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

MUKTA PATEL, ASHOK PAREKH, JITU PATEL, and ANDREA and PHIL BOSWELL, on Behalf of Themselves and All Others Similarly Situated, Plaintiffs,	:	Case No.: 09-CV-3684-CAP
v.	:	CLASS ACTION
MUKESH C. PATEL, R.C. PATEL, EDWARD L. BRISCOE, SCOTT DIX, BRIJ M. KAPOOR, MUKUND R. PATEL, NARENDA D. PATEL, DHIRU G. PATEL, and BALVANT PATEL, Defendants.	:	DEMAND FOR JURY TRIAL ORAL ARGUMENT REQUESTED

PLAINTIFFS' MEMORANDUM OF LAW IN
OPPOSITION TO DEFENDANTS' MOTION TO DISMISS

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Court-appointed Lead Plaintiff Mukta Patel (Dkt. 22), and additional plaintiffs Ashok Parekh, Jitu Patel, and Andrea and Phil Boswell, on behalf of themselves and the class ("Plaintiffs"), respectfully submit this memorandum in opposition to Defendants' Motion to Dismiss (Dkt. 27) the operative Amended Complaint ("Complaint").[1]

PRELIMINARY STATEMENT

Faced with detailed allegations about their failures to simply tell the truth, Defendants make the remarkable response that they were forbidden from doing so by government regulations. Defendants then blame the economy for the failure of Haven Trust Bancorp, Inc. ("Haven Trust" or the "Company"), and even go so far as to blame the Plaintiffs for investing in Haven Trust in the first place (Defs' Mem. at 1, 3)[2], despite the fact that Plaintiffs did not invest in Defendants' commercial loans, but instead on Defendants' representations. Defendants' Motion ignores that it was their reckless malfeasance in operating Haven Trust that led to the Company's demise, and their own failure to tell investors about the Company's true financial condition and business operations that makes them liable for the

1 Although captioned as an amended pleading, the Complaint was filed following the Court-appointment of the Lead Plaintiff, pursuant to 15 U.S.C. § 78u-4 (*see* Dkt. 22), but was never amended based on a pleading challenge by the Defendants.

2 References to Defendants' accompanying Memorandum of Law (Dkt. No. 27-2) are cited as "Defs' Mem. at __."

claims asserted. Indeed, as this Court observed in *Johnson v. Aegon USA, Inc.*, 355 F. Supp. 2d 1337, 1345 (N.D. Ga. 2004) (Pannell, J.): "[D]isclosure is the overarching policy chosen and expressed by Congress in the various Securities Acts…. Courts have consistently recognized that a fundamental purpose of the various Securities Acts, 'was to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry.'"

Defendants' attacks on the adequacy of Plaintiffs' allegations, while lengthy, are unavailing. Defendants first argue that Plaintiffs' Georgia Securities Act ("GSA") claims (*see* Claims I and II) must be dismissed because it is "incontrovertible" that such claims sound in fraud.[3] However, plain language in the statute suggests otherwise. Moreover, the Eleventh Circuit has found uncertain whether scienter is required for such claims, and the Georgia Supreme Court has yet to even address the issue. In challenging the fraud claims (*see* Claims IV, VI, VII and VIII), Defendants urge the Court to make premature decisions on materiality, and to impose and apply improper pleading standards for scienter and

3 The class includes those who purchased Haven Trust stock between April 1, 2006 and December 12, 2008 (the "Class"); claims are also brought only on behalf of persons who made purchases between December 31, 2007 and December 12, 2008 (the "Subclass"). (¶ 1).

loss causation. Defendants' related challenge to control person liability (*see* Claims I, II, V, VI and VII) likewise fails, as this Court and other courts have held that officers and directors can be held liable for the primary acts of a bankrupt corporation, even where the corporation is not named as a defendant. Defendants also ignore caselaw from the Georgia Supreme Court in arguing that they cannot be held liable for negligence (*see* Claim III).

To the extent Defendants seek to blame the economy, or even Plaintiffs for investing in the Company, these are prematurely asserted fact-based defenses that should be reserved for the jury, or at least summary judgment on a full factual record. Nevertheless, the "Material Loss Review of Haven Trust Bank" (the "Audit Report"), conducted by the Office of Inspector General ("OIG") for the Federal Deposit Insurance Corporation ("FDIC"), sets forth the reasons for Haven Trust's collapse in its very first sentence (Dkt. 23-3, at ECF p.3): "Haven failed due to bank management's lack of oversight and failure to control risk in its loan portfolio." Here, in sum, the scope of the allegations reflect the breath of Defendants' claimed wrongdoing and not impermissible pleading as Defendants argue (*see, e.g.*, Dkt. 22; *Davis v. Coca-Cola Bottling Co.*, No. 05-12988, 2008 WL 314962 (11th Cir. Feb. 6, 2008)). Defendants are not being prosecuted for

mismanagement, but for their failure to tell the truth and for concealing from investors Haven Trust's true financial condition and business operations. Plaintiffs' Complaint sufficiently alleges plausible claims against each Defendant.

STATEMENT OF FACTS

I. Founding and Operations of Haven Trust

The Company was founded as Horizon BanCorp, Inc. in 2000 by defendants Mukesh ("Mike") Patel and R.C. Patel, and changed its name to Haven Trust Bancorp, Inc. in 2005. (¶¶ 13, 14).[4] The Company was organized as a shell holding company for Haven Trust Bank (f/k/a Horizon Bank) (the "Bank"), and had no business operations other than the Bank, its sole and wholly-owned subsidiary.[5] (¶ 33). The Company was a vehicle to obtain cash for the Bank by selling the Company's common stock to investors, including Plaintiffs.

Haven Trust and the Bank were operated and controlled by defendants Mike Patel, R.C. Patel, Edward L. Briscoe, Scott Dix, Brij M. Kapoor, Mukund R. "Bobby" Patel, Narenda D. "Tony" Patel, Dhiru G. "Danny" Patel, and Balvant

4 References to the Complaint (Dkt. 23) are cited as "¶ __."

5 Haven Trust was a private corporation organized under the laws of Georgia. The Bank was a Georgia state-chartered bank, headquartered in Duluth, Georgia. The Bank operated four branches in Atlanta and had loan production offices in Birmingham, Alabama and Oklahoma City, Oklahoma. (¶ 33).

Patel (collectively, "Defendants"). (¶¶ 13-23). As Directors of *both* the Company and the Bank, the Defendants were responsible for and controlled the operations of both entities. (¶¶ 23, 127-129). In addition, as the founders, defendant Mike Patel (who also served as the Chairman of Haven Trust) and his brother, defendant R.C. Patel, along with Haven Trust's President and Chief Executive Officer, defendant Edward Briscoe, shared in the daily operations of the Company and the Bank. (¶¶ 13-14).[6]

From its inception, Haven Trust grew at a rapid pace, from $29 million in assets in its first year of operation in 2000, to approximately $575 million by 2008, or an increase of over 40% per year. (¶ 35). This rapid growth was largely predicated on the use of non-core funding, including brokered deposits, which were used for risky ADC loans and other types of CRE lending.[7] (¶¶ 38-44). This

6 Haven Trust initially marketed itself to the Indian and Asian-American communities, and likewise focused much of its efforts to sell the Company's common stock to those same communities. (¶ 33). The Bank concentrated its loan portfolio in commercial real estate (CRE) with a focus in acquisition, development and construction (ADC) and in lending related to hotels and motels. (¶ 34).

