IN THE UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

MUKTA PATEL, et al., Plaintiffs, v. MUKESH C. PATEL, et al., Defendants.	)	**CASE NO: 1:09-CV-3684CAP**

DEFENDANTS' MEMORANDUM OF LAW
IN SUPPORT OF THEIR MOTION TO DISMISS
PLAINTIFFS' AMENDED COMPLAINT

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I. INTRODUCTION

Plaintiffs in this case join the multitude of disappointed investors who now improperly seek to blame their losses caused by the recent financial crisis on securities fraud. They invested in Haven Trust Bancorp, the holding company for Haven Trust Bank, through private offerings in 2006 and 2008. At the time they invested, Plaintiffs knew by virtue of the offering memoranda they received that over 70% of the Bank's loan portfolio was secured by real estate – mainly in the metro Atlanta area. Thus, Plaintiffs consciously decided to tie their fortunes to the Atlanta real estate market when they invested in Haven Trust.

In the wake of the recent financial crisis and its deleterious impact on the Atlanta economy and real estate market, the Bank was put into FDIC receivership, and Plaintiffs (as well as Defendants) lost their entire investment in the company. Yet, Plaintiffs claim in their Amended Complaint that they lost their investments, not because of the recent financial crisis, but rather because Defendants committed fraud. However, the Amended Complaint's fundamental pleading deficiencies, particularly with regard to scienter and loss causation, and their extensive reliance on the Defendants' alleged failure to disclose information they were expressly prohibited from disclosing by FDIC regulation, reveal and confirm that no securities fraud occurred here.

At best, all that Plaintiffs have done is complain of mismanagement and allege fraud by hindsight. But as this Court well knows, claims of mismanagement and fraud by hindsight cannot form the basis for a securities fraud claim.

Beyond these fundamental and fatal defects, Plaintiffs did not heed the Court's warning that they should avoid "those tactics that result in a shotgun pleading." (Order dated March 18, 2010.) Instead, Plaintiffs have compounded their shotgun pleading by adding purported securities fraud claims on behalf of a separate group of investors (purchasers in the Haven Trust Bancorp 2006 private offering) without making any effort to specify which allegations of fact support which cause of action.

For example, Plaintiffs devote only one paragraph to pleading their loss causation element (Am. Compl. ¶ 89) but evidently intend this conclusory allegation to show loss causation for both the 2006 and 2008 offerings. Plaintiffs also assert most of their causes of action on behalf of the "Class," which is defined to include all purchasers of Haven Trust stock during the period between April 1, 2006 and December 12, 2008 (Am. Compl. Preamble) but nowhere delineate, specify or distinguish which alleged misrepresentations or omissions apply to which subgroups of the purported Class in any of those causes of action.

The entirety of the Amended Complaint should be dismissed pursuant to Fed. R. Civ. P. 12(b)(6) for failure to state any claim upon which relief can be granted.

All of the Subclass's "non-fraud" Georgia Securities Act claims may be easily dispensed with because it is incontrovertible Georgia law that scienter is an essential element of such claims. Therefore, Counts I and II, which "expressly exclude and disclaim any allegation that could be construed as alleging or sounding in fraud or intentional, knowing or reckless misconduct" (Am. Compl. ¶¶ 90 and 96), are fatally deficient.

In the same vein, much of the Amended Complaint may be dispensed with because it is erroneously premised on the alleged failure to disclose information contained in the regulators' Reports of Examination of the Bank during the period from 2004 through 2008. Plaintiffs fail to acknowledge that Defendants were absolutely prohibited by FDIC regulation from disclosing any portion of those examination reports. 12 C.F.R. § 309.6(a). Defendants cannot be faulted under any asserted legal theory for failing to disclose that which they were prohibited by law from disclosing.

The remainder of the Amended Complaint, such as it is, also should be dismissed for failure to state any cognizable claim. Since Plaintiffs' allegations fail

to meet the mandatory pleading requirements of the Private Securities Litigation Reform Act of 1995 ("Reform Act"), 15 U.S.C. § 78u-4, *et seq.*, Plaintiffs' claim for violation of § 10(b) of the Securities Exchange Act of 1934 ("1934 Act"), 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5 ("10b-5 claim"), in Count IV should be dismissed. And because Plaintiffs have failed to properly allege a primary 10b-5 claim, their claim for "control person" liability pursuant to § 20(a) of the 1934 Act in Count V necessarily fails as well.

Since the elements of claims for violation of § 10-5-12(a) of the Georgia Securities Act of 1973 mirror those of 10b-5 claims and common law fraud claims, including the essential elements of scienter and loss causation, Plaintiffs' Georgia Securities Act claims, both fraud-based and "non-fraud," in Counts I, II, and VI, and their fraud claim and claim for punitive damages, in Counts VII and VIII, should be dismissed. And since there is no negligence or negligent misrepresentation available as a matter of law by these Plaintiffs and these Defendants, Count III should be dismissed.

Finally, as an alternative basis for dismissal of the state law claims, Defendants show that, upon dismissal of Plaintiffs' federal securities claims, there is no independent basis for subject matter jurisdiction of the state law claims so

that they should be dismissed pursuant to Fed. R. Civ. P. 12(b)(1) and 28 U.S.C. § 1367(c)(3) for lack of subject matter jurisdiction.

II. STATEMENT OF FACTS

Haven Trust Bancorp, Inc., now in bankruptcy (the "Company"), was the holding company for Haven Trust Bank (the "Bank" or "Haven Trust"), a Georgia state-chartered community bank based in Duluth, Georgia, with four branches in the Metro Atlanta area. (Am. Compl. ¶¶ 33, 37.) Haven Trust was founded in 2000 by Defendants Mukesh "Mike" Patel and Rajesh C. "RC" Patel as a minority-owned bank serving the Indian and Asian-American communities. (Am. Compl. ¶¶ 13, 14, 33.) The Bank was regulated by the Federal Deposit Insurance Corporation ("FDIC") and the Georgia Department of Banking and Finance ("GDBF"). (Am. Compl. ¶ 45.)

