

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

THE WINER FAMILY TRUST : CIVIL ACTION
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MICHAEL QUEEN, et al. : NO. 03-4318

MEMORANDUM

Padova, J.

February , 2004

Presently before the Court in this securities fraud class action is The Winer Family Trust's "Motion to Confirm Right to Proceed with Discovery Related to Breach of Fiduciary Duty Claim and for Relief from Stay of Discovery Related to Federal Securities Claims." For the reasons that follow, the Court grants the Motion in part and denies the Motion in part.

I. BACKGROUND

On July 24, 2003, The Winer Family Trust (hereinafter "Lead Plaintiff") filed a putative Class Action Complaint on behalf of public investors who purchased the securities of Pennexx Foods, Inc. ("Pennexx") during the period from February 8, 2002 until June 12, 2003. The Class Action Complaint alleged violations of sections 10(b) and 20(a) of the Securities Exchange Act of 1934, as amended by the Private Securities Litigation Reform Act of 1995 ("PSLRA"), 15 U.S.C. §§ 78j(b), 78t(a), and Rule 10b-5 promulgated thereunder, see 17 C.F.R. § 240.10b-5, as well as a breach of fiduciary duty claim, against Pennexx, Smithfield Foods, Inc.

("Smithfield"), and various officers and directors of those corporations.¹ On December 5, 2003, Pennexx filed a Cross-Claim against Defendants Smithfield, Joseph W. Luter IV, and Michael H. Cole, alleging a number of state law claims. On December 22, 2003, Lead Plaintiff filed an Amended Class Action Complaint that reiterated the federal securities claims, and also asserted, on behalf of public investors who currently own Pennexx securities, state law claims for breach of fiduciary duty against Defendant Michael Queen, breach of fiduciary duty against Smithfield, aiding and abetting the breach of fiduciary duty against Defendants Joseph W. Luter IV and Michael H. Cole, and successor liability against Smithfield and Showcase Foods, Inc. ("Showcase"). On December 30, 2003, Lead Plaintiff filed the instant Motion, to which Smithfield, Showcase, Joseph W. Luter IV, and Michael H. Cole (collectively "the Smithfield Defendants") filed a timely response. Pennexx, Michael Queen, Dennis Bland, and Thomas McGreal (collectively "the Pennexx Defendants") have not timely responded to the instant Motion.² Subsequent to the filing of the instant Motion, the

¹ The individual Defendants include Joseph W. Luter IV, executive Vice President of Smithfield and Pennexx director; Michael H. Cole, associate general counsel of Smithfield and Pennexx director; Michael Queen, Chief Executive Officer of Pennexx; Dennis Bland, Chief Operating Officer of Pennexx; and Thomas McGreal, Vice President of Sales for Pennexx.

² With respect to the Pennexx Defendants, the Court declines to grant the instant Motion as uncontested pursuant to Local Rule of Civil Procedure 7.1(c).

Pennexx Defendants and the Smithfield Defendants each filed Motions to Dismiss the Amended Complaint, the response to which is due by February 20, 2004.

II. LEGAL STANDARD

The PSLRA provides that “[i]n any private action arising under this title, all discovery and other proceedings shall be stayed during the pendency of any motion to dismiss, unless the court finds upon the motion of any party that particularized discovery is necessary to preserve evidence or to prevent undue prejudice to that party.” 15 U.S.C. § 78u-4(b)(3)(B). The automatic stay of discovery proceedings reflects the PSLRA’s general purpose of restricting abuses in securities class action litigation, including the abuse of the discovery process to coerce settlement. In re Advanta Corp. Securities Litigation, 180 F.3d 525, 531 (3d Cir. 1999)(citing H.R. Conf. Rep. No. 104-369, at 28 (1995)); see also Novak v. Kasaks, 216 F.3d 300, 304 (2d Cir. 2000)(observing that PSLRA is intended “to deter strike suits wherein opportunistic private plaintiffs file securities fraud claims of dubious merit in order to exact large settlement recoveries”). Because the PSLRA’s automatic stay of discovery provision contemplates that “discovery should be permitted in securities class actions only after the court has sustained the legal sufficiency of the complaint,” only “exceptional circumstances” will justify relief from the stay prior to a ruling on the motion to dismiss. SG Cowen Sec. Corp. v. U.S.

