UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

IN RE WORLDCOM, INC. SECURITIES LITIGATION This Document Relates to:	MASTER FILE 02 Civ. 3288 (DLC)
IN RE TARGETS SECURITIES LITIGATION This Document Relates To: ALL ACTIONS	MASTER FILE 03 Civ. 9490 (DLC) OPINION AND ORDER

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DENISE COTE, District Judge:

Defendants Citigroup Inc. ("Citigroup"), Citigroup Global

Markets Inc., formerly known as Salomon Smith Barney Inc. ("SSB"), and Jack Grubman ("Grubman") (collectively, "SSB Defendants") have moved to dimiss a class action complaint asserting federal securities law claims based on a derivative security whose value was linked to the value of the common stock of WorldCom, Inc. ("WorldCom"). The plaintiffs assert Sections 11 and 12(a)(2) claims under the Securities Act of 1933 ("Section 11," "Section 12(a)(2)," and "Securities Act"), and Sections 10(b) and 20(a) claims under the Securities Exchange Act of 1934 ("Section 10(b)," "Section 20(a)," and "Exchange Act") in connection with an instrument called Targeted Growth Enhanced Terms Securities With Respect to the Common Stock of MCI WorldCom, Inc. ("TARGETS"). For the following reasons, the motion to dismiss is granted in part.

Background

On June 25, 2002, WorldCom announced a massive restatement of its financial statements. Government investigations and prosecutions followed. WorldCom entered bankruptcy in the summer of 2002, and has recently emerged from bankruptcy.

Civil litigation had anticipated the June 25 announcement. The first class action concerning WorldCom securities was filed in this district on April 30, 2002. The WorldCom class actions in this district were consolidated on August 15, 2002, and the WorldCom securities litigation as a whole, including many actions bringing individual as opposed to class claims and actions filed

throughout the nation and transferred here by the Judicial Panel on Multi-District Litigation, was consolidated through Orders of December 23, 2002, and May 22, 2003 (collectively, the "Securities Litigation"). See In re WorldCom, Inc. Sec. Litig., No. 02 Civ. 3288 (DLC), 2002 WL 31867720, at *1 (S.D.N.Y. Dec. 23, 2002); In re WorldCom, Inc. Sec. Litig., No. 02 Civ. 3288 (DLC), 2003 WL 21219037 (S.D.N.Y. May 22, 2003).

Two class actions have been filed in connection with derivative securities that were linked to WorldCom's stock price. On February 13, 2003, an action brought on behalf of purchasers of "GOALs" was filed.[1] On January 6, 2004, that action was dismissed for failure to state a claim. In re PaineWebber GOALs Sec. Litig., 303 F. Supp. 2d at 390. Of particular relevance to this motion, the GOALs complaint was dismissed on the ground that it failed to plead the existence of a false statement when it relied for such an allegation on the accurate listing of historical WorldCom stock prices in the GOALs prospectus. Id.

The first TARGETS action was filed on November 26, 2003. A

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[1] The GOALs are notes issued by UBS AG that paid an annual interest rate of 12% over two years, payable semi-annually. The GOALs matured on January 24, 2003. The amount of the investor's principal to be repaid at maturity depended on the performance of WorldCom common stock during the term of the notes. If the price of WorldCom common stock rose, investors would be repaid their full principal in cash at maturity; if it fell below certain trigger points, they would be repaid their principal in a pre-set number of WorldCom shares. The GOALs were listed on the American Stock Exchange and traded in the secondary market. See In re Painewebber Sec. Litig., 303 F. Supp. 2d 385, 387 (S.D.N.Y. 2004).

second action was filed on December 18, 2003. A consolidated class action complaint ("Complaint") was filed on March 5, 2004. Plaintiffs seek recovery for those who purchased TARGETS between June 22, 1999 and April 21, 2002, and were damaged thereby.