As a community bank, Haven Trust concentrated its loan portfolio in commercial real estate ("CRE") with a focus in acquisition, development and construction projects ("ADC") and hotel/motel lending. (Am. Compl. ¶ 34.) By 2008, the Bank had approximately $575 million in assets, up from $29 million in assets at the end of its first year of operation in 2000. (Am. Compl. ¶ 35.) The Bank's growth coincided with the real estate development boom in metro Atlanta, and that growth generated strong profits for the Company's shareholders from

2004 through December 31, 2007. The offering memoranda Plaintiffs received disclosed that the Company earned net income for the calendar years ended 2004 through 2007 as follows:[1]

2004	2005	2006	2007
$1,841,000	$3,428,000	$6,583,000	$5,004,000

Plaintiffs do not allege that any of the financial information disclosed in those offering memoranda was false and misleading.[2]

The Company made a private offering in 2006 (the "2006 Offering") pursuant to the 2006 PPM. (*See* Declaration of R.C. Patel ("RC Patel Decl."), Ex. 1 ("2006 PPM").) The 2006 PPM disclosed that the 2006 Offering was being made only to sophisticated investors willing to bear the loss of their entire

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[1] *See* Haven Trust Bancorp, Inc. Confidential Private Placement Memorandum dated March 31, 2006 (the "2006 PPM") at 32, attached as Exhibit 1 to the Declaration of R. C. Patel ("RC Patel Decl."), filed in support of the instant motion; Haven Trust Bancorp, Inc. Confidential Private Placement Memorandum dated March 31, 2008 (the "2008 PPM") at 36, attached as Exhibit 2 to the RC Patel Decl.

[2] *"[W]here the plaintiff refers to certain documents in the complaint and those documents are central to the plaintiff's claim,* then the Court may consider the documents part of the pleadings for purposes of Rule 12(b)(6) dismissal, and the defendant's attaching such documents to the motion to dismiss will not require conversion of the motion into a motion for summary judgment." *Brooks v. Blue Cross & Blue Shield of Fla., Inc.*, 116 F.3d 1364, 1369 (11th Cir. 1997).

investment. (2006 PPM at 4-5.) The 2006 PPM furthermore was replete with disclosures and risk factors specific to the Bank's business, including the Bank's high concentration of real estate loan business (70% of loans) and the economic, regulatory and other risks that could have a material impact on the business and viability of a community bank like Haven Trust. (2006 PPM at 5-9, 16-17, 23-31.)

Defendants RC Patel, Mike Patel, several other Directors and their family members invested in the 2006 Offering. (RC Patel Decl. ¶ 3.) On December 28, 2006, Plaintiff Ashok Parekh purchased 4,000 shares of Company stock for $100,000, and Plaintiff Jitu Patel purchased 3,000 shares for $75,000. (Am. Compl. ¶¶ 10, 11.)

The Company made another private offering in May 2008 (the "2008 Offering") pursuant to the 2008 PPM. (*See* RC Patel Decl., Ex. 2 ("2008 PPM"); Am. Compl. ¶¶ 73-74.) Like the 2006 PPM, the 2008 PPM disclosed that only sophisticated, accredited investors were eligible to purchase shares in the 2008 Offering and that any investment in the Company "is speculative, involves a significant degree of risk and is suitable only for persons who have substantial financial resources, have no need for liquidity in this investment, and understand completely the tax consequences, risk factors and all other aspects of this investment." (2008 PPM at 6, 14-15.) And like the 2006 PPM, the 2008 PPM was

replete with disclosures and risk factors specific to the Bank's business, including the Bank's even higher concentration of loans secured by real estate (73%), and all material economic, regulatory and other risks. (2008 PPM at 6-13, 21-22, 28-35.)

Notably, the 2008 PPM made additional disclosures about the adverse impacts of the evolving economic downturn that had already caused the Bank's non-performing assets to increase significantly, and the fact that 24% of the loan portfolio represented loans for which the related property was neither presold nor preleased. (2008 PPM at 8-10.) The 2008 PPM went on to disclose:

> These land acquisition and development and construction loans are considered more risky than other types of residential mortgage loans. . . . Given the current environment, we expect that in 2008, the non-performing loans in our land acquisition and development and construction portfolio will increase substantially and these non-performing loans could result in a material level of charge-offs, which will negatively impact our capital and earnings.
>
> Furthermore, to the extent that real estate collateral is obtained through foreclosure, the costs of holding and marketing the real estate collateral, as well as the ultimate values obtained from disposition, could reduce the Company's earnings and adversely affect the Company's financial condition.

(Id. at 9-10.)

The 2008 Offering raised $3,216,800. Of this amount, Defendants RC Patel and Mike Patel invested $500,000 each - $1,000,000 in total. Defendants Brij Kapoor, Mukund R. "Bobby" Patel, Narendra D. "Tony" Patel, Dhiru G. "Danny"

Patel and Balvant "Bill" Patel invested a total of $864,300. Thus, the purported "Subclass" as defined in the Amended Complaint invested a total of $1,352,500 and is comprised of only 15 individuals, including Plaintiffs Mukta Patel and the Boswells. (Am. Compl. ¶ 1; RC Patel Decl. ¶ 5 and Ex. 3 attached thereto.) Plaintiff Mukta Patel made her $100,000 investment in the Company on or about September 23, 2008, and Plaintiffs Andrea and Phil Boswell made their $25,000 investment on or about September 25, 2008. (Am. Compl. ¶¶ 9, 12.)

The Bank's fortunes quickly turned for the worse in late 2008. On August 12, 2008, the FDIC informed the Bank that it would be lowering the Bank's capitalization status from "well capitalized" to "adequately capitalized." (Am. Compl. ¶ 52.) Then, in September 2008, the Bank entered into a Memorandum of Understanding with the FDIC, the purpose of which was to address examination concerns, inadequate risk management controls and other safety and soundness issues. (Am. Compl. ¶ 53.)

Also, the GDBF commenced an examination in September 2008, and some time thereafter was preparing to downgrade the Bank's CAMELS rating below 3, the Bank's then-current rating. (Am. Compl. ¶ 54.) Notably, a composite CAMELS rating of 3 connotes that the financial institution requires more than normal [regulatory] supervision, which may include formal or informal

enforcement actions. "Failure appears unlikely, however, given the overall strength and financial capacity of the[ ] institution." Uniform Financial Institutions Rating System, 61 Fed. Reg. 67021-02 at 67026 (Dec. 19, 1996) (Fed. Fin. Inst. Exam. Council).

On November 17, 2008, the FDIC informed the Bank that due to further decreases in certain of its capital ratios, the Bank was going to be classified as "undercapitalized" as of September 30, 2008. (Am. Compl. ¶ 55.) Then, on December 10, 2008, the Bank's Board of Directors passed a resolution to place the Bank into receivership, and the FDIC became the receiver of the Bank on or about December 12, 2008. (Am. Compl. ¶ 56.)

The Company soon thereafter filed for bankruptcy in February 2009. (Am. Compl. ¶ 3.) Just like Plaintiffs, RC and Mike Patel and all of the other Defendants who were shareholders lost their entire investment in the Company.[3] (Am. Compl. ¶ 89.)