7 Brokered deposits are certificates of deposits that are marketed to independent brokers who are charged with dividing the holdings of cash-rich individuals or businesses in order to obtain FDIC insurance coverage. Although such deposits may boost liquidity, those deposits pose profitability and other risks, as they often

strategy gave an outward *appearance*, albeit false, of viability, while the Atlanta real estate market was performing well and Haven Trust's return on assets compared favorably to its peers. However, Haven Trust was eventually exposed as a house of cards, built through reckless lending practices to fund highly-speculative and excessively risky loans, some of which were self-dealing in nature, and a failing to adhere to applicable laws and regulations – all of which Defendants omitted to disclose to the investors they solicited, and which forms the core of Plaintiffs' claims in this litigation. (¶¶ 38-44).

II. Haven Trust's False PPMs

In order to fund the Bank's growth, Defendants marketed and sold to investors Haven Trust stock. (¶ 60). Specifically, Defendants solicited investors through private placement memorandums (PPMs), which were drafted and approved by Defendants. (¶¶ 22, 26). The first stock offering was in March 2006 (¶¶ 61-72), with a second offering in March 2008 (¶¶ 73-88). The 2006 and 2008 PPMs, however, concealed the true financial condition and business operations of Haven Trust, and specifically omitted to disclose the Bank's excessively risky lending practices, and the Defendants' self-dealing transactions, violations of laws

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require enhanced interest returns and may be legally precluded by bank regulations if, as here, a bank falls short of being classified as "well capitalized." (¶¶ 43-44).

and regulations related to loan underwriting deficiencies, and complete failure to address and correct the numerous known operating improprieties that had been repeatedly identified by federal and state regulators, including the FDIC and the Georgia Department of Banking and Finance ("GDBF"). Defendants' knowing failure to heed "red flags" identified by regulators directly led to the eventual collapse of Haven Trust in December 2008, when it then had assets in excess of $500 million. (¶¶ 2-3, 36-37, 45-59).

Specifically, the PPMs stated that the Bank had an "internal loan limit" but omitted that the Bank did *not adhere to the stated loan limit*, as evidenced by several specified exceptions. (¶¶ 58, 62-63; *see also* ¶¶ 74-76). The PPM also stated that the loan portfolio is comprised of real estate and commercial loans, as well as consumer loans, and that none of these categories represents a relatively higher risk "when properly managed and monitored," but misleadingly omitted that Haven Trust's *loans were not properly managed and monitored* – a fact subsequently confirmed by the FDIC's Audit Report and flagged as a core cause of the Bank's collapse. (¶¶ 58, 62, 64; *see also* ¶¶ 74-76). In addition to concealing the true relative risks of CRE and other loans, the PPM omitted other critical operating deficiencies, in that loans were *inadequately collateralized*, *borrowers*

lacked creditworthiness, and the *core loan-to-value ratios were as high a 100%*. In providing investors with other false assurances of propriety, the PPM further omitted truthful descriptions of the Bank's so-called "Loan Committee" and the actual oversight provided by federal and state regulators (¶¶ 65-71, 74-76), and the fact that some dubious "loans" simply funneled Bank funds to Company insiders through their children. (¶¶ 38, 40-42, 109-110). The undisclosed truth was that not only had the regulators repeatedly warned Defendants as to critical operational problems, but that Defendants knowingly or recklessly failed to both remedy and timely disclose such "red flags" to the investors they solicited. (¶¶ 2, 45-50, 58-59, 69-71, 81).

III. Collapse of Haven Trust and the Revelations of the Truth

During the period December 2000 through January 2008, the FDIC and the GDBF conducted seven safety and soundness examinations of the Bank. (¶ 45). The resulting Reports of Examination ("ROEs") were not made public. (¶ 45). However, those ROEs were provided to the director Defendants, contained the FDIC's detailed admonitions concerning Haven Trust's operations and regulatory non-compliance, and specifically warned Defendants on an ongoing basis – to no

avail – of numerous deficiencies and improprieties which required prompt remediation. (*See, e.g.*, ¶¶ 2, 45-50, 58-59, 69-71, 81).[8]

On August 12, 2008, the FDIC informed Defendants that its latest examination had led to a downgrade in the Bank's classification from "well capitalized" to "adequately capitalized." (¶ 52). By September 2008, with the Bank insufficiently capitalized, experiencing high default rates and no longer viable as a going concern, the Bank was forced to enter into a Memorandum of Understanding with the FDIC, to "address examination concerns, including apparent violations of laws and regulations, inadequate risk management controls, and other safety and soundness issues." (¶ 53). In September 2008, the GDBF also commenced an examination, which further confirmed significant deteriorations and concluded that the Bank was no longer viable. (¶ 54). On November 17, 2008, the FDIC found that the Bank had been "undercapitalized" since at least September 30, 2008, and

8 Defendants were repeatedly warned of regulatory violations, occurring between 2004 and 2008, related specifically to: *Part 365 of Appendix A to Interagency Guidelines* (failure to report excessive loan-to-value ratios); *Section 323.5(b)(1) of FDIC Rules and Regulations* (appraisal independence); *Federal Reserve Board Regulation O* (credit); *Part 364 of FDIC Rules and Regulations* (unreasonable director compensation); *Part 337 of FDIC Rules and Regulations* (improper brokered deposits); and *Federal Reserve Part 23A and Georgia Banking Rules* (improper dividend payments). (¶¶ 47, 49(a) to (g)).

imposed additional restrictions on asset growth, dividends, distributions and management fees – all of which remained undisclosed to investors. (¶ 55).

On December 12, 2008, the GDBF announced publicly that the Bank had been closed, with the FDIC appointed as receiver. (¶ 3). At that time, the Bank had assets (or outstanding loans) of $572 million, with customer deposits of only $515 million. (¶ 57). The resulting liquidation costs to the FDIC's insurance fund was estimated to be in excess of $200 million. (¶ 3). The Bank's collapse rendered Haven Trust's stock worthless, resulting in damage to Plaintiffs' investments. (¶¶ 37, 89).[9] According to later admissions by the Haven Trust Bankruptcy Trustee, the Company's deteriorating financial condition had rendered the Company effectively insolvent by at least *January 2008* – well *before* the March 2008 PPM and private sale of stock to the Subclass. (¶ 51). Following the Bank's failure, the FDIC's OIG conducted a mandatory review of the Bank's failure and concluded that (¶ 85):

> The key cause of failure of the institution was that its BOD [Board of Directors] did not adequately identify, measure, monitor, and control risk in its loan portfolio. Bank management pursued an aggressive loan growth

9 Haven Trust also filed for liquidation under Chapter 7 of the federal Bankruptcy Code. *See In re Haven Trust Bancorp., Inc.*, No. 09-64497-mgd (Bankr. N.D. Ga.) (filed Feb. 23, 2009).

> strategy concentrated in high-risk CRE construction and development loans with poor loan underwriting and funded by high-cost deposits and borrowings…. By and large, bank management ignored the increasing risks of the bank's loan originations and failed to address examiner concerns or take appropriate steps to manage those risks.
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> ****
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> Management's lack of oversight and failure to control risk led to substantial losses and capital and liquidity erosion that accelerated the bank's deterioration and eventual failure.