The initial TARGETS registration statement became effective on February 3, 1999; there was an amended registration statement of March 8, 1999. 5,600,000 of TARGETS shares were issued by an SSB affiliate in June 1999. As the June 24, 1999 prospectus for the TARGETS ("Prospectus") advised investors, WorldCom was not affiliated with the issuer of TARGETS and had no obligations with respect to TARGETS. The Prospectus reported the history of WorldCom stock prices from 1994 to the second quarter of 1999.

TARGETS are synthetic equity-linked debt securities. Investors in TARGETS were entitled to receive a predetermined dividend for each quarter between purchase date and maturity date. The TARGETS were due August 15, 2002. The redemption value at maturity was linked to the trading price of WorldCom's common stock at that time with a cap on appreciation that allowed purchasers to participate in the "first 40% of appreciation in the price" of WorldCom stock. The Complaint asserts that the price of TARGETS in the secondary market rose and fell with the price of WorldCom stock.[2]

The Complaint alleges that the Prospectus failed to disclose conflicted business relationships between the SSB Defendants and

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[2] TARGETS were traded on the Chicago Board of Options Exchange.

WorldCom in violation of Sections 11 and 12(a)(2).[3] The complaint filed on October 11, 2002 in the consolidated WorldCom class action describes an alleged illicit, quid pro quo relationship between the SSB Defendants and WorldCom that was undisclosed to investors and it is on those allegations which the plaintiffs in the TARGETS litigation rely. The allegations are described in some detail in the May 19, 2003 Opinion on the first wave of motions to dismiss the WorldCom class action complaint and that discussion is incorporated here. See In re WorldCom, Inc. Sec. Litig., 294 F. Supp. 2d 392, 404-406 (S.D.N.Y. 2003). The Complaint also alleges violations of Sections 10(b) and 20(a), as well as Rule 10b-5, based on purported omissions from the Prospectus and SSB's research reports on WorldCom.

The SSB Defendants have moved to dismiss on the ground that many of the claims are time-barred; that the claims based on the Prospectus' listing of historical WorldCom stock prices fail to plead a misrepresentation or material omission; that the Section 10(b) claims based on the Prospectus fail adequately to plead scienter; that the Section 10(b) claims based on the research reports fail to plead statements made "in connection with" TARGETS; and that the Section 12(a)(2) claim is defective to the extent that it seeks recovery from SSB for secondary market purchases.

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[3] The Sections 12(a)(2) and 20(a) claims are brought only against defendant SSB.

Discussion

When considering a motion to dismiss, a court must take all facts alleged in the complaint as true and draw all reasonable inferences in favor of the plaintiff. Securities Investor Protection Corp. v. BDO Seidman, LLP, 222 F.3d 63, 68 (2d Cir. 2000). "Dismissal is inappropriate unless it appears beyond doubt that the plaintiff can prove no set of facts which would entitle him or her to relief." Raila v. United States, 355 F.3d 118, 119 (2d Cir. 2004).

Plaintiffs' Sections 11, 12(a)(2), and 20(a) claims are governed by the pleading standard set forth in Rule 8(a), Fed. R. Civ. P.[4] See In re WorldCom, Inc. Sec. Litig., 294 F. Supp. 2d at 406-08, 415-16, 419-20, 423. Under Rule 8(a), a complaint adequately states a claim when it contains "a short and plain statement of the claim showing that the pleader is entitled to relief." Swierkiewicz v. Sorema N.A., 534 U.S. 506, 512 (2002) (citing Rule 8(a)(2), Fed. R. Civ. P). Thus, under Rule 8(a)'s liberal pleading standard, a complaint is sufficient if it gives "fair notice of what the plaintiff's claim is and the grounds upon which it rests." Id. (citation omitted). Plaintiffs' Section 10(b) and Rule 10b-5 claim is governed by Rule 9(b), Fed. R. Civ. P., and the heightened pleading standard in the Private

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[4] The Second Circuit recently announced that claims brought under Sections 11 and 12(a)(2) that "sound in fraud" are governed by the pleading requirements of Rule 9(b), Fed. R. Civ. P. See Rombach v. Chang, 355 F.3d 164, 171 (2d Cir. 2004). Plaintiffs' Complaint explicitly disclaims that its Securities Act claims are fraud claims.

