IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

WM HIGH YIELD FUND, WM INCOME FUND, AT HIGH YIELD FUND, WM VT INCOME FUND, AT INCOME FUND, EVERGREEN FUNDING LTD./EVERGREEN FUNDING CORP., and STELLAR FUNDING, LTD.,	
Plaintiffs,	**Case No. 04-3423-LDD**
v.	
MICHAEL A. O'HANLON, STEVEN R. GARFINKEL, RICHARD MILLER, ANTHONY J. TUREK, JOHN P. BOYLE, TERRY W. CADY, MATTHEW COLASANTI, RAYMOND FEAR, GERALD COHN, HARRY T.J. ROBERTS, WILLIAM S. GOLDBERG, JOHN E. MCHUGH, NATHAN SHAPIRO, DELOITTE & TOUCHE, LLP, HAROLD NEAS, ONCURE TECHNOLOGIES CORPORATION, JEFFREY GOFFMAN, PRESGAR IMAGING, LLC, and DOLPHIN MEDICAL, INC.,	
Defendants.	

REPLY BRIEF IN SUPPORT OF MOTION TO DISMISS PURSUANT TO FEDERAL RULE OF CIVIL PROCEDURE 12(B)(6) OF DEFENDANTS TERRY CADY AND MATTHEW COLASANTI

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Dated: January 10, 2005

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TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page(s)

CASES

Page(s)

Page(s)

Page(s)

OTHER AUTHORITIES

IN THE UNITED STATES DISTRICT COURT
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WM HIGH YIELD FUND, WM INCOME FUND, AT HIGH YIELD FUND, WM VT INCOME FUND, AT INCOME FUND, EVERGREEN FUNDING LTD./EVERGREEN FUNDING CORP., and STELLAR FUNDING, LTD.,	
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I. INTRODUCTION

Plaintiffs' Complaint fails to state a claim against Defendants Terry Cady and Matthew Colasanti.[1] Plaintiffs' Omnibus Brief in Opposition to All Defendants' Motions to Dismiss the

[1] Terry Cady and Matthew Colasanti separately moved to dismiss the Complaint. They jointly file this reply brief. Cady's principal brief in support of his Motion to Dismiss is referred to herein as (continued...)

Complaint ("Plaintiffs' Omnibus Brief") does nothing to remedy the principal defect of the Complaint with respect to the federal claims for securities fraud against Cady and Colasanti; it fails to specify, as required by the Private Securities Litigation Reform Act ("PSLRA"), any conduct engaged in by either Cady or Colasanti that would support a claim under Section 10(b) of the Exchange Act (15 U.S.C. § 78j(b)), Rule 10b-5 (17 C.F.R. § 240.10b-5)) or Section 20(a) of the Exchange Act (15 U.S.C. § 78t-1(a)). As for the Complaint's state law claims, Plaintiffs' Omnibus Brief does nothing to undercut the propositions that there is no recognized cause of action in Pennsylvania for aiding and abetting common law fraud, that the allegations of motive and agreement in the claim for conspiracy to commit common law fraud are insufficient, and that there is no basis for the Securities Act of Washington to govern the conduct of Cady or Colasanti.

Plaintiffs' failure to address meaningfully the PSLRA's impact on the adequacy of the Complaint is a central flaw of their brief. The Complaint fails completely to meet the PSLRA's heightened pleading standard applicable to securities fraud cases.[2] Plaintiffs' reliance on the "group-pleading" doctrine to meet that standard is unavailing. The great weight of authority establishes that the doctrine has not survived the enactment of the PSLRA. Accordingly, the generalized allegations against the Individual Defendants (a thirteen-person group that includes Cady and Colasanti) fail to state a claim against Cady or Colasanti and the Rule 10b-5/Section

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(continued...)

"Cady Brief." Colasanti's principal brief in support of his Motion to Dismiss is referred to herein as "Colasanti Brief."

[2] The PSLRA is described at length in, among other places, Section III.B.1(a)(i) of Terry Cady's Memorandum of Law in Support of Motion to Dismiss the related case of In re DVI Securities Litigation, Civil Action No. 2:03-cv-5336-LDD. That discussion is incorporated in the Cady Brief at 12 and the Colasanti Brief at 10.

10(b) claim should be dismissed. In addition, since there is no allegation that either Cady or Colasanti controlled DVI, Inc. or culpably participated in any fraud allegedly committed by DVI, Inc., the Section 20(a) claim also should be dismissed.

Notwithstanding the arguments in Plaintiffs' Omnibus Brief, the state law claims against Cady and Colasanti should also be dismissed under Rule 12(b)(6). As to the claim for conspiracy to commit fraud, the Complaint fails adequately to allege essential elements of the tort. As to the claim for aiding and abetting fraud, Pennsylvania law does not even recognize the tort, and, even if it did, the Complaint fails adequately to allege its elements as to either Cady or Colasanti. Finally, with respect to Plaintiffs' claim under Sections 21.20.430 and 21.20.010 of the Washington State Securities Act, Washington State law does not apply to these transactions and there is no link between Cady or Colasanti to any purported violations.

II. ARGUMENT

A. Count I Should Be Dismissed Because, Under The Heightened Pleading Standard Of The PSLRA, Plaintiffs Fail To State A Claim Under Section 10(b)/Rule 10b-5 Against Cady Or Colasanti

The Complaint contains very few specific allegations about either Cady or Colasanti. Colasanti was an internal consultant to DVI, Inc. and ran its loan workout group. See Compl. at ¶ 33. He is mentioned briefly at paragraphs 72-78 in connection with what the Complaint describes as "Improper Revenue Recognition." Importantly, his name does not even appear in the Complaint's litany of alleged misstatements and omissions in securities filings and press releases. See Compl. at ¶¶ 104-93. Nor is he even mentioned in the allegations of DVI, Inc.'s purported violations of accounting principles.[3] See Compl. at ¶¶ 204-37.