The Audit Report provided a detailed analysis supporting its conclusions; included specific examples of Defendants' alleged misconduct; and concluded that Defendants failed to address and correct the deficiencies and improprieties that the FDIC had been warning of since 2002. Dkt. 23-3, at ECF pp. 9-22.[10]

ARGUMENT

Defendants largely bypass the standards courts apply on a motion to dismiss. Under Rule 12(b)(6), a complaint should be dismissed only where the facts alleged fail to state a "plausible" claim for relief. *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1949 (2009). Further, all well-pleaded facts in the complaint are to be accepted as true,

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10 The Audit Report is attached to, and incorporated in, Plaintiffs' Complaint, *see* Dkt. 23-3; *Prager v. FMS Bonds, Inc.*, No. 09-cv-80775, 2010 U.S. Dist. LEXIS 74820, at *6 (N.D. Ga. July 26, 2010) (in deciding a motion to compel, "'[c]ourts must also consider the complaint in its entirety, including 'documents incorporated in the complaint by reference'").

and all reasonable inferences are to be construed in the light most favorable to the plaintiff. *Ziemba v. Cascade Int'l, Inc.*, 256 F.3d 1194, 1198 n.2 (11th Cir. 2001).[11]

I. PLAINTIFFS HAVE PROPERLY PLEADED NON-FRAUD CLAIMS PURSUANT TO THE GEORGIA SECURITIES ACT

Claims I and II of Plaintiffs' Complaint assert claims under the GSA, O.C.G.A. §§ 10-5-12 and 10-5-14. The GSA provides for both legal damages and rescissionary relief.[12] Defendants seek to avoid answering altogether Claims I and II by arguing that it is "incontrovertible" and "beyond genuine dispute that scienter is an essential element of claims under O.C.G.A. §§ 10-5-12 and 10-5-14." Defs' Mem. at 15. However, Defendants cite no decision by the Georgia Supreme Court endorsing such a sweeping proposition. Defendants also fail to even discuss the language of the statute, which provides as follows:

> (2) In connection with an offer to sell, sale, offer to purchase, or purchase of any security, directly or indirectly:

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11 While Plaintiffs' fraud claims require particularity under Fed.R.Civ.P. 9(b) (*see* Claims IV, V, VI, VII and VIII), notice pleading under Fed.R.Civ.P. 8(a) applies to Plaintiffs' non-fraud claims (*see* Claims I, II and III). *Accord Hays v. Adam*, 512 F. Supp. 2d 1330, 1346 (N.D. Ga. 2007) (Pannell, J.) (requiring "short and plain statement of the claim").

12 Notably, Claims I (for legal damages) and II (for rescissionary relief) are pleaded as non-fraud causes of action, while Claims VI and VII, discussed below, are pleaded in the alternative as fraud-based claims for damages under O.C.G.A. §§ 10-5-12 and 10-5-14. *Accord* Fed.R.Civ.P. 8(d)(2).

> (A) To employ a device, scheme, or artifice to defraud;
>
> (B) To make an untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading; or
>
> (C) To engage in an act, practice, or course of business that operates or would operate as a fraud or deceit upon a person; ....

O.C.G.A. § 10-5-12(a)(2). Unlike cases where a plaintiff invokes subsections (A) and (C), Claims I and II here rely on the non-fraud provision of subsection (B). Indeed, the fact that subsections (A) and (C) specifically reference a fraud requirement, but subsection (B) does not, suggests that the culpable conduct is, in fact, different, as other courts have held, as discussed more fully below.

As Defendants point out, two intermediate appellate courts have held that O.C.G.A. § 10-5-12(a)(2) claims – in general – require scienter, observing that the statute tracks the language of SEC Rule 10b-5, 17 C.F.R. § 240.10b-5, which was promulgated pursuant to the anti-fraud provisions of § 10(b) of the Securities Exchange Act of 1934 (the "1934 Act"), 15 U.S.C. § 78j(b). *See Keogler v.*

Krasnoff, 268 Ga. App. 250, 254, 601 S.E.2d 788 (2004); *GCA Strategic Inv. Fund v. Joseph Charles & Assocs.*, 245 Ga. App. 460 537 S.E.2d 677 (Ga. App. 2000).[13]

First, however, neither the Georgia Supreme Court nor the Eleventh Circuit has definitively resolved this issue. Further, this Court has observed that the language of subsection (B) tracks the language of the non-fraud provision of § 12(a)(2) of the Securities Act of 1933 ("1933 Act"), 15 U.S.C. § 77l(a)(2), which was modeled on section 410(a)(2) of the Uniform Securities Act (the "Uniform Act"). *See Abrams & Wofsy v. Renaissance Inv. Corp.*, 820 F. Supp. 1519, 1528 (N.D. Ga. 1993) (O'Kelley, J.).[14] Courts of other states with similar statutes and

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13 Notably, § 10(b) of the 1934 Act is entitled "Manipulative and Deceptive Devices." *Accord* SEC Rule 10b-5. By contrast, O.C.G.A. § 10-5-12 is entitled "Unlawful practices," thus ostensibly encompassing both fraudulent and non-fraudulent conduct.

14 Section 12(a)(2) does not require scienter. *See Johnson v. Aegon USA, Inc.*, 355 F. Supp. 2d at 1343 (plaintiff need only allege the prospectus "(1) contained an untrue statement of a material fact; (2) omitted to state a material fact required to be stated therein; or (3) omitted to state a material fact necessary to make the statements therein not misleading"); *Taam Assocs. v. Housecall Med. Res., Inc.*, No.96-cv-2214A, 1998 U.S. Dist. LEXIS 22372, at *13 n.3 (N.D. Ga. Mar. 30, 1998) ("negligent conduct" sufficient for § 12(a)(2) of the 1933 Act) (citing *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976)).

also commentators (including a former director of the Georgia Securities Division) are in accord.[15]

Both the Eleventh Circuit and this Court have voiced some uncertainty as to the *mens rea* required under O.C.G.A. 10-5-12(a)(2)(B). For example, in *Friedlander v. Troutman, Sanders, Lockerman & Ashmore*, 788 F.2d 1500, 1508 & n.10 (11th Cir. 1986), the Eleventh Circuit acknowledged that courts, including the Fifth Circuit, have found ambiguity and held that, "[g]iven our disposition of this case, we need not resolve the question of whether or not the Georgia blue sky law requires scienter." *See also Diamond v. Lamotte*, 709 F.2d 1419, 1423 (11th Cir. 1983) ("it is not clear that there is such a [scienter] requirement under the Georgia blue sky statute").[16] Nor, as noted, has the Georgia Supreme Court resolved the

15 Indeed, nearly every state that has enacted a statute modeled on section 410(a)(2) of the Uniform Act has concluded likewise. *See* J. Steven Parker and Jason R. Doss, *Georgia Securities Act-Let the Buyer Beware!*, Ga. Bar J., at 16-17 & n.20 (June 2005) (attached as Exhibit 1) (citing court decisions from Colorado, South Carolina, Minnesota, Indiana, and Washington). *See also Gilliland v. Hergert*, No. 05-01059, 2008 WL 2682587 at *5-7 (W.D. Pa. July 1, 2008) (predicting Pennsylvania Supreme Court would recognize that 70 Pa. Stat. § 1-501 does not require proof of scienter).

16 Without differentiating subsection (B), the Eleventh Circuit has also stated in other cases, more generally, that § 10-5-12(a)(2) requires the same proof as SEC Rule 10b-5. *See Ledford v. Peeples*, 605 F.3d 871, 895 n.65 (11th Cir. 2010); *Pelletier v. Zweifel*, 921 F.2d 1465, 1511 (11th Cir. 1991).

issue and it is at least conceivable that the Georgia Supreme "might render" a decision contrary to *Keogler*. *Accord Doyle v. Volkswagenwerk Aktiengel-Ellschaft*, 81 F.3d 139, 143 (11th Cir. 1996).[17]

Accordingly, if there remains any doubt, the Court should not at a minimum dismiss on a highly disputed issue of law as Defendants assert, but instead certify to the Georgia Supreme Court the question of whether subsection (B) requires scienter. *See, e.g.*, *Shields v. BellSouth Advertising & Publ'g Co.*, 228 F.3d 1284, 1290-91 (11th Cir. 2000) (holding that "'when such doubt exists as to the application of state law, a federal court should certify the question to the state supreme court to avoid making unnecessary state law guesses and to offer the state court the opportunity to interpret or change existing law'") (citation omitted).[18]

During the pendency of the certified question to the Georgia Supreme Court, this litigation can also proceed, as a resolution of the above state law question does

17 Denial of certiorari in *Keogler* (268 Ga. App. 250) is not precedential and does not provide authoritative guidance "'on the merits of the decision'" that was being appealed. *Wilson v. Baldwin*, 239 Ga. App. 327, 519 S.E.2d 251 (1999) (emphasis and citation omitted).

