

1992

Johnson-Bowles Company and Marlen V. Johnson v. Division of Securities and Utah Department of Commerce : Unknown

Utah Supreme Court

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DOCKET NO. _____ 120

920145

CLERK SUPREME COURT
UTAH

JOHNSON-BOWLES COMPANY, INC., and
MARLEN VERNON JOHNSON,

V.

The DIVISION OF SECURITIES and
the UTAH DEPARTMENT OF COMMERCE,
STATE OF UTAH,

Respondents.

Rule 29(a)(13) priority

ATTORNEYS FOR RESPONDENTS

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The Division's Brief in Opposition to the Petition for Writ of Certiorari embraces the same error engaged in by the Court of Appeals -- not in its amended opinion of February 19, 1992, but in the Court of Appeals' original opinion of November 29, 1991. Specifically, and as if it hadn't read the amended opinion, the Division continues to argue that its Summary Order of March 1, 1989, was a "Stop Trading Order." See e.g., Division brief at pp. 3-4. The Court of Appeals scuttled this untenable proposition in its amended opinion. The Division simply doesn't understand what the amended opinion says and what the Division itself, as a state regulatory agency, has the power to do.

While the Division continues to embrace the admittedly erroneous original opinion of the Court of Appeals, the Court of Appeals' amended opinion acknowledges that a summary order entered under Utah Code Ann. §61-1-14(3) does not operate to "suspend trading."¹ Further, while the amended opinion does indeed recognize that trading cannot be suspended under Utah law,

¹ This singular aspect of the amended opinion (something it holds by default by deleting its prior §12 analysis) is correct because "trading" is an exclusively federal concept as set forth in the avowed purpose of the Securities Exchange Act of 1934, an Act over which federal courts have exclusive jurisdiction. The Preamble of such Act states:

An Act to provide for the regulation of securities exchanges and of over-the-counter markets operating in interstate and foreign commerce and through the mails, to prevent inequitable and unfair practices on such exchanges and markets, and for other purposes.

See p. 33, Petitioners' Court of Appeals Brief below; see also Section 2 of the Exchange Act, Necessity for Regulation as Provided in This Title, Vol 2, Fed. Sec. L. Rep. (CCH) ¶120,111 at p. 15,051, Rel. #1267 (January 6, 1988).

the Court of Appeals still errs by further holding (in an effort to achieve the same, original result) that the "intent, scope or purpose" of the Summary Order is to "suspend trading." The amended opinion is thus even more erroneous than the first opinion because it allows the Division to accomplish indirectly what it admittedly could never do directly. The Division's brief in opposition only underscores the whole problem: the Division has tried to convince the Court of Appeals, from the ALJ on up, that a §14(3) summary order is a "trading suspension" when it cannot be as a matter of law. Thus, even if the Johnsons' post-market-making purchases were tantamount to "trading" (which they aren't as a matter of law), it doesn't matter.

The Division next argues that because Judge Greene concluded that Johnson-Bowles "knew or should have known about the irregularities" respecting U.S.A. Medical stock, its conduct in honoring its outstanding federal contracts -- after it was no longer a market-maker -- is necessarily "dishonest or unethical." Three things this Court must recognize: First, under Rule 15c2-11(f)(3)(i) and (ii) of the General Rules and Regulations of the Commission, a full copy of which is attached hereto as Exhibit "A", a broker may commence market-making activities in a security with no due diligence based on other brokers already being "in the sheets" on (i.e., trading) the same stock. In other words, Johnson-Bowles had every right to trade U.S.A. Medical in late 1988/early 1989 without confirming -- on its own, independently -- the truth and accuracy of

U.S.A. Medical's due diligence materials.² See Exhibit "A". Thus, for what it's worth, based on Rule 15c2-11(f)(3)(i) and (ii), Judge Greene was wrong and he didn't need to make such finding to deny Johnson-Bowles' motion for preliminary injunction even though he may have thought it was necessary to do so. At the same time, the exemptions provided in Rule 15c2-11(f) were never pointed out to Judge Greene because Johnson-Bowles was not, or at least didn't think, that it was on trial on February 27 and 28, 1989.

Secondly, it would be sheer madness for a broker to trade a security knowing the stock is "boxed" by a band of hoodlums. Johnson-Bowles obviously had no idea this was the case or it never would have allowed its traders to become "short" in the first place.³

Third, no one would expect a stock which was forward-split to increase ten-fold. On the contrary, the stock should have traded at 10¢ per share after the forward-split, not the

² In order to make-a-market in U.S.A. Medical, Johnson-Bowles was entitled to rely on the exemptions provided in Rule 15c2-11(f)(3) because it was not the first broker to be "in the sheets" in late 1988/early 1989 and several other broker-dealers had continuously been "in the sheets." Furthermore, assuming such had not been the case, Johnson-Bowles complied with Rule 15c2-11(a)(5), also comprising Exhibit "A", because the "source" of U.S.A. Medical's due diligence materials, namely, James L. Averett, a local securities attorney who prepared and endorsed such materials, is a person that Johnson-Bowles had "a reasonable basis for believing was reliable." See Subsection (a)(5) to Rule 15c2-11. See also p. 9, footnote 6, the Johnsons' Court of Appeals Brief below, citing to U.S.A. Medical's due diligence package in the record, an exhibit to Johnson-Bowles' federal court 10b-5 complaint. Specifically, it is Exhibit "H" to the Johnsons' Hearing Exhibit R-5.

³ This is not to ignore that Johnson-Bowles originally became "short" 15,000 shares, an amount which automatically converted on January 23, 1989 into 150,000 shares, as a result of a fail-to-deliver by Rick Hermanson, one of the U.S.A. Medical co-conspirators.

equivalent of \$10 per share. Again, that this occurred was not the fault of either Johnson-Bowles or Mr. Johnson and the opposite effect of a normal forward-split was far beyond their control.

In sum, having made a market in U.S.A. Medical in late 1988/early 1989 -- even in light of Judge Greene's determination -- does not make Johnson-Bowles in pari delicto with the criminals who manipulated its stock. See e.g., Jessup, Josephthal & Co v. Piquet & Cie, [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶96,195 at p. 91,029 (S.D.N.Y., August 21, 1991) (negligence, imprudence, stupidity, or even recklessness are legally insufficient to trigger in pari delicto or aiding and abetting liability), a copy of which is attached hereto as Exhibit "B". See also pp. 59, 71, 72, 75 and 81, the Johnsons' Court of Appeals Brief below, citing the U.S. Supreme Court's 1988 Pinter v. Dahl⁴ decision and this Court's decision in Schanaveldt v. Noy-Burn Milling & Processing Corp., 347 P.2d 553, 554 (Utah 1959). Thus, if Johnson-Bowles was indeed stupid or negligent for having made a market in U.S.A. Medical stock in the first instance, it is a classic non sequitur to conclude that Johnson-Bowles (and Johnson) acted "dishonestly" or "unethically" several months later in buying stock to honor contractual commitments incurred in the ordinary course of such prior market-making activity, conduct subsequently undertaken in good faith to protect itself and those to whom it owed stock.