[3] Despite the settled law that new allegations in a brief cannot be used to sustain a complaint in the face of an otherwise valid 12(b)(6) motion, see In re Loewen Group, Inc., No. Civ. A. 98-6740, 2004 WL 1853137, *11 (E.D. Pa. Aug. 18, 2004), Plaintiffs' Omnibus Brief repeatedly makes allegations that (continued...)

Cady is alleged to have been a Senior Vice-President of DVI, Inc. and DVI FS, and a President and Director of DVI BC. His principal duties involved running DVI BC. See Compl. at ¶ 32. He is alleged to have "developed," "known of and approved" a practice called "round tripping" where DVI BC lent cash to delinquent DVI FS borrowers to pay DVI FS so that the borrowers would not default. See Compl. at ¶¶ 65-67, 90. None of the alleged misstatements or omissions in SEC filings and press releases is attributed to Cady. Likewise, none of the alleged violations of accounting principles mentions him.[4]

Plaintiffs cite In re Scholastic Corp. Sec. Litig., 252 F.3d 63, 76 (2d Cir. 2001), for the proposition that these allegations are sufficient to impose primary liability on Cady and Colasanti. See Plaintiffs' Omnibus Brief at 50. In that case, the defendant who claimed the misstatements at issue could not be attributed to him was the vice president for finance and investor relations. See Scholastic, 252 F.3d at 76. It was logical, therefore, that he was "primarily responsible for Scholastic's communications with investors." See id. (emphasis added). In stark contrast, in the instant case, there is no factual or logical support for Plaintiffs'

(continued...)

have no foundation in the Complaint. For example, on page 10 of the Opposition Brief, Plaintiffs assert that Colasanti was "personally involved in artificially inflating DVI's reported financial condition." (Emphasis supplied). Yet the Brief's citations to the Complaint do not contain particularized support for the contention that Colasanti had any personal involvement in calculating or reporting DVI's financial condition. See Compl. at ¶¶ 33-34, 238, 240-41. Similarly, Plaintiffs assert at page 21, referring to Paragraph 77 of the Complaint, that "Garfinkel documented the improper forebearance practices and urged O'Hanlon, Miller and Colasanti in Spring 2002 to create false forebearance documentation . . . ." Citing to the same paragraph, Plaintiffs also assert in their brief that Colasanti was "drafting and had drafted phony forebearance agreements." See Plaintiffs' Omnibus Brief at 31. However, paragraph 77 of the Complaint says neither of these things; it references a memo from Garfinkel to O'Hanlon and Miller only, not Colasanti.

[4] As with Colasanti, Plaintiffs try to bootstrap new allegations about Cady that are not in the Complaint into their Omnibus Brief. Again, these new allegations should not be considered. There is no allegation in the Complaint, for example, that Cady "purposefully caused DVI to engage in inadequate credit checks and issue loans that were unlikely to be repaid." See Plaintiffs' Omnibus Brief at 18.

blanket allegation that the Individual Defendants' positions (ranging from CEO to consultant) somehow make them primarily liable for statements made in press releases and securities filings.

Paraschos v. YBM Magnex Intern., Inc., No. Civ. A. 98-6444, 2000 WL 325945, *10 (E.D. Pa. Mar. 29, 2000), also cited by Plaintiffs at pages 50-51 of the Omnibus Brief, is similarly distinguishable. In that case, as contrasted with the instant case, the complaint alleged specific conduct and statements of each defendant that supported making that defendant primarily liable. Here, there are little more than non-particularized allegations about Cady and Colasanti.

Notwithstanding this scarcity of specific allegations about the conduct and knowledge of Cady and Colasanti, Plaintiffs nevertheless argue that the allegations of securities fraud against them are adequate to state cognizable claims. However, as discussed below, Plaintiffs' Omnibus Brief essentially ignores the dispositive argument that, under the PSLRA's heightened pleading standard, 15 U.S.C. § 78u-4, these allegations are not sufficiently specific to survive a motion to dismiss. See GSC Partners CDO Fund v. Washington, 368 F.3d 228, 237 (3d Cir. 2004); In re NAHC, Inc. Sec. Litig., 306 F.3d 1314, 1328 (3d Cir. 2002).

1. The Group Pleading Doctrine Has Been Rendered Invalid By The PSLRA

For their claims under Section 10(b)/Rule 10b-5 against Cady and Colasanti, Plaintiffs rely on the group pleading doctrine. See Plaintiffs' Omnibus Brief at 51-55. The weight of authority, however, is that the doctrine (never adopted, even pre-PSLRA, by the Third Circuit) did not survive the PSLRA's enactment.[5] While Plaintiffs baldly assert that the "better reasoned

[5] Plaintiffs' citations to cases preceding the enactment of the PSLRA which upheld the doctrine are of course inapposite. See, e.g., Quantum Overseas, N.V. v. Touche Ross & Co., 663 F. Supp. 658, 667-68 (S.D.N.Y. 1987).

decisions" have recognized the ongoing validity of group pleading, the only Circuit court that has discussed the doctrine in the wake of the PSLRA has concluded that the doctrine did not survive. See Southland Sec. Corp. v. INSpire Ins. Solutions, Inc., 365 F.3d 353, 365 (5th Cir. 2004). Moreover, in this District, multiple cases, in rejecting the doctrine, have recognized its inconsistency with the PSLRA. See The Winer Family Trust v. Queen, No. Civ. A. 03-4318, 2004 WL 2203709, at *6 n.5 (E.D. Pa. Sept. 27, 2004); In re Unisys Corp. Sec. Litig., No. Civ. A. 00-1849, 2000 WL 1367951, at *8 (E.D. Pa. Sept. 21, 2000); Marra v. Tel-Save Holdings, Inc., Nos. Master File 98-3145, 1999 WL 317103, at *5 (E.D. Pa. May 18, 1999); In re Home Health Corp. of Am., Inc., No. Civ. A. 98-834, 1999 WL 79057, at *21 (E.D. Pa. Jan. 29, 1999).

