cir. 2002). To satisfy the falsity requirement, the complaint must (1) “specify each statement alleged to have been false or misleading,” (2) specify “the reason or reasons why the statement is misleading,” and (3) if an allegation regarding the statement or omission is made on information and belief, “state with particularity all facts on which that belief is formed.” 15 U.S.C. § 78u-4(b)(1).

To satisfy the scienter requirement, the complaint must “state with particularity facts giving rise to a *strong* inference that the defendant acted with the required state of mind.” *Gompper v. VISX, Inc.*, 298 F.3d 893, 895 (9th Cir. 2002) (quoting 15 U.S.C. § 78u-4(b)(2) (emphasis added in *Gompper*)). This means that Plaintiffs “must plead, *in great detail*, facts that constitute circumstantial evidence of *deliberately reckless or conscious misconduct*.” *In re Silicon Graphics Inc. Sec. Litig.*, 183 F.3d 970, 974 (9th Cir. 1999) (emphasis added). “[P]laintiffs proceeding under the PSLRA can no longer aver intent in general terms of mere ‘motive and opportunity’ or ‘recklessness,’ but rather, must state specific facts indicating no less than a degree of recklessness that strongly suggests actual intent.” *Id.* at 979.

[W]hen determining whether plaintiffs have shown a strong inference of scienter, *the court must consider all reasonable inferences to be drawn from the allegations, including inferences unfavorable to the plaintiffs.*

District courts should consider all the allegations in their entirety, together with any reasonable inferences that can be drawn therefrom, in concluding whether, on balance, the plaintiffs' complaint gives rise to the requisite inference of scienter.

*Gompper*, 298 F.3d at 897 (emphasis added). When a benign explanation is “equally if not more plausible,” an inference of scienter should be rejected. *Id.*

“Falsity and scienter in private securities fraud cases are generally strongly inferred from the same set of facts,’ and the two requirements may be combined into a unitary inquiry under the PSLRA.” *In re Vantive Corp. Sec. Litig.*, 283 F.3d at 1091 (quoting *Ronconi v. Larkin*, 253 F.3d 423, 429 (9th Cir. 2001)).

**B. Plaintiffs' allegations of oral misrepresentations by nonparties fail to satisfy the falsity and scienter requirements of the PSLRA.**

Plaintiffs allege that a nonparty made oral misstatements in telephone calls to a few NCB shareholders. But no well-pled facts tie these alleged misstatements to Defendants, no facts at all (well-pled or otherwise) suggest that Plaintiffs heard or relied on these alleged misstatements, and nothing creates a strong inference that Defendants said or did anything with the requisite scienter.

- 1. Plaintiffs have not alleged facts with particularity showing that the alleged oral misrepresentations of a nonparty were made at Defendants' direction.**

Plaintiffs' argument that they have adequately pled falsity and scienter rests *entirely* on their allegations at paragraphs 68-90 of the First Amended Complaint (ER 778-84) regarding oral misrepresentations by a nonparty, NCB's president. *See* Appellants' Brief at 2-3 (stating that issues two and three for review are whether the "Campaign of Deception" suffice to state a claim under sections 10(b) and 14(e)); *id.* at 24 (citing only to allegations regarding "Campaign of Deception" in arguing that "the allegations [of the First Amended Complaint] are sufficient to find a strong inference of scienter").

These alleged oral misstatements were made by NCB, not Defendants. Plaintiffs argue that Capitol and Reid were "clearly tied to the Campaign of Deception" based on the First Amended Complaint's allegation that NCB made the oral misrepresentations "at the request of Reid on behalf of Capitol." Appellants' Brief at 25 (citing ER 762 (FAC ¶ 1)). But if one reads what Plaintiffs alleged (as opposed to what they now argue), it is information and belief, bereft of any facts:

68. *Based on information and belief*, in response to letters and other communications from the Minority Shareholder Committee, the directors of NCB and the President of NCB, Dennis Pedisich, in a meeting of the board of directors on May 26, 2005 in the NCB boardroom in Napa, California, and on other occasions during the period of March through June, 2005, *were exhorted by Reid* to call or otherwise communicate with the NCB shareholders on behalf of Capitol. These oral communications were made in order to induce NCB shareholders to sell their shares to Capitol as part of the

Share Exchange Offer and to ensure that Capitol obtained over 80% of the shares of NCB.

FAC ¶ 68, ER 778 (emphasis added).