4 486 U.S. 622, 108 S.Ct. 2063, 100 L.Ed.2d 658, ['87-'88 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶93,790 (June 15, 1988); see also p. 6, the Johnsons' December 13, 1991, Petition for Rehearing below.

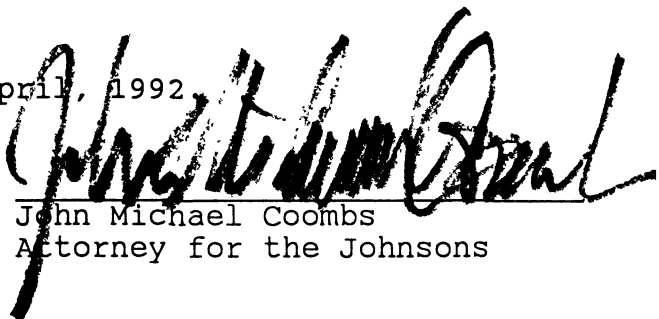
The Johnsons' Petition is not, by any means, an attempt to reargue the facts of the case. Division brief, pp. 3-4. On the contrary, it is only an attempt to get a fair and honest application of the law to such facts.

The Johnsons' Petition for Writ of Certiorari adequately addresses all other issues raised by the Division in its brief in opposition.⁵

Based on the foregoing, more especially the Johnsons' March 20, 1992, Petition for Writ of Certiorari, there is absolutely no legal or other basis for the Court of Appeals' conclusion that the Johnsons engaged in "dishonest or unethical [business] practices," let alone that it was in the "public interest" to put them out of business.

RESPECTFULLY SUBMITTED,

DATED this 30th day of April, 1992.



John Michael Coombs
Attorney for the Johnsons

⁵ The Division argues that the Johnsons have failed to meet any criterion for certiorari set forth in Rule 46, Utah R. App. Pro. Division brief at pp. 6-7. While the Johnsons contend in their Petition that they meet Rule 46(a), (c) and (d), they also meet Rule 46(b). This is because the Court of Appeals' amended decision is in direct conflict with Morton Int'l v. Auditing Div. of the Utah State Tax Comm., 814 P.2d 581, 585 (Utah 1991). While Morton talks generally of agencies being "in a better position than the courts to give effect to the regulatory objective," Morton does not give the Court of Appeals a blanket and blind license to "rubberstamp" final agency actions -- something that unquestionably occurred in this case.

EXHIBIT "A"

~~**Proposed Rule**~~

(h) If the Commission after appropriate notice and hearing finds that the sponsor of any plan absent reasonable justification or excuse, has failed to comply, or to enforce compliance by participants or subscribers with the terms conditions, and undertakings of its effective trading system plan, and if it appears to the Commission that such failure is inconsistent with the public interest, the protection of investors, and the maintenance of fair and orderly markets or the removal of impediments to and perfection of the mechanisms of a national market system for securities and a national system for the clearance and settlement of securities transactions the Commission shall rescind the effectiveness of the trading system plan

(i) *Effective dates* The effective date of this section shall be [six months after date for adoption of rule]

~~**End of Proposed Rule**~~

[§ 25,116] Initiation or Resumption of Quotations Without Specified Information

➡➡➡ *Rule 15c2-11 is amended and proposed to be amended See below*

Reg § 240.15c2-11. (a) It shall be a fraudulent, manipulative, and deceptive practice within the meaning of Section 15(c)(2) of the Act, for a broker or dealer to publish any quotation for a security or, directly or indirectly, to submit any such quotation for publication, in any quotation medium (as defined in this rule) unless

(1) The issuer has filed a registration statement under the Securities Act of 1933, other than a registration statement on Form F-6, which became effective less than 90 calendar days prior to the day on which such broker or dealer publishes or submits the quotation to the quotation medium, *Provided* That such registration statement has not thereafter been the subject of a stop order which is still in effect when the quotation is published or submitted, and such broker or dealer has in his records a copy of the prospectus specified by Section 10(a) of the Securities Act of 1933, [Amended in Release No 34-21470 (¶ 83,705), effective January 14, 1985, 49 F R 45117]

(2) the issuer has filed a notification under Regulation A under the Securities Act of 1933 which became effective less than 40 calendar days prior to the day on which such broker or dealer publishes or submits the quotation to the quotation medium, *provided* that the offering circular provided for under Regulation A has not thereafter become the subject of a suspension order which is still in effect when the quotation is published or submitted, and such broker or dealer has in his records a copy of such offering circular, or

(3) (i) the issuer is required to file reports pursuant to Section 13 or 15(d) of the Act, or is the issuer of a security covered by Section 12(g)(2)(B) or (G) of the Act, and

(ii) the broker or dealer has a reasonable basis for believing that the issuer is current in filing the reports required to be filed at regular intervals pursuant to Section 13 or 15(d) of the Act, or, in the case of insurance companies exempted from Section 12(g) of the Act by subparagraph 12(g)(2)(G) thereof, the annual statement referred to in Section 12(g)(2)(G)(i) of the Act, and

(iii) the broker or dealer has in his records the issuer's most recent annual report filed pursuant to Section 13 or 15(d) of the Act or the annual statement in the case of an insurance company not subject to Section 12(g) of the Act together with any other reports required to be filed at regular intervals under such provisions of the Act which have been filed by the issuer after such annual report or annual statement, or

(4)(i) The issuer is exempt from Section 12(g) of the Act by reason of compliance with the provisions of § 240 12g3-2(b), and [Added in Release No 34-21470 (§ 83,705), effective January 14, 1985, 49 F R 45117]

(ii) The broker or dealer wishing to submit for publication a quotation for such security has in his records, and makes reasonably available upon request to any person expressing an interest in a proposed transaction in the security with such broker or dealer, the information furnished to the Commission pursuant to § 240 12g3-2(b) since the beginning of the issuer's last fiscal year, which the broker or dealer has no reasonable basis for believing is not true and correct and which was obtained by him from sources that he has a reasonable basis for believing are reliable, or [Added in Release No 34-21470 (§ 83,705), effective January 14, 1985, 49 F R 45117]