Securities Litigation Reform Act of 1995 ("PSLRA"), Pub. L. 104-67, 109 Stat. 737 (1995). See In re Scholastic Corp., 252 F.3d 63, 69-70 (2d Cir. 2001); In re WorldCom, Inc. Sec. Litig., 294 F. Supp. 2d at 410.

1. Securities Act Claims

The SSB Defendants move to dismiss the Securities Act claims on the ground, inter alia, that they are barred by the three year statute of limitations contained in the Securities Act. In addition, they argue that there is no Section 12(a)(2) cause of action for aftermarket purchases. Because the Securities Act claims must be dismissed based on these two grounds, it is unnecessary to consider the defendants' alternative arguments in support of dismissal.

a. Section 11

The Securities Act imposes strict liability on issuers for the accuracy of statements in issuing documents. See In re WorldCom, Inc. Sec. Litig., 294 F. Supp. 2d at 407. In doing so, it limits the class of potential plaintiffs. Section 11 addresses misrepresentations and omissions in a registration statement.[5] Id. at 407-08.

Section 13 of the Securities Act sets forth the statute of limitations for Securities Act claims. It provides:

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[5] The Complaint bases both its Section 11 and Section 12(a)(2) claims on the Prospectus.

> No action shall be maintained to enforce any liability created under section 77k [Section 11] or 77l(a)(2) [Section 12(a)(2)] of this title unless brought within one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence . . . . In no event shall any such action be brought to enforce a liability created under section 77k or 77l(a)(2) of this title more than three years after the security was bona fide offered to the public, or under section 77l(a)(2) of this title more than three years after the sale.

15 U.S.C. § 77m (emphasis supplied). Thus, under Section 13, plaintiffs must bring suit by the earlier of (a) three years from the date the parties in the offering "obligate themselves to perform," in the case of a Section 12(a)(2) claim, see Finkel v. Stratton Corp., 962 F.2d 169, 173 (2d Cir. 1992) (citation omitted), or three years from the date of the registration statement, in the case of a Section 11 claim, id. at 174, or (b) one year from the date on which they are put on actual or constructive notice of the facts underlying the claim. Dodds v. Cigna Secs., Inc., 12 F.3d 346, 350 (2d Cir. 1993).

The plaintiffs filed their complaint on November 26, 2003, more than four years after the effective date of the registration statement and the issuance of the Prospectus. All of their Section 11 claims are therefore time-barred. While the plaintiffs seek to preserve their argument that the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley") extended the limitations period for their Securities Act claims, for the reasons explained in prior Opinions issued in the Securities Litigation, that Act did not encompass either their Section 11 or Section 12(a)(2)

claims. In re WorldCom, Inc. Sec. Litig., 294 F. Supp 431, 440-44 (S.D.N.Y. 2003); In re WorldCom, Inc. Sec. Litig., 308 F. Supp. 2d 214, 220-21, 224-25 (S.D.N.Y. 2004).[6]

b. Section 12(a)(2)

For the reasons just described in connection with Section 11, all Section 12(a)(2) claims for those who purchased TARGETS more than three years before November 26, 2003 are also time-barred. The defendant SSB contends that to the extent that the plaintiffs seek to pursue Section 12(a)(2) claims for those who purchased TARGETS securities after November 26, 2000, those claims must be dismissed since Section 12(a)(2) does not provide a cause of action for aftermarket purchases.[7]

Section 12(a)(2) states, in pertinent part:

> Any person who . . . offers or sells a security . . . by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements . . . not misleading . . . shall be liable . . . to the person purchasing such security from him.

15 U.S.C. § 77l(a)(2) (emphasis supplied). Section 12(a)(2)

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[6] In their brief in opposition to this motion, the plaintiffs seek to benefit from the fact that Sarbanes-Oxley extended the statute of limitations period for fraud claims, by characterizing their Securities Act claims as fraud claims. As discussed infra, Sarbanes-Oxley is not retroactive. In any event, as already noted, the plaintiffs' pleading expressly denies that its Securities Act claims sound in fraud.