When allegations of misstatements are made based on information and belief, the PSLRA requires that the complaint “state with particularity all facts on which the belief is held.” *In re Daou Systems, Inc.*, 411 F.3d at 1015 (“[T]his circuit does strictly adhere to the PSLRA’s mandate that the complaint ‘state with particularity all facts on which [a] belief is formed,’ and in so doing, requires that a plaintiff reveal ‘the sources of her information.’” (quoting *Silicon Graphics*, 183 F.3d at 985)).<sup>7</sup> Plaintiffs failed to allege *any* facts on which their belief that Reid “exhorted” NCB to lie to its shareholders was based, let alone facts stated with the particularity required by the PSLRA.<sup>8</sup>

---

<sup>7</sup> Even before passage of the PSLRA, this Court required that complaints containing fraud claims based on allegations of information and belief to provide “a statement of the facts upon which the belief is formed.” *Wool v. Tandem Computers, Inc.*, 818 F.2d 1433, 1439 (9th Cir. 1987).

<sup>8</sup> With well-pled facts, it may be *possible* to state a claim against a purchaser under Section 10(b) or Section 14(e) based on misrepresentations made by a third party acting on behalf of the purchaser. That is the sole import of the cases cited in Appellants’ Brief at 26-28; none says that conclusions without facts suffice. Their cases are distinguishable, moreover. *Cooper v. Pickett*, 137 F.3d 616 (9th Cir. 1997), *Warshaw v. Xoma Corp.*, 74 F.3d 955 (9th Cir. 1996) and *In re Cabletron Systems, Inc.*, 311 F.3d 11 (1st Cir. 2002) dealt with the specialized arena of primary liability for analyst’s statements. *Simpson v. AOL Time Warner, Inc.*, 452 F.3d 1040 (9th Cir. 2006) dealt with the liability of non-issuers for fraudulent *acts*, not statements, and set a pleadings standard that Plaintiffs do

The district court, when holding that Plaintiffs had not alleged enough to tie the alleged oral misstatements to Defendants, invited Plaintiffs to amend and add some facts. ER 833 (“If 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.”). Plaintiffs, however, declined to amend and took this appeal instead. If the PSLRA (and now *Twombly*, 127 S. Ct. at 1968-69) mean anything, they mean that this sort of pleadings gamesmanship cannot be countenanced.

**2. The alleged oral misrepresentations of a nonparty were not made to or relied upon by Plaintiffs or other class members.**

Although Plaintiffs purport to bring this class action on behalf of “all persons who owned shares of NCB common stock and who, on or about June 30, 2005 sold their shares to Capitol” (ER 765 (FAC ¶ 18)), they fail to allege that anyone who heard the ‘Oral Misrepresentations’ sold his or her NCB stock. Instead, each of these persons is described as “an NCB shareholder”; none is alleged to have sold his or her NCB stock, which is required for them to be class members. The First Amended Complaint also notably fails to allege that *Plaintiffs* heard the Oral Misrepresentations (much less relied on them). Nor does the First

---

not begin to meet here. *Lawton v. Nyman*, 62 F. Supp. 2d 533 (D.R.I. 1999) holds that a corporation can be found liable under section 10(b) for misrepresentations of its officers and directors through the application of *respondeat superior*.

Amended Complaint allege that the “Oral Misrepresentations” were made to *all* NCB shareholders.<sup>9</sup> See ER 765, 781-83 (FAC ¶¶ 19, 77, 80, 83, 87). Thus, the First Amended Complaint simply does not allege facts establishing that NCB’s statements were made to or relied upon by any class members, including Plaintiffs.

Plaintiffs’ failure to allege facts demonstrating reliance is reinforced by the fact that NCB shareholders were specifically told in the Exchange Offer that:

No one has been authorized to give any information or make any representation about NCB, Capitol or the exchange offer that differs from, or adds to, the information in this document or in documents that are publicly filed with the SEC. *Therefore, if anyone does give you different or additional information, you should not rely on it.*

ER 360 (emphasis added). Because the NCB shareholders were specifically told not to rely on statements like the Oral Misrepresentations, they could not reasonably have relied upon them in deciding to sell their shares.