(5) Such broker or dealer has in his records, and shall make reasonably available upon request to any person expressing an interest in a proposed transaction in the security with such broker or dealer, the following information (which shall be reasonably current in relation to the day the quotation is submitted), which he has no reasonable basis for believing is not true and correct or reasonably current, and which was obtained by him from sources which he has a reasonable basis for believing are reliable (1) the exact name of the issuer and its predecessor (if any), (2) the address of its principal executive offices, (3) the state of incorporation, if it is a corporation, (4) the exact title and class of the security, (5) the par or stated value of the security, (6) the number of shares or total amount of the securities outstanding as of the end of the issuer's most recent fiscal year, (7) the name and address of the transfer agent, (8) the nature of the issuer's business, (9) the nature of products or services offered, (10) the nature and extent of the issuer's facilities, (11) the name of the chief executive officer and members of the board of directors, (12) the issuer's most recent balance sheet and profit and loss and retained earnings statements, (13) similar financial information for such part of the two preceding fiscal years as the issuer or its predecessor has been in existence, (14) whether the broker or dealer or any associated person is affiliated, directly or indirectly with the issuer, (15) whether the quotation is being published or submitted on behalf of any other broker or dealer, and, if so, the name of such broker or dealer, and, (16) whether the quotation is being submitted or published directly or indirectly on behalf of the issuer, or any director, officer or any person, directly or indirectly the beneficial owner of more than 10 per cent of the outstanding units or shares of any equity security of the issuer, and, if so, the name of such person, and the basis for any exemption under the federal securities laws for any sales of such securities on behalf of such person. If such information is made available to others upon request pursuant to this subparagraph, such delivery, unless otherwise represented, shall not constitute a representation by such broker or dealer that such information is true and correct, but shall constitute a representation by such broker or dealer that the information is reasonably current in relation to the day the quotation is submitted, that he has no reasonable basis for believing the information is not true and correct, and that the information was obtained from sources which he has a reasonable basis for believing are reliable. This paragraph (a)(5) shall not apply to any security of an issuer included in paragraph (a)(3) of this section unless a report or statement of such issuer described in paragraph (a)(3) of this section is not reasonably available to the broker or dealer. A report or statement of an issuer described in paragraph (a)(3) of this section shall be "reasonably available" when such report or statement is filed with the Commission. [Amended in Release No 34-21470 (§ 83,705), effective January 14, 1985, 49 F R 45117]

(b) With respect to any security the quotation of which is within the provisions of this rule, the broker or dealer submitting or publishing such quotation shall maintain in his records information regarding all circumstances involved in the submission of publication of such quotation, including the identity of the person or persons for whom

the quotation is being submitted or published and any information regarding the transaction provided to the broker or dealer by such person or persons.

(c) The broker or dealer shall maintain in writing as part of his records the information described in paragraphs (a) and (b), and any other information (including adverse information) regarding the issuer which comes to his knowledge or possession before the publication or submission of the quotation, and preserve such records for the periods specified in Rule 17a-4

(d) For any security of an issuer included in paragraph (a)(5), the broker or dealer submitting the quotation shall furnish to the inter-dealer-quotation-system (as defined below), in such form as such system shall prescribe, at least 2 days before the quotation is published or submitted, the information regarding the security and the issuer which such broker or dealer is required to maintain pursuant to said paragraph (a)(4). [Amended in Release No. 34-21470 (¶ 83,705), effective January 14, 1985, 49 F.R. 45117.]

➡ *Reproduced below is the text of Rule 15c2-11, paragraph (a)-(d) as amended, effective June 1, 1991.*

Preliminary Note: Brokers and dealers may wish to refer to Securities Exchange Act Release No. 29094 (April 17, 1991), for a discussion of procedures for gathering and reviewing the information required by this rule and the requirement that a broker or dealer have a reasonable basis for believing that the information is accurate and obtained from reliable sources.

Reg. § 240.15c2-11. (a) As a means reasonably designed to prevent fraudulent, deceptive, or manipulative acts or practices, it shall be unlawful for a broker or dealer to publish any quotation for a security or, directly or indirectly, to submit any such quotation for publication, in any quotation medium (as defined in this section) unless such broker or dealer has in its records the documents and information required by this paragraph (for purposes of this section, "paragraph (a) information"), and, based upon a review of the paragraph (a) information together with any other documents and information required by paragraph (b) of this section, has a reasonable basis under the circumstances for believing that the paragraph (a) information is accurate in all material respects, and that the sources of the paragraph (a) information are reliable. The information required pursuant to this paragraph is:

(1) A copy of the prospectus specified by section 10(a) of the Securities Act of 1933 for an issuer that has filed a registration statement under the Securities Act of 1933, other than a registration statement on Form F-6, which became effective less than 90 calendar days prior to the day on which such broker or dealer publishes or submits the quotation to the quotation medium, *Provided* That such registration statement has not thereafter been the subject of a stop order which is still in effect when the quotation is published or submitted; or

(2) A copy of the offering circular provided for under Regulation A under the Securities Act of 1933 for an issuer that has filed a notification under Regulation A which became effective less than 40 calendar days prior to the day on which such broker or dealer publishes or submits the quotation to the quotation medium, *Provided* That the offering circular provided for under Regulation A has not thereafter become the subject of a suspension order which is still in effect when the quotation is published or submitted, or

(3) A copy of the issuer's most recent annual report filed pursuant to Section 13 or 15(d) of the Act or a copy of the annual statement referred to in Section 12(g)(2)(G)(i) of the Act, in the case of an issuer required to file reports pursuant to Section 13 or 15(d) of the Act or an issuer of a security covered by section 12(g)(2)(B) or (G) of the Act, together with any quarterly and current reports that have been filed under the provisions of the Act by the issuer after such annual report or annual statement; *Provided, however, That* until such issuer has filed its first annual report pursuant to

Section 13 or 15(d) of the Act or annual statement referred to in Section 12(g)(2)(G)(i) of the Act, the broker or dealer has in its records a copy of the prospectus specified by Section 10(a) of the Securities Act of 1933 included in a registration statement filed by the issuer under the Securities Act of 1933, other than a registration statement on Form F-6, that became effective within the prior 16 months or a copy of any registration statement filed by the issuer under Section 12 of the Act that became effective within the prior 16 months, together with any quarterly and current reports filed thereafter under section 13 or 15(d) of the Act; and *Provided Further* That the broker or dealer has a reasonable basis under the circumstances for believing that the issuer is current in filing annual, quarterly, and current reports filed pursuant to section 13 or 15(d) of the Act, or, in the case of an insurance company exempted from section 12(g) of the Act by reason of section 12(g)(2)(G) thereof, the annual statement referred in section 12(g)(2)(G)(i) of the Act; or

(4) The information furnished to the Commission pursuant to § 240.12g3-2(b) since the beginning of the issuer's last fiscal year, in the case of an issuer exempt from Section 12(g) of the Act by reason of compliance with the provisions of § 240.12g3-2(b), which information the broker or dealer shall make reasonably available upon request to any person expressing an interest in a proposed transaction in the security with such broker or dealer; or

(5) The following information, which shall be reasonably current in relation to the day the quotation is submitted and which the broker or dealer shall make reasonably available upon request to any person expressing an interest in a proposed transaction in the security with such broker or dealer:

- (i) the exact name of the issuer and its predecessor (if any);
- (ii) the address of its principal executive offices;
- (iii) the state of incorporation, if it is a corporation;
- (iv) the exact title and class of the security;
- (v) the par or stated value of the security;
- (vi) the number of shares or total amount of the securities outstanding as of the end of the issuer's most recent fiscal year;
- (vii) the name and address of the transfer agent;
- (viii) the nature of the issuer's business;
- (ix) the nature of products or services offered;
- (x) the nature and extent of the issuer's facilities;
- (xi) the name of the chief executive officer and members of the board of directors;
- (xii) the issuer's most recent balance sheet and profit and loss and retained earnings statements;
- (xiii) similar financial information for such part of the two preceding fiscal years as the issuer or its predecessor has been in existence;
- (xiv) whether the broker or dealer or any associated person is affiliated, directly or indirectly with the issuer;
- (xv) whether the quotation is being published or submitted on behalf of any other broker or dealer, and, if so, the name of such broker or dealer, and,
- (xvi) whether the quotation is being submitted or published directly or indirectly on behalf of the issuer, or any director, officer or any person, directly or indirectly the beneficial owner of more than 10 per cent of the outstanding units or shares of any equity security of the issuer, and, if so, the name of such person, and the basis for any

exemption under the federal securities laws for any sales of such securities on behalf of such person.