As of the Company's bankruptcy filing, the Company had only 76 shareholders (excluding the named Defendants and members of their immediate

[3] Defendant Ed Briscoe was not a shareholder. (*See* Declaration of Theodore J. Sawicki ("Sawicki Decl."), Ex. 1.)

family).[4] (Sawicki Decl., Ex. 1 (List of Haven Trust Bancorp, Inc. Equity Security Holders); RC Patel Decl. ¶ 6.) Of those shareholders, on information and belief based on their addresses of record on the Company's shareholder list, only 23 are not citizens of Georgia. (Sawicki Decl., Ex. 1.)

III. STANDARDS GOVERNING THE DECISION ON THIS MOTION TO DISMISS

A. General Principles

The basic elements of a 10b-5 claim are: (1) a material misrepresentation or omission; (2) made with scienter; (3) a connection with the purchase or sale of a security; (4) reliance on the misstatement or omission; (5) economic loss; and (6) a causal connection between the material misrepresentation or omission and the loss, known as "loss causation." *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 341-42 (2005). In alleging such a claim, a plaintiff must comply with the heightened pleading standards imposed by the Private Securities Litigation Reform Act of 1995 (the "Reform Act").

[4] Haven Trust Bancorp, Inc. at all relevant times was an S corporation pursuant to Internal Revenue Code § 1361, 26 U.S.C. § 1361. In an S corporation, a husband and wife (and their estates), and all members of a family (and their estates) are treated as one shareholder. 26 U.S.C. § 1361(c)(1)(A).

B. The Reform Act

In passing the Reform Act, Congress responded to dangers that the Supreme Court had first identified in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975). There, the Supreme Court observed that securities class action litigation "presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general" and provides "the potential for nuisance or 'strike' suits" whose "very pendency . . . may frustrate or delay normal business activity of the defendant which is totally unrelated to the lawsuit." *Id.* at 739-740. Thus, even a complaint "which by objective standards may have very little chance of success at trial has a settlement value to the plaintiff out of any proportion to its prospect of success at trial." *Id.*

The Reform Act is intended to strengthen pleading standards for securities claims "to establish a uniform and stringent pleading requirement to curtail the filing of abusive lawsuits," deter the filing of strike suits and empower courts to dismiss them. S. Rep. No. 104-98, at 15 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 694. "In enacting [the Reform Act], Congress clearly intended to cut back the ease with which shareholders, through federal class action suits, could hold corporations and their officers at legal swordpoint. . . . The means Congress chose to achieve that goal was to tighten up pleading and practice in such suits." *In re*

Manugistics Group, Inc., No. CIV.S 98-1881, 1999 WL 1209509, at *1 (D. Md. Aug. 6, 1999).

The Reform Act requires that a securities fraud class action complaint:

> 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.

15 U.S.C. § 78u-4(b)(1)(B).

The Reform Act also raises the standard for pleading scienter. It states that a plaintiff asserting a securities fraud claim "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." 15 U.S.C. § 78u-4(b)(2). The requisite state of mind for a 10b-5 claim is an intent to deceive, manipulate, or defraud, or a showing of severe recklessness. *Mizzaro v. Home Depot, Inc.*, 544 F.3d 1230, 1238 (11th Cir. 2008). Therefore, in a securities fraud class action, a plaintiff can no longer plead the scienter element generally. *Id.* Moreover, the complaint must allege facts supporting a strong inference of scienter "for each defendant with respect to each violation." *Phillips v. Scientific-Atlanta, Inc.,* 374 F.3d 1015, 1016 (11th Cir. 2004).

C. Fed. R. Civ. P. 9(b)'s Heightened Pleading Requirements

All of Plaintiffs' other state statutory and common law fraud claims are subject to the heightened pleading requirements of Fed. R. Civ. P. 9(b). *Mizzaro*, 544 F.3d at 1237. Rule 9(b) is satisfied if the complaint sets forth "(1) precisely what statements were made in what documents or oral representations or what omissions were made, and (2) the time and place of each such statement and the person responsible for making (or, in the case of omissions, not making) same, and (3) the content of such statements and the manner in which they misled the plaintiff, and (4) what the defendants obtained as a consequence of the fraud." *Id*. (citations omitted).

D. Fed. R. Civ. P. 12(b)(1) Motions

"Rule 12(b)(1) motions to dismiss for lack of subject matter jurisdiction can be asserted on either facial or factual grounds." *Carmichael v. Kellogg, Brown & Root Serv., Inc.*, 572 F.3d 1271, 1279 (11th Cir. 2009), *cert*. *denied*, No. 09-683, 2010 WL 2555215 (U.S. June 28, 2010). Where a factual attack is made, the trial court is free to consider matters outside the pleadings, including testimony and affidavits. *Lawrence v. Dunbar*, 919 F.2d 1525, 1529 (11th Cir. 1990).

IV. ARGUMENTS AND CITATIONS OF AUTHORITY

A. Plaintiffs' Purported "Non-fraud" Claims Under the Georgia Securities Act of 1973 Must Be Dismissed Because Scienter is an Essential Element of All Such Claims.

It is beyond genuine dispute that scienter is an essential element of claims under O.C.G.A. §§ 10-5-12(a) and 10-5-14(a). *Keogler v. Krasnoff*, 268 Ga. App. 250, 254, 601 S.E.2d 788, 791 (2004). Indeed, the Georgia Court of Appeals has held that claims for common law fraud and securities fraud under O.C.G.A. § 10-5-12(a) involve similar elements. *GCA Strategic Inv. Fund, Ltd. v. Joseph Charles & Assocs.,* 245 Ga. App. 460, 463-64, 537 S.E.2d 677, 681-82 (2000).[5] Therefore, Counts I and II of the Amended Complaint, wherein Plaintiffs "expressly exclude and disclaim any allegation sounding in fraud, or intentional, knowing or reckless conduct" (Am. Compl. ¶¶ 90, 96), must be dismissed.

[5] According to the Georgia Court of Appeals, "[s]cienter must be pleaded with particular facts that give rise to a strong inference that the defendant acted in a severely reckless manner. 'Severe recklessness is limited to those highly unreasonable omissions or misrepresentations that involve not merely simple or even inexcusable negligence, but an extreme departure from the standards of ordinary care. . . .'" *GCA Strategic Inv. Fund, Ltd.* at 464, 537 S.E.2d at 682 (quoting *Bryant v. Avado Brands, Inc.*, 187 F.3d 1271, 1281 (11th Cir. 1999)).

B. The Amended Complaint's Scienter Allegations Fail To Support An Inference Of Scienter That Is At Least As Compelling As Plausible Nonculpable Inferences.

In *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007), the Supreme Court held that plaintiffs in private securities fraud actions must plead facts in their complaints that raise an inference of scienter that is "more than merely plausible or reasonable – it must be cogent and at least as compelling as any opposing inference of nonfraudulent intent." *Id.* at 309. This showing must be made as to each individual defendant and as to each alleged act or omission. *Mizzaro*, 544 F.3d at 1238.