[7] The plaintiffs do not contend that there were any purchases of TARGETS after November 26, 2000 except in the aftermarket.

imposes liability without requiring "proof of either fraud or reliance." Gustafson v. Alloyd Co., 513 U.S. 561, 582 (1995). A plaintiff need only show "some causal connection between the alleged communication and the sale, even if not decisive." Metromedia Co. v. Fugazy, 983 F.2d 350, 361 (2d Cir. 1992) (citation omittted). The statute grants buyers the "right to rescind without proof of reliance." Gustafson, 513 U.S. at 576.

Section 12 creates a cause of action against sellers who "passed title, or other interest in the security, to the buyer for value." Pinter v. Dahl, 486 U.S. 622, 642 (1988); see also Wilson v. Saintine Exploration & Drilling Corp., 872 F.2d 1124, 1126 (2d Cir. 1989) (applying Pinter's Section 12(1) analysis to what is now Section 12(a)(2)); Capri v. Murphy, 856 F.2d 473, 478 (2d Cir. 1988) (same). Section 12(a)(2) "imposes liability on only the buyer's immediate seller; remote purchasers are precluded from bringing actions against remote sellers. Thus, a buyer cannot recover against his seller's seller." Cortec Indus. v. Sum Holding L.P., 949 F.2d 42, 49 (2d Cir. 1991) (citing Pinter, 486 U.S. at 644 n.21) (emphasis added in Cortec).

Defendants may be liable under Section 12(a)(2) either for selling a security or for soliciting its purchase. Cortec Indus., 949 F.2d at 49. Persons who are not in privity with the plaintiff may be liable if they "successfully solicit[ed] the purchase, motivated at least in part by a desire to serve [their] own financial interests or those of the securities owner." Pinter, 486 U.S. at 647; see also Commercial Union Assurance Co.

v. Milken, 17 F.3d at 608, 616 (2d Cir. 1994); Wilson, 872 F.2d at 1126. Defendants must have "actually solicited" the purchase by the plaintiffs. Capri, 856 F.2d at 479.

Relying on an extensive analysis of the requirement that a Section 12(a)(2) claim be based on a sale "by means of a prospectus," the Supreme Court stated in Gustafson that "[t]he intent of Congress and the design of the statute require that [Section 12(a)(2)] liability be limited to public offerings." Gustafson, 513 U.S. at 579. The Court reasoned that, since the federal securities laws require a prospectus to include information contained in a registration statement, and only public offerings require the filing of a registration statement, a prospectus "is confined to documents related to public offerings by an issuer or its controlling shareholders." Id. at 569. The Court found this reading of interlocking Securities Act sections to be entirely consistent with the general purpose of the Securities Act. "[T]he 1933 Act was primarily concerned with the regulation of new offerings." Id. at 577 (citation omitted). Moreover, the fact that Section 12(a)(2) provides "buyers with a right to rescind, without proof of fraud or reliance, as to misstatements contained in a document prepared with care," was further evidence of Congressional intent to impose such strict liability only in connection with the public offering itself. Id. at 578. Liability under Section 12(a)(2), therefore, does not extend to "private or secondary" sales. Id. at 582. See also id. at 571 (Congress did not intend through Section 12(a)(2)

to create liability for "secondary market transactions").

As just noted, Section 12(a)(2) governs only those sales made "by means of a prospectus." 15 U.S.C. § 77l(a)(2). As a consequence, the Second Circuit and other circuit courts have repeatedly observed that purchasers in the secondary market are excluded from bringing Section 12(a)(2) actions. See Demaria v. Andersen, 318 F.3d 170, 177-78 (2d Cir. 2003) (distinguishing Section 11 claims); Lee v. Ernst & Young, LLP, 294 F.3d 969, 976 (8th Cir. 2002) (same); Joseph v. Wiles, 223 F.3d 1155, 1160-61 (10th Cir. 2000) (same); Hertzberg v. Dignity Partners, Inc., 191 F.3d 1076, 1080-81 (9th Cir. 1999) (same). See also In re WorldCom, Inc. Sec. Litig., 219 F.R.D. 267, 283 (S.D.N.Y. 2003) (named plaintiff who purchased in aftermarket did not have standing to bring Section 12(a)(2) claim); In re Sterling Foster & Co., Inc. Sec. Litig., 222 F. Supp. 2d 216, 244-45 (E.D.N.Y. 2002) (collecting cases).

