UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

Securities and Exchange Commission v. PIMCO Advisors Fund Management LLC

341 F. Supp. 2d 454 (S.D.N.Y. 2004) · No. 04 Civ. 3464(VM) · Decided October 22, 2004

SUMMARY

The court addressed motions to dismiss brought by former PIMCO executives in an SEC enforcement action concerning undisclosed mutual-fund market-timing arrangements with Canary Capital Partners LLC. It held that the SEC pleaded its fraud allegations with sufficient particularity and denied most of the motions, while dismissing without prejudice the claims against Kenneth W. Corba for primary violations of Sections 10(b) and 34(b).

CASE DETAILS

COURT	United States District Court for the Southern District of New York
WRITING FOR THE COURT	Victor Marrero
JURISDICTION	New York
DECIDED	October 22, 2004
DOCKET	04 Civ. 3464(VM)
DISPOSITION	other
PROCEDURAL POSTURE	Defendants Stephen J. Treadway and Kenneth W. Corba moved under Federal Rule of Civil Procedure 12(b)(6) to dismiss the SEC's enforcement complaint for failure to plead fraud with particularity and failure to adequately allege scienter and the elements of the charged securities-law violations.
STANDARD OF REVIEW	On a Rule 12(b)(6) motion, the court accepts well-pleaded factual allegations as true and draws reasonable inferences in favor of the nonmoving party. Dismissal is appropriate only when the plaintiff can prove no set of facts entitling it to relief. Fraud allegations must also satisfy Rule 9(b)'s particularity requirement, while scienter may be alleged generally if the facts support a strong inference of fraudulent intent.
PRECEDENTIAL VALUE	published federal district court opinion

PARTIES	Securities and Exchange Commission

TOPICS

motions to dismiss · securities fraud · commercial litigation · administrative law · corporate law

PRACTICE AREAS

securities regulation · securities fraud · civil litigation · administrative enforcement · corporate governance

QUESTIONS PRESENTED

1. Whether the SEC pleaded the alleged securities fraud with the particularity required by Federal Rule of Civil Procedure 9(b).
2. Whether the SEC adequately pleaded primary liability under Exchange Act Section 10(b) and Rule 10b-5 for material misrepresentations or omissions.
3. Whether Corba could be held primarily liable under Rule 10b-5 for misleading statements formally issued by PIMCO entities.
4. Whether Treadway and Corba could be held liable for using a fraudulent device under Rule 10b-5.
5. Whether the SEC adequately pleaded primary violations of Securities Act Section 17(a), aiding-and-abetting violations of Advisers Act Sections 206(1) and 206(2), primary violations of Investment Company Act Section 34(b), and violations of Section 36(a).

HOLDINGS

1. The SEC's complaint satisfied Rule 9(b) because it identified the allegedly misleading market-timing disclosures, the persons responsible for or involved in them, the circumstances in which they were made, and why they were misleading.
2. The SEC adequately pleaded Treadway's primary Rule 10b-5 liability because he allegedly signed or approved disclosures representing that PIMCO restricted market timing while knowingly permitting an inconsistent arrangement with Canary, and the allegations supported a strong inference of scienter.
3. The SEC adequately pleaded Corba's aiding-and-abetting liability but did not adequately plead his primary Rule 10b-5 liability for misleading disclosures formally issued by others.
4. The SEC adequately pleaded Corba's aiding-and-abetting liability by alleging a primary securities-law violation, Corba's knowledge or recklessness, and his substantial assistance.
5. The SEC adequately pleaded primary Section 17(a) violations by both Treadway and Corba, including Corba's participation in a fraudulent course of business under Section 17(a)(3).
6. The SEC adequately pleaded aiding-and-abetting claims against both Treadway and Corba under Advisers Act Sections 206(1) and 206(2), although they could not be charged directly because they were not themselves investment advisers covered by those provisions.
7. Treadway's Section 34(b) claim could proceed, but Corba could not be held primarily liable for disclosures issued by the PIMCO entities because the complaint did not allege that he personally made

or controlled the challenged statements.

8. The SEC adequately pleaded Section 36(a) claims against both Treadway and Corba because the complaint alleged personal misconduct involving breaches of fiduciary duty and alleged that each defendant fell within the statutory class of covered persons.