If such information is made available to others upon request pursuant to this paragraph, such delivery, unless otherwise represented, shall not constitute a representation by such broker or dealer that such information is accurate, but shall constitute a representation by such broker or dealer that the information is reasonably current in relation to the day the quotation is submitted, that the broker or dealer has a reasonable basis under the circumstances for believing the information is accurate in all material respects, and that the information was obtained from sources which the broker or dealer has a reasonable basis for believing are reliable. This paragraph (a)(5) shall not apply to any security of an issuer included in paragraph (a)(3) of this section unless a report or statement of such issuer described in paragraph (a)(3) of this section is not reasonably available to the broker or dealer. A report or statement of an issuer described in paragraph (a)(3) of this section shall be "reasonably available" when such report or statement is filed with the Commission. [Amended in Release No. 34-21470 (¶ 83,705), effective January 14, 1985, 49 F.R. 45117; and Release No. 34-29094 (¶ 84,725), effective June 1, 1991, 56 F.R. 19148.]

(b) With respect to any security the quotation of which is within the provisions of this section, the broker or dealer submitting or publishing such quotation shall have in its records the following documents and information:

(1) A record of the circumstances involved in the submission of publication of such quotation, including the identity of the person or persons for whom the quotation is being submitted or published and any information regarding the transactions provided to the broker or dealer by such person or persons;

(2) A copy of any trading suspension order issued by the Commission pursuant to Section 12(k) of the Act respecting any securities of the issuer or its predecessor (if any) during the 12 months preceding the date of the publication or submission of the quotation, or a copy of the public release issued by the Commission announcing such trading suspension order; and

(3) A copy or a written record of any other material information (including adverse information) regarding the issuer which comes to the broker's or dealer's knowledge or possession before the publication or submission of the quotation. [Amended in Release No. 34-29094 (¶ 84,725), effective June 1, 1991, 56 F.R. 19148.]

(c) The broker or dealer shall preserve the documents and information required under paragraphs (a) and (b) of this section for a period of not less than three years, the first two years in an easily accessible place. [Amended in Release No. 34-29094 (¶ 84,725), effective June 1, 1991, 56 F.R. 19148.]

Proposed Amendment

➡➡➡ *Reproduced below is the text of paragraph (c)(2) as proposed to be added in Release No. 34-29095 (¶ 84,726), April 17, 1991. Existing paragraph (c) would be redesignated as (c)(1).*

(2) The broker or dealer need not have in its records the information described in this paragraph (a), or make information available to other persons in accordance with paragraph (a)(4) or (a)(5) of this section, to the extent that such information is reasonably available to the broker or dealer and such other persons from an entity designated by the Commission by rule, regulation, or order as a securities information repository. In determining whether to grant, deny, suspend, condition, or withdraw such a designation, the Commission will consider whether the repository

(i) collects information about a substantial segment of issuers of securities subject to this rule,

(ii) maintains current and accurate information about such issuers;

Proposed Amendment

- (iii) has effective acquisition, retrieval, and dissemination systems;
- (iv) places no inappropriate limits on the issuers from or about which it will accept information;
- (v) provides access to the documents deposited with it to anyone willing and able to pay the applicable fees;
- (vi) charges reasonable fees; and
- (vii) in general, is so organized and has the capacity to be able reasonably to carry out the purposes of this section.

End of Proposed Amendment

➡ *Paragraph (d) is proposed to be removed in Release No. 34-29095 (¶ 84,726), April 17, 1991. Existing paragraphs (e)-(h) would be redesignated as (d)-(g).*

(d)(1) For any security of an issuer included in paragraph (a)(5) of this section, the broker or dealer submitting the quotation shall furnish to the interdealer quotation system (as defined in paragraph (e)(2) of this section), in such form as such system shall prescribe, at least 3 business days before the quotation is published or submitted, the information regarding the security and the issuer which such broker or dealer is required to maintain pursuant to said paragraph (a)(5) of this section.

(2) For any security of an issuer included in paragraph (a)(3) of this section, (i) a broker-dealer shall be in compliance with the requirement to obtain current reports filed by the issuer if the broker-dealer obtains all current reports filed with the Commission by the issuer as of a date up to five business days in advance of the earlier of the date of submission of the quotation to the quotation medium and the date of submission of paragraph (a) information pursuant to Schedule H of the By-Laws of the National Association of Securities Dealers, Inc.; and (ii) a broker-dealer shall be in compliance with the requirements to obtain the annual, quarterly, and current reports filed by the issuer, if the broker-dealer has made arrangements to receive all such reports when filed by the issuer and it has regularly received reports from the issuer on a timely basis, unless the broker-dealer has a reasonable basis under the circumstances for believing that the issuer has failed to file a required report or has filed a report but has not sent it to the broker-dealer. [Amended in Release No. 34-21470 (¶ 83,705), effective January 14, 1985, 49 F.R. 45-117; and Release No. 34-29094 (¶ 84,725), effective June 1, 1991, 56 F.R. 19148.]

(e) For purposes of this rule:

(1) "Quotation medium" shall mean any "inter-dealer quotation system" or any publication or electronic communications network or other device which is used by brokers or dealers to make known to others their interest in transactions in any security, including offers to buy or sell at a stated price or otherwise, or invitations of offers to buy or sell.

(2) "inter-dealer quotation system" shall mean any system of general circulation to brokers or dealers which regularly disseminates quotations of identified brokers or dealers.

(3) Except as otherwise specified in this rule, "quotation" shall mean any bid or offer at a specified price with respect to a security, or any indication of interest by a broker or dealer in receiving bids or offers from others for a security, or any indication by a broker or dealer that he wishes to advertise his general interest in buying or selling a particular security. [Amended in Release No. 34-21470 (¶ 83,705), effective January 14, 1985, 49 F.R. 45117.]

(4) "Issuer," in the case of quotations represented by American Depositary Receipts, shall mean the issuer of the deposited shares represented by such

American Depositary Receipts. [Added in Release No. 34-21470 (¶ 83,705), effective January 14, 1985, 49 F.R. 45117.]

(f) The provisions of this rule shall not apply to:

(1) The publication or submission of a quotation respecting a security admitted to trading on a national securities exchange and which is traded on such an exchange on the same day as, or on the business day next preceding, the day the quotation is published or submitted

(2) The publication or submission by a broker or dealer, solely on behalf of a customer (other than a person acting as or for a dealer), of a quotation that represents the customer's indication of interest and does not involve the solicitation of the customer's interest, *Provided, however*, That this paragraph (f)(2) shall not apply to a quotation consisting of both a bid and an offer, each of which is at a specified price, unless the quotation medium specifically identifies the quotation as representing such an unsolicited customer interest. [Amended in Release No. 34-21470 (¶ 83,705), effective January 14, 1985, 49 F.R. 45117.]