18 "Only a state supreme court can provide what we can be assured are 'correct' answers to state law questions, because a state's highest court is the one true and final arbiter of state law." *Id.* (citation omitted). *See, e.g.*, *Holmes v. Grubman*, No. S09Q1585, –S.E.2d–, 2010 WL 424225 (Ga. Feb. 8, 2010) (answering certified questions on Georgia state law regarding negligent misrepresentation).

not implicate this Court's core jurisdiction, but instead involves a discrete question concerning only two of the eight claims asserted. *See Castaneda v. Burger King Corp.*, 597 F. Supp. 2d 1035 (N.D. Cal. 2009) (rejecting stay during pendency of certified questions, even where jurisdiction was at issue).

II. PLAINTIFFS HAVE PROPERLY PLEADED A CLAIM FOR NEGLIGENT MISREPRESENTATION AND OMISSION

As Defendants must acknowledge, the Georgia Supreme Court recently reaffirmed the viability of claims for negligence in securities litigation. *See Holmes v. Grubman*, 2010 WL 424225. There, Georgia's high court held that "'[t]he same principles apply to both fraud and negligent misrepresentation cases … [the only real distinction between the two is the] absence of the element of knowledge of the falsity of the information disclosed.'" *Id.* at *4 (citation omitted).[19]

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19 Defendants' correctly note that *Holmes* extended negligence claims to so-called "holder" cases, where the plaintiff forebears in selling securities. By contrast, the claims here involve omissions in Plaintiffs' *purchases* of stock. Defendants' efforts to impose on Plaintiffs certain "holder" case requirements, such as "direct communications" with a defendant and "specific reliance" thereon, are therefore misplaced. *See* Defs' Mem. at 36-38. Nevertheless, the omissions were in Defendants' direct communications to Plaintiffs vis-à-vis the false 2006 and 2008 PPMs (*see supra*). Here, moreover, direct reliance is inapplicable in any event because this case involves primarily one of omissions. *See In re Piedmont Office Trust Sec. Litig.*, 264 F.R.D. 693, 701 (N.D. Ga. 2010) (Pannell, J.) (quoting *Affiliated Ute Citizens of Utah v. U.S.*, 406 U.S. 128, 153-54 (1972)) ("The Supreme Court has held in that a case that involves primarily a failure to disclose,

As control persons of Haven Trust who issued, and were identified in, the misleading PPMs, Defendants were effectively in privity with Plaintiffs. Even without such privity, however, courts have held that "[a]n exception has been carved out in those cases where a known third party's reliance was the desired result of the representation." *Robert & Co. Assocs. v. Rhodes-Haverty P'ship*, 250 Ga. 680, 681, 300 S.E.2d 503, 504 (1983). In *Robert & Co.*, the Georgia Supreme Court relied on the *Restatement of the Law, Second, Torts*, § 552, which states, in pertinent part (*id.* at n.1*)*:

> (1) One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.
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> (3) The liability of one who is under a public duty to give the information extends to loss suffered by any of the class of persons for whose benefit the duty is created, in any of the transactions in which it is intended to protect them.

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positive proof of reliance is not a prerequisite to recovery. 'All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of this decision.'").

Here, as senior officers and/or as paid Directors of Haven Trust, the Defendants omitted to state numerous material facts in connection with the sale of the Company's stock to Plaintiffs, including adverse information about the Company's excessively risky lending practices; inadequate loan practices; inadequate loan underwriting; inadequate credit administration procedures (¶¶ 2, 38, 40-42, 64, 65-71, 74-76); and violations of federal and state law that resulted from its unlawful business operations (¶¶ 47, 49, 69). These claims are clearly cognizable under Georgia statutory and common law. *See, e.g.,* O.C.G.A. §§ 51-1-6 and 51-1-8; *Holmes v. Grubman*, 2010 WL 424225, at *4; *Brown v. Moe's Southwest Grill, LLC*, No. 1:07-CV-0741-RWS, 2009 U.S. Dist. LEXIS 119775, at *9-11 (N.D. Ga. Dec. 21, 2009) (denying summary judgment as to negligent omission claim based on factual dispute).[20]

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20 Defendants' reliance on *Smiley v. S&J Investments, Inc.*, 260 Ga. App. 493, 580 S.E.2d 283 (2003) and *Am. Casual Dining , L.P. v. Moe's Southwest Grill, LLC*, 426 F. Supp. 2d 1356 (N.D. Ga. 2006) is inapt. Contrary to Defendants, liability for negligence claims is not limited to so-called "professionals" or to those "with a pecuniary interest." Each Defendant here is alleged to have acted "in the course of his business, profession or employment" in concealing key information from Plaintiffs. *Accord Restatement of Torts, Second*, § 552(1). Moreover, liability also extends to "one who is under a public duty to give the information," for losses "suffered by any of the class of persons for whose benefit the duty is created." *Id.* § 552(3). Here, Defendants' omissions occurred in the context of the PPMs that are required by Georgia law for the protection of Plaintiffs and other investors.

III. PLAINTIFFS PROPERLY PLEADED FRAUD UNDER THE GSA AND SECTION 10(b) OF THE SECURITIES EXCHANGE ACT

Plaintiffs have narrowly limited their primary-liability fraud claims to three defendants, *i.e.*, Mukesh ("Mike") Patel, R.C. Patel and Edward Briscoe (the "Fraud Defendants").[21] Each Fraud Defendant served as a senior officer and/or Director of Haven Trust and the Bank, and thereby not only exerted control over those entities, but possessed actual knowledge as to the true financial condition and business operations of the Company and the Bank. (¶¶ 13-15, 45-50, 58, 107-114). *Accord* Dkt. 23-3, at ECF pp.22-23 (documenting Fraud Defendants' knowledge of undisclosed deficiencies and improprieties since 2002).

A. Plaintiffs Have Pleaded with the Requisite Particularity

As discussed above, the Fraud Defendants omitted to timely disclose several highly material facts in connection with Plaintiffs' purchases of Haven Trust stock, many of which pertain to the 2006 and 2008 PPMs, including:

- *the Bank's excessively risky and undisclosed lending practices*, where highly-speculative and risky loans were made in connection with CRE and ADC activities without adequate collateral, credit requirements and loan-to-value rations (¶¶ 2, 62-64, 65-71, 74-76);

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21 *See* Claim IV (§ 10(b) of the 1934 Act) and Claims VI and VII (O.C.G.A. §§ 10-5-12 and 10-5-14). As discussed in Section I above, Claims I and II are pleaded under Fed.R.Civ.P. 8(d)(2) in the alternative as non-fraud securities violations against all of the Defendants.

- *the Defendants' self-dealing transactions*, including at least nine loans totaling $12 million that were made to "Bank owners and their related interests," some of which were made to a shell corporation controlled by the family of R.C. Patel (¶¶ 38, 40-42);

- *the Bank's violation of laws and regulations related to loan underwriting deficiencies*, notwithstanding that the FDIC and GDBF repeatedly warned Defendants and admonished them to take corrective measures (¶¶ 45-50, 58); and

- *the Defendants' failure to heed the "red flag" warnings* as to operating improprieties and regulatory violations which required immediate remediation and correction, as the FDIC found Defendants' failures to be the cause of Haven Trust's collapse (¶¶ 2, 45-50, 58-59, 69-71, 81).