**3. The alleged oral misrepresentations of a nonparty do not create a strong inference of actual knowledge of fraud or deliberate recklessness by Defendants.**

Even if Plaintiffs had alleged facts establishing that the statements of NCB’s president were made at Defendants’ direction, which they have not, these statements would not establish falsity or scienter. To the contrary, the information

---

<sup>9</sup> See ER 778-83 (FAC ¶¶ 69, 70, 77, 80, 83, 87). Plaintiffs’ allegation, on information and belief, that “similar statements” were made to “other NCB shareholders” (ER (FAC ¶¶ 69-70, 77, 80, 83, 87)) likewise does not suffice, since Plaintiff do not allege that “similar statements” were made to NCB shareholders *who sold their stock*.

allegedly misrepresented or concealed by NCB's president was disclosed in the Exchange Offer, or was already known to the NCB shareholders, or did not exist at the time the allegedly false statements were made. Thus, when all reasonable inferences are drawn from these allegations, they do not give rise to the requisite "strong inference" of scienter. *Gompper*, 298 F.3d at 897.

*NCB shares would be worthless if not sold to Capitol.* Citing paragraphs 71-76 of the First Amended Complaint, Plaintiffs argue that this June 22, 2005 representation by NCB's president was false and misleading because "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 Capitol considered the shares to have value." Appellants' Brief at 24.

All of this information was either disclosed by Capitol in the Exchange Offer or was already known to NCB shareholders. As discussed above, Capitol disclosed that it expected NCB's profitability to increase and that NCB's net income for the first quarter of 2005 was almost *four times* net income for the same period in 2004. ER 318. Although Capitol had no duty to inform NCB shareholders of their rights, it nevertheless provided a comparison of NCB and Capitol shareholder rights in the Exchange Offer (ER 128); Plaintiffs certainly do

not allege that NCB's President said they would *lose* those rights if they did not exchange their shares. And Plaintiffs' reference to the Minority Shareholders' tender offer (i.e., the "persons other than Capitol [who] considered the shares to have value") is unavailing: the Minority Shareholders' tender offer was made on June 24, 2005, *after* this alleged oral misrepresentation.

*NCB shareholders were required to sell.* The Exchange Offer clearly disclosed that shareholders were *not* required to sell.<sup>10</sup> It was, after all, an offer.

*NCB shares would be illiquid if not sold.* Plaintiffs argue that this alleged statement was false because "an informal market existed for NCB shares as evidenced by a competing tender offer." ER 21 (FAC ¶ 81). But, again, the Minority Shareholders' "competing tender offer" was not made until June 24, 2005, *after* this alleged oral misrepresentation. ER 20 (FAC ¶ 75). And it is undisputed that NCB stock has never been listed on any market.

*Percentage of shareholders tendering.* Plaintiffs allege that NCB

---

<sup>10</sup> *E.g.*, ER 309 ("If you elect to tender your shares of NCB common stock pursuant to the exchange offer . . ." (emphasis added)); ER 310 (Capitol's obligation to exchange shares *conditioned* on "[t]he tender of enough shares of NCB common stock so that . . . Capitol beneficially owns . . . at least 80% of the outstanding shares of NCB common stock . . ."); ER 313 (Tendered shares "*may be withdrawn* at any time prior to the exchange of those shares . . ." (emphasis added)); ER 332 ("In deciding *whether* to tender your shares of NCB common stock for exchange, you should read carefully this prospectus . . ." (emphasis added)).

shareholders were “led to believe that there was no risk that their exchange would be taxable” because over 80% of the outstanding NCB shares were being exchanged. ER 782-83 (FAC ¶ 86). But anyone who read the Exchange Offer would have known that it was an express condition of Capitol’s obligation to exchange shares that at least 80% of the outstanding shares be tendered (ER 342 (“Minimum Tender Condition”)), suggesting the risk of this being a taxable exchange was never substantial.

Plaintiffs also alleged this statement was material because if over 90% of the shares were tendered Capitol could effect a short-form merger pursuant to California Corporations Code section 1110, and NCB shareholders who heard this statement therefore believed their shares would have less value after the Exchange Offer. FAC ¶ 86. But Capitol would be required to pay fair market value in a short-form merger. *See Cal. Corp. Code § 1300(a)*. That, of course, is more than Plaintiffs claim they got from the Exchange Offer.

*All NCB board members were tendering.* Contrary to their brief, Plaintiffs did not allege that NCB’s president said that all NCB board members “had tendered” their shares; instead they alleged that “all the members of the NCB board of directors were tendering their shares.” ER 783 (FAC ¶ 87). This was a forward-looking statement, as opposed to a statement of historical fact, and thus is shielded from liability “unless it is shown that [it] was made or reaffirmed without

a reasonable basis or was disclosed other than in good faith.” 17 C.F.R.

§ 230.175(a); *see also Krim v. BancTexas Group, Inc.*, 989 F.2d 1435, 1446

(5th Cir. 1993); *Wielgos v. Commonwealth Edison Co.*, 892 F.2d 509, 513 (7th Cir.