Plaintiffs purport to allege that only three of the named Defendants – RC Patel, a director, Mike Patel, the Chairman of the Board of Directors, and Ed Briscoe, CEO and a director, acted with intent to defraud or reckless disregard. (Am. Compl. ¶¶ 107-114.) As demonstrated below, the Complaint fails to plead any inference of scienter, much less the strong inference required by the Reform Act.

First, as the Court is aware, securities plaintiffs typically rely on insider trading to demonstrate scienter. *See Mizzaro*, 544 F.3d at 1253. Here, it is

significant that Plaintiffs do not and cannot allege any insider stock sales by RC Patel, Mike Patel or Ed Briscoe.[6]

Second, the Amended Complaint's reliance on the Defendants' positions as directors and officers, their attendance at meetings, and access to internal documents and reports is insufficient to allege scienter. *See In re Coca-Cola Enters., Inc. Sec. Litig.*, 510 F. Supp. 2d 1187, 1200-01 (N.D. Ga. 2007).

Third, Plaintiffs' allegation that RC Patel, Mike Patel and Ed Briscoe were motivated to commit fraud in order to maintain a dividend stream does not establish a strong inference of scienter, as required by the Reform Act and Supreme Court precedent. *Malin v. IVAX Corp.*, 17 F.Supp.2d 1345, 1361 (S.D. Fla. 1998). Plaintiffs specifically point to two dividend payments of $.21 per share made in January 2008 and May 2008. (Am. Compl. ¶ 114.) As disclosed in the 2008 PPM, all shareholders of the Company, including Plaintiffs and the Class, shared equally in the "benefits" of the dividend stream.[7] The motivation to maintain a dividend stream does not establish scienter because it is closely

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[6] To the contrary, Defendants RC Patel and Mike Patel, as well as the other named Defendants, all purchased stock in the 2006 and 2008 Offerings. (RC Patel Decl., ¶¶ 3, 5.)

[7] Defendant Briscoe was not a shareholder, so this allegation could not provide a basis for inferring scienter as to him. (*See* Sawicki Decl., Ex. 1.) Defendants respectfully submit that Plaintiffs' reference to this information in the Amended Complaint (Am. Compl. ¶ 28) makes it entirely appropriate to consider in deciding the sufficiency of their scienter pleading.

analogous to the desire to sustain a company's stock price, which courts have held does not support a strong inference of scienter. *See In re Homebanc Corp. Sec. Litig.*, No. 08-cv-1461-TCB, 2010 WL 1524836, at *19 (N.D. Ga. Apr. 13, 2010); *Malin v. IVAX Corp.*, 17 F.Supp.2d 1345, 1361 (S.D. Fla. 1998); *Druskin v. Answerthink, Inc.*, 299 F.Supp.2d 1307 (S.D. Fla. 2004)). Indeed, preserving a dividend stream is merely a motive that "can be ascribed to virtually all corporate officers and directors." *Malin*, 17 F.Supp.2d at 1361. Thus, this allegation as a matter of law cannot support the essential element of scienter. *Id*.

Fourth, how the Defendants' knowledge that the Bank was "adequately capitalized" in 2008, which Plaintiffs acknowledge is specifically disclosed in the 2008 PPM, supports the element of scienter is simply baffling. (Am. Compl. ¶ 113.) And Plaintiffs offer no specificity as to how the fact that the Bank was "adequately capitalized" at some point in 2005, but returned to "well capitalized" soon thereafter and remained so until 2008, supports a strong inference that any of the Defendants was acting with scienter.

Fifth, Plaintiffs' conclusory and speculative allegations about certain loans made to adult children of RC Patel and their related interests (Am. Compl. ¶¶ 109-110) cannot form the basis of any scienter allegations. There is no specific allegation that there was concealment from the regulators or anyone else about the

nature, purpose or terms of those loans, or that the Defendants bypassed or skirted the Bank's normal loan approval process, which included review and approval by the Bank's Directors unrelated to RC Patel (who were themselves Company shareholders). Moreover, the 2008 PPM specifically disclosed that the Bank had entered into and would continue to enter into banking and other business transactions in the ordinary course of business with the Company's directors and officers and their related interests. (2008 PPM at 43-44.)

Lastly, the FDIC and GDBF were closely examining the Bank, and the FDIC was negotiating a Memorandum of Understanding with management in August and September 2008, while the 2008 Offering was ongoing, and before Plaintiffs made their investments. (Am. Compl. ¶¶ 9, 12, 52-54.) Defendants respectfully submit that the FDIC and GDBF presumably were aware of the 2008 Offering. While Defendants do not suggest that the FDIC and GDBF by their silence endorsed the 2008 Offering or the 2008 PPM, Defendants do submit that it is not plausible to infer that Defendants were able to perpetrate a fraudulent securities offering while under the strict scrutiny of the Bank's regulators.

When the Amended Complaint's allegations are viewed holistically, the reasonable inferences showing culpable motive are not as compelling as those showing innocent behavior. *See Tellabs*, 551 U.S. at 323; *see also Andropolis v.*

Red Robin Gourmet Burgers, Inc., 505 F. Supp. 2d 662, 678 (D. Colo. 2007); *Crowell v. Ionics, Inc.*, 343 F. Supp. 2d 1, 15 (D. Mass. 2004).

C. Plaintiffs Fail to Allege Loss Causation.

To demonstrate loss causation, a plaintiff must allege that "'the untruth was in some reasonably direct, or proximate, way responsible for his loss.'" *See Homebanc*, 2010 WL 1524836, at *20; *Robbins v. Koger Props., Inc.,* 116 F.3d 1441, 1447 (11th Cir. 1997). Thus, even if a defendant's misconduct induces the plaintiff to make the investment, if the particular loss complained of is caused by supervening general market forces or other factors unrelated to the defendant's misconduct that operate to reduce the value of the plaintiff's securities, the plaintiff is precluded from recovery under Rule 10b-5. *Id*. Further, to survive a motion to dismiss, "something beyond the mere possibility of loss causation must be alleged." *Bell Atlantic Corp. v. Twombly,* 550 U.S. 544, 557-58 (2007*)* (citing *Dura, supra*).

Here, Plaintiffs allege that the FDIC's December 2008 announcement that it was taking over the Bank caused the loss in value of Plaintiffs' stock.[8] (Am.