Plaintiffs' allegations concerning these specific deficiencies are supported by the FDIC's Audit Report, including the findings of the FDIC's OIG as to the causes of Haven Trust's failure. (¶ 58). In short, Plaintiffs have adequately pleaded the "who, what, why and where" of Defendants' omissions in failing to timely disclose to investors material adverse information about the Company's actual operations and financial condition.[22]

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22 On reply, Defendants may cite *Waterford Twp. Gen. Employees Ret. Sys. v. SunTrust Banks, Inc.*, No. 1:09-cv-00617-TWT, 2010 U.S. Dist. LEXIS 85755 (N.D. Ga. Aug. 19, 2010), but that case is different. In *Waterford*, the court found that plaintiffs' allegations were "plucked out of thin air" and that the complaint "does not allege that anyone – other than the Plaintiff" found SunTrust's accounting to be improper. *Id.* at *5-6. Here, by contrast, the FDIC's OIG determined that Haven Trust's failure was caused by the specific malfeasance of

1. Defendants' Materiality Challenges Are Premature

Defendants also argue that their alleged omissions are not material, are just puffery, or amount merely to non-actionable claims of mismanagement. Defs' Mem. at 23-35. However, this argument is premised on a mischaracterization of Plaintiffs' allegations and prematurely raises issues of factual dispute. In *Johnson v. Aegon USA, Inc.*, 355 F. Supp. 2d 1337, 1345 (N.D. Ga. 2004) (Pannell, J.), this Court rejected a similar invitation to make premature materiality decisions:

> Ultimately, certain statements or representations, "although literally accurate, can become, through their context and manner of presentation, devices which mislead investors. For that reason, the disclosure required by the securities laws is measured not by literal truth, but by the ability of the material to accurately inform rather than mislead prospective buyers." *In re Convergent Technologies Securities Litigation*, 948 F.2d 507 (9th Cir. 1991) quoting *McMahan & Co. v. Wherehouse Entertainment, Inc.*, 900 F.2d 576, 579 (2d Cir. 1990). Accordingly, at this stage in the litigation, the court cannot conclude that the defendants bore no duty to disclose the allegedly omitted facts to the plaintiffs in the relevant prospectuses and registration agreements.

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the director Defendants named in Plaintiffs' Complaint. Similarly, *Belmont Holdings Corp. v. Sun Trust Banks, Inc.*, 1:09-cv-1185-WSD, slip op. (N.D. Ga. Sept. 10, 2010), is also inapplicable as that case involved alleged misstatements of opinion concerning the adequacy of loan loss reserves going forward, and not, as here, omissions of material fact concerning previous and ongoing fundamental bank operations and financial results.

Indeed, this Court recently reaffirmed that materiality determinations are rarely appropriate on summary judgment, let alone on a motion to dismiss, because they typically involve disputed factual issues. *See* Ex. 2, *In re Wells Real Estate Invest. Trust Secs. Litig.*, No. 1:07-CV-862-CAP, slip op. at 8 (N.D. Ga. Aug. 2, 2010) (citing, *inter alia*, *S.E.C. v. Reyes*, 491 F. Supp. 2d 906, 909 (N.D. Cal. 2007) ("assessments [of materiality] are peculiarly ones for the trier of fact")).

2. Defendants Had a Duty to Speak the Full Truth

It is black-letter law that when Defendants chose to speak, including in their 2006 and 2008 PPMs, they were obliged to not only tell the truth, but to tell the whole truth.[23] As alleged, Defendants were aware and knowledgeable of the Company's true operations and condition as control persons of the Company and the Bank, and were continually confronted with reports concerning the Bank's operations by the FDIC and the GDBF during, and even prior to, the Class Period.

23 Omissions of material fact "are proscribed only when the defendant has a duty to disclose." *Ziemba v. Cascade Intern., Inc.*, 256 F.3d at 1206 (quotations omitted). "A duty to disclose arises when 'a defendant's failure to speak would render the defendant's own prior speech misleading or deceptive.'" *In re Immucor Inc. Sec. Litig.*, No. 1:05-cv-2276-WSD, 2006 U.S. Dist. LEXIS 72335, at *32-33 (N.D. Ga. Oct. 4, 2006) (quoting *Ziemba*, 256 F.3d at 1206). "'A duty to speak the full truth arises when a defendant undertakes to say anything.'" *Id.* (quoting *First Virginia Bankshares v. Benson*, 559 F.2d 1307, 1317 (5th Cir. 1977)).

Defendants, however, chose to conceal the truth concerning the Bank to mislead investors.

Defendants conflate their obligation to tell the complete truth with "the FDIC's clear and comprehensive prohibition against the disclosure of any examination reports." Defs' Mem. at 22-23. Plaintiffs do not fault Defendants for failing to actually publish the regulators' ROEs, or even the fact of the regulators' ongoing criticisms and admonitions. Instead, the claims here arise from Defendants' omissions of underlying material adverse information concerning the Bank's failure to comply with its stated underwriting policies, violations of regulatory law, inadequate and undisclosed underwriting practices, and unsecured sham "loans" to insiders (including those funneled through the children of defendant R.C. Patel), as discussed above. Surely, Defendants could have and should have timely disclosed the truth concerning these practices without violating any banking regulations.

Further, these allegations are sufficiently pleaded. *Accord In re Wells Real Estate*, slip op. at 8 (N.D. Ga. Aug. 2, 2010) (Ex. 2). Plaintiffs have provided "specific allegations … that point to fraud on the defendants' part, as opposed, say, to poor management or simple misfortune." *Jones v. Corus Bankshares, Inc.*, No.

09-cv-1538, 2010 U.S. Dist. LEXIS 33579, at *16-17 (N.D. Ill. Apr. 6, 2010) (holding that "specific examples of bad loans" was one possible way of pleading fraud with the requisite particularity).[24]

B. Plaintiffs Adequately Alleged Scienter

As Plaintiffs allege, the failure of Haven Trust and the collapse of a half billion dollar Georgia bank were not mere unforeseen business failures. To the contrary, Plaintiffs contend that their demise was the result of Defendants' malfeasance in failing to operate the business in a lawful manner and to heed the repeated warnings by regulators to address and correct operational and other deficiencies. Defendants' claimed liability flows not from mismanagement, but from their knowingly or recklessly false portrayal to investors of the financial condition and business operations of Haven Trust. These allegations sufficiently allege scienter.

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24 Defendants' assertion that Plaintiffs have alleged puffery is incorrect. To the contrary, even if "a statement [were] not actionable when considered individually, it can be actionable if it 'reinforce[s] factual misstatements and therefore contribute[s] to ongoing deception", or "if the speaker is aware that the statement is deceptive." *Jones v. Corus Bankshares, Inc.*, 2010 U.S. Dist. LEXIS 33579, at *37-38 (citations omitted). Here, Plaintiffs' allegations are premised on Defendants' malfeasance in omitting to timely disclose then-known facts concerning the Bank's past and ongoing operations and results.