Dist. Ct. for N. Dist. of Cal., 189 F.3d 909, 912-13 (9th Cir. 1999)(quoting S. Rep. No. 104-98, at 14 (1995)).

Such extraordinary circumstances are established only where discovery is necessary either "to preserve evidence or to prevent undue prejudice to [the moving] party." 15 U.S.C. § 78u-4(b)(3)(B). A party alleging that discovery is necessary to preserve evidence is required to make a specific showing that "the loss of evidence is imminent as opposed to merely speculative." In re CFS-Related Sec. Fraud Litig., 179 F. Supp. 2d 1260, 1265 (N.D. Okla. 2001). A party alleging that discovery is necessary to prevent undue prejudice must specifically identify "improper or unfair treatment amounting to something less than irreparable harm." Sarantakis v. Gruttadauria, Civ. A. No. 02-1609, 2002 WL 1803750, at *2 (N.D. Ill. Aug. 5, 2002)(citations omitted); see also In re CFS-Related Sec. Fraud Litig., 179 F. Supp. 2d at 1265 ("Undue prejudice is prejudice that is improper or unfair under the circumstances.").

Even where a movant demonstrates that discovery is necessary to either preserve evidence or prevent undue prejudice, the court should refrain from lifting the PSLRA stay unless the movant has made "particularized" requests for discovery. 15 U.S.C. § 78u-4(b)(3)(B). Thus, the movant must "adequately specify the target of the requested discovery and the types of information needed" to relieve the extraordinary circumstances. In re Lernout & Hauspie

Sec. Litig., 214 F. Supp. 2d 100, 108 (D. Mass. 2002).

III. DISCUSSION

A. Discovery for Breach of Fiduciary Duty Claims

Despite the express applicability of the PSLRA's automatic stay provision to "all discovery," Lead Plaintiff argues that this Court should allow discovery to proceed on the state common law breach of fiduciary duty claims, which are set forth in counts III-V of the Amended Complaint. In support of this argument, Lead Plaintiff cites Tobias Holdings, Inc. v. Bank United Corp., 177 F. Supp. 2d 162 (S.D.N.Y. 2001), wherein the court held that the PSLRA does not stay discovery with respect to a plaintiff's non-fraud state law claims where such claims are separate and distinct from the federal securities claims alleged in the complaint and where the court has an independent basis for jurisdiction over the non-fraud state law claims. Id. at 168-69.

In contrast to the scenario presented in Tobias Holdings, this Court does not have an independent basis for jurisdiction over Lead Plaintiff's breach of fiduciary duty claims. Indeed, the lone basis for jurisdiction identified in Plaintiff's Amended Complaint is supplemental jurisdiction. (See Am. Compl. ¶ 11.) As the United States Court of Appeals for the Ninth Circuit has recognized, "Congress' attempt to address [concerns of discovery abuse] would be rendered meaningless if securities plaintiffs could circumvent the stay simply by asserting *pendent* state law claims in

federal court in conjunction with their federal law claims." SG Cowen Sec. Corp., 189 F.3d at 913 n.1 (9th Cir. 1999)(emphasis added). For this reason, numerous courts have held that the PSLRA stay on discovery is applicable to pendent state law claims. See, e.g., Sarantakis, 2002 WL 1803750, at *4 (holding that Tobias Holdings was inapposite because plaintiff did not plead diversity jurisdiction); In re CFS-Related Sec. Fraud Litig., 179 F. Supp. 2d at 1267 (holding that PSLRA stay provision applied to plaintiffs' state law claims in part because plaintiffs have "not demonstrated that they have an independent jurisdictional basis for their state law claims").