(3)(i) The publication or submission, in an interdealer quotation system that specifically identifies as such unsolicited customer indications of interest of the kind described in paragraph (f)(2) of this section, of a quotation respecting a security which has been the subject of quotations (exclusive of any identified customer interests) in such a system on each of at least 12 days within the previous 30 calendar days, with no more than 4 business days in succession without a quotation; or [Amended in Release No. 34-21470 (¶ 83,705), effective January 14, 1985, 49 F.R. 45117.]

(ii) The publication or submission, in an interdealer quotation system that does not so identify any such unsolicited customer indications of interest, of a quotation respecting a security which has been the subject of both bid and ask quotations in an interdealer quotation system at specified prices on each of at least 12 days within the previous 30 calendar days, with no more than 4 business days in succession without such a two-way quotation; [Amended in Release No. 34-21470 (¶ 83,705), effective January 14, 1985, 49 F.R. 45117.]

(iii) A dealer acting in the capacity of market maker, as defined in section 3(a)(38) of the Act, that has published or submitted a quotation respecting a security in an interdealer quotation system and such quotation has qualified for an exception provided in this paragraph (f)(3), may continue to publish or submit quotations for such security in the interdealer quotation system without compliance with this section unless and until such dealer ceases to submit or publish a quotation or ceases to act in the capacity of market maker respecting such security. [Amended in Release No. 34-21470 (¶ 83,705), effective January 14, 1985, 49 F.R. 45117.]

Proposed Amendment

➡➡➡ *Reproduced below is the text of paragraphs (e)(2) and (e)(3) as proposed to be redesignated from (f)(2) and (3) and amended in Release No. 34-29095 (¶ 84,726), April 17, 1991.*

(2) The publication or submission by a broker or dealer, solely on behalf of a customer (other than a person acting as or for a dealer), of a quotation that represents the customer's indication of interest and does not involve the solicitation of the customer's interest; *Provided, however*, That no broker or dealer shall publish or submit for publication in an interdealer quotation system a quotation representing such an unsolicited customer interest unless the system specifically so identifies the quotation.

(3) The publication or submission by a broker or dealer, in an interdealer quotation system, of a quotation respecting a security which has been the subject of quotations by that broker or dealer in such a system on each of at least 12 days within the previous 30 calendar days and no more than 4 successive business days have elapsed during such 30-day period between published quotations of such broker or

Proposed Amendment

dealer for the security: *Provided*, That such broker or dealer has, at least once during the 12-month period prior to the publication or submission of the quotation, complied with the provisions of paragraph (a) of this section concerning the requirement to have and review specified records relating to the security.

End of Proposed Amendment

(4) The publication or submission of a quotation respecting a municipal security. [As added by Release No. 34-12468 (§ 80,544), May 20, 1976, effective July 5, 1976, 41 F.R. 22826.]

(5) The publication or submission of a quotation respecting a security that is authorized for quotation in an interdealer quotation system sponsored and governed by the rules of a registered securities association, and such authorization is not suspended, terminated or prohibited. [Added in Release No. 34-21470 (§ 83,705), effective January 14, 1985, 49 F.R. 45117.]

➡➡➡ *Reproduced below is the text of paragraph (f)(5) as amended effective June 1, 1991.*

(5) The publication or submission of a quotation respecting a security that is authorized for quotation in the NASDAQ system (as defined in § 240.11Ac1-2(a)(3) of this chapter), and such authorization is not suspended, terminated, or prohibited. [Added in Release No. 34-21470 (§ 83,705); effective January 14, 1985; amended in Release No. 34-29094 (§ 84,725), effective June 1, 1991, 56 F.R. 19148.]

[Adopted in Release No. 34-12630 (§ 80,646), July 15, 1976, 41 F.R. 30009; amended in Release No. 34-13310 (§ 80,987), February 28, 1977, 42 F.R. 50646; amended in Release No. 34-13544 (§ 81,174), May 16, 1977, 42 F.R. 27881; amended in Release No. 34-13807 (§ 81,268), July 28, 1977, 42 F.R. 27881; amended in Release No. 34-21470 (§ 83,705), effective January 14, 1985, 49 F.R. 45117.]

(g) The requirement in subparagraph (a)(5) that the information with respect to the issuer be "reasonably current" will be presumed to be satisfied, unless the broker or dealer has information to the contrary, if: [Amended in Release No. 34-21470 (§ 83,705), effective January 14, 1985, 49 F.R. 45117.]

(1) the balance sheet is as of a date less than 16 months before the publication or submission of the quotation, the statements of profit and loss and retained earnings are for the 12 months preceding the date of such balance sheet, and if such balance sheet is not as of a date less than 6 months before the publication or submission of the quotation, it shall be accompanied by additional statements of profit and loss and retained earnings for the period from the date of such balance sheet to a date less than 6 months before the publication or submission of the quotation.

(2) other information regarding the issuer specified in subparagraph (a)(4) is as of a date within 12 months prior to the publication or submission of the quotation. [Amended in Release No. 34-21470 (§ 83,705), effective January 14, 1985, 49 F.R. 45117.]

(h) This rule shall not prohibit any publication or submission of any quotation if the Commission, upon written request or upon its own motion, exempts such quotation either unconditionally or on specific terms and conditions, as not constituting a fraudulent, manipulative or deceptive practice comprehended within the purpose of this rule.

[Adopted in Release No. 34-9310 (see CCH Special Report No. 387, Extra Edition, September 1, 1971), effective December 13, 1971, 36 F.R. 18,641; Release No. 34-12468 (§ 80,544), May 20, 1976, effective July 5, 1976, 41 F.R. 22826. Temporary rule (f)(4)(T) adopted in Release No. 34-12630 (§ 80,646) and extended to February 28,

EXHIBIT "B"

[¶ 96,195] *Jesup, Josephthal & Co., Inc., et al. v. Piguet & Cie., et al.*

United States District Court, Southern District of New York. 90 Civ. 6544 (WK). August 21, 1991. Opinion in full text.

1. Exchange Act—Jurisdiction—Minimum Contacts.—A foreign bank charged with securities fraud was subject to jurisdiction in the district in which it maintained brokerage bank accounts. Although the bank had no offices in the United States, and was not authorized to conduct business here, by opening trading accounts it availed itself of the privilege of conducting activities within the forum state and invoked the benefits and protections of its laws.

See ¶ 26,540. "Exchange Act—Insiders; Recordkeeping; Clearance & Transfer" division, Volume 4.

2. Exchange Act—Antifraud—Aiding and Abetting.—Allegations that a foreign bank assisted a trader's price manipulation scheme by representing to a brokerage firm that it would pay for the trader's purchase orders when it knew that he did not have the funds to cover the purchases were sufficient to state an aiding and abetting claim. Limited discovery would be permitted as to whether the representations were known by the bank to be false at the time they were made, and whether the bank's knowledge of the trader's fraudulent scheme could be inferred from its own trading activities in the stock in question.