In *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 127 S. Ct. 2499, 2505 (2007), the Supreme Court held that in order to plead a strong inference of scienter in accord with the Private Securities Litigation Reform Act ("PSLRA"), the facts alleged must give rise to an inference of scienter that is cogent and at least as compelling as any opposing inference of non-fraudulent intent suggested by defendants: "When the allegations are accepted as true and taken collectively, would a reasonable person deem the inference of scienter at least as strong as any opposing inference?" *Id.* at 2511. The strong inference test is satisfied where, as here, the Complaint alleges sufficiently the Defendants' "'knowledge of facts or access to information contradicting their public statements.'" *In re Unicapital Corp. Sec. Litig.*, 149 F. Supp. 2d 1353, 1372 (S.D. Fla. 2001) (quoting *Novak v. Kasaks*, 216 F.3d 300, 308 (2d Cir. 2000)).[25]

25 "In the Eleventh Circuit, a showing of 'severe recklessness' satisfies the scienter requirement." *Grand Lodge of Pa. v. Peters*, 550 F. Supp. 2d 1363, 1368 n.49 (M.D. Fla. 2008) (quoting *McDonald v. Alan Bush Brokerage Co.*, 863 F.2d 809, 814 (11th Cir. 1989)). Severe recklessness includes 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," and that present "a danger of misleading buyers or sellers which is either known to the defendant or is so obvious that the defendant must have been aware of it." *Id.* (quoting *McDonald*, 863 F.2d at 814).

Plaintiffs' Complaint presents cogent, compelling facts which make it at least as likely as not that Defendants engaged in a calculated or knowing scheme to omit and conceal Haven Trust's regulatory and financial deficiencies. As such, this case is not about "fraud by hindsight" or a business succumbing to adverse market conditions (*see* Defs' Mem. at 1-2, 33-35), but about Defendants' knowing or reckless failure to disclose material adverse facts to the investors they solicited – ***including as late as September 2008, just two months before the Bank actually failed***. (¶ 88).

Defendants' attempt to refute Plaintiffs' scienter allegations on a piecemeal basis violates the *Tellabs* mandate that the allegations must be considered not individually, but as a whole.[26] Here, Defendants' scienter is demonstrated, in the aggregate, through the longstanding operational deficiencies and practices of the

26 Defendants also incorrectly imply that their purported lack of insider sales undercuts any showing of scienter. Defs' Mem. at 16-17. *See Mizzaro v. Home Depot, Inc.*, 544 F.3d 1230, 1254 (11th Cir. 2008) (insider stock trades "may be relevant"); *PR Diamonds, Inc. v. Chandler*, 364 F.3d 671, 691 (6th Cir. 2004) ("[W]e have never held that the absence of insider trading defeats an inference of scienter."); *In re Nuko Info. Sys., Inc. Sec. Litig.*, 199 F.R.D. 338, 344-45 (N.D. Cal. 2000) (absence of defendants' selling has little bearing on adequacy of scienter allegations where insider trading not alleged); *In re ProQuest Secs. Litig.*, 527 F. Supp. 2d 728, 741 (E.D. Mich. 2007) (finding no legal requirement that individual alleged to have committed securities fraud personally profit).

Bank, and their knowing disregard of the regulators' ROEs, among other things. (¶¶2, 45-50, 58-59, 69-71, 81).[27]

C. Plaintiffs Adequately Alleged Loss Causation

Defendants also contend that the Complaint does not adequately plead loss causation. Defs' Mem. at 20-22. Because the Complaint sufficiently alleges that Defendants' misconduct directly and proximately caused Plaintiffs' losses, Defendants are wrong.

"Loss causation describes the link between the defendant's misconduct and the plaintiff's economic loss." *Robbins v. Koger Props.*, 116 F.3d 1441, 1447 (11th Cir. 1997) (quotation omitted). "Loss causation does not require a showing that the alleged misstatements were the sole cause of loss. Instead, Plaintiffs need only allege that Defendants' misstatements or omissions were a 'significant contributing cause' to the loss." *In re Immucor Inc. Sec. Litig.*, 2006 U.S. Dist. LEXIS 72335, at *57-58 (quoting *Robbins*, 116 F.3d at 1447). "[T]o sufficiently plead loss

27 Defendants' contention that they could not have perpetrated a fraud because regulators conducted examinations of Haven Trust is illogical (Defs' Mem. at 19) and is belied by their own disclaimer on the covers of both PPMs: "**Neither the Securities and Exchange Commission nor any state securities Commission has approved or disapproved of these securities or passed upon the accuracy or adequacy of this memorandum. Any representation to the contrary is a criminal offense.**"

causation, a plaintiff must allege a disclosure or revelation of truth about a defendant's prior misstatement or omission that is in some way connected with a stock price drop." *In re Paincare Holdings Secs. Litig.*, No. 06 cv 362 Orl 28DAB, 2007 U.S. Dist. LEXIS 97709, at *28 (M.D. Fla. Nov. 16, 2007), *adopted*, 541 F. Supp. 2d 1283 (M.D. Fla. 2008) (citation omitted).

"Overall, the complaint must contain 'a short and plain statement of the claim' ... [that] provide[s] the defendant with 'fair notice of what the plaintiff's claim is and the grounds upon which it rests.'" *In re NetBank Secs. Litig.*, No. 1:07-CV-2298-BBM, 2009 U.S. Dist. LEXIS 69030, at *43 (N.D. Ga. Jan. 29, 2009) (quoting Fed.R.Civ.P. 8; *Conley v. Gibson*, 355 U.S. 41 (1957)).[28]

Here, Plaintiffs allege that Defendants misrepresented the true financial condition and business operations of Haven Trust, including the Company's excessively risky lending practices, inadequate loan underwriting and inadequate credit administration procedures (¶¶ 2, 38, 40-42, 64, 65-71, 74-76); and the violations of federal and state law that resulted from the Bank's unlawful business

28 "In essence this requires a plaintiff to allege that the share price of the security 'fell significantly after the truth became known.'" *In re NetBank*, 2009 U.S. Dist. LEXIS 69030, at *43 (quoting *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 346, 347 (2005)). "The focus on the inquiry, thus, is whether 'a plaintiff who has suffered an economic loss [has] provide[d] a defendant with some indication of the loss and the causal connection that the plaintiff has in mind.'" *Id.* at 347.

operations (¶¶ 47, 49, 69). Plaintiffs also allege that Defendants' undisclosed malfeasance led to the FDIC taking over the Bank on December 18, 2008, and the resulting bankruptcy of Haven Trust. (¶¶ 33, 37, 89). Further supporting Plaintiffs' loss causation allegations, the FDIC's Audit Report concluded that "Haven failed due to bank management's lack of oversight and failure to control risk in its loan portfolio." (¶¶ 58, 89; *accord* FDIC Audit Report, Dkt. 23-3, at ECF pp.3, 8-9). As a result, Plaintiffs' stock (for which many had paid some $25 per share) was left worthless. (¶¶ 2, 37, 89). These facts give Defendants fair notice of Plaintiffs' loss causation allegations.[29] To the extent that Defendants want to make a fact-based challenge to loss causation, they are free to do so at a later stage, not on a motion to dismiss.

IV. PLAINTIFFS PROPERLY ALLEGED COMMON LAW FRAUD

Again targeting their claims narrowly, Plaintiffs have limited their fraud claims to only the three Fraud Defendants given the extent of these three

29 As this Court recently concluded in other litigation, "[i]n light of the notion that 'proof of loss causation should not typically be resolved on a Rule 12(b)(6) motion, as here the Plaintiffs have adequately alleged that their financial loss is connected to the Defendants' fraudulent conduct." *In re NetBank Secs. Litig.*, 2009 U.S. Dist. LEXIS 69030, at *46 (citation omitted). Accord *Eastwood Enters., LLC v. Farha*, No. 8:07-cv-1940-T-33EAJ, 2009 U.S. Dist. LEXIS 88945, at *16 (M.D. Fla. Sept. 28, 2009).