[8] The only other disclosure that Plaintiffs even attempt to claim touched upon the alleged misrepresentations and omissions is the FDIC OIG Report (Am. Compl. ¶ 89), which was released in August 2009 -- 8 months ***after*** the drop in the stock price. It defies logic to suggest that the FDIC OIG Report caused a drop in the stock price that occurred 8 months prior. *See also Homebanc*, 2010 WL

Compl. ¶ 89 ("Haven Trust stock . . . lost all of its value upon the announcement of the FDIC takeover of the Bank.").) But, rather than establish that Defendants' alleged misrepresentations or omissions caused Plaintiff's loss, these allegations only establish that their loss was directly caused by the precipitous decision of the FDIC to close the Bank in the wake of the unanticipated, calamitous effects of the subprime mortgage and financial crises on the Bank's loan portfolio and value of its real estate collateral.[9] The loss causation element is not satisfied, however, by alleging only "that the putative class paid artificially inflated prices for their stock and that [the company's] collapse alone revealed the 'truth' so that [the company's] statements during the class period must have been false." *Homebanc*, 2010 WL 1524836, at *20; *see also D.E. & J. Ltd. P'ship v. Conaway*, 133 F. App'x. 994, 1001-02 (6th Cir. 2005) (allegation that stock price dropped following bankruptcy announcement was not the same as alleging that defendants' fraud caused the loss).

Further, this Court has held that "[w]hen the plaintiff's loss coincides with a marketwide phenomenon causing comparable losses to other investors, the

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1524836, at *20 ("In essence, [the loss causation] element requires a plaintiff to allege that the share price of the security 'fell significantly ***after*** the truth became known.'") (emphasis added).

[9] The Court may take judicial notice of the nationwide financial crisis. *See Homebanc*, 2010 WL 1524836, at *1.

prospect that the plaintiff's loss was caused by the fraud decreases, and a plaintiff's claim fails when it has not adequately pled facts which if proven would show that its loss was caused by the alleged misstatements **as opposed to intervening events**." *See Homebanc*, 2010 WL 1524836, at *21 (emphasis added). Here, Plaintiffs have not offered any facts distinguishing between any losses purportedly caused by Defendants' alleged misrepresentations and the intervening events that wreaked havoc on the banking industry as a whole.[10] Thus, Plaintiffs have not adequately alleged loss causation. Accordingly, the 10b-5 claim should be dismissed for failure to plead loss causation.

D. All of Plaintiffs' Claims Based on Alleged Omissions to Disclose Information Contained in the Regulators' Reports of Examinations of the Bank Must Be Dismissed Because Defendants Were Prohibited by Law from Disclosing Any Such Information.

Much of the Amended Complaint depends on Plaintiffs' allegations that Defendants wrongfully omitted to disclose criticisms, comments, deficiencies and warnings made by the Bank's regulators (the FDIC and GDBF) to the Bank in connection with the periodic examinations of the Bank's activities by those

[10] Further lacking from Plaintiffs' Complaint is any allegation that the December 2008 FDIC announcement "revealed the truth" of the alleged fraud or even touched upon the alleged misrepresentations and omissions. *See Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 175 (2d Cir. 2005) (loss causation lacking if alleged curative disclosure does not "reveal the truth" about the misconduct alleged in complaint).

regulators during the relevant period. (*See* Am. Compl. Preamble, ¶¶ 45-50, 52-55, 69, 70, 75, 81, 89, 111-112.) In making these allegations, Plaintiffs blithely ignore the FDIC's clear and comprehensive prohibition against the disclosure of *any* examination reports or information contained therein. 12 C.F.R. §309.6(a).

It is hornbook law that a securities fraud omission claim cannot be premised on the failure to disclose information that cannot be disclosed. "Silence, absent a duty to disclose, is not misleading under Rule 10b-5." *Basic, Inc. v. Levinson*, 485 U.S. 224, 239 n. 17 (1988); *see also Ziemba v. Cascade Int'l, Inc.*, 256 F.3d 1194, 1206 (11th Cir. 2001).

E. The Remaining Alleged Misrepresentations and Omissions Are Not Material or Otherwise Actionable.

1. The statement about the Bank's internal loan limit in juxtaposition with certain loans that were exceptions thereto is not material.

Plaintiffs attempt to transform isolated loan decisions into a securities fraud scheme. They claim that two loans made by the Bank in 2004, one loan with no referenced origination date, and one loan made in 2007, exceeded the Bank's internal loan limits described in the 2006 and 2008 PPMs, and Defendants therefore misled investors by failing to tell them that the Bank did not adhere to its own loan limits. (Am. Compl. ¶¶ 39, 63, 76.) The source of Plaintiffs'

information about those loans is the FDIC OIG Report on the Bank. (Am. Compl., Ex. 2 (FDIC OIG Report), at pp. 12, 14-17.)

However, the FDIC OIG Report makes clear with respect to those loans that either the portion of the loan that exceeded the Bank's internal loan limit was sold to another party, or the loan did not in fact exceed the Bank's internal or legal lending limits. (*Id.*)[11] Thus, Plaintiffs' own complaint reveals that there is no basis in fact for Plaintiffs' allegations.

Moreover, Plaintiffs' erroneous effort to transform the Bank's loan decisions and credit administration activities into securities fraud fails in any event because such allegations raise nothing more than claims for mismanagement, which are not actionable under 10b-5. *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 479 (1977); *see also Barr v. Matria Healthcare, Inc.*, 324 F. Supp. 2d 1369, 1384 (N.D. Ga. 2004).

2. The risks of CRE loans, including inadequate collateral value, were adequately disclosed in the 2006 PPM.

Plaintiffs allege in Paragraph 65 of the Amended Complaint that the 2006 PPM was materially misleading because it omitted any mention of the risk that the

[11] As to the undated loan referenced on page 12 of the FDIC OIG Report, the report itself does not expressly state whether any portion of the loan was sold to another entity, but the FDIC OIG does not complain or allege that the loan violated either the Bank's internal loan limit or its legal lending limit. (Am. Compl., Ex. 2.)

value of the collateral securing real estate loans would be insufficient to protect the Bank. However, given the numerous other risk factors discussed and disclosed in the 2006 PPM, and the fact that the 2006 Offering was specifically addressed to sophisticated investors (2006 PPM at 5-9, 16), it is inappropriate and unavailing to attempt to characterize as materially misleading the discussion in the PPM about real estate collateral value risk.

3. The alleged omission to fully disclose the potential ramifications of the Bank being rated as "adequately capitalized" for brief periods of time is not material or otherwise actionable.

Plaintiffs allege that the Bank relied on brokered deposits as a source of funding but for brief periods in 2005 and 2008 was rated as "adequately capitalized" without applying for the required FDIC waiver to continue to accept brokered deposits. (Am. Compl. ¶113.) To support their claims, Plaintiffs repeatedly allege that Defendants omitted to fully disclose the potential adverse regulatory consequences of the Bank being rated "adequately capitalized" – namely, the restriction on accepting brokered deposits absent an FDIC waiver. (Am. Compl. ¶¶ 2, 3, 36, 43, 44, 52, 71, 79, 80 and 113.) These allegations fail, however, for the basic reason that the PPMs actually disclose what Plaintiffs claim was omitted.