See ¶ 22,721 and 22,725, "Exchange Act—Manipulations; National Market System" division, Volume 3.

3. Exchange Act—Antifraud—Aiding and Abetting—*In Pari Delicto* Defense.—A brokerage firm was not precluded from recovering on an aiding and abetting claim against a bank by its own claimed imprudence and negligence which allegedly caused its financial losses. The *in pari delicto* defense may be invoked only if the plaintiff has been an active, voluntary participant in the unlawful activity that is the subject of the suit. Mere stupidity or recklessness will not trigger this bar.

See ¶ 22,721 and 22,725, "Exchange Act—Manipulations; National Market System" division, Volume 3.

Opinion of KNAPP, District Judge.

By this complaint plaintiffs Jesup, Josephthal & Co., Inc. and Securities Settlement Corporation (hereinafter "plaintiff"), registered securities broker-dealers in the state of New York, allege, *inter alia*, that the defendants violated provisions of the Securities Exchange Act of 1934, 15 U.S.C. § 78aa. On January 16, 1991, plaintiff filed an amended complaint. Pursuant to Fed. R. Civ. P. 12(b)(2) defendant Piguet & Cie, Banquiers (hereinafter, "Piguet") now moves to dismiss that complaint on the ground that this court lacks personal jurisdiction over it. In the alternative, pursuant to Rule 12(b)(6) it moves to dismiss for failure to state a claim upon which relief can be granted. For the reasons that follow, the motions are denied.

Rule 12(b)(2)

Because a determination that we do not have jurisdiction over Piguet would leave us without power to adjudicate any other matter relating to it, we first address this question.

BACKGROUND

Piguet is a private bank organized as a partnership under the laws of Switzerland with its

principal place of business in Switzerland. Plaintiff seeks to recover as against Piguet for its alleged involvement in a fraud perpetrated by defendant Paul Kutik (hereinafter "Kutik"), whom the complaint names as the primary wrongdoer. As discussed in greater detail *infra*, Piguet's alleged participation in this fraud arises from activities it performed in connection with a brokerage bank account it maintains at Morgan Guaranty Trust (hereinafter "Morgan Guaranty") in New York City.

In support of its contention that we lack personal jurisdiction over it, Piguet informs us that it does not maintain offices in the United States and is not authorized to conduct business here. Its sole contacts with the United States are three brokerage bank accounts in New York: the above described Morgan Guaranty account, and one account each with the Philadelphia International Bank and the American Express Bank Limited. Piguet asserts that these accounts exist solely to facilitate international banking transactions, including stock purchase transactions, and that it maintains these accounts primarily as a service to its customers. Def. Mem. p.24.¹ Although it does not dispute plaintiff's allegation that some of the transactions in these

¹ In opposition to the instant motion, plaintiff draws our attention to yet another account that Piguet has with a New York brokerage house, namely the "Cowen & Co. account" which is nowhere mentioned in the complaint. Plaintiff asserts that Piguet has engaged in substantial

trading in this account. Piguet contests plaintiff's description of this account as a New York account asserting that this account was serviced by Cowen's office in Geneva, Switzerland. See Def. Reply Mem. p. 13. Since we find that on the facts pleaded in the complaint that we have personal

accounts are performed for the bank's own investment purposes, it contends that since the only alleged connection which these accounts have with the instant suit stems from activities it performed on behalf of its client, Kutik, "it would be unreasonable and unfair to subject [it] to the jurisdiction of this Court." *Id.* We disagree.

DISCUSSION

It is well settled that personal jurisdiction under the Securities Exchange Act of 1934 extends "to the full reach permitted by the due process clause." *Perez-Rubio v. Wyckoff* (S.D.N.Y. 1989) 718 F.Supp. 217, 227. Accordingly jurisdiction can be obtained over any defendant who has "certain minimum contacts with [the forum] such that the maintenance of this suit does not offend 'traditional notions of fair play and substantial justice.'" *Id.* at 227-228 (citing *International Shoe Co. v. Washington* (1945) 326 U.S. 310, 316). The inquiry is necessarily fact specific. Where, as here, jurisdiction is to be asserted over a defendant who is not present in the forum state but has caused an effect in the state by an act done elsewhere, due process requires that the court determine that the defendant's conduct was such that he "should reasonably anticipate being haled into court [in the forum state]" before the exercise of jurisdiction is proper. See *Perez-Rubio*, 718 F.Supp. at 228 (citation omitted).

Despite Piguet's recitation of the dearth of contacts it has with this forum, it is undisputed that it purchases and sells stock for its clients on a continuing basis through the above described correspondent bank accounts. It is also undisputed that the cause of action here asserted against it arises out of its alleged activities in one of these accounts, namely the account at Morgan Guaranty. Although Piguet strenuously argues that its activities with respect to the Morgan account here complained of were performed on behalf of its client, and not itself, we find this fact to be of little relevance for by offering the services provided by these accounts to its clients, Piguet acts to inure to its own benefit. See *Securities Exchange Commission v. Gilbert* (1979) 82 F.R.D. 723, 725. By opening these accounts Piguet purposely chose to "[avail] itself of the privilege of conducting activities within the forum State, thus invoking the benefits and protections of its laws." *Hanson v. Denckla* (1957) 357 U.S. 235, 253. Thus, it is only reasonable to conclude that Piguet must "anticipate being haled into court" in New York for alleged illegal conduct it performed through these accounts. *World-Wide Volkswagen Corp. v. Woodson* (1980) 444 U.S. 286, 297 ("When a

corporation 'purposefully avails itself of the privilege of conducting activities within the forum State' it has clear notice that it is subject to suit there"); see *Gilbert*, 82 F.R.D. at 725, 726 (noting that personal jurisdiction was proper over Swiss bank whose only contact with New York was through four accounts maintained with three New York broker-dealers, since the cause of action sued upon arose out of the purchases and sales of stock in New York "which were not only the direct and foreseeable, but the intended 'effects' of the bank's 'acts' in Switzerland). Accordingly we find that in the circumstances before us the exercise of personal jurisdiction over Piguet comports with traditional notions of fair play and substantial justice. Cf. *Perez-Rubio*, 718 F.Supp. at 227 ("On a motion to dismiss pursuant to Rule 12(b)(2) . . . all doubts are to be resolved in the plaintiff's favor . . . a plaintiff need make out only a *prima facie* case of personal jurisdiction").

Rule 12(b)(6)

In support of its motion to dismiss pursuant to 12(b)(6) Piguet makes two contentions. First it asserts that plaintiff has failed to plead fraud with particularity as required by Rule 9. Second, it contends that plaintiff's actions were as egregious as its own, and therefore that the doctrine of *pari delicto* should bar plaintiff from recovering as against it. We shall address each of these contentions in turn.

BACKGROUND

The theory of the complaint is that defendant Paul Kutik (hereinafter "Kutik") schemed to inflate the value of Columbia Laboratories stock (hereinafter "Columbia") in violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5, promulgated thereunder. See 15 U.S.C. § 78j; 17 C.F.R. § 240.10b-5. In particular, the complaint alleges that Kutik placed buy orders for Columbia stock with various brokerage houses with no intention of actually paying for the ordered shares. Plaintiff contends that Kutik's motivation for this fraud stems from the fact that he had secured substantial loans using Columbia shares as collateral, and that, according to the terms of these loan agreements, he would be obligated to put up additional collateral as security should the value of Columbia stock decline to below \$9.00 a share.