Defendants' direct involvement in controlling the operations of Haven Trust. *See* Claim VIII (common law fraud). To assert a claim under Georgia law for common law fraud, a plaintiff must show: "(1) a false representation; (2) scienter; (3) intention to induce [the plaintiff] to act or refrain from acting; (4) justifiable reliance by [the plaintiff]; and (5) damages to [the plaintiff]." *Jones v. Infocure Corp*., No. 1:01-CV-2845-TWT, 2005 U.S. Dist. LEXIS 46745, at *40 (N.D. Ga. Sept. 2, 2005) (quoting *Pendley Quality Trailer Supply, Inc. v. B & F Plastics, Inc.*, 260 Ga. App. 125, 126, 578 S.E.2d 915 (2003)).[30]

In testing the adequacy of a pleading alleging common law fraud, this Court has held that the particularity requirement of federal "Rule 9(b) must be read in conjunction with Rule 8 of the Federal Rules of Civil Procedure, and that the heightened pleading requirements for fraud should not be interpreted in a manner that would abrogate the basic concept of notice pleading." *Bailey v. Reliance Trust Co.*, No. 1:04-CV-0340-JOF, 2006 U.S. Dist. LEXIS 23081 (N.D. Ga. Mar. 23, 2006) (citing *Friedlander v. Nims*, 755 F.2d 810, 813 n.3 (11th Cir. 1985)). In

30 Furthermore, common law fraud is not subject to the same pleading requirements for § 10(b) claims, which are covered by the PSLRA, 15 U.S.C. § 78u-4(b). Thus, for example, although Plaintiffs here meet the requirements of loss causation under *Dura*, 544 U.S. at 346-47, such an analysis is not even applicable to a claim for common law fraud. *Lopez v. Rica Foods, Inc.*, 277 Fed. Appx. 931, 932, 2008 U.S. App. LEXIS 10773, at *4-5 (11th Cir. May 14, 2008).

meeting those pleading requirements, a complaint "can be read together with other documents in the record to establish specific allegations of fraud." *Id.* (citing, *inter alia*, *Durham v. Bus. Mgmt. Assocs.*, 847 F.2d 1505, 1512 (11th Cir. 1988)).

Here, the FDIC's Audit Report, which Plaintiffs incorporated in their Complaint, comprehensively analyzed Haven Trust's records and other evidence in concluding that the Bank's failure was due to Defendants' malfeasance, as discussed above (¶¶ 58, 89, 107-114). At a very minimum under *Bailey* and other cases, that Report supports the sufficiency of Plaintiffs' claims that Defendants' fraudulent omissions directly led to the demise of Haven Trust, and damage to Plaintiffs and the Class.

V. PLAINTIFFS' CONTROL PERSON CLAIMS ARE ALLEGED PROPERLY

Under § 20(a) of the 1934 Act, any person who "controls" someone who violates the Act is jointly and severally liable for that violation. 15 U.S.C. § 78t(a). The 1934 Act's implementing regulations define control as "the possession, direct or indirect, of the power to direct or cause the direction of the management policies of a person." 17 C.F.R. § 230.405. *Accord In re Clarus Corp. Secs. Litig.*, 201 F. Supp. 2d 1244, 1251-52 (N.D. Ga. 2002) (Pannell, J.).

The GSA also provides for secondary liability, pursuant to O.C.G.A. § 10-5-14(c). However, liability under the Georgia statute is even broader than that under § 20(a) of the 1934 Act, as the Georgia statute does not limit secondary liability to "control persons", but provides liability by virtue of being an officer or director of a primary violator of O.C.G.A. § 10-5-12(a) – which indisputably encompasses each Defendant in this case.[31]

Here, the crux of Plaintiffs' allegations is that the Defendants are not only liable as primary violators of § 10(b) and O.C.G.A. § 10-5-12, but are also secondarily liable as control persons of Haven Trust for its primary violations of the statutes. *See* Claims I, II, V, VI and VII. Indeed and also as alleged, Haven Trust would have been named as a defendant but for its bankruptcy filing. (¶ 26; *accord* 11 U.S.C. § 362(a) (automatic stay under the federal bankruptcy laws)).[32]

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31 *Accord Jones v. Infocure Corp.*, 2005 U.S. Dist. LEXIS 46745, at *40 (sustaining allegations under § 10-5-14(c); finding defendants failed to present "evidence sufficient to demonstrate that he did not and should not have known" of the alleged misstatements).

32 Haven Trust's liability is premised on the indisputable facts that it was the issuer of the misleading PPMs; marketer and seller of the stock to Plaintiffs and other investors; operator of the Bank; and recipient of the regulators' ROEs that provided specified "red flags" of improprieties, which went unheeded and undisclosed. The Company's scienter is also demonstrated by that of its agents, the Defendants, as discussed above. *Accord Mizzaro,* at 1254 (imputing to corporation

As alleged, each of the Defendants had the ability and controlled the operations of Haven Trust and the Bank. (¶¶ 127-129). Each of the Defendants served as a Director for both Haven Trust (the issuer of Plaintiffs' common stock) and the Bank (the Company's sole business operation). (¶¶ 22, 23, 61; *see also* ¶¶ 13-21).[33] Indeed, all of the Defendants consented to their identification as Directors in the Company's 2006 and 2008 PPMs, upon which Defendants solicited, and Plaintiffs purchased, their Haven Trust shares. (¶¶ 22, 60). Defendants, as Haven Trust's executive officers and Directors, were each responsible for the private offerings made to Plaintiffs, including the misleading 2006 and 2008 PPMs, and had the ability to edit and add to the PPMs content. (¶¶ 22, 61, 73).[34] These facts adequately plead the basis for Defendants' control person liability.

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the scienter of its agents) (citing *Teamsters Local 445 Freight Div. Pension Fund v. Dynex Capital Inc.*, 531 F.3d 190, 195-96 (2d Cir. 2008)).

33 In addition, as the founders of Haven Trust, Defendants Mike Patel and R.C. Patel acted as the "public face" of Haven Trust, meeting with investors and publicly speaking on behalf of Company to the press and at investor road shows. (¶¶ 13, 14, 86, 88). Defendant Mike Patel served as the Chairman of Haven Trust, and defendant Edward Briscoe was the Chief Executive Officer/President for both the Company and the Bank. (¶¶ 13, 15).

34 Moreover, each of the Defendants had access to the ROEs and other adverse non-public information about the Company's true financial condition and business

Defendants' apparent position that control person liability does not exist because the controlled person, Haven Trust, is not named as a defendant (Defs' Mem. at 35-36), is simply incorrect as a matter of law. *See, e.g., In re Suprema Specialties, Inc. Sec. Litig.*, 438 F.3d 256, 285-86 (3d Cir. 2006) ("[T]here is no requirement in the language of either statute that the controlled person be named as a defendant as a predicate to imposing liability upon the controlling individual defendants…. [To hold otherwise would be] inconsistent with the broad remedial purposes of the securities laws to permit senior executives of a bankrupt corporation – whose actions allegedly contributed to the bankruptcy – to avoid liability by relying on the corporation's bankruptcy."). *Accord In re Mirant Corp. Secs. Litig.*, No. 02-cv-1467 BBM, 2003 U.S. Dist. LEXIS 26263, at *69 (N.D. Ga. July 14, 2003); *In re World Access Sec. Litig.*, 119 F. Supp. 2d 1348, 1358 (N.D. Ga. 2000).

Recently, District Judge (now Circuit Judge) Beverly Martin sustained control person claims in nearly identical circumstances. *See In re NetBank Secs. Litig.*, 2009 U.S. Dist. LEXIS 69030, at *10, 51-54 ("Because NetBank has filed a petition for bankruptcy … which filing operates as an automatic stay on judicial

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operations, through internal, non-public corporate documents and other sources of non-public information. (¶ 127).

proceedings against the debtor, NetBank was not named as a Defendant....”). Here, as in *NetBank* and other cases, Plaintiffs did not and, in view of 11 U.S.C. § 362, could not, assert any claims against the bankrupt controlled person. Nevertheless, Plaintiffs’ control person claims remain sufficiently pleaded.