KEY QUOTATIONS

> *"To comply with the requirements of Rule 9(b), an allegation of fraud must "(1) specify the statements that the plaintiff contends were fraudulent, (2) identify the speaker, (3) state where and when the statements were made, and (4) explain why the statements were fraudulent."" * (463)

> *"The Court concludes that the Complaint does in fact contain numerous allegations constituting the necessary "strong circumstantial evidence of conscious misbehavior or recklessness," at least with respect to the misleading nature of the disclosures."* (466)

> *"While the Supreme Court has abolished private causes of action for aiding and abetting liability under Rule 10b-5, see Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 114 S. Ct. 1439, 128 L. Ed. 2d 119 (1994), the SEC still may bring civil enforcement actions against those who aid and abet violations of federal securities laws."* (467)

> *"The Investment Company Act defines as an investment advisor "any person ... empowered to determine what securities ... shall be purchased and sold" by an investment company."* (472)

FACTUAL BACKGROUND

Treadway and Corba were executives of PIMCO entities that managed and distributed mutual funds. Although PIMCO publicly represented that it restricted market timing to protect long-term investors, Treadway and Corba allegedly negotiated and managed an undisclosed arrangement allowing Canary Capital to conduct extensive market timing in several PIMCO funds in exchange for placing long-term assets in another fund. The SEC alleged that the defendants knew Canary's activities were harmful and disruptive, failed to stop them for more than a year, and failed to disclose the arrangement and related portfolio information to investors.

PROCEDURAL HISTORY

The SEC filed the action on May 5, 2004, against Treadway, Corba, and several PIMCO entities based on an alleged undisclosed market-timing arrangement with Canary Capital Partners LLC. The PIMCO entities later agreed to an SEC settlement and were to be dismissed from the action, while the claims against Treadway and Corba continued. The court denied Treadway's motion in its entirety and denied Corba's motions except as to primary violations of Exchange Act Section 10(b) and Investment Company Act Section 34(b), which were dismissed without prejudice.

DISPOSITION

other

CASES CITED

- First Lincoln Holdings, Inc. v. Equitable Life Assurance Soc'y, 164 F. Supp. 2d 383, 390-94 (S.D.N.Y. 2001)
- Shields v. Citytrust Bancorp, Inc., 25 F.3d 1124, 1128 (2d Cir. 1994)
- Ganino v. Citizens Utils. Co., 228 F.3d 154, 168 (2d Cir. 2000)
- Rombach v. Chang, 355 F.3d 164, 170 (2d Cir. 2004)
- Mills v. Polar Molecular Corp., 12 F.3d 1170, 1175 (2d Cir. 1993)
- Securities Investor Protection Corp. v. BDO Seidman, LLP, 222 F.3d 63, 68 (2d Cir. 2000)
- Krimstock v. Kelly, 306 F.3d 40, 48 (2d Cir. 2002)
- SEC v. Monarch Funding Corp., 192 F.3d 295, 308 (2d Cir. 1999)
- Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988)
- Goldman v. Belden, 754 F.2d 1059, 1067 (2d Cir. 1985)
- P. Stolz Family Partnership L.P. v. Daum, 355 F.3d 92, 97 (2d Cir. 2004)
- Wright v. Ernst & Young LLP, 152 F.3d 169, 175 (2d Cir. 1998)
- Shapiro v. Cantor, 123 F.3d 717, 720 (2d Cir. 1997)
- In re Scholastic Corp. Securities Litigation, 252 F.3d 63, 75-76 (2d Cir. 2001)
- SEC v. U.S. Environmental, Inc., 155 F.3d 107, 111 (2d Cir. 1998)
- In re Global Crossing, Ltd. Securities Litigation, 322 F. Supp. 2d 319, 331 (S.D.N.Y. 2004)
- Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164 (1994)
- SEC v. Lybrand, 200 F. Supp. 2d 384, 398 (S.D.N.Y. 2002)
- In re Laser Arms Corp. Securities Litigation, 794 F. Supp. 475, 491-92 (S.D.N.Y. 1992)
- Field v. Trump, 850 F.2d 938, 947-48 (2d Cir. 1988)
- SEC v. Moran, 922 F. Supp. 867, 896-97 (S.D.N.Y. 1996)
- Sullivan v. Chase Investment Services of Boston, Inc., 434 F. Supp. 171, 184-85 (N.D. Cal. 1977)
- SEC v. Manor Nursing Centers, Inc., 458 F.2d 1082, 1089 n.3 (2d Cir. 1972)
- Saylor v. Lindsley, 456 F.2d 896, 903 (2d Cir. 1972)
- Strougo v. Scudder, Stevens & Clark, Inc., 964 F. Supp. 783, 799 (S.D.N.Y. 1997), vacated in part on other grounds, 282 F.3d 162 (2d Cir. 2002)
- DGM Invs., Inc. v. N.Y. Futures Exch., Inc., 265 F. Supp. 2d 254, 259 (S.D.N.Y. 2003)