Lead Plaintiff attempts to distinguish these cases by asserting that supplemental jurisdiction over its breach of fiduciary duty claims is predicated on Pennexx's Cross-Claim, rather than on the federal securities claims alleged in the Amended Complaint. See (Pl. Reply Mem. at 2-3.) Lead Plaintiff maintains that since Pennexx has an independent basis of jurisdiction with respect to its Cross-Claim, i.e., diversity jurisdiction, this Court may properly exercise jurisdiction over the breach of fiduciary duty claims, which are related to the same set of facts as Pennexx's claims. In essence, Lead Plaintiff appears to argue that allowing discovery on state law claims where supplemental jurisdiction is predicated on a defendant's cross-claim is less offensive to the PSLRA's general purpose of restricting abuses in

securities class action litigation, as the defendant has "opened the door" for such discovery by filing the cross-claim.

This Court concludes, however, that Congress's attempt to address concerns of discovery abuse would also be rendered meaningless if securities plaintiffs could circumvent the PSLRA stay (and relevant case law) simply by asserting *pendent* state law claims in conjunction with a defendant's cross-claim. Indeed, regardless of whether supplemental jurisdiction is based on Lead Plaintiff's federal securities claims or Pennexx's Cross-Claim, any discovery sought on the breach of fiduciary duty claims will very likely be relevant to the federal securities claims, as each set of claims is necessarily based on a "common nucleus of operative fact." See De Asencio v. Tyson Foods, Inc., 342 F.3d 301, 308 (3d Cir. 2003)(noting that federal courts may exercise supplemental jurisdiction where state law claims share a "common nucleus of operative fact" with claims that support the court's original jurisdiction)(quoting United Mine Workers v. Gibbs, 383 U.S. 715, 725 (1966)); Ambromovage v. United Mine Workers of America, 726 F.2d 972, 990 (3d Cir. 1984)(holding that any claim satisfying Federal Rule of Civil Procedure 13's "transaction or occurrence" test necessarily satisfies the supplemental jurisdiction requirements of 28 U.S.C. § 1367(a)).³ Accordingly, the Court

³ Notably, while Lead Plaintiff stresses that its breach of fiduciary duty claims are separate and distinct from its federal securities claims, it has made no showing that the *discovery* it

declines to allow discovery to proceed on this ground.

Lead Plaintiff also contends that the PSLRA stay of discovery is inapplicable to its breach of fiduciary duty claims because it would otherwise be penalized for asserting these claims in federal court. Lead Plaintiff's contentions are misplaced, however, as the PSLRA expressly authorizes federal courts to stay discovery proceedings in a state court action. See 15 U.S.C. § 78u-4(b)(3)(D) ("Upon a proper showing, a court may stay discovery proceedings in any private action in a State court, as necessary in aid of its jurisdiction, or to protect or effectuate its judgments, in an action subject to a stay of discovery pursuant to this paragraph"); see also Benbow, 2003 WL 1873910, at *3 (noting that "Congress enacted [the PSLRA stay of state court discovery provision] as a tool to be used as necessary to stay proceedings/discovery in *state court* used to circumvent the automatic stay provisions of the PSLRA")(emphasis in original); In re Trump Hotel Shareholder Derivative Litig., Civ. A. No. 96-7820, 1997 WL 442135 (S.D.N.Y. Aug. 5, 1997)(rejecting argument that

seeks on each set of claims would be separate and distinct. See Benbow v. Aspen Tech., Inc., Civ. A. No. 02-2881, 2003 WL 1873910, at *4 (E.D. La. Apr. 11, 2003)(staying discovery on state law claims in part because plaintiff's discovery requests "constitute[] general discovery addressing all of the plaintiffs' claims against [Defendant] (*i.e.*, state and federal claims)"); Angell Investments, LLC v. Purizer Corp., Civ. A. No. 01-6359, 2001 WL 1345996, at *1 (N.D. Ill. Oct. 31, 2001)(staying discovery on state law claim where the discovery sought on state claim "would be precisely the same as what plaintiffs would seek on the securities violation claims absent the discovery stay").