First, both PPMs specifically disclosed that: "Failure to meet capital guidelines could subject a bank . . . to a variety of enforcement remedies, including . . . a prohibition on accepting brokered deposits. (2006 PPM at 28; 2008 PPM at 33.) Further, the 2008 PPM states: " . . . the cost related to out of market and brokered deposits can be volatile, and ***if we are unable to access these markets*** or if our costs related to out of market and brokered deposits increases, ***our liquidity and ability to support demand for loans could be adversely affected.***" (2008 PPM at 11 (emphasis added).) Thus, Plaintiffs were specifically warned of the consequences to the Bank if it could not accept brokered deposits.

Second, the 2008 PPM specifically disclosed that the Bank's rating was "adequately capitalized" as of May 31, 2008. (2008 PPM at 30.)

Third, assuming *arguendo* the truth of the allegation that the Bank continued to accept brokered deposits without an FDIC waiver during the periods it was rated "adequately capitalized," Plaintiffs do not allege that the Bank in fact suffered any undisclosed negative consequences.

All of these disclosures and circumstances undermine Plaintiffs' contention that material information was not disclosed and lead to the conclusion that prospective investors were provided with sufficient information about the Bank's

capital rating and funding sources to enable them to make informed investment decisions.

4. The 2008 PPM's statements about the Bank's ALLL methodology were not misleading.

The Amended Complaint alleges in ¶¶ 82 and 83 that the following statement in the 2008 PPM about the Bank's allowance for loan and lease loss ["ALLL"] methodology was materially misleading:

> Consistent with supervisory guidance, the Bank maintains a prudent and conservative, but not excessive, ALLL . . . , that is at a level appropriate to cover estimated credit losses on individually evaluated loans determined to be impaired as well as estimated credit losses in the remainder of the loan and lease portfolio. The Bank's estimate of credit losses reflects consideration of all significant factors that affect the collectability of the portfolio as of the evaluation date.

(2008 PPM at 31.) Plaintiffs base this allegation solely on their assertion that the FDIC OIG Audit Report states that the Bank failed to incorporate the current ALLL methodology into its loan policy. (Am. Compl. ¶ 83.)

In fact, the only reference to the Bank's ALLL in the FDIC OIG Report appears in the report's section entitled "Assessment of FDIC Supervision." (Am. Compl., Ex. 2 at pp. 17-22.) Specifically, the OIG Report states: "ROEs [Reports of Examination] from 2004 through January 2008 were generally not critical of the bank's ALLL. The DBF's ***September 2008 examination*** [i.e., *after* the 2008 PPM was prepared] noted that the bank was in contravention of the December 2006 . . .

Interagency ALLL Guidance." (*Id*. at p. 21 (emphasis added).) The OIG Report then goes on to say: "In our opinion, additional examiner attention should have been given to the analysis of the bank's ALLL. . . . Given the inherent risk in Haven's loan portfolio, ***examiners should have required bank management to develop a better methodology for determining its ALLL earlier than 2008***." (*Id*. (emphasis added).)

The 2008 PPM statement about ALLL begins with the qualifier: "Consistent with supervisory guidance, . . .," indicating that at the time the PPM was issued – March 2008 -- the Company believed that the Bank was performing its methodology in accordance with the examiners' advice. Thus, the OIG Report does not support Plaintiffs' claim that Defendants were intentionally misleading prospective investors about the efficacy of the Bank's ALLL policy or its conformance to regulatory guidance, and instead actually confirms the truthfulness of the 2008 PPM's statement about the Company's belief at the time that the Bank's ALLL methodology conformed to regulatory guidance.

Nothing in the OIG Report or the Amended Complaint alleges with the requisite specificity that Defendants were intentionally misleading prospective investors about regulatory guidance regarding the Bank's ALLL methodology. Plaintiffs' conclusory statements of falsity can be given no weight on a motion to

dismiss. *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1949 (2009); *Next Century Commc'ns Corp. v. Ellis*, 318 F.3d 1023, 1025 (11th Cir. 2003).

5. Plaintiffs' allegation that the 2008 PPM was misleading because it failed to disclose the Bank's purported "amend and pretend" practices does not meet Reform Act pleading standards.

Plaintiffs allege that the 2008 PPM omits to disclose that by 2008 the Bank "had in practice adopted a policy" of never charging off delinquent loans, but instead restructuring, extending or refinancing them. (Am. Compl. ¶ 84.) To support this allegation, Plaintiffs apparently rely on "a former Bank employee knowledgeable of the process for extending loans." (*Id*.)

These conclusory allegations do not meet the specificity requirements for Reform Act pleading. As an initial matter, the broad-side accusation lacks the specificity required by the Reform Act. The single paragraph does not identify any specific loans, amounts or terms of refinanced, or restructured or extended loans, and does not provide any allegations establishing that these refinancing and extension decisions were material and caused Plaintiffs' loss.

This lack of specificity is all the more problematic given that the source of the information is purportedly a "knowledgeable" former Bank employee. Plaintiffs do not provide any of the specific information required concerning the former Bank employee to enable Defendants and the Court to properly evaluate the

credibility of the source of the information and the accusation being made. *Mizzaro*, 544 F.3d at 1239-40. The courts have consistently dismissed 10b-5 claims based on general allegations proffered by unnamed persons with an indeterminate basis for knowledge or connection to the defendants' business. *See, e.g., Hubbard v. BankAtlantic Bancorp, Inc.*, 625 F.Supp.2d 1267, 1284-85 (S.D. Fla. 2008).

In any event, Plaintiff's allegation in essence complains of mismanagement in the handling of troubled loans. Such criticisms cannot supply the basis for a 10b-5 claim. *See Homebanc*, 2010 WL 1524836, at *20 ("In sum, at most the complaint tells a narrative of Defendants' unsound business strategy; it does not allege facts sufficient to support a cogent and compelling inference of fraud."); *see also* Section IV.E.9 *infra*.

6. Plaintiffs' allegation that the 2008 PPM was misleading because it failed to disclose that the Bank was insolvent as of January 2008 is conclusory, speculative and fails to meet applicable heightened pleading standards.

The Amended Complaint summarily asserts that the 2008 PPM was materially misleading because it failed to disclose that Haven Trust was insolvent by January 2008. (Am. Compl. ¶¶ 51, 85.) In support of this claim, Plaintiffs merely refer to an allegation made by the Company's bankruptcy trustee in the Haven Trust Bancorp Chapter 7 proceeding.