The sole case in this District to suggest the post-PSLRA viability of the doctrine recognized only "a narrowly construed group pleading doctrine," appropriate in limited circumstances "when applied to officers where it is almost certain that given the high-level position of the officer within the company and the nature of the published writing that he or she would have been involved directly with writing the document or approving its content and that the officer was privy to information concerning the accuracy of the statements within the document." See In re U.S. Interactive, Inc., No. 01-cv-522, 2002 WL 1971252, at *4 (E.D. Pa. Aug. 23, 2002).[6] As discussed below, these limited circumstances are not present in the instant case.

Plaintiffs' string cite of cases from other districts purportedly upholding the doctrine at page 52 of their brief is not persuasive in light of the reasoned decisions of multiple courts in this

[6] Another case cited by Plaintiffs in support of their contention that group pleading survived the PSLRA is inapposite; as the court simply did not reach that issue. See In re Aetna Inc. Sec. Litig., 34 F. Supp. 2d 935, 949 n.7 (E.D. Pa. 1999) ("Although it is unclear whether the group pleading doctrine survives under the PSLRA, the Court will assume for the purposes of this Motion that the group pleading doctrine is still viable.") (Emphasis added).

District (and others) that group pleading is inconsistent with the PSLRA's heightened pleading standard that the complaint specify the "who, what, when, where, and how." See In re Advanta Sec. Litig., 180 F.3d 525, 534 (3d Cir. 1999).[7] Additionally, many of Plaintiffs' cases hardly constitute ringing endorsements of the group pleading doctrine. See, e.g., In re Rent-Way Sec. Litig., 209 F. Supp. 2d 493, 518 (W.D. Pa. 2002)(court acknowledges split in authority on group pleading, finds the doctrine not per se invalid, and proceeds to analyze the individual allegations); Tracinda Corp. v. DaimlerChrysler AG, 197 F. Supp. 2d 42, 85 (D.Del. 2002) (discussing split in authority on group pleading and determining that it need not reach the question of its ongoing viability to dismiss the claim)

Moreover, even assuming that group pleading were a viable doctrine in the post-PSLRA era – and it is not – Plaintiffs fall far short of meeting its standards. As explained above, the doctrine, as applied by the only court in this District to suggest its post-PSLRA viability, requires that the officer's role in the company be alleged with sufficient specificity to make it "almost certain" that he or she was "direct[ly] involve[d]" in the preparation, review, editing and

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[7] Defendants offer the following string cite of their own of cases rejecting the group pleading doctrine after the enactment of the PSLRA. See Napier v. Bruce, No. 02-C-8319, 2004 WL 1194747, at *6 (N.D. Ill. May 27, 2004); In re Cable & Wireless, PLC, 321 F. Supp. 2d. 749, 773 (E.D. Va. 2004); S.E.C. v. Yuen, 221 F.R.D. 631, 636 (C.D. Cal. 2004); In re Syncor Int'l Corp. Sec. Litig., 327 F. Supp. 2d 1149, 1171 (C.D. Cal. 2004); In re Cross Media Mktg. Corp. Sec. Litig., No. 02-5462, 2004 WL 842350, at *6 (S.D.N.Y. Apr. 20, 2004); Johnson v. Tellabs, Inc., 262 F. Supp. 2d 937, 955 (N.D. Ill. 2003); D.E. & J Ltd. P'ship v. Conaway, 284 F. Supp. 2d 719, 730 (E.D. Mich. 2003); Jones v. Intelli-Check, Inc., 274 F. Supp. 2d 615, 646 (D.N.J. 2003); Collmer v. U.S. Liquids, Inc., 268 F. Supp. 2d 718 (S.D. Tex. 2003); Glaser v. Enzo Biochem, Inc., 303 F. Supp. 2d 724, 734 (E.D.Va. 2003); In re Digital Island Sec. Litig., 223 F.Supp.2d 546, 553 (D.Del. 2002); In re First Union Corp. Sec. Litig., 128 F. Supp. 2d 871, 888 (W.D.N.C.2001); P. Schoenfeld Asset Mgmt. LLC v. Cendant Corp., 142 F. Supp. 2d 589, 618 (D.N.J.2001); In re Sunbeam Sec. Litig., 89 F. Supp. 2d 1326, 1341 (S.D.Fla.1999); In re CIENA Corp. Sec. Litig., 99 F. Supp. 2d 650, 663 n. 11 (D.Md. 2000); Allison v. Brooktree Corp., 999 F. Supp. 1342, 1350 (S.D. Cal. 1998); Coates v. Heartland Wireless Communications, Inc., 26 F. Supp. 2d 910, 916 (N.D. Tex. 1998).

approval of public statements and securities filings. In addition, it requires that the officer have been privy to knowledge that such statements were misleading or incomplete.

In this case, Plaintiffs have made no more than conclusory allegations that Colasanti and Cady, by virtue of their positions, participated in the alleged material misrepresentations or omissions at issue. See Compl. at ¶ 44. Colasanti, a workout consultant for DVI, Inc., is not specifically alleged to have had anything whatsoever to do with the allegedly offending documents. See Compl. at ¶ 34. Likewise, while the allegedly misleading statements were all made by DVI, Inc., see, e.g., Compl. at ¶¶ 104-181, Cady is only alleged to have actually participated in the day to day operation of DVI BC. See Compl. at ¶ 33.

The Complaint contains no specific allegation that either Cady or Colasanti ever reviewed the documents in question, participated in their preparation, or signed them. Rather, Plaintiffs rely on generic allegations that, by virtue of their positions, they (and eleven others) played some unspecified and undetailed role in the misrepresentations.

These generic allegations are plainly inadequate. The cases cited by Plaintiffs require a specific link between the individual and the preparation, review or signing of the offending documents. Without particularized factual allegations actually linking Cady or Colasanti to specific roles in making the misrepresentations, even Plaintiffs' cases therefore lend no support to the application of group pleading in this case. See Plaintiffs' Omnibus Brief at 50-52.