The plaintiffs' pleading reflects their understanding of these principles and does not contain allegations to support a Section 12(a)(2) claim for aftermarket purchasers. For instance, the Complaint makes no allegation that plaintiffs purchased directly from SSB or were actually solicited by SSB in the aftermarket. Plaintiffs allege only that SSB acted as "underwriter" for the 1999 TARGETS offering.

Plaintiffs contend that the reasoning in Feiner v. SS&C Technologies, Inc., 47 F. Supp. 2d 250 (D. Conn. 1999), compels a different result. In rejecting the defendants' argument that

Section 12(a)(2) only addresses sales in the initial distribution of shares, Feiner held that "§ 12(a)(2) extends to aftermarket trading of a publicly offered security, so long as that aftermarket trading occurs by means of a prospectus or oral communication." Id. at 253 (citation omitted). The Feiner analysis is not persuasive. But, in any event, Feiner provides no comfort to plaintiffs. Feiner further held that plaintiffs who purchased shares in the aftermarket from someone other than the defendant did not have standing to sue the defendant under Section 12(a)(2). Id. at 254.[8] As already noted, the Complaint does not allege that the aftermarket purchasers bought TARGETS directly from SSB.

2. Exchange Act Claims

The SSB Defendants move to dismiss the Exchange Act claims on the grounds, inter alia, that the claims based on statements in or omissions from the Prospectus are time-barred. It is undisputed that all of the Exchange Act claim based on the Prospectus are time-barred unless Sarbanes-Oxley, which extended the statute of limitations for securities fraud claims in 2002, is retroactive. The SSB Defendants also assert that the claims

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[8] Feiner observed that in the context of a firm commitment underwriting, where a defendant sells all the shares to the public, the defendant is liable under Section 12(a)(2) for aftermarket sales only if the defendant reacquired shares in the aftermarket and resold them, or if the defendant acted as a dealer for third parties in aftermarket trading. Feiner, 47 F. Supp. 2d at 254.

based on the SSB research reports are based on statements not made "in connection with" the TARGETS securities.[9]

a. Statute of Limitations

Prior to the enactment of Sarbanes-Oxley, the statute of limitations for Exchange Act claims was a one-year/three-year regime which made any claim brought more than three years after the occurrence of the alleged violation untimely. 15 U.S.C. § 78i(e); Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 501 U.S. 350, 364 n.9 (1991); Levitt v. Bear Sterns & Co., Inc., 340 F.3d 94, 101 (2d Cir. 2003). Sarbanes-Oxley became effective on July 30, 2002. Section 804 of Sarbanes-Oxley lengthened the statute of limitations for private causes of action alleging securities fraud. See 28 U.S.C. § 1658 ("Section 804"). Section 804 provides, in pertinent part, that

> [A] private right of action that involves a claim of fraud, deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning the securities laws, as defined in section 3(a)(47) of the [Exchange Act] [15 U.S.C. § 78c(47)], may be brought not later than the earlier of --
> (1) 2 years after the discovery of the facts constituting the violation; or
> (2) 5 years after such violation.

28 U.S.C. § 1658 (emphasis supplied). Sections 804(b) and (c) also state that its provisions "shall apply to all proceedings

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[9] The SSB Defendants have preserved their argument that the Complaint does not sufficiently allege their scienter with respect to the allegations of an illicit quid pro quo relationship with WorldCom. For the reasons explained in In re WorldCom, Inc. Sec. Litig., 294 F. Supp. 2d at 426, that argument is rejected.

addressed by this action that are commenced on or after the date of enactment of this Act. . . . Nothing in this section shall create a new private right of action." Sarbanes-Oxley Act §§ 804(b) and (c), P.L. No. 107-204, 116 Stat. 745 (2002).