VI. DEFENDANTS’ CLAIMED JURISDICTION DEFICIENCIES ARE INCORRECT

Defendants’ efforts to raise non-existent jurisdictional questions is similarly unavailing. Defs’ Mem. at 39-40. Plaintiffs have sufficiently alleged two federal law claims (Claims IV and V), invoking jurisdiction under 28 U.S.C. § 1331, and supplemental jurisdiction under 28 U.S.C. § 1367 for their state law claims. (¶¶ 4, 6). Plaintiffs also properly allege diversity jurisdiction under 28 U.S.C. § 1332(d)(2). (¶ 5).[35] Jurisdiction is thus clearly proper here.

Nevertheless, Defendants ask the Court to rule as a matter of law that Plaintiffs have no viable federal claims. Defendants then contend that Plaintiffs’ state law claims should fail for lack of diversity jurisdiction, on the alleged factual

35 The amount in controversy here is in excess of $5 million, and at least one named Plaintiff, Lead Plaintiff Ms. Mukta Patel (a citizen of North Carolina), is diverse from all of the Defendants, who are citizens of Georgia. (¶¶ 5, 9). In addition, Ms. Patel’s individual claim is in excess of $75,000. (¶ 9). *Accord Cappuccitti v. DirecTV, Inc.*, No. 09-14107, –F.3d–, 2010 U.S. App. LEXIS 14724, at *12-13 (11th Cir. July 19, 2010).

premise that "greater than two-thirds of the members of all proposed plaintiff classes in the aggregate are citizens of the State in which the action was originally filed." *See* 28 U.S.C. § 1332(d)(4)(a)(i)(I). Defendants' hypothetical is premised on facts outside of the record and, in any event, is erroneous.

First, Defendants reference a shareholder list that was filed in the Haven Trust bankruptcy proceedings, which is attached to the Declaration of Theodore J. Sawicki, Esq. (Dkt. 29). Although this list purports to identify Company shareholders (including by home address, in violation of Local Rules, App. H, at A10), the document does *not* purport to list all persons who purchased the Company's common stock during the April 1, 2006 - December 12, 2008 Class Period. Indeed, neither the Sawicki Declaration, nor defendant Briscoe's Declaration also attached there (*see* Dkt. 29), even tries to make such a sweeping claim. Instead, at most, that list *may* accurately represent the Haven Trust shareholders only at some specific (and presently unknown) date in time.

Second, Defendants creatively tally the shareholder list by counting related shareholders as a single class member. Defendants' explanation is that family members invested in an S Corp. are treated as one person for purposes of federal income taxes. Defs' Mem at 11 n.4. Unsurprisingly, Defendants offer no support

for their novel proposition that the federal tax regulations govern diversity jurisdiction analysis. If all shareholders are included, a straightforward count yields a total of 104 shareholders. After subtracting Defendants and their spouses, there are a total of 60 shareholders listed as Georgia residents and 35 non-residents. In other words, *less than* two-thirds (about 63.2%) are Georgia residents. Thus, in sum, Defendants' misleading count also fails in any event on the merits.[36]

VII. DEFENDANTS' *IN TERROREM* INVOCATION OF RULE 11 SANCTIONS IS ITSELF SUBJECT TO RULE 11

Defendants also purport to seek sanctions under FRCP 11. Defs' Mem. at 40. However, Defendants provide no explanation as to their legal or factual basis for their request. Nor have Defendants even attempted to comply with applicable procedural requirements, much less satisfy them; *see* Fed.R.Civ.P. 11(c)(2). Instead, Defendants appear to invoke the threat of sanctions for their *in terrorem* effect. However, in doing so, Defendants have exposed themselves to the scrutiny of Rule 11. For example, in *Mortgage Payment Prot., Inc. v. Cynosure Fin., Inc.*, No. 6:08-cv-1212-Orl-22DAB, 2010 U.S. Dist. LEXIS 40611, at *6-7 (M.D. Fla.

36 If a numerical analysis under 28 U.S.C. § 1332(d) were necessary, Plaintiffs would be entitled to discovery and a hearing. *Accord U.S. ex rel. McElmurray v. Consol. Gov't of Augusta-Richmond County*, 501 F.3d 1244, 1251 (11th Cir. 2007); *Williamson v. Tucker*, 645 F.2d 404, 413 (5th Cir. May 20, 1981).

Mar. 15, 2010), a sister court recently addressed a defendant's similar procedural maneuverings, stating as follows:

> Procedurally, there is no showing that [defendant] has complied with the mandatory safe harbor provision. Moreover, even a cursory review of the allegedly offending pleading does not show that it is objectively frivolous…. This Court should decline [defendant's] invitation to determine the merits of the case on these papers. Rule 11 is not a substitute for trial.

Further, the court in *Mortgage Payment* also stated as follows (*id.* at *7 n.1):

> Indeed, the filing of such an unsupported motion for Rule 11 sanctions is itself, perilously close to sanctionable.

Defendants' threats are misplaced and unwarranted. Defendants will properly have ample opportunity to dispute the actual merits of Plaintiffs' claims at a later stage of these proceedings. But proceeding to the merits of this dispute is exactly where this case should now go.

CONCLUSION

For all of the foregoing reasons, Defendants' Motion should be denied.[37]

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37 If the Court were inclined to dismiss any of Plaintiffs' claims, Plaintiffs respectfully request leave to replead under Fed.R.Civ.P. 15(a). *See In re S1 Corp. Secs. Litig.*, 173 F. Supp. 2d 1334, 1357 (N.D. Ga. 2001) ("presumption that leave to amend should be granted at least once after the dismissal of a complaint when a more adequately pled complaint might state a cause of action") (citing *Bank v. Pitt*, 928 F.2d 1108, 1112 (11th Cir. 1991)).

Dated: September 14, 2010

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

MUKTA PATEL, ASHOK PAREKH, JITU PATEL, and ANDREA and PHIL BOSWELL, on Behalf of Themselves And All Others Similarly Situated, Plaintiffs,	:	Case No.: 09-CV-3684-CAP
v.	:	CLASS ACTION
MUKESH C. PATEL, R.C. PATEL, EDWARD L. BRISCOE, SCOTT DIX, BRIJ M. KAPOOR, MUKUND R. PATEL, NARENDA D. PATEL, DHIRU G. PATEL, and BALVANT PATEL, Defendants.	:	DEMAND FOR JURY TRIAL

CERTIFICATE OF COMPLIANCE

Pursuant to Rule 7.1(D) of the Local Rules of the Northern District of Georgia, the undersigned counsel for the Lead Plaintiff hereby certifies that the foregoing document was prepared in a font and point selection approved by this Court and authorized in Local Rules 5.1(C).

Dated: September 14, 2010

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

MUKTA PATEL, ASHOK PAREKH, JITU PATEL, and ANDREA and PHIL BOSWELL, on Behalf of Themselves And All Others Similarly Situated, Plaintiffs,	:	Case No.: 09-CV-3684-CAP
v.	:	CLASS ACTION
MUKESH C. PATEL, R.C. PATEL, EDWARD L. BRISCOE, SCOTT DIX, BRIJ M. KAPOOR, MUKUND R. PATEL, NARENDA D. PATEL, DHIRU G. PATEL, and BALVANT PATEL, Defendants.	:	DEMAND FOR JURY TRIAL

CERTIFICATE OF SERVICE

This is to certify that I have this day served counsel for all parties in the foregoing matter with a copy of Plaintiffs' Memorandum of Law in Opposition to Defendants' Motion to Dismiss by filing same with the Clerk of Court using the CM/ECF system, which will automatically send e-mail notification and allow electronic access to the filing to the following counsel of record:

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Dated: September 14, 2010

Respectfully submitted,

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