B. The Complaint Fails Sufficiently To Plead Scienter As To Cady And Colasanti

The absence of adequate scienter allegations provide a second and independent basis for dismissing Count I against Cady and Colasanti. Under the PSLRA, scienter must be pled with particularity "for each defendant and with respect to each alleged violation of the statute." See Phillips v. Scientific-Atlanta, Inc., 374 F.3d 1015, 1017-18 (11th Cir. 2004); see also 15 U.S.C. §

78u-4(b)(2). And, just as group pleading cannot be used to impute statements to individuals, group pleading cannot be used to establish an individual's scienter. See In re Home Health Corp., 1999 WL 79057 at *21.

The standards for adequately pleading scienter in the Rule 10b-5/Section 10(b) context are demanding. As Plaintiffs concede, Plaintiffs' Omnibus Brief at 28, the magnitude of a misstatement of financial results is not enough to show scienter.[8] Nor is the position of a person within a company dispositive of scienter. See In re Cendant Corp. Sec. Litig., 76 F. Supp. 2d 539, 547 (D.N.J. 1999). Similarly, ordinary compensation, continued employment, and even "standard incentive compensation cannot be the sole basis on which to plead scienter." In re AFC Enter. Sec. Litig., No. 01:03-cv-817-TWT, 2004 WL 2988212, at *8 (N.D. Ga. Dec. 28, 2004). See also In re Digital Island, 357 F.3d 322, 331 (3d Cir. 2004). And, contrary to Plaintiffs' assertions, individually inadequate allegations about scienter cannot be automatically aggregated to somehow create an "inference" of scienter. See Plaintiffs' Omnibus Brief at 28. As the Third Circuit recently observed, "[c]obbling together a litany of inadequate allegations does not render those allegations particularized in accordance with Rule 9(b) or the PSLRA." California Public Employees Retirement Sys. v. Chubb Corp., No. 03-3755, 2004 WL 3015578, at * 20 (3d Cir. Dec. 30, 2004).

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[8] Despite Plaintiffs' concession, they still rely on the "magnitude" of the dollars at issue to show scienter--without linking the misstatements to either Colasanti or Cady. This is most striking with respect to Cady, who allegedly ran DVI BC, see Compl. at ¶ 33. Neither that allegation nor the bare allegation that Cady was a Senior Vice President of DVI, Inc. can support a conclusion that because of the magnitude of alleged fraud at DVI, Inc., Cady "must have known" of it. See Rosen v. Textron, Inc., 321 F. Supp. 2d 308, 328 (D.R.I. 2004) (dismissing claim against officer of a subsidiary based on allegation that he must have known about fraudulent accounting at parent company).

1. The Scienter Allegations As To Cady Are Insufficient

As to Cady's scienter , the allegations as to his title, position, salary and bonus (see Compl. at ¶¶ 33, 247) are, as established by the cases discussed, in Section II.B, supra, insufficient to establish scienter. It is true that the Complaint also alleges that Cady "developed a scheme to lend cash from DVI BC to a health care provider who was delinquent on its DVI FS loan or lease" and that he "knowingly or recklessly approved of numerous round trip financings using DVI BC to make payments on debts owed to DVI FS in which no funds were ever actually received from the borrower." Compl. at ¶¶ 65, 241. However, there is no allegation that Cady knew at the time of the alleged financings that no funds would be received from the borrower or that the transactions were motivated by anything other than what DVI BC did in the normal course of its business: lend funds to operators of medical centers secured by accounts receivable. See GSC Partners CDO Fund v. Washington, 368 F.3d 228, 237 (3d Cir. 2004) ("motives . . . generally possessed by most corporate [employees] do not suffice [for scienter]; instead, plaintiffs must assert a concrete and personal benefit to the . . . defendant[] resulting from this fraud.") The pejorative term "scheme" does not change the fact that Cady was doing what DVI BC ordinarily did – lending money to health care providers secured by their receivables. The fact that these loans allegedly were ultimately not repaid is not evidence of any fraud by Cady. There can be no "fraud by hindsight." See California Public Employees Retirement Sys., 2004 WL 3015578 at *20; In re Rockefeller Center Props. Sec. Litig., 311 F.3d 198, 225 (3d Cir. 2002). Likewise, the securities acts were not intended to provide a cause of action for allegedly poor business decisions. See In re Alpharma Sec. Litig., 372 F.3d 137, 152 (3d Cir. 2004). Awareness of a transaction is insufficient to show scienter. See In re Citigroup, Inc. Sec. Litig., 330 F. Supp. 2d 367, 381 (S.D.N.Y. 2004). In the final analysis, the allegations about Cady fail

to show "a mental state embracing intent to deceive, manipulate or defraud." See In re Ikon Office Solutions, Inc., 277 F.3d 658, 667 (3d Cir. 2002).

The inadequacy of Plaintiffs' scienter allegations as to Cady also dooms the Complaint's fallback claims of violations of Rule 10b-5(a) and (c) in addition to Rule 10b-5(b). The Complaint not only fails to connect Cady to any public misstatements or omissions under Rule 10b-5(b); it also fails to connect him with any fraud under Rule 10b-5(a) or (c), much less the scienter required to support such claims. See In re Initial Public Offering Sec. Litig., 241 F. Supp. 2d 281, 385 (S.D.N.Y. 2003) (particularized scienter allegations must be made to state claims under Rule 10b-5(a) and (c)). [9]

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[9] Plaintiffs also err when they contend, without any explanation or authority, that the Court may "ignore" Cady's and Colasanti's argument about market manipulation. See Plaintiffs' Omnibus Brief at 63 n. 27; Cady Brief at 17; Colasanti Brief at 15. Plaintiffs attempt to assert a claim under Rule 10b-5(a) and (c), but those provisions in fact focus on market manipulation and there is simply no allegation that either Cady or Colasanti engaged in market manipulation. See Cady Brief at 17-18; Colasanti Brief at 15-17; see also S.E.C v. Martino, 255 F. Supp. 2d 268, 287 (S.D.N.Y. 2003) (market manipulation is limited to certain specific manipulations of market for securities); In re Initial Public Offering Sec. Litig., 297 F. Supp. 2d 668, 674 (S.D.N.Y. 2003)(Rule 10b-5(a) and (c) claims are for market manipulation). As discussed in the opening briefs of both Cady and Colasanti, with citations to authority, market manipulation is a term of art and claims under Rule 10b-5(a) and (c) must assert, pursuant to the PSLRA, specifically the kind of market manipulation at issue as well as scienter. See In re Global Crossing, Ltd. Sec. Litig., 322 F. Supp. 2d 319, 329 (S.D.N.Y. 2004)(PSLRA's particularity requirements apply to Rule 10b-5(a) and (c) claims, both of which require a showing of scienter) Plaintiffs do so nowhere in their Complaint, and compound the error by glossing over the argument in their Omnibus Brief.