Repeating an allegation someone else has made does not change it into a specific fact or infuse the assertion with more weight or credibility. Plaintiffs offer no specific factual support for this conclusory allegation. They do not even allege that any of the financial information disclosed in either the 2006 PPM or 2008 PPM was false or fraudulent. Consequently, this sort of pleading falls well short of the heightened pleading standards imposed by the Reform Act, and cannot provide a basis for Plaintiffs' purported 10b-5 claim. *In re Spectrum Brands, Inc. Sec. Litig.*, 461 F. Supp.2d 1297, 1307 (N.D. Ga. 2006).

7. Plaintiffs' allegations that Defendants stated that Haven Trust was a "great investment opportunity" and "safe" are inactionable puffery.

The Amended Complaint mentions that in 2008 Defendants Mike and RC Patel "told investors that Haven Trust stock was a great investment opportunity" (Am. Compl. ¶ 86) and that in September 2008 they "again described the investment as safe." (Am. Compl. ¶ 88.) These statements are not actionable because they are merely puffery. *Waterford Twp. Gen. Emps. Ret. Sys. v. BankUnited Fin. Corp.,* No. 08-civ-22572 Cooke/Bandstra, 2010 WL 1332574, at *8 (S.D.Fla. Mar. 30, 2010).

8. The Amended Complaint's allegations concerning alleged insider loans are insufficient as a matter of law.

To bolster their attempt to cast Defendants as fraudfeasors, Plaintiffs parrot the FDIC OIG Report's allegations and speculations about certain loans made to Defendants, their children and related interests. (*Cf.* Am. Compl., Ex. 2 at pp. 11, 16 *with* Am. Compl. ¶¶ 40-42, 78, 109, 110.) These allegations do not pass muster under the Reform Act.

First, Plaintiffs neglect to point out that the 2008 PPM specifically disclosed to prospective investors that the Bank has entered into and will continue to enter into banking and other business transactions in the ordinary course of business with the Company's directors and officers and their related interests. (2008 PPM at 43-44.)

Second, the only thing the FDIC OIG Report and the Amended Complaint say are that the loans were made. They do not allege with any specificity that any material aspect of the loans was concealed from the Loan Committee, that the Bank's usual process for underwriting, approving and administering these loans was not followed, or that the terms of the loans differed substantially from, or involved more than the normal risk of collectibility than, loans to unrelated parties.

Third, neither Plaintiffs nor the FDIC OIG Report allege or show that the loans were not current at the time the Bank was closed by the FDIC, or that the

making of those loans, and their concealment from Plaintiffs, caused Plaintiffs' investment loss.

And fourth, even assuming *arguendo* the truth of the FDIC's descriptions and criticisms of the loans, those descriptions and criticisms suggest nothing more than mismanagement.

9. The remainder of the Amended Complaint alleges nothing more than fraud by hindsight or corporate mismanagement.

Far before the Reform Act's passage, the Supreme Court held that the federal securities laws do not provide a remedy for acts "'which constitute no more than internal corporate mismanagement.'" *Santa Fe*, 430 U.S. at 479; *see also Barr*, 324 F. Supp. 2d at 1384. Gripes about management cannot be permitted to evade the *Santa Fe* doctrine by allowing Plaintiffs to use "artful legal draftsmanship" to transform a claim arising from corporate mismanagement into a cognizable claim under federal law. *Panter v. Marshall Field & Co.*, 646 F.2d 271, 287-88, 289 (7th Cir. 1981).

Moreover, the securities laws do not allow fraud by hindsight claims. *Plumbers & Steamfitters Local 773 Pension Fund v. Canadian Imperial Bank of Commerce*, 694 F.Supp.2d 287, 301 (S.D.N.Y. 2010) (citing *Acito v. IMCERA Group, Inc.*, 47 F.3d 47, 53 (2d Cir. 1995); *DiLeo v. Ernst & Young*, 901 F.2d 624, 627 (7th Cir. 1990). "[T]he accuracy of offering documents must be assessed in

light of information available at the time they were published. . . . A backward-looking assessment . . . cannot help plaintiff's case." *Yu v. State Street Corp.*, 686 F.Supp.2d 369, 377 (S.D.N.Y. 2010).

Compounding its other fatal deficiencies discussed herein, the Amended Complaint rests in large measure on critiques of the quality and comprehensiveness of the Bank's underwriting, loan approval and credit administration policies and management's adherence to those policies. (Am. Compl. ¶¶ 63, 64, 65, 67, 77-78, 82-83, 84.) For example, Plaintiffs allege:

> The statement [in the 2006 PPM] that "when properly managed and monitored none of these categories represents a significantly higher risk than the other" was materially misleading in its omissions. First, Haven Trust's portfolio was *not* properly managed and monitored, as discussed above. Second, Haven Trust's real estate and commercial loans *both* represented unreasonable risks of default because of the Bank's deficient approval process.

(Am. Compl. ¶ 64.) Similarly, in support of their scienter allegations, Plaintiffs allege:

> First, the Bank pursued excessively risky lending practices. The Bank extended highly speculative and risky CRE and ADC loans to borrowers. The Bank's poor loan underwriting and lack of risk management controls combined with loans concentrated in high-risk CRE and ADC made the Bank particularly vulnerable to any downturn in the real estate market.

(Am. Compl. ¶ 108.)

In the same vein, Plaintiffs' heavy reliance on the opinions in the August 2009 FDIC OIG Report on Haven Trust (Am. Compl., Ex. 2) about the quality, responsiveness and operational skills of the Bank's Board of Directors and management does not save or improve their claims.

First, the opinions of the FDIC OIG are merely opinions; they are not allegations of fact. As such, they do nothing to help Plaintiffs meet the Reform Act's requirement that they plead specific facts in support of their 10b-5 claim. *See Homebanc*, 2010 WL 1524836, at *9.

Second, these *post mortem* assertions, opinions and comments in the FDIC OIG Report are nothing more than allegations of mismanagement made with the benefit of hindsight. *See In re Serologicals Sec. Litig.*, No. Civ.A. 1:00-CV1025CAP, 2003 WL 24033694, at *10 (N.D. Ga. Feb. 20, 2003) (plaintiffs' use of SEC order to bolster allegations was demonstrative of fraud by hindsight and did not support a strong inference of scienter). Their character and weight, for purposes of satisfying the Reform Act's pleading standards, are not transformed merely because they were made by a regulatory authority.

F. The Complaint Does Not State a Claim for "Control Person" Liability.

As shown, the Amended Complaint fails to state a claim against any Defendant for a primary 10b-5 violation or primary violation of § 10-5-12(a) of the

Georgia Securities Act of 1973. Thus, there can be no claim for "control person" liability under Section 20(a), 15 U.S.C. § 78t(a), or § 10-5-14(c) of the Georgia Securities Act of 1973. *Mizzaro*, 544 F.3d at 1255; O.C.G.A. § 10-5-14(c).