1989) (“Forward-looking statements need not be correct; it is enough that they

have a reasonable basis.”). Plaintiffs have not alleged that this statement lacked a

reasonable basis; in particular they have not alleged *when* Ms. Leftwich disclosed

her alleged intent not to tender her shares. These inconsistent and uncertain

allegations cannot satisfy the PSLRA or Rule 9(b).

## CONCLUSION

Defendants lived up to the representations they made back in 2001. They made an Exchange Offer and they scrupulously disclosed its terms—both its attractive features and its arbitrary elements. The Exchange Offer gave NCB investors, including Plaintiffs, an option to exchange their stock for 150% of their original investment. Those who, like Plaintiffs, accepted the offer enjoyed, by the time this suit was filed, significant further appreciation on top of that; they have nothing to complain about.

For all the reasons stated above, this Court should affirm the judgment of the district court.

Dated: June 13, 2007.

PILLSBURY WINTHROP SHAW PITTMAN LLP  
BRUCE A. ERICSON  
KEVIN M. FONG  
ANDREW D. LANPHERE

By Bruce A. Ericson / SLW  
Bruce A. Ericson

Attorneys for Defendants-Appellees  
CAPITOL BANCORP LIMITED  
and JOSEPH D. REID

**STATEMENT OF RELATED CASES**

Defendants-Appellants are aware of no cases that should be deemed related to this case within the meaning of Ninth Circuit Rule 28-2.6.

Dated: June 13, 2007.

PILLSBURY WINTHROP SHAW PITTMAN LLP  
BRUCE A. ERICSON  
KEVIN M. FONG  
ANDREW D. LANPHERE

By Bruce A. Ericson / SLW  
Bruce A. Ericson

Attorneys for Defendants-Appellees  
CAPITOL BANCORP LIMITED and  
JOSEPH D. REID

**CERTIFICATE OF COMPLIANCE PURSUANT TO FED. R. APP. P.  
32(a)(7)(C) AND CIRCUIT RULE 32-1 FOR CASE NO. 07-15083**

I certify, pursuant to Fed. R. App. P. 32(a)(7)(C) and Ninth Circuit Rule 32-1, that the foregoing brief is proportionately spaced, has a typeface of 14 points, and contains 8,840 words.

Dated: June 13, 2007.

Bruce A. Ericson /SLW  
Bruce A. Ericson

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

**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.

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

**(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.

**(3) Motion to dismiss; stay of discovery**

**(A) Dismissal for failure to meet pleading requirements**

In any private action arising under this chapter, the court shall, on the motion of any defendant, dismiss the complaint if the requirements of paragraphs (1) and (2) are not met.

**PROOF OF SERVICE BY MAIL**

I, David A. Kramlick, the undersigned, hereby declare as follows:

1. I am over the age of 18 years and am not a party to the within cause. I am employed by Pillsbury Winthrop Shaw Pittman LLP in the City of San Francisco, California.
2. My business address is 50 Fremont Street, San Francisco, CA 94105-2228. My mailing address is 50 Fremont Street, P. O. Box 7880, San Francisco, CA 94120-7880.
3. I am familiar with Pillsbury Winthrop Shaw Pittman LLP's practice for collection and processing of correspondence for mailing with the United States Postal Service; in the ordinary course of business, correspondence placed in interoffice mail is deposited with the United States Postal Service with first class postage thereon fully prepaid on the same day it is placed for collection and mailing.
4. On June 13, 2007, at 50 Fremont Street, San Francisco, California, I served a true copy of the attached document(s) titled exactly BRIEF OF APPELLEES CAPITOL BANCORP LIMITED AND JOSEPH D. REID by placing it/them in an addressed, sealed envelope clearly labeled to identify the person being served at the address shown below and placed in interoffice mail for collection and deposit in the United States Postal Service on that date following ordinary business practices:

**[See Attached Service List]**

I declare under penalty of perjury that the foregoing is true and correct. Executed this 13th day of June, 2007, at San Francisco, California.

---

David A. Kramlick

Service List

John F. Friedemann  
Kyle M. Fisher  
Friedeman Goldberg LLP  
420 Aviation Boulevard  
Suite 201  
Santa Rosa, CA 95403

George S. Trevor  
Law Office of George S. Trevor  
300 Tamal Plaza  
Suite 180  
Corte Madera, CA 94925-1131

James V. Weixel, Jr.  
Weixel Law Office  
2370 Market Street – No. 133  
San Francisco, CA 94114

Attorneys for Plaintiffs-Appellants