Separately,with respect to Rule 10b-5(c), as explained in Section II.B.1 and 2, there are no particularized factual allegations in the Complaint that either Cady or Colasanti "engage[d] in any act, practice or course of business which operate[d] or would operate as a fraud or deceit upon any person" with scienter. See Rule 10b-5(c); In re Global Crossing, 322 F. Supp. 2d at 329. In any event, the alleged conduct, if construed as fraudulent, was not alleged to have been "in connection with the purchase or sale of any security." See Rule 10b-5(c). The cases cited by Plaintiffs at page 60 of their brief in support of these claims are inapposite. For example, S.E.C v. Zandford, 535 U.S. 813, 818-19 (2002), involved a Rule 10b-5(c) claim based on a stockbroker's fraud in converting investors' funds to his own use. Likewise, the case of Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128, 152-53 (1972), dealt with the liability of a bank and its employees for devising a plan to induce Native Americans to sell certain stock they held. In both cases, the defendants were directly involved with a fraud to induce a particular buyer or holder of securities to engage in certain conduct. These claims are a far cry from the alleged conduct here.

(continued...)

2. The Scienter Allegations Regarding Colasanti Are Insufficient To State A Claim

As to Colasanti, the Complaint alleges that he "knowingly or recklessly approved accruals to report income on delinquent loans (overdue more than 180 days), which falsely enhanced DVI's reported income." Compl. at ¶ 241. The Complaint also alleges that O'Hanlon sought, and Colasanti participated in, "a plan to aid a borrower friend of O'Hanlon's by ramming through without proper Credit Committee approval $4.5 million in working capital 'loans' that were intended to be used by the borrower solely to make the monthly payments due to DVI FS." Compl. at ¶ 242.

Neither of these allegations connect Colasanti with misstatements or omissions about DVI, Inc.'s securities. And misstatements and omissions are of course the gravamen of securities fraud under Rule 10b-5(b).

Plaintiffs' further allegation that, because of Colasanti's consulting position, he was necessarily involved in making representations to the public and was responsible for the content of these representations (Compl. at ¶¶ 44) is not adequate to show scienter. See Alpharma, 372 F. 3d at 149. See also Advanta, 180 F.3d at 539; GSC Partners, 368 F.3d at 239 ("it is not enough for plaintiffs to merely allege that defendants 'knew' their statements were fraudulent or that defendants 'must have known' their statements were false.") Colasanti's role as a special consultant in no way suggests that he was involved in day-to-day-operation of DVI, Inc. Plaintiffs cannot sustain their claim by "coupl[ing] a factual statement with a conclusory

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(continued...)

The law on Rule 10b-5(a) and (c) in this Circuit and others is sparse. The Court should decline Plaintiffs' invitation to create from Rule 10b-5(a) and(c) general, wide-ranging prohibitions, especially where, as here, the Complaint is so plainly focused on alleged misrepresentations and omissions consistent with a claim under Rule 10b-5(b).

allegation of fraudulent intent." See Shields v. Citytrust Bancorp, Inc., 25 F.3d 1124, 1129 (2d Cir. 1994). Accordingly, notwithstanding Plaintiffs' assertions to the contrary, Colasanti's position does not support an inference of scienter.

Likewise, to the extent Plaintiffs argue that their Complaint asserts claims against Colasanti under Rule 10b-5(a) and (c), the allegations of scienter are also defective.[10] As stated above, it is not enough to show awareness of a transaction; there must be "facts establishing that [the defendant] knew such transactions to be fraudulent." See In re Citigroup, 330 F. Supp. 2d at 381. And, to the extent that the allegations about Colasanti center around accounting issues such as the accrual of income, it is well-established that violations of GAAP do not show scienter. See Lovelace v. Software Spectrum, Inc., 78 F.3d 1015, 1020-21 (5th Cir. 1996); In re Comshare, Inc. Sec. Litig., 183 F.3d 542, 553 (6th Cir. 1999); In re Worlds of Wonder Sec. Litig., 35 F.3d 1407, 1426 (9th Cir. 1994). Nor do bad credit decisions show scienter. See Santa Fe Indus. v. Green, 430 U.S. 462, 479 (1977) (Congress did not intend to remedy bad business decisions through the Securities Acts); In re Advanta, 180 F.3d at 537 (same).

Finally, as with Cady, the Complaint attempts to establish Colasanti's scienter by claiming that since his compensation was tied to "certain performance criteria designed to foster increasing DVI's securities value," he was therefore motivated to engage in fraud. See Compl. at ¶ 246. However, motive based on an executive's compensation, where, as here, the compensation is not alleged to be outside the ordinary, is not probative of scienter. See In re Burlington Coat Factory Sec. Litig., 114 F.3d 1410, 1424 (3d. Cir. 1997). The Complaint simply

[10] The same arguments about Rule 10b-5(a) and (c) made with respect to Cady, see Footnote 7, supra, also apply to Colasanti.

fails to allege a concrete and personal benefit actually received by Colasanti resulting from the fraud. GSC Partners, 368 F.3d at 237. As a result, there is no adequate pleading of scienter.