G. Plaintiffs Have Failed to State a Cognizable Negligence/Negligent Misrepresentation Claim.

Plaintiffs attempt to assert an amorphous negligence/negligent misrepresentation claim in Count III. Plaintiffs merely allege that "the Defendants breached their legal duty to provide accurate information to each Class Member as prospective purchasers of investments in Haven Trust . . . ." (Am. Compl. ¶ 103.) This negligent misrepresentation claim fails, however, because Defendants are not subject to this claim, and Plaintiffs do not properly allege the essential elements of actual reliance and loss causation.

In *Holmes v. Grubman*, 286 Ga. 636, 691 S.E.2d 196 (Ga. 2010), the Supreme Court of Georgia answered certified questions from the Second Circuit about whether Georgia common law recognizes fraud and negligent misrepresentation claims based on forbearance in the sale of publicly traded securities. The court answered the questions in the affirmative, but in so doing, set forth strict limitations as to the scope of a negligent misrepresentation claim. Specifically, the court held that a negligent misrepresentation claim is viable only when a plaintiff can allege and prove (in addition to the other essential elements)

direct communication with a defendant and ***specific reliance*** on that defendant's communication. *Holmes*, 286 Ga. at 199-200, 691 S.E.2d at 638-41 (emphasis added).

Here, Plaintiffs do not allege any direct communication with any Defendant or specific reliance on any Defendant's communication with any of them. The only specific communications Plaintiffs point to are the 2006 and 2008 PPMs, but those documents are not communications by any of the individual Defendants; they are the communications of the Company. Ignoring this distinction and critical limitation on the scope of a negligent misrepresentation claim in the circumstances presented by the instant case would expose every individual associated with an entity personally liable for negligent misrepresentation for all of that entity's communications. Such a gross expansion of the claim would contravene Georgia law and undermine the policy reasons for the Supreme Court of Georgia's affirmative decision to place strict limitations on such causes of action, as discussed and referenced in the *Holmes* decision.

In Paragraph 86, Plaintiffs allege that Defendants RC and Mike Patel made at least two "road show" presentations, but they do not allege that any of them attended those events, nor do they identify any specific alleged misrepresentation or omission. Thus, this allegation does not meet the *Holmes* requirements.

Plaintiffs' allegation in Paragraph 88 that Defendants RC and Mike Patel solicited Plaintiff Mukta Patel fails for the same reasons.

Furthermore, as a general rule, "negligent misrepresentation generally applies to professional defendants only, who provide information that is false through failure to exercise reasonable care or competence in obtaining information that is relied upon by a third party." *Smiley v. S & J Invs., Inc.*, 260 Ga. App. 493, 496, 580 S.E.2d 283, 287 (2003). Plaintiffs do not and cannot allege that any of the Defendants are professionals.

Some courts have held that negligent misrepresentation applies to a defendant who has a pecuniary interest in the underlying transaction. *See American Casual Dining, L.P. v. Moe's Southwest Grill, L.L.C.*, 426 F.Supp.2d 1356 (N.D. Ga. 2006) (citing *Smiley*, *supra*). However, Plaintiffs do not and cannot allege Defendants sold their own stock to them. Instead, the Company was the issuer and the only person or entity that had a direct pecuniary interest in the subject investment transactions.

In any event, the claim for negligent misrepresentation fails because Plaintiffs fail to properly allege actual reliance and loss causation, which are essential elements under Georgia law. *See Holmes*, 286 Ga. at 640-43, 691 S.E.2d at 199-201; Section § IV.C, *supra*.

H. There is no Basis for Subject Matter Jurisdiction Under 28 U.S.C. § 1332(d)(2).

Plaintiffs allege 28 U.S.C. § 1332(d)(2) as an alternative basis for subject matter jurisdiction in this case. However, 28 U.S.C. § 1332(d)(4)(B) provides that "a district court ***shall*** decline to exercise jurisdiction under [§ 1332(d)(2) where] . . . two-thirds or more of the members of all proposed plaintiff classes in the aggregate, and the primary defendants, are citizens of the State in which the action was originally filed." Also, 28 U.S.C. § 1332(d)(5)(B) provides that § 1332(d)(2) is not available where the number of all proposed classes in the aggregate is less than 100.

Excluding Defendants and their immediate family members, the Company had 76 shareholders. There are 23 shareholders who, on information and belief, are not citizens of Georgia. (Sawicki Decl., Ex. 1.) Thus, more than two-thirds of the members of all proposed plaintiff classes in the aggregate, and the primary defendants, are citizens of Georgia. (Sawicki Decl., Ex. 1; Am. Compl. ¶¶ 9-21.) Accordingly, there is no basis for subject matter jurisdiction over this action pursuant to 28 U.S.C. § 1332(d)(2).

Consequently, upon the dismissal of Plaintiffs' only federal claims (the 10b-5 claim and the "control person" claim in Counts IV and V) for failure to state any claim upon which relief can be granted, and if the Court decides not to dismiss the

remaining claims under Fed. R. Civ. P. 12(b)(6) for the reasons set forth above, the Court should dismiss the state law claims for lack of subject matter jurisdiction, and decline to exercise supplemental jurisdiction over those claims pursuant to 28 U.S.C. § 1367(c)(3). *Nolin v. Isbell,* 207 F.3d 1253, 1258 (11th Cir. 2000).

V. CONCLUSION

For the reasons set forth herein, Defendants respectfully move the Court to dismiss the Amended Complaint in its entirety pursuant to Fed. R. Civ. P. 12(b)(6). In the alternative, and in the event the Court dismisses only the federal claims pursuant to Fed. R. Civ. P. 12(b)(6), Defendants respectfully move the Court to dismiss the remaining state law claims pursuant to Fed. R. Civ. P. 12(b)(1) and 28 U.S.C. § 1367(c)(3).

Further, Defendants respectfully pray for such other and further relief as the Court deems just and proper, including and not limited to sanctions for abusive litigation, per the provisions of Fed. R. Civ. P. 11 and 15 U.S.C. § 78u-4(c). *Ledford v. Peeples*, 605 F.3d 871 (11th Cir. 2010).

Dated: July 16, 2010

Respectfully submitted,

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CERTIFICATION OF TYPEFACE COMPLIANCE

Pursuant to LR 7.1(D), NDGa., counsel for Defendants hereby certifies that this brief has been prepared with one of the font and point selections approved by the Court in LR 5.1, NDGa.

IN THE UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

MUKTA PATEL, et al., Plaintiffs, v. MUKESH C. PATEL, et al., Defendants.	)	**CASE NO: 1:09-CV-3684CAP**

CERTIFICATE OF SERVICE

I hereby certify that on this date, I electronically filed the foregoing with the Clerk of Court using the CM/ECF system, which will automatically send email notification of such filing upon Counsel of Record.

Dated: July 16, 2010.

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