application of PLSRA stay would penalize plaintiffs for alleging a federal securities claim in conjunction with their state law claims as “[h]aving chosen to invoke Section 14 of the Exchange Act, plaintiffs are necessarily subject to the PSLRA”). Accordingly, the Court declines to allow discovery to proceed on this ground.

The Court concludes, therefore, that the PSLRA stay of “all discovery” encompasses the breach of fiduciary duty claims set forth in the Amended Complaint. See Fazio v. Lehman Brothers, Inc., Civ. A. Nos. 02-157, 02-370, 02-382, 2002 WL 32121836, at *2 (N.D. Ohio May 16, 2002)(observing that “the reference in the [PSLRA] statute to a stay of ‘all discovery’ is to be interpreted broadly.”) Accordingly, whether Lead Plaintiff can obtain particularized discovery on its breach of fiduciary duty claims, as well as its federal securities claims, will depend on whether a showing of sufficiently extraordinary circumstances has been made under the PSLRA.

B. Relief from PSLRA Stay of Discovery

1. Preservation of evidence

Lead Plaintiff asserts that discovery is necessary to preserve evidence because there exists a significant risk of spoliation of relevant documents and materials. Specifically, Lead Plaintiff contends that Pennexx’s business records could potentially be lost or destroyed because Pennexx, which has ceased to function as an operational entity, no longer has possession of its own documents.

Lead Plaintiff's spoliation concerns are also founded on allegations in Pennexx's Cross-Claim that Defendants Luter IV and Cole ordered Smithfield lawyers to conceal statements that they had made during the September 2002 Pennexx Board of Directors meeting which revealed their potentially conflicting loyalties between Smithfield and Pennexx. (Pennexx Cross-Claim ¶ 204-208, 216, 219.) Lead Plaintiff also notes that, in a separate action involving Smithfield and Pennexx, Smithfield's counsel wrote a letter to the court advising that a Pennexx employee had warned Smithfield, against the instructions of his superiors, that Smithfield should send its auditors to Pennexx's plant "because of what was happening there." (Am. Comp. ¶ 141; Pl. Mem. Ex. D ¶ 15.)

In response, the Smithfield Defendants argue that the letter referenced by Lead Plaintiff provides no clear indication that Pennexx was destroying or altering documents. Even if Pennexx was previously destroying or altering documents, the Smithfield Defendants note that Pennexx is no longer in control of its documents, as Smithfield took over Pennexx's operations several months ago. Furthermore, the Smithfield Defendants deny the allegations in the Cross-Claim that the minutes from the September 2002 Pennexx Board of Directors meeting was fraudulently edited.

The Court concludes that the incidents cited by Lead Plaintiff fail to specifically show that "the loss of evidence is imminent as opposed to merely speculative." In re CFS-Related Sec. Fraud

Litig., 179 F. Supp. 2d at 1265; see also In re Fluor Corp. Sec. Litig., Civ. A. No. 97-734, 2001 WL 817206, at *3 (C.D. Cal. Jan. 15, 1999)(holding that generalized “allegations of *possible* loss or destruction” are insufficient)(emphasis added). In any event, Lead Plaintiff’s concerns about the potential spoliation of relevant evidence are adequately addressed by the Stipulated Order that the Court has entered in this case, which expressly provides that all parties shall “take reasonable steps, during the pendency of this litigation, or until the further order of this Court, to preserve all documents, data compilations (including electronically recorded or stored data) and tangible objects within their possession, custody, or control, containing information that is relevant to the allegations and defenses in this litigation or may lead to the discovery of admissible evidence.” (11/17/03 Order); see also In re CFS-Related Sec. Fraud Litig., 179 F. Supp. 2d at 1264 (denying plaintiff’s request for immediate discovery in part because the court had already entered two document preservation orders in the case). In addition, the PSLRA itself mandates the preservation of evidence during the pendency of a stay of discovery and permits courts to impose sanctions on willful violators. See 15 U.S.C. § 78u-4(b)(3)(C). Finally, the Court notes that the Smithfield Defendants have specifically represented that they will preserve all relevant documents and materials in their possession. See (Smithfield Brf. at 10); see also In re AOL Time Warner, Inc. Sec.