C. Count II (Section 20(a) Of The Exchange Act) Should Be Dismissed Because It Fails Adequately To Allege That Cady Or Colasanti Were Control Persons Of DVI, Inc. Or That They Culpably Participated In Any Fraud

As explained in the opening briefs of Cady and Colasanti, the elements of a Section 20(a) claim are: "(1) an underlying violation by a controlled person or entity; (2) a controlling person; and (3) culpable participation in the fraud by the controlling person 'in some meaningful sense.'" See In re CDNOW, Inc. Sec. Litig., 138 F.Supp.2d 624, 644 (E.D. Pa. 2001); Cady Brief at 18; Colasanti Brief at 17. The PSLRA's heightened pleading standards apply to Section 20 claims. See id. ("a plaintiff must plead the particularized facts of the controlling person's conscious misbehavior as a culpable participant in the fraud.") As set forth below and in the opening briefs of Cady and Colasanti, Plaintiffs' allegations fail to meet those standards.

The only allegations of control over DVI, Inc. made with respect to Cady or Colasanti deal with their "titles," not with any link between those titles and any allegedly fraudulent activities. See Opposition Brief at 68. Such conclusory, non-particularized allegations do not suffice to show control. See Lilley v. Charren, 936 F. Supp. 708, 716-17 (N.D. Cal. 1996) ("To state a cause of action for 'controlling person' liability under . . . section 20, plaintiffs must allege facts showing that each defendant possessed the actual power to control the person primarily liable. Conclusory allegations based on director or officer status are insufficient as a matter of law."). "Control" is "possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise." 17 C.F.R. § 240.12b-2. Generalized allegations that the Individual Defendants had access to information and the ability to correct misleading statements

do not establish that control on the part of either Cady or Colasanti. See In re Digital Island Sec. Litig., 223 F. Supp. 2d at 562.

In addition, "culpable participation must be proved before control person liability for misrepresentation attaches." In re MobileMedia Sec. Litig., 28 F.Supp.2d 901, 940 (D.N.J. 1998) (citing Rochez Bros., Inc. v. Rhoades, 527 F.2d 880, 890 (3d Cir. 1975)). See also In re Ravisent Tech., Inc., No. Civ. A. 00-CV-1014, 2004 WL 1563024, at *15 (E.D. Pa. July 13, 2004); In re Cendant Corp. Sec. Litig., 81 F.Supp.2d 550, 558 (D.N.J. 2000); In re Equimed, Inc. Sec. Litig., No. 98 CV 5374 NS, 2000 WL 562909, at *10 (E.D.Pa. May 9, 2000). As the Third Circuit has explained, culpable participation is "'deliberate and ...intentional[ ]' action or inaction by the defendant 'to further the fraud.'" Rochez Brothers, 527 F.2d at 890. See also In re Tyson Foods, Inc., No. Civ. A. 01-425-SLR, 2004 WL 1396269, at *13 (D. Del. June 17, 2004). There is no specific allegation of culpable participation in the alleged fraud by either Cady or Colasanti;[11] the Complaint simply alleges that they were performing their duties as, with respect to Cady, the CEO of DVI BC (at paragraph 32), and with respect to Colasanti, the internal workout consultant for DVI, Inc. (at paragraph 33). Since the allegations about Cady and Colasanti do not support an inference of scienter, a fortiori, Section II.B, they cannot support an inference of culpable participation in the fraud.

D. Count VI Should Be Dismissed Because The Complaint Fails To Allege That Cady Or Colasanti Conspired To Commit Fraud

The Complaint's allegations regarding Colasanti and Cady do not implicate either of them in any fraud, much less a conspiracy to engage in any fraud. Contrary to Plaintiffs' suggestion, see Plaintiffs' Omnibus Brief at 77, because this claim is for a conspiracy to commit

[11] Although Paragraph 65 of the Complaint makes certain allegations about Cady's involvement, those allegations are not particularized or well-pleaded as discussed supra at Section II.B.1.

fraud (as opposed to some other tort), it must be pled with particularity under Federal Rule of Civil Procedure 9(b). See Lum v. Bank of America, 361 F.3d 217, 228 (3d Cir. 2004); Christidis v. First Pennsylvania Mortgage Trust, 717 F.2d 96, 99 (3d Cir. 1983); Liebman v. Prudential Fin., Inc., No. Civ. A. 02-2566, 2002 WL 31928443, at *6 (E.D. Pa. Dec. 30, 2002) (Rule 9(b) applies to state law claims of fraud). Particularity in this context means specific facts about the agreement and the fraud, such as the identity of the participants, the time, place and circumstances of the agreement, and the acts done in furtherance of it. See Palladino v. VNA of S. New Jersey, Inc., 68 F. Supp. 2d 455, 462 (D.N.J. 1999) ; Klein v. Council of Chem. Ass'n, 587 F. Supp. 213, 227 (E.D. Pa. 1984). At the very least, the facts and allegations must "inject[ ] ... some measure of substantiation into their allegations of fraud." Liebman, 2002 WL 31928443 at *6 (quoting Seville Indus. Mach. Corp. v. Southmost Mach. Corp., 742 F.2d 786, 791 (3d Cir. 1984)).

The Complaint makes no specific allegations with respect to Cady or Colasanti of either (1) an agreement, (2) overt acts in furtherance of an agreement, or (3) malice. Plaintiffs must aver "that two or more persons combined or agreed with intent to do an unlawful act or to do an otherwise lawful act by unlawful means. Proof of malice, i.e., an intent to injure, is essential in proof of a conspiracy." Skipworth by Williams v. Lead Indus. Ass'n, Inc., 690 A.2d 169, 174 (Pa. 1997). Indeed, implicitly acknowledging an inability to allege the common law fraud purportedly underlying the alleged conspiracy, the Complaint does not even name Cady or Colasanti in Count V, the claim for common law fraud. Skipworth, 690 A.2d at 174 (a claim of conspiracy must charge an underlying unlawful act by the defendant). See also Boyanowski v. Capital Area Intermediate Unit, 215 F.3d 396, 407 (3d Cir. 2000) ; In re Orthopedic Bone Screw Prod. Liab. Litig., 193 F.3d 781, 789 (3d Cir. 1999) ("The established rule is that a cause of

action for civil conspiracy requires a separate underlying tort as a predicate for liability."); Fresh Made, Inc. v. Lifeway Foods, Inc., No. Civ. A. 01-4254, 2002 WL 31246922, at *10 (E.D. Pa. Aug. 9, 2002) (same).