The gravamen of the claim against Piguet is that Piguet aided and abetted Kutik's scheme to manipulate the price of Columbia stock. The relevant facts of this claim are as follows.

Plaintiff alleges that on or about August 3, 1990, it was contacted by Kutik to open an

(Footnote Continued)

jurisdiction over Piguet we need not presently address the merits of this dispute.

account on behalf of Dermal Panama, SA (hereinafter, the "Dermal" account)². Kutik informed plaintiff that he had authority to open this account and to direct trading activities therein on Dermal's behalf. In the following week, acting under Kutik's instructions, plaintiff purchased an aggregate of 80,500 shares of Columbia common stock for the Dermal account. Although Kutik represented that payment for said purchases would be prompt, no such payments were ever made. Compl. ¶ 96.

On August 14, at Kutik's request, plaintiff opened a second account, entitled the Farnell Holdings, Ltd. account (hereinafter the "Farnell" account)³. Pursuant to Kutik's instructions, plaintiff purchased an aggregate of 88,300 shares of Columbia common stock for this account over the next week.

After plaintiff made repeated demands for payment for the Dermal purchases, Kutik informed it that payment could be facilitated if it would transfer the stock which it had purchased for the Dermal account to a new account entitled the "Dermal Morgan" account and designate Morgan Guaranty as the receiving agent for stock purchased for this new account. Kutik explained that his bank, Piguet, had an account at Morgan Guaranty, and that it would furnish the funds necessary to pay for the stock on a delivery versus payment basis. He assured plaintiff that at all times there would be sufficient funds on deposit with Morgan Guaranty to pay for all transactions effected for this account. See *id.* at ¶ 102.

Pursuant to this information, and at Kutik's instruction, plaintiff contacted Piguet and was informed that "both Kutik and Dermal were clients of Piguet and that arrangements were being made to make payment for the 80,500 shares of Columbia stock which [would be] transferred to the Dermal Morgan account."⁴ *Id.* at ¶ 107. Accordingly, on August 21, 1990, plaintiff opened the Dermal Morgan account. Between August 21 and August 27, plaintiff attempted to deliver to Morgan Guaranty the 80,500 shares of Columbia stock now purchased on behalf of the Dermal Morgan account. Morgan Guaranty, however, refused such delivery. *Id.* at ¶¶ 111, 112.

Again pursuant to Kutik's instructions, on August 29, plaintiff opened a separate account entitled the "Farnell Morgan" account, desig-

nated Morgan Guaranty the receiving agent for this account, and transferred to it the stock previously purchased for the Farnell account. The complaint alleges that to confirm that payment arrangements were being made for this transferred stock, plaintiff again contacted Piguet, and was informed that Piguet would make immediate payment for "all of the Columbia shares purchased for the various accounts maintained by Kutik . . . upon delivery of such securities to Morgan [Guaranty]." *Id.* at ¶¶ 126, 127.

At or about this time plaintiff, acting on Kutik's instructions, purchased an additional 66,000 shares of Columbia stock for the Farnell Morgan account and transferred all stock then in the Dermal Morgan account to this Farnell Morgan account. Accordingly, by September 1 plaintiff had purchased a total of 234,800 shares of Columbia stock for Kutik, all of which were held in the Farnell Morgan account.

On several occasions between August 29 and September 7 plaintiff attempted to deliver the 234,800 shares to Morgan Guaranty. However, Morgan Guaranty continued to refuse receipt of this stock. *Id.* at ¶ 132.

The complaint alleges that thereafter Piguet was advised that the 234,800 shares presently held in the Farnell Morgan account would be resold due to nonpayment. In response, on September 7 Piguet represented to plaintiff that:

[it] was in the process of making arrangements for the payment for all of the full purchase price for all 234,000 [234,000] [shares] of Columbia stock held in the Farnell Morgan brokerage account, and that the previous delays preventing Morgan [Guaranty] from accepting delivery of said securities and tendering payment for same was due to problems encountered in transmitting the appropriate instructions to Morgan [Guaranty] for the conversion of Swiss Francs into U.S. Dollars for payment to [plaintiff] for the Columbia shares.

Id. at ¶ 133.

On September 10, Piguet did in fact forward to plaintiff \$922,075.58 to pay for 100,000 of the 234,800 Columbia shares. Plaintiff alleges that in light of the September 7 conversation with Piguet it justifiably relied upon the fact that this was a partial payment and accordingly

² Dermal, a defendant in this action, is a Panama corporation with its principal place of business in Switzerland.

³ Farnell, also a defendant, is a United Kingdom corporation with its principal place of business in Gibraltar.

⁴ Paragraph 107 of the complaint states that "[Piguet] telephoned [plaintiff] prior to August 21, 1990, and confirmed that both Kutik and Dermal were clients of Piguet and that arrangements were being made to make payment

for the 80,500 shares of Columbia stock, which had been transferred to the Dermal Morgan Account, in cash, or by delivery of other negotiable securities, to Morgan . . ." Since the complaint informs that the Dermal Morgan account was not opened until plaintiff had received this information we presume the language cited above was intended to be set forth in conditional terms.

did not liquidate the remaining 134,800 shares. *Id.* at ¶ 191. Thereafter, on September 19, 20, and 21, plaintiff's registered representative Jeffrey Leach introduced Kutik to other broker-dealers, with whom Kutik proceeded to place purchase orders for an additional 56,000 shares of Columbia stock. Piguet made no additional payments to plaintiff, and in the period of September 20 to December 6 plaintiff sold the remaining stock for \$684,743. Plaintiff asserts that it suffered a loss of \$509,958 on this transaction.⁵

In support of its claim that Piguet aided and abetted Kutik's alleged illegal conduct, the complaint specifically pleads "upon information and belief" that Piguet knew of the existence and purpose of Kutik's scheme to violate the securities laws, and that it rendered substantial assistance to this scheme. *See id.* at ¶¶ 188, 190. The complaint asserts that Piguet's knowledge of the underlying securities fraud perpetrated by Kutik can be inferred from the fact that Piguet, as Kutik's bank, "[knew] of Kutik's financial resources and concomitant inability to make payment" for the amount of shares he ordered. *See id.* at ¶ 189. The complaint does not, however, specifically state that at the time Piguet represented to plaintiff that it would pay for all shares, *see id.* at ¶ 133, it knew that its client would not be forwarding to it funds necessary to pay for said shares; nor does it allege that when Piguet asserted that it had had difficulty transferring Swiss francs into U.S. currency, *see id.*, it knew this statement to be false.

In its brief in opposition plaintiff offers an additional fact from which Piguet's knowledge of the alleged securities fraud might be inferred, namely that it itself owned a substantial number of shares of Columbia stock in August 1990, and that it engaged in substantial trading activity in this stock during the period of Kutik's alleged fraudulent scheme. *See Pl. Mem.* at 20 n.2; *supra* at 2, n.1. Plaintiff concedes, however, that this information is not pleaded in its complaint.