"A statute may not be applied retroactively [] absent a clear indication from Congress that it intended such a result." INS v. St. Cyr, 533 U.S. 289, 316 (2001). See also Landsgraf v. USI Film Prods., 511 U.S. 244, 280 (1994). The first step in determining whether a statute has a retroactive effect is to ascertain whether Congress has directed with the requisite clarity that the law be applied retroactively. Martin v. Hadix, 527 U.S. 343, 352 (1999).

> The standard for finding such unambiguous direction is a demanding one. Cases where this Court has found truly retroactive effect adequately authorized by statute have involved statutory language that was so clear that it could sustain only one interpretation.

St. Cyr, 533 U.S. at 316-17 (citation omitted).

With respect to statutes that lengthen a statute of limitations, circuit courts have consistently held that applying the longer statute of limitations to revive previously time-barred claims is impermissible unless the legislature clearly expresses the intent to revive already time-barred actions. See Million v. Frank, 47 F.3d 385, 390 (10th Cir. 1995); Kan. Pub. Employees Ret. Sys. v. Reimer & Kroger Assocs., Inc., 61 F.3d 608, 615 (8th Cir. 1995); Chenault v. United States Postal Serv., 37 F.3d 535, 539 (9th Cir. 1994); Resolution Trust Corp. v. Artley, 28 F.3d 1099, 1103 n.6 (11th Cir. 1994); FDIC v. Belli,

981 F.2d 838, 842-43 (5th Cir. 1993). See also Stone v. Hamilton, 308 F.3d 751, 757 (7th Cir. 2002); In re Apex Exp. Corp., 190 F.3d 624, 642 (4th Cir. 1999). The Court in Hughes Aircraft Co. v. United States, ex rel. Schumer, 520 U.S. 939 (1997), cited with approval Chenault's holding that a statute that expands the statute of limitations does not revive time-barred claims. Id. at 950. Hughes held that an amendment to a statute did not renew plaintiff's previously barred qui tam action and analogized the legal issue to a statute's ability to revive previously time-barred claims. Id.

Sarbanes-Oxley does not revive previously time-barred private securities fraud claims. There is no explicit language in the statute stating that it applies retroactively or that it operates to revive time-barred claims. Applying the statute of limitations that was lengthened in July 2002 to claims that expired in June 2002 would affect the substantive rights of the defendants by depriving them of a defense on which they were entitled to rely. See Lieberman v. Cambridge Partners, L.L.C., No. Civ. A. 03-2317, 2004 WL 1396750, at *3 and n.12 (E.D. Pa. June 21, 2004) (Sarbanes-Oxley does not revive stale claims); In re Enron Corp. Sec., Derivative & Erisa Litig., No. MDL-1446, Civ.A. H-01-3624, 2004 WL 405886, at *17 (S.D. Tex. Feb. 25, 2004) (same); In re Enterprise Mortgage Accept. Co., 295 F. Supp. 2d 307, 312 (S.D.N.Y. 2003) (same); In re Heritage Bond Litig., 289 F. Supp. 2d 1132, 1148 (C.D. Cal. 2003) (same). But see Roberts v. Dean Witter Reynolds, Inc., No. 8:01-CV-2115-T-26

(EAJ), 2003 WL 1936116 (M.D. Fla. Mar. 31, 2003) (relying on legislative history to find intent to make the statute retroactive).