In addition, to the extent that Count VI purports to assert a claim based on a conspiracy between DVI, Inc. on the one hand and Cady or Colasanti on the other hand, see Complaint, ¶¶ 332, 337, such allegations, as a matter of law, do not constitute a conspiracy. It is clearly established that the agent or employee of a corporation cannot "conspire" with the corporation. See id.; Mill Run Assocs. v. Locke Prop. Co., 282 F. Supp. 2d 278, 294 (E.D. Pa. 2003); Keating v. Bucks Cty. Water and Sewer Auth., No. Civ. A. 99-1584, 2000 WL 1888770, at *16 (E.D. Pa. Dec. 29, 2000).

Importantly as well, the Complaint does not adequately allege that either Cady or Colasanti acted with malice. To the contrary, the allegations show only that Cady and Colasanti were doing their jobs and trying to advance the business of DVI and its subsidiaries. See Compl. at ¶¶ 33-34, 90, 241-43. 247. Against that background, the "sole purpose" rule dooms any claim of malice. Contrary to Plaintiffs' assertions at page 79 of their Omnibus Brief, the Pennsylvania Supreme Court held in Thompson Coal Co. v. Pike Coal Co., 488 Pa. 198, 211, 412 A.2d 466, 472 (Pa. 1979), that the defendant did not have the requisite malice because he had not "acted solely to injure appellants" and instead had "acted solely to advance the legitimate business interests of his client and to advance his own interests." See id. Plaintiffs' Omnibus Brief at 79 argues that, "[t]he sole purpose concept . . . stands for the proposition that a defendant who does not violate any fiduciary duty, commits no underlying unlawful act, and acts solely to advance its business interest, cannot be held liable for civil conspiracy." Such a narrow reading of the Thompson court is not sustainable in light of the cases adopting the "sole purpose" rule. See

Swartzbauer v. Lead Indus. Ass'n, Inc., 794 F. Supp. 142, 145 (E.D. Pa. 1992); Bristol Township v. Independence Blue Cross, No. Civ. A. 01-4323, 2001 WL 1231708, *6 (E.D. Pa. Oct. 11, 2001) (no malice where purpose was to "further defendants' business dealings); Spitzer v. Abdelhak, No. Civ. A. 98-6475, 1999 WL 1204352 at *9 (E.D. Pa. Dec. 15, 1999).

E. Count VII Of The Complaint Should Be Dismissed Because There Is No Cause of Action In Pennsylvania For Aiding And Abetting Fraud

Plaintiffs point to recent cases recognizing a cause of action for aiding and abetting a breach of fiduciary duty to argue that this Court should recognize a claim for aiding and abetting fraud, an entirely different tort with entirely different elements. See Plaintiffs' Omnibus Brief at 80. However, in not a single one of these cases did the court mention aiding and abetting fraud much less suggest a link between aiding and abetting a breach of fiduciary duty and aiding and abetting fraud. In light of that fact, these cases are hardly persuasive.

There is not a single case in either state or federal court in Pennsylvania even discussing the possibility of an aiding and abetting fraud claim, much less adopting one. Nor is there any reason to think that the Pennsylvania Supreme Court would recognize a claim for aiding and abetting fraud, a tort that is subject to additional pleading requirements of specificity under both federal and state procedural law, just because the Pennsylvania Commonwealth Court has recognized a claim for aiding and abetting breach of fiduciary duty. Particularly in light of the Third Circuit's admonition that federal courts sitting in diversity should "permit state courts to decide whether and to what extent they will expand state common law," Count VII should be dismissed. See City of Phila. v. Lead Ass'n, Inc., 994 F.2d 112, 123 (3d Cir. 1993); see also Flood v. Makowski, No. Civ. A. 3:CV-03-1803, 2004 WL 1908221, *36 (E.D. Pa. Aug. 24, 2004); S. Kane & Son Profit Sharing Trust v. Marine Midland Bank, No. Civ. A. 95-7058, 1996

WL 325894, *9 (E.D. Pa. June 13, 1996) ; Constitution Bank v. DiMarco, 836 F. Supp. 304, 309 (E.D. Pa. 1993) ; In re Jack Greenberg, 240 B.R. 486, 524 (Bankr. E.D. Pa. 1999).

Moreover, even if such a claim were recognized – and it should not be – Plaintiffs have failed to plead adequately the elements of an aiding and abetting claim under Restatement (Second) of Torts § 876(b). In order to plead such a claim, Plaintiffs would have to aver that Cady and Colasanti (a) committed a tortious act (here, fraud) in concert with another person (or entity) or pursuant to a common design with him (or it); or (b) knew that the other's conduct constituted a breach of duty and gave substantial assistance or encouragement to the other so to conduct himself (or itself); or (c) gave substantial assistance to the other in accomplishing a tortious result and his own conduct, separately considered, constituted a breach of duty to the third person. See Restatement §876(b). As explained in detail above, Section II.B, the Complaint lacks specific allegations as to any intent, acts, or substantial assistance by Cady or Colasanti. (Interestingly, Plaintiffs mention neither Cady nor Colasanti in the section of their brief addressing the aiding and abetting claim. See Plaintiffs' Omnibus Brief at 80-81. Accordingly, Count VII should be dismissed.