Litig., Civ. A. No. 02-5575, 2003 WL 21729842, at *2 (S.D.N.Y. July 25, 2003)(denying discovery request where Defendants "assured the Court that they will uphold their obligation under the PSLRA to preserve evidence"); Sarantakis, 2002 WL 1803750, at *3 (holding that "lifting the stay is not necessary to preserve evidence when, as in this case, the party from whom discovery has sought has represented to the court that it will maintain the evidence at issue"); In re Carnegie Int'l Corp. Sec. Litig., 107 F. Supp. 2d 676, 684 (D. Md. 2000)(same). Accordingly, the Court declines to grant Lead Plaintiff relief from the PSLRA stay of discovery on this ground.

Lead Plaintiff next asserts that discovery is necessary to preserve evidence from two critical witnesses. Specifically, Lead Plaintiff maintains that Joseph W. Luter III, who serves as Chairman and Chief Executive Officer of Smithfield, and Robert McClain, who was employed by Smithfield as an engineer during the time period relevant to the allegations in the Amended Complaint, are experiencing serious health problems.

In response, the Smithfield Defendants insist that Mr. Luter III does not have any significant health problems that would necessitate the preservation of his testimony. The Court accepts this representation by the Smithfield Defendants, as Lead Plaintiff has offered no evidence to the contrary. Indeed, the Lead Plaintiff merely cites a letter sent by its counsel to the

Smithfield Defendants' counsel inquiring "about whether expedited discovery is necessary because of health concerns regarding Joseph W. Luter III." (Pl. Mem. Ex. A.) Notably, counsel for the Smithfield Defendants' responded in kind to this inquiry by advising that "we know of no reason for expedited discovery because of health concerns regarding Joseph W. Luter III." (Pl. Mem. Ex. B.) Accordingly, the Court declines to grant Lead Plaintiff relief from the PSLRA stay of discovery on this ground.

The Smithfield Defendants do admit, however, that Mr. McClain has been diagnosed with Stage IV brain cancer, for which he has recently undergone chemotherapy, radiation, and intensive speech and physical therapy. The Smithfield Defendants further allege that Mr. McClain cannot be deposed in the foreseeable future because of his diminished physical and mental capacities. Nevertheless, the fact remains that Lead Plaintiff has a right to preserve evidence and may well be unduly prejudiced should Mr. McClain pass away during the pendency of the stay of discovery. Significantly, "[t]he sole example proffered by Congress as to what justifies lifting the stay is 'the terminal illness of an important witness,' which might 'necessitate the deposition of the witness prior to ruling on the motion to dismiss.'" Faulkner v. Verizon Communications, Inc., 156 F. Supp. 2d 384, 402 (S.D.N.Y. 2001)(citation to Senate Report omitted). As the Smithfield Defendants do not dispute the seriousness of Mr. McClain's illness

nor his importance to Lead Plaintiff's case, the Court concludes that Lead Plaintiff is entitled to relief from the PSLRA stay for the narrow purpose of pursuing discovery from Mr. McClain. Given Mr. McClain's alleged incapacity, however, the Court will require the parties to file motions or other appropriate submissions concerning the scope, terms, and conditions of any such discovery.