DISCUSSION

Rule 9

To state a claim for aider and abettor liability under Section 10(b) of the Securities and Exchange Act of 1934 a plaintiff must allege sufficient facts to demonstrate: (1) the existence of a securities law violation by the primary party; (2) knowledge of the violation by the

aider and abettor; and (3) substantial assistance by the aider and abettor in achievement of the primary violation. *Armstrong v. McAlpin* (2d Cir. 1983) 699 F.2d 79, 91. In support of this motion to dismiss, Piguet contends that the allegations of the complaint are insufficient to properly plead factors (2) and (3).⁶

With respect to factor (3) Piguet contends that as a matter of law its three conversations with plaintiff do not constitute "substantial assistance". *Def. Mem.* at 20. We disagree. The success of Kutik's alleged scheme artificially to inflate the price of Columbia stock was dependent on his ability to induce plaintiff to purchase shares on his behalf, over a period of time. We can not say as a matter of law that no reasonable juror could conclude that Piguet's affirmative statement to plaintiff that it would pay for all shares ordered by Kutik did not substantially assist Kutik in this task. Accordingly, we turn to the question of whether or not plaintiff has pleaded facts sufficient to establish that Piguet knew that Kutik was engaged in a scheme to violate the securities laws.

Citing Rule 9⁷, Piguet contends that even if we were to assume that it knew that its client Kutik did not have the funds at hand to pay for the stock he was instructing plaintiff to purchase, it by no means follows that it would have known—or even should necessarily have suspected—that Kutik was entering orders which he did not hope to be able to cover. Rather, it contends that it is only logical to infer that it assumed Kutik would in due course provide the necessary funds for his purchases. In support of this argument, Piguet draws our attention to the absence of any allegation by plaintiff that any statements it made to plaintiff were "knowingly false" when made. *See 5/30/91 Tr.* at 24.

At first glance we found these arguments persuasive. However, at oral argument plaintiff informed us that it did not affirmatively plead that Piguet made false statements precisely because the information necessary to plead such an allegation is exclusively within Piguet's possession. In particular, plaintiff argued that *whether or not Piguet had in fact had difficulty transferring Swiss francs to U.S. dollars, or had made any efforts whatsoever prior to September 10 to pay for any of the stock ordered by Kutik, were facts known only to Piguet and could be substantiated only through discovery.* *See id.* at 23-28.

⁵ \$509,958 represents the difference between the price plaintiff originally paid for the shares namely 2,116,777 and the price it received from this delayed sale.

⁶ For purposes of this motion, Piguet assumes that the allegations in the Amended Complaint are sufficient to allege securities laws violations by Kutik. *See Def. Mem.* at 14 n.7.

⁷ Rule 9 provides:

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

Although Rule 9 requires that allegations of fraud be pleaded with particularity, it specifically provides that "[m]alice, intent, knowledge, or other conditions of a mind of a person may be averred generally". In *Hospital Bldg. Co. v. Rex Hospital Trustees* (1975) 425 U.S. 738, 746, the Supreme Court observed that:

'[A] complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief.' *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957) ... And in ... cases, where 'the proof is largely in the hands of the alleged conspirators,' *Poller v. Columbia Broadcasting*, 368 U.S. 464, 473 (1962), dismissals prior to giving the plaintiff ample opportunity for discovery should be granted very sparingly.

Having reviewed all of the allegations of the complaint, as well as the briefs submitted in relation to the instant motions, we can not say that plaintiff can not prove any set of facts in support of its claim that Piguet knew of Kutik's scheme to violate the securities laws and, accordingly, that it aided and abetted him in this task. *Cf. Ouaknine v. MacFarlane* (2d Cir. 1990) 897 F.2d 75, 80-81 ("[p]lausible allegations that defendants made specific promises to induce a securities transaction while secretly intending not to carry them out or knowing they could not be carried out, and that they were not carried out, are sufficient ... to state a claim for relief under Section 10(b)" (citations omitted)). Accordingly, pursuant to the teaching of *Hospital Bldg. Co.*, we presently deny Piguet's motion to dismiss for failure to plead fraud with particularity, and grant plaintiff limited discovery on the following two issues: (1) whether or not statements which Piguet made to plaintiff during any of the three above discussed conversations were known by Piguet to be false at the time they were made, and (2) whether—or to what extent—Piguet's knowledge of Kutik's fraudulent scheme can be inferred from its own trading activities in the shares of Columbia stock it owned. Piguet may, of course, renew this motion to dismiss at the close of discovery on these issues. Plaintiff, if so advised, may in the interim file a second amended complaint.

In pari delicto

As an alternative ground for dismissing the complaint, Piguet asserts that even if the plaintiff could allege a valid aiding and abetting claim, the doctrine of *in pari delicto* should preclude it from recovering on this claim

because it was plaintiff's own imprudence and negligence which caused it to suffer the financial loss here asserted. See 5/30/91 Tr. at 28. In support of this claim, Piguet cites the facts that plaintiff, a sophisticated broker-dealer, proceeded to permit Kutik to order an aggregate of 234,800 shares of Columbia stock over a period of less than six weeks without ever having paid one cent for said purchases, and it even "aided" Kutik in his purchase of an additional 56,000 Columbia shares by introducing him to other broker-dealers even though it, itself, had never been paid for any of the stock Kutik ordered purchased.

The common law defense of *in pari delicto* prohibits a plaintiff from recovering only if he "is as guilty of wrongdoing as the party he accuses." *Ross v. Bolton*, (S.D.N.Y. 1986) 639 F.Supp. 323, 328 citing *Mallis v. Bankers Trust*, (2d Cir. 1980) 615 F.2d 68, 76 cert. denied, (1981) 449 U.S. 1123, 101 S. Ct. 938, 67 L.Ed.2d 109. Mere stupidity, or even recklessness, will not suffice to trigger this bar. As the Court in *Pinter v. Dahl* (1988) 486 U.S. 622, 636 stated:

The plaintiff must be an active, voluntary participant in the unlawful activity that is the subject of the suit. 'Plaintiffs who are truly *in pari delicto* are those who have themselves violated the law in cooperation with the defendant'. Unless the degrees of fault are essentially indistinguishable or the plaintiff's responsibility is clearly greater, the *in pari delicto* defense should not be allowed, and the plaintiff should be compensated. (citations omitted).

On the facts presently before us, we can not conclude that this affirmative defense will inevitably bar plaintiff from recovering against Piguet. Piguet does not claim that plaintiff knew of Kutik's fraudulent scheme nor does it assert that plaintiff's actions to accommodate Kutik's requests to purchase stock were in any way unlawful. Accordingly, the motion to dismiss on this ground is denied.

CONCLUSION

Piguet's motions to dismiss are denied. It is granted leave to renew that portion of its Rule 12(b)(6) motion specified above after discovery on the issues outlined is completed or after a reasonable period of time has passed. Plaintiff is granted leave to file a second amended complaint, if it be so advised.

SO ORDERED.