Plaintiffs contend that Vernon v. Cassadaga Valley Cent. Sch. Dist., 49 F.3d 886 (2d Cir. 1995), compels a different result. Vernon is inapposite. Vernon applied retroactively a statutory amendment that reduced a limitations period, but applied it to claims that were not time-barred at the time of the amendment. Id. at 888. The Vernon plaintiffs had specific notice of the new limitations period and an opportunity to comply with it. Id. at 889. See Brown v. Angelone, 150 F.3d 370, 373 n.2 (4th Cir. 1998); Zotos v. Linbergh School Dist., 121 F.3d 356, 361-62 (8th Cir. 1997). The Second Circuit did not address those situations in which a plaintiff would have no opportunity to comply and thus would lose the right to sue. Id. at 889 n.1. See Reyes v. Keane, 90 F.3d 676, 679 (2d Cir. 1996) (it was "entirely unfair and a severe instance of retroactivity" to apply a shorter statute of limitations to bar a plaintiff's claim), overruled on other grounds, Lindh v. Murphy, 521 U.S. 320, 326-27 (1997).

To the extent that the Exchange Act claims are based on the Prospectus, they are time-barred.[10] Such claims had to be brought no later than June 24, 2002, or over one year before the

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[10] This same holding would apply to any claim based on the TARGETS registration statements, but it does not appear that the Complaint is premised on the registration statements.

first complaint in the TARGETS litigation was filed. To the extent that the Exchange Act claims are based on SSB research reports, they are time-barred as to any reports issued before July 30, 1999, or three years before Sarbanes-Oxley extended the statute of limitations.

b. The "In Connection With" Requirement

The plaintiffs allege that the SSB Defendants violated Sections 10(b) and 20(a) of the Exchange Act through the allegedly material misstatements and omissions in SSB research reports regarding WorldCom. The SSB Defendants argue that these statements and omissions were not made "in connection with" the plaintiffs' purchase or sale of TARGETS securities since they concerned "different securities issued by a different issuer."

Section 10(b) provides that:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange - . . . (b) To use or employ, <u>in connection with</u> the purchase or sale of <u>any</u> security registered on a national securities exchange or any security not so registered, . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j(b) (emphasis supplied). Section 10(b) is designed to protect investors by serving as a "catchall provision" which creates a cause of action for manipulative practices by defendants acting in bad faith. <u>Ernst & Ernst v.</u>

Hochfelder, 425 U.S. 185, 206 (1976).

To state a cause of action under Section 10(b) and Rule 10b-5,[11] a plaintiff must allege that "the defendant, in connection with the purchase or sale of securities, made a materially false statement or omitted a material fact, with scienter, and that plaintiff's reliance on defendant's action caused injury to the plaintiff." Lawrence v. Cohn, 325 F.3d 141, 147 (2d Cir. 2003) (citation omitted) (emphasis supplied).

The "in connection with" requirement must be construed broadly and flexibly to allow the securities fraud statute to capture novel frauds as well as more commonplace ones. In re Ames Dep't Stores Inc. Stock Litig., 991 F.2d 953, 964-65 (2d Cir. 1993). In the usual case, the requisite connection between a fraud and a purchase or sale of securities is present "when the fraud alleged is that the plaintiff bought or sold a security in reliance on misrepresentations as to its value." Id. at 967

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[11] Rule 10b-5, the parallel regulation, describes what constitutes a manipulative or deceptive device and provides that it is unlawful for any person, directly or indirectly:

> (a) To employ any device, scheme, or artifice to defraud,
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5.

(emphasis supplied). The Second Circuit has summarized that "Congress, in using the phrase intended only that the device employed . . . be of a sort that would cause reasonable investors to rely thereon, and, in connection therewith, so relying, cause them to purchase or sell a corporation's securities." In re Carter-Wallace, Inc. Sec. Litig., 150 F.3d 153, 156 (2d Cir. 1998) (citation omitted). Where a fraud on the market theory is employed, the "in connection with" requirement is satisfied with "a straightforward cause and effect test under which it is sufficient that statements which manipulate the market are connected to resultant stock trading." Id. (citation omitted). See also Press v. Chem. Inv. Serv. Corp., 166 F.3d 529, 537 (2d Cir. 1999).