2. Undue prejudice

Lead Plaintiff argues that it will suffer undue prejudice if Defendants are permitted to seek discovery from each other in connection with Pennexx's Cross-Claim, especially should Defendants attempt to reach a settlement that would inure to their benefit and to the detriment of either of the two proposed plaintiff classes. Lead Plaintiff notes that Pennexx recently filed a "Motion for Discovery and Evidentiary Hearing" in a separate action in this District involving Pennexx and Smithfield (civil action number 03-3155), and served a broad set of interrogatories and document requests on Smithfield. See (Pl. Reply Mem. Ex. 1). Lead Plaintiff maintains that these broad requests cover most of the issues relevant to its claims. Moreover, Lead Plaintiff notes that Pennexx's motion makes clear Pennexx's intent to pursue such discovery in the instant case if discovery does not proceed in the civil action number 03-3155.

The Court notes that no discovery has yet taken place between Pennexx and Smithfield in civil action number 03-3155, as Pennexx's

discovery motion is still pending. Furthermore, the Smithfield Defendants have refused to consent to a request by Pennexx for discovery relating to the Cross-Claim in the instant action, see Pl. Mem. Ex. B., and Pennexx has not yet filed any discovery motions with this Court. Thus, Lead Plaintiff's concerns about Defendants obtaining discovery from each other on the Cross-Claim in the instant action, or in civil action number 03-3155, are merely speculative and do not demonstrate undue prejudice. Moreover, even if Lead Plaintiff could make a sufficient showing of undue prejudice, it has failed to satisfy the "particularized discovery" requirement of the PSLRA. Lead Plaintiff maintains that this Court should permit discovery to proceed "without limitation." (Pl. Reply Mem. at 3.) Although the PSLRA's requirement of particularized discovery is "a nebulous one," Mishkin v. Ageloff, 220 B.R. 784, 793 (S.D.N.Y. 1998), courts have made clear that "[g]eneral requests to open all discovery do not satisfy this burden." Sarantakis, 2002 WL 1803750, at *2; see also Faulkner, 156 F. Supp. 2d at 404 (finding that plaintiffs request of "all documents, testimony and transcripts that have been previously been produced or will be produced in the future" not sufficiently particularized); In re Carnegie Intern. Corp. Sec. Litig., 107 F. Supp. 2d at 684 (declining to grant relief from stay where discovery requests covered "virtually every piece of paper and every piece of information" in opposing party's possession);

Mishkin, 220 B.R. at 793 (denying request to lift stay where “the items of discovery sought by the [plaintiff] encompass an open-ended boundless universe of discovery” and “is basically a request to continue any and all discovery that may arise”). Accordingly, the Court declines to grant Lead Plaintiff relief from the stay of discovery on this ground.

IV. CONCLUSION

For the foregoing reasons, Lead Plaintiff’s Motion to Confirm Right to Proceed with Discovery Related to Breach of Fiduciary Duty Claim and for Relief from Stay of Discovery Related to Federal Securities Claims is granted in part and denied in part. An appropriate Order follows.

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O R D E R

AND NOW, this day of February, 2004, upon consideration of Lead Plaintiff Winer Family Trust's Motion to Confirm Right to Proceed with Discovery Related to Breach of Fiduciary Duty Claim and for Relief from Stay of Discovery Related to Federal Securities Claims (Doc. No. 30), the Smithfield Defendants' Response thereto (Doc. No. 31), and all attendant and responsive briefing, **IT IS HEREBY ORDERED** that said Motion is **GRANTED IN PART** and **DENIED IN PART** as follows:

1. Lead Plaintiff's request for relief from the stay of discovery to pursue discovery from Robert McClain is hereby **GRANTED**. The parties shall file motions or other appropriate submissions as to the scope, terms, and conditions of any such discovery within seven (7) days of the date of this Order.
2. Lead Plaintiff's Motion is hereby **DENIED** in all other respects.

BY THE COURT:

John R. Padova, J.