F. Plaintiffs' Omnibus Brief Wrongly Asserts That The Complaint Pleads A Claim For Negligent Misrepresentation Against Cady And Colasanti

In their Omnibus Brief, Plaintiffs assert that they have made a claim against Cady and Colasanti for negligent misrepresentation. See Plaintiffs' Omnibus Brief at 81-89. This is not the case. As explicitly reflected in the headings to the Counts, neither Count VIII nor IX (the

negligent misrepresentation counts) is pleaded against Cady or Colasanti. There is, very simply, no negligent misrepresentation claim against either of them.[12]

G. Count X Should Be Dismissed Because The Washington State Securities Act Does Not Apply To Either Cady Or Colasanti

Plaintiffs baldly assert that there is a "substantial nexus" between "this action" and Washington State that justifies application of the Washington State Securities Act to these transactions. See Plaintiffs' Omnibus Brief at 91. However, the Complaint fails even to allege a nexus between Cady and Colasanti and the group of Plaintiffs who, for the first time in this unsworn brief, assert links between themselves and Washington State. The Complaint also fails to allege that sales of securities occurred in Washington, that misrepresentations were made there, that Plaintiffs relied on misrepresentations there, or that Plaintiffs suffered any damages there. Although the statute itself does not set forth any requirement that the transactions sued upon have a nexus with Washington State, Washington Courts have interpreted the statute in that manner. See Ito Intern. Corp. v. Prescott, Inc., 83 Wash.App. 282, 289, 921 P.2d 566, 570 (Wash. App. Div. 1 1996) ("Here, the State has a strong interest in applying its securities act to a partnership involving several Washington defendants, Washington plaintiffs, and property located in Washington.") Moreover, as explained in the opening briefs, extraterritorial application of Washington State law to transactions with minimal links to the state violates the interstate commerce clause. See Cady Brief at 24; Colasanti Brief at 23. Accordingly, the Washington State Securities Act ("WSSA") simply does not reach the conduct at issue here.

[12] If the Court were somehow to construe Count VIII or Count IX to be pleaded against Cady and/or Colasanti--and it should not--they would respectfully request an opportunity to move for dismissal of those counts against them.

Even if the WSSA were applicable, the Complaint does not meet its requirements. Apparently, Plaintiffs have resorted to the WSSA because the WSSA, unlike the federal securities laws, does not require evidence of scienter. However, it does still require a misrepresentation or omission, or a manipulation of the market for the securities at issue. See RCW 21.20.010. And, as explained supra, Section II.A, since the Complaint fails to link Cady or Colasanti to any fraudulent conduct, that element of the WSSA claim is not pled and the claim should be dismissed. (Nor, moreover, is there any allegation that Plaintiffs relied on any misstatements by Cady or Colasanti. See Stewart v. Estate of Steiner, 93 P.3d 919, 922 (Wash. Ct. App. 2004).

In addition, the claim under Section 21.20.430(1) of the WSSA should be dismissed because Plaintiffs have failed to allege that Cady or Colasanti are "sellers" of DVI, Inc. securities. See Tuscany, Inc. v. Paragon Capital Corp., No. 44637-1-I, 2000 WL 1224795, *12-13 (Wash. Ct. App. Aug. 28, 2000). While Plaintiffs argue that under Washington law, a person is a "seller" if his or her participation in a securities transaction "was a substantial contributive factor in the violation," see Haberman v. Washington Public Power Supply Sys,, 744 P.2d 1032, 1051 (Wash. 1987), they do not point out where in the Complaint Cady or Colasanti are alleged to have been "substantial contributive factors." There is no allegation that Colasanti, a special workout consultant, or Cady, the CEO of DVI BC (a company not publicly traded), had any role in sales of DVI, Inc., securities.

Finally, to the extent that Plaintiffs rely on "control person liability" under the WSSA, such reliance is unavailing. As explained above, Section II.C, supra, there is no factual support for the Complaint's conclusory allegations that Colasanti or Cady were control persons of DVI, Inc. Accordingly, Count X should be dismissed as to both of them.

III. CONCLUSION

For the reasons set forth here and in the opening briefs of Cady and Colasanti, the Complaint against each of them should be dismissed in its entirety.[13]

Dated: January 10, 2005

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[13] Even if some or all of the state law claims were adequately pleaded against Cady or Colasanti, the dismissal of the federal claims at this early state of the litigation would argue strongly against this Court's exercising supplemental jurisdiction over the state claims. See 28 U.S.C. § 1367; Bonenberger v. Plymouth Township, 132 F.3d 20, 23 (3d Cir. 1997); Borough of West Mifflin v. Lancaster, 45 F.3d 780, 788 (3d Cir. 1995); Markowitz v. Northeast Land Co., 906 F.2d 100, 106 (3d Cir. 1990) ("[T]he rule within this Circuit is that once all claims with an independent basis of federal jurisdiction have been dismissed, the case no longer belongs in federal court").

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing Reply Brief in Support of Motion to Dismiss Pursuant to Federal Rule of Civil Procedure 12(B)(6) of Defendants Terry Cady and Matthew Colasanti was served via first class mail, postage prepaid, on the following:

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Dated: January 10, 2005

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

WM HIGH YIELD FUND, WM INCOME FUND, AT HIGH YIELD FUND, WM VT INCOME FUND, AT INCOME FUND, EVERGREEN FUNDING LTD./EVERGREEN FUNDING CORP., and STELLAR FUNDING, LTD.,	)	
Plaintiffs,	)	**Case No. 04-3423-LDD**
v.	)	
MICHAEL A. O'HANLON, STEVEN R. GARFINKEL, RICHARD MILLER, ANTHONY J. TUREK, JOHN P. BOYLE, TERRY W. CADY, MATTHEW COLASANTI, RAYMOND FEAR, GERALD COHN, HARRY T.J. ROBERTS, WILLIAM S. GOLDBERG, JOHN E. MCHUGH, NATHAN SHAPIRO, DELOITTE & TOUCHE, LLP, HAROLD NEAS, ONCURE TECHNOLOGIES CORPORATION, JEFFREY GOFFMAN, PRESGAR IMAGING, LLC, and DOLPHIN MEDICAL, INC.,	)	
Defendants.	)	

ORDER

AND NOW, upon consideration of the Motion by Defendants Matthew Colasanti and Terry Cady to Dismiss the Complaint, Plaintiffs' Omnibus Opposition, and the Reply Brief of Cady and Colasanti in Further Support of the Motion, IT IS HEREBY ORDERED that the Motion is GRANTED and that the Complaint is dismissed as to Defendants Colasanti and Cady.

Legrome Davis, United States District Judge