The plaintiffs have sufficiently alleged that the SSB research reports, containing allegedly false and misleading information about WorldCom, were "in connection with" plaintiffs' purchase of TARGETS. TARGETS were a derivative instrument whose redemption value was directly tied to the value of WorldCom stock. As a consequence, their price in the secondary market fluctuated with the price of WorldCom stock. The Complaint alleges a direct link between the value of the TARGETS securities and the alleged misrepresentations and omissions regarding WorldCom, and alleges that the plaintiffs bought TARGETS in reliance on the misrepresentations and omissions about WorldCom. There could be no serious argument that statements which are admittedly "in connection with" the purchase and sale of WorldCom

stock were not also statements "in connection with" the trading in WorldCom options. Given the linkage between the value at redemption of TARGETS and the WorldCom stock price, it requires a very small extension of this principle to find that the plaintiffs have alleged a fraud in connection with the purchase and sale of TARGETS.

The SSB Defendants argue that Anatian v. Coutts Bank (Switzerland) Ltd., 193 F.3d 85 (2d Cir. 1999), supports dismissal. Anatian involved misrepresentations as to the authority to loan money and the failure to carry out a loan commitment. Id. at 88. The Anatian plaintiffs also asserted that the defendant had inflated the value of stock pledged as collateral for the loans in order to extend more credit. Id. at 87. The court dismissed the securities fraud claims since the misrepresentations did not "pertain to the purchase or sale of a security;" the securities were only "tangentially" involved in the breach of fiduciary duty claims. Id. at 88. Anatian is inapposite. It is undisputed that the SSB analyst reports directly concerned the purchase and sale of securities. The TARGETS plaintiffs contend that these reports' enthusiastic recommendations to buy WorldCom stock contributed to the fraud alleged here.

The SSB Defendants also contend that a recent decision, which addressed the concept of standing in securities litigation, is of assistance to them. In Ontario Public Service Employees Untion Pension Trust Fund v. Nortel Networks Corp., 369 F.3d 27

(2d Cir. 2004), the Second Circuit held that the plaintiffs, who had purchased the securities of a company that purchased a business unit from the defendant, did not have standing under Section 10(b) to sue the defendant, whose securities they had not purchased. Id. at 30-34. The plaintiffs asserted that the defendant had misrepresented its own financial condition. The Second Circuit held that the class of plaintiffs who have standing to sue is limited "to those who have at least dealt in the security to which the prospectus, representation, or omission relates." Id. at 32 (citation omitted).

In the course of its analysis of Ontario, the Second Circuit acknowledged the discussion of the "in connection with" requirement in Semerenko v. Cendant Corp, 223 F.3d 165, 174-77 (3d Cir. 2000). The Cendant court remanded its case to the district court to determine whether the "in connection with" requirement had been met when the plaintiffs purchased shares of a target of a bidding war in a tender offer, and brought suit against a company that withdrew its bid based on its own disclosure of its accounting irregularities. Id. at 177-78. When the defendant withdrew its offer, the price of the target's shares fell and the plaintiffs lost money.

The Second Circuit observed that a merger creates a "far more significant relationship" between two companies than a sale of a business unit, but left unresolved whether a potential merger might permit a finding of standing. Ontario, 369 F.3d at 33-34. As this discussion reveals, Ontario did not rest its

analysis on the "in connection with" requirement, and did not face the situation in which one security's value was directly and contractually linked to another's. While the precise issue presented here appears to be novel, the application of well-established principles provides ample authority to find that alleged misrepresentations and omissions concerning WorldCom were made "in connection with" a security whose value at maturity was derived from the WorldCom stock price.

Conclusion

Defendants' motion to dismiss the Sections 11 and 12(a)(2) claims as time-barred is granted. Plaintiffs' Sections 10(b) and 20(a) claims based on the Prospectus are also dismissed as time-barred. Defendants' motion to dismiss the Sections 10(b) and 20(a) claims for post-July 30, 1999 purchasers of TARGETS on the ground that the alleged false representations and omissions in SSB research reports were not "in connection with" with the purchase or sale of TARGETS is denied.

SO ORDERED:
Dated: New York, New York
June 28, 2004

DENISE COTE